2025 SENATE JUDICIARY

SB 2364

2025 SENATE STANDING COMMITTEE MINUTES

Judiciary Committee
Peace Garden Room, State Capitol

SB 2364
2/11/2025

Relating to choice of law, the property interest in a financial asset held by a securities intermediary, priority among security interests and entitlement holders, and the law governing perfection and priority of security interests in investment property.

9:00 a.m. Chair Larson opened the meeting.

Members present:
Chair Larson, Vice Chairman Paulson, Senators: Castaneda, Cory, Luick, Myrdal, Braunberger.

Discussion Topics:

- Securities ownership rights
- Financial system complexity
- Investor protection mechanisms
- Impact of digital asset management
- Margin account regulations
- Jurisdictional authority in financial disputes

9:01 a.m. Senator Mark Enget introduced the bill and submitted testimony in favor #36358.

9:12 a.m. Kyle C. Wanner testified in favor and submitted testimony #36846.

9:20 a.m. Don R. Grande, Attorney, Don R Grande PC, testified in favor and submitted testimony #36995.

9:25 a.m. David R. Webb, Senior Managing member of Verus Investments testified in favor and submitted testimony #37003, #37004, and #37005.

9:31 a.m. Benjamin Orzeske, Chief Counsel of Uniform Law Commission, testified in opposition and submitted testimony #36844.

9:46 a.m. Rick Clayburgh, President & CEO of ND Bankers Association, testified in opposition and submitted testimony #36851, #36853 and #36856.

9:52 a.m. Lisa Cruz, Commissioner for the Department of Financial Institutions and State Regulator, testified in opposition.

Additional written testimony:

Joel Malus submitted testimony in favor #36914.

Paul T. Letvin submitted testimony in favor #37010.

Alexis Baxley, President of Independent Community Banks of ND, submitted testimony in opposition #36942.

Tim Karsky, Commissioner, ND Securities, submitted testimony in opposition #37125.

9:59 a.m. Chair Larson closed the hearing.

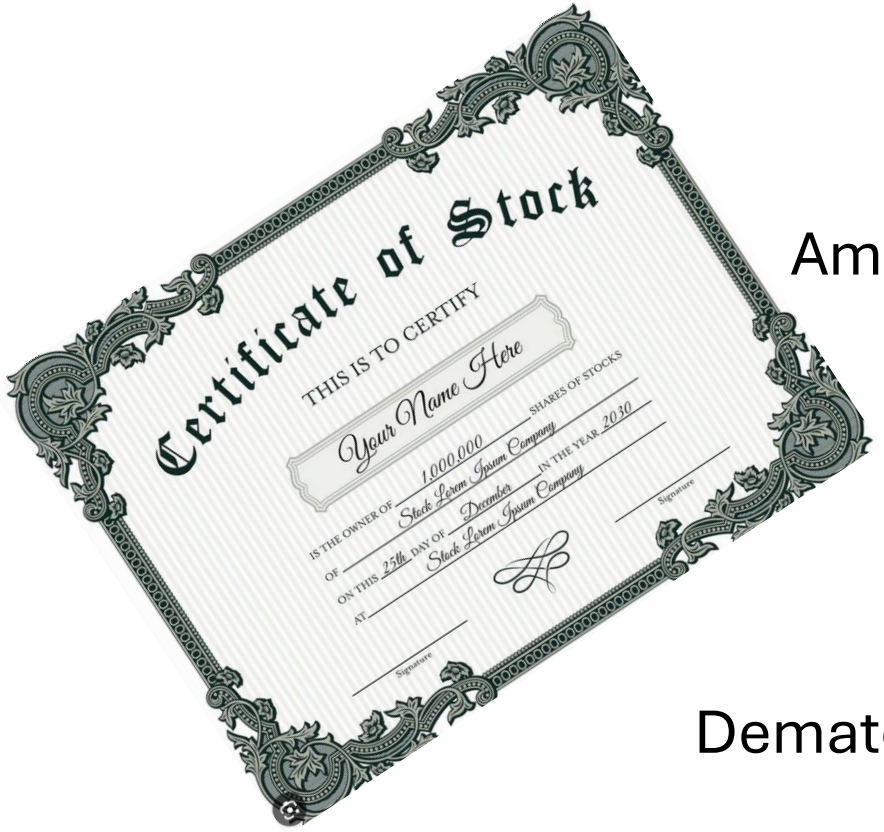
Kendra McCann, Committee Clerk

Uniform Commercial Code Article 8

Distilling the Complexities and Understanding the Risk

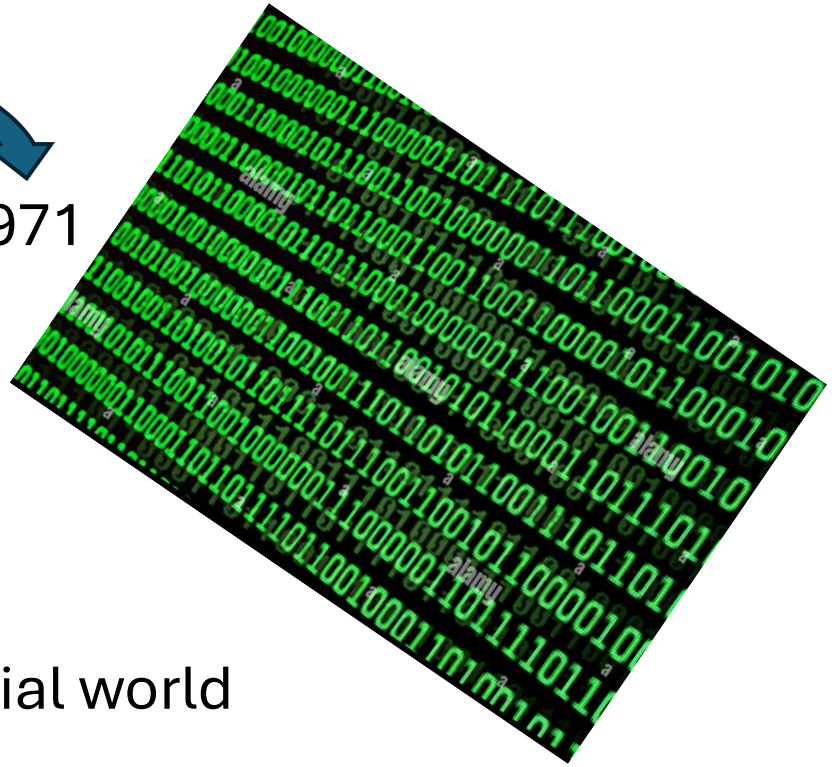
Mark Enget
Senator D2
303-579-2267
menget@ndlegis.gov

Stock Ownership: Yesterday vs. Today



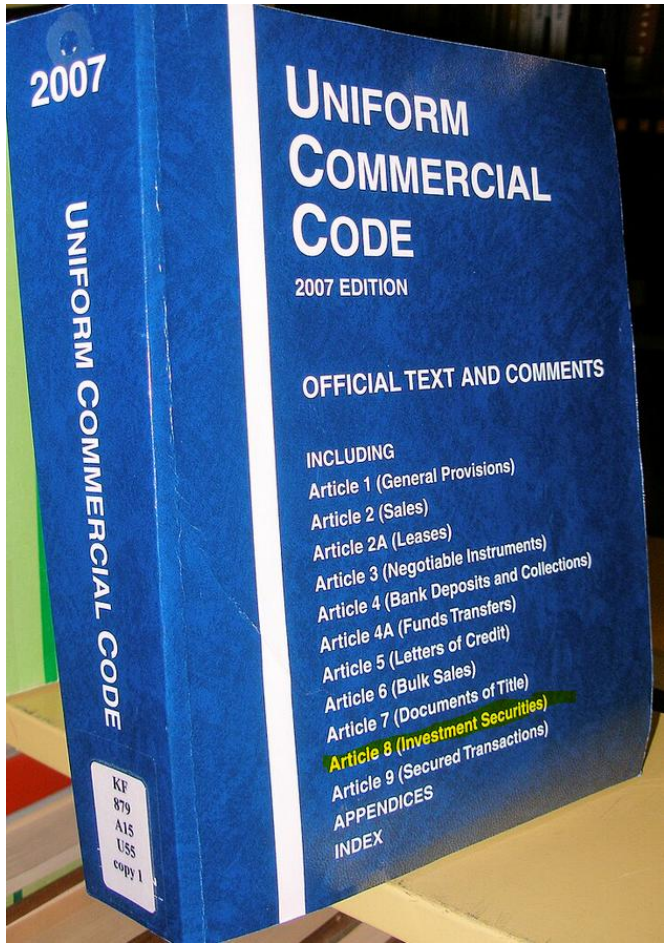
Amsterdam
1602

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

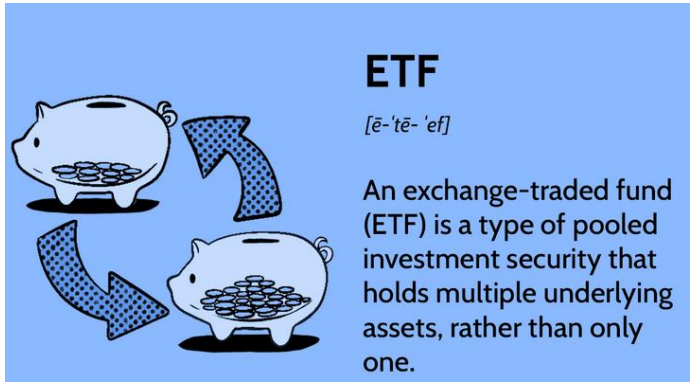
When you buy stocks, you become a part-owner of the company.

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

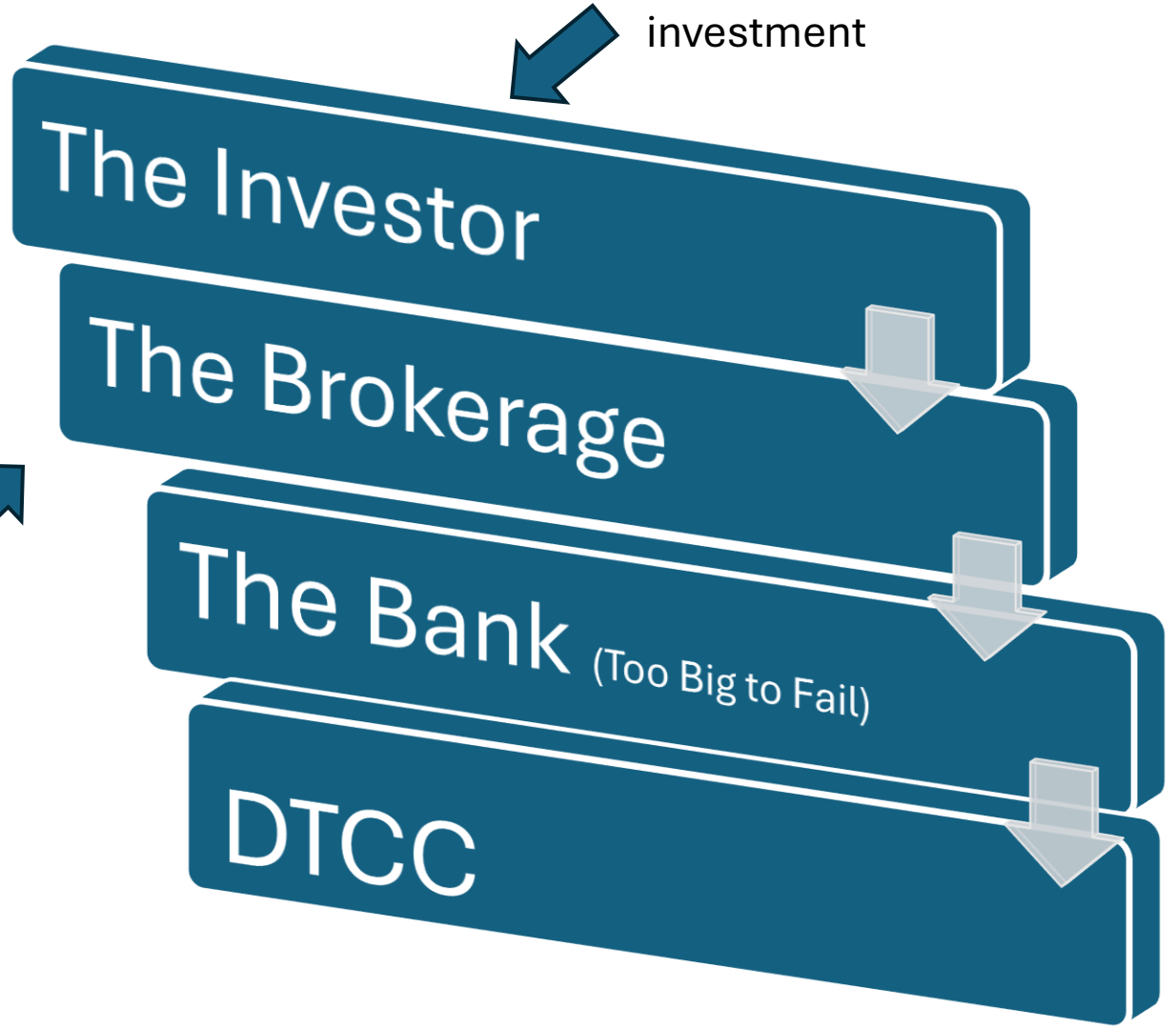
Sorry, but all of your money is gone. . .

- 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



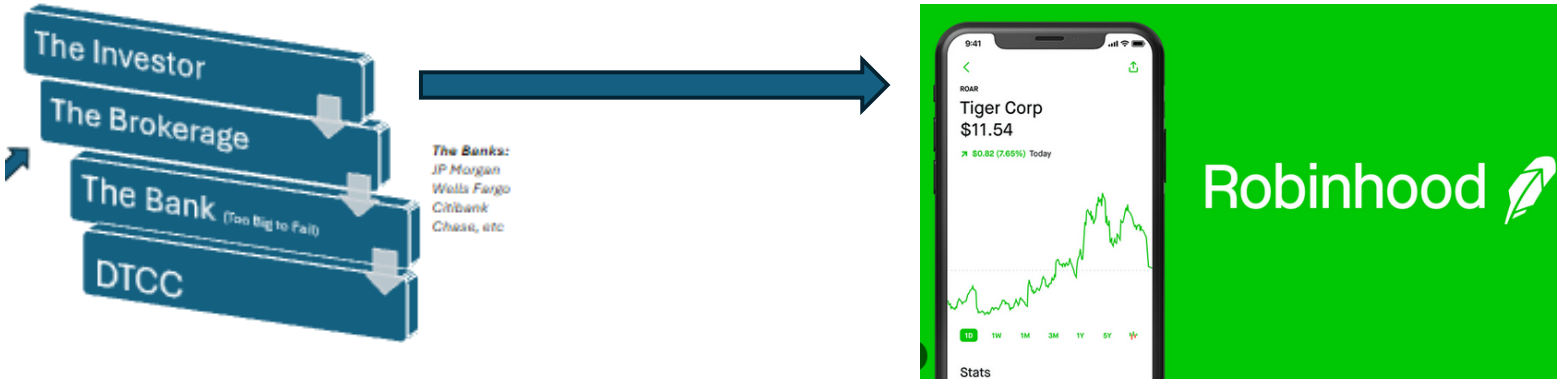
Some examples of a Broker:
Ameritrade, Charles Schwab, Edward James, TradeStation, RobinHood, etc.

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 **not** 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 **big, multinational banks** 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.

