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Mr. Matthew Dooley, Senior Project Manager
Industry Canada
C.D. Howe Building
235 Queen Street
Ottawa, ON K1A 0H5

Dear Matt:

Re: Definition of Eligible Financial Contract

We understand that Industry Canada may be considering possible alternative approaches to the definition of “eligible financial contract”. We understand that the technical bill to amend the definition has already been prepared, but we hope these comments will be helpful in considering the language prior to second and third reading and with respect to any future amendments.

The language that ISDA recommended in its letter of March 2006 was prepared with a view to making as few changes as possible to the definition currently in the various Canadian insolvency statutes. ISDA agrees that there would, however, be advantages to revisiting the definition in its entirety as the original definition was not ideal.

Support for Consistency with the U.S. Bankruptcy Code Approach

ISDA would support moving the definition of eligible financial contract closer in wording to the relevant definitions in the U.S. *Bankruptcy Code*. ISDA and other industry groups were closely involved in the recent amendments to the U.S. *Bankruptcy Code* as they related to swap agreements and other financial contracts. As you may be aware, the U.S. Senate and House of Representatives has recently passed a new Act, the

Financial Netting Improvements Act of 2006 (Bill H.R. 5585) to, among other things, clarify and add to the definitions relevant to the safe-harbours in U.S. bankruptcy legislation.

ISDA believes that the U.S. definitions have significant market acceptance in terms of providing a high degree of certainty for the enforceability of close-out netting and collateral enforcement rights. As we noted in our previous letters, relatively uniform levels of protection for the exercise of contractual rights are important to Canadian participants in this global and competitive market. That said, it would be preferable to move toward consistency with the U.S. Bankruptcy Code, rather than European laws, given the volume of Canada-U.S. cross-border derivatives, securities and securities financing business.

Complexity of Code Not Recommended for Canada

As you have no doubt noted from your review of chapter 5 of the U.S. *Bankruptcy Code*, it would not be feasible or indeed necessary to adopt all aspects of the relevant concepts and definitions. Those provisions are much more complicated than the current Canadian provisions in a number of respects.

First, the U.S. close-out netting protections define classes of counterparties (eg swap participants, financial participants, financial institutions, stockbrokers, commodities brokers) and attempt to limit the protections to the types of typical transactions for those kinds of parties. For example, stockbrokers' rights are protected under securities contracts. The definitions of the relevant parties refer to categories provided for in U.S. securities and commodities laws. The Canadian eligible financial contract provisions do not currently make those distinctions and are, in that respect, relatively clear in their application and easy to understand, which is beneficial to the market.

Secondly, many of the definitions also adopt by reference definitions from the U.S. *Commodity Exchange Act*. This Act creates defined categories of markets and a tiered system of regulation of derivatives.

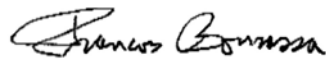
A similar approach would not be feasible for Canada. Securities and commodities laws are not uniform across Canada. There is no equivalent of the *Commodity Exchange Act* in terms of a federal or uniform statute that defines markets and tiers of regulation for participants in derivatives markets. In any event, in a global business environment, referencing definitions in domestic statutes would inevitably result in uncertainty. Netting protections are relied on not only with respect to domestic transactions, but by counterparties dealing with Canadian entities participating in foreign securities and derivatives markets. Any definitions in the Canadian insolvency legislation should be self-contained and distinct from domestic securities and commodities regulatory laws.

Benefits of a “List” Approach

There are advantages to abandoning the “laundry list” approach to defining eligible financial contracts in favour of a more rationalized definition. Some form of a list does serve a useful function. However, the current list could be significantly improved. For example, a “cap, collar or floor” is not a specific type of eligible financial contract, but a particular feature of derivatives of many types. Also, more specific definitions of the types of contracts may be useful. Market participants take a large degree of comfort when the transactions they are entering into are specifically described. ISDA recommends retaining some form of relatively comprehensive definition.

We have attached a proposed definition of “eligible financial contract” that is more consistent with the U.S. *Bankruptcy Code* than the current definition. It does not include any distinctions based on the identity of the party seeking to exercise the close-out rights. It orders the list of contracts in what we believe is a more logical fashion. We hope that you find it of assistance and we would welcome the opportunity to provide any further input that might be useful to you.

Yours truly,



Francois Bourassa

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The Canadian Depository for Securities Limited: Toomas Marley
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Proposed Eligible Financial Contract Provisions

Bankruptcy and Insolvency Act

The text in bold is the current BIA as amended by Bill C-55.

BIA section 65.1 (7), (8) and (9)

65.1 (1) If a notice of intention or a proposal has been filed in respect of an insolvent person, no person may terminate or amend any agreement, including a security agreement, with the insolvent person, or claim an accelerated payment, or a forfeiture of the term, under any agreement, including a security agreement, with the insolvent person, by reason only that

(a) the insolvent person is insolvent; or

(b) a notice of intention or a proposal has been filed in respect of the insolvent person.

