

SECURED TRANSACTIONS

UNDER THE

UNIFORM COMMERCIAL CODE

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Developed and written by the
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INTRODUCTION

Secured transactions play an integral role in the lending operations of every credit union. What does the term "secured transactions" really mean? Is a credit union's security interest in collateral superior to all other parties'? When does a credit union have the right to repossess collateral on a defaulted loan? How must a credit union dispose of collateral following repossession? The answers to these and many other questions are found in Article 9 of the Uniform Commercial Code (UCC).

This manual was originally developed and published by the Michigan Credit Union League in 1985. It was updated in 1995 and is being revised now to reflect recent amendments to Article 9 of the UCC. The manual provides an overview of the intricacies of Article 9 of the UCC, the article that deals with secured transactions. This revision was prepared to provide credit unions with a summary of the current state of the UCC.

This manual is intended to assist credit unions with a general understanding of Article 9 of the Uniform Commercial Code. It is distributed with the understanding that the Michigan Credit Union League is not engaged in rendering legal advice.

DEFINITIONS

The following terms appear throughout this manual. Understanding them is an important part of understanding secured transactions law. These terms are not listed here in alphabetical order, but rather in an order designed to facilitate an easier understanding of how they fit together within the UCC.

Uniform Commercial Code (UCC) - A body of law intended to cover the entire field of general commercial transactions.

Secured Transactions - That part of the UCC addressed in Article 9, which covers the creation and perfection of security interests.

Security Interest - An interest in personal property or fixtures which secures payment of an obligation.

Collateral - The property which is subject to a security interest.

Security Agreement - The agreement which creates or provides for a security interest in collateral. **It must be in writing (or in a substitute form allowed by law), signed or otherwise authenticated by the debtor, and contain a description of the collateral.**

Debtor - Includes the borrower, all co-borrowers and cosigners (guarantors), and persons providing collateral (whether or not they are also liable for the debt).

Purchase Money Security Interest - (a) The security interest taken by a seller in something sold to secure payment of all or part of its price; or (b) the security interest taken by a lender who advances funds used by a debtor to acquire or obtain the use of the collateral ((b) applies to credit union transactions).

Financing Statement - A statement in writing (or in a substitute form allowed by law) authorized by the debtor which (a) gives the addresses of the debtor and the secured party; and (b) describes the collateral by type or item. (The term "financing statement" also includes any amendments made to the original financing statement.) This is the document that must be filed when filing is required to perfect lien status. It gives notice to the world of the credit union's security interest. The authorization by the debtor does not need to be part of the financing statement itself; it can be incorporated into the security agreement of some other document.

Certificate of Title - A certificate issued by the state that indicates ownership of a motor vehicle and certain other items of property. When ownership of an item is indicated by a certificate of title, the credit union perfects its lien by having the lien noted on the certificate of title. A financing statement is not used in this case. It should be noted that the most that a credit union can do to see that its lien is perfected is to have it noted on the application for title and, in the case of used motor vehicles, etc., noted in the appropriate place on the title itself. The credit union, after taking these steps, is actually relying on the

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Secretary of State's office to complete the process of perfection (i.e., the actual noting of the lien on the new title). Unless the credit union takes the paperwork to the Secretary of State's office itself, it is also relying on the member to get the paperwork to the state in proper form. The decision on who should deliver the paperwork to the state is a business decision. However, the credit union needs to document whatever decision is made and who made it should a loss arise (from trusting the member) and questions are asked, particularly by regulators. Often when paperwork doesn't make it to the state, it is because the member is quarreling with the seller about who is to pay the sales taxes that the Secretary of State's office will insist on collecting as part of handling the title transfer.

Attachment of Security Interest - A security interest "attaches" when (a) a security agreement has been authenticated and delivered, (b) the debtor has acquired rights in the collateral, **and** (c) value has been given by the creditor. Once a security interest "attaches," it is enforceable against the debtor. As to the priority rights between multiple secured parties, the party which files first generally has priority. For property covered by a certificate of title, the order of the listing of lienholders controls.

Perfection of Security Interest - The steps a seller or lender must take in order to perfect a security interest in collateral. Perfection is necessary to protect the lender's rights against third parties, such as other creditors. Perfection occurs when a security interest attaches **and one of the following occurs**:

- a financing statement is filed (where filing is permissive or mandatory);
- the lien is noted on the certificate of title (for items covered by certificate of title);
- the lender takes possession of the collateral (where possession is an appropriate method of perfection); or
- automatic perfection applies.

If filing or possession occurs before the security interest attaches, perfection takes place when the security interest attaches.

Automatic Perfection - A purchase money security interest is perfected without filing when the collateral is consumer goods (except generally for fixtures or vehicles, mobile homes, or watercraft for which a certificate of title is required). However, such perfection is limited and does not prevail against a consumer who purchases the goods from the borrower without actual knowledge of the outstanding security interest.

Goods - Movable, tangible personal property. "Goods" does not include money, documents, instruments, accounts, or minerals before extraction.

Consumer Goods - Goods used or bought for use primarily for personal, family, or household purposes, but only while so used.

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Equipment - Goods, other than inventory, used or bought for use primarily in a business or profession.

Fixture - Personal property which is to be attached to real estate, such as a furnace or built-in stove to be installed in a home.

Inventory - Stock in trade of a business for sale or lease. Inventory does not include "equipment."

Accessories or Accessions - Goods that are affixed to personal property, such as a radio installed in an automobile previously given as security.

Proceeds - Whatever is received when collateral is sold or exchanged, including insurance proceeds, except when it is payable to someone other than the debtor or the secured party.

Value - In addition to the usual meaning of the word, the UCC also includes a binding commitment to extend credit and a pre-existing debt within the definition of "value."

Authenticate - This term, which is new in the recent revisions, means either (1) to sign or (2) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record. By definition under the UCC, "signature" includes "any word or mark used in lieu of a written signature." The official comments to the UCC state that a signature may be "handwritten, typed, printed or made in any other manner." It is recommended, however, when signatures are used that handwritten signatures be obtained in all instances. Serious problems in proof of execution may arise if this is not done. Carbonized imprints of a signature are signatures. The second alternative in the definition is meant to accommodate electronic means of authenticating and recording transactions. If a credit union does business in such a manner in the future, it will need policies to ensure that the authentication is actually coming from the intended person and who is responsible for establishing the standards to be used for such assurance.

Lien Creditor - A creditor, or a representative of creditors, who has acquired a lien on the property involved through legal proceedings. This includes a bankruptcy trustee.

Holder in Due Course - A person who receives a note, check, or draft for value given, in good faith, without notice of any defense against it. The Federal Trade Commission has sharply restricted holder in due course rights except for checks and drafts.

Vehicles Required to be Titled - All automobiles and motor vehicles (except generally farm vehicles moved only incidentally upon a highway), mobile homes, some watercraft (see page 46 for more information on mobile homes and watercraft), and all trailers, semitrailers and pole-trailers, except those weighing less than 2,500 pounds. A certificate of title is used to indicate ownership of such vehicles.

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Secured Transactions Which Are Subject to the Uniform Commercial Code

Secured transactions which are of interest to credit unions and which are subject to the provisions of the UCC include:

- Secured transactions involving goods. "Goods" includes all things which are movable, such as furniture, jewelry, radios, TV sets, garden equipment, sports equipment, trailers, trailer homes, automobiles, trucks, farm animals, farm machinery, crops, etc.
- Secured transactions involving fixtures. "Fixtures" includes goods that are attached to real estate such as furnaces, built-in ovens, etc.
- Secured transactions involving instruments. "Instruments" includes stock certificates, bonds, promissory notes, etc.

Secured Transactions Which Are Not Affected by the Uniform Commercial Code

Secured transactions which are of interest to credit unions and which are **not** affected by the UCC's secured transactions provisions include:

- Mortgages on real estate.
- Pledges and assignments of insurance policies.
- Credit union liens on deposits and share accounts of members *to the extent that the liens are created by force of federal or state statutes.*
- Voluntary pledge arrangements by which share and deposit accounts maintained with a credit union are transferred to the credit union as security for a loan to a member.

Agreements of cosigners (guarantors) of promissory notes.

Under the UCC, a security interest is created by a "security agreement." The parties to a security agreement are always the "debtor" (the member) and the "secured party" (the credit union). The interest in collateral which is acquired by the credit union as the secured party under the terms of a security agreement is always called a "security interest."

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Classification of Collateral

In most situations the same basic rules govern all secured transactions. Special rules come into play only where the nature of the collateral makes such special rules desirable.

In order for these special rules to function where intended, collateral is broken into a number of categories. These categories are very important, and it is necessary that credit unions as lenders become accustomed to identifying secured transactions in terms of these categories so that they will recognize when special rules are applicable.

Goods, when taken as collateral, will always fall into one of the following categories:

- Consumer goods - items used or bought for use primarily for personal, family or household purposes.
- Equipment - items used or bought for use primarily in business.
- Farm products - crops, livestock or supplies used or produced in farming operations and in the possession of a debtor engaged in farming operations.
- Inventory - items held for sale or lease, or to be furnished under contracts of service, or which are raw materials, work in process or materials used or consumed in a business.
- Fixtures - items affixed to realty such as built-in stoves, furnaces, etc. Courts are notoriously unpredictable (and inconsistent) in what they regard as fixtures.

It should be noted that the category that applies depends on how a consumer actually uses the goods, not on the physical characteristics of the goods themselves. If the consumer changes his or her use of the goods, the classification of those goods may change. It is possible for goods to change categories many times, but they may be in only one category at any given time.

Instruments constitute a separate category of collateral and include stocks and bonds.

The Security Agreement

There are only four requirements which are absolutely essential to the validity of a security agreement.

- It must be in **writing or other form allowed by law** (including the names and addresses of the debtor and the secured party).
- It must be **signed or otherwise authenticated** by the debtor.
- It must grant the creditor a security interest in the debtor's property.

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- It must **describe** the collateral. If the collateral is fixtures, “as-extracted collateral” (including minerals, oil, and gas), or timber to be cut, it must also describe the relevant real estate.

Attachment of the Security Interest

The security interest attaches to the collateral in favor of the secured party when three events have occurred:

- the security agreement is **signed or otherwise authenticated by the debtor**;
- **value** is given by the secured party (i.e., the credit union disburses its loan); and
- the debtor has **ownership rights** in the collateral. In the case of a purchase money loan, the debtor will not have ownership rights in the collateral until the seller performs its obligations under the sales contract.

Once the security interest attaches, the secured party (the credit union) has rights in the collateral and can foreclose on the debtor's rights in that collateral, after a default, in full or partial satisfaction of the indebtedness.

Perfection of the Security Interest

Perfection of the security interest is the event which gives protection to the secured party against other creditors of the debtor or purchasers from the debtor. Filing or notation on a certificate of title alone is not perfection. Perfection involves **both** (a) filing or notation on a certificate of title (or some other act that legally informs the world of the creditor's rights) **and** (b) attachment of the security interest.

There can be no perfection of a security interest until the security interest has attached, although a creditor may, and if possible should, have filed or had its lien noted on a certificate of title prior to the attachment.

Perfection of the security interest can be accomplished in five different ways which are of interest to credit unions:

- By filing a financing statement.
- By notation on a certificate of title.
- By taking possession of the collateral.
- Through automatic perfection.
- By following filing or registration requirements under statutes other than the UCC, e.g.,

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aircraft.

These methods of perfection are discussed in greater detail in Section II.

Protection Given to the Perfected Security Interest

In typical credit union transactions, a properly perfected security interest in goods (other than fixtures) will be protected against anyone who later purchases the goods from the debtor. Exceptions to this general rule in the case of automatic perfection are discussed on page 22.

A properly perfected purchase money security interest is superior to and will prevail over a perfected non-purchase money security interest in the same collateral, even though a financing statement covering the non-purchase money security interest was filed first.

A properly perfected security interest will take priority over the claims of general creditors and of subsequent lien creditors, including a trustee in bankruptcy, except in the case of certain non-purchase money security interests.

In the case of a conflict between two perfected, non-purchase money security interests, the following rule applies:

Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

Note: To be fully protected, the credit union must perfect its security interest within 20 days after making the loan to the debtor. Otherwise, other creditors may gain superior rights, or the security interest might be lost in a bankruptcy proceeding.

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SECTION I SELF TEST

1. True Mortgages are secured transactions which are covered by Article 9
 False of the UCC.

2. True Although goods may change from one category to another, they
 False may be classified in only one category at any given time.

3. True In order to perfect a security interest, it is not necessary that the
 False security interest attach.

4. True A properly perfected purchase money security interest is superior to
 False perfected non-purchase money security interest in the same collateral,
unless the financing statement covering the non-purchase money
security interest was filed first.

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ANSWERS

1. False
2. True
3. False
4. False

Security Interest Concepts -- Some Basic Considerations

Under the law, credit unions obtain their security interests in goods through the execution of a "security agreement." The security interest is usually perfected through notation on a certificate of title or the filing of a financing statement, whichever is specified by the law concerning the collateral involved.

A financing statement can be filed **before** the execution of the security agreement. Because of this, credit unions should keep two key concepts in mind:

- When filing of a financing statement is necessary, perfection of the security interest will occur **either** upon the filing of the financing statement or attachment, **whichever occurs last**; and
- Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, **whichever is earlier**.

Procedures Prior to Closing

Filing

Under the UCC, filing may precede the making of the loan. Since the time of filing can determine the priority of security interests (except purchase money security interests), this is an important consideration. Credit unions should complete filing requirements as early as possible on all non-purchase money loans. (For a further discussion on when to file financing statements, see page 29).

Searches

Since a financing statement once filed may be kept effective indefinitely and can be used by a creditor on future loans without any new filings, it is important to determine whether there are outstanding financing statements covering the collateral that the credit union plans on taking as security.

A credit union making a secured loan -- even though it files at the earliest possible moment -- may be faced with the predicament of ending up with a secondary security interest unless it protects itself. This is true even though the borrower was not then indebted to the lender who would later claim a prior (superior) security interest in the collateral.

This could happen under the following circumstances: Suppose a member had previously received a loan secured by his stereo system from a finance company. The loan had been repaid prior to the time of the credit union loan, but the *financing statement had not been terminated*. After the credit union lends money to its member (taking a security interest in the stereo), the borrower receives another loan from the finance company secured by the same collateral, but under the previously filed financing statement. Since the priority of security interest dates back to the date of filing, the finance company would have a prior

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security interest.

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This could also happen if the member purchased the collateral from another consumer, and a financing statement covering the goods had been filed by the seller. If a member purchases collateral second hand, the credit union must do a search on the seller as well as on the member. This search must be done based on the seller's residence.

If the credit union conducts a search and learns of an outstanding financing statement, it could insist that its borrower make a demand for a termination of the outstanding financing statement. Once the termination statement has been received and filed, the credit union will be protected.

It may not be safe for a credit union to make a secured loan between the time that a demand for a termination statement is made and it is received, even though the law requires that the termination statement be given within 10 days of receipt of the demand.

There is some danger in proceeding on the assumption that a termination statement will be received. It is possible that after the credit union has made a loan to the borrower and forwarded the borrower's request for a termination statement to the finance company, the borrower could go to the finance company and request a new loan. At the same time he or she could advise the finance company to disregard the request for a termination statement. In such a situation, the credit union would end up with a secondary security interest in the collateral.

A search will not be necessary when a purchase money security interest is obtained by the credit union, provided that the borrower purchased the collateral from a person (other than a pawnbroker) regularly engaged in the business of selling such goods.

On all consumer goods (except vehicles required to be titled) and farm crops, farm equipment and farm accounts, the search will have to be made both (1) in the office of the Register of Deeds in the county where the debtor resides or has resided during the previous five years, or, if the debtor doesn't live in Michigan, then in the county where the goods are kept (in the case of farm crops, the search must be made in the county in which the land on which the crops are grown is located), and (2) at the Secretary of State's office or, if the debtor doesn't reside in Michigan, at the appropriate filing location for the state of the debtor's residence. This seems like duplication. However, financing statements filed under the old (pre-July 1, 2001) version of Article 9 can be valid for as long as five years (or until July 1, 2006). Therefore, until July 2006, a search will need to be made for potential pre-July 2001 filings as well as for filings made in July 2001 or afterward.

On vehicles required to be titled, the search consists of an examination of the certificate of title, if it is available. If no security interest is shown on the certificate, the vehicle should be free of any security interest. If a security interest is shown on behalf of another creditor, any loan by that creditor and secured by the vehicle will have priority over the credit union's loan. Therefore, the credit union should have such security interests terminated prior to making its loan if it is relying on a first lien on the vehicle as security.

If the certificate is not available, the credit union can call the Michigan Secretary of State's office, Record Services Division, to see if there are any outstanding security interests. However, this will not allow the credit union to be absolutely sure there are no outstanding

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liens since one may have recently been filed but not yet processed. For more information on the search process, see page 35.

