Securities Transfer - Tiered Holdings Project 1997

SECURITIES TRANSFER - TIERED HOLDINGS PROJECT

Report of the Production Committee
April 30, 1997

Eric Spink - Reporter

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introduction

This report is an overview of the Tiered Holding System project of the Uniform Law Conference of Canada ("ULCC"). This project deals with the transfer of investment securities. It proposes significant changes to some of Canada's laws governing securities transactions.

This report was prepared by the project's Production Committee after a long and thorough review of the policy issues in this project. It is intended to permit all stakeholders who may be affected by the project to assess it on a conceptual level. The objective is to obtain informed comments and to solicit support for the important reforms proposed by this project.

If stakeholders support the Production Committee's proposals, then the next step will be for the ULCC to begin drafting uniform legislation. This will be considered at the ULCC annual meeting in August, 1997.

more information is available

This report contains a simplified explanation of concepts that have been the subject of extensive review and study. Anyone interested in pursuing this subject in more detail is invited to review the material referred to in the endnotes, or to contact the Reporter directly. **See footnote 1**

background and history of this project

The ULCC is an independent organization founded in 1918 to promote uniformity of legislation in Canada. The Conference was created in response to a recommendation by the Canadian Bar Association, based largely on the success of the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), which had met annually in the U.S. since 1892 to prepare model and uniform statutes. The subsequent adoption of such statutes by the states has produced a high degree of uniformity in U.S. legislation, especially in the area of commercial law. The ULCC pursues a similar objective in Canada.

The ULCC undertook this project in August of 1993, based on a proposal and recommendations by the Alberta Law Reform Institute. **See footnote 2** The proposal was to develop uniform Canadian legislation governing the settlement of securities transfers, and the use of investment securities as collateral for obtaining credit.

The central recommendation was to reform Canadian legislation to be compatible with (then) pending revisions to Articles 8 and 9 of the American Uniform Commercial Code ("UCC"). The revisions to Articles 8 and 9 of the UCC were finalized in 1994, and has already been enacted in 30 states. Almost all of the current Canadian legislation in this area is based on old versions of Articles 8 and 9 of UCC.

In June, 1994, a one-day symposium was held at the University of Toronto to gather government and private stakeholders to discuss this project. Twenty-three people attended the symposium, including representatives of:

Industry Canada
Department of Finance (federal)
Ontario Ministry of Consumer & Corporate Relations
Ontario Ministry of the Attorney General
Quebec Ministry of Finance
British Columbia Ministry of Finance and Corporate Relations
The Canadian Bankers' Association
Investment Dealers' Association of Canada
The Canadian Depository for Securities Limited
Canadian Investor Protection Fund
The Group of Thirty
The Royal Bank of Canada
The Bank of Nova Scotia
Alberta Law Reform Institute

We were very fortunate to also have Mr. Dick Smith and Professor Jim Rogers at the symposium. Professor Rogers was the Reporter for the NCCUSL Article 8 Drafting Committee. Mr. Smith was the American Law Institute Representative on the Drafting Committee. Their comments on the background, policy and process behind the Article 8 revisions were extremely valuable. The symposium produced a general consensus on:

* the need for uniform Canadian law in this area,
* the need for law reform in this area, and
* the desirability of compatibility with revised UCC Article 8.

The symposium also identified the need for a "Production Committee" to review and assess policy issues arising from the "Canadianization" of the revised UCC system. The Production Committee met 8 times over the next 2½ years. This report summarizes their review and assessment.

globalization of securities markets and systemic risk

Over the past few decades, securities markets in Canada and around the world have seen enormous growth in trading activity. In 1996, secondary market trading of securities in Canada totalled over $10 trillion, yet this is only about 3% of the global market. As with other industrialized countries, Canada has experienced explosive growth in cross-border securities trading (transactions between residents and non-residents).

cross-border trading of bonds and equities in Canada. **See footnote 3**
(as a percentage of GDP)

1970	1975	1980	1985	1990	1993
5.7	3.3	9.6	26.7	64.1	152.7

The growth and globalization of securities trading is, in part, due to advances in clearance and settlement systems. At the same time, there has been a growing recognition that the legal foundation for the securities clearance and settlement systems in many countries (including Canada) should be reformed to keep pace with market practices. This project may be seen as one part of a multi-national endeavour to modernize and harmonize the legal rules underpinning the clearance and settlement systems for securities trading.

