

# Cryptocurrencies and Trustees: What are the risks?

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## **Introduction**

This article shows how cryptocurrencies create several risks for trustees when either held as trust property or acquired as an investment asset through the trustees' investment duty. It is argued that the risks are primarily generated by both the regulatory and market risks that surround crypto assets. Additionally, there is also the reputational risk that trustees may face in the light of the above.

Cryptocurrency's popularity has inevitably led it to increase exponentially as an investment asset and opportunity.<sup>1</sup> As with most technological developments, this growth has happened in a relatively short time.<sup>2</sup> Quantitative research from the Financial Conduct Authority (FCA) in 2021 has shown that cryptocurrencies have risen in popularity, with some 78% of adults saying that they have heard of this asset.<sup>3</sup> Interestingly, cryptocurrencies' growth in public popularity has not damaged its reputation, as ownership is up from 3.9% to 4.4% and 'consumers are now less likely to cite cryptocurrency as a gamble... and are more likely to see them as an alternative or complement to mainstream investments.'<sup>4</sup> The FCA's above data are compelling. They show that cryptocurrencies are more likely than ever to be purchased as investments, and ultimately, the importance of this article.

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<sup>1</sup> Financial Conduct Authority, 'Research Note: Cryptoasset consumer research 2021' (*FCA*, 17 June 2021) <<https://www.fca.org.uk/publications/research/research-note-cryptoasset-consumer-research-2021>> accessed 12 December 2022.

<sup>2</sup> *ibid.*

<sup>3</sup> *ibid.*

<sup>4</sup> *Ibid.*

Indeed, the exponential growth of cryptocurrency has resulted in a lacuna to form in the regulation of this anarchic asset. In consequence, calls have been made for a more adequate legal response to reduce the risks.<sup>5</sup> The gaps in the regulation and lack of legal certainty in the light of this highly unique subject matter means that the law's specific application is still largely being negotiated;<sup>6</sup> this is especially true with how cryptocurrencies interact with the law of trusts and trustees.<sup>7</sup> The overarching purpose of this work is to better understand how cryptocurrencies apply to trusts law. But the writing nevertheless fills a more specific research gap. Ultimately this article is greatly interested in the risks that cryptocurrency investment poses to trustees, who may incur exposure to risks during the exercise of their fiduciary duty of investment.<sup>8</sup> The investment duty in question is codified and enforced by the Trustees Act 2000.<sup>9</sup>

This article is concerned with the “risk profile” of cryptocurrency when such an asset is considered as an investment option for trustees. In short, there are three main risks for trustees to consider when investing in cryptocurrency, *viz.* (i) regulatory risk; (ii) market risk; and (iii) reputational risk. Such risks must be considered by trustees before investing in cryptoassets.

It is noteworthy the writing of this paper was driven by two principal sources. First, the author is interested in cryptocurrency's application to trusts law. In recent years the courts have had to respond to how cryptoassets are captured by the rules surrounding trusts' “subject matter”.<sup>10</sup> Since cryptocurrency has been adjudged to be a form of “property”,<sup>11</sup> the

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<sup>5</sup> Editorial Board, ‘FTX's collapse underscores the need for regulating crypto’ *Financial Times* (London, 23 November 2022).

<sup>6</sup> *ibid.*

<sup>7</sup> G Cooper, ‘Virtual property as trust assets and investments’ (2021) *Butterworths Journal of International Banking and Financial Law* 751.

<sup>8</sup> *ibid.*

<sup>9</sup> *Trustee Act 2000.*

<sup>10</sup> *Knight v Knight* (1840) 3 Beav 148, 173-180; or *Knight v Boughton* (1840) 49 ER 58.

<sup>11</sup> *Ruscoe v Cryptopia Ltd (in Liquidation)* [2020] NZHC 728.

corollary is that these assets can form the subject matter of a trust.<sup>12</sup> The significance of cryptocurrency being property is that protection is afforded through the establishment of proprietary interests.<sup>13</sup> Solinas says that ‘Without a valid trust, account holders might be left with a personal contractual right of redelivery in respect of their (interests in) cryptocurrencies and would rank as general creditors in the exchange’s insolvency.’<sup>14</sup> Such proprietary protection against *pari passu* creditors is clearly important for beneficiaries.<sup>15</sup> The second source of inspiration for this article came from the recent collapse of FTX, the crypto trading platform founded by Sam Bankman-Fried.<sup>16</sup> The ruination of FTX is significant because it demonstrates the significant market volatility that exists for cryptocurrency investors.<sup>17</sup> FTX’s collapse has led to calls for greater regulation as investors have lost millions.<sup>18</sup>

The section below defines cryptocurrencies and provides an explanation of their nature. Following this, the trustees’ duty of investment is outlined. Thereafter the difference “risks” (as above) are discussed, in turn.

### **Cryptocurrency: an enigmatic concept?**

It is essential that some definition of cryptocurrency is provided in this work. The UK Jurisdiction Taskforce (UKJT) has suggested that ‘it is difficult to formulate a precise definition of a crypto asset and, given the rapid development of the technology, that would

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<sup>12</sup> *ibid.*

<sup>13</sup> M Solinas, ‘Investors’ Rights in (Crypto) Custodial Holdings: *Ruscoe v Cryptopia Ltd (in Liquidation)*’ (2022) 84(1) MLR 155, 156.