Vehicle Purchases

If the member is purchasing a vehicle with loan proceeds, the credit union may not have the certificate of title available for examination. This is especially true with new car sales. In this case, the credit union will have to take the application for title to the Secretary of State's office itself, or rely on someone else, such as the selling dealer, to make sure that the credit union's lien is noted. The dealer is obligated to do so only if the credit union (a) pays the dealer a fee not to exceed \$10.¹, and (b) places the following stamp on the back of the loan check (which will show the member and the dealer as payees):

Under Michigan law, the Seller must record a first lien in favor of (*name of credit union*) on the vehicle with vehicle identification number _____ and title the vehicle only in the name(s) shown on the reverse side.

The fee is best paid by adding the fee to the total check and putting a note on the front of the check as follows: "\$8,000.00 (for example) purchase price of car, \$1.00 lien placement fee." If a separate check is used, it is more likely to be returned or lost and the dealer will not be obligated to record the lien. If the credit union fails to either pay the fee or use the required wording, the dealer will be under no obligation to properly place the credit union's lien.

The credit union must also note the name(s) of all prospective owners of the vehicle on the front of the check. This will ensure that only person(s) who signed the security agreement will be listed as owners on the car title. If the check is not made payable to all prospective owners of the vehicle, the name of any owner to whom the check is not payable should be noted on the front of the check in the memo section.

Protecting against Danger of Outstanding Security Interest in Consumer Goods Perfected Automatically

A sale of consumer goods to a consumer and a loan to a consumer for the purpose of acquisition of consumer goods can result in a purchase money security interest perfected **without** filing (i.e., **automatic perfection**), except when the collateral is a vehicle, motor home, or watercraft requiring a title, or when the collateral is fixtures. There is no foolproof way to determine such outstanding interests. It is suggested on secured loan transactions where there is a possibility of such an outstanding security interest that the borrower be

¹ The payment of a fee as small as \$1.00 is sufficient unless the dealer requests more. The dealer may not request a fee greater than \$10.00.

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carefully questioned to determine whether he or she purchased the collateral on installments or borrowed the money to purchase the collateral. If so, the credit union should determine whether the seller or lender has been paid in full. If not, the credit union may wish to have the member put the answer in writing.

The Security Agreement

No particular form is prescribed by the UCC for the security agreement. Several forms of security agreements (such as MICH 821 and MICH 552-A) have been prepared by MCUL for credit union use, and are available through CUcorp.

Security Agreement Used as a Financing Statement

If a copy of the security agreement is to be filed as a financing statement, it must satisfy all the requirements of a financing statement (please refer to the definition of financing statement on page 2). If it does, it will, in fact, be a financing statement and should be referred to as such when so used.

Credit Unions Should Use the Financing Statement as the Filing Instrument

Because of the nature of credit union operations, it is recommended that credit unions use the financing statement as the filing document. A financing statement is good for five years and can be renewed for successive five-year periods indefinitely.

Credit unions often use the same collateral for refinanced or new loans to the same borrower. The financing statement can be amended to add or subtract collateral. Once the financing statement is on file and provided it has not expired, it can serve as the filed document, not only for the original loan transaction, but for future advances, new loan transactions or refinancing of an old loan. Where the same security is used, no new financing statement need be filed for such successive transactions.

For practical reasons, the UCC provisions have been devised so that a financing statement can, in most instances, be prepared and executed **before** the necessary information as to identity of collateral is available for preparation of the security agreement. This is so because the UCC specifies that the description shall **reasonably** identify the collateral. In situations where thousands of identical items are sold, it is best to identify the particular item given as security by reference to its manufacturer and serial number. Even if this information is not available at the time the debtor first makes his or her application for a loan, the credit union can still prepare a financing statement, since it is only necessary to indicate the type or describe the items of collateral -- exact identification is not required.

The most important reason for using the financing statement as the filing instrument is that it can be obtained at the time of the application for the loan and filed immediately. When the credit union completes the transaction (i.e., executes the security agreement and

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disburses the loan), the priority of its lien will date back to the date of filing of the financing statement. This early filing may become of vital importance because it may provide precedence over other liens obtained through statute or legal proceedings by creditors, and is of special importance in the event of the later bankruptcy of the debtor.

Furthermore, when a credit union files its financing statement, it can, at the same time, request a search of records from the Register of Deeds or the Secretary of State concerning other liens affecting the debtor's property. If the search shows reasons for rejecting the application, the loan need not be made and the financing statement can be terminated.

It should be noted that Michigan law requires all financing statements and lien notations on certificates of title to be terminated within one month (or within 10 days after demand) if the debtor owes no money and the credit union has no commitment requiring it to make a future loan. Reasonably expecting to make future loans is no longer enough to justify not terminating a financing statement. This is designed to reduce the volume of obsolete records held by government officials. For financing statements, the termination must be sent by the credit union directly to the filing officer. For motor vehicles, the termination papers are to be sent to the debtor.

Rights of the Credit Union Under the MCUL's Standard Security Agreement (for Closed-end Loans) and Permanent Security Agreement (for Open-end Loans)

The standard MCUL Security Agreement (part of MICH 821) and the "specific advance" Security Agreement (MICH 552-A) contain provisions on the reverse side spelling out rights of the credit union and obligations of the debtor-member. The agreements are discussed here together because their provisions concerning rights and obligations are virtually identical. Key provisions include the following:

- **Listing of an address of the debtor where notices are to be sent:** This relieves the credit union of the duty of "finding" a debtor after default in order to foreclose on collateral. This is particularly important where a cosigner or another person provided the collateral, and the principal debtor's whereabouts cannot be immediately determined after default. This provision allows the credit union to satisfy UCC notice requirements by sending the notice to the listed address. Of course, if the member has notified the credit union of a change of address, it must use the new address in its notices, etc. In a number of instances, the UCC provides for notice to be given. Whenever it does, to be safe, a separate notice (separately mailed) should be given to each debtor party whether he or she borrowed the money, acted as cosigner, or provided the security.
- **Representation by debtor for use of goods:** Many of the distinctions made by the UCC regarding rights and remedies depend upon the use by the debtor of the goods given as security. The agreement, therefore, includes a representation by the debtor of his/her use of the collateral upon which the credit union can rely.

For example, suppose a debtor pledges a set of tools to a credit union. The credit union does not know that the borrower uses the tools on his/her job, but assumes that the collateral is used in a home workshop. The credit union assumes the goods are consumer goods. In fact they are equipment, and different procedures after default may apply. If the credit union decided not to file because it had a purchase money interest in what it considered consumer goods, the result could be disastrous, since filing is required to perfect a purchase money security interest in equipment (tools used on the job), but not in consumer goods.

Another creditor might later obtain a perfected security interest or a lien on the tools which would be superior to the credit union's security interest. If the credit union had known that the security was equipment, it could have protected itself by filing a financing statement to perfect its security interest.

- **Provision making sale of collateral without written consent of credit union an event of default:** This provision is most appropriate to credit union transactions since credit unions intend to deal only with their members. The UCC provides that a creditor cannot prohibit a sale of collateral subject to the security interest, but it recognizes the right of the creditor to make such a condition an event of default -- thus, in effect, providing for an immediate maturity of the loan with the resulting right to proceed against the collateral if the debtor doesn't immediately pay the loan in full.
- **Place for keeping of collateral:** The security agreement contains a provision requiring the debtor to keep the collateral in a particular place. When the collateral is consumer goods, it is intended that the place to be designated will be the residence of the debtor. The provision further states that if the debtor has removed the goods to another place without the written consent of the credit union, the credit union may immediately declare the entire debt due and payable. This is intended primarily to prevent a debtor from removing the collateral to another state or, in the event that he or she does so without consent, to give the credit union the right to proceed against the collateral at the time of discovery -- before other creditors may obtain superior interests in it. Of course, with motor vehicles, the object is to prevent permanent removal, not vacation use, etc.
- **Right to inspect collateral -- duty to maintain and abuse of collateral:** On many loans made by credit unions, the value of the collateral depreciates faster than the loan is amortized. Thus it is important to protect against the borrower who abuses the collateral because he or she has no "equity" in the deal. For this reason, the credit union has the right to inspect the collateral. The debtor has been placed under a duty to properly maintain the collateral and breach of the duty has been made an event of default.
- **Evidence that the lien has been placed on the certificate of title -- vehicles required to be licensed:** The law requires that the security interest be included in the

application for certificate of title filed with the Secretary of State, so that it will be shown on the certificate of title.

Since the credit union does not always control the making of the application for certificate of title, a clause has been included in the security agreement requiring the debtor to procure the endorsement of the security interest of the credit union on the certificate of title. Failure to do so in the time reasonably necessary to obtain the certificate of title from the Secretary of State constitutes an event of default and gives the credit union the right to proceed against the security at an early date. Of course, relying on the debtor can lead to practical problems, and might result in another creditor gaining rights superior to the credit union's. If loss of rights is a significant concern, the credit union should not rely on the debtor to get the necessary paperwork into the hands of the Secretary of State; the credit union should handle the paperwork itself.

- **Clause protecting debtor who supplies security as accommodation for principal debtor:** Since the definition of "Debtor" under the UCC includes a person who supplies collateral as accommodation for a borrower, that person is required to sign the security agreement as a debtor. It has, therefore, been considered advisable to include a provision in the agreement recognizing that such a debtor is not liable for the debt or for any deficiency after resale of the collateral. *THIS WOULD NOT APPLY WHERE SUCH DEBTOR IS ALSO A COSIGNER. IN SUCH CASE, THE COSIGNER WILL ALSO BE LIABLE FOR THE DEBT AND ANY DEFICIENCY.*
- **Clause protecting against outstanding liens and security interests:** The security agreement contains warranties (i.e., promises) that:
 - the collateral is free of liens, other security interests, or encumbrances; and
 - there is no unpaid balance of principal or interest owing on the purchase price of the collateral, or for any money loaned for the acquisition of the collateral.

The falsity of either of these warranties is made an event of default.

The second clause above has been made necessary by the provisions of the UCC which give a purchase money security interest in consumer goods the status of perfection without filing. The credit union cannot discover such outstanding interests through a search of records.

These warranties provide some measure of protection since they enable the credit union to declare a loan in default if the representations are untrue. Furthermore, if the borrower should later become a bankrupt, the credit union could claim that the loan should not be discharged because of the borrower's false statements that the collateral given to secure the loan was free of liens and security interests.

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Other provisions of the security agreement: There are other provisions of the security agreement which provide additional protection for the credit union and define the rights of the parties, but which are not discussed here because they are self-explanatory.

Whether or not MCUL forms are used, the security agreement should be read with care by all credit unions so that its provisions may be used as operational tools.

Financing Statement Forms

There are five basic UCC financing statement forms that credit unions can utilize. These forms, which are available from CUcorp, are referred to as UCC-1, UCC-1Ad, UCC-3, UCC-3Ad, and UCC-11. The use of each one is explained below.

UCC-1 Financing Statement

This is the regular financing statement. It is the one that the credit union will file most of the time when it takes personal property (other than vehicles required to be titled) as security for a loan. It applies to all such security except fixtures, timber, and as-extracted collateral.

UCC-1Ad Financing Statement Addendum (Fixtures, Timber, As-Extracted Colateral)

There are two basic reasons to use a UCC-1Ad Addendum. The first use is to add additional names or information to a UCC-1. The second, and probably more common for credit unions is the use of the UCC-1Ad as an attached addendum to UCC-1 when the collateral for the loan is fixtures, timber, or as-extracted collateral. There are several items that must be noted by the credit union on the face of the UCC-1Ad to make it work as intended for use with these types of collateral. Note the following discussion for more detail.

If a credit union makes a loan secured by timber, or as-extracted collateral, the UCC-1Ad financing statement must show that it covers this type of collateral, must contain a description of the land where the timber or crops are growing or minerals are located, and must contain a recital that the financing statement is to be recorded in the **real estate** records of the county in which the land is located. In addition, if the debtor does not own the land, the financing statement must include the name of the record owner of the land.

When a credit union takes a security interest in fixtures, it must do a "fixture filing." A "fixture filing" is a recording of a financing statement UCC-1 with UCC-1Ad Addendum attached covering goods that are, or will become, part of real estate. This recording is

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done in the **real estate** records of the Register of Deeds for the county in which the real estate is located. When used for a fixture filing, the financing statement must:

- indicate that the collateral is goods which are, or which will become, part of land;
- describe the land to which the goods will be affixed; and
- indicate that the financing statement is to be recorded in the real estate records of the county where the land is located. If the debtor does not have a recorded interest in the land, the financing statement must show the name of the record owner of the land.

*NOTE: As was mentioned earlier, the courts are not clear on what exactly is a fixture and what isn't. If a credit union believes something is (or may become) a fixture, it should file **both** a UCC-1 alone (with the Secretary of State, as if the collateral wasn't a fixture) and a UCC-1 with UCC-1Ad (with the Register of Deeds as if the collateral was a fixture). Such a dual filing is the only way to be sure that the credit union's security interest is perfected.*

Refer to Appendix A for further discussion of some of the problems associated with fixtures.

Real Estate Descriptions: Since UCC-1 financing statements with UCC-1Ad addenda must be recorded in the Register of Deeds' real estate records, the description of the real estate that is required to be inserted in the UCC-1Ad form must be at least as good as a description to be used in a real estate mortgage. Therefore the credit union will have to use legal descriptions rather than mailing addresses.

For example, if a credit union does a fixture filing relating to a mobile home, or does a filing on a loan secured by crops, the description of the land cannot be "589 Merriweather Road, Oshkosh, Michigan." It has to be something like "North 200 feet of the N.W. ¼ of the N.E. ¼ of the S.W. ¼ of Section 25, Town 6 North, Range 14 West, Deerpath Township, Osceola County, Michigan." Or, sometimes, it will have to be a metes and bounds description (for example: "a parcel of land beginning at the East quarter-corner of Section 25, T. 6 N., R. 14 @., Deerpath Township, Osceola County, Michigan; thence South 200 feet; thence West 100 feet; thence North 200 feet; thence East 100 feet to the point of beginning").

For another example, if the credit union did a fixture filing on a new furnace going into a member's home in a city, it would **not** use "123 Americana Drive, Southfield, Michigan."

Rather, it would use something like "Lot 88, Bergengren Sub. No. 1, according to plat recorded in Liber 88, Page 108, Plats, Oakland County Records." The credit union can obtain a correct legal description from the member's deed or from a mortgage on the real estate. Sometimes (but not always) the description on a tax bill covering the real estate will be accurate enough. In any event, the borrower will have to provide the correct description.

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Credit unions which have had experience in making loans secured by real estate mortgages won't find this requirement confusing. But those which have only rarely done real estate lending may need to get some practice on reading and writing legal descriptions of real estate to ensure that they complete UCC-1Ad forms correctly.

The space allowed in the UCC-1Ad form for the real estate description is somewhat small. So in some cases the credit union will have to type it on a separate sheet and fill in the blank on UCC-1Ad with words such as "See legal description on attached sheet."

UCC-3 Statement (Amendments, Continuations, and Terminations)

The UCC-3 is used by credit unions to amend a financing statement (UCC-1 or UCC-1 With UCC-1Ad) which is already on file. It can be used:

- to continue the security interest (beyond the 5-year expiration point);
- to assign the security interest, if the credit union sells the loan secured by it to someone else;
- to terminate the security interest;
- to amend the financing statement to add new collateral (for such new collateral, the "date of filing" will be the date the amendment is filed); and
- to release some of the collateral described in the original statement from the credit union's lien.

A single UCC-3 form can be used to do more than one of these things.

Due to the change in the law, however, continuing or amending a financial statement filed with a Register of Deeds Office covering farm products, farm equipment, or consumer goods requires a different procedure. For those situations, the credit union must file a new financing statement with the Secretary of State. This financing statement should make reference to the earlier filing with the Register of Deeds with enough information to locate the earlier filing. Further continuations will need to be filed with the Secretary of State based on the filing date of the new financing statement. The Michigan Secretary of State's Office refers to the new financing statement filings that in essence "move" the filing from being a local one to being one at the Michigan Secretary of State's office as "In Lieu Of" (ILO) filings. The following comments, based on information from the Secretary of State's Office is provided to guide credit unions with ILO filings:

“IN LIEU OF” FILINGS

An "in lieu of" (ILO) filing addresses moving a filing from a Register of Deeds office under old Article 9 to the state UCC office as required by Revised

Article 9. There is no special “in lieu of” financing statement form. In Michigan the "state UCC office" is the Michigan Secretary of State's office. If another state is involved, the credit union will need to determine the appropriate office. The “in lieu of” filing is submitted on a UCC1 Financing Statement form and is properly filed at the state UCC office. The law involved provides that an initial financing statement may be filed in place of a continuation statement.

