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BILL ANALYSIS

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House Bill 4089 (as reported without amendment)

Sponsor: Representative David Honigman

House Committee: Corporations and Finance

Senate Committee: Commerce and Technology

Date Completed: 4-1-87

RATIONALE

Article 8 of the Uniform Commercial Code (UCC) governs the buying and selling of investment securities such as stocks and bonds. Historically, securities have been represented by pieces of paper: certificates. In the last 20 years, however, "uncertificated" transfers of securities, i.e., transfers made without the physical exchange of certificates, have commanded a significant portion of market activity. Mutual funds and brokerage accounts are common examples. Where large numbers of securities are traded frequently, computer-generated certificateless transfers often are favored over the physical transfer of certificates.

The next step in this technological evolution — certificateless issues of securities — is the amendment of laws that recognize only certificated securities. To facilitate the development and use of uncertificated securities, as well as certificateless transfers, the National Conference of Commissioners of Uniform State Laws has recommended amendments to Article 8 that accommodate the existence and use of uncertificated securities. Those amendments have been adopted by at least 27 states, including the prominent commercial jurisdictions of New York and Delaware, and the Michigan Law Revision Commission and others have proposed that Michigan also enact the amendments.

CONTENT

House Bill 4089 would amend Article 8 of the Uniform Commercial Code (UCC), which deals with investment securities, to incorporate provisions for the issuance, transfer, and creation of enforceable security interests in "uncertificated securities" — i.e., securities for which no certificates are issued; to make the Act's references to certificated securities consistent with those provisions; and to make additional changes regarding the treatment of both certificated and uncertificated securities.

Uncertificated Securities

The bill would extend to uncertificated securities the structure that now applies to certificated securities. The uncertificated security's analog to a certificate would be the "initial transaction statement" that the issuer of an uncertificated security would send to the appropriate parties when an uncertificated security was transferred, pledged, or released from a pledge. This statement would notify the purchaser, secured party, or owner of important conditions attached to the security. Transfers of and security interests in uncertificated securities would be effected by proper notice to the issuer and changes on the issuer's books, rather than by the exchange of a certificate. The issuer then would send confirming initial transaction statements to the involved parties.

The proposed duties of transferor, broker, and issuer under various circumstances are spelled out in detail. Transfers, pledges, and releases also could be made by appropriate entries on the books of a clearing corporation. Issuers would have to send regular statements to owners and pledgees generally reiterating the information (including notice of liens, restrictions, and adverse claims) required on an initial transaction statement.

Information on a statement would apply only at the time of issuance; a statement would offer no further guarantees (which also is true in the case of a certificate). In addition to receiving statements, a pledgee would receive dividends and any additional securities that the issuer otherwise would send to the owner; the owner would retain all powers other than the power to transfer.

Issuers who regularly issued both certificated and uncertificated securities in a given class would have to convert either form into the other upon an owner's or pledgee's request.

Certificated and Uncertificated Securities

The bill would do the following in regard to certificated and uncertificated securities:

- Incorporate provisions for transfers of security interests by or to any "financial intermediary" (a bank, clearing corporation, or other entity that maintains securities accounts for its customers).
- Allow certificated or uncertificated securities to be reached by creditors by legal process, as well as by seizure of the certificate.
- Include both certificated and uncertificated securities in a new section providing for the enforceability and termination of security interests in securities. This section would declare a security interest to be enforceable only if transferred to the secured party (or someone designated by the secured party) under the portion of Article 8 dealing with transfers of security interests in securities (MCL 440.8313(1)). Such a transfer generally would be sufficient to perfect the security interest; enforceability would be determined by the applicable portions of Article 8, rather than Article 9, which otherwise governs security interests in property. A security interest generally would be terminated by transfer to the debtor under Section 8313(1).

MCL 440.1201 et al.

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

H.B. 4089 (4-1-87)

ARGUMENTS

Supporting Argument

The bill is necessary for Michigan law to remain consistent with national changes in the UCC. It would enable brokers and others to make uncertificated transfers for Michigan clients under Michigan law, and would offer lenders the procedural assurances they need to make loans in Michigan on uncertificated issues. Without the bill, new firms wishing to incorporate under a certificateless system may go elsewhere to incorporate. (Although Michigan's Business Corporation Act allows uncertificated issues, the absence of a transfer system in Michigan law remains a deterrent.) The bill would expand the practical options open to businesses likely to favor uncertificated systems, whether they are giant publicly traded corporations with extensive computer capability, or small closed corporations whose internal securities transactions are so simple that certificates are unnecessary. Businesses would be able to choose between certificated, uncertificated, and mixed systems without the unnecessary pressure imposed by an out-of-date law that favors a certificated system over others.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.