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BY E-MAIL & COURIER August 30, 2011

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- and -

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Dear Sir/Madame:

Re: Comments re Proposed Securitized Products Rules

Attached please find our comments regarding the Proposed Securitized Products Rules.

Yours truly,

Michael D. Rumball

MDR/sd
Encl.

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August 30, 2011

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
New Brunswick Securities Commission
Office of the Attorney General, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Government of Yukon
Superintendent of Securities, Department of Justice,
Government of the Northwest Territories
Superintendent of Securities, Legal Registries Division,
Department of Justice, Government of Nunavut

Dear Sirs/Mesdames:

Re: Proposed Securitized Products Rules

This letter is submitted in response to the request for comments by the Canadian Securities Administrators in its April 1, 2011 release referenced above. Thank you for the opportunity to comment on these proposals.

This letter represents the general comments of certain individual members of our structured finance and securities practice groups (and not those of the firm generally or any client of the firm other than those specifically referenced below) and are submitted without prejudice to any position taken or that may be taken by our firm on its own behalf or on behalf of any client. Subject to any letters submitted by any of the following parties, the views expressed in this letter are supported by Central 1 Credit Union, Mercedes-Benz Financial Services Canada Corporation, Nissan Canada Inc., TAO Asset Management Inc. and Xceed Mortgage Corporation.

I Executive Summary

As recognized in the request for comments, securitization represents an important source of credit to the economy. Other than with respect to portions of

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the Canadian ABCP market that were backed directly or indirectly by U.S. sub-prime residential mortgages, the financial crisis in Canada was purely a liquidity crisis and did not reflect unsoundness of Canadian assets or structures. The Canadian securitization market did not experience a sub-prime mortgage bubble nor did any of the other asset classes experience undue losses. Accordingly, any regulatory changes to the eligibility of assets for funding in the securitization market or to the range of structures that are available to facilitate such funding cannot be justified on the basis that such changes would result in enhanced creditworthiness. In their guiding principles and in the proposals, the CSA have recognized this reality and we commend the disclosure-oriented approach taken by the CSA while at the same time recommending a greater emphasis on the promotion of liquidity.

As discussed in further detail below:

1. The definition of securitized product should be amended by ensuring that its application is restricted to securities which are issued in multiple tranches by a special purpose entity which grants to investors some sort of property interest in a pool of assets from multiple obligors segregated from the risk of other creditors.

2. A general safe harbour that defines conditions under which a security should not be considered to be a securitized product should be created. Specifically, we suggest that any security that is (directly or indirectly through a guarantee) a full recourse, general obligation of any entity that is not a special purpose entity should not be subject to the securitized product rules even if it is collateralized by self-liquidating assets.

3. Apart from specific recommendations, the proposals for prospectus disclosure are appropriate and sufficient to promote the CSA's primary objective of enhanced disclosure.

4. While we support the elimination of the retail end of the market as evidenced by the new definition of eligible securitized products investor, we are concerned that the elimination of many of the other available exemptions will unduly reduce liquidity.

5. It is essential that investors, or at least a class of investors with established expertise in dealing with securitized products, be allowed to waive the requirement to deliver an information memorandum without affecting the issuer's access to the prospectus exemption.

6. While we agree that enhanced disclosure is appropriate for information memoranda for short-term securitized products, it will be practically impossible for securitized commercial paper issuers to continually maintain certain of the requirements, specifically those dealing with transaction descriptions and asset pool characteristics and performance. Any such requirements should be restricted to monthly continuous disclosure obligations.

II Comments

Our comments below have been organized in accordance with the subheadings and question numbers used in paragraph 7 of the Proposed Securitized Product Rules entitled "Questions on the Proposed Securitized Product Rules".

(a) General

1. **Principles.** You have asked for comments on the three principles that you have taken into account in developing the Proposed Securitized Products Rules. As motherhood statements, no one can take issue with these principles. However, as presently drafted, principles 1 and 2 are at least partially duplicative in that they both endorse transparency as a critical feature of a reformed market for securitized products. Liquidity in the Canadian term ABS market disappeared in the wake of the collapse of the US sub-prime residential mortgage market neither because of any exposures to those products in Canadian term programs nor due to any underperformance of any assets funded through these programs. The occurrence of catastrophic downgrades and defaults of securities backed directly and indirectly by US sub-prime residential mortgages (including ABCP issued by Canadian conduits other than those sponsored by the Big 6 Canadian banks) washed away confidence in the reliability of the ratings of ABS products. Without ratings to rely upon as a basis for liquidity, secondary markets for term ABS disappeared and spreads widened dramatically as holders were forced to mark their books on the basis of small volumes of trades executed by distressed sellers. This is the phenomenon that must be addressed by market reform: the excessive reliance upon ratings as the basis for ABS liquidity. Enhanced transparency is clearly one way of ensuring that investors have the means of undertaking independent analysis to value and trade ABS, and that aspect of reform is covered off by the first stated principle. However, rather than restating the commitment to transparency in the second principle, it might be more valuable to state the second principle more broadly, substituting the word "liquidity" for the word "transparency" in the first sentence of the second principle as follows:

> "The rules should facilitate liquidity in the securitization market so that it can function even in times of financial stress..."

