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FUND DIRECTORS' OVERSIGHT OF INVESTMENTS IN CRYPTOCURRENCIES AND OTHER DIGITAL ASSETS

Fund investments in cryptocurrencies and other digital assets present oversight challenges for fund directors. In this article, after noting the absence of tested market infrastructure and of regulation for this new asset class, the authors focus first on technical considerations of blockchain technology and the limited regulatory jurisdiction of the SEC, the CFTC, and federal banking regulators. They then turn to the implications that the absence of infrastructure and regulation has for boards, including oversight of new service providers, and issues surrounding custody, valuation, and liquidity of digital assets. Consequently, their closing thought is that, as digital assets find their way into registered products, boards will need to be more diligent and sophisticated in their scrutiny and oversight of this new asset class.

By Paulita Pike and David M. Geffen *

Hardly a week goes by without several stories in the financial press about burgeoning investor interest in digital assets, especially cryptocurrencies. In July 2021, U.S. Senator Elizabeth Warren sent a letter to SEC Chair Gary Gensler regarding the SEC's "authority to properly regulate cryptocurrency exchanges" and to determine whether Congress "needs to act to ensure that the SEC has the proper authority to close existing gaps in regulation" that leave investors vulnerable. In her letter, Senator Warren asserted that, during the six-month period ending March 2021, nearly 7,000 people reported losses from cryptocurrency scams, "resulting in a cumulative $80 million lost — about 12 times the number of reports and nearly 1,000% more in reported losses compared to the same period a year earlier."

Driving investors' interest in cryptocurrencies is the fact that the price of Bitcoin, the most popular cryptocurrency, more than tripled in value during 2020. Indeed, in the quarterly report of a headline-making ETF — headline-making because its March 31, 2021 *one-year performance was +183%* — the CIO listed the ETF's indirect Bitcoin exposure among the top contributors to the ETF's performance.

As recently as May 2021, the SEC's Division of Investment Management issued a statement warning investors that Bitcoin is a "highly speculative investment," and that investors should consider Bitcoin's volatility and "the lack of regulation and potential for fraud or manipulation in the underlying Bitcoin market."

Despite the SEC staff's warnings, there appears to be significant investor appetite for registered funds that invest directly or indirectly in cryptocurrencies. Not surprisingly, a large number of fund sponsors are

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