How Lenders Should Prepare for Crypto as Collateral

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Considering this administration's desire to position the U.S. as a digital banking capital and the ongoing loosening of restrictions from the Office of the Comptroller of the Currency,[1] lenders must prepare themselves for the wishes of their customers to utilize digital assets as a basis for securing financings.

This article is intended to provide a concise report of the Uniform Commercial Code provisions governing the classification of cryptocurrency among the states, as well as an overview of potential risks when considering the use of cryptocurrency as collateral.

Brief History

The UCC is a set of laws governing voluntary commercial transactions. Article 9 of the UCC governs the creation and perfection of security interests in most personal property according to the classification of such property.

As cryptocurrency has risen to prominence and has gained, and lost, significant value, lending institutions have grappled with the classification of cryptocurrencies under the UCC. Namely, if a borrower wants to utilize their cryptocurrency holdings to secure a loan, how does one perfect their security interest in such cryptocurrency?

Importantly, the defining feature of cryptocurrencies, in addition to being digital, is the lack of a government-controlled or regulated central authority. Instead, cryptocurrencies are maintained on blockchains, or digital ledgers, which record the transactions and are generally publicly available.

Blockchain transactions are identifiable by a public key, which is an alias for the individual performing the transaction and does not contain any identifying information. Therefore, while one can see the transactions recorded on the blockchain, those transactions cannot be linked to the individuals underlying the transaction without

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additional knowledge.

These features appeal to the consumer but are also inherent in the difficulties of lenders in securing such assets.

To address this uncertainty, the Uniform Law Commission prepared a set of modifications known as the 2022 Amendments, which have been adopted in 25 jurisdictions, including the District of Columbia and 24 states. Ten more states have introduced their own legislation, including Florida and New York.[2]

Default Treatment of Cryptocurrencies under UCC

Given that cryptocurrencies are designed to be used in place of traditional money, one may assume that cryptocurrencies would be treated as money under the UCC.

However, money is narrowly defined as "a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries."

Because one feature of cryptocurrency is the lack of a central regulatory body, it is evident that cryptocurrency would not currently fall within the definition of "money" under the UCC.

However, there was speculation that upon El Salvador's adoption of Bitcoin as legal tender, Bitcoin would now be considered "money."[3]

This is because under the Official Comment to the 2001 version of the UCC allows the subsequent adoption and broader definition of money to apply, "The test is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected."

This view has been summarily rejected by the Uniform Law Commission and the definition of money has been amended as part

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of the 2022 Amendments to address such an application. However, such an application of the definition of money to cryptocurrency would prevent anyone from being able to perfect a security interest in cryptocurrency.

This is because the only method of perfection for money is control, which requires possession of the money.[4] Thus, it would be impossible to have a perfected secured interest in cryptocurrency because there is no mechanism to possess it.

Therefore, holdings of any cryptocurrency or other digital currency would likely default into the definition of "general intangibles."[5] Consequently, the only method of perfecting one's security interest in cryptocurrency would be the recording of a financing statement. This poses a significant risk for any lender securing a loan with such assets.

To reduce the risk, a creditor should require the interest to be properly identified, which would require the identification of the public key. Given cryptocurrency's essential characteristic of anonymity, it is unlikely that any debtor would desire or consent to having their personal information linked with their cryptocurrency identity so publicly.

Alternatively, a lender may require the private key for such cryptocurrency as the only mechanism for repossession of such collateral if debtor were to default. This alone does not provide complete protection, as the debtor has access to the private key and could also give access to a third party.

Thus, the collateral could fail to exist or be recoverable at the time of default.

Even in light of the risks of classification as a general intangible, there are still unaddressed issues of priority and competing lenders. As a general intangible, priority is determined by the "first-in-time" filing of a financing statement.

Thus, if a lender with a later security interest intends to secure its loan against the debtor's cryptocurrency and even has possession of the private key, the lender's interest may be subordinate to an earlier interest if the collateral under the earlier filed financing

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statement includes “all general intangibles.”

Ultimately, the default treatment of cryptocurrency under the UCC leaves all participants wanting. While still possible to use as collateral, the lender must consider the risks associated with a security interest in cryptocurrency prior to the loan as well as during the life of the loan.

Impact of Adoption of 2022 Amendments

Definition of Money and Electronic Money

As discussed, the 2022 Amendments narrow the scope of the definition of money. The amended definition states, “The term does not include an electronic record that is a medium of exchange recorded and transferable in a system that existed and operated for the medium of exchange before the medium of exchange was authorized or adopted by the government.”

For that reason, Bitcoin and any other cryptocurrencies not adopted by the government at its inception cannot ever become classified as money under the UCC, which specifically excludes situations like the adoption of Bitcoin by El Salvador.[6]

When specifically created and adopted by a government, such digital currency would fall within the definition of “electronic money” or “money in an electronic form.” The 2022 Amendments provide a new Section 9-105A for the detailing of “Control of Electronic Money” to combat the impossibility of obtaining control of electronic money under the same mechanism as money.