Modernization and harmonization of these rules is also part of a larger effort to control systemic risk throughout the financial system. Systemic risk is "the risk that the inability of one institution to meet its obligations when due will cause other institutions to be unable to meet their obligations when due". **See footnote 4** In 1996, Canada enacted legislation designed to reduce systemic risk in the payment system .**See footnote 5** This project is intended to reduce systemic risk in the securities settlement system. **See footnote 6**

why reform is needed

current Canadian law

Current Canadian law governing the settlement of securities transfers is found in a variety of statutes. Specific provisions are found in the provincial business corporations acts, and also in the Quebec *Securities Act*. Some provinces (e.g. British Columbia) do not have legislation governing this topic. Federally, settlement rules are found in the *Canada Business Corporations Act*, *Bank Act*, *Trust and Loan Companies Act*, *Insurance Companies Act*, and the *Cooperative Credit Associations Act*. The *Bills of Exchange Act* also contains provisions

governing the transfer of certain instruments.

Pledges of security certificates are currently governed by Personal Property Security acts ("PPSAs") in those provinces that have PPSAs. The perfection of security interests through the indirect holding system is governed by special provisions in the Ontario *Business Corporations Act*.

Canadian securities market law and practices have always been heavily influenced by U.S. law and practices. Canadian and U.S. securities markets are highly integrated. Almost all of the legislation described above is based on old (1962 or earlier) versions of Articles 8 and 9 of the UCC. It relies upon the concepts of possession and delivery of negotiable security certificates to complete a transfer or to perfect a pledge. The use of these concepts dates back many years to when actual physical delivery of security certificates was the normal method of settling transactions and perfecting pledges.

securities clearance and settlement systems

Securities clearance and settlement systems evolved in response to the demands of the securities markets. Settlement by physical delivery of certificates worked adequately until the 1960s when a sharp increase in trading volumes overwhelmed the existing system, producing the so-called "paperwork crisis". This provided the impetus for a number of legal and operational innovations to clearance and settlement systems.

The major legal innovation was the 1977 revision to UCC Article 8, which introduced a new set of provisions designed to accommodate the use of uncertificated securities. At that time, it was thought that a certificateless system might evolve where issuers would not issue certificates at all. Transfers would be settled by registration on the books of the issuer according to an "instruction" provided to the issuer by the previous registered owner.

Although some issuers have started using a book-entry-only or certificateless system, most securities are still issued in traditional certificated form. To date, the problems with the physical handling of certificates have been alleviated mainly by the increased use of intermediaries to hold securities on behalf of others. Although some investors still take actual possession of their securities and are registered with the issuer, most investors now hold securities through a multi-tiered **See footnote 7** system of intermediaries.

At the lower tier, the intermediaries are brokers, banks or trust companies holding securities on behalf of their customers. These brokers, banks and trust companies are typically participants in the upper-tier intermediary - a securities depository/clearing agency such as the Canadian Depository for Securities ("CDS").

CDS receives securities from its participants and holds them in fungible bulks. **See footnote 8** CDS registers these securities in the name of a CDS nominee, and maintains accounts showing the entitlements of each participant. Securities market transactions are reported to CDS, which then performs two separate functions: clearance and settlement.

Clearance involves the calculation of each participant's net obligations, which greatly improves the efficiency of processing. Settlement is the actual transfer of money and securities to satisfy those net obligations.

Since most transactions occur between CDS participants, settlement of the security-transfer obligations can be done merely by book entries in the records of CDS, debiting the account of the seller and crediting the account of the purchaser, without any need for movement of certificates. This is called "book-entry" settlement.

Currently, CDS holds over $1 trillion worth of securities on deposit (approximately 80% of publicly-traded Canadian securities by value). The gross value of trades reported to CDS is about $100 billion daily, which the clearing process distills down to about $5 billion in settlement obligations. Less than 1% of the trades reported to CDS result in withdrawals of certificates from the depository - the rest are settled by book-entry.

the indirect holding system

Book-entry settlement only operates with securities positions held by intermediaries who are participants in the depository/clearing agency. This practice of holding securities through intermediaries is called the "indirect holding" system. The indirect holding system contrasts with the "direct holding" system, where the beneficial owner is also registered as such on the records of the issuer, or in actual possession of unregistered negotiable certificates.

