

Legal Commentary

November 25, 2024

Judicial Disposal of Crypto Currencies in China: Legislation, Challenges, Risks and Way Out

Authors: Andy (Ronghua) LIAO | Candice (Yanhui) LI | Yafei XIANG

Crypto currencies (also known as crypto assets) have seen rapid development since Bitcoin's emergence during the financial crisis in 2008. Due to their anonymity and privacy, crypto currencies are widely used for illegal and criminal activities and serve as a tool to evade judicial accountability. In response to the increasingly frequent criminal cases involving crypto currency, Chinese governments grapple with the complexities of judicial disposal at both policy and practice levels. This article reviews current crypto currencies legislation, analyzes the challenges and legal risks in its judicial disposal, and proposes measures for more effective regulation.

Current crypto currency legislation

I. Legislation on the classification of crypto currency

1. Circular on Preventing the Risks of Bitcoin

On December 3, 2013, the People's Bank of China (PBoC) and other authorities issued the Circular on Preventing the Risks of Bitcoin, which specifically targeted Bitcoin. It was the first document to assert that "*Bitcoin does not possess the attributes of currency*" and "*prohibited financial institutions from engaging in any Bitcoin-related business*".

2. Announcement on Guarding Against the Risks of Financing by Token Offering

On September 4, 2017, due to the emergence of financing activities involving crypto currency issuances, the PBoC and other authorities issued the Announcement on Guarding Against the Risks of Financing by Token Offering, expanding the scope of regulation from Bitcoin to all crypto currencies, out of the consideration for maintaining financial stability. The PBoC reiterated that "*crypto currencies do not have the attributes of currency*" and "*prohibiting financial institutions and non-banking payment institutions from carrying out business related to financing by token offering*". Then, it clarified that "*no organization or individual may illegally engage in activities of financing by token offering*" and expanded the prohibition of crypto currency exchange business from financial institutions and non-banking payment institutions to "*any so-called token financing trading platform*".

3. Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks

On September 15, 2021, to safeguard China's overall economic security and social stability, the PBoC, along with ten other authorities, issued the Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks. This circular maintains a strong stance against crypto currencies and related business activities. The notice not only reiterates that crypto currencies do not have the attributes of currency, but also clearly defines crypto currency-related business activities as "illegal financial activities". The circular specifies that "relevant civil legal acts are invalid, and any loss arising therefrom shall be borne by the investor", and noted for the first time that "services provided by overseas exchanges to domestic residents also constitute illegal financial activities".

4. Minutes of the National Court Financial Trial Work Conference (Draft for Comments)

The administrative departments of China have shown a trend of increasingly strict supervision of crypto currencies and business activities, as evidenced by the Circular on Preventing the Risks of Bitcoin, issued in 2013, the Announcement on Guarding Against the Risks of Financing by Token Offering, issued in 2017, and the Circular on Further Preventing and Disposing of Crypto currency Trading Speculation Risks, issued in 2021. However, with the increasing number of disputes related to crypto currency transactions, the views of the judiciary in practice are not entirely consistent with those of the regulatory authorities, and the courts also face the issue of unifying judgment standards. Therefore, the Supreme People's Court specifically drafted rules in January 2023 for adjudication of disputes related to crypto currency in the Minutes of the National Court Financial Trial Work Conference (Draft for Comments) (hereinafter referred to as the "Minutes of the Financial Conference (Draft for Comments)").

II. Rules related to the management and disposal of crypto currency

1. Guidelines for Handling Crypto Currency Cases by the Economic Crime Investigation Department of Public Security Organs (Trial Implementation)

The Guidelines for Handling Crypto Currency Cases by the Economic Crime Investigation Department of Public Security Organs (Trial Implementation) outline procedural requirements for investigating and handling crypto currency cases, including investigation, seizure, custody, and recovery.