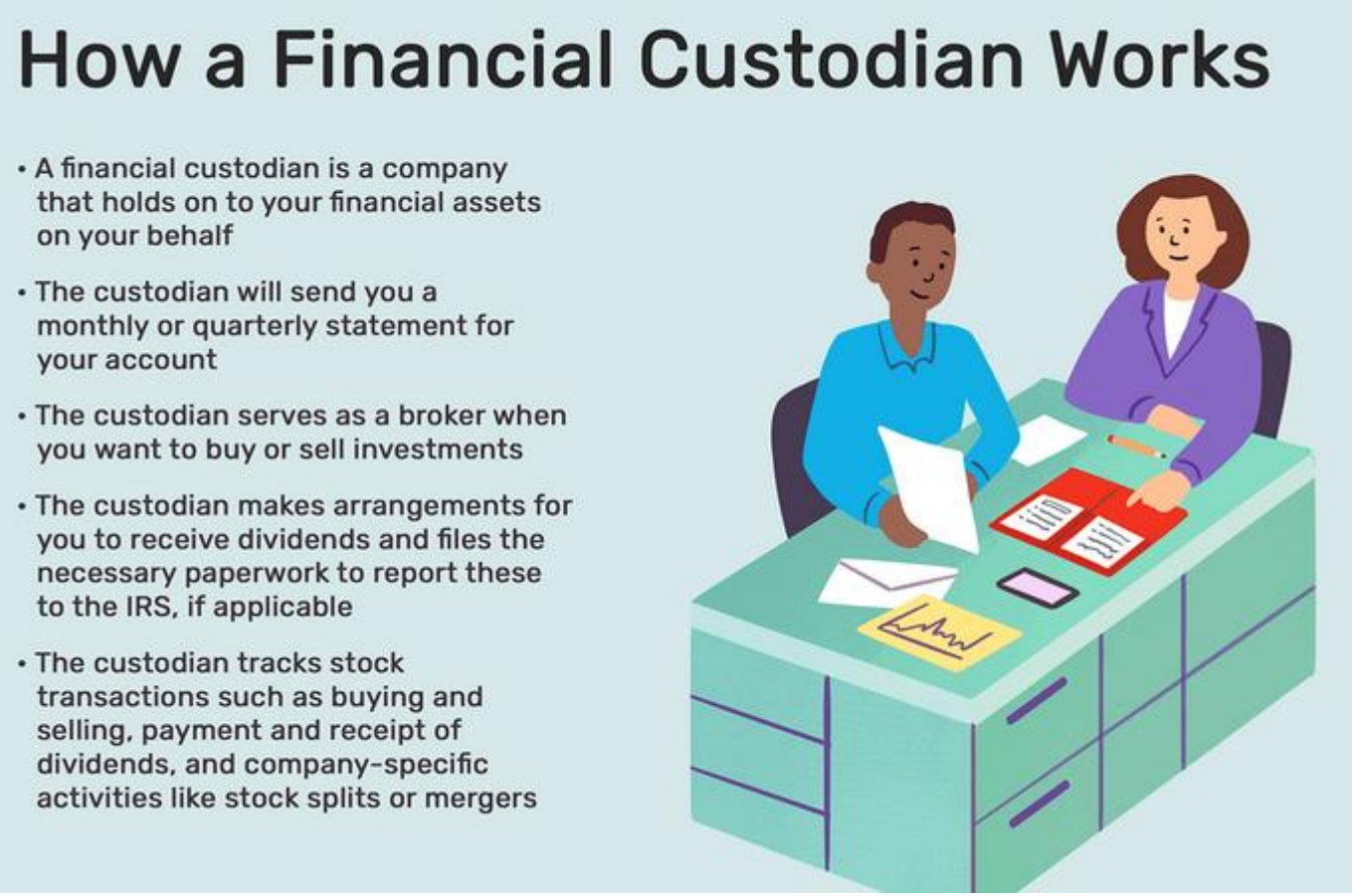
So then…What is a Security Entitlement?

- 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...

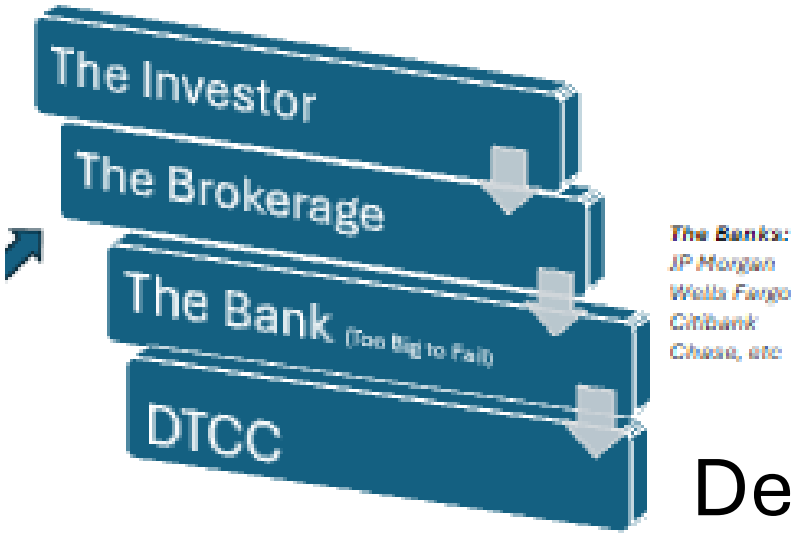
-"Security entitlement“ (**Stock**) means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary (**Broker**).
-A security entitlement (**Stock**) is both a package of personal rights against the securities intermediary (**Broker**) 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

NVDA = 215,000,000 Shares Per day

DTCC

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…

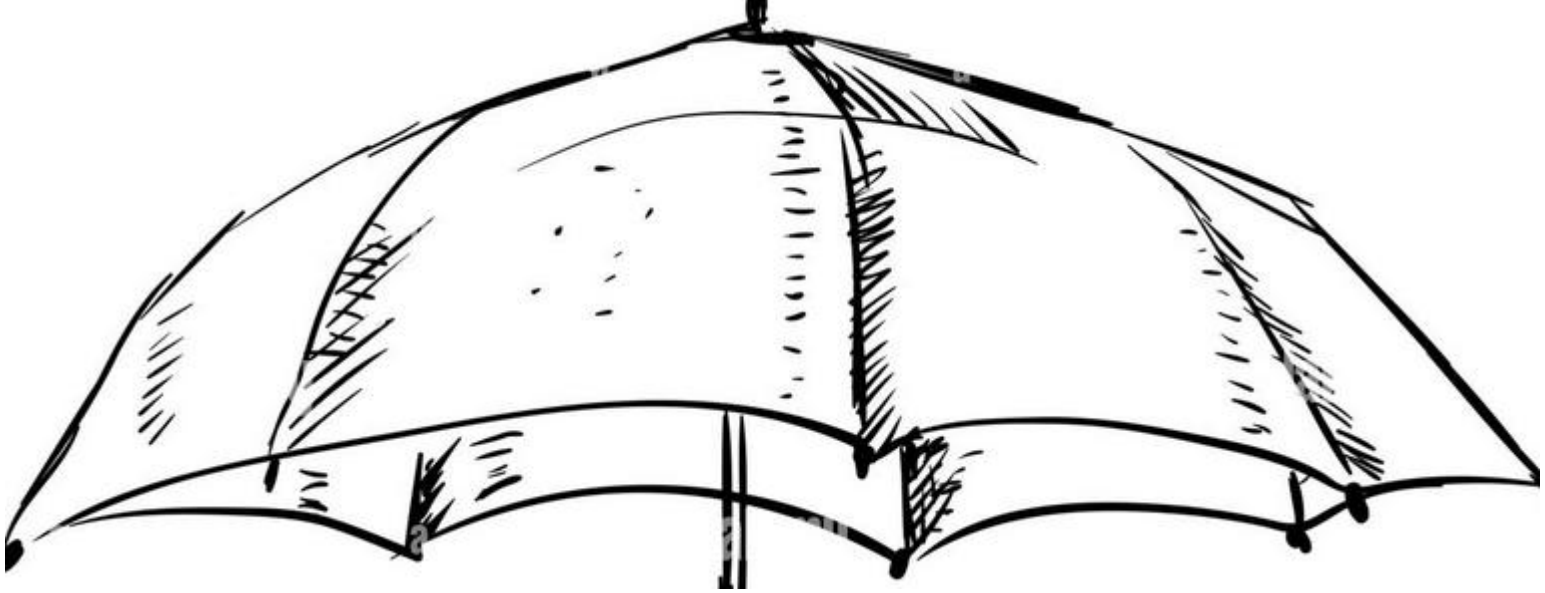
- Transactional tracing is entirely achievable. If you disbelieve, look at blockchain and its capabilities for tracing.
- Tracing eliminates the possibility of an investor's money disappearing into the ether , as it could always be located by the associated tags.
- Without tracing, try to imagine the 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.

Uniform Law Commission
NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

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February 11, 2025

The Honorable Diane Larson, Chair
The Honorable Bob Paulson, Vice Chair
North Dakota Senate Judiciary Committee

RE: SB 2364, To Amend Provisions of the Uniform Commercial Code

Dear Chair Larson, Vice Chair Paulson, and Members of the Committee:

Thank you for the opportunity to speak with you about Senate Bill 2364. This legislation to amend the Uniform Commercial Code has been introduced in eight states, including North Dakota, but it has not been enacted anywhere, and for good reason. There is a process for amending uniform laws. Anyone can submit a proposal to the Uniform Law Commission, which updates its model laws regularly. It is telling that the proponents have never contacted the ULC to propose their amendments. They suggest that this amendment will protect investors in North Dakota, but that is unfortunately not true.

The premise behind this legislation is a bizarre and unfounded claim in a self-published book called "The Great Taking." The author of that book claims that at some future point in time, large financial institutions will decide to collude to create a cataclysmic financial crisis and use the opportunity to take financial assets from their own customers on a massive scale.

It is difficult to see how large, publicly owned financial firms who compete against each other for customers could suddenly shift course and collude with each other to steal their own customers' property, or how the shareholders and employees of those firms would somehow be better off with a pile of stolen property and a horde of angry, newly broke customers. Nevertheless, that implausible scenario is the so-called "problem" that this bill is supposed to fix. If you want to see for yourselves how this false narrative has gained traction, it won't take much searching online to find videos that promote this bizarre theory while advertising alternative investments to frightened viewers.

I want to be perfectly clear that I do not believe any of the sponsors of this bill are disingenuous. I presume they are hearing from misinformed constituents asking them to take action to protect their investments. But that is not what this bill does. Existing securities laws and regulations already provide strong protection for investors, and this bill would not add any additional safety. Instead, it would defeat the purpose of the Uniform Commercial Code by making North Dakota law different from the law of every other state, adding friction to interstate transactions and driving up costs for individuals and businesses in North Dakota, and for any counterparties in other states that transact business with North Dakotans.

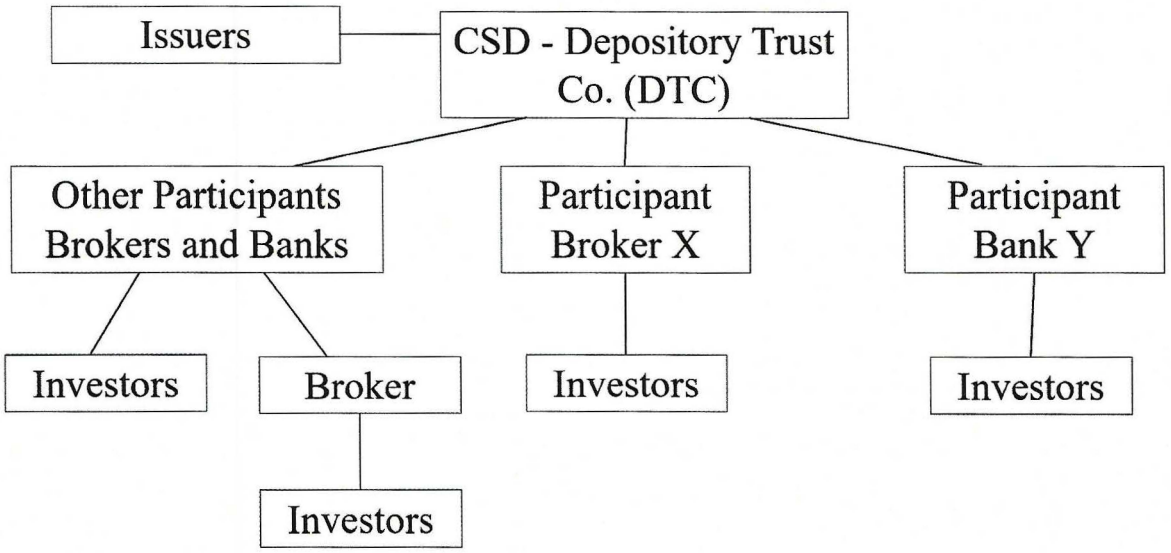
It took a full semester of law school for me to learn just the basics about the federal and state laws that regulate the sale of securities and protect investors—I cannot give a complete overview in the time allotted for this hearing. Instead, I will explain the purpose of Uniform Commercial Code Section 8-511, which Senate Bill 2364 proposes to amend. If any of the committee members want more information after the hearing, I will

be happy to follow up.

To understand the purpose of UCC Section 8-511, it must be read in conjunction with other law. In general, the law that regulates banks, brokers, and securities dealers and protects their customers' investments is federal law. Those laws make it illegal for an investment firm to use its customers' investment property for the firm's benefit.[1]

The Uniform Commercial Code is not regulatory law—it is private law that governs the rights of parties who enter into commercial transactions with each other. Because the UCC has been enacted in every U.S. state, commerce in the United States is predictable and efficient. Much litigation is avoided because the UCC sets out rules that follow sound business practices and conform to the expectations of buyers and sellers.

Article 8 of the UCC governs transactions involving investment securities and was last amended in 1994 to keep pace with evolving technology. Beginning in the 1960s, many U.S. investors began using the electronic holding system for securities because of its many features that benefit investors, like consolidated brokerage accounts with net tax accounting, near instantaneous trading, and the ability to place buy and sell orders at a limit price rather than at the market price. By the 1990s, nearly all investors used the multi-tiered electronic holding system, which is illustrated in the diagram below.



UCC Article 8, Part 5 was added in 1994 to provide rules for this modern electronic holding system. In the United States, companies that issue stock for public sale generally do so using jumbo certificates representing millions of shares. Those shares are held by a clearinghouse called the Depository Trust Company (DTC)[2]. All major securities dealers have an account with DTC, and DTC electronically credits each firm's account with shares of individual securities representing the holdings of all the firm's customers. Each firm in turn maintains individual accounts for each customer and credits each customer's account with the appropriate

[1] In particular, the Securities Investor Protection Act of 1970 as amended by the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 and associated Securities and Exchange Commission regulations serve to protect investors' property from misappropriation by a securities intermediary.

[2] Other clearinghouses exist for other types of investments, but this example is illustrative of how they all function.

number of shares.

When a firm's customers trade, the firm can reallocate shares from the seller's account to the buyer's account, and send payment from the buyer back to the seller. At the end of each trading day, each firm nets all of its customers' sales and purchases, and then either purchases shares from or delivers shares to the clearinghouse to settle accounts. The clearinghouse functions as a market for its member firms to exchange securities based on the net trades of each firm's customers.

With this background, we can begin to understand the rules in UCC Article 8. UCC § 8-503 states that all securities held by the firm (called a "securities intermediary") for its customers (called "entitlement holders") are owned by the customers and are not subject to claims of the firm's creditors *except* as provided in UCC § 8-511. UCC § 8-511 provides a general rule in subsection (a) stating that in the event of competing claims between a firm's customer and a firm's creditor, the customer has priority to the securities held by the firm. Subsections (b) and (c) then provide two exceptions to the general rule, which SB 2364 would delete. We'll consider each exception in turn.

Subsection (b) comes into play only when a customer intentionally pledges its investment property as collateral, either for a margin loan from the broker, or to fund a "short sale." In either case, the lender will take control of the shares pledged as collateral until the loan is repaid or the short sale settled. While the lender has control of the collateral, the lender naturally has priority over the customer in the event of a competing claim—no customer would expect otherwise after voluntarily pledging shares as collateral. Once the lender has been repaid, the shares are returned to the customer and the customer will again have priority over a lender's competing claim under subsection (a).

Subsection (c) is an exception for the clearinghouses that settle trades at the wholesale level between securities firms. Clearinghouses are tightly regulated under federal law and required to maintain lines of credit to ensure the timely settlement of trades. If one firm fails to deliver cash or securities to settle its customers' trades on time, the clearinghouse can use its line of credit to borrow the needed cash or securities and settle the trades as expected. In this way, one firm's failure does not affect the customers of other firms who were counterparties to the trades of the failing firm. This is an important systemic protection to ensure the system works to settle trades on time, as expected, even when problems occur.

