



Stock: Are Your Interests Perfected in the Digital Age?

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In a secured loan transaction, it is critical for you, as the secured lender, to ensure that your security interest in the collateral is perfected in accordance with the Uniform Commercial Code (UCC) requirements. In the case of bankruptcy or breach of the borrower's obligations, a lender needs the protection afforded by a perfected security interest in the collateral as it may provide the only meaningful source of funds to repay the loan.

The methods for perfecting a security interest under the UCC vary depending on the type of collateral. Under Article 9 of the UCC, corporate stock certificates are a type of investment property, which includes certificated securities and uncertificated securities. A security interest in investment property is perfected (i) by filing a properly completed UCC-1 financing statement in the appropriate filing office, or (ii) by control. Depending on the type of investment property, control can be achieved, for example, by possession of a certificated security properly indorsed or by the execution of a control agreement with the issuer of an uncertificated security.

Traditionally, when ownership of stock in a corporation is represented by a physical certificate, the UCC refers to the interest as a **certificated security**. In the case of a certificated security, the requirements of perfection by control are satisfied when the secured party obtains possession of the stock certificate, typically together with an executed stock power indorsed to the secured party or in blank. The stock power enables the secured party to transfer the certificate from the borrower to a purchaser if the secured party enforces its security interest and sells the collateral at foreclosure.

Although paper stock certificates still exist, electronic stock certificates have become popular in the digital age. Digital or electronic stock is simply ownership in a company that is represented on an electronic stock ledger of some sort. *Electronic stock certificates* can be either certificated securities, as described above, or uncertificated securities. For example, securities can be digitally signed securities in the form of PDFs and can be entered on an electronic stock ledger.

If electronic stock certificates are entered in a company ledger but the purchaser of the stock certificate does not receive a certificate, the stock certificate is a type of **uncertificated security**. Uncertificated securities are tracked on the books of the company. Unlike certificated securities, these securities are

issued without a certificate to evidence ownership. The company, the company's transfer agent, or a broker-dealer provides evidence of ownership to the owner via an account statement and regular updates.

If there is not a certificate to evidence ownership, how do you know your interest is perfected? Like certificated securities, a security interest in uncertificated securities is perfected by properly filing a UCC-1 financing statement or by control. Obtaining control of an uncertificated security, however, requires either re-registration of the security in the name of the secured party, or an agreement by the issuer that it will comply with instructions originated by the secured party without further consent by the registered owner. This is commonly achieved by executing a control agreement.

In conclusion, a security interest in electronic stock certificates can be perfected by either filing a UCC-1 financing statement or obtaining control as described above. Although perfection by filing a UCC-1 financing statement is a convenient and inexpensive option, perfection by control of an uncertificated security or a certificated security will take priority over any UCC-1 filing, regardless of the time of filing. Therefore, it is important to first identify the type of electronic stock and to perfect your interests accordingly to ensure that you are adequately protected.



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