2. Minutes of the Financial Conference (Draft for Comments)

The Minutes of the Financial Conference (Draft for Comments) specify that courts must determine the status of crypto currency holdings and the feasibility of their delivery or return. After that, the court should make a specific determination as to whether to specify the delivery or return of crypto currency in the judgment and may take corresponding measures in accordance with the relevant provisions of the civil procedure law on the enforcement procedures.

3. Guidelines on Disposal of Crypto Currency Involved in Criminal Proceedings of Xuhui District, Shanghai, the Administrative Provisions of Fujian Province on the Management of Crypto Currency Involved in Criminal Cases, the Operating Rules of Shandong Province

for Disposal of Confiscated Items (Trial Implementation), the Guidelines for Investigation of Crypto Currency Involved Crime of Xiangcheng District, Suzhou City, Jiangsu Province, and other local regulations

In addition to the national regulations, various provinces and cities have also developed effective management strategies for crypto currency based on their case-handling experiences.

On August 29, 2024, in response to common problems and characteristics reflected in case handling, the People's Procuratorate of Xuhui District, Shanghai, and the Public Security Bureau of Xuhui District jointly signed the Guidelines on Disposal of Crypto Currency Involved in Criminal Proceedings. The Guidelines provide detailed and explicit regulations for the entire process and various stages involved in handling crypto currency cases, including investigation and evidence preservation, seizure and custody, and transfer and disposal, offering a specific guide for the lawful disposal of crypto currencies involved in cases.

Article 36 of the Operating Rules of Shandong Province for Disposal of Confiscated Items (Trial Implementation), jointly issued by the Shandong Provincial Department of Finance and other departments on August 25, 2023, stipulates that "*Prepaid cards and crypto currencies confiscated by law enforcement agencies according to the law may be negotiated with the issuing parties for repurchase. The repurchase price shall be determined through negotiation between both parties and, in principle, it shall not be lower than 80% of the face value or balance of the crypto currency or prepaid card. Both parties shall sign a repurchase agreement*".

The Fujian Provincial Public Security Department issued the Administrative Provisions of Fujian Province on the Management of Crypto Currency Involved in Criminal Cases in December 2023, which regulates the seizure, custody, and disposal of crypto currency.

The People's Procuratorate of Xiang Cheng District, Suzhou City, Jiangsu Province, after handling a fraud case involving crypto currency, summarized the experience and, with the office for supervision and cooperation in investigation, issued the Guidelines for Investigation of Crypto currency Involved Crime to the public security authorities in April 2022. The Guidelines incorporate 14 articles to analyze and summarize the issues of seizure of property, collection of evidence, and disposal of property in crypto currency cases, providing a comprehensive guide for the handling of cases involving crypto currencies.

Challenges in the judicial disposal of crypto currency

As mentioned above, business activities related to crypto currency, including the exchange between statutory currency and crypto currency, the exchange between crypto currencies, acting as a central counterparty in the exchange of crypto currency, providing intermediary and pricing services for crypto currency transactions, financing by token issuance, and the transactions of crypto currency derivatives, are all currently considered "illegal financial activities" and are strictly prohibited. Despite this, the emergence of crimes involving crypto currencies continues to rise. Consequently, public security and judicial authorities are inevitably confronted with the management and disposal of crypto currencies in their case handling.

Considering the actual transaction value of crypto currency, it is necessary to liquidate crypto currency for the purpose of asset recovery. However, some judicial and technical challenges are associated with their disposition. Currently, some central and local judicial authorities have established guidelines for the seizure, custody, and disposition of crypto currency to standardize these processes. However, some of these guidelines are still in the trial phase, lack specificity, and are not widely publicized.

Accordingly, the following sections examine the specific judicial and technical challenges involved in the seizure, custody, and disposition of crypto currency.

I. Seizure of crypto currency

Most crypto currencies are decentralized. They are neither tangible nor stored in a central institution which accounts for them. As a result, judicial authorities face difficulties in the process of seizing crypto currencies held by criminal suspects that are different from those encountered in the seizure of traditional assets.

Typically, crypto currencies are stored either in addresses controlled by the suspect or within a crypto currency exchange. These two scenarios are discussed in detail below.

