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Canada

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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?**

There are two different markets for asset-backed securities (ABS) issued in Canada: asset-backed commercial paper (ABCP) and term ABS.

Nearly all ABCP is currently issued by ABCP conduits sponsored by the large Canadian banks. Banks provide liquidity facilities to their own conduits.

Term ABS may be issued publicly by means of a prospectus or can be issued in a private placement, typically by means of an offering memorandum.

According to DBRS, as at 31 December 2010, a total of Can$95.3 billion (as at 1 May 2011, US$1 was about Can$0.97) of notes was outstanding in the Canadian ABS market, down from Can$107.5 billion a year earlier. Of this amount, about Can$44.7 billion comprised term ABS, $25.1 billion consisted of ABCP and the balance was made up of structured notes (*see below*) and floating rate notes.

DBRS noted that, as at 31 December 2010, the following asset classes composed the major types of assets backing ABS and ABCP:

- Credit cards (29.9%).
- Commercial mortgages (20.7%).
- Residential mortgages (13.6%).
- Auto loans and leases (12.3%).
- Secured lines of credit (10.4%).
- Floorplan loans (4.3%).

Prior to 2008 there was also a market for non-bank-sponsored ABCP. Liquidity facilities for programmes in these ABCP conduits were provided by "third-party" banks. About two-thirds of the assets in these conduits were synthetic assets, typically leveraged credit default swaps (CDS). Third-party liquidity facilities were subject to a condition precedent to draws that there had to be a "general disruption in the Canadian commercial paper market". These liquidity facilities (referred to as general market disruption (GMD) liquidity) carried with them lower regulatory capital requirements than liquidity facilities that were not subject to this condition (referred to as global style liquidity).

In August 2007, in the face of margin calls being made by counterparties to the leveraged CDS and liquidity calls being made on the liquidity providers (who were usually the same as the CDS counterparties), a standstill was negotiated among a number of interested market participants. This ultimately led to a court-supervised restructuring of approximately Can$32 billion of third-party ABCP into long-term structured notes. Since August 2007, only bank-sponsored ABCP has been issued in Canada, and since January 2008, only global style liquidity has been acceptable to all rating agencies and the regulatory relief afforded to GMD liquidity facilities in Canada has been eliminated.

Beginning on 31 March 2008, the Bank of Canada began accepting certain ABCP as collateral for loans under its Standing Liquidity Facility. This provided assistance to Canadian banks during the tightest period of liquidity shortage in 2008 and 2009.

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?**

No specific enabling legislation facilitates securitisation in Canada. However, several laws affect Canadian securitisation.

Specific securities law rules address the public distribution of ABS in Canada. Each of the ten provinces and three territories has its own securities commission, or equivalent body, that regulates the distribution of securities in its jurisdiction. All securities commissions co-operate in a body called the Canadian Securities Administrators (CSA).

Certain transactions are subject to various federal and provincial laws depending on the type of assets being securitised, and the nature and domicile of the originator. Applicable insolvency laws are relevant to the bankruptcy remoteness of securitisation structures.

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

The usual reasons for securitisation are to obtain lower cost financing as compared with other sources of funding or to provide an alternative source of financing.

Accounting practices

With the adoption of IFRS in Canada for all public issuers for fiscal years commencing on or after 1 January 2011, it has become much more difficult to achieve off-balance sheet treatment for securitisation transactions in Canada. The achievement of off-balance sheet treatment is no longer a major reason for securitisation in Canada. Whole loan sales are generally used to achieve off-balance sheet treatment.

Capital adequacy

Guideline B-5 of the Office of the Superintendent of Financial Institutions (OSFI) governs the methodology for assigning risk weighting to various securitisation exposures of federally regulated financial institutions (FRFIs). OSFI is responsible for implementing the amendments to Basel II, dealing with specific securitisation issues and implementing the Basel III capital accord for FRFIs.

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?**

Traditionally, the SPV that issues ABS or ABCP (Issuer SPV) normally takes the form of an "orphan" trust. The trust is established by a licensed trust company, as trustee, which then appoints the sponsor of the securitisation programme as its agent to administer the trust. The beneficiary of the trust is normally a charity or not-for-profit entity selected by the administrator from time to time. For a properly constructed trust, if the trustee becomes insolvent, it should be possible to replace the insolvent trustee with a new trustee without the assets of the trust becoming subject to the trustee's insolvency.

