IN FACT AND IN LAW

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In the absence of negotiable instruments, can deposits held with financial institutions be pledged?

By Johanne L. Rémillard

On January 22, 2001, in *Berthold Blouin and Chantal Bérubé* v. *Métivier et Associés and Caisse populaire Desjardins de Val-Brillant* (hereafter referred to as the "*Blouin Bérubé* case")[1], the Québec Court of Appeal declared invalid a hypothec on a term deposit certificate deposited in a Registered Retirement Savings Plan ("RRSP"). As discussed below, the judgement contains statements that could indirectly have a significant impact on the issue of whether a natural person (i.e., an "individual") can pledge deposit accounts (including savings accounts and RRSP-type term deposits) by granting a movable hypothec with delivery on such accounts, given that such persons are not entitled to grant a movable hypothec without delivery within the meaning of article 2683 of the *Civil Code of Québec* (the "Code"), unless it is a hypothec that charges the property of the enterprise operated by that person.

The facts

In 1995, Berthold Blouin and his wife Chantal Bérubé contributed to an RRSP by making cash deposits at the Caisse populaire Desjardins de Val-Brillant (the "Caisse"). The Caisse applied the funds and issued term deposits maturing in 1998 in favour of the trustee of the plan, on behalf of each spouse. Each certificate states that it is issued in respect of a standard Desjardins RRSP, in favour of Fiducie Desjardins, on behalf of the depositor, and that the deposit is not redeemable before the maturity date.

In 1997, i.e., before the maturity date of the certificates of deposit, Blouin and Bérubé contacted the Caisse seeking to cash in their deposits. At that time, the Caisse reminded them that the deposits were not redeemable

before maturity, but it offered them a loan, on the condition that they grant the Caisse a movable hypothec on these certificates of deposit.

In December 1997, subsequent to the bankruptcy of Blouin and Bérubé, the Caisse sent the trustee in bankruptcy proof of its claim as a secured creditor. In September 1998, the trustee in bankruptcy informed the Caisse that its secured claim had been refused. In October 1999, the Caisse appealed the decision of the trustee in bankruptcy.

The decision of the Court of first instance[2]

The Judge at first instance allowed the appeal, overturned the decision of the trustee in bankruptcy and declared the Caisse a "secured creditor". In rendering his decision, the Judge took a specific position on various aspects of the issue:

- money paid by a depositor into an account opened with a financial institution always constitutes a loan to the financial institution;
- relying specifically on pre-1980 case law, he stated that sums deposited in an account with a financial institution may not be the subject of a movable hypothec with delivery, as those sums lose their particularity and become confused with the general funds held by the financial institution;
- a certificate of deposit constitutes a negotiable debt instrument of the issuing Caisse, and although purchased in an RRSP, it can be given as collateral in favour of the Caisse, given that the creation of an RRSP does not alter the general rule that a deposit creates a "creditor-debtor" relationship between the client and the financial institution;

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[1] REJB 2001-22101 (CA). Also see the judgement rendered the same day in the bankruptcy case of *Marie-Thérèse Lambert and Serge Morency and Associés inc. and Caisse populaire de Bienville and Fiducie Desjardins inc.*, 2001 RJQ 317, (CA) REJB 2001-22100, amended on January 24, 2001, REJB 2001-22278, which makes the same statements of principle, but in a different context.

[2] Rimouski, Superior Court, No. 100-11-000756-986, March 5, 1999.

- the retention by the Caisse of the certificates of deposit provided as security for a loan constitutes a good and valid movable hypothec with delivery; and, lastly,
- the term "negotiable instrument" in the Code should be given a broad interpretation.

The decision of the Court of Appeal

The Court of Appeal reversed the decision of the Judge of first instance in favour of the trustee in bankruptcy. The Court of Appeal made the following points in support of its decision:

- in order to determine the existence of a trust (in this case, an RRSP), the intention to create one must be demonstrated. If not a trust, then the RRSP is akin to a creditor-debtor relationship governed by the clauses in the contract which are binding upon both parties (namely, the depositor and the financial institution concerned);
- an "RRSP deposit" may not be pledged or assigned as security without prior "deregistration" within the meaning of sections 146(12)(a) and 146(13) of the *Income Tax Act*, through an agreement entered into for that purpose[3]. Sums deposited in an existing RRSP account may not be assigned or pledged to secure a loan, given the provisions of section 146(2) (c.3) (i) and (ii) of the *Income Tax Act of Canada*[4] where the RRSP has not clearly been set up as a trust by contract, as provided for in article 1262 of the Code. Therefore, the term deposit certificate, which represents non-assignable sums, does not constitute a negotiable instrument;
- a movable hypothec with delivery of a claim is granted by the delivery of a negotiable instrument to the creditor; and, lastly,
- only a negotiable instrument may be the subject of a movable hypothec with delivery.

The Court of Appeal stressed that it was not ruling on whether a non-RRSP deposit certificate may or may not be the subject of a valid movable hypothec with delivery. Finally, it should be noted that the Court of Appeal's judgement is silent regarding the assertion made by the Judge of first instance to the effect that sums of money deposited in an account with a financial institution may not be the subject of a movable hypothec with delivery (i.e., a pledge).

