Bottom Line
December 2008

NEWS: Roadblock looms for restructuring
By KEN MARK

An innocent-looking amendment looks like it could lead to problems for the asset-backed commercial paper restructuring deal. A crucial part of finalizing the documentation under the Companies' Creditors Arrangement Act (CCAA) requires having a group of foreign banks sign off on the restructuring plan. If they do not, it would jeopardize meeting the targeted completion date.

"The amendment places the foreign banks outside the reach of Canadian courts," says Mississauga-based independent financial analyst, Diane Urquhart. "That's because when it was passed in November 2007, the amendment removed derivative contracts such as credit default swaps (CDSs) from the list of assets automatically stayed or frozen when firms seek bankruptcy protection under CCAA."

In other words, during court-supervised bankruptcy proceedings, derivative counterparties could settle their contracts without waiting for a judge to unfreeze such assets and apportion them between debtors and creditors. ABCP trust issuers hold CDSs since they have sold them to counterparties, i.e. the foreign banks, as a form of a hedge defaults of the trusts'' assets.

Until the foreign banks sign off on the restructuring plan, "all noteholders will have to wait in purgatory," says Urquhart. "If the banks sign, they will be in heaven because the restructuring plan will go forward and they will get paid."

All signatories to the final restructuring agreement waive the right to sue. But, "if the banks don't sign, it's hell because all the parties will start suing each other."

Without the power of the courts, the foreign banks' decision to sign is essentially voluntary.

"What's missing is someone with a hammer to bring the foreign banks to the table and sign," says Karim Jamal, University of Alberta accounting professor in Edmonton. "I don't foresee Ottawa getting involved with a bailout. The election is over and ABCP never came up as an issue.

" That was the time for noteholders to raise a fuss and get some reaction. But the election is over and their leverage is now gone."

Purdy Crawford, chairman of the Pan-Canadian Investors Committee for Third-Party Structured ABCP, was unavailable for comment, but released a statement saying: "We continue to work with the plan participants and major stakeholders to finalize the

documentation and move forward with the closing process and we expect that the restructuring plan will be completed by the end of November."

Since August 2007, $32 billion in ABCP has been locked up after market demand for such investments evaporated. The restructuring plan crafted by the Pan-Canadian Investors Committee gained court approval in mid-September after the Supreme Court of Canada refused to hear an appeal of a lower court decision.

But continuing delays compound the pain and frustration of so-called retail investors – defined as individuals, family trusts or personal investment holding companies. According to Urquhart, they number about 2,500 and collectively hold $371 million in toxic paper.

Vancouver-based Canaccord Capital Inc. and other sellers of ABCP to retail investors have signed agreements to make them whole. However, the arrangements do not kick in until the Pan Canadian Committee's restructuring plan is finally approved.

To keep up the pressure, many of the retail investors have been constantly lobbying federal agencies; departments and other institutions on the latest twists and turns.

When Wynne Miles, a retail ABCP investor in Victoria, wrote to Bank of Canada Governor Mark Carney outlining her concerns, the governor's office sent her a reply containing the explanation, "This delay is no doubt a reflection of the great complexity that underlies the plan itself. Nonetheless, it is encouraging that the committee has expressed its strong commitment to move forward on this issue as quickly as possible. Indeed, this is its obligation as a result of the ruling confirmed by the Supreme Court."

Miles was left unimpressed with the bank's response. "To me, this illustrates a lack of understanding of the fact that the international banks are not subject to the authority of the CCAA," she says.

The Bank of Canada refused to comment on individual cases. In an e-mail to The Bottom Line, Jeremy Harrison, senior media relations officer, stated: "The bank is not going to reply via the media to the direct inquiries of individual Canadians to the governor."

Since some of the participating foreign banks including the Royal Bank of Scotland (RBS) and Deutsche Bank are victims of the global market meltdown, they have become partial financial wards their shareholders after purchasing huge equity stakes in them.

Other such as Merrill Lynch and Wachovia have been taken over by rivals.

The survivors and acquirers are now in dire need of liquidity to stay in business. As CDS counterparties, they can raise funds by making collateral calls on ABCP trusts, which are underwater because their value has dropped below the spread-loss-trigger. In fact, RBS has already made such a call requesting $60 million from a satellite trust of Structured Investment Trust III, only to retract it later. But there are lingering fears that RBS could

make more collateral calls in future. Or, if the value of underlying $230 million asset falls severely, RBS could take the next, and more drastic step of seizing the asset and selling it at fire-sale prices. In a declining market, such sales would further depress prices for similar assets.

