Uniform Commercial Code Article 8

Distilling the Complexities and Understanding the Risk

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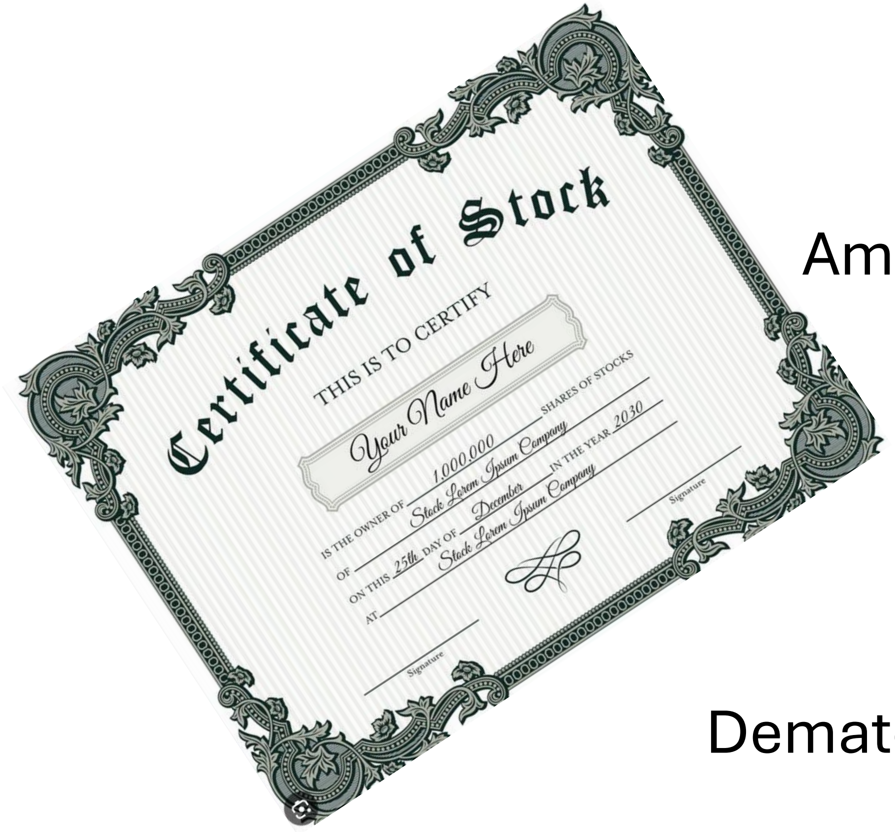
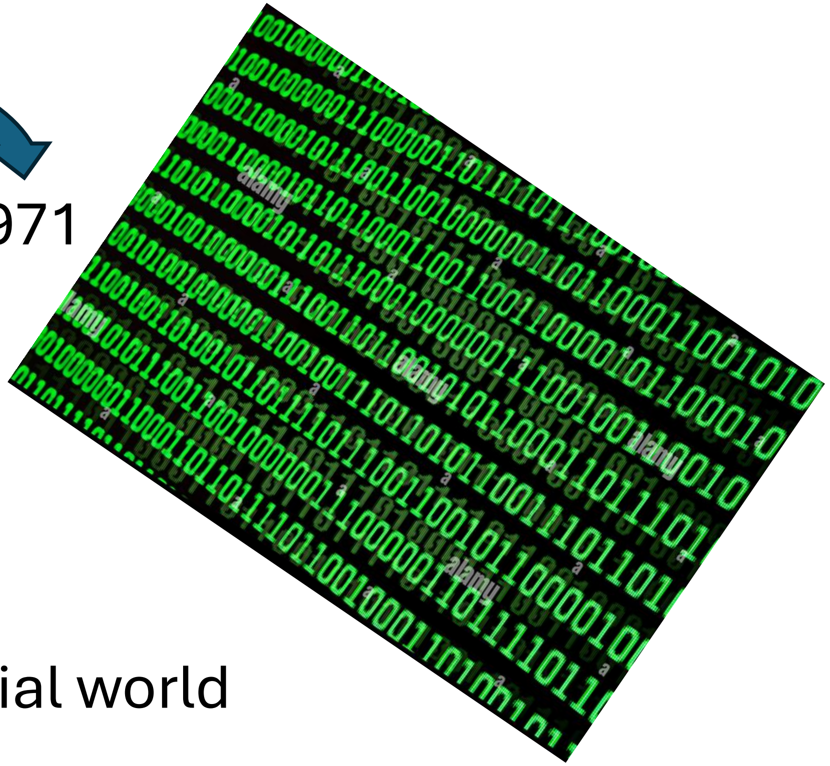
Stock Ownership: Yesterday vs. Today



