

Written Testimony in Opposition of SB 2364:
UCC Article 8



Chairwoman Larson and Members of the Committee,

For the record, I am Rick Clayburgh, President and CEO of the North Dakota Bankers Association and I am here to **testify in opposition to SB 2364**.

Proponents of SB 2364 believe provisions of Article 8 of the UCC allow a securities intermediary (e.g., a bank or brokerage firm) to assume ownership of its customers' investment property in the event of the intermediary's insolvency. **This is false.**

Most investors today own their securities through a securities account maintained with a securities intermediary (like a broker or bank), rather than holding the securities directly.

This indirect holding system provides many advantages for investors, such as quick, computer-based trading and secure backup of their account holdings. Under UCC Article 8, which has been enacted in every U.S. state, an investor who owns securities through an intermediary has a property interest in the securities, not merely a contract claims against the intermediary as the critics contend. Because the securities are not property of the intermediary, they are generally not subject to the claims of the intermediary's creditors. That is, the investors will not lose their assets just because the intermediary becomes insolvent. See UCC § 8-503 (NDCC 41-08-43) establishing the property interest of entitlement holders

Proponents of legislation to amend UCC Article 8 have focused on two narrow exceptions that apply only in special situations; they misunderstand the purpose and effect of those exceptions.

Exception #1: applies when the investor consents in writing to the intermediary pledging the investor's securities. The investor may, for example, borrow funds from the broker/securities intermediary to purchase securities and pledge the securities as collateral to secure payment of the loan. Under these voluntary arrangements, UCC Article 8 gives priority to the securities intermediary's lender who has accepted securities as collateral for an extension of credit to the securities intermediary that enables it to engage in these types of transactions.

This exception would be a brokerage margin account. To understand this, consider the example of borrowing money from a bank. A customer goes to the bank to borrow \$3,000 to build a deck. The customer offers their \$5,000 certificate of deposit on deposit in that bank as collateral. This example is like the brokerage margin account. Bank customer consents and pledges the certificate of deposit as security/collateral for the loan. Under this voluntary arrangement, the UCC gives priority to the bank that has accepted the certificate of deposit as collateral for the loan from the bank. If the bank customer is unable or unwilling to repay the bank as agreed, the pledged certificate of deposit would be liquidated to repay the bank loan. This agreement is agreed to by the bank and the consenting bank borrower.

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Exception #2: deals with secured creditors of clearing corporations. Clearing corporations are companies that play a central role in the clearing and settlement of most of the securities trades executed daily by investors who hold their securities through brokers and banks.

These types of organizations were created decades ago to improve safety and soundness as well as the efficiency of the securities markets. UCC Article 8 gives priority to those lenders who extend secured credit to the clearing corporation to provide the liquidity that might be needed to settle a given day's trades if one of the brokers or banks fails to perform its obligations to deliver securities sold or make payment for securities purchased. The extension of credit prevents one firm's failure from causing massive market disruption that would harm all investors.

Members of the Committee, passage of SB 2364 will make North Dakota a non-uniform state, putting the stability of North Dakota's capital markets at risk. This will affect individual investors, institutional investors, and trusts. The North Dakota Bankers Association requests a ***do-not pass motion on SB 2364.***

Thank you