

“Crypto Insolvency and You, Why it Matters”

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I. Introduction

Crypto¹ has been a hot topic with growing interest ever since the value of Bitcoin skyrocketed in 2017. Just last year, there was a craze over Non-Fungible Tokens (“NFTs”), a type of crypto-asset. Blockchain technology has also been adapted for use in new technologies like Smart Contracts, which are contracts that can automatically trigger an outcome when certain conditions are met.² Due to such trends and innovations, investors are watching the crypto space carefully for new investment opportunities.

However, investing in crypto is risky business. The Singapore Government has distinguished between *direct investments* in crypto-assets like Bitcoin, which is highly discouraged due to its risks,³ and *crypto-related investments* like investing in digital asset innovation and technology, which may be viable in *some* cases.⁴ Having said that, even such crypto-related investments carry a fair amount of risk. For example, Temasek Holdings’ \$275 million investment in the cryptocurrency exchange platform FTX was written off as a loss when the platform collapsed in November 2022.⁵

Nonetheless, if you wish to dabble in crypto investments, what safeguards have the law developed to protect you when crypto companies go insolvent? This article considers this question from two angles: First, from the viewpoint of someone who has invested *directly* in the crypto-assets; and second, from the viewpoint of an investor of *crypto-related* companies such as a crypto exchange platform.

II. The Problems Crypto Causes for Insolvency

A common feature of Crypto is the use of Decentralised Ledger Technologies (“DLTs”), which offer unique benefits for Crypto traders. However, those same unique characteristics create obstacles for a smooth insolvency proceeding.

A. Decentralisation

Firstly, DLTs are decentralised, which means that control of the crypto network is not left to one entity. To put this into perspective, imagine that your bank accounts are not controlled or supervised by the bank. The benefit of such an arrangement is the ease of transfer between

¹ ‘Crypto’ is commonly used as blanket term commonly used to refer to Cryptocurrencies like Bitcoin or other Crypto-assets like Non-Fungible Tokens (“NFTs”).

² “Introduction to Smart Contracts”, September 2022, <https://ethereum.org/en/developers/docs/smart-contracts/>

³ “MAS cautions against investments in cryptocurrencies”, Monetary Authority of Singapore Media Release on 19 December 2017.

⁴ “Reply to Parliamentary Questions related to the bankruptcy of the cryptocurrency trading platform FTX (MAS)”, 30 Nov 2022, Lawrence Wong, DPM and Minister for Finance, Deputy Chairman of MAS.

⁵ “FTX Statement and FAQs”, Temasek Holdings News Room, 17 Nov 2022, <https://www.temasek.com.sg/en/news-and-resources/news-room/statements/2022/statement-FTX>

parties. There would be no need to contact the bank to effect a transfer, since it would be as simple and effortless as handing someone cash.

However, this same ease of transfer is problematic when it comes to securing assets in an insolvency. For example, when a crypto exchange sees signs of imminent collapse, it can easily transfer its crypto-assets out of jurisdiction to avoid seizure of the assets for insolvent distribution,⁶ thus reducing the available pool of assets for creditors.

B. Immutability

Secondly, DLTs are immutable, meaning that transaction records are almost impossible to tamper with. Going back to the bank example above, decentralisation means that the bank no longer keeps a record of your transactions. Instead, every customer of the bank will keep an individual copy of *all* transactions done by *all* customers. Imagine it to be a type of ‘shared responsibility’ to ensure that records are kept properly.

The benefit of this is that one person cannot tamper with the transactions and change the records on his own, as there will be other copies of the transaction history. This ensures the integrity of the records. However, this also means that once a transaction has been completed, it cannot be altered or reversed easily unless the majority of users agree to the change.

In the context of insolvencies, this leads to difficulties seizing crypto-assets if they have been dispersed, as reversing the transaction would be challenging due to requiring majority consent. The most straightforward way to reobtain the crypto-asset would be for the receiver of the asset to willingly transfer it back, but it is difficult to compel uncooperative receivers to do so.⁷

C. Anonymity

Lastly, participants in a crypto network are anonymous. Despite every participant having a copy of the transaction records, the exact individual behind the transaction is not identified. This encourages investors who wish to remain anonymous to trade or invest in crypto.

Yet, anonymity stands in the way of identifying who was the receiver of dispersed assets. This creates some difficulties in legal proceedings when identifying who to bring an action against or who to enforce a court order on. Although crypto exchanges are increasingly required to maintain records of their users’ personal information,⁸ anonymity nonetheless acts as an additional hurdle in an insolvency.

