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MARKET AND LEGAL REGIME

1. Please give a brief overview of the securitisation market in your jurisdiction. In particular:

- **How active and/or developed is the market and what notable transactions and new structures have taken place recently?**
- **To what extent have central bank liquidity schemes assisted the securitisation market in your jurisdiction? Were retained securitisations common in the last 12 months?**
- **Is securitisation particularly concentrated in certain industry sectors?**

Overview

The Canadian securitisation market is a well-developed and important part of the Canadian debt capital markets. Total debt outstanding in the securitisation market decreased from about Can$178 billion (about US$176.4 billion) in August 2007 to Can$106 billion (about US$105 billion) in February 2010, in line with an overall decrease in new issue since the onset of the credit crisis.

Securitisation typically involves traditional asset classes:

- Consumer obligations.
- Commercial mortgages.
- Residential mortgages.
- Auto-related financing.

Non-bank sponsored ABCP

Until August 2007, there was an active market in non-bank sponsored asset-backed commercial paper (ABCP). In August 2007 there were credit fears about Canadian non-bank sponsored ABCP's exposure to US subprime mortgages. This caused the ABCP market to dry up, which made it impossible for non-bank sponsors to refinance maturing ABCP.

This problem worsened as non-bank sponsors could not access existing liquidity facilities. This was because general market disruption was required for a drawdown under these liquidity facilities and many liquidity providers took the position that no general market disruption existed. The Can$32 billion (about US$31.7 billion) third-party ABCP market halted and noteholders who had invested short-term funds in ABCP issued by 22 non-bank sponsored conduits found their funds effectively frozen.

The affected trusts, banks, investors and originators entered into a restructuring plan. Under this plan, investors in the affected trusts exchanged their investments for term notes that matched the amortisation and maturity of the underlying transactions. After prolonged negotiation and several court challenges, the largest ever Canadian court-supervised debt restructuring was completed in January 2009.

Recent developments

The securitisation market is in a period of retrenchment and reassessment. Market consensus is that non-bank sponsored ABCP will not return. However, the market has been stabilised and the importance of securitisation to the economy has been confirmed by recent developments, including:

- The acceptance of certain ABCP as collateral for loans provided under the Bank of Canada Standing Liquidity Facility. This supports settlements in the payments system and is a mechanism through which the Bank of Canada (BOC) acts as a lender of last resort.
- The creation of the Canadian Structured Credit Facility (CSCF) in 2009. This made Can$12 billion (about US$11.9 billion) available for government purchases of newly issued term asset-backed securities (ABS) backed by loans and leases on vehicles and equipment. About Can$3.4 billion (about US$3.37 billion) of funding had been used when the CSCF expired in March 2010.
- The recent Government of Canada announcement of its intention to introduce legislation to establish a framework for covered bonds. This will facilitate the issue of these debt instruments by increasing legal certainty for investors.

2. Is there a specific legislative regime within which securitisations in your jurisdiction are carried out? In particular:

- **What are the main laws governing securitisations?**
- **Is there a regulatory authority?**

There is no specific legislative regime governing securitisations and no single regulatory authority has jurisdiction over securitisation transactions. Various aspects of securitisation transactions may be subject to a variety of provincial and federal laws, regulations and regulators, depending on the:

- Type of assets securitised (for example, consumer loans or government receivables).
- Transaction parties (for example, federally regulated financial institutions (FRFIs)).
- Means by which the securities are offered to investors (for example, public offering or private placement).
- Domicile of the originator and the obligors.

Laws relevant to securitisation include the:

- Personal Property Security Acts (PPSAs), which govern security interests in all Canadian jurisdictions except Québec.
- Civil Code of Québec (Civil Code), which governs assignments of receivables and security interests (hypothecs) in Québec.
- Bank Act (Canada) and guidelines published by the Office of the Superintendent of Financial Institutions (OSFI).
- Provincial securities legislation, national policy statements and instruments.
- Bankruptcy and Insolvency Act (Canada) (BIA) and the Companies' Creditors Arrangement Act (Canada).
- Provincial legislation governing fraudulent conveyances and preferences.
- Provincial consumer protection legislation.
- Financial Administration Act (Canada) (FAA).