1. Storage in addresses controlled by the criminal suspect

When crypto currencies are stored in addresses controlled by the suspect, their anonymous and confidential nature means that only the suspect is aware of the quantity, location, and private key associated with these currencies.

Firstly, unless the criminal suspect voluntarily confesses or the transaction process of obtaining crypto currencies is tracked through technical means, it is difficult for the judicial authorities to determine whether the suspect holds crypto currencies and, if so, the extent of their holdings.

Secondly, due to the high volatility in the trading value of crypto currencies, even if judicial authorities have control over the sources and the amounts of funds used by criminal suspects to exchange for crypto currencies, it is still difficult to determine the amount of crypto currencies obtained by the suspect unless the judicial authority has access to the specific process and time of the exchange for crypto currencies. The suspect may only confess to a portion of their holdings, thereby complicating the authorities' efforts to secure all related crypto currencies.

Thirdly, even with knowledge of the quantity and address of all the crypto currencies involved in the case, unless the suspect stores the private key in an electronic device, and that device is seized by the investigative authorities and the private key corresponding to the address where the crypto currencies are stored is obtained through a comprehensive examination of the information stored on it; otherwise, if the suspect does not disclose the private key information, and since it is technically impossible to reverse-engineer the private key from the address, the judicial authorities would likely find it very difficult to obtain the private key.

Lastly, for general electronic data, judicial authorities can control it by seizing physical media such as hard drives and USB drives. However, in cases where the seized items are crypto currencies, even if the suspect stores the private key in a physical medium and the judicial authorities have control of

the medium and knowledge of the private key information, it is difficult to prevent the suspect or their accomplices from immediately transferring the crypto currencies to other addresses through a backup private key.

2. Storage in a crypto currency exchange

In cases where crypto currencies are stored within an exchange, the cooperation of these exchanges, often based overseas due to domestic trading prohibitions, is crucial. The willingness of these overseas exchanges to cooperate with Chinese judicial authorities to seize and freeze crypto currency is uncertain.

If the overseas exchange is unwilling to cooperate, the judicial authority may only withdraw and seize the crypto currencies from the overseas exchange after the suspect provides its password and other relevant information.

Therefore, similar to the circumstance of suspect-controlled addresses mentioned above, the seizure of crypto currencies in overseas exchanges also requires the cooperation of the suspect, which introduces considerable difficulty and unpredictability into the judicial process.

II. The custody of crypto currency

If the judicial authorities can successfully complete the seizure of crypto currency, then further issues regarding the custody of crypto currency arise.

Unlike conventional currencies, which are stored in banks and directly frozen with the assistance of banks, crypto currencies pose a transfer risk if left in the possession of the suspect. Therefore, transferring crypto currency into a crypto currency wallet address established by judicial authorities and custody by these authorities is a feasible method currently adopted, but it comes with its own set of considerations.

Article 3 of Several Provisions of Public Security Authorities on Management of Involved Property stipulates that, “*The management of property involved shall follow the principles of separation between case handling and property management, clarity of sources and whereabouts, timely handling according to law, and comprehensive acceptance of supervision*”. In cases involving crypto currency, after judicial authorities obtain the private key from the suspect, since the private key is the fundamental means of controlling crypto currency, this means that the case handlers effectively control the crypto currencies, which may violate the principle of separation between case handling and property management. If the public security authorities do not establish a separate address, and instead, the case handlers transfer the crypto currencies to an address which the handlers establish and hold the private key to, it may also violate the foregoing principles.

A breach of the separation principle may lead to improper disposal of crypto currency by judicial authorities during the case handling process. Moreover, due to the unique nature of crypto currency, it is challenging to trace any covert transfers, and once transferred, it is also difficult to recover.

Furthermore, improper custody and lack of understanding of the relevant technical measures may also lead to the risk that the private key may be obtained by hackers through malicious software or programs,

leading to the loss of the custodied crypto currencies.

III. Value determination in the disposal of crypto currency

Determination of the value of crypto currency is an inevitably part of the process of crypto currency disposal.

