

# FTX Collapse Causes SEC to Request Additional Crypto Asset Disclosures

December 12, 2022

On December 8, 2022, the Securities and Exchange Commission's ("SEC") Division of Corporation Finance (the "Division") released a [sample comment letter](#) (the "Letter") regarding recent developments in crypto asset markets. In its review of disclosure documents, the Division may issue a tailored form of the Letter to a public company or other entity with SEC filing obligations, asking it to address specific concerns raised by these recent developments and the crypto asset market in general through a response letter or in amended disclosures. The Letter comes as regulators respond to the "[r]ecent bankruptcies and financial distress among crypto asset market participants," including the sudden collapse of FTX last month, which, until recently, was one of the largest crypto exchanges in the world, as well as increased pressure from other regulators and [members of Congress](#) to enhance supervision of the crypto industry.

## KEY TAKEAWAYS

- The release of the Letter represents an increased focus on crypto asset activities of public companies, especially with regard to risks implicated by the recent bankruptcies in the industry, FTX being the most prominent.
- Based on past letters of this nature, companies should expect scrutiny of their upcoming SEC filings and should ensure the issues identified in the Letter are addressed going forward.
- If a company receives a letter based on this sample, the company's response should be thoughtfully crafted, explain clearly the reasons the company believes any information excluded is not material (or update the disclosure accordingly) and not rely on any conclusory statements.
- The Letter may also portend future SEC rulemakings surrounding disclosure of crypto asset activities, as was the case for [climate-related disclosures](#).

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## LETTER CONTENT

Broadly, the Letter asks issuers to revise or update their public disclosures regarding their crypto asset holdings as well as their risk exposure to certain crypto-related bankruptcies (e.g., FTX, BlockFi), and other market developments. These risks are heightened in light of the highly interrelated nature of the crypto asset industry.

The Letter first asks generally for disclosure of any significant crypto asset market developments material to understanding or assessing the company's business, financial condition and results of operations, or share price, including any material impact from the price volatility of crypto assets.

It then asks the company to update its "Description of Business," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" disclosures. Specific topics for updating include (each if, and to the extent, material):

- the impact or potential impact of the recent bankruptcies and the downstream effects of those bankruptcies on the company's business, financial condition, customers and counterparties, either directly or indirectly;
- measures the sample company has undertaken to safeguard customers' crypto assets and any policies and procedures that are in place to prevent self-dealing and other potential conflicts of interest or regarding the commingling of assets (including any material changes to such procedures);
- effects from the possibility of regulatory or legislative developments related to crypto assets and crypto asset markets; and
- general risk categories affected by disruptions in the crypto asset markets, such as risk of depreciation in stock price, decreased customer demand or increased losses or impairments on assets.

## CONTEXT OF RECENT BANKRUPTCIES

The Division's increased focus on crypto-related disclosures appears prompted by the absence of meaningful precedent and guidance on many novel issues surrounding crypto assets, as demonstrated by recent bankruptcy filings. Among other things, a bankruptcy filing will likely preclude a company from recovering from the debtor during the bankruptcy case, potentially resulting in short- and medium-term liquidity

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challenges for the company. More specifically, immediately upon the bankruptcy filing, there is a global “automatic stay” imposed by section 362(a) of the Bankruptcy Code to prevent creditors from taking a variety of actions against a debtor, including the enforcement of liens, acts to collect, assess or recover certain debts, and the setoff of obligations owing to a debtor against claims against such debtor. 11 U.S.C. § 362(a). While certain financial contracts relating to securities and commodities are excluded from the automatic stay by safe harbor provisions in the Bankruptcy Code that allow counterparties to exercise their contractual rights notwithstanding a debtor’s filing for Chapter 11, it is uncertain if such provisions may apply to crypto asset contracts.

In addition to the uncertainty in the timing and amount of a recovery, there is an additional risk that the crypto assets that are held by the debtor entity (including those crypto assets of its platform users) could, under certain circumstances, be viewed by a bankruptcy court as the debtor’s corporate assets in a bankruptcy proceeding and not assets of the creditor/customer. In that event, creditors and customers may be treated as unsecured creditors and, thus, potentially, have a lower priority right to payment and could lose some or all of the value of their investment in the crypto assets. As we explained in an earlier [article](#), the SEC’s April 11, 2022, Staff Accounting Bulletin (“SAB 121”) added interpretive guidance “for entities to consider when they have obligations to safeguard crypto assets for their platform users” in order to identify certain bankruptcy-related risk exposures. Disputes regarding ownership over crypto assets has been one of the key issues being litigated in pending crypto chapter 11 cases.

## NEXT STEPS

In light of these developments, companies should consider the materiality of any crypto-related disclosures when preparing their public filings or other disclosure documents, regardless of whether they have received a comment from the Division directly. In the event that a company does receive a letter, the company should be prepared to respond with a thoughtfully crafted answer as to why it believes that the requested information is not material to its business, or update the disclosure accordingly.

From our own experience, and as evidenced in publicly released comment letters, the Division has pushed back against companies that have responded to similar “sample” comment letters in a conclusory fashion, such as without a detailed explanation why the requested information was immaterial. The Division has often responded to companies’ answers with additional comments, which may ask for specific and in-depth backup for their assertions and explanations.

Similar to the recent SEC proposal that would require certain climate-change related disclosures in public filings, which was also preceded by a [sample letter](#) (see our client update on the proposal [here](#)), it is possible that data gathered from responses to comments based on the Letter, as well as other preemptive disclosures, could be used in future SEC rulemaking regarding crypto asset disclosures. The highly interrelated nature of the crypto asset industry, including the effects of the FTX and BlockFi bankruptcies, and recent pressure from lawmakers, could heighten the likelihood of future crypto asset regulation from the SEC.

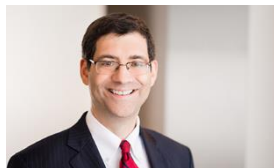
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For more discussion and analysis of developments regarding bankruptcy law and crypto entities see our other posts:

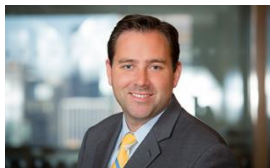
- [Recent Disclosure Guidance Highlights Growing Concern Surrounding the Risks of User Assets Held by Various Crypto Custodians](#)
- [SEC Chair Gary Gensler's Top Crypto Market Priorities](#)
- [Recent Crypto Bankruptcy Filings May Provide Clarity to Critical Unresolved Questions](#)

Please do not hesitate to contact us with any questions.

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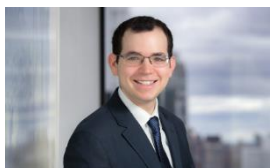
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