REASONS FOR DOING A SECURITISATION

3. Which of the reasons for doing a securitisation, as set out in the Model Guide, usually apply in your jurisdiction? In particular, how are the reasons for doing a securitisation in your jurisdiction affected by:

- **Accounting practices in your jurisdiction, such as application of the International Financial Reporting Standards (IFRS)?**
- **National or supra-national rules concerning capital adequacy (such as the Basel International Convergence of Capital Measurement and Capital Standards: a Revised Framework (Basel II Accord) or the Capital Requirements Directive)? What authority in your jurisdiction regulates capital adequacy requirements?**

Usual reasons for securitisation

Originators securitise receivables for all of the reasons stated in the Model Guide.

Accounting practices

Accounting principles applicable to originators and sponsors have greatly affected securitisation structures. Parties usually seek to:

- Achieve accounting sale treatment for transferred assets.
- Avoid consolidation of the SPV on the balance sheet of the originator or sponsor.

Accounting Guidelines 12 and 15, based closely on US FASB 140 and FIN 46R, contain the generally accepted accounting principles (GAAP) governing securitisations. However, these will soon be replaced by the IFRS rules, under which derecognition and non-consolidation of transferred financial assets will be much more difficult to achieve.

Capital adequacy

The Basel II Accord capital adequacy rules, as adopted and administered by OSFI, govern FRFIs. The rules establish the methodology for assigning risk weightings to various securitisation exposures of FRFIs, including:

- Investments in the debt obligations of SPVs.
- First or subsequent loss enhancement.
- Liquidity support.

These determine the FRFI's capital to risk-weighted assets ratio and the level of capital that must be maintained against these exposures. Regulatory capital treatment may affect the role played by an FRFI in a securitisation. For example, first-loss enhancement, which requires a punitive deduction from capital, is generally avoided. Formerly, most banks providing liquidity support used general market disruption (GMD) facilities (*see Question 22*) because of their 0% risk weighting (which OSFI abolished in 2008).

THE SPECIAL PURPOSE VEHICLE (SPV)

Establishing the SPV

4. How is an SPV established in your jurisdiction? Please explain:

- **What form does the SPV usually take and how is it set up?**
- **What is the legal status of the SPV?**
- **How is the SPV usually owned?**
- **Are there any particular regulatory requirements that apply to the SPVs?**

Trust form

The SPV is usually structured as a trust because it is both:

- A flexible organisational form.
- Not subject to federal or provincial capital taxes. However, this preferential tax treatment has become less important as capital taxes have largely been eliminated.

A trust is not a separate legal entity, but is a relationship that arises when a person (the trustee) agrees to hold property for the benefit of other persons (the beneficiaries). The creator of the trust (either by a declaration of trust or a trust agreement) establishes the SPV. An institutional trustee is generally appointed to carry out the activities of the trust and hold title to the trust property. The beneficiary is usually a charitable or non-taxable institution which does not retain the power to dissolve or wind-up the trust.

A trust pays income tax at the highest marginal rate on its income, so cash flows are structured to match expenses (including interest payable to investors, deferred purchase price payable to the originator and trust expenses).

There are no regulatory requirements related to the creation of a trust and there are no owners of a trust.

Other forms of SPV

The SPV can take the form of a corporation or a limited liability partnership, although this approach is far less common.

5. Is the SPV usually established in your jurisdiction or offshore? If established offshore, in what jurisdiction are SPVs usually established and why? Are there any particular circumstances when it is advantageous to establish the SPV in your jurisdiction?

During a typical securitisation:

- A Canadian resident originator transfers assets to a Canadian resident SPV.
- The Canadian resident SPV then issues debt securities in the Canadian market.

There is virtually no withholding tax on arm's-length interest payments. Therefore, cross-border securitisation of Canadian receivables into foreign SPVs (for example, US SPVs) has become more common (although this approach involves various legal, tax and business issues).

