

2022 | **Dubrovnik**

The Third YANIL Restructuring and Insolvency Workshop



Crypto insolvencies and regulation of crypto-asset service providers under the MiCA

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Letters to Martin Glenn, Bankruptcy Judge for the S.D.N.Y., bankruptcy of Celsius

I am a 65 year old retired man writing this letter in the hopes that justice will be served for myself and many others who have lost their investments. [...]

I have worked since I was 15 years old, and have saved my earnings, sacrificing and pinching pennies for the last 50 years. Now, upon retirement I have found that most of my savings are being withheld from me by Celsius- just two weeks after my new marriage!

[Letter](#)

I often cannot sleep at night worrying how I will survive in the future.

[Letter](#)

I'm glad I didn't put everything in Celsius but with what I did I stand to lose almost half of my retirement savings.

[Letter](#)

I am a 69yo, widow, who deposited my crypto into Celsius. I didn't sign up to be scammed, in a structured Ponzi scheme. I will never be able to accumulate any wealth at my age, I'm old. I will have to go back to work, if I can find work, if I can manage my health to be able to work.

The devastation to my life situation is irreparable, its despair, hopelessness, its failure, a slow death, that eats at you every minute of every day. It takes your heart, mind, soul and body.

[Letter](#)

I do not and have never owned my own home, I do not own a car, I shop at second hand stores to save money. After I learned about Bitcoin, crypto and eventually Celsius I became a real believer. This looked to me my best and possibly only shot at becoming a homeowner and retiree. I went all in ... 100% of my savings followed by everything I had left over after each check.

It's very somber for me to look at my account knowing that I no longer have access to any of my savings.

[Letter](#)

AGENDA

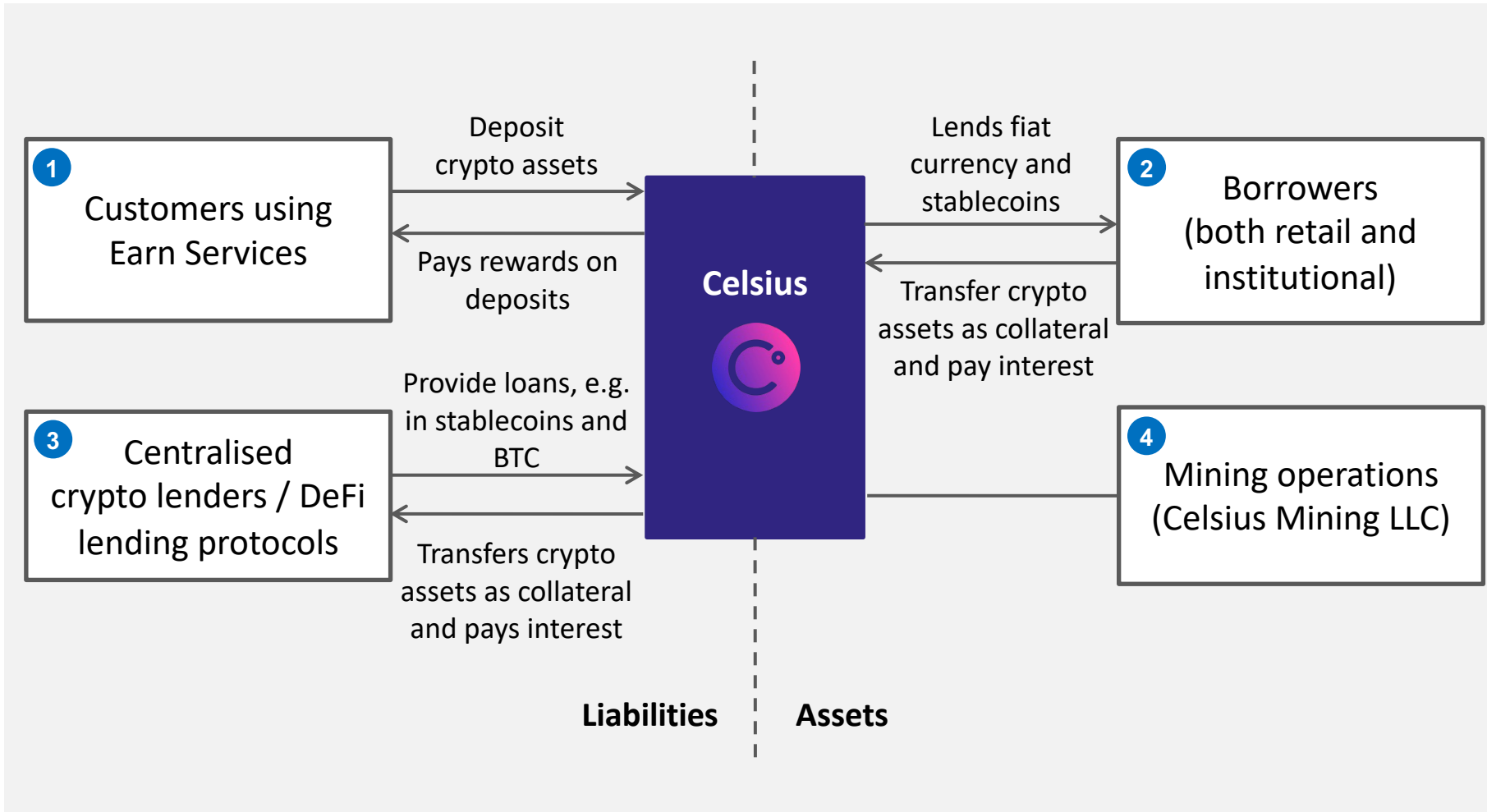
1. Celsius Network LLC
 - business model
 - crypto insolvencies in “crypto winter”
 - new observations
2. Legal issues
 - allocation of proprietary rights over deposited crypto assets
3. Regulation on Markets in Crypto-Assets (MiCA)
 - segregation of crypto assets
 - crypto-lending