GUIDELINES FOR “IN LIEU OF” (ILO) FINANCING STATEMENTS

1. The secured party completes a National UCC1 Financing Statement form with the current information for debtor, secured party and collateral according to the standard instructions.
2. In addition to the standard filing information, an ILO financing statement requires special continuation wording as follows (or similar) in box #4 of the UCC-1 form.

Option A – Attaching Copies of Filings: If attaching copies of the financing statement(s), include the following wording in box #4:

“This financing statement is filed ‘in lieu of’ a continuation statement. The financing statement(s) attached remain(s) effective.”

Attach copies of the original financing statement(s) and any later action financing statement(s).

Option B – Listing Filings: If filings are listed, include the following wording in box #4:

“This financing statement is filed ‘in lieu of’ a continuation statement. The financing statement(s) listed below remain(s) effective.”

List the information for the original financing statement(s) and all later action statement(s) including the state, the office in which the financing statement(s) was filed, type of filing(s) (i.e., continuation, amendment), date(s) of filing, and file number(s).

3. An ILO filing may list multiple original financing statements and corresponding later action statements for a given debtor.

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4. If the amount of the loan involved warrants, the credit union should determine in consultation with its legal counsel whether an "in lieu of" financing statement is needed. It may also want to secure some general guidance from its attorney on the subject.

UCC 3Ad Financing Statement Amendment Addendum

This form is used as an addendum to add to a UCC-3 to add additional names or information to a financing statement filing.

UCC-11 Search Request

A credit union can use this form to request that the filing officer tell the credit union about other financing statements that have been filed regarding its member. Credit unions can obtain this form through the CUcorp Supply division at 1-800-262-6285, extension 295. If there is any possibility that the debtor (or other party whose records are being searched) acquired the property before July 1, 2001, the credit union will need to search both with the office where a filing would be required to be made after July 1, 2001 and where a filing would have been required to have been made before July 1, 2001.

The Superiority of the Purchase Money Loan Transaction

Priority of the Security Interest

In practically every instance where goods are purchased from a dealer, a credit union **purchase money loan transaction** will insure that the credit union obtains a security interest in the collateral superior to the claims of any other person. Other creditors whose security interests are perfected and filed prior to perfection and filing of the credit union's purchase money security interest will nevertheless be subordinate to the credit union's security interest.

When the goods are not purchased from a dealer, the sale will probably not be in the "ordinary course of business" as defined by the UCC, and the security interest acquired will, therefore, be subject to security interests previously perfected, which were created by prior owners.

Grace Period on Filing - Automatic Perfection

It is important to remember that a credit union loan for the purchase of consumer goods is **perfected without filing**, except for vehicles, mobile homes and watercraft requiring certificates of title, and fixtures, *provided these goods are the only goods used as collateral for the loan*. This is an additional advantage given by the UCC. If the requirements are met, the credit union will be assured of a perfected prior interest in the collateral as soon as the borrower acquires the collateral.

It is equally important to remember (for consumer goods) the **exceptions to automatic perfection**. These are:

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- vehicles, mobile homes and watercraft where notation on the certificate of title is required, and
- fixtures.

The UCC provides that the secured party (credit union) may have 20 days after the debtor comes into possession of the collateral to perfect its purchase money security interest (by filing or notation, as appropriate) in such collateral.

Therefore, the credit union is provided with the opportunity, where filing is required, to perfect its security interest **after** the loan is made without affecting the priority of its security interest.

Many credit unions have established procedures that enable them to disburse a loan within a short time after the application is made. In many instances, there will not be sufficient opportunity to complete filing of the financial statement before the debtor acquires ownership of the collateral. If it were not for the grace-period-in-filing provision, an opportunity would be afforded for another person to acquire a superior security interest in the collateral.

Insuring That the Credit Union's Loan is Protected by a Purchase Money Security Interest

In order for a credit union to obtain a purchase money security interest in collateral, the proceeds of the loan must actually be used for the purpose of acquiring (purchasing) the collateral.

A purchase money security interest in consumer goods provides two advantages: (a) a priority over other security interests in the same collateral; and (b) the privilege of not having to file to perfect the security interest (except in the case of vehicles, mobile homes and watercraft requiring certificates of title and fixtures, where filing is required).

Purchase money security interests in other collateral (e.g., equipment) have the priority of status described in "a," but not the privilege of non-filing described in "b" above.

The importance of having a purchase money security interest is better appreciated when considered in context with the nature of the collateral credit unions usually obtain.

Many secured loans which credit unions make that are secured by personal property are secured by personal, family or household goods -- in other words, by consumer goods.

In this category fall such types of security as household furniture, automobiles, house trailers, utility and boat trailers, jewelry, works of art, appliances, television sets, radios and stereo equipment, garden tractors, mowers and other garden equipment, musical instruments, cameras and projectors, tools for hobby purchases or home use, books, guns and other sporting equipment, etc.

*NOTE: The Credit Practices Rule, issued by the Federal Trade Commission effective March 1, 1985, made **non**-purchase money security interests in many household goods illegal. In the rule, "household goods" means clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects of the consumer and his or her dependents. The term "household goods" does **not** include works of art, electronic entertainment equipment (other than one radio and one TV), items acquired as antiques, and jewelry (other than wedding rings). The rule does not prevent a credit union from taking a purchase money security interest in any household goods.*

As an additional precaution, many credit unions place a special endorsement on their checks restricting the use of the funds to the purchase of the goods specified in the endorsement. Under such circumstances, if the payee (other than the credit union member) permits the use of the funds for some other purpose, he or she may be liable to the credit union for fraud.

These precautions are supplemented by a clause in the security agreement which gives the credit union the right to declare a loan in default if the proceeds of the loan were not, in fact, used for the acquisition of the specified collateral.

When a Loan for the Acquisition of Collateral May Not be Considered a Purchase Money Loan -- Refinancing, Consolidation, and Future Advances

Because of the importance of the status of purchase money security interests for priority and bankruptcy law purposes, it is important to know when a loan advanced for the acquisition of collateral may not qualify as a purchase money loan, and when a purchase money security interest may lose its identity as such.

Future Advances -- Original Loan a Purchase Money Loan

- Future advance -- secured by same collateral:
 - **Loan consolidation; new note issued covering new advance and old balance:** When this is done in a consumer transaction, the loan will no longer be a purchase money loan and the credit union will no longer have a purchase money security interest in the collateral. This refinancing will have the same effect as a new loan that is not given for the purpose of acquisition of collateral.

It will, therefore, be important to determine whether another security interest has attached to the collateral that will take priority over the credit union's security interest. *If the credit union filed its financing statement when it made the original loan, there will be no priority problem since its priority will date back to the filing date. The same is true for notations on a certificate of title.*

If the credit union did not file, but depended on automatic perfection of its

security interest, it will have to determine whether a financing statement affecting the same collateral has been filed by another lender which would become superior once the credit union loses its purchase money status.

For non-consumer transactions, the purchase money status may be retained for at least part of the balance. The drafting of the note, including provisions dealing with allocation of payments, will be very important in such loans.

- **Loan not consolidated; new note issued covering only future advance as separate loan:** When this is done, each loan will be treated as a separate loan and the original loan will retain its status as a purchase money loan. The credit union will retain its purchase money security interest on the balance due on the first note.

If the credit union on the first loan depended on automatic perfection of its purchase money security interest and did not file a financing statement, it will be necessary to determine whether a financing statement covering the same collateral was previously filed giving another creditor a prior security interest in the collateral over the second loan.

It is important (from the standpoint of establishing credit union procedure) to remember that had the financing statement been filed originally, the priority of the credit union's second loan would date back to the time of original filing. In other words, even if a credit union's security interest can be perfected without filing, it may be a good idea to file (for a further discussion of this issue, refer to page 27).

- Future advance -- new consumer goods added:
 - **Loan consolidated; new note issued covering old balance and new advance:** This transaction will not be treated as a purchase money loan either as to the old or new collateral.

Credit unions must, therefore, determine whether there are any outstanding security interests covering the old collateral and the new collateral at the time the new advance is made. If a financing statement was filed, this determination need be made only for the new collateral.

It should also be noted that the credit union will lose its security interest in household goods in a bankruptcy proceeding if its security interest has lost the purchase money status. Because of this, it may be better to book the new advance as a separate loan.

NOTE: When open-end lending is used, treat each advance as a separate balance (i.e., don't consolidate them) to preserve the purchase money status of each advance.

Where the loans are not consolidated, the problem of reducing the member's

payment (which is ordinarily accomplished through loan consolidation) can be handled through a reduction in payments on the original note by granting an extension agreement, provided the credit union's member qualifies for an extension under the credit union's loan policies.

- **New note issued covering new advance; loan not consolidated:** This method of handling the transaction has definite legal advantages. The character of the original loan will retain its status and the danger of loss of priority of the security interest in the collateral will be avoided.

The new loan can be secured by the new collateral and the old, in which event it should not be treated as a purchase money security advance.

If the new collateral is adequate to secure the new advance, then the transaction can be treated as a purchase money advance as long as the collateral for the new loan is limited to the newly acquired collateral.

Where the loans are not consolidated, the problem of reducing the member's payments (which is ordinarily accomplished through loan consolidation) can be handled through a reduction in payments on the original note by granting an extension agreement, provided the credit union's member qualifies for an extension under the credit union's loan policies.

Security Interest in Fixtures

This is a highly complicated area of the UCC. The following guidelines should be followed by credit unions in making loans secured by fixtures as collateral. In addition, see Appendix A - Mobile Home and Fixture Problems.

Where the Borrower is the Only Person With an Interest in the Real Estate

In the case where the borrower is the owner of record of the real estate, and there are no outstanding mortgages or land contracts, it is preferable to use a real estate loan and not a loan secured by fixtures. This is especially true where the member borrows a substantial amount of money.

Where There are Other Outstanding Interests

If there are other outstanding interests in the realty besides the borrower's interest (as in the case where the borrower is purchasing on a land contract, or the borrower owns the property subject to a mortgage), the credit union should be sure that (a) the loan qualifies as a purchase money advance, i.e., that the funds are used for the purpose of acquiring

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the fixtures, and (b) the financing statement is filed **before** the fixtures are attached to the realty. Given the uncertainty surrounding fixtures, both a UCC-1 (alone) and a UCC-1 with UCC-1Ad addendum attached should be filed with the Secretary of State and appropriate Register of Deeds respectively.

If these precautions are taken, the credit union in practically every instance will have an interest which takes priority over the claims of all persons who have an interest in the real estate. Note however, that the credit union would have to reimburse any party (other than the debtor) with an interest in the real estate for any physical injury to the real estate (or structures, etc. thereon) due to the removal. If the credit union does not hold a mortgage on the real estate, chances are someone else will, and this is the most likely circumstance will give rise to the duty to reimburse for damage. The credit union does not have to reimburse for loss of value caused by the removal of the fixture.

If the credit union does not enjoy such priority of interest, it cannot remove the fixtures from the real estate after default and, therefore, for all practical purposes, its security interest is valueless.

If the loan is not a purchase money advance, or the financing statement cannot be filed within the grace period and prior to the time the fixtures are attached to the realty, the credit union must obtain a written consent to the credit union's security interest, or a written disclaimer of any interest in the goods or fixtures, by all persons having an interest in the realty at the time of filing.

Purchase Money Security Interest in Consumer Goods -- Should the Credit Union File a Financing Statement?

Although a purchase money security interest in consumer goods may be automatically perfected without filing, *it does not provide priority over the interest of a second consumer purchaser who acquires the goods without knowledge of the credit union's security interest.*

If the goods are sold (or traded) by the borrower to another consumer who has no knowledge of the credit union's interest, **that purchaser will obtain an interest in the collateral superior to the credit union's security interest** if the credit union has not filed.

If the security interest is perfected through filing, then the credit union's interest will be superior to the interest of the subsequent consumer purchaser.

Another advantage of filing has been made apparent in the preceding discussion on refinancing and consolidation of loans (see pages 24 and 25). If the items of collateral are

of a type which a credit union member can be expected to retain over a period of time during which he or she would ordinarily be expected to borrow additional funds, then there is definite advantage to perfecting by filing.

Filing in all cases has the added advantage of providing a uniform treatment for perfecting interests in tangible goods. It also eliminates the risk of non-compliance with UCC provisions necessary to obtain the status for automatic perfection.

Non-Filing Insurance

Many credit unions' bonding coverage includes non-filing insurance. It is important to remember that non-filing insurance protects only against loss resulting from the failure to file a document when filing is required. The credit union must, therefore, have a properly executed security agreement. A credit union should also check to see if its insurance company requires any additional documents, such as a properly completed (though not filed) financing statement. Credit unions using non-filing insurance should review it periodically to see if they would be better off using the filing procedures.

If a credit union decides to depend on its purchase money security interest in consumer goods as being perfected without filing, non-filing insurance in the case of such goods will not be necessary. However, even for those categories of goods where filing isn't required for perfection, filing (or non-filing insurance) will give the credit union greater protection.

Credit unions should bear in mind that both the NCUA and the OFIS (Michigan's Office of Financial and Insurance Services, formerly the FIB) have taken the position that credit unions are required to perfect their security interests or obtain non-filing insurance.

Summary of the Methods of Perfection of a Security Interest

A security interest may be perfected:

- by filing a financing statement;
- by having a lien noted on a certificate of title;
- by filing a registration under statutes other than the UCC (e.g., copyrights, aircraft, etc.);
- by the secured party taking possession of the collateral (e.g., pledge of stock) (some exceptions are stated below); or
- without any action being taken by the secured party to perfect (e.g., automatic perfection when the creditor takes a purchase money security interest in consumer goods).

Perfection of a Security Interest by Filing a Financing Statement

- A financing statement must be filed to perfect a security interest in the following types of collateral:
 - Fixtures. Filing is mandatory.
 - Goods which were not purchased with the proceeds of the loan, unless there is a certificate of title issued for the goods or the credit union takes possession of the goods.
- Filing a financing statement is **not** effective to perfect a security interest in the following types of collateral:
 - Money or instruments, i.e., stocks, bonds, certificates of deposit, or other types of investment securities (possession of the pledged items perfects these security interests.) In the case of certificates of deposit, it is important to get the issuer's assurance that it has no claim and agrees to be subject to the credit union's rights.
 - Property subject to a statute of the United States that provides for national registration or filing of all security interests in such property, i.e., copyrights, aircraft, watercraft registered under federal law.
 - Pledge of credit union shares.
 - Vehicles, mobile homes or watercraft subject to certificate of title requirements.

Mechanics of Perfection by Filing a Financing Statement

- **Where** to file a financing statement:
 - If the collateral is goods which are, or are to become, fixtures, or is timber or as-extracted collateral, file in the office of the Register of Deeds where a mortgage on the real estate concerned would be filed or recorded.
 - In all other cases, filing is required with the Secretary of State.
- **When** to file the financing statement:
 - Under the "notice filing" concept, a financing statement can be filed at any time. It can even be filed before the security agreement is made or the security interest attaches. With regard to any purchase money security interest, filing a financing statement within 20 days after the collateral comes into the

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possession of the debtor gives priority over other financing statements covering the same collateral and over the rights of a lien creditor which arise between the time the security interest attaches and the time of filing.

Termination and Continuation of Security Interest

- The credit union must terminate all security interests in the property of a member within one (1) month (30 days for titled vehicles) whenever there is no longer any outstanding secured obligation and no commitment by the credit union to give further value. Note that the credit union no longer has the option of keeping a security interest on file for any type of consumer goods if it reasonably expects to make future advances – The provision of the old law allowing this in the case of security interests perfected through financing statements has been dropped from the law as part of the revisions to Article 9. The debtor may make written demand upon the credit union for a termination statement, and if the debtor does so and there is no secured indebtedness outstanding at the time, the credit union must comply within 10 days (20 days if a financing statement was used to perfect the security interest). Whether or not the consumer debtor makes a request for the security interest to be terminated, if a secured party is obligated to terminate the security interest and fails to do so, it will be liable to the debtor for FIVE HUNDRED DOLLARS PLUS ANY LOSS TO THE DEBTOR CAUSED BY THE FAILURE TO TERMINATE. Actual damages could, for example, arise if the debtor seeks a loan from someone else, the credit union's loan has been paid in full but the security interest is still in place, and taking care of the termination after the debtor discovers the situation causes a delay in his/her obtaining the new loan (especially if rates go up during the period of delay). The requirement to cancel liens when there is no balance owing (note this must be done even if the secured plan, such as line of credit or revolving credit, remains open) isn't as much of a disadvantage as it seems, since the Secretary of State's office removes such liens from its computers after five years anyway, and refiling when there is new account activity avoids the need to monitor these five-year periods for plans without outstanding balances.
- Termination of record is accomplished by filing the termination statement where the original filing was made. Filing is the obligation of the credit union except in the case of titled vehicles. Termination of record will occur automatically after 5 years if the credit union does not take steps to keep its security interest perfected. Financing statements terminate after 5 years automatically by law unless the credit union files a continuation statement within 6 months before the expiration date. (See Appendix D for more details.) In the case of certificates of title, the Secretary of State removes all liens more than 7 years old due to computer storage limitations. To continue a lien on a title beyond 7 years, the credit union and the member must submit a new title application.