<sup>14</sup> *ibid.*

<sup>15</sup> See, *Attorney General of Hong Kong v Reid* [1994] UKPC 36; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45. Cf. *Keech v Sandford* (1726) EWHC J76; *Lister v Stubbs* (1890) LR 45 Ch D 1; *Sinclair Investments v Versailles Trade Finance Ltd* [2011] EWCA 347.

<sup>16</sup> n. 5.

<sup>17</sup> *ibid.*

<sup>18</sup> *ibid.*

not be a useful exercise.’<sup>19</sup> The uncertainty surrounding this enigmatic concept can be seen in the lexicon that is used to express it. The Taskforce’s report notes the inconsistency of the nomenclature used in this area.<sup>20</sup> This is certainly already evident in this work, as the author uses “cryptoassets”, “virtual and digital currencies”, and “cryptocurrencies” to describe the same thing.

“Cryptocurrency” may be defined as ‘A digital or virtual currency secured by cryptography and based on a network that is distributed across a large number of computers.’<sup>21</sup> The cryptography in question describes the use of “distributed ledger technology” (DLT) for cryptoassets.<sup>22</sup> In 2018 the Taskforce identified that DLT ‘has the potential to deliver substantial benefits, both in financial services and other sectors.’<sup>23</sup> Certainly the Taskforce sees cryptocurrency, and the blockchain technology underpinning it, as an important source for future innovation in the UK economy.<sup>24</sup> Blockchain is a type of DLT and, as such, the technology has a wider application than virtual currency.<sup>25</sup> In relation to blockchain, Frankenfield states that:

[B]lockchain is essentially a set of connected blocks or an online ledger. Each block contains a set of transactions that have been independently verified by each member

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<sup>19</sup> UK Jurisdiction Taskforce, ‘Legal statement on cryptoassets and smart contracts’ (UKJT, November 2019) 9 <<https://resources.lawtechuk.io/files/4.%20Cryptoasset%20and%20Smart%20Contract%20Statement.pdf>> accessed 12 December 2022.

<sup>20</sup> *ibid.*

<sup>21</sup> J Frankenfield, ‘Cryptocurrency Explained with Pros and Cons for Investment’ (*Investopedia*, 26 September 2022) <<https://www.investopedia.com/terms/c/cryptocurrency.asp>> accessed 12 December 2022.

<sup>22</sup> *n.* 19.

<sup>23</sup> *ibid.*

<sup>24</sup> *ibid.*

<sup>25</sup> *ibid.*

of the network. Every new block generated must be verified by each node before being confirmed, making it almost impossible to forge transaction histories.<sup>26</sup>

Cryptocurrencies are presently viewed as an ‘investment by people who expect their value to rise.’<sup>27</sup> The most well-known and successful cryptocurrency is undoubtedly Bitcoin, which was created in 2009.<sup>28</sup> The mysterious Satoshi Nakamoto is said to be the creator of Bitcoin.<sup>29</sup> However, historically speaking, the idea of digital currency predates the advent of Bitcoin by some ten or so years. In theory, at least, virtual currencies were being developed as early as 1998.<sup>30</sup> Bitcoin’s first valuation occurred in 2010, where the infamous story goes that 10,000 Bitcoins were traded for the value of two pizzas!<sup>31</sup> Indeed, the success of Bitcoin has pathed the way for other crypto assets to emerge.<sup>32</sup>

The Bank of England’s central mission is to ‘to promote the good of the people of the United Kingdom by maintaining monetary and financial stability’.<sup>33</sup> In the light of this mission statement, the Bank sees cryptocurrency as a significant challenge for future market regulation.<sup>34</sup> It has therefore analysed the nature of crypto assets to determine how it may approach cryptocurrencies in its drafting of future policy.<sup>35</sup> The Bank usefully explains cryptocurrency as a term by breaking up the word in two parts. First, it looks at the meaning

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<sup>26</sup> n. 21.

<sup>27</sup> Bank of England, ‘What are cryptoassets?’ (*BOE*, 2020) <<https://www.bankofengland.co.uk/knowledgebank/what-are-cryptocurrencies>> accessed 12 December 2022.

<sup>28</sup> B Marr, ‘A Short History of Bitcoin and Crypto Currency Everyone Should Read’ (*Forbes*, 2017) <<https://www.forbes.com/sites/bernardmarr/2017/12/06/a-short-history-of-bitcoin-and-crypto-currency-everyone-should-read/?sh=3901143a3f27>> accessed 12 December 2022.

<sup>29</sup> S Nakamoto, ‘Bitcoin: A Peer-to-Peer Electronic Cash System’ (2009) <[https://www.ussc.gov/sites/default/files/pdf/training/annual-national-training-seminar/2018/Emerging\\_Tech\\_Bitcoin\\_Crypto.pdf](https://www.ussc.gov/sites/default/files/pdf/training/annual-national-training-seminar/2018/Emerging_Tech_Bitcoin_Crypto.pdf)> accessed 12 December 2022.

<sup>30</sup> n. 28.

<sup>31</sup> *ibid.*

<sup>32</sup> n. 27.

