

Off-Balance Sheet Financing: U.S. and Canadian Securities Law Developments*

A. U.S. SECURITIES LAW DEVELOPMENTS

Background

The enactment of the U.S. *Sarbanes-Oxley Act of 2002* (S-Ox) on July 30, 2002¹ has dramatically altered securities law practice in the United States and, in addition to the highly publicized corporate governance mandates, will have a significant impact on the public disclosure obligations of Canadian cross-listed issuers. For example, section 401(a) of S-Ox added section 13(j) of the *Securities Exchange Act of 1934*² (the *Exchange Act*), which required the Securities and Exchange Commission (SEC) to issue rules providing that each annual and quarterly financial report filed with the SEC disclose “all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.”³ On January 27, 2003, to implement this mandate, the SEC adopted final rules (the SEC MD&A Rules) requiring enhanced disclosure of certain off-balance sheet arrangements in the management’s discussion and analysis (MD&A) section of various disclosure documents, such as annual reports on Form 10-K, Form 20-F and Form 40-F, for the fiscal year ending on or after June 15, 2003.⁴ In addition, effective August 23, 2004, U.S. issuers are required to file current reports on Form 8-K to report the creation of an obligation under an off-balance sheet arrangement or the occurrence of triggering events that accelerate or increase an obligation under an off-balance sheet arrangement.

Off-Balance Sheet Arrangements

The definition of off-balance sheet arrangements primarily targets the means through which companies typically structure off-balance sheet transactions or otherwise incur risk of loss that are not transparent to investors.⁵

Off-balance sheet arrangements include any contractual arrangement to which an unconsolidated entity (even a genuine third-party entity that is not a subsidiary or an affiliate established for purposes of the arrangement) is a party, under which the registrant has (i) any obligation under certain guarantee contracts; (ii) a retained or contingent interest in assets; (iii) any obligation under certain derivative instruments; or (iv) any obligation under a material variable interest held by the registrant in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the registrant or engages in leasing, hedging or research and development services with the registrant.⁶

(i) Guarantees

Off-balance sheet arrangements include those guarantees that may be a source of potential risk to a registrant’s future liquidity, capital resources and results of operations. The guarantees specifically classified as off-balance sheet arrangements are those that have any of the characteristics identified in paragraph 3 of Financial Accounting Standards Board (FASB) Interpretation No. 45 (FIN 45) and that are not excluded from the initial recognition and measurement provisions of FIN 45.⁷ These characteristics include (i) contracts that contingently require the guarantor to make payments to the guaranteed party based on changes in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates or other variable (an “underlying”) that is related to an asset, a liability or an equity security of the guaranteed party; (ii) contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity’s failure to perform under an obligating agreement; (iii) indemnification agreements that contingently require the indemnifying party to make payments to the indemnified party based on changes in an underlying that is related to an asset, a liability or an equity security of the indemnified party; and (iv) indirect guarantees of the indebtedness of others. These guarantees do not have to be recorded as liabilities to qualify as an off-balance sheet arrangement.

* Please note that this article was written in November 2004.

Contracts and arrangements that are guarantees classified as off-balance sheet arrangements include financial standby letters of credit, market value guarantees, guarantees of the market price of common stock, guarantees of the scheduled contractual cash flows from individual financial assets held by a special purpose entity, performance guarantees, indirect guarantees of indebtedness to others and indemnification agreements that require the indemnifying party to make payments based on contingencies.⁸ Excluded items include guarantees issued by insurance and reinsurance companies, a lessee's guarantee of residual value of leased property in a capital lease, vendor rebates, product warranties, contingent consideration in business combinations, guarantees issued between a parent and its subsidiary, a parent's guarantee of a subsidiary's debt or a subsidiary's guarantee of its parent's debt.⁹

(ii) Retained or Contingent Interest

An off-balance sheet arrangement includes retained or contingent interests in assets transferred to an unconsolidated entity or similar arrangements that serve as credit, liquidity or market risk support to such entity for the assets.¹⁰ This would apply to most securitization transactions.

