

Regulatory Alert

Regulatory Insights

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Crypto Assets: SEC issues crypto exposure sample letter

KPMG Insight. In light of recent financial distress and disruption within the crypto asset market and growing pressure from policymakers, multiple regulators have denoted potential financial and exposure concerns, including:

- The SEC issuance of a sample letter to provide more information on crypto assets and associated risks. (NOTE: This is a similar approach to how the SEC addressed climate risk, culminating in the issuance of its climate disclosure proposal.)
- The OCC's [Semiannual Risk Perspective](#), underscoring key concerns around crypto-assets, including risk management and governance practices, and stablecoin stability
- A recent FRB [speech](#) on stress tests with a reference to "contagion risk"

The regulators are looking to assess related financial exposures and interconnectedness of the crypto markets via direct, counterparty, third-party, collateral, etc. They are also looking to assess the strength of risk management, safeguards and controls. The SEC issuance denotes express questions that all companies should be asking relative to potential financial exposures and general risk management processes and controls.

The Securities and Exchange Commission (SEC) Division of Corporation Finance (Division) states that companies may have disclosure obligations under the federal securities laws related to direct or indirect impacts that the recent widespread disruption in the crypto asset markets have had, or may have, on their businesses.

The Division released a [sample letter](#) containing illustrative comments similar to those that the Division may issue to companies based on a review of their disclosures and depending on their facts and circumstances. The Division adds that the comments "focus on the need for clear disclosure about the material impacts of crypto asset market developments, which may include exposure to counterparties and other market participants; risks related to a company's liquidity and ability to obtain financing; and risks related to legal proceedings, investigations, or regulatory impacts in the crypto asset markets."

The Division cautions that the accuracy and adequacy of a company's disclosures are the responsibility of the company

and its management. Companies should consider addressing crypto asset market developments in their filings generally, including in business descriptions, risk factors, and management's discussion and analysis.

SEC Sample Letter

The sample letter highlights the following areas of focus.

General

- "Provide disclosure of any significant crypto asset market developments relevant to understanding or assessing the business, financial condition and results of operations, or share price since the last reporting period, including any impact from the price volatility of crypto assets."

Description of Business

To the extent material to the business, describe:

- How the bankruptcies of certain companies and the downstream effects of those bankruptcies have impacted

or may impact the business, financial condition, customers, and counterparties, either directly or indirectly, and whether, due to the bankruptcies, assets may not be recovered or may otherwise be lost or misappropriated.

- Direct or indirect exposures to other counterparties, customers, custodians, or other participants in crypto asset markets known to have: i) filed for bankruptcy, been decreed insolvent or bankrupt, made any assignment for the benefit of creditors, or have had a receiver appointed for them; ii) experienced excessive redemptions or suspended redemptions or withdrawals of crypto assets; iii) the crypto assets of their customers unaccounted for; or iv) experienced corporate compliance failures.
- Steps taken to “safeguard customers’ crypto assets and describe any policies and procedures that are in place to prevent self-dealing and other potential conflicts of interest. Describe any policies and procedures regarding the commingling of assets, including customer assets, company assets, and those of affiliates or others. Identify what changes, if any, have been made to processes in light of the current crypto asset market disruption.”

Management’s Discussion and Analysis of Financial Condition and Results of Operations

Explain whether the company:

- *Has experienced excessive redemptions or withdrawals, or has suspended redemptions or withdrawals, of crypto assets and the potential related effects on financial condition and liquidity.*
- *Owns or has issued and/or holds on behalf of third parties, crypto assets that serve as collateral for any loan, margin, rehypothecation, or other similar activities to which the company or affiliates are a party. “If so, identify and quantify the crypto assets used in these financing arrangements and disclose the nature of the relationship for loans with parties other than third-parties. State whether there are any encumbrances on the collateral. Discuss whether the current crypto asset market disruption has affected the value of the underlying collateral.”*
- *Has issued crypto assets that serve as collateral for any other person’s or entity’s loan, margin, rehypothecation or similar activity. “If so, discuss whether the current crypto asset market disruption has impacted the value of the underlying collateral and explain any financing and liquidity risk this raises for the business.”*

Risk Factors

Describe “material” risks to the business arising from disruption in the crypto asset markets related to:

- *Redemptions and Withdrawals*, either direct or indirect, due to excessive redemptions, withdrawals, or a suspension of redemptions or withdrawals, of crypto assets as well as any concentrations of risk; quantify any exposures.
- *Reputation*, such as the perceptions of customers, counterparties, and regulators, and potential impacts on operations or financial condition.
- *Security*, such as risks from unauthorized or impermissible customer access to products and services outside of jurisdictions where the company has obtained governmental licenses and authorization.
- *Legislation and Regulation*, including any effects potential crypto legislation or regulation may have on the business, financial condition, and results of operations.
- *Jurisdiction*, including risks related to the assertion of jurisdiction by U.S. and foreign regulators and other government entities over crypto assets and crypto asset markets.
- *Safeguarding and Controls*, including effort to safeguard the company’s, affiliates’, or customers’ crypto assets as well as risks to the business and financial condition if policies and procedures surrounding the safeguarding of crypto assets, conflicts of interest, or comingling of assets are not effective.
- *Risk Management* gaps identified by the board or management and any changes made to address those gaps.
- *Financing, Liquidity, and Other Risks* related directly or indirectly to the value of the crypto assets used as collateral or the value of crypto assets used by others as collateral.
- *Other Risks*, including risks related to:
 - Depreciation in stock price.
 - Loss of customer demand for products and services.
 - Financing risk, including equity and debt financing.
 - Increased losses or impairments in investments or other assets.
 - Legal proceedings and government investigations, pending or known to be threatened, in the United States or in other jurisdictions.
 - Price declines or price volatility of crypto assets.

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