(7) Subsection (1) does not apply and no order to the contrary may be made in any proceeding¹ under this Act;²

(a) in respect of an eligible financial contract; or

(b) to prevent a member of the Canadian Payments Association established by the *Canadian Payments Act* from ceasing to act as a clearing agent or a group clearer for an insolvent person in accordance with that Act and the by-laws and rules of that Association.

(8) In subsections (7) and (9) [others?],

“cash” means money credited to an account in any currency or a similar claim for repayment of money, such as money market instrument;

“credit support” means (i) cash, (ii) and financial property.

“credit support arrangement” means a title transfer credit support arrangement or a security interest collateral arrangement;

“eligible financial contract” means

(a) a securities contract;

(b) a repurchase agreement;

¹ Added the words “in any proceeding” to ensure that such an order could also not be made in a bankruptcy proceeding or on the basis of the court’s inherent jurisdiction.

² With courts in BIA proposals now making orders similar to those in the CCAA it is necessary to make it clear that the court cannot make such an order. Also, once the protections are extended to collateral, it becomes necessary to ensure they apply to the stays that are possible in a bankruptcy proceeding as well.

- (c) a forward contract;
- (d) a futures contract;
- (e) a swap agreement;
- (f) a master agreement;
- (g) an agreement, contract or transaction similar to an agreement, contract or transaction referred to in this definition;
- (h) an agreement, contract or transaction of a kind prescribed;³
- (i) any combination of agreements, contracts or transactions referred to in this definition;
- (j) any option to enter into or in respect of an agreement, contract or transaction referred to in this definition;
- (k) any credit support arrangement or any other credit enhancement related to any agreement, contract or transaction referred to in this definition, including any guarantee, indemnity or reimbursement obligation to the extent that it applies to obligations under any agreements, contracts or transactions referred to in this definition⁴;

“financial property” means a security, securities account, security entitlement, futures contract, futures account, precious metals and other commodities, money market instruments, mortgage related securities, mortgage loans, interests in mortgage related securities or mortgage loans, and any proceeds or distributions with respect to such property,⁵

³ This element is in the existing definition, but we recommend changing its order in the list because if transactions are added by regulation, then it would be necessary to ensure that the master agreement definition and the derivative, combination or option and collateral agreements, etc would apply as well, without having to specify this in the regulation itself.

⁴ It should, for example, be clear that a guarantee of a guarantee of an etc is an etc.

⁵ This definition is not from the Bankruptcy Code. However, the Code includes “repurchase agreements” as a separate category of protected contract and defines them by reference to a specific list of financial instruments that is narrower than the broad range of products that would be covered by the repo market. However, repurchase transactions are included in other definitions (securities contract, forward contract) but there is no generic definition of a repurchase transaction. Consequently, we have suggested a generic definition of a repurchase transaction that would be relevant to the definition of securities contract and forward contract as well as to the definition of a repurchase arrangement. There is overlap between the definitions, but this is preferable to a gap. The Bankruptcy Code has recently been amended to clarify that a repurchase agreement in the context of the definition of securities contract, forward contract etc is not the same restrictive definition as it is in the context of the repurchase agreement category.

“forward contract” means a contract for or option to enter into a contract for the purchase, sale, or transfer of a commodity⁶, or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or a product or by-product of such a contract or option, [with a maturity date more than two days after the date the contract is entered into], including, but not limited to, leverage transaction, margin transaction, repurchase transaction, consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any other similar agreement;

“futures contract” means a contract for or option to enter into a contract for the purchase, sale, or transfer of a commodity, or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing on or subject to the rules of a regulated contract market, board of trade or exchange, or a product or by-product of such contract or option,

“master agreement” means

- (a) an agreement, together with all supplements to any such master agreement, or
- (b) any rule or by-law of an exchange, derivatives clearing organization, or securities clearing agency or in a resolution of the governing body of such an organization,

providing for the exercise of rights, including rights of netting, set-off, liquidation, termination, acceleration, or close out, under or in connection with one or more agreements or transactions that are described in any one or more parts of the definition of eligible financial contract and any other master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not an eligible financial contract as so defined, except that such master agreement is an eligible financial contract only with respect to each agreement or transaction that is an eligible financial contract as so defined;

“money market instruments” means bankers’ acceptances, certificates of deposit, commercial paper, government debt instruments and similar documents, instruments or interests and any proceeds or distributions in respect to such property;

⁶ Should “commodity” be defined? Given that ACA defined it in Blue Range quite well, it probably isn’t necessary.