(iii) Certain Derivative Instruments

A derivative instrument may be considered an off-balance sheet arrangement. For registrants that do not use U.S. GAAP, an off-balance sheet arrangement includes any obligation under a derivative instrument that is both indexed to the registrant's own stock and classified in stockholders equity, or not reflected, in the registrant's statement of financial condition.¹¹ Similarly, for those registrants using U.S. GAAP for their financial statements, derivative instruments covered in the definition of off-balance sheet arrangements are those excluded by Statement of Financial Accounting Standards (SFAS) No. 133.¹² Specifically these are contracts that are both indexed to the registrant's own stock and classified in stockholders equity in its statement of financial condition.

(iv) Variable Interests

The fourth category of off-balance sheet transactions are any obligations under a material variable interest held by

the registrant in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the registrant or engages in leasing, hedging or research and development services with the registrant.¹³ The SEC has stated that it intends to make the concept of a variable interest consistent with FASB Interpretation No. 46 (FIN 46).¹⁴ Therefore variable interests that are considered off-balance sheet arrangements are those investments or other interests that will absorb a portion of the entity's losses or receive a portion of residual returns should they occur.¹⁵

Required Disclosure of Off-Balance Sheet Arrangements and Obligations

The SEC MD&A Rules amend item 303(a)(4) of Regulation S-K to require that a company's MD&A include a separate section that discloses all of the company's "material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other person, that have or are reasonably likely to have a current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses that is material to investors."¹⁶ Management therefore must assess the likelihood of the occurrence of any material event that could affect an off-balance sheet arrangement and disclose those that are reasonably likely to occur in the MD&A. Arrangements in which the circumstances triggering the obligation are remote would not have to be disclosed. The SEC chose a "reasonably likely" standard as opposed to a "more than remote" standard (which had been proposed in earlier drafts of the rule) because this is the standard that, under the SEC's 1989 Interpretive Release on MD&A disclosure, is applied to other portions of MD&A disclosure.

Item 303(a)(4) requires the registrant to disclose the material facts and circumstances that provide investors with a clear understanding of off-balance sheet arrangements and their effects. Specifically a registrant must disclose the nature and business purpose of the off-balance sheet arrangements. The MD&A should include a discussion of the importance of the off-balance arrangements to the registrant's liquidity, capital resources, market risk support, credit risk support or other

benefits and the importance of the arrangements to the registrant as a financial matter.¹⁷ Disclosure must include the following items to the extent they are necessary to an understanding of the effect of a particular off-balance sheet arrangement: (i) the amounts of revenues, expenses and cash flows of the registrant arising from the arrangement; (ii) the nature and total amount of any retained interests, securities issued and other indebtedness incurred as a result of the arrangement; (iii) the nature and amount of any other obligation or liability arising from the arrangements that are, or reasonably likely to become, material and the circumstances that could cause them to arise.¹⁸ The discussion must identify any known event, demand, commitment, trend or uncertainty that will reasonably likely result in termination, or material reduction in availability to the registrant, of its off-balance sheet arrangements that currently provide a material benefit.¹⁹ Pursuant to the rule, a company is also required to provide other information that it believes necessary to an understanding of its off-balance sheet arrangements and the material effects of these arrangements on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.²⁰

The MD&A discussion should be presented in language and a format that is clear, concise and understandable. Instructions to item 303(4)(a) state that the registrant should aggregate off-balance sheet arrangements in groups that provide information in an efficient and understandable manner and avoid repetition and disclosure of immaterial information.²¹ Issuers must analyze common or similar effects that may result from a number of different off-balance sheet arrangements in the aggregate to the extent that the aggregation increases understanding of the arrangements. For example, if particular triggering events or circumstances would either require an issuer to become directly obligated, or accelerate its obligations, under a number of off-balance sheet arrangements, and the overall obligations would be material, then the final rules require an analysis of the circumstances and their aggregate effect to the extent it increases understanding of the issuer's off-balance sheet arrangements. There is no obligation to disclose until an unconditionally binding definitive agreement is executed

or settlement of the transaction occurs.²² The disclosure must generally cover the most recent fiscal year, although it should also address changes from the previous year where it is necessary for an understanding of the disclosure.²³ To eliminate repetition the rules allow the registrant to include within its MD&A section a cross-reference to information in the footnotes to its financial statements. However, such cross reference must integrate the substance of the footnote into the MD&A discussion in a manner designed to inform the reader of the significance of the information that is not included within the body of the MD&A.²⁴

Effective August 23, 2004, the SEC substantially revised the items required to be disclosed in a current report on Form 8-K. U.S. issuers are generally required to file Form 8-K within four business days after the occurrence of the event that requires the filing of the report. Two of the new items are item 2.03 "Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant" and item 2.04 "Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement."