No particular regulatory requirements apply to SPVs in Canada.

Securitisation transactions in Canada can be structured either as one-step or as two-step transactions. In a one-step transaction, the originator sells its receivables to the Issuer SPV. In a two-step transaction, the originator sells its receivables to an intermediate SPV (Intermediate SPV) and in the second-step sale the Intermediate SPV sells receivables to, or borrows money on a secured basis from, the Issuer SPV. The Intermediate SPV normally takes the form of a corporation or a limited partnership in which the originator owns 100% of the economic interest.

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

SPVs are normally established in Canada.

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?

It is possible to reduce (but not eliminate) the risk that an SPV may become subject to insolvency proceedings. Steps that may be taken include:

- Limiting the activities of the SPV so that its creditors will be unable to subject it to bankruptcy proceedings.
- Isolating the SPV from the originator in the securitisation programme so that creditors of the originator will be unable to consolidate the SPV in the insolvency proceedings of the originator (*see Question 7*).

Steps to limit the activities of the SPV itself include:

- Limiting the powers of the SPV in its constating documents.
- Requiring non-petition agreements from all contractual counterparties.
- Ensuring that all contractual obligations of the SPV stipulate that the remedies of contractual counterparties or creditors are limited in recourse to particular assets of the SPV.
- Ensuring that a securitisation transaction is structured to avoid giving rise to tax liabilities of the SPV.
- Stipulating in the SPV's constating documents that it cannot be terminated, wound-up or dissolved until one year after all its liabilities have been satisfied.

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?

There is a risk that creditors of the originator could look to the assets of the SPV in the following circumstances:

- A court could re-characterise the sale of receivables by the originator to the SPV as a secured loan from the SPV to the originator whereby the originator has only granted security over such receivables (*see Question 16*).
- A court could determine that the failure of the SPV to perfect its assignment from the originator results in the SPV being subordinated to the rights of third parties (*see Question 12*).
- A court could exercise the equitable remedy of substantive consolidation in the course of insolvency proceedings initiated by or against the originator.

  Since substantive consolidation is an equitable remedy, the risk that it may be applied cannot be eliminated. However, to reduce the risk of substantive consolidation, the following steps can be taken:

  - the Issuer SPV can be established as an orphan trust legally under the control of an arm's-length trustee, with no beneficiary having a right to terminate the trust;
  - an Intermediate SPV that is wholly-owned by the originator can be required to have an independent director who would be required to approve any fundamental change (such as amalgamation, winding-up or sale of substantially all assets of the Intermediate SPV);
  - the SPV can be made operationally separate from the originator through the following means:
    - the SPV can have its own bank accounts to pay its liabilities;
    - the SPV can have its own financial statements prepared;
    - the liabilities of the SPV should not be guaranteed by the originator;
    - the SPV should be represented to public investors and to creditors of the originator as a separate entity.

THE SECURITIES

Issuing the securities

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

ABCP is issued privately under exemptions from the registration and prospectus requirements of Canadian securities law.

Term ABS can be offered either publicly under a prospectus or through a private placement on a prospectus-exempt distribution to accredited investors.

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.**

ABS is typically not listed on any regulated exchange. The dealers involved in the distribution of a particular series of ABS are usually expected to make a market in such securities.

Constituting the securities

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

The trust concept is recognised in Canada. The issue of debt securities is typically governed by a trust indenture between the SPV and an indenture trustee that holds the rights granted under the trust indenture for the benefit of noteholders and other secured creditors of the SPV.

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 largest classes of securitised receivables in Canada are:

- Credit cards.
- Commercial mortgages.
- Residential mortgages.
- Auto loans and leases.
- Secured lines of credit.
- Floorplan loans.

Other asset classes that have been securitised in Canada include trade receivables, equipment leases, auto rental, auto fleets, reverse mortgages, water heater rentals and mutual fund deferred sales charges.

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, subparticipation, 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

Sales are structured as absolute assignments. There are no rules, requirements or exemptions that apply specifically to transfers of receivables in a securitisation transaction.

