

MEMORANDUM

FROM : Edwin E. Smith

TO: Members of, and Advisers and Observers to, the Drafting Committee on the Uniform Regulation of Virtual Currency Businesses Act

DATE: February 13, 2017

RE: Consideration of Incorporating Article 8 of the Uniform Commercial Code into the Uniform Regulation of Virtual Currency Businesses Act

As the Drafting Committee is considering further revisions to the draft of the Uniform Regulation of Virtual Currency Businesses Act (the “Act”), one question that has arisen is to what extent, if at all, the Act should incorporate protections for users similar to those given to customers of a bank or broker holding customer securities under Article 8 (“Article 8”) of the Uniform Commercial Code (the “UCC”) ¹ as well as possibly other provisions of Article 8.

This Memorandum is intended to assist the Drafting Committee by explaining how the provisions of Article 8 might work in the context of the Act. This Memorandum provides (a) some background to the question, (b) a summary of how the relevant provisions of Article 8 operate in general, (c) some observations as to how the provisions of Article 8 might operate in relation to the Act, (d) a discussion of the benefits and burdens of incorporating provisions of Article 8 into the Act, and (e) some other considerations if the provisions of Article 8 were to be incorporated into the Act.

Background

Thus far, no state statute regulating virtual currencies has addressed very basic commercial law questions as to the treatment of virtual currency under the control of a licensee if the licensee becomes insolvent. The October 2016 meeting draft of the Act contained Section 503. That section, modeled on UCC § 8-503, provided some minimal protection for users to the effect that virtual currency under the control of a licensee is not subject to the claims of the licensee’s creditors. However, there was some discussion at the October 2016 meeting of the Drafting Committee whether the Act should go further and incorporate all of the Article 8 provisions that might be relevant to the regulation of a virtual currency business.

It would appear that the options available to the Drafting Committee on the question are to:

¹ References to the Uniform Commercial Code or the “UCC” in this memorandum, are to the current Official Text of the Uniform Commercial Code promulgated by the American Law Institute and the Uniform Law Commission.

1. Delete Section 503 and not deal with the question at all,
2. Retain Section 503 and do no more,
3. Slightly expand Section 503 to incorporate some select additional Article 8 provisions but not incorporate all of Article 8's provisions,
4. Replicate all of Article 8 in the Act,
5. Require that, to obtain a license, an applicant must agree with users to "opt in" to Article 8, or
6. Require that the Department consider, as a factor in granting a license, whether the applicant will agree with users to "opt in" to Article 8.

To assist the Drafting Committee in deciding which option to choose, it is important that the Drafting Committee understand the relevant provisions of Article 8 and how those provisions might be useful in the context of the Act.

Summary of Relevant Provisions of Article 8

Substantive law

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 Article 8 is generally on investment securities, Article 8 itself is not so limited in its provisions relating to the indirect holding system.²

The key to understanding the scope of Article 8 in respect of the indirect holding system is first to understand the terminology used in Article 8 for the indirect holding system. Under 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".³ 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.⁴ A financial asset under Article 8 includes not only a "security" as defined in Article 8⁵ but also "*any property* that is held by a securities intermediary for

² See generally Official Comment 9 to UCC § 8-102.

³ UCC § 8-102(a)(14).

⁴ UCC §§ 8-501(a) and 8-102(a)(9).

⁵ UCC § 8-102(a)(15).

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” (emphasis added).⁶

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”⁷ and has what is called in Article 8 a “security entitlement” with respect to the financial asset.⁸ 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 Article 8.⁹

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 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,¹⁰ the duty to take action to obtain a payment or distribution made by the issuer of the financial asset,¹¹ the duty to exercise rights in respect of the financial asset as directed by the entitlement holder,¹² the duty to comply with the entitlement holder’s instruction (referred to in Article 8 as an “entitlement order”¹³) to transfer or redeem a financial asset,¹⁴ 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.¹⁵

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.¹⁶ 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

⁶ 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.”

⁷ UCC § 8-102(a)(7).

⁸ UCC § 8-501(b)(1).

⁹ UCC § 8-102(a)(17).

¹⁰ UCC § 8-504.

¹¹ UCC § 8-505.

¹² UCC § 8-506.

¹³ UCC § 8-102(a)(8).

¹⁴ UCC § 8-507.

¹⁵ UCC § 8-508.

¹⁶ UCC § 8-503(b).

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.¹⁷

The Part 5 Duties are generally enforceable by the entitlement holder against the securities intermediary under the UCC by a private right of action.¹⁸ And, while the securities intermediary is subject to the Part 5 Duties, the securities intermediary has certain protections under 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.¹⁹ The collusion standard suggests that the licensee's behavior must be egregious, or close to it, for the securities intermediary to be liable to an adverse claimant.²⁰

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.²¹ "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.²² The securities intermediary is not permitted to grant a security interest in the financial asset without the consent of the entitlement holder.²³

¹⁷ See generally Official Comment 1 to UCC § 8-503.