Duties of Filing Officers (Secretary of State and Register of Deeds)

The filing officers, in addition to their usual duties of filing, assigning, and indexing filing information, are required to:

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- Hold all filed financing statements open for public inspection;
- Upon receipt of a termination statement, note the termination statement in the index;
- Upon request of any person, the filing officer must perform the following services:
- Issue a search listing certifying whether there is any presently effective financing statement naming a particular debtor and which gives the date and hour of filing of each financing statement and the name and addresses of each secured party.

The fee for a search listing is \$6.00 per debtor name requested plus \$2.00 per page of copies, if copies are requested. If the search listing discloses more than 100 records, there is an additional \$6.00 fee. See Appendix H for a note on expedited search requests.

Procedures for Requiring Secured Party to Furnish Debtor a Statement of Account of His or Her Indebtedness

- If a member sends to a credit union a signed statement indicating what he or she believes to be the aggregate amount of unpaid indebtedness as of a specified date, together with a request that the statement be approved or corrected and returned to the debtor, the credit union must, within two weeks after receipt of the statement and request, send a written correction or approval of the statement to the debtor. Keep in mind that collateral for one loan may well secure another loan as well, and, if so, this fact must be noted along with the particulars in the credit union's response. If the member has made a good faith statement of the unpaid indebtedness and the credit union, without reasonable excuse, fails to comply with the request:
 - The credit union is liable to the debtor for any loss caused to the debtor; and
 - The credit union can claim a security interest only to the extent of the obligation shown in the debtor's statement as to persons misled by the credit union's failure to comply.
- The member is entitled to such a statement once every six months without charge. A credit union may not charge more than \$25 for each additional statement. If the credit union no longer has an interest in the obligation at the time the request is received, it must disclose the name and address of any successor in interest known to it, and it is liable for any loss caused to the member as a result of failure to disclose.

Procedure for Requiring Secured Party to Furnish Debtor a List of Collateral

- When the security agreement or any other record kept by the credit union identifies the

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PROVISIONS OF SPECIAL INTEREST

collateral, the member may send to the credit union a signed statement listing the collateral as of a specified date, together with a request that the statement be approved or corrected and returned to the member.

- Within two weeks after receipt of the statement and request, the credit union must send a written correction or approval of the statement to the debtor. If the credit union claims a security interest in all of a particular type of collateral owned by the member, it may so state in its reply and need not approve or correct the itemized list of collateral.
- If the member has made a good faith statement listing the collateral and the credit union -- without reasonable excuse -- fails to comply with the request:
 - The credit union is liable to the debtor for any loss caused to the debtor; and
 - The credit union can claim a security interest only in the collateral listed by the debtor as to persons misled by the credit union's failure to comply.
- The member is entitled to such a statement once every six months without charge. A credit union may not charge more than \$25 for each additional statement. If the credit union no longer has an interest in the collateral at the time the request is received, it must disclose the name and address of any successor in interest known to it and it is liable for any loss caused to the debtor as a result of failure to disclose.

Signature/Authentication Requirements

- The revisions to Article 9 of the Uniform Commercial Code have eliminated all signature and authentication requirements with regard to financing statements, and documents that amend, continue, or terminate them. They must still be authorized someplace by the debtor or secured party as applicable, but such authorization is not a part of the filing process; it merely needs to be documented someplace in the contractual relationship between the debtor and the secured party (credit union).
- If a certificate of title is used, the application for title must be signed by the debtor(s) (persons holding ownership interests in the collateral). The credit union must sign any lien release.

Signatures need not be notarized in any of these situations.

NOTES

SECTION II

PROVISIONS OF SPECIAL INTEREST

SECTION II SELF TEST

1. True In order to perfect its security interest, a credit union should always
 False wait until after its loan has been disbursed before it files a Financing
Statement.
2. True A copy of a security agreement may be used as a Financing
 False Statement, provided it satisfies all the requirements of a Financing
Statement.
3. True A UCC-1 Financing statement can be used to file a credit union's
 False security interest in an automobile.
4. True A UCC-1 Financing Statement with a UCC-1Ad Addendum can be
 False used to file a credit union's security interest in fixtures, timber, and as-
extracted collateral.
5. True UCC-1 Financing Statements expire five years from the time they are
 False filed, unless a continuation is filed.
6. True The debtor's signature is required on a UCC-1 Financing Statement.
 False
7. True If a credit union grants a loan consolidation to a member which
 False covers an old loan balance plus new money to be used to purchase
additional collateral, the transaction will be treated as a purchase
money loan.

ANSWERS

1. False
2. True
3. False
4. True
5. True
6. False
7. False

SECTION III LOAN PROCEDURES AND THE USE OF FORMS

Pre-Loan Closing Considerations

Prior to entering into a loan transaction, a credit union can take some steps to ensure a proper security interest will be obtained.

Search for Other Security Interests

First of all, the credit union should determine whether there is any outstanding security interest covering the collateral offered.

- Is the collateral paid for? If the seller has not been paid in full, that seller may have a prior security interest. Such a security interest will be a "Purchase Money Security Interest" and it may even be unrecorded. A purchase money security interest, even if unrecorded, will have first priority if it is in consumer goods that are not subject to a certificate of title law.
- Has the collateral been used as security by another lender? If the other lender has not been paid in full, of course, it still has a prior security interest. ***If it has been paid, remember that unless a termination statement or lien release is filed, cancelling the security interest, the prior lender's security interest can be revived and will be superior to the security interest of the credit union if the member returns to the first lender and makes another loan using the same collateral.***

When a credit check or the member's list of creditors on the financial statement in the loan application reveals that the applicant has been involved with other lenders, the search for outstanding financing statements becomes much more important. If the financing statement involved has not been terminated, it can be revived as discussed above. In most cases, a search will have to be made. If a car is to be used as collateral, the credit union should inspect the title for evidence of another security interest.

Where to Search

On all consumer goods (except vehicles required to be titled) and farm crops, farm equipment and farm accounts, the search will have to be made both (1) in the office of the Register of Deeds in the county where the debtor resides or has resided during the previous five years, or, if the debtor doesn't live in Michigan, then in the county where the goods are kept (in the case of farm crops, the search must be made in the county in which the land on which the crops are grown is located), and (2) at the Secretary of State's office or, if the debtor doesn't reside in Michigan, at the appropriate filing location for the state of the debtor's residence. This seems like duplication. However, financing statements filed under the old (pre-July 1, 2001) version of Article 9 can be valid for as long as five years (or until July 1, 2006). Therefore, until July 2006, a search will need to be made for potential pre-July 2001 filings as well as for filings made in July 2001 or afterward. For business equipment and inventory (other than farm equipment and farm goods) the search

SECTION III LOAN PROCEDURES AND THE USE OF FORMS

should be made at the Secretary of State's office. For fixtures, timber, or as-extracted collateral, the search will need to be made at the Register of Deeds Office for the county where the real estate involved is located. If a search reveals a financing statement, it may be wise to delay the disbursement until the member brings a termination statement to the credit union. This could take up to 10 days.

If the search is for liens on a vehicle required to be titled, the search can be made only by reference to the certificate of title.

Whether a search is made in the applicant's county of residence or with the Secretary of State, credit unions must use form UCC-11 to request information and/or copies of existing financing statements. The fee for a search listing is \$6.00 per debtor name requested plus \$2.00 per page of copies, if copies are requested. If the search listing discloses more than 100 records, there is an additional \$6.00 fee. See Appendix H for a note on expedited search requests.

If the credit union is lending the member money to pay off another lender who has a perfected security interest in the collateral, the credit union can protect itself by making the check payable to the other lender, and typing the following special endorsement on the back of the check:

"Endorsement of this check by the payee constitutes acceptance of this check as payment in full for the obligation of ___(debtor's name)___ and acceptance of the demand to deliver to (credit union name and address), or the proper filing officer, a termination statement covering the collateral supporting the indebtedness paid in full with this check."

This procedure is a good precaution because under the UCC, if the debtor returns to the other lender and borrows again while the financing statement is still in effect, that lender's security interest has priority over the security interest of the credit union.

When to File the Financing Statement

As has been discussed, the UCC permits the secured party to file the financing statement either before or after the loan is disbursed. Generally, it will be most convenient to file after the closing, but in a few instances, the credit union will choose to make an early filing which can give a better guarantee of a first security interest (see discussion on page 29).

An early filing will be used occasionally when, at the time the loan application is taken, the credit union has reason to make a search for a filed financing statement covering the same collateral. In such a case, the financing statement could be executed upon receipt of the loan application and could be sent or taken for filing at the same time a search is requested. When the search does not disclose any security interests, the loan is then closed and the credit union will be assured, except for a seller's unrecorded purchase money security interest, of a first security interest in the collateral.

SECTION III LOAN PROCEDURES AND THE USE OF FORMS

If the search reveals other security interests in the same collateral, the credit union can delay disbursement of the funds until after termination statements are obtained and filed or the loan can be disbursed using the special endorsement suggested above. After the termination statements are filed, the time of priority of the credit union's security interest goes back to the date of filing. If the loan is not made, the credit union would have to pay the cost of filing termination statements.

Suggested Procedures for Closing Loans

The following transactions will be discussed by subject:

- Loans secured by household furniture and appliances -- consumer goods.
- Car Loans (new or used).
- Loans secured by both car and household furniture and appliances.
- Farm equipment and products.
- Instruments -- stocks and bonds.
- Equipment.
- Inventory.
- Fixtures.
- Mobile homes and watercraft.

Credit unions have traditionally made loans secured by collateral in most of these classes. The following paragraphs describe, in more detail, how to close such loans.

Loans secured by Household furniture and appliances -- consumer goods

Most credit unions make loans secured by personal, family, or household goods. *All personal, family or household goods are officially placed in the same group under the code -- consumer goods.* In this category fall such types of security as household furniture, jewelry, works of art, appliances, television sets, radios and stereo equipment, garden tractors, mowers and other garden equipment, musical instruments, cameras and projectors, tools for hobby purposes or home use, books, guns and other sporting equipment, etc. *(Note: As was discussed earlier, the Credit Practices Rule, issued by the Federal Trade Commission rule effective March 1, 1985, prohibits taking a non-purchase money security interest in some types of household goods. (See page 23).*

SECTION III LOAN PROCEDURES AND THE USE OF FORMS

A security interest in all the goods in this category is perfected under the procedure discussed below. However, if the money loaned is actually used to purchase the goods used as collateral, an optional method of perfecting a security interest automatically, without filing, is possible.

(Note: Two types of property that may be used for family use require special procedures. These types of property are (a) motor vehicles or other titled items; and (b) fixtures.)

The security interest can be perfected without filing financing statements only if three conditions are present:

- the loan is made to purchase consumer goods for personal, family or household use;
- the proceeds of the loan are, in fact, used for the purchase of the specific goods; **and**
- only the articles purchased are used as collateral for the loan.

This method of perfecting without filing is both inexpensive and convenient, but in operational practice will not be used frequently for three reasons:

- A frequent credit union practice when a loan is approved for the purpose of purchasing household goods or appliances is to take, in addition to the articles purchased, **other** household goods (at least to the extent allowed by the FTC Credit Practices Rule). When this is done, perfection can only be through filing as described below.
- If, in the judgement of the credit union, the borrower is likely to apply for additional loans in the future, such as under a revolving credit plan, using the same collateral, it is much more practical to perfect the security interest by filing at the time the original loan is made (see procedure below). At the time of the next advance, the filing will not need to be repeated and the priority of the credit union's security interest will go back to the date of filing under the first loan.
- Automatic perfection does not give as complete protection as perfection through filing. (See discussion on page 27). For this reason, credit unions will usually elect to file in order to gain the added protection filing affords.

To **perfect without filing**, the credit union should take the following steps:

- Complete the promissory note or revolving credit voucher.
- Complete the security agreement.
- Make the check payable to both the member-borrower and the party selling the collateral.

SECTION III LOAN PROCEDURES AND THE USE OF FORMS

If it is a purchase money security interest, the credit union should be sure that the credit union check is used to purchase the collateral. We suggest that the following endorsement be stamped or typed on the back of the check.

"This check is to be used only for the purchase of the following described goods _____ and acceptance of this check by the second named payee shall constitute its acknowledgement of the application of the funds for said purpose, and its warranty that the goods are free and clear of any outstanding liens, encumbrances or security interests."

When the credit union intends to perfect its purchase money security interest without filing, it is important to be sure that the debtor does not intend to use the collateral in his or her business. For example, the debtor may be purchasing power tools for his or her basement workshop, but if the tools are to be used to make cabinets for sale, the tools are equipment. In these cases, perfection must be by filing. (See the discussion on page 6 concerning classification of collateral.)

To **perfect by filing**, a credit union should take the following steps:

- Complete the promissory note or revolving credit voucher.
- Complete the security agreement. The security agreement or an addendum to it should identify, by description, all articles in which the credit union has a security interest.
- Complete the financing statement. The financing statement should be checked to ensure the collateral matches that listed in the security agreement. The description of the collateral should be as complete as possible.
- Issue the check. To whom the check is made payable is not as important in a non-purchase money transaction, as long as it is satisfactory to the member. The loan may even be disbursed in cash if the bylaws of the credit union permit. If the transaction is a purchase money security interest that is to be perfected by this filing procedure, the special endorsement suggested above should be used on the back of the check.
- Give the borrower his or her copies of the security agreement and the financing statement.
- The filing fees are \$10.00 for the first two debtors' names and \$10.00 for each name more than two. Send two copies (the filing officer copy and the acknowledgement copy) of the financing statement, the proper fees determined by the number of debtor names, and a stamped self-addressed envelope to the Michigan Department of State, UCC Section, P.O. Box 30197, Lansing, MI 48909-7697. (If the debtor does not live

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in Michigan, file in the appropriate location for the debtor's place of residence.) This step can be taken any time after the loan application is received.

- Establish a follow up procedure to guard against accidental expiration. (Financing statements must be renewed every 5 years or they expire.)

This method **must** be used, even on purchase money security loans, when the collateral is:

- farm equipment or other equipment; or
- a fixture.

This method **must** also be used when any part of the personal, family or household goods used as collateral is previously owned by the borrower because the loan is not then a purchase money loan, i.e., the funds are not used for the acquisition of all collateral.

Refinancing: The procedures a credit union should follow to complete a refinancing depend on whether new collateral is added. If **no additional collateral is added**, the credit union should simply complete the promissory note or revolving credit voucher, and disburse the funds to the member. It is not necessary to execute a new security agreement or financing statement.

The credit union should be sure the filing of the original financing statement has not expired. As was discussed earlier, the credit union can continue the filing period of the financing statement by filing a continuation statement during the last six months of the filing period. Note that the credit union may, depending on the circumstances, need to make an "In Lieu Of" filing instead of filing a continuation statement. See the discussion of this matter beginning on page 20.

If **new collateral is added**, the credit union should:

- Complete the promissory note or revolving credit voucher.
- Complete a new security agreement.
- Complete an amendment to the financing statement (UCC-3), describing only the type of item of collateral being added. Note – If the added collateral is consumer goods or farm goods or equipment, file a new financing statement with the Secretary of State, do not amend any old filing with the Register of Deeds. For a detailed discussion of how to handle this type of situation, see the discussion of "In Lieu Of" filings beginning on page 20.
- Give the borrower his or her copies of the security agreement and amendment to the

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financing statement.

- Filing fees are \$10.00 for the first two debtor names and \$10.00 for each name more than two. Send two copies, the filing officer copy and the acknowledgement copy, of the financing statement, the proper fees determined by the number of names and a stamped, self-addressed envelope. In the case of a filing to be made with the Secretary of State, send these items to the Michigan Department of State, UCC Section, P.O. Box 30197, Lansing, MI 48909-7697. If the filing that needs to be made with the Register of Deeds (because, for example, the proposed collateral is a fixture), these items will need to be sent to the Register of Deeds for the county involved rather than to the Secretary of State. This step can be taken any time after the loan application is received.
- Establish a follow up procedure to guard against accidental expiration.

*Note: It is better to file an amendment to the original financing statement than a new statement (except where the new law changes the filing location) because the priority of the credit union security interest in the original collateral continues from the date the original financing statement was filed. The security interest in the **added** collateral starts on the date of the filing of the amendment. If an entirely new financing statement is filed instead of an amendment to the old one, keep the original filing in effect as long as the credit union has an interest in the original collateral so that the credit union's priority on that collateral isn't lost.*

Most standard security agreements provide that they can secure more than one loan. Therefore, several loans can be secured by the same security agreement.

The next situation discussed applies when the credit union makes a **new loan**, takes **new security**, obtains a **new security agreement** and a **new note** covering the additional advance as a separate loan. Here if the new security is adequate to support the new loan, it can be closed as an independent transaction according to the procedures above.