Three different approaches are generally used for the transfer of receivables:

- The originator may assign receivables to the applicable SPV for a closing payment and a right to receive a deferred purchase price out of excess cash flow periodically as the receivables amortise, as well as at the end of the transaction.
- The originator may assign a co-ownership interest in a pool of receivables to the SPV, and the co-ownership agreement will stipulate how the cash flow generated by the revolving pool of assets is to be allocated between the SPV and the originator.
- In a two-step transaction, the originator assigns receivables to a wholly-owned bankruptcy-remote Intermediate SPV for a closing payment, with the balance of the purchase price represented by equity or subordinated debt issued by the Intermediate SPV to the originator. The Intermediate SPV then assigns the receivables to the Issuer SPV in one of the two manners described above.

Obligors are not required to be notified of the assignment of their receivables to effect an absolute assignment, unless the terms of the contract giving rise to the receivables specified that they are not assignable without the consent of, or notice to, the obligor. However, until notified of the assignment, the obligor can discharge its debt by making payment to the originator.

Perfection of the transfer

In each of the common law provinces (all provinces other than Québec), perfection is governed by that province's Personal Property Security Act (PPSA). Under the PPSA, an absolute transfer of receivables is deemed to be a security interest. For the transferee to take priority in those receivables over third parties, the deemed security interest must be perfected, usually by registering a financing statement in the PPSA registry in the province where the assignor is located for purposes of the PPSA.

In Québec, an assignment of receivables can be rendered opposable to the obligor and third parties by registration only if the receivables transferred constitute a "universality of claims". If the receivables do not constitute a universality of claims, the assignment can be perfected in relation to Québec obligors only by providing evidence of the assignment to such obligors. Considerable uncertainty exists about what constitutes a universality of claims, but it is generally accepted that a sale of all receivables of a particular type generated by the originator between two specified dates would constitute a universality of claims.

In each of the common law provinces, an assignment of interests in real property (such as mortgages) is perfected by registering the assignment in the applicable land titles or land registry office. Usually, originators anticipating the sale of mortgages by securitisation will arrange for their mortgages to be originated in the name of a licensed trust company as nominee and custodian for the benefit of the beneficial owner in order to obviate the need to reassign the mortgages for the securitisation. Where mortgages are not registered in the name of a custodian or nominee, registration of assignments is typically not made at the closing of the securitisation transaction; instead, assignors will deliver a power of attorney in registrable form, which may be used by the transferee to register mortgage assignments at a later date.

In Québec, claims under a mortgage (loan secured by immovable hypothec) constitute personal (movable) property and perfection is obtained in the same manner as for other receivables, that is, by registration at the personal property security register (and not the land registry office) in the case of a universality of claims, or otherwise by providing evidence of the assignment to the obligor.

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

It is possible to securitise future receivables in Canada, although the assignment will take place only once the receivable comes into existence.

There are statutory procedures for assigning government receivables (including tax refunds) and so these are rarely securitised, except in a context where there is a specific large government contract, such as a commercial lease, where the necessary procedures are observed.

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

Security interests securing the receivables transferred to the SPV are assigned together with the receivables. Under the PPSA, the registration of an assignment of a security interest by the secured party is optional; such registration is not necessary to maintain perfection of the original security interest. Since the originator is also normally appointed as the servicer of the receivables, it is rare to effect these registrations at the time of a securitisation. However, if a replacement servicer is appointed, such registrations would be effected by or on behalf of the SPV at that time. Under the Québec Civil Code, the need to register an assignment of a security interest depends on the type of security interest involved.

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

Contractual restrictions on the assignment of receivables are not binding on third party assignees. Therefore, an assignment of "non-assignable" receivables may be perfected. However, an assignment of an undivided interest in a receivable (rather than the entire receivable) would remain subject to contractual restrictions.

A non-assignment clause may provide a defence to an obligor that insists on satisfying its contractual obligation by paying the originator rather than the SPV. Therefore, the assignment of non-assignable receivables would still subject investors to originator bankruptcy risk. Furthermore, if the SPV accepts an assignment of a non-assignable receivable knowing that it is non-assignable without the consent of the obligor (or the SPV is reckless in its failure to investigate the possibility of such contractual restriction), the SPV may become subject to a claim by the obligor under the common law tort of inducing breach of contract.

Legislative restrictions

There are restrictions regarding the assignment of government receivables (*see Question 13*).

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? Are true sale legal opinions typically delivered in your jurisdiction or does it depend on the asset type and/or provenance of the securitised asset?