2. **Risk Retention Rules.** You have asked whether it is necessary or appropriate to make rules prescribing mandatory risk retention for securitized products in order to mitigate some of the risks associated with securitization. You have cited, in this connection, the recent proposals under the Dodd-Frank Act and the SEC April 2010 Proposals. The U.S. proposals were made in response to specific industry conditions which by and large were not present in Canada. The 'originate-to-distribute' model of securitization which has attracted so much adverse attention in the U.S. was not in fact prevalent in Canada (except, perhaps, in the CMBS sector), at least not in the manner or to the degree which is said to have caused so much damage. In transactions involving most asset classes, Canadian originators in fact retained a significant amount of "skin-in-the-game". The financial crisis was

arguably the product of the radical and unregulated application of this model in the U.S. real estate sector alone and, as recognized in the introduction to the Proposed Securitized Product Rules, there was no subprime housing bubble in Canada. Canadian securitizations in general have not suffered anywhere near the level of losses that were experienced in the U.S. Many U.S. commentators have warned of the danger to the U.S. securitization market represented by the cumulative burdens which would be imposed by the implementation of the U.S. proposals.

For detailed critiques of the Dodd-Frank risk retention proposals and the danger which they represent to the securitization market in general, reference can be made to the responses of the American Securitization Forum and the Securities Industry and Financial Markets Association (SIFMA), each dated June 10, 2011. The former is especially insistent that those sectors of the securitization market which performed well during the financial crisis (which would include the entire Canadian bank-sponsored ABCP market) should not be subjected to undue constraints:

> "What is at stake is the risk of significant reductions in the availability of auto loans, mortgages, student loans, credit cards, and commercial credit all across America. Given that many engines of the U.S. economy are still sputtering and unemployment remains extremely high, the ASF advocates strongly that these rules not overreach to attempt to "fix" sectors of the securitization markets that did not see any losses during an extreme economic downturn and instead are now powering economic revival in some areas of the economy. Attempts to realign incentives in many types of securitization structures, where those incentives have demonstrated through strong performance to be well-aligned between issuer and investor, only serve to risk harm to the American economy, American consumer and to investors."

SIFMA also emphasizes the importance of a healthy securitization market to the general state of financial markets:

> "As the Agencies know, securitization is a key component of long term, stable funding for banks and other lenders. As much as mistakes in securitization were a detriment to safety and soundness over the past few years, going forward, responsible securitization must be a necessary component of bank capital and balance sheet management strategies. The recovery of these markets is critical to the provision of credit, the long term health of the banking system and the broader financial markets that interact with it. Therefore, rules that seek to address past bad practices

> must also foster active, liquid, and transparent markets in the future."

According to SIFMA, the Dodd-Frank proposals could be "*so burdensome that significant segments of the ABS market could simply shut down ... SIFMA has described the potential impact of the proposed risk retention rules as 'monumental' and we do not exaggerate*". We believe that if similar rules were to be imposed in Canada, where the market is much shallower than its U.S. counterpart, the impact would be, if possible, even more profound.

3. **Conflicts of Interest.** You have asked whether the Proposed Securitized Product Rules should include a prohibition similar to that contained in the Dodd-Frank Act which prohibits certain parties to securitized product transactions from engaging in any transaction that would involve or result in any material conflict of interest with respect to any investor in a sale of securitized products. The impetus behind the Dodd-Frank Act provision was the conflicts that arose in the U.S. on a few well-publicized occasions where financial firms that had designed certain highly-complex synthetic CDOs and sold them to their customers then allegedly entered into a transaction by which they would profit on the failure of the original transaction. If rules relating to conflicts are to be introduced they should be restricted to similar circumstances. A wider prohibition could inhibit many beneficial activities currently undertaken by market participants. For example, many underwriters of asset-backed securities provide transaction sponsors with short-term funding facilities whereby the underwriter or one of its affiliates provides financing to the sponsor to fund asset originations or purchases of assets. These facilities provide essential liquidity until the assets can be packaged through a term securitization and sold into the debt capital markets. As the proceeds from the securitization are used to repay the financing, a broad reading of material conflicts of interest could prohibit this financing arrangement, essentially cutting off one of the only available sources of credit in today's constrained market. Similarly, a broad interpretation of material conflicts of interest could prohibit servicers of mortgage loans, auto loans, and other assets who are affiliated with the sponsor of a transaction from pursuing customary servicing activities. (This may be of particular concern in Canada as the number of independent sub-servicers is extremely limited and each of them participate in the market in other capacities and any imposition of restrictive conflict of interest rules could be unfairly detrimental to them.) Further, many investors in asset-backed securities seek to invest in products that are denominated in a currency and/or are subject to interest rates that differ from that of the underlying assets, which require that the structures employ interest rate or currency swaps. The counterparties of these swaps are often the underwriters of the asset-backed transaction or an affiliate. An expansive interpretation of material conflicts of interest could prohibit such a party from providing such a swap, potentially depriving investors of important services.

4. **Independence.** You have asked whether there are circumstances where you should require that certain parties be independent from each other. We believe that there is no policy reason why parties to ABS transactions should be treated any differently than parties to other transactions. Accordingly, we do not believe that

there is any necessity to amend National Instrument 33-105 in order to require that an underwriter in a securitization be independent from the sponsor.

5. **Definitions.** You have asked whether the definition of "securitized product" is sufficiently clear. We have significant concerns with this definition as well as the embedded definition of "asset-backed security".

"asset-backed security"

The "asset-backed security" definition is the same as the current definition in NI 51-102, being "a security that is primarily serviced by the cash flows of a discrete pool of mortgages, receivables or other financial assets, fixed or revolving, that by their terms convert into cash within a finite period and any rights or other assets designed to assure the servicing or the final distribution of proceeds to securityholders".

