ASSEMBLY FINANCIAL INSTITUTIONS COMMITTEE

STATEMENT TO

ASSEMBLY, No. 2019

STATE OF NEW JERSEY

DATED: OCTOBER 7, 1996

The Assembly Financial Institutions Committee reports favorably Assembly Bill No. 2019.

This bill enacts Uniform Commercial Code Revised Article 8 "Investment Securities." The revision was approved by the National Conference of Commissioners on Uniform State Laws (NCCUSL) at its 1994 Annual Meeting. The New Jersey Law Revision Commission has examined Revised Article 8 pursuant to its statutory obligation to consider uniform state laws for adoption in New Jersey. The Law Revision Commission recommends its enactment. Revised Article 8 has already been adopted in many states. The Chairman of the Federal Reserve Board and the Chairman of the Securities and Exchange Commission support Revised Article 8 and have urged states to adopt it because the legal uncertainties that arise when existing Article 8 is applied to the indirect holding system prevent banks from making loans to securities firms in times of financial crisis.

Revised Article 8 deals with the transfer of investment securities such as stocks and bonds. The revision was necessitated by the development of the indirect holding system for securities. Under this system, securities are mainly held through a chain of securities intermediaries starting with a central depository holding an immobilized certificate representing a large number of shares of the issuer. Existing Article 8 is based on the assumption that securities are held directly from the issuer. Since this assumption is completely at odds with how securities actually are held, existing Article 8 impedes the transfer of securities and affects the ability of securities firms to obtain bank financing.

The bill establishes legal rules for the settlement of securities trades. "It sets the ground rules for implementing transfers and resolves disputes that may arise when different people claim conflicting interests." While federal securities law establishes disclosure requirements of financial information for the sale of securities and regulates brokers, dealers and other market place participants, Article 8 supplements this scheme of regulation by setting rules about the transfer of securities.

The revision was necessitated by major changes in the way securities are held. Article 8 assumes that a person who owns securities has a direct relationship with the company that issued the security. It assumes that if the securities are evidenced by physical certificates, the owner holds them. If the securities are uncertificated, the company transfers ownership on its own books. While both of these situations occur, a third possibility is far more common. Almost all forms of publicly traded securities are issued in certificated form. However, these certificates are held, not by individual investors, but by clearing corporations in what is called an "immobilized" form, designating that the physical document remains in the possession of the clearing corporation and does not change hands to indicate transfers in ownership. This type of securities holding system is called the indirect holding system. "Settlement of securities trading occurs not by delivery of certificates or by registration of transfer on the records of the issuers or their transfer agents, but by computer entries in the records of clearing corporations and securities intermediaries." Current Article 8 does not deal effectively with the indirect holding system.

Revised Article 8 accommodates the indirect holding system. It takes a neutral position on the evolution of securities holding practices. The revision assumes that "the path of development will be determined by market and regulatory forces and that the Article 8 rules should not seek to influence the development in any specific direction." As a result, the rules of existing Article 8 have been retained for the direct holding system and a new Part 5 added to set forth the commercial law rules for the indirect holding system. In addition, the rules for obtaining a security interest in securities have been moved to Article 9.

Equally important are the rules addressing the question of systemic risk, "that is, the risk that a failure of one securities firm might cause others to fail." If securities transactions are not final, and if a securities firm fails, persons injured by the failure may seek to unwind the transaction and thus threaten the solvency of other firms. Revised Article 8 reduces systemic risk by establishing rules to finalize securities transactions. As a further precaution, Revised Article 8 "establishes simple rules on the use of securities as collateral for loans in order to ensure that financial institutions can be assured of their legal rights in providing financing to securities firms that may be necessary to maintain liquidity in times of stress."

Sections 1 through 12 of P.L.1959, c.200 (C.14:18-1 through 14:18-12), concerning fiduciary security transfers are repealed.