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Industry Canada
Corporate and Insolvency Law Policy Directorate
Room 561-F, West Tower
235 Queen Street
Ottawa, Ontario
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Attention: Mr. Gilles Gautier,
Director - Corporate and Insolvency Law Policy Directorate

Dear Sirs/Mesdames:

Re: Bill C-55 - Amendments to the Bankruptcy and Insolvency Act and Companies' Creditors Arrangement Act

We understand that there will be an opportunity to make further amendments to Bill C-55 when it reaches the committee stage in the next few months. The International Swaps and Derivatives Association (ISDA) would like to offer the following comments for consideration by Industry Canada and the committee with respect to the impact of the Bill on the derivatives products market. ISDA urges you to take advantage of this opportunity to make changes that will have a measurable and positive impact on the competitiveness of Canadian financial markets.

This letter supplements the letter that ISDA previously sent to Industry Canada, dated June 7, 2004. We have attached a copy of that letter for your reference.

Comments on the Provisions of the Bill

Section 84.2 of the BIA

The Bill adds to the BIA *bankruptcy* provisions (s.84.2) an automatic stay on the termination, acceleration or the forfeiture of a term of any agreement by reason only of the bankruptcy. (This is similar to the stay that currently exists in a BIA *proposal* proceeding.)

Only if the operation of the provision causes significant financial hardship can a person apply for an exemption. This provision applies only to *individuals* who are bankrupt. Under the parallel provision in the BIA proposal provisions eligible financial contracts are exempt from this automatic stay. They are not exempt where there is a consumer proposal, but as you are aware consumer proposals would apply to only a limited class of individuals and not all individuals.

It is very important that an eligible financial contract exemption be added to section 84.2. High net worth individuals are important customers of Canadian financial intermediaries for various types of derivatives products, particularly equity derivatives. Under the current law, termination and netting rights would be enforceable in both a bankruptcy and a proposal proceeding. These products will not be available to Canadian individuals without an eligible financial contracts exemption. Further, there is presumably no policy reason why an exemption should be available for a BIA proposal proceeding with respect to these individuals but not a bankruptcy proceeding. Doubtless, this was a drafting oversight and you will want to make the BIA consistent in this regard.

CCAA s.11 and s.34

The Bill adds the same specific automatic stay on the termination of agreements to the CCAA that it added in section 84.2 of the BIA (CCAA, s.34). It also adds a new provision permitting the court to make *any order it considers appropriate* (s.11).

While the existing exemption for eligible financial contracts remains (now in s.11.05), that exemption applies only to the general power of the court to grant a stay of proceedings provided for in section 11.02 and does not apply to either section 34 or section 11. Also, the stay in section 34 is automatic and the eligible financial contract exemption only prevents a court from making an order that prevents termination, so for that reason also it would also be difficult to say that the exemption applies to section 34.

The courts had interpreted the stay of proceedings provision to give them jurisdiction to stay termination or acceleration of contracts; consequently the existing exemption applied to the general stay of proceedings. By adding a specific stay on termination and acceleration (similar to what is currently in the BIA proposal provisions), the legislation appears to have completely undermined the exemption. We suspect that this was not deliberate, but we would emphasize that a failure to fix this by adding an eligible financial contracts exemption would seriously compromise the derivatives products market.

Also, we question whether section 34 is in fact needed or indeed beneficial. It seems antithetical to the nature of a CCAA proceeding to provide for any *automatic* stay. Given the wide nature of the powers granted to the court to make orders that its considers are appropriate in scope and given that the main benefit of the CCAA is its flexibility, section 34 is not needed and can only have unintended results. Unless there was some

strong policy reason driving the inclusion of section 34, we believe that it should be removed.

Priority over Secured Creditors

A number of provisions have been added to both the BIA and the CCAA providing for the priority or potential priority of certain claims (DIP financing, administration costs, wage arrears etc.) over the claims of any secured creditor. ISDA requests that the government exempt security arrangements relating to eligible financial contracts from these priorities.

In our earlier letter we explained the importance to the Canadian market of the unimpeded enforcement of the collateral arrangements that support the derivatives marketplace. The typical collateral for these arrangements is cash or securities in the possession or control of the secured party and in which the secured party has a first priority security interest. Parties in this market are extremely sensitive to any claim that can even potentially take priority over their security interests. The opinions that ISDA obtains on behalf of its members specifically ask counsel to itemize the types of claims that potentially take priority over the collateral. Parties in other jurisdictions, particularly the United States, do not face the same impediments to enforceability.

Additional Matters to Consider

The List of Eligible Financial Contracts

We understand that Industry Canada may not have had sufficient time to fully consider whether the list of eligible financial contracts should be expanded to include all of the products that have become widely used in derivatives markets since the time the eligible financial contracts exemption was added to the BIA and CCAA. At the time the eligible financial contract exemptions were first enacted, the government recognized that this was an evolving marketplace where new products would develop over time. For that reason the enactments provided for additional types of transaction to be prescribed by regulation. This process has not been used and consequently the market has developed far beyond what it was in the early 1990s. It is, however, vitally important to this market that there be certainty that termination and netting rights with respect to credit, equity and weather derivatives are enforceable. That certainty does not exist with the current out-of-date list.