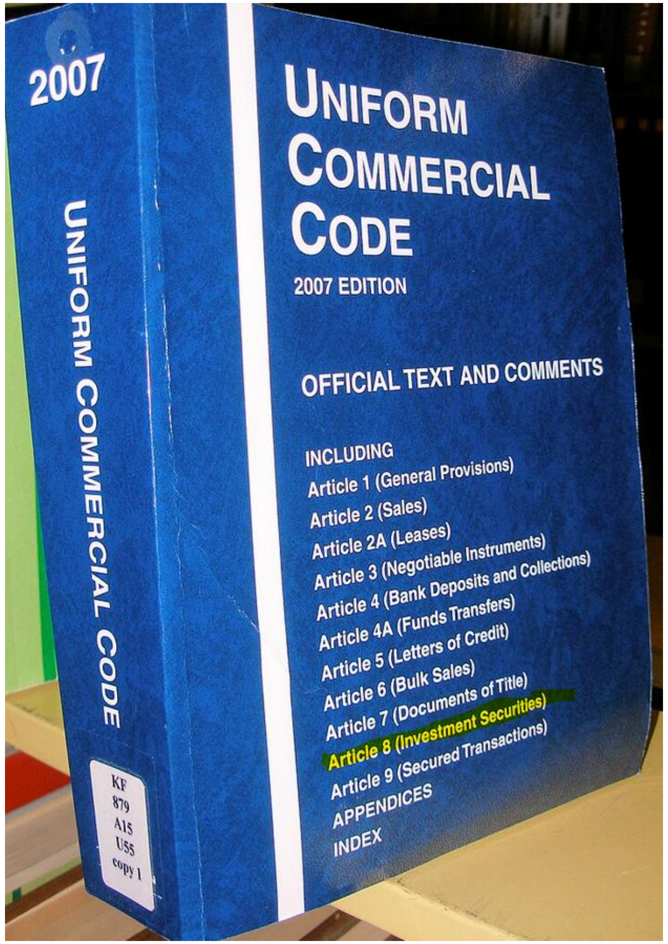
Amsterdam
1602

1971



Dematerialization of the financial world

Uniform Commercial Code



The **Uniform Commercial Code** (**UCC**), first published in 1952, is one of a number of uniform acts that have been established as law with the **goal of harmonizing the laws of sales and other commercial transactions** across the United States through UCC adoption by all 50 states, the District of Columbia, and the Territories of the United States.

The (**UCC**) exists today in all 50 States, and is continually subject to change. Some laws that have changed ultimately revoke or rescind your private property rights.

Buying, Selling & Trading Stocks & Bonds

MSFT APPL PG XOM META NUGT OIL

NVDA SLB UNG INTC CLX GOOG HAL AMZN

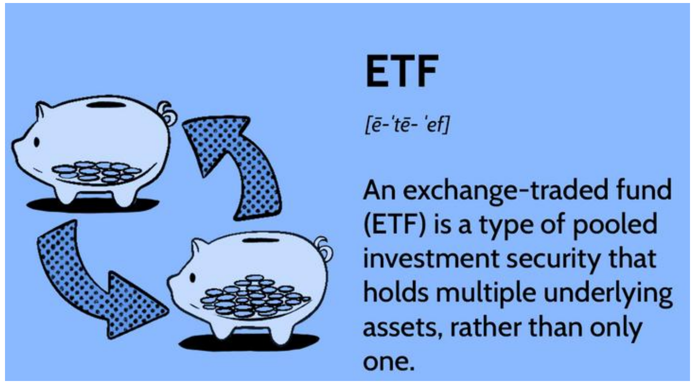
When you buy stocks, you become a part-owner of the company.