<sup>33</sup> *ibid.*

<sup>34</sup> *ibid.*

<sup>35</sup> *ibid.*

of the word “crypto” in this context. The Bank suggests that ‘The first part of the word “crypto”, means “hidden” or “secret” reflecting the secure technology used to record who owns what, and for making payments between users.’<sup>36</sup> Thereafter the report goes on to evaluate the meaning behind the word “currency”, stating that: ‘The second part of the word, “currency”, tells us the reason cryptocurrencies were designed in the first place: a type of electronic cash.’<sup>37</sup> However, the Bank distinguishes crypto assets from physical currency. It says that crypto assets ‘exist electronically and use a peer-to-peer system. There is no central bank or government to manage the system or step in if something goes wrong.’<sup>38</sup> Some may see this degree of autonomy as a significant benefit to crypto assets, but this article shall show this to be a significant market risk in a future section.

There are different ways in which cryptocurrency may be made.<sup>39</sup> The most widely known method of cryptocurrency creation is “mining”, whereby computers are used to analyse and work out complex mathematical problems.<sup>40</sup> This is an expensive process by virtue of the computing power that is required for a crypto asset to be mined.<sup>41</sup> The transactions are recorded ‘on a public log of who owns what... This log is known as the distributed ledger.’<sup>42</sup> The ledger, also known as the “blockchain”, acts as a form of security as the crypto assets are linked together in blocks.<sup>43</sup> The Bank of England states that ‘Each block includes a reference to the previous one, linking them all together in a long chain. Linking the blocks together in this way makes it very difficult to tamper with the ledger.’<sup>44</sup>

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<sup>36</sup> *ibid.*

<sup>37</sup> *ibid.*

<sup>38</sup> *ibid.*

<sup>39</sup> *ibid.*

<sup>40</sup> *ibid.*

<sup>41</sup> *ibid.*

<sup>42</sup> *ibid.*

<sup>43</sup> *ibid.*

<sup>44</sup> *ibid.*

Once made, cryptocurrencies are then traded on trading platforms.<sup>45</sup> However, the lack of regulation of these platforms is a significant risk for investors in the cryptocurrency market, as shall be discussed below.

## **Trusts law and cryptocurrencies**

This section analyses whether cryptocurrencies can be held as a form of legal “property” and, as such, can form the subject matter of a trust. Following this, there is a discussion of the fiduciary investment duty that trustees owe to their principals (the beneficiaries).

### ***Is cryptocurrency “property” and capable of forming the subject matter of a trust?***

Before setting out the risks posed to trustees, it is important, for context, to provide an overview of the law. It is noteworthy that the author’s understanding of this highly complex area has been greatly assisted by several sources, but none more so than a feature written by Cooper in 2020 on the law of trusts and its application to “virtual property”.<sup>46</sup> Furthermore, the Taskforce’s 2019 report, titled ‘Legal statement on cryptoassets and smart contracts’ (2019),<sup>47</sup> has also been an important resource to draw upon.

The legal concept of “property” is ‘part of the lexicon of the law’.<sup>48</sup> It describes a legal relationship that a person has with an object or thing, as opposed to describing the object or thing itself.<sup>49</sup> Therefore, understanding the concept of property is important for understanding the relationship that people have with cryptocurrencies. For instance, if crypto

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<sup>45</sup> *ibid.*

<sup>46</sup> n. 7.

<sup>47</sup> n. 19.

<sup>48</sup> *ibid.*, para 37.

<sup>49</sup> *ibid.*, para 35.

assets are not to be determined as legal property, such assets would be rendered incapable of forming the subject matter of a trust.<sup>50</sup> In truth, if cryptoassets are not property they do not pose any direct risk to trustees, although there may be associated indirect risks that impact, for instance, the value of trust property.

It goes without saying that the law's application to virtual currencies has been made somewhat difficult by the asset's unique nature.<sup>51</sup> Property law has shown that "pure information" cannot be property.<sup>52</sup> For example, in *Fairstar Heavy Transport NV v Adkins and another* [2012] EWHC 2952 (TCC) it was held that property rights are not created in emails, as such electronic communication is a form of pure information.<sup>53</sup> In one case involving the hacking and later insolvency of a cryptocurrency exchange, the liquidators argued that cryptocurrency should be viewed as a form of "pure information" rather than property.<sup>54</sup> In that case the court disagreed with the argument put forward by the liquidators and adjudged cryptocurrencies to be property at common law.<sup>55</sup> This is in line with the Taskforce's findings, which suggest that 'cryptoassets have all of the indicia of property'.<sup>56</sup> Moreover, at paragraph 36 of the 2019 report, the Taskforce sets out why it matters that a cryptoasset is capable of existing as property, as follows:

It matters because in principle proprietary rights are recognised against the whole world, whereas other – personal – rights are recognised only against someone who has assumed a relevant legal duty. Proprietary rights are of particular importance in an insolvency, where they generally have priority over claims by creditors, and when someone seeks to recover something that has been lost, stolen or unlawfully taken.

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<sup>50</sup> *ibid*, para 36.

<sup>51</sup> *ibid*.