There is a risk of a court re-characterising a sale of receivables as a secured loan. True sale legal opinions are typically delivered in Canadian securitisation transactions. The most important factor in determining if there has been a true sale is the intention of the parties, as evidenced by the documents, communications and conduct of the parties. The most important indication of the intention that an arrangement is a secured loan is the existence of a right of the originator to require that the receivables sold be reassigned to it.

In the only reported judicial decision in Canada that considered the issue of the re-characterisation of a sale in a securitisation context, the court listed the following factors, in addition to the intention of the parties, to be considered in determining whether a transaction constitutes a true sale:

- The transfer of ownership risk and the level of recourse.
- The ability to identify the assets sold.
- The ability to calculate the purchase price.
- Whether the return to the purchaser will be more than its initial investment and a calculated yield on such investment.
- The right of the seller to retain surplus collections.
- A right of redemption by the seller.
- The responsibility for collection of the receivables.
- The ability of the seller to extinguish the purchaser's rights from sources other than the collection of the receivables.

Of these factors, it is likely that the only one that is determinative of the issue by itself is the presence of a right of redemption. In determining whether there is a right of redemption, the court merely looked at whether there was a contractual right of the seller to repurchase or redeem the purchased receivables and did not infer that there was such a right on the basis of an economic analysis of the transaction.

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?

Numerous statutes may be relevant in connection with the insolvency of the originator (collectively, Insolvency Statutes), including the Bankruptcy and Insolvency Act (Canada), the Companies' Creditors Arrangement Act (Canada), the Winding-up and Restructuring Act (Canada) and various provincial fraudulent preference and fraudulent conveyance statutes.

Under the Insolvency Statutes, certain transactions by an originator may be overridden or set aside in certain circumstances, including the following:

- A transfer of property made with the intention of defeating or defrauding creditors or others in relation to their claims against the originator.
- A transaction that is entered into by an insolvent originator (or an originator that knows that it is on the verge of insolvency):
  - with the intent to defeat or prejudice its creditors;
  - with a creditor with the intent to give that creditor preference over the other creditors of the originator; or
  - with a creditor and that has the effect of giving that creditor a preference over other creditors of the originator.
- A gratuitous conveyance made within three months immediately preceding the commencement of a winding-up proceeding.
- A contract whereby creditors are injured or delayed, made by an originator unable to meet its engagements with a person who knows of that inability or who has probable cause for believing that such inability exists.
- A conveyance for consideration whereby creditors are injured or obstructed, made by an originator unable to meet

its engagements with a person ignorant of that inability and before that inability has become public, but within 30 days before the commencement of a winding-up proceeding.

- A sale, deposit, pledge or transfer of any property by an originator in contemplation of insolvency by way of security for payment to any creditor whereby that creditor obtains or will obtain an unjust preference over other creditors.

In addition, under the sale at undervalue provisions of the Bankruptcy and Insolvency Act, a court may review a disposition of property for which the consideration received by the originator is conspicuously less than the fair market value of the receivables sold by the originator who becomes insolvent or bankrupt.

Bulk sales legislation applies in certain provinces if there is a sale of tangible assets (such as leased autos or equipment) out of the ordinary course of business. Failure to comply with applicable bulk sales legislation could make the transferee SPV responsible for losses suffered by the creditors of the originator (up to the value of the transferred assets).

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?

In Canada, it is most common for parties to select Ontario law to govern their agreements in securitisation transactions, particularly where Ontario counsel is expected to provide an opinion on the true sale of receivables. Ontario law would recognise the choice of law of a foreign jurisdiction (foreign law) in agreements subject to certain qualifications, including the following:

- The parties' choice of foreign law was bona fide and they had no reason for avoiding the choice on the grounds of Ontario public policy.
- Notwithstanding the parties' choice of law, an Ontario court:
  - will not take judicial notice of the provisions of the foreign law but will apply such provisions only if they are pleaded and proven by expert testimony;
  - will apply Ontario law that would be characterised as procedural; and
  - will apply provisions of Ontario law that have overriding effect (for example, certain enforcement provisions of the PPSA would take priority over inconsistent remedy provisions in a security agreement governed by foreign law).

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.

The SPV would grant a security interest in all of its present and future assets to an indenture trustee for the benefit of ABS investors and other secured creditors. Where a series of notes is secured by a specific pool of receivables with recourse limited to these receivables, the security interest granted to the indenture trustee for that particular series of ABS would be limited to that pool of receivables and related assets, such as specified bank accounts. The security interest would be perfected in PPSA provinces by registration of a financing statement against the SPV.

