

Recent Developments Could Facilitate Greater Bank and Broker-Dealer Involvement in Cryptoasset Services

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On September 9, 2024, the Chief Accountant of the U.S. Securities and Exchange Commission (SEC), Paul Munter, [delivered remarks describing circumstances](#) in which, in the SEC staff's view, entities may engage in cryptoasset safeguarding activities without the need to account for those assets on their balance sheets in accordance with Staff Accounting Bulletin No. 121.

This evolution in the SEC staff's stance on accounting for cryptoasset safeguarding activities could open the door to greater involvement of banks and broker-dealers in providing certain cryptoasset custodial services by reducing the balance sheet and capital impacts associated with the provision of such services.

Background: Staff Accounting Bulletin No. 121

On March 31, 2022, the SEC staff in the Office of the Chief Accountant released [Staff Accounting Bulletin 121 \(17 CFR Part 211\)](#) (SAB 121), which provides interpretive guidance on accounting for certain entities' obligations to safeguard cryptoassets held for their platform users.¹

SAB 121 requires entities performing custodial duties for cryptoassets simultaneously to recognize a safeguarding liability and corresponding asset on their balance sheets, measured at initial recognition and each reporting date at the fair value of the cryptoassets held for customers.

SAB 121 has had major implications for banks and broker-dealers by causing customers' cryptoassets held in custody to be treated as part of the institutions' own balance sheets and subject to significant regulatory capital requirements. These capital impacts have discouraged many banks and broker-dealers from offering cryptoasset custody services to customers at scale. SAB 121 also imposes additional disclosure requirements.²

A congressional effort to repeal SAB 121 under the Congressional Review Act (CRA) failed earlier this year, when President Biden vetoed the resolution and the House's subsequent effort to overturn the presidential veto fell short on July 11, 2024.³

Scope of SAB 121 Narrowed by Remarks on SEC Staff Views

Munter's speech on September 9 reveals a potential softening of the SEC staff's interpretation of SAB 121. Munter asserted that "the staff's views on SAB 121 remain unchanged" but nevertheless outlined the staff's eased views on certain fact patterns where staff have not objected to an entity's conclusion that its arrangement was not within the scope of SAB 121.

¹ SAB 121 applies to entities that file reports pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (Exchange Act) and entities that have submitted or filed a registration statement under the Securities Act of 1933 or the Exchange Act. SAB 121 also applies to (a) entities submitting or filing an offering statement or post-qualification amendment under Regulation A, (b) entities subject to the periodic and current reporting requirements of Regulation A, and (c) private operating companies whose financial statements are included in filings with the SEC in connection with a business combination involving a shell company, including a special purpose acquisition company.

² Entities must include a clear disclosure in the notes to their financial statements of the nature and amount of cryptoassets held for platform users, and entities must also disclose the vulnerabilities faced due to any concentration in cryptoasset safeguarding activities.

³ 170 Cong. Rec. H4610 (daily ed. July 11, 2024).

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Bank Holding Companies

Munter described a scenario in which a bank holding company's bank subsidiary held cryptographic private key information for institutional customers where it had sufficiently mitigated the risks present such that its arrangement was not within the scope of SAB 121. His remarks suggest an approach for firms seeking to offer cryptoasset safeguarding custodial services without having to comply with SAB 121.

- **Obtain approval from and engage with prudential regulators.** The bank Munter discussed obtained written approval from its state prudential regulator for its proposed cryptoasset safeguarding activities after the regulator's review of the governance and risk management practices designed for those activities. The bank also engaged its primary federal regulator consistent with the regulator's expectations.⁴ The bank's operational controls in place to mitigate risks associated with holding its customers' private keys are subject to continuous supervision and oversight by the bank's prudential regulators, including certain limitations on the types of cryptoassets that can be safeguarded for customers.
- **Hold institutional customers' cryptoassets in a bankruptcy-remote manner, as supported by a legal opinion.** Each customer's cryptoassets are held in an individual blockchain wallet for which the customer is the beneficial owner. Each wallet is segregated from other assets and from wallets that hold cryptoassets for other customers or for the entity. The bank's cryptoasset safeguarding contractual agreements with its institutional customers limit the bank's activities to holding and transferring cryptoassets based on customer instructions, with no ability for the bank to use its customers' cryptoassets. The entity obtained a legal opinion from outside counsel affirming its "bankruptcy-remote" conclusion.
- **Negotiate clear standards of care in cryptoasset safeguarding contracts with institutional customers.** The terms and conditions in the bank's cryptoasset safeguarding agreements with its institutional customers clearly set forth the standard of care the bank must exercise and the scope of the bank's liability, thereby mitigating the bank's exposure to blockchain-specific risks outside of the bank's control.