If the new security is not adequate, or for another reason the credit union desires to secure the new loan with both the new and old collateral, the original and new security should be referred to in the new security agreement. Both security agreements should be retained in the file because both continue in effect. The loan is then closed according to the procedures for perfection by filing (discussed on page 38).

When this procedure is followed, the credit union retains its prior security interest in the collateral supporting its original loan; the second loan is secured by the new collateral **and** the original collateral. In effect, with the second loan, the credit union has a secondary security interest in the collateral supporting the first loan. If the credit union repossessed and sold the original collateral for more money than was needed to recover the balance due on the first loan, the remainder of the funds could be applied to the second loan, provided it is also in default, and procedures after default are observed.

Car Loans and Other Vehicles Required to Be Titled

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The following procedures should be followed when making an auto loan:

- Complete the promissory note or revolving credit voucher.
- Complete the security agreement. A complete description of car, including vehicle identification number, should be shown.
- Note the credit union's lien on the back of the certificate of title for a used car. Complete Form TR-11C (Application for Certificate of Title) in duplicate, showing security interest, and have the member (and any other owner of the car) sign the original. The Secretary of State will stamp the duplicate copy and return it to the credit union, but only if the credit union presents the form in person. These forms can be obtained from any branch office of the Secretary of State. When the vehicle is purchased through an automobile dealer, the Application for Title will usually be prepared by the dealer. Since recording of the security interest on the certificate of title is a condition for perfection of the security interest, the credit union must take steps to ensure that the dealer records the credit union's lien, otherwise, it risks not having a perfected lien. The credit union must establish a follow-up procedure to ensure the dealer properly placed the credit union's lien. Usually, the dealer will send a copy of the form TR-11C (RD-108 in the case of new vehicles) to the credit union.
- Issue the check. The check should be made payable to both the member and the seller. The special endorsement appearing on page 13 of this manual should be typed or stamped on the reverse side of the check to assure the credit union that the money is used as expected and the seller indicates the credit union's security interest on the title of the car. Keep in mind, the dealer is not obligated to record the credit union's lien unless a fee is paid to the dealer, and the special endorsement is used. This fee cannot be charged to the member. It should be noted that some dealers may agree to record the lien without charging the fee. However, the wording of the law in all likelihood would not allow the credit union to collect from the dealer if the dealer made such a promise and failed to follow through, the credit union as a result lost its security interest, and the loan wasn't paid as agreed.

When the seller is not a dealer, the credit union may wish to consider having the sale closed at the credit union office. The credit union may also wish to take responsibility for filing the documents, to insure that it does, in fact, get its lien recorded.

- Give the borrower his or her copies of the security agreement.
- Give the borrower the check along with Form TR-11C for delivery to the seller of the motor vehicle.

Procedure for Loan on Which a Car Already Owned by the Member is Offered as Security: Generally, the same procedures are used in this type of loan as those described above, but with the following considerations:

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- The check will not contain a special notice of security interest endorsement and will be made out to the member only.
- The credit union must obtain the certificate of title from the member, and
 - determine whether or not any liens or security interest are shown on the title;
 - if any liens or security interests are shown, the credit union must obtain a discharge of the lien shown or a termination of the security interest, whichever applies;
 - send the certificate of title (with the credit union's lien noted) and \$11 to the Secretary of State, along with the following attachments.
 - (1) A completed Form TR-11C showing the credit union's security interest and signed by the owner.
 - (2) A separate form to discharge any liens or terminate any security interests if shown on the title. This will be provided by the lienholder involved.

If additional funds are advanced to a member and added to an existing loan balance, and the credit union's security interest in the car is already perfected, the credit union need only:

- complete the promissory note or revolving credit voucher;
- check the member's title (e.g., make a photocopy for the file); and
- issue the check.

Note: When the same car is used as security, it is not necessary to execute a new security agreement.

Note: With minor exceptions, the various procedures discussed to this point are also used in closing loans in the categories that follow. Rather than repeat all the procedures below, we will make references to certain procedures described in categories above, and add some notes where the procedures differ.

Loans Secured by Both Car and Household Furniture and Appliances

The same procedures are used for loans in this class as for loans discussed earlier on pages 38 through 44. Perfection is always by dual filing, i.e., (1) filing the financing

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statement with the Secretary of State and, (2) with regard to the car, noting the credit union's lien on the front of the title, (unless the car is new, with no title issued yet) and filing the application for certificate of title, showing security interest, with the Secretary of State.

Note: As was discussed in Section II (see page 29), the law provides that when there is no outstanding loan balance and no binding obligation to make a future advance (the possibility of a optional future loan is irrelevant), the secured party must, for titled motor vehicles, within 10 days after demand, and, in any event, within one month, mail or deliver any title that it holds (Michigan law does not provide for a secured party to hold the title but some other states do) and a termination statement (of the security interest shown on the title) to the owner. If the credit union holds an out-of-state title showing a second secured party, the title and termination statement should be sent to that party instead of the owner. The law also requires a termination statement for financing statements to be sent directly to the proper filing officer when all loans secured by use of the financing statement have been paid in full unless the credit union has a binding obligation to make new advances. (A reasonable expectation of making optional future advances is no longer a basis for keeping a financing statement in effect due to a change in the law.) This must be done within one (1) month after payoff. However, if the member demands the release and has no current balance outstanding, the termination statement must be filed within 10 days after the demand is made.

Farm Equipment and Products

If a loan is secured by **non-titled farm equipment**, the security interest can only be perfected by filing. Refer to the procedures on perfection by filing beginning on page 38.

If the loan is secured by a **farm vehicle** for which a **certificate of title** is required to be issued, refer to the procedures on perfection on car loans and other vehicles beginning on page 40.

If the loan is to be secured by **fixtures** (articles which will be affixed to the real estate), please refer to the discussion on fixture filings beginning on page 44.

If the loan is to be secured by **farm products** -- i.e., crops, livestock, etc. -- the security interest can only be perfected by filing. Refer to the procedures on perfection by filing beginning on page 38. The credit union should include the legal description of the real estate in the security agreement and the financing statement.

The financing statements should be filed with the Secretary of State.

Instruments, Stocks and Bonds

Many credit unions accept this type of security for loans. The standard security agreement is used to create the security interest in the instruments used as collateral. **As a practical matter perfection of these security interests can occur *only* by possession of the instruments. A financing statement should never be used.**

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Equipment (Including Farm Equipment)

By definition, equipment means goods, other than inventory, used or bought for use primarily in a business or profession. The security interest in equipment can only be perfected by filing. Refer to the procedures on perfection by filing beginning on page 38.

Inventory

In the past, few credit unions have made inventory-based loans. Few credit union loan officers or employees have the formal training needed to finance business ventures, and such loans are beyond the scope of this manual. It is important to be aware that the supervision of a loan secured by business inventory includes a constant -- perhaps weekly -- check on the level and value of the inventory because the credit union runs the risk that the security may disappear overnight (this is not an uncommon occurrence when a business gets into trouble). It must be noted that the lender's lien is lost in an item of inventory when it is sold by the debtor to a purchaser in the ordinary course of business.

While a credit union certainly could make such business loans properly and soundly, errors in judgement are frequent with this type of loan. It may be wise to look for other security and avoid tying the loan into the debtor's business inventory. A security interest in inventory is perfected by filing a financing statement with the Secretary of State, in the same manner as for equipment.

Fixtures

The UCC makes fixture loans practical. It enables credit unions to help members purchase many "home improvement" items. Fixtures are defined as items which are to be attached to real estate. Aluminum storm windows and screens, garage doors, furnaces, "built-in" ovens, etc., are examples of what are generally fixtures. Again, credit unions need to keep in mind the uncertainty in the courts as to what is a "fixture" and what isn't.

Items used as building materials and incorporated in a structure such as bricks, mortar, lumber, etc., are not fixtures. Loans for an added room, a new floor, paint and plaster are not fixture loans.

Perfection of the security interest in fixtures is accomplished by filing a UCC-1 with a UCC-1Ad Addendum.

It is important to file the financing statement and perfect the security interest **before** the article is attached to the real estate, and to limit such loans to purchase money loans.

Fixture filings are made in the Register of Deeds office where a mortgage on the property would be filed or recorded, i.e., the county in which the realty is located. The filing fee is \$10.00 for this type of filing. The credit union should include a legal description of the real estate in the security agreement and the financing statement.

Mobile Homes and Watercraft (More detail provided in Appendix A)

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All mobile homes and some watercraft are covered by certificate of title laws. These certificate of title laws are similar to the law covering certificates of title for motor vehicles.

For loans secured by mobile homes and the watercraft described below, follow the earlier procedures relating to car loans, with the modifications indicated below.

Mobile Homes: The credit union's lien can be perfected only by notation on the certificate of title. A filed financing statement is not required, however credit unions may wish to do a fixture filing (see Appendix A). Certificates of title for mobile homes are issued by the Department of Consumer and Industry Services. However, applications for certificates of title and for liens on titles are handled for the Department of Consumer and Industry Services by the Secretary of State's branch offices. For mobile homes sold by a dealer, the credit union may wish to let the dealer handle the title and lien application. If this is done, the credit union should refer to our CMS Lending Publications Release entitled "Perfecting Mobile Home and Watercraft Liens" dated January 2001 for further information.

To obtain a security interest in a mobile home already owned by the member, the credit union must send the existing certificate of title to the Secretary of State, along with completed duplicate copies of Form S-110, a check for \$5.00 and evidence of discharge of any liens shown on the certificate of title.

Watercraft: With some exceptions, all watercraft which either (a) are equipped with a permanently affixed engine, or (b) are at least 20 feet in length **must** be titled. Watercraft which are registered with the U.S. Coast Guard **cannot** be titled. *(Note: Boats in this category are usually very large. A credit union wishing to use such boats as collateral should consult its attorney to ensure proper lien placement under federal law.)* Watercraft less than 20 feet in length may be titled voluntarily. As a practical matter, some credit unions require their members to obtain titles on all watercraft.

For watercraft that are not titled, the credit union's lien is perfected under the UCC filing procedures relating to consumer goods (see page 38). For watercraft subject to the certificate of title law, the credit union's lien can be perfected only by notation on the certificate of title. For such watercraft, filing under the UCC is not required. Certificates of title are issued by the Secretary of State's office.

To obtain a security interest in a watercraft being sold by a dealer, the credit union should first contact the dealer to see if it will be titled. If it will be titled, the credit union may wish to arrange for the dealer to handle the titling. If this is the case, the credit union should refer to our CMS Lending Publications Release entitled "Perfecting Mobile Home and Watercraft Liens" dated January 2001 for further information. If the watercraft won't be titled, the credit union should obtain an accurate description for its UCC filing.

To obtain a security interest in a watercraft already owned by the member, the credit union should (1) if it is titled, send the certificate of title, a check for \$5,00 and proof of discharge of liens listed on the title to the Secretary of State's office; or (2) if it is not titled, file a

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financing statement as would be done with consumer goods (see page 38).

SECTION III LOAN PROCEDURES AND THE USE OF FORMS

SUMMARY OF METHODS OF PERFECTION OF SECURITY INTEREST IN VARIOUS TYPES OF COLLATERAL

Type of Collateral	Methods of Perfection
Purchase money security interest in consumer goods (except vehicles, some boats, and fixtures)	Automatic or Filing – Secretary of State or Possession
Non-purchase money security interest in consumer goods (except vehicles, some boats, and fixtures)	Filing – Secretary of State or Possession
Equipment (except vehicles, some boats, fixtures, and farm equipment)	Filing - Secretary of State or Possession
Farm products and farm equipment	Filing – Secretary of State or Possession
Inventory (including vehicles)	Filing - Secretary of State or Possession
Vehicles (except inventory)	Notation on and filing of application for title
Fixtures	Filing - Register of Deeds (in the office where a mortgage on the real estate would be filed)
Instruments (including investment securities)	Possession
Mobile Homes and Watercraft	Notation on certificate of title. (For certain small boats, filing or automatic perfection will apply)

NOTES

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

Default

A loan is in default whenever the debtor misses a required payment or has breached any other provision of the loan contract or security agreement. However, a credit union must be careful not to waive a default unintentionally. If late payments have been accepted in the past, or the credit union hasn't complained about a lack of required insurance in the past, it should consider giving the debtor a written warning that future payments will have to be made on time (or insurance obtained). The debtor should then be given a reasonable chance to comply. Absent such a warning, some courts have held that a creditor can't change its mind and treat the loan as being in default if the debtor's default pattern hasn't changed. This does not apply if a new type of default has occurred, or the default has worsened (i.e., a debtor who hasn't in the past been more than 10 days late with a payment goes 25 days past due, etc.).

A credit union cannot treat a loan as in default once the member makes up past due payments (or obtained the required insurance, etc.) unless prior to that time it has accelerated the loan. "Accelerated" means that the full balance has been declared due and payable as a result of a default so that the idea of "monthly payments" no longer applies. If a loan is accelerated, the credit union must make a note in its loan file and, except in cases where repossession is planned, should notify the debtor in writing. Collateral should not be repossessed until the decision to accelerate has been made. The actual repossession will serve to notify the borrower that the loan has been accelerated -- a prior notice is not necessary. However, there is some risk here since liability can result if the member brings a loan current, the collateral is repossessed afterwards (likely by an outside agent) and the member had not been previously told that the loan had been accelerated. Thus, if a loan is brought current, the credit union must contact its repossession agent **immediately** to inform the agent not to repossess the collateral. Members who make payments after repossession must be told that the loan has been accelerated, and that payment of less than the full balance does not reinstate the right to make monthly payments. The credit union may, however, allow such reinstatement for less than the full balance and return the collateral.

Repossession of Collateral After Default

The UCC allows a secured party to repossess, without court action, if it can obtain possession without a breach of the peace. Unfortunately, court cases do not provide a good guide for determining what conduct will be considered a breach of the peace. For this reason, a credit union would be well advised to always employ a licensed and bonded repossession agency for this purpose if one is available.

Before repossession, the credit union needs to determine the priority of its lien. If a search was not made at the time the loan originated, or if time elapsed between the search and the perfection of the security interest, a search should be made to determine the priority of the credit union lien. The seizure of collateral by a credit union when it has a secondary lien and the collateral is not equal in value to the amount of the first lien may result in the credit union being liable to the first lienholder. The credit union needs to contact any such first lienholder immediately to determine its loan balance and work out details on disposing

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

of the collateral.

Repossession of Automobiles

While on public property: Generally speaking the repossession of a motor vehicle while it is on public property and unattended will not be considered involving a breach of the peace even though it may be necessary to gain access to a locked automobile. Where, however, the debtor (or anyone else) challenges or resists the repossession, a breach of the peace would be involved and the taking would not be lawful.

While on private property:

- From parking lots: If the repossession agent can obtain peaceful possession by cooperation with a parking lot attendant and where the taking is not resisted, a breach of the peace will probably not be involved.
- From a driveway (and not within a fenced-in area): Courts have generally held in such circumstances that the taking of possession, when not resisted and even though from private property, does not involve a breach of the peace.
- From a garage or a fenced-in area: Courts have almost always held that such a taking, even when unresisted, involves a breach of the peace and is unlawful. This is true even if the fence has an opening or the garage door is open.

What constitutes resistance? In view of the courts' decisions, it is not possible to clearly define what constitutes resistance. Resistance may not necessarily involve a physical act, especially in circumstances where physical resistance is not made because of intimidation.

Notification of the debtor: It is usually not desirable to notify a debtor specifically of an intent to repossess, since this will enable the debtor to take precautions to thwart the action. It is also generally advisable to word any notice in indefinite language such as "failing to hear from you on or before the _____ day of _____, we will take such steps as we may deem necessary to enforce our rights."

Repossession of Household Goods

This is almost always not practical, since these tend to be in buildings or enclosed areas. Court proceedings will almost always be necessary here. A credit union should consult its attorney regarding the proper court proceeding.

Soldiers and Sailors Civil Relief Act

A credit union should not repossess collateral without court proceedings while the debtor is protected by the Soldiers' and Sailors' Civil Relief Act. For more details on this subject, note our CMS Lending Publications Release dated June 1998 entitled "The Soldiers' and Sailors' Civil Relief Act and Uniformed Services Employment and Reemployment Rights

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Act."

Repossession Procedures

A credit union may handle its own repossessions or may have an outside agency do it. Any outside agency should be licensed under the Michigan Collection Practices Act (get its license number and verify the licensing with the Michigan Department of Consumer and Industry Services), bonded and reputable. Note that an outside agency cannot transport repossessed property across state lines unless it is licensed by the Interstate Commerce Commission.

If the credit union decides to conduct its own repossession, then it should, if possible, send two representatives who should be given a letter on the credit union's stationery naming them and stating that they are authorized to repossess the collateral described in the security agreement because of a default. A certified copy of the security agreement should be attached to the letter. The credit union representatives should be sure to have with them means of personal identification. This should help avoid problems if the debtor reports the property as stolen, and the representatives are stopped by the police.

