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June 21, 2006

Mr. David Dodge
Governor
Bank of Canada
234 Wellington Street
Ottawa, Ontario, Canada
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Dear Mr. Dodge:

Re: Canadian Insolvency Law Reform

We are writing to you to seek your support and that of the Bank of Canada for important reforms to Canadian insolvency legislation as it relates to securities lending, securities repurchase and derivatives markets.

Many Canadian and international industry groups, including the International Swaps and Derivatives Association, the Canadian Bankers Association and the IDA-IA¹, as well as market participants, including international investment banks, have communicated to Finance Canada and Industry Canada at both the Ministerial and officials level regarding these reforms. The Ministers have indicated that they understand their importance and have asked their officials to look into it further. However, there has been no clear indication from the government that the reforms will be introduced. Further, it is critical that these reforms be introduced on an expedited basis and it appears that the need for immediate reform may not be fully appreciated.

We are seeking your support because of the Bank of Canada's interest in the vitality of Canadian capital markets generally and because, as a participant in these

¹ Formerly the Industry Relations Division of the Investment Dealers Association of Canada.

markets, the Bank will be directly affected if securities lending and repo markets are compromised.

The most important of the required reforms for securities financing and derivatives markets is an exemption of financial collateral arrangements from statutory and court ordered stays on the realization of collateral. Currently Canadian insolvency statutes protect rights to terminate these arrangements in an insolvency proceeding and to set-off or net transaction exposures. However, they do not protect the right to immediately realize on the collateral that it posted to secure these transactions. As you no doubt know, all securities lending and repo transactions are conducted on a fully collateralized basis.

The requirements of the new Basel Capital Accord, which is already being implemented in many international institutions and which will come into effect in Canada in 2007, will only allow institutions to get full capital relief with respect to collateral if the right to realize on the collateral is unimpeded in an insolvency proceeding. In Canada, on the other hand, stays on realization of collateral are either automatic under the insolvency statute or almost always ordered by the court where not automatic. If insolvency laws are not reformed, Canadian institutions, investment funds and other market participants will be seriously compromised in their ability to participate in these markets. It is already the case that certain international institutions are deciding that they are not able to do business with Canadian institutions. As you no doubt appreciate, the lack of protection for financial collateral arrangements will ultimately diminish the market for Canadian government securities.

Reforms such as these have already been enacted in the United States and in every member state of the European Union. The relative protections provided by a country are extremely important in these markets and as Canada falls further behind international standards the adverse effect on its markets will be acute.

To implement these reforms Finance Canada must sponsor amendments to the *Winding-up and Restructuring Act*, the *Canada Deposit Insurance Corporation Act* and the *Payment Clearing and Settlement Act* and Industry Canada must seek further amendments to the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*. Because the Industry Canada amendments must be made to the BIA and CCAA through a Senate sponsored Bill to amend the as yet unproclaimed chapter 47 (formerly Bill C-55), there may be political complications. Chapter 47, among other things, added the Wage Earner Protection Act and certain provisions relating to Canada Student Loans, which are not as strongly supported by the current government. There is perhaps reluctance at Industry Canada to add anything to the Bill that is also potentially controversial.

We believe that your involvement in helping Finance Canada and Industry Canada to understand that these reforms should be a timing priority and in helping the

relevant members of all political parties to understand why these amendments should be supported is extremely important.

Please do not hesitate to contact me or ISDA's Canadian counsel, Margaret Grottenthaler of Stikeman Elliott LLP, for any further information, including copies of our correspondence with the government.

Yours truly,



Francois Bourassa

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and Senior Vice-President, Trading and
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