Stocks are also known as Securities and are considered to be private property.

Stocks Come in all Shapes and Sizes

- **Small-cap:** companies valued below $2 billion
- **Mid-cap:** companies valued between $2–10 billion
- **Large-cap:** companies valued over $10 billion

Through Various Financial Instruments



What's the Problem?

Much of what you "own" …

has been digitized …

Stock Ownership is a Myth

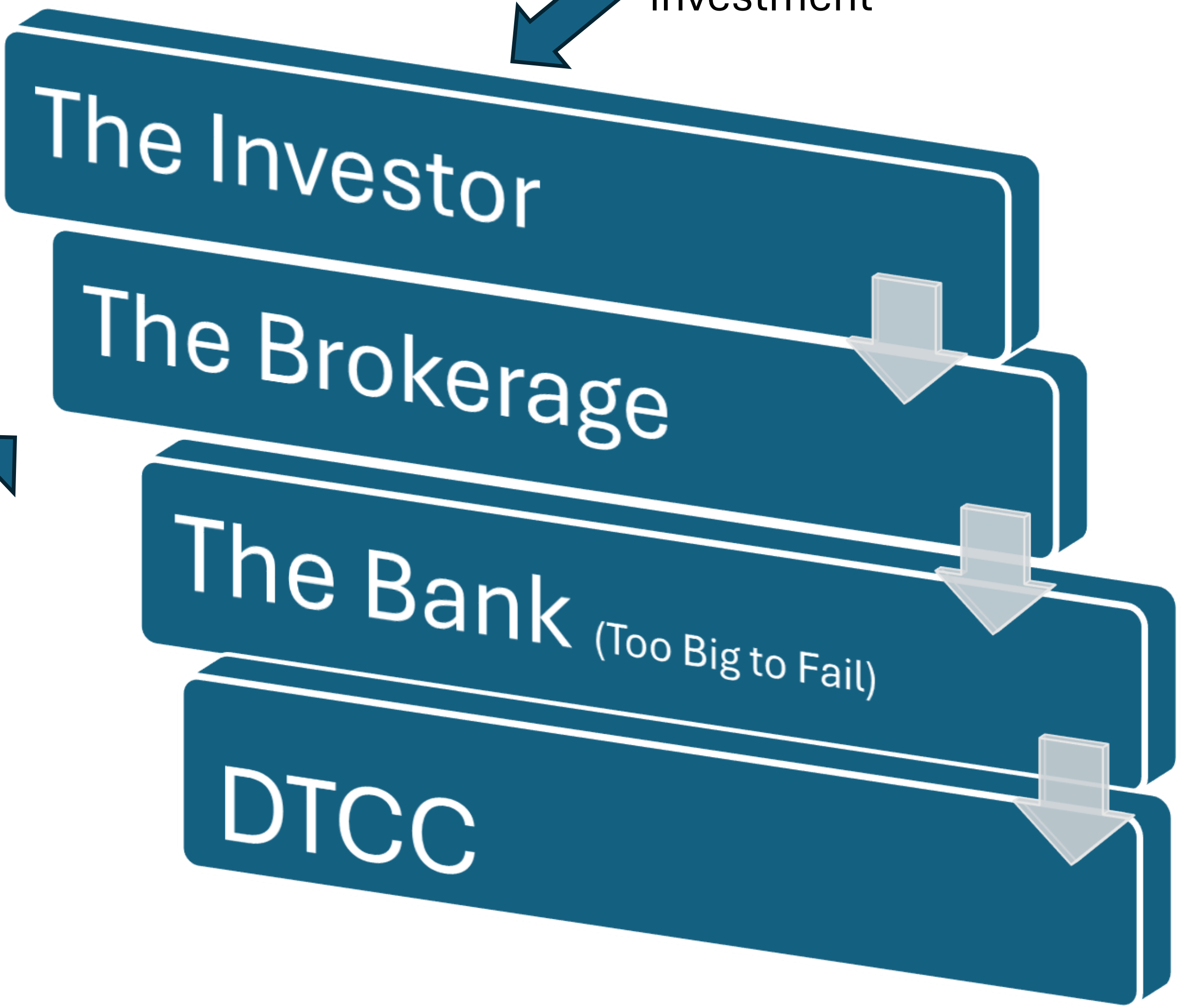
Sorry, but all of your money is gone. . .

