American Bankers Association

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February 29, 2024

The Honorable Patrick McHenry
Chairman
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Re: Providing for congressional disapproval under chapter 8 of title 5, United States Code, of the rule submitted by the Securities and Exchange Commission relating to "Staff Accounting Bulletin No. 121" (H.J. Res. 109).

Dear Chairman McHenry and Ranking Member Waters:

The American Bankers Association (ABA)[1] welcomes and supports H.J. Res. 109, the Congressional Review Act resolution of disapproval for the Securities and Exchange Commission "Staff Accounting Bulletin 121," which was recently introduced by Reps. Mike Flood (R-NE) and Wiley Nickel (D-NC).

Adverse Impact of SAB 121 on Bank Digital Asset Products and Services

In March 2022, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin 121 (SAB 121) to address perceived risks to publicly traded companies that safeguard crypto assets for their customers. Under SAB 121, an entity responsible for safeguarding cryptocurrency assets for platform users must present a liability on its balance sheet at fair value to reflect that obligation, as well as a corresponding asset. SAB 121 is a departure from the banking industry's historical practice of treating custody assets off-balance sheet, and this accounting treatment effectively precludes banks from offering digital asset custody at scale since placing the value of client assets on balance sheet will impact prudential requirements such as capital, liquidity, and other mandates.

On February 14, 2024, ABA joined with several other financial trades in a joint letter to the SEC.[2] In the letter, we noted that U.S. banking organizations' experience over the past two years with SAB 121 shows that it has curbed the ability of our members to develop and bring to market at scale certain digital asset products and services. We gave two concrete examples:

[1] The ABA is the voice of the nation's $23.4 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2.1 million people, safeguard $18.6 trillion in deposits and extend $12.3 trillion in loans.
[2] https://www.aba.com/advocacy/policy-analysis/joint-comments-to-sec-on-sab-121

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(1) Spot Bitcoin ETPs

The Commission recently approved Spot Bitcoin Exchange Traded Products (ETPs), allowing investors access to this asset class through a regulated product. However, notably absent from those approved products are banking organizations serving as the asset custodian, a role they regularly play for most other ETPs. These ETPs have already experienced billions of dollars in inflows, but it is practically impossible for banks to serve as custodian for those ETPs at scale due to the Tier 1 capital ratio and other reserve and capital requirements that result from SAB 121. This raises important questions about the safety and stability of this ecosystem.

We believe that this result could raise concentration risk, as one nonbank entity now serves as the custodian for the majority of these ETPs. That risk can be mitigated if prudentially regulated banking organizations have the *same ability* to provide custodial services for Commission regulated ETPs as qualified nonbank asset custodians. SAB 121 does not appear to contemplate this type of concentration risk, in part perhaps because Spot Bitcoin ETPs or similar products were not an approved product at the time SAB 121 was issued.

(2) Use of DLT to record traditional financial assets

Banking organizations are increasingly exploring the use of Distributed Ledger Technology (DLT) to record traditional financial assets, such as bonds. The use of DLT has the potential to expedite and automate payment, clearing, reconciliation and settlement services, and multiple central banks outside the United States are partnering with banks to explore the adoption of DLT. However, SAB 121 has proven to be a barrier to banking organizations' ability to meaningfully engage in DLT-based projects due to the breadth of the definition of "crypto-asset" in SAB 121: "a digital asset that is issued and/or transferred using distributed ledger or blockchain technology using cryptographic techniques."

Under this definition, a traditional financial asset issued or transferred using DLT could be considered a "crypto asset" and thus within scope of SAB 121, regardless of the applicable risks. SAB 121 makes no distinction between asset types and use cases, but instead generally states that crypto-assets pose certain technological, legal, and regulatory risks requiring on-balance sheet treatment. However, there are significant differences between a cryptocurrency like Bitcoin that exists on a public, permissionless network versus a traditional financial instrument that is recorded on a blockchain network where access is controlled and transactions can be cancelled, corrected, or amended.

The past two years have underscored these differences, as the turmoil in the crypto market has been wholly unrelated to banks' use of permissioned DLT. DLT does not change the underlying nature or risks of traditional assets, nor do they present the risks SAB 121 purports to address, and thus SAB 121's application to those assets should be reconsidered. Clear indication from the Commission that the use of DLT to record or transfer traditional financial assets is consistently outside the scope of SAB 121 would alleviate associated challenges.

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In the February 14 letter, we made several recommendations for changes to SAB 121 that would mitigate the specific challenges identified above without undermining the stated policy objectives of the SEC to enhance the information received by investors and other users of financial statements. We also asked for a meeting to discuss those changes, but as yet have not had a response from the SEC.

Adverse Consequences for Consumers

Banks have long provided safe and well-regulated custody services to investors for securities and other assets. However, the implications of SAB 121 mean few banks are currently offering custody services for digital assets, leaving consumers with few options for a safe, well-regulated custody service for digital assets.

In fact, many have turned to non-bank market entrants that are not subject to prudential regulation and examination and are not subject to robust capital and liquidity requirements. This unregulated activity can expose consumers and counterparties to significant harm.

Conclusion

We applaud Representatives Flood and Nickel for their leadership on this important issue. The SEC's Staff Accounting Bulletin 121 represents a significant departure from longstanding accounting treatment for custodied assets and threatens the banking industry's ability to provide its customers with safe and sound custody of digital assets. Limiting banks' ability to offer these services leaves consumers with few well-regulated, trusted options for their digital asset portfolios and ultimately exposes them to risk.

We encourage you and your membership to favorably report this resolution out of the Committee. We would be pleased to meet with you and your staff to discuss how Staff Accounting Bulletin 121 inhibits consumer access to safe, sounds access to digital asset custody services.

Sincerely,

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Cc: Members of the House Committee on Financial Services