The phrase "discrete pool of financial assets" presents several problems which, subject to our comment below, should be addressed in much the same manner as in U.S. Reg AB. For instance, in the context of the usual co-ownership structure used for revolving assets such as credit cards, a single pool could support multiple series of securities.

"securitized product"

Our initial comment on this definition is that the inclusion of asset-backed security as an example of a securitized product under paragraph (a) leaves room for interpretive confusion as the wording of the asset-backed security definition and paragraph (a) are similar but nevertheless not the same and the inclusion of the former as an example of the latter may colour the interpretation of the latter. We recommend that the definition of asset-backed security be either eliminated or else included as a separate paragraph in the definition of securitized product.

Paragraph (a) of the definition of securitized product is "a security that entitles the security holder to receive payments that primarily depend on the cash flow from self-liquidating financial assets collateralizing the security, such as loans, leases, mortgages and secured or unsecured receivables". Issues arise in respect of the meaning of the phrase "collateralizing the security". In a number of transactions, including most CMBS, the offered security represents a direct ownership interest in the underlying assets. The assets cannot really be said to "collateralize" the security in accordance with the usual meaning of the word.

In the proposed credit risk retention rules for securitizations recently released by the U.S. Securities and Exchange Commission and other federal regulators and agencies, it was thought necessary to clarify the meaning of the phrase "securities that are collateralized by self-liquidating financial assets" used in the definition of "securitized asset". It was stated that it does not imply any specific legal structure.

> "Assets or other property collateralize an issuance of ABS interests if the assets or property serves as

> collateral for such issuance. Assets or other property serve as collateral for an ABS issuance if they provide the cash flow for the ABS interests issued by the issuing entity (regardless of the legal structure of the issuance), and may include security interests in assets or other property of the issuing entity, fractional undivided property interests in the assets or other property of the issuing entity, or any other property interest in such assets or other property. The term collateral includes leases that may convert to cash proceeds from the disposition of the physical property underlying the assets. The cash flow from an asset includes any proceeds of a foreclosure on, or sale of, the asset."

The adoption of a similar provision would address issues of interpretation on each end of the spectrum. On one hand, by expanding the meaning of 'collateralize' to include any property interest in the assets from which the cash flow supporting the ABS is derived, it would provide more certainty that securities which have traditionally been considered to be ABS, such as CMBS and others which represent an undivided interest in the underlying property, will be caught. On the other hand, by insisting that some sort of property interest be present, the likelihood that the definition would be broadly interpreted to include securities that contain securitization or structured finance elements but would not traditionally be thought of, or categorized, as securitization or structured finance products would be reduced.

Many issuers of securities, including financial institutions, mutual funds, closed-end investment funds and certain income trusts and REITs, depending on their underlying structure and asset mix, may hold various self-liquidating financial assets and the cash flow to support payments to their securityholders may depend (primarily or not) on payments made on, or from the liquidation of, these assets. For example, shares in a money market mutual fund or other fixed-income oriented mutual fund could fit this definition. The assets are self-liquidating, the holder has the right to redeem the securities, and those redemption proceeds can only come from cash flows or sale proceeds.

Our concern is only exacerbated by the negative implication of the exclusion in s.3(2)(b) relating to securities, other than debt securities, issued by a mortgage investment entity, which is defined as a person or company

(a) who invests substantially all of its assets in debts owing to it that are secured by one or more mortgages, hypothecs, or other instruments, on real property; and

(b) whose primary purpose or business activity is originating and administering mortgage loans, with the intent of holding such mortgages for the entire term and of using the revenues generated by holding the mortgages to provide a return for its investors.

This would seem to imply that any security (including equity and corporate debt) issued by an entity whose primary business, and thus source for funding payment to investors, is the originating and administering of financial assets other than mortgages on real property, and any debt security, however structured (or for that matter unstructured), issued by a mortgage investment entity, may be a securitized product. Again, this would seem to imply that shares of a money market mutual fund would be caught.

While each of the foregoing examples of securities may in some way depend upon the cash flow from financial assets, in most cases such cash flow is not dedicated by way of a property interest to the payment of the securities, which we would suggest should be an essential element of securitized products. As indicated in the SEC note, such a property interest may be indirect, by way of a security interest granted to securityholders, or direct, by way of an undivided co-ownership interest in the underlying assets. We could take this further or, rather, look at it from another perspective. One of the hallmarks of ABS is that the assets producing the cash flows for investors are isolated from the seller of the assets into a special purpose entity, in a manner designed to minimize the risk that those assets will be consolidated with the estate of that seller in the event that it becomes bankrupt or insolvent. Without this legal isolation into a special purpose entity, the securities offered are, in our view, no more than secured corporate debt of an operating company. As discussed below, we do not believe securities that are, in substance, corporate debt present risks of the kind that should be included as securitized products and thus subjected to different rules. Therefore segregation of the assets from the risk of other creditors of the sponsor should be a key element of securitized products.