- When someone purchases a stock electronically, the stock purchase results in the purchasing party receiving a "Security Entitlement". There is a **BIG** difference between a "*Stock*" and a "*Security Entitlement*".
- Our largest financial institutions have been deemed "Too big to fail" by governments around the world.
- In a financial crisis or systemic meltdown, liquidity (instant access to money) is all important. **The UCC, Article 8 has provided the legal means for the big banks (JP Morgan, Wells Fargo, Bank of America, Chase Manhattan, etc) to seize/own the collateral of your stocks in order to fortify/liquify the financial system in times of desperation.**

So Who does What?

When you buy a stock, there is a path that your money follows. It doesn't reside at your brokerage. The Brokerage is nothing more than an intermediary.

You or some other individual or entity that desires to buy stocks, bonds, or some other financial investment



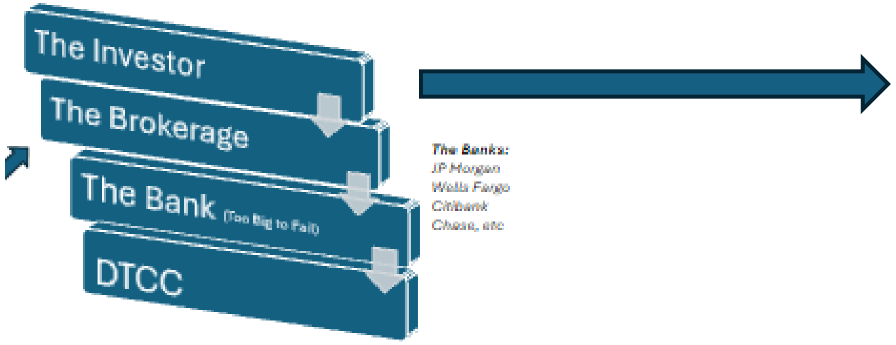
Some examples of a Broker:
Ameritrade, Charles Schwab, Edward James, TradeStation, RobinHood, etc.

The Banks:
Bank of NY Mellon,
JP Morgan,
Wells Fargo,
Citibank,
Chase, etc

Who does the UCC, Article 8 cover?

- Regional Banks and Community Banks are **<u>not</u>** covered by the UCC, Article 8. They are not part of the "protected" class. In fact, no bank in North Dakota is part of the so-called protected class.
- When it comes to Regional and Community banks and their need to invest in financial securities on open markets, they are also holding assets that are "at risk" just like you and I. Our ND Trust Funds? Exposed…
- Again, the UCC covers the **<u>big, multinational banks</u>** such as Bank of NY Mellon, JP Morgan, Chase Manhattan, etc.

What does the Brokerage do?



The Investor opens an account and deposits money in an account with a brokerage. The money can then be invested in stocks that he or she chooses.

- The natural "belief" is that the investor has invested in a stock or bond (or financial instrument of his/her own choosing). In reality, the investor actually owns a "**Security Entitlement**".
- The brokerage is an intermediary step and your broker is a **Security Intermediary**. The Security Intermediary acts to facilitate the transaction of buying a security. Again, what actually happens is that the investor has purchased a Security Entitlement.
- The broker, in turn, holds a Security Entitlement with the Custodian, who is one of the big banks.. The Custodian is always one or several of the "Too big to fail" banks (JP Morgan, Wells Fargo, etc)
- Eventually the Security lands with the Custodian, and **all "ownership" of the security is erased**. The name of the investor is no longer associated with the security entitlement.
  - The Security Entitlement is anonymously pooled in a giant pool of the same stock at the DTCC.
    - The Security Entitlement is used as collateral by the Custodian.

So then…What is a Security Entitlement?

Cornell Law School

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§ 8-501. SECURITIES ACCOUNT; ACQUISITION OF SECURITY ENTITLEMENT FROM SECURITIES INTERMEDIARY.

