Ilya Kokorin, PhD candidate at Leiden University, The Netherlands

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

Abstract

The recent crash of crypto markets and the following “crypto winter” have led to insolvencies of a number of major crypto market players. On 5 July 2022 the crypto trading and lending firm Voyager Digital Holdings Inc. filed a voluntary petition for relief under Chapter 11. A few days later, a crypto lending platform Celsius Network LLC filed for bankruptcy. Voyager and Celsius acted as lenders to one of the world’s largest crypto hedge funds, Three Arrows Capital Ltd., which since June 2022 is subject to the liquidation proceeding in the British Virgin Islands.

Insolvencies of crypto firms are not new. Perhaps, the most well-known example is insolvency of the Japanese crypto exchange Mt. Gox (2014). Other notable cases include insolvencies of the Italian crypto exchange Bitgrail (2019) and the New Zealand crypto exchange Cryptopia (2020). The recent wave of crypto insolvencies raises familiar legal questions, including those concerning the rights of customers of a crypto custodian in case of its insolvency. Yet it reveals novel problems. First, it highlights the interconnectedness of crypto markets, where the failure of one market participant might have a ripple effect. This feature of crypto insolvencies has not manifested in the past, at least not to the same degree as now. Second, it shows that markets in crypto assets are increasingly shaped by new business models and functionalities. Whereas previous crashes of crypto firms were mostly related to hacks and other idiosyncratic events, recent crypto failures can be attributed to illiquidity problems facilitated by large exposures and operation of collateralized lending protocols based on smart contracts.

The regulation of crypto firms has made progress since 2014. Bespoke regimes targeting them were introduced at the national level. The EU has also taken steps to regulate crypto markets. In 2020, the Proposal for a Regulation on Markets in Crypto-assets (MiCA) was released. In June 2022, it was reported that a provisional agreement has been reached on the MiCA. This instrument seeks to promote legal certainty and instil appropriate levels of investor protection. Among other things, it contains rules on crypto-asset service providers. In this article, I analyse these rules to see whether they are capable of addressing the problems uncovered by the new wave of crypto insolvencies. I make suggestions for the improvement of these rules to ensure protection of customer’s rights in insolvency and to mitigate the described contagion problem.