This emphasis on the segregation of the assets would also help eliminate the danger that certain purely commercial arrangements could be characterized as securitized products. For instance, it is not uncommon for two (or more) entities to enter into contractual arrangements by which their respective interests in a pool of mortgages are divided into senior and subordinated co-ownership interests. In certain circumstances such an arrangement could be characterized as an investment contract, a form of security and, obviously, payments to the participants depend on the cash flow from self-liquidating financial assets which collateralize (in the broader sense) the security. Indeed, from the perspective of the participants there is little that differentiates their holdings from those of holders of CMBS other than the number of holders and that, as a purely formal matter, the interests of security holders of CMBS are typically represented by certificates. Nevertheless, we think most would agree that this is a purely commercial arrangement which should not be at risk of being characterized as a securitized product. In our view, what, on a substantive level, differentiates such arrangements from the sale of co-ownership interests in a typical CMBS transaction, is that in a CMBS transaction the assets have been segregated in a special purpose vehicle.

A small nuance in the above discussion is that certain investment funds and similar vehicles are sometimes structured as unit trusts, arguably giving investors some sort of property interest in the underlying trust property. If properly structured, however, the trust document should provide that beneficiaries have no interest in the trust assets but are only entitled to receive distributions.

Another difficulty with paragraph (a) of the definition of securitized product is related to the list of examples which it is said to include, such as collateralized debt obligations (CDOs) or similar securities. These terms (other than asset-backed securities) have no specific meaning and could be interpreted very broadly such that virtually any instrument utilizing a credit default swap could conceivably be considered to be a CDO. If these phrases are given such broad meanings then the danger is that, in order to accommodate these meanings, the lead-in language to paragraph (a) would be interpreted extremely broadly. We would therefore recommend that the list of examples either be deleted or that the definition be clarified to ensure that the examples do not operate to expand the definition but must otherwise satisfy the definition.

The inclusion of an illustrative list in statutes or regulations often leads to interpretative difficulties. If the list is not explicitly exclusive, then similar items are in danger of being caught. We note that collateralized loan obligations (CLOs) are not listed. While there are good reasons for specifically excluding CLOs from the definition of securitized products (see the comment letter of the American Securitization Forum referenced above), the lead-in language of paragraph (a) of the definition is, on its face, broad enough to include them and the list of very similar instruments only reinforces this interpretation.

Perhaps the most troubling aspect of paragraph (a), however, is the fact that there is no concept of pooling imbedded in it. We believe this to be another essential element of securitized products which separates them from other instruments. For instance, a CDO could include a structured note, the underlying interest of which is a single financial asset or a basket of specified financial assets of specifically identified issuers such as issuers of corporate bonds or preferred shares. Or an entity which is restricted from holding certain securities may seek to enter into a repackaging transaction where the securities are held by a special purpose vehicle which issues debt to the entity. Each of these cases could be caught by paragraph (a), a result which seems to be inherently problematic; we suggest for the reason that in neither case is there pooling of relatively homogenous assets.

In our view, where payments on a security depend primarily on the credit of a single obligor, and not on segregated cash flows from a pool of assets with multiple obligors (regardless of whether or not the obligations are secured against assets of the obligor), the security is more akin to a corporate bond and should not be considered a securitized product. Perhaps the only reasonable exception to this would be the case of one or two very large commercial mortgages. In our view, a single-loan CMBS can be distinguished in that, even though the obligor on the loan is a single entity, the cash flows used to pay the offered securities generally come from multiple tenants and sources.

Another interpretive issue arising in connection with paragraph (a) of the definition of securitized product and the definition of "asset-backed security" is that they each use the word "primarily" in connection with the cash flow upon which payments on the securities depend or which service the securities, respectively. The question is what constitutes "primarily". For purposes of U.S. Reg. AB, less than 50% of the value of the pool may be attributable to the residual values of the pool assets (or, for automobile leases, less than 65%). A security where at least 50% of the payments do not depend primarily on the cash flows from self-liquidating financial assets generally should not be considered to be a securitized product. Common examples of such transactions would be transactions involving cell tower, aircraft and equipment leases, where the residual value of the leased assets is significantly greater than the expected payments on the lease. An interpretive note to this effect would be very helpful.

Finally, one other typical feature of securitizations should be considered as an element of the definition of securitized product. As referenced in the section of the Proposed Securitized Products Rules entitled "What is securitization and why is it important?", a basic feature of securitized products is the use of structured finance techniques (such as pooling [dealt with above,] and tranching) to alter the credit risk associated with underlying assets". Not all investors have the same investment priorities and tranching is an important mechanism by which the various investors are matched with their appropriate places in the risk/yield continuum.

Synthetic asset-backed securities

Paragraph (b) of the definition of securitized product is meant to capture so-called "synthetic asset-backed securities". It reads "a security that entitles the security holder to receive payments that substantially reference or replicate the payments made on one or more securities of the type described in (a) but that do not primarily depend on the cash flow from self-liquidating financial assets that collateralize the security" and examples are once again listed such as synthetic CDOs, CMOs, CBOs, etc.

We have several comments on this element of the definition. First, it may also end up capturing a much wider variety of instruments than may have been intended. For instance, structured notes such as credit-linked notes that reference a basket of corporate debt could conceivably be caught if the basket can in some way be thought of as including "securities of the type described in paragraph (a)" which includes CDOs, etc. As we have indicated above, the amorphous meaning of CDO is particularly unhelpful here.

Second, the definition may not even accurately reflect the nature of most synthetic products, which may be more properly said to entitle investors to receive payments that primarily depend upon the cash flows from (i) one or more derivatives that provide economic exposure to referenced debt obligations or defined categories of obligations and (ii) the collateral securing such derivatives. We would suggest revising the definition to more accurately reflect the foregoing.

