October 25, 2010

BY FAX AND EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
Office of the Attorney General, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Government of Yukon
Registrar of Securities, Department of Justice,
Government of the Northwest Territories
Registrar of Securities, Legal Registries Division,
Department of Justice, Government of Nunavut

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Dear Sirs/Mesdames:

Re: Comments on Proposed National Instrument 25-101 *Designated Rating Organizations* (the "Proposed Instrument" or "NI 25-101")

We are responding to your request for comments on the proposed NI 25-101. Section A of this letter consists of our response to the specific requests for comment in Annex B of the Notice and Request for Comment on NI25-101 released on July 16, 2010 (the "Notice"). Section B of this letter consists of additional comments that we have. The comments in this letter are limited to the role of credit rating agencies or organizations ("CROs") in rating structured finance instruments such as asset-backed securities ("ABS").

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Under the Canadian Government's economic stimulus plan, to help resolve the recent economic crisis, the 2009 Federal Budget named BDC as the institution that would be responsible for managing the $12 billion Canadian Secured Credit Facility ("CSCF"). Under the facility, the BDC was to help provide credit to the auto and equipment sector in order to provide credit to businesses and consumers to maintain economic growth. The mechanism for the provision of credit was to be direct acquisition of term ABS. Under the program, BDC acquired a portfolio of $3.5 billion of ABS, which helped establish benchmark pricing for the securitization market in the third quarter of 2009, a market which had seen almost no public activity for two years.

As one of the largest holders of ABS in the Canadian capital markets, BDC is keenly interested in the current proposals regarding the Proposed Instrument. As one of the objectives of the CSCF was to restart the ABS market, BDC is also interested in the impact of regulation on this important source of financing for Canadian consumers and businesses.

Section A - Specific Requests for Comment

1. The Notice requests comment on whether Section 7 of the Proposed Instrument (which provides that a Code of Conduct must specify that waivers of the Code are prohibited) is feasible or achieves its purpose.

BDC believes that this requirement is feasible and is a desirable feature of the Proposed Instrument that will lead to enhanced transparency. We note that while the Proposed Instrument prohibits waivers, it does permit amendments to be made to a CRO's Code of Conduct, but these amendments must be filed with the Canadian Securities Administrators (the "CSA") and prominently posted on the CRO's website, thereby making all such amendments to the CRO's Code of Conduct publicly available. In the absence of Section 7 of the Proposed Instrument, waivers to a CRO's Code of Conduct could be made by the CRO without any public notification.

A waiver amounts to an exception to the CRO's general Code of Conduct. Where a CRO believes that an exception should be made in a particular instance, it should be required to articulate the factors leading to the conclusion that the exception should be made and these factors should then be reflected in an amendment to the CRO's Code of Conduct rather than as an *ad hoc* waiver. In this way, the factors leading to the CRO's decision would be publicly available.

2. The Notice requests input on certain questions relating to personal information forms ("PIFs") for each director and executive officer, as well as the compliance officer, for each applicant to be designated as a CRO.

Since PIF's are not intended to be made publicly available, BDC has no comment. We believe that the questions relating to the PIFs ultimately depend upon what the CSA intends to do with the information. The requirement for PIFs ought not to be a meaningless make work exercise for CROs.

3. The Notice requests input on the factors used to determine the principal regulator for a CRO's designation application.

BDC has no views as to who and under what circumstances the principal regulator should be.

4. The Notice seeks input on whether an exemption for CROs whose rating is referred to in a prospectus from filing an "expert's consent" with securities regulators continues to be appropriate in Canada.

In July 2010, with the passage of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act"), the exemption from civil liability for NRSROs was suspended in the United States. The outcome has simply been that NRSROs have refused to allow their ratings to be included in prospectuses. Although investors have access to ratings other than pursuant to prospectuses, the refusal by rating agencies to permit their ratings to be included in prospectuses is in no way helpful to investors. This situation in the United States is even more acute in connection with shelf prospectus offerings of ABS governed by Regulation AB. The current Regulation AB stipulates that one of the eligibility criteria for issuing ABS pursuant to a shelf-prospectus is that the rating of the ABS be disclosed in the prospectus. Since rating agencies have been refusing to permit their ratings to be disclosed in prospectuses until such time as they determine the increased risk that this presents to them under the Dodd-Frank Act and how they will be compensated for assuming such additional risk, the SEC was forced to provide a six-month no action period whereby it suspended the requirement for disclosing ratings in ABS prospectuses as an eligibility criteria under Regulation AB.