<sup>52</sup> *Fairstar Heavy Transport NV v Adkins and another* [2012] EWHC 2952 (TCC)

<sup>53</sup> *ibid*.

<sup>54</sup> n. 11.

<sup>55</sup> *ibid*.

<sup>56</sup> n. 19, 7.

They are also relevant to the questions of whether there can be a security interest in a cryptoasset and whether a cryptoasset can be held on trust.<sup>57</sup>

Cooper's analysis has led him to opine that 'The courts have so far taken the view, consistently with the view of most commentators, that cryptocurrencies are, or at least can be, a form of property.'<sup>58</sup> In coming to this conclusion Cooper cites the case of *AA v Persons Unknown* [2020] 4 WLR 35, in which a proprietary injunction was served against cryptocurrency.<sup>59</sup> Another English authority that also dealt with a freezing order application in respect to bitcoin and ether, and can be cited with approval, is *Vorotyntseva v Money-4 Ltd t/a Nebeus.Com* [2018] EWHC 2596 (Ch).<sup>60</sup> Helpfully, Cooper provides further persuasive precedent to assist in demonstrating that cryptoassets should be seen as "property".<sup>61</sup> He cites, for instance, the case of *B2C2 Ltd v Quoine Pte Ltd* [2019] SGHC(I) 03, in which the Singaporean High Court was required to determine whether cryptocurrency could be property.<sup>62</sup> The court in *B2C2 v Quoine* assessed cryptocurrencies against Lord Wilberforce's definition of "property right", in *National Provincial Bank v Ainsworth* [1965] 1 AC 1175.<sup>63</sup> In so doing it was satisfied that cryptoassets meet the *Ainsworth* criteria of being 'definable, identifiable by third parties, capable in its nature of assumption by third parties, and having some degree of permanence or stability.'<sup>64</sup> In *B2C2 v Quoine* the court stated *obiter* that it was content that cryptocurrencies were property and could form the subject matter of a trust.<sup>65</sup> However, a case analysis of *B2C2 v Quoine* by the law firm

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<sup>57</sup> *ibid*, para 36.

<sup>58</sup> n. 7, 751.

<sup>59</sup> *AA v Persons Unknown* [2020] 4 WLR 35.

<sup>60</sup> *Vorotyntseva v Money-4 Ltd t/a Nebeus.Com* [2018] EWHC 2596 (Ch).

<sup>61</sup> n. 7, 751-752.

<sup>62</sup> *B2C2 Ltd v Quoine Pte Ltd* [2019] SGHC(I) 03.

<sup>63</sup> *National Provincial Bank v Ainsworth* [1965] 1 AC 1175.

<sup>64</sup> *ibid*.

<sup>65</sup> n. 62.

Norton Rose Fulbright suggests a regulatory gap still remains.<sup>66</sup> In short, the firm's analysis is that, on this legal point at least, the court could (and should) have gone further in its evaluation:

Regrettably, the court did not consider the precise nature of the property right (as that point was not in dispute), although it noted that it was the subject of academic debate. It is disappointing that this opportunity was not taken, as the nature of the property right is important. For example, it will be critical in ascertaining the location of property (its *situs*) and the law governing transfers of property (that is, *alienation*). It is also significant in matters of insolvency, insurance, inheritance and taxation, amongst others.<sup>67</sup>

Cooper questions whether cryptocurrency should be seen as a “chose in possession” or a “chose in action”.<sup>68</sup> Solinas agrees with Cooper's reasoning and goes on to say that ‘One of the difficulties in legal taxonomy faced by Gendall J in [*Cryptopia*] was that cryptocurrencies are difficult to square with the traditional boundaries of personal property, as they are not technically choses in action nor choses in possession.’<sup>69</sup> While some no doubt think that the lack of central regulation of the crypto market is liberating, it has nevertheless been identified as an issue. Cooper argues that: ‘Because there is no centralised issuer of the cryptocurrency unit, it is very difficult to identify, in legal terms, where the asset is, or to define exactly what

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<sup>66</sup> ‘Singapore court's cryptocurrency decision: Implications for cryptocurrency trading, smart contracts and AI’ (Norton Rose Fulbright, 2019) <<https://www.nortonrosefulbright.com/en-gb/knowledge/publications/6a118f69/singapore-courts-cryptocurrency-decision-implications-for-trading-smart-contracts-and-ai>> accessed 13 December 2022.

<sup>67</sup> *ibid.*

<sup>68</sup> n. 7, 751-752.

<sup>69</sup> n. 13, 159.

it is that the purchaser actually “has”.<sup>70</sup> This is also something that was identified in *B2C2 v Quoine*.<sup>71</sup>

As the above case has identified cryptocurrencies to be a type of “intangible” property, it is thereafter interesting to surmise the application of the trusts law cases surrounding the segregation of property from a homogenous mass. This issue that arose in the New Zealand High Court case of *Ruscoe v Cryptopia Ltd (in Liquidation)* [2020] NZHC 728.<sup>72</sup> In *Cryptopia* the court was asked to assess cryptocurrencies against the backdrop of section 2 of the Companies Act 1993 (New Zealand).<sup>73</sup> Solinas has stated that *Cryptopia* ‘offers a good illustration of the existing gulf between the techno-utopian perception of the cryptocurrency world and the reality of market practice.’<sup>74</sup> In his analysis of the *Cryptopia* case, Cooper suggests that problems with certainty could arise where cryptocurrencies are owned by different individuals but nevertheless are ‘not segregated into separate “wallets”’.<sup>75</sup>