Finally, any synthetic securitized products caught by the definition would become subject to the disclosure requirements specified in Proposed NI 41-103. These almost entirely deal with topics applicable to traditional asset-backed securities and would be of doubtful applicability to synthetic securitized products. Thus the supplementary disclosure required in respect of the latter remains unclear. In any case, synthetic products have been almost exclusively financed in the exempt market. We recommend either revisiting the disclosure requirements to more closely reflect the nature of synthetic products or limiting the applicability of the definition to the exempt market (or some subset thereof).

6, 7. **Carve-Outs.** You have asked whether the carve-outs in paragraph 3(2) for (i) covered bonds and (ii) a security, other than a debt security, that is issued by a mortgage investment entity, are appropriate. As indicated above, the inclusion of the latter causes more interpretative issues than it addresses and should be deleted.

The other exemption, pertaining to covered bonds, may also have unintended interpretive implications. A covered bond is described in the request for comments as "a primary obligation of the financial institution with the cover or collateral pool serving as credit enhancement". If such instruments would have been caught but for the exclusion then, presumably, other securities may be included which in some sense, are "collateralized" by a pool of self-liquidating financial assets which primarily rely on the general credit of another party (i.e., the security bears recourse to a specific operating company or other credit source).

While we do not object to the specific exclusion of covered bonds, we believe they should be only an example of a broader exclusion, one relating to any security which provides full recourse to the issuer. Notwithstanding that there may also be recourse to a pool of assets, if, ultimately, there is full recourse to the issuer or a guarantor (at least one of which is an operating entity owning other material assets and not a special purpose entity) then there is no justification for treating the securities any differently than any other debt issuance. This rationale would apply, most notably, to ABCP that is covered by "global-style" liquidity. The availment rights under these facilities are so broad that it is virtually impossible to devise an asset deterioration scenario in which the resulting risk of loss is not borne by the liquidity provider. Accordingly, programs subject to this type of liquidity coverage, like covered bonds, are protected by both the recovery value of the assets backing the issue and the covenant of the applicable financial institution. We would suggest that any instrument that is not somehow limited in recourse to a pool of assets should not be included in the definition of securitized product regardless of any other characteristics which it may otherwise share with securitized products.

(b) The Proposed Prospectus Disclosure Rules

In this part of our letter we will first consider certain of the questions asked under the above heading, following which we will turn to certain technical comments on proposed Form 41-103F1.

Eligibility for the Shelf System

8. **Restrictions on Shelf System.** You have asked whether there should be restrictions on the kinds of asset-backed securities distributions that are eligible for the shelf system such as those in U.S. Reg AB. In their purest form, asset-backed securities are debt securities whose payments flow directly from the amortization of a known portfolio of financial assets. When elements like pre-funding or revolving periods for longer term assets are introduced, the exposure of holders of ABS become more linked to the ability of the asset originator to market and sell financial products rather than simply the ability of the servicer to collect amounts owing with respect to the identified portfolio. However, preventing these structures from accessing the public ABS market by way of shelf offering would do nothing to assist in managing this risk. In fact, transactions in which the specific identity of the assets to be earned out through the life of the program would not even be known at closing would benefit the least if they were provided with a long form prospectus, since neither the base document nor the supplement would contain specific portfolio details. Nevertheless, we would not oppose certain of the types of limitations contained in U.S. Reg. AB, although not necessarily the specific quantums thereof.

9. **Time Considerations.** You have asked whether investors need additional time to review shelf supplements prior to sale. In the structuring process, rating agencies generally require about a week to perform their final modeling on the final portfolio data. In addition, the rating agencies will already have had the benefit of a review of a preliminary representative portfolio and they have arguable if not actual "advanced" expertise in such analysis. If the Proposed Securitized Products Rules are intended to allow investors to replicate the rating agency review process on the basis of loan-level data then they would need at least a similar amount of time. However, if the supplements are to contain only composite portfolio data, as is currently proposed, we do not believe any additional time is required between the filing of the supplement and the pricing of the deal.

10. **SEC April 2010 Proposals**. You have asked whether issuers should satisfy one or more additional criteria such as those in the SEC's April 2010 Proposals being (i) 5% vertical slice risk retention; (ii) third party review of repurchase obligations; and (iii) CEO certification.

The main, practically universal, criticism of the 5% vertical slice risk retention proposal was that its "one-size-fits-all" approach was far too simplistic and did not reflect the different facts and market practices in respect of the various asset classes. The extremely complex proposals under the Dodd-Frank Act were, to some degree, an attempt, ultimately unsuccessful, to address these differences. We refer you to our answer to Question # 2 in respect of those proposals.

The apparent assumption of much of the regulatory reform relating to risk retention appears to be that, if left to their own devices, originators are inclined to create programs with indifference to the prospects of ABS investors recovering their investment. Originators choose ABS for funding their assets because ABS funding offers them a favourable cost of funds. Losing access to this relatively cheap source of funding by permitting ABS investors to take a credit loss on any outstanding program is not something any rational originator would expressly contemplate. That being said, originators would always prefer structures that minimize the upfront cost of ensuring that their issued ABS is protected against loss and instead permit them to backstop the program when and if credit problems develop. The difficulty that this approach creates is that it reintroduces originator credit risk into a program that is supposed to stand or fall on the asset quality alone.