In summary, the exceptions in UCC § 8-511 (b) and (c) serve important functions and do not pose any risk to investors. They have functioned as intended since North Dakota adopted the Article 8 amendments in 1997. Subsection (b) is only applicable to the small percentage of investors who voluntarily choose to pledge their securities in exchange for a benefit. Deleting this option will make credit more expensive or more difficult to obtain, putting North Dakota investors at a disadvantage compared to investors in other states. Subsection (c) only applies to clearinghouses and is necessary for a clearinghouse to maintain lines of credit required under federal law as a safety measure. The availability of credit is a systemic protection to ensure the clearinghouses can function as expected to settle each investor's trades in a timely manner and prevent one firm's failure from affecting other firms.

With that explanation, I urge the committee not to advance SB 2364. The bill addresses a problem that does not exist with a proposed solution that could only cause harm to North Dakota residents and businesses. I welcome any questions from the committee.

February 10th, 2025

RE: Testimony to the North Dakota Senate Judiciary Committee – SB 2364

Chair Larson and Members of the Committee,

Thank you for the opportunity to testify in support of Senate Bill No. 2364.

For the record, my name is Kyle Wanner, and I am providing this testimony as a private citizen—born, raised, and currently residing in North Dakota. My education background includes a double major with a Bachelor of Business Administration & a Bachelor of Science in Aeronautics from the University of North Dakota. Additionally for full transparency - I am also a current employee of the state of North Dakota. As a private citizen, I recognize the critical importance of this bill and the profound positive impact it could have on North Dakotans. I also firmly believe this may be one of the most significant pieces of legislation you will consider this session.

As a father of five, I am testifying not only on behalf of my own family and future generations but also for the many North Dakotans who remain unaware of the systemic financial risks that this bill seeks to address. The complexity of our financial system and the legal jargon embedded within financial regulations are not accidental—they are intentional. Layers of convoluted language are designed to discourage scrutiny and keep the public dependent on so-called financial "experts," many of whom will likely oppose this bill.

To fully grasp the implications of Senate Bill 2362, it's essential to first understand the history of our financial system, the risks it carries, and then identify who currently holds control over the custody of our financial securities.

Complexities of the Current Financial System

Over the past five years, I have extensively studied our financial system. During the COVID-19 crisis, I watched as central banks across the world acted together in lockstep: slashing interest rates, printing massive amounts of fiat currency, and inflating asset prices. These actions led to the largest wealth transfer in history, disproportionately benefiting those who already controlled substantial financial assets while devaluing the savings and purchasing power of everyday citizens.

The root of this problem traces back to 1971, when the U.S. dollar was unpegged from gold. True money serves three essential functions: it acts as a medium of exchange, a store of value, and a unit of account**.** When our currency was detached from gold, it lost its ability to be a reliable store of value. The consequences of this decision are clear—since 1971, the U.S. dollar has lost over 85% of its purchasing power, largely due to excessive monetary expansion. Inflation is not just a natural economic phenomenon; it is a direct result of policies that continue to erode the wealth of hardworking Americans.

With the shift away from the gold standard and the adoption of a debt-based fiat system, financial institutions have engineered a vast web of artificial, "money-like" instruments—including derivatives, securities, and synthetic financial products that lack backing by tangible assets. They are financial contracts whose value is based on the price of an underlying asset, such as stocks, bonds, commodities, or even interest rates. Instead of trading the actual asset, the derivative market allows investors to speculate on the price movements of the asset. Common types of financial derivatives include options, futures, swaps, and forwards. The worldwide derivatives market alone is currently estimated to exceed 2 quadrillion U.S. dollars—an unfathomable figure that dwarfs the annual GDP of the entire world. This phenomenon, known as the **financialization of assets**, has exponentially increased systemic risk, leaving the now fully connected worldwide economy more vulnerable to instability.

These dynamics have allowed central banks worldwide to sustain an unsustainable cycle of debt expansion. Data from the Federal Reserve's own website highlights a troubling trend: since 1971, the money supply, the federal government's balance sheet, and the national debt have not only increased - they have grown exponentially. As a result, the annual interest payments on the national debt have now surpassed the total spending of our military and has become the third-largest line item in the federal budget – now exceeding $1 trillion each year. I have included charts from the Federal Reserve's own website in the appendix of this testimony to illustrate these concerning trends.

This trajectory is unsustainable. Anyone who thoroughly examines and understands this issue quickly realizes that our financial system cannot persist indefinitely on its current path. History proves that financial resets have occurred many times before and that fiat currencies have historically high failure rates. Yet, because most Americans have never experienced a monetary reset in their lifetime, they fail to grasp the profound implications of what may lie ahead.

This is why I also believe that there is a growing push to normalize a new system of cryptocurrencies, central bank digital currencies (CBDCs), and the tokenization of assets—initiatives that further centralize financial control and erode fundamental property rights. These trends expose ordinary citizens to even greater risk, as control over personal wealth shifts away from individuals and into the hands of unelected financial institutions.

The Risks to Bank Deposits and Personal Assets

Since the 2008 financial crisis, the Federal Reserve has kept interest rates historically low to "encourage borrowing and economic growth" —a trend that has continued through the COVID-19 pandemic, with rates remaining near zero. As a result, the worldwide economy has become deeply dependent on low interest rates and easy monetary policies, leading to historically high debt burdens across governments, businesses, and individuals.

However, in response to rising inflation is recent years… central banks have now reversed course, implementing the fastest interest rate hike in modern history. This sudden shift comes at the risk of triggering financial instability, recession, and a debt crisis, as economies throughout the world now struggle to adjust after decades of ultra-loose monetary policy.

To make matters more concerning - during the COVID-19 pandemic, the Federal Reserve lowered the deposit reserve requirement ratio for banks to 0%. While the “emergency status” of the pandemic has long passed, this policy still remains in effect today. In simple terms, this 0% reserve requirement allows banks to use all of their bank deposits for lending, with no requirement to hold any money in reserve to cover those loans if anything goes wrong. This eliminates a critical safety buffer, making the system more vulnerable if large numbers of people suddenly desire to withdraw their money or if banks experience any sort of financial instability.

Additionally, one of the most overlooked concerns is the vulnerability of our bank deposits**.** While the Federal Deposit Insurance Corporation (FDIC) provides deposit insurance to protect depositors in the event of a bank failure, insured deposits represent only a fraction of the total deposits within the banking system. Essentially, we now have a financial system that is burdened with immense debts and obligations and lacks sufficient collateral to fully cover them. If multiple major financial institutions were to fail simultaneously, the FDIC would likely require emergency funding from the Federal Reserve—potentially leading to more money printing, higher inflation, and even direct depositor losses or widespread bank failures.

Lastly, another important point to make – is that these low interest rates and inflationary policies of the past two decades have not only eroded the purchasing power of our currency but have also discouraged traditional savings. As a result, individuals have been increasingly driven to invest in financial instruments simply to preserve their wealth and keep pace with inflation. This shift has led to a world where **the majority of the wealth is now concentrated in financialized assets** rather than in tangible, real-world assets. So now, we need to ask the question – who truly owns these finalized assets?

Who Truly Owns these Financialized Assets?

In 1973 - only two years after the U.S. dollar was unpegged from gold, the Depository Trust Company (DTC) was founded and took over the responsibility for holding and transferring financial securities in book-entry form, with Cede & Co**.** serving as the nominee’s name for the holdings. It is important to note that the DTC and Cede & Co are both **privately owned** by its members. These members include major banks, broker-dealers, and financial institutions that provide for the clearing, settlement, and custody of financial securities.

Cede & Co. holds securities on behalf of DTC participants, making it the **legal owner of most publicly traded securities in the U.S.** on paper, while the actual investors hold "beneficial ownership" through their brokerage accounts.

In fact, this excerpt is taken directly from the Cede & Co – Wikipedia page:

> Cede and Company (also known as Cede and Co. or Cede & Co.) is a specialist United States financial institution that processes transfers of stock certificates on behalf of Depository Trust Company, the central securities depository used by the United States National Market System, which includes the New York Stock Exchange, and Nasdaq.[1] Cede and Company is a shorthand for the phrase 'certificate depository.'[2]

> **Appropriately, the word 'cede' means to 'give up (power or territory)'[3] because investors give up their stock and companies give up their shareholders to an intermediary**.[4]
>
> **Cede technically owns most of the publicly issued stock in the United States.[5] Thus, most investors do not themselves hold direct property rights in stock, but rather have contractual rights that are part of a chain of contractual rights involving Cede.**[6] Securities held at Depository Trust Company are registered in its nominee name, Cede & Co., and recorded on its books in the name of the brokerage firm through which they were purchased; on the brokerage firm's books they are assigned to the accounts of their beneficial owners.[7]

This is a critical finding - as we find ourselves now living in a system where the people truly do not own the financial assets that we have been purchasing. Essentially, financial institutions have quietly worked over the years to shift the legal ownership of financial assets away from individuals and towards banks and other secured creditors.

Protecting North Dakotans' Property Rights: The Case for SB 2364

Senate Bill 2364 introduces two key improvements for North Dakotans.

First, it would ensure that North Dakota law would govern security entitlement disputes and would prevent financial institutions from dictating jurisdiction. This change strengthens legal clarity and guarantees that disputes over security interests are resolved locally, right here in North Dakota—further protecting the rights of our investors and ensuring fair oversight.

Second, and most importantly, this bill restores property rights of financial assets to their rightful owners**.** Under current law, financial institutions—such as banks, brokerages, and clearing corporations—can claim priority over an individual's financial assets in times of insolvency**.** This means that in the event of a financial crisis, everyday investors are left with little to no recourse while institutional creditors seize assets that should belong to North Dakotans.

The problem is clearly outlined in Section 3 of SB 2364**,** which reveals that owners of financial asset owners are now referred to as an "entitlement holder." The current law then grants priority of ownership to financial institutions instead of the "entitlement holder" in cases of insolvency**.**

Specifically, as the law currently states:

> "In the event that a clearing corporation does not have sufficient financial assets to satisfy its obligations… the **claim of the creditor has been given priority** over the claims of entitlement holders."

This is nothing short of legalized theft, obscured behind layers of complex legal language. SB 2364 seeks to correct this injustice.

In summary - by passing this bill, North Dakota will:

- **Ensure security interest disputes are resolved locally**, keeping jurisdiction within the state.
- **Strengthen property rights** by ensuring that financial assets remain in the hands of their rightful owners.
- **Protect individual investors** from predatory claims by banks and financial institutions.
- **Position North Dakota as a leader in financial security reform**, setting an example for other states to follow.

While other states are also beginning to recognize this issue, North Dakota has the opportunity to lead the way in restoring true ownership rights. This legislation ensures that, in times of financial uncertainty, North Dakotans' private property is protected—not seized by powerful institutions. Now is the time to take action and defend the property rights and financial security of North Dakotans.

The Opposition's Motivations

Our financial system is currently controlled by unelected and unaccountable individuals within the major commercial banks and the Federal Reserve— which is a private institution, not a government agency. Many are unaware that the United States has actually abolished two previous central banking systems, and I firmly believe it is time to reconsider the role of the current one. While a nationwide solution may eventually be necessary, we are currently seeking a local solution to this dilemma. North Dakota has the power—right now—to take a stand and safeguard its own people.

I fully expect the banking industry to oppose this bill, as they have in other states. However, I have yet to encounter a compelling argument from the banking sector that justifies their opposition to ensuring financial securities are prioritized to their rightful owners.

Some in the opposition have claimed that this language only applies to "margin accounts," but this is simply not true. They will also likely argue that modifying these sections will pose a risk to our financial system and economy, but this is also a misrepresentation. These proposed changes do not impact how the system is operating, **it only affects the procedures in the event of insolvency**, ensuring that individual property rights of these financialized assets are protected—rather than being seized by large financial institutions. I urge you to demand more substantial responses from the opposition.

Please ask yourselves - Are those who oppose this bill truly acting in the best interests of North Dakotans who have been led to believe that they fully own their financial assets? Or are the financial institutions merely protecting their ability to exploit a system that was designed to serve them?

A Call to Action

I urge this committee to recognize the historical significance of this issue. This is not just another bill—it's passing would provide us with critical defense of fundamental property rights. North Dakotans deserve financial security and the assurance that their financial assets are truly theirs.

I respectfully urge the committee to give Senate Bill No. 2364 a **"Do Pass"** recommendation. Thank you for your time and consideration.

Respectfully,

Kyle Wanner

Kyle C. Wanner
North Dakota Citizen

Key Word Definitions

1. **Adverse Claim** - A claim that disputes the ownership or rights to a security or financial asset and can be asserted against a person who holds a security.
2. **Clearing Corporation** -An organization responsible for facilitating and clearing the settlement of transactions between buyers and sellers in financial markets, ensuring the proper transfer of securities.
3. **Commodity Account** - A financial account that holds contracts or rights related to commodities, which can be used as collateral for loans or other financial transactions.
4. **Commodity Contract -** An agreement or contract related to the purchase or sale of commodities, which may include goods, materials, or products typically traded in markets.
5. **Control (of a financial asset)** - The power of a person or entity to direct the disposition of a financial asset, often granting them authority to access, transfer, or utilize it in transactions.
6. **Creditor (of a securities intermediary)** - An entity or individual that holds a financial claim against a securities intermediary, which may include a claim over securities or assets held by the intermediary.
7. **Financial Asset** - A non-physical asset that represents a financial value or investment, such as stocks, bonds, or other securities.
8. **Financial Asset Held by a Securities Intermediary** - A financial asset that is held by an entity, known as a securities intermediary, on behalf of a client or entitlement holder.
9. **Issuer's Jurisdiction** - The jurisdiction or legal authority under which the issuer of a security is organized or operates, which governs various aspects of the security's validity and transfer.
10. **Perfection (of a security interest)** - The legal process by which a lender or secured party establishes priority rights over a financial asset or security, often involving the filing of public records to ensure the security interest is legally enforceable.
11. **Priority (of security interests)** - The order of rights that different parties have in a financial asset or security when multiple claims exist, which determines who has the first right to access or control the asset.
12. **Security Entitlement** - The rights a person or entity holds in a security, typically as a result of holding a financial asset through a securities intermediary, giving them the right to transfer or use the asset.
13. **Security Interest** - A legal claim or right in a financial asset or property, typically used as collateral for a loan or other financial obligation.
14. **Security Certificate** - A physical document representing ownership of a security, such as a stock certificate or bond certificate, that can be transferred or pledged.
15. **Securities Account** - A financial account held by a securities intermediary that tracks the ownership or interest in securities on behalf of entitlement holders.
16. **Securities Intermediary** - An entity, such as a broker or custodian, that holds securities or financial assets on behalf of a client or entitlement holder, and has responsibilities related to the administration and transfer of those assets.
17. **Security's Jurisdiction** - The jurisdiction under which a security's registration or legal transfer is governed, based on the laws applicable to the issuer or intermediary.
18. **Secured Party (or Entitlement Holder)** -A person or entity who holds a security interest or entitlement in a financial asset, often having a claim or right to that asset under specified conditions.

How do Financial Securities Flow through the System?

The financial securities system in the U.S. operates through a **multi-tiered structure**, with the **Depository Trust Company (DTC)** at the top and individual investors at the bottom. Here's a top-down explanation of how financial securities flow through the system:

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1. Depository Trust Company (DTC) (Top Level)

- The DTC acts as the central securities depository in the United States.
- It immobilizes physical securities and holds electronic records of ownership through Cede & Co**.**, its nominee name.
- The DTC and Cede & Co are both **privately owned** by its members

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2. DTC Participants (Broker-Dealers & Banks)

- Major financial institutions (e.g., JPMorgan, Goldman Sachs, Morgan Stanley) are direct DTC participants. These firms hold securities in "street name" at DTC, meaning that the DTC records them under the firm's name.
- They act as intermediaries, facilitating trading and safekeeping for their clients.

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3. Clearing Firms & Custodians

- Some broker-dealers use clearing firms (e.g., Pershing, Apex Clearing) that handle trade processing and settlements.
- Custodian banks (e.g., Bank of New York Mellon, State Street) hold securities on behalf of institutional investors.