Oddly enough, the U.S. Federal Reserve Bank's continuing efforts to stabilize security markets are tied to a similar amendment to U.S. bankruptcy laws providing safe harbour exclusion for derivatives held by financial firms filing for Chapter 11 protection.

"The U.S. security industries lobbied Congress in 2005 to bring in the amendment to protect large Wall Street firm such as Bear Stearns, Lehman Brothers and AIG that were actively selling CDSs to counterparties, mainly to hedge funds," says Franklin Edwards, a Columbia University (New York City) finance professor. "The sellers wanted protection against a counterparty seeking bankruptcy protection which would require the CDSs to be stayed or frozen until released by a judge.

"As it turns out, it was the sellers who got into trouble. After forcing Lehman Brothers into bankruptcy, the Federal Reserve realized that it could not do the same to AIG since it was the major counterparty to CDSs and other derivatives. It had to keep AIG solvent to ensure the orderly disposal of the derivative contracts that it had put together."

The Federal Reserve has recently upped its investment in AIG to US$150 billion from its original US$85 billion stake. The new funds will be used to meet collateral calls from counterparties. In a separate move, the Federal Reserve also plans to invest US$70 billion to set up a separate Fed/AIG facility to buy up CDOs (collateralized debt obligations) from banks and others enabling AIG to unwind CDSs it has written and take them off the table.

In contrast, with the fate of ABCP still uncertain a cloud hangs occur Canadian securities market. "If the international banks do not sign the agreement, it will result in to an implosion of the ABCP restructuring plan," says Toronto international finance lawyer Henry Juroviesky.

"And that will lead to an everyman-for-himself litigation environment."

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October 28, 2008

Honourable Jim Prentice
Minister of Industry
House of Commons
Ottawa, Ontario
K1A 0A6

Re: November 17, 2007 Order in Council to Amend the Companies' Creditors Arrangement Act and Regulations

Dear Honourable Minister Prentice:

On November 17, 2007, you signed an Order in Council to amend the Companies' Creditors Arrangement Act (CCAA) and Regulations after the August 16, 2007 freeze of the Canadian Non Bank Asset Backed Commercial Paper Market (ABCP), and while the largest credit restructuring in Canadian history was in progress. In doing so, I feel that you have made a serious error, for which I and approximately 1800 Canadians are paying a serious price.

If it were not for that Order in Council, the Canadian court approved restructuring of the Canadian Non Bank ABCP trusts (currently under CCAA protection) by the Pan-Canadian Investors Committee would not be facing the current delays and uncertainty.

By approving the inclusion of credit default swaps (CDS) in the list of Eligible Financial Contracts (EFC) as of November 17, 2007, you prevented the international banks owed money under these CDS contracts from being stayed by the CCAA court. There are $22 billion of collateral assets associated with $221 billion of CDS contracts within the 20 ABCP trusts under CCAA. As a consequence of the November 17, 2007 Order in Council, the collection of these assets by the international banks, who are counterparties for the CDS within the ABCP trusts, cannot be stayed in the normal course of a CCAA proceeding. These CDS counterparties are a class of creditors to the ABCP Trusts under CCAA, just like the ABCP owners are another class of creditors. Yet as a result of the November 17, 2007 Order in Council, no Canadian judge has authority to stay the rights within the CDS contracts between the ABCP trusts and the international banks. This has set up a grievous imbalance of power in negotiations with the international banks and in the CCAA judges' decision making process.

If you as Minister of Industry had not signed the November 17, 2007 Order in Council, then international CDS counterparties would currently be subject to the same court stay as the ABCP creditors. This would have given both parties equal footing to negotiate with the debtor trusts for a court approved compromise settlement, rather than allowing the international banks the option of walking away from the CCAA court process to protect their own interests in response to a change in financial conditions. Further, if the November 17, 2007 Order in Council had not occurred, then Judge Colin Campbell presiding over the CCAA proceeding in the Ontario Superior Court of Justice would have the authority to order execution of the ABCP Restructuring Plan by a certain date. The international bank CDS counterparties, as creditors to the ABCP trusts, would not be free to withdraw from the Restructuring Plan and to take the legal steps entitled within their contracts to collect collateral assets for payment of the amounts owed to them by the trusts.

I question the public interest policy on why CDS were ever placed on the EFC list and therefore exempted from stays in CCAA court decisions. The function of the CCAA is to facilitate compromises and arrangements between companies and their creditors so that the companies may continue operations for the benefit of stakeholders. The CDS counterparties are another class of creditors that should be stayed with all creditors.

In light of the current financial market upheavals, other financial regulations such as OSFI's Guideline to Regulation B-5 were reexamined and reversed. I feel that the November 17, 2007 Order in Council on CDS as an EFC must be reversed so that in the future all credit investors will be treated on a fair basis with the international banks who are counterparties to credit default swap contracts. All creditors need to be subject to the CCAA court stay that a judge administers, until there is a compromise established that is fair, without the threat that one class of creditors may withdraw from the CCAA proceedings.

I would welcome your comments on my concerns as outlined above.

Respectfully,

Wynne Miles

(Retail ABCP Holder)

c.c
Honourable Jim Flaherty
Mark Carney
Robert Turnbull

Diane Urquhart

Subject: Industry Canada Says New Reg on Credit Default Swaps Improved Canada's Derivatives Market

Industry Canada Industrie Canada

INTERNET

Ms. Diane Urquhart
Independent Analyst
(urquhart@rogers.com)

Dear Ms. Urquhart:

Thank you for your e-mail of June 30, 2008, addressed to the Honourable Jim Prentice, Minister of Industry. I have been asked to reply on his behalf.

In chapter 5 of Budget 2007, "A Stronger Canada Through a Stronger Economy", the government indicated its commitment to improving Canada's derivatives market. This lead to Bill C-52, *An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2007*, which was introduced in Parliament on March 29, 2007.

Further to the adoption of Bill C-52, the proposed EFC General Rules were pre-published in the *Canada Gazette Part I* on August 4, 2007 for a 30 day comment period. The stakeholder comments received were considered and certain changes were made to the proposed EFC General Rules. They then followed the normal regulatory process and were published in the *Canada Gazette Part II* on November 28, 2007. The EFC General Rules came into force on November 17, 2007.

In considering stakeholder comments received during the regulatory process, the government strived for a solution which was most consistent with its underlying policy objectives and fairest to the collective interests of all stakeholders.

Once again, thank you for writing to the Minister of Industry. I trust that this information is of assistance.

Sincerely,

Susan Bincoletto
Director General
Marketplace Framework Policy Branch

Canada

-----Original Message-----

9/9/2008

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Notice

Vol. 141, No. 24 — November 28, 2007

Registration
SOR/2007-256 November 15, 2007

BANKRUPTCY AND INSOLVENCY ACT

Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act)

P.C. 2007-1731 November 15, 2007

Her Excellency the Governor General in Council, on the recommendation of the Minister of Industry, pursuant to section 209 (see footnote a) of the *Bankruptcy and Insolvency Act* (see footnote b), hereby makes the annexed *Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act)*.

ELIGIBLE FINANCIAL CONTRACT GENERAL RULES (BANKRUPTCY AND INSOLVENCY ACT)

1. The following definitions apply in these Rules.

"derivatives agreement" means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

(*a*) a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

(*b*) a futures agreement;

(*c*) a cap, collar, floor or spread;

(*d*) an option; and

(*e*) a spot or forward. (*contrat dérivé*)

"financial intermediary" means

(*a*) a clearing agency; or

(*b*) a person, including a broker, bank or trust company, that in the ordinary course of business maintains securities accounts or futures accounts for others. (*intermédiaire financier*)

2. The following kinds of financial agreements are prescribed for the purpose of the definition "eligible financial contract" in section 2 of the *Bankruptcy and*

Insolvency Act:

(*a*) a derivatives agreement, whether settled by payment or delivery, that

(i) trades on a futures or options exchange or board, or other regulated market, or

(ii) is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or commodities markets;

(*b*) an agreement to

(i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,

(ii) clear or settle securities, futures, options or derivatives transactions, or

(iii) act as a depository for securities;

(*c*) a repurchase, reverse repurchase or buy-sellback agreement with respect to securities or commodities;

(*d*) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;

(*e*) any combination of agreements referred to in any of paragraphs (*a*) to (*d*);

(*f*) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (*a*) to (*e*);

(*g*) a master agreement in so far as it is in respect of a master agreement referred to in paragraph (*f*);

(*h*) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (*a*) to (*g*); and

(*i*) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (*a*) to (*h*).

3. These Rules come into force on the day on which subsection 91(2) of the *Budget Implementation Act, 2007*, chapter 29 of the Statutes of Canada, 2007 comes into force.

REGULATORY IMPACT ANALYSIS STATEMENT

(*This statement is not part of the Rules and Regulations*.)

Description

Efficient capital markets require a modern legal framework for financial transactions. This framework must provide issuers, investors and other parties to a transaction with clear rights and obligations. It must also keep up with international standards, advances in business practices, and evolving types of financial instruments.

The use of "eligible financial contracts" (EFCs), commonly referred to as derivatives, has become an integral part of the risk management strategy for many Canadian businesses. For example, EFCs are currently used by

lenders, commodity companies, and exporters that wish to protect against risks related to credit default, commodity prices, or currency fluctuations. Growth in both exchange-traded and over-the-counter derivatives markets has been strong in recent years.

Canadian insolvency and financial sector legislation currently permits the termination of, and netting of financial obligations under, an EFC. In addition, the legislation has recently been amended to allow counterparties to seize financial collateral under EFCs. These rights are not generally available to counterparties to contracts that do not fall within the definition of EFC. Because of these particular rights, determining which contracts qualify under the definition is vitally important to the parties and financial markets.

The definition of "eligible financial contract" was enacted in 1992 and has not been substantively amended. The definition can be found in the *Bankruptcy and Insolvency Act* (BIA), the *Companies' Creditors Arrangement Act* (CCAA), the *Winding-up and Restructuring Act* (WURA), the *Canada Deposit Insurance Corporation Act* (CDICA), and the *Payment Clearing and Settlement Act* (PCSA) (by reference to WURA).

Three factors are driving the need to revise the definition. First, the financial markets have evolved significantly since 1992 and the definition is no longer in line with current practice. As such, there are inconsistencies in application that are causing difficulties in the market. Second, the United States and the European Union have legislation that contains a modern definition. The legal risks associated with the inconsistencies are reducing the competitiveness of Canadian financial markets, financial institutions and other market participants. Third, the Basel II Capital Accord, which will be applicable to Canadian banks starting on November 1, 2007, has drawn attention to national insolvency regimes. Legal opinions prepared for foreign market participants highlight the fact that the Canadian legislation is not competitive vis-à-vis other jurisdictions.

To address this issue, Part 9 of the *Budget Implementation Act, 2007*, which received Royal Assent on June 22, 2007, introduced amendments to enable the Governor in Council to prescribe the meaning of "eligible financial contract." This will allow the Government to establish a revised definition and to update it with relative ease as financial market practices evolve.

The revised definition, which is largely based on the current definition, has the benefit of capturing agreements that may evolve from market practices. In addition, it includes margin loans made by a financial intermediary. The revised definition will be consistent with that of the United States and the European Union.

The Regulations would apply to the BIA, CCAA, and WURA, which are the responsibility of the Minister of Industry. Similar regulations are being proposed in respect of the CDICA and, by reference, to the PCSA, both of which are the responsibility of the Minister of Finance.

Alternatives

Maintaining the status quo fails to provide enough legal certainty to Canadian financial market participants. Further, it would put Canada's financial markets at a competitive disadvantage vis-à-vis the United States and the European Union.

Updating the definition by amending the legislation limits the Government's ability to further revise it as financial markets continue to evolve. The original definition has not been substantively amended in over 15 years despite the changing markets.

Benefits and costs

Benefits:

In light of evolving financial markets and of the upcoming implementation of the Basel II Capital Accord in Canada, the revised definition will provide legal certainty to market participants and ensure that Canadian financial markets remain competitive vis-à-vis other jurisdictions.

Costs:

The implementation of the General Rules and Regulations does not bear any cost.

Consultation

The department of Finance and Industry have consulted with key stakeholders regarding this proposal. In addition, a number of other market participants have expressed their support for a change. To date, neither department is aware of any opposition to the revised definition.

After further consultation with key stakeholders during the consultation period, a number of changes have been introduced to the Regulations, namely:

- The paragraphs on derivatives agreements have been restructured for ease of reading and future agreements have been moved under that heading. In addition, it has been clarified that, in order to meet the definition of "eligible financial contract," derivatives agreements must be traded on regulated markets or be subject to recurrent dealings in the markets. This will ensure that contracts that are strictly bilateral in nature are not captured by the definition;
- The language on the borrowing and lending of securities and commodities, as well as that for margin loans, has been further refined to ensure that it is not overly broad;
- Given the new language for margin loans, a definition of "financial intermediary" has been added;
- The basket clause has been removed as section 1 is now sufficiently broad for the definition to cover future market developments;
- A few paragraphs have been moved in order to preserve the logic of the definition; and
- A few other minor editorial changes have been introduced to ensure the accuracy of the definition.

No other comments were received during the consultation period.

Compliance and enforcement

The General Rules and the Regulations will not result in any alteration to compliance or enforcement. The revised definition will simply serve as the new basis for determining which contracts are eligible for special treatment in insolvency. Further, as the revised definition will better reflect current market practices, it is expected to result in less litigation.

Contact

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Footnote a

S.C. 1997, c. 12, s. 112

Footnote b

R.S., c. B-3; S.C. 1992, c. 27, s. 2

NOTICE:
The format of the electronic version of this issue of the *Canada Gazette* was modified in order to be compatible with hypertext language (HTML). Its content is very similar except for the footnotes, the symbols and the tables.

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Important notices

Updated: 2007-11-28

Eligible Financial Contract General Rules (Companies' Creditors Arrangement Act)

SOR/2007-257

Registration November 15, 2007

COMPANIES' CREDITORS ARRANGEMENT ACT

Eligible Financial Contract General Rules (Companies' Creditors Arrangement Act)

P.C. 2007-1732 November 15, 2007

Her Excellency the Governor General in Council, on the recommendation of the Minister of Industry, pursuant to subsection 18(1) of the *Companies' Creditors Arrangement Act*, hereby makes the annexed *Eligible Financial Contract General Rules (Companies' Creditors Arrangement Act)*.

ELIGIBLE FINANCIAL CONTRACT GENERAL RULES (COMPANIES' CREDITORS ARRANGEMENT ACT)

1. The following definitions apply in these Rules.

"derivatives agreement" means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

(*a*) a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

(*b*) a futures agreement;

(*c*) a cap, collar, floor or spread;

(*d*) an option; and

(*e*) a spot or forward. (*contrat dérivé*)

"financial intermediary" means

(*a*) a clearing agency; or

(*b*) a person, including a broker, bank or trust company, that in the ordinary course of business maintains securities accounts or futures accounts for others. (*intermédiaire financier*)

2. The following kinds of financial agreements are prescribed for the purpose of the definition "eligible financial contract" in section 2 of the *Companies' Creditors Arrangement Act*:

(*a*) a derivatives agreement, whether settled by payment or delivery, that

(i) trades on a futures or options exchange or board, or other regulated market, or

(ii) is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or

commodities markets;

(*b*) an agreement to

(i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,

(ii) clear or settle securities, futures, options or derivatives transactions, or

(iii) act as a depository for securities;

(*c*) a repurchase, reverse repurchase or buy-sellback agreement with respect to securities or commodities;

(*d*) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;

(*e*) any combination of agreements referred to in any of paragraphs (*a*) to (*d*);

(*f*) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (*a*) to (*e*);

(*g*) a master agreement in so far as it is in respect of a master agreement referred to in paragraph (*f*);

(*h*) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (*a*) to (*g*); and

(*i*) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (*a*) to (*h*).

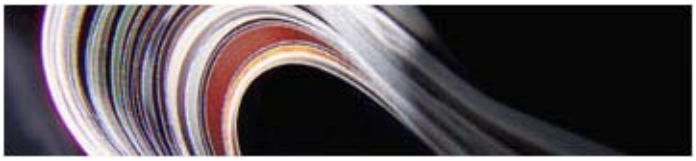
[*] **3.** These Rules come into force on the day on which subsection 104(2) of the *Budget Implementation Act, 2007*, chapter 29 of the Statutes of Canada, 2007 comes into force.

[*] [Note: Rules in force on November 17, 2007, *see* SI/2007-106.]

Last updated: 2008-06-23 Important Notices

Diane Urquhart

From: Diane Urquhart [urquhart@rogers.com]
Sent: Sunday, May 25, 2008 1:54 PM
To: 'arthur jacques'; 'Arthur Jacques'; 'hjuroviesky@jruslaw.com'; 'Eli Karp'; 'jricci@jruslaw.com'
Subject: Stikeman Elliot Source - Federal insolvency statutes governing OTC derivatives were amended on November 17; 2007



December 1, 2007
Ottawa releases updated "Eligible Financial Contract" definition
Wide range of products, including margin loans, now covered

Margaret Grottenthaler

In the Spring of 2007, Canada's Parliament amended several federal insolvency statutes so as to transfer the definition of the class of protected contracts known as "eligible financial contracts" (EFCs) from the federal insolvency statutes themselves to their respective associated regulations. On November 15, the Treasury Board approved the finalized regulations to the *Bankruptcy and Insolvency Act*, the *Winding-up and Restructuring Act*, the *Companies' Creditors Arrangement Act*, and the *Canada Deposit Insurance Corporation Act*. The changes were effective November 17, 2007. The long-awaited EFC definition includes the following types of agreement:

a. a derivatives agreement, whether settled by payment or delivery, that

   i. trades on a futures or options exchange or board, or other regulated market, or

   ii. is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or commodities markets;

b. an agreement to

   i. borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,

   ii. clear or settle securities, futures, options or derivatives transactions, or

   iii. act as a depository for securities;

c. a repurchase, reverse repurchase or buy-sellback agreement with respect

to securities or commodities;

d. a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;

e. any combination of agreements referred to in any of paragraphs (a) to (d);

f. a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (a) to (e);

g. a master agreement in so far as it is in respect of a master agreement referred to in paragraph (f);

h. a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and

i. an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).

The term "derivatives agreement" in paragraph (a) is in turn defined as follows:

"derivatives agreement" means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

a. a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

b. a futures agreement;

c. a cap, collar, floor or spread;

d. an option; and

e. a spot or forward.

Industry observers will be pleased that the definition now encompasses a full range of products that have become prevalent in the market, including equity, credit and weather derivatives, as well as emerging products such as freight and emissions allowance derivatives. Margin loans have also been included. The relocation of the definition to the regulations will make it easier to add new products in the future as the market evolves further.

The regulation also makes some changes as to how securities loans and repos are described. Notably, commodities loans have also been included to cover such products as gold loans.

It is also now clearer than it was under the previous definition that guarantees

of any of the obligations under any type of eligible financial contract are covered.

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OSLER

Osler, Hoskin & Harcourt LLP

Osler Update

Federal Budget Introduces New Insolvency Rules for Eligible Financial Contracts

June 11, 2007
By Rupert H. Chartrand Sam P. Rappos

On March 29, 2007 the Federal Government introduced Bill C-52: *An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2007* (Bill C-52). Bill C-52 amends the *Bankruptcy and Insolvency Act* (the BIA), the *Companies' Creditors Arrangement Act* (the CCAA), the *Winding-Up and Restructuring Act*, the *Canada Deposit Insurance Corporation Act* (the CDICA) and the *Payment Clearing and Settlement Act* with respect to eligible financial contracts (EFCs).

The introduction of these EFC amendments was unexpected; it is unusual for insolvency law amendments to be dealt with in a federal budget. However, by introducing the EFC amendments in this manner, the amendments will all be implemented at the same time. This is an improvement to the piecemeal amendment approach that has been utilized in the past.

Bill C-52 is currently being debated at Third Reading. Once passed by the House of Commons, it will be forwarded to the Senate for approval. This Osler Update highlights the EFC amendments to insolvency legislation that are of particular interest to financial institutions and insolvency professionals.

EFCs and Insolvency
EFCs were first granted protection in 1992 when amendments were made to the BIA and the CDICA. Similar protection for EFCs was later introduced in the other statutes mentioned above. Derivatives are protected in insolvency situations if they are characterized as EFCs; the insolvency laws provide that a stay of proceedings is not applicable to EFCs and a solvent counterparty can rely upon insolvency events of default to terminate an EFC, accelerate any payments under an EFC and net the positions under an EFC or master agreements in accordance with the contractual provisions.

In November 2005, the Federal Government passed *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47 (Chapter 47, formerly Bill C-55) which introduced substantial amendments to the BIA and the CCAA. The provisions of Chapter 47 did little to improve the position of EFCs in an insolvency proceeding. To the contrary, Chapter 47 introduced super priority rules for unpaid wages, current pension deficiencies, debtor-in-possession (DIP) financing, and critical supplier and administrative charges, all of which could prime collateral security for derivatives in insolvency proceedings. Fortunately, Chapter 47 has not yet been proclaimed into force.

Bill C-52 introduces substantial amendments to Chapter 47 and other insolvency laws which strengthen the protection afforded to EFCs in insolvency proceedings.

Definition of EFCs

In the past 15 years, the approach to EFCs under insolvency legislation has been to specify, in the statutes, the types of derivatives which qualify as EFCs. If a derivative is not listed as an EFC under the applicable statute, the courts are required to determine whether the derivative is analogous to the specified list of potential derivatives. Bill C-52 eliminates this approach and provides that EFCs will be defined by regulation. This amendment may provide greater flexibility, since regulations can more readily be amended to adapt to new derivative products that emerge in the market (i.e. credit derivatives, which are not listed as EFCs under insolvency legislation).

Financial Collateral

Under existing insolvency legislation, a solvent counterparty can terminate an EFC with an insolvent counterparty and net the positions of the counterparties. However, if the solvent counterparty has a security interest in the insolvent counterparty's property to secure payment or performance of the obligations under an EFC, enforcement of the rights and remedies under the security are stayed.

Bill C-52 will allow the realization of financial collateral securing obligations under EFCs. Financial collateral includes: cash or cash equivalents, securities, a securities account, a securities entitlement or a right to acquire securities. Bill C-52 grants protection to financial collateral to: (i) permit parties to deal with or realize upon financial collateral notwithstanding a stay of proceedings; and (ii) provide that no court order may be made which would have the effect of preventing a secured creditor from realizing or otherwise dealing with financial collateral. Thus, secured creditors will not be stayed from realizing on financial collateral in certain insolvency proceedings.

Additionally, insolvency legislation will be amended to provide that no order may be made in certain insolvency proceedings if the order would have the effect of priming financial collateral. This is an important amendment since, as noted above, Chapter 47 includes provisions which will permit courts to grant orders in respect of DIP financing, critical supplier and administrative charges that could prime financial collateral in connection with EFCs. As a result of Bill C-52, any DIP financing, critical supplier or administrative charge order made in an insolvency proceeding will not be able to prime financial collateral securing derivatives. However, Bill C-52 fails to provide any protection to financial collateral with respect to the statutory priorities introduced under Chapter 47 in respect of unpaid wages and current pension deficiencies. This will operate to prime financial collateral in connection with an EFC if and when Chapter 47 is proclaimed into force.

Bill C-52 also amends the fraudulent preference provisions of the BIA by providing that the presumption of intent to prefer a creditor following a transfer, charge or payment made to a creditor does not apply in respect of a transfer, charge or payment made in connection with financial collateral and in accordance with the provisions of an EFC.

Solvent counterparties who intend to enforce upon financial collateral may have to satisfy the notice requirements under the BIA, which oblige secured creditors to provide 10-days notice to an insolvent debtor prior to enforcing upon collateral which constitutes substantially all of the property of the debtor. The notice requirement cannot be waived by the debtor in advance of receiving the notice. It will be particularly relevant if the insolvent counterparty is a special purpose vehicle and its major or sole asset is the financial collateral.

EFCs Not Protected - Receiverships

The current receivership provisions of the BIA and court receivership orders under provincial laws do not provide specific protection for derivatives, nor do they provide for an automatic stay of the termination of contracts. This lack of protection for EFCs became evident in the receivership of the Norshield Group where the court stayed the exercise of all rights and remedies under futures, options, swaps and other financial contracts in respect of present or future rights or obligations. Additionally, the court granted a priority court charge to the receiver for all of its fees and disbursements, and allowed the receiver to incur borrowings to finance the receivership secured by way of a priority charge; these court charges ranked ahead of any security and cash deposits held by counterparties to secure obligations under various derivatives.

Chapter 47 makes substantial amendments to the receivership provisions of the BIA which will permit the courts to appoint a receiver with the power to act nationally. The amendments to the BIA contained in Bill C-52 which prohibit a court order from staying the termination of EFCs or priority of financial collateral are only applicable to a bankruptcy or a proposal. Thus, EFCs may continue to be at risk in a receivership.

Significance

The amendments to insolvency legislation contained in Bill C-52 introduce extensive protection for EFCs. They provide an exemption from a stay of proceedings in non-receivership insolvency proceedings to allow enforcement of financial collateral, and prevent the priming of DIP financing, critical supplier and administrative charges over financial collateral. However, EFCs remain potentially unprotected in receivership proceedings, and if and when Chapter 47 is proclaimed into force, EFCs will be primed by statutory priorities for unpaid wages and current pension costs.