THE HEAT IS ON

FOR INSOLVENCY PROFESSIONALS IN CRYPTO WINTER

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On 3 January 2009 the first block on the Bitcoin Blockchain was mined. This was shortly after the start of the Great Recession. That is no coincidence; confidence in centralised financial systems had plummeted.

Satoshi Nakamoto encoded that first block of Bitcoin mined with the immutable message taken from the newspaper that day: "The Times 03/Jan/2009 Chancellor on brink of second bailout for banks."

Crypto was seen as the answer to the centralized financial system crisis in the eyes of Nakamoto and the early Bitcoin adopters. It is highly doubtful that they anticipated the vast re-centralisation of crypto. Users are now doing exactly the opposite to what the whitepaper envisaged by handing control of their finances over to third parties that are in large part regulated by the same systems as those very banks.

The first line of the Bitcoin white paper reads, "A purely peer-to-peer version of electronic cash would allow online payments to be sent directly from one party to another without going through a financial institution." In a whitepaper that was so articulately put that it changed the world in just 9 pages, the inclusion of the word "purely" must have been deliberate.

Not so Nakamoto, not so. Re-centralisation followed as more and more people wanted to enter the world of crypto but were not ready to do that which was intended, to actually take responsibility for their own digital money. The idea of being the master of your empire seems liberating until you realize you forgot your access credentials, no one has a password reset button and you've lost access to all your money. And so a whole generation of crypto native businesses, exchanges, hosted wallets and more nefarious custodians were born to do this for them.

But if you thought a recession when the banks had the money was bad, well, let's explore the alternative we now face. Banks rarely end up in insolvency

thanks to government backing. When they do, most of us have a guaranteed amount of protection against our finances via regulators/governments, and there are limitless highly skilled insolvency experts who can jump in with decades of experience in traditional financial markets to manage the process and investigate. But this time it's "normal corporate businesses" (read: businesses whose account holders' funds are not guaranteed protection) that will fall into insolvency far more often (because no one is propping them up) holding millions if not billions of pounds, euros, dollars and so forth of customers' assets (both in crypto and fiat).

It has already begun. Voyager, Three Arrows and Celsius all entered insolvency processes thanks to external threat and market forces. People leverage algorithms that break causing prices to crash, external threat actors breach security systems and steal funds, and even Joe Public will take advantage of a smart contract vulnerability to siphon out funds (and then send it back because they realize the blockchain's inherent transparency means they'd easily be tracked, identified and caught). Chainalysis estimates that $2 billion in cryptocurrency has been stolen from cross-chain bridges alone across 13 separate hacks, most of which occurred this year, demonstrating how fast these emerging threat classes are moving.

The biggest threat is perhaps yet to come: the internal threat. Let's set that scene.

2009 was not just the launch of Bitcoin, it was also the year in which the Association of Certified Fraud Examiners (ACFE) published a survey of more than 500 experts titled "Occupational Fraud: A Study of the Impact of an Economic Recession." One conclusion may seem obvious: in times of intense financial pressure, there is an increase in fraud. But noteworthy was the conclusion that not only is it the employees of entities that pose the greatest fraud risk, but that the gaps in workforce caused by layoffs meant there were holes in internal control systems.

Whether or not you believe a recession is imminent, it is a fact that crypto prices have plummeted and many crypto firms have responded to the changing market conditions with layoffs. As Crypto Winter and perhaps the next global recession unfolds, how many crypto businesses will find they have gaps in their internal control systems that leave them open to internal threat? In a world where even the US Secret Service had agents run off with ill-gotten crypto this is a real and current risk for crypto businesses. This risk also applies to any business holding crypto on its balance sheets or any business operating in fiat in which someone (whether a director anticipating insolvency, or a disgruntled accountant) decides to convert fiat into crypto thinking they can run off with it undetected. In other words, this may apply to any business. This is likely to lead to an increase in demand for crypto literate advisory professionals in compliance, audit, restructuring, internal investigations and of course insolvency and asset recovery.

The good news – because there is some (hurrah!) – is that we are seeing the first few lawyers and accountants firms taking genuine steps to equip themselves at scale with the tools, data and staff who know the right questions to ask, are trained in tracing cryptocurrency, know how to graph out crypto frauds, and are familiar with the case law around freezing and recovering crypto assets. But to meet current demand and the increase that is inevitably coming, scaling crypto asset investigation and recovery expertise is time critical.

Every law firm and every accountancy practice should have someone who knows enough to update their questionnaires and procedures to at least detect when crypto may be in play.

But anyone who is responsible for asset preservation and recovery is going to need to be skilled to respond urgently when the situation arises. Few assets are more liquid and dissipated than crypto, although on the plus side (another one!) few are less immutably traceable for recovery.

For those of you who are not corporate insolvency professionals and are enjoying watching your corporate colleagues or competitors squirm at this point, I have one final note. Based on research undertaken by the FCA and Gemini this year, the percentage of UK adults who own crypto could be anywhere between 4.4% and 18%. Either way, that's millions of people who are holding assets that could and should be realized for creditors. Everyone needs to ask the questions and understand the implications. It may only be 4 or 5 figures in value now, but we have seen that crypto assets recovered while the value of crypto assets are low – as they arguably are now in crypto winter – can transform insolvency to solvency, as we've seen in the Mt Gox case. So there's an opportunity for you too.