AFME-AGC joint response to The Law Commission Public Consultation on Digital Assets

This response is on behalf of the AFME Post Trade Legal Committee and the Association of Global Custodians – European Focus Committee ("The Associations").

AFME[1], through its Post Trade Legal Committee, has previously responded to the Law Commission's Call for Evidence on Digital Assets in 2021, and its consultation on Intermediated Securities in 2019, as well as contributing to other DLT-related initiatives in the EU and UK.

The Association of Global Custodians – European Focus Committee ("AGC-EFC")[2] also responded to the above-mentioned Law Commission consultations and has engaged extensively with government and regulatory authorities throughout the world to support their work to better understand our industry and ensure the safe and efficient provision of securities custody services for the benefit of investors and the financial system as a whole. The Association continues to support these efforts and stands ready to provide assistance and information – within the boundaries of competition and antitrust constraints - as authorities require. The Association has actively participated in DLT-related initiatives across the EU, the UK and the United States.

The Associations have read with interest the Law Commission's Digital Assets: Consultation Paper 256 (the "CP").[3] As the associations representing the largest part of the custody services sector, we wish to raise some points for consideration by the Law Commission as it considers

[1] The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. We represent the leading global and European banks and other significant capital market players. We advocate for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

[2] Established in 1996, the Association of Global Custodians (the "Association") is a group of 12 global financial institutions that each provides securities custody and asset-servicing functions primarily to institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members' common interests on regulatory and market structure. The member banks are competitors, and the Association does not involve itself in member commercial activities or take positions concerning how members should conduct their custody and related businesses. The members of the Association are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company.

[3] Law Commission, *Digital Assets Consultation Paper*, Law Com No 256 (28th July 2022).

the way forward. We wish to address the CP first with this introductory note in order to explain areas of emphasis and special concern: our responses to the specific questions raised in the CP are attached as an Appendix. Our contribution is based upon practical experience, as well as the work that has been undertaken for several decades to achieve more efficient and effective post-trade operations for the securities markets.

We agree with the Law Commission that the development of new technologies means that the legal position of securities issued under English law using Distributed Ledger Technology ("DLT") systems needs to be considered urgently in order to avoid English law being relegated as a legal system of choice for international capital markets.

There are a number of challenges arising from the introduction of innovative technology and business models for the entire life cycle of securities transactions – primary issuance, secondary trading, clearing, settlement and custody – using DLT systems. Some of these are inherent to systems that are utilised and business models employed by market participants. Others are connected to the international features of securities markets. Still others are linked to unique features of English law. In this note, we highlight some key areas for attention, but our overarching concern is that there is a continuing need to address (and preferably codify) the status of dematerialised, book-entry, securities under English law. In order to place new systems for securities issuance, transfer, clearing, settlement and custody on a sound footing, it seems to us essential to recognise and address the outstanding problems of book-entry securities.[4] Otherwise, outstanding problems will be carried forward from one set of systems to another; potentially becoming more pronounced as business models and the roles of securities intermediaries evolve.[5]

We note that the Law Commission is taking an observer part in the work of the UK Jurisdiction Taskforce ("UKJT") as well as participating as an observer in UNIDROIT's Digital Assets and Private Law Project.[6] Both of these other projects figure prominently in our response.

In light of the scope of Law Commission's work, we would especially like to address several areas of concern that are relevant to **tokenised or digital securities**. **We emphasise our recognition that the Law Commission's CP addresses digital assets writ large, not only tokenised securities** (which is the focus of the recent UKJT Consultation). However, we believe focus on tokenised securities is warranted if the outcome of the Law Commissions' efforts is to establish a template for all digital assets of which they are considered a part. In large part this is because we believe that some form of centralised governance framework (as we try to explain further below) will still be needed in the case of tokenised securities and, if this is true, significant consequences need to be addressed.[7]

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[4] These problems have been identified in a number of papers over the years.

[5] We therefore urge review of existing legislation – such as the Uncertificated Securities Regulations – to consider whether and how it can be augmented and made fit for purpose for securities across any technology platforms. We note numerous examples of a similar approach being taken in civil law jurisdictions, e.g., Luxembourg, Germany and France, in which existing dematerialisation regimes have been reviewed and adjusted in order to accommodate tokenized securities.

[6] See, https://www.unidroit.org/work-in-progress/digital-assets-and-private-law/

[7] We recognise, too, that "native" digital assets share many attributes with intermediate securities in dematerialised form, which the Law Commission explores at length throughout the CP, particularly in relation to collateral and custody.

Each area of concern is set out under a separate heading, below:

1. Shareholder Rights and Corporate Actions

The status of shareholders and their identification is a longstanding issue for issuers, intermediaries and investors. Issuers have an interest in knowing who their shareholders are, despite intermediated shareholding arrangements, such as custody services, which concentrate legal title in the hands of nominee companies used to safely segregate client holdings. Intermediaries both in the UK and elsewhere have an interest in arranging their services to provide the safest and most efficient holding arrangements for their clients, which often means the use of omnibus account structures through other intermediaries or at CSDs directly. Investors have an interest in exercising their rights as shareholders, such as voting rights and corporate actions, directly, despite the indirect holding arrangements they set up with their appointed intermediaries. These interests sometimes change or come into conflict, which requires interaction between two or more actors in the chain – i.e., which broadly may be described as: investor>global custodian>domestic custodian>registrar>issuer - to adjust their positions or operational arrangements.

The extent to which innovative technology, such as a DLT-based system, will address these issues will depend on the system's design. The use of intermediaries arises from the needs of investors; and, as the CP has noted, there are questions to be resolved as to the meaning and methods of intermediated holdings in the context of new systems. They cannot be resolved by an algorithm based on a simple series of "If…Then…" instructions, which is the basis of computer coding, because discretionary actions, operational realities, and commercial relationships are all factors that also must be considered. We note the possibility of designing DLT systems based on segregated accounts, or direct holding arrangements, which could create operational efficiencies as well as improve transparency for both issuers and investors. What is needed is a legal basis for identifying and reconciling the competing interests that arise with respect to the rights of shareholders and their claims on issuers, the exercise of rights attached to securities, and the roles and responsibilities of intermediaries who provide a set of custody and related services.[8]

To take an example, if a German investor were to appoint a French bank as its global custodian, and the French bank were to appoint a UK bank as its sub-custodian, all with respect to a share in a listed UK company, the situation is already complex. The records of the registrar in the UK could indicate that a nominee company is the owner of the share. The UK bank, as the controller of the nominee company, would maintain book-entry account records evidencing the beneficial interest of the French bank for the account of its client. The French bank would have its own account record, evidencing the entitlement of its client, but no trust relationship with its client would be established (the rules of trusts being creatures of English equity law). The German investor would have a contract with the French bank, managing its

[8] Competing interests may not just arise as between parties "in the chain". Third-party claims must be considered, too, with concepts of negotiability and good faith acquisition rules still needing to be considered: recent U.S. UCC amendments as well as the forthcoming UNIDROIT instrument (where this is called the "shelter" principle) address this aspect in connection with digital assets.

role as an intermediary and the services it will provide with respect to the holding and administration of the UK share, including with respect to corporate actions. The issuer would have no visibility of the German investor, and the German investor would have limited power to exercise its rights with respect to the share, without the involvement of the French and UK banks. The steps they take, on a day-to-day basis, for the administration of the shareholding are linked but separate: e.g., dividends would be paid to the UK bank, which would hold them in a bank account for the account of the French bank as a custodian; but the French bank would reflect the funds in its own books as a debit (i.e., a debt owed) for the benefit of the German investor. The sale of the share would take place in a market, which might not involve any of the intermediaries, but the settlement instructions on the sale would be passed from the German investor (or its agent) to the French bank, which would instruct the UK bank, which in turn would instruct the CSD. On settlement, the identity of the new shareholder might be known to the registrar or another intermediary structure would become effective.