Obtain duplicates of the car keys to use, if possible. This can be done by contacting the dealer who sold the car. Obtain the key numbers from the dealer and have duplicates made, if possible. (*Note: It is a good idea to request key numbers from dealers at the time the credit union places its lien, i.e., **before** the loan is disbursed.*)

It is best to have a towing service tow the car away when making a repossession. There is always a risk that a past due debtor hasn't maintained the car and the brakes or some other key part could as a result fail while the car is being driven. The credit union would be liable for any damage caused by any resulting accident. If the automobile is driven away, the credit union should be sure that it is covered by insurance to protect against possible liability, property and collision damage (credit unions should contact their bonding companies regarding this type of coverage). In addition, the car should not be driven under its own plates, but with special repossession plates which can be obtained from the Secretary of State.

To acquire a repossession plate, the credit union needs to do the following: Complete the Michigan Secretary of State's form BDVR-124, entitled "Application for Repossession, In-Transit Repair," or Special Farm Plate, at any Secretary of State branch office. The original and renewal fee is \$20.00. (The replacement fee is \$5.00.) The plate may be used by the credit union only to move a repossessed vehicle from the place of repossession to a place of impoundment or sale. Proof of insurance covering all non-owned vehicles must be presented by the credit union as part of the process...

Immediately upon making the repossession, notify the police in order to avoid a stolen car search. Some credit unions also immediately notify the debtor.

Immediately after taking possession, representatives of the repossession company should make an inventory list of the debtor's personal property in the vehicle and a memorandum

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concerning the condition of the vehicle, especially noting the condition of the tires, glass, and body. A letter should be sent to the debtor within 24 hours advising him or her that the credit union is holding the license plate(s) and whatever personal property was left in the automobile, and that these items should be picked up at the credit union office at or before a specified time. The security agreement should provide that the debtor is to pick up such property within a certain number of days (e.g., five) or it is to be deemed abandoned. However, credit unions are advised not to be strict in the enforcement of this provision. When a debtor comes to pick up the plate(s) and property, he or she should be requested to sign a statement releasing the credit union from any liability resulting from the taking of the debtor's property in connection with such repossession. The release should acknowledge that the inventory (give the debtor a copy) includes all of the personal property that was in the car, and that it has all been returned to the debtor. If the plate(s) are not picked up, the credit union should forward them to the Secretary of State.

When the collateral is repossessed, the credit union must use reasonable care in the custody and preservation of the collateral and may be liable to the debtor if there is damage to the collateral after repossession. Insurance should be purchased to protect the credit union in case of damage.

Repossessions Through Legal Proceedings

If the debtor refuses to permit the taking of possession of collateral, or it is located in a building or other place where self-help repossession would be illegal, the credit union should immediately place the matter in the hands of its attorney so that appropriate court proceedings can be instituted.

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SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

Obtaining a Repossession Title

In order to sell a repossessed vehicle, the credit union will first need to obtain a repossession title. The Secretary of State has adopted the following procedures that should be followed to secure title to vehicles repossessed after default:

On every repossession of a vehicle, voluntary or otherwise, the lender must apply for a repossession title, submitting:

- the old certificate of title, if available;
- a completed application for title (form TR-11C)
- a completed Certification of Repossession, which is prescribed by the Secretary of State (form TR-10);
- a copy of the security agreement (which must be attached to the TR-10);
- a check for \$11.

In order to apply for a repossession title in Michigan, the vehicle involved must have a Michigan title. If the vehicle is titled in another state, the repossession title must go through the other state. The Michigan Secretary of State's office notes that some states do not issue repossession titles, and that Michigan will honor the other state's process in such situations. The Certificate of Repossession can be obtained online from the Michigan Secretary of State's website at <http://www.sos.state.mi.us/bar/pdf/forms/tr-10.pdf>.

The sale of the vehicle should be scheduled not less than 10 days later to allow for the necessary processing time and the forwarding of the title to the credit union. Then, upon the sale, the repossession title, properly assigned, can be delivered to

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the purchaser for submission to the Secretary of State, together with an application for a new title in the purchaser's name.

The Credit Union's Obligation to Sell the Collateral After Repossession

When repossessed collateral is consumer goods, the credit union is required to sell the collateral if the debtor has paid 60% or more of the cash price (in the case of a purchase money security interest) or 60% or more of the loan (in the case of a non-purchase money security interest).

In such a situation, the credit union must sell the collateral within 90 days after repossession unless the debtor waives his or her rights to a sale by signing a statement to this effect after default.

Failure to sell within the allotted time will render the **credit union** liable to the **debtor** for the greater of the following amounts:

- actual damages for unlawful retention or control of the goods; or
- 10% of the principal amount of the debt plus all of the finance charge.

The credit union may also lose its right to collect a deficiency (the loan balance after applying the sale proceeds to the loan).

The Credit Union's Right to Retain the Collateral in Full Satisfaction of the Indebtedness

Consumer Goods

When repossessed collateral is consumer goods, if the debtor has paid less than 60% of the cash price (in the case of a purchase money security interest) or less than 60% of the loan (in the case of a non-purchase money security interest) the credit union may retain the collateral in full satisfaction of the indebtedness if the following steps are taken:

- The credit union must send written notice of its intention to retain the collateral in full satisfaction of the indebtedness to:
 - the debtor;
 - any person known to the credit union to have become the owner of the collateral without assuming the debt; and
 - any other secured party with an interest in the collateral whose lien is properly

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

perfected. (Note – If such secured party's lien is superior to that of the credit union, the credit union will be subject to such lien if it seeks to retain the property in full satisfaction of the indebtedness.)

Any person entitled to receive notice may, after default, waive, in writing, his or her right to receive notice (such a provision cannot, under the UCC, be part of the security agreement). This may be helpful when the debtor voluntarily surrenders the collateral.

- If no written objection is made to the credit union's proposal within 21 days after the persons entitled to notification have received notice of the credit union's proposal, the credit union may retain the collateral and need not sell it.
- If written objection is received within the 21-day period, the credit union must sell the collateral.

Non-Consumer Goods

In the case of repossessed collateral other than consumer goods -- regardless of the percentage of the loan the debtor has repaid -- the credit union may retain the collateral in full satisfaction of the indebtedness if the following steps are taken:

- The credit union must send written notice of its intention to retain the collateral in full satisfaction of the indebtedness to:
 - the debtor;
 - any secured party who has a security interest in the collateral (Note – The credit union's interest will still be subject to superior liens); and
 - any person known to the credit union to have become the owner of the collateral without assuming the debt.

Any person entitled to receive notice may, after default, waive, in writing, his or her right to receive notice (such a provision cannot, under the UCC, be part of the security agreement).

- If no written objection is made to the credit union's proposal within 21 days after the persons entitled to notification have received notice of the credit union's proposal, the credit union may retain the collateral and need not sell it.
- If written objection is made within the 21-day period, the credit union must sell the collateral.

The law also allows a credit union to propose to retain goods in partial satisfaction of an

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

obligation if the goods are not consumer goods. The procedure can get involved; the credit union should contact its attorney if it wants to pursue this approach in a given situation.

Manner and Method of Selling the Collateral After Repossession

Sale of the collateral must be made in a "commercially reasonable" manner. Ultimately, what will be deemed "commercially reasonable" is a question for a court to decide. So long as this requirement is met, the sale may be made:

- at public or private sale;
- at any time;
- at any place; and
- on any terms, e.g., cash or credit or a combination of both.

The collateral may be sold in its existing condition or after reasonable repair and preparation for sale.

Notification of Sale

No notification of sale is necessary if the collateral is:

- perishable;
- of a type which threatens to decline speedily in value; or
- of a type customarily sold on a recognized market (e.g., the stock exchange).

In other cases, if the sale involves consumer goods, the credit union must give reasonable notification of the sale to the debtor and any person known to the credit union to have become the owner of the collateral without assuming the debt.

If the sale does not involve consumer goods, the credit union must give reasonable notification of the sale to the following persons:

- the debtor;
- any secured party who has a security interest in the collateral and who has given the credit union written notice of a claim of an interest in the collateral; and
- any person known to the credit union to have become the owner of the collateral without assuming the debt.

Any person entitled to receive notice may, after default, waive, in writing, his or her right

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

to receive notice. Here, too, the UCC does not allow such a provision to be part of the security agreement.

Contents of Notification of Sale

The Uniform Commercial Code actually refers to the notice as being a notice of disposition. However, since credit unions routinely sell the items involved, here we will refer to it as a notification of sale. The notification of sale must contain all of the following information:

The names of the debtor(s) and the secured party

A description of the collateral that is the subject of the notification

The intended method of disposition (sale, lease, etc.)

The fact that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting.

States the time and place of a public sale of the time after which any other sale (such as a private sale) is to be made.

In the case of consumer goods, the following information must be provided in addition to the information described above:

A description of any liability for a deficiency of the person to whom the notification is sent. This may differ depending on the person to whom the notification is sent.

That, for example, a situation where a husband takes out a loan in his own name, but he and his wife both grant the credit union a security interest in their jointly owned automobile and the automobile is repossessed due to non payment. The notification to the husband would state that he would be liable for any deficiency, but the notification to the wife (remember, each must received an individual, separately mailed notice) would state that she is not liable for any deficiency (since she didn't sign the loan as a borrower).

A telephone number that the debtor can use to contact the credit union to find out how much must be paid to the credit union to redeem the collateral.

A telephone number or mailing address from which additional information concerning the sale (disposition) and the obligation secured is available.

In the case of a public sale, the notice must state the time and place of the sale. In the case of a private sale, the notice must state the time after which the sale will be made. Note that auctions that aren't open to the public (such as many dealer auctions) are considered private sales.

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See Appendix G for sample sale notices.

Application of the Proceeds of the Sale of Repossessed Collateral

Proceeds of the sale are first applied to the following expenses incurred by the credit union:

- expense of repossession;
- expense of holding and storing the collateral;
- expense of reasonable repairs and preparation of the collateral for sale;
- expense of selling the collateral;
- reasonable attorneys' fees and legal expenses if provided for in the security agreement and allowed by the court (*unfortunately, Michigan courts usually do not allow creditors to collect these attorney fees and legal expenses*).

Proceeds of the sale are next applied to the accrued interest on the loan.

Proceeds of the sale are next applied to reduce the principal balance of the loan.

Proceeds of the sale are next applied to the discharge of any indebtedness owed by the debtor to any party holding a subordinate security interest in the collateral if:

- such subordinate secured party makes written demand upon the credit union; and
- proof of the subordinate security interest is furnished to the credit union if requested.

Proceeds of the sale are next applied to reduce the balance of any other loan the member has defaulted on, if the credit union's security agreement contains a cross collateral clause.

Any proceeds remaining after the foregoing distribution must be turned over to the debtor or to the owner of the collateral who had purchased the collateral without assuming the debt, if such owner is known to the credit union.

Explanation of Sale of Collateral

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

After selling repossessed collateral, the credit union should immediately send to all persons obligated on the debt and any other owner of the collateral a written explanation. Note that electronic substitutes are not allowed to be used to meet this requirement, the explanation must be written! Each person involved should receive a separate explanation, separately mailed.

The explanation needs to do all of the following:

1. State the amount of the surplus or deficiency resulting from the application of the sale proceeds to the secured debt.
2. Provide an explanation concerning how the credit union calculated the surplus or deficiency showing the following information in the order shown:
 - a. The aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest (unusual for a credit union loan) an indication of that fact, calculated as of a date that is not more than 35 days before the credit union takes possession of the collateral if the credit union took possession after default (the usual case). If the credit union took possession before default or disposed of the collateral without ever taking possession, the date must be a date not more than 35 days prior to the disposition.
 - b. The amount of the proceeds of the disposition.
 - c. The aggregate amount of the obligations remaining after deducting the amount of the proceeds.
 - d. The amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and attorneys fees (to the extent allowed by the court) secured by the collateral that are known to the credit union and relate to the disposition.
 - e. The amount, in the aggregate or by type, and types of credits, including rebates of interest, to which the obligor is know to be entitled and that are not reflected in item "a" above. This could include, for example, a rebate of the unearned portion of collateral protection insurance premiums that were added to the loan.
 - f. The amount of the surplus or deficiency.
3. State, if applicable, that future debits, credits, etc. may affect the amount of the surplus or deficiency. The most common item is interest accruing on the deficiency balance.
4. Provide a telephone number or mailing address from which additional information concerning the transaction is available.

A sample explanation letter appears in Appendix G.

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

Right to Deficiency

If the proceeds of the sale are not sufficient to discharge the indebtedness, the debtor remains liable for the deficiency, unless the debtor lives in one of the few states (Michigan is not one of these) that do not allow collection of deficiencies. A Co-signer guarantor will also be liable for the deficiency, although a person who only provided collateral without signing on the loan itself would not be liable. The deficiency may be pursued on a regular collection basis. Keep in mind that if a co-signer pays the remaining balance, the credit union must take all necessary steps to transfer the note to the cosigner so the cosigner can collect from the debtor. When a cosigner pays the balance owed to the credit union, the cosigner is in actuality purchasing the debt involved, not paying it off. If the credit union does anything to jeopardize the cosigner's ability to collect from the debtor, the credit union could be liable to the cosigner for the resulting loss.

Debtor's Right to Redemption

The debtor (if he/she has an interest in the collateral) or any other person with an interest in the collateral can redeem it at any time before the secured party has:

- sold the collateral;
- entered into a contract for sale of the collateral; or
- discharged the indebtedness by retaining the collateral in full satisfaction of the debt rather than selling it.

In order to redeem, the debtor, any other party with an ownership interest in the collateral, or any secured party whose lien is inferior to the credit union's must tender fulfillment (payment) of all obligations secured by the collateral and must tender payment of all expenses reasonably incurred by the credit union:

- in repossessing the collateral;
- in holding and storing the collateral;
- in repairing and preparing the collateral for sale;
- in arranging for sale of the collateral; and
- for reasonable attorneys' fees and legal expenses, to the extent provided in the security agreement and allowed by the court. *(Note: Michigan courts usually do not allow creditors to collect these attorney fees and legal expenses.)*

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

The credit union may allow a redemption for less than a full loan payoff and reinstate part of its loan balance, if it chooses, but it isn't obligated to do so.

Under the Bankruptcy Code, the debtor may be able to redeem for less than the amounts shown above, depending on the value of the collateral. Please refer to the MCUL's "Bankruptcy Manual" (in the Compliance Management System Bankruptcy & Collections binder) for a further discussion of this topic.

After default, the debtor or any other party with an interest in the collateral can execute a written waiver of his or her right to redeem.

As noted above, a person who has become the owner of the collateral without assuming the debt has the same right to redeem as the debtor and must be given an assignment of the credit union's rights against the debtor if he or she does redeem the collateral.

Right of the Credit Union to Purchase the Collateral After Repossession

The credit union may purchase the collateral when it sells it at a public sale. The credit union may even purchase the collateral by private sale if the collateral is of a type which is customarily sold in a recognized market (e.g., the stock exchange), or which is the subject of widely distributed standard price quotations. Most credit union collateral, such as used automobiles, will not fall within either of these two categories.

Liability for Failure to Comply with Default Procedures

When collateral involved is consumer goods, the debtor can recover any loss actually caused by the failure of the credit union to comply with the default procedures, and can also recover all of the finance charge, plus 10% of the principal amount of the debt.

In the case of other types of collateral, the debtor can recover any loss actually caused by the credit union's failure to comply with the default procedures.

In addition, the credit union will be liable for failure to comply with the default procedures to other parties entitled to notification under the default procedures. Such liability will extend to any loss actually suffered due to the credit union's failure to comply.

The credit union may also lose any right to a deficiency if it fails to comply with default procedures.

SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

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SECTION IV PROCEDURES AND REMEDIES AFTER DEFAULT

SECTION IV SELF TEST

1. True A loan is in default whenever the debtor misses a required payment
 False or has breached any other provision of the loan contract or security agreement.
2. True Generally speaking, the repossession of an automobile while it is on
 False public property and unattended will be considered involving a breach of the peace, and is therefore not allowed under the UCC.
3. True If a debtor refuses to surrender collateral, or the collateral is located
 False in a place such that self-help repossession would be illegal, the credit union should place the matter in the hands of its attorney to use appropriate court proceedings to obtain the collateral.
4. True When a credit union repossesses consumer goods, it must sell those
 False goods if the debtor has repaid less than 60% of the cash price.
5. True The UCC requires that the sale of repossessed collateral must be
 False made in a "commercially reasonable" manner.
6. True Regardless of the type of collateral involved, a credit union must
 False provide written notification of sale to its member **prior** to selling repossessed collateral.
7. True After selling repossessed collateral, a credit union must apply funds
 False first to its member's loan balance. Any proceeds remaining after the member's loan has been paid in full may then be applied to the expense incurred by the credit union in repossessing the collateral.
8. True Michigan law does not permit a credit union to attempt collection of
 False a deficiency balance.
9. True Michigan law does not permit a credit union to allow its member to
 False redeem his or her repossessed car unless the member pays the loan in full.
10. True A credit union may be liable to its member for damages if the credit
 False union fails to follow the UCC's default procedures.