In the indirect holding system, the beneficial owner is not shown on the issuer's records (in the case of registered securities), nor does the beneficial owner have actual possession of a negotiable certificate (in the case of unregistered securities such as bearer bonds). Instead, the securities are registered or in the actual possession of CDS. The records of CDS show the securities held on behalf of its various participant brokers, banks and trust companies. The records of each such participant show the securities held on behalf of their individual customers (typically, the beneficial owners).

Book-entry settlement, combined with improved clearance techniques, provides an extremely efficient system for processing securities transactions. Indeed, it would be impossible to settle the current daily volume of transactions by actual delivery of certificates. In June 1995 the settlement period for most securities transactions was shortened from 5 days to 3 days ("T+3"). This makes it practically necessary for securities to be in book-entry form before they are traded .

problems with existing law

As noted above, current Canadian law and prior versions of UCC Article 8 rely upon the concepts of possession and delivery of negotiable certificates to complete a transfer or to perfect a pledge. This works very well for transfers within the direct holding system. It is essentially a specialized negotiable instruments code that has been evolving in the U.S.

since the 1908 Uniform Stock Transfer Act. Similar rules have been operating reliably in Canada since the 1976 *Canada Business Corporations Act*. Revised Article 8 makes few changes to the direct holding system rules because few are needed.

The concepts of actual or deemed possession and delivery work less well when applied to the modern indirect holding system. This is not surprising, since they were not originally designed to describe indirect holding, but were pressed into service as the system evolved. They are essentially fictions, since there can be no actual possession or delivery of the intangible aspects of the property interest in the indirect holding system. They also rely upon equitable tracing rules that may be sound in theory, but very difficult to apply in practice, especially under the extreme conditions that arise during market disturbance or participant failure.

Uncertainties about the application of the old rules arose during the October 1987 stock market break. Details of this are complex and tedious, **See footnote 9** but the problem was serious enough to prompt U.S. federal legislation and a major law reform project culminating in the 1994 revisions to Article 8.

revised Article 8

This project recommends using revised Article 8 as the basis for uniform, reformed Canadian law in this area. The Production Committee endorses the objective, approach and concepts used in revised Article 8 as the most appropriate way to reform Canadian law applicable to the indirect holding system. The key characteristics of Article 8 are summarized below.

The objective of revised Article 8 was not to change securities holding practices, but to provide a clear and certain legal foundation for the practices that already dominate the market (the indirect holding system). The approach was to reform the rules to more accurately describe the special property interest of one who holds a book-entry security position through an intermediary. The Article 8 drafting technique was simple: first describe it, then name it.

Revised Article 8 describes the relationship between the intermediary and the "entitlement holder" as follows: See footnote 10

. the entitlement holder does not take credit risk of the intermediary's other business activities; that is, property held by the intermediary is not subject to the claims of the intermediary's general creditors;

. the intermediary will maintain a one-to-one match between the assets that it itself holds and all of the claims of its entitlement holders;

. the intermediary will pass through to the entitlement holder payments or distribution made with respect to the securities;

. the intermediary will exercise voting rights and other rights and privileges of ownership of the securities in the fashion directed by the entitlement holder;

. the intermediary will transfer or otherwise dispose of the positions at the direction of the entitlement holder; and

. the intermediary will act at the direction of the entitlement holder to convert the position into any other available form of securities holding, e.g. obtain and deliver a certificate.

This package of rights and duties is called a "security entitlement". It should be noted that the security entitlement is itself a unique form of property interest, not merely a personal claim against an intermediary.

The security entitlement concept provides a number of advantages over existing law.

advantages of the security entitlement concept

The advantages of the security entitlement concept derive from the simple fact that it is a more rational description of the unique property interest that is central to the indirect holding system. This produces clearer and more certain legal rules. What follows are specific examples of these advantages.

distinguishing direct vs. indirect instead of certificated vs. uncertificated

The format of the old rules was confusing because there was no clear distinction between the rules governing the direct vs. indirect holding systems. There was a definite distinction between the rules governing certificated vs. uncertificated securities. The revised rules recognize that the much more important distinction is between the direct and indirect systems, so these rules are clearly separated.