Ensuring the SPV is insolvency remote

6. Is it possible to make the SPV insolvency remote in your jurisdiction? If so, how is this usually achieved?

The SPV can be made bankruptcy remote by isolating the SPV, its assets and its identity, by:

- Restricting in the constating documents the powers, activities and organisational changes to the SPV that could put the assets of the SPV at risk (for example, prohibiting additional debt, restricting activities unrelated to securitisation, and prohibiting mergers or amalgamations).
- Ensuring trustee activities will not result in a claim against the SPV's assets.
- Confirming the SPV has an unencumbered ownership interest in the assets.
- Protecting the SPV from significant tax liabilities which could erode its assets and threaten its solvency.
- Using a charitable organisation as the beneficiary, or obtaining a waiver of termination rights from the beneficiary, to ensure a trust SPV maintains its existence.

Ensuring the SPV is treated separately from the originator

7. Is there a risk that the courts can treat the assets of the SPV as those of the originator if the originator becomes subject to insolvency proceedings? If so, can this be avoided/minimised?

The SPV's assets could be treated as the originator's assets in an insolvency proceeding. However, this is unlikely if both the:

- SPV maintains a separate legal identity independent from the originator.
- Transfer of assets constitutes a true sale (*see Question 16*).

In addition:

- The transaction should be structured to avoid the transfer of assets being set aside under the applicable fraudulent conveyance or preferences legislation (*see Question 17*).
- The SPV should have an unencumbered ownership interest in the assets.
- There should be no other liens that could compete with the SPV's interest (other than those securing the securities).

Substantive consolidation

The transaction should be structured to ensure that on the originator's insolvency, neither the SPV nor its assets are substantively consolidated into the originator's estate. Substantive consolidation involves separate entities having their assets and liabilities consolidated and treated as one, allowing the creditors of each entity to assert a claim against the assets of the entire consolidated estate. Courts in insolvency proceedings have a general equitable and discretionary power to order substantive consolidation (although they rarely do).

The courts have identified the following factors which suggest substantive consolidation should be granted (and which should be considered in structuring the transaction):

- Difficulty in segregating assets of the entities.
- The presence of consolidated financial statements.
- Commingling of assets and business functions where boundaries between entities have not been observed.
- Unity of ownership interests.
- The existence of inter-entity loan guarantees.
- The existence of asset transfers between the entities without observance of transaction formalities.

THE SECURITIES

Issuing the securities

8. Are the securities issued by the SPV usually publicly or privately issued?

The SPV can issue securities by either:

- A public offering under a prospectus.
- Through private placement, subject to exemptions from the registration and prospectus requirements.

Most debt securities are publicly issued.

9. If the securities are publicly issued:

- **Are the securities usually listed on a regulated exchange in your jurisdiction or in another jurisdiction?**
- **If in your jurisdiction, please briefly summarise the main documents required to make an application to list debt securities on the main regulated exchange in your jurisdiction. Are there any share capital requirements?**
- **If a particular exchange (domestic or foreign) is usually chosen for listing the securities, please briefly summarise the main reasons for this.**

Publicly offered securities are not typically listed on a regulated exchange.

Constituting the securities

10. If the trust concept is not recognised in your jurisdiction, what document are the securities issued by the SPV constituted by and how are the rights in them held?

The trust concept is recognised.

The issue of debt securities is typically governed by a trust indenture between the SPV and an indenture trustee, which:

- Creates a lien in favour of investors over the SPV's assets.
- Restricts the SPV's operations and financing activities.
- Assigns rankings to the securities.
- Sets out the rights and remedies available to investors.

The indenture trustee acts as an agent for the investors and the trust indenture provides for its rights, duties and appointment.

TRANSFERRING THE RECEIVABLES

Classes of receivables

11. What classes of receivables are usually securitised in your jurisdiction? Please explain any particular reasons (for example, the strength of the origination market) why such receivables are usually securitised and the progress of the market in securitising new classes of receivables.

The lending environment is generally conservative with strong underwriting standards and a legal system that enforces creditors' rights. This supports the securitisation of a wide variety of receivables.

With the general decline of new issue activity since the credit crisis, securitisation of new classes of receivables has lessened. The largest asset classes in the public market are (the figures exclude structured floating rate notes):

- Consumer obligations (credit cards, lines of credit): 39.9%.
- Commercial mortgages: 21.3%.
- Residential mortgages: 14.9%.
- Auto-related financing: 12.4%.

