UNIFORM LAW CONFERENCE OF CANADA

CIVIL SECTION

INTERIM REPORT ON THE HAGUE CONVENTION ON THE LAW APPLICABLE TO CERTAIN RIGHTS IN RESPECT OF SECURITIES HELD WITH AN INTERMEDIARY

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Report of the Working Group

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I. Background

[1] The subject of this report is the *Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* (the "Convention" or "The Hague Securities Convention"). At its 2011 Annual Meeting, the Uniform Law Conference of Canada (ULCC or Conference) resolved that a Working Group be established to develop uniform implementing legislation for the Hague Securities Convention for consideration at a subsequent meeting. The decision was made further to the review of the Pre-Implementation Report prepared by Michel Deschamps, which outlined the similarities and differences between the rules of the Convention and those applicable in Canada. The Pre-Implementation Report also identified modifications to the laws of the Canadian provinces and territories that would be necessary for the implementation of the Convention.

[2] The purpose of this Working Group Interim Report is to report on the progress made by the Working Group on particular aspects of the implementation of the Convention in Canadian law.

[3] The Working Group is constituted of the following participants:

- Dominique D'Allaire (chair), Private International Law Section, Justice Canada
- Michel Deschamps, McCarthy Tétrault,
- Allen Doppelt, Lawyer
- Joseph Primeau, Department of Finance, Government of British Columbia
- Eric Spink, Lawyer

II. The Convention

[4] The Convention was prepared under the auspices of the Hague Conference on Private International Law and was adopted during a diplomatic session held in The Hague in December 2002. This Convention is not yet in force as only Switzerland and Mauritius have deposited their instrument of ratification and ratification by three states is required for the Convention to enter into force. There is interest globally for the rules made available by the Convention, in particular in the United States where the adoption of the Convention is under consideration.[1]

[5] The objective of the Convention is to determine the law applicable to a number of issues relating to securities held with an intermediary, including the perfection of transfers or security interests relating to securities of that nature. The Convention is a conflict of laws instrument and does not propose substantive law rules. It must be noted that the Convention relates essentially to the transfer of securities and the rights of interest holders in these securities and does not concern the regulation of trading in securities or the issuance of securities.

[6] The subject matters covered by the Convention can be divided into four different groups:

- provisions dealing with key concepts or definitions with respect to securities held through intermediary;
- the scope of application of the Convention;
- the conflict of laws rules *per se* proposed by the Convention; and
- final clauses dealing primarily with the coming into force of the Convention and its possible application on a provincial basis, which is of particular interest to Canada.

Current Canadian legislation

[7] The implementation of the Convention in Canadian law would impact existing legislation dealing with securities held through intermediaries and security interests. The Uniform Securities Transfer Act, approved by the ULCC in 2004, was subject to a number of significant changes (including to the conflicts provisions) to create the final product, the *Securities Transfer Act* (the Québec's version is entitled *An Act Respecting the Transfer of Securities and the Establishment of Security Entitlements*). For this reason, reference is made in this Report to the provincial and territorial Acts as opposed to the uniform legislation adopted by the Conference.

[8] The *Securities Transfer Act* ("STA") has been adopted by all jurisdictions in Canada except Prince Edward Island. Implementation is uniform across the country. The objective of the STA is to provide legal foundation for the market practices of indirect securities holding or holding through an intermediary. The key concept in the STA is the "security entitlement", which is the term used to describe the special property interest of a person who holds a financial asset in a securities account with a securities intermediary.

[9] The STA defines a security entitlement as "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 6 (Part 6 deals with securities entitlements)". The entitlement holder's rights may only be asserted against its immediate intermediary. This locates the entitlement holder's property interest with the entitlement holder's intermediary, greatly simplifying the situation. So, for example, it becomes clear that a creditor wishing to seize the entitlement holder's property must deal with that intermediary.

[10] The STA also contains conflict of laws rules with respect to indirect holding of securities i.e., which law applies to certain rights of the securities holder, in particular rights resulting from the transfer of securities and when the transfer is effective.

[11] Provincial and territorial *Personal Property and Security Acts* (PPSA) provide rules on the validity and enforceability of security interests over personal property. They recognize that security interests can attach to security entitlement.[2] PPSA legislation is relatively consistent across all Canadian common law jurisdictions. In Québec, provisions covering the same subject matters are found in the Civil Code.[3]

III. Report on the activities of the Working Group

[12] The Working Group held four conference calls in the period leading to the 2013 annual meeting of the Conference and conducted research on developments in foreign countries with respect to the implementation of the Convention. The Working Group discussed specifically the changes that would be required to the STA, the PPSA and the Civil Code to bring Canadian legislation in line with the requirements of the Convention. The Working Group considered possible implementation techniques (e.g., adoption of the text of the Convention in Canadian legislation or the adoption of the substance of the Convention in specific statutes dealing with the relevant subject matters). Finally, the Working Group considered extensively the relative benefits of the current Canadian rules over those found in the Convention, in particular in light of the benefit of having harmonised conflict of law rules in Canada and in the United States.

[13] The Working Group is of the view that it would be premature to take steps for the adoption of the Convention in the current context and that for at least two reasons. First, the primary objective of adopting the Hague Securities Convention is to bring securities legislation up to US and Canadian standards. Typically, countries where conflict of laws rules are inexistent with respect to securities held through intermediaries and where clauses on applicable law are ineffective would benefit from these improvements. The Working Group is of the view that current Canadian and US laws are better equipped to respond adequately to business and legal needs than any other legal system, including the

Convention. Existing Canadian rules are better because they are clearer and simpler. In particular, there is a requirement in the Convention that a choice of applicable law be substantiated by evidence that the law selected is connected to a place of business of the relevant intermediary. This business reality test implicitly requires parties to document elements supporting their choice of law. This test does not exist under current Canadian law and may be found to be onerous by the various participants to transfers in securities.

[14] Second, Canada would likely benefit from considering implementation techniques used by foreign jurisdictions as part of its policy analysis for recommending uniform legislation.

IV. Next steps: monitoring developments abroad

[15] At this time, the Working Group recommends that it be tasked with monitoring developments with respect to the Convention. Given our economic relationship, the Working Group's position will be reviewed if and when the United States ratifies the Convention. In such event, it is likely that the Working Group would recommend that Canada follow suit and prepare uniform legislation implementing the Convention.

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[1] See http://www.state.gov/s/l/commercial/index htm and the Committee on the Hague Securities Convention of the Uniform Law Commission (USA).

[2] For example: sections 2(1), 7.1, and the definition of "security interest", Ontario PPSA, 1990 R.S.O. c. P-10.

[3] Civil Code of Québec, Book 6 (sect. 2644 et seq.).