Celsius Network LLC (Celsius)



- Founded by Alex Mashinsky in New Jersey, U.S. in 2017
- By the end of 2018, over USD 50 million worth of crypto assets were transferred to Celsius and by March 2021 this number had grown to more than USD 10 billion
- Since March 2022, reduction of assets by USD 17.8 billion due to, inter alia, user withdrawals (USD 1.9 billion), a decline in market value of holdings (USD 12.3 billion), and as a result of crypto assets liquidated by third parties (USD 0.9 billion)
- By July 2022, Celsius had appr. 1.7 million registered users and appr. USD 6 billion in assets
- On 12 June 2022, Celsius paused all withdrawals
- On 13 July 2022 Celsius filed a voluntary Chapter 11 petition in the United States Bankruptcy Court for the S.D.N.Y.

Celsius: Business model



1. Customers lend crypto assets to Celsius and earn rewards (“**Earn Services**”) or deposit crypto assets via “**Custody Services**”
2. Third parties borrow fiat currency and stablecoins from Celsius and pay interest
3. Celsius borrows stablecoins and cryptocurrency from centralized (CeFi) and decentralised (DeFi) lenders
4. Celsius owns mining rigs

Crypto insolvencies in “crypto winter”

New observations

1. Domino-like insolvency of crypto firms highlight how closely interconnected market participants are and how fragile markets in crypto assets can be

2. New business models and new risks (e.g. centralised and decentralised crypto-lending)

3. Regulation of crypto services and crypto-asset service providers has made substantial progress over the last decade. Yet it did not sufficiently protect clients of crypto firms

Legal issues

1. Allocation of ownership rights over deposited crypto assets (who owns deposited crypto assets?)

2. Establishment of security interest over crypto assets (crypto collateral is at the heart of crypto-lending)

3. Avoidance of pre-bankruptcy re-payments carried out automatically following liquidation of crypto collateral

4. Valuation of crypto assets and method of distribution in insolvency (in cash or in-kind)

Who owns deposited crypto assets?

A depositor exercises a proprietary (*in rem*) right against a crypto custodian and is entitled to **retrieve (revendicate)** deposited crypto assets

High level of investor protection

Prerequisites:

- Claimed crypto asset can be distinguished (individualised) from other crypto assets
- Claimed crypto asset is in “possession” of the debtor

Property rights are not individualised with regard to individual assets. Instead, depositors are treated as **co-owners** of a specified pool of crypto assets and their rights are determined in proportion to the original deposit made

Intermediate level of investor protection

Ruscoe & Moore v. Cryptopia Limited (in liquidation) [2020] NZHC 728

Pearson & Ors v. Lehman Brothers Finance SA & Ors [2010] EWHC 2914 (CH)

A depositor does not have *in rem* (property) rights in transferred crypto assets and only has an *in personam* claim. Transferred crypto assets become **part of the insolvency estate**

Low level of investor protection

MtGox, Tokyo District Court, 5 August 2015, Reference No. 25541521

Bitgrail, Court of Florence, 21 January 2019, Bankruptcy Docket Nos. 178/2018 and 205/2018, Decision No. 17/2019

HR 12 January 1968, NJ 1968/274 (*Teixeira de Mattos*)

