

The background features a dark blue grid with various financial data points, including percentages like 0.07%, 0.03%, 0.05%, and 0.04%, and numerical values such as 12.00, 13.00, 14.00, 15.00, 16.00, 17.00, 18.00, 19.00, 20.00, 21.00, 22.00, 23.00, 18775, 18771.56, 18754.73, 18752.00, 18747.50, and 18742.51. There are also line graphs and bar charts overlaid on the grid.

The Bankruptcy Court as Crypto Market Regulator

Bankruptcy by the Beach

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New York Times



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Overview

- In the absence of a financial regulatory framework for digital asset oversight, the Bankruptcy Court is taking center stage.
- Its fact-finding, analysis and opinions are playing a critical role in shaping digital asset market design (e.g., disclosure/custody standards).
- Even as financial regulators assert authority, they are doing so in the shadow of, and subject to, the Bankruptcy Court's judgment.
- While the Court is doing its job using Chapter 11 tools, relying on it to perform key functions in financial regulation is highly problematic.

What the...***COIN...?!

- Digital assets have taken the world – and courts – by storm. But what exactly does it all mean?
- ❖ Entirely digital
- ❖ Designed to work without central intermediaries
- ❖ Key functions performed by code
- ❖ Coins are assets that reflect a product of various networks.
- To mainstream assets, this world is also home to centralized finance like exchanges, brokers, financiers...many of whom you are seeing in bankruptcy.

Traditional Functions of Financial Regulation

- Systemic risk – ensuring that firms do not cause costly externalities by taking on more risks than they can assume.
- Uncovering information – investigating regulated firms and industries to understand risks and using information to craft rules and standards.
- Customer protection – devising standards to govern the conduct of firms to ensure that customers have sufficient information and, in some cases, that their downside risk is covered (e.g., insurance).

Crypto Market Meltdown

Crypto Market Failures in Bankruptcy Court

- Major crypto firms have failed over the last year, showcasing several failures that ought to have been addressed by regulation.
- Celsius, Voyager, FTX, BlockFi and Genesis Global constitute some of the biggest and most interconnected firms in crypto.
- As revealed by FTX, externalities resulted in several knock-on failures (e.g., BlockFi), abject customer protection and a lack of information.

Bankruptcy Court as Decision- Maker

- Yet the Bankruptcy Court has (or is being asked to) take decisions that mean it is performing key functions of a financial regulator.
- It has become a major fact-finder – see, examiners reports for Cred, Celsius and public disclosures arising within FTX.
- Determinations about the status of customer assets (e.g., Celsius) exert a knock-on effect on other firms (e.g., exchanges) (and the SEC).
- Judgments about which assets may be sold, when and at what price, about releasing collateral impact solvency and liquidity within the crypto-ecosystem.

Applying Traditional Tools to Digital Asset Distress

- For the most part the Court is applying traditional tools:
 - The automatic stay
 - Asset sales under Section 363
 - Examiners and document production orders
 - Clawbacks for preferences and fraudulent conveyance
- Judges are analyzing terms of service, exchange market structure, blockchain data.

The background is a complex, abstract composition of overlapping, semi-transparent blue geometric shapes, primarily triangles and polygons. The colors range from a very dark, almost black blue to a bright, vibrant blue. The shapes are layered, creating a sense of depth and movement. The overall effect is a dynamic, low-poly aesthetic.

BUT....

The Court Lacks Key Information

- The Court is being asked to act in the absence of information that tends to be important for financial regulators.
- What are the regulatory characteristics of assets? Without such clarity in crypto-assets, the court lacks insight about key aspects of their technology, their value and usefulness.
- The usual reserve of information on regulated firms is largely missing for cryptocurrency firms.
- The court finds out information to ensure that creditors can be paid and asset value maximized, rather than to understand the performance and riskiness of a firm within its marketplace.

The Court Might Not Get to Find Out More

- The capacity of the Court to understand a firm's riskiness and value is curtailed by the nature of the process itself.
 - The Court does not have to listen to everyone.
 - Only those that can appear at the court and make a claim will be heard.
 - The Court is focused on a few key goals driven by the resolution.
 - Outcomes may be driven by conventional practices and norms, e.g., for valuation, to take the middle position between competing claims.

Bankruptcy Can Conflict with Financial Regulation

- Sometimes norms and practices in bankruptcy may conflict with those in financial regulation.
- The application of the automatic stay may result in knock-on liquidity problems for interconnected entities (e.g., derivatives exemptions).
- Certain creditors in financial regulation have special status (e.g., depositors).
- Some firms may not be suitable for bankruptcy (e.g., banks/broker-dealers).

Bankruptcy Decisions May Have Sticky Effects

- The Court has authority now to decide critical questions that will determine the look and feel of markets.
- The SEC's interventions in at least one case (e.g., Voyager's proposed sale to Binance and assertions of BUSD as a security were rebuffed).
- Private ordering is responding to the Court's determinations – (e.g., in relation to custody, even when it is not clear how workable solutions might be for crypto specifically).

Some Questions and Implications

- The outsize role played by the Bankruptcy Court as a regulator of first resort raises several questions and implications:
 - What is the impact on the room to maneuver enjoyed by traditional market regulators – how constrained will they be by the Court’s rulings? (e.g., will regulators create exemptions, push customer priority higher up the ladder?)
 - How fully will market regulators investigate bankrupt crypto companies – or will an understanding of FTX’s workings always be determined by the facts arising from its failure?
 - How will norms regarding valuation and business combination be impacted by the judgment of the Court?
 - ...More to come...

THANK YOU!