The distinction between certificated and uncertificated securities is retained, but to a lesser extent. The distinction is relevant only to the relationship between the issuer and the registered owner. Uncertificated securities may be held in either the direct or indirect holding systems, so both systems include rules dealing with them.

This produces a number of organizational changes to the legislation which should make it easier to understand.

the entitlement holder's rights are only against its own intermediary

This is not a change in the law. It merely clarifies a reality of current practice that was obscured by the old rules.

Conceptually, the old rules define the property interest of an entitlement holder in terms of physical objects (certificates) that were normally held by an upper-tier intermediary (depository). This provides a legal foundation for the notion that the entitlement holder, or someone claiming through or against them, might be able to trace that property interest all the way to the depository. That notion is, however, impractical and inconsistent with the

need for certainty in the settlement system.

The revised rules make it clear that the entitlement holder's rights may only be asserted against its own intermediary. This greatly simplifies the situation by identifying and locating the entitlement holder's property interest with their intermediary. So, for example, it becomes clear that a creditor wishing to seize the entitlement holder's property must deal with that intermediary.

coherent choice of law rules

Choice of law rules are extremely important because of the massive and growing number of cross-border securities transactions.

The old rules, using property-tracing concepts, cannot cope with the indirect holding system. For example, the pledging rules purport to apply the law of the jurisdiction where the collateral is located. For indirectly-held securities, that location is difficult to determine, and often has no meaningful connection to the transacting parties. This adds uncertainty and risk to transactions.

Revised Article 8 provides much clearer choice of law rules. As described above, the security entitlement is identified and located with a particular intermediary. There are detailed rules, but generally speaking the entitlement is located where the securities intermediary and its customer specify that it is located. In the absence of a specific agreement, the rules provide that it is located where the securities account is served, which will ordinarily be the same place where the entitlement holder deals with the securities intermediary. This makes it easy to determine the location of the property and applicable law in advance.

finality of settlement

Finality of settlement means that the transfer of a security, if performed according to certain rules, cannot be unwound. Finality has been a key objective of settlement rules since long before the indirect holding system. The early transfer rules applied negotiable instruments principles to stock certificates, so that a bona fide purchaser for value without notice acquired shares free from all adverse claims.

Over the years, revisions to the transfer rules were designed, successfully, to extend the finality principle to other types of certificated securities. However, there were difficulties in both concept and practice arising from the old rules' application of negotiable instruments concepts to the indirect holding system.

Revised Article 8 abandons the terms "bona fide purchaser" and "good faith" in favour of rules that more clearly state when a purchaser does (or does not) obtain protection against adverse claims. The new term used is "protected purchaser". Revised Article 8 narrows, and thereby clarifies, the method of effectively asserting adverse claims and the rights and duties of intermediaries and issuers in respect of such claims.

improved rules governing secured transactions

The old rules apply pledge concepts that relied upon deemed delivery and possession to perfect a security interest in indirectly-held securities. Pledge concepts are inherently incompatible with the intangible rights of entitlement holders in the indirect holding system. This produces uncertainty. Using the security entitlement concept to precisely describe the property interest permits the revised rules to operate more clearly.

Under the revised rules, a security interest in "investment property" may be perfected by "control". "Investment property" includes most anything that might be held through a securities account: securities, interests in securities, interests in commodity contracts, and money. This is intended to facilitate the common practice of granting a creditor a charge against the entire contents of such an account.

"Control" means that the creditor has taken whatever steps are necessary to be in a position to sell the collateral without any further action by the debtor. This does not change the normal method of perfecting a pledge of directly-held certificated securities: possession is control. For security entitlements, the creditor

may obtain control by agreement with the debtor's intermediary to act on the creditor's instructions, or by having the security entitlements transferred into the creditor's own account.

As part of the revision, the secured transaction rules were moved from Article 8 to Article 9, which also deals with secured transaction rules for other types of property. In Canada, comparable rules have generally been kept separate from security transfer rules, which is consistent with the current U.S. approach.

the scope of this project

Because this is an arcane area of law, it can be difficult for the non-specialist to accurately picture the scope of this project. Although the rules are long and complex, their scope is actually quite narrow. The key to understanding these rules is to recognize that they focus only the *settlement* of trades in securities and security entitlements. To do this, it is useful to distinguish between settlement rules and the rules governing other components of the securities market.

settlement vs. trading

Securities "trading" often invokes the classic image of a busy stock exchange: a floor strewn with paper and crowded with traders shouting and gesturing to one another. That image may be somewhat dated because many exchanges are now computerized, but the legal analysis remains the same. The traders are making contracts to buy or sell securities (in securities parlance: "trades"). There are many rules governing how those trades are

made, and regulating the rights and duties of traders (e.g. general contract law, the provincial *Securities Acts*, stock exchange and IDA rules).