The transfer of the receivables from the originator to the SPV

12. How are the receivables usually transferred from the originator to the SPV (for example, assignment, novation, sub-participation, declaration of trust)? How is the transfer perfected? Are there any rules, requirements or exemptions that apply specifically to transferring receivables in a securitisation transaction?

Transfer of the receivables

A legal true sale is easier to achieve under Canadian law than under US law, because Canadian courts generally respect the legal form of a securitisation transaction whereas US courts look more closely at its economic substance. To mitigate the risk of recharacterisation, US securitisation sales are typically structured in two steps:

- First, a clean, unstructured and absolute assignment from the seller to an intermediate SPV.
- Second, a structured sale from the SPV to the ultimate purchaser.

In contrast, a Canadian sale of receivables is usually structured as a one-step transaction, using one of the following structures:

- For ABCP and similar "pay through" debt securities, the originator typically assigns receivables directly to the SPV under a receivables purchase agreement.
- For "pass through" ABS:
  - the originator assigns mortgages or other receivables to a custodian or an intermediary SPV;
  - the SPV then issues securities in the form of certificates representing sales of undivided ownership interests in the pools of assets.

  This intermediate assignment is required chiefly to comply with securities legislation that requires a distinct issuer.
- In revolving structures, the transfer is typically structured as a single assignment of an undivided co-ownership interest (with the seller) in all present and future receivables satisfying certain eligibility criteria. The purchase price is paid in a lump sum on closing and periodically out of collections, rather than as daily purchases of new receivables.

The transfer of receivables is typically documented as an absolute assignment of the receivables and related security. A separate instrument of assignment is not required. The seller often retains a subordinated interest that functions as credit support.

Perfecting the transfer

An absolute transfer of accounts (receivables) creates a security interest. This must be perfected, usually by registering (filing) a PPSA financing statement in the jurisdiction where the seller is located for the purposes of the relevant PPSA (generally, the seller's chief executive office). Failure to do so does not invalidate the sale, but the SPV's ownership interest both:

- May become subject to competing claims of the seller's secured creditors.
- Would be ineffective against a trustee in bankruptcy.

An assignment of receivables payable in Québec or subject to Québec law must be perfected under Québec law. Perfection by registration in the Québec central registry is only possible if the receivables transferred constitute a "universality of claims" (that is, all of the receivables in a specified category). Otherwise notice must be given to each obligor, which is usually not practicable or desirable.

The PPSAs do not apply to transfers of real property interests (mortgages or leases). These must be registered on title to the

land to be effective against third parties. Registrations are typically not made until enforcement (sale or foreclosure), under powers of attorney delivered on closing.

Rules, requirements and exemptions

There are no rules, requirements or exemptions that apply specifically to transferring receivables in a securitisation transaction.

13. Are there any types of receivables that it is not possible or not practical to securitise in your jurisdiction (for example, future receivables)?

Government receivables are not often securitised because their assignment may be subject to onerous statutory notice or consent requirements (*see Question 15*). Some provinces permit sales of certain municipal debts (for example, parking tickets, water rates and user fees) but securitisation of these assets is uncommon (partly due to legislative constraints).

Most provincial insurance legislation prohibits trafficking in life insurance policies, effectively banning securitisation of viatical settlements (that is, the sale of a life insurance policy by the policy owner before the policy matures).

Generally, future receivables can be securitised in all Canadian jurisdictions.

14. How is any security attached to the receivables transferred to the SPV? What are the perfection requirements?

Transfer of security to SPV

Security interests securing transferred receivables (such as liens against motor vehicles) are assigned to the SPV along with the related receivables (*PPSAs and the Civil Code*).

Perfecting the transfer

A PPSA registration that perfects the transfer of receivables does not apply to the related security as such (unless incorporated in chattel paper). A financing change statement can be registered to record the assignment of a security interest. However, the registrations are not mandatory and are usually not done where large numbers of liens are involved.

The transfer of most leases and conditional sale agreements must be registered (*Civil Code*):

- If the lien is a lease or conditional sale, reference to the underlying lien can be made in the registration of the assignment of the receivables.
- If the lien is a hypothec, registration is required and a copy of the certified statement of registration must be provided to the account debtors.

