

## Association of Business Recovery Professionals

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Wednesday 13 December 2023

Dear Sir or Madam,

### **Public consultation - Digital Assets and English Insolvency Law UK Jurisdiction Taskforce**

#### **1. INTRODUCTION**

- 1.1. R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession. Our members work across the spectrum of the profession, from global legal and accountancy firms through to smaller, local practices.
- 1.2. The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession rescues businesses and jobs, creates the confidence to trade and lend by returning money fairly to creditors after insolvencies, investigates and disrupts fraud, and helps indebted individuals get back on their feet. Our members have direct experience of insolvencies and their impact on the UK economy and insolvent companies' stakeholders.
- 1.3. This response has been prepared by R3 in collaboration with members of its General Technical Committee. The Committee deals with issues of general importance and significance to the profession in the United Kingdom, keeping under re-view all UK and EU legislation, prospective and other matters relating to insolvency law. The Committee is multi-disciplinary and is made up of representatives from across the insolvency and restructuring profession, including practising insolvency practitioners, lawyers (including those specialising in advising regulated entities), academics, and others.

#### **2. GENERAL OBSERVATIONS**

- 2.1. The digital universe is vast and ever changing in the modern world. As you will appreciate, the term 'Digital Assets' is a broad term; however, it is generally held to mean any digital representation of value with corresponding usage rights. This includes cryptocurrencies, non-fungible tokens, other types of tokens, Central Bank Digital currencies, cloud computing software, and audio content.
- 2.2. Whilst we appreciate that the English courts have thus far not had occasion to address the application of various important English insolvency law concepts to digital assets, it is important that any developments reflect the meaning of a digital asset and existing law.

- 2.3. Across all jurisdictions regulation and legal frameworks are being developed, however, digital assets remain unregulated in the UK as of 2023. It is worth noting that many crypto asset related business being domiciled outside of the UK, and in some cases move jurisdictions as the regulatory landscape evolves.
- 2.4. Different countries have different regulations in place, and the situation is constantly changing. For example, in the United States of America, the Securities and Exchange Commission ('SEC') has taken the lead in regulating digital assets. The SEC has classified some cryptocurrencies as securities, which means that they are subject to the same regulations as stocks and bonds.
- 2.5. The Financial Conduct Authority (FCA) is the UK's main financial regulatory body. The FCA currently has oversight to check that cryptoasset firms have effective anti-money laundering (AML) and terrorist financing procedures in place, but cryptoassets themselves are not regulated. Security tokens (tokens with specific characteristics that provide rights and obligations akin to specified investments, like a share or a debt instrument) are the only FCA-regulated cryptoasset.
- 2.6. Given the UK Government's work in response to the recent consultation "Managing the failure of systemic Digital Settlement Asset ('DSA') (including stablecoin) firms", where it indicated that it intends to update the Financial Market Infrastructure Special Administration Regime with an additional objective and to make further amendments as necessary to account for the differences between existing payment systems and systemic DSA systems, we suggest that UKJT liaise with HM Treasury about the Legal Statement and the possible implications on the proposed actions.

### 3. PUBLIC CONSULTATION RESPONSE

*"Are there any material issues of concern to stakeholders in relation to the application of English insolvency law to digital assets, other than those set out in the Annex to this consultation paper" (Appendix 1)*

- 3.1. In terms of the questions posed, we think the questions cover the main points in principle, in particular Question 5 around the expectations of an officeholder.
- 3.2. With regard to Question 5 *'Are office-holders subject, generally, to any obligations in relation to holding/realisation of volatile digital assets in an English insolvency?'* we comment as follows –
  - 3.2.1. Whilst the duties of an Administrator, a Liquidator and a Trustee may differ, they all have a duty in some form to secure the assets of the company/individual and take steps to realise, if appropriate, for the benefit of creditors. In this technological era, assets may include some form of digital asset and given the complexity of these types of asset, it is important for the officeholder to have regard for the relevant insolvency regime and get relevant expert advice before liquidating this type of asset.
  - 3.2.2. Transactions involving some form of digital asset are normally open to the public and traceable. However, if assets are stored in a digital wallet this can make realising such assets more complex. Cryptoasset digital wallets store users' private keys, which are unique codes that allow them to access their cryptoassets. Private keys should be kept secret, as anyone who knows your private key can steal your cryptoassets. As a consequence, identifying the true beneficial owner of an asset may prove difficult.
  - 3.2.3. However, officeholders have extensive investigative powers at their disposal meaning they can often overcome these types of complexities. For example, sections 234 to 236 of the Insolvency Act 1986 –
    - S234 Getting in the company's property
    - S235 Duty to co-operate with officeholder
    - S236 Inquiry into company's dealings, etc.

3.2.4. The value of digital assets are well known to be volatile and therefore it would be prudent for an officeholder to have a strategy in place to secure the asset and dispose of it for value for the benefit of creditors.

3.2.5. Officeholders need to identify whether there are any potential digital assets as quickly as possible (pre or post appointment) by speaking to directors, the debtor, employees etc. It is then vital the private keys are located as those with the private keys have the ability to move the asset without the officeholders knowledge.

3.2.6. Finally, due to the complex nature, it would be practical to instruct specialist crypto advisers who have relevant experience to ensure the asset is captured and secured at an early stage.

3.2.7. Therefore, we believe no obligation should be placed on an officeholder to hold digital assets unless directed by a specialist crypto adviser or legal advisor. The volatility of a digital asset is far too great to speculate or hold without specialist advice.

3.3. With regard to Question 6. *‘Can you perceive any difficulties in the application of the English insolvency legislation relating to avoidance of prior transactions to pre-insolvency dealings with digital assets? If so, what are they?’*, we comment as follows –

3.3.1. It may prove difficult to determine whether the transaction occurred during the look-back period, due to the potential difficulty of finding records/ determining when the contract was actually executed.

3.3.2. Furthermore, the location and capture of the ‘private key’ will be crucial to trace a digital asset. Without the private key, anyone who has or knows the private key can take control of that digital asset and as a consequence identifying the true beneficial owner of an asset may prove difficult.

#### 4. CONCLUSION

4.1. As rightly pointed out in the consultation paper, insolvency practitioners would welcome guidance and certainty as to how various aspects of the English insolvency law regime apply to issues digital assets. However, given the ever changing landscape of digital asset world, we would request that any form of Legal Statement on the matter is kept under constant review.

4.2. Furthermore, we also emphasise the importance of consulting a wide range of lawyers and experts in order to define digital assets more clearly, and indeed answer the questions posed in the consultation.

4.3. Prior to the release of a Legal Statement, members of R3’s General Technical Committee would welcome the opportunity to comment further on a draft or accommodate a Chatham House virtual meeting with committee members of UKJT to discuss.

4.4. If you would like to virtually meet or if you have any other queries, please contact R3's Head of Technical, Ben Luxford, at [ben.luxford@r3.org.uk](mailto:ben.luxford@r3.org.uk) or on 020 7566 4218.

Yours faithfully,



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