Rating agencies stand as bulwarks against this inclination on the part of originators. Requiring originators to hold a 5% vertical slice of the issued ABS backed by their assets (or any of the other forms of risk retention proposed under the Dodd-Frank Act) would not replace or even supplement the role played by rating agencies in this dynamic. Originators would be no less inclined to minimize the upfront cost of a structure even if they were holding a portion of the securities that were at risk, since it would always be their intention to remedy a credit problem if and when it arose.

In respect of the proposal relating to third party review of repurchase obligations, we do not believe that this proposal would be effective for at least a couple of reasons. First, the SEC proposal contemplates giving trustees the authority to require third party audits after a refusal to repurchase assets following an asserted breach of asset eligibility representations. This does not address the lack of transparency at the heart of the problem since the trustee may not have sufficient knowledge at the asset level to assert a breach. This creates a serious dilemma for trustees. If they do not exercise their right to request such an audit in connection with any reported loss with respect to an asset that is included in a portfolio, they run the risk that the asset will later be found to have been ineligible in circumstances in which the originator no longer has sufficient liquidity to honour its repurchase obligation. Accordingly, trustees will prudently overuse this audit right, driving the cost of ABS funding up significantly. Second, it is not clear that any qualified third party could be found to give the type of opinion contemplated in the proposal. It would not only need to make a technical assessment that the representation and warranty has been breached, but also under most documentation, the less objective determination of whether the breach is material and adverse. Given the factual and subjective elements involved in the required assessments, these questions would not be appropriate subjects of opinions from either accountants or lawyers and it is difficult to think who would be in a position to render such an opinion. Fortunately, the practical difficulties that doom this proposal will not leave unresolved any significant shortcoming of the Canadian ABS market. The motivating factor for this proposal in the U.S. has been the difficulty experienced in enforcing buy-back provisions of which there is absolutely no evidence in Canada. For this reason, we do not support the inclusion of the cumbersome and ultimately ineffective Reg. AB II/Dodd-Frank proposals relating to third party review of repurchase obligations in the new Canadian regulatory regime.

We note that, in its *Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities*, dated July 26, 2011 (the "**July 2011 Re-Proposals**"), the SEC abandoned many aspects of its April 2010 Proposals on this topic and proposed a revised version of the shelf eligibility condition according to which the underlying transaction documents must appoint a credit risk manager to review the underlying assets upon the occurrence of certain trigger events and provide its report to the trustee of the findings and conclusions of the review of assets. In addition, the documents are to contain certain provisions relating to the resolution of repurchase requests. While this proposal may avoid certain of the difficulties referenced above, we still do not believe that the added complexity and cost are warranted in the Canadian market which has not experienced the sort of problems relating to the enforcement of buy-back provisions which precipitated the regulatory response in the U.S.

Neither do we believe that the proposal relating to CEO certification is appropriate. Under the SEC's April 2010 Proposals, the issuer would be required to provide a certificate of the depositor's chief executive officer regarding the underlying assets to the effect that "to his or her knowledge, the assets have characteristics that provide a reasonable basis to believe that they will produce, taking into account internal credit enhancements, cash flows at times and in amounts necessary to service payments on the securities as described in the prospectus". The officer would also be required to certify that he or she has reviewed the prospectus and the necessary documents for this certification. By means of this requirement, the SEC hopes that the officer in question will review the disclosure more carefully and participate more extensively in the oversight of the transaction, thus leading to enhanced quality of the securitization. The SEC suggests that the proposed certification "would be an explicit representation by the chief executive officer of the depositor of what is already implicit in the disclosure contained in the registration statement". With one important difference: CEOs are being asked to predict the future performance of the underlying assets, as opposed to the adequacy of the disclosure, which prediction must be based on assumptions about the future which are not qualified by any of the risk factors and other disclosures found in registration statements which protect the issuer from liability if the offered securities fail to perform. The CEO is essentially being asked to perform a credit review and to assume some degree of liability, again uncertain, in respect of his or her review. CEOs of originators are experts in the origination and servicing of portfolios of financial assets, not financial modeling. To present their certification as valuable ratification of rating conclusions is not responsible. Even though the SEC states that the certification would not serve as a guarantee of payment of the securities, in a situation where there has been default and loss and arguments are being made over what was known or, perhaps more importantly, what should have been known, it is not clear that the knowledge qualifier would provide an appropriate defence. Unfair personal liability could result, which may chill the Canadian securitization market.

In its July 2011 Re-Proposals, the SEC also modified its requirements for certification, including certain of those aspects of its April 2010 Proposals discussed above. Perhaps most notably, the certification relating to the adequacy of cash flow has been modified to state that "the structure of the securitization, including internal credit enhancements, ...is designed to produce, but is not guaranteed by this certification to produce, cash flows at times and in amounts sufficient to service expected payments on the asset-backed securities offered and sold pursuant to the registration statement". While such a reformulation may, to a certain extent at least, address certain of the criticisms levelled against the April 2010 Proposals, in our view it still fails to address the fundamental issue regarding the appropriateness of requiring certification relating to asset credit quality.

11. **MTN/Continuous Distributions.** You have asked whether offerings of asset-backed securities through the MTN/continuous distributions prospectus supplement provisions give investors enough time to review the information or provide the public disclosure of the offering on a sufficiently timely basis. As far as we are aware, the only type of ABS transaction utilizing the MTN system, and indeed the only type for which it is particularly useful, is credit card securitizations where the variable details provided in the supplement are minimal and the pool data is posted monthly. Accordingly, we do not think that any additional time to review is necessary.

