Taking Security over Stablecoins

*by Duncan Sheehan

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The article discusses the nature of stablecoins, how a lender might take security interests over them and how – and against what assets – that security might be enforced.

Key Points:

- Stablecoins traded on a blockchain or distributed ledger, like Ethereum, come in different varieties, but they are designed with the aim of maintaining a stable price against a given asset or basket of assets.
- It is possible to give a collateral taker a non-possessory security interest – charge or mortgage – over stablecoins, although often a loan secured by another type of crypto-asset is disbursed in stablecoins.
- In some cases, a lender may have recourse to the stablecoin's backing assets, although care will need to be taken in understanding precisely how the stablecoin works.

Background

Crypto or digital assets have become big business with CoinGecko reporting that the total crypto-market capitalisation grew to $3.91 trillion in 2024 (£3.13 trillion) of which just less than 54% was accounted for by bitcoin alone. These assets are strings of tradeable computer code some of which are free-floating in value and some of which – the so-called stable-coins – are pegged to a reference asset or assets.

These crypto-assets run on blockchains. Blockchains are in essence exactly what they sound like – chains of blocks. Each block contains a record of transactions, which are mathematically linked together. A crypto-asset is linked to a public address. Those addresses are operated via a private key, uniquely cryptographically linked to the public coin address. A crypto-token can only be transferred by use of that private key, which can be held in a so-called wallet. Once the transfer is made and signed by the private key, it must be validated if it is to be included in a block. In a proof-of-work system the validating computer must find a value – a nonce as it is called – such that when hashed, hashing being a cryptographic function, with the transaction data it produces a hash within a particular target range. This method is an arduous process of trial-and-error, although easy to verify once done, and a reward is necessary to induce actors to engage in this validation exercise. Ethereum on which many (but not all) stablecoins run, now uses a different proof-of-stake system, which is much less energy intensive, but the basic idea of independent validation is the same.

The point of a stablecoin is to maintain a stable price relative to a reference asset or basket of assets. Unlike bitcoin, which is fully decentralised, most – but crucially not all - stablecoins are controlled by a single entity. USDT for example is issued by Tether Inc. Crucially, Tether for instance is an identifiable counterparty with whom coin holders can have a contractual relationship. Not all coin holders enjoy such a counterparty relationship either because they do not have an account with the issuer or because it is a decentralized stablecoin like DAI or FRAX, controlled by the MakerDAO and Frax protocols respectively, both of which run on Ethereum, and where a counterparty-issuer is hard to identify. The second element is the peg. USDT, DAI and FRAX are for example all pegged to the US dollar. In principle this means that a DAI is always worth $1, although de-pegging is far from uncommon. USDC, a stablecoin pegged to the US dollar and issued by Circle Internet Group traded as low as $0.87 in 2023 on news of its issuer's exposure to the failed Silicon Valley Bank. In June 2025 BCP Technologies launched the first stablecoin, dubbed tGBP, pegged 1:1 to the Pound Sterling.

The important question is how price is stabilised. The issuers need to implement mechanisms to absorb any volatility from holders freely trading their coins in the open market. There are three main mechanisms. Tether for example holds a large pool of liquid dollar assets, which it claims fully backs every USDT issued, and guarantees redemption of any USDT returned to it (provided you redeem at least 100,000) at a 1:1 ratio with the US dollar. If the price dips for example to 99 cents therefore arbitrageurs will buy up USDT and make a cent on the dollar, selling them back to Tether. This mechanism renders the custodial structure of the coin and how those backing assets are held key. We return to this under the heading of how we enforce security interests in stablecoins. Another mechanism is the dual coin structure. This mechanism is significantly more vulnerable, and was the mechanism used in the twin coins Terra (UST) and Luna which famously collapsed in May 2022. In principle, however, the issuer creates a primary coin (A) the price of which is tied to the peg. It then creates a secondary coin (B) to soak up the volatility. If A dips below its peg, B is auctioned off in exchange for A which contracts (reduces) the supply of A and brings the price back in line. Importantly this is dependent on B retaining value, which did not occur in the Terra (UST)/Luna collapse. As users exchanged their Terra (UST) coins for Luna, the price of the latter began to drop and ultimately resulted in a "death spiral". Essentially once nobody wanted Luna, Terra collapsed. A third mechanism is purely algorithmic. The algorithm operates as a quasi-central bank reducing or increasing supply as the price fluctuates but always ensuring that individual holders retain the same percentage of total supply.