In this simple and commonplace example, there are issues of trusts, commercial agency, contract law and corporate law that are relevant and which may be brought to bear on the end investors rights -- and the combination of them can change depending on the nature and location of each investor. In the current world of book-entry securities, these considerations are addressed through the application of established legal principles, but there are *lacunae* that are filled through commercial and operational adjustments. For example, if the German investor was an activist fund that wished to intervene in a general meeting of the UK issuer, its relationship with the French bank would be relevant; but so, too, would be the arrangements in place between the French bank and the UK bank. It might be possible for a proxy vote to be arranged, so that the German investor could take part, but it might also be impractical or uneconomical for the UK bank to provide such a service. In the end, whether adjustments are made – and the form that they take -- is a function of the relationships among the various actors. There are arguments that the legal position ought to be more prescriptive, but there are counter-arguments based upon the need for commercial flexibility.

If the share of the UK company were issued on a DLT system, which is not purely part of the internal operations of the CSD, then issues would arise concerning the legal analysis of the relationships, roles, and responsibilities of each of the actors. In part this is because the roles of certain of the actors are addressed in English/Welsh law already (i.e., the issuer, the CSD, the registrar, and the domestic custodian). Any changes to their roles and responsibilities under statute ought to be the domain of statute, also, not least in order to maintain consistency. Questions about the investor's rights and their relationship to the issuer ought to be taken into consideration, as well, both for tokenised securities reflected on the DLT and for book-entry securities.[9]

[9] We note that entries on the blockchain (a distributed ledger) may not be considered the register under English law. Whether it is or isn't does not detract from the overarching considerations that we describe.

2. Legal Certainty

Once trades in digital securities have been executed in financial markets, it is essential that legal certainty is provided with respect to both rights and entitlements. This can be supported if the following considerations are taken into account:

- An entry on the ledger should represent definitive direct rights against issuers that are enforceable by end-investors through intermediary chains, where relevant.[10]

- Entries on the ledger should be considered a clearly identifiable form of intangible personal property, which provides protections such as good-faith acquisition, insolvency remoteness (e.g., from the other participants or operators of the DLT system), certainty in financial collateral arrangements, and identification and (as expanded upon below) the application of governing law.

- Rules applicable to the transfer and disposition of rights (e.g., settlement finality, security arrangements, good-faith acquisition) in any asset must be clearly established and supported.

- A centralised governance framework[11] for which appropriately regulated and supervised market infrastructure is responsible. Technology affords the possibility that such a framework could be established in different ways: what is important is that the framework creates predictable and certain outcomes for market participants. Key elements of such a framework would include rules defining the rights, obligations, responsibilities and liabilities of the framework (as market infrastructure) as well as those of the members, participants, issuers and/or clients using or participating in it. These rules should address, *inter alia*:
    - Location of the account (see below);
    - The governing law of the framework, which would apply to all the parties mentioned above;
    - A pre-litigation dispute resolution mechanism;
    - Insolvency protection measures under relevant insolvency law, including rules on shortfalls;

[10] There are some important considerations that complicate the picture. For example, a cryptocurrency without smart contract capabilities such as Bitcoin is completely native to the protocol and the system only manages its own data and therefore has full sovereignty over state change: "[i]t results in the constant generation of 'truthful' state updates of this endogenous data without the real world being able to record the meaning attached to this data in the same system." S. Werner, *What Makes Digital Assets Digital?* (22nd October 2022). Available at: https://www.linkedin.com/pulse/what-makes-digital-assets-swen-werner. Werner notes that investors need to reconcile between the on-chain and off-chain identity (public address vs. legal owner) and that the more investors bind themselves to data and rules that are managed off-chain, the less 'digital' such an asset becomes. Werner states that a promising approach to overcome this issue are smart contracts, which are native to certain protocols such as Ethereum, however, we believe this is not likely to be a panacea any time soon and possibly not available in all scenarios.

[11] We recognise this strays into considerations that are potentially beyond the scope of the CP, however, given the centrality of financial market infrastructure to the basis upon which rights in dematerialised and immobilised securities are obtained, we believe it needs to be addressed in tandem with the CP to the extent the outcome affects securities that are held using DLT.

- The jurisdiction for bringing legal action (which we expect would usually be the jurisdiction of the governing law of the framework).[12]

- As noted above, clarity is needed as to what law governs - and which court is approached - if the above-mentioned rules are to be applied or if an aggrieved party seeks redress. This should be based on clarity of the definition of the type of property in question, location of account, consistent with the well-known "Place of Relevant Intermediary Approach" (PRIMA), in order to ensure continuity of existing national law principles on governing law. This, in turn, emphasises the criticality of establishing such a "location" or something approximating this under the rules of the above-mentioned centralised governance framework.13

Finally, it must be assumed that post-trade intermediaries will continue to act for investors by providing access to DLT-based systems. For this reason, we emphasise that the core records of intermediaries – whether or not their records reflect ownership entitlements - will be a function of what is recorded on the ledger.

3. Statutory change or common law decision-making?

Our recommendation is that a statutory foundation be provided for digital assets as a class of personal property, generally. We note that the Law Commission's proposals prefer, as the main sources of law, common law decisions informed by the opinions of experts. **In our view, this is an approach that will be insufficient to provide the legal certainty required to support the development of markets in digital assets, including in particular digital securities.** Issues like the balancing of interests among securities issuers, intermediaries, and investors require primary and secondary legislation; as seen, for example, in the SRD II and its implementation in the UK.[14]

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[12] It is no coincidence that these recommendations align closely with similar requirements proposed by the European Securities and Markets Authority (ESMA) for DLT Market Infrastructure under the DLT Pilot Regime. See, *Consultation Paper, On guidelines on standard forms, formats and templates to apply for permission to operate a DLT market infrastructure*, ESMA 70-460-34 (11th July 2022), p. 18. We believe it is in the UK's interest to harmonise and align sensibly with regimes covering the same kinds of digital assets (tokenised securities) in other major markets in order for the UK to remain a major and desirable market for market participants and intermediaries who operate on a trans-national basis.

[13] We note – as does the Law Commission – that different principles may need to be employed in the case of other kinds of digital assets that may not involve the existence of a centralised governance framework. We also note the Law Commission's recent announcement of a forthcoming consultation on governing law and conflicts of law, which, as noted here, we believe are critically important to the development of digital assets and their use in global capital markets.

