Box 348, Commerce Court West
199 Bay Street, 30th Floor
Toronto, Ontario, Canada M5L 1G2
www.cba.ca

Warren Law
Vice-President, Corporate Affairs, Treasurer,
General Counsel and Secretary

Tel.: [416] 362-6093 Ext. 214
Fax: [416] 362-7708
wlaw@cba.ca

June 16, 2000

Purdy Crawford, Q.C.
Chair, Securities Review Advisory Committee
c/o Osler Hoskin & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto Ontario M5X 1B8

Dear Mr. Crawford:

Re: Request for Comments - Item 18

We wish to respond to Item 18 ("Tiered Holding System") on the Issues List set out in the Request for Comments dated April 28, 2000.

We are very pleased to note that the Tiered Holding System will be considered by your Committee. The Tiered Holding System is a topic for which we have had, and have often expressed, a keen interest for over seven years, beginning with the publication of the report of the Alberta Law Reform Institute on Transfers of Securities in 1993, and continuing with the work of the Production Committee of the Uniform Law Conference, which preceded the CSA task force to which you refer.

We consider that it is work of the very highest priority. Canada urgently requires amendments to its investment securities and personal property laws to deal effectively with book-entry securities and the new market conditions that have given such prominence to the tiered holding system in recent years. Domestically, it is a matter that affects the integrity of our laws governing securities holdings by the public and the efficiency of our personal property security laws in dealing with such forms of property. Internationally, it dramatically impacts the competitiveness of Canadian financial institutions as participants in financial markets abroad. Canada is rapidly falling behind as law reform initiatives addressing these issues are being given high priority by governments and regulators in the other developed countries of the world. Even countries that have not yet addressed the larger issues have recognized the importance of modernizing their conflict of laws rules with respect to book-entry securities by enacting special legislation to require the recognition of the legal effects of the rules of the proliferating electronic securities settlement services. We refer, for example, to the Finality Directive of the European Community which required all EU member states to change their conflicts rules to recognize foreign security interest in book-entry securities by 31 December 1999. That single initiative

moved Canada from 2nd to 20th place in the hierarchy of the world's legal systems on that issue. The sooner your Committee can move to restore Canada's competitive position on these issues, the better it will be for all Canadians.

Your specific questions on this issue are:

(i) "How should Ontario and other Canadian provinces modernize laws that govern the holding, transferring and pledging of securities held through the indirect holding system? and
(ii) How closely should Article 8 of the US Uniform Commercial Code be followed?"

Our responses are as follows:

1. **Amending legislation:** It is our view that your Committee should move quickly and propose new legislation to recognize the new forms of property now represented by book-entry investment securities, both equity and debt securities, and to establish a solid foundation of modern legal principles to govern them and dealings in them, in place of the antiquated laws and deeming provisions that we now have.

A modern legal principle on the model of Revised Article 8 of the UCC, to which you refer, recognizes book-entry securities as a new form of property and provides workable and reliable rules to deal with the creation, transfer, pledge and perfection of interests in them. There are three essential aspects to this:

(a) recognition of book-entry securities ("investment entitlements") as a novel form of property with characteristics different from those of securities themselves;

(b) provision of practical domestic rules for the creation of investment entitlements, and the transfer, pledge, perfection and enforcement of security interests in them; and

(c) recognition of the legal effects of foreign laws governing the creation of securities entitlements, and the transfer or pledge and realization of security interests in them in transactions abroad.

A law that accomplishes these three aspects would be an enormous improvement on our existing laws dealing with securities transfers and pledges. A law that also incorporates supporting provisions from the existing precedents (such as Article 8) would be even better.