Controllable Electronic Records

The new Article 12 addresses “controllable electronic records.” A controllable electronic record is defined as “a record stored in an electronic medium that can be subjected to control under Section 12-105.”[7] Under Section 12-105, the following powers are required to have control over an electronic record:[8]

- Ability to utilize substantially all the benefit from the electronic record;

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- Exclusive ability to prevent others from obtaining such benefit from the electronic record;
- Exclusive ability to transfer control of the electronic record to another person or cause another person to obtain control of another controllable electronic record by a transfer; and
- Ability to identify itself as the person having such powers, "in any way, including by name, identifying number, cryptographic key, office, or account number."

While potentially misleading, the exclusive power required under Section 12-105 includes power shared with another person.[9] Control may also be obtained through another person on behalf of the lender.

Even though cryptocurrency must be able to be subject to control to be within the definition of controllable electronic record, lenders are able to perfect their interest in controllable electronic records by either control or filing.

Control is the preferred method of perfection because it also provides priority over any other security interests in the collateral, including those perfected by filing.

Choice of Law

Newly created Sections 12-107 and 9-206B supply the rules for determining the governing laws (critically, the laws relating to perfection and priority) of controllable electronic records.[10]

If the lender decides to perfect its interest by control, the controllable electronic record is subject to jurisdiction based upon a choice of law waterfall that prioritizes expressly stated UCC jurisdictions, expressly stated jurisdictions, and finally defaults to the District of Columbia.

This choice of law waterfall only applies to matters covered by Article 12 of the UCC. Thus, if securing multiple types of collateral, it is possible that without careful consideration of jurisdictions, multiple jurisdictions could govern a security agreement.

Even potentially more problematic, the choice of law waterfall could result in a jurisdictional outcome that returns the cryptocurrency to

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its default treatment as a general intangible.

Alternatively, if the lender decides to perfect its interest by filing a financing statement, the controllable electronic record is subject to the laws of the debtor's location.

Considerations of Cryptocurrency as Collateral

In this divided landscape, lenders should consider which rules their transaction is subject to and their ability to obtain or maintain control of the cryptocurrency. Even if the lender has possession of the private key, the lender should work to mitigate risks as it is possible for the debtor to provide access to the private key to other parties, including other lenders or even sold to a qualified purchaser.

Lenders should consider a control agreement in a form similar to a securities account control agreement or a more creative solution, such as partnering with a digital wallet provider to enable control. Further, lenders should consider the volatility of the asset.

Is there a plan for what happens if the value of the cryptocurrency asset declines significantly or becomes worthless? Lenders can contemplate financial reporting and reserve requirements to mitigate some risk with respect to this possibility.

Finally, lenders must consider the treatment of cryptocurrency under bankruptcy and the potential treatment of such assets under the bankruptcy code. For more information, contact the authors or any member of our Commercial Finance Practice.

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[1] Interpretive Letter 1183, OCC Letter Addressing Certain Crypto-Asset Activities, https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2025/int1183.pdf.

[2] UCC, 2022 Amendments to – Uniform Law Commission, https://www.uniformlaws.org/committees/community-home?communitykey=1457c422-ddb7-40b0-8c76-39a1991651ac#LegBillTrackingAnchor.

[3] Brian M. McCall, How El Salvador Has Changed U.S. Law by A Bit: The Consequences for the UCC of Bitcoin Becoming Legal Tender, 74 Okla. L. Rev. 313, 319 (2022).

[4] Commercial Code § 9-312.

[5] "'General intangibles' means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, and money." Unif. Commercial Code § 9-106.

[6] Uniform Law Commission, Statement on Central Bank Digital Currency and the 2022 UCC Amendments (April 12, 2023), https://higherlogicdownload.s3.amazonaws.com/UNIFORMLAWS/b7c515db-1895-4387-bb2d-ee99e58c0066/UploadedImages/Documents/ULC_Statement_on_the_UCC_a

[7] Record is defined in Section 1-201 and includes "information . . . that is stored in an electronic or other medium and is retrievable in perceivable form." In the Official Comments, it is noted that an electronic record could include "music stored on compact disks, email messages, digital photos, personal and other information stored on a social media platform, and all types of databases stored on in an electronic medium."

[8] While not discussed in this article, control is required for a person to become a "qualifying purchaser" which allows a person to take the controllable electronic records free of liens. §12-104.

[9] Section 12-107(c) provides that a power is not shared when "(1) the person can exercise the power only if the power also is exercised by the other person; and (2) the other person: (A) can exercise the power without exercise of the power by the person; or

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(B) is the transferor to the person of an interest in the controllable electronic record or a controllable account or controllable payment intangible evidenced by the controllable electronic record."

[10] Section 1-301 of the UCC, which provides that the parties may choose their own governing laws when reasonably related to the subject of the transaction, is limited by § 12107.

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