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

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

Summary of Relevant Provisions of UCC Article 8

Substantive law

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

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

Once the securities intermediary has indicated by book entry that a financial asset has been credited to a person’s securities account, the person is referred to as an “entitlement holder” and has what is called in UCC Article 8 a “security entitlement” with respect to the financial asset.  

A security entitlement encompasses the rights and property interest of an entitlement holder with respect to a financial asset as specified in Part 5 of UCC Article 8.

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

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

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

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

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

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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).
asset. If for some reason the securities intermediary does not maintain sufficient financial assets of a particular class or issuer to satisfy all security entitlements to the financial assets, then the entitlement holders of the financial assets share ratably in the financial assets of that class or issuer still maintained by the securities intermediary and have ratable unsecured claims against the securities intermediary for the shortfall.\footnote{UCC § 8-503(b).}

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

\textit{Choice-of-law}

UCC Article 8 contains choice-of-law rules.\footnote{UCC § 8-110.} Generally, if a dispute arises in a court in a jurisdiction that has adopted the UCC (a “\textit{UCC jurisdiction}”) and concerning an issue addressed under UCC Article 8 with respect to the indirect holding system, the court would apply the law of the jurisdiction that governs the account relationship between the securities intermediary and the entitlement holder to determine the issue.\footnote{UCC §§ 8-110(b) and (e).} There are currently no material differences between the UCC Article 8 of one UCC jurisdiction and the UCC Article 8 of another UCC jurisdiction in respect of matters relating to the indirect holding system.\footnote{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).}

However, the UCC Article 8 choice-of-law rules for securities credited to a securities account are affected by the Hague Securities Convention.\footnote{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 \url{https://www.hcch.net/en/instruments/conventions/full-text/?cid=72}.} The Convention became effective in the United States on April 1, 2017. Even though the Convention applies only to “securities” as defined in the Convention, it is unclear whether the definition of “securities” in the Convention might include virtual currency.

The choice-of-law rules in the Hague Securities Convention pre-empt the choice-of-law rules in UCC Article 8 for the issues covered by Article 2(1) of the Convention. Those issues substantially overlap with the issues addressed in the choice-of-law rules in UCC Article 8 for securities held in the indirect holding system. Even so, the choice-of-law rules of the Convention will in most cases produce the same results as under the choice-of-law rules of UCC Article 8.
Here is why. Under Article 4(1) of the Convention, the court would apply to an issue covered by Article 2(1) the law of the jurisdiction that governs the account agreement between the securities intermediary and the entitlement holder to determine the issue so long as the securities intermediary maintains an office (a “qualifying office”) that deals with securities in the country of the jurisdiction. As a result, assuming that the qualifying office test is met, the issues to be determined by the choice-of-law rules of either the Convention or UCC Article 8 would generally be determined by the law governing the account agreement.

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

How UCC Article 8 Operates in Relation to the Act

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

More on terminology

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

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

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

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

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

Opt-in

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

Part 5 Duties of the licensee or provisional registrant

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

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

- **The duty to maintain sufficient financial assets to satisfy all security entitlements to the financial assets.**\(^{37}\)

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

- **The duty to comply with the entitlement holder’s entitlement orders to transfer or redeem a financial asset.**\(^{38}\)

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

- **The duty to change the entitlement holder’s security entitlement to another form of holding for which the entitlement holder is eligible, or to deliver out a financial asset, at the request of the entitlement holder.**\(^{39}\)

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

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

**Licensee or provisional registrant protections**

If licensee or provisional registrant transfers a virtual currency as instructed by the resident, the licensee or provisional registrant generally cannot be held liable to an adverse claimant to the virtual currency for the transfer unless the licensee or provisional registrant acted in collusion with the wrongdoer in violating the rights of the adverse claimant.\(^{40}\)

**Creditor claims**

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

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\(^{37}\) UCC § 8-504.
\(^{38}\) UCC § 8-507.
\(^{39}\) UCC § 8-508.
\(^{40}\) UCC, § 8-115(3).
assets credited to the residents’ securities accounts, then a financial asset giving rise to a security entitlement is generally not subject to the claims of creditors of the securities intermediary in priority over the security entitlement.\footnote{See UCC § 8-503(a).} Accordingly, virtual currency of which a licensee or provisional registrant has control for a resident would not be subject to claims of creditors of the licensee or provisional registrant.