This project does not deal with trading, nor does it significantly affect the rules that govern trading. It deals only with the exchange of property in settlement of contracts to buy or sell securities and security entitlements.

The securities settlement rules govern how securities and property interests in securities are transferred in roughly the same way that land titles acts govern how land and interests in land are transferred. Neither regulates the conduct of the parties to the transactions.

Settlement rules deal with some of the related functions, rights and duties of those involved in the transfer process (especially intermediaries, but also issuers and transfer agents). The distinction is particularly important here: this project deals with the role of, say, brokers in their role as *holders* of property on behalf of their customers, not in their role as *traders* of that property.

transfer of securities vs. payment

As noted above, there are two components to settlement: 1) the transfer of securities, and 2) payment for the securities. This project deals only with the specialized rules governing the transfer of securities and property interests in securities. The payment system has its own specialized rules, and its own clearance and settlement systems, that are not affected by this project.**See footnote 11**

settlement rules and the Personal Property Security Acts

Settlement rules are conceptually distinct from PPSAs. This is recognized by the fact that the rules are segregated in separate statutes.

The only reason this project deals with the law of security interests in investment securities is that the settlement rules have created a unique new form of property: the security entitlement. Consequently, full implementation of the proposed reforms will require conforming amendments to provincial PPSAs, and perhaps other provincial chattel security legislation, to deal with security interests in such property.

the law follows the market it serves

It is worth emphasizing how and why the law in this area follows commercial practice. A casual observer might think that the settlement rules have become too specialized and complex, or that they should actively encourage a different type of securities holding practice. That would ignore the purpose and function of commercial law.

There is a long history of specialized commercial law rules that follow market practices. A hundred years ago, the specialized property transfer rules of the dominant market of the day (chattels) were codified in the *Sale of Goods Act*, while the payment system rules were codified separately in the *Bills of Exchange Act*. Since then, the payment system rules have continued to evolve independently, with the most recent developments involving electronic funds-transfer systems. **See footnote 12**

Similarly, specialized chattel security law (i.e. UCC Article 9 and the Canadian PPSAs) evolved largely in response to the market demand for consumer credit after WWII. It continues to evolve as a result of this project, with new rules governing security interests in security entitlements.

Over the past hundred years, the securities market also evolved. It developed new trading and holding practices, and its own clearance and settlement systems. These new commercial practices created the need for a specialized branch of commercial law to govern the transfer of securities.

The first codification of these rules was the U.S. Uniform Stock Transfer Act of 1908. It only dealt with transfers of corporate shares because, at that time, the market was truly a "stock market". By the time work began on the UCC in 1942, the market had changed. There was a need for transfer rules governing debt and non-corporate securities, as well as shares. The 1977 revision of Article 8 to deal with uncertificated securities is another example of the law evolving, and becoming more specialized, in response to market developments.

The 1994 revisions to Article 8, and this project, merely continue the evolution of increasingly specialized property transfer rules designed to accommodate the unique characteristics of modern securities market practices.

policy issues considered by the Production Committee

harmonizing to the global standard via the U.S. model

The Production Committee agreed that the objective of this project should be to clarify and harmonize Canadian settlement rules to ensure that Canadian securities markets remain globally competitive. After reviewing revised Article 8 and comparing it with Canadian legislation in this area, we concluded that Canadian rules should use the same basic concepts and approach as revised Article 8 (i.e. the "security entitlement", and perfection of security interests in "investment property" by "control").

