

1 **Appendix**

2 **Reporter’s Notes**
3 **to Section 502 [UCC Article 8 provisions]**
4

5 Thus far, no state statute regulating virtual currencies has addressed very basic
6 commercial law questions, such as the treatment of virtual currency when the licensee or
7 provisional registrant has the control of the virtual currency for a resident and the licensee or
8 provisional registrant is in financial distress or otherwise becomes insolvent. This draft seeks to
9 do so by requiring licensees or provisional registrants to agree with residents to “opt in” to
10 Article 8 (“UCC Article 8”) of the Uniform Commercial Code (the “UCC”).
11

12 These Notes will describe the impact of a licensee or provisional registrant “opting in” to
13 UCC Article 8 as provided in Section 502. They first summarize the relevant provisions of UCC
14 Article 8. They then describe how UCC Article 8 operates generally in relation to the Act under
15 Section 502 and the benefits that result. They will then explain certain supplemental provisions
16 included in Section 502 to facilitate the operation of UCC Article 8 in relation to the Act.
17

18 Summary of Relevant Provisions of UCC Article 8

19 *Substantive law*

20 UCC Article 8 sets forth a statutory scheme for the holding and transfer of investment
21 securities, such as stocks and bonds. The statutory scheme applies to both investment securities
22 held directly by an investor from an issuer (so-called “directly-held securities”) and investment
23 securities held indirectly by an investor through a bank, broker or other intermediary (so-called
24 “indirectly-held securities”). Of relevance to the Act is the system (the “indirect holding
25 system”) for holding indirectly-held securities. While the primary focus of UCC Article 8 is
26 generally on investment securities, UCC Article 8 itself is not so limited in its provisions relating
27 to the indirect holding system.¹
28

29 The key to understanding the scope of UCC Article 8 in respect of the indirect holding
30 system is first to understand the terminology used in UCC Article 8 for the indirect holding
31 system. Under UCC Article 8, a bank, broker or other person that in the ordinary course of its
32 business maintains securities accounts for others and is acting in that capacity is referred to as a
33 “securities intermediary”.² A “securities account” is an account to which a “financial asset” is or
34 may be credited in accordance with an agreement under which the person for whom the account
35 is maintained is entitled to exercise the rights that comprise the financial asset.³ A financial asset
36 under UCC Article 8 includes not only a “security” as defined in UCC Article 8⁴ but also “*any*
37 *property* that is held by a securities intermediary for another person in a securities account if the
38 securities intermediary has expressly agreed with the other person that the property is to be

¹ See generally Official Comment 9 to UCC § 8-102.

² UCC § 8-102(a)(14).

³ UCC §§ 8-501(a) and 8-102(a)(9).

⁴ UCC § 8-102(a)(15).

1 treated as a financial asset” (emphasis added).⁵

2

3 Once the securities intermediary has indicated by book entry that a financial asset has
4 been credited to a person’s securities account, the person is referred to as an “entitlement
5 holder”⁶ and has what is called in UCC Article 8 a “security entitlement” with respect to the
6 financial asset.⁷ A security entitlement encompasses the rights and property interest of an
7 entitlement holder with respect to a financial asset as specified in Part 5 of UCC Article 8.⁸

8 The rights comprising a security entitlement with respect to a financial asset include the
9 rights of the entitlement holder to enforce the duties of the securities intermediary to the
10 entitlement holder under Part 5 of UCC Article 8. Those duties (the “Part 5 Duties”) consist of
11 the duty to maintain sufficient financial assets to satisfy all security entitlements to the financial
12 assets,⁹ the duty to take action to obtain a payment or distribution made by the issuer of the
13 financial asset,¹⁰ the duty to exercise rights in respect of the financial asset as directed by the
14 entitlement holder,¹¹ the duty to comply with the entitlement holder’s instruction (referred to in
15 UCC Article 8 as an “entitlement order”¹²) to transfer or redeem a financial asset,¹³ and the duty
16 to change the entitlement holder’s security entitlement to another form of holding for which the
17 entitlement holder is eligible, or to deliver out a financial asset, at the request of the entitlement
18 holder.¹⁴

19 The property interest comprising a security entitlement with respect to a particular
20 financial asset consists of a pro rata property interest in all interests of the securities intermediary
21 in that financial asset.¹⁵ For example, an entitlement holder may have 100 shares of XYZ stock
22 maintained for it in an account with a securities intermediary, but nine other entitlement holders
23 may each have 100 shares of XYZ stock maintained for each of them in their accounts with the
24 securities intermediary. A clearing corporation, such as Depository Trust Company, may show
25 on its books and records that, of all the XYZ stock that the clearing corporation holds, 1000
26 shares are for the securities intermediary’s account. The securities intermediary would then
27 reflect on its books and records that 100 shares of XYZ stock are held by the securities
28 intermediary through the clearing corporation as being for the account of each of the ten
29 entitlement holders. A particular entitlement holder’s security entitlement will be to 100 of the
30 1000 shares of XYZ stock as the entitlement holder’s pro rata share of the “fungible bulk” of
31 XYZ stock held by the securities intermediary.¹⁶

⁵ UCC § 8-102(a)(9). The quoted language is in clause (iii) of UCC § 8-102(a)(9)’s definition of the term “financial asset.”

⁶ UCC § 8-102(a)(7).

⁷ UCC § 8-501(b)(1).

⁸ UCC § 8-102(a)(17).

⁹ UCC § 8-504.

¹⁰ UCC § 8-505.

¹¹ UCC § 8-506.

¹² UCC § 8-102(a)(8).

¹³ UCC § 8-507.

¹⁴ UCC § 8-508.

¹⁵ UCC § 8-503(b).

¹⁶ See generally Official Comment 1 to UCC § 8-503.

1 The Part 5 Duties are generally enforceable by the entitlement holder against the
2 securities intermediary under the UCC by a private right of action.¹⁷ And, while the securities
3 intermediary is subject to the Part 5 Duties, the securities intermediary has certain protections
4 under UCC Article 8. For example, a securities intermediary that transfers a financial asset
5 pursuant to an entitlement order generally cannot be held liable to an adverse claimant to the
6 financial asset for the transfer, whether in conversion or otherwise, unless the securities
7 intermediary acted in collusion with the wrongdoer in violating the rights of the adverse
8 claimant.¹⁸ The collusion standard suggests that the licensee or provisional registrant’s behavior
9 must be egregious, or close to it, for the securities intermediary to be liable to an adverse
10 claimant.¹⁹

11 A financial asset giving rise to a security entitlement is generally not subject to the claims
12 of creditors of the securities intermediary in priority over the security entitlement. However, a
13 financial asset will be subject to a claim of a creditor of a securities intermediary, senior in
14 priority to the security entitlement, if (a) the securities intermediary has granted to the creditor a
15 security interest in the financial asset, whether to secure the securities intermediary’s own
16 obligations to the creditor or otherwise, (b) the creditor has “control” of the financial asset, and
17 (c) the securities intermediary has not complied with its duty to maintain sufficient financial
18 assets to satisfy the security entitlement in addition to satisfying the security interest of the
19 creditor.²⁰ “Control” would generally require the financial asset to be credited to a securities
20 account of the creditor at another securities intermediary, or otherwise to be delivered out to the
21 creditor and registered in the name of the creditor or, in the case of a certificated security not
22 registered in the name of the creditor, indorsed to the creditor or in blank.²¹ The securities
23 intermediary is not permitted to grant a security interest in the financial asset without the consent
24 of the entitlement holder.²²

25 It follows from a securities intermediary’s duty to maintain sufficient financial assets to
26 satisfy security entitlements that, if the securities intermediary holds financial assets of a
27 particular class and issuer that in part give rise to security entitlements and in part are financial
28 assets of the securities intermediary maintained for its own account, then the security
29 entitlements in the financial assets have priority over the securities intermediary’s ownership of
30 its own financial assets unless a creditor of the securities intermediary has control of the financial

¹⁷ UCC. § 1-305(b) (“Any right or obligation declared by [the UCC] is enforceable by action unless the provision declaring it specifies a different or limited effect.”). A Court of Appeals case surprisingly came to the conclusion that an entitlement holder has no private right of action under Part 5 of UCC Article 8 unless a provision in Part 5 expressly provides for a private right of action. *See Harris v. T.D. Ameritrade, Inc.*, 805 F.3d 664 (6th Cir. 2015). However, the court did not address UCC § 1-305(b) in the opinion.

¹⁸ UCC. § 8-115(3).

¹⁹ *See generally* Official Comment 5 to UCC § 8-115.

²⁰ UCC §§ 8-503(a) and 8-511(a), (b).

²¹ UCC § 8-106; *see* UCC § 8-301 for when “delivery” occurs. The creditor could also obtain control by entering into an agreement (a so-called “control agreement”) with the securities intermediary by which the securities intermediary agrees that it will comply with entitlement orders originated by the creditor without further consent of the entitlement holder. UCC § 8-106(d)(2). However, the securities intermediary may not enter into a control agreement in respect of a securities account without the consent of the entitlement holder. UCC § 8-106(g). “Control” for purposes of UCC Article 8 should be distinguished from “control of virtual currency” as defined in the Act.

²² UCC § 8-504(b).

1 asset. If for some reason the securities intermediary does not maintain sufficient financial assets
2 of a particular class or issuer to satisfy all security entitlements to the financial assets, then the
3 entitlement holders of the financial assets share ratably in the financial assets of that class or
4 issuer still maintained by the securities intermediary and have ratable unsecured claims against
5 the securities intermediary for the shortfall.²³

6 For example, if ten entitlement holders of a securities intermediary each have security
7 entitlements to 100 shares of XYZ stock, but the securities intermediary has only 800 shares of
8 XYZ stock credited to its account at a clearing corporation (inclusive of shares held by the
9 securities intermediary for its own account) and has no other XYZ shares, each entitlement
10 holder will have a security entitlement to 80 shares of XYZ stock and an unsecured claim against
11 the securities intermediary for the value of 20 shares of XYZ stock.

12 *Choice-of-law*

13 UCC Article 8 contains choice-of-law rules.²⁴ Generally, if a dispute arises in a court in a
14 jurisdiction that has adopted the UCC (a “UCC jurisdiction”) and concerning an issue addressed
15 under UCC Article 8 with respect to the indirect holding system, the court would apply the law
16 of the jurisdiction that governs the account relationship between the securities intermediary and
17 the entitlement holder to determine the issue.²⁵ There are currently no material differences
18 between the UCC Article 8 of one UCC jurisdiction and the UCC Article 8 of another UCC
19 jurisdiction in respect of matters relating to the indirect holding system.²⁶

20
21 However, the UCC Article 8 choice-of-law rules for securities credited to a securities
22 account are affected by the Hague Securities Convention.²⁷ The Convention became effective in
23 the United States on April 1, 2017. Even though the Convention applies only to “securities” as
24 defined in the Convention, it is unclear whether the definition of “securities” in the Convention
25 might include virtual currency.

26
27 The choice-of-law rules in the Hague Securities Convention pre-empt the choice-of-law
28 rules in UCC Article 8 for the issues covered by Article 2(1) of the Convention. Those issues
29 substantially overlap with the issues addressed in the choice-of-law rules in UCC Article 8 for
30 securities held in the indirect holding system. Even so, the choice-of-law rules of the
31 Convention will in most cases produce the same results as under the choice-of-law rules of UCC
32 Article 8.

33

²³ UCC § 8-503(b).

²⁴ UCC § 8-110.

²⁵ UCC §§ 8-110(b) and (e).

²⁶ If the account agreement were governed by a law of a jurisdiction that has not adopted the UCC and the account agreement did not provide that a particular UCC jurisdiction is the “securities intermediary’s jurisdiction” for purposes of the UCC, then the non-UCC substantive law of the jurisdiction whose law governs the account agreement would determine the rules for the holding and transfer of investment securities, including whether the financial assets are subject to the claims of the securities intermediary’s creditors. UCC §§ 8-110(b) and (e)(1) and (2).

²⁷ The Hague Securities Convention is formally known as the Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary. The Convention is available at <https://www.hcch.net/en/instruments/conventions/full-text/?cid=72>.

1 Here is why. Under Article 4(1) of the Convention, the court would apply to an issue
2 covered by Article 2(1) the law of the jurisdiction that governs the account agreement between
3 the securities intermediary and the entitlement holder to determine the issue so long as the
4 securities intermediary maintains an office (a “qualifying office”) that deals with securities in the
5 country of the jurisdiction.²⁸ As a result, assuming that the qualifying office test is met, the
6 issues to be determined by the choice-of-law rules of either the Convention or UCC Article 8
7 would generally be determined by the law governing the account agreement.
8

9 If the parties wish for the law of another jurisdiction to determine the UCC Article 8
10 choice-of-law issues, they can choose for the “securities intermediary’s jurisdiction” to be that
11 jurisdiction.²⁹ If the parties wish for the law of another jurisdiction to determine all of the Article
12 2(1) issues, they can so specify in the account agreement so long as the qualifying office test is
13 met.³⁰
14

15 How UCC Article 8 Operates in Relation to the Act

16 It may be counterintuitive to think that UCC Article 8, which generally deals with
17 investment securities, would have any relevance to the Act and virtual currencies. However,
18 UCC Article 8 is a broad statute that in some circumstances, applicable here, permits parties to
19 “opt in” to the UCC Article 8 scheme, and for their transactions to be governed by the rules of
20 UCC Article 8, for purposes of the indirect holding system. Here is how the “opt-in” operates in
21 the context of the Act and what the effect of the “opt-in” would be.

22 *More on terminology*

23 For a licensee or provisional registrant to be subject to UCC Article 8, the licensee or
24 provisional registrant must be a “securities intermediary” maintaining a “securities account” to
25 which a “financial asset” is or may be credited. The definitions of these three terms, taken
26 together, indicate that a licensee or provisional registrant, which maintains accounts for residents
27 to which virtual currency is or may be credited, could expressly agree with the residents to be
28 subject to the rules of UCC Article 8.

29 The definition of “securities intermediary” in UCC Article 8 is not confined to a bank or
30 broker. Moreover, it is not confined to a person who is regulated under banking or securities
31 law. The definition includes “a person...that in the ordinary course of its business maintains
32 securities accounts for others and is acting in that capacity.”³¹

²⁸ The second sentence of Article 4(1) of the Hague Securities Convention sets forth the minimal office activity that is required for the qualifying office test to be met. Because the United States is considered to be a “multi-unit” country under the Convention, the qualifying office test for the choice-of-law in the account agreement is met if the account agreement between the securities intermediary and the entitlement holder selects the law of a particular *stare* in the United States and the qualifying office is located in any state of the United States. Hague Securities Convention, Art. 12(1)(b).

²⁹ UCC § 8-110(e)(1).

³⁰ Hague Securities Convention, Art. 4(1). The parties may not select for less than all of the Article 2(1) issues to be determined by the law of the other jurisdiction.

³¹ UCC § 8-102(a)(14)(ii).

1 Likewise, the definition of “securities account” is not confined to an account at a bank or
2 broker or to an account maintained by a person regulated under banking or securities law. The
3 term is defined as “an account to which a financial asset is or may be credited in accordance with
4 an agreement under which the person maintaining the account undertakes to treat the person for
5 whom the account is maintained as entitled to exercise the rights that comprise the financial
6 asset.”³²

7 Similarly, the definition of “financial asset” is not confined to a security. The term is
8 defined to include “any property that is held by a securities intermediary for another person in a
9 securities account if the securities intermediary has expressly agreed with the other person that
10 the property is to be treated as a financial asset under [UCC Article 8].”³³

11 Notice how a financial asset may be “any property” so long there is an express agreement
12 between the securities intermediary and the entitlement holder that the property be treated as a
13 financial asset. As Official Comment 9 to UCC § 8-102 states: “The term financial asset is
14 defined to include not only securities but also a broader category of obligations, shares,
15 participations, and interests.”³⁴

16 *Opt-in*

17 It follows that a licensee or provisional registrant in the business of maintaining control
18 of virtual currencies for residents may expressly agree with the residents that virtual currency of
19 which the licensee or provisional registrant has control for the residents will be treated as
20 “financial assets” credited to the residents’ “securities accounts” under UCC Article 8. UCC
21 Article 8 does not dictate what form the express agreement might take, but it would certainly
22 permit the express agreement to be contained in the account agreement between the licensee or
23 provisional registrant and a resident. Assuming that the express agreement is contained in the
24 account agreement, then, in order for a court in a UCC jurisdiction to apply the substantive law
25 of UCC Article 8 to the financial assets held in the account, the law governing the account
26 agreement would need to be that of a UCC jurisdiction or the agreement would need to provide
27 for a UCC jurisdiction to be the “securities intermediary’s jurisdiction”³⁵ and for the issues
28 governed by Article 2(1) of the Hague Securities Convention to be governed by the law of the
29 UCC jurisdiction.³⁶

30 *Part 5 Duties of the licensee or provisional registrant*

31 If the licensee or provisional registrant does expressly agree with residents to treat virtual
32 currency of which the licensee or provisional registrant has control for the residents as financial
33 assets credited to the residents’ securities accounts, then the licensee or provisional registrant has

³² UCC § 8-501(a).

³³ UCC § 8-102(a)(9)(iii)

³⁴ For a case in which a bank certificate of deposit was treated as a financial asset credited to a securities account, see *Flener v. Alexander (In re Alexander)*, 429 B.R. 876 (Bankr. W.D. Ky. 2010, *aff’d*, 2011 WL 9961118 (6th Cir. 2011).

³⁵ UCC §§ 8-110(b) and (e)(1) and (2).

³⁶ Hague Securities Convention, Art. 4(1).

1 the following Part 5 Duties relevant for a virtual currency and enforceable by the residents by
2 private right of action:

- 3 • *The duty to maintain sufficient financial assets to satisfy all security entitlements to the*
4 *financial assets.*³⁷

5 The licensee or provisional registrant would need to maintain control of sufficient virtual
6 currency of each type to satisfy all entitlements of the residents to virtual currency of that
7 type.

- 8 • *The duty to comply with the entitlement holder's entitlement orders to transfer or redeem*
9 *a financial asset.*³⁸

10 The licensee or provisional registrant would need to comply with a resident's instructions
11 to transfer virtual currency of which the licensee or resident has control for the resident to
12 another person, as and when, for example, the resident wishes to exchange the virtual
13 currency for goods, services, fiat currency or any other type of virtual currency.

- 14 • *The duty to change the entitlement holder's security entitlement to another form of*
15 *holding for which the entitlement holder is eligible, or to deliver out a financial asset, at*
16 *the request of the entitlement holder.*³⁹

17 The licensee or provisional registrant would need to comply with a resident's instructions
18 to transfer virtual currency of which the licensee or provisional registrant has control for
19 the resident to another licensee or provisional registrant for the account of the resident or
20 to another eligible account of the resident.

21 These Part 5 Duties would not appear to be controversial. They seem to be consistent
22 with a resident's expectations of the licensee's or provisional registrant's performance with
23 respect to virtual currency of which the licensee or provisional registrant has control for the
24 resident.

25 *Licensee or provisional registrant protections*

26 If licensee or provisional registrant transfers a virtual currency as instructed by the
27 resident, the licensee or provisional registrant generally cannot be held liable to an adverse
28 claimant to the virtual currency for the transfer unless the licensee or provisional registrant acted
29 in collusion with the wrongdoer in violating the rights of the adverse claimant.⁴⁰

30 *Creditor claims*

31 If the licensee or provisional registrant expressly agrees with residents to treat virtual
32 currency of which the licensee or provisional registrant has control for the residents as financial

³⁷ UCC § 8-504.

³⁸ UCC § 8-507.

³⁹ UCC § 8-508.

⁴⁰ UCC. § 8-115(3).

1 assets credited to the residents’ securities accounts, then a financial asset giving rise to a security
2 entitlement is generally not subject to the claims of creditors of the securities intermediary in
3 priority over the security entitlement.⁴¹ Accordingly, virtual currency of which a licensee or
4 provisional registrant has control for a resident would not be subject to claims of creditors of the
5 licensee or provisional registrant.

6 That being said, under UCC Article 8 the virtual currency would be subject to a claim of
7 a creditor of the licensee or provisional registrant, senior in priority to the resident’s entitlement,
8 if (a) the licensee or provisional registrant has granted to the creditor a security interest in the
9 virtual currency, (b) the creditor has “control” of the virtual currency,⁴² and (c) the licensee or
10 provisional registrant has not complied with its duty to maintain sufficient virtual currency of
11 that type to satisfy the entitlement in addition to satisfying the security interest of the creditor.⁴³
12 The licensee or provisional registrant, though, is not permitted under UCC Article 8 to grant a
13 security interest in the virtual currency without the consent of the resident.⁴⁴

14 *Secured transactions*

15 If the licensee or provisional registrant expressly agrees with residents to treat virtual
16 currency over which the licensee or provisional registrant has control for the residents as
17 financial assets credited to the residents’ securities accounts, then several problems that exist
18 today under secured transactions law will be addressed. Addressing these problems will
19 facilitate the greater availability of credit or lower its costs for a resident who wishes to offer the
20 resident’s virtual currency account of the licensee or provisional registrant has control as
21 collateral for a loan or other obligation and will otherwise facilitate the utility of virtual currency
22 as a medium of exchange.

23
24 Competing security interests

25
26 One problem concerns the method of perfection and the priority of a security interest that
27 the resident might grant in the resident’s virtual currency account. Absent the licensee or
28 provisional registrant expressly agreeing with residents to treat virtual currency of which the
29 licensee or provisional registrant has for the residents as financial assets credited to the residents’
30 securities accounts, a resident’s entitlement to virtual currency maintained for the resident by the
31 licensee or provisional registrant would be considered under Article 9 (“Article 9”) of the UCC
32 to be a “general intangible.”⁴⁵ The filing of a financing statement would be the sole method for
33 the secured party to perfect its security interest in the virtual currency account.⁴⁶ The priority of
34 competing security interests in the virtual currency account would be determined in favor of the
35 first secured party to file or perfect its security interest.⁴⁷

36

⁴¹ See UCC § 8-503(a).

⁴² “Control” in this context means “control” as defined in UCC. § 8-106 in contrast to “control of virtual currency” as defined in the Act.

⁴³ UCC §§ 8-503(a) and 8-511(a), (b).

⁴⁴ UCC § 8-504(b).

⁴⁵ UCC § 9-102(a)(42).

⁴⁶ UCC § 9-310.

⁴⁷ UCC §§ 9-322(a)(1).

1 However, if the licensee or provisional registrant expressly agreed with residents to treat
2 virtual currency of which the licensee or provisional registrant has control for the residents as
3 financial assets credited to the residents' securities accounts, a resident's virtual currency
4 account would be considered to be "investment property" under Article 9.⁴⁸ The method of
5 perfection of a security interest in the resident's virtual currency account as investment property
6 would be by either the filing of a financing statement or the secured party obtaining control of
7 the investment property.⁴⁹ A secured party who obtains control would have priority over a
8 secured party who perfects by filing even if the filing preceded in time the control secured party
9 obtaining control.⁵⁰

10
11 It would appear to be preferable as a policy matter for the investment property perfection
12 and priority scheme to apply to the virtual currency account instead of the scheme for general
13 intangibles. The policy rationale is analogous to that for the perfection and priority of security
14 interests in investment property generally. A secured party taking a security interest in
15 investment property and relying upon that collateral in extending credit should demonstrate that
16 reliance by taking the steps to obtain control. If the secured party takes those steps, its security
17 interest is entitled to priority over a secured party who had perfected its security interest merely
18 be the filing of a financing statement and who, presumably by not taking the steps to obtain
19 control, was not relying on the investment property in extending credit.

20
21 Likewise, a secured party that extends credit in reliance on the virtual currency account
22 as collateral would want its security interest to be senior. It would take the necessary steps to
23 obtain control. Absent "investment property" treatment of the virtual currency account, though,
24 control would not be a permitted method of perfection or a method for obtaining priority. The
25 secured party would need to bargain with any other secured party who had already filed a
26 financing statement covering general intangibles in order to obtain a release or subordination of
27 the other secured party's security interest and who presumably is not relying on the virtual
28 currency account as collateral. There would seem to be no policy justification for the filed
29 secured party to be entitled to the priority benefit and negotiating leverage over the later secured
30 party, that would be relying on the account as collateral, merely because the filed secured party
31 has, without that reliance, taken a general security interest in all of the resident's assets that
32 includes a security interest in general intangibles.

33
34 Still, for a secured party to take control of a virtual currency account, some new
35 techniques may need to be developed. Unless the licensee or provisional registrant itself is the
36 secured party or the virtual currency is credited to an account of the secured party at another
37 licensee or provisional registrant, the secured party, the resident and the licensee or provisional
38 registrant would need to enter into a control agreement by which the licensee or provisional
39 registrant would agree to follow instructions from the secured party to transfer the virtual
40 currency without any further consent of the resident.⁵¹ Such an agreement may require a
41 mechanism for the resident confidentially to inform the secured party of the resident's private

⁴⁸ UCC § 9-102(a)(49)(defining "investment property" to include a "security entitlement" and a "securities account").

⁴⁹ UCC §§ 9-312(a) and 9-314(a).

⁵⁰ UCC § 9-328(a).

⁵¹ See UCC §§ 8-106(d) and (g) and 9-106(a).

1 key, or for the secured party to have its own private key, to the virtual currency account.

2
3 Transferees
4

5 Another problem concerns the rights of transferees of virtual currency. If a secured
6 party's security interest in a virtual currency account is perfected as a general intangible, any
7 transfer of the virtual currency by the resident out of the account will be subject to the secured
8 party's security interest unless the secured party had authorized the transfer free of the security
9 interest.⁵² This is a problem under current law since there is no rule under Article 9 that
10 otherwise cuts off a security interest in a virtual currency account perfected as a general
11 intangible by the filing of a financing statement. A secured party of the transferee, thinking of
12 extending credit against the virtual currency account, may have no practical way of assuring
13 itself that the virtual currency credited to the account is not subject to a security interest in favor
14 of a prior transferor's secured party.
15

16 However, if the licensee or provisional registrant expressly agreed with residents to treat
17 virtual currency over which the licensee or provisional registrant has control for the residents as
18 financial assets credited to the residents' securities accounts, then the adverse claim cut-off rule
19 of UCC Article 8 would apply. Under that rule, when a transferee acquires for value a "security
20 entitlement" in the transferred virtual currency resulting from a credit of the virtual currency to
21 the transferee's account at its licensee or provisional registrant, the transferee will have acquired
22 its interest in the virtual currency free any "adverse claims" of which the transferee did not have
23 notice.⁵³
24

25 An "adverse claim" is defined is defined in UCC § 8-102(a)(1) as "a claim that a claimant
26 has a property interest in a financial asset and that it is a violation of the rights of the claimant"
27 for the transferee to acquire an entitlement in the financial asset. Notice of an adverse claim
28 under UCC § 8-105 means generally that the transferee knows of the adverse claim (which under
29 UCC § 1-202(b) means actual knowledge) or has acted with willful blindness to avoid knowing
30 about the claim.⁵⁴
31

32 The mere fact that the transferee may suspect or even be aware that its transferor may
33 have granted a security interest in the transferor's virtual currency account at its licensee or
34 provisional registrant does not put the transferee on notice of an adverse claim to the virtual
35 currency. Often, the secured party will have authorized the transfer of the virtual currency free
36 of the security interest. For a transferee to be on notice of an adverse claim, the transferee must
37 know, or have been willfully blind in avoiding knowing, that the acceptance by the transferee of
38 a security entitlement in the transferred virtual currency violates the rights of the adverse
39 claimant.

⁵² See UCC § 9-315(a)(1).

⁵³ UCC § 8-502 ("An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under section 8-501 for value and without notice of the adverse claim.").

⁵⁴ A notice of an adverse claim can also arise if the transferee were under a statutory or regulatory duty to investigate whether an adverse claim exists and the investigation would have revealed the adverse claim. See UCC § 8-105(a)(3). Such a statutory or regulatory duty in this context seems unlikely.

1 Benefits the UCC Article 8 “Opt-in” for the Act

2
3 Section XXX’s requirement for a UCC Article 8 “opt-in” will have some clear benefits
4 for residents that in turn support responsible behavior by licenses and provisional registrants:
5

- 6 • Protecting the virtual currency of a resident from the claims of the licensee’s or
7 provisional registrant’s own creditors.
8
- 9 • Requiring the licensee or provisional registrant to maintain control of sufficient virtual
10 currency of each type to satisfy each resident’s entitlement to the virtual currency of that
11 type.
12
- 13 • Subordinating the licensee’s or provisional registrant’s proprietary interest in virtual
14 currency of a type, and establishing a ratable loss sharing rule among residents, if there is
15 a shortfall in the virtual currency of that type of which the licensee or provisional
16 registrant has control for residents.
17
- 18 • Requiring the licensee or provisional registrant to comply with a resident’s transfer
19 instructions as to the virtual currency and, absent collusion with the wrongdoer,
20 protecting the licensee or provisional registrant from liability to an adverse claimant for
21 the transfer.
22
- 23 • Establishing that the commercial law relationship between the licensee or provisional
24 registrant and the resident is the relationship that a securities intermediary has to an
25 entitlement holder with respect investment property and is not to be viewed as falling
26 under other relationships, such as an agency relationship or a relationship arising from a
27 transaction to which UCC Article 2 applies or from a mere bailment under the common
28 law.
29
- 30 • Clarifying secured transactions law on the perfection and priority of a security interest in
31 a resident’s virtual currency account at a licensee or provisional registrant.
32
- 33 • Using UCC Article 8’s adverse claim cut-off rule to facilitate the transfer of virtual
34 currency free of a secured party’s adverse claim of a security interest in the virtual
35 currency.
36

37 Supplemental Provisions

38
39 In addition to requiring a licensee or provisional registrant and a resident to “opt-in” to
40 UCC Article 8, Section XXX contains provisions designed to insure that the benefits of UCC
41 Article 8 are indeed obtained for the resident.
42

43 *Choice-of-law*

44
45 Subsection (b)(1) requires that the agreement between the licensee or provisional
46 registrant and a resident providing for the UCC Article 8 “opt in” be governed by the law of

1 UCC jurisdiction. The agreement may provide for the law of a non-UCC jurisdiction to apply to
2 the agreement, but only if the agreement also provides for the “securities intermediary’s
3 jurisdiction” to be that of a UCC jurisdiction and for the issues addressed in Article 2(1) of the
4 Hague Securities Convention to be governed by the law of the UCC jurisdiction.
5

6 Subsection (e) requires the licensee or provisional registrant to maintain an office that
7 satisfies the “qualifying office” test of the second sentence of Article 4(1) of the Hague
8 Securities Convention. It is not necessary under subsection (e) or the Hague Securities
9 Convention for the qualifying office to be located in the enacting state. The test requires only
10 that the qualifying office be located anywhere in the United States.⁵⁵
11

12 The requirements to satisfy the “qualifying office” test within the United States under the
13 Hague Securities Convention are minimal. The requirements may be met by the licensee or
14 provisional registrant in a variety of ways: effecting transactions in virtual currency accounts
15 from the office in the United States, monitoring virtual current transactions from the office in the
16 United States, or administering payments, or otherwise being engaged in a regular activity of
17 maintaining virtual currency accounts, from the office in the United States.⁵⁶ The test may also
18 be met if the licensee or provisional registrant, by a specific means of identification, identifies on
19 its books and records that virtual currency accounts are maintained in the United States.⁵⁷
20 Moreover, it is not necessary that the test apply to the virtual currency of which the licensee or
21 provisional registrant has control for a particular resident so long as test is met for any virtual
22 currency accounts of which the licensee or provisional registrant has control for any residents or
23 non-residents.
24

25 Subsections (b)(1) and (e) are necessary to be sure that, once the UCC Article 8 “opt-in”
26 provisions are contained in the account agreement between the licensee or provisional registrant
27 and the resident, the UCC Article 8 or, if applicable, Hague Securities Convention choice-of-law
28 rules point to the law of a particular jurisdiction where the substantive rules of UCC Article 8
29 actually apply. For example, subsection (b)(1) protects the resident from the governing law of
30 the account agreement being that of a foreign jurisdiction that does not have the UCC Article 8
31 protections for the resident contemplated by the Act. Likewise, if the governing law of the
32 account agreement does point to a jurisdiction in which UCC Article 8 is in effect and if the
33 Hague Securities Convention is applicable, subsection (e) protects the resident from the choice of
34 governing law being ineffective under the Convention because the licensee or provisional
35 resident failed to maintain a qualifying office in the United States.
36

37 *Part 5 Duties*

38

39 UCC Article 8 permits a securities intermediary and an entitlement holder to vary by
40 agreement the standard of care for a securities intermediary to comply with the Part 5 Duties. In
41 the absence of variation the standard of care is “due care in accordance with reasonable
42 commercial standards.”⁵⁸

⁵⁵ Hague Securities Convention, Art. 12(1)(b).

⁵⁶ Hague Securities Convention, Art. 4(1)(a).

⁵⁷ Hague Securities Convention, Art. 4(1)(b).

⁵⁸ See UCC §§ 8-504(c), 8-505(a), 8-506, 8-507(a) and 8-508.

1 Subsection (b)(3) does not permit the parties to vary the standard below the “due care”
2 default standard. This provision protects the resident from the licensee or provisional registrant
3 lowering in the account agreement the standard of care that the licensee or provisional resident
4 must follow in complying with its Part 5 Duties.

5
6 *No Dealings with Resident’s Virtual Currency Account*
7

8 Under UCC Article 8, without the consent of the entitlement holder, a securities
9 intermediary may not, for the proprietary account of the securities intermediary, grant a security
10 interest in or otherwise deal with financial assets held in a securities account for the entitlement
11 holder.⁵⁹

12
13 Subsection (d) prohibits the registrant from entering into an account or other agreement
14 with the licensee or provisional registrant that permits the licensee or provisional registrant to use
15 for its own proprietary purposes the virtual currency of which the licensee or provisional
16 registrant has control for the resident. An exception is made for the virtual currency being used
17 to pay the fees, charges and other amounts owing by the resident to the licensee or provisional
18 registrant for the virtual currency business activity conducted in the account.

19
20 *Failure to “Opt in”*
21

22 Subsection (c) provides that, if the licensee or provisional registrant and the resident fail
23 to “opt in” to UCC Article 8, their respective rights and obligations will be determined as if the
24 “opt in” has occurred.

25
26 Subsection (c) assures a resident that the resident will have the protections of UCC
27 Article 8 even if there is no account agreement between the licensee or provisional resident and
28 the resident or the account agreement does not include the “opt-in” provisions required by
29 subsection (b). However, if the Hague Securities Convention is applicable, the licensee or
30 provisional registrant must still maintain a qualifying office in the United States under subsection
31 (e) for subsection (c) to be effective.

⁵⁹ See UCC §§ 1-302 and 8-504(b).