That being said, under UCC Article 8 the virtual currency would be subject to a claim of a creditor of the licensee or provisional registrant, senior in priority to the resident’s entitlement, if (a) the licensee or provisional registrant has granted to the creditor a security interest in the virtual currency, (b) the creditor has “control” of the virtual currency,\footnote{“Control” in this context means “control” as defined in UCC. § 8-106 in contrast to “control of virtual currency” as defined in the Act.} and (c) the licensee or provisional registrant has not complied with its duty to maintain sufficient virtual currency of that type to satisfy the entitlement in addition to satisfying the security interest of the creditor.\footnote{UCC §§ 8-503(a) and 8-511(a), (b).}

That being said, under UCC Article 8 the virtual currency would be subject to a claim of a creditor of the licensee or provisional registrant, senior in priority to the resident’s entitlement, if (a) the licensee or provisional registrant has granted to the creditor a security interest in the virtual currency, (b) the creditor has “control” of the virtual currency,\footnote{UCC § 8-504(b).} and (c) the licensee or provisional registrant has not complied with its duty to maintain sufficient virtual currency of that type to satisfy the entitlement in addition to satisfying the security interest of the creditor.\footnote{UCC § 8-511(a), (b).}

The licensee or provisional registrant, though, is not permitted under UCC Article 8 to grant a security interest in the virtual currency without the consent of the resident.\footnote{UCC § 8-504(b).}

Secured transactions

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

Competing security interests

One problem concerns the method of perfection and the priority of a security interest that the resident might grant in the resident’s virtual currency account. Absent the licensee or provisional registrant expressly agreeing with residents to treat virtual currency of which the licensee or provisional registrant has control for the residents as financial assets credited to the residents’ securities accounts, a resident’s entitlement to virtual currency maintained for the resident by the licensee or provisional registrant would be considered under Article 9 (“Article 9”) of the UCC to be a “general intangible.”\footnote{UCC § 9-102(a)(42).} The filing of a financing statement would be the sole method for the secured party to perfect its security interest in the virtual currency account.\footnote{UCC § 9-310.} The priority of competing security interests in the virtual currency account would be determined in favor of the first secured party to file or perfect its security interest.\footnote{UCC §§ 9-322(a)(1).}
However, if the licensee or provisional registrant expressly agreed with residents to treat virtual currency of which the licensee or provisional registrant has control for the residents as financial assets credited to the residents’ securities accounts, a resident’s virtual currency account would be considered to be “investment property” under Article 9. The method of perfection of a security interest in the resident’s virtual currency account as investment property would be by either the filing of a financing statement or the secured party obtaining control of the investment property. A secured party who obtains control would have priority over a secured party who perfects by filing even if the filing preceded in time the control secured party obtaining control.

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

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

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

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

Transferees

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

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

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

The mere fact that the transferee may suspect or even be aware that its transferor may have granted a security interest in the transferor’s virtual currency account at its licensee or provisional registrant does not put the transferee on notice of an adverse claim to the virtual currency. Often, the secured party will have authorized the transfer of the virtual currency free of the security interest. For a transferee to be on notice of an adverse claim, the transferee must know, or have been willfully blind in avoiding knowing, that the acceptance by the transferee of a security entitlement in the transferred virtual currency violates the rights of the adverse 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.
Benefits the UCC Article 8 “Opt-in” for the Act

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

- Protecting the virtual currency of a resident from the claims of the licensee’s or provisional registrant’s own creditors.
- Requiring the licensee or provisional registrant to maintain control of sufficient virtual currency of each type to satisfy each resident’s entitlement to the virtual currency of that type.
- Subordinating the licensee’s or provisional registrant’s proprietary interest in virtual currency of a type, and establishing a ratable loss sharing rule among residents, if there is a shortfall in the virtual currency of that type of which the licensee or provisional registrant has control for residents.
- Requiring the licensee or provisional registrant to comply with a resident’s transfer instructions as to the virtual currency and, absent collusion with the wrongdoer, protecting the licensee or provisional registrant from liability to an adverse claimant for the transfer.
- Establishing that the commercial law relationship between the licensee or provisional registrant and the resident is the relationship that a securities intermediary has to an entitlement holder with respect investment property and is not to be viewed as falling under other relationships, such as an agency relationship or a relationship arising from a transaction to which UCC Article 2 applies or from a mere bailment under the common law.
- Clarifying secured transactions law on the perfection and priority of a security interest in a resident’s virtual currency account at a licensee or provisional registrant.
- Using UCC Article 8’s adverse claim cut-off rule to facilitate the transfer of virtual currency free of a secured party’s adverse claim of a security interest in the virtual currency.

Supplemental Provisions

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

Choice-of-law

Subsection (b)(1) requires that the agreement between the licensee or provisional registrant and a resident providing for the UCC Article 8 “opt in” be governed by the law of
UCC jurisdiction. The agreement may provide for the law of a non-UCC jurisdiction to apply to
the agreement, but only if the agreement also provides for the “securities intermediary’s
jurisdiction” to be that of a UCC jurisdiction and for the issues addressed in Article 2(1) of the
Hague Securities Convention to be governed by the law of the UCC jurisdiction.

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

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

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

Part 5 Duties

UCC Article 8 permits a securities intermediary and an entitlement holder to vary by
agreement the standard of care for a securities intermediary to comply with the Part 5 Duties. In
the absence of variation the standard of care is “due care in accordance with reasonable
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.
Subsection (b)(3) does not permit the parties to vary the standard below the “due care” default standard. This provision protects the resident from the licensee or provisional registrant lowering in the account agreement the standard of care that the licensee or provisional resident must follow in complying with its Part 5 Duties.

No Dealings with Resident’s Virtual Currency Account

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

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

Failure to “Opt in”

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

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

59 See UCC §§ 1-302 and 8-504(b).