

The Division of Examinations Names Valuation as a Focus for Digital Asset Securities

On February 26, 2021, the SEC on behalf of the Division of Examinations (“Division”), formerly known as the Office of Compliance Inspections and Examinations (“OCIE”), released a Risk Alert¹ that provides observations to assist firms in developing and enhancing their compliance practices regarding the offer, sale, and trading of digital assets that are securities (“Digital Asset Securities”). The Risk Alert is intended to provide transparency about areas of focus for future examinations for market participants involved with Digital Asset Securities, based on prior examinations of Investment Advisers, Broker Dealers, and Transfer Agents.

Valuation has been listed as an area of focus for Investment Advisers managing Digital Asset Securities, as well as other digital assets and derivative products, for their clients directly or indirectly through pooled vehicles, such as private funds. The Division’s focus will include:

- **Disclosures** – Examinations will assess disclosures regarding unique risks of digital assets, inclusive of any risks that “are heightened as a result of the digital nature of such assets”. In particular, the staff will assess disclosures regarding valuation methodology, as well as additional disclosures of such assets, including technical, legal, market, and operational risks, price volatility, illiquidity, related-party transactions and conflicts of interest.
- **Pricing Client Portfolios** –As valuation methodology determines the value of digital assets managed on behalf of clients, Investment Advisers may face valuation challenges due to market fragmentation, illiquidity, volatility, and the potential for manipulation. Exams will include:
 - Review of, among other things, valuation methodologies utilized, including those used to determine principal markets, fair value, valuation after significant events, and recognition of forked and airdropped digital assets²
 - Review of disclosures relating to valuation methodologies and advisory fee calculations and the impact valuation practices have on such fees.

By sharing focus areas for Digital Asset Securities examinations, the Division encourages market participants to reflect upon their own practices, policies, and procedures to improve their supervisory, oversight and compliance programs.

How Houlihan Capital Can Help

Houlihan Capital has significant experience in valuing digital assets since January 2018. We can help with the valuation process, including reviewing or drafting your valuation policy and with the process of determining fair value of your illiquid digital asset investments. The firm has extensive experience in providing objective, independent and defensible opinions of value that meet accounting and regulatory requirements. Houlihan Capital is SOC-compliant, a Financial Industry Regulatory Authority (FINRA) and SIPC member and committed to the highest levels of professional ethics and standards.

For more information, please contact:
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¹ <https://www.sec.gov/files/digital-assets-risk-alert.pdf>

² <https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm>