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Securities Transfer Act and Consequential Amendments to the Personal Property Security Act

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INTRODUCTION

As you may be aware, the Saskatchewan legislature has recently enacted *The Securities Transfer Act* (the “STA”). The STA’s inception has also resulted in amendments to other commercial statutes including *The Personal Property Security Act* (the “PPSA”). The STA was designed and implemented to promote uniformity in North America with respect to the transfer of securities (ie. shares, warrants, options, etc.).

Many securities that trade on the public markets are held in a “book-based system”. These securities are not “certificated” in the name of individual shareholders. Rather, they are held electronically in accounts that shareholders maintain through securities intermediaries (also commonly referred to as “brokers” or “dealers”). One of the chief objectives of the STA is to facilitate the transfer of securities held in a “book-based system”.

The STA, and the resulting amendments to the PPSA (the “Updated PPSA”), will have implications on lenders who take security interests in the equity holdings of their borrowers. A summary of those implications is set forth below.

IMPLICATIONS OF THE STA AND CONSEQUENTIAL AMENDMENTS TO THE PPSA

Terminology

The STA and the Updated PPSA have introduced new terminology that lenders should get acquainted with. The following sets forth some of these terminology changes.

Security Entitlement and Entitlement Holder

The STA and the Updated PPSA recognize a property interest known as a “security entitlement”. An “entitlement holder” is a person who holds a security entitlement. A security entitlement constitutes those rights that the entitlement holder may assert against its broker in a book-based system. Though the entitlement holder does not hold the underlying security directly, he/she/it does have all the rights associated with direct ownership such as the right to vote or receive dividends. A lender may take a security interest in a security entitlement. There are special rules in place for the perfection of such a security interest. These rules are discussed below.

Investment Property: A New Category of Personal Property

In order for a security agreement to be enforceable against a third party, the debtor must sign a security agreement containing a certain description of the encumbered property. In many instances, the property needs to be described by “item or kind” with reference to one of the seven types of personal property. Prior to the enactment of the STA and the consequential amendments to the PPSA, “securities” comprised one of the seven categories of personal property. Now, pursuant to the Updated PPSA, the term “investment property” has replaced the term “securities” as one of the seven categories of personal property.

The term “investment property” is broader in scope than the term “securities”. Investment property is defined as “a security, whether certificated or uncertificated, security entitlement, securities account, futures contract, or futures account”. Thus, in addition to replacing the term “securities” as one of the seven categories of personal property, the term “investment property” also subsumes the term “security” within its definition.

Control

There are prescribed methods for a secured party to obtain control of an investment property. For example, in order to obtain control of a “security”, a secured party generally must either take possession of the security or become the registered holder of the security.

In order to obtain control of a “security entitlement”, the secured party must satisfy one of the following three conditions:

1. It must become the entitlement holder;
2. The broker must agree that it will comply with orders originated by the secured party without further consent of the entitlement holder; or

3. Another person must have control on behalf of the secured party, or having previously obtained control, acknowledge that it has control on behalf of the secured party.

As you'll see below, in order for a secured party to ensure, to the best extent possible, its priority to a security interest in an "investment property", it should obtain "control" of the investment property. Thus, the concept of "control" has become central to the notion of perfecting a security interest in investment property.

Security Interest in Investment Property

Prior to the inception of the STA, a secured party could "perfect" its security interest in securities by (a) taking possession of the securities, or (b) registering its security interest in the Personal Property Registry (the "PPR") (although mere registration was not the ideal perfection method). A secured party may still perfect its security interest in a security using either of these two methods. However, in order to "super-perfect" a security interest in any "investment property" under the new regime, the secured party must obtain "control" of the investment property. Insofar as the security interest relates to investment property, "control" will be the determining factor in priority competitions.

Rights Against Third Party Purchasers

The Updated PPSA has special rules governing priority competitions between a secured party and a purchaser of an investment property. For example, a purchaser of an investment property acquires such interest free of a security interest if, among other things, it obtains control of the security. Practically speaking, it would be difficult for a purchaser to obtain "control" over the investment property without the secured party's knowledge and consent. Thus, secured parties should obtain "control" of investment property collateral to ensure priority to such property.

Rights Against Other Secured Parties

The Updated PPSA also has special rules governing priority among conflicting security interests in the same investment property. Generally, a secured party who has control of the investment property has priority over another secured party who lacks control of the investment property. In the event both secured parties have control of the investment property, priority is generally determined in a "first to gain control" contest between the secured parties.

Transitional Provisions

Pre-Existing Proceedings

The STA and the Updated PPSA do not affect an action or proceeding commenced before September 1, 2007.

Continuity of Perfection

No further action is required to continue perfection of a security interest in a "security" if (a) the security interest was perfected immediately before the coming into force of the STA and the Updated PPSA, and (b) the perfection method used would suffice to perfect

the security interest pursuant to the Updated PPSA. If the perfection method would not suffice under the Updated PPSA, a lender has until January 1, 2008 to update the perfection of its security interest.

RECOMMENDATIONS FOR LENDERS

Security Agreement

Lenders must alter their security documents to reference security interests in “investment property” rather than “securities”. “Investment property” has replaced “securities” as one of the seven categories of personal property.

Super-Perfection

“Super-perfection” of a security interest in investment property is effected by taking control of the investment property. Therefore, if the investment property is a security, a lender should take possession of the security. If the investment property is a security entitlement, the lender should either (a) ensure that it becomes the entitlement holder of the security entitlement, or (b) enter into a tri-partite agreement with the debtor and the broker pursuant to which the lender may provide orders to the broker without any further consent of the debtor.

The Personal Property Security Regulations (the “Regulations”) govern the “registration” of security interests in the Personal Property Registry. The Regulations have not yet been updated to reflect the new terminology introduced in the Updated PPSA. Therefore, a lender should register its security interest in the PPR against both “investment property” and “securities”. Once the Regulations are updated to accord with the Updated PPSA, registering against “investment property” will likely be sufficient.

CONCLUSION

For more information on *The Securities Transfer Act* or the consequential amendments to *The Personal Property Security Act*, please contact Layh & Associates at (306)743-5520 or visit our website at www.layhlaw.com.