The group of cases that may be cited to shed some light on segregation issues within digital wallets are well known to undergraduate trusts students throughout the UK. The overarching legal principle governing this area is that the subject matter (property) of a trust must be identifiable.<sup>76</sup> If property is not identifiable, the trust will fail for being too uncertain and property rights will not confer title (which is particularly important in insolvency situations).<sup>77</sup> Together with the property, the beneficial interest of the subject matter must be ascertainable.<sup>78</sup> Ultimately, this is important where the trust property forms a part of a larger,

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<sup>70</sup> n. 7, 751.

<sup>71</sup> n. 66.

<sup>72</sup> n. 11.

<sup>73</sup> Companies Act 1993 (NZ), s.2.

<sup>74</sup> n. 13, 155.

<sup>75</sup> n. 7, 752.

<sup>76</sup> See, *Re London Wine Co (Shippers) Ltd* [1986] PCC 121; *Re Goldcorp Exchange Ltd* [1994] UKPC 3.

<sup>77</sup> *ibid.*

<sup>78</sup> *Boyce v Boyce* (1849) 60 ER 959. Cf. *Re Golay's Will Trusts* [1965] 1 WLR 969.

homogenous mass. The trust failed for want of uncertainty in *Palmer v Simmonds* (1854) 2 Drew 221 as the testator bequeathed ‘the bulk of my said residuary estate’ to the beneficiary.<sup>79</sup> The bequest was deemed too uncertain an allocation to identify the property from the homogenous residuary estate.<sup>80</sup>

Importantly for cryptoassets the courts have distinguished “true homogenous masses” (e.g., shares) from “apparent homogenous masses” (e.g., chattels).<sup>81</sup> On that basis, it is likely that *Re London Wine Co (Shippers) Ltd* [1986] PCC 121 does not apply to cryptocurrencies as that the case concerned tangible property (i.e., wine bottles) stored in a warehouse that were not segregated from the bulk of non-trust property.<sup>82</sup> The court in *Re London Wine* held that tangible trust property that is commingled with a fungible mass makes the trust uncertain as the property is not capable of segregation.<sup>83</sup> However, *Hunter v Moss* [1994] 1 WLR 452 distinguished *Re London Wine* on the ground that the court had to determine the certainty of intangible property that formed the subject matter of a trust (i.e., shares) and were not segregated from the bulk.<sup>84</sup> In *Hunter* the Court of Appeal viewed shares as a truly homogenous mass and, as a precedent, is distinguishable from cases such as *Re London Wine*.<sup>85</sup> The decision in *Hunter v Moss* has received mixed reviews.<sup>86</sup> Nevertheless, it may be speculated that *Hunter* would be applied to cryptoassets instead of *Re London Wine*, with the latter being distinguished on the ground that it dealt with tangible property.<sup>87</sup> *Re Goldcorp Exchange Ltd* [1995] 1 AC 74, a case involving a unsegregated, fungible mass of

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<sup>79</sup> *Palmer v Simmonds* (1854) 2 Drew 221,

<sup>80</sup> *ibid.*

<sup>81</sup> *Hunter v Moss* [1994] 1 WLR 452.

<sup>82</sup> *Re London Wine Co (Shippers) Ltd* [1986] PCC 121.

<sup>83</sup> *ibid.*

<sup>84</sup> n. 81.

<sup>85</sup> *ibid.*

<sup>86</sup> See, amongst others, Jill Martin, ‘Certainty of Subject Matter: A Defence of *Hunter v Moss*’ [1993] Cov 446; cf. David Hayton, ‘Uncertainty of subject-matter of trusts’ (1994) 110 LQR 335.

<sup>87</sup> n. 13, 162-163.

gold bullion was distinguished in *Cryptopia* on the ground that it concerned the sale of goods.<sup>88</sup> Cooper is reserved about *Cryptopia*'s treatment of *Re Goldcorp Exchange* on the basis that cryptocurrency is fully fungible.<sup>89</sup> However, Solinas, referring to Cutts,<sup>90</sup> states the following:

It is a misconception to speak of holding and transferring particular book-entry cryptocurrencies as if they were physical assets capable of segregation. As cryptocurrency transactions occur pseudonymously, it is impossible to ascertain the identity of the counterparties in order to identify which specific cryptocurrencies are to be the subject matter of the trust.<sup>91</sup>

Felicitously, further support for cryptocurrency constituting property can be seen most recently in the decision of *Wang v Darby* [2021] EWHC 3054 (Comm), which concludes the matter for the time being.<sup>92</sup>

### ***What is the fiduciary duty of investment that trustees owe to their beneficiaries?***

This section assists in explaining how a trustee may be made directly and personally liable for cryptocurrency investment. Trustees owe their beneficiaries a duty of care.<sup>93</sup> In relation to cryptoassets proper risk exposure may occur *ex officio*, by virtue of the statutory investment duty that trustees must exercise. The nature of this duty is outlined here.