The trading value of crypto currency often fluctuates significantly, making an accurate assessment difficult. In addition to providing grounds for judicial disposal, the determination of crypto currency prices also has a significant impact on the conviction and sentencing of the suspect. Meanwhile, if the methods for valuing crypto currency are not clear, it may create opportunities for some individuals to exploit this loophole for improper benefits, such as disposing of the crypto currencies at issue at a lower price for illegal profits.

In practice, the following four methods are generally adopted to determine the value of crypto currencies:

1. Determination through market price

Determination through market price refers to determining the value based on the current market price of the crypto currency.

Since China does not recognize the legality of crypto currency trading, it is impossible to use the so-called domestic market price of crypto currency. One potential approach is to determine the value of crypto currency based on its real-time trading price on overseas trading platforms, and then convert it into RMB through common intermediate currencies such as USDT and the U.S. dollar. However, the problem of this method is that the market price of crypto currency is highly volatile and unstable. Meanwhile, due to the illegality of crypto currency trading platforms in China, the legality of using the market price from overseas trading platforms is questionable.

2. Determination through proceeds of crime

Determination through proceeds of crime refers to assessing the value of crypto currencies based on the proceeds obtained by the criminal suspect from the sale of crypto currencies.

However, this method is not applicable when the criminal suspect has not yet sold the crypto currency. If the judicial authorities seize the crypto currencies and instruct the suspect to liquidate them, there is an inherent risk that the suspect may exploit the opportunity to transfer assets.

3. Determination through acquisition cost

Determination through acquisition cost refers to assessing the value based on the price paid by the criminal suspect or the victim to obtain the crypto currencies involved in the case.

This method is effective for calculating the victim's loss, but for the judicial disposition of the proceeds of crime, due to the volatility of the crypto currency market value, the price at which the criminal suspect or victim obtained the crypto currencies is often significantly different from the price at the time of judicial disposition.

4. Determination through price appraisal

Determination through price appraisal refers to entrusting an appraisal institution to appraise the value of crypto currency.

The method of price appraisal involves the issue of whether crypto currency falls within the scope of judicial appraisal. According to Article 2 of the Decision of the Standing Committee of the National People's Congress on the Management of Judicial Appraisal, "*The state shall implement a registration management system for appraisers and appraisal institutions engaged in the following judicial appraisal: (1) Forensic medical appraisal; (2) Physical evidence appraisal; (3) Audio-visual material appraisal; (4) Other appraisal matters that are registered and managed according to the requirement of legal proceedings, as determined by the State Council's judicial administrative department in consultation with the Supreme People's Court and the Supreme People's Procuratorate*".

The court determined the value of crypto currency through price appraisal in the theft case of Zhao tried by Intermediate People's Court of Dalian City, Liaoning Province [Case No.: (2021) Liao 02 Criminal Final No.258]. In that case, the court held that the price appraisal of crypto currency does not fall into the above four categories, and therefore no judicial appraisal is required.

Due to the qualification requirements for judicial appraisal institutions and the legal scope of judicial appraisal businesses, whether the appraisal of crypto currency should be included within the scope of judicial appraisal is a question worth clarification.

Legal risks in the disposal of crypto currency

In judicial practice, there are generally two methods for the judicial disposal of crypto currency: one is to manage and dispose of the crypto currency by judicial authorities, and the other is to entrust third-party institutions to dispose of the crypto currency. The following paragraphs analyze in detail the potential legal risks associated with these two disposal methods.

I. Legitimacy of judicial authorities' custody and disposal of crypto currency

In the process of judicial disposal of crypto currency, judicial authorities inevitably face issues regarding the legality of the storage and disposal of crypto currency, whether in the pre-judgment recovery of illegal gains or in the post-judgment enforcement of confiscated illegal gains.

