

# PMSI: FREQUENTLY ASKED QUESTIONS

## WHAT IS A PMSI?

A “Purchase Money Security Interest” is exactly what its name implies. To qualify as a PMSI, the loan must be given to the debtor for the purpose of acquiring the specific goods/inventory. If the funds are used for another purpose, such as using the money to pay off an existing debt, the loan will not qualify as a PMSI. If the strict PMSI requirements are met, it provides the lender with a first priority interest in the PMSI collateral.

## ARE THERE DIFFERENT TYPES OF PMSI TRANSACTIONS?

Yes. PMSI transactions can involve equipment, fixtures, inventory, or consigned goods. Our FAQs primarily discuss PMSI transactions involving inventory or consignment interests. The rules applicable to PMSIs in inventory apply equally to consignment transactions.

## COULD YOU PROVIDE AN EXAMPLE OF A PMSI TRANSACTION?

Seller is entering into an agreement to sell lighting fixtures to Lighting Store Inc., who will then place the lighting fixtures in its inventory to sell to retail buyers. Seller will provide a line of credit to Lighting Store, Inc., who will be required to make a payment every month. Seller had Lighting Store, Inc., sign a security agreement. The security agreement identified the transaction as a PMSI, and seller specified the funding must be used for the ongoing purchase of lighting fixtures.

However, Lighting Store, LLC, already has an open line of credit with Bank A. Bank A had previously filed a UCC-1 financing statement against Lighting Store, LLC, which created a blanket lien against all of Lighting Store, LLC's assets, including all inventory. To protect its interest in the collateral, Seller will need to take the necessary steps to create a PMSI interest. This will give seller first priority over the PMSI collateral (the lighting fixtures), while Bank A will still retain its first priority interest in all of the other assets identified in its blanket lien.



## **WHAT DO THE DEBTOR AND SECURED PARTY NEED TO DO TO CREATE A PMSI INTEREST?**

As with any secured transaction, the debtor and secured party must sign a security agreement. The security agreement must expressly confirm the intent to create a PMSI and grant a security interest in the inventory (as well as an interest in the proceeds). The security agreement should only relate to the goods that will be purchased in the future. If the security agreement covers prior debts, it will not be treated as a PMSI.

## **WHEN DOES THE UCC-1 FINANCING STATEMENT NEED TO BE FILED?**

The timing of the filing of the financing statement is a crucial step in obtaining PMSI protection! It will depend upon the type of collateral that is subject to the PMSI:

- If the collateral consists of goods (other than inventory or fixtures), such as equipment or other collateral, the financing statement must be filed before or within the twenty day period after the debtor receives possession of the collateral.
- If the collateral consists of inventory, the financing statement must be filed before the customer receives the goods that will be placed into its inventory.

## **DOES THE UCC-1 FINANCING STATEMENT NEED TO CONTAIN ANY SPECIFIC LANGUAGE TO INDICATE IT RELATES TO A PMSI FILING?**

There are no statutory requirements relating to the content of the UCC-1 financing statement. However, there are recommended practices that many lenders choose to follow. The first is to include language on the financing statement that references it is a PMSI filing. Most frequently, this language is included in the collateral description field. However, there are other fields (e.g. the “optional filer reference data” in field 8) that can be used for that purpose.

Many lenders also include a collateral description on the UCC-1 that is more detailed than they may normally provide. For example, rather than simply indicating the financing statement is intended to cover “inventory”, the lender will add more specifics, such as “inventory, including but not limited to all lighting fixtures, and any proceeds thereof”.



Please keep in mind that when a PMSI transaction involves inventory, the PMSI lender is also required to send notification letters. These letters contain more detail regarding the transaction and the collateral involved. PMSI notification letters are discussed in more detail in subsequent FAQs.

## **WHAT IS A PMSI NOTIFICATION LETTER?**

When a PMSI transaction involves inventory, the secured party is required to “send an authenticated notification to the holder of the conflicting security interest”. This is normally achieved by sending a letter to any secured parties who have previously filed a financing statement against the debtor. The letter provides specific information relevant to the PMSI transaction and the collateral involved.

## **WHO IS CONSIDERED A “HOLDER OF A CONFLICTING SECURITY INTEREST”?**

A “holder of a conflicting security interest” is a secured party who filed a UCC-1 financing statement against the same inventory, or type of inventory, prior to the time the PMSI lender filed its UCC-1 financing statement. An example of this is a secured party who had previously filed a blanket lien against all of the debtor’s assets (including inventory).

## **HOW DOES A PMSI LENDER IDENTIFY ALL THE PRIOR SECURED PARTIES, IN ORDER TO ENSURE EACH OF THEM RECEIVES A NOTIFICATION LETTER?**

The PMSI lender must first file a UCC-1 financing statement. After it is filed and indexed by the filing office, a UCC search is conducted. The UCC search will provide a listing of all earlier-filed UCC filings as well as a copy of each filed UCC record. The information uncovered during the UCC search will provide the name and address of all secured parties of record to whom notification letters must be sent.

