

CRYPTOCURRENCIES : TO HAVE AND TO HODL

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The Financial Conduct Authority (FCA) gives clear warnings about investing in crypto. Apart from recently introduced regulation on marketing, crypto is largely unregulated in the UK as things stand. The FCA warns that investors should not invest money that they are not prepared to lose. Nevertheless, crypto is going to feature in financial remedy cases for so long as there are spouses out there who are not losing everything they put into crypto.

Crypto is increasingly commonplace within family finances, ranging from 'dabbling' to large-scale investing. There is going to be further evolving regulation, in this jurisdiction and elsewhere. For now, we are familiar that crypto constitutes 'property', and the Family Court has the jurisdiction to make orders. Yet we are still without any stream of reported cases in the Family Courts to inform our work as divorce lawyers. We have to make sense of what we are dealing with and what we can do with it, within established frameworks.

In many cases the crypto may seem a small portion of the marital pot – though we must recognise where there may be significant value (now or in the future). We need to be familiar with available procedure and remedies so that we can advise clients on their options before determining a proportionate approach.

It is nothing new for us family lawyers to have to make judgement calls in relation to proportionality, for example whether to investigate a potentially hidden asset or get an expert valuation. Those who understand the unique features of different types of crypto, and the industry in general, will have an advantage – whether that be to comfortably dissuade a client from spending fortunes on copious disclosure requests or to support a client to engage relevant experts. Not to mention addressing the most appropriate way to share the value between spouses.

Let us explore the challenges we face in a typical financial remedy case.



First we consider disclosure obligations, including information we should seek in a Questionnaire. As well as disclosure of wallets, transaction histories etc, it is going to be important to understand what any coin or token represents, beyond it being 'crypto'. Are we looking at a coin (eg. Bitcoin) or a utility token (giving access to a product or service), a security token which is linked to another tradable asset (generally linked to a business, like stocks and shares), or an NFT. Stablecoins are a type of cryptocurrency pegged to the value of another asset or currency, such as Tether which is linked to the US Dollar. The Bank of England has published a discussion paper to look at regulating stablecoins pegged to the British Pound, seeing the benefits of crypto technology but hoping to redress some of the risk. There have even been Meme coins which gained popularity through social media but have shown to be as quick to fall as they have risen in value.

The type of crypto is going to give an indication of the liquidity and volatility relating to its value – a utility token is likely less liquid, for example, and meanwhile a stablecoin is likely to be less volatile.

We also need to understand where the relevant data is stored. This is not only for identification and access purposes but because, whilst many cryptocurrencies are traded through Exchanges (often making information much more accessible), some have limits around withdrawals again indicating illiquidity which is relevant in a divorce scenario. Crypto can be stored in physical hardware "cold" wallets, easily concealed and there are many cases where these have even been lost.

It was only in 2018 that crypto tax treatment was clarified, and we need to be able to apply the appropriate tax treatment (this could be capital gains tax, income tax or corporation tax depending on the scenario) for the purposes of an accurate asset schedule/ES2.



Then we consider potential non-disclosure, and we have to consider what evidence there is to support an application for specific disclosure, search and seizure, or pay for expert investigations for example. Otherwise, we may have to rely on adverse inferences which could be particularly difficult and unsatisfactory.

On the other hand, a non-disclosing spouse must be mindful of the risk of a set-aside application in the future if they do ultimately reap the rewards of their hidden crypto. The blockchain provides a permanent and visible record of transactions.

Also topical for a case involving crypto will be the potential for dissipation, quickly and covertly. We will mostly rely on injunctive relief by way of a Freezing Injunction under FPR 20.2(1), but to do so we must quickly understand what exactly we need to freeze, who will action this and in what jurisdiction. We fall back on evidencing the loss and claiming an add-back, which we know is tricky.

When it comes to valuing crypto, some users trade through an Exchange which will give a 'sell' price but there are experts with the requisite understanding to apply established valuation methods to these more novel assets. Even if we can determine a value, the volatility is a huge factor especially given that a financial remedy application is likely to take over a year or two to resolve. If a spouse has unilaterally invested marital savings into crypto and it has tanked during this time, will this impact the discretionary exercise? What about the impact the volatility has on assessing the reasonableness of settlement offers?

We have familiarity with comparison of copper-bottomed and risk-laden assets, and may fall back on a "Wells v Wells" type outcome, or alternatively could achieve fairness between the spouses with an order for immediate sale to crystallise the value in a more stable currency. Both options are likely to fall out of favour for one or the other spouse.

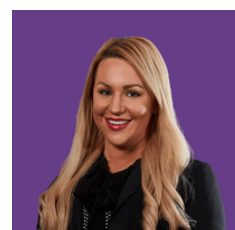
How do we approach offsetting? Crypto is unlike any other type of asset and includes a myriad of different types of coins and tokens each uniquely different. By comparison, it has not long since been acknowledged that, prior to the Pension Advisory Group guidance in 2019, many cases with pension assets were dealt with in a wholly unsatisfactory manner despite that pension sharing on divorce has been around for over 20 years.



A handy toolkit for family lawyers dealing with crypto might include a handbook of go-to experts for tracing and valuation, confident knowledge of urgent injunctive remedies and the associated procedure and, otherwise, simply tailoring the 'usual' principles applicable to property claims on divorce.

Looking forward it seems likely that, although crypto was borne out of a desire for decentralization, we will find that regulation will gradually evolve. It is anticipated that in 2024 the Bank of England will begin to regulate stablecoins. There is commentary on the likelihood of Spot Bitcoin ETFs being approved by regulators in the US and, if approved, momentum may follow. Crypto might become more accessible and more prevalent within our financial disclosure; it might make some crypto more straightforward to deal with in divorce.

A final thought: It is often the case that, amongst spouses, it is one party with the appetite to invest in more "quirky" crypto. Given the volatility of crypto assets the timing of a divorce might mean the difference of significant values and create an unforeseeable outcome, potentially representing an overall loss of value of the marital "pot". For some couples and with a bit of foresight, could a nuptial agreement seeking to ring-fence for one spouse more stable investments and giving the 'investing' spouse freedom to invest separate ring-fenced funds to their individual gain or loss, be a potential solution to avoid the potential headaches outlined above?



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