The use of the U.S. model is appropriate because Canadian market practices are similar to U.S. practices, and because settlement rules must adhere to global standards that are, practically, set by the U.S. In this sense, we enjoy the advantage of being able to adopt the U.S. model with few modifications. That would place Canada among the leaders in the quest for international harmonization in this area. **See footnote 13**

The Production Committee noted that Canada has not yet experienced many of the problems that lead to the U.S. reforms in this area. That does not detract from the need to reform Canadian law. The Production Committee believes that the proposed reforms offer a number of significant advantages:

- reduction in systemic risk
- clarification of legal rights for all market participants
- maintenance of global standard clearance and settlement systems
- clarification of choice of law rules
- improved secured transaction rules
- consistency with other initiatives (e.g. *Payment Clearing and Settlement Act*, *Bankruptcy and Insolvency Act*)

uniformity and harmonization within Canada

Currently, Canadian legislation in this area is much less uniform than U.S. legislation. This is partly due to Canada's constitutional division of powers, but uniformity and harmonization are possible, and highly desirable. The Production Committee recommends that each province enact uniform legislation governing this area, to be harmonized with federal legislation.

It is not surprising that this topic raises some uniquely Canadian jurisdictional issues. While settlement rules deal in one sense with private property transfers (which may be considered a matter of provincial jurisdiction), they also involve a federal dimension. Revised Article 8, and particularly its choice of law provisions, was not designed to deal with this federal dimension.

Settlement rules affect corporations governed by federal legislation such as the *Canada Business Corporations Act*, the *Bank Act*, and others. There is also a whole class of securities traditionally governed by the federal *Bills of Exchange Act*, and which may in future be governed by the proposed *Depository Bills and Notes Act*. **See footnote 14** The detailed issues raised by this project must be considered within the larger context of federal/provincial relations.

After consideration, the Production Committee recommends that the project proceed immediately with the preparation of a model *Securities Transfer Act* for provincial enactment. That statute should be the reference point for the next stage: development of a federal *Securities Transfer Act*. The objective is harmonized federal and provincial legislation providing clarity and certainty for all transactions, regardless of jurisdiction.

We welcome and recommend the continued involvement of federal authorities to work towards this objective as the project continues.

using specialized, separate statutes

In recognition of the specialized nature of this legislation, the Production Committee recommends that settlement rules be removed from corporate legislation and placed in a separate statute with the same scope as revised Article 8. This approach has several advantages:

* it clarifies the purpose and function of the settlement rules, which long ago ceased to apply strictly (or even mainly) to corporate securities;

* it avoids the need to modify the settlement rules to accommodate the disparate corporate law systems throughout Canada, which produces non- uniformity; and

* it facilitates making future revisions to maintain global standards.

no policy change is required to adapt revised Article 8 to the Canadian context

The Production Committee's review of revised Article 8 did not reveal any areas where major policy changes are required. We found the principles reflected in revised Article 8 to be appropriate and applicable to Canadian market practices.

conclusion

The Production Committee is convinced that the proposed reforms are essential to maintaining the global competitiveness of Canada's securities markets, and that they will benefit all market participants. Market participants should recognize the importance of these reforms and the need for action in this area. The Production Committee needs the support of these stakeholders to ensure that reformed legislation is appropriate, and that it will be enacted.

The Production Committee asks market participants to express their support for this project in writing directly to the Reporter at the address below. Any comments, or requests to receive other material relating to this project, are also welcome.

Tiered Holding System - Uniform Legislation Project
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John Kennedy - Group of Thirty
Robert Kohl - Ontario Securities Commission
Marguerite Mooney - Borden & Elliot
David Phillips - Canadian Bankers' Association

ENDNOTES

Footnote: 1

*1. The essential U.S. materials on this subject include a series of articles published in Volume 12 of the Cardozo Law Review (1990): C. Mooney, "Beyond Negotiability: A New Model for Transfer and Pledge of Interests in Securities Controlled by Intermediaries" at 305; M.J. Aronstein, "The New/Old Law of Securities Transfer: Calling a 'Spade' a 'Heart, Diamond, Club or the Like'" at 429; E. Guttman, "Transfer of Securities: State and Federal Interaction" at 437; J.S. Rogers, "Negotiability, Property, and Identity" at 471; M.E. Don and J. Wang, "Stockbroker Liquidations Under the Securities Investor Protections Act and Their Impact on Securities Transfers" at 509; and J.L. Schroeder and D.G. Carlson, "Security Interests Under Article 8 of the Uniform Commercial Code" at 557. See also the Prefatory Note and Official Comments to American Law Institute & National Conference of Commissioners on Uniform State Laws, Uniform Commercial Code Revised Article 8 - Investment Securities (With Conforming and Miscellaneous Amendments to Articles 1, 4, 5, 9, and 10) (1994 Official Text with Comments). The most current and complete summary of the U.S. material is J.S. Rogers, "Policy Perspectives on Revised U.C.C. Article 8", (1996) 43 U.C.L.A. L. Rev. 1431. This Report of the Production Committee draws heavily on Professor Rogers' article. The Canadian perspective on this subject is reviewed in Alberta Law Reform Institute, Report No. 67 - Transfers of Investment Securities (June, 1993). Copies of this Report are available upon request from the Alberta Law Reform Institute at 402 Law Centre, University of Alberta, Edmonton, Alberta, T6G 2H5; fax (403) 492-1790; email: **reform@alri.ualberta.ca**.*