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4. Retail & Institutional Brokers

- These include platforms like Charles Schwab, Fidelity, or Robinhood, which serve individual retail investors.
- Institutional investors (e.g., hedge funds, pension funds) also work through brokers.
- Brokers maintain customer accounts and execute trades on exchanges.

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5. Individual Investors (Bottom Level)

- Investors hold securities in their brokerage accounts, **but not directly in their name.**
- Securities are held in **"**street name" under the brokerage, meaning the broker is the registered owner, while the investor is the "entitlement holder".
- Investors rely on brokers for dividends, voting rights, and trade execution.

How Financial Securities Move in the System (Trade Settlement)

1. Investor places a trade via a brokerage (e.g., buys Apple stock).
2. Broker executes the order on an exchange or through a market maker.
3. The clearing firm matches the trade and reports it to DTC for settlement.
4. DTC updates its records, showing the brokerage as the new entitlement holder underneath Cede & Co.
5. The investor's account is credited with the shares, but they remain legally registered under the broker and owned by the DTC & their nominee's name Cede & Co.

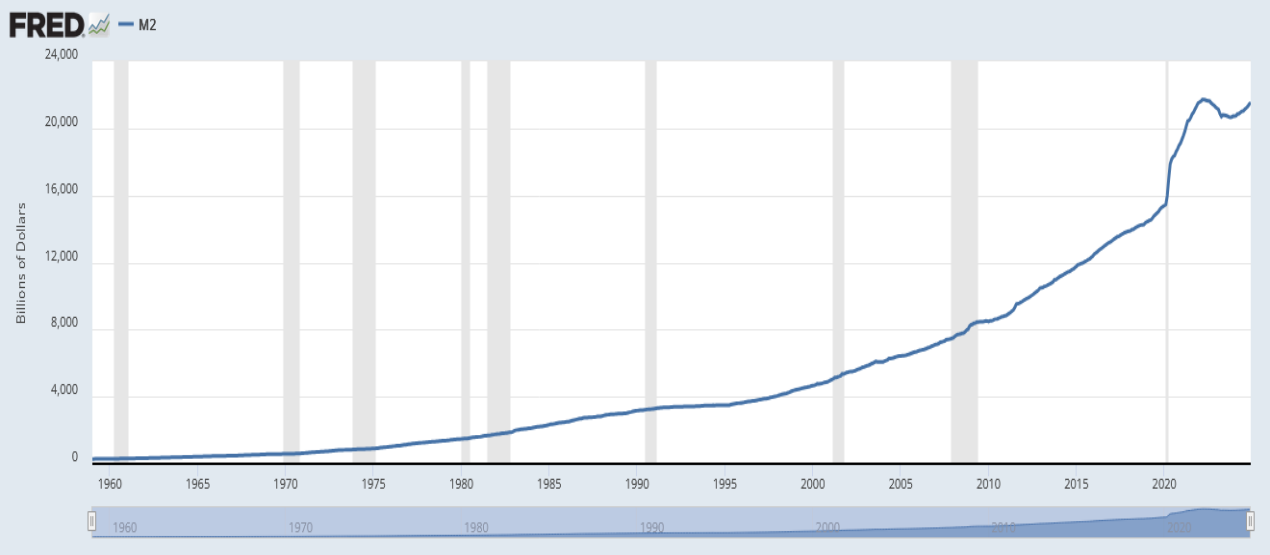
Key Takeaways

- The DTC (via Cede & Co.) is the ultimate registered owner of nearly all securities.
- Brokerages act as intermediaries, holding securities for investors.
- Investors have beneficial ownership as "entitlement holders" but not direct title to shares.
- The system is currently built to limit direct investor control over securities especially in cases of systematic insolvency.

Appendix

This appendix offers a historical perspective on our financial system from some key indicators and highlights the unsustainable trajectory we're currently facing. This context emphasizes the ***urgent need*** *to pass Senate Bill 2364, which would safeguard North Dakota citizens from potential asset confiscation by secured creditors in the event of future financial instability.*

United States Historical M2 Money Supply (1960 – 2024)

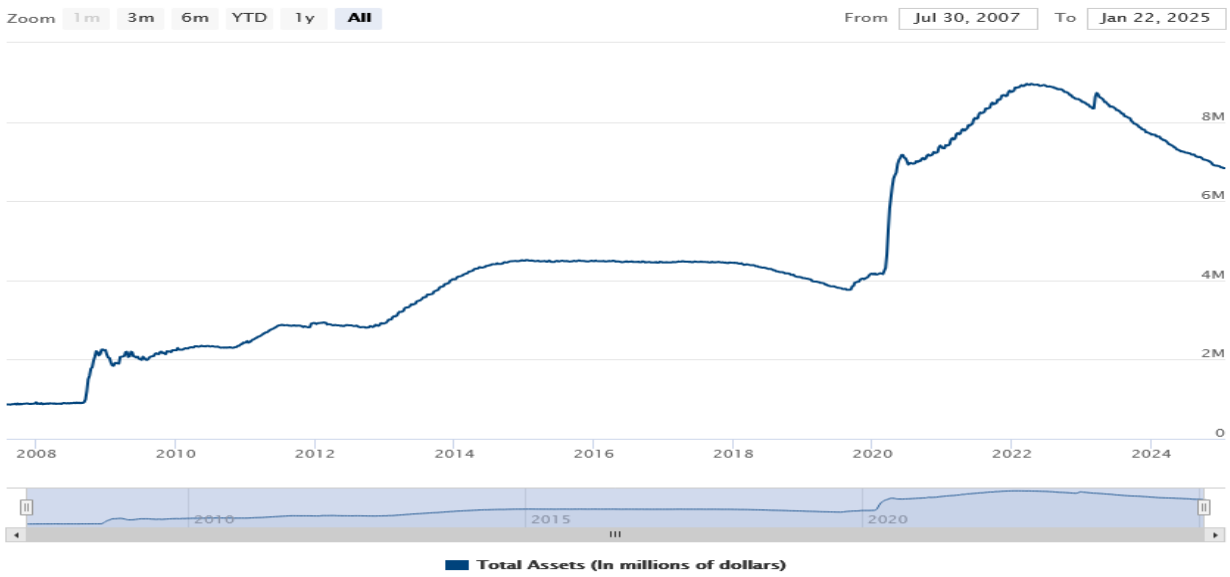


Source: https://fred.stlouisfed.org/series/M2SL

The M2 money supply is a broad measure of the total money available within the economy, including cash, checking deposits, and easily convertible near-money assets. Since the U.S. dollar was unpegged from gold in 1971, the M2 money supply has expanded dramatically. In January 1971**,** it stood at approximately $624.3 billion, but by November 2024**,** it had surged to around $21.45 trillion—an increase of approximately 3,336%**.**

While an expanding money supply can provide short-term economic stimulus, excessive and prolonged growth is often a symptom of unsustainable economic policies. Rapid increases in M2 contribute to inflation**,** financial instability, and a potential erosion of confidence in the monetary system. Historically, unchecked money supply expansion has led to asset bubbles, rising consumer prices, and long-term economic distortions, ultimately threatening financial security and economic stability.

The Balance Sheet of the total Assets of the Federal Reserve (2008 – 2024)



Source: https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm

The Federal Balance Sheet refers to the financial statement of the U.S. federal government or the Federal Reserve, detailing its assets, liabilities, and net position. It serves as a key indicator of the financial health of both the government and the central banking system.

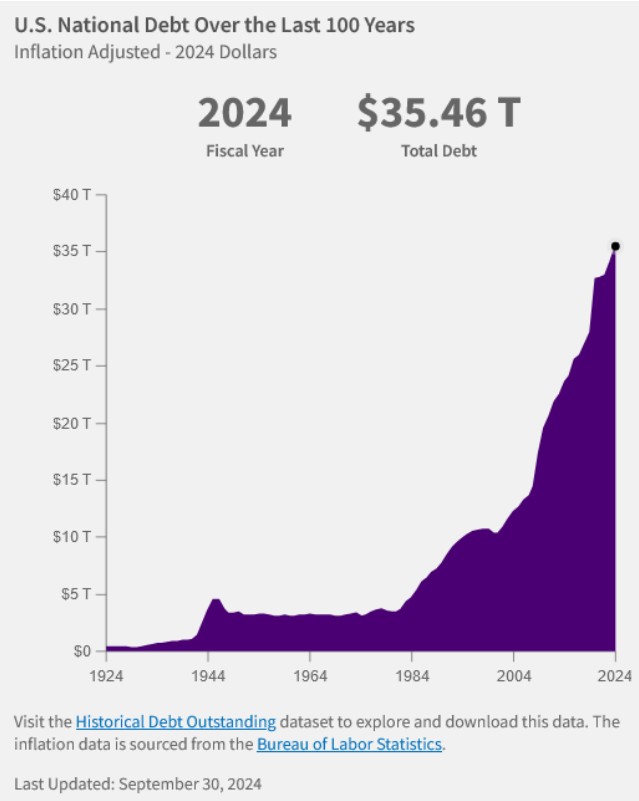
The Federal Reserve's balance sheet expands or contracts based on monetary policy actions, such as quantitative easing (QE) and quantitative tightening (QT). These policies influence inflation, interest rates, and overall financial stability.

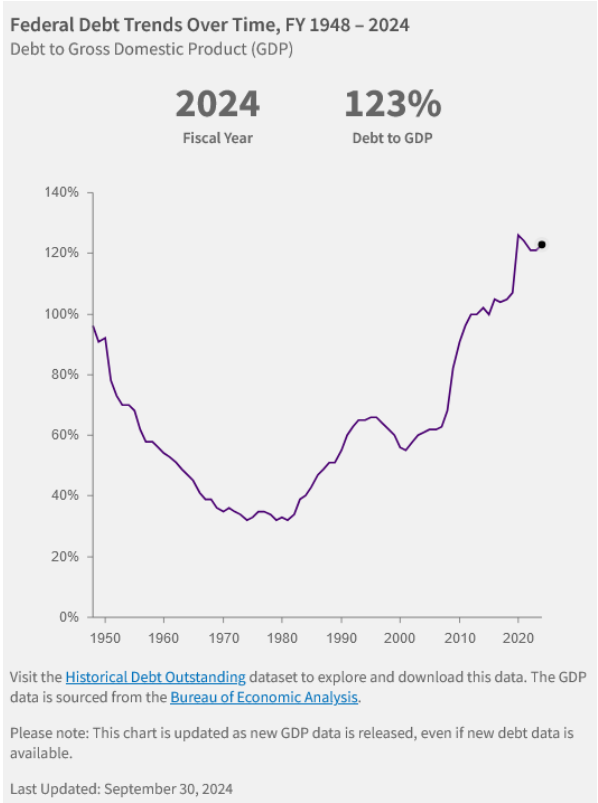
Since the 2008 financial crisis, the Federal Reserve has significantly expanded its balance sheet through QE, actively purchasing financial assets—including U.S. Treasury securities and mortgage-backed securities from banks and financial institutions. These purchases increase the Fed's assets while injecting newly created money into the financial system to maintain liquidity and stabilize markets.

In 1971, the Federal Reserve's balance sheet was approximately $100 billion. By January 2025, it had expanded to around $6.8 trillion, marking a staggering increase of about 6,700%.

While a growing Federal Reserve balance sheet can help address short-term fiscal challenges, it carries significant long-term risks, including higher inflation, market distortions, wealth erosion, and increased dependence on unsustainable debt. If left unchecked, these issues could jeopardize economic stability and undermine the financial security of future generations. Addressing these concerns will require fiscal discipline, a more balanced monetary policy, and a long-term strategy to reduce debt accumulation and mitigate financial risks.

U.S. National Debt Historical Information





Source: https://fiscaldata.treasury.gov/americas-finance-guide/national-debt/

Since 1971, the U.S. national debt has skyrocketed from approximately $398 billion to over $36 trillion in early 2025, marking an increase of more than 8,900%**.** This surge in debt has far outpaced economic growth, leading to a significant rise in the debt-to-GDP ratio**.** In 1971, the debt-to-GDP ratio was around 35%**,** meaning national debt was just over a third of the country's economic output. However, by 2024, this ratio has ballooned to nearly 120%**,** indicating that the U.S. now owes more than its entire annual economic production.

This dramatic shift reflects decades of deficit spending, economic crises, and monetary policy changes, including the abandonment of the gold standard, financial bailouts, and pandemic-related stimulus measures. The growing debt burden raises concerns about long-term fiscal sustainability, interest payment obligations, and potential impacts on inflation and economic stability.

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Statement on Ownership of Investment Property under Uniform Commercial Code Article 8

September 6, 2024

Executive Summary

Recent legislation introduced in several state legislatures proposed to repeal certain provisions of Article 8 of the Uniform Commercial Code (UCC). Proponents of these bills contend that UCC Article 8 allows 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. This statement explains how individual investors are protected in the event of a securities intermediary's insolvency.

The below Q&A offers an overview of UCC Article 8 and its impact on investment securities, followed by an in-depth explanation of the specific provisions at issue with an expanded analysis and examples to illustrate how these provisions benefit investors.

Q&A

What is the UCC?

The UCC is a set of rules enacted in every state that govern a wide variety of commercial transactions in the United States. This set of rules allows commerce to proceed predictably and gives Americans the confidence to do business with each other across state lines, because the law of every state is uniform.

The law governing securities (stocks, bonds, and other types of investments) is a combination of federal and state law. Federal law provides a regulatory framework that governs the issuance and registration of securities offerings and regulates securities firms and exchanges to ensure investors are treated fairly and their investments are kept safe. State law in the form of UCC Article 8 provides the rules that govern certain rights and obligations of parties to securities transactions – including issuers, buyers, sellers, borrowers, lenders and securities custodians. Together, these laws protect the interests of investors and provide additional benefits, like access to credit.

These UCC Article 8 rules, which were approved by the Uniform Law Commission and the American Law Institute in 1994, together with federal laws and Securities and Exchange Commission (SEC) regulations, have protected investor interests for 30 years. They also promote efficiency and reduce the risk of legal disputes over financial transactions.

The ULC is a nonprofit formed in 1892 to create nonpartisan state legislation. Over 350 volunteer commissioners—lawyers, judges, law professors, legislative staff, and others—work together to draft laws ranging from the Uniform Commercial Code to acts on property, trusts and estates, family law, criminal law and other areas where uniformity of state law is desirable.

Why is UCC Article 8 being scrutinized?

Proponents of legislation to amend Article 8 have said that its provisions 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.

What do critics of UCC Article 8 have wrong?

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 claim against the intermediary as the critics contend[1]. 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.

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. The first exception applies when the investor consents in writing to the intermediary pledging the investor's securities. The investor may, for example, borrow funds from the 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.

The other exception 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 the 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 a massive market disruption that would harm all investors.

What would happen if these two exceptions were repealed through state legislation?

The proposed alterations to UCC Article 8 are unnecessary and potentially harmful to investors. If the exceptions were repealed, investors would find that obtaining margin loans would be more expensive or, in some circumstances, these financial services might not be available. It is also possible that the differential treatment would lead to a clearing corporation's inability or unwillingness to permit banks or brokers in a state that has eliminated the relevant exceptions to remain members of that clearing corporation. That elimination would seriously hinder the ability of the bank or broker to conduct business.

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[1] See UCC § 8-503 establishing the property interest of entitlement holders.

Repealing these provisions of UCC Article 8 would also significantly impede commerce. Interstate business thrives because the UCC makes transactions predictable. If laws differed between states, companies, investors, and consumers would have to either learn about, plan for, and contract around those differences, or else avoid doing business in states with non-uniform laws. At a minimum, repealing these exceptions would add unnecessary legal expenses to otherwise routine commercial transactions, and in a worst-case scenario could cause some companies to cease doing business in states with non-uniform laws.

Have these exceptions led to losses for individual investors in the past?

No individual investor has *ever* suffered a loss because of UCC Article 8's two limited exceptions to the general rule that gives investors priority over creditors to securities held by their intermediaries. That proved true even after several securities intermediaries, including Lehman Brothers, Inc., failed during the 2008 recession.

In-Depth Analysis

A. The Purpose of the Uniform Commercial Code

The UCC is a set of rules to govern commercial transactions that generally reflect the expectations of participants in commercial markets. Many of the UCC's rules only apply when the parties to a transaction have not made a different agreement. However, some rules represent public policy choices that restrict or prevent parties from deviating from these expectations.

