

## **Perfecting a Security Interest in Digital Assets** **Clarification is Coming**

Many individuals and entities now own digital assets – such as cryptocurrency or nonfungible tokens (NFTs). And if those individuals or entities want to borrow money they may want to use their digital assets as collateral for the loan. Although lenders are increasingly willing to accept digital assets as collateral, they have run into a problem – namely, how to perfect their security interest in the digital assets.

### **Perfecting an Interest in Personal Property**

Digital assets are personal property. And the perfection of a security interest in personal property is, in general, governed by Article 9 of the Uniform Commercial Code (UCC) – which has been adopted by every state.

Perfection under Article 9 can be accomplished by filing a UCC-1 financing statement, by controlling the property, or by possessing the property. Which method to use depends upon how the property is characterized in Article 9. Although Article 9 lists a number of different property types, digital assets are not included – which is not surprising considering that the ownership of digital assets was not nearly as common in 2010 – the last time Article 9 was revised.

## **Perfecting an Interest in Digital Assets under Current Article 9**

Because Article 9 does not include digital assets, lenders have analogized them to the types of property that are included in Article 9. Some lenders have treated digital assets as “general intangibles” – which are perfected by filing a UCC-1 financing statement. Others as “investment property” – which can be perfected by filing a UCC-1 or, preferably, by control. Some analogized them to “money” – which is perfected by possession. But because digital assets are intangible, there was uncertainty as to whether they could be controlled or possessed.

### **Clarity is Coming**

Clarification as to how to perfect a security interest in digital assets is on the way. A few states have already amended their versions of Article 9 to address the issue. In addition, the Uniform Law Commission and American Law Institute have proposed amendments to the UCC, which are expected to be offered to the states for enactment later this year. The UCC draft amendments include a new Article 12, which governs transfers of interests involving a subset of digital assets referred to as “controllable electronic records” or “CERs”, as well as amendments to Article 9 addressing the perfection of a security interest in these CERs.

In general, the states that have already amended their laws, as well as the UCC draft amendments, provide that a security interest in digital assets or CERs can be accomplished by filing a UCC-1 and/or by controlling the asset. They also provide that a lender that has perfected by control takes priority over a lender that has perfected by filing a UCC-1 but not by control.

The laws also define control. Under the UCC draft amendments, for example, control occurs when a person has (1) the power to enjoy substantially all of the benefits of the CER, (2) the exclusive power to prevent others from enjoying substantially all of the benefits of the CER, and (3) the exclusive power to transfer control of the CER.

## **Conclusion**

Recent amendments to a small number of state UCC laws, as well as proposed changes to the UCC itself that states may be able to adopt, are clarifying how lenders can perfect their security interests in cryptocurrency, NFTs, and certain other kinds of digital assets. If all states (or at least most states) amend their versions of Article 9 to address this issue it should provide a level of comfort for lenders and borrowers interested in using digital assets as collateral. However, it is important that they keep track of the state legislative developments to see if and when they have amended their versions of Article 9 to address the perfection of security interests in this increasingly popular asset class.