BDC believes that it serves no purpose to change the liability profile of rating agencies at this time. Ultimately, the investor will end up paying the increased cost; or, alternatively, rating agencies will simply refuse to permit their ratings to be disclosed in prospectuses. Neither of these alternatives are particularly helpful to investors. The financial resources of even the largest rating agencies in the world are insignificant when compared to the degree of exposure that they could be subject to if they were liable to be sued every time investors lose money on a rated instrument.

Section B - Other Issues

5. BDC requests the CSA to consider imposing a requirement on all CROs for structured finance products to publish a notice each time that an issuer, sponsor or underwriter of a structured finance (including ABS) offering (collectively, the "Arranger") provides it with data in order to initiate a ratings process where the transaction proceeds but such CRO is not hired to provide a rating. This requirement would be intended to discourage "ratings shopping". In the past, it has not been uncommon for Arrangers to provide data in connection with a structured finance product to three or four different CROs and then select only the two CRO's that will provide a AAA rating with the smallest amount of required credit enhancement.

We note that fundamental challenges still exist in regaining investor confidence in the rating agency system. One of the most significant issues is the conflict of interest inherent in a model where the recipient of the rating is paying for this service. While we recognize this is a longstanding situation, we think the insertion of an impartial entity to manage the relationship between issuers and rating agencies, for the protection of investors, should be considered in the context of the Notice.

6. As part of the conflict of interest provisions in the Proposed Instrument, Section 8(d) provides as follows:

> "A designated rating organization must not issue or maintain a credit rating ... with respect to a security where the designated rating organization or a person or company that is an affiliate or associate of the designated rating organization made recommendations to the issuer, underwriter, or sponsor of those securities about the corporate or legal structure, assets, liabilities, or activities of the issuer of the securities".

It is important to note that this restriction on making recommendations is relevant not only at the time that the initial rating is determined but also throughout the entire period that the rating is maintained.

Many structured finance transactions provide for numerous situations where amendments or waivers to a structured finance program can only be made if they satisfy a "rating agency condition" or "RAC". There is no single definition of RAC, but a typical one is:

> "Rating Agency Condition" means, with respect to any proposed action or determination in relation to or affecting any **[applicable ABS]**, that the Rating Agency shall have notified the **[Issuer of the relevant ABS]** in writing that the Rating Agency either (i) consents to such action or (ii) such action will not cause a reduction or suspension of the Rating Agencies then rating of the **[relevant ABS]**.

BDC has two issues with the practice of taking proposed actions based on satisfying a RAC rather than obtaining the approval of investors. The first is that the process of seeking a consent from the relevant CRO is as much an invitation to the CRO to make recommendations to the issuer of the ABS as is the seeking of the initial rating. Consequently, it is important to ensure that the CRO not be engaged in negotiations with the issuer with respect to any matter for which the RAC is to be satisfied. The response from the CRO to any such request should simply be a statement that the action will not result in a reduction of the rating as proposed or that it will or might result in a reduction or withdrawal of the rating. It is inappropriate to seek consent from a CRO with respect to a proposed action any more than it is appropriate to seek consent of a CRO to the way in which a transaction will be structured in the first place.

Secondly, in many cases it is possible for the issuer to take actions affecting ABS by means of satisfying the Rating Agency Condition without the investors even being made aware of the fact that such actions have been taken. Granted there are continuous disclosure obligations on issuers of public ABS to disclose material changes. However, investors are never asked for their views as to what change may constitute a material change. It would be very desirable from an investor's perspective to impose an obligation on any CRO rating a structured finance instrument that provides the necessary notification in writing to satisfy a RAC to disclose the fact that such notification was provided and indicating what the proposed action was. At lease in this way investors will be kept apprised of any changes to the programs that they invested in and, if they feel it is warranted, would then be free to exercise whatever rights or remedies they may have.

Yours very truly,

Paula L. Cruickshank
Vice President, Securitization