III. How the Law protects you in a Crypto Insolvency

For simplicity, we will be looking at the scenario of a *crypto exchange platform* becoming insolvent. In such a scenario, how can the law protect you if you were a *user* of the platform (investing in crypto-assets directly through the platform), compared to if you were an *investor* of the platform (investing in the crypto exchange itself)?

A. Investing in crypto directly as a user of the crypto exchange

⁶ “Crypto Winter is here – What does it mean for Insolvency Practitioners?”, Aug 2022, Apáthy, Wilkinson, Emmerig, Herbert Smith Freehills.

⁷ “Crypto Complexity in Insolvencies”, Kroll 2022, Li, Kehoe, Chi, Hoyland.

⁸ Keith Tnee, “Crypto, Fraud, and Insolvency”, TKQP Tan Kok Quan Partnership, INSOL's Small Practice Group Newsletter on 15 November 2021 at p 2.

As a direct crypto investor, one uses the crypto exchange platform as a *medium* to carry out transactions. When an exchange suddenly freezes transactions and announces that it would be going insolvent, the first question that comes to mind is: “what happens to all my crypto-assets?”.

Unfortunately, there is no blanket rule as to how crypto-assets traded on the platform will be dealt with in an insolvency. Whether you will be able to withdraw your crypto-assets in full will generally depend on whether the law considers these crypto-assets as belonging to the users,⁹ or as part of the company’s pool of insolvent assets for distribution to creditors. In the latter case, users of the platform will not be able to reclaim their crypto-assets in full.¹⁰ How the crypto-assets will be classified varies from case to case, depending heavily on how the exchange platform operates, among other factors such as the wording of their user agreements.¹¹

One example where crypto-assets were not considered as belonging to users is the local case of *Quoine v B2C2*.¹² In this case, users could trade cryptocurrencies on the crypto platform QUOINExchange.¹³ However, the amount of crypto-assets displayed on users’ account balance did not necessarily correlate with Quoine’s consolidated crypto-wallet. In other words, what users saw on their account balance was essentially what Quoine *owed* them, and did not represent the amount of cryptocurrency *actually owned* by the user.¹⁴ In addition, Quoine’s user agreement stated that in the event the platform goes bankrupt, it would not be able to return customer assets.¹⁵ These facts supported the inference that the cryptocurrencies did not belong to users. In such a scenario, it is more likely than not that a direct investor of crypto-assets using an exchange platform like Quoine would not be able to reclaim the crypto-assets.

Note that in situations like *Quoine*, even if one manages to withdraw their crypto-assets before transactions on the platform are frozen, such ‘lucky’ investors may still be at risk of a clawback,¹⁶ meaning that the withdrawn crypto-assets must be returned to the pool of assets for insolvent distribution.

On the other hand, the New Zealand case of *Ruscoe v Cryptopia*¹⁷ illustrates when crypto-assets are considered to belong to the users of a platform. Here, the crypto exchange Cryptopia acted merely as a platform to allow users to store and trade their currencies, in return for a service fee.¹⁸ Cryptopia’s instruction pages also suggested that users would be depositing, buying, selling and owning their *own* cryptocurrency,¹⁹ and its internal financial accounts also demonstrated that the platform did not assert any ownership in the cryptocurrencies in

⁹ The term ‘belonging to users’ is used here to aid understanding by the general public. Legally speaking, the usage of ‘belonging to users’ in this context refers to whether the trading platform holds the crypto-assets for the user on trust.

¹⁰ See the New Zealand High Court case of *Ruscoe v Cryptopia* [2020] NZHC 728 at [191].

¹¹ See *Quoine Pte Ltd v B2C2* [2020] 2 SLR 20 at [148];

¹² *Quoine Pte Ltd v B2C2 Ltd* [2020] 2 SLR 20.

¹³ *Quoine Pte Ltd v B2C2 Ltd* [2020] 2 SLR 20 at [9].

¹⁴ *Quoine Pte Ltd v B2C2 Ltd* [2020] 2 SLR 20 at [148].

¹⁵ *Quoine Pte Ltd v B2C2 Ltd* [2020] 2 SLR 20 at [148].

¹⁶ Keith Tnee, “Crypto, Fraud, and Insolvency”, TKQP Tan Kok Quan Partnership, INSOL’s Small Practice Group Newsletter on 15 November 2021 at p 7.

¹⁷ *Ruscoe v Cryptopia* [2020] NZHC 728.

¹⁸ *Ruscoe v Cryptopia* [2020] NZHC 728 at [169].