[14] Work is also being carried in the United States on investor rights in securities by the American Bar Association Business Law Section "Task Force on Securities Holdings Infrastructure". The task force most recently has been focused on whether to propose reform to the U.S. Uniform Commercial Code Article 8 ("UCC Article 8") to address perceived problems in the effectiveness of the exercise of investor rights. The task force's overall mandate is to (i) examine the infrastructure for the intermediated holding of securities in the United States, (ii) identify, analyze and assess the significance of any problems associated with the infrastructure, and (iii) identify and assess plausible means of addressing any problems. Meeting notes of the task force are available at: https://www.law.upenn.edu/live/files/11214-a-hreflivefiles11214-meeting-notes

We do not envision that litigation can or should be the primary motor for legal reform in an area based upon innovative technology that breaks down the traditional (and highly regulated) roles and responsibilities of actors in securities markets. While disputes will arise, which require the assistance of the courts to resolve, the focus of cases on particular facts and arguments in the interests of the parties is unlikely to lead to clarity where it is needed most. In the book-entry securities markets, there are problems that never reach the courts, because the actors resolve them between themselves in commercially appropriate ways; leaving academics to speculate on how the lacuna ought to be filled. Where disputes do reach the courts, the results may not provide satisfactory clarity even if they do reach the "correct" result. [15]

A firm statutory foundation for digital securities would be significantly more desirable than a Legal Statement by the UKJT (to which courts have cited thus far in cases involving digital assets[16]) in order to ensure that digital securities are subject to a framework providing legal certainty and necessary predictability, including with respect to shareholder rights. We are concerned that an informal approach to setting seminal principles carries a material risk of market disruption and which negates the potential benefits.[17]

Moreover, we also note – as did the Law Commission in the CP[18] - that the UNIDROIT Digital Assets and Private Law Working Group (the "UNIDROIT Working Group") is developing a set of international principles designed to facilitate transactions in digital assets. We note the Law Commission's recognition that the guidance of the UNIDROIT Working Group "provides strong support for the law of England and Wales to explicitly recognise a third category of personal property rights that would be able to better embrace digital assets" and that they consider that their proposals will be important in this respect as they will provide "a clear and

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This is ***separate from and in addition to*** recently approved amendments to the UCC that were developed by American Law Institute and the Uniform Law Commission's UCC and Emerging Technologies Committee: the amendments include a new UCC Article 12 that would govern entitlements to and the transfer of rights in certain intangible digital assets that have been or may be created using new technologies, with Article 8 covering digital assets that parties choose to treat as "securities entitlements" thereunder. See: https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=67fe571b-e8ad-caf8-4530-d8b59bdca805.

[15] *See, e.g., SL Claimants v Tesco plc* [2019] EWHC 2858 (Ch), at, 88. Tesco asserted that the law failed to keep pace with the development of post-trade services supporting dematerialised securities - and argued that because the ultimate investors held shares through more than one intermediary (in this case, overlapping trusts), they had no interest in the securities. The court, in dismissing this claim, wrote that the Financial Services and Markets Act 2000 ("FSMA") should be read to effectively protect investors because ". . . the draftsman and legislature did understand the market in intermediated securities, did not intend to strip away the rights of investors who chose that mode of holding their investment, and must have been persuaded that the words they used were appropriate to preserve and enhance those rights". The court's reasoning is important to consider for what it ***didn't*** say, *i.e.*, that ultimate beneficial owners' rights are clearly protected through the chain through trusts or otherwise based either on an interpretation of the common law or a facial reading of statutory law.

[16] *See,* AA v Persons Unknown [2019] EWHC 3556 (Comm), [2020] 4 WLR 35, as noted by the Law Commission, referring to this and other cases. Law Commission CP, para. 1.29, p. 6.

[17] Indeed, there would seem to be a legitimate question as to whether the UKJT should always be relied upon to fulfil this role in view of the highly complex market practices and other considerations (such as regulatory considerations) that may emerge in connection with DLT.

[18] We note that the Law Commission is an observer sitting on both the UNIDROIT Working Group and the U.S. ULC Committee. See, para. 1.47, p. 9.

logical foundation from which to develop further, more conceptually difficult, legal principles on an equally clear and logical basis (including regulatory intervention if and where appropriate)."[19] The Law Commission explains:

> *If our law does not evolve in this way, it risks being overtaken and therefore overshadowed by other jurisdictions, including the US and those UNIDROIT Member States that implement the recommendations of the UNIDROIT Working Group more swiftly.*[20]

We agree with this sentiment. However, we would go further. Whilst we agree with the Law Commission that it is inevitable that many concepts discussed in the CP in the end will be left to courts in common law systems to better define, the fundamental ruleset against which courts operate still needs to be established by statute, as will be the case in the United States with the adoption of the aforementioned amendments to the UCC and – perhaps more important – as envisioned by the UNIDROIT Working Group. In other words, we would be very concerned at the prospect of leaving the digital securities framework – and possibly the framework for other kinds of digital assets - to development according to common law principles that only look to the UKJT (by way of example) for "guidance" instead of statutory law.

In particular, we are not entirely convinced that the proposed third category of data objects would necessarily apply to all digital assets – especially (quite possibly) tokenised securities. By way of example, if a centralised governance framework were to be retained, it would seem possible that at least one of the Law Commission's gateway criteria for treatment as a data object – that of independence from a legal system – may not necessarily apply, since (much as we see today in the context securities that are dematerialised by way of the CREST system) a legal system would or could be in place upon which rights in the securities would depend. Without clarification in statutory law, we are concerned about how this might play out.

We believe an important overriding consideration is that digital ledger technology first and foremost is a tool and that the law should strive to be technology-neutral: the characterisation of an asset under the law should be less driven by the technology employed and more driven by "like-for-like" characteristics. We take pause at the idea that a share of a UK security in dematerialised form is considered a different category of property from one having identical characteristics except for the fact that DLT is employed in accessing it. Indeed, following the Law Commission's analysis of "independence", it seems possible that a digital security may be considered a chose in action, but this does not seem certain, especially if the determination is left to developing case law.

Taking another example – the example of "control" - we do not share the Law Commission's confidence in whether and the way in which "courts will turn to the broad concept of control as a matter of default" or how they will "draw on necessary, analogous case law in other jurisdictions, and the UNIDROIT Working Group's Control Principle, to help them develop (by way of example) the concept of control under the law of England and Wales."[21]

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[19] See, Law Commission CP, para. 4.92, p. 74.
[20] Id.
[21] Id., paras. 11.124-11.127, p. 223.

We therefore don't share the Law Commission's comfort in relying on "iterative legal developments".

Moreover, the establishment of relevant case law is likely to take a significant amount of time. This period of uncertainty might stifle the growth of the DLT market in the UK, whereas a statutory instrument would help to immediately resolve at least some open questions.

Our answers to the Law Commission's questions follow in the attached Appendix.

AFME's and AGC's members include securities intermediaries from the investment banking, brokerage and custodian services sectors. We would be very happy to meet with the Law Commission, perhaps together with other trade associations representing those sectors, in order to elaborate the securities law reform and related issues that we have been addressing and which arise in the context of the current Consultation. We trust that our combined experience will prove helpful to the work of the Law Commission and look forward to hearing from you.

4 November 2022

John Siena
Chair, Association of Global Custodians
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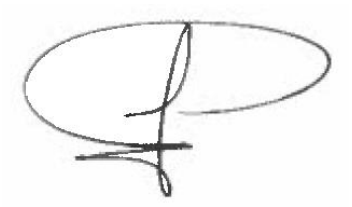

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APPENDIX

CONSULTATION QUESTIONS AND ANSWERS of AFME and AGC-EFC

Consultation Question 1.

20.1 We provisionally propose that the law of England and Wales should recognise a third category of personal property. Do you agree?

Paragraph 4.101

ANSWER:

Yes.

