



**Digital Assets and Private Law
Working Group**

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1. This document has been prepared by the Drafting Committee and includes an amended draft of Principle 13 (Insolvency of custodian), its Commentary, as well as Paragraph 4 of the Commentary to Principle 10, and Paragraph 14 of the Commentary to Principle 11. These changes have been made to reflect input received as part of the Public Consultation.

Principle 13

Insolvency of custodian

(1) If a custodian enters into an insolvency proceeding, a digital asset that it maintains for a client under a custody agreement does not form part of that custodian's insolvency estate.

~~(2) If a custodian enters into an insolvency proceeding, the insolvency representative must take reasonable steps for the control of the digital assets maintained for its client to be changed to the control of that client or of a custodian nominated by that client.~~

~~(3)~~ **(2) Where a custodian has entered into a custody agreement with a sub-custodian with respect to a digital asset that is the subject matter of a custody agreement between that custodian and a client, and the custodian enters into an insolvency proceeding, the rights it has against the sub-custodian in respect of the digital asset maintained for the custodian's client do not form part of the custodian's insolvency estate.**

(3) If a custodian enters into an insolvency proceeding, the insolvency representative must take reasonable steps

(a) for the control of a digital asset maintained for its the custodian's client to be changed to the control of that client or of a custodian nominated by that client.

(b) for any rights the custodian has against any sub-custodian in respect of a digital asset maintained for the custodian's client to be transferred or otherwise made accessible to that client, including through transfer to another custodian nominated by that client.

(4) Paragraphs (5) and (6) apply if all of the following requirements are fulfilled:

- (a) a custodian enters into an insolvency proceeding;**
- (b) fungible digital assets of two or more clients are maintained by the custodian as an undivided pool; and**

(c) the number or amount of digital assets maintained by the insolvent custodian is less than the aggregate number or amount of digital assets of that description recorded by the custodian as the digital assets maintained for those clients (‘shortfall’).

[(5) The shortfall is met first by any digital assets of the same description, maintained by the custodian for itself.]

(6) Any [remaining] shortfall shall be borne by the clients for whom the custodian maintains the digital assets, as if an undivided pool, in proportion to the respective number or amount of digital assets of that description recorded by that the custodian as the digital assets maintained has agreed to maintain for those clients.

(7) Where a custodian has entered into a custody agreement with a sub-custodian with respect to a digital asset that is the subject matter of a custody agreement between that custodian and a client, and the sub-custodian enters into an insolvency proceeding, the custodian must seek to obtain control of the digital asset, or to be able or the ability to exercise the rights against the sub-custodian, from the insolvency representative, or to maintain the digital asset or relevant rights with another sub-custodian.

Commentary

1. Principle 13 paragraphs (1) applies to (6) apply if a custodian enters an insolvency proceeding. ‘Insolvency proceeding’ is defined in [Principle 2\(8\)](#), but it should be borne in mind that a State might specify a special type of insolvency regime for certain types of financial institutions, which could include some custodians of digital assets. If this is the case, and the special regime does not fall within the definition in [Principle 2\(8\)](#), a State will need to modify the definition of insolvency proceeding in relation to those custodians accordingly. Similarly, if the consequences set out in Principle 13 would not be possible under the special regime, Principle 13 will need to be modified accordingly.

2. Principle 13(1) sets out the consequences of the insolvency of the custodian in a functional way rather than using legal concepts such as property or ownership. On the custodian’s insolvency, assets it maintains for clients as custodian are not part of the distributable estate. If, on the other hand, a service provider is not a custodian in the circumstances set out in (see the commentary to Principle 10(3), and paragraph 16 of the commentary to [Principle 10](#)), any assets it controls will usually be part of its assets for distribution to its creditors. A service provider could be a custodian in relation to some clients, and not a custodian (in the sense mentioned in the previous sentence) in relation to other clients. The effect of Principle 10(3) and Principle 10(4) is that any agreement which has the three characteristics of a custody agreement set out in [Principle 10\(3\)](#) will attract the consequences in Principle 13(1) unless the agreement makes it clear that this is not the case. In Principle 13(1), the ‘custodian’ could in fact be a sub-custodian and the ‘client’ could be a custodian.

3. Principle 13(2) sets out the consequences where a digital asset is held through a sub-custodian (see Principle 11(4)). As explained in paragraph 4 in the commentary to Principle 10, where a custodian maintains a digital asset through a sub-custodian, the custodian (who will be the client of the sub-custodian under a custody agreement) has rights against that sub-custodian under the custody agreement. If the custodian is insolvent, its rights against the sub-custodian are not part of its distributable insolvency estate.

3.4. Principle 13(3), (4), (5), and (6) give guidance as to suitable rules which should (or, in the case of Principle 13(5), could) apply in relation to digital assets or (if a sub-custodian is used, rights against the sub-custodian) if a sub-custodian enters an insolvency proceeding. These rules are not comprehensive; the applicable insolvency law governs all other issues that could arise in these circumstances.