If these formalities are not satisfied, the assignment is not perfected against a subsequent assignee who has complied with them. However, the trustee in the bankruptcy of the assignor is not a subsequent assignee for these purposes.

Prohibitions on transfer

15. Are there any prohibitions on transferring the receivables or other issues restricting the transfer? For example, is a negative pledge enforceable, or are there any legislative provisions that affect the transfer of receivables (such as consumer or data protection rules)?

Contractual restrictions

Under most PPSAs, contractual restrictions on assignments of receivables or chattel paper are unenforceable against third parties. However, these saving provisions only apply to purchases of whole receivables, not to undivided interests. There are no similar saving provisions under the Civil Code.

The effect of a negative covenant prohibiting the assignment of a contract on a purported assignment (either subject to the Civil Code or not covered by the PPSA saving provision) is unclear. However, the better view is that this assignment would be ineffective. Therefore, receivables subject to restrictions on assignment are often excluded as ineligible.

Legislative restrictions

Assignments of contract debts owed by the government of Canada and many federal Crown corporations are invalid unless both (*FAA*):

- The assignment is absolute.
- Notice in prescribed form is given to the appropriate government official.

Several provinces and territories have similar restrictions. Complying with these restrictions may be onerous and time consuming. Therefore, government receivables are often excluded as ineligible unless they comprise a large portion of the securitised assets, in which case statutory notices must be given.

Avoiding the transfer being re-characterised

16. Is there a risk that a transfer of title to the receivables will be re-characterised as a loan with security? If so, can this risk be avoided and/or minimised?

It is possible that a transfer can be re-characterised as a financing by way of loan rather than a true sale. This risk can be reduced by structuring a transaction to constitute a true sale. The following factors indicate a true sale (from the decision of the Ontario Superior Court in *Metropolitan Toronto Police Widows and Orphans Fund et al v. Telus Communications Inc. (2003), 30 B.L.R. (3rd) 288 (Ont. C.J.); rev'd (2005) B.L.R. (4th) 251, 75 O.R. (3d) 784, 12 C.B.R. (5th) 251 (Ont. C.A.)*):

- The parties intend to effect a sale of the assets, as evidenced in the documents, conduct and communications.
- The ownership/collection risk passes to the SPV and recourse to the originator is limited.
- The ability to identify the transferred assets and calculate the purchase price at any time.

- The right to retain surplus collections passes to the SPV.
- The originator has limited repurchase rights.
- Responsibility for collection of the accounts receivable passes to the SPV (though not determinative, since the originator may retain servicing responsibilities).

Ensuring the transfer cannot be unwound if the originator becomes insolvent

17. Can the originator (or a liquidator or other insolvency officer of the originator) unwind the transaction at a later date? If yes, on what grounds can this be done and what is the timescale for doing so? Can this risk be avoided or minimised?

Contractual right to unwind

The originator does not generally have a contractual right to unwind the transaction.

Other creditor protections

The originator's creditors can challenge and seek to set aside a sale of assets under bankruptcy legislation and the other following legislation:

- **Bulk sales.** Several provinces have bulk sales legislation that protects creditors if a debtor sells its assets outside the ordinary course of business. Such a sale can be voided unless either:
  - the legislation is complied with;
  - a court order is obtained allowing the sale.

  Failure to comply with bulk sales legislation (if applicable) could cause the SPV to be responsible for any losses suffered by the originator's creditors (up to the value of the transferred assets). This risk is minimised if either:
  - the transfer of assets to the SPV is clearly in the ordinary course of the originator's business;
  - a bulk sales order is obtained.
- **Fraudulent preference.** The BIA allows creditors to challenge the sale of assets, to protect them from unfairly prejudicial transactions, depending on:
  - the nature and timing of the sale;
  - the condition of the originator at the time of sale;
  - the relationship between the originator and SPV.
- **Fraudulent conveyance.** Provincial legislation regarding fraudulent conveyances and preferential assignments is designed to prevent debtors from disposing of assets in an attempt to defeat creditors. These remedies are circumstance-specific, but this risk can be minimised by having the originator certify that:
  - it is not insolvent or close to insolvency, and the sale will not cause its insolvency;
  - no act or proceeding has been taken to dissolve, wind-up, liquidate or reorganise the originator, or put the originator into bankruptcy;
  - the originator enters the agreement to sell assets in good faith, not for the purpose of defeating, hindering, delaying, defrauding, impeding, obstructing, prejudicing or oppressing the rights and claims of creditors;
  - the consideration paid for the assets is a fair-market value of the assets;
  - the originator and SPV deal at arm's length.