As the Announcement on Guarding Against the Risks of Financing by Token Offering and the Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks repeatedly clarify that crypto currencies shall not circulate in the market, thus making the trading of crypto currencies strictly prohibited in China. However, there is still a lack of clear prohibitory regulations regarding the holding of crypto currency. As a public authority exercising judicial functions, judicial authorities are entitled to be in the custody of criminal proceeds, but the corresponding operational procedures still need to be specifically described. At the same time, the current regulations prohibit crypto currency trading, which raises questions about the legality of judicial authorities' disposal and liquidation of crypto currency.

II. Entrustment of third-party institutions for the custody and disposal of crypto currency

Since judicial authorities cannot directly conduct public auctions for crypto currency in China, and the disposal of crypto currency requires a certain level of expertise, judicial authorities may choose to entrust its disposal to a professional third-party institution.

The public security organs seized a large amount of crypto currency during the case handling process, including 190,000 BTC, 830,000 ETH, and 27,240,000 EOS in the case of Chen, Ding, et al., who were charged with organizing and leading pyramid schemes and concealing and hiding the proceeds of crime [Case No.: (2020) Su 09 Criminal Final No.488]. In this case, the public security organs entrusted a technology company in Beijing to liquidate the crypto currencies, and the proceeds were returned as illicit funds.

Compared with the direct disposal by judicial authorities, third-party institutions generally have advantages in technology, resources, and information. They are professional in the technical processing of crypto currency and have more liquidation channels of crypto currency and are familiar with the price and liquidation models of crypto currencies. In judicial practice, third-party agencies are also a popular choice for judicial authorities to facilitate judicial progress. However, the disposal of crypto currency has its own unique features, and the following issues are worth further analysis.

1. Legality of crypto currency disposal by a third-party institution

Firstly, the disposal and liquidation by third-party institutions inevitably raise concerns regarding compliance with existing regulations that prohibit crypto currency transactions.

Secondly, when accepting the entrustment, third-party institutions may encounter issues such as potential rent-seeking behavior, the reasonableness of their fee structures, and the legality of the fund flows involved.

Lastly, since China has banned crypto currency exchanges and characterized the trading of crypto currency as “illegal financial activities”, the liquidation of crypto currencies often necessitates overseas transactions, which may lead to issues including reporting and settlement of foreign exchange for overseas transactions. If third-party institutions declare and exchange foreign currency with false documents or other illegal methods, and finally exchange the crypto currency-related funds into RMB, they may be suspected of violating the foreign exchange administration system.

2. The pricing of fees charged by third-party institutions

The pricing of fees charged by third-party institutions is closely related to the value determination of crypto currency mentioned earlier. Due to the lack of legal provisions and specific standards, as well as the lack of market transparency caused by compliance issues, the standards for the intermediary fees charged by third-party institutions and the basis for the price of crypto currency liquidation are questionable.

In the absence of unified market rules and regulatory provisions, third-party institutions are likely to report excessively high liquidation and disposal costs and charge unreasonable intermediary fees. Due to the compliance issues of crypto currency transactions, there are fewer third-party institutions

capable and willing to dispose of crypto currency. Therefore, third-party institutions may take advantage of judicial authorities' unfamiliarity with crypto currency disposal models and prices, as well as their own advantageous position. This can lead to unreasonably high quotes, inflating disposal costs and diminishing the final amount recovered. At the same time, the lack of standardized pricing can easily lead to judicial corruption, where relevant personnel may exploit ambiguous pricing structures to engage in rent-seeking behavior for personal gain.

As mentioned above, similar to intermediary fees, judicial authorities lack a consistent and clear pricing standard for crypto currency, and the market value of crypto currency fluctuates greatly. Third-party institutions may exploit these variations, mixing entrusted crypto currencies with their own and liquidating them in batches, and then reporting the lower prices as the liquidation prices to judicial authorities, obtaining the difference between the actual transaction proceeds of the crypto currencies and the amount remitted to judicial authorities. In addition, third-party institutions may also collude with the downstream buyers, selling at nominally lower prices to obtain illegal benefits.

