



THE CANADIAN DEPOSITORY  
FOR SECURITIES LIMITED

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June 22, 2004

Mr. David Brown  
Executive Sponsor, USTA Project  
Ontario Securities Commission  
19th Floor, 20 Queen Street West  
Toronto, Ontario  
M5H 3S8

Mr. Maxime Paré  
Chair, USTA Task Force  
Ontario Securities Commission  
19th Floor, 20 Queen Street West  
Toronto, Ontario  
M5H 3S8

Dear Sirs:

Re: **Uniform Securities Transfer Act ("USTA") Benefits to CDSX**

As you are aware, during the past three years CDS, our legal counsel and participants have been engaged in a project to re-write the participant Rules for our securities clearing and depository services, as part of the CDSX systems development project. In addition, our legal counsel have prepared a comprehensive legal analysis relating to the Rules and the applicable general law for the benefit of participants and their legal advisers in understanding the system and its legal framework.

At the same time, we have been mindful of the significant progress which you have made in the USTA legislative project, including the recent re-publication of the draft statute and further request for comments. We recognize that once the USTA has been enacted, there will be some further changes required to the CDSX Rules to ensure conformity with the legislation. We have always believed that the benefits of the USTA will more than justify any consequential Rule amendments.

Accordingly, in the course of re-writing the CDSX Rules and preparing the legal analysis, we requested our legal counsel to summarize the benefits to CDS and participants in our services of the enactment of the USTA. We are enclosing a copy of their report as a further submission to the USTA Task Force. We think

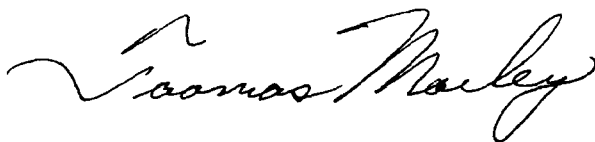
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you will agree that there will be considerable concrete benefits to the Canadian securities settlement and depository system from the implementation of the USTA. We hope this submission will be persuasive to the Canadian legislators to enact this important legislation expeditiously, simultaneously and uniformly across the country.

Yours very truly,

A handwritten signature in cursive script, appearing to read "Toomas Marley".

Toomas Marley  
Vice-President, Legal, and Corporate Secretary

Cc: Eric Spink



## MEMORANDUM

**Date:** June 22, 2004

**To:** The Canadian Depository for Securities Limited  
Attention: Tom Marley

**From:** Borden Ladner Gervais LLP

**Subject:** Implications of the *Uniform Securities Transfer Act* for CDSX

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### INTRODUCTION

You have asked us to prepare a summary description of the implications of the draft *Uniform Securities Transfer Act* (the "USTA") and corresponding amendments to other legislation and, in particular, how the USTA is expected to resolve issues relating to the current legal framework for CDSX. We understand that you will include this memorandum in your submission to the Canadian Securities Administrators' *Uniform Securities Transfer Act* Task Force (the "Task Force") in response to their request for comments.

In preparing this memorandum, we have reviewed the draft USTA and the draft amendments to the *Business Corporations Act* (Ontario) (the "OBCA"), the *Personal Property Security Act* (Ontario) (the "OPPSA"), the *Business Corporations Act* (Alberta) (the "ABCA") and the *Personal Property Security Act* (Alberta) (the "APPSA"). We have assumed that, as recommended by the Task Force, (1) the USTA will be enacted by each of the provinces and territories with corresponding amendments to the legislation governing business corporations and personal property security interests; and (2) the relevant federal legislation, including the *Depository Bills and Notes Act* (Canada) and the securities transfer rules in the *Bank Act* (Canada) and the *Canada Business Corporations Act*, will be amended or repealed as required to successfully implement the USTA.

It is important that all federal and provincial jurisdictions enact the USTA and the related amendments to other legislation. If the federal government or certain provinces maintain the existing regime, many of the benefits of the USTA will be lost and the result may be less legal certainty than is the case under the current system.