2. **Article 8 as a Precedent:** In our view, Revised Article 8 of the UCC is a good model, but should not be followed slavishly. We wish to make five observations in this regard with reference to Article 8:

(a) **Retain existing Tier I law:** As we see the issues, there is a need to distinguish between Tier I and Tier II and lower tiers when reforming the Canadian law. Recognition of the existence of tiers in the investment holding structure does not require the repeal of all existing laws that govern those matters. Many of the important existing provisions of the provincial and federal investment securities statutes deal with relations between the issuer and the registered holders of securities issued by them. These provisions are relatively well understood and are reflected in the standard documents that banks and other financial institutions now use in transactions involving investment securities that are held in the Tier I system. Even if a new law were written to deal with the lower tiers, virtually all of that familiar law would continue to apply to the relations of persons who deal with securities in Tier I. There is no need, and strong reasons not, to make extensive changes

in the existing provisions of the investment securities parts of the Ontario, Canada or any other Business Corporations Act that deal with these issues.

(b) **Adopt principles, not text:** In proposing new provisions for business corporations statutes to deal with the new issues raised by book-entry securities, we should be guided by the principles of Revised Article 8, but not simply copy that text. The American processes of law reform are open and adversarial; even projects as uncontroversial as Revised Article 8 undergo rigorous scrutiny before being adopted. In the process, the principles on which their law reform is based are often weakened or diluted in their application as a consequence of the compromises they are forced to make in order to achieve consensus. There is no reason why we should adopt the finished product, with all its compromises as the beginning point for our own deliberations. For example, Revised Article 8 excludes commodity contracts entirely from its scope. It may be, but we are not certain that is, the best policy for a Canadian version of the law.

(c) **Address Canadian conditions and participants:** A third reason for not adhering slavishly to the US text is that, on a closer examination, it will be seen that it addresses and makes specific provisions for: (i) types of financial institutions that do not exist in Canada and (ii) financial products that do not exist in Canada. Conversely, Revised Article 8 does not address (i) all the types of participants in the Canadian investment securities markets or (ii) all kinds of financial products that are dealt in by those market participants (e.g. OTC derivatives and other eligible financial contracts). If the Canadian version of Revised Article 8 is to solve more problems than it creates, it must be carefully tailored to meet the needs and conditions in the Canadian investment securities markets.

(d) **Integrate with Canadian law:** Part XXII of the Bankruptcy and Insolvency Act of Canada deals extensively with the rights of investors upon the insolvency of a Canadian securities intermediary. We must be certain that all the provisions of the Canadian version of a Revised Article 8 comports with that legal regime, both reflecting and supporting its operation. There will also be a need to integrate the new forms of property and methods of taking security interests in them into our provincial personal property security acts. We prepared a memo for the Production Committee of the ULCC on this topic over two years ago, and would be pleased to provide you with a copy of that work if you wish.

(e) **Address the Federal Component:** An important aspect of the points in our paragraphs (c) and (d) is the importance in the Canadian financial markets of securities issued by federally incorporated entities (banks, insurance companies etc.), and by them and other corporations under the federal laws (Bills of Exchange Act, but increasingly, the Depository Bills and Notes Act). Your question asks what should be done to modernize the laws of Ontario and the other provinces on book-entry securities. We respectfully submit that there is a large and very important federal dimension to this aspect of your project, and it would be appropriate if the federal authorities were involved in your discussions from the beginning. We understand that the Debt Clearing Service of CDS holds over $500 billion in debt securities, the majority of which are governed by the federal DBNA. The importance of ensuring that the new proposals deal satisfactorily with the $200 billion (net $4 billion) per day trading in those securities is, we trust, self-evident.

We hope that the foregoing comments underscore our intense interest in this item on your project list, and our reasons for urging that your Committee give immediate and prompt attention to it. The Canadian Securities Administrators have had conduct of the preparation of a suitable draft for over two years. We understand from Eric Spink of the Alberta Securities Commission that a draft suitable for circulation for comment is almost ready. We hope that your involvement will

expedite the completion of the draft so that all participants in the investment securities markets can participate in developing the modern law that we badly needed two years ago, and now need very badly, indeed.

Yours very truly,