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<sup>88</sup> *Re Goldcorp Exchange Ltd* [1995] 1 AC 74.

<sup>89</sup> n. 7, 752-753.

<sup>90</sup> n. 13, citing Tatiana Cutts, 'Smart Contracts and Consumers' (2019) 122 W Va L Rev 389, 434.

<sup>91</sup> *ibid*, 162.

<sup>92</sup> *Wang v Darby* [2021] EWHC 3054 (Comm).

<sup>93</sup> The common law duty is outlined in *Learoyd v Whiteley* [1887] UKHL 1; on the other hand, the statutory duty of care can be found in the Trustees Act 2000, s.1.

A breach of trust is where ‘a trustee contravenes the terms of the trust or fails to carry out their duties will be in breach of trust.’<sup>94</sup> Where a breach is committed, the beneficiary may bring a claim and hold the trustee personally liable to recover the property;<sup>95</sup> this is also true for charitable trusts.<sup>96</sup> Whether a breach has occurred is dependent upon the type of trust at issue,<sup>97</sup> and the skill and care that are taken ‘as is reasonable in the circumstances of the case making allowance for [any] specialist knowledge, experience or professional status.’<sup>98</sup> Thus the law distinguishes between professional and amateur trustees, and rightly so. The Trustee Act 2000 Explanatory Notes states that with ‘the purchase of stocks and shares, a higher standard may be expected of a trustee who is an investment banker, specialising in equities, than of a trustee who is a beekeeper.’<sup>99</sup>

Upon becoming a trustee, the legal title holder (the trustee) also becomes a fiduciary.<sup>100</sup> This fiduciary duty means that trustees have a duty of “loyalty”<sup>101</sup> towards their beneficiaries and are normally prohibited from ‘having a conflict, or potential conflict, of interests, and/or not profiting from [their] positions’ without the principal’s consent.<sup>102</sup> Thus, taking a bribe or secret commission, without consent, would be a breach of loyalty and the agent would hold the property for the principal.<sup>103</sup> The office of trustee is an apparent

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<sup>94</sup> ‘Breach of trustee duties explained’ *The Gazette* (London, 26 April 2021) <<https://www.thegazette.co.uk/all-notices/content/103922>> accessed 13 December 2022.

<sup>95</sup> *ibid.*

<sup>96</sup> Charity Commission, ‘Charity Commission policy on restitution and the recovery of charitable funds misappropriated or lost to charity in breach of trust’ (no date) <<https://www.gov.uk/government/publications/how-we-ensure-charities-meet-their-legal-requirements/our-policy-on-restitution-and-the-recovery-of-charitable-funds-misappropriated-or-lost-to-charity-in-breach-of-trust>> accessed 13 December 2022.

<sup>97</sup> n. 94.

<sup>98</sup> Trustee Act 2000, s.1(1)(a) and (b).

<sup>99</sup> ‘Trustee Act 2000: Explanatory Notes’ (2000)

<<https://www.legislation.gov.uk/ukpga/2000/29/notes/division/5/1>> accessed 13 December 2022.

<sup>100</sup> Parker Hood, *Principles of Lender Liability* (OUP 2012) 234.

<sup>101</sup> *ibid.*, 237.

<sup>102</sup> BJ Richardson, ‘Fiduciary Relationships for Socially Responsible Investing: A Multinational Perspective’ (2011) 48(3) *American Business Law Journal* 597.

<sup>103</sup> *FHR European Ventures LLP & Ors v Cedar Capital Partners LLC* [2014] UKSC 45.

fiduciary relationship, meaning that all trustees are fiduciaries.<sup>104</sup> However, this is unlike the situation for some relationships which are usually conducted at “arm’s length”, and an event or circumstance triggers the imposition of fiduciary duties.<sup>105</sup>

Trustees have a specific powers and duties when it comes to the investment of the trust property.<sup>106</sup> These can be found codified in Part II of the Trustee Act 2000.<sup>107</sup> Section 3 states the following: ‘Subject to the provisions of this Part, a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust.’<sup>108</sup> This section sets out the trustees’ “general power of investment”,<sup>109</sup> although this general power is restricted for investments in land<sup>110</sup> and, still further, by any provision set out in the trust instrument.

The extant investment power has been determined in the courts, most notably in the case of *Cowan v Scargill* [1985] Ch 270.<sup>111</sup> *Cowan* concerned the general strategy to be adopted for the National Coal Board’s (NCB) pension fund (of some £3 million assets).<sup>112</sup> Together with five NCB members, the board of pension trustees further consisted of five members of the National Union of Mineworkers (NUM).<sup>113</sup> The NUM wanted the adoption of an investment strategy which, inter alia, ceased new overseas investment and the withdrawal of any investments that compete with coal.<sup>114</sup> This strategy was, of course, at the behest of the NCB members.<sup>115</sup> Sir Robert Megarry VC held that the NUM board members

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<sup>104</sup> n. 100, 235.

<sup>105</sup> *ibid*, 241.

<sup>106</sup> Graham Virgo, *The Principles of Equity & Trusts* (4<sup>th</sup> edn, OUP 2020) 363-445.

<sup>107</sup> Trustee Act 2000.

<sup>108</sup> *ibid*, s.3.