New item 2.03, among other things, requires that when an issuer becomes directly or contingently liable for an obligation that is material to the company arising out of an off-balance sheet arrangement, it must provide the following information:

- the date on which the company becomes directly or contingently liable on the obligation and a brief description of the transaction or agreement creating the arrangement and obligation;
- a brief description of the nature and amount of the obligation of the company under the arrangement, including the material terms under which it may become a direct obligation, if applicable, or may be accelerated or increased and the nature of any recourse provisions that would enable the company to recover from third parties;
- the maximum potential amount of future payments (undiscounted) that the company may be required to make, if different; and

- a brief description of the other terms and conditions of the obligation or arrangement that are material to the company.

A company must provide the disclosure required regarding off-balance sheet arrangements, whether or not the company is also a party to the transaction or agreement creating the contingent obligation arising under the off-balance sheet arrangement. In the event that neither the company nor any affiliate of the company is also a party to the transaction or agreement creating the contingent obligation arising under the off-balance sheet arrangement in question, the four-business-day period for reporting the event under item 2.03 would begin on the earlier of (i) the fourth business day after the contingent obligation is created or arises, and (ii) the day on which an executive officer of the company becomes aware of the contingent obligation.

Among other things, new item 2.04 provides that if a triggering event causes a company's obligation under an off-balance sheet arrangement to increase or be accelerated or causes a company's contingent obligation under an off-balance sheet arrangement to become a direct financial obligation of the company, and the consequences of such event are material to the company, it must disclose the following information:

- the date of the triggering event and a brief description of the off-balance sheet arrangement;
- a brief description of the triggering event;
- the nature and amount of the obligation, as increased if applicable, and the terms of payment or acceleration that apply; and
- any other material obligations of the company that may arise, increase, be accelerated or become direct financial obligations as a result of the triggering event or the increase or acceleration of the obligation under the off-balance sheet arrangement or its becoming a direct financial obligation of the company.

Disclosure is required if a triggering event occurs in respect of the company's obligation under an off-balance sheet arrangement and the consequences are material to the company, whether or not the company is also a party to the transaction or agreement under which the triggering event occurs. However, no disclosure is required unless and until a triggering event has occurred in accordance with the terms of the relevant agreement, transaction or arrangement, including, if required, the company receives notice of the occurrence of a triggering event under the terms of the agreement, transaction or arrangement and the satisfaction of all conditions to such occurrence, except the passage of time. Moreover, no disclosure is required if the company believes, in good faith, that no triggering event has occurred, unless the company has received a notice as described in the previous sentence. Finally, if a company is subject to an obligation arising out of an off-balance sheet arrangement, whether or not disclosed pursuant to item 2.03, if a triggering event occurs as a result of which under that obligation an accrual for a probable loss is required under SFAS No. 5, the obligation arising out of the off-balance sheet arrangement becomes a direct financial obligation for purposes of item 2.04. In this situation, if the consequences are material to the company, disclosure is required under item 2.04.

The Rules Prior to the *Sarbanes-Oxley Act of 2002*

To a lesser degree, the MD&A Rules prior to the enactment of S-Ox did require some disclosure of off-balance sheet arrangements and contingencies. The pre-S-Ox MD&A Rules required disclosure, among other things, of "[a]ny known material trends, favorable or unfavorable, in the registrant's capital resources, including any expected material changes in the mix and relative cost of capital resources, considering changes between debt, equity and any off-balance sheet financing arrangements."²⁵

The SEC MD&A Rules differ from the pre-S-Ox MD&A disclosure requirements in that they require specific disclosures that a registrant must make of off-balance sheet financing arrangements and require a registrant to set apart disclosure in a separate section of the MD&A, as opposed to leaving the determination of whether and

what to disclose in large part to the discretion of the registrant. The new rules increase transparency in the presentation of a company's financial statements and enhance investor confidence in a full and fair disclosure system. With a greater understanding of a registrant's off-balance sheet arrangements, investors will be better able to assess the quality of a company's earnings and risks that are not apparent on its financial statements.

