Lien Solutions

5 THINGS YOU CAN’T AFFORD TO OVERLOOK WHEN MANAGING YOUR LIEN FILINGS
UNIFORM COMMERCIAL CODE (UCC) FORMS ARE CRITICAL TO SECURED LENDING PROCESSES AND SEVERAL KEY DISTINCTIONS CAN GREATLY AFFECT A LENDER’S STANDING.

That’s why there are plenty of reasons to be concerned about filing liens properly. The modern financial landscape is littered with potholes that can trip you up if you’re not careful. If lenders do not secure their asset because of an overlooked nuance, the ability to collect if something goes wrong is affected or completely compromised.

While it can be extremely difficult to keep track of all the granular aspects of the UCC and secured lending, there are ways to mitigate the inherent risks. This paper considers five things that a lender simply cannot afford to miss when managing their lien portfolio. If they are addressed properly, a lender can confidently perfect their interest in a loan.
Even the smallest difference can cause a mountain of problems

The debtor name that is used on a filing is arguably the very first step in lien perfection. If you don’t get that right, the rest of the process is nearly irrelevant.

The Uniform Commercial Code dictates the basic rules about names and business entities. Those rules can be found in Section 9-503 of Article 9 of the UCC under “Name of Debtor and Secured Party”. The main idea here is that the filing must “sufficiently provide the name of the debtor,” but it has been left to bankruptcy courts to clarify what that means, exactly.

A single incorrect letter proves costly

Consider the case of Ronald Markt Nay v. LEAF Capital Funding, LLC (U.S. Bankruptcy Court for the Southern District of Indiana). MainSource Bank (MainSource) filed a financing statement against Ronald Markt Nay (debtor) on Feb. 4, 2014. The financing statement was a blanket lien, and was filed against the individual debtor name “Ronald Markt Nay.”

LEAF Capital Funding (LEAF) made a loan to the debtor to finance the purchase of a Terex TA400 Dump Wagon (a brand of high-capacity dump truck). The lender diligently filed a financing statement on Dec. 21, 2015. LEAF made a second loan to the debtor to finance the purchase of a Terex 3066C Dump Wagon, and filed a financing statement for that loan on Dec. 10, 2015.

Each of the LEAF financing statements identified the debtor’s name as “Ronald Mark Nay,” while the debtor’s actual name listed on his most-recently issued, unexpired Indiana driver’s license is “Ronald Markt Nay.” There is but a single letter difference in the names; however, that difference proved crucial and costly.
Nay and his wife, Sherry L. Nay, filed a Chapter 11 bankruptcy on May 13, 2016. Indiana has adopted the 2010 Amendments to Article 9 of the UCC. These amendments include an important provision stating that a financing statement sufficiently provides the debtor’s name only if it provides the “full, correct” name of the individual as indicated on their driver’s license. As noted above, LEAF’s statements did not, as there was a subtle difference in the spelling between the debtor name statement and the one on driver’s license.

That difference brought a key question to the forefront: Is using an alternate name permissible when conducting a UCC search? LEAF claimed that an Indiana filing office administrative rule permitted searches on variations of the debtor’s “full, correct name.” MainSource contended that alternative names are not permitted, as the statute itself provides that the “full, correct name” of the debtor is the name as it appears on his or her Indiana driver’s license. The court agreed with MainSource.

The court explained that, under Section 9-506, the variation of a debtor name on the financing statement is not considered seriously misleading if it is uncovered during a search of the full, correct name using the filing office’s standard search logic and while searching the filing office’s official records. In this case, the filings containing the name variant were not found when a search of the correct name was made, and thus the filings are legally ineffective.

The court found that the security interests of LEAF Capital Funding were unperfected (or unsecured), meaning their place in the line of secured lenders was not guaranteed. MainSource Bank, not LEAF, held the first priority lien against the collateral. In other words, MainSource gets to recover the debtor’s collateral before LEAF. LEAF, therefore, may have to settle for significantly less, if it receives anything by the time the secured lender is satisfied.

**State-issued I.D. is the standard**

The easiest way to ensure the correct name is used on the UCC: the debtor’s driver’s license. In 2013, the 2010 amendments to Article 9 took effect. Among other provisions, the amendments provide that a driver’s license (or state-issued I.D.) is the correct source for determining an individual debtor’s name for a financing statement.
Keeping your finger on the pulse of your portfolio

Has an entity changed their name but not informed you? Have they merged, dissolved or lost good standing? Has someone terminated your UCC filing without your knowledge? Without searching and checking your filings or entities regularly, you might not know. And, not knowing can leave you vulnerable and at risk.

A UCC is good for five years and if it’s continued, that adds another five years. Plenty of things can happen during those five-year periods. Debtors may change their name. Businesses may have merged with another company, dissolved or lost good standing. In other cases, it’s possible somebody terminated your filing without you knowing.

What we’re talking about here are items filed against your lien that you, as the lender, did not authorize or aren’t aware of. If your borrower takes our other loans and UCCs are filed, it impacts their ability to pay you, and your risk grows with every additional lien that’s filed.