¹⁸ 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 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.

¹⁹ UCC § 8-115(3).

²⁰ See generally Official Comment 5 to UCC § 8-115.

²¹ UCC §§ 8-503(a) and 8-511(a), (b).

²² 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).

²³ UCC § 8-504(b).

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 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.²⁴

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.

Choice-of-law

Article 8 contains choice-of-law rules.²⁵ Generally, if a dispute arises in a court in a jurisdiction that has adopted the UCC (a "UCC jurisdiction") and concerning an issue addressed under 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.²⁶ There are currently no material differences between the Article 8 of one UCC jurisdiction and the Article 8 of another UCC jurisdiction in respect of matters relating to the indirect holding system.²⁷

How Article 8 Might Operate in Relation to the Act

²⁴ UCC § 8-503(b).

²⁵ UCC § 8-110. The choice-of-law rules for securities credited to a security account will be affected by the Hague Securities Convention. The Convention will become effective in the United States on April 1, 2017. However, the Convention applies only to "securities" as defined in the Convention. It is unlikely that the definition of "securities" in the Convention would include virtual currency.

²⁶ UCC §§ 8-110(b) and (e).

²⁷ 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).

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

More on terminology

For a licensee to be subject to Article 8, the licensee 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, which maintains accounts for users to which virtual currency is or may be credited, could expressly agree with the users to be subject to the rules of Article 8.

The definition of “securities intermediary” in 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.”²⁸

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.”²⁹

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 [Article 8].”³⁰

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.”³¹

Opt-in

²⁸ UCC § 8-102(a)(14)(ii).

²⁹ UCC § 8-501(a).

³⁰ UCC § 8-102(a)(9)(iii)

³¹ 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).

It follows that a licensee in the business of maintaining virtual currencies for users may expressly agree with the users that virtual currency maintained by the licensee for the users will be treated as “financial assets” credited to the users’ “securities accounts” under Article 8. 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 and a user. 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 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.”³²

Part 5 Duties of the licensee

If the licensee does expressly agree with users to treat virtual currency maintained by the licensee for the users as financial assets credited to the users’ securities accounts, then the licensee has the following Part 5 Duties relevant for a virtual currency and enforceable by the users by private right of action:

- *The duty to maintain sufficient financial assets to satisfy all security entitlements to the financial assets.*³³

The licensee would need to maintain sufficient virtual currency of each type to satisfy all entitlements of the users to virtual currency of that type.

- *The duty to comply with the entitlement holder’s entitlement orders to transfer or redeem a financial asset.*³⁴

The licensee would need to comply with a user’s instructions to transfer virtual currency maintained for the user to another person, as and when, for example, the user 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.*³⁵

The licensee would need to comply with a user’s instructions to transfer virtual currency maintained for the user to another licensee for the account of the user or to another eligible account of the user.

³² UCC §§ 8-110(b) and (e)(1) and (2).

³³ UCC § 8-504.

³⁴ UCC § 8-507.

³⁵ UCC § 8-508.

These Part 5 Duties would not appear to be controversial. They seem to be consistent with a user's expectations of the licensee's performance with respect to virtual currency maintained by the licensee for the user.

Licensee protections

If licensee transfers a virtual currency as instructed by the user, the licensee generally cannot be held liable to an adverse claimant to the virtual currency for the transfer unless the licensee acted in collusion with the wrongdoer in violating the rights of the adverse claimant.³⁶

Creditor claims

If the licensee expressly agrees with users to treat virtual currency maintained by the licensee for the users as financial assets credited to the users' securities accounts, then current Section 503 of the draft Act may not be necessary. 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.³⁷ Accordingly, virtual currency maintained by a licensee for a user would not be subject to claims of creditors of the licensee.

That being said, under Article 8 the virtual currency would be subject to a claim of a creditor of the licensee, senior in priority to the user's entitlement, if (a) the licensee has granted to the creditor a security interest in the virtual currency, (b) the creditor has control of the virtual currency, and (c) the licensee 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.³⁸ The licensee, though, is not permitted under Article 8 to grant a security interest in the virtual currency without the consent of the user.³⁹

Secured transactions

If the licensee expressly agrees with users to treat virtual currency maintained by the licensee for the users as financial assets credited to the users' securities accounts, then several problems that exist today under secured transactions law would be addressed. Addressing these problems would facilitate the greater availability of credit or lower its costs for a user who wishes to offer the user's virtual currency account at the licensee as collateral for a loan or other obligation and would otherwise facilitate the utility of virtual currency as a medium of exchange.

Competing security interests

³⁶ UCC. § 8-115(3).

³⁷ See UCC § 8-503(a).

³⁸ UCC §§ 8-503(a) and 8-511(a), (b).

³⁹ UCC § 8-504(b).