Establishing the applicable law

18. Are choice of law clauses in contracts usually recognised and enforced in your jurisdiction? If yes, is a particular law usually chosen to govern the transaction documents? Are there any circumstances when local law will override a choice of law?

Canadian courts generally recognise and apply contractual choice of law clauses if:

- Expert evidence of the foreign law is adduced.
- The choice is bona fide and legal.
- There is no reason for avoiding it on public policy grounds.

However, the court:

- Applies Canadian laws relating to procedural matters or laws having overriding effect (such as bankruptcy, tax, securities or criminal law).
- Does not give effect to foreign revenue, expropriatory or penal laws (except in Québec, where there is reciprocity).
- Does not enforce any obligation whose performance would be illegal.

SECURITY AND RISK

Creating security

19. Please briefly list the main types of security that can be taken over the various assets of the SPV in your jurisdiction, and the requirements to perfect such security.

An SPV issuing debt securities typically grants a security interest in all its present and future assets to an indenture trustee (for the benefit of investors and other secured creditors). This is perfected in PPSA jurisdictions by filing a financing statement against the SPV where the SPV is located. In Québec, a hypothec may also need to be registered under the Civil Code (*see Question 20*).

Collateral assignments of real property mortgages or leases are only effective against third parties if registered on title. However, unless the SPV or a custodian already holds legal title to the real property interests, registration is typically only done before enforcement.

20. How is the security granted by the SPV held for the investors? If the trust concept is recognised, are there any particular requirements for setting up the trust (for example, the security trustee providing some form of consideration)? Are foreign trusts recognised in your jurisdiction?

Security is usually held by a security trustee on behalf of investors and other creditors under a trust indenture (*see Question 10*). The security trustee must be qualified to carry on business as a trust company in the relevant provinces. In addition, certain minimum standards and duties of care of issuers and trustees may apply to securities distributed to the public under trust indentures.

In Québec there are limits on holding security as agent (*Civil Code*). The indenture trustee must be appointed as the authorised representative (*fondé de pouvoir*). Security is granted to the *fondé de pouvoir* in the form of a hypothec securing payment of a bond issued by the SPV and pledged to the *fondé de pouvoir*. The hypothec must be executed before a Québec notary.

Trusts validly established under their jurisdiction of establishment are generally recognised under Canadian contract law.

Credit enhancement

21. What methods of credit enhancement are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the credit enhancement techniques set out in the Model Guide?

The most common methods of credit enhancement are:

- Over-collateralisation.
- Excess spread.
- Reserve accounts.
- Subordination.
- Letters of credit.
- Guarantees.

Federal regulation prohibits financial guarantee insurance. However, insurance provided outside of Canada for risks located in Canada may not be subject to this regulation. Care must still be taken to ensure that both:

- Provincial insurance regulation does not apply.
- An exemption is available.

However, following the credit crisis many monoline insurers's ratings are not sufficient to provide meaningful enhancement.

The use of subordinated securities has been curtailed due to:

- A limited domestic sub-debt market.
- Withholding taxes.

However, the recent repeal of withholding tax on most interest payments to arm's-length foreign investors and non-arm's length US investors has created greater opportunity for the use of subordinated debt (*see also Question 26*).

Guarantees are often provided where an originator is a subsidiary of a foreign parent but lacks a sufficient credit rating to support its servicing obligations and indemnities.

Risk management and liquidity support

22. What methods of liquidity support are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the provision of liquidity support as set out in the Model Guide?

Liquidity is usually provided by a rated financial institution:

- By way of a credit facility.
- Under an asset purchase agreement.
- Synthetically under a credit default swap.

Liquidity for ABCP must support the face value and interest of all the outstanding ABCP. Extendible notes do not require liquidity support, but are used less frequently due to increased liquidity concerns during the credit crisis. The originator generally provides additional liquidity support in the form of cash reserves and servicer advances, to address cash flow mismatches arising from obligor payment delays.