**SECTION IV
SELF TEST**

ANSWER

1. True
2. False
3. True
4. False
5. True
6. False
7. False
8. False
9. False
10. True

APPENDIX A

Mobile Homes and Fixture Problems

Many questions have arisen in the past concerning security interests in mobile homes and fixtures. Questions have especially arisen in this area concerning the credit union's priority over the rights of owners and mortgagees of the land on which mobile homes are to be located.

Perfection of a Security Interest in Mobile Homes

Purchase of a Mobile Home from a Dealer

When a licensed mobile home dealer sells a mobile home, new or used, the dealer will be required by rules of the Department of Consumer and Industry Services to execute a form S-111 (which is very similar to the RD-108 used by the Secretary of State in the case of dealer sales of cars and trucks). This S-111 form is a combination of a bill of sale from the dealer to the buyer and an application to the Department for a certificate of title.

The dealer and the buyer both sign this S-111 form and their signatures are notarized. The dealer must file the form with the Department. A \$45 fee must accompany the S-111 form. The dealer will collect that money from the buyer but will use its own check to pay the fee. This \$45 can be included in the amount financed on the sale.

It is imperative that the credit union's name and address as the first secured party appear in this S-111 form before it is filed with the Department.

How can the credit union assure that its security interest will be shown in the S-111? The surest approach would be for the credit union to handle the paperwork itself. The next best approach we can determine is to create a contractual obligation of some sort requiring the dealer to take the necessary steps. For more details on how to approach this problem, note our CMS Lending Publications Release dated January 2001 entitled "Perfecting Mobile Home and Watercraft Liens."

Even if the S-111 is properly filled out, is properly signed and notarized, shows the credit union's security interest, and is filed with the Department of Consumer and Industry Services along with the \$45 fee, **perfection will not** occur until the Department has **issued** the actual certificate of title, **in correct form**. Therefore, the only way the credit union can be **sure** it is perfected (and when perfection occurred) is to **see** the certificate of title after it is issued by the Department. In order to do this, the debtor must bring the certificate to the credit union after he or she gets it. Or, prior to disbursing the loan, the credit union can require its members to sign a TR-114 form (available from Secretary of State branch offices) authorizing the Department of Consumer and Industry Services to mail the new certificate, when issued, to the credit union rather than to the member. This form can be stapled to the disbursement check and delivered to the dealer. The dealer will then be required to submit the TR-114 form along with the S-111 it will submit to the branch office.

There is a special problem if the credit union finances the purchase of a second-hand mobile home being purchased from a licensed dealer.

In these cases, unlike new mobile home purchases, the dealer will have on hand an outstanding certificate of title surrendered to it by the party that sold or traded that unit to the dealer. By a peculiar quirk in the law, it is possible -- though unlikely -- that the dealer might fail to surrender that earlier certificate of title to the Department when it files the S-111 in connection with the later resale to your member that you are financing. This has already happened in a few cases. Of course, this means that two valid certificates could end up being outstanding at the same time and they could reflect two different security interests.

In this situation, the credit union is faced with some options. One choice is simple but perhaps not practical -- just don't make any loans to finance the purchase of a second-hand mobile home from a dealer.

If the credit union chooses to make these loans, it must take it upon itself, before disbursing the loan, to get the **old** certificate of title, to make sure any security interests noted on it are discharged, and to make sure that the old certificate **is** delivered to the Department along with the S-111 for the **new** certificate of title which is going to show the credit union's security interest.

Purchase-Money Loans-No Dealer Involved:

When financing a members' purchase of a second-hand mobile home from a person who is **not** a mobile home dealer, credit unions will follow the same procedures described above. Here, though, lies an additional problem.

The credit union **must** see to it -- by doing whatever is necessary -- that:

- the seller executes the assignment on the reverse side of the existing certificate of title (make sure it is properly notarized) transferring title to the member;
- the old certificate is delivered to the member; **and**
- the old certificate is surrendered to the branch office of the Secretary of State along with a completed S-110 -- Application for Certificate of Mobile Home Title.

In this case, since there is a transfer of ownership as well as the creation of a security interest, a \$45 fee will also have to be paid for the issuance of the new certificate in the name of the new owner. There is no additional fee for the notation of the lien.

If all this is done, the credit union will get perfection -- but the same questions as were pointed out in the preceding section about **when** it occurs are applicable here too.

In cases of this category, the credit union should not rely on its member to get the old certificate or to make the appropriate filing with the branch office. Credit unions should keep in mind that the seller is not likely to give up the old certificate of title, duly assigned, until he or she gets paid. The loan will be disbursed by then. Once the seller has the money, there will be no pressure, on the seller or the buyer, to protect the credit union's interests. Hence, credit unions need to protect their own interests in these situations.

Non-purchase Money Loans

In the case where the member already owns a mobile home free and clear; has a certificate of title covering it; and now wants to borrow \$5,000 and give the credit union a security interest in the unit, the credit union must have the member sign a form S-110 prescribed by the Department of Consumer and Industry Services. It looks a lot like the TR-11C (which credit unions are familiar with in the case of car deals) and it works in a very similar manner. The S-110 **must** show **the credit union's** name and address as secured party. The form is to be notarized.

The credit union must also get the member's existing certificate of title but it is not necessary for the member to execute the assignment on the reverse side of the certificate since there is no transfer of ownership.

The credit union must then take (1) the old certificate; (2) the S-110 signed by the member, (3) a fee of \$5.00, and (4) an unsigned copy of the S-110 to a branch office of the Secretary of State. For this purpose, the Secretary of State is acting as an agent for the Department of Consumer and Industry Services.

The branch office is to stamp the unsigned copy of the S-110 application with the time and place of filing and return the copy to the credit union. Thereafter the Department of Consumer and Industry Services will ultimately issue a new certificate of title showing the credit union's security interest and will, unless instructed to send it to the credit union, mail it to the member. Just as in the case of purchase money loans, the credit union should have its member sign a TR-114 form so that the certificate will be mailed to the credit union.

One part of the law seems to say that the credit union is perfected at the time the S-110 is **filed** with the branch office. But other parts of the law seem to say just about as clearly that the credit union is not perfected until later (and if) the Department actually issues the certificate of title, in correct form, and mails it out.

Since the credit union can't control what the Department does or doesn't do, even if a court should rule that perfection doesn't occur (in cases like this) until the certificate is correctly issued and mailed, all the credit union can do in any case is to see to it that the steps up to delivery of documents to the branch office are done correctly. Of course, if the credit union has the member sign the TR-114, then it will be able to see if the certificate is in correct form.

The right of rescission: Another important point to keep in mind when using a mobile home as collateral is this -- in a **non-purchase** money transaction, if the mobile home is the primary dwelling of the borrower, Regulation Z (Truth in Lending) provides the member has **three days to rescind the transaction**. The right to rescind does **not** apply to purchase money transactions. Credit unions should refer to the Compliance Management System "Guide to Home Equity Lending" (in the REAL ESTATE binder) for details surrounding a consumers right of rescission.

Mobile Homes as Fixtures

To this point, the subject of this appendix has been how to perfect the credit union's security interest in a mobile home as a piece of tangible personal property, so that the credit union's security interest will be superior to other creditors claiming interest in the unit as personal property. However, mobile homes are often installed upon land in such a manner that owners of the land, or mortgagees of the land, may be able to assert interests in the mobile home. There are steps a credit union can take to protect itself fairly well against such land interests, as will be discussed below.

Mobile Homes Located on Rented Land

Suppose the debtor moves his or her mobile home to a trailer park. The normal rental agreement between a trailer park operator and a mobile home owner contains nothing that would prevent the mobile home owner from removing the mobile home to another location. This is true regardless of the manner in which the mobile home is installed in the trailer park. The law is clear that so long as the debtor has the right to remove the mobile home, the credit union's security interest in it has priority over the rights of the owner of the trailer park and over any party having a mortgage on that real estate. As a matter of fact, this rule will hold true even if the credit union *failed* to perfect its security interest in the mobile home.

The rules just described would, of course, apply in cases where the debtor installs the mobile home on a rented parcel of land -- for example, a 1-acre parcel in the country. So long as the debtor has the right as against the landowner to remove the mobile home, the credit union's security interest (perfected or not) has priority over the rights of the landowner and any mortgagee of the land in question. However, in an arrangement like this it is important for the credit union to find out what kind of a lease its member has with the landowner, so that it can verify that the debtor does have the right to remove the mobile home.

There is an even better way to handle the last type of case. The credit union should make the debtor disclose -- in advance -- where he or she is going to put the mobile home. Then, before making the loan, the credit union can get the owner of that land to sign a written document disclaiming any interest in the mobile home as a fixture (that is, as something that becomes part of the land by being installed on the land). In addition, if there is already a mortgage on the land in question, the credit union can get the mortgagee to sign that disclaimer document too. Once this is done, the credit union has priority over that landowner **and** that mortgagee regardless of how the debtor installs the mobile home on the land. Whether it just sits on its own wheels or the wheels and axles are taken off and it is permanently affixed to a concrete block foundation, the credit union will keep priority if it gets the disclaimer documents.

In a slight variation of the facts just discussed, suppose the credit union did get the landowner to sign the disclaimer and there was no mortgage at the time of the loan, but after the loan was made, the landowner gave a mortgage on the land to a bank. Would the bank acquire an interest in the mobile home and would it be superior to the credit union's security interest? Probably not. So long as the debtor has the right as against the

bank to remove the mobile home, the credit union *will* have priority over the bank. And
under state

property law the debtor probably *will* have such a right to remove, because it is unlikely that the mobile home would be so permanently affixed to rented land that a later mortgagee could successfully argue it had become part of the land. However, to eliminate any possibility of the bank succeeding in this illustration, **the credit union should make a "fixture filing" at the time of its loan** (refer to page 45 for a discussion of fixture filings). This will **assure** the credit union's priority over the bank's later mortgage.

Mobile Homes Located on Debtor-Owned Land

Some fairly complex rules come in to play in cases where the debtor owns the land on which the mobile home is going to be installed.

For example, suppose the debtor is the record owner of the land or is in possession of it, and there is a recorded real estate mortgage on it. The debtor gets a loan from the credit union to buy a mobile home that is to be permanently affixed to that land. The real estate mortgage -- like all real estate mortgages -- provides that anything the debtor permanently attaches to the land will become part of the land and will be subject to the mortgage. What can the credit union do to protect its security interest?

In this case, if the credit union perfects its security interest by a "fixture filing" **before** the debtor installs the mobile home on the land or within 10 days after such installation, it has priority over the *earlier* mortgage.

To review, a "fixture filing" is the filing of a financing statement, in this case covering the mobile home, **in the real estate records** of the Register of Deeds for the county where the land upon which the mobile home is or will be placed is located. Such a "fixture filing" would be **in addition** to getting the credit union's security interest noted in the application for the certificate of title.

Note that in the example just discussed, the loan was a purchase money loan, i.e., the loan was used to buy the mobile home. The results given above do **not** apply if the loan was **not** a purchase money loan. In other words, if the debtor already owned the mobile home and was simply giving it as collateral for a loan, the credit union would **not** be able to get priority over an existing mortgage, **unless** it first gets the mortgagee to sign a disclaimer document.

Note also that in the same example it was stated that the member (1) was the record owner of the land or (2) was in possession of the land. He or she would be the record owner of the land if there was a deed then on record with the Register of Deeds or if a land contract in which the member was the purchaser was so recorded. It is easy to find out if this is the case--simply check the Register of Deeds' records. However, it is not always easy to check on who is in possession of land, and sometimes the credit union can be mistaken even if it tries to check it out. If the member is buying vacant land under an *unrecorded* land contract, he or she may or may not be in possession of it. Credit unions should use caution in making a loan in a case like this.

In light of this discussion, when a credit union is making a loan to enable its member to buy a mobile home, the following steps should be taken:

- ask where the mobile home is going to be placed after purchase;
- if told it is going to be placed on land owned by its member, search the title records to verify that a deed or land contract to the member is recorded;
- if nothing shows up on the land records, get hold of the member's land contract and see *to it that the land contract is recorded before the loan is disbursed.*

Suppose the debtor owns the land free and clear at the time the credit union makes the loan (therefore, there will be a recorded deed to the member). The loan in this example can be either a purchase money loan (to buy a mobile home) or a regular loan (using a mobile home already owned as collateral). The credit union will perfect its security interest by getting it noted in an application for a new certificate of title in either case. And, in either case, the credit union should also make a "fixture filing" relating to the loan because it will then have priority over any later mortgage of the real estate, even if the mobile home is permanently affixed to the real estate. If the credit union fails to make a "fixture filing," its security interest *may* become subordinate to a later recorded real estate mortgage if the mobile home is or becomes affixed to the land in a permanent manner.

Credit Union Rights Versus Other Creditors

Regardless of whether a mobile home loan was a purchase money loan or a nonpurchase money loan, once the credit union has perfected its security interest by getting it noted on the application for the certificate of title, it need not worry about future judgment creditors.

If another creditor later gets a judgment against the debtor and levies a writ of execution against the debtor's land on which the mobile home is installed, the credit union has priority over that other creditor even if the mobile home is attached to the land in a permanent manner. This is true regardless of whether the credit union also made a "fixture filing."

Another potential problem with mobile home financings, though it occurs only rarely, arises in that even if a credit union has priority over all other parties having an interest in the land in question, if the debtor defaults and the credit union takes the mobile home back, the credit union must reimburse such other parties (excepting the debtor) for the cost of repairing any physical injury to the land caused by removing the mobile home. This seems to be a rather remote problem, insofar as mobile homes are concerned. Other types of fixture-collateral (example: furnaces or central air-conditioning units in a residence) would probably create more problems in this area.

Other Fixtures

All of the foregoing discussion has been in terms of mobile homes, as mobile home loans will likely be made by credit unions more than other types of fixture loans. But mobile homes are not the only type of collateral that create problems related to the law of fixtures. Many other items of personal property can become fixtures. A furnace is personal property when sitting on the floor at the local appliance store. However, once installed in a house it has become a fixture (that is, it is now a part of the real estate). The same is true of a

built-in dishwasher.

Credit unions should be aware of a special problem relating to fixture-type collateral such as new furnaces, central air-conditioning units, built-in major appliances, etc. The above discussion explained the importance of the "fixture filing" in terms of providing the credit union with protection against **real estate** interests. But there are other creditors who might get a security interest in the collateral itself. To ensure priority over *those* creditors, the credit union must also file a *regular* financing statement (UCC-1) in the regular way.

In other words, when these types of fixtures are taken as collateral, to be 100% sure, the credit union must file **both**:

- a UCC-1 financing statement with a UCC-1Ad Addendum, which the credit union files with the Register of Deeds for the county in which the land is located, and which is recorded in the real estate records; **and**
- a regular UCC-1 financing statement, which the credit union files with the Secretary of State.

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APPENDIX B

Removal of Collateral to Another State

The following situation arises all too frequently in actual practice: the credit union makes a secured car loan to its member and perfects its security interest in the car in the proper manner (that is, the lien is noted on the application for title in his or her name); the certificate is issued showing the credit union's lien; and the member holds the certificate.

A year later, however, the member moves to Kansas (for example) taking the car along, as well as the certificate of title. Now some big questions arise as to whether or not the credit union's security interest remains perfected in Kansas.

The mere moving of the collateral to Kansas does **not** in and of itself, defeat the perfected status of the credit union's security interest. It will stay perfected when the car is first taken to Kansas. It will also **remain** perfected in Kansas for four months after it was taken there. And it will continue perfected there even *after* the four-month period **unless** the debtor registers the car under Kansas law -- if that happens, the credit union's perfected status ends.

But the debtor can end the credit union's perfected status a lot earlier than stated in the last paragraph in one case. If he or she surrenders the Michigan certificate of title and gets a new Kansas certificate of title, that ends the perfection the credit union previously had under Michigan law. And the debtor *could* do this the day after the car was moved to Kansas.

This may not be as bad as it sounds if Kansas has a law (like Michigan's) **requiring** that security interests be noted on certificates of title. If it does, then the new Kansas certificate of title should still show the credit union's security interest and, probably, the credit union would then get perfected status under the Kansas law.

On the other hand, (for example) if Kansas says that security interests in cars are perfected by filing a financing statement, then there would be no way Kansas authorities could place the credit union's security interest on the new certificate and the credit union would lose its perfected status because it would not be there, in Kansas, to file the required financing statement.