One problem concerns the method of perfection and the priority of a security interest that the user might grant in the user's virtual currency account. Absent the licensee expressly agreeing with users to treat virtual currency maintained by the licensee for the users as financial assets credited to the users' securities accounts, a user's entitlement to virtual currency maintained for the user by the licensee would be considered under Article 9 ("Article 9") of the UCC to be a "general intangible."⁴⁰ 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.⁴¹ 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.⁴²

However, if the licensee expressly agreed with users to treat virtual currency maintained by the licensee for the users as financial assets credited to the users' securities accounts, a user's virtual currency account would be considered to be "investment property" under Article 9.⁴³ The method of perfection of a security interest in the user'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.⁴⁴ 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.⁴⁵

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

⁴⁰ UCC § 9-102(a)(42).

⁴¹ UCC § 9-310.

⁴² UCC §§ 9-322(a)(1).

⁴³ UCC § 9-102(a)(49)(defining "investment property" to include a "security entitlement" and a "securities account").

⁴⁴ UCC §§ 9-312(a) and 9-314(a).

⁴⁵ UCC § 9-328(a).

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 user'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 itself is the secured party or the virtual currency is credited to an account of the secured party at another licensee, the secured party, the user and the licensee would need to enter into a control agreement by which the licensee would agree to follow instructions from the secured party to transfer the virtual currency without any further consent of the user.⁴⁶ Such an agreement may require a mechanism for the user confidentially to inform the secured party of the user's private 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 user 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.⁴⁷ 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 expressly agreed with users to treat virtual currency maintained by the licensee for the users as financial assets credited to the users' securities accounts, then the adverse claim cut-off rule of 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, the transferee will have acquired its interest in the virtual currency free any "adverse claims" of which the transferee did not have notice.⁴⁸

⁴⁶ See UCC §§ 8-106(d) and (g) and 9-106(a).

⁴⁷ See UCC § 9-315(a)(1).

⁴⁸ 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.").

An “adverse claim” 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.⁴⁹

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 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.

Benefits and burdens of incorporating Article 8 into the Act

Incorporating Article 8 provisions into the Act will have both benefits and burdens for the Act.

Benefits

Incorporating Article 8 into the Act will have some clear benefits for users that in turn support responsible behavior by licensees:

- Protecting the virtual currency of a user from the claims of the licensee’s own creditors.
- Requiring the licensee to maintain sufficient virtual currency of each type to satisfy each user’s entitlement to the virtual currency of that type.
- Subordinating the licensee’s proprietary interest in virtual currency of a type, and establishing a ratable loss sharing rule among users, if there is a shortfall in the virtual currency of that type maintained by the licensee for users.
- Requiring the licensee to comply with a user’s transfer instructions as to the virtual currency and, absent collusion with the wrongdoer, protecting the licensee from liability to an adverse claimant for the transfer.

⁴⁹ 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.

- Clarifying secured transactions law on the perfection and priority of a security interest in a user's virtual currency account at a licensee.
- Using 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.

Burdens

However, there may also be some burdens incorporating Article 8 into the Act:

- Incorporation may slow or otherwise jeopardize the enactment process for the Act by referring to an entire body of law, i.e., Article 8, that may be unfamiliar to users, licensees, government authorities and others involved in the enactment process.
- Incorporation may preclude or interfere with other efforts at the federal or state level to provide protections to users or to address the commercial law issues relating to virtual currency.
- The strategy of using Article 8 for virtual currency is novel and may have unforeseen consequences.

Other considerations

If the Drafting Committee decided as a policy matter that Article 8 provisions should be incorporated into the Act, the simplest technique for implementing that policy would be to require, as a condition to obtaining a license, (a) the licensee to agree with its users in their account agreements to treat virtual currency maintained for the users as financial assets credited to the users' security accounts under Article 8 and (b) for the account agreements between the licensee and the users to be governed by the law of a UCC jurisdiction or otherwise require that a UCC jurisdiction be the "securities intermediary's jurisdiction" for purposes of the UCC.⁵⁰

The alternative of replicating Article 8 provisions in the Act has its drawbacks. It would require thoughtful and extensive drafting by our Reporter. Moreover, merely incorporating Article 8 provisions into the draft would result in the loss of the secured transaction benefits that come from the "opt-in" to Article 8. By replicating Article 8 provisions in the Act without also amending the UCC itself, the Act would not permit the perfection and priority of a security interest in a virtual currency account over which a secured party merely has control, and it would not cut off an Article 9 security interest when virtual currency was transferred from the account.

⁵⁰ UCC §§ 8-110(b) and (e).

This Memorandum does not address whether Article 8 provisions should apply to a provisional registrant. Even if the Drafting Committee were to decide that a licensee should be subject to Article 8 provisions, there may be competing considerations relating to encouraging start-ups, innovation and the like that may affect whether the same decision should be made for a provisional registrant.