Principle to be derived from the Court of Appeal's decision in the *Blouin Bérubé* case

Given the reasoning followed by the Court of Appeal, account balances maintained with a financial institution, including "RRSP deposits", may apparently not be pledged nor given as security with delivery to the institution for the following reasons:

- the holder of a deposit account is a creditor of the financial institution for the sums deposited in the account. Only the claim itself can be pledged, as opposed to the deposits that are the subject thereof; such deposits are consistently assimilated to incorporeal property, which, to be pledged, must be represented by a negotiable instrument, notwithstanding the broader interpretation that may be inferred from the wording of article 2708 of the Code;
- the amount of money transferred by a depositor to a financial institution upon the opening of an account may not be pledged, on the basis of the effective delivery of "liquid" monies when the account is opened[5] (by way of a tangible or intangible mode of transfer, i.e., by direct remittance of cash, by cheque or other commercial instrument, by personal or electronic transfer of funds), and on the grounds of the modification of the contractual relationship established with the financial institution, which initially acts as depositary and borrower of such sums, and then acts as the pledge-holder thereof.[6]
- the sums deposited in the account that are the subject of the claim may never be the subject of a movable hypothec with delivery,

[3] Sections 146(12)(a) and 146(13) read as follows:
- **S. 146(12)(a)** "the amended plan shall be deemed, for the purposes of this Act, not to be a registered retirement savings plan."
- **S. 146(13)** "For the purposes of subsection 146(12), an arrangement... under which payment of any amount by way of loan or otherwise is made on the security of a right under a retirement savings plan, **shall be deemed to be a new plan substituted for that retirement savings plan**."

[4] Section 146(2) (3) (i) and (ii) reads as follows:
- **S. 146(2)** "The Minister shall not accept for registration ... any retirement savings plan unless, in the Minister's opinion, it complies with the following conditions:
(c. 3) the plan, **where it involves a depositary**, includes provisions stipulating that:
(i) the depositary has no right of offset as regards the property held under the plan **in connection with any debt or obligation owing to the depositary**, and,
(ii) the **property held under the plan cannot be pledged, assigned or in any way alienated as security for a loan** or for any purpose other than that of providing for the annuitant, commencing at maturity, a retirement income."

[5] - Nicole L'Heureux, Droit bancaire, 3rd edition, Éditions Yvon Blais Inc. (1999), p. 21, 43.
- Pierre Ciotola, Droits des sûretés, idem, p. 234.

[6] Pierre Ciotola, Droits des sûretés, 5th edition, Éditions Thémis, (1999) p. 235.

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– despite the fact that articles 2702 and 2703 of the Code refer to the delivery of property or title, without according priority to one method of delivery over another;

– despite the fact that the term "property" is not defined anywhere in the Code and could indiscriminately mean corporeal or incorporeal property, or even corporeal property that subsequently becomes incorporeal (i.e., sums actually deposited, that subsequently become incorporeal through the accounting entries of the financial institution);[7]

– despite the fact that the depositor's specific claim in respect of the balance of the deposit account is at all times for **liquid and exigible monies**[8] that could be seized by creditors, and whose value could fluctuate over time;

– despite the fact that article 2702 of the Code stipulates that "a movable hypothec with delivery [*pledge*] is granted by the delivery of property or title to the creditor, or if the property [*in this case, the sums deposited*] is already in his hands, **by his continuing to hold it, in order to secure his claim**";

– despite the fact that article 1592 of the Code recognizes the possibility of a relationship between the debt that a depositor may have incurred with the financial institution and the deposit previously remitted to the financial institution and retained by it in the event of non-payment of its claim;

– despite the fact that under article 2781 of the Code, the taking in payment of the balance of the bank account could be seen as an acceptable hypothecary recourse available to the financial institution (even though, at present, a taking in payment may be effected only with respect to saleable corporeal property), provided that the depositor has voluntarily given prior consent thereto, and because such taking in payment could materialize the financial institution's ownership rights with respect to the balance in question; and, lastly,

– notwithstanding the broader interpretation advanced in two earlier decisions rendered by the Court of Appeal of Québec on substantially similar issues.[9]

Conclusions

Given its wording, the Court of Appeal's judgment will inevitably have an impact on the nature of the securities on movable property that Québec's financial institutions can accept in the normal course of their activities.

The Court of Appeal's decision contains a statement of principle that does not admit any exception (i.e., failing registration, the pledge of a claim evidenced by a negotiable instrument is now the only pledge possible in the case of deposits held in savings or deposit accounts), even where a financial institution, in its discretion and in specific circumstances, may have decided that possession of the property subject to the claim (property that was corporeal at the time of transfer, but which subsequently became incorporeal pursuant to the accounting entries of the financial institution) would suffice for its immediate protection.

Given that the Court of Appeal has not made any pronouncement on the validity and requirements applicable to pledging non-RRSP deposit certificates, the decision also creates a new area of uncertainly regarding the characteristics of negotiable instruments that financial institutions may accept when claims are pledged to them.

In our view, legislative intervention is needed to allow individuals to hypothecate their movable property without delivery, or to provide outright that a pledge of sums of money, of the secured creditor's accounting entries related thereto and of debt instruments of any nature, negotiable or otherwise, constitute a valid hypothec with delivery, entitling the holder to exercise a hypothecary action, if required, that is adapted to the particular circumstances.

Final remarks

We have learned from a well-informed source that the Canadian Bankers' Association intends to make further representations to the Québec Government on the subject. Other financial sector associations or participants may wish to work with the Association in this matter.

Any organization interested in the issue or wishing to become involved may contact us at the following e-mail address:

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[7] Nicole L'Heureux, idem, p. 21.
[8] Nicole L'Heureux, idem, p. 88.
[9] - *Caisse Populaire Desjardins de La Plaine* v. *Lemire,* REJB 99-11791, p. 3.
- *Les Entreprises Bogira Inc.* v. *Parkland Valdec Inc.* (1996), RDI 35: The Court of Appeal upheld the reasoning of the court of first instance, which found a deposit in trust is equivalent to a delivery of property.

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