Most lenders feel confident that they are on top of things. They believe that their paperwork is accurate and that the borrower will communicate any changes on their end. But belief and reality can all too often be polar opposites. Many are simply not aware of every filing made by other lenders or even law firms that file on behalf of an anonymous lender.

As we have discussed, the correct name is important and therefore a name change can have a large effect on a lien. But name changes can raise another red flag as well. Often a business changes their name after they have had an adverse status change, such as a lawsuit or bad
publicity. The new name is a way to avoid or get away from the potential bad effects. It may even be a way to avoid you, the lender.

A debtor has 120 days from the time they change their name to amend it on the UCC filing and have that filing perfected. 120 days in the business world goes by quickly and, your customer probably doesn’t realize the importance of making you aware of changes to their business. By the time they get around to telling you, you’re already at risk.

An automated UCC lien monitoring program can be a useful and cost-effective solution to this problem. Lien monitoring can automatically detect changes that affect lien perfection, including debtor name and status changes, subsequent UCCs and more.
Amendments that work for you...but can work against you as well

A UCC-3 is used for multiple purposes: amendments, assignments, continuations and terminations. These classifications relate to changes made to an original lien filing (UCC-1). A UCC-3 is vital if a loan is for longer than five years. If an originated loan has not been paid off within five years, a lender has to continue it. That’s done with a UCC-3. If a debtor changes their name during the life of the loan, you have to amend your filing. That’s done with a UCC-3. If the collateral changes, you have to amend it. That’s done with a...well, you get the idea.

How can a lender ensure that the protections it puts in place through a UCC filing are maintained over time? A recent client case study reveals an informative and illustrative example.

Safeguarding assets through Auto Continuation

Traditionally, the client assigned an employee or group to manually monitor and address expiring UCC-1s, and file the appropriate continuations with UCC-3s. Upon examination, this practice was found to present several inherent risks. For example, as personnel change over time, oversight can lapse, and with employees increasingly responsible for a greater workload, keeping up with expiring UCCs can get lost amidst everyday demands.

Previously, a single employee in loan operations would monitor filings with end-dates coming up. But, when this employee left the company, management eventually realized that no one was focused on watching expiring liens anymore. What was needed was a
more surefire way to ensure that, where appropriate, liens would be continued without
the risk of a loss of perfection.

Use of Auto Continuation began at the beginning of the year. The impacts were felt
immediately. Many of the client’s loans are longer-term – with lifecycles of up to 25 years
– so continuation is the default in these cases. However, the client prefers to err on the
side of caution – it would rather accidentally continue a lien than accidentally let one
lapse. It’s much easier to go back and terminate without any consequences or negative
impact than it is to re-file an expired lien.

Another example involves ensuring that UCC filings are continued after five years if
the life of loan exceeds that timeframe. Traditionally, a client used a manual process
to handle this aspect of its portfolio management. With the departure of a key subject
matter expert, they realized that the time was right to adopt an automated process to
manage continuations.

**Automation can help manage lien amendments**

The larger a lender’s lien portfolio, the greater the need to efficiently monitor and
manage a significant quantity of UCCs – and, by extension, a sizeable number of
UCC continuations – and, by further extension, a large number of continuations and
terminations.

One client saw a total volume of more than 7,000 new UCC-1s in a single year, along
with extending the life of more than 6,500 loans via continuations (UCC-3s). Each
UCC-1 represented a lien on a loan, and associated financial risks, which needed to be
judiciously managed. With the anticipated personnel changes in this area of the business,
our client began to explore alternative ways to ensure the smooth ongoing management
of its UCC continuations. Up to that point, to continue the perfection of all active loans,
the client had to manually review all UCCs due to expire. To accomplish this, they had
to specifically dedicate several employees to handling the continuations, including
the creation, submission, follow-up and acknowledgement. The potential value of an
automated approach was clear in comparison.

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Auto Continuation can mean faster cost-efficient operations

Before the adoption of Auto Continuation, the client had to correct 2% to 4% of its total continuation volume. Due to oversights, it was necessary to create historical records on about 80 items per month in our automated, web-based lien management solution (iLien) for UCCs that were filed by attorneys. Today, those numbers have been reduced considerably. The client’s overall processes use greater automation, data and filings are more accurate, and there are very few items that need to be double-checked in the system. Because there are fewer rejections, less employee time has to be spent handling the reject queue and the on-hold queue. Where previously two full-time employees were assigned to continuations, the client now devotes only half a full-time employee to the process. The rest of the time dedicated to continuations by these employees is now applied to other processes and projects.

What’s more, the client has realized a savings of more than $41,000 per year in incremental revenue.
50 different ways to manage liens

The Uniform Commercial Code does not transfer to the processes states use to file forms and liens. There is enormous variety in the way that states manage UCCs. If that’s the case, surely the individual states provide data to help monitor, right? Unfortunately, not. States do not provide the same consistent search logic to allow you, on the front end, to understand your risk and ensure that you are establishing the appropriate lien position.