Because these uniform rules have been enacted in every state, commerce in the United States is predictable and Americans generally have confidence to do business with strangers. This is not always the case in other parts of the world and is a major reason why American commercial markets thrive.

B. Background Concepts

The legislation proposed in several states would amend UCC Section 8-511. To explain why that provision should not be changed, it is helpful to understand two concepts underlying much of UCC Article 8: securities accounts, and indirect holding of securities.

1. Securities accounts

A securities account is a type of account many banks and brokerage firms offer to their customers as a way of safely holding multiple types of investments. Common investments like stocks, bonds, and mutual funds can all be held in a securities account.

Most brokerage firms also give their customers the option of opening what is called a "margin account." A customer who opens a margin account may borrow funds from the brokerage firm and pledge securities as collateral for the loan. If the customer fails to repay the loan, the securities pledged as collateral can be sold by the brokerage firm up to the amount of the unpaid loan. This power to borrow against one's own investments is strictly voluntary on the customer's part. If a customer opens a margin account, there is a specific set of federal regulations that apply to govern the customer's and the lender's rights in

securities.[2]

Importantly, retirement accounts like IRAs and 401(k)s *cannot be margin accounts.* Borrowing against one's investments significantly increases the risk of loss and is not appropriate for retirement savings accounts. For that reason, the Internal Revenue Code in effect prohibits such transactions.[3]

Some employer-sponsored retirement plans do allow employees to borrow a percentage of their retirement account balances. But such a transaction involves taking a loan against the existing balance in the employee's retirement account, not borrowing funds from a bank or broker, and hence is quite different.

To summarize, securities accounts can hold many types of investments. Margin accounts are an option for investors who want a line of credit from their brokerage firm using their investments as collateral. Retirement accounts like IRAs, 401(k)s, and 403(b)s are never margin accounts.

2. The indirect holding system for securities

Historically, securities like stocks and bonds were issued as paper certificates. Each certificate identified the owner by name, and ownership of the stock or bond was tied to possession of the certificate. To sell the security, the owner had to sign the back of the certificate and deliver it to the buyer.

As the volume of trading increased, this system proved to be impossible to maintain. In the mid-1960s a paperwork crisis paralyzed Wall Street as a backlog of paper certificates piled up at brokerage firms causing delays in trade settlement.[4] For a time, the New York Stock Exchange (NYSE) had to close on Wednesdays and hold reduced trading hours on other days in order to allow its members to process backlogged transactions. In some cases, transactions went unfulfilled for weeks after the trade was initiated.

At the time of Wall Street's paperwork crunch, the average daily trading volume on the NYSE was in the range of 10 to 20 million shares. In 2023 the average volume of shares traded on the NYSE was about 100 times that amount, and many more shares trade at other securities exchanges. Obviously, improved trading and settlement systems were necessary to process the increased volume of daily trades and to ensure that trades settle within an acceptable time frame. To meet the demands of the modern economy, a new system was devised in which securities owned by an investor could be held with a central securities depository and credited to the account of the investor's bank or broker, which would in turn credit the account maintained for the investor by means of a computer entry.

For most investors, the indirect holding system for securities that exists today consists of three levels and is best illustrated using an example:

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[2] See, e.g., C.F.R. § 240.15c3-3 (often referred to as the "Customer Protection Rule").
[3] See I.R.C. § 4975 (imposing a tax on such a transaction, thus making the transaction economically infeasible).
[4] See, e.g., William F. Jaenike, "The Paperwork Crisis" (2008) available at https://optimizeronline.com/the-paperwork-crisis/ (last accessed Aug. 27, 2024); Wyatt Wells, The Remaking of Wall Street, 1967 to 1971(2000) available at https://hbswk.hbs.edu/archive/the-remaking-of-wall-street-1967-to-1971 (last accessed Aug. 27, 2024).

Level 1: Individual investors

Investor Alice deposits cash into a securities account that she opened with her securities intermediary (which could be a bank or a brokerage firm). Alice then places an order to buy 100 shares of stock of XYZ corporation. Assume for this example that Alice is using her own funds for the purchase, and not using funds borrowed from her securities intermediary. In other words, Alice is not buying securities "on margin" through a margin account. The securities intermediary will credit Alice's securities account with 100 shares of XYZ stock and debit the amount of cash used to make the purchase.

Level 2: Securities intermediaries

Of course, Alice is only one of her broker's many customers. Assume for this example that Alice's securities intermediary (e.g. Fidelity, Charles Schwab, E-Trade, etc.) has 50,000 total customers with securities accounts that, like Alice's account, are not margin accounts. Further assume that collectively those 50,000 customers own 1 million shares of XYZ stock purchased with their own funds. Under federal law and SEC regulations, as well as under UCC Article 8, the firm is required to maintain 1 million shares of XYZ stock for its customers.[5] The firm is not permitted under federal law to loan out or pledge as collateral for its own benefit any of the 1 million shares of XYZ that it is required to hold for its customers.[6] Nor under UCC Article 8 is the firm permitted to pledge the securities without the consent of the customer.[7]

Now consider the transaction from the firm's perspective. On the same Monday that Alice placed her order, it is likely that some of the firm's other customers also placed orders to buy or sell XYZ stock. One of the functions of a securities intermediary is to aggregate the trade orders placed by its customers. If, when Alice ordered a purchase of 100 shares of XYZ stock, another customer of the firm placed an order to sell 100 shares of XYZ, the firm can simply reallocate 100 of the shares of XYZ stock that the firm holds for its customers. In essence, Alice's account is credited with 100 shares, the other customer's account is debited by 100 shares. This type of internal trade settlement involving customers of the same broker is very common.

Some brokerage firms have proprietary positions in the types of securities their investors own – i.e., they hold *more* than the required number of shares owned by the firm's customers. For example, Alice's brokerage firm might own 200,000 shares of XYZ beyond the 1 million shares of XYZ it holds for its 50,000 customers. Under federal law those extra 200,000 shares of XYZ must be segregated from the 1 million shares the firm holds for its customers.[8] By holding proprietary shares, the firm can also process orders to buy or sell XYZ stock from investors who have securities accounts at *other* banks or brokerage houses. When acting in this capacity, the firm is referred to as a "market-maker," or a "liquidity provider." This type of trade between a securities intermediary and outside investors is also very common. And of course, the firm can use its proprietary shares to trade for its

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[5] C.F.R. § 240.15c3-3; UCC § 8-504(a).

[6] 15 U.S.C.A. § 78h; C.F.R. § 240.8c-1 The analysis is different if Alice purchased her XYZ shares in a margin account using funds borrowed from her brokerage firm. In that case, Alice has pledged at least a percentage of her shares to the brokerage firm as collateral, voluntarily giving up some of her rights in exchange for using the firm's money. This process is called "hypothecation" and is used by some investors who choose to accept the risk of loss that comes from using borrowed funds.

[7] UCC § 8-504(b).

[8] 15 U.S.C.A. § 78h.

own benefit, in which case the firm is referred to as a "securities dealer".

Level 3: Clearing corporations

At the end of each trading day, all brokers and banks who act as securities intermediaries must total their customers' purchases and sales of each security to determine how many shares their customers will own upon settlement. For example, Alice's broker could have started the day owning 1 million shares of XYZ for its customers' accounts. Upon settlement of all the trades that were executed, the firm's customers collectively will likely own either more or less than 1 million shares. If the firm's customers bought more XYZ shares than the number of XYZ shares they sold over the course of the day, the total number of shares the firm is required to hold for its customers will increase. Conversely, if the firm's customers sold more XYZ stock than they bought, the firm's required holdings will go down.

Banks and brokers use clearing corporations (a particular type of securities intermediary) to clear and settle securities trades. For securities firms in the United States dealing with publicly traded stocks and bonds of U.S. companies, the use of clearing corporations is generally required. Two major clearing corporations are involved: National Securities Clearing Corporation (NSCC), which compares trades and uses a continuous netting service to "net down" the number of transactions to the smallest number each day, and The Depository Trust Company (DTC), which is the central securities depository through which nearly all publicly traded stock and bonds of U.S. companies are held.[9] Most entities registered with the U.S. Securities and Exchange Commission to trade securities for their investor-customers are participants of NSCC, and hold securities at DTC or through a DTC participant.

The process for settling securities firms' accounts by exchanging securities between securities firms through a clearing corporation such as DTC is similar to the process described above for settling the accounts of individual customers at the same brokerage firm. The central securities depository is itself registered as the owner on the books of the issuer and can electronically credit the balance of one firm's account and electronically debit another firm's account without the underlying securities changing hands.

3. Benefits of the indirect holding system

As a result of this system of indirect holding that developed over the past fifty years, most securities traded on U.S. securities exchanges today are held by clearing corporations rather than by brokerage firms, other securities custodians, or individual investors. By computerizing trading and eliminating the need to deliver paper certificates from seller to buyer, the indirect holding system allows for a far greater volume of securities trades and has reduced the time required for a trade to settle.

C. The Evolution of UCC Article 8

Since the 1950s, UCC Article 8 has provided a comprehensive set of rules for trading and holding investment securities. Article 8 takes no position on the relative advantages of direct and indirect holding of securities – that choice is left to the investor and to the

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[9] In 1973 DTC was formed as a central clearing corporation to hold stock certificates and other types of paper securities on behalf of their owners to facilitate more efficient trading. NSCC was established three years later to net trades and payments among participants. For more information about NSCC, DTC and the parent company the Depository Trust & Clearinghouse Corporation, see https://www.dtcc.com.

company that issues shares of stock or bonds for purchase by investors.

The first version of UCC Article 8, which was enacted by states in the 1950s and 1960s, applied only to the direct holding of securities. At the time, securities were printed as certificates, and to settle trades the seller would sign the certificate and deliver it to the buyer (or the buyer's broker). The original rules in Article 8 were written to facilitate this type of transaction.

Article 8 was amended in 1978 to add rules governing uncertificated securities. These rules permitted companies to issue securities not on paper certificates, but to simply maintain a ledger to keep track of the securities' owners. Many mutual fund shares are held by investors in this manner—i.e., "directly" as registered as owners on the issuer's books.[10]

Over time, the indirect system of holding securities became dominant and required another update to UCC Article 8. Part 5 of UCC Article 8 on Security Entitlements was added in 1994. It includes rules for securities owned by investors but held indirectly through securities intermediaries and clearing corporations as described above. The term "security entitlement" was coined to describe this new form of ownership and is defined in UCC Section 8-102 as "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5."[11] Those financial assets are further described in UCC Section 8-501 as assets credited to a person's securities account by a securities intermediary.[12]

The 1994 amendments to UCC Article 8 codified important investor protection rules. For example, UCC Section 8-503 provides that securities held by a securities intermediary for the account of a customer ***are not property of the securities intermediary and not subject to claims of the securities intermediary's creditors*** unless one of the exceptions described below applies.[13] More specifically, to the extent necessary to satisfy the investors to whose accounts securities have been credited, all securities of the type credited to investors' accounts—including securities held in a proprietary capacity— ***"are held by the securities intermediary for the [investors]"***.[14]

There are two narrow exceptions to the rule. It is these exceptions—which have been the law in all 50 states for more than a quarter-century—that have led some to call for states to amend UCC Article 8. The next section of this paper describes why these exceptions exist and why they do not pose any danger to individual investors or to the investing public generally.

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[10] If the investor holds the mutual fund shares through a securities intermediary in the indirect holding system, the shares are treated much like any other investment security in the indirect holding system. The mutual fund shows on its books the securities intermediary as the registered owner of the shares, and the securities intermediary credits those shares to the securities account of the individual investor.

[11] Importantly, a security entitlement is defined under UCC § 8-102 as a property interest, and not a contract claim. Proponents of amending UCC Article 8 have misstated this fact to legislators to justify the proposed change.

[12] The UCC, like all uniform acts, is drafted using descriptive terms rather than commonly used names for specific things. This is necessary so that the statute, when enacted by a state, cannot be evaded by simply changing the name by which a thing is called. Hence, the broadly defined terms "securities intermediary" rather than "broker," and "security entitlement" rather than "indirectly-owned security."

[13] UCC § 8-511(b)

[14] Id.

D. The purpose of UCC Article 8's priority rules for security entitlements

UCC Section 8-511(a) provides a general rule that applies if the securities intermediary (a bank or brokerage firm) does not have enough securities of a particular issue to satisfy claims of both the securities intermediary's customers and the securities intermediary's secured creditors. The rule is that the customers' claims have priority over the creditors' security interests. This priority rule would typically be applied if a securities intermediary became insolvent *and did not have all the securities it is supposed to have.* Recall, as noted above, that federal laws and SEC regulations, as well as UCC Article 8, require securities intermediaries to hold sufficient assets to satisfy all of its customers' claims to securities.

However, subsections (b) and (c) of UCC Section 8-511 provide two exceptions to the general customer priority rule in UCC Section 8-511(a). These exceptions give secured creditors priority over customers under certain circumstances. The legislation recently proposed in several states would have repealed the exceptions and left the general rule in place, giving the customer priority over the creditors in *all* circumstances. While this proposed legislation was undoubtedly intended to offer additional protection to investors, a deeper analysis will reveal that the proposed alterations to UCC Article 8 are unnecessary and potentially harmful to investors.

1. The alleged doomsday scenario

Proponents of the legislation to amend UCC Article 8 have stated that the exceptions to the general priority rule in UCC Section 511(a) could cause an investor's retirement account balance to "vanish" overnight.[15] They contend that if a securities intermediary becomes insolvent, UCC Section 8-511(b) would allow the creditors of the intermediary to seize assets belonging to investors and held by the securities intermediary for investors' accounts. This is false.

UCC Article 8 is designed to—and does—work harmoniously with other state and federal laws to protect the property rights of securities owners. In the United States, the issuance, initial sale, and resale of most securities is regulated under federal law, as are the major securities exchanges and their member firms who act as securities brokers and dealers.[16] In particular, the Securities Exchange Act of 1934, the Securities Investor Protection Act of 1970, the Internal Revenue Code, and associated regulations issued by the U.S. Securities and Exchange Commission prevent the misuse of an investor's securities by a securities intermediary or clearing corporation that holds the property for the investor's account.[17]

The scenario envisioned by proponents of the changes to UCC Section 8-511 involves a securities intermediary who pledges all of the securities in a customer's retirement account

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[15] A letter sent to legislators in several states stated: "Imagine waking up one morning and logging into your IRA or 401(k) account to see how it is performing. To your shock and horror, there is nothing there; your account balance is $0. Through no actions of your own, your stocks and bonds have vanished. This might sound impossible, but it could happen under current law in the event of a financial crisis. The full letter is available at https://heartland.org/wp-content/uploads/2024/01/1-26-24-UCC-Article-8-State-Legislative-Alert_Final.pdf, last accessed Aug. 27, 2024

[16] For a list of federal securities laws and accompanying regulations, see https://www.sec.gov/rules-regulations/statutes-regulations, last accessed Aug 27, 2024. State laws regulating securities apply mainly to securities that are exempt from federal regulation because, for one example, the market for the security is limited to investors from a single state.

[17] See statute and regulations cited at notes 2 and 3, *supra.* See also the Securities Investor Protection Act of 1970, 15 U.S.C.A. § 78aaa et seq.

as collateral for a loan. This would be both highly illegal, and as a practical matter, impossible.

First, investments held in retirement accounts like IRAs and 401(k)s cannot be pledged as collateral. Doing so would be a prohibited transaction under the Internal Revenue Code.[18]

In non-retirement accounts, it is illegal under both federal and state law for a securities intermediary to use a customer's securities for its own benefit. Federal regulations require that "a broker or dealer shall promptly obtain and thereafter maintain the physical possession or control[19] of all fully paid securities[20] carried by a broker or dealer for the account of customers."[21] UCC Article 8 also provides, subject to federal regulations, that "a securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset" and "except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain."[22]

In other words, securities intermediaries are required by law to hold their customers' investments (either directly or indirectly through another securities intermediary) and are not permitted to pledge their customers' investments as collateral for the firm's borrowing without the customer's consent. Any person who violates this law is subject not only to civil damages to make the investors whole again, but also to severe criminal penalties.[23]

But even if a securities intermediary were willing to risk violating the law, the securities intermediary is a regulated entity, subject to periodic audits and reporting requirements by the SEC or banking regulators. The SEC ensures compliance with customer protection rules, and the bank regulators likewise ensure the protection of bank customers.