The Impact on Canadian Cross-listed Companies

The SEC MD&A Rules have a direct impact on Canadian cross-listed companies. Section 401(a) of S-Ox does not distinguish between U.S. registrants and foreign private issuers. The SEC has interpreted this to mean that its rules requiring expanded disclosure of off-balance sheet transactions should apply equally to Form 20-F and Form 40-F annual reports filed by foreign private issuers.²⁶ The SEC has held that requiring disclosure of off-balance sheet arrangements is consistent with MJDS and will provide investors with information that is comparable to that provided by U.S. registrants that file under the *Exchange Act*.²⁷

Off-balance sheet arrangements are defined identically for U.S. and non-U.S. companies. Accordingly, a Canadian issuer subject to SEC regulation must assess its guarantee contracts, retained interests and variable interests pursuant to U.S. GAAP in order to determine which arrangements are subject to the new standards of disclosure.²⁸ However, the MD&A disclosure should continue to focus on the Canadian issuer's primary financial statements even though the off-balance sheet arrangements have been defined by reference to U.S. GAAP.²⁹

Section 401(a) required the SEC to adopt off-balance sheet disclosure rules that apply to each annual and quarterly financial report filed.³⁰ However, foreign private issuers are not required to file quarterly reports and therefore the rule does not apply to Form 6-K reports submitted by foreign private issuers, even if they contain quarterly financial information. Therefore, unless a Canadian issuer files a registration statement that has quarterly financial statements and a related MD&A disclosure (or voluntarily

chooses to file quarterly reports on Form 10-Q), it is required to update its MD&A disclosure of off-balance sheet arrangements only on an annual basis.³¹ Moreover, foreign private issuers are not required to file current reports on Form 8-1C, so the new requirement to disclose the creation of off-balance sheet arrangements and triggering events will not apply to most Canadian issuers.

Safe Harbour Provisions

The SEC has invoked its rulemaking authority under sections 27A of the *Securities Act of 1933* and 21E of the *Exchange Act* to create a new safe harbour rule to apply to forward-looking statements in the MD&A. The statutory safe harbour contains provisions to protect forward-looking statements disclosed in the MD&A from private legal actions that are based on allegations of a material misstatement or omission.³² However, the safe harbour provisions do not apply if the MD&A forward-looking statements were made in connection with an initial public offering or in certain other circumstances.³³

There are three bases for a registrant to claim the protection against liability for the forward-looking statements made in its MD&A. The first basis requires the issuer to identify the statement as forward-looking and have it be accompanied by meaningful cautionary statements that identify important factors that could cause actual results to differ materially from those disclosed in the forward-looking statement. Except for historical facts, MD&A disclosure will be deemed to be a "forward-looking" statement as that term is defined in the safe harbour provisions.³⁴ The "meaningful cautionary" requirement will be satisfied if the registrant satisfies all of its off-balance sheet arrangement disclosure requirements.³⁵ The second category of protection is that the safe harbour applies to forward-looking statements that are not material. Finally, the safe harbour precludes private liability if the plaintiff fails to prove that the forward-looking statement was made by or with the approval of an executive officer who had actual knowledge that the statement was false or misleading.³⁶ Those who may qualify for statutory safe harbour protection are reporting companies and people acting on their behalf, outside reviewers hired by the companies and underwriters given information by the companies.