“net termination value” means the net amount obtained after netting or setting off the mutual payment or delivery obligations or entitlements between the parties to an eligible financial contract in accordance with its provisions, including the application of the proceeds of sale of any credit support or the setting off or application of the value of credit support against such obligations;

“repurchase transaction” means an agreement which provides for the transfer of financial property against the transfer of funds by the transferee of such financial property with a simultaneous agreement by such transferee to transfer to the transferor the financial property or equivalent or substitute financial property at a date certain or on demand, and includes a reverse repurchase transaction and a sell buy-back transaction;

“repurchase agreement” means a repurchase transaction, including related terms, with respect to one or more financial properties, [but does not include a repurchase obligation under a participation in a commercial mortgage loan];

“securities contract”

(a) means:

- (i) a contract for the purchase, sale, or loan of a security, or option on a security, including an option to purchase or sell any such security or option, and including any repurchase transaction with respect to any such security or option;
- [(ii) any option entered into on a contract market, board of trade or securities exchange;⁷]
- (iii) the guarantee by or to any securities or options clearing agency of a settlement of cash or securities;
- (iv) any margin loan;
- (v) any extension of credit for the clearance or settlement of securities transactions;
- (vi) any loan transaction coupled with a securities collar transaction, any prepaid forward securities transaction or

⁷ Query whether a definition is needed. The problem with a definition in this context is that it has to be wide enough to cover foreign exchanges that do not carry on business in Canada (and therefore would not necessarily be recognized or licensed in Canada) but on which Canadians might nevertheless participate. Another difficulty is the inconsistency in the laws with respect to commodity exchanges in Canada. These laws are also in a state of flux given that both Ontario and Quebec are currently considering their wholesale revision.

any total return swap transaction coupled with a securities sale transaction;

[(b) does not include any purchase, sale, or repurchase obligation under a participation in a commercial mortgage loan;]⁸

“security” means any document, instrument or interest⁹ that is commonly known as a security, and includes, without limiting the generality of the foregoing:

(i) a share, participation right or other right or interest in property or in an enterprise, including an equity share or stock, a partnership unit or a mutual fund share or unit;

(ii) indebtedness, including a note, bond, debenture, money market instrument, mortgage, or mortgage related securities, any interest in a mortgage loan, a group or index of securities, money market instruments, or mortgage loans or interests in them (including an interest in those interests or based on the value of the mortgage loan or interests in them);

(iii) a right or interest in respect of an option, warrant or subscription;

(iv) such other document, instrument or interest as is prescribed;

“security interest collateral arrangement” means an agreement under which a collateral provider provides credit support by way of security in favour of, or to, a credit support taker, and where, at the time the security right is established, the credit support provider has a property interest in a right of redemption with respect to the credit support or equivalent or substitute credit support;

“swap agreement” means: [*largely from US Bankruptcy Code*]

(a) any agreement, contract or transaction including the terms and conditions incorporated by reference in such agreement, contract or transaction that is:

(i) an interest rate swap, option, future, or forward agreement, including a rate floor, rate cap, rate collar, cross-currency rate swap, and basis swap;

⁸ This is an exclusion from the U.S. Bankruptcy Code. It should be considered whether it is necessary to make a similar exclusion in Canada.

⁹ This use of the word “interest in” is intended to be wide enough to include a securities entitlement with respect to a security.

- (ii) a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange or precious metals or other commodity agreement;
- (iii) a currency swap, option, future, or forward agreement;
- (iv) an equity index or equity swap, option, future, or forward agreement;
- (v) a debt index or debt swap, option, future, or forward agreement;
- (vi) a total return, credit default, credit spread or credit swap, option, future, or forward agreement;
- (vii) a commodity index or a commodity swap, option, future, or forward agreement; or
- (viii) a weather swap, option, future or forward agreement;
- (ix) an emissions swap, option, future or forward agreement;
- (x) an inflation swap, option, future or forward agreement;
- (xi) a freight swap, option, future or forward agreement;
- (xii) a real property swap, option, future or forward agreement;
- (b) any agreement, contract or transaction that is similar to any other agreement or transaction referred to in this subsection and that:
 - (i) is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets (including terms and conditions incorporated by reference in the agreement or transaction); and
 - (ii) is a forward, swap, future, option or spot transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or

contingency associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value;

“title transfer credit support arrangement” means an arrangement, under which a credit support provider provides title to or ownership of property to a credit support taker for the purpose of securing or otherwise covering the performance of obligations to the credit support taker;

Application of paragraphs 69(1)(a) and 69.1(1)(a)

(9) For greater certainty, where an eligible financial contract entered into before the filing in respect of an insolvent person of

(a) a notice of intention, or

(b) a proposal, where no notice of intention was filed, is terminated on or after that filing, the netting or setting off of any termination value, payment amount, transfer obligation or other obligations between the insolvent person and the other parties arising under or in connection with one or more eligible financial contracts, and the exercise by such other party of any right of liquidation, sale, foreclosure, set off or application of the value of credit support, in accordance with its provisions or the provisions of any related credit support arrangement, shall be permitted, and if net termination values determined in accordance with the eligible financial contract are owed by the insolvent person to another party to the eligible financial contract, that other party shall be deemed, for the purposes of paragraphs 69(1)(a) and 69.1(1)(a), to be a creditor of the insolvent person with a claim provable in bankruptcy in respect of those net termination values.

(9.1) (a) An eligible financial contract, is an eligible financial contract notwithstanding that the purpose of entering into the transaction may not be either wholly or partly financial; and

(b) an agreement, contract or transaction subject to or appended to a master agreement constitutes a single agreement with respect to all eligible financial contracts subject to the agreement and the master agreement, unless the agreement, contract or transaction provides otherwise.