⁴ See, e.g., Federal Deposit Insurance Corporation, Financial Institution Letter, *Notification of Engaging in Crypto-Related Activities*; Board of Governors of the Federal Reserve System, Supervision and Regulation Letter SR 22-6/CA 22-6, *Engagement in Cryptoasset-Related Activities by Federal Reserve-Supervised Banking Organizations*; and Office of the Comptroller of the Currency, Interpretive Letter #1179, *Chief Counsel's Interpretation Clarifying Authority of a Bank to Engage in Certain Cryptocurrency Activities*.

- **Conduct ongoing assessments of regulatory, legal and technological risks.** The entity has a robust process for assessing risks and uncertainties on an ongoing basis specific to each particular cryptoasset the bank contemplates safeguarding for its institutional customers.

Based on this fact pattern, Munter indicated that SEC staff did not object to the entity's conclusion that its cryptoasset safeguarding arrangement was not within the scope of SAB 121.

Introducing Brokers and Dealers

Munter further noted that SEC staff have also addressed instances in which a registered broker-dealer facilitates the purchase, sale and holding of cryptoassets by others (*i.e.*, an introducing-broker). Munter indicated that staff would not object to a conclusion that an arrangement is outside the scope of SAB 121 under the following circumstances.

- **No possession of the cryptographic key.** Neither the introducing broker-dealer, nor any person or entity acting as an agent for the introducing broker-dealer, has rights to, control over, or possession of the cryptographic key information, or any part or portion of that information required to transfer any cryptoassets held by the third party on behalf of the customer.⁵
- **Third party is the agent of the customer.** The third party acts as the customer's agent, not the introducing broker-dealer's, regarding the safeguarding, transfer or disposition of cryptoassets held on behalf of the customer. Both the third party and the introducing broker-dealer acknowledge that no agency relationship exists between them. The staff has considered certain facts as compelling evidence of the third party's role as the customer's agent.
 - The broker-dealer's written agreement with the customer states that it will not act as an agent in safeguarding, transferring or disposing of cryptoassets held by a third party.
 - The broker-dealer provides clear and prominent disclosures indicating that the third party or its agents is or are responsible for safeguarding, transferring or disposing of cryptoassets.
 - The third-party interacts directly with the customer as the account holder, handling account information directly with the customer regarding the cryptoassets it holds.
 - The customer has a direct contractual relationship with the third party, allowing the customer to give instructions directly to the third party for the handling of cryptoassets.

⁵ Still, the entity indicated that it would provide disclosure in its SEC filings about the extent of cryptoassets safeguarded, risk management impacts, and significant judgments made in reaching its accounting policy conclusion.

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- The third party provides the customer with contact information for direct communication.
 - The third party handles complaints or disputes related to handling of the cryptoassets.
 - The customer's cryptoasset account at the third party will remain active, and the third party will continue to follow the customer's instructions regarding the assets, even if the customer closes their securities account with the introducing broker-dealer or the introducing broker-dealer ceases operations.
- **Obtain legal opinion supporting status of introducing broker-dealer as it relates to cryptoasset activities.** The introducing broker-dealer obtains an opinion from outside legal counsel supporting assertions that the third party is acting as the customer's agent, the broker-dealer has no legal obligation to compensate the customer for any losses resulting from the third party's handling of the customer's cryptoassets, and the cryptoassets held by the third party on behalf of the customer would not be included in the broker-dealer's estate in the event of a formal liquidation or receivership.

Other Uses of Distributed Ledger Technology

Munter also described instances where SEC staff did not find that SAB 121 applies where an entity is involved with distributed ledger or blockchain technology that is used to facilitate certain types of transactions, such as where distributed ledger technology is utilized by entities to track holdings and transfers of traditional financial assets.

Key Points and Opportunities

Notwithstanding potential changes in the crypto landscape hinging on the outcome of the U.S. election, the SEC staff's softened stance on SAB 121 provides greater opportunities for banks and broker-dealers to offer cryptoasset safeguarding services at scale, subject to compliance with existing U.S. banking and broker-dealer legal requirements. The exemptions outlined in these fact patterns could potentially carve out a significant portion of entities initially subject to the requirements introduced by SAB 121.

As suggested by the SEC, its staff is available for consultations with any entity that requests the staff's views on its accounting conclusions, including those related to obligations to safeguard cryptoassets for others. We will continue to track updates as developments in this landscape continue to unfold.

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