

MAPPING GREY AREAS IN INTERNATIONAL LEGAL APPROACHES TO THE FAILURE OF CRYPTO FIRMS

PRELIMINARY FINDINGS FROM WORKSHOP 1
Held on 17 and 18 June 2024

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Introduction

Cryptoassets have grown in popularity in recent years, with 2.3 million UK citizens identified as having invested in these assets, with around 6% borrowing money to do so. There has been similar or greater interest in many other countries, including in developing countries, often without awareness of the real risk entailed. Legal issues in this sector are beset with uncertainties, not least as to what will happen in the event of an insolvency. Cryptocurrencies and crypto exchanges, “crypto firms”, operate in a volatile market beset with legal uncertainties, making insolvencies likely, especially where cryptocurrencies have no intrinsic value and where regulatory changes will bring turmoil. In the event of an insolvency, claims by crypto investors are likely to be met with difficulty as proceedings may be opened in another, unfamiliar, jurisdiction. **The legal impacts of insolvencies in the crypto sector are also complex, international in dimension, and under researched.** There is presently no comprehensive analysis of this international dimension and little public awareness.

This project is a first step towards this analysis by identifying the issues that are likely to arise in the event of the failure of a crypto firm, mapping the jurisdictions that are likely to be involved, and identifying possible legal responses. It will do so through the establishment of an international network funded by the Arts and Humanities Research Council and in partnership with INSOL International and the Istanbul Bar Association, bringing together academic and practitioner representation from major crypto-investing countries, with equal representation from developing countries where there are high levels of crypto investment.

There has already been excellent discussion in our first workshops, attended by 22 experts from 14 countries. In this report we identify the key points that emerged from the discussions.

WORKSHOP 1

The first workshops were held online on 17 and 18 June 2024. We divided participants into two groups, “East” and “West” according to time zone. We had very interesting discussions during the 6 hours of the East Group and 6 hours of the West Group.

WORKSHOP 1 KEY INSIGHTS

Below we set out the questions that were included in the Preparatory Pack as well as key points from the discussions in both the ‘East’ and ‘West’ sessions:

1. Are cryptocurrencies freely accessible in your country?

- Crypto assets seem to be largely available across jurisdictions in the sense that they are not banned. - For example, India, Czech, Germany, UK, UAE, Kenya (see below), Nigeria (see below), Mexico, Uganda, Singapore, Argentina, Brazil.
- Some governments were initially opposed to crypto but attitudes have softened more recently. For example, Nigeria have eased their restrictions – but potentially this is due to continued use and engagement within the sphere. The banks cannot hold or trade in crypto and 3rd party cheques cannot be cleared through crypto, which would limit the potential for crypto to present systemic risks. Kenya is also an example where the Bank was against it initially but did not formally ban crypto previously. The Indian parliamentary report also published stating it is against crypto, but ban was unsuccessful in the supreme court.

2. Are crypto investments or exchanges subject to any regulation in your country?

- Regulations have been developing in many jurisdictions which changes occurring recently (including upcoming pending regulations in jurisdictions such as Turkey, Uganda, Argentina).
- Further recent changes have been highlighted in addition to the above in Nigeria and Kenya. For instance, the Nigerian government’s approach was to ban the operation of crypto exchanges initially. Because the government believes that Binance affects the country’s national currency, Naira. The government has introduced eNaira for crypto users. VPN is used by the Nigerian users to bypass the government restrictions so that they can access the Binance.

- In India, the central bank banned crypto in 2018, which a bill proposed in 2019. This ban was challenged successfully in 2020 however on the basis of being disproportionate, given that citizens have rights to trade and profession under the constitution.
- Proposed personal liability for shareholders and directors in Turkey is being proposed in the event of crypto insolvencies – though this might be challenged and there will likely be more developments in the coming months.
- Present regulations include various forms of licensing/registration requirements for exchanges – examples such as MiCAR in EU, the UK, Singapore, UAE, Nigeria, Argentina.
- In the UAE there is a tiered form of regulation: Federal, Local and free-zone. There is real desire from regulators to create a crypto hub (particularly in the free-zone) and be at the forefront.
- Some regulation focuses on AML Regulation, advertising, tax but limited if any on insolvencies (and liability issues).
- Some insolvency related aspects in the MiCAR in the EU and also in the central bank guidelines in Nigeria and certain conditions of registration, such as a fidelity bond and the need to segregate client assets and notify the SEC prior to winding up. Broadly assessed as securities. In Brazil they are also securities.

3. From your impressions, please consider the following. How do people in your country buy crypto? For what reason? Is the concept of crypto well understood?

- The most common form of ‘access’ to crypto or as well as the most common platform for transactions does appear to be the centralised exchange.
- There are also peer-to-peer variants in some jurisdictions.
- Also, the use of dark market trading and VPNs to operate through exchanges not registered in that jurisdiction.
- Reasons for trading in crypto that were noted included: high inflation and depreciating fiat currency (as noted in Turkey, Nigeria and Brazil as examples). In Argentina there is also the issue of high inflation, though the USD is still preferred as a hedge.
- Reasons for trading in crypto that were noted included: migration and cross border purchases (as noted in Nigeria and Mexico).
- Reasons for trading in crypto that were noted included: get rich (some discussions of short and long term here also.) (Noted in largely all the countries with respect to short term. Some long-term discussions in the context of EU). Also, some discussions of age and digital/tech literacy with notions of risk (risk-aware or risk-averse cultures) discussed (noted in Nigeria, Czech, Kenya, Turkey).

- Reasons for trading in crypto that were noted included: trusting a friend or family member (noted in UAE and general Arab culture, Kenya also, Nigeria).
- Also, a discussion was raised about the very loose term of 'investment' when discussing crypto as this can give the perception that it is akin to a heavily regulated market, which it is not.