To take security in Québec, the SPV must enter into a hypothec that would be perfected by registration at the Québec personal property register. The hypothec must be executed before a Québec notary.

Provincial car registration systems do not record liens. Security over cars is therefore perfected under the applicable PPSA or Québec Civil Code.

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 a trust (for example, the security trustee providing some form of consideration)? Are foreign trusts recognised in your jurisdiction?

All common law provinces recognise the trust concept. Québec also recognises the concept of a trust indenture provided certain formalities are followed.

A trust in a common law province must have all of the following:

- A trustee (generally a trust company licensed across the country).
- Trust property.
- One or more beneficiaries.

Trusts validly established under foreign law would generally be recognised as such if they satisfy the three requirements noted above.

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 following are the most common methods of credit enhancement:

- Excess spread.
- Over-collateralisation.
- Cash reserve accounts.
- Letters of credit posted by third party credit enhancers.
- Senior/subordinated capital structure.

No monoline financial guarantee insurers are licensed in Canada, although there have been transactions whereby monoline insurers have provided credit enhancement outside Canada in relation to the risks of credit default on Canadian receivables. However, following the credit crisis in 2007, the use of financial guarantee insurance in Canada came to a halt and has not yet been revived.

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?

Term ABS transactions do not commonly provide for liquidity support, other than for swap agreements to hedge specific interest rate or currency exposures, for servicer advances in certain monthly pay transactions or for certain types of credit enhancement (*see Question 21*). One exception is that amortising assets are sometimes funded using semi-annual pay bullet maturity notes as Canadian investors demand a premium for accepting monthly pay pass-through notes. Liquidity support for bullet notes is provided by the issuance of a variable funding note (VFN) to a bank or a bank-sponsored ABCP conduit. The VFN absorbs the monthly payments, and commitments to advance under the VFN can be renewed on an annual basis to fund payment of bullet notes on their maturity. If the VFN lender elects not to advance funds to repay bullet notes at maturity and an alternative VFN lender cannot be found, the bullet notes convert to monthly pay pass-through notes.

Rated ABCP conduits must have liquidity support for the principal and interest of all outstanding ABCP, other than extendable ABCP. Liquidity support is generally provided by committed credit facilities or asset-purchase agreements.

To avoid being treated as credit enhancement for regulatory capital purposes, liquidity provided by FRFIs must qualify as an eligible liquidity facility under OSFI Guideline B-5. Among other things, these facilities:

- Should not provide credit support or fund prior losses.
- Must benefit from first and subsequent loss enhancement.
- Must rank *pari passu* with claims of senior securities and be fully secured by underlying collateral.

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.

In Canada, most originators are not required to establish lockbox or blocked accounts to receive payments on account of receivables. Investment grade originators are normally permitted to remit collections on a monthly basis and non-investment grade originators must remit collections within two days of collection.

In some transactions, there are separate cash flow waterfalls for interest collections and for principal collections.

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 most common method of profit extraction depends on the type of transaction structure used (*see Question 12, Transfer of the receivables*). For the sale of a discrete pool of receivables, the most common method is a deferred purchase price paid out of excess spread each month and by a reassignment of over-collateralisation and cash reserves at the end of the transaction. If there is a sale of a co-ownership interest in a revolving pool of receivables, the most common method of profit extraction is the use of an allocation formula in the co-ownership agreement. Since servicing fees are subject to goods and service tax (GST) or harmonised sales tax (HST) (*see Question 26*), servicing fees are typically not used to extract profit.

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 has a sovereign debt rating of AAA with stable outlook from DBRS, Standard and Poor's, Moody's and Fitch. Each rating agency. Each publishes the factors that they consider in arriving at its sovereign debt ratings.

The authors are not aware of any factors specific to Canada that would affect the ratings of Canadian ABS.

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?**

No stamp taxes or other transfer taxes apply to the sale of Canadian receivables.

The federal government imposes GST and some provinces impose a provincial sales tax (PST) that is combined with GST into a blended HST. Certain provinces, including Québec, maintain their own PST. These taxes apply to the transfer of certain

tangible assets, such as leased cars and equipment. Dealing with transfer taxes associated with the transfer of leased equipment is complex and requires specialised tax advice.