As the Law Commission explains in its CP, English case law does not recognise a third category of personal property beyond a "chose in possession" or "chose in action", throwing doubt on the status of digital assets since they do not seem to neatly fall within either of these two categories. Recent case law however reflects a general sense that most digital assets should be treated as some form of personal property.[22] If this is true, clarity on categorisation of digital assets is needed in order to establish clear crucial rules on such questions as ownership, transfer, grants of security interests, treatment in insolvency, available remedies and governing law: how these questions are addressed depend in large part on how the subject assets are categorised in the first place.

The CP explains why the application of either of the existing traditional categories of property may not be appropriate for digital assets. We agree with this analysis, although issues raised are more problematic for some kinds of digital assets than others. For example, if a tokenised security were held using digital assets technology via a platform offering centralised control and governance – as we suggest later in our response – we are not convinced that they could not be treated as choses in action under existing law.[23] This is particularly true in cases of book-entry intermediation, where a party looking after rights and entitlements of its customer isn't maintaining a private key itself.

However, we agree with the Law Commission's proposed recognition of "data objects" as a "third" category of personal property as there is little doubt of its necessity since we cannot assume the existence of a market infrastructure framework that is the same or analogous to the one that exists today for book-entry securities. We support statutory recognition but advocate further reflection as

[22] See, *Fetch.ai v Persons Unknown* [2021] EWHC 2254 (Comm), [2021] 7 WLUK 601, *AA v Persons Unknown* [2019] EWHC 3556 (Comm), [2020] 4 WLR 35. Even non-fungible tokens ("NFTs") have been treated similarly by a court. See, *Lavinia Deborah Osbourne v (1) Persons Unknown and (2) Ozone Networks Inc trading as Opensea* [2022] EWHC 1021 (Comm). However, we note that in a recent case published on 25th March by the High Court, Tulip Trading Limited v Bitcoin Association for BSV and others [2022] EWHC 667 (Ch) (the "Tulip Trading Case"), whilst the Court reaffirmed that English law will not find a positive duty to assist in the absence of a special, contractually-established relationship, and whilst the Court expressed a clear view on situs by reference to a single location of control, the claimants pleaded *in personam* rights only (not rights *in rem*). This suggests a need for clarity on the nature of rights arising in respect of these assets.

[23] This, very roughly, is the result in the United States: digital assets that may be treated as "controllable electronic records" under UCC Art. 12 may be "opted in" to UCC Art. 8 as "securities entitlements". This is most likely when intermediaries believe it is appropriate to do so, which is most likely to be the case where financial market infrastructure or some form of reliable central governance framework exists.

to whether and when slotting certain kinds of assets – such as digital securities - into an existing category could be a more congruent approach and less disruptive for the reasons stated in our introduction.

In any case, we emphasise the importance of legal certainty for investors, for issuers and for financial markets connecting the two, as well as for how these assets may be used in financial markets, including (importantly) in collateral arrangements.

Consultation Question 2.

20.2 We provisionally propose that, to fall within our proposed third category of personal property, the thing in question must be composed of data represented in an electronic medium, including in the form of computer code, electronic, digital or analogue signals. Do you agree?

Paragraph 5.21

ANSWER:

We agree with this approach and welcome it as it generally aligns with other approaches being taken elsewhere, improving chances for cross-border hamonisation. We note however (as does the Law Commission) that the UNIDROIT approach speaks to retrievability whilst the U.S. approach (UCC 12-105) proves that a person must have the power to "enjoy the benefits" of the electronic record. In order to be treated as personal property, it would seem logical that data that constitutes certain data objects is always "capable of being retrieved" and would suggest this makes sense.

Consultation Question 3.

20.3 We provisionally propose that, to fall within our proposed third category of personal property, the thing in question must exist independently of persons and independently of the legal system. Do you agree?

Paragraph 5.41

ANSWER:

As we discuss above, we believe that digital securities may still be considered choses in action to the extent rights in them arise by virtue of a centralised governance framework.

The Law Commission noted in the CP that in the case of *Fetch.ai v Persons Unknown*, crypto-tokens held on a cryptotoken exchange called Binance, in holding that crypto-tokens could attract property rights, Judge Pelling QC described the "assets credited to the first applicant's accounts on the Binance Exchange" as things in action. The Law Commission notes here that Binance Exchange generally operates as a custodial exchange and therefore considers the court to have correctly classified the applicant's right against Binance Exchange as a thing in action.[24] Our points above about a centralised governance framework suggest the same approach to the extent rights in digital securities are accessed via such a framework, which, in effect would operate as a custodial platform.

[24] Law Commission CP, Para. 4.46, p. 62.

We understand the Law Commission's emphasis of the importance of the distinction between a data object itself and any legal relationship to which the data object is (or purported to be) linked or connected.[25] However, the operation and success of capital markets in large part rely on the legal certainty that rights ascribed to securities are predictably enforceable. This is a function of the legal system by which these rights are supported.

We might go further in this respect. For example, as we noted above, even a cryptocurrency without smart contract capabilities such as Bitcoin – which is completely native to the protocol with full sovereignty over state change – would seem to commit its users to the protocol and rules of engagement which could be enforceable under the law. Smart contracts – also native to the protocol as noted above – could provide further certainty in this respect, especially if clearly supported in the law.

Consultation Question 4.

20.4 We provisionally propose that, to fall within our proposed third category of personal property, the thing in question must be rivalrous. Do you agree?

Paragraph 5.73

ANSWER:

We agree with the approach taken by the Law Commission and believe it is sufficiently consistent with forthcoming UNIDROIT principles as well as developing law in other major markets (e.g., "exclusive control" as the term is used in the amended U.S. Uniform Commercial Code). We agree with the Law Commission's analysis of these comparisons.

Consultation Question 5.

20.5 We provisionally propose that a data object, in general, must be capable of being divested on transfer. Do you agree? Please give examples, if any, of when this will not be the case.

20.6 We provisionally propose that divestibility should be regarded as an indicator, or general characteristic of data objects, rather than as a gateway criterion. Do you agree?

Paragraph 5.105

ANSWER:

We agree a data object must be divestible, however, we believe this should be a gateway criterion.

Consultation Question 6.

20.7 We provisionally propose that:

> (1) the law of England and Wales should explicitly recognise a distinct third category of personal property; and

[25] Id., Para. 5.45, p. 87.

(2) a thing should be recognised as falling within our proposed third category of personal property if:

(a) it is composed of data represented in an electronic medium, including in the form of computer code, electronic, digital or analogue signals;

(b) it exists independently of persons and exists independently of the legal system; and

(c) it is rivalrous.

Do you consider that the most authentic and appropriate way of implementing these proposals would be through common law development or statutory reform?

Paragraph 5.142

ANSWER:

We respectfully disagree. We believe that the fundamental ruleset against which courts operate still needs to be established by statute, as will be the case in the United States with the adoption of the aforementioned amendments to the UCC and – perhaps more important – as envisioned by the UNIDROIT Working Group. In other words, we would be very concerned at the prospect of leaving the digital securities framework to development according to common law principles.

We therefore don't share the Law Commission's comfort in relying on "iterative legal developments" because we do not share the Law Commission's confidence in the way in which courts will develop guidance in case law. For example, as discussed in our introductory note, whilst we believe the Court in the Tulip Trading case reached the correct conclusion, we note that the plaintiff asserted rights *in personam* rather than rights *in rem.* We believe that some basic clarification of the nature of a party's entitlements to property should be asserted in statute.