One of the more notoriously difficult states to manage UCCs in is Michigan. In Michigan, they use “exact name search logic” all the way down to punctuation. When you search on the Michigan Secretary of State’s (SoS) website, you will not find what you’re looking for unless every single piece of the search is identical to the information on the UCC form. And, if you have to search multiple times, you have to pay multiple times. It’s not the definition of user-friendly.

Georgia’s (process is) on my mind

Georgia is another state with unique processes. They have unique logins for every institution and those institutions can only have one individual (with one login) in their system at any one point in time. If you somehow allow multiple individuals to log into the Georgia SoS site, they can (and will!) deactivate your company ID. You will not be able to search and it takes anywhere from one to three days to have your ID reactivated. This is the kind of thing that can trip you up and slow you down when attempting to perform
your due diligence. Not being able to efficiently verify entity name or risk can present significant problems.

You don’t have to worry about whether or not your teams have universal jurisdiction expertise. You simply have to have the right training and support to process documentation across all 50 states.

The right lien management partner can utilize something like generalized search logic. That means a provider is able to aggregate data directly from the jurisdictions as often as possible and put it into a searchable database that allows lenders to use the same consistent search logic: same processes, same platform.
Maintaining diligence even when things seem calm

It’s clear that filing the UCC is just the first step and that there is a fairly significant level of due diligence and maintenance that is required to manage a portfolio. But no matter what, there will be the permanent presence of risk. Even when all of the major signposts are identified and accounted for, there can still be things like wrongful terminations, lapse filings and debtor information changes to trip you up.

In particular, wrongful terminations happen all the time and the revised Article 9 allowed debtors to terminate filings freely. Debtor terminations supposedly don’t have the same weight in court that a secured party termination does but when you’re doing a search, it doesn’t tell you if it’s a debtor termination or secured party termination, it just notes that it has been terminated. As a lender, terminating an interest affects your lien position and there's always the possibility that somebody else – such as a law firm – can terminate your filings.

One interesting example of an “accidental” termination involved a bankruptcy. A lender had three key filings at risk in the bankruptcy motion. In the restructuring, the agreement was that one would be left alone and the other two would be terminated and be reworked under reorganization. Unfortunately, the law firm mistakenly terminated all three. The one that was supposed to be kept secured was a $1.5 billion loan.

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The lender was deemed to have no secured position so they fell in line with all the unsecured creditors and were unable to collect on a $1.5 billion loss.

Not everyone has $1.5 billion loans in their portfolio, but how much risk can you support if wrongful or accidental terminations happen? Even more importantly, how does your existing process alert you if somebody has terminated your filing?

Another example of an accidental termination involved a captive finance lender who learned that a bank terminated a very large loan of theirs. The bank user in creating the determination accidentally transposed two numbers and no one caught the error. This terminated the loan and ended the captive finance lender’s status as a secured lender. The captive finance lender’s only subsequent recourse was to file a corrections statement, refile a new UCC and hope nothing went wrong before they were processed. Until the filings were complete, the captive finance lender was at risk of losing all collateral associated with the loan as it was no longer secured, nor was there any record of the loan (as it had been terminated).

Tying it all together

The lending world is fraught with risk and always will be. We have reviewed five key areas that will help any lender maintain perfection, but secured lending will only grow more complex and the UCC process will continue to evolve.

The path to greater confidence in lien perfection begins with defining your institution’s biggest areas of risk, prioritizing them and beginning the work to institute mitigation measures. In many cases that will be a daunting list, but working with a trusted partner who has the right resources to help can make it more reasonable.
Section 9-503 of Article 9 of Uniform Commercial Code
(a) [Sufficiency of debtor’s name.]
A financing statement sufficiently provides the name of the debtor:
(1) except as otherwise provided in paragraph (3), if the debtor is a registered organization, or the collateral is held in a trust that is a registered organization, only if the financing statement provides the name that is stated to be the registered organization’s name on the public organic record of most recently filed with or issued or enacted by the registered organization’s jurisdiction of organization which purports to state, amend, or restate the registered organization’s name;
(2) subject to subsection (f), if the collateral is being administered by the personal representative of a decedent, only if the financing statement provides, as the name of the debtor, the name of the decedent and, in a separate part of the financing statement, indicates that the collateral is being administered by a personal representative;
(3) if the collateral is held in a trust that is not a registered organization, only if the financing statement:
(A) provides, as the name of the debtor:
(i) if the organic record of the trust specifies a name for the trust, the name specified; or
(ii) if the organic record of the trust does not specify a name for the trust, the name of the settlor or testator; and
(B) in a separate part of the financing statement:
(i) if the name is provided in accordance with subparagraph (A)(i), indicates that the collateral is held in a trust; or
(ii) if the name is provided in accordance with subparagraph (A)(ii), provides additional information sufficient to distinguish the trust from other trusts having one or more of the same settlers or the same testator and indicates that the collateral is held in a trust, unless the additional information so indicates