Security Interests in CDS: Some Recent Developments and Proposals

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Security Interests in CDs: Some Recent Developments and Proposals

By Alvin C. Harrell

The revisions to the Oklahoma UCC section 9-105(1)(e) do not include the word "subject" to a security interest. This section in the United States Code ("USC") or ("the Code") Article 9 was revised to clarify the method for ascertaining a security interest in a certificate of deposit ("CD"). The uniform text of Article 9 is somewhat unclear on this issue: Section 9-140(6) excludes deposit accounts from Article 9, except where the secured party is tracing proceeds, but the definition of "depositor account" at section 9-105(1)(c) excludes deposits held in a CD in addition to Article 9. Article 9 does not, however, define what a CD is. Potentially, under the uniform text of Article 9, a CD could be considered an instrument, an investment security, a deposit account, or a general intangible. Since the method of perfection is determined by the character of the collateral, the result is considerable uncertainty under the uniform text. The Article 9 Drafting Committee is considering several revisions to Article 9 that will likely address these issues, but in the meantime courts continue to grapple with the issues and Oklahoma law has not been treated to resolve some of the uncertainty.

II. The Oklahoma Revisions

The revisions to the Oklahoma UCC section 9-105(1)(e) define to include (1) an instrument as defined at section 9-104(1) even if nonnegotiable under UCC section 3-104 because it is not payable to order, (2) an acknowledgment and promise to repay that is considered a CD by the insurer ("insurer" defined as in UCC section 9-105(1)), even if denominated "nontransferable," and (3) an uncertificated ("book entry") CD that meets the test at (2) above. This broad definition is designed in part to avoid the gryphons that courts and legislatures have felt compelled to perform in order to achieve the same result. The Oklahoma definition of "instrument," though not necessary because many CDs are treated like an instrument, must be addressed. If this provision is interpreted as requiring all CDs to be treated as instruments under Article 9, many of the concerns expressed in the uniform text may be resolved.

The Oklahoma revisions to section 9-105(1)(e) also specify that a writing CD will be treated as an instrument under Article 9, while an uncertificated CD will be treated as a general intangible, subject to a special perfection rule. This codifies and clarifies the characterization and method of perfection for each type of CD.

The Oklahoma revisions also add a new section 9-302(1)(o), providing that a security interest in a deposit account is perfected upon the request of the bank. This section is intended to provide a blanket collateral description that would cover all "personal property" in a deposit account as proceeds of other collateral. This section remains to be topics of discussion at meetings of the Article 9 Drafting Committee. The current proposal would award priority to a right of set-off that "accrues" before the depositor's insolvency. The proposal would be reviewed with knowledge of the security interests in consumer deposit accounts.

I. Introduction—Oklahoma Revised Article 9

Effective September 1, 1994, the Oklahoma version of Uniform Commercial Code ("UCC" or "the Code") Article 9 was revised to clarify the method for ascertaining a security interest in a certificate of deposit ("CD"). The uniform text of Article 9 is somewhat unclear on this issue: Section 9-140(6) excludes deposit accounts from Article 9, except where the secured party is tracing proceeds, but the definition of "depositor account" at section 9-105(1)(c) excludes deposits held in a CD in addition to Article 9. Article 9 does not, however, define what a CD is. Potentially, under the uniform text of Article 9, a CD could be considered an instrument, an investment security, a deposit account, or a general intangible. Since the method of perfection is determined by the character of the collateral, the result is considerable uncertainty under the uniform text. The Article 9 Drafting Committee is considering several revisions to Article 9 that will likely address these issues, but in the meantime courts continue to grapple with the issues and Oklahoma law has not been treated to resolve some of the uncertainty.

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sions, in order to achieve approval of a workable system for commercial secured transactions. If so an opportunity, to rationalize the somewhat chaotic law governing security interests in consumer bank accounts would have been lost. Fortunately, the interested parties seem to be moving toward a position that will allow consumer deposit accounts to be included in the Article 9 revision, though the outcome is not yet assured.

Another problem with security interests in CDs remains unresolved by the Oklahoma revisions. Consistent with common practice, the Oklahoma revisions treat certificated CDs like a lien instrument, with possession creating something similar to "holder" status under UCC Article 9, even if the CD is denoted "non-transferable." This reflects the practice of perfecting a common law pledge by taking possession of the CD.

However, it is not uncommon for the owner of a CD to lose the certificate or other evidence of the account. In addition, many CDs are automatically renewed, so that the certificate and any deposit instrument may then be presented with a request for withdrawal by a custodian who has not seen the certificate. This practice has been followed for many years and has no idea where it is, or with a similar request by an heir or surviving joint tenant who has never seen the certificate.

