# Cryptoassets:
## Their typology, classification and treatment in a crisis and insolvency

Marc d'Avoine explains how cryptoassets are recognized in Germany, with reference to particular characteristics which require specific actions by the insolvency administrator

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### Type and classification of cryptoassets

Cryptocurrencies and other types of crypto assets have entered global financial systems. Cryptocurrencies, such as Bitcoin,[1] are a tradable means of exchange. Although state control or regulation is an objective, cryptocurrencies remain largely unregulated until today. There is a widespread perception that cryptocurrencies are anonymous and transactions cannot be traced. However, stated in such simple terms, that is not correct.

### Treatment in a crisis and insolvency

From the perspective of an insolvency administrator, the treatment of cryptocurrencies in insolvency is highly demanding. The first problem is whether cryptocurrencies are even part of the insolvency estate. And if so, how best to recover them. It is also questionable how the insolvency administrator becomes aware of these assets and what consequences threaten insolvency debtors who refuse to cooperate in the identification/detection or recovery of assets.

### Regulations of legal quality

The German legislature has defined the legal quality of cryptocurrencies in section 1 (11) sentence 4 of the German Banking Act (KWG).[2] According to this, cryptocurrencies are digital representations of value which serve as a means of payment or are used for investment purposes and are transmitted, stored and traded exclusively electronically.

The fact that cryptocurrencies may be valuable assets is obvious, including due to the brisk trading of them on the market.

### Cryptocurrencies are part of an insolvency estate

There is now widespread agreement in the German literature that cryptocurrencies also fall under the insolvency estate according to section 35 of the German Insolvency Code (InsO). The prerequisite for this is that cryptocurrencies are subject to seizure under section 36 (1) of the InsO. Attachability is part of the German law of compulsory execution and is regulated in the German Code of Civil Procedure (ZPO). Various enforcement options can be found there, sometimes also in relation to movable or immovable assets as well as to claims.

However, none of these possibilities initially applied to crypto assets. With the introduction of section 1 (11) sentence 4 of the KWG, the transferability of crypto assets has been clearly defined. The transferability of cryptocurrencies is intrinsic. Therefore, a catch-all provision of German enforcement law, which subjects transferable rights to seizure, applies via sections 857 and 857 (1) of the ZPO. Thus, with the derived attachability of cryptocurrencies, they are ultimately part of the insolvency estate pursuant to section 35 of the InsO. According to the principles of German insolvency law, the insolvency administrator shall exercise the power of administration and disposal over the assets of the insolvency debtor upon the opening of insolvency proceedings, as per section 80 (1) of the InsO.

### Ownership of the private key

Basic technical knowledge is required for transactions with crypto assets. The technical requirements are in part extensive and complicated. The decisive factor is where the insolvent debtor keeps his private key. This private key is in fact absolutely necessary for the disposing party's ability to execute transactions with crypto assets. The private key is stored in a wallet. This wallet can be designed in different ways (hardware wallet, paper wallet, etc.).[3] The debtor may maintain the wallet itself or commission a provider to store it (crypto custodian).[4] This provider must grant the insolvency administrator the power of disposal upon request. However, it is more problematic if the debtor is keeping his private key himself.

### Knowledge of cryptoassets

It is often difficult for an insolvency administrator to obtain information about existing crypto values in the first place. There is a risk that insolvency debtors "forget" or even knowingly conceal existing crypto assets. Detection of assets is then considerably more difficult. Account statements of the debtor could reveal conversions or purchases of crypto assets. Otherwise, of course, there is also the possibility of gaining knowledge from individual

creditors who claim crypto assets in the table in insolvency proceedings. Without the cooperation of third parties, however, it is almost impossible to acquire knowledge of this, if the crypto assets have not been properly recorded in the debtor's books.

## Participation of the debtor and enforcement

If the debtor's crypto assets are known, the debtor is obliged to cooperate in their recovery: section 97 of the InsO.[5] For this purpose, he can be asked to convert the crypto assets directly into fiat currency (i.e. money) such as euros and to pay the conversion value to the insolvency estate. In addition, he can also be asked to disclose the private key or the custodian of the private key and the respective access information (login, password etc.). The insolvency administrator only gains direct control over crypto assets or currencies with the private key.

If the debtor refuses to participate in the proceedings, he may also be subject to coercive measures under section 98 of the InsO. For this purpose, coercive means such as compulsory attendance or even imprisonment are available.[6] However, the term of imprisonment would be limited to a period of six months in accordance with section 802j (1) sentence 1 of the ZPO. Once a debtor has served a term of imprisonment, further coercive measures under the InsO are not available. Pursuant to section 300 (3) of the InsO, the insolvency court would also have to decide on the application of a creditor on the refusal of the discharge of the residual debt. Further measures to force the insolvency debtor to disclose the access data are not provided by the InsO.

## Recovery in insolvency

If the insolvency administrator is ultimately in possession of the private key, he has several options to use existing cryptocurrencies.

The easiest way is to sell the private key directly to a third person and hand it over to them against payment of fiat currency. With the private key, the insolvency administrator could also transfer the crypto assets or currencies directly himself or convert them into money at a recognized crypto exchange. He could also engage special service providers to support him in the exploitation of the asset on a fiduciary basis.

## Risks during recovery

Haste is required in the asset recovery.[7] The market value of individual crypto assets is extremely volatile. Significant price fluctuations up to the possible total loss of value of the crypto assets require rapid action by the insolvency administrator. At the same time, even if the private key is known, it is not excluded that the debtor will continue to use it and execute unauthorized transactions with third parties. The direct transfer of the crypto assets to the assets of the insolvency administrator as a security measure should be avoided[8] for liability reasons. This applies even if this is particularly advantageous if the insolvency administrator himself is a participant in crypto space.

## Summary and outlook

Crypto assets play an increasingly important role in the global financial systems, as well as in insolvency of debtors. Whether and how government control or regulation can or should take place in the future is open. The current and future expected market capitalization of cryptocurrencies (currently approx. €112 billion) and the ability to transfer them from the crypto space into state-recognized currencies (Euros, US Dollars etc.) requires increased attention in all areas. As a result, crypto assets are also increasingly in the focus of restructuring companies and insolvency administrators. Treating them, securing them and exploiting extremely volatile

values is both a task and a challenge. ■

**Footnotes:**
1   The first cryptocurrency was Bitcoin, launched on 3 January 2009.
2   Introduced with effect from 1 January 2020 (Federal Law Gazette [BGBl.] I p. 2602).
3   For more details, see: *Maume/Maute, Kryptowerte-HdB* (Beck, 2020), Section 1, Marginal note 24.
4   Known crypto custodians in the German-speaking countries are: coinbase, bison, Finoa, Tangany.
5   Applicable to legal entities via section 101 (1) (2), InsO.
6   Janssen in *MünchKomm/InsO* (4th edn) (Beck, 2019), Section 159 of the InsO, Marginal note 13; Schmittmann/Schmidt, *DZWIR* 2021, 652.
7   Section 159, InsO, requires the "immediate" realization of assets.
8   cf. D'Avoine/Hamacher, *ZIP* 2022, 6.

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