<sup>109</sup> *ibid*, s.3(2).

<sup>110</sup> *ibid*, s.3(3).

<sup>111</sup> *Cowan v Scargill* [1985] Ch 270.

<sup>112</sup> *ibid* 277.

<sup>113</sup> *ibid* 276

<sup>114</sup> *ibid*.

<sup>115</sup> *ibid*.

could not follow the Union’s proposals, opining that such an action would result in a breach of trust.<sup>116</sup> The VC stated that trustees ‘[M]ust put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests.’<sup>117</sup> This certainly does not mean, as some may suggest, that the trustees cannot invest ethically.<sup>118</sup> However, it does show the boundaries of the trustees’ investment power. It is noteworthy that charitable trusts are treated more leniently, for obvious reasons.<sup>119</sup>

Part II also outlines the Standard Investment Criteria (SIC) to apply,<sup>120</sup> as well as the need for trustees to take the appropriate advice.<sup>121</sup> Section 4(1) states that, ‘In exercising any power of investment, whether arising under this Part or otherwise, a trustee must have regard to the standard investment criteria.’<sup>122</sup> In so doing a trustee ‘must from time to time review the investments of the trust and consider whether, having regard to the standard investment criteria, they should be varied.’<sup>123</sup> The SIC require an evaluation of ‘the suitability to the trust of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind.’<sup>124</sup> And, moreover, trustees must consider ‘the need for diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust.’<sup>125</sup> This section describes the modern investment strategy that is adopted by trustees, being “portfolio theory”.<sup>126</sup> Under this

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<sup>116</sup> *ibid.*

<sup>117</sup> *ibid* 287.

<sup>118</sup> Lloyd Brown, ‘*Cowan v Scargill* and the fiduciary duty of investment: has the nature of the investment duty changed and what is currently driving “socially responsible investing” in pension schemes’ (2020) 26(8-9) *Trust & Trustees* 756.

<sup>119</sup> *Harries v The Church Commissioners for England* [1992] 1 WLR 1241.

<sup>120</sup> Trustee Act 2000, s.4.

<sup>121</sup> *ibid*, s.5.

<sup>122</sup> *ibid*, s.4(1).

<sup>123</sup> *ibid*, s.4(2).

<sup>124</sup> *ibid*, s.4(3)(a).

<sup>125</sup> *ibid*, s.4(3)(b).

<sup>126</sup> n. 106, 406, citing Ford, ‘Trustee investment and modern portfolio theory’ (1996) 10 *TLI* 102.

strategy trustees are not concerned with the risks posed by specific investments, but rather how a given investment impacts the wider “portfolio”.<sup>127</sup> In truth cryptocurrencies can be purchased, as high risk investments are permitted so long as the portfolio is balanced.<sup>128</sup>

Trustees need to acquire the appropriate advice under section 5 before exercising their section 3 power, viz.:<sup>129</sup>

(1) Before exercising any power of investment, whether arising under this Part or otherwise, a trustee must (unless the exception applies) obtain and consider proper advice about the way in which, having regard to the standard investment criteria, the power should be exercised.<sup>130</sup>

This must also be carried out when reviewing the trust fund’s investments.<sup>131</sup> However, section 5(3) permits an exception to obtaining advice where the trustee ‘reasonably concludes that in all the circumstances it is unnecessary or inappropriate to do so.’<sup>132</sup> Moreover, “proper advice” is defined as ‘the advice of a person who is reasonably believed by the trustee to be qualified to give it by his ability in and practical experience of financial and other matters relating to the proposed investment.’<sup>133</sup>

### **What are the risks for trustees from cryptocurrencies?**

This section of the article outlines the different risks that can emerge for trustees from crypto assets and establishes a risk profile. Given that cryptocurrencies are likely to form a more

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<sup>127</sup> *ibid.*

<sup>128</sup> *ibid.*

<sup>129</sup> Trustee Act 2000, s.5.

<sup>130</sup> *ibid.*, s.5(1).

<sup>131</sup> *ibid.*, s.5(2).

<sup>132</sup> *ibid.*, s.5(3).

<sup>133</sup> *ibid.*, s.5(4).

important part of trust investment strategies in the future, it is necessary to better understand the associated risks for trustees. This section begins by looking at “regulatory risk”, which directly affects trustees personally. Market risk and reputational risk are more indirect in nature but can still greatly impact the trustees’ investment strategy and, more importantly still, the value of the trust fund which they manage.

### ***Regulatory risk***

Cryptocurrencies create “regulatory risks” for trustees. A great risk arises because of the existing regulatory gaps. At the present time of writing there are significant holes in the regulation governing cryptocurrencies, and this creates a shroud of uncertainty around this asset. This article has shown that the law governing cryptocurrencies is still in its infancy and, in truth, requires much greater development.

Furthermore, trustees are subject to the direct, personal liability risk that they can incur from exercising their investment duty. However, this risk is manageable so long as trustees comply fully with their statutory duties, as outlined in the section above. Under their statutory investment duty, it is evident that trustees can purchase cryptoassets as an investment opportunity. As stated above, trustees take a portfolio approach to investing, and, under the SIC, cryptocurrency may be seen as a diverse asset. So, while cryptocurrency would be considered a “high” risk, it is nevertheless capable of being acquired so long as the portfolio’s overall risk strategy is sound.