(a)
"Securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(b) Except as otherwise provided in subsections (d) and (e), a person acquires a security entitlement if a securities intermediary:

(1) indicates by book entry that a financial asset has been credited to the person's securities account;

(2) receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(3) becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

(c) If a condition of subsection (b) has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

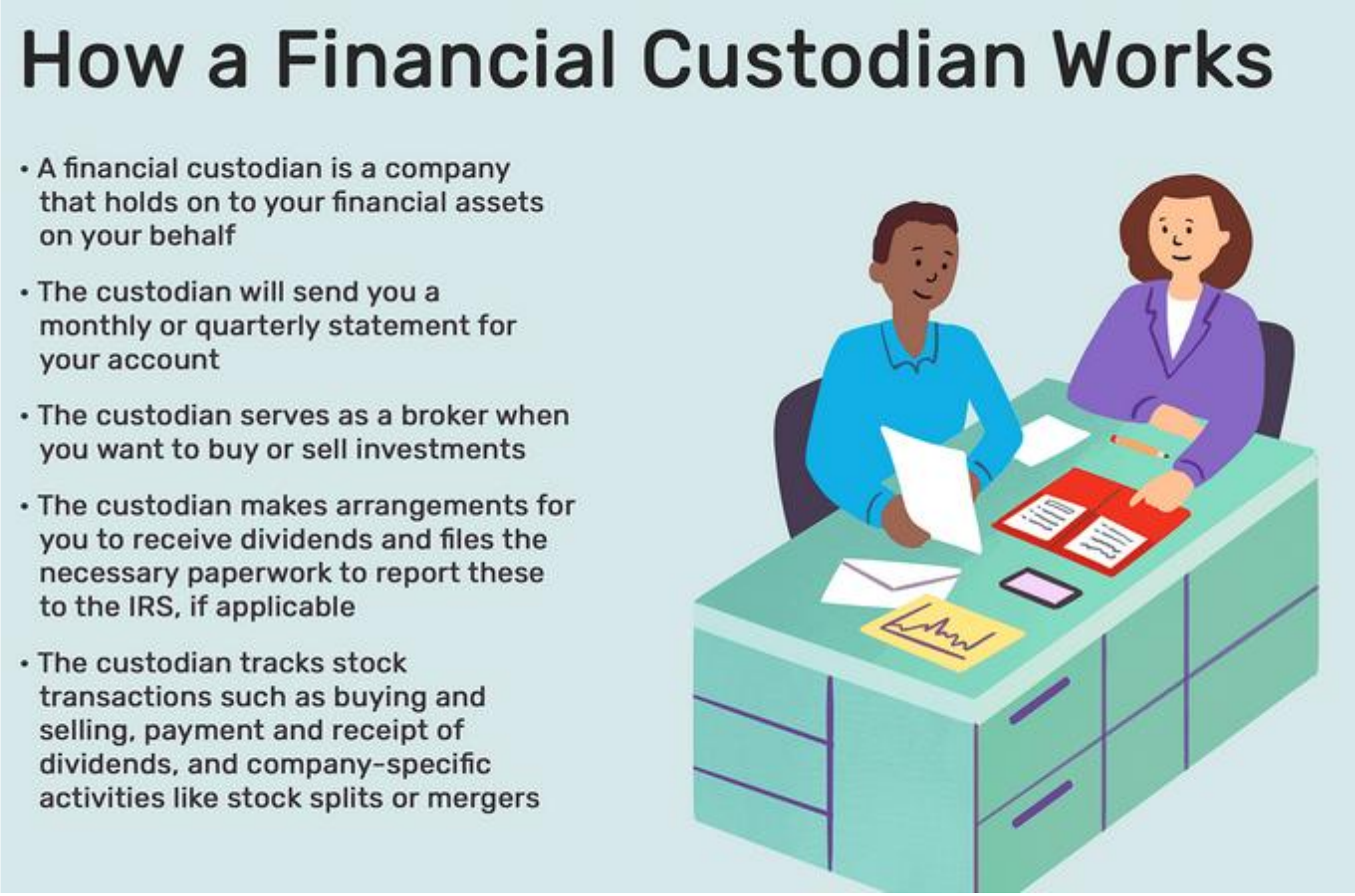
(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement

- Officially, it's the bundle of rights you hold against your broker. It's a contractual claim to the security.
- These "Rights" permit you to draw dividends and vote proxies.
- The problem? Your Security Entitlements are controlled (owned??) by the Custodian. Amongst other things, the Custodian (= Big Bank) provides record keeping services for the Broker.