For all of the above reasons, it is incorrect to suggest that a person's investment property could "vanish" because of claims by a securities intermediary's creditors.

2. The purpose of the priority rules in UCC Section 8-511

Once again, federal laws and SEC regulations require securities intermediaries to "promptly obtain" and "maintain the physical possession or control"[24] of all securities held for the account of their customers.[25] UCC Article 8 has a similar rule.[26] To understand what that means, recall the example of Alice's brokerage account. Alice placed the order on Monday, and her broker "promptly obtained" the 100 shares of XYZ stock by settling the trade through its clearing corporation. The shares were credited to Alice's account by

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[18] I.R.C. § 4975

[19] C.F.R. § 240.15c3-3(c) provides that "possession or control" allows for the intermediary to either physically possess certificates or to control those certificates by holding them in an account with a securities clearing corporation under an indirect holding system.

[20] Fully paid securities are those purchased with the customer's funds, and not on margin.

[21] C.F.R. § 240.15c3-3(b). Exceptions apply for temporary lags while trades settle, for margin accounts, and for securities subject to a written repurchase agreement.

[22] UCC § 8-504.

[23] Individual violators may be fined up to $5 million and imprisoned for up to 20 years. Businesses may be fined up to $25 million. 15 U.S.C.A. § 78ff.

[24] C.F.R. § 240.15c3-3(b).

[25] This rule is not applicable to customers who purchase securities using borrowed funds in margin accounts.

[26] UCC § 8-504(a).

Tuesday. Alice's brokerage firm then "maintained control" of the shares by holding them in its account at the clearing corporation for the benefit of Alice.

When an investor owns securities that are held indirectly by a securities intermediary, UCC Section 8-501 establishes that the investor has a *security entitlement* to the investment property, and UCC Section 8-503 establishes that the investment property *belongs to the entitlement holder* and is not subject to claims of the intermediary's creditors unless one of the exceptions in Section 8-511 applies.

Unfortunately, we all know that laws can be broken. If a securities intermediary fails in its duties to maintain control of enough securities for the accounts of all its customers, there are consequences. Federal law provides for criminal and civil penalties as described above.[27] UCC Section 8-511 provides the practical rules that govern who receives the insufficient number of securities that the securities intermediary does control.

The general rule is simple, and more protective of investors than the law as it existed prior to 1994.[28] UCC Section 8-511(a) provides that, if a securities intermediary has not maintained a sufficient number of a particular type of security to satisfy both its customer's accounts and creditor claims, the customer's claims have a higher priority and the customers are entitled to receive all of the securities available. UCC Sections 8-511(b) and (c) provide two narrow exceptions to this general rule.

a) UCC Section 8-511(b) exception

To illustrate one common and widely understood circumstance when the exception in UCC Section 8-511(b) would apply, return to the earlier example.

Recall from the discussion above that Alice's brokerage firm may offer financing to its customers to enable them to acquire securities on margin. If Alice wished to obtain credit rather than pay for the securities in full, she would need to open a margin account with her brokerage firm. Many customers find this option desirable. Margin accounts are subject to a specific set of federal regulations.[29] If Alice, or other customers chose to purchase securities on margin, these securities could be available for the brokerage firm to use as collateral for the loan.[30] This circumstance is one in which the exception in UCC Section 8-511(b) could apply.

To elaborate, in order for Alice or another investor to obtain financing from the brokerage firm, the brokerage firm will take a security interest in the securities carried in the margin account, thus becoming a secured creditor[31] of the investor. If Alice defaults on the terms of her credit, she can lose the securities she pledged as collateral to the extent necessary to repay the loan from the firm. In order for the brokerage firm to provide this financing to the investor, the firm will in turn need to obtain financing. This is typically accomplished by

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[27] See Note 23, *supra.*

[28] See James Steven Rogers, *"Policy Perspectives on Revised U.C.C. Article 8,"* 43 UCLA Law Review 1431 at 1526 (concluding that "...the major respect in which the rules set out in Section 8-511 alter present law is a change in favor of the position of customers.")

[29] 12 CFR Part 220.

[30] Subject to the rules governing rehypothecation – see Note 6, *supra.*

[31] A "secured creditor" is a lender who takes a security interest in specific property as collateral for a loan. See UCC §§ 1-102(b)(35) and 9-101(a)(73).

borrowing from a bank lender.[32] The bank will, in turn, require (and indeed is usually required by regulation to acquire) a security interest in the subject securities (the securities Alice or the other investor purchased on margin), thus becoming a secured creditor of the brokerage firm. The granting of the security interest, as noted above, requires the investor's consent, but the financing obtained by the investor is conditioned on this arrangement.

UCC Section 8-511(b) says that a secured creditor of a securities intermediary (the brokerage firm) would have priority as to any shares of XYZ over which that creditor has "control" within the meaning of the UCC. Ordinarily the bank lender to the brokerage firm would, in fact, have "control," because the bank would be the securities intermediary through which the brokerage firm holds its securities positions.[33] Why is the rule designed to permit this outcome?

First, as just noted, some customers elect to open margin accounts to obtain credit from their brokerage firm and voluntarily pledge their securities as collateral. Brokers can offer margin credit to these customers because the law allows them, *only with their customers' express permission,* to grant a security interest in those securities to the very lender providing the funds to the brokerage firm to extend the margin credit. Any contrary rule would effectively prevent a brokerage firm from obtaining secured credit, because the creditor could never be assured of priority to the collateral. The contrary rule would harm the brokerage firm's customers who want margin accounts.

Second, the regulatory infrastructure discussed above which limits the extent to which a brokerage firm can encumber "customer" assets is designed to ensure that the investor's interest in the subject securities will not be impaired. This is because the amount of the investor's interest is limited to the amount for which it has paid the purchase price (i.e., the value of the securities purchased less the amount borrowed to acquire the securities). Moreover, the brokerage firm's customers are protected under the federal Securities Investor Protection Act.[34] That law requires brokerage firms to be members of the Securities Investor Protection Corporation (SIPC) which insures investment accounts for up to $500,000 per individual investor, and retirement accounts for up to an additional $500,000 per account. This insurance is in place to protect investors against a brokerage firm's insolvency, similarly to how FDIC insurance protects bank deposits. As a practical matter, individual investors' accounts at the brokerage firm would usually be transferred to a solvent securities intermediary so the investors do not lose access to their securities during the time it takes for the brokerage firm to be liquidated.

Third, a secured creditor, like any other innocent party, has its own obligations to its own customers and creditors. The fact that one brokerage firm became subject to an insolvency proceeding should not be the start of a chain reaction affecting investors with accounts at other firms and potentially threatening the greater economy. The UCC Section 8-511(b) exception ensures that responsible lenders who protect themselves by legally holding investment property as collateral can access that collateral if the loan is not repaid.

Finally, although the secured creditor has priority in collateral under the limited

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[32] Often the lender is a "clearing bank" that acts as custodian for both the firm's proprietary securities and (in segregated accounts) securities owned by the firm's customers.
[33] UCC § 8-106(e).
[34] 15 U.S.C. § 78aaa, et seq.

circumstances described in UCC Section 8-511(b), UCC Section 8-503(e) itself removes this priority if the secured creditor is acting in collusion with the brokerage firm in violating the firm's obligation to its customers. Under that subsection, the customers, acting through an insolvency representative for the brokerage firm, could set aside the security interest and recover their interests or, if the insolvency representative elects not to pursue that right, an entitlement holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the secured creditor.[35]

In summary, the UCC Section 8-511(b) exception benefits individual investors by facilitating the ability of investors to purchase securities on margin with borrowed funds.[36] The exception also benefits the general investing public by ensuring that one firm's insolvency is contained. Additionally, customers of any firm that becomes insolvent are protected by SIPC insurance.

b) UCC Section 8-511(c) exception

UCC Section 8-511(c) contains an additional exception that gives priority to secured creditors of clearing corporations. If a securities intermediary becomes insolvent and fails to deliver shares or cash to a clearing corporation as required to settle its own or its customers' trades, the clearing corporation has a special role to play, as illustrated with the following example.

Suppose that instead of buying, Alice sold 100 shares of XYZ stock through her broker. On the other side of that trade, some other investor purchased 100 shares of XYZ stock. If the other investor's broker failed to deliver the cash purchase price for the 100 shares to the clearing corporation for any reason, Alice's sale might fail.

The rule under UCC Section 8-511(c) ensures that Alice's trade can settle on time. Under the indirect holding system that exists today, the clearing corporation can settle Alice's trade by borrowing from a lender to provide the cash purchase price to Alice for the 100 shares of XYZ stock. But this borrowing (like the financing provided by a broker's clearing bank) will be conditioned on the lender obtaining a security interest in collateral sufficient to protect the lender against loss.

The exception in UCC Section 8-511(c) ensures that banks are willing to lend to clearing corporations and can accept any securities held by the clearing corporations as collateral. To reiterate the point made above, none of the securities used as collateral could be "fully paid" customer securities.

Though this type of borrowing is very rare, it serves an important purpose. Because the clearing corporation can settle trades as expected, a problem that affects one securities intermediary can be contained, rather than starting a chain-reaction of failed trades at other securities intermediaries. The entire system is protected for the benefit of all investors.

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[35] UCC § 8-511, cmt.1; UCC § 8-503(d).

[36] Other types of transactions can also implicate UCC Section 8-511(b). For example, an investor selling securities "short" and using the proceeds to buy other securities could result in a lender taking a security interest. The general point remains: the obligation of an intermediary to maintain sufficient assets for its investors' accounts, and the limited right of the intermediary to create a security interest in favor of its own creditor that would have priority over the interest of its customer in specific circumstances when the customer has consented to the arrangement, are both extensively prescribed and proscribed by federal law and regulation.

E. Conclusion

Amending UCC Article 8 to remove the exceptions in UCC Section 8-511(b) and (c) is not necessary to protect investors and would significantly impede commerce.

If even one state enacted a non-uniform version of UCC Section 8-511, any legal dispute would potentially require analysis and resolution of difficult choice-of-law issues to determine which state's law applies to the dispute. That is precisely what the sponsors of the UCC tried to avoid when drafting it, and one of the goals that the legislatures in all fifty states sought to achieve when enacting the UCC. Interstate business thrives because the UCC makes transactions predictable. If any state's law differs from the laws of other states, businesses will have to learn about, plan for, and potentially contract around those differences. This adds unnecessary legal expenses into otherwise routine commercial transactions.

Amending UCC Article 8 would also harm individual investors in the state by limiting their access to credit. Securities brokers are unlikely to offer margin accounts to their customers if the loans would be unsecured.

UCC Article 8 has operated as its drafters intended in conjunction with other federal and state laws to protect investor interests for nearly 30 years. Since UCC Article 8 was approved by the Uniform Law Commission and the American Law Institute in 1994, several securities intermediaries have failed, the largest being Lehman Brothers, Inc. during the 2008 recession. Individual customers with investment accounts at Lehman Brothers, Inc. had their accounts quicky transferred to a solvent brokerage firm along with all of their investment assets.[37] No individual investors lost any of their assets in the transfer, while larger investors had the chance to litigate their claims in court. Indeed, no individual investors have ever suffered a loss by virtue of UCC Article 8's limited exceptions to the general rule giving investors priority over creditors to securities held by their securities intermediaries.

In summary, UCC Article 8 does not pose any danger to individual investors. The general rule in UCC Section 8-511 ensures that individual investors have priority over a firm's creditors in most circumstances. The two narrow exceptions to the general rule serve to provide individual investors with access to credit, and to ensure that a single firm's insolvency is contained and can be resolved fairly without harming individual investors.

[37] https://libertystreeteconomics.newyorkfed.org/2019/01/customer-and-employee-losses-in-lehmans-insolvency/, last accessed Aug. 27, 2024.

sifma

Who Has Control Over the Securities in Your Brokerage Account?

YOU DO

There are strong, effective and wide-reaching laws in place that protect your brokerage account and ensure you have full control over **your** securities. These include:

- **Federal Law** (including the Securities Exchange Act of 1934 and the Securities Investor Protection Act);
- **Securities and Exchange Commission Rules** (particularly SEC Rule 15c3-3);
- **Financial Industry Regulatory Authority Rules** (including Rules 2150, 4330, and others);
- **State Laws** (including criminal laws, anti-fraud statutes, the Uniform Securities Act and the Uniform Commercial Code); and
- **State Securities Regulator Rules** (including deceptive practices prohibitions and business practice standards).

Unless you specifically ask your securities professional to do so, they may not:

Buy/sell on your account

Loan out your assets

Pledge your assets to a third party; or

Use your assets for their own benefit

In other words, you have full control over your account.

Your securities professional is there to provide advice and access to America's robust financial markets.

www.sifma.org/securities-ownership

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.

Written Testimony in Opposition of SB 2364:
UCC Article 8

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

Testimony in writing provided by Joel Malus of Fargo, North Dakota on February 10, 2025

Regarding ND SB 2364 – Uniform Commercial Code Article 8 – Investment Securities

- Under ND law (NDCC 41-8) when we buy a stock, bond, mutual fund, or exchange traded fund (ETF) we do not receive what we thought you bought. We receive a 'security entitlement' to the stock we thought we bought .

- We are no longer a stockholder or bondholder but an 'entitlement holder' and other parties can have claims against the stock we paid for and thought we bought.

- We have a contract with our broker – This does not confer property ownership.

- Under ND law (41-8) certain secured creditors (for instance, too big to fail banks) have priority (they are first in line) over our investment account (including IRAs & 401(k)s) if our broker or a higher-level custodian files for bankruptcy.

- This is done without our knowledge or approval.

- This is like your home being used as collateral for someone else's loan.

- This exception does not apply to margin accounts – a scare tactic used by the bank lobbyists.

- SB 2364 would put – the investor – YOU - at the front of the line to get your investments back if your broker or custodian becomes insolvent.

- UCC Article 8 protects the largest banks if we have a financial collapse (the definition of too big to fail).

- Protecting property rights is a primary duty of the Legislature and the state.

- The banking lobby is fighting hard and twisting arms – the rights of the people of ND must come first.

- A lot of people have heard the phrase from the World Economic Forum "It's 2030 you will own nothing and be happy" But 2030 is today if the market fails. You already don't own anything.

If you doubt any of this, then read The Great Taking by David Webb.

His sources have been vetted by financial and legislative and academic personnel.

They are solid. We need to be afraid, and work to overcome this theft until this bill is passed in North Dakota, and all 50 states. It must happen on the state level, because that is where the theft happened. It must be undone. NOW.

SB 2364
Senate Judiciary | February 11, 2025
Testimony of Alexis Baxley

Good morning, Chair Larson, and members of the Senate Judiciary Committee. My name is Alexis Baxley, and I am the president of the Independent Community Banks of North Dakota (ICBND). ICBND exclusively represents the interests of more than 40 independent community banks in North Dakota. ICBND opposes SB 2364 and urges a Do Not Pass recommendation from the Committee.

SB 2364 addresses a problem that does not exist, is based on misinformation, and has the potential to create unnecessary risk and cause harm to North Dakota citizens and businesses. This misinformation centers on the priority rules in UCC Section 8-511, more specifically the exceptions contained in subsections (b) and (c). While the general rule would provide that in the event of a shortfall, investors have priority over a creditor of the bank or broker to the pooled shares held by their bank or broker, subsections (b) and (c) provide exceptions for shares voluntarily pledged as collateral for a loan if the lender has taken control of those shares and for securities clearinghouses. However, there are still protections in place for the investor in case of a shortfall.

ICBND is concerned that rather than protecting investors, the adoption of SB 2364 would negatively impact North Dakota citizens and businesses. By significantly amending North Dakota's adoption of UCC Section 8-511 and becoming a non-uniform state, SB 2364 has the potential to limit investors' access to credit, put the stability of our State's capital markets at risk, and eliminate North Dakotan's access to electronic securities trading altogether. These consequences impact individual and institutional investors.

For these reasons, ICBND stands in opposition to SB 2364 and asks that the committee give SB 2364 a Do Not Pass recommendation and I will stand for any questions. Thank you.