4. Are there any exchanges or crypto coins established in your country?

- Binance seems to be prominent in a lot of jurisdictions. Some examples where big exchanges such as Binance dominate even local exchanges (for example Binance appears more popular than NairaX in Nigeria).
- However, there are also local exchanges present and in some jurisdictions these seem to be more trusted. (Bitso in Mexico for example, BitPesa in Kenya, Trezor wallet in Czech, numerous local exchanges in Turkey, UAE, Nigeria, India).
- Also an example of a local stablecoin in Turkey – BiLira.

5. Have there been any examples of crypto failures in your country, for example a failure of an exchange or a cryptocurrency?

- Examples raised such as Todex in Turkey, Nuri in Germany.
- Also discussed FTX impact globally and whether this impacted the market perception – though this appears mainly from an academic perspective. Though there was an example of an Indian subsidiary of FTX discussed which was managed by 'Liquid' in Japan – highlighting the truly cross border nature of these aspects.

6. Has the concept of a crypto asset been the subject of any legal decision or other analysis in your country?

- The focus of the discussion was whether crypto assets are regarded as 'property' or not.
- Discussions that in most countries crypto is not legal tender.
- Discussions of securities/property.

7. Has the concept of a DAO (decentralised autonomous organisation) been considered in your country? Do DAOs present any likely difficulties for the operation of the insolvency procedures in your country?

- The concept of a DAO has been considered in Turkey by entrepreneurs, but it has not been addressed by regulatory authorities yet. The Turkish Commercial Code does not provide any guidance on the legal status of DAOs. GFY DAO in Turkey was used as an example and a discussion of the Swiss system of foundations.

GFY operates with a community-focused membership structure that is based on NFT ownership.

- There was discussion of whether DAOs can work within the concept of an ordinary partnership – although an acknowledgement that presently it does not easily fit.
- A question was raised regarding how a DAO can fit into a country's regulatory model if there is the requirement of licensing/registration?
- Some mentioned DAOs being used as almost an alternative to venture capital, or a source of crowdfunding (noted in Turkey, Kenya).
- Others noted DAOs not being prevalent currently within their jurisdictions either as it has not been tried or there have been some failures (noted discussions in Nigeria, Uganda, Brazil and Mexico with the failure of Apecoin). Also, the first DAO being hacked potentially impacting trust. The DAO framework is regarded as in its infancy in Singapore.
- DAOs largely seem to be developmental (with lots of issues to unpick and some uncertainties in respect of law in insolvencies, possibility of entering into agreements with other entities, asset recovery, terminology and overlap with AI as some points discussed) and will be a focus of the next workshop.
- The State of Vermont and the State of Wyoming allow DAOs to be operated through LLCs and some other structures such as Swiss foundations are also used as "legal wrappers".

8. In the event of the failure of a) a crypto exchange or b) a cryptocurrency that is operated by a decentralised entity what factors in private international law should determine the choice of jurisdiction in the event of an insolvency?

- Difficulty in recognising the COMI of a decentralised entity was noted.
- Acknowledgement that different jurisdictions' reliance on COMI varies and in some jurisdictions it is well established.
- Tracking down assets, investigative work, issues of anonymity were all noted as barriers, though there were also some discussions of the traceability of DLT broadly and the possibility that DAOs might offer some clarity in respect of COMI.
- Numerous factors discussed include whether there is a connect with that Jurisdiction, any terms & conditions, location of the asset (or person who owns the asset).

9. In the event of the failure of a) a crypto exchange or b) a cryptocurrency that is operated by a centralised entity what factors

in private international law should determine the choice of jurisdiction in the event of an insolvency?

- A much easier and clearer approach was noted with a centralised entity (though it is not without its own issues). Aspects such as COMI or main place of business (or place of the exchange's server) were discussed – this will be more complex for international companies.
- Query raised regarding nominating the insolvency jurisdiction in advance (per [Casey, Gurrea Martinez and Rasmussen](#)). 'in the event of an insolvency, it would be filed...'. However, the fact that COMI is so well established (particularly noted in the EU), this could be unlikely.
- Also, a discussion around whether the approach for crypto should be unique to that of general insolvency issues on this topic.
- Discussion of VPN use by users further complicating this issue as well as cloud computing.
- Possibility of ADR mechanisms such as mediation to be used in this context.

10. What are the challenges in recognising and enforcing foreign insolvency judgments pertaining to cryptocurrency exchanges/cryptocurrencies in another jurisdiction?

- Possibility/necessity of an international convention and collaboration here – though barriers to this were noted.
- Potentially private international law will play a key role.
- Key challenges discussed: INSOL are currently looking at asset tracing and tracking as key aspects.
- Key challenges discussed: speed and efficacy.
- Key challenges discussed: how differing jurisdictions treat crypto and have different mechanisms for dealing with such proceeding.
- Key challenges discussed: volatility of the crypto which can impact valuation and the point at which you convert crypto to fiat and the further issues surrounding directors' duties and wrongful trading.
- Key challenges discussed: tax havens and shell companies.
- Discussion of whether utility tokens could be utilised to provide some degree of priorities for creditors?

11. Are there any other issues relevant to the project that we should be looking at?

- Discussions of automatic stay and priorities?
- No reason why key features of insolvency law would not be equally as relevant issues in the context of crypto.

WORKPLAN

The project's events consist of two online workshop and a face to face event. Workshop 1 is considered in this report. The project also builds on a thematic analysis of the terms and conditions of crypto businesses to identify where insolvencies might take place and what impacts there might be for customers. The analysis is in progress and findings will be presented during the workshops. The concluding event will be held on 12 and 13 August when we look forward to welcoming participants to Nottingham's Crowne Plaza hotel.

NETWORK

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