3. The qualifications of third-party institutions

Since China has not established relevant qualification review standards, industry specifications, or industry qualification standards in the field of crypto currency, judicial authorities lack clear guidelines to assess the compliance and professionalism of third-party institutions. This may lead local judicial authorities to adopt different disposal approaches, leaving room for third-party institutions or other related personnel to unjustly benefit themselves.

Judicial authorities have taken notice of this issue, requiring that the disposal and liquidation of crypto currency involved in cases should be entrusted to "qualified third-party institutions" and requiring the provision of "evidence of compliance with laws and regulations". However, there are no specific regulations and standards to judge whether they are "qualified third-party institutions", and what should be included in the "evidence of compliance with laws and regulations" still needs to be detailed.

4. Supervision over third-party institutions

At present, China lacks supervisory standards or measures for third-party institutions dealing with crypto currency, and there is no effective mechanism to monitor their daily operations, methods of crypto currency disposal, the sources of funds obtained from the liquidation of crypto currency, and the ultimate destination of the crypto currency.

Due to the anonymity of crypto currency, there is a significant risk of associated illegal money laundering activities., and third-party institutions may also be involved in crimes such as concealing the proceeds of crime, or money laundering, during the disposal process.

Firstly, the third-party institutions responsible for disposing of crypto currency may themselves be involved in crimes such as concealing the proceeds of crime or participating in money laundering. The decentralized nature of crypto currency means that there is no centralized agency registering the identity information of holders. Therefore, in the case of anonymous holders, anyone who knows the private key can control the crypto currency at the corresponding address. This leads to crypto currency often being used for money laundering through multiple transactions, thereby concealing the

final source of the currency and making it difficult for regulators to trace the transaction process. Therefore, without strict scrutiny, third-party institutions may also take advantage of the opportunity to assist others in money laundering or other criminal activities.

Secondly, third-party institutions responsible for disposing of crypto currency may unknowingly receive illegal funds. Even without malicious intent, the prevalence of criminal activities in crypto currency transactions means that if these institutions fail to scrutinize their counterparties, they risk becoming entangled in their illegal activities. The funds obtained by the third-party institutions from the disposal of crypto currency may originate from criminal proceeds within China; that is, the counterparties may use the illegal funds to purchase the crypto currencies that the third-party institutions are responsible for disposing of, thus involving the crypto currency disposal process in criminal activities. It may even be the case that, after the third-party institutions have completed the disposal, the proceeds are seized and frozen by other public security authorities because of the relationship with criminal activities.

Way out for the disposal of crypto currency

Although there are many difficulties and risks in the judicial disposal of crypto currency as mentioned above, these challenges and risks can be solved with the introduction of relevant legal regulations and standards in the future. The following paragraphs will elaborate on the legal response and prospects to the disposal of crypto currency.

I. Legality of judicial disposal

1. Interpretation on the legality of judicial disposal

While administrative authorities have characterized crypto currency-related business activities as illegal financial activities, we believe that in the context of judicial disposal, it may be possible to resolve this issue of legality through legal interpretation.

Regulations deny crypto currency's classification as currency but do not prohibit it as general virtual property or its holding. This distinction suggests that judicial disposal may be feasible, unlike wholly prohibited items such as drugs or counterfeit currency.

Transactions related to crypto currencies are restricted in order to prevent speculative trading and to protect investors, according to the Notice on Guarding Against the Risks of Financing by Token Offering and the Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks. However, in the judicial disposal process, the disposal actions are under supervision and are essentially a measure to recover victim's property and mitigate losses. They do not involve speculative trading and collective investment risks, and they generally do not undermine the national financial order. Therefore, the judicial disposal of crypto currency should not fall within the scope of the restrictions of the aforementioned documents.

2. Legal disposal based on special policy

China is currently piloting a program allowing qualified third-party institutions to conduct judicial disposal of crypto currency. Since financial activities involving crypto currency are prohibited within

China's territory, a viable approach is to cooperate with foreign countries that allow crypto currency transactions. Special policies are implemented within specific cooperation areas, and qualified third-party institutions are granted relevant qualifications.