Servicing fees are also subject to GST or HST. Generally, no GST or HST is applicable to receivables that are sold on a fully serviced basis whereby the servicing component is an ancillary part of the receivables and no separate servicing fee is charged. Therefore, it is most common in Canada not to specify a separate servicing fee but instead to sell the receivables on a fully serviced basis. However, if a replacement servicer is appointed, the replacement servicing fees would be subject to GST or HST. The GST rate is 5%. The HST rate depends on the province. For example, in Ontario it is 13% and in Québec there is a combined GST and PST rate of 13.92%.

Withholding tax

Canada has now fully eliminated withholding tax on interest paid to arm's-length lenders, other than participating debt interest. Therefore, notes can be issued by Canadian issuers to non-Canadian investors free from withholding tax.

Similarly, Canadian receivables, other than those that produce lease or royalty payments and dividends, sold to a non-Canadian SPV will not be subject to Canadian withholding tax. However, due to concerns about a non-Canadian SPV becoming subject to Canadian tax by virtue of carrying on business in Canada through the servicing of the Canadian receivables, it is more common for an intermediate Canadian SPV to be established, which would then issue an interest-bearing note to a non-Canadian SPV.

Withholding tax of 25% is generally payable on most cross-border lease, royalty and dividend payments, subject to reduction through bilateral tax treaties.

Capital tax

Trusts were initially used as SPVs in Canada because they are not subject to capital tax. An off-balance sheet securitisation between a corporate originator and a trust SPV could therefore result in an overall reduction of capital tax. This benefit has effectively been removed by the elimination of federal capital tax and the reduction of provincial capital taxes over the past decade, coupled with difficulty in achieving off-balance sheet treatment for securitisations under IFRS.

Tax neutrality

A trust pays income tax on its net income at the highest marginal rate for individuals. Therefore, cash flows are structured so that the income of the trust matches its expenses (such as interest payable to investors, fees payable to trustees and the deferred purchase price payable to the originator), except for a small amount of income distributed to its beneficiary and taxed to the beneficiary.

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 through CDS was very common in Canada between 2004 and mid-2007 (*see Question 1*). This market was funded primarily through ABCP conduits dependent on third party (non-sponsor) liquidity facilities. This market was restructured in a court-supervised restructuring that was completed in January 2009. While it is still possible to effect synthetic securitisations in Canada, they have very much fallen out of favour except in connection with private CDS transactions.

OTHER SECURITISATION STRUCTURES

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

Most of the structures set out in the Model Guide (namely, single issue SPVs, multiple issue SPVs, master trusts and multi-seller conduits) are used in Canada. Structured investment vehicles (SIVs) are not currently in use.

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?

Legislative

The March 2010 federal budget announced an intention to introduce covered bond legislation. As at the time of writing, no bills have yet been introduced.

Securities Regulation

In July 2010, the CSA published a proposed National Instrument (NI) 25-101 (Designated Rating Organizations, Related Policies and Consequential Amendments), which, among other things, requires designated rating organisations to adopt and publish their conflict-of-interest procedures. A slightly revised version of proposed NI 25-101 was released on 18 March 2011 with a comment period ending on 17 May 2011. The final version of NI 25-101 is expected to be released before the end of 2011.

On 1 April 2011, the CSA issued a comprehensive set of new rules relating to the distribution of securitised products in Canada (Securitization Proposals). The Securitization Proposals:

- Revise prospectus disclosure requirements.
- Revise continuous disclosure and certification requirements.
- Revise exempt distribution rules.

The comment period for the Securitization Proposals ends on 1 July 2011. Revised proposals are expected to be released before the end of 2011, following which there will be a further comment period. The new securitisation rules are expected to be finalised by the CSA in the first half of 2012.

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Represented:

- The Toronto-Dominion Bank on Canadian aspects of its acquisition of Chrysler Financial for US$6.3 billion.
- Business Development Bank of Canada in the design and implementation of the Can$12 billion Canadian Secured Credit Facility to restart Canada's term ABS market in 2009 and 2010.
- National Bank of Canada and its affiliates in the restructuring of Canada's Can$32 billion third party ABCP market.

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Represented:

- Ally Credit Canada and CCARAT II in numerous public offerings of car loan receivables-backed notes.
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