¹⁹ *Ruscoe v Cryptopia* [2020] NZHC 728 at [172].

question.²⁰ These facts, among other factors,²¹ pointed towards the finding that Cryptopia was holding the crypto-assets *on behalf of the users*.²² This meant that users' crypto-assets belonged to the them, and could be withdrawn.²³

It is worth noting that the court in *Ruscoe* reached this conclusion despite the fact that users' funds were pooled together in Cryptopia's wallets.²⁴ In *Quoine*, however, this factor militated *against* the existence of a trust.²⁵ Nonetheless, *Quoine* was distinguished due to the contractual factors present in the *Ruscoe* case, as outlined in the above paragraph.²⁶

Interestingly, *Ruscoe* also clarified that in cases of crypto-assets that are stolen, only account holders who held that type of cryptocurrency could benefit from their recovery.²⁷ For example, if all the Ethereum was stolen from the platform through a hack, any Ethereum that is recovered would only be distributed to those who dealt in Ethereum. If I had only traded Bitcoin, I would not have a share in the recovered Ethereum. This makes sense, as I did not lose any of my Bitcoin from the hack.

Regardless, whether a direct investor can withdraw the crypto-assets from a bankrupt exchange platform still depends on the facts of each case. Although *Ruscoe* has not been considered by the Singapore Courts on this point, it may nonetheless provide some guidance as to how our local courts may view such scenarios. Overall, however, there is no clear answer to this issue and it might be wiser to heed the warnings of the MAS and avoid investing in crypto-assets directly to prevent substantial losses.

B. Investing in the crypto exchange platform

As someone investing in the crypto exchange like Temasek Holdings, the main concern would be how much of one's investment can be recouped during the distribution of the insolvent exchange's assets. Here, a relevant concern would be the risk of the exchange dissipating its crypto-assets, and whether these dissipated assets can be recovered and distributed among creditors. Fortunately, the law has developed in some aspects to protect such investors.

(1) Availability of Proprietary Injunctions to Prevent Dissipation of Crypto-assets

In Singapore, crypto-assets have been recognised as a form of property able to be subject to proprietary injunctions.²⁸ Insolvency practitioners are thus able to obtain such injunctions to protect the crypto-assets meant for an insolvent distribution. Essentially, these injunctions can prevent platforms from dissipating their crypto-assets, and can prevent any crypto-assets already transferred away from being further transacted with. This allows authorities to track, locate and clawback such assets to ensure a bigger pool for distribution among creditors.

²⁰ *Ruscoe v Cryptopia* [2020] NZHC 728 at [165]. [174].

²¹ *Ruscoe v Cryptopia* [2020] NZHC 728 at [167]–[187].

²² *Ruscoe v Cryptopia* [2020] NZHC 728 at [184].

²³ *Ruscoe v Cryptopia* [2020] NZHC 728 at [191].

²⁴ *Ruscoe v Cryptopia* [2020] NZHC 728 at [22(m)].

²⁵ *Quoine Pte Ltd v B2C2 Ltd* [2020] 2 SLR 20 at [146]–[147].

²⁶ *Ruscoe v Cryptopia* [2-2-] NZHC 728 at [164]–[166].

²⁷ *Ruscoe v Cryptopia* [2020] NZHC 728 at [204].

²⁸ *CLM v CLN* [2022] SGHC 46 at [46]; *Janesh s/o Rajkumar v Unknown Person* at [69]–[72].

In addition, such injunctions can even be granted against unknown persons, as long as this unknown person can be “described with sufficient certainty”.²⁹ For example, an injunction against unknown persons was allowed in the case of *CLM v CLN* as it was clear that one of the seven defendants had committed the theft of the cryptocurrency, even though it was unknown who exactly was responsible.³⁰ Similarly, in *Janesh s/o Rajkumar v Unknown Person*³¹, an injunction was granted against an unknown person with the pseudonym “chefpierre.eth” despite not knowing his true identity, as the pseudonym “chefpierre.eth” was sufficiently certain to refer to the user behind this account.³²

The possibility of such injunctions against unknown persons would serve as a useful tool in cases where a crypto exchange platform gets hacked or improperly dissipates its assets to unknown individuals. Such proprietary injunctions can still be used to urgently freeze the assets, even if we do not know who exactly was the receiver of the assets, so long as we can describe them with “sufficient certainty”.

Thus, the law has successfully evolved to tackle the difficulties caused by anonymity on the crypto network by granting proprietary injunctions to restraint dissipation of crypto-assets, even against persons whose identities are unknown. However, it is important to remember that it will not be easy to obtain such injunctions due to the surrounding uncertainties and lack of information. Describing receivers with “sufficient certainty” will still be a challenge. For example, if it is unclear which corporation operates the crypto exchange, it will be difficult to determine against whom the injunction should apply.