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February 11, 2025

State of North Dakota
North Dakota Legislature
Senate Judiciary Committee

Re: SB 2364 – A BILL for an Act to amend and reenact sections of Article 8 of the Uniform Commercial Code.

Chairman Larson, Vice-Chairman Paulson, and Members of the Committee:

My name is Don Grande, and I am an attorney in private practice. I have worked on issues related to the Uniform Commercial Code (UCC) for many years and specifically on Article 8 of the UCC for over a year. Thank you for allowing me to testify in support of SB 2364.

Certain provisions in North Dakota's UCC put investor (individuals, entities, and institutions) assets at risk of loss in a financial crisis. As an investor under the current law if your broker, custodian, or higher-level securities intermediary becomes insolvent your investment assets are at risk - without your knowledge or consent. I address the specific statutory language below, but I want to provide some background and foundation.

The Uniform Law Commission (ULC) formed a Drafting Committee to revise UCC Article 8 which deals with investment securities (Code Section 41-08). The ULC adopted a model amendment in 1994, and it was provided to the states for ratification. It was passed into law in North Dakota in the 1997 session.

The current statute provides the appearance of normalcy, investors are not even aware that their property rights have been subverted. But, in the event of a financial collapse the statute protects the biggest banks at the expense of the investor.

This revision made a fundamental change to the concept of property rights. The Committee conjured a new ownership concept – a 'security entitlement'. When an investor initiates an order to buy a stock what the investor receives is a security

entitlement related to the stock the investor intended to purchase. The Drafting Committee defines a security entitlement as *'a bundle of personal rights one holds against their broker'*, essentially a contract.

The investor is no longer a stockholder or bondholder under your current law, but an entitlement holder. In addition, your broker or custodian is referred to as a 'securities intermediary'. These definitions are important to understand when evaluating SB 2364.

Code Section 41-08-51 (8-511) provides certain secured creditors of your broker and/or custodian priority to your investment assets in the event of *insolvency of your broker or custodian*.

Specifically, Sections 8-511(2) and (3) state:

> (2) *A claim of a creditor of a securities intermediary* who has a security interest in a financial asset held by a securities intermediary *has priority over claims of the securities intermediary's entitlement holders* who have security entitlements with respect to that financial asset if the creditor has control over the financial asset. (emphasis added)
> (3) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to *a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders*. (emphasis added)

The Official Comment to this Code Section makes clear the risk to investors. SB 2364 removes these two exceptions from your UCC Article 8 and ensures the investor will always have priority to his or her investment assets.

Opposition

Opponents of this Bill make two primary arguments. They testify that the exception in 8-511(2) only applies to a margin account. This is false. A margin account is used by an investor who wants to borrow money from his broker and use securities in his account as collateral. Each margin account requires a separate written agreement between the investor and the broker. This separate written agreement supersedes UCC Article 8 and grants a full security interest in the collateral to the broker.

Section 8-511(2) does not mention 'margin account' because there is no competing claim requiring this priority provision. It is not that Section 8-511(2) does not apply to margin accounts – it cannot apply to margin accounts by law.

Opponents may also point to Section 41-08-44 (8-504) stating that this section protects investors. This argument also fails upon analysis.

41-08-44 Duty of Securities Intermediary to Maintain Financial Asset. –
(1) *A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset.* The securities intermediary may maintain those financial assets directly *or through one or more other securities intermediaries.* (emphasis added)
(2) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (a).
(3) A securities intermediary satisfies the duty in subsection (a) if:
(a) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or
(b) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.
(4) *This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements*. (emphasis added)

Subsection (1) provides that a broker can satisfy this requirement directly <u>*or indirectly*</u> through another securities intermediary. The investor remains at risk.

For example, an investor maintains an investment account with broker-dealer. Broker-dealer complies with UCC 8-504 through a higher-level custodian.

If that custodian fails, the custodian's secured creditor will have priority over the broker-dealer's financial assets. *The investor's assets can be lost even though the broker-dealer is in compliance with 8-504*.

<u>Conclusion</u>
Opponents will say unforeseen consequences will harm the state if your UCC is not uniform with the other states. But they cannot point to a specific unintended negative consequence from this bill.

More certain are the ***intended consequences*** in your current statute. Uniformity cuts both ways. It will be little consolation and comfort to investors in North Dakota knowing that people in the other 49 states lost their securities too thanks to the need for uniformity.

Protecting property rights is a priority of government, a priority this body takes seriously. This is not a red vs. blue issue – it is the people vs. too big to fail banks issue. The UCC can seem complex and unfamiliar, but the intent and impact of SB 2364 is simple – the protection of property rights.

Sincerely,

/s/ Don R. Grande

Additional Information and Resources:

The Oklahoma House held an interim study hearing on Article 8 of the Uniform Commercial Code. Click here to view that Hearing.

This Too Big To Fail article provides additional background and analysis of the 1994 UCC Article 8 Amendment.

Stop It - The Great Taking film documents the legislative efforts in South Dakota and Tennessee in the 2024 legislative sessions and provides additional information relative to SB 2364.

There is also a short 13-minute video summarizing this issue by Taylor Kenny with ITM Trading, Inc..

Appendix I

The New York Federal Reserve's reply to the EU Clearing and Settlement Legal Certainty Group's questionnaire

These are the key facts:

- Ownership of securities as property has been replaced with a new legal concept of a "security entitlement", which is a contractual claim assuring a very weak position if the account provider becomes insolvent.
- *All* securities are held in un-segregated pooled form. Securities used as collateral, and those restricted from such use, are held in the same pool.
- *All* account holders, including those who have prohibited use of their securities as collateral, must, by law, receive only a pro-rata share of residual assets.
- "Re-vindication," i.e. the taking back of one's own securities in the event of insolvency, is absolutely prohibited.
- Account providers may legally borrow pooled securities to collateralize proprietary trading and financing without restriction.
- "Safe Harbor" assures secured creditors priority claim to pooled securities ahead of account holders.
- The absolute priority claim of secured creditors to pooled client securities has been upheld by the courts.
-

The documentation is absolutely irrefutable. In March of 2006, the Deputy General Counsel for the Federal Reserve Bank of New York provided a detailed response to a questionnaire prepared by The Legal Certainty Group, which was established by The European Commission Internal Markets and Services Director General to address problems of legal uncertainty for secured creditors. The following are excerpts from that response (1):

Q (E.U.):

> In respect of what legal system are the following answers given?

A (N.Y. Fed):

> This response confines itself to U.S. commercial law, primarily Article 8 … and parts of Article 9, of the Uniform Commercial Code ("UCC") … The subject matter of Article 8 is 'Investment Securities' and the subject of Article 9 is 'Secured Transactions.' Article 8 and Article 9 have been adopted throughout the United States.

Q (E.U.):

> Where securities are held in pooled form (e.g. a collective securities position, rather than segregated individual positions per person), does the investor have rights attaching to particular securities in the pool?

A (N.Y. Fed):

> No. The security entitlement holder … has a pro rata share of the interests in the financial asset held by its securities intermediary … This is true even if investor positions are 'segregated.'

Q (E.U.):

> Is the investor protected against the insolvency of an intermediary and, if so, how?

A (N.Y. Fed):

> … an investor is always vulnerable to a securities intermediary that does not itself have interests in a financial asset sufficient to cover all of the securities entitlements that it has created in that financial asset …
>
> If the secured creditor has "control" over the financial asset it will have priority over entitlement holders …
>
> If the securities intermediary is a clearing corporation, the claims of its creditors have priority over the claims of entitlement holders.

Q (E.U.):

> What rules protect a transferee acting in good faith?

A (N.Y. Fed):

> Article 8 protects a purchaser of a financial asset against claims of an entitlement holder to a property interest in that financial asset, by limiting the entitlement holder's ability to enforce that claim … Essentially, unless the purchaser was involved in the wrongdoing of the securities intermediary, an entitlement holder will be precluded from raising a claim against it.

Q (E.U.):

> How are shortfalls [i.e. the intermediary's position with an upper-tier intermediary is less than the aggregate recorded position of the intermediary's account-holders] handled in practice?

A (N.Y. Fed):

> … The only rule in such instances is that the security entitlement holders simply share pro rata in the interests held by the securities intermediary …
>
> In actual fact, shortfalls occur frequently due to fails and for other reasons, but are of no general consequence except in the case of the securities intermediary's insolvency.

Q (E.U.):

> Does the treatment of shortfalls differ according to whether there is (i) no fault on the part of the intermediary, (ii) if fault, fraud or (iv) if fault, negligence or similar breach of duty?

A (N.Y. Fed):

> In terms of the interest that the entitlement holders have in the financial assets credited to its securities account: regardless of fault, fraud, or negligence of the securities intermediary, under Article 8, the entitlement holder has only a pro rata share in the securities intermediary's interest in the financial asset in question.

That's how it works directly from the most authoritative source possible—lawyers working for the Fed.

1. Commission, E. (2005) The New York Federal Reserve's reply to the EU Clearing and Settlement Legal Certainty Group's questionnaire.

Professional Summary – David R. Webb

Mr. Webb was the founder and Senior Managing Member of Verus Investments. Beginning in January of 2003, Mr. Webb was the Portfolio Manager of Verus Investment Partners, L.P., Verus Investments Partners (Q.P.), L.P., and of Verus Investment Fund, Ltd. Mr. Webb managed these three entities as a single strategy. The committed assets in this strategy were in excess of $600 million.

Prior to forming Verus, Mr. Webb was a Senior Managing Member of Shaker Investments. From September 1, 1998, Mr. Webb was the sole Portfolio Manager of Shaker Investments, L.P. and Shaker Heights Investment Fund, and from its formation on January 1, 2001, of Shaker Investments (QP), L.P. Mr. Webb managed these three entities (the "Shaker Hedge Funds") as a single strategy. Between September of 1998 and November of 2002, the Shaker Hedge Funds produced a cumulative net return to investors of 258%. The combined assets in this strategy were in excess of $1.3 billion.

Mr. Webb has extensive experience in financial and business issue analysis. Prior to joining Shaker Investments, Mr. Webb served as a Principal with Primus Venture Partners in Cleveland, as an Associate with the venture investment arm of E.M. Warburg, Pincus & Co., Inc. in New York, and as an Associate in the Mergers and Acquisitions Department of Oppenheimer & Company, Inc. While with E.M. Warburg, Pincus, Mr. Webb served as a Director of Conventure Corporation, and as an Officer and Director of LCI Communications Holdings Co., managing the due diligence, financing and legal work in the $200 million acquisition of LiTel Communications. Inc. LCI was subsequently sold to Quest Communications for $4.4 billion, making this one of the largest gains in the history of E.M. Warburg Pincus.

North Dakota SB 2364

Relating to choice of law, the property interest in a financial asset held by a securities intermediary, priority among security interests and entitlement holders, and the law governing perfection and priority of security interests in investment property

Testimony -- David R. Webb February 11, 2025

OUR PREDICAMENT

Q: How can we know that we no longer have property rights to securities?

A: Recovering one's own securities in the event of insolvency of the intermediary is prohibited.

Q: How can we know the above?

A: The Federal Reserve response to the Legal Certainty Group re. operation of UCC Article 8. (1)

While acknowledging that there will be competing priority claims to pooled assets in the event of insolvency, the banking lobby will have you believe that giving priority to investors to their own assets is frightening to contemplate, fraught with insurmountable difficulty, complexity and cost! Further study is required, which will take a long, long time!

AN ELEGANT SOLUTION

Q: What does the bill do? A:

1. It strikes two exceptions which have allowed secured creditors of intermediaries priority over investors in the event of insolvency of an intermediary.

2. It establishes the ability to be protected by setting the place of law in the state.

Nothing changes otherwise. Operation and legal constructs of the present system continue unhindered.

Existing contracts will not be disrupted, as they continue under the place of law set by contract.

(1) Please see Appendix I.

Freedom to set place of law by contract continues.

Existing margin accounts, to which the owner has explicitly granted control under a written agreement, continue unchanged.

Q: How then will the public benefit of the change in this law be realized?

A: Institutional investors will demand that investment contracts set the place of law in the state; those doing so will immediately have priority to pooled securities ahead of secured creditors of intermediaries. The Treasurer of the state will immediately have ability to do so, protecting the pension funds and finances of the state. Investors outside the state, indeed internationally, will seek to set investment contracts under the law of the state. In short, change for the public good will be driven by the most powerful, sophisticated investors. Other states will seek to follow in this.

IN SHORT, THIS…

is not difficult!

is not complicated!

is not costly (i.e., no expenditure whatsoever)!

can be implemented immediately!

requires no further change in law or regulation!

IS A MIRACLE!

A FINAL CONCERN

Q: What impact will this have on J.P. Morgan?

A: They will have to curtail doing what they say they are not doing.

February 11, 2025

Written Testimony to the North Dakota Senate Judiciary Committee in Favor of SB 2364: UCC Article 8

Chairwoman Larson and Members of the Committee,

I am grateful for this opportunity to testify **in support** of Senate Bill 2364.

For the record, my name is Paul Letvin, and I am providing this testimony as a private citizen of North Dakota. I was raised in this state from the time I was five years old and have enjoyed the freedoms of North Dakota since then. My education includes a Bachelor of Music in Music Education from the University of North Dakota, as well as ten years of intense training in private education through the Great Commission Leadership Institute and Heart and Character Development of Great Commission Churches. I taught music for seven years between Thompson and Grand Forks, and now I have been a pastor for well over ten years at Submerge Church, located in West Fargo, ND.

What does a pastor know about property and financial assets, and why would he care about this bill? Well for one, I have an incredible family, a faithful wife and six young children, and I want to know that they and their children have a prosperous future long after I am gone. Proverbs 13:22 says, *"A good man leaves an inheritance to his children's children, but the sinner's wealth is laid up for the righteous."*

Secondly, as a Christian and pastor, I am called to be a good steward of all that God has entrusted me with, including property and assets. 1 Corinthians 4:2 says, *"Moreover, it is required of stewards that they be found faithful."* If I know about a situation where I might not actually own what I think I own and do nothing about it, then I'm not being a good steward.

Thirdly, the Bible commands us to walk as children of light. That means that there should be honesty and transparency in all our dealings, both public and private. If there are flaws, or even intentional deceptions, in our current financial system, then they need to be exposed and corrected. They need to be brought to the light. Ephesians 5:11 tells us, *"Take no part in the unfruitful works of darkness, but instead expose them."*

I praise God for men like David Rogers Webb, who in his book, *The Great Taking*, has had the courage to expose some matters of great concern regarding our current financial system. I have great hope that SB 2364 will be a step in the right direction to make some needed corrections in North Dakota.

Finally, our own printed and coined currency that we use and accept for monetary transactions in the United States, including North Dakota, bears the words, "IN GOD WE TRUST." As that is the case, ought we not take heed of what God says regarding property

and ownership? If we truly trust God, as our currency says we do, then we should believe and follow what He says as it applies to all of life, including our financial dealings. I will let God's Word speak for itself on this important matter:

Exodus 20:15 - "You shall not steal."

Leviticus 19:11 - "You shall not steal; you shall not deal falsely; you shall not lie to one another."

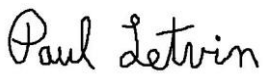
Deuteronomy 19:14 - "You shall not move your neighbor's landmark, which the men of old have set, in the inheritance that you will hold in the land that the LORD your God is giving you to possess."

Micah 2:1-3 – "Woe to those who devise wickedness and work evil on their beds!
When the morning dawns, they perform it, because it is in the power of their hand.
2 They covet fields and seize them, and houses, and take them away;
they oppress a man and his house, a man and his inheritance.
3 Therefore thus says the LORD:
behold, against this family I am devising disaster, from which you cannot remove your necks, and you shall not walk haughtily, for it will be a time of disaster."

Luke 11:21 – "When a strong man, fully armed, guards his own house, his possessions are undisturbed."

I want North Dakota to be "fully armed" in protecting all that the Lord has entrusted to us. I respectfully urge the committee to give Senate Bill 2364 a "**Do Pass**" recommendation. Thank you for your time and consideration.