Further to this, the establishment of relevant case law is likely to take a significant amount of time. This period of uncertainty might stifle the growth of the DLT market in the UK, whereas a statutory instrument would help to immediately resolve at least some open questions.

Consultation Question 7.

20.8 We provisionally conclude that media files do not satisfy our proposed criteria of data objects, and therefore that they fall outside of our proposed third category of personal property. Do you agree?

20.9 Regardless of your answer to the above question, do you think that media files should be capable of attracting personal property rights?

Paragraph 6.52

ANSWER:

[not answered]

Consultation Question 8.

20.10 We provisionally conclude that program files do not satisfy our proposed criteria of data objects, and therefore that they fall outside of our proposed third category of personal property. Do you agree?

20.11 Regardless of your answer to the above question, do you think that program files should be capable of attracting personal property rights?

Paragraph 6.62

ANSWER:

[not answered]

Consultation Question 9.

20.12 We provisionally conclude that digital records do not satisfy our proposed criteria of data objects, and therefore that they fall outside of our proposed third category of personal property. Do you agree?

20.13 Regardless of your answer to the above question, do you think that digital records should be capable of attracting personal property rights?

Paragraph 6.68

ANSWER:

[not answered]

Consultation Question 10.

20.14 We provisionally conclude that email accounts do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?

20.15 Regardless of your answer to the above question, do you think that email accounts should be capable of attracting personal property rights?

Paragraph 7.31

ANSWER:

[not answered]

Consultation Question 11.

20.16 We provisionally conclude that in-game digital assets do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?

20.17 Regardless of your answer to the above question, do you think that in-game digital assets should be capable of attracting personal property rights?

Paragraph 7.59

ANSWER:

[not answered]

Consultation Question 12.

20.18 We provisionally conclude that (DNS) domain names do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?

20.19 Regardless of your answer to the above question, do you think that (DNS) domain names should be capable of attracting personal property rights?

Paragraph 8.26

ANSWER:

[not answered]

Consultation Question 13.

20.20 We provisionally conclude that Carbon Emissions Allowances do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?

Paragraph 9.22

ANSWER:

[not answered]

Consultation Question 14.

20.21 We provisionally conclude that most VCCs do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?

20.22 Regardless of your answer to the above question, do you think that VCCs should be capable of attracting personal property rights?

Paragraph 9.45

ANSWER:

[not answered]

Consultation Question 15.

20.23 We provisionally conclude that crypto-tokens satisfy our proposed criteria of data objects and therefore that they fall within our proposed third category of personal property. Do you agree?

Paragraph 10.139

ANSWER:

We agree, subject to the considerations that we express above.

Consultation Question 16.

20.24 We provisionally propose that the concept of control is more appropriate for data objects than the concept of possession. Do you agree?

Paragraph 11.111

ANSWER:

Yes, definitely. We agree entirely with the Law Commission's analysis and conclusion.

Consultation Question 17.

20.25 We provisionally propose that, broadly speaking, the person in control of a data object at a particular moment in time should be taken to be the person who is able sufficiently:

> (1) to exclude others from the data object;
> (2) to put the data object to the uses of which it is capable (including, if applicable, to effect a passing of, or transfer of, that control to another person, or a divestiture of control); and
> (3) to identify themselves as the person with the abilities specified in (1) to (2) above. Do you agree?

Paragraph 11.112

ANSWER:

We agree this approach is sufficient. We might add that (2) seems similar to "retrievability", discussed above.

Consultation Question 18.

20.26 We provisionally conclude that the concept of control as it applies to data objects should be developed through the common law, rather than being codified in statute. Do you agree?

Paragraph 11.128

ANSWER:

In describing proposed requisites of "exclusive control" and "rivalrousness", the Law Commission acknowledges the concepts involved are "highly nuanced".[26] Whilst we agree that it is inevitable that concepts like these in the end will be left to courts in common law systems to better define,[27] the fundamental ruleset against which courts operate still needs to be established by statute, as will be the case in the United States with the adoption of the aforementioned amendments to the UCC and – perhaps more important – as envisioned by the UNIDROIT Working Group. In other words, we would be very concerned at the prospect of leaving the digital securities framework to development according to common law principles that only look to the UKJT for "guidance" instead of statutory law.

We therefore don't share the Law Commission's comfort in relying on "iterative legal developments" because we do not share the Law Commission's confidence in whether and the way in which "courts will turn to the broad concept of control as a matter of default" or how they will "draw on necessary, analogous case law in other jurisdictions, and the UNIDROIT Working Group's Control Principle, to help them develop the concept of control under the law of England and Wales."[28]

Consultation Question 19.

20.27 We provisionally conclude that it would be beneficial for a panel of industry, legal and technical experts to provide non-binding guidance on the complex and evolving issues relating to control and other issues involving data objects more broadly. Do you agree?

Paragraph 11.133

ANSWER:

Yes, however we do not think this obviates the need for statutory clarification where sensible.

Consultation Question 20.

20.28 We provisionally conclude that a transfer operation that effects a state change within a crypto-token system will typically involve the replacing, modifying, destroying, cancelling, or eliminating of a pre-transfer crypto-token and the resulting and corresponding causal creation of a new, modified or causally-related crypto-token. Do you agree?

20.29 We provisionally conclude that this analysis applies in respect of UTXO based, Account based and token-standard based (both "fungible" and "non-fungible" crypto-token implementations). Do you agree?

Paragraph 12.61

ANSWER:

[26] See, Id., paras. 5.57-5.68, pp. 89, *et. seq.*

[27] "… our preferred concept of control aligns with the UNIDROIT Digital Assets and Private Law Working Group's 'control principle' for digital assets. According to the principle's explanatory notes, control is a 'purely factual matter' or a 'factual standard'. Furthermore, our concept of control aligns with the views expressed by several eminent consultees in response to our call for evidence." Id., para. 11.87, p. 211.

[28] Id., paras. 11.124-11.127, p. 223.

We express no view here but refer to our response to Question 21.

Consultation Question 21.

20.30 We provisionally conclude that the rules of derivative transfer of title apply to crypto-tokens, notwithstanding that a transfer of a crypto-token by a transfer operation that effects a state change involves the creation of a new, causally-related thing. Do you agree?

Paragraph 13.90

ANSWER:

We believe that foundational premise by statute – to the extent possible – should be established so that courts do not rule that transfers are ineffective when they should be. It seems to us that concerns regarding whether or not a state change has the effect the Law Commission suggests is less important than ensuring the intent of the parties and the expectations of the market. This is an example that is ripe for statutory clarification to the extent there is any doubt or concern.

As we have said elsewhere, the law should develop in a manner that is as technology-neutral as possible in order to create legal certainty, clarity and predictability.

Consultation Question 22.

20.31 We provisionally propose that:

> (1) A special defence of good faith purchaser for value without notice (an innocent acquisition rule) should apply to a transfer of a crypto-token by a transfer operation that effects a state change. Do you agree?
> (2) An innocent acquisition rule should apply to both "fungible" and "nonfungible" technical implementations of crypto-tokens. Do you agree?
> (3) An innocent acquisition rule cannot and should not apply automatically to things that are linked to that crypto-token. Do you agree?

Paragraph 13.91

ANSWER:

(1) And (2): Yes. It is important that innocent acquirers trading digital assets be able to take good title, free of defects in the title of the transferor. As pointed out in the CP, the market already functions on the basis that this is the case. We support statutory intervention that clarifies this.