B. CANADIAN SECURITIES LAW DEVELOPMENTS

Introduction

On March 30, 2004, National Instrument 51-102, *Continuous Disclosure Obligations*, came into force and applies to all reporting issuers in Canada other than investment funds. This National Instrument significantly expands on the general continuous disclosure obligations of public companies in Canada and, in particular, disclosure obligations in MD&A relating to off-balance sheet arrangements and contractual obligations.³⁷

On this same date, Multilateral Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, came into force in all jurisdictions other than British Columbia. MI52-109 requires the CEO and CFO of a reporting issuer to certify as to the accuracy of the issuer's annual and interim filings, including MD&A. Although not yet fully in effect, MI52-109 (or a replacement national instrument) is expected to also require certification related to an issuer's disclosure and internal controls over financial reporting. The requirement to make these certifications raises important considerations for issuers with extensive off-balance sheet arrangements.

Additionally, National Instrument 52-107, *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*, came into force on that date. NI52-107 sets out which bodies of accounting principles and auditing standards will be acceptable for use in preparing and auditing financial statements for purposes of both continuous disclosure and prospectus filing requirements.

National Instrument 51-102

Part 5 of NI51-102 requires reporting issuers to file MD&A relating to its annual and interim financial statements concurrently with the filing of those financial statements. Generally, annual financial statements are now required to be filed within 90 days of an issuer's fiscal year-end and interim financial statements are now required to be filed within 45 days of an issuer's fiscal quarter-end.³⁸ Form 51-102F1 sets out the content requirements for annual and interim MD&A.

Importantly, Part 1(a) of Form 51-102F1, in describing MD&A, specifically indicates that MD&A should discuss material information that may not be fully reflected in an issuer's financial statements, such as off-balance sheet financing arrangements or other contractual obligations. Specifically, sections 1.6 and 1.8 of Form 51-102F1 expressly set out the disclosure required in respect of an issuer's contractual obligations and off-balance sheet arrangements. Part 1(b) of Form 51-102F1 indicates that the securities regulators' concept of materiality is consistent with the financial reporting notion of materiality contained in the *CICA Handbook*.

Section 1.6 (Liquidity) of Part 2 of Form 51 102F1 requires a reporting issuer to provide an analysis of its liquidity. This includes a requirement to discuss conditions, or income or cash flow items, that may affect liquidity. Nothing is specifically said about off-balance sheet arrangements; however, instruction (iv) under section 1.6 stipulates that a reporting issuer should "present a summary, in tabular form, of contractual obligations including payments due for each of the next five years and thereafter." The instruction then provides an example of such a table as follows:

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-Term Debt					
Capital Lease Obligations					
Operating Leases					
Purchase Obligations					
Other Long-Term Obligations					
Total Contractual Obligations					

As can be seen, no distinction is made between on-balance sheet and off-balance sheet items in this section 1.6.

Section 1.7 (Capital Resources) of Part 2 of Form 51-102F1 requires a reporting issuer to provide an analysis of its capital resources. It states that “capital resources are financing resources available to your company and include debt, equity and any other financing arrangements, that you reasonably consider will provide financial resources to your company.” Again, no distinction is made between on-balance sheet and off-balance sheet items in this section 1.7.

Section 1.8 (Off-Balance Sheet Arrangements) of Part 2 of Form 51-102F1 requires a reporting issuer’s MD&A to “discuss any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations or financial condition of your company including, without limitation, such considerations as liquidity and capital resources.” The express requirement to discuss off-balance sheet arrangements was first introduced by this National Instruments and so mandatory disclosure is in its infancy in Canada. Instruction (iv) to section 1.8 provides that an issuer need not repeat information provided in the notes to the issuer’s financial statements provided appropriate cross-references are included and the substance of the notes is properly integrated into the MD&A.³⁹

The required discussion of off-balance sheet arrangements is in respect of those arrangements that are “reasonably likely” to affect an issuer’s financial condition. This requires management to assess the likely impact on the issuer’s financial condition, using an objective analysis; the impact does not have to be certain, or even more likely than not, to require disclosure.

