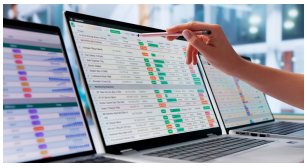

Lessons from Cryptocurrency Insolvencies for Traditional Lenders

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This is the third article in a series examining the litigation risks lenders face as commercial loan defaults rise, brought to you by the team behind our Banking On It blog.

The wave of cryptocurrency insolvencies that began in 2022 and continued through the following years generated an extraordinary volume of judicial guidance on topics that most traditional lenders assumed had little relevance to their operations. The collapses of FTX, Celsius Network, Voyager Digital, BlockFi, and Genesis Global Capital produced bankruptcy proceedings of remarkable complexity, involving novel questions of asset ownership, governance accountability, data valuation, and creditor recoveries.

It would be a mistake, however, to view these cases solely through the lens of digital assets. The largest crypto insolvencies exposed legal and governance issues that extend beyond digital assets and carry direct lessons for traditional commercial lending. The principles that emerged concerning collateral ownership, corporate governance, the pace of financial distress, and the role of litigation in driving recoveries are fundamental creditor rights principles that apply with equal force to a commercial real estate loan workout or a middle-market borrower restructuring. The first and second articles in this series addressed common risks facing special assets officers and the importance of prepetition and contingency planning in mitigating litigation risks. Here, we examine how crypto bankruptcies have pressure-tested those principles, giving rise to what could be a new era of litigation-driven recoveries.

Lesson 1: Ownership Matters

The single most consequential legal issue in the major crypto bankruptcies was asset ownership. In the Celsius and Voyager cases, courts were confronted with fundamental questions about whether customer deposits constituted property of the estate or remained the property of the depositors. The answers turned on the precise language of terms-of-service agreements, which are

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contracts that, in many cases, were poorly drafted, internally inconsistent, or ambiguous about the nature of the custody relationship.

For traditional lenders, this is a lesson or a reminder. Collateral ownership disputes are not unique to cryptocurrency. They arise whenever the borrower's ownership of pledged assets is less clear than the lender believed at origination. Inventory held on consignment, equipment subject to purchase-money security interests, intellectual property with unclear title chains, and deposit accounts with competing claims are all traditional collateral categories where ownership can be contested.

The takeaway is to review collateral definitions with fresh eyes, particularly in distressed credit situations. Lenders should clarify ownership structures for all pledged assets, while also verifying that the borrower actually owns the collateral that secures the loan. The crypto cases demonstrated that ambiguity in ownership documentation is an issue, and one that is resolved only after great expense in a bankruptcy proceeding with results that are difficult to predict. Addressing ambiguities prepetition is far more efficient.

Lesson 2: Governance Failures Destroy Value

The governance failures that characterized the major crypto insolvencies were staggering in scope. FTX operated without a functioning board of directors, with minimal financial controls, and with a commingling of customer and corporate funds that the bankruptcy examiner described as unprecedented.

These governance failures did not merely contribute to the companies' insolvencies; they destroyed recoverable value. Assets were dissipated, records were incomplete or unreliable, and the costs of untangling the resulting chaos consumed a significant portion of the estates' resources.

For traditional lenders, the lesson is to evaluate governance as a standalone credit risk factor, not merely a checkbox in the underwriting process. When a borrower enters distress, the quality of its governance becomes even more critical. Lenders should increase monitoring of distressed borrowers' governance practices,

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including board composition, financial reporting integrity, related-party transactions, and the adequacy of internal controls. Governance weakness in a distressed borrower is a clear indicator of value destruction, and lenders who recognize it early may be able to take protective action before that destruction occurs.

Lesson 3: Data and Technology Are Assets

One of the more surprising developments in the crypto bankruptcies was the recognition that digital records, customer data, and operational technology infrastructure represented significant asset value independent of the companies' core business operations. In the FTX bankruptcy, the debtor's technology platform and customer data were identified as valuable assets that contributed to recoveries.

For many borrowers, particularly those in technology, healthcare, financial services, and consumer-facing industries, customer data, proprietary software, and digital infrastructure may represent a substantial portion of enterprise value. Yet these assets are frequently excluded from collateral packages or inadequately described in security agreements.

