

December 9, 2022

# SEC Staff Highlights Disclosures Regarding Crypto Market Developments

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## SEC Division of Corporation Finance Publishes Sample Comment Letter Regarding Disclosure Obligations With Respect to Recent Events and Conditions in the Crypto Markets

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### OVERVIEW

On December 8, 2022, the Division of Corporation Finance of the SEC published sample comments it may issue to companies regarding their disclosure obligations with respect to recent events and conditions in the crypto markets.<sup>1</sup> The Division announcement states that “[c]ompanies may have disclosure obligations under the federal securities laws related to the direct or indirect impact that these events and collateral events have had or may have on their business.” The sample comments are relevant for SEC-reporting companies and those planning to register securities offerings with the SEC, including, as the announcement notes, in connection with automatically effective registration statements and prospectus supplements for shelf takedowns.<sup>2</sup> Companies contemplating private capital raises or other securities offerings exempt from registration requirements should also consider the Division’s views in the letter.

Similar to other sample comment letters of the Division,<sup>3</sup> the guidance generally takes a principles- and materiality-based approach, with a focus on disclosures in the following three areas:

- a company’s exposure to counterparties, customers, custodians and other crypto market participants;
- self-dealings and other potential conflicts of interest of companies having custody over or otherwise holding customer assets; and
- compliance and risk management processes.

In addition to disclosures related to recent market developments, the guidance reiterates existing Staff comment practice, such as calling on issuers to disclose material pending crypto regulation and “material

risks ... related to the assertion of jurisdiction by U.S. and foreign regulators and other government entities over crypto assets and crypto asset markets.”<sup>4</sup>

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### SAMPLE COMMENTS FOR COMPANIES

In addition to asking companies to disclose “any significant crypto asset market developments material to understanding or assessing [their] business, financial condition and results of operations,” the letter provides a more specific set of sample comments, many of which are applicable principally to crypto market participants, such as crypto trading platforms, crypto lenders, custodians, funds and other trading firms. The sample comments are organized along the SEC’s traditional disclosure framework – Description of Business, Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and Risk Factors:

- **Description of Business.** To the extent material, a company should disclose:
  - the effects on the company of recent bankruptcies in the industry, including any material assets that may not be recovered due to the bankruptcies or that may otherwise be lost or misappropriated;
  - exposures to other counterparties, customers, custodians or other market participants known to (i) have filed for bankruptcy or taken similar actions, (ii) have experienced excessive redemptions or suspended redemptions or withdrawals of crypto assets, (iii) have the crypto assets of their customers unaccounted for, or (iv) have experienced material corporate compliance failures; and
  - steps to safeguard customers’ crypto assets and any policies and procedures to prevent self-dealing and other potential conflicts of interest, including the commingling of assets.
- **MD&A.** To the extent material, a company should disclose:
  - excessive redemptions or withdrawals, or suspensions of redemptions or withdrawals, of crypto assets and potential effects on the company’s financial condition and liquidity;
  - whether crypto assets serve as collateral for any loan, margin, rehypothecation or other similar activities;
  - the nature of the company’s relationship for loans with parties other than third parties;
  - whether there are any encumbrances on the collateral;
  - whether, to the company’s knowledge, crypto assets it has issued serve as collateral for any other person’s or entity’s loan, margin, rehypothecation or similar activity; and
  - whether the current crypto asset market disruption has affected the value of the underlying collateral.
- **Risk Factors.** To the extent material, a company should disclose:
  - risks, either direct or indirect, due to excessive redemptions, withdrawals, or a suspension of redemptions or withdrawals, of crypto assets, including any material concentrations of risk and quantification of any material exposures;
  - any reputational harm in light of the recent disruption in the crypto asset markets and related risks;
  - risk of unauthorized or impermissible customer access to products and services outside of jurisdictions in which the company has obtained required governmental licenses and

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- authorizations;
- risks from the possibility of regulatory developments related to crypto assets and crypto asset markets, including pending crypto legislation or regulation;
  - risks related to the assertion of jurisdiction by U.S. and foreign regulators and other government entities over crypto assets and crypto asset markets;
  - risks related to safeguarding of the company's, its affiliates' or customers' crypto assets, including if policies and procedures surrounding the safeguarding of crypto assets, conflicts of interest or comingling of assets are not effective;
  - gaps identified with respect to risk management processes and policies in light of current crypto asset market conditions as well as any changes made to address those gaps;
  - any financing, liquidity or other risks related to the impact of the current crypto market disruption on the value of the crypto assets the company uses as collateral or the value of crypto assets used by others as collateral; and
  - risks due to disruptions in the crypto asset markets from (i) a depreciation in stock price, (ii) loss of customer demand for products and services, (iii) financing risk, including equity and debt financing, (iv) increased losses or impairments in investments or other assets, (v) legal proceedings and government investigations, and (vi) price declines or price volatility of crypto assets.

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### NEXT STEPS

Participants in the crypto markets and companies in other industries that may have exposure to those markets should evaluate their existing disclosures in light of the Division's views. The guidance comes at a time of heightened regulatory focus on a rapidly evolving industry. It continues a line of existing "ad hoc" guidance in the area, consisting of speeches, reports, no-action letters and enforcement activity. It remains to be seen to what extent a comprehensive regulatory framework will evolve from these efforts.

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ENDNOTES

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- <sup>1</sup> Division of Corporation Finance, “Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets” (December 8, 2022), [SEC.gov | Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets \[1\]](#).
- <sup>2</sup> Id.
- <sup>3</sup> For Client Memoranda on the Division’s sample letters on climate disclosures and the conflict in Ukraine, see:
- “SEC Staff Highlights Review of Climate Change Disclosure: SEC Division of Corporation Finance Publishes Sample Comment Letter Regarding Compliance with Existing Climate Change Disclosure Guidance”, [S&C Publication: SEC Staff Highlights Ongoing Review of Climate Change Disclosure \(sullcrom.com\)](#); and
  - “SEC Staff Highlights Review of Disclosures Pertaining to Russia’s Invasion of Ukraine: SEC Division of Corporation Finance Publishes Sample Comment Letter Regarding Disclosures Pertaining to Russia’s Invasion of Ukraine and Related Supply Chain Issues”, [S&C Publication: SEC Highlights Disclosures Pertaining to Russia’s Invasion of Ukraine \(sullcrom.com\)](#).
- <sup>4</sup> Division of Corporation Finance, “Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets” (December 8, 2022), [SEC.gov | Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets \[1\]](#).

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