For example, the People's Republic of China and the Republic of Kazakhstan, in accordance with the Framework Agreement between the Government of the People's Republic of China and the Government of the Republic of Kazakhstan on the Establishment of the "Khorgos International Border Cooperation Center", have signed the Agreement between the Government of the People's Republic of China and the Government of the Republic of Kazakhstan on the Regulation of Activities in the Khorgos International Border Cooperation Center (hereinafter referred to as the "**Agreement**"). Article 7 of the Agreement provides that, "*Business entities operating within the Center may engage in activities that are not prohibited by the laws of both countries. In case of disagreements related to activities carried out within the Center, both parties will consult with each other*". According to public information, the People's Republic of China and the Republic of Kazakhstan have established the Khorgos International Border Cooperation Center near the border based on the Agreement and have issued Business Entity Registration Certificates to some enterprises, including those whose business scope contains digital assets, digital currency, virtual assets, and crypto currency disposal. Meanwhile, relevant government agencies will conduct examination and verification of such enterprises, supervise the compliance of their operations and may revoke the Business Entity Registration Certificate of the unqualified enterprise.

Participants in judicial disposal include judicial authorities, crypto currency disposal companies with special qualifications, appraisal institutions with judicial appraisal qualifications, and evaluation institutions with judicial evaluation qualifications. The current process involves judicial authorities signing a crypto currency disposal entrustment agreement with a crypto currency disposal company and entrusting judicial appraisal institutions and evaluation institutions to conduct judicial appraisal and evaluation of crypto currency. Therefore, judicial authorities can consider this approach as a form of judicial disposal if needed.

II. Outlook

1. Clear empowerment

As mentioned earlier, the first concern in the judicial disposal of crypto currency is the legality of such disposal by judicial agencies and third-party institutions. Although there is a certain margin of interpretation for the legality of judicial disposal under existing regulations, the lack of clarity in relevant rules may lead to doubts about its legality. Therefore, it is necessary to introduce relevant regulations to clarify the issue of legality.

In practice, despite the current trend of strict supervision over crypto currency, there are still a considerable number of civil or criminal cases involving crypto currency transactions. Disposal actions taken by judicial authorities in the exercise of public power to maintain the public interest, should be entitled to an exception to the supervision over crypto currency. Without prejudice to the normal legal system, it is clear that judicial authorities are entitled to custody and to dispose of crypto currency in order to perform their duties. In addition, where judicial agencies authorize third-party

institutions to dispose of crypto currency, it is crucial to clarify the legality of their actions, and to specify the authorization requirements, scope of authorization, and supervision process. The legality of third-party actions should be confined to authorized limits, with judicial oversight ensuring compliance.

In addition, a white-list system should be established for qualified third-party institutions for the disposal of crypto currency. A special department of the central judicial authority can select qualified institutions with the list being adjusted dynamically according to the actual situation to provide guidance for judicial authorities across the country in disposing of crypto currency and to mitigate negative impact arising from exceptions to prohibitions on crypto currency transactions.

2. Clear procedures

Apart from the issue of legality, the risks and challenges in the judicial disposal of crypto currency may arise from the lack of procedural rules and inconsistency between regulations. Comprehensive and specific regulations for the entire judicial disposal process should be formulated to standardize measures nationally, ensuring that judicial authorities, third-party institutions, and responsible personnel strictly follow standardized processes for disposal.

Firstly, with regard to the seizure and custody of crypto currency, the central judicial authority or provincial judicial authorities can establish a special seizure address for crypto currency or establish a unified national platform or provincial platform based on the establishment of a special address for judicial authorities.

The private key for the special seizure address for crypto currency should be held by specialized personnel outside the case-handling department, and the electronic devices that store the private key should not be connected to the outside network. It is more appropriate if the specialized personnel responsible for custody have relevant technical backgrounds. After the case-handling personnel obtain the private key of the crypto currency held by the criminal suspect, they should immediately transfer the crypto currency to the special seizure address established by the judicial authorities and record the type and quantity of the crypto currency, and record the entire process of seizure and transfer for review. If a suspect is uncooperative, guidance should be offered to encourage cooperation.