## **DO I NEED TO OBTAIN THE ACTUAL COPIES OF ALL PREVIOUS UCC FILINGS? IS A LISTING OF ALL OF THE UCC FILINGS FOUND IN THE UCC INDEX SUFFICIENT?**

It is always necessary to obtain copies of the actual UCC filings. A listing of UCC records from the filing office will not always provide all of the information you need to comply with the strict requirements of PMSI filing. A UCC filing may contain multiple secured parties or assignees of secured parties, as well as other relevant information that is not always captured in a UCC index/listing.



All the information provided on the actual UCC filing must be reviewed to ascertain the full scope of existing interests in the debtor's collateral. This includes the name and address for each secured party, as the name and address provided on the financing statement is deemed to be the correct contact information for the purpose of providing notifications to a secured party.

## **IS THERE A SPECIFIC FORMAT THAT MUST BE USED FOR A PMSI NOTIFICATION LETTER?**

No. The only requirement is that it contain the necessary information. At Do Diligence, LLC, we use a notification letter that is based upon a model notification letter created by the American Bar Association, as well as additional provisions we've added based upon our experience over 40 years in the UCC industry.

## **WHAT INFORMATION MUST BE PROVIDED IN THE PMSI NOTIFICATION LETTER?**

The notification must:

1. Inform the holder of the conflicting security interest that the PMSI lender has, or expects to acquire, a PMSI in the specified inventory of the debtor,
2. The notification must also describe the covered collateral by item or type. This is generally a more detailed description than simply indicating "inventory". The collateral description on the notification letter is generally copied directly from the UCC-1 financing statement or the security agreement itself.
3. The notification must be received by the holder of the conflicting security interest prior to the debtor's receipt of the goods. This is particularly important. The PMSI protection does not extend to collateral already in the debtor's possession. It only applies to inventory collateral acquired after the notifications are received by the prior secured parties.

## **ARE THERE ANY STATUTORY TIMEFRAMES ASSOCIATED WITH SENDING PMSI NOTIFICATION LETTERS?**

The notification letter must be received by the holder of the conflicting security interest prior to the debtor's receipt of the inventory. The notice is valid for five years and provides notice for all inventory received by the debtor during the five year period. The rationale for this is that inventory constantly rotates in and out as part of the debtor's business. It would be cost prohibitive if an inventory lender had to constantly send new notifications and file new UCC filings every time inventory changed.



It is important to know that the five year period for which the notification letter applies may differ from the five year statutory period of the UCC financing statement. Generally, the financing statement and the notification letters are sent within a very close timeframe of one another. However, should there be any significant gap of time between the filing of the financing statement and sending the notification letters, it is important to monitor the timing of future filings/notices.

## **WHAT IS THE RISK TO THE INVENTORY LENDER IF THEY FAIL TO PROPERLY FOLLOW THE PMSI NOTIFICATION PROCEDURES?**

If the inventory lender fails to comply with the PMSI procedures, it will result in the lender losing the PMSI priority over the collateral. As long as the financing statement was filed and perfected, the lender will still have a perfected security interest in the collateral. It will just have a lower priority and will fall in line behind prior secured parties.



# I'D RATHER SPEND MY TIME BUILDING MY BUSINESS AND HELPING MY CUSTOMERS. HOW CAN DO DILIGENCE, LLC, ASSIST ME WITH ALL OF MY PMSI COMPLIANCE NEEDS, AND WHAT ARE THE COSTS INVOLVED FOR YOUR SERVICES?

## PMSI Compliance Package:

1. **File the UCC-1 Financing Statement:** Don't waste your time trying to learn all of the nuances of each state's filing requirements, signing up for passwords and accounts on the filing office websites, and dealing with ACH payments, credit cards, checks, etc. to pay the statutory filing fees. Our team of experts will prepare/review your UCC-1 financing statement in accordance with state requirements, file it, and provide you with the filing acknowledgement for your records after it is filed.
2. **Conduct a UCC Search:** Once we receive your filing's acknowledgment, we will conduct a UCC search to identify any prior secured parties. We will provide you with the results of your UCC search on our industry-leading Do Diligence PMSI Report.
3. **Send PMSI notification letters:** Once the UCC search is complete, and all prior secured parties have been identified, the next step is to send each of them a PMSI notification letter. You can avoid the hassle of creating letters, preparing envelopes, tracking certified mail delivery, etc. We will prepare letters on your behalf, send them to each prior secured party using mail with delivery confirmation, and provide you with a report containing the tracking information from the US Postal service proving your notification letters were sent and *received*.
4. **Once this process is complete, you can confidently deliver the collateral or consigned goods to the debtor.**

**COST: \$65 PLUS \$15 PER NOTIFICATION LETTER  
NOTIFICATION LETTER PRICE INCLUDES ALL MAILING  
COSTS. CORRESPONDENT FEES AND STATUTORY FEES ARE  
NOT INCLUDED. HOWEVER, WE WILL INCLUDE ALL SUCH  
PROJECTED COSTS IN OUR INITIAL ESTIMATE TO YOU.**



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