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Ontario's New Laws for Pledging Securities

New Ontario laws will apply to a pledge of securities beginning on January 1, 2007. The *Securities Transfer Act, 2006* dramatically changes Ontario laws that govern the transfer of securities and the use of securities as collateral for loans, derivatives and other financings. Similar laws will come into force in Alberta on the same day. The new laws are closely based on the Uniform Commercial Code in the United States, which was revised in a similar fashion in 1994, and has worked effectively since then.

One of the most significant changes in practice will arise when a secured party wants to rely on a securities account at another financial institution as collateral for a customer's obligations. In typical cases, the secured party will need to either (i) arrange for the securities to be transferred into the secured party's security account at CDS, at a securities dealer or at a custodian; or (ii) ask the customer's securities dealer or custodian to sign a control agreement to protect the secured party's interests under the new laws. Under the control agreement, the securities dealer or custodian agrees to comply with the secured party's instructions to transfer or redeem the securities without further consent of the customer.

A secured party seeking to protect a security interest in uncertificated securities (such as mutual fund units or shares held directly by a customer) will need to take similar steps—either arrange for the securities to be registered in the name of the secured party or obtain a control agreement from the issuer of the securities (e.g., the mutual fund trustee or corporation, or someone acting on its behalf).

Since dealers, custodians, issuers and secured parties are likely to approach control agreements from different perspectives, parties may need to negotiate the form of control agreement until industry standards are developed. However, no clear industry standard exists in the United States. To avoid the costs of negotiation, dealers, custodians and issuers may refuse to sign control agreements presented by third parties in respect of smaller customers. As a result, smaller customers wishing to use their securities account as collateral may have to choose between obtaining financing from their own dealer (or its affiliate) and transferring their account to a competitor's dealer to obtain financing from that dealer (or its affiliate).

Securities dealers and custodians holding a security interest in their own customer's accounts need not take any additional steps under the new laws. Where securities are evidenced by a certificate (e.g., shares of a private company), a secured party can still protect its interests by obtaining possession of the certificate, duly endorsed. A secured party can continue to protect its security interest by registering a financing statement under the *Personal Property Security Act*, but that interest is easily defeated by another secured party or transferee.

Securities dealers, securities custodians and mutual fund issuers will want to review their account documents in light of these new laws, in the following ways:

- At least until other provinces pass similar legislation, ideally agreements between dealers or custodians and their customers should specify that Ontario (or Alberta) laws apply.
- Dealers and custodians may wish to revise their agreements to use the terminology in the new laws—"securities entitlements", "securities accounts" and other terms. However, these changes are not essential.

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- Dealers, custodians and mutual fund issuers will need to carefully review control agreements presented to them by lenders and other secured parties, to avoid creating unexpected liability for themselves.
- Dealers, custodians and mutual fund issuers may wish to establish their own forms of control agreements to deal with numerous requests they might receive from their customers and secured parties who want to use customer securities as collateral.

Lenders and others who rely on securities as collateral also may want to amend their standard security documents to use the new terminology, although not essential; and may wish to create standard control agreements to facilitate secured transactions.

Saskatchewan has introduced a similar bill (not yet passed) that closely resembles the Ontario and Alberta laws. Observers expect British Columbia to table a similar bill in the new year and Quebec is working on a draft bill. Those watching these developments hope that each province and territory will follow suit. Until each jurisdiction in Canada has adopted the new laws, difficult questions will continue to arise about whether the new laws apply in the other jurisdictions.

Torys partner John Cameron (416.865.8112; jcameron@torys.com) was a member of the Personal Property Security Act Working Group of the Uniform Law Conference of Canada, which worked with the Canadian Securities Administrators' Uniform Securities Transfer Act Task Force to draft the relevant parts of these new laws. John Cameron's brief summary of the new laws is available on Torys' website at www.torys.com/publications/pdf/AR2006-39T.pdf.

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