This National Instrument in particular requires issuers to include in their MD&A a discussion of the business purpose and activities, economic substance, and the risks associated with, and key terms and conditions of, any off-balance sheet arrangements, including (among other things):

- the amounts receivable or payable, revenues, expenses and cash flows resulting from the arrangement;

- the nature and amounts of any other obligations or liabilities arising from the arrangement that could require the company to provide funding under the arrangement and the triggering events; and
- any known event, commitment, trend or uncertainty that may affect the availability or benefits of the arrangement.⁴⁰

The instructions for section 1.8 define off-balance sheet arrangements to include any contractual arrangement with an entity not reported on a consolidated basis with the issuer, under which the issuer has

- any obligation under certain guarantee contracts;
- a retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for the assets;
- any obligation under certain derivative instruments; or
- any obligation under a material variable interest held by the company in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the company, or engages in leasing, hedging or research and development services with the company.⁴¹

This instruction does not provide any further guidance on the meaning of off-balance sheet arrangements; however, as the four categories are generally similar to the SEC MD&A Rules, reporting issuers are able to seek guidance from those rules in their interpretation of NI51-102F1 requirements.

The disclosure required by Part 1.8 of Form 51-102F1 need only cover the reporting issuer’s most recently completed financial year, as well as changes from the previous year where such discussion is necessary to understand the disclosure. Beyond this, there is no requirement to include any discussion of historical off-balance sheet arrangements.

Multilateral Instrument 52-109

Additional disclosure relating to off-balance sheet arrangements in a reporting issuer's MD&A may be required as a result of the annual and interim certifications that are required under MI52-109. Although not yet in effect, the long forms of certificates will require an issuer's CEO and CFO to personally certify as to disclosure controls and procedures, as well as internal controls over financial reporting, including the design of internal controls over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting, the preparation of financial statements and the evaluation of the effectiveness of those controls. For these purposes, internal controls include policies and procedures that

- pertain to the maintenance of records;
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the issuer's annual or interim financial statements.
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the issuer's annual or interim financial statements.⁴²

Upon the long form certificates becoming mandatory, conclusions about the effectiveness of disclosure controls and procedures as well as any material changes to internal controls will be required to be disclosed in the reporting issuer's annual and interim MD&A.⁴³ Such MD&A disclosure is not currently required under the short form certificate requirements.⁴⁴

For reporting issuers with extensive off-balance sheet arrangements (such as reporting issuers who utilize securitization conduits), it would be prudent for the issuer to require the counterparty to the off-balance sheet arrangement to be contractually obligated to open its books, internal controls and procedures for review by the issuer, and provide "back-up" certificates for the reporting

issuer so that the CEO and CFO can responsibly sign the required long form MI52-109 certificates. At a minimum, the counterparty should also be obligated to provide the issuer with timely reports (in addition to the customary pool reports) that will allow an issuer to satisfy its continuous disclosure obligations and to enable certification to be made in respect of the disclosure controls and procedures in relation thereto.

The difficulties faced by reporting issuers of asset-backed securities (ABS) have been addressed by the SEC in its proposed rule published in May 4, 2004. Certification over internal controls for those issuers is not required; but, rather, a servicer compliance statement is required in its place. This servicer compliance statement confirms compliance with the servicer's obligations under the applicable servicing agreement. Currently, NI52-109 does not provide for anything similar and so an issuer's certification would have to include certification of internal controls regardless of the nature of the relationship between the parties to the off-balance sheet arrangement unless the issuer were to obtain regulatory relief. Without such relief, and without a contractual right for the issuer to be able to verify that the servicer has appropriate disclosure and internal controls, the CEO and CFO will be faced with a difficult task of signing a MI52-109 certificate without full information. As the requirement for long forms of MI52-109 certificates is not yet in effect, this is not yet an issue. In some cases, the Ontario Securities Commission has granted relief from the interim certificate requirements as a result of the difficulties faced by ABS issuers where the only financial statements are servicer pool reports, but has deferred any decision on the long form certificate until after it completes a review of the NI52-109 requirements as they apply to ABS issuers generally. It is reasonable to expect, however, that certification as to disclosure controls will at least be required (as is the case in the U.S.) and so issuers with extensive off-balance sheet arrangements should be cognizant of that in their dealings with their counterparties.