Humbly,



Paul Letvin
Pastor and North Dakota Citizen

SB 2364

Senate Judiciary

Peach Garden Room

February 11, 2025

Madam Chair and members of the Senate Judiciary Committee, my name is Tim Karsky and I am Commissioner for the North Dakota Securities Department. I am here today to ask you to vote Do Not Pass on SB 2364. As you have heard in previous testimony, SB 2364 will make changes to N.D.C.C. §§ 41-08-51 and 41-09-25. As mentioned, several times, this section was adopted per the Uniform Commercial Code and mirrors the law throughout the country and as of today, no other state has adopted these amendments. In fact, South Dakota defeated the amendments last week. I believe there were approximately eight states that have looked at this issue and no state has adopted them, as of today.

I do not think North Dakota wants to become the first state to adopt this, which would make us the first non-uniform law state. Although I am not an attorney, I do think this would complicate businesses operating in ND and they may elect not to do business here.

The Uniform Commercial Code (UCC) is a uniform state law adopted by all fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The UCC governs commercial transactions between private parties. The fact that all U.S. states have adopted the UCC in substantially identical form facilitates interstate commerce. North Dakota citizens and businesses can confidently enter transactions with counterparties in other states knowing that the background law governing their respective rights is the same in every United States jurisdiction.

Article 8 of the UCC governs transactions involving investment securities. It was drafted to operate in conjunction with federal securities law and regulations to facilitate interstate securities trading and protect investor interests.

The 1994 revision to Article 8 was necessary in part because of changes to the way in which most investors hold securities. Investments, like stocks and bonds, used to be issued on paper certificates. To sell a security, an investor had to endorse the certificate by signing it on the back and deliver the paper to the buyer. As trading volume increased this system became untenable and brokerage firms began to offer their customers computerized trading through a system of electronic holding. Over time, the electronic holding system for investment securities was adopted by most investors and the firms that serve them because of its many advantages over holding paper certificates. The securities markets that exist today allow for near-instantaneous trading, one-day settlement of trades, consolidated brokerage accounts, and many other efficiencies and conveniences that would not be possible in a market using paper certificates.

The 1994 revision of UCC Article 8 included a new Part 5, titled "Security Entitlements," that sets out the rights and obligations of investors using the electronic system for holding securities. This law, which has operated effectively for nearly thirty years on behalf of investors and businesses, has recently been criticized because of a misunderstanding about its investor protections. Specifically, the rules in UCC § 8-511 that govern priority in security interests have been misinterpreted as harmful to the property interests of individual investors.

Priority rules exist to settle conflicting claims. If more than one party claims an interest in the same securities, something has gone wrong with a transaction – one party has failed to deliver cash or securities to complete a trade. When that happens, the priority rule determines who receives the security and who must pursue another remedy, such as an insurance claim or a lawsuit.

The second faulty assumption is that individual shares of a security are traceable to a particular transaction. Under the electronic holding system that exists to facilitate computerized trading, securities are held by brokerage firms and clearinghouses in pools for the benefit of individual investor accounts. At the end of each trading day, all of the trades involving each particular security are settled, and shares are reallocated from the accounts of the sellers to the accounts of the buyers. But it would be impossible, in most cases, to identify any particular share of a stock or bond as changing hands in a particular trade. The investment's firm's obligation under the law is to hold a sufficient *total* number of shares of a security to satisfy the claims of *all* of its investors, not to determine which shares from the pool belong

to which investor.

Finally, critics make the faulty assumption that these exceptions giving priority to creditors benefit large financial institutions rather than individual investors. In fact, large financial institutions do not just trade securities for their own accounts – they trade securities on behalf of their customers. The priority rules under UCC § 8-511 exist to limit systemic risk when something goes wrong. If a single brokerage firm fails in its legal obligation to settle trades by delivering cash or securities, it is not only the failing firm's customers who potentially suffer a loss. The investors from other brokerage firms who are counterparties to the failing firm's trades could also face losses. The priority rules in UCC § 8-511 serve to protect investors by containing the losses to the firm that failed, rather than allowing a chain reaction that affects customers of other firms.

Madam Chair, I am still new to this position and learning daily, but I do understand the UCC and have worked with it on the banking side as a regulator or banker for over 40 years. I think it is important for all states regarding securities transactions operate under a uniform law. I would be happy to answer any questions you may have.

2025 SENATE STANDING COMMITTEE MINUTES

Judiciary Committee
Peace Garden Room, State Capitol

SB 2364
2/12/2025

Relating to choice of law, the property interest in a financial asset held by a securities intermediary, priority among security interests and entitlement holders, and the law governing perfection and priority of security interests in investment property.

9:40 a.m. Chair Larson opened the hearing.

Members present:
Chair Larson, Vice Chairman Paulson, Senators: Castaneda, Cory, Luick, Myrdal, Braunberger.

Discussion Topics:

- Stock ownership rights
- Electronic stock holding

9:40 a.m. The committee discussed clear language of first-right ownership of stocks and decided to wait for clarification from the bankers.

9:42 a.m. Chair Larson closed the hearing.

Kendra McCann, Committee Clerk

2025 SENATE STANDING COMMITTEE MINUTES

Judiciary Committee
Peace Garden Room, State Capitol

SB 2364
2/17/2025

Relating to choice of law, the property interest in a financial asset held by a securities intermediary, priority among security interests and entitlement holders, and the law governing perfection and priority of security interests in investment property.

10:19 a.m. Chair Larson opened the hearing.

Members present:
Chair Larson, Vice Chairman Paulson, Senators: Castaneda, Cory, Luick, Myrdal, Braunberger.

Discussion Topics:

- Banking industry input
- SB 2364, SB 2383, SB 2321

10:20 a.m. Committee discussion on upcoming schedule.

10:23 a.m. Chair Larson decided to wait before hearing Senator Cory's proposed amendments for SB 2383.

10:23 a.m. SB 2364 waiting on amendment from the banking industry.

10:23 a.m. Senator Paulson planned to speak with bill sponsor for SB 2321 to make adjustments.

10:25 a.m. Chair Larson closed the hearing.

Kendra McCann, Committee Clerk

2025 SENATE STANDING COMMITTEE MINUTES

Judiciary Committee
Peace Garden Room, State Capitol

SB 2364
2/18/2025
a.m.

A BILL for an Act to provide for a legislative management study relating to the property rights of entitlement holders in Uniform Commercial Code transactions.

9:30 a.m. Chair Larson opened the hearing on SB 2364.

Discussion Topics:

- Bill update

9:30 a.m. Senator Patten indicates additional information is needed.

9:31 a.m. Chair Larson closed the hearing.

Kendra McCann, Committee Clerk by Lynn Wolf, Chief Clerk

2025 SENATE STANDING COMMITTEE MINUTES

Judiciary Committee
Peace Garden Room, State Capitol

SB 2364
2/19/2025

Relating to choice of law, the property interest in a financial asset held by a securities intermediary, priority among security interests and entitlement holders, and the law governing perfection and priority of security interests in investment property.

11:00 a.m. Chair Larson opened the hearing.

Members present:
Chair Larson, Vice Chairman Paulson, Senators: Castaneda, Cory, Luick, Myrdal, Braunberger.
`

Discussion Topics:

- Property rights issues
- Jurisdictional concerns

11:00 a.m. Senator Paulson introduced the amendment and submitted testimony #38344.

11:02 a.m. Senator Paulson moved amendment LC# 25.0840.02001.

11:03 a.m. Senator Myrdal seconded.

11:03 a.m. Voice Vote - Motion Passed.

11:04 a.m. Senator Paulson moved a Do Pass as amended.

11:04 a.m. Senator Luick seconded the motion.

Senators	Vote
Senator Diane Larson	Y
Senator Bob Paulson	Y
Senator Ryan Braunberger	Y
Senator Jose L. Casteneda	Y
Senator Claire Cory	Y
Senator Larry Luick	Y
Senator Janne Myrdal	Y

Motion Passed 7-0-0.

11:04 a.m. Senator Paulson will carry the bill.

11:06 a.m. Chair Larson adjourned the meeting.

Kendra McCann, Committee Clerk

25.0840.02001
Title.03000

Prepared by the Legislative Council staff for Senator Paulson
February 19, 2025

Sixty-ninth
Legislative Assembly
of North Dakota

PROPOSED AMENDMENTS TO

HD
2/19/25
Page 1 of 5

SENATE BILL NO. 2364

Introduced by

Senators Enget, Boehm, Paulson, Clemens

Representatives Hendrix, S. Olson

A BILL ~~for an Act to amend and reenact section 41-08-10, subsection 1 of section 41-08-43, section 41-08-51, and subsection 1 of section 41-09-25 of the North Dakota Century Code, relating to choice of law, the property interest in a financial asset held by a securities intermediary, priority among security interests and entitlement holders, and the law governing perfection and priority of security interests in investment property.~~for an Act to provide for a legislative management study relating to the property rights of entitlement holders in Uniform Commercial Code transactions.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

~~**SECTION 1. AMENDMENT.** Section 41-08-10 of the North Dakota Century Code is amended and reenacted as follows:~~

~~**41-08-10. (8-110) Applicability - Choice of law.**~~

~~1. The local law of the issuer's jurisdiction, as specified in subsection 4, governs:~~

~~a. The validity of a security;~~

~~b. The rights and duties of the issuer with respect to registration of transfer;~~

~~c. The effectiveness of registration of transfer by the issuer;~~

~~d. Whether the issuer owes any duties to an adverse claimant to a security; and~~

~~e. Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.~~

~~2. The local law of the securities intermediary's jurisdiction, as specified in subsection 5,~~law of this state ~~governs:~~

~~a. Acquisition of a security entitlement from the securities intermediary;~~

~~b. The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;~~

~~c. Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and~~

~~d. Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.~~

~~3. The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.~~

~~4. "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this state may specify the law of another jurisdiction as the law governing the matters specified in subdivisions b through c of subsection 1.~~

~~5. The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:~~

~~a. If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part, this chapter, or this title, that jurisdiction is the securities intermediary's jurisdiction.~~

~~b. If subdivision a does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.~~

~~c. If neither subdivision a nor b applies and an agreement between the securities intermediary and its entitlement holder governing the securities account~~

~~expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.~~

~~d. If none of the preceding subdivisions applies, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.~~

~~e. If none of the preceding subdivisions applies, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.~~

~~6. A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other recordkeeping concerning the account.~~

~~7. The local law of the issuer's jurisdiction or the securities intermediary's jurisdiction governs a matter or transaction specified in subsection 1 or 2 even if the matter or transaction does not bear any relation to the jurisdiction.~~

~~**SECTION 2. AMENDMENT.** Subsection 1 of section 41-08-43 of the North Dakota Century Code is amended and reenacted as follows:~~

~~1. To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in section 41-08-51.~~

~~**SECTION 3. AMENDMENT.** Section 41-08-51 of the North Dakota Century Code is amended and reenacted as follows:~~

~~**41-08-51. (8-511) Priority among security interests and entitlement holders.**~~

~~1. Except as otherwise provided in subsections 2 and 3, if~~If a securities intermediary does ~~not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a~~

~~creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.~~

~~2. A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.~~

~~3. If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.~~

~~**SECTION 4. AMENDMENT.** Subsection 1 of section 41-09-25 of the North Dakota Century Code is amended and reenacted as follows:~~

~~1. Except as otherwise provided in subsection 3, the following rules apply:~~

~~a. While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby.~~

~~b. The local law of the issuer's jurisdiction as specified in subsection 4 of section 41-08-10 governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.~~

~~c. The local law of the securities intermediary's jurisdiction as specified in subsection 5 of section 41-08-10~~this state~~ governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.~~

~~d. The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account.~~

~~e. Subdivisions b, c, and d apply even if the transaction does not bear any relation to the jurisdiction.~~

SECTION 1. LEGISLATIVE MANAGEMENT STUDY - UNIFORM COMMERCIAL CODE PROPERTY RIGHTS. During the 2025-26 interim, the legislative management shall consider

studying the property rights of entitlement holders in Uniform Commercial Code transactions, along with the jurisdiction for disputes between entitlement holders and securities intermediaries. The study must review the provisions of the Uniform Commercial Code, including a review of article 8, in relation to state law, federal law, and the law's interaction as it relates to ownership of personal property. The study must seek input from relevant stakeholders, including securities intermediaries. The legislative management shall report its findings and recommendations, together with any legislation necessary to implement the recommendations, to the seventieth legislative assembly.

REPORT OF STANDING COMMITTEE
SB 2364

Judiciary Committee (Sen. Larson, Chairman) recommends **AMENDMENTS (25.0840.02001)** and when so amended, recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT OR EXCUSED AND NOT VOTING). SB 2364 was placed on the Sixth order on the calendar. This bill does not affect workforce development.

25.0840.02001
Title.

Prepared by the Legislative Council staff for Senator Paulson
February 19, 2025

Sixty-ninth
Legislative Assembly
of North Dakota

PROPOSED AMENDMENTS TO

SENATE BILL NO. 2364

Introduced by

Senators Enget, Boehm, Paulson, Clemens

Representatives Hendrix, S. Olson

A BILL ~~for an Act to amend and reenact section 41-08-10, subsection 1 of section 41-08-43, section 41-08-51, and subsection 1 of section 41-09-25 of the North Dakota Century Code, relating to choice of law, the property interest in a financial asset held by a securities intermediary, priority among security interests and entitlement holders, and the law governing perfection and priority of security interests in investment property.~~for an Act to provide for a legislative management study relating to the property rights of entitlement holders in Uniform Commercial Code transactions.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

~~**SECTION 1. AMENDMENT.** Section 41-08-10 of the North Dakota Century Code is amended and reenacted as follows:~~

~~**41-08-10. (8-110) Applicability - Choice of law.**~~

~~1. The local law of the issuer's jurisdiction, as specified in subsection 4, governs:~~

~~a. The validity of a security;~~

~~b. The rights and duties of the issuer with respect to registration of transfer;~~

~~c. The effectiveness of registration of transfer by the issuer;~~

~~d. Whether the issuer owes any duties to an adverse claimant to a security; and~~

~~e. Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.~~

~~2. The local law of the securities intermediary's jurisdiction, as specified in subsection 5,~~law of this state ~~governs:~~

~~a. Acquisition of a security entitlement from the securities intermediary;~~

~~b. The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;~~

~~c. Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and~~

~~d. Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.~~

~~3. The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.~~

~~4. "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this state may specify the law of another jurisdiction as the law governing the matters specified in subdivisions b through c of subsection 1.~~

~~5. The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:~~

~~a. If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part, this chapter, or this title, that jurisdiction is the securities intermediary's jurisdiction.~~

~~b. If subdivision a does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.~~

~~c. If neither subdivision a nor b applies and an agreement between the securities intermediary and its entitlement holder governing the securities account~~

~~expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.~~

~~d. If none of the preceding subdivisions applies, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.~~

~~e. If none of the preceding subdivisions applies, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.~~

~~6. A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other recordkeeping concerning the account.~~

~~7. The local law of the issuer's jurisdiction or the securities intermediary's jurisdiction governs a matter or transaction specified in subsection 1 or 2 even if the matter or transaction does not bear any relation to the jurisdiction.~~

~~**SECTION 2. AMENDMENT.** Subsection 1 of section 41-08-43 of the North Dakota Century Code is amended and reenacted as follows:~~

~~1. To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in section 41-08-51.~~

~~**SECTION 3. AMENDMENT.** Section 41-08-51 of the North Dakota Century Code is amended and reenacted as follows:~~

~~**41-08-51. (8-511) Priority among security interests and entitlement holders.**~~

~~1. Except as otherwise provided in subsections 2 and 3, if~~If a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a

~~creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.~~

~~2. A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.~~

~~3. If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.~~

~~**SECTION 4. AMENDMENT.** Subsection 1 of section 41-09-25 of the North Dakota Century Code is amended and reenacted as follows:~~

~~1. Except as otherwise provided in subsection 3, the following rules apply:~~

~~a. While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby.~~

~~b. The local law of the issuer's jurisdiction as specified in subsection 4 of section 41-08-10 governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.~~

~~c. The local law of the securities intermediary's jurisdiction as specified in subsection 5 of section 41-08-10~~this state governs ~~perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.~~

~~d. The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account.~~

~~e. Subdivisions b, c, and d apply even if the transaction does not bear any relation to the jurisdiction.~~

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