Taking Security over Stablecoins

Specialist crypto-lenders such as Bitcoin Suisse and Youhodler do not typically take stablecoins as collateral but rather take other crypto-assets and require significant over-collateralisation. Stablecoins are then frequently used to disburse the loan, but security over them is obviously still possible and the market may develop to accommodate this. In any case, where a borrower has significant holdings of stablecoins that will be covered by any floating charge created over the (corporate) borrower's assets. Lenders will need to be aware of the

background above, however and pay close attention to the specific design of the coin and whether there are any backing assets and who the counterparty might be if they take security over the borrower's stablecoin holdings.

Crypto-assets cannot be possessed. As I have argued before, (D Sheehan 'Crypto-Assets are Choses in Action' (2025) 4~~0~~ JIBFL 231) crypto-assets are intangible choses in action. Consequently, pledges and liens are impossible. A collateral provider can only charge or mortgage the stablecoins. A mortgage involves the transfer of legal title to the lender with an equity of redemption in the borrower, and a right to sell the assets on the borrower's default in the lender – either by statute, at common law or contractually. This involves the on-chain transfer of the asset to an address controlled by the lender or off-chain transfer of control. The Law Commission has suggested that a change of control is a necessary condition for the transfer of legal title to the asset, coupled with an intention to do so (Law Commission *Digital Assets* (Law Comm no 412 2023) paras 6.39-6.47). Without that transfer of control to immobilise the assets, the transferee-lender runs the risk of the assets being re-transferred on-chain by the borrower-transferor. Most specialist crypto-lenders operate a custodial service whereby the collateral is deposited in a secure vault controlled by the lender. Whether the borrower grants a mortgage or a charge to the lender will therefore depend on the intention of the parties as found in the contractual terms proffered by the lender. If there is no intention to pass title to the assets the control taken by the lender will act to fix the charge by rendering it impossible for the borrower to remove the assets from the security (*Spectrum Plus v National Westminster Bank* [2005] UKHL 41). Complications may now arise from the decision in *Re Avanti Communications Ltd (in Administration)* [2023] EWHC 940 which loosened the requirements of a fixed charge. It may now be possible to fix the charge without a collateral taker acquiring complete legal negative control over the asset.

Where stablecoins are deposited in such a secure vault, the lender has practical – and through the terms of the lending contract legal - control over the crypto-asset. This is vital for the lender's protection. If the collateral provider is an individual, the only registration requirements for security are contained in the Bills of Sale Act 1878 and Bills of Sale Act 1878 (Amendment) Act 1882. This requires registration with the High Court where the individual creates security in writing over goods or chattels capable of delivery. Being non-possessable and therefore not susceptible to delivery in legal terms, stablecoins fall outside this provision. This creates the risk that the chargor might transfer the stablecoins without the transferee ever being aware of a possible security interest. Further even if there were a registration requirement, as there is, where the chargor is a company, under Companies Act 2006, s 859A, it remains extremely easy to trade collateral away so that either the secured lender cannot tell to which address it has been transferred because a mixer such as CoinJoin has been used (where funds are blended to obscure their origin), or cannot tell which off-chain entity controls the address or even if it does know who the off-chain owner is that entity is abroad in a jurisdiction with difficult-to-access courts. This means that in practice lenders or decentralised protocols must take control of the stablecoin to protect themselves from their borrower's unauthorised disposal of the asset. One implication of the collateral taker's taking control is that any false wealth concerns regarding the borrower are already allayed. A potential lender does not see the stablecoin as at the free

disposal of the borrower. As avoiding false wealth is a key reason for registration of security interests, registration requirements could be disapplied in this context.

One important practical kink that lenders will also have to pay attention to is whether the stablecoin will count as financial collateral if the borrower is a corporate entity. The Financial Services and Markets Act 2023 provided for the revocation of the Financial Collateral (no 2) Regulations 2003 in schedule 1 part 2; this aspect of the Act has not yet been brought into force, however. At least for the moment, regulation 3 defines financial collateral as either "cash or financial instruments". Regulation 3 also defines security financial collateral arrangements to be between non-natural persons. Even if crypto-assets are financial collateral for the purposes of transactions between corporate bodies, they are not where the borrower is an individual, or probably where the borrower is a company, but the platform used is a decentralized one such as Aave as it is not clear that there is a person (natural or legal) to act as a counterparty. While most crypto-currencies are unlikely to meet the definition of being either cash or a financial instrument because they are not shares; nor are they generally "bonds or other forms of instrument giving rise to… indebtedness," a stablecoin might meet this definition if the token gives rise to a fiat debt owed by the issuer. Under such circumstances the collateral taker's control will count as dispossession of the collateral provider and the registration provisions will be disapplied (Financial Collateral (no 2) Regulations 2003, r 4). Careful attention will need to be paid to this question as it will depend on the precise design of the stablecoin in question and its terms of service. It, for example, excludes a coin like DAI where a right to redeem exists but not for fiat and where in any case the identity of any legal counterparty is unclear. Given that control for the purposes of the regulations can accommodate the collateral provider's ability to substitute assets for those of equivalent value (*Re Lehman Bros* [2010] EWHC 1772 (Ch)), and the loosening of the criteria in *Re Avanti* to determining that a charge is fixed, attention needs to be paid to whether some charges that were previously floating (but caught by the regulations) are now fixed.

