

SEC RESCINDS 2022 ACCOUNTING GUIDANCE REGARDING CRYPTO-ASSETS UNDER CUSTODY AND ISSUES NEW GUIDANCE

On January 23, 2025, the SEC issued Staff Accounting Bulletin (SAB) 122 to rescind previously imposed accounting guidance for crypto-assets under custody (SAB 121).¹ By removing non-technology-neutral barriers to safekeeping digital assets, SAB 122 is widely expected to increase the provision of custody services for digital assets by banks, trust companies and other traditional custodians as well as accelerate the tokenization of traditional financial instruments and the use of digital ledger technology in traditional financial markets. Unlike SAB 121, which created uncertainty and paralysis, if it achieves its anticipated effects, SAB 122 should contribute to the increasing maturation and institutionalization of digital asset markets in the United States.

Traditionally, assets held in custody for customers for safekeeping purposes are not recorded on a custodian's own balance sheet pursuant to U.S. General Applicable Accounting Principles (GAAP), absent special circumstances, as the assets are beneficially owned by the custodian's customers and, with appropriate safeguards, generally excluded from the custodian's estate in the event of its insolvency. Ordinarily, a custodian would record neither an asset nor a liability on its balance sheet in respect of assets held in custody for customers for safekeeping purposes.

In a departure from that practice, SAB 121 ordered entities subject to SEC issuer reporting requirements with obligations to safeguard crypto-assets for customers (e.g., most major US banking institutions and crypto market participants operating as public companies), to record **all** crypto-assets held for customers as a liability on their balance sheet, regardless of the custodian's assessment of the likelihood of loss of such assets.² Under SAB 121, custodians were also required to recognize a corresponding asset on their balance sheet in respect of custodied crypto-assets, which was also a departure from traditional practice. SAB 121 justified this by, among others, citing the "unique" risks posed by crypto-assets and uncertainties about how they would be treated in bankruptcy.

Critics of SAB 121 argued that, by ordering custodians to record crypto-assets held for customers on their own balance sheet, SAB 121 created an accounting

¹ <https://www.sec.gov/rules-regulations/staff-guidance/staff-accounting-bulletins/staff-accounting-bulletin-122>

² <https://www.sec.gov/regulation/staff-interpretations/accounting-bulletins/old/staff-accounting-bulletin-121>

treatment of crypto-assets that differs from the traditional treatment of most other custodial assets. They stressed that SAB 121 could cause custodied crypto-assets to be included in the custodian's estate and treated as the custodian's, rather than the customer's, property in bankruptcy.³ SAB 121, they explained, could have the perverse effect of increasing the risk of customers losing access to their crypto-assets in the event of the custodian's bankruptcy, a result contrary to the investor protection concerns the SEC cited in promulgating SAB 121, and that are embodied in SEC rules applicable to broker-dealers carrying customer assets.

Most significantly, many public companies that sought to offer custody and safekeeping services with respect to crypto-assets, including many traditional providers of custody services such as banks and trust companies, either shelved plans to offer such services or significantly curtailed such activities due to the related capital consequences and other balance sheet constraints. Holders of crypto-assets were therefore left with significantly less options as the SEC through SAB 121 actively discouraged already highly-regulated, financial services providers from offering crypto-custody services.⁴

After SAB 121 was issued on March 31, 2022, and became effective on April 11, 2022, bills were introduced seeking to overturn SAB 121 in both the House and Senate.⁵ Both bills were passed with bipartisan support in the House and the Senate, but the House resolution bill was vetoed by President Biden, rendering such legislative efforts aimed at overturning SAB 121 moot.⁶

The newly issued SAB 122 rescinds SAB 121's non-technology-neutral accounting treatment for custodial crypto-assets. Thus, before accruing or disclosing a liability, SAB 122 instructs entities with obligations to safeguard crypto-assets to assess the probability of loss in accordance with Financial Accounting Standards Board Accounting Standards Codification ("**FASB ASC**") Subtopics 450-20, Loss Contingencies, or International Accounting Standard ("**IAS**") 37, *Provisions, Contingent Liabilities and Contingent Assets*. SAB 122 rescinds SAB 121's instruction that custodians with safeguarding obligations in respect of customer crypto-assets should automatically reflect such assets on their own balance sheet whether or not required to do so by GAAP. Accordingly, whether a custodian would recognize an asset on its balance sheet in respect of customer custodial crypto-assets would be governed by other GAAP standards.

The rescission of SAB 121, as well as other recent developments, should open the door to greater institutionalization of the digital asset class as well as accelerating participation by traditional financial services providers and market participants. We are actively working with clients to assess the changing US

³ See, e.g., Conference of State Bank Supervisors Letter to Chairman McHenry and Ranking Member Waters regarding SAB 121, dated February 28, 2024, Cong.Rec. 170:80, 118th Cong., 2d Sess., H2950-H2963, at H2954 (May 8, 2024)

⁴ In the closing days of the Biden administration, SEC staff acknowledged that certain arrangements involving crypto-assets and distributed ledger technology were outside the scope of SAB 121 and provided certain generic fact patterns that the staff would not object to if a reporting company deemed SAB 121 inapplicable. Most of these involved already-regulated financial institutions. See Paul Munter, SEC Chief Accountant, Remarks before the 2024 AICPA & CIMA Conference on Banks & Savings Institutions: Accounting for Crypto-Asset Safeguarding Obligations—A Facts-Based Analysis, (Sept 9, 2024), available online at <https://www.sec.gov/newsroom/speeches-statements/munter-speech-safeguarding-crypto-assets-09-09-24>

⁵ See, e.g., H.J.Res.109, <https://www.congress.gov/bill/118th-congress/house-joint-resolution/109/all-info>

⁶ <https://bidenwhitehouse.archives.gov/briefing-room/presidential-actions/2024/05/31/a-message-to-the-house-of-representatives-on-the-presidents-veto-of-h-j-res-109/>

legislative and regulatory frameworks for digital assets, and to assist our clients in identifying emerging opportunities and risks.

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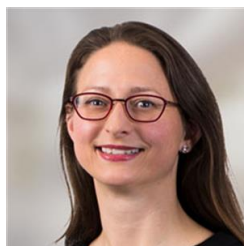
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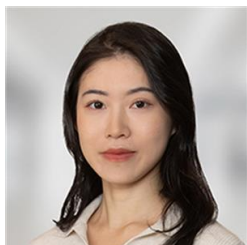
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