### DISCUSSION

The draft USTA and corresponding legislation specifically address the following issues in the current legal framework for CDSX:

#### 1. Security Entitlements

The vast majority of the value of securities in Canada is held in a tiered holding system through CDS. The nature of the property interest of an indirect holder of a security is unclear, as not all federal and provincial laws have been modernized to reflect this reality,

and as there are substantial differences between the laws of various provinces. This lack of consistency is of particular concern to a national clearing system. By introducing the concept of a security entitlement, the draft USTA clarifies the nature of the property interest that arises when a security is held through an intermediary. In doing so, much of the uncertainty relating to the legal regime surrounding the tiered holding system is removed. Many of the benefits described below flow from the introduction of the underlying concept of a security entitlement.

One significant example of this change is the concept of control, as opposed to possession, of securities. The current system of law in provinces such as Ontario relies upon the outdated model of possession (and deemed possession). While this model was applicable in a time when physical security certificates were issued and securities were held directly, it is difficult to make sense of the concept of possession of a security which is held through various intermediaries and for which there may be no security certificate. The concept of control eliminates the fiction of possession.

The USTA clearly establishes the rights and duties of each party in the tiered holding system and thereby strengthens the legal framework for CDSX.

## **2. Law Governing Transactions through CDSX**

Historically, the *situs* of a security has been used to determine the applicable jurisdiction, which establishes the law governing the transfer or pledge of that security. These historic principles are not well adapted to determining the *situs* of uncertificated securities held through a central depository and transferred electronically.

The draft USTA and supporting legislation eliminate the uncertainty and potential for conflict arising from the historical use of *situs* to determine the applicable law. Each of the draft USTA, OPPSA and APPSA specifically addresses the reality of how securities, or interests in securities, can be transferred and pledged. As discussed below, these new rules clarify the law applicable to two areas of particular relevance to CDS.

### **(a) Security Entitlements**

Section 52(3) of the USTA provides that, in respect of a security represented by a security entitlement, the law of the securities intermediary's jurisdiction governs the acquisition of security entitlements; the rights and duties of the securities intermediary and the entitlement holder; whether the securities holder owes any duties to a person making an adverse claim to a security entitlement; and whether an adverse claim can be asserted against a person who acquires or purchases a security entitlement from a securities intermediary or entitlement holder.

Section 52(3) is of primary importance to CDS, as uncertainty relating to these issues may undermine confidence in the legal effectiveness of transfers within the CDSX system. The provisions of the draft USTA ensure that transactions within CDS are governed by Ontario law, and therefore assist in developing certainty regarding the legal effectiveness of transfers within the CDSX system.

### **(b) Security Interests**

One of the important risk-minimization measures in the CDSX system is CDS's security interest in securities held by participants through CDS as intermediary. Due to questions arising from the historical use of *situs* to determine the applicable law, there has been some confusion as to the law that governs CDS's security interest. Out of an abundance of caution, CDS has registered financing statements under the personal property security legislation of various provinces in which its participants have registered or chief executive offices.

The draft OPPSA and APPSA create certainty as to the law governing the determination of the validity of a security interest in investment property. As the participants' interests in securities held through CDS constitute security entitlements, a form of investment property, the laws of CDS's jurisdiction (Ontario) for the purposes of section 7.1 of the OPPSA and APPSA will govern the validity of CDS's security interest.

Similarly, the draft OPPSA and APPSA provide greater certainty with respect to the security interests granted pursuant to CDS's rules by participants in favour of other participants in respect of securities held through CDSX.

### **3. Perfection**

Under personal property security legislation, secured parties can generally perfect their security interest by way of possession of the collateral and/or registration against the debtor, depending on the nature of the collateral. The variation in personal property security legislation between provinces, coupled with the difficulties in determining the applicable jurisdiction under historic *situs* principles, leads to uncertainty as to the creation, perfection and priority of security interests.

In particular, as noted above, the concept of possession is not well suited to a tiered holding regime. Therefore, out of an abundance of caution, CDS registers a financing statement against all participants to ensure that its security interest is perfected.

The USTA eliminates the risk that CDS's security interest will not be perfected. Section 22.1 of the draft OPPSA, section 24.1 of the draft APPSA and sections 32 and 33 of the draft USTA work together to ensure that CDS has control of the securities pledged by participants and therefore has a perfected security interest in such securities.