Pool asset and payment disclosure

12. **Asset-Level Disclosure.** You have asked whether asset or loan-level disclosure or group asset disclosure of the type proposed under the SEC's April 2010 Proposals is necessary. In our view such disclosure is not necessary. It has been proposed in the U.S. largely in response to the failings of the real estate market. Issuances in this market were typified by very complex structurings of securities with multiple tranches which, in many cases, were completely distributed. As a result, small changes in pool performance could have major impacts on those specific narrowly-tailored securities. Products involving mortgage loans also involved many fewer discrete assets of a much larger per-asset size than transactions involving most other asset classes. Finally, mortgage assets are subject to refinancing risk and involve protracted liquidation.

In contrast, ABS assets are typically homogenous, short term, not particularly interest rate sensitive, generally not subject to financing risk and liquidated quickly. Pools typically contain many more assets than would, for example, a CMBS pool. The securities involved are much simpler and less structured and the tranches are 'thicker' than CMBS and much less sensitive to changes in pool performance. It is rare for these structures to be tranched and distributed beyond the mid-to-high investment grade level. The more senior the investor, the less it is subject to the types of risks that require asset-level data to properly assess.

In addition, the credit models applied by finance companies are proprietary and competitively sensitive and there is a risk that, in certain cases, such disclosure could be reverse-engineered by competitors. This may also create a threat to consumer privacy and the originators' related legal obligations. Finally, the burden placed on issuers (other than, perhaps, issuers of CMBS) would be extraordinary given the number of loans in the typical ABS transaction.

13. **Computer Waterfall Program.** You have asked whether it is necessary to require that issuers provide a computer waterfall program to investors as proposed in the SEC's April 2010 Proposal. That proposal requires the computer program to

perform ABS cash flow modelling allowing a potential investor to input its own assumptions about future performance of the collateral and extrinsic factors, upload asset level data and produce, for each remaining month of the transaction, output of all resulting cash flows. Contrary to the SEC's underlying premise, that "issuers already produce such a code to structure the ABS deal", this is apparently not the case.

Issuers would need to engage significant resources in order to maintain and update the program and provide instructions on use and customer service. More than one commentator has observed that this proposal would in effect require issuers to become software developers and distributors, a role for which they are likely to be particularly unsuited. Rather it would seem to be more likely that issuers would turn to third-party service providers.

The waterfall computer program proposal also raises significant legal issues. The proposal requires that the program be filed with, and incorporated by reference into, an issuer's registration statement. It is unclear to what extent this would mean that the design features and the output of the computer program would be treated as issuer "statements" attracting the same liability as all other statements. Even more problematic is the question of whether a flaw in the program resulting in error would attract liability. Strictly in the Canadian context, it is not clear how the specific disclosure requirements relating to forward looking information would apply to such a program.

Perhaps the most fundamental issue of all is raised by the requirement that the "code must provide the user with the ability to programmatically input the user's own assumptions regarding the future performance and cash flows from the pool assets". But any such code, like any credit assessment model, must itself invariably be predicated upon certain assumptions, based on a subjective assessment of the remoteness of various risks, involving the selection of variables that are deemed sufficiently material to merit modelling. To build an open-ended model which is able to anticipate assumptions of others and quantify all risks no matter how remote may not even be possible.

In the past, modeling was the domain of those with experience in the area, such as underwriters and credit agencies. To shift responsibility for this to issuers who have no expertise in the area and, at the same time, to arguably impose a strict liability regime with respect to outputs generated not by the issuer but by investors is well beyond what is fair and reasonable in the context of an ABS issue. Given the complexity of the required programs, the necessity for reliance on third parties and the uncertain liability issues, it is unclear how issuers (or underwriters for that matter) would ever be able to get sufficiently comfortable with their due diligence on the programs to sign the required certificates.

Mandatory review of pool assets

14. **Asset Review.** You have asked whether you should introduce a requirement similar to the Dodd-Frank Act rule requiring that issuers who offer asset-backed

securities pursuant to a registration statement must perform a review of the pool assets underlying the asset-backed securities. Under the Dodd-Frank rule the review must, at a minimum, be designed and effected to provide reasonable assurances that the disclosure regarding the pool assets in the prospectus is accurate in all material respects. In our view, such a proposal is unnecessary as the conduct of an asset review is already an essential element of any due diligence conducted by the issuer and necessary in order to allow it to certify that the prospectus contains full, true and plain disclosure. As such, it would not appear to impose any greater burden upon issuers than that which is already imposed pursuant to existing prospectus liability for misrepresentations and omissions. There is no need to replicate this in Canadian reform proposals.

Risk factor disclosure

15. **Risk Factors**. You have asked whether you should prescribe risk factor disclosure. ABS by their nature are subject to certain fundamental assumptions that are common to all such issues, and these assumptions give rise to common risks. For example, ABS issues include structural credit protection that has been sized in virtually all cases on the basis of historical static pool performance histories that are assumed to be valid predictors of future portfolio performance. While the actual future performance of the portfolio can vary within certain tolerances supported by historical levels of volatility, it is always possible that something in the external environment can occur that radically transforms the environment in which this historical performance was generated. Given the universal nature of this risk, it is tempting to prescribe the language used in prospectuses to describe this and perhaps other common risks. To some extent, this standardization occurs naturally, as lawyers draw upon precedents to describe comparable risks and thereby homogenize the language used to describe this risk. However, the adoption of common language to describe these sorts of risk does and should fall upon the individual issuer, and the loss of accountability for nuance in language must remain with the issuer and not be subsumed in statutorily prescribed language.