The Implications of U.S. GAAP Financial Statements

On March 30, 2004, National Instrument 52-107, *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*, became effective. NI52-107 permits issuers to use U.S. GAAP and U.S. generally accepted

auditing standards in satisfaction of their continuous disclosure and prospectus filing obligations. SEC issuers are reporting issuers that have a class of securities registered under section 12 of the *Exchange Act* or are required to file reports under section 15(d) of that Act and that are not investment companies under the U.S. *Investment Company Act of 1940*.

One consequence of this for SEC issuers is that all of the requirements of U.S. securities laws that are applicable to the disclosure of off-balance sheet financing will apply to that issuer's Canadian-filed financial statements and MD&A.

CONCLUSION

In the U.S., the SEC has taken the lead in dictating required disclosure of contractual arrangements and off-balance sheet arrangements. In Canada, securities regulators, while initially taking a more benign approach, have followed the SEC's lead by the introduction of new mandatory specific disclosure with respect to contractual obligations and off-balance sheet arrangements.

1 Pub. L. 107-204, 116 Stat. 745 (2002).
 2 15 U.S.C. §78m(j).
 3 Pub. L. 107-204 Sec. 401(a).
 4 *Final Rule: Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations*, Release Nos. 33-8182;34-47264; FR-67 (January 27, 2003). Form 20-F is the general annual report form for foreign private issuers and Form 40-F is a special form for Canadian issuers eligible to use the Multijurisdictional Disclosure System (MJDS).
 5 *Ibid.*
 6 *Supra* note 4.
 7 *Ibid.*
 8 *Financial Accounting Standards Board ("FASB") Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (Nov. 2002).
 9 *Ibid.*
 10 *Supra* note 4.
 11 *Ibid.*
 12 Statement of Financial Accounting Standards No.133, paragraph 11a., *Accounting for Derivative Instruments and Standards* (June 1998).

13 *Supra* note 4.
 14 See FIN 46 at paragraph 2(c).
 15 *Ibid.*
 16 *Supra* note 4.
 17 17 CFR 229.303(a)(4)(i)(B).
 18 17 CFR 229.303(a)(4)(i)(C).
 19 17 CFR 229.303(a)(4)(i)(D).
 20 17 CFR 229.303(a)(4)(i).
 21 17 CFR 229.303.
 22 *Ibid.*
 23 *Supra* note 12.
 24 *Supra* note 4.
 25 17 C.F.R. 229.303(a) - 17 C.F.R. 229.303(a)(3)(iii).
 26 *Supra* note 4.
 27 *Supra* note 4.
 28 *Ibid.*
 29 *Supra* note 4.
 30 Exchange Act 13(K) [15U.S.C. 78m(j)].
 31 *Supra* note 4.
 32 *Ibid.*
 33 15 U.S.C. §77z-2(b) and § 78u-5(b).
 34 *Supra* note 4.
 35 Item 303 (c)(2)(I) of Regulation S-K [17 C.F.R. 229.303(c)(2)(I)].
 36 *Supra* note 4.
 37 Prior to the implementation of this National Instrument, the Canadian Performance Reporting Board of the CICA published a guideline in November 2002 entitled "Management's Discussion and Analysis: Guidance on Preparation and Disclosure". In May 2003 the CICA issued an Interpretive Release, entitled "Disclosure about Off-Balance Sheet Arrangements and Related Exposures" which provided detailed guidance on this particular topic. This Interpretive Release, which was withdrawn in May 2004 as a result of the implementation of NI51-102, did not have the force of law, but indicated what the CICA believed would be best practice in providing MD&A disclosure. The Interpretive Release was very similar in content to the SEC MD&A Rules.
 38 NI51-102 Parts 4.2 and 4.4.
 39 A general review of recently filed MD&A by many significant Canadian reporting issuers shows that a many are taking advantage of this instruction by relying extensively on the notes to their financial statements for off-balance sheet arrangement discussion purposes.
 40 Section 1.8 of NI51-102F1.
 41 Instruction (i) to Section 1.8 of NI51-102F1.
 42 Section 1.1 of MI52-109.
 43 Form 52-109F1 and Form 52-109F2.
 44 Form 52-109FT1 and Form 52-109FT2.

This memorandum is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss with you the issues raised by this memorandum in the context of your particular circumstances.

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