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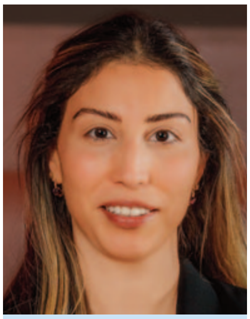
**Dávid Oršula** *david.orsula@bnt.eu*
**Laurent Le Pajolec** *lpa@exco.pl*

# Cryptocurrency custody solutions for insolvency practitioners in Turkey

BURAK BAYDAR
*Partner, Moroglu Arseven, Istanbul, Turkey*



CEYLAN NECIPOĞLU
*Senior Associate, Moroglu Arseven, Istanbul, Turkey*

**The rapid proliferation of cryptocurrencies has transformed the financial landscape globally, including in Turkey. As digital assets gain traction, insolvency practitioners face new challenges in managing and safeguarding these assets during insolvency proceedings.**

Turkey has seen a significant rise in cryptocurrency adoption, driven by factors such as economic instability, inflation, and a tech-savvy population. Cryptocurrencies like Bitcoin, Ethereum, and various altcoins offer an alternative investment avenue and a hedge against currency devaluation. This growing interest necessitates a robust framework for managing these assets, especially during insolvency, where the protection and proper liquidation of assets are paramount.

## Legal framework and challenges

Turkey's insolvency issues are set out under the Execution and Bankruptcy Law number 2004 ("**Law No. 2004**"), which was not designed with digital assets in mind. The legal framework, therefore, does not explicitly address cryptocurrencies, leading to ambiguities in their classification and treatment during insolvency proceedings. However, under the scope of Law No. 2004, assets that are not exempt from seizure and possess monetary value can be seized unless specifically prohibited by Turkish law. Within this grey area, although cryptocurrencies are defined under several regulations, there is still ambiguity due to lack of prohibitions – even they have monetary value. Since it is possible to determine the value of cryptocurrencies in Turkish lira, it is theoretically feasible to pursue them through general attachment procedures. Thus, there is no apparent legal obstacle to the seizure of a debtor's crypto-currencies, although, as of now, there is no specific legislation governing the insolvency and custody of cryptocurrencies.

According to the "Regulation on the Non-Use of Crypto Assets in Payments" published in the Official Gazette on 16 April 2021, number 31546 ("**Regulation**"), the use of crypto assets for payment transactions has been prohibited in Turkey. Using such assets as an investment tool and conducting transactions through banks is not prohibited under the Regulation. It is possible to ascertain whether a debtor has investments in foreign cryptocurrency exchanges operating in Turkey. As stipulated in Article 4/2 of the Regulation, payments related to crypto-currencies must be made through banks. Therefore, based on Article 89 of Law No. 2004, a notice of attachment can be sent to cryptocurrency platforms. On the other hand, if the debtor holds cryptocurrencies on foreign crypto platforms, locating and seizing these assets is nearly impossible.

However, on cryptocurrency exchanges within Turkey, Turkish Republic citizens are required to provide Know Your Customer (KYC) details when opening accounts. This is due to Turkey's cryptocurrency market being primarily regulated by the Capital Markets Board of Turkey ("**CMB**") and the platforms being obliged entities regulated by the Financial Crimes Investigation Board ("**MASAK**"). While comprehensive regulations specific to cryptocurrencies are limited, these authorities provide oversight for compliance and anti-money laundering (AML) requirements. As a result, the ownership of cryptocurrencies held in these accounts or wallets can be readily identified, enabling the seizure of the debtor's cryptocurrencies by sending a notice of attachment to cryptocurrency trading platforms established in Turkey.

When the situation is evaluated in terms of insolvency proceedings, in order to secure the receivables held in the debtor's cold wallet, custody service should be provided by the enforcement office in principle. However, in practice, since enforcement offices lack the ability to reach and secure cryptocurrency through blockchain technology, custody service is expected to be provided by cryptocurrency platforms, along with the decision of the Enforcement Court. With this decision in place, the required platforms can freeze the account and hold the cryptocurrency. Consistently, recent years have seen judicial precedents aligning with this approach. For instance, on 19 April 2021, the Istanbul Enforcement Court ruled that cryptocurrencies could be subject to attachment. In this ruling, it was stated that: "Although the plaintiff claimed that cryptocurrencies cannot be seized, it has been determined that such assets should be considered within the scope of commodities and securities, regarded as a type of digital currency or virtual money, and thus, can be seized." The decision to evaluate cryptocurrencies as securities has established a precedent.