(3) We respectfully disagree – at least in the context of digital securities, particularly if these are subject to a centralised governance framework. We believe the reason for this equally expressed in our response to Question 27.

Consultation Question 23.

20.32 We provisionally propose that an innocent acquisition rule in respect of transfers of crypto-tokens by a transfer operation that effects a state change should be implemented by way of legislation, as opposed to common law development. Do you agree?

Paragraph 13.94

ANSWER:

We agree with the Law Commission's sentiment that "it is important for the law of England and Wales to remain as consistent as possible with international developments." We are heartened to see that, here, the Law Commission recommends that the best approach is by way of legislation, as opposed to relying solely on common law development.[29]

Consultation Question 24.

20.33 We provisionally conclude that the rules of derivative transfer of title apply to crypto-tokens and that it is possible to separate (superior) legal title from the recorded state of the distributed ledger or structured record and/or factual control over a crypto-token. Do you agree?

20.34 We provisionally conclude that, over time, the common law is capable of developing rules to assist with the legal analysis as to title and/or priority where disputes arise between multiple persons that have factual control of a cryptotoken, and that statutory reform would not be appropriate for this purpose. We consider that those rules will need to be specific to the technical means by which such factual circumstances can arise within crypto-token systems or with respect to crypto-tokens. Do you agree?

Paragraph 13.112

ANSWER:

Whilst we agree that it is possible to separate (superior) legal title from the recorded state of the distributed ledger or structured record and/or factual control over a crypto-token, we believe this should be addressed in statutory law in the case of a centralised governance framework where it is in place for assets such as digital securities. As we note above, an entry on the ledger should represent definitive direct rights against issuers that are enforceable by end-investors through intermediary chains: this might be capable of being addressed – at least in part - in other law, such as law on financial markets infrastructures.

Consultation Question 25.

20.35 We provisionally conclude that it is not appropriate to treat crypto-tokens as analogous to "goods", as currently defined in the Sale of Goods Act 1979 and other related statutes, including the Supply of Goods and Services Act 1982 and the Consumer Rights Act 2015. Do you agree?

Paragraph 13.144

[29] Id., para 13.94, p. 268.

ANSWER:

We agree.

Consultation Question 26.

20.36 We provisionally propose that the law should be clarified to confirm that a transfer operation that effects a state change is a necessary (but not sufficient) condition for a legal transfer of a crypto-token. We consider that this state change condition is more appropriate than the potentially wider condition of "a change of control". Do you agree? Do you agree that such a clarification would be best achieved by common law development rather than statutory reform?

20.37 Accordingly, we provisionally conclude that allowing title to a crypto-token to transfer at the time a contract of sale is formed, but where no corresponding state change has occurred, would be inappropriate. Do you agree?

Paragraph 13.145

ANSWER:

Yes.

Consultation Question 27.

20.38 Are there any other types of link between a crypto-token and a thing external to a crypto-token system that you commonly encounter or use in practice?

20.39 We provisionally conclude that market participants should have the flexibility to develop their own legal mechanisms to establish a link between a crypto-token and something else — normally a thing external to the crypto-token system. As such, we provisionally conclude that no law reform is necessary or desirable further to clarify or specify the method of constituting a link between a crypto-token and a linked thing or the legal effects of such a link at this time. Do you agree?

Paragraph 14.114

ANSWER:

We agree with the Law Commission that there is no reason why a link cannot be as strong as it is with record keeping or registration systems that do not rely on crypto-tokens/crypto-token systems.[30] However, while the Law Commission acknowledges that it is possible for legislation to create a "very strong" statutory link between a crypto-token and a thing external to the crypto-token system (such as rights associate with a security), it avers that "[t]he statutory link would be imperfect".[31] The Law Commission therefore does not recommend the adoption of legislation providing for a "broadly-defined" statutory link, instead leaving it to be addressed "as practice develops in particular areas" with "specific, limited legislation [as] might be appropriate and/or necessary to establish the relevant statutory link."[32] We strongly urge consideration of such legislation at least in the context of **digital securities** given

[30] See, Id. para. 14.43, p.292.
[31] Id., para 14.56, p. 295.
[32] Id., para 14.57, p. 296.

the significant level of uncertainty that contractual consensus alone would achieve with respect to the role that DLT plays in the constitution and registration process. This carries the risk of considerable confusion around ownership of crypto tokens, what such tokens represent relative to the property interests in the securities themselves.

Legal certainty will be essential to the development of DLT-based markets, which can in our opinion only be provided through statutory instruments, as opposed to case law.

Consultation Question 28.

20.40 Do you consider that there are any specific legal issues relating to non-fungible tokens ("NFTs") that would require different treatment from other crypto-tokens under the law of England and Wales?

Paragraph 15.74

ANSWER:

[no answer]

Consultation Question 29.

20.41 We provisionally conclude that it is appropriate to draw a distinction between direct custody services (that is, holding crypto-tokens on behalf of or for the account of other persons and having capacity to exercise or to coordinate or direct the exercise of factual control in terms of both its positive and negative aspects) and custodial or other technology-based services that do not involve a direct custody relationship. Do you agree?

Paragraph 16.41

ANSWER:

Yes – we touch on this in our introductory note in respect of intermediated holdings. In this case, approaches that approximate existing practices and law would be appropriate. However, we still see statutory clarification – covering all such holdings (without regard to technology employed) – as warranted. We have addressed this extensively with the Law Commission in previous submissions in respect of dematerialised securities. Fundamentally, the issues at play are no different.

However, as we also point out in our introductory note, direct holdings that are subject to a centralised governance framework, could also be subjected to the same or similar approach.

Consultation Question 30.

20.42 We provisionally conclude that, under the law of England and Wales, crypto-token custody arrangements could be characterised and structured as trusts, even where the underlying entitlements are (i) held on a consolidated unallocated basis for the benefit of multiple users, and (ii) potentially even commingled with unallocated entitlements held for the benefit of the custodian itself. Do you agree?

20.43 We provisionally conclude that the best way of understanding the interests of beneficiaries under such trusts are as rights of co-ownership in an equitable tenancy in common. Do you agree?

20.44 Do you consider that providers and users of crypto-token custody services would benefit from any statutory intervention or other law reform initiative clarifying the subject matter certainty requirements for creating a valid trust over commingled, unallocated holdings of crypto-tokens? If yes, please explain what clarifications you think would assist.

Paragraph 16.75

Consultation Question 31.

20.45 We provisionally conclude that a presumption of trust does not currently apply to crypto-token custody facilities and should not be introduced as a new interpretive principle. Do you agree?

Paragraph 16.107

ANSWER:

We respectfully disagree. Whilst the RASCALS case (by way of example) may provide some comfort, reflected in the opinion of Briggs, J., that a beneficial co-ownership share in a fungible bulk of securities is a more "persuasive" than alternatives[33], we see no reason why this should not be addressed as a default assumption in statutory law, absent provision to the contrary as agreed by the parties.