Liquidity provided by FRFIs

Liquidity provided by FRFIs (*see Question 2*) must qualify as an eligible liquidity facility (*Guideline B-5, OSFI*). These facilities:

- Should not provide credit support or fund prior losses.
- Must benefit from first and subsequent loss enhancement.
- Must rank *pari passu* (that is, equal in right of payment) with claims of senior securities.

Facilities which fail to satisfy these criteria are treated as enhancement facilities. This has consequences for the institution's regulatory capital treatment and requirements.

GMD liquidity

Before October 2007, ABCP with GMD liquidity (*see Questions 3 and 1, Non-bank sponsored ABCP*) could obtain an investment grade rating from DBRS (a rating agency). Before October 2008, GMD liquidity received favourable capital treatment. Although there is currently no restriction against providing GMD liquidity, securities supported by GMD liquidity:

- Are no longer eligible for an investment-grade rating.
- Will have the same capital treatment as global-style liquidity facilities.

Rating requirements

OSFI requires that ABS issued after October 2008 be rated by at least two recognised rating agencies, to permit FRFIs to use external ratings to establish capital requirements relating to exposures. The BOC requires that ABCP used by institutions as collateral for advances under the Large Value Transfer System be rated by at least two rating agencies.

CASH FLOW IN THE STRUCTURE

Distribution of funds

23. Please explain any variations to the Cash flow index accompanying Diagram 9 of the Model Guide that apply in your jurisdiction.

Receivables are generally sold on a fully-serviced basis with no separate servicing fee, to avoid sales tax. Replacement servicer fees must be included in the waterfall and may attract sales tax.

As "control" is not required for perfection purposes relating to deposit accounts, lockboxes and blocked accounts are not common and are used only for credit purposes.

Principal and interest payments for liquidity provided by FRFIs must be made *pari passu* with senior notes.

Profit extraction

24. What methods of profit extraction are commonly used in your jurisdiction? Are there any variations or specific issues that apply to the profit extraction techniques set out in the Model Guide?

The originator primarily receives:

- Payments in the form of deferred consideration.
- Payments under swap agreements.

Originators do not seek separate compensation as servicer, as servicing fees may attract sales taxes.

THE ROLE OF THE RATING AGENCIES

25. What is the sovereign rating of your jurisdiction? What factors impact on this and are there any specific factors in your jurisdiction that affect the rating of the securities issued by the SPV (for example, legal certainty or political issues)? How are such risks usually managed?

Canada's sovereign rating is AAA with a stable trend. The risk factors related to sovereign ratings include:

- Economic structure, performance and growth prospects.
- Political environment.
- Government management and policy.
- Debt and liquidity and contingent liabilities.
- Monetary policy and financial stability.
- Balance of payments.

These factors may affect exchange rates, which may also affect the ratings of securities either:

- Issued by SPVs in a foreign currency.
- If the underlying receivables are denominated in a foreign currency.

These risks are usually addressed by swaps.

TAX ISSUES

26. What tax issues arise in securitisations in your jurisdiction? In particular:

- **What transfer taxes may apply to the transfer of the receivables? Please give the applicable tax rates and explain how transfer taxes are usually dealt with.**
- **Is withholding tax payable in certain circumstances? Please give the applicable tax rates and explain how withholding taxes are usually dealt with.**
- **Are there any other tax issues that apply to securitisations in your jurisdiction?**

Stamp and transfer taxes

There are generally no stamp or other transfer taxes payable on the transfer of receivables.

Goods, services and sales taxes

Sales of financial products (loans and receivables) are generally not subject to federal goods and services tax (GST), harmonised sales tax (HST) or provincial sales taxes (PST). Transactions should be structured carefully to avoid or otherwise address transfers of non-financial products through either:

- Specific statutory exemptions.
- Available tax credits.

This is because these transfers may be subject to GST and PST. GST is currently 5%, but where PST (or HST) applies, the combined rate is higher.

GST or HST may apply to certain services provided in connection with a securitisation structure, such as servicing. To avoid this, the relevant receivables are usually sold on a fully-serviced basis. This embeds the services into the transferred receivables, so that the services are not considered to constitute a separate supply for GST or HST purposes. This technique generally only works if the originator provides the servicing.