A significant recent development that could facilitate the implementation of Article 89/3 of Law No. 2004[1] is the submission of a Draft Law Amending the Capital Markets Law No. 6362 to the Presidency of the Grand National Assembly of Turkey on 16 May 2024. It aims to regulate the activities of crypto asset service providers and platforms,[2] the custody of crypto assets, and the purchase, sale, and transfer transactions of crypto assets conducted by individuals residing in Turkey on these platforms. Additionally, it seeks to establish provisions requiring crypto asset service providers to obtain authorization from the CMB to be established and operate.

## Custody solutions for cryptocurrencies

### *Hot wallets vs. Cold wallets*

Cryptocurrency custody solutions can be broadly categorized into hot wallets and cold wallets.

- **Hot Wallets:** These are connected to the internet and allow for quick access and transactions. They are user-friendly but are more vulnerable to cyberattacks and hacking attempts. For insolvency practitioners, hot wallets can be useful for managing smaller amounts of cryptocurrencies that need to be liquidated quickly.
- **Cold Wallets:** These are offline storage solutions, such as hardware wallets or paper wallets, that provide enhanced security against cyber threats. Cold wallets are ideal for long-term storage of larger amounts of cryptocurrencies, ensuring that assets are safeguarded during the insolvency process. The legal detection of cryptocurrencies stored in cold wallets is challenging. Therefore, determining whether a debtor has cryptocurrencies in their wallet will rely on the debtor's asset declaration.

### *Multi-signature wallets*

Multi-signature (multi-sig) wallets require multiple private keys to authorize a transaction, adding an additional layer of security. This is particularly useful in insolvency scenarios, where multiple stakeholders need to approve asset movements, thereby reducing the risk of unauthorized access and ensuring that the process remains transparent and secure.

### *Custodial services*

Professional custodial services offer specialized solutions for managing cryptocurrencies. These services include secure storage, insurance against theft or loss, and compliance with regulatory requirements. For insolvency practitioners, partnering with a reputable custodial service can mitigate risks and provide peace of mind that the digital assets are being handled by experts.

In principle, the systems are as described above. However, if one of these methods is not feasible and/or direct communication with the cryptocurrency platform is not possible, cryptocurrencies in cold wallets can be transferred to the wallet of the relevant enforcement office without any loss of value, if the enforcement offices have their own cold wallets, without being converted to fiat currency unlike the current practice. It can be stored on behalf of the creditor, and when the enforcement process is finalized, it can be transferred to the creditor's cold wallet or paid in cash, depending on the creditor's preference.

## Technological considerations

Blockchain forensics is essential for tracking and managing cryptocurrencies during insolvency. Tools and techniques such as transaction analysis, wallet tracking, and blockchain analytics help insolvency practitioners trace the movement of digital assets, identify asset ownership, and detect fraudulent activities. Leveraging blockchain forensics can enhance transparency and ensure that all assets are accounted for and managed appropriately.

Considering the expectations, it seems that smart contracts, which are self-executing contracts where conditions are written directly into the code, will be used to automate various aspects of the execution process. For example, by managing enforcement processes for crypto values with smart contracts, the possibility of human error can be reduced and the collection process can be shortened.

## Conclusion

As the adoption of crypto-currencies continues to rise in Turkey, insolvency practitioners must develop robust strategies for managing and safeguarding these digital assets. The complexities of cryptocurrency custody, particularly the challenges of legally detecting and securing assets stored in cold wallets, necessitate a comprehensive understanding of both technological and legal frameworks. The recent submission of a draft law to amend the Capital Markets Law No. 6362 marks a significant step towards regulating cryptocurrency activities and ensuring proper oversight. Effective custody solutions, such as the use of multi-signature wallets and professional custodial services, along with the application of blockchain forensics and smart contracts, can enhance transparency and security in the insolvency process. ■

> *"Tools such as transaction analysis, wallet tracking, and blockchain analytics help insolvency practitioners trace the movement of digital assets"*

**Footnotes:**

1 Article 89/3 of Law No. 2004 states that: "The third party may object to the enforcement office within seven days from the notification of the payment order, claiming that he does not hold any property, right, or receivable belonging to the debtor, or that the debt has been paid or extinguished by him, or that the seizure of the receivable is not possible. If this objection is not made within seven days from the notification of the payment order, the third party must pay the debt owed to the debtor to the enforcement office."

2 At time of writing, the draft crypto law proposal was accepted in the plan and budget commission on 30 May 2024.