Security Entitlement - A Bit More…

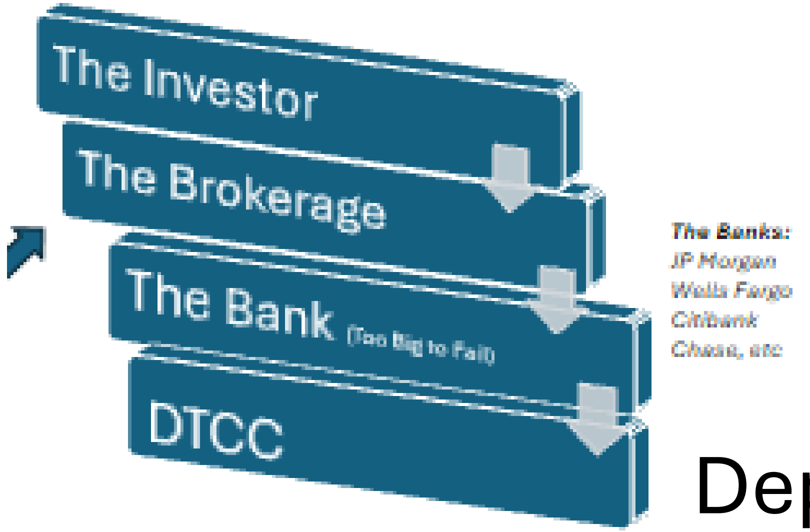
-"Security entitlement“ (**Stock**) means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary (**Broker**).
-A security entitlement (**Stock**) is both a package of personal rights against the securities intermediary (**Broker**) and an interest in the property held by the securities intermediary (**Broker**).
-A security entitlement (**Stock**) **is not,** however, a specific property interest in any financial asset held by the securities intermediary (**Broker**) or by the clearing corporation (**DTCC**) through which the securities intermediary (**Broker**) holds the financial asset. See Sections 8-104(c) and 8-503.
-The formal definition of security entitlement (**Stock**) set out in subsection (a)(17) of this section is a cross-reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement (**Stock**). The Part 5 rules specify the rights and property interest that comprise a security Entitlement (**Stock**).

So what is the role of the Custodian?



- The Custodian is the administrative arm and is one (of several) of the big banks. The power resides right here.
- Your broker is an entitlement holder with a bundle of personal rights against the Custodian.

So who is the DTCC?



- The DTC was formed in 1973, and evolved into the DTCC in 1999 (Early phases of dematerialization)
- It is owned, managed, & governed by the "Too Big to Fail" banks
- The DTCC holds all shares of a particular security entitlement in one "jumbo" certificate (reflects the total float of the security)
- The DTCC ultimately holds all securities for all companies traded on the market. They hold pools of security entitlements.

Depository Trust and Clearance Corporation

- The DTCC generally provides pooling services for all securities but does not participate in the daily management of the "float" of any particular security. That is managed by the Custodians.
- A process called "Netting" occurs at the end of each day that allows the Custodians to rebalance the net shares they hold in each security in order to maintain the established float levels at the DTCC. Shares are moved and rebalanced at each of the various Custodian accounts.

Custodian

DTCC

NVDA =

215,000,000

Shares Per

day

Think of this as a flow of faceless "**tokens**".

Tracing…What's it all about?

Electronic tracing allows investors a means of electronically tagging and tracing an investment and following its movement and whereabouts as it moves throughout the financial spectrum. Tracing was doable with technologies available in the 90's, but it is no longer done. It's fair to assume that this is done by intent.