(2) Restructuring Mechanisms in Singapore

Singapore has been encouraging struggling companies to opt for restructuring instead of a winding-up.³³ For example, if a struggling crypto exchange wishes to obtain a moratorium under section 64(1) of the Insolvency, Restructuring and Dissolution Act³⁴ (“IRDA”),³⁵ the company must show evidence of creditor support for an intended or proposed compromise,³⁶ or promise to put forward a rescue plan for proposal.³⁷

Such restructuring efforts also give rise to greater communication between the crypto exchange and the investors such as through town hall discussions and creditor meetings, which ensure that investors’ concerns are heard.³⁸ Creditors are also given chances to express support or opposition for the moratorium.

These restructuring mechanisms place emphasis on a company’s rehabilitation and recovery, which, if successful, could potentially result in investors recouping more of their investment compared to if the company had simply liquidated. The focus on effective communication

²⁹ *CLM v CLN* [2022] SGHC 46 at [32]; *Janesh s/o Rajkumar v Unknown Person* at [39]–[41].

³⁰ *CLM v CLN* [2022] SGHC 46 at [35].

³¹ *Janesh s/o Rajkumar v Unknown Person* [2022] SGHC 264.

³² *Janesh s/o Rajkumar v Unknown Person* [2022] SGHC 264 at [39]–[41].

³³ Aurelio Gurrea-Martinez, “Building a Restructuring Hub: Lessons from Singapore” (2021) Singapore Management University School of Law Research Paper 16/2021, at p 7.

³⁴ Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (“IRDA”).

³⁵ See, *Re Zipmex Co Ltd* [2022] SGHC 196.

³⁶ IRDA s 64(4)(a).

³⁷ IRDA s 64(4)(b).

³⁸ See *Defi Payments Pte Ltd, Re Zipmex Co Ltd* [2022] SGHC 196 at [2].

between investors and the company also promotes transparency and greater investor control on the proceedings.

In addition, the adoption of the Insolvency Model Law under the 3rd Schedule of the IRDA confers powers on insolvency practitioners that could assist cryptocurrency exchanges recover their losses. For example, Article 5 authorises local insolvency practitioners to act in a foreign state on behalf of proceedings in Singapore.³⁹ Since cryptocurrency frauds commonly involve assets dissipated across multiple jurisdictions,⁴⁰ this could facilitate and streamline the procedure for the launching of cross-border investigations. It thus seems that investors in crypto companies are better protected under the law as compared to investors who directly invest in crypto-assets.

IV. Where should the law go next?

The law in Singapore has been developing and adapting to the growing trends of crypto technology, not least due to the growing number of crypto-related litigation. However, there is more to be done if Singapore wishes to safely capitalise on the “potential for new technologies to transform cross-border payments, trade and settlement, as well as capital market activities”.⁴¹

One potential area that can be improved is the hurdle posed by anonymity. Some experts have raised the need for a better regulatory framework to centralise information, such as creating a central information depository so that authorities are able to easily track down who the dissipated assets are with.⁴² This area has seen some development in the UK with the proposed Markets in Crypto-Assets (MiCA) regulation, which aims to introduce easier tracing of crypto-assets via the storing of personal information on both sides of a transfer: in the source of the asset and in its beneficiary.⁴³ Striving to improve the ease of access to information will greatly aid insolvency proceedings in Singapore.

The Monetary Authority of Singapore has also introduced plans to require financial institutions providing cryptocurrency services to take additional measures, such as evaluating if potential retail customers are suitable for investing in cryptocurrency.⁴⁴ These measures will serve as an additional layer of protection to those who wish to invest directly in crypto-assets, which, as we discussed above, are not well-protected from the highly risky venture.

V. Conclusion

Crypto has been a continuous wave of new developments and trends. The inevitable onset of such new technologies will only become more evident as time goes on. It is thus important that the Law continues to develop in tandem with these new technologies that give rise to novel

³⁹ IRDA, Third Schedule, Article 5(1).

⁴⁰ Covered in Part II.

⁴¹ “Reply to Parliamentary Questions related to the bankruptcy of the cryptocurrency trading platform FTX (MAS)”, 30 Nov 2022, Lawrence Wong, DPM and Minister for Finance, Deputy Chairman of MAS at [3].

⁴² “Why It Matters: Safeguarding your digital assets, amid a landscape where crypto and NFT scams are rampant”, Danny Ong on Money FM 89.3, 5 April 2022.

⁴³ “Crypto regulations in Singapore and the EU: an overview”, Cropper-Mawer, Tan and Koh, January 2023.

⁴⁴ “Reply to Parliamentary Questions related to the bankruptcy of the cryptocurrency trading platform FTX (MAS)”, 30 Nov 2022, Lawrence Wong, DPM and Minister for Finance, Deputy Chairman of MAS at [13].

situations. Importantly, one has to know how to protect themselves with the legal frameworks in place, and should strive to stay abreast of new legal developments in the Crypto space.