Contractual arrangements with crypto firms

Celsius Terms of Use

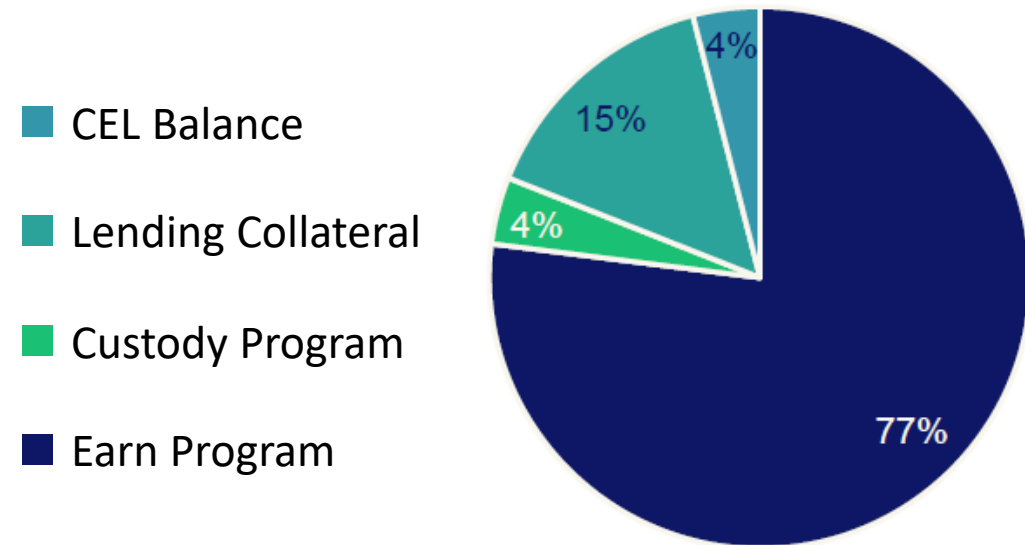
B. Custody

Title to any of your Eligible Digital Assets in a Custody Wallet shall at all times remain with you and not transfer to Celsius. Celsius or a Third Party Custodian controls the private keys to the Blockchain addresses of all Custody Wallets.

D. Earn Rewards

If our Earn Service is available to you, upon your election, you will lend your Eligible Digital Assets to Celsius and grant Celsius all rights and title to such Digital Assets, for Celsius to use in its sole discretion while using the Earn Service.

Deposit breakdown (13 July 2022)



Regulation on Markets in Crypto-Assets (MiCA)

- Proposal for MiCA published in September 2020
- In June 2022, provisional agreement reached on MiCA
- Likely to enter into force in 2024
- The largest piece of supranational legislation targeting crypto assets and crypto-asset service providers
- MiCA seeks to (i) promote legal certainty, (ii) support innovation, (iii) instil appropriate levels of consumer and investor protection, and (iv) ensure financial stability
- MiCA introduces authorisation, prudential, organisational and conduct of business requirements for crypto-asset service providers

MiCA, Article 63 (Safekeeping of clients' crypto-assets and funds)

Crypto-asset service providers that hold crypto-assets belonging to clients [...] shall make adequate arrangements to safeguard the ownership rights of clients, especially in the event of the crypto-asset service provider's insolvency [...].

Operational, technological and legal segregation

Under MiCA (Article 67)

1. Crypto firms “shall keep a register of positions, opened in the name of each client, corresponding to each client’s rights to the crypto-assets”
2. Crypto firms “shall segregate holdings of crypto-assets on behalf of their clients from their own holdings”
3. Crypto firms “shall ensure that, on the DLT, their clients’ crypto-assets are held on separate addresses from those on which their own crypto-assets are held”

MiCA prescribes operational/administrative and technological segregation, but **not legal segregation**

Alternative approaches



UNIDROIT
International Institute for the Unification of Private Law
Institut International pour l'Unification du Droit Privé

Digital Assets and Private Law

Principle 15: “If a custodian enters into any insolvency proceeding, a digital asset that it holds for the account of a client does not form part of that custodian’s assets for distribution to its creditors”

Uniform Commercial Code (UCC)

§ 8-503(a) UCC: “[t]o the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset [...] are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary”

MiCA and crypto-lending

EARN YIELD

Earn up to 17% every week.

Giving back is fundamental to how Celsius works. Up to 80% of our revenue is paid back to the community as weekly rewards on crypto.

And, you get up to 25% more when you choose to earn in CEL token. Everyone wins.

Start earning today



Moments ago,
[@CelsiusNetwork](#) filed voluntary petitions for Chapter 11 protection and announced that the company initiated a financial restructuring.

- Asset segregation is unlikely to protect clients who invest (lend) their crypto assets in return of rewards (see slide with letters to Martin Glenn)
- MiCA does not contain provisions directly or specifically targeting crypto lenders (such as Celsius) and crypto-lending activities
- How should crypto lenders be regulated?
- The business of crypto lenders has many similarities with that of banks (fractional reserve banking, liquidity and maturity transformations, giving rise to bank runs) – *Functional equivalence*
- Future regulation of crypto lenders should draw inspiration from post-global financial crisis regulation of banks – *Regulatory equivalence*
- Important to strike a balance between achieving appropriate levels of consumer and investor protection and avoiding insurmountable constraints on innovative businesses and new business models

Thank you!



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