A common practice is to allow such a customer to withdraw the funds by excusing an affidavit stating that the CD has been lost. Obviously, in view of the Oklahoma revisions and the proposed Article 9 revisions, this may become a more hazardous practice, since "lost CD" may in fact be pledged to a third party and its credit deemed to have an interest in that account. This scenario poses obvious problems for the third party creditor as well, since its collateral may be dissipated by an innocent withdrawal using a "lost CD."
titled it to priority over a common law right of set-off.35

On appeal the District Court of Appeal of Florida for the Fifth District recognized that Article 9 does not govern a priority conflict between a security interest and the right of set-off.36 The Court of Appeal then concluded that under Florida law a bank's right of setoff will prevail if the right to setoff existed when the bank received notice of the competing claim, even if the right to setoff had not at that time been exercised.37

This currently represents a minority view.38 The Winter Park court analyzed the issue by reference to cases involving the priority of a right of setoff as against a garnishment summons.39 There is indeed an exception to the general rule regarding the priority of set off, allowing a right of set off to be exercised after the bank has received notice of a competing garnishment.40 However, this exception generally does not extend to priority as against competing security interests.41 As noted, Winter Park represents a minority view on this issue.42

The Winter Park court also suggested, as an alternative basis for its decision, that the language in the CD prohibiting transfers may have prevented American Pioneer from achieving perfection against it as an instrument under Article 9.43 This raises again a wide range of issues relating to nontransferable CDs, as discussed supra with regard to Latin Investment.44 The Winter Park court recognized Florida precedent favoring the transferability of "nontransferable" CDs,45 but questioned the basis for that position.46

All of which serves as another reminder of the need for statutory clarification in this area of the law. Hopefully the forthcoming Article 9 revisions will provide such a clarification.


36. Of UCC §§ 9-301, 9-307, 9-308, 9-309, 9-319, 9-312, and 9-313 (Article 9 priority provisions). Note, however, that the CD in the Hegel/Kempner case under UCC Article 2, claims against the mortgagor (by setoff or otherwise) will be governed by and possibly cut off under UCC §§ 3-302, 3-305, and 3-306, among others.

37. Winter Park, 633 So. 2d at 55.

38. See, e.g., Harrell, The Basic Law of Bank Accounts, supra note 4, at 128-26 and 137-38. See also discussion of the proposed Article 9 revisions, supra infra text at note 12.


42. The court's conclusion was based in part on the Bank of Winter Park's decision of default, an event triggering the conditional right of setoff prior to receipt of notice of American First's claim. If any action was taken to effectuate that default, the court's decision could be justified on that basis. See Harrell, supra note 1.

43. See supra Part V-A.

44. See supra Part V-A.


46. 633 So. 2d at 56.

Commentary: Banking Law 1994-Problems and Prospects

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In the aftermath of FISMA and FDICIA, the banking agencies have been able to install in many bank lawyers a sense that they must represent the interests of the agencies as well as those of their banker clients. Thus, some believe that the modern role of the bank lawyer is to act as a kind of monitor in negotiations between the bank and the regulator, and ultimately to help the bank accept the inevitability that the regulator will prevail, to face the fact that legal resistance is futile. As one banking law specialist said to your author, "It is now against the law to represent your bank client.

Some banking lawyers have quietly, and in some cases even eagerly, accepted the effective nationalization of the industry. Perhaps this should come as no surprise; rather, the surprise is that so many other banking law professionals have had the courage to risk their careers by standing up to object on an apparently lost cause.

VIII. Summary and Conclusions

History may record that the insolvency of the Federal Savings and Loan Insurance Corporation was resolved by the effective nationalization of the American banking system. Perhaps this was inevitable, consistent with long-term trends in the United States and occupied public policy in many other countries. Yet

27. See Banking Supervision: New Zealand adopts a New Approach, in this issue.


30. This is largely the result of misinformation fed to the public by Congress, the government, and the press. See, e.g., Alan C. Harrell, Deposit Insurance and the Impact of the Resolution of the American Financial System, 86 Ohio St. L. Rev. 779 (1983); see also the Supreme Court decision in Citizens United Corp. v. Napolitano, 555 U.S. 361 (2009).

31. It seems likely that additional securities and possibly insurance powers will be granted to banks. See, e.g., David Rogers, GOP's Leaders In House to Act On Bank Reform, Wall St. J., Dec. 1, 1994, at S20. But these reforms will not address the fundamental imbalance of power between regulators and banks. This is a different issue that is destroying the competitive banks and independent community banks. See supra text at note 22.