~~4.5.~~ Principle 13(2~~3~~) imposes a duty on the insolvency representative to take reasonable steps so that that client can obtain the digital assets maintained for it by the custodian. If the digital assets are maintained by the custodian by entering into a custody agreement with a sub-custodian (Principle 10(2)(b)), the duty on the insolvency representative relates to the custodian's rights against the sub-custodian. The client may want to obtain control of the digital assets or obtain the rights against the sub-custodian itself, or may want another custodian to maintain them on its behalf. The insolvency representative may need to take certain steps to achieve this result, such as obtaining the private key(s) relating to those digital assets.

~~1.~~ Principle 13(3) sets out the consequences where a digital asset is held through a sub-custodian (see Principle 11(4)). ~~If the custodian is insolvent, its rights against the sub-custodian under the custody agreement are not part of its distributable insolvency estate.~~

~~5.6.~~ Principle 13(4) to 13(6) ~~deals with the situation~~ apply where fungible digital assets are maintained by a custodian as an undivided pool (see Principle 11(2)) ~~and there is a shortfall of digital assets of a particular description, and paragraph 6 of the commentary to Principle 11).~~ A custodian can maintain digital assets as an undivided pool either by controlling the assets itself or by entering into a custody agreement with a sub-custodian in respect of an undivided amount of digital assets. In this situation, its rights against the sub-custodian will be undivided. Principle 13(4) to 13(6) deal with the situation where there is a shortfall of digital assets or rights against the sub-custodian of a particular description. Principle 13(4) explains the situation of shortfall. In relation to one custodian, a shortfall of digital assets may occur in one undivided pool of digital assets of the same description, or in several undivided pools, each consisting of digital assets of a particular description.

~~6.7.~~ If there is a shortfall, a State may wish to provide that the loss is first met by any digital assets of the same description maintained by the custodian on its own account: whether by controlling those assets itself or by use of a sub-custodian. This approach follows that of Article 25 of the Geneva Securities Convention. However, under that Convention, a State can make a declaration that this rule is not to apply in that State. In a similar way, it is a policy decision for a State as to whether to adopt the rule set out in Principle 13(5). For this reason, Principle 13(5) is in square brackets.

~~7.8.~~ Under Principle 13(6) the loss of digital assets, or rights against a sub-custodian, caused by the shortfall should be borne *pari passu* by all the clients for whom the custodian agreed to maintain the assets of which there is a shortfall. In other words, if there is a shortfall of digital asset A, or rights against the sub-custodian that relate to digital asset A, and none for digital asset B, or rights against the sub-custodian that relate to digital asset B, the shortfall in respect of ~~digital asset~~ A is shared rateably among all clients for whom the custodian is maintaining an undivided pool of ~~asset~~ A. The approach follows that of Article 26(2) of the Geneva Securities Convention. If a State chooses to adopt the rule in Principle 13(5), then the word 'remaining', which is in square brackets in Principle 13(6), applies. Otherwise, that word is not required.

~~8.9.~~ Principle 13(7) sets out the consequences of the insolvency of a sub-custodian where a digital asset is maintained through that sub-custodian (see Principle 11(4)). In these circumstances, the custodian must seek to change control of the digital asset from the insolvent sub-custodian, either to itself or to another sub-custodian. If the custodian is insolvent, its rights against the sub-custodian under the custody agreement are not part of its distributable insolvency estate.

Commentary to Principle 10 paragraph 4

The purpose of Principle 10(2) is to introduce the concept of 'maintaining' a digital asset, which is wider than the (factual) concept of 'control' as defined in the Control Principle. The word 'maintain' is defined as encompassing two situations in which a custodian 'maintains' a digital asset for a client.

The first is where a custodian controls an asset within the meaning of the Control Principle. The second is where a custodian is the recipient of custody services, that is, where another custodian (a sub-custodian) is obliged to control the asset for that custodian. Where a sub-custodian is used, the sub-custodian and the custodian both 'maintain' the asset. [In this situation, the custodian enters into a custody agreement with the sub-custodian and becomes its client. The custodian, therefore, has rights against the sub-custodian under that custody agreement.](#) There could also be more than one layer of custodians. For example, if there were three layers, the sub-custodian itself 'maintains' the asset for the custodian, because a third custodian is obliged to control the asset for that sub-custodian.

Commentary to Principle 11 paragraph 14

Principle 11(4) makes it clear that a sub-custody structure, ~~as explained above, especially in paragraphs 2 and 5 of the commentary to~~ [can be used. Under this structure, the custodian maintains the digital asset by entering into a custody agreement with a sub-custodian with respect to that asset \(see Principle 10\(2\) and paragraph 4 of the commentary to Principle 10, can be used\).](#) ~~Such a structure can be used if the sub-custodian is bound by the duties set out in Principle 11.~~ Other law determines the extent to which, if any, a custodian is responsible to its client with regard to the performance by the sub-custodian of its duties under this Principle.