The advantage of adopting a special seizure address lies in its security: only designated personnel of the judicial authorities hold the private key of the address, preventing the criminal suspect or his accomplices from transferring crypto currency, ensuring the security of the seizure. On the other hand, it also complies with Article 21 of the Several Provisions of Public Security Authorities on Management of Involved Property regarding the separation of property management and case handling, preventing relevant personnel from obtaining illegal benefits. In addition, the private key held by specialized technical personnel and stored in hardware isolated from the outside network can prevent the loss of crypto currency from cyber-attacks or other technical means. A standardized national or provincial process for the seizure and custody of crypto currency aids investigations if losses occur. To ensure the safety of the crypto currency, a special address can be established for each individual case.

Secondly, the central judicial authorities or provincial judicial authorities should establish or designate a department and personnel responsible for the liquidation of crypto currency to handle all crypto currencies that needs to be disposed of nationwide or provincewide. This will enhance the professionalism of crypto currency disposal and prevent inconsistencies in disposal methods and standards across different regions.

Clarifying the party responsible for judicial disposal of crypto currency and the supervisory party for the entrustment of third-party disposal institutions facilitates tracking of potential illegal and irregular behaviors involved in the disposal process. In conjunction with this, judicial authorities can establish dedicated transaction accounts at designated banks to handle the flow of currency involved in the disposal. For larger transactions, higher authority or peer review may be required. For example, in cases where public security authorities dispose of crypto currency, prosecutorial authorities could review and approve.

Thirdly, a whitelist database of third-party institutions could be established to limit the scope of institutions authorized to dispose of crypto currency.

The criteria for selecting third-party institutions in the white-list database include that: the institution should have no record of illegal or criminal activities; no history of illegal or criminal activities; absence of administrative penalties related to crypto currency; robust confidentiality mechanisms; a secure system to protect crypto currency from loss; relevant expertise and experience in crypto currency; reasonable pricing for services; efficiency in disposal; and sufficient financial capacity to manage disposal or cover potential losses.

Fourthly, in the process of entrusting third-party institutions to dispose of crypto currency, measures supporting the above procedures should be established.

Prior to entrusting a third-party institution to dispose of crypto currency, it is necessary to sign a standardized power of attorney, specifying the scope, quantity, and possible disposal measures. A unified pricing mechanism is also essential, potentially involving a qualified appraisal institution to assess market value and disposal fees. On this basis, judicial authorities can negotiate with the third-party institution to determine the disposal measures and costs, setting standards for the specific rates and maximum limits of fees charged. Furthermore, the obligations of the third-party institution, as well as the compensation responsibilities for violations of relevant laws or agreements should be determined through written agreements. A reasonable explanation should be provided if the third-party institution's final liquidation price of crypto currency significantly deviates from the assessed price. Serious faults in the disposal process should result in removal from the whitelist and accountability for compensation. Lastly, a supervision mechanism for the disposal of crypto currency by third-party institutions should be established, with dedicated personnel from judicial authorities holding the crypto currency throughout the entire transaction process until the disposal is completed, or requiring the third-party institution to establish a special transaction address for the crypto currency involved in the case, and the aforementioned department responsible for the disposal of crypto currency should monitor the disposal procedures and flow of crypto currency, establish a mechanism for public disclosure of information, require the third-party institution to issue a disposal report, and ensure the

legality of the final flow of the crypto currency, the disposal process, and the procedures involving foreign exchange settlement.

As a product of new technology, crypto currencies have special characteristics different from legal tender and general property. Its concealment and anonymity present specific risks and challenges in judicial proceedings. The current regulations on the judicial disposal of crypto currencies require enhancement, and it is hoped that China will introduce comprehensive regulations and procedures for the judicial disposal of crypto currency as soon as possible to provide a solid legal basis for the unified judicial disposal.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact:

Andy (Ronghua) LIAO

Tel: +86 21 6080 0990

Email: andy.liao@hankunlaw.com