Commented [DS1]: This read to me as if the fact of a right of redemption means there is no dispossession which doesn't make sense. I'd remove it.

Enforcing Security over Stablecoins

In general, chargees and mortgagees have access to the same basic remedies. While a mortgagee is formally able to foreclose the mortgage and a chargee may not, in practice foreclosure never happens and a sale is ordered instead (*Palk v Mortgage Services* [1993] Ch 330). If a given stablecoin is deemed to be financial collateral, it will allow the collateral taker to avail itself of the remedy of appropriation under Financial Collateral (no 2) Regulations 2003 rr 17-18. On sale, any surplus must be returned to the charger and if there is a deficit the chargor remains indebted, albeit on an unsecured basis. The ability to sell the crypto currency on default is precisely what we find in many crypto-lenders' terms and conditions, although often inappropriately expressed. Youhodler refers for example to "ordinary foreclosure" in clause 6 of its standard contract terms but it is unlikely that this means foreclosure in the usual legal sense.

Of more interest in the context of stablecoins is the question whether the chargee or mortgagee should have access to any backing assets. We have already seen that not all stablecoins have such backing assets and it is fair, as a broad generali~~z~~sation, to say that those stablecoins that do not have backing assets are inherently less stable than those that do. Lenders will need to take due account of this in accepting such coins as collateral. Given the ever-present risk of issuer insolvency, however, it is also important to know whether the coin holders' rights to redeem are *in personam* or amount to a proprietary right in the backing assets. Paxos and Gemini make clear statements that reserve assets are excluded from their estate – ie the coin holders have a proprietary right. Tether says, "the composition of the reserves…is within the sole discretion of Tether" and that the right to redeem is a personal right. Lenders should scrutinize the precise wording of the borrower's right to redeem to be sure of what their own protection will be. It is worth remembering as well that Paxos, Gemini and Tether are not regulated by the Financial Conduct Authority.

BCP Technologies is, however, regulated by the FCA and tGBP is the Pound Sterling-referenced stablecoin issued by them in June 2025 after a period within the FCA's regulatory sandpit. The FCA recently issued a consultation paper on *Stablecoin Issuance and Cryptoasset Custody* (CP 25/14) in which (para 3.10) they propose that qualifying stablecoins are always fully backed and that the backing assets be managed prudently. Only certain asset classes should be permitted as backing assets; they should be held on a statutory trust whereby the issuer is trustee with fiduciary duties to the coin holders (para 3.84) and a third party should be appointed to hold the assets (para 3.91). The rules for safeguarding those assets build on the existing CASS regime (para 3.74). The idea is that (para 3.30) the assets be low risk, secure and sufficiently liquid to manage redemptions without loss of confidence. Further rules would exist around redemption. Those proposals aim to make the redemption process at par for all holders as easy as possible and with as few restrictive conditions as possible (see paras 3.119-3.132). The FCA concluded that these rules were needed in addition to the new Consumer Duty to provide maximum protection to coin holders. However, given that a stablecoin carries with it these rights to redemption they become rights that a collateral taker can also enforce and provide protection to collateral takers as well. The collateral taker may, however, need to take practical steps such as opening an account with the issuer. Simply holding a coin is typically not enough to bring with it a right to redeem.

Conclusion

Stablecoins come in many different varieties and issuers have many different business models. This entails that coin holders have different rights, depending on the design of the stablecoin in question. Lenders are advised to look closely at the design of the stablecoin, whether it has backing assets, a centralis~~z~~ed issuer and whether the issuer holds on any sort of trust for the coin holder before agreeing to accept it as collateral. There are also uncertainties as to whether and in what instances a stablecoin might count as financial collateral and this might have important legal implications as well for the creation and enforcement of security rights.