UNIVERSITY OF SASKATCHEWAN

REGULATING THE USE OF CRYPTO-ASSETS IN SECURED TRANSACTIONS: REFORM OF THE APPLICABLE PERFECTION PROVISIONS OF THE PERSONAL PROPERTY SECURITY ACT

ESEOSA OSAYUWAME OMORUYI

INTRODUCTION

The term "perfection" in the secured financing context is the process of completing the claim of a security interest in particular collateral. The aim of perfection is to notify the entire world that the secured party has a security interest in the debtor's collateral and give the secured party priority against third parties with competing interests in the collateral. In other words, the perfection of collateral enables the secured party to maintain priority of payment over other creditors if the debtor defaults on its payment obligation and the collateral needs to be sold to offset the debtor's outstanding obligations.

Crypto-assets as collateral in secured transactions

Cryptocurrency is a relatively new asset class that has become recognized as a store of value. This is because it is viewed as a good hedge against inflation and is expected to appreciate over time. Its attraction as a form of collateral is therefore growing and is already being used this way by millions of people as security for their fiat loans. The Personal Property and Security Act does not currently provide specific coverage for the regulation of crypto-assets and the current rules applicable to crypto-assets are insufficient and do not take into consideration the unique nature of the asset class. This has led to concerns around the methods available for lenders to perfect their security interests in crypto-assets under the PPSA and enforce their rights in the event of debtor default.

OBJECTIVES

1. To advocate for the specific coverage of crypto-assets under the PPSA.
2. To identify the issues currently plaguing the perfection of security interests in crypto-assets.
3. To recommend an expansion of the options for perfection of crypto-assets under the PPSA.
4. To analyze regulatory efforts made by other jurisdictions (the United States) in the categorization and perfection of crypto-assets in secured finance legislation.
5. To make recommendations for reform of the PPSA.

WHY WE NEED A SPECIFIC FRAMEWORK FOR THE PERFECTION OF CRYPTO-ASSETS

The PPSA defines personal property as *"goods, chattel paper, investment property, a document of title, an instrument, money or an intangible."* It has been argued that Crypto-assets be categorized as money but it is clear from the treatment of money under the PPSA that it is intended to be a tangible asset.

Also, the scope of crypto-assets has expanded far beyond currencies and so money will not be an appropriate categorization. On the other hand, crypto-assets do not automatically fall under the categorization of investment property, because a securities intermediary has to agree to treat it that way before it can be categorized as such. The only safe way to categorize crypto-assets at this point is as an intangible, which is a residual category under the PPSA.

Intangibles can only be perfected by registration. This means that a secured party can register its interest in crypto-assets at the property registry but has no right under law to hold these assets. This means that the debtor can dispose of his crypto-assets without the secured party's knowledge and the secured party would need to file an action for enforcement of its security interest in court.

This is problematic because there is no guarantee that the secured party would be able to recover its investment, and this may discourage them from accepting to deal in crypto-related secured transactions. Unlike other forms of collateral that can be easily seized by the secured party upon debtor default, the secured party cannot access the debtor's crypto-assets without having the private key of the debtor, and even where the debtor discloses its private key to the secured party prior to the default, there is no guarantee that the debtor would not transfer the crypto-assets from its wallet if he maintains total control over the assets.

FINDINGS

1. The recent declaration of Bitcoin as legal tender in El Salvador automatically re-categorizes Bitcoin as money under the PPSA. This is not appropriate because the PPSA contemplates money to be a tangible asset and the applicable perfection rules reflect this.
2. Perfection by control is necessary to protect secured parties who agree to accept crypto-assets as collateral.
3. Crypto-assets can be regulated in a similar manner to investment property and an examination of the law governing investment property will be helpful in developing a workable perfection and enforcement framework for crypto–assets.
4. Any effective control mechanism must aim to protect not only the secured party but also the debtor. This means that total control by one party may lead to an undesirable outcome.

RECOMMENDATIONS

1. The term "crypto-asset" should be defined under the PPSA and should be specified as a type of personal property under the PPSA. The term "controllable electronic record", which has been suggested in draft Article 12 of the Uniform Commercial Code (UCC) in the United States may be utilized to cover a broader range of digital assets such as Non-Fungible Tokens (NFTs).
2. The definition of money under the PPSA needs to be amended to either clarify that it only applies to tangible legal tender, or specifically exclude digital assets that may otherwise be classified as currency.
3. Control of crypto-assets may be achieved through an escrow mechanism, where a neutral party (human or AI) holds the assets on behalf of the parties. Several platforms that accept crypto-asset collateral already use smart contracts to automate the escrow process. However, many of these are rigid and do not give the debtor an opportunity to cure the default. The law can offer more protection to debtors in this case, by providing minimum protections such as grace periods, to allow them to cure the default and redeem their collateral.
4. In reforming the PPSA, Canada should consider reviewing provisions of the draft article 12 of the UCC as it contains thoughtful provisions that reflect a deep understanding of the unique nature of crypto-assets and the issues that may be encountered in its perfection.

REFERENCES

Clayton Bangsund, *Bangsund on the PPSA: The CCPPSL Model* (Thomson Reuters, 2021).
Bankruptcy and Insolvency Act, RSC 1985, c B-3.
Enforcement of Money Judgments Act, SS 2010, c E-9.22
Personal Property Security Act, SS 1993, c P-6.2.
Personal Property and Security Regulations, RRS c P-6.2 Reg 1.
Securities Transfer Act, SS 2007, c S-42.3.
Ashlyn Robinson, "Crypto-Collateral? Securing Loans with Digital Currency" (21 March 2019) online: Yahoo Finance <finance.yahoo.com/news/crypto-collateral-securing-loans-digital-070045279.html>[perma.cc/TDV7-ZWXE].
Geoffrey Peck & Steven Bleiberg, "Security Interests: Bitcoins and other Cryptocurrency Assets" (24 April 2019), online: Practical Law Finance <media2.mofo.com/documents/190424-security-interests-bitcoins-cryptocurrency.pdf>.
Laurel Tincher, "What is a Private Key? How Cryptocurrency Keys Work" (1 April 2021), online: Sofi Learn <www.sofi.com/learn/content/private-key/ > [perma.cc/8NQY-KVDS].
RCC Cuming et al, "Report to the Canadian Conference on Personal Property Security Law on Proposals for changes to the Personal Property Security Acts," 2017 CanLiiDocs 3526 ("CCPPSL Reports"), online: <www.canlii.org/en/commentary/doc/2017CanLIIDocs3526?zoupio-debug&printMode=all#!fragment//(hash:(chunk:(anchorText:''),notesQuery:'',searchQuery:'',searchSortBy:RELEVANCE,tab:toc)) >[perma.cc/9BKQ-BNQE].
Steven Harris, "Memorandum to the Committee on the Uniform Commercial Code and Emerging Technologies" (22 January 2021), online: Uniform Law Commission <www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=9afdf04c-04f8-5b6c-0ee6-8610af6ffe71&forceDialog=0> [perma.cc/438B-4UR3].
Timothy Jones & Dillon Collett, "Cryptocurrency Assets Under Insolvency and Personal Property Security Law" (15 February 2018), online: Aird & Berlis, <www.airdberlis.com/insights/publications/publication/cryptocurrency-assets-under-insolvency-and-personal-property-security-law> [perma.cc/CG64-D4N4]

ACKNOWLEDGEMENTS & CONTACT

Thank you to Professor Clayton Bangsund of the College of Law for providing me with a firm grasp of secured finance law.

Contact
Eseosa Omoruyi
Master of Laws Candidate
College of Law, University of Saskatchewan
ydr739@usask.ca