



INSOL Europe Insolvency Tech & Digital Assets Wing

This new section of eurofenix will bring you the most relevant news in the field of insolvency tech and digital assets. To contribute an article to a future edition, please send your proposal to: insolvencytech@insol-europe.org or the individual Chairs:
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“Roads? Where we’re going, we don’t need (Silk) Roads!”

In this edition, we look at cryptoassets and fraud – what the insolvency practitioner needs to know



Cryptoassets are easier to track and trace than most non-digital assets and understanding the art of the possible in digital investigations can aid overall asset recovery efforts



Cryptoassets are not a new concept that the insolvency practitioner should consider getting to grips with at some stage. They are already here. This was considered by a panel at the Dublin Congress, which included Carmel King (Grant Thornton UK LLP; Co-Chair, INSOL Europe Anti-Fraud Forum), José Carles (Carles Cuesta; Co-Chair, Insolvency Tech and Digital Assets Wing), Dani Haston (Chainalysis) and Aidan Larkin (Asset Reality).

In its 2022 *Crypto Crime Report*, Chainalysis reports that, in 2021, the total amount of transactions across the cryptocurrencies it tracks grew to USD 15.8 trillion, up 567% on the previous year. Practitioners are already seeing insolvencies, where corporates are involved in this space, or cases where cryptoassets can unexpectedly form part on an estate or claim.

The good news is that practitioners do not need to become overnight experts, as the panellists at the Congress session are amongst an excellent group of specialists that can trace cryptoassets, advise debtors and creditors, identify strategies for recovery, offer safe custodianship options and realisation into fiat currencies. However, in order to

avoid the obvious risks of falling afoul of various laws and regulatory guidelines, failing to identify assets of an estate or censure by creditors or professional regulators for failure to get value for those assets, practitioners need to be able to identify the signifiers of crypto and know what to do thereafter. It needs to be incorporated into checklists, included as part of due process.

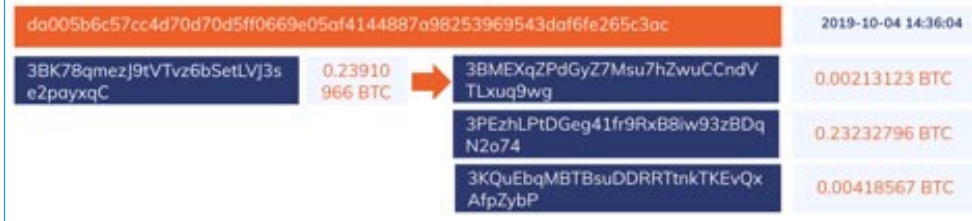
Cryptoassets are just another **intangible asset** and, in the same way that practitioners quickly learn the specifics of managing fine art, livestock, intellectual properties or contract-based rights, crypto is due for demystification. Case law is on the practitioner’s side, with a number of English and Spanish courts having already made decisions that will enable the pursuit and successful recovery of these assets. For example, the Criminal Section of the Spanish Supreme Court referred to bitcoin in its ruling from 30 June 2019 as “*an intangible asset, in the form of a unit of account defined by computer and cryptographic technology called bitcoin. Its value is the one that each unit of account (or portion) reaches by the rules of supply and demand in the sale of these units made through Bitcoin trading platforms*”.

Too often in the industry a lack of basic understanding and awareness around cryptoassets

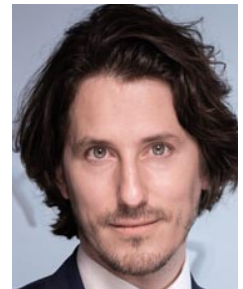
prevails and the inevitable mis-categorisation of ‘crypto cases’ happens. It is easy when we hear the term “crypto” to immediately think of the incredibly technical ecosystem it operates in and that often leads to a combination of misconceptions, panic and assumptions that hinder asset recovery attempts for victims. The truth is, in an asset recovery context, crypto presents more opportunities for success than traditional cases.