We believe a default assumption of the imposition of a trust is sensible unless the parties specify otherwise. This would operate to protect underlying beneficial owners as a matter of course through potentially multiple intermediaries while still respecting party autonomy should parties wish to adopt a different approach. Whilst we understand the Law Commission's concern about extending this principle not only to conventional intermediary custodians and custodial exchanges but also potentially to certain (centrally controlled) "lock and mint" facilities[34], we see no reason to make a distinction regarding default assumptions in view of the overriding need for a common understanding and approach to the nature of investors' rights in their acquired property – particularly in the event of an insolvency. Whilst we realise that the adoption of an approach founded in trust concepts is not a panacea (e.g., this does not provide guaranty against a shortfall of intangible assets where an intermediary fails to segregate sufficiently today), we believe a common approach nevertheless would provide the most clarity for all stakeholders. We therefore recommend a statutory basis of holding premised on a trust (absent specification otherwise by an account provider and an account holder).[35]

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[33] *Re Lehman Brothers International (Europe) (in administration), Pearson v. Lehman Brothers Finance SA* (RASCALS) [2010] EWHC 2914 (Ch) (upheld [2011] EWCA Civ 1544).

[34] "These could include crypto-token bridges, wrapping protocols, collateralised lending arrangements, fractional ownership, and collateralised tracker-token issuance platforms."

[35] Providing this kind of clarity – clear imposition of trust principles – would align with best industry practice in any case, including with respect to such key practices as proper segregation of accounts for customers. This obviously is consistent with fiduciary principles under trust law and would align with regulatory (e.g., FCA) expectations, which generally impose client asset requirements founded on these principles.

Consultation Question 32.

20.46 We provisionally propose that clarification of the scope and application of section 53(1)(c) LPA 1925 would be beneficial for custodians and would help facilitate the broader adoption of trust law in structuring custody facilities, in relation to cryptotokens specifically and/or to other asset classes and holding structures, including intermediated investment securities. Do you agree?

20.47 If you think that clarification of the scope and application of section 53(1)(c) LPA 1925 would be beneficial, what do you think would be the best way of achieving this? Please indicate which (if any) of the models suggested in the consultation paper would be appropriate, or otherwise outline any further alternatives that you think would be more practically effective and/or workable.

Paragraph 17.58

ANSWER:

We agree with the Law Commission's concern expressed in the summation of this discussion that "any actual or perceived ambiguity as to the scope of section 53(1)(c) LPA 1925 could undermine confidence in the efficacy of numerous activities undertaken in connection with crypto-token custody arrangements if they have been structured under or characterised as being governed by trust law."[36] Common examples of the activities that could be affected are provided in subsequent passages of the Law Commission Consultation– all of which we recognise and agree are accurately described. We especially note and appreciate the Law Commission's identification of new fact patterns that could emerge due to the availability and use of new technology, such as dealings in tokenised securities that involve transfers of control from one network address to another (a) where the recipient address is controlled by a different person (other than to the custodian in its capacity as trustee) or (b) where the recipient address is either an address with no (or no known) private key or an address controlled by the custodian in its capacity as trustee.[37] We also note that the Law Commission considers transfers that may occur both "on"- and "off-chain".[38]

We agree with the Law Commission's concern about perceived uncertainty regarding the application of section 53(1)(c) LPA 1925 to emerging and growing industries such as crypto-token markets and that perceived lack of legal clarity could disincentivise market participants in the crypto-token sector from drawing on the utility and flexibility of trusts for structuring crypto-token custody arrangements under the law of England and Wales.[39]

We welcome and strongly endorse the Law Commission's proposal for clarifying legislation. However, whilst the Law Commission recommends reform that appears to take a simple one-size-fits-all approach, and which certainly offers the benefit of setting out relatively simple

[36] Id., para 17.23, p. 363.
[37] Id., paras 17.30-17.35, p. 365.
[38] Id., paras. 17.36, et seq., pp. 365, et seq.
[39] Id., para. 17.42. p. 368.

statutory-based principles[40], we believe its other option for reform ("Option 2(b)")[41] makes more sense in view of our above-expressed recommendation for a centralised governance framework for tokenised securities. Option 2(b) - in introducing new statutory provisions that confirm the formality requirements for certain specified dealings in equitable entitlements undertaken through specified holding and transaction arrangements – would specifically address entitlements represented by entries in ledgers subject to centralised control. In this context we agree with a ruleset modelled on equivalent rules developed for intermediated securities set out in the Geneva Convention on Substantive Rules for Intermediated Securities, which we historically have endorsed and continue to endorse. In particular, we urge – where possible - the adoption of a uniform approach to all securities held for customers ***regardless of technology used***: there is no reason why Articles 11(1) and 11(2) of the Geneva Convention - which provide that acquisitions and dispositions of intermediated securities can be effected by authorised credits and debits to the securities accounts of the relevant parties maintained by their respective intermediary, with "no further step…necessary" for such dealings to be legally valid - could not be employed in this context. The Law Commission notes that, alongside provisions for entitlements in professionally operated, centrally-controlled ledgers, a corresponding set of rules could also be developed for dealings in other forms of tokenised equitable entitlements, including those subject to decentralised ledgers,[42] but the need for this is reduced or possibly obviated to the extent that a centralised governance framework is employed.

Consultation Question 33.

20.48 We provisionally propose that legislation should provide for a general pro rata shortfall allocation rule in respect of commingled unallocated holdings of crypto-tokens or crypto-token entitlements in a custodian insolvency. Do you agree?

Paragraph 17.81

ANSWER:

We agree with the Law Commission that some form of intervention should be considered in order to provide confidence to crypto-token custody clients that their commingled assets are protected from the general creditors of an intermediary in the event of its insolvency. We believe that statutory intervention providing clarity on this point is sensible rather than waiting for the common law to be tested.

However, the question of whether or not client assets maintained by an intermediary should be considered insolvency remote viz. an intermediary is different from the question of how to handle shortfalls should they arise. Here we caution against blunt instruments that may be premised on overly simplistic assumptions. It is important to retain lessons learned from the

[40] The Law Commission recommends amending section 53(1)(c) LPA 1925 directly to incorporate:
(a) an express qualification that disapplies it to specified dealings in equitable entitlements; and (b) an express recognition of various forms of electronic communication and records as satisfying the in writing and signature formalities. Both revisions would be expressed as matters of general principle and not by reference to any particular category of assets. See, Id., para.17.55, p. 372, and para. 17.57, p. 373.
[41] Id.
[42] Id.

2008 financial crisis since issues around the possibility of shortfalls fundamentally are no different conceptually in the DLT context.

Post-crisis reform measures imposing new and/or different regulatory requirements on intermediaries varied depending on ***types*** of intermediaries and the activities undertaken by them. For example, the UK undertook an overhaul of its client asset rules, imposing extensive new requirements on intermediaries, including brokers, and relevant insolvency law.[43] A number of improvements were made in regulations to improve the UK FCA's client assets regime, particularly so-called "behavioural" enhancements around good recordkeeping, enhanced reporting to clients, improved understanding around the client assets regime (i.e., requiring disclosure of the protections it affords and its limitations) and increased clarity around certain intermediaries' intra-group relationships.

Because, for the most part, concerns that arose regarding disposition of client assets were about ***behaviour***, we do not believe there is a fundamental problem with substantive law. Therefore, we believe that any concerns regarding contractual undertakings of intermediaries to clients should be addressed in this context: a "regulatory overlay" is appropriate in order to clarify and enhance contractual obligations to be imposed on intermediaries.