### **4. Priority**

As noted above, securities held through CDS may be classified as intangibles pursuant to the current APPSA. CDS's security interest may therefore rank behind the security interests of other secured parties who made prior registrations pursuant to the APPSA. Given CDS's role within the Canadian financial system, it is important that CDS has a first-priority claim on the securities pledged to it by its participants.

The draft USTA and APPSA eliminate this problem in the definition of "security". In addition, section 35.1(5) of the APPSA provides that a security interest held by a securities intermediary in a security entitlement has priority over a conflicting security interest held by

another secured party. The security interest granted by participants to CDS in securities held through CDS will therefore have first priority.

Section 30.1(5) of the draft OPPSA has a similar effect to section 35.1(5) of the APPSA. In addition, the draft USTA and OPPSA eliminate the inconsistency between the definitions of "security" in the current OBCA and OPPSA.

#### **5. Bills of Exchange**

Both the OBCA and the OPPSA expressly exclude securities issued under the *Bills of Exchange Act* (Canada) from the application of the provisions validating clearing agency transactions. The USTA and corresponding amendments to federal and provincial legislation will provide greater certainty with respect to the transfer and pledge of securities that are debt instruments (including those that are Canadian or foreign government debt instruments), and contain clearing agency provisions that assist in ensuring the validity of transactions in such securities.

#### **6. CDS Rules**

Section 54 of the draft USTA provides that a clearing agency rule is effective even if the rule conflicts with the USTA or the relevant PPSA, and affects another party who does not consent to the rule. This provision will assist in ensuring that clearing and settlement of transactions in securities occur in accordance with CDS's Rules and will therefore increase legal certainty with respect to such transactions.

#### **7. Other Benefits**

This memorandum discusses the benefits of the USTA and related amendments to the legal framework for the CDSX Rules. However, the implementation of the USTA will bring numerous benefits in other areas. As examples:

- Section 85 of the current OBCA only applies to transfers of securities where CDS is the intermediary. The USTA will provide a legal framework for pledges and transfers of securities where CDS is not the intermediary.
- International linkages between clearing and settlement systems will be facilitated as the USTA more closely conforms to developing international norms in the modernization of securities transfer law (for instance, Article 8 of the Uniform Commercial Code).



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News Release

**For Immediate Release  
June 24, 2004**

**Securities Regulators Propose Uniform Securities Transfer Act**

**Calgary** – The Canadian Securities Administrators' (CSA) Uniform Securities Transfer Act Task Force has released for public comment a revised consultative draft of a proposed provincial *Uniform Securities Transfer Act* (USTA).

The USTA project is unrelated to the CSA's Uniform Securities Legislation project. The proposed USTA is not securities regulatory law, but is commercial property-transfer law, governing the transfer and holding of securities and interests in securities. The USTA requires conforming amendments to the common-law provincial *Personal Property Security Acts* that govern the use of securities as loan collateral. It also replaces securities settlement rules currently contained in provincial *Business Corporations Acts*.

Current Canadian law in this area needs to be modernized to deal with current securities market practices, particularly the holding and trading of securities through multiple tiers of intermediaries. Implementation of the USTA will provide a sound legal foundation for existing practices and support the continuing evolution of market practices in the future. It is essential that Canadian legislation in this area be uniform within Canada and harmonized with existing similar legislation in the United States.

“Securities market participants and Canadian financial services industries as a whole urgently need uniform legislation like the USTA to improve the efficiency and legal soundness of the Canadian securities settlement system,” said Stephen Sibold, Chair of the CSA and of the Alberta Securities Commission. “The Canadian securities settlement system handles an enormous quantity and value of transactions on a daily basis. Issuers, investors and financial institutions rely heavily on this system. It is vital to the continued growth and evolution of the Canadian capital markets -- and to their competitiveness with international markets -- that the system be supported by a modern legal foundation that produces predictable results, especially in situations involving cross-border transactions.”

The Task Force welcomes comments until July 30, 2004 on any aspect of the draft USTA and related material, and most specifically on the issues summarized in the Consultation Paper (under Part 3, B.). The proposed USTA is available on the web site of the Ontario Securities Commission at [www.osc.gov.on.ca](http://www.osc.gov.on.ca) and the web site of the Alberta Securities Commission at [www.albertasecurities.com](http://www.albertasecurities.com).

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