Withholding taxes

Most interest payments to arm's-length non-residents are no longer subject to withholding taxes. Recent Canada-US Tax Treaty amendments generally provide a withholding tax exemption for related-party interest payments (most Canadian treaties reduce the statutory withholding rate of 25% to 10%). Therefore, interest-bearing receivables or ABS can generally be sold cross-border to SPVs, investors or other arm's-length parties without withholding tax.

Withholding tax of 25% is generally payable on most cross-border lease payments, royalty payments and dividends, subject to reduction under an applicable tax treaty.

Corporate capital taxes

The federal government and most provinces have eliminated (or are eliminating) corporate capital taxes. Liability to capital tax in the provinces that impose capital taxes depends on whether a corporation has a permanent establishment in the province. Since most SPVs were structured as trusts to avoid capital tax concerns, other types of SPV entities may begin to be used.

SYNTHETIC SECURITISATIONS

27. Are synthetic securitisations possible in your jurisdiction? If so, please briefly explain any particularly common structures used. Are there any particular reasons for doing a synthetic securitisation in your jurisdiction?

Synthetic securitisation under credit default swaps are used frequently. The protection buyer (that is, a buyer who seeks to hedge against credit risk) pays a periodic premium to the protection seller (usually an SPV). The SPV then pays the buyer on the occurrence of a credit event relating to the reference entities covered by the swap (usually limited to senior tranches of a portfolio of the reference entities). The SPV's payment obligations are generally secured by highly-rated assets that are posted as collateral in favour of the protection buyer.

Synthetic securitisation has allowed ABS issuers access to highly-rated cash flows to meet investor demand for highly-rated ABS. However, there has been a substantial decrease in synthetic securitisation because reference portfolios, collateral and counterparties underwent significant ratings pressure during the credit crisis. In 2006, about 18% of the ABS market (or 27% of ABCP) were backed by primarily synthetic collateralised debt obligation (CDO) assets. Currently, no ABCP is backed by CDO assets.

OTHER SECURITISATION STRUCTURES

28. Which of the various structures, set out in the Model Guide or otherwise, are commonly used in your jurisdiction?

Historically, structures used single-seller and multi-seller trusts, due to capital taxes. Public CDO issue has essentially stopped. With the widespread repeal of capital taxes, there is now greater opportunity for structures using corporations, partnerships and other entities as SPVs.

Structured Investment Vehicles (SIVs) are not commonly used.

REFORM

29. Please summarise any reform proposals and state whether they are likely to come into force and, if so, when. For example, what structuring trends do you foresee and will they be driven mainly by regulatory changes, risk management, new credit rating methodology, economic necessity, or other factors?

OSFI and the BOC have implemented various reforms relating to:

- ABCP liquidity requirements.
- The eligibility requirements of ABS investments held by regulated entities.

Likewise, DBRS as Canada's sole domestic rating agency has adopted more stringent liquidity requirements for ABCP.

In October 2008, the Canadian Securities Administrators and the Investment Industry Regulatory Organization of Canada:

- Released two industry studies examining the issues that lead to the freeze of non-bank sponsored ABCP in 2007.
- Called for sweeping reforms in relation to:
  - credit ratings and rating agencies;
  - disclosure requirements;
  - exemptions;
  - the distribution of ABCP.

  These have not yet been implemented.

Canadian legislation often follows US capital markets initiatives. However, there have been no significant government-initiated legislative proposals. In fact, the federal government has been critical of various international reform proposals. This is probably because the credit crisis has been less severe in Canada.

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McMillan LLP is active in all aspects of the Canadian securitisation market and familiar with the US market. We regularly advise sellers, conduit sponsors, SPVs, servicers, credit enhancers, liquidity providers and rating agencies. Our expertise covers all major Canadian asset classes, including residential and commercial mortgages, trade receivables, government receivables, credit cards, automobile finance and personal credit lines. We have helped establish and implement a variety of securitisation structures, and were extensively involved in the restructuring efforts following the asset-backed commercial paper (ABCP) crisis in August 2007 and the resulting Montreal Accord.