Cryptoassets are easier to track and trace than most non-digital assets and understanding the art of the possible in digital investigations can aid overall asset recovery efforts, especially in contentious insolvency cases. Examples of this include the immutable evidence forever preserved on the blockchain that proves dissipation of assets or a debtor’s attempts to obfuscate their actions when trying to conceal assets from creditors – this evidence, regardless of whether it leads to the recovery of a digital asset, could be used in other parts of a case such as proving a post-petition disposition of assets or transactions at an undervalue. There are also multiple regulatory developments to consider and a number of very interesting international crypto insolvency cases including Cryptopia, Mt Gox and Quadriga that are leading the charge.

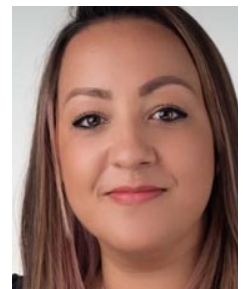
Diagram 1



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One of the first issues that bankruptcy trustees or insolvency practitioners – or lawyers advising an insolvent debtor – should deal with is to find out **whether the debtor owns any kind of cryptoassets**. The information requests to prepare the lists of assets of the debtor should therefore be updated and include express references to crypto and digital assets. The bank statements (for example, searching for transactions which involve “Bitcoin” or “BTC”) or references to cryptocurrency transactions in any documents could also help in this task. Besides, digital devices owned by the company could also reveal the existence of virtual currencies (for example, large files that could imply that blockchain has been downloaded in that device).

Another issue that might need to be addressed is **if there ever was crypto that might have disappeared**. Once you find a starting point in records/disclosure such as a crypto address or a transaction reference you can look it up in a free block explorer without leaving your desk... for example, you can type a transaction hash (such as “da005b6c57cc4d70d70d5ff0669e05af4144887a98253969543daf6fe265c3ac”) which will let you see how much value was transferred, between which addresses and where it moved next, if it moved at all. Whereas following fiat requires you to obtain a

disclosure each time funds move to a new bank, with cryptocurrency **you can follow funds indefinitely thanks to blockchains’ inherent transparency**. But public blockchain explorers come up short when it comes to understanding who or what those addresses represent. Going back to our example, diagram 1 (above) shows what you would see when you look up the transaction above using free online tools.

If you have had basic crypto investigation training, you know you are seeing funds move from the address starting with 3BK78... to the three addresses on the right. But that does not tell you the entity controlling the funds. That is the essential information you need to build your case evidence and to have a chance of recovering the funds. That is where Chainalysis Reactor comes in. This software maps cryptocurrency addresses to real world entities, so that the transactions you are analysing becomes readable and actionable. Diagram 2 (below) shows what the transaction above looks like in Chainalysis Reactor.

Now, you have the cryptocurrency services involved in the transactions rather than just pseudonymous addresses. You can reach out to those businesses and learn who the users behind the transactions are, as recent regulations mean virtually all of the most popular services now collect KYC

information.

Applications to obtain disclosure from these virtual asset service providers, including those out of the jurisdiction, have already proven successful. Orders to secure funds in their custody under proprietary injunctions and freezing orders have already been made. Enforcement against assets they hold on behalf of the debtor using a third-party debt order has already been successful in the High Court in London. We are seeing similar orders being made elsewhere, including in the BVI and Canada. The Norwegian Court of Appeal has even expressly confirmed the evidentiary reliability of blockchain analysis techniques, such as, specifically, clustering and labelling (which Chainalysis Reactor uses). Moreover, that was in criminal proceedings which typically require a higher burden of proof.

Another issue that is relevant to take into account is the valuation and realization of digital assets, as they may experience relevant variations over time. From the insolvency practitioner or liquidator’s liability perspective, insolvent Japanese exchange Mt. Gox (2015) taught us an important lesson: large realizations of digital currencies may impact the valuation of successive sales. Thus, expert opinions, utilising experienced asset managers (in the same manner that you would appoint an asset manager over a yacht or real estate) and Court approvals of when and how to realize cryptoassets prove really useful for the liquidator to avoid accusations from creditors. Cryptoassets have been repeatedly investigated, recovered, managed and realised around the world – best practice (and what to avoid) is available in abundance, knowing where to seek support and assistance will allow new practitioners in this space to get involved in this exciting and growing sector. ■

Diagram 2