The credit union can always continue uninterrupted perfected status by *perfecting again in the new state* after the car was taken to the new state. Of course, this will only work if the credit union knows the car has been moved. But if the credit union does know about the removal, and if the credit union does re-perfect under the law of the other state before time or debtor action has cut off its perfection, the credit union can thereby continue perfection right on into the other state.

Realistically speaking, it is much more likely that the debtor can and will defeat the credit union's perfection, even if the credit union learns about the removal. Suppose, for example, Kansas, like Michigan, has a law saying the only way to perfect a security interest in a car is to get it noted on the certificate of title. The credit union may have difficulty doing this in Kansas (in this hypothetical case) because it doesn't have the old

Michigan certificate to turn in when it applies for a new Kansas certificate of title. In fact, creditors may not even be allowed to apply for the Kansas title.

In a nutshell, once a debtor moves titled collateral to another state, there really isn't too much of a practical nature the credit union can do to prevent the defeat of its Michigan perfection.

There are two main problems with losing perfected status if the debtor moves the car to another state. First, the member could give a security interest in the car to another lender in the second state and that lender (if it perfects under that state's law) could attain priority over the credit union's security interest. Second, the debtor could go bankrupt after leaving Michigan and, if the security interest has become unperfected, the credit union would lose the car to the bankruptcy trustee. Clearly, then, a credit union could have real problems when its collateral is taken out of state permanently.

What should be done about it -- and what *can* be done about it?

One alternative is to do nothing at all. This is fine so long as the debtor keeps up payments after moving to another state. And, of course, in most cases payments will be kept up.

Another thing the credit union can do is to repossess the car in the second state. The credit union can do this even if payments are current because -- at least under the CUcorp security agreement forms -- taking the car to another state is in itself a default that, like defaults in payment, allows the credit union to repossess. However, it is always a very drastic step to repossess a car when payments are still current. A credit union would probably be reluctant to do this.

The only other alternative is referring these cases to the credit union's attorney. He or she may be able to find something in the law of the second state that can help the credit union keep perfection there.

Note that this discussion deals with collateral where the credit union perfects its security interest via notation of a certificate of title. If perfection of its lien was originally done by filing a financing statement, the credit union can usually continue its perfection by filing a new financing statement (which either the credit union or the debtor may sign) with the proper official in the new state.

APPENDIX C

Lien Perfection and Future Advances

Under the CUcorp standard revolving credit plan, once security is taken it remains as security for all later advances under the plan (at least until such time as the credit union releases the collateral). So once the credit union has perfected its security interest in collateral, it remains perfected as security not only for the balance outstanding at the time but also for advances made later. However, even though that security interest is perfected, the credit union may not have first priority on future advances.

Suppose that the credit union has perfected as to collateral given to it by its revolving credit plan debtor. A year later another creditor gets a judgment against that debtor and levies a writ of execution on the same collateral. At that moment the debtor's balance to the credit union is \$3,000. After the other creditor has levied, the credit union advances an additional \$500 to the debtor. In this case, the credit union definitely has priority over the other creditor as to the \$3,000. But the credit union will be *subordinate* to that other creditor as to the new \$500 advanced *if the credit union knew about that creditor's lien when it made that \$500 advance*. However, if the credit union made the \$500 advance during the first 45 days after the other creditor made its levy, it **will** have priority -- even as to the \$500 advance -- even if the credit union knew of the other creditor's lien when it made the advance.

A somewhat similar situation occurs if the revolving credit plan debtor sells the collateral after the credit union has perfected its security interest. The credit union will remain perfected as to all advances made prior to the sale. However, the buyer will take the collateral free of the credit union's security interest as to any advances made more than 45 days after the sale or after the credit union learns of the sale, *whichever occurs first*. This result will likely follow even if the buyer knows about the credit union's security interest and even if the member's sale of the collateral is a violation of the security agreement signed with the credit union.

What about the case where the revolving credit plan debtor has given the credit union collateral, the credit union has perfected by filing, and the debtor later gives a security interest in the same collateral to another lender which the other creditor also perfects by filing? Where does the credit union stand if it makes more advances on the plan after the second security interest has been perfected?

In this case, the general rule of priority applies. So long as there is no break in the perfection of the credit union's security interest, the credit union will have priority over the later secured creditor, not only as to the balance outstanding when the later creditor perfected, but also as to advances made on the credit union's plan *after* the second creditor has perfected. Keep in mind, however, the credit union's obligation to release its lien if the balance under the plan is reduced to zero.

The foregoing discussion has been made in terms of revolving credit plans. However, these rules will also apply to closed end loans if the credit union's security agreement provides that the collateral will serve as security for future advances and, the credit union

does in fact make future advances using the same collateral and security agreement.

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APPENDIX D

Financing Statements -- Duration of Perfection

The UCC provides that all financing statements are effective for five years after filing.

A financing statement can be renewed for additional five-year periods by filing a continuation statement. Continuation statements must be filed during the six-month period preceding the end of the five-year period. Only the secured party need sign a continuation statement. Note however, if the financing statement was originally filed with the Register of Deeds but the security is now (due to the law change) in a category where the financing statement must be filed with the Secretary of State (that is, farm equipment, farm products, and consumer goods), the procedure is different. For those situations, the credit union must file a new financing statement with the Secretary of State. This financing statement should make reference to the earlier filing with the Register of Deeds with enough information to locate the earlier filing. Further continuations will need to be filed with the Secretary of State based on the filing date of the new financing statement.

Filing of continuation statements is becoming more and more important in credit union operations. Revolving credit plans may remain in effect for much longer than five years. Mobile homes often require financing lasting well over five years. So, for example, where a credit union does a "fixture filing" for a mobile home and the pay-out period is seven years, it will be necessary to file a continuation statement at the right time in order to keep the "fixture filing" continuously perfected.

Under the revisions to the UCC, if the debtor goes into bankruptcy, the validity of a filed financing statement is no longer automatically extended, it still expires at the end of the five-year period expires. But the credit union can still and should) renew the filing, in the six-month period preceding expiration of the original five-year period.

Another UCC provision states that if a security interest lapses by expiration of the financing statement, then it is considered unperfected as against a purchaser or lien creditor who became such prior to the lapse.

What does this mean to the credit union? Suppose the credit union perfected a security interest in collateral by filing a financing statement. Four and one-half years later another creditor gets a judgment against the debtor and levies a writ of execution against the same collateral. When this happens, the other creditor acquires a lien (i.e., a security interest in that collateral), but it is *subordinate* to the credit union's security interest. If six months later the credit union lets its financing statement lapse, the other creditor's lien becomes superior to the credit union's, because the credit union's security interest would then be deemed to have been unperfected as against that other creditor.

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APPENDIX E

If the Member Sells the Collateral

Suppose a credit union makes a loan to a member and takes as collateral a snowmobile or other property for which a certificate of title is not required. The credit union perfects its security interest by filing a proper financing statement in the proper place. Now, suppose the debtor later sells the snowmobile to his brother-in-law. The credit union knows about the sale but does nothing because loan payments are kept current. Later on, the brother-in-law gets a loan from a bank and offers the snowmobile as collateral. The bank searches the public records in the name of the brother-in-law and, naturally, it doesn't discover the credit union's financing statement covering the snowmobile. So it makes the loan and then it files a financing statement covering the same snowmobile but, of course, indexed in the brother-in-law's name. Now there are two financing statements, covering the *same* collateral but indexed (possibly in two different counties) in the names of two different debtors.

Now assume the worst -- the credit union's debtor goes sour, or the brother-in-law goes sour, or both do. Whose security interest is superior, the credit union's or the bank's?

The UCC gives a clear answer. In the case illustrated, the credit union wins over the bank, even though it did nothing after learning about the sale to the brother-in-law. In fact, the credit union wins even if it **consented** to the member's sale to the brother-in-law.

There is no duty, in order to protect its position, that the credit union file some kind of an amendment to its financing statement to notify the rest of the world that its member no longer owns the snowmobile and to identify the new owner, unless its member removes the property to another state (see Appendix B).

This is great so long as the credit union is on the winning end. But it can also end up on the losing end. Suppose it was *the credit union*, in the above illustration, which made the *later* loan to the brother-in-law!

Clearly then, it can be very important for the credit union to find out from its member where he or she got the collateral being offered as security. If the credit union was told it was purchased second-hand from a certain person, the credit union would have to check public records in that person's name, as well as in its member's name, to make sure there are no prior security interests outstanding.

The above discussion deals with collateral where the credit union perfected its security interest using a financing statement. What if it perfected with a notation on a certificate of title? The Michigan Secretary of State's office will not allow a transfer of title without the consent of the lienholders, so the credit union should be protected. The Secretary of State also won't release a lien without the secured party's consent. However, a member may sell his or her automobile to someone who lives in another state. This could create a problem (refer to Appendix B for a discussion on removal of collateral to another state).

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APPENDIX F

Proceeds of the Credit Union's Collateral

If a member sells collateral in which he or she has given his or her credit union a security interest, the money received constitutes "proceeds" of the collateral. Similarly, if the collateral is traded for other property (example: a snowmobile traded for a riding lawn tractor), the property received in exchange is also a form of "proceeds" of the collateral.

The UCC provides that for all security agreements executed after January 1, 1979, proceeds of collateral will automatically be subject to the security interest granted in the original collateral, unless the security agreement says otherwise.

The various security agreements printed by CUcorp do provide that "proceeds" of the collateral covered are also subject to the security interest granted. MICH 821 specifically refers to insurance proceeds, which is the major area of concern. The financing statement, by merely identifying the collateral in question, will give notice of the fact that the credit union's security interest extends to "proceeds" of that collateral.

A specific provision of the UCC makes clear that and insurance claim paid because of loss of or damage to the collateral is considered proceeds and, therefore, is subject to the credit union's security interest, unless by the terms of the insurance policy it is payable to someone other than the credit union or the debtor.

As has been stated above, if a credit union is perfected by filing as to the original collateral, it is also perfected as to the proceeds of collateral. There are, however, some exceptions to this general rule -- in certain cases perfection as to the proceeds continues only for 10 days after the debtor gets the proceeds. Without going into these rather complicated provisions, suffice it to say that if a credit union discovers that its member has gotten rid of collateral, it must start proceedings immediately against whatever proceeds the member got, or take the risk of losing its perfected security interest in those proceeds.

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APPENDIX G

Sample Repossession Forms

(Name and address of credit union)
(Date)

**NOTICE OF OUR PLAN TO SELL PROPERTY
(Public Sale)**

To: (Name and Address of any obligor who is also a debtor/owner of the collateral)

Subject: Loan Number _____, with an unpaid balance of \$ _____
owed by (name of persons obligated on the loan) to _____
Credit Union.

We have your (describe collateral) because you broke promises in our agreement.

We will sell (describe collateral) at a public sale. The sale will be held as follows:

Date:

Time:

Place:

You may attend the sale and bring bidders if you want.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you will still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at (telephone number).

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at (telephone number)(or write to us at (credit union's address) and request a written explanation.

If you need more information about the sale, call us at (telephone number) or write us at (credit union address)

We are sending this notice to the following other people who have an interest in (describe collateral) or who owe money under you agreement: (Names of all other debtors and people with an interest in the collateral, if any.)

(Name and address of credit union)
(Date)

NOTICE OF OUR PLAN TO SELL PROPERTY
(Private Sale)

To: (Name and Address of any obligor who is also a debtor/owner of the collateral)

Subject: Loan Number _____, with an unpaid balance of \$ _____
owed by (name of persons obligated on the loan) to _____
Credit Union.

We have your (describe collateral) because you broke promises in our agreement.

We will sell (describe collateral) at a private sale sometime after (date).

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you will still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at (telephone number).

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at (telephone number)(or write to us at (credit union's address) and request a written explanation.

If you need more information about the sale, call us at (telephone number) or write us at (credit union address)

We are sending this notice to the following other people who have an interest in (describe collateral) or who owe money under you agreement: (Names of all other debtors and people with an interest in the collateral, if any.)

Note that these forms assume that the borrower also owns the collateral. If an owner of the collateral is not obligated on the debt, the form will have to be modified to indicate that such person will not owe the credit union any money if the collateral is sold for less than the loan balance. Other modifications may also be needed from time to time depending on the circumstances of the transaction involved.

EXPLANATION OF SALE OF COLLATERAL

The revisions to Article 9 of the Uniform Commercial Code do not prescribe a form for the Explanation of Sale of Collateral. The following information and the details contained on page 58 should assist a credit union in drafting up a form to fit its own circumstances. We suggest a format along the following lines:

Name of Credit Union:

Date:

Explanation of Sale of Collateral

To: (Name and address of debtor or other party with an interest in the collateral)

We have sold the (describe collateral) securing your (described secured loan). After applying the proceeds to the secured loan, there is a (surplus)(deficiency) of \$_____.

The (surplus)(deficiency) was calculated as follows:

A. Aggregate debt secured by security interest in the Sold collateral, calculated as of (date)	\$ _____
B. Proceeds from sale:	\$ _____
C. "A" minus "B":	\$ _____
D. Expenses of Sale (and Attorneys Fees if allowed By a court)	\$ _____
E. Credits not included in "A" (if any)	\$ _____
F. Deficiency or Surplus	\$ _____

Future debits or credits (describe, such as interest accruing on the deficiency or potential proceeds from the sale of other collateral) may affect the amount of the (surplus)(deficiency).

Additional information may be obtained from the credit union by calling the credit union at (Phone Number) or writing to the credit union at (address).

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APPENDIX H

Expedited Search Requests

A regular search of the records at the Secretary of State, UCC Division, takes between 10 and 14 days to complete. A credit union seeking to cut down this time may wish to consider the Secretary of State's expedited search procedures.

Before obtaining an expedited search, the credit union must acquire a billing account number with the Secretary of State. To open a billing account, the credit union should telephone the Secretary of State, Finance Division, Accounts Receivable Unit, at 1-517-322-6716. Once it has a billing account number, the credit union can make search requests by phone or fax. The UCC Division's phone number is 1-517-322-1144, and its fax number is 1-517-322-5434.

All requests received by the UCC Division by phone or fax are considered expedited search requests. If received between 8 a.m. and 11 a.m., an expedited search request will be completed by 3 p.m. the same day. The results of an expedited search request are not given over the phone -- they are instead mailed to the requesting party. The UCC Division will send the results via express mail if an express mail account is provided with the request.

The cost to the credit union for an expedited search is \$6.00 plus \$25 per debtor name, plus \$2.00 per copy if copies are requested.

NOTES:

APPENDIX I

Forms: Reference Table

In this manual reference has been made to many forms. The following table is provided to serve as a guide to credit unions. These forms are available through most business forms providers, including CUcorp. Credit unions can contact the CUcorp Supply division at 1-800-262-6285, extension 295.

Form Number	Form Name	Form Use
MICH 821	Note, Security Agreement, and Truth-in-Lending Disclosure	To make closed-end loans.
MICH 552-A	Security Agreement for use with Revolving Credit	To add specific items of collateral to a revolving credit plan.
UCC-1	UCC Financing Statement	To perfect security interests in most items of personal property.
UCC-1Ad	UCC Financing Statement Addendum	To perfect security interests in personal property (Fixtures/Timber/As-Extracted Collateral) attached to specified real estate. Also used for adding additional names or information
UCC-3	UCC Continuation Statement	To continue, assign, terminate, amend, or partially release security interests covered by a financing statement.
UCC-3Ad	UCC Financing Statement Amendment Addendum	For use in conjunction with a UCC-3 to add additional names or information
UCC-11	Information or Copy Request	To search UCC records.
TR-11C	Application for Certificate of Title and Registration	To apply for a title to a <u>used</u> car.
RD-108*	Application for Michigan Title-Statement of Vehicle Sale	To apply for a title for a <u>new</u> car.
S-110	Michigan Department of Consumer and Industry Services - Mobile Home Commission - Application for Certificate of Mobile Home Title	To apply for a title for a used mobile home when not being purchased from a dealer.
S-111*	Dealer/Broker Application for Certificate of Mobile Home Title and Statement of Mobile Home Sale	To apply for a title when mobile home (new or used) is being purchased from a dealer.
TR-114	Special Mailing of Certificate of Title	To have a title mailed to lender instead of owner.
TR-10	Certification of Repossession	To apply for a new title after repossession.

* The RD-108 and S-111 forms are listed here for reference purposes only. Credit unions will not need to maintain a supply of them.

NOTES:

Generally, a secured transaction is a loan or a credit transaction in which the lender acquires a security interest in collateral owned by the borrower and is entitled to foreclose on or repossess the collateral in the event of the borrower's default. The terms of the relationship are governed by a contract, or security agreement. In the United States, secured transactions in personal property are governed by Article 9 of the Uniform Commercial Code. The Secured Transactions Guide recommends that the following information and only the following information needs to be provided in an initial notice for the registration to be effective: (a) the identifier and address of the grantor; (b) the identifier and address of the secured creditor or its representative; (c) a description of the encumbered asset; (d) the duration of the registration, if.