The Point of this slide…

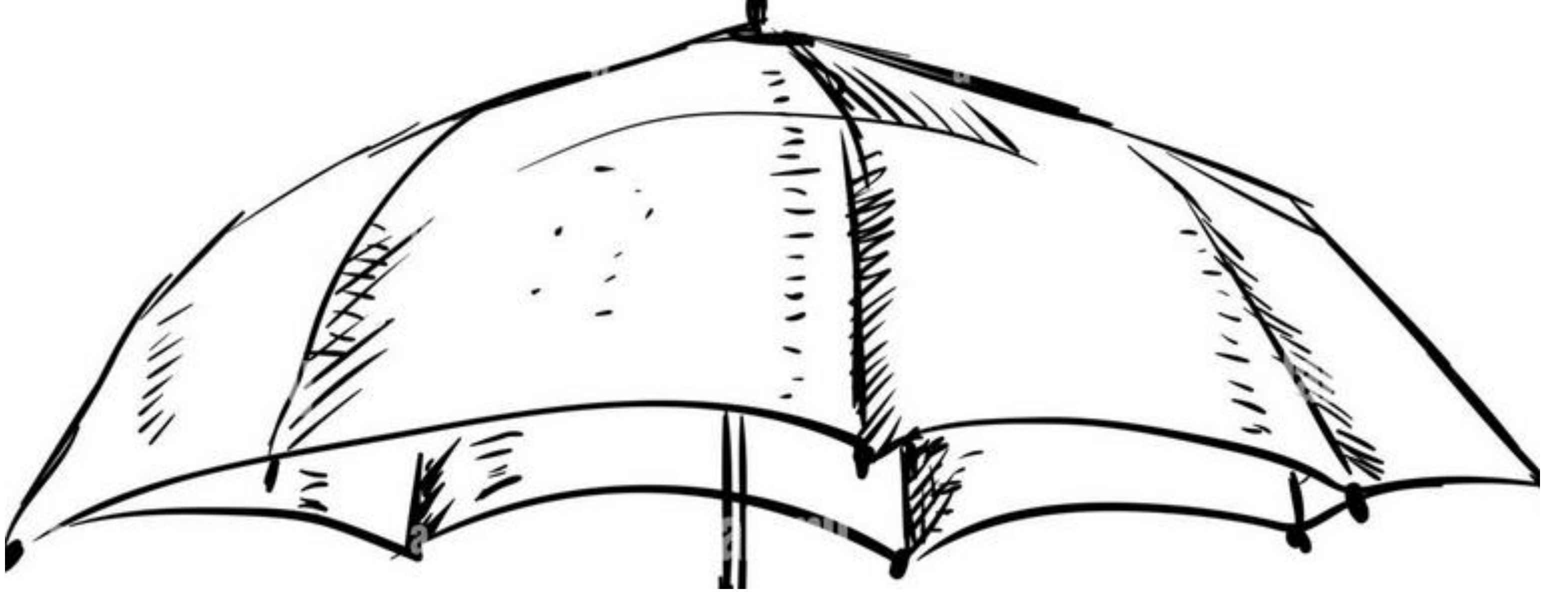
- Transactional tracing is entirely achievable. If you disbelieve, look at blockchain and its capabilities for tracing.
- Tracing eliminates the possibility of an investor's money disappearing into the ether , as it could always be located by the associated tags.
- Without tracing, try to imagine the difficulty of mounting a case with your broker when trying to recover your investment. You could mount a breach of contract against your broker, but where would the small investor be in the line-up? Let me help…dead last!

Summarizing Points

The Security Entitlement (stock) you buy has no signature on it. It's all electronic, meaning it's digital, and once a transaction is made, the security ends up flowing into a pool of identical security entitlements.

Due to the constant flow of securities in and out of the bucket, there are no identifiers attached to the security. It is simply a token, and your ownership of "**a**" security is only identifiable via the security entitlement provided you through the brokerage.

The Custodian, by law, is allowed to use your security entitlement as collateral. Should the brokerage go bankrupt, your entire investment is at risk. Now you get in line in a bankruptcy court and fight against the big boys.



UCC-Art 8

Big Banks

4,000,000,000,000,000 (4 Quadrillion $$ in Derivatives)

Global GDP ~100 trillion

The question is easy to understand. In times of financial distress, who should have the first legal right to your money?

Should it be the Bank?

Or Should it be you?

As written today in the Uniform Commercial Code Article 8, the rightful owner will be the bank.

Consider this. If litigation occurs...

Do you prefer to litigate in the Virgin Islands”

Or here in North Dakota?

As written today in the Uniform Commercial Code Article 8, the litigation will take place where the Big Bank chooses.