That said, it is evident that sections 4 and 5 of the Trustee Act 2000 create a direct liability risk for trustees. For instance, if a trustee invests in a cryptocurrency because they believe it to be a worthwhile investment, then a failure to consider the SIC and/or obtain the proper advice could lead to a breach of fiduciary duty. Given that cryptocurrencies are such a

volatile asset, it may be argued that the “suitability” of such assets must be scrutinised very carefully before acquisition.

### ***Market risk***

Market risk may be defined ‘as the risk of losses in on and off-balance-sheet positions arising from movements in market prices.’<sup>134</sup> This section argues that cryptocurrency is such a volatile market that it presents a significant risk for trustees. Cooper acknowledges this risk and suggests, for example, that ‘Cryptocurrencies are currently too volatile and speculative to be regarded as a sound, or even plausible, trust investment.’<sup>135</sup> Nevertheless, given the popularity and growth of cryptocurrencies, the above author nevertheless stipulates that the future of trusts’ investment strategies is likely to bring ‘at least an element of exposure’ to cryptoassets.<sup>136</sup> Hence the need to evaluate and understand the inherent risks involved.

Recently cryptoassets’ reputation has taken a significant hit in the light of the collapse of FTX; this event has well demonstrated the volatility and risks in this market. *The Financial Times* has reported thoroughly on FTX’s demise, which has resulted in a financial hole of \$8bn and 1 million creditors are now left out of pocket.<sup>137</sup> In consequence, FTX’s founder has been indicted in eight criminal courts and has been described as a perpetrator of ‘one of the biggest financial frauds’.<sup>138</sup> *The Financial Times* has described this dire situation as follows:

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<sup>134</sup> BIS, ‘Definition and application for market risk’ (*BIS*, 15 December 2019) <[https://www.bis.org/basel\\_framework/chapter/MAR/10.htm](https://www.bis.org/basel_framework/chapter/MAR/10.htm)> accessed 14 December 2022.

<sup>135</sup> n. 7, 754.

<sup>136</sup> *ibid.*

<sup>137</sup> n. 5.

<sup>138</sup> S Palma, J Chaffin, J Oliver and K Shubber, ‘Sam Bankman-Fried charged in one of “biggest financial frauds” in US history’ *Financial Times* (London, 13 December 2022).

A near-existential disaster seems to have hit the cryptosphere: FTX, a big exchange that enjoyed a \$32bn valuation in January, has collapsed with an \$8bn hole. FTX's founder, Sam Bankman-Fried – hitherto crypto's friendly face – is mired in allegations that his firm misplaced or misused client money. Confidence in the wider crypto market – its stock-in-trade – has been badly hit, with bitcoin tumbling in value. The time for politicians, policymakers and regulators to put protections in place is now.<sup>139</sup>

Virtual currency has always prided itself on its unregulated status, its unfettered standing from the central banks. In consequence, many that believe in cryptocurrency see its segregated status as a part of its overall identity. But this section on market risk largely links to the one above. Ultimately, it is a cogent argument to suggest that the collapse of FTX – and subsequent indictment of Bankman-Fried – demonstrates that greater regulation is required for cryptocurrency, to reduce market risk. Together with general market volatility and trading platform fraud, cybersecurity risks must also be taken seriously with virtual currencies.<sup>140</sup>

### ***Reputational risk***

At the present time of writing, it may be argued that trustees that invest in cryptocurrency are risking their reputations. This indirect risk is potentially more problematic for professional trustees as opposed to amateur ones, lest they impact their careers. Trustees may consider cryptocurrency to be a high risk yet worthwhile investment, but they should proceed with caution. The case of *Cowan v Scargill*, as previously discussed, shows the reputational risk

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<sup>139</sup> n. 5.

<sup>140</sup> Z Amos, 'The Cybersecurity Risks of Cryptocurrency' (*CyberSecurity Magazine*, 4 March 2022) <<https://cybersecurity-magazine.com/the-cybersecurity-risks-of-cryptocurrency/>> accessed 14 December 2022.

of being a trustee. In that case, the NCB's evaluation of the general investment strategy was met with much vitriol from the Union and the pension fund's beneficiaries. It is sometimes necessary to make difficult decisions as a trustee, but the beneficiaries' best interests (being their financial interests) are paramount. Indeed, the role of the pension trustee can be seen as particularly ignominious on account of the size of the trust funds and the number of beneficiaries being managed in the trust administration.

## **Conclusion**

In conclusion, this article has set out the law of trusts relating to cryptocurrency. It established from its analysis that cryptoassets are legal property and, as such, can form the subject matter of a trust. Furthermore, trustees can invest in cryptocurrency under statutory investment duty, so long as this is permitted by the trust instrument. Having looked at the law relating to this enigmatic asset, the article thereafter set out the risks that may impact trustees specially, in carrying out their statutory investment duty. Three main risks were identified: (i) regulatory risk; (ii) market risk; and (iii) reputational risk. In assessing the risks, it became apparent that further regulation is required to quell the resting uncertainty that plagues this area.

**Word count: 5930**