The lesson for traditional lending is to consider nontraditional collateral categories, particularly in industries where data and technology are core value drivers. During workouts, lenders should evaluate data-related assets as potential sources of recovery, whether through sale, licensing, or inclusion in a restructured credit facility. The crypto cases demonstrated that in a modern economy, the most valuable assets may not be the ones that appear on a traditional balance sheet.

Lesson 4: Distress Moves Faster Than Expected

The speed at which the major crypto companies collapsed was extraordinary. Celsius suspended withdrawals and filed for bankruptcy within weeks. FTX went from apparent solvency to a Chapter 11 filing in approximately 10 days. The contagion effects were equally rapid, with the failure of one platform triggering liquidity crises at others in a matter of days.

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While traditional commercial borrowers are unlikely to experience distress at quite this velocity, the crypto cases are a stark reminder that financial deterioration can accelerate far more rapidly than historical experience might suggest. In a world of interconnected supply chains, just-in-time inventory management, and digital payment systems, a borrower's liquidity position can deteriorate in weeks rather than months.

The practical implication for traditional lenders is the importance of early intervention, real-time monitoring, and contingency planning. Lenders should not assume that they will have months to develop a workout strategy after the first signs of distress appear. Financial monitoring should be as close to real-time as practicable, with automated triggers for enhanced review when key metrics deteriorate. Contingency plans, including prepetition remedies, collateral protection strategies, and bankruptcy preparation, should be developed well before they are needed, so they can be deployed rapidly when circumstances require.

Lesson 5: Litigation Drives Recoveries

Perhaps the most instructive lesson from the crypto bankruptcies for traditional creditors is the extent to which litigation became the primary driver of recoveries. In the FTX case, avoidance actions targeting preferential transfers and fraudulent conveyances recovered billions of dollars for the estate. Director and officer liability claims provided additional recovery paths. In Celsius and Voyager, estate causes of action, including claims against insiders, former executives, and related parties, represented a significant component of the assets available for distribution to creditors.

Traditional lenders should view litigation as a recoverable asset, not merely as a cost center. In distressed credit situations, the borrower's potential causes of action against directors and officers, third parties who received fraudulent transfers, or insiders who engaged in self-dealing may represent meaningful value that should be factored into recovery planning. That planning should begin before formal proceedings are initiated, when the evidence is freshest and the litigation positions are strongest.

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Future Trends

Looking ahead, several developments at the intersection of technology and finance will continue to generate new challenges for traditional lenders. Tokenized assets — real estate interests, fund interests, and securities represented by blockchain tokens — are beginning to appear in commercial lending transactions, raising novel questions about perfection, priority, and enforcement. Digital collateral of all types will require lenders to develop new frameworks for identification, valuation, and protection.

Artificial intelligence (AI) introduces its own set of insolvency risks. Companies that depend on AI systems for core operations face unique vulnerabilities related to technology obsolescence, regulatory intervention, and intellectual property disputes. Director and officer exposure in distressed companies will continue to expand as courts and regulators hold corporate leadership accountable for governance failures that contribute to insolvency.

Key Takeaways

The cryptocurrency insolvencies of recent years are not simply interesting technology stories. They are modern case studies in creditor rights, governance, collateral protection, and litigation strategy. The largest crypto insolvencies exposed legal and governance issues that extend beyond digital assets and carry direct lessons for traditional commercial lending.

For traditional lenders, the takeaways are concrete and actionable:

- Verify asset ownership with the same rigor that the crypto bankruptcies revealed was lacking;
- Treat governance as a first-order credit risk; recognize the asset value of data and technology;
- Plan for distress that moves faster than expected; and
- View litigation as a tool for value recovery, not merely as a cost of doing business.

Interested readers are encouraged to check out the first two articles in this series if they haven't already done so. Part one

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identifies five common litigation risks that special assets officers face in the event of a commercial loan default. Part two explains how lenders can use the critical window before a Chapter 11 is filed to strengthen their recovery position. As for the lessons discussed here, please contact the author or any attorney with the firm's Regional & Community Banks team if you have questions and would like further guidance.

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