This certainty is one that marketplace participants enjoy in other jurisdictions. In particular, Title IX of the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* ("Title IX") recently enacted in the United States, has amended the *United States Bankruptcy Code* and the *Federal Deposit Insurance Act* to specifically enumerate in the definition of "swap agreement" (i) total return, credit spread and credit swap, options, futures or forward agreements, (ii) equity index and equity swaps, options, futures or

forward agreements, (iii) debt index or debt swaps, options, futures or forward agreements, and (iv) weather swaps, derivatives and options. While the previous definition of “swap agreement” contained language that was intended to encompass such market developments, the express enumeration added market certainty.

Also added to the definition of “swap agreement” was an expanded similar agreement basket clause that provides more certain guidance for market participants and for the courts. It augments the existing “any other similar agreement” with the following description:

any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph 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 markets (including terms and conditions incorporated by reference therein); and
- II. is a forward, swap, future or option 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.

This definition would cover very new types of contracts such as emissions trading derivatives, inflation derivatives and freight derivatives.

In addition, margin loans have been added to the list of protected contracts in the U.S. Bankruptcy Code. These are loans extended in connection with the purchase, sale, carrying or trading of securities. The House Judiciary Committee Report accompanying the recent revision to the U.S. Bankruptcy Code makes clear that “margin loan” does not cover any commercial lending arrangement just because it is secured by securities collateral. Margin loans are an element of any prime brokerage arrangement as well as many securities account agreements. These types of agreements provide for termination and netting of all transactions under the agreement including the margin loans. The securities transfer aspects of these agreements (such as repos or securities lending arrangements or purchases and sales of securities) are themselves eligible financial contracts under the BIA and CCAA. It is important in these markets that participants also have certainty that they can terminate and set-off the loans that relate to these arrangements at the same time that they terminate the transactions to which they relate. Given how integrally tied margin loans are to securities trading it really makes little sense to permit

the termination of the securities trades while not permitting acceleration of the related margin loans.

There have also been several recent judicial decisions which have brought into question whether contracts which will or may be settled by physical delivery of a commodity, for example, forward contracts for natural gas, qualify as eligible financial contracts. Given that transactions which settle through the physical delivery of securities are clearly eligible financial contracts, there appears to be no reason in principle why commodity contracts should be treated any differently and we believe it would be beneficial to market participants, particularly in the crucial energy sector, to eliminate any uncertainty on this point.

Amendments along these same lines for the BIA and CCAA, as well as the *Winding-up and Restructuring Act* are highly recommended. Given the developments in the U.S., Canadian market participants will very soon begin to feel the negative impact from the comparative lack of certainty in the legal regime. Another acceptable approach would be to add these transactions by regulation to the list of eligible financial contracts.

Collateral Arrangements

In our earlier letter we set out in some detail the reasons why security supporting eligible financial contracts should be excluded from any statutory or court-ordered stay on the realization of collateral. In addition to the points we made in that letter, we note that the amendments to the U.S. Bankruptcy Code (and FDIA and FDICA) will now include within the definitions of a swap agreement, securities contract, forward contract, repurchase agreement and commodity contract any security agreements or arrangements or other credit enhancements related to such agreements. Such an inclusion makes it clear that the security arrangements can be accelerated. The language used in the US legislation in the definition of swap agreement, which is included in similar form for the other agreements listed above, is the following:

... any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this clause, including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in this clause.

(In the Canadian context we do not need the reference to “any guarantee” as that is already included in the list.)

In addition to adding security arrangements to the list of eligible financial contracts (which will protect any termination or acceleration rights), it is necessary to specifically protect the right to enforce them and realize on the security interest.

The existence of the stay on realization of collateral continues to be a major impediment to the full participation of Canadians in these markets.

Safe-Harbours from Preference Laws

In our earlier letter, we noted the added cost to market participants resulting from the uncertainty as to whether or how fraudulent preference laws could apply to mark-to-market collateral arrangements supporting derivatives, securities lending and repurchase transactions. As we pointed out, European law and U.S. bankruptcy laws provide a safe-harbour for collateral provided for these types of transactions. Again, this is a matter upon which ISDA obtains opinions for its members because it is considered a significant legal risk in transactions of this nature.

The new amendments to the U.S. Bankruptcy Code extend the existing protections in the U.S. They now extend not only to collateral “under” a swap agreement, but also to collateral “in connection with” such agreements. In addition, the Code now states that safe harbours that apply to all of the protected transactions also apply to cross border insolvency proceedings under the new chapter 15 of the Code (which deals specifically with cross border insolvency proceedings).

Other countries have clearly recognized the importance of providing a safe-harbour of this nature and Canada should also if it wishes to reduce in the eyes of the international financial community the legal risk associated with collateralized transactions in Canada.

Conclusion

ISDA would be pleased to provide you with additional information about how the matters addressed in this letter are dealt with in the U.S. or Europe. As you are aware, the relative degree of protection that countries provide to participants that deal with entities from that country in these markets in the context of insolvency proceedings has a dramatic effect on the competitiveness of these entities and the availability of these important financial products to them. It is important that Canada keep pace with global developments. Currently it is not doing so.

Yours truly,



Katherine Darras
Assistant General Counsel