Perhaps most important, difficulties relating to intermediated securities – regardless of technology employed - tend to become visible in cases of insolvency of intermediaries. Insolvency, its rules and how it is administered, therefore, constitute the true testing ground for whether and how intermediated securities are maintained and protected sufficiently in the interest of ultimate investors. Under the UK model, beneficial interests, and therefore trust property, fall outside of the insolvency estate of a trustee.[44] However, the time taken either to get before a court or to engage with an administrator in order to obtain consent to enforcement of rights is inevitably longer than the needs of participants in financial markets typically allow.

The clear lesson learned from the financial crisis is that regulation, insolvency and private commercial law must all be considered and addressed together so they operate – together – in order to create favourable conditions for the protection of ultimate investors both ***before*** and ***after*** the insolvency of an intermediary.

There are limitations of what can be achieved in solely in private commercial (statutory) law: the question of how to deal with shortfalls is particularly contextual and, we believe, reliant on regulatory and supervisory requirements and insolvency law based on applicable existing legal principles in order to respond to changing facts, circumstances and behaviours.

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[43] "*We [the FCA] increased our focus on client assets protection following the failure of Lehman Brothers International (Europe) ('LBIE'). We did this by creating the Client Assets Unit (bringing together specialist risk, supervision and policy functions) and making various improvements to the client assets regime, such as enhancements to auditor reporting, reintroduction of the Client Money and Asset Return ('CMAR') and the creation of the CASS operational oversight function ('CF10a')."* See, PS14/9, Review of the client assets regime for investment business and Feedback to CP13/5 and final rules (June 2014).

[44] We noted further above the prospect of further statutory clarification of this result.

Consultation Question 34.

20.49 We provisionally conclude that extending bailment to crypto-tokens, or the creation of an analogous concept based on control, is not necessary at this time. Do you agree?

If not, please provide specific examples of market structures or platforms that would benefit from being arranged as bailments, that could not be effectively structured using the trust and/or contract frameworks currently available.

Paragraph 17.103

ANSWER:

We agree with the law commission that bailment is not an appropriate concept for intangible assets including digital assets.

Consultation Question 35.

20.50 We provisionally conclude that crypto-tokens, as objects of personal property rights, can be the subject of title transfer collateral arrangements without the need for specific law reform to provide for this. Do you agree?

Paragraph 18.17

ANSWER:

We defer to other associations on this point (e.g., ISDA, ISLA).

Consultation Question 36.

20.51 We provisionally conclude that non-possessory securities can be satisfactorily granted in respect of crypto-tokens without the need for law reform. Do you agree?

Paragraph 18.26

ANSWER:

Yes, so long as property interest that crypto-tokens bestow on their owner is clear.

Consultation Question 37.

20.52 We provisionally conclude that it is not desirable to make provision for data objects to be the subject of possessory securities such as the pledge, or to develop analogous security arrangements based on a transfer of control. Do you agree?

If not, please provide specific examples of market structures or platforms that would benefit from the availability of possessory security arrangements, that could not be effectively structured using the non-possessory security frameworks currently available.

Paragraph 18.44

ANSWER:

We express no view here.

Consultation Question 38.

20.53 We provisionally conclude that the Financial Collateral Arrangements (No 2) Regulations 2003, SI 2003 No 3226 (the "FCARs") should not be extended to more formally and comprehensively encompass crypto-token collateral arrangements. Do you agree?

Paragraph 18.47

ANSWER:

We disagree. We think effort should be undertaken to ensure the framework is as harmonised as possible in order to reduce the risk of different frameworks or approaches. We see no reason in principle why crypto-tokens cannot be made subject to the FCARs, which can be done whilst clarifying lingering uncertainty across all financial collateral concerning control.

Consultation Question 39.

20.54 We provisionally conclude that it would be beneficial to implement law reform to establish a legal framework that better facilitates the entering into, operation, rapid, priority enforcement and/or resolution of crypto-token collateral arrangements. Do you agree?

If so, do you have a view on whether it would be more appropriate for any such law reform to aim to create: (i) a unified, comprehensive and undifferentiated regime for financial collateral arrangements involving both traditional types of financial collateral and crypto-tokens; or (ii) a bespoke regime for financial collateral arrangements in respect of crypto-tokens?

Paragraph 18.113

ANSWER:

We agree. This reform should include consideration of reform of the Financial Collateral Arrangements Regulations ("FCARs")[45] to address longstanding concerns regarding control, which remain unsatisfactorily resolved in connection with book-entry securities to this day – leaving obvious potential gaps in connection with digital securities.

Consultation Question 40.

20.55 We provisionally conclude that an action to enforce an obligation to "pay" nonmonetary units such as crypto-tokens would (and should) be characterised as a claim for unliquidated damages, unless and until crypto-tokens are generally considered to be money (or analogous thereto). Do you agree?

Paragraph 19.26

ANSWER:

[45] See, fmlc.org/wp-content/uploads/2018/03/Issue-1-Collateral-Directive-Report.pdf.

We agree: crypto-tokens like Bitcoin or Ether do not currently possess the characteristics of 'money' under conventional and legal principles.

Consultation Question 41.

20.56 We provisionally conclude that tracing (rather than following) provides the correct analysis of the process that should be applied to locate and identify the claimant's property after transfers of crypto-tokens by a transfer operation that effects a state change, and that the existing rules on tracing (at equity and common law) can be applied to crypto-tokens. Do you agree?

20.57 Do you consider that the common law on tracing into a mixture requires further development or law reform (whether generally or specifically with respect to crypto-tokens)?

Paragraph 19.52

ANSWER:

[no answer]

Consultation Question 42.

20.58 We provisionally conclude that the following existing legal frameworks can be applied to data objects, without the need for statutory law reform (although the common law may need to develop on an iterative basis):

(1) breach of contract;
(2) vitiating factors;
(3) following and tracing;
(4) equitable wrongs;
(5) proprietary restitutionary claims at law; and
(6) unjust enrichment.

Do you agree?

Paragraph 19.88

ANSWER:

We agree.

Consultation Question 43.

20.59 We provisionally conclude that, in relation to the tort of conversion, there are arguments in favour of extending conversion (or a conversion-type cause of action grounded in control rather than possession) to data objects. Do you agree?

20.60 We provisionally conclude that the introduction of a special defence of (or analogous to) good faith purchaser for value without notice (at law) would limit the impact of the application of strict liability for conversion in the context of data objects. Do you agree?

Paragraph 19.123

ANSWER:

We agree. There is no reason to confuse the picture with the introduction of such a defence – this is would not be consistent with existing market practice or expectations.

Consultation Question 44.

20.61 We provisionally conclude that existing principles in relation to injunctive relief can apply to data objects, without the need for law reform. Do you agree?

Paragraph 19.148

ANSWER:

We agree.

Consultation Question 45.

20.62 Are there any other causes of action or remedies you think may be highly or specifically relevant to data objects but which require law reform?

Paragraph 19.149

ANSWER:

[no answer]

Consultation Question 46.

20.63 We provisionally conclude that the existing methods of enforcement of judgments (and ancillary mechanisms) in the context of crypto-tokens are satisfactory. Do you agree?

Paragraph 19.158

ANSWER:

[no answer]

Consultation Question 47.

20.64 We provisionally conclude that there is an arguable case for law reform to provide courts in England and Wales with the discretion to award a remedy (where traditionally denominated in money) denominated in certain crypto-tokens in appropriate cases. Do you agree?

20.65 If so, what factors should be relevant to the exercise of this discretion?

Paragraph 19.168

ANSWER:

[no answer]