



UNIFORM REGULATION OF VIRTUAL-CURRENCY BUSINESSES ACT AND UNIFORM SUPPLEMENTAL COMMERCIAL LAW FOR THE UNIFORM REGULATION OF VIRTUAL-CURRENCY BUSINESSES ACT

Frequently Asked Questions on the Relationship to Distributed Ledger Technology

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The Uniform Law Commission finalized the Uniform Regulation of Virtual-Currency Businesses Act (the “URVCBA”) in 2017 and the Uniform Supplemental Commercial Law for the Uniform Regulation of Virtual-Currency Businesses Act (the “Supplemental Act”) in 2018. Since then, various questions have been raised as to how the URVCBA and the Supplemental Act relate to the development of distributed ledger technology, including “blockchains,” and what risks, if any, the URVCBA and the Supplemental Act may pose to users of this technology. Below is a list of the questions frequently asked with responses.

Does the URVCBA regulate distributed ledger technology or virtual currency?

No. The URVCBA regulates those businesses that store, transfer, or exchange virtual currency for their customers, i.e., virtual currency custodians. The businesses that are subject to regulation in the enacting state generally do not include banks, broker-dealers, or other businesses that are already heavily regulated at the state or federal levels. The URVCBA regulates virtual-currency businesses whose virtual currency custodial activities are not already heavily regulated.

The URVCBA regulates neither distributed ledger technology nor virtual currency. Although distributed ledger technology is a primary means of verifying transactions in virtual currency, the URVCBA regulates the custodians, not the technology or the virtual currency.

What are the benefits of the URVCBA?

The URVCBA offers both more flexible licensing and pre-licensing “registration” of custodians than has existed under state “money transmitter” laws and enhanced protections for customers of the custodians. The URVCBA has numerous exclusions and exemptions that help achieve this flexibility and still afford protections for custodial customers. Among these are an absolute exemption for a business whose volume of activity falls below \$5,000 annually and a registration option for a business with a volume from \$5,000 to \$35,000 annually. Licensing is required only for a business whose volume exceeds \$35,000 annually.

Customer protection requirements for custodians include those relating to minimum capitalization, cybersecurity, disclosure, record-keeping, inspection and proper custody of customer assets that are designed to ensure that virtual currency customers have protections similar to those of customers of regulated banks, broker-dealers, and traditional money transmitters.

Will the URVCBA stifle innovation?

No. Given the low volume exemption and the low volume registration requirement discussed above, the URVCBA will assist virtual-currency businesses by providing room for testing, revision and growth.

Why does the URVCBA not address directly-held virtual currency?

The Uniform Law Commission understood from industry groups and other stakeholders that the regulation of the custodian function was the area requiring the most immediate attention. States had begun to enact their own bespoke regulatory schemes for the virtual-currency custodial function, driving up the costs of virtual currency transactions. The URVCBA provides a uniform set of rules for regulating the custodial function. If widely enacted, the URVCBA will address the concern of non-uniform regulation among the states while still providing prudent custodial oversight of virtual currency custodians.

What are the benefits of the Supplemental Act?

The Supplemental Act results in virtual currency held by custodians for customers being characterized under the Uniform Commercial Code (the “UCC”), enacted in all states, as “investment property” under Article 9 of the UCC and “financial assets” credited to a “securities account” in the indirect holding system under Article 8 of the UCC. This characterization has two immediate benefits:

1. Under the Article 8 rules, transfers of virtual currency to innocent purchasers for value are free of third-party property claims to the virtual currency, enhancing the liquidity of virtual currency and thereby enhancing its use as a payment method.
2. Under the Articles 8 and 9 rules, security interests in virtual currency held with a custodian may be perfected by “control” without necessity of the secured party perfecting the security interest by the filing of a financing statement, obtaining a release or subordination from any earlier filed conflicting secured party or monitoring the debtor/user for any change of location requiring the filing of a new financing statement. This method of perfection enhances the use of custodial held virtual currency as collateral for extensions of credit at a lower risk to the lender and lower cost to the borrower.

The Supplemental Act also contains various user protections further described below.

Will the URVCBA and the Supplemental Act encourage users of virtual currency to hold virtual currency through a custodian rather than directly?

The URVCBA Act and the Supplemental Act are agnostic on whether virtual currency is held directly by the user or is held indirectly through a custodian. If the user wishes to obtain the benefits of the URVCBA and the Supplemental Act, the user may hold the virtual currency through a custodian. But neither the URVCBA Act nor the Supplemental Act requires this or even encourages it. The choice between holding virtual currency through a custodian or directly is left to the marketplace.

Will the URVCBA Act and the Supplemental Act expose a user of virtual currency to the insolvency risk of the custodian?

The URVCBA contains minimum capital and other requirements designed to protect the user from the risk of the custodian’s insolvency. The Supplemental Act incorporates the provisions of Article 8 of the UCC by

which, except in very limited situations, virtual currency held for users is not subject to the claims of the custodian's creditors.

Will the URVCBA Act and the Supplemental Act expose a user to the risk of misconduct by the custodian?

The URVCBA contains various record-keeping, reporting, inspection and similar requirements to minimize the risks of custodian misconduct. The Supplemental Act incorporates provisions of Article 8 of the UCC that require custodians to maintain enough virtual currency of each type to satisfy the entitlement of each user to virtual currency of that type. The Supplemental Act also prohibits the custodian from contractually lowering the standard of performance of its duties under Article 8.

Like any regulatory scheme, the URVCBA and the Supplemental Act cannot fully eliminate the risk of custodian misconduct any more than the regulation of banks, securities issuers, broker-dealers or other intermediaries can prevent that risk. But the safeguards of the URVCBA and the Supplemental Act are substantial and, again, do not require the use of a custodian but leave to the marketplace the decision by the user on how to hold virtual currency.

Will the Supplemental Act expose a user to the risk that its virtual currency has been repledged to a third party?

The Supplemental Act incorporates the provisions of Article 8 of the UCC that require the user's consent to any repledge of the virtual currency by the custodian for the custodian's own account. The Supplemental Act, in fact, goes beyond Article 8 by prohibiting the custodian from obtaining that consent.

If the Supplemental Act requires custodial held virtual currency to be treated, like custodial held securities, as a financial asset under Article 8 of the UCC, does that treatment suggest that virtual currency is a security under other law?

No. A specific provision of the Supplemental Act states that the treatment of custodial held virtual currency as a financial asset under Article 8 does not determine the treatment of virtual currency under other law.

If the URVCBA Act and the Supplemental Act do not address directly-held virtual currency or other commercial law rules affected by distributed ledger technology, how can the law be improved to fill that hole if it exists?

The Uniform Law Commission believes that the answer to this question requires study, especially in the context of the UCC. Of particular importance is the development of uniform statutory provisions, if any are needed, that not only provide the substantive law but also uniform choice-of-law rules that discourage conflicting outcomes and forum shopping among the states. The Uniform Law Commission and its UCC partner, the American Law Institute, have formed a study committee to look at these issues in a deliberative fashion. Further information concerning the work of the study committee may be obtained by contacting the Uniform Law Commission's Chicago office at (312) 450-6600.