



CONSTELLATION  
Part of IQEQ

## SEC Risk Alert: Digital Asset Securities

On February 26, 2021, the Division of Examinations (“the Division”) for the U.S. Securities and Exchange Commission (the “SEC”) released guidance regarding activities related to the offer, sale, and trading of Digital Asset Securities, which includes virtual currencies, coins, and tokens that are issued and/or transferred using distributed ledger or blockchain technology that meet the definition of a security.

As summarized in more detail below, the Division set out six areas of focus for investment advisers managing Digital Asset Securities, which are:

- Portfolio Management
- Books and Records
- Custody
- Disclosures
- Pricing Client Portfolios
- Registration Issues

Additionally, the Division identified risk areas for broker-dealers, national security exchanges, and transfer agents who deal in Digital Asset Securities. To view the alert in its entirety, please [click here](#).

### Summary of Investment Adviser Focus Areas

**Portfolio Management:** The Division acknowledges that not all digital assets will qualify as securities for SEC purposes. Accordingly, the Division will focus on whether the adviser has policies in place for:

- Classifying digital assets as Digital Asset Securities
- Conducting thorough due diligence to understand the digital asset, wallets, or devices/software to interact with the digital asset network, and liquidity and volatility of the digital asset
- Evaluation and mitigation of risks related to trading venues and execution or settlement facilities with respect to security breaches, fraud, insolvency, market manipulation, quality of market surveillance, and KYC/AML procedures
- Management of risks and complexities associated with forked and airdropped digital assets, including allocations across client accounts, and conflicts of interest

**Recordkeeping:** The Division notes the varying level of reliability and consistency with digital asset trading venues, and as such, will focus on reviewing whether advisers are maintaining accurate books and records for their transactions.

**Custody:** The Division will focus on whether advisers have controls in place for safekeeping of digital assets, including:

- Unauthorized transactions, including theft of digital assets
- Security controls around safekeeping of digital assets including employee access to private keys and trading platforms and how the adviser views harm due to loss of private keys
- Business continuity plans where key personnel have exclusive access to private keys
- Reliability of software used to interact with digital asset networks
- Storage of digital assets
- Security procedures related to software and hardware wallets

**Disclosures:** The Division will review whether advisers have provided thorough and clear disclosures to investors regarding the unique risks associated with digital assets.

**Pricing Client Portfolios:** The Division will focus examinations on valuation policies for digital assets and whether appropriate disclosures are provided to clients regarding those valuations and advisory fee calculations.

**Registration Issues:** The Division will review the adviser's policies for classifying digital assets with regards to calculating regulatory assets under management, as well as classifications with regard to determining applicable fund exemptions from registration as investment companies.

## **Broker-Dealers, National Security Exchanges, and Transfer Agents**

The Division also identified several risk areas for other institutions. For broker-dealers, the Division highlights that its focus will be on reviewing policies around: (1) safekeeping of funds and operations; (2) registration requirements; (3) anti-money laundering; (4) due diligence and appropriate disclosures to customers; and (5) outside business activities of registered representatives related to digital assets.

For national securities exchanges, the Division will review platforms that facilitate trading in Digital Asset Securities and review whether they meet the definition of an "exchange" under the Exchange Act, which would require registration. In addition, the Division will review whether an existing exchange is meeting the compliance requirements for any applicable exemption from registration, such as the exemption for an alternative trading system ("ATS").

For transfer agents, the Division will focus on whether registered transfer agents are meeting their compliance obligations regarding facilitating prompt and accurate clearance and settlement of securities transactions.

## **Take Action**

In reviewing the above summary, Clients should:

- Determine whether they are advising any digital assets that are Digital Asset Securities;
- Verify that they have adequate policies and procedures in place to address the concerns identified above;
- Confirm appropriate disclosures to clients and registration implications associated with services related to Digital Asset Securities; and
- Ensure controls are in place for safekeeping of digital assets and recordkeeping for transactions.

**For further information on this announcement, please contact:**

Steven Graham, Head of Regulatory and Compliance Services, Americas

E: [sgraham@constellationadvisers.com](mailto:sgraham@constellationadvisers.com)

Constellation Advisers, LLC | 250 W 57th Street, 10th Floor, New York, NY 10107

[Unsubscribe {recipient's email}](#).

[Update Profile](#) | [Customer Contact Data Notice](#)

Sent by [info@constellationadvisers.com](mailto:info@constellationadvisers.com)