Footnote: 2 2. ALRI Report No. 67 - Transfers of Investment Securities, ibid.

Footnote: 3 3. Source: Bank For International Settlements, Cross-Border Securities Settlements (Basle: 1995), Table 1, p. 9.

Footnote: 4 4. Ibid. at 40.

Footnote: 5 5. See the Payment Clearing and Settlement Act, enacted by S.C. 1996, c.6, s.162. The payment system has been described as "essentially a part of the banking system"; see B. Crawford, "The Payment Clearing and Settlement Act, 1996" (1997), 28 C.B.L.J. 1, at 20.

Footnote: 6 *6. For an analysis of systemic, legal and other risk in cross-border securities trading see Clearance and Settlement Systems in the World's Securities Markets (New York: Group of Thirty, 1989); Cross-Border Clearance, Settlement, and Custody: Beyond the G30 Recommendations (Morgan Guaranty Trust Company of New York, Brussels office as Operator of the Euroclear System, 1993) at 14-24; Cross- Border Securities Settlements, supra, note 3 at 17-30; and Rogers, "Policy Perspectives on Revised U.C.C. Article 8", supra, note 1 at 1436-8.*

Footnote: 7 *7. In this report, the discussion is limited to a basic two-tier system: e.g. a customer deals with a broker (lower tier); the broker deals with the depository (upper tier). There may be more than two tiers. For example, in the context of what were formerly called "service arrangements", now "introducing and carrying broker arrangements", the customer may deal with and introducing broker (lower tier), who deals with a carrying broker (middle tier), who deals with the depository (upper tier). See Investment Dealers Association of Canada Compliance Interpretation Bulletin C-111, March 4, 1997. See also the definition of "multi-tiered securities holding system" in Cross-Border Clearance, Settlement, and Custody: Beyond the G30 Recommendations, ibid. at 55. The additional tier (or tiers) do not significantly affect the system.*

Footnote: 8 *8. Current Canadian law, which is based on UCC 1-201(17), defines fungible to mean "...in relation to securities, securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit". See for example CBCA s. 48(2), where "securities" refers to certificates, and OBCA s. 53(1), where "securities" refers to the underlying intangible interest. Because securities of the same issue are fungible there is normally no need to keep them separately identifiable and they are held in bulk. The use of such "fungible bulks" is a significant contributor to the efficiency of depository operations.*

Footnote: 9 *9. The most thorough analysis is by C.W. Mooney in "Beyond Negotiability" ,supra, note 1. A more general discussion in the Canadian context is found in Chapter 6 of ALRI Report No. 67 - Transfers of Investment Securities, supra, note 1.*

Footnote: 10 *10. J.S. Rogers, "Policy Perspectives on Revised U.C.C. Article 8", supra, note 1 at 1450-1.*

Footnote: 11 *11. See the definitions of "clearing and settlement system" and "systemic risk" in s. 2 of the Payment Clearing and Settlement Act, supra, note 5.*

Footnote: 12 *12. This area is another example of extremely specialized and complex commercial law. See B. Geva, The Law of Electronic Funds Transfers (New York: Matthew Bender, 1994).*

Footnote: 13 *13. See R.D. Guynn, "Modernizing Securities Ownership, Transfer and Pledging Laws: A Discussion Paper on the Need for International Harmonization",*

International Bar Association Section on Business Law, Capital Markets Forum, February 1996.

Footnote: 14 14. The proposed Depository Bills and Notes Act was introduced as Bill C-90, 35th Parliament, 2nd Session. It received 1st reading March 13, 1997, but died on the Order Paper when Parliament was dissolved on April 27, 1997.

April 1997