Form 41-103F1

The following comments are organized in accordance with the heading and Item and Section numbers of Form 41-103F1.

Instructions

Instruction (1) provides that "this Form sets out specific disclosure requirements relating to securitized products that are in addition to the general requirement under securities legislation to provide full, true and plain disclosure of all material facts relating to the securities to be distributed. Issuers must comply with the specific instructions or requirements in this Form if the instruction or requirement is applicable". Thus, unless the specific requirement is limited by a materiality threshold, it appears that all applicable facts, however immaterial, are expected to be discussed. This may be of concern in respect of some of the more open-ended line items noted below. We would recommend adding a general materiality standard.

Item 1 Parties with significant functions and responsibilities

1.5 Originator

In paragraph (1)(a), disclosure is required where "the originator has originated as of the cut-off date, or is reasonably expected to originate, assets in respect of a pool in which a sponsor and its affiliates have cumulatively originated less than 10% of the pool assets". In other words, disclosure is not required in respect of originators of less than 10% of the asset pool (originators of more than 10% being captured in paragraph (1)(b)) if the sponsor and its affiliates have originated 10% or more of the asset pool. We would suggest that it would be more appropriate to exclude disclosure as being immaterial where it represents an insignificant proportion of the asset pool when compared to the sponsor. Therefore we recommend that the reference to "less than 10%" should be changed to "less than 90%" or a new calculation be included based on 10% of the assets originated by the sponsor and its affiliates. We believe that this would also be in keeping with the approach reflected in the relevant amendment in U.S. Reg AB II.

Paragraph (3)(c)(i) requires disclosure of the originator's "credit-granting or underwriting criteria for assets of the type being securitized". (A similar requirement applies to sponsors as well). This is an example of the interpretive difficulties which may ensue if instruction (1) cited above is applied here. We suggest that an interpretive note be attached making it clear that only a very general discussion is required here as the details may be proprietary and competitively sensitive and not likely relevant in any case since, in any transaction, the eligibility criteria of the specific asset pool being securitized will be required to be disclosed.

Paragraph (3)(d) requires disclosure in respect of the originator's financial condition "to the extent that there is a significant risk that its financial condition could have a material impact on its ability to comply with any obligations to, or fulfill any reasonable expectations that it will, originate assets for the pool." In any situation involving an amortizing pool of assets, this would not be a material consideration and we would suggest that this be limited to revolving asset pools.

1.6 Issuer

Paragraph (f) requires a description of "the creation, perfection and priority status of any security interest in a pool asset, and each person or company who holds a security interest in a pool asset." On its face, this language could be read to include security interests in the pool assets given to the originator by the underlying obligors, which of necessity would need to be provided on an asset-level basis and would necessitate hundreds, if not thousands, of searches being conducted against the obligors. The issuer relies on the representations and warranties of the originator in respect of these matters. This provision should be clarified to apply only to security interests created under the transaction documents.

In Reg AB, disclosure is required in respect of "any provisions or arrangements included to address any one or more of the following issues:

(a) Whether any security interests granted in connection with the transaction are perfected, maintained and enforced.

(b) Whether declaration of bankruptcy, receivership or similar proceeding with respect to the issuing entity can occur.

(c) Whether in the event of a bankruptcy, receivership or similar proceeding with respect to the sponsor, originator, depositor or other seller of the pool assets, the issuing entity's assets will become part of the bankruptcy estate or subject to the bankruptcy control of a third party.

(d) Whether in the event of a bankruptcy, receivership or similar proceeding with respect to the issuing entity, the issuing entity's assets will become subject to the bankruptcy control of a third party."

In the equivalent CSA proposals (paragraphs (h), (i) and (j)), the introductory wording is restricted to paragraph (h) while paragraphs (i) and (j), which correspond to (b), (c) and (d) above, are left as unqualified line items. As a result, rather than just requiring a description of the contractual provisions, if any, meant to address bankruptcy issues, this would seem to require discussion of the substantive issues themselves. These are really the proper subject-matter of the legal opinions provided in the transaction which are lengthy and qualified in various ways in accordance with accepted practice. They are not appropriate subject-matters for prospectus disclosure with its associated liability. Therefore we recommend that the relevant paragraphs be revised to more closely parallel the Reg AB equivalent.

1.7 Servicer

In many transactions, servicers or sub-servicers are independent third parties. As such, there are a couple of disclosure items which may be problematic. Disclosure is required under paragraph (2)(c) in respect of the servicer's "procedures for servicing assets of the type included in the securitized product transaction" and under paragraph (2)(f) in respect of its "process for handling delinquencies and losses". A servicer's collection policies are often extremely lengthy and detailed and may, to a certain extent, be considered to be proprietary.

In Reg AB, disclosure is required if "any special or unique factors are involved in servicing particular types of assets included in the current transaction, such as subprime assets, and the servicer's processes and procedures designed to address such factors". Paragraph (2)(f) also requires disclosure of "any factors involved in servicing the types of assets included in the securitized product transaction that are particularly relevant to assets of that type. For example, describe the factors that are particularly relevant to subprime assets and loans with deferred payments, and the servicer's processes and procedures designed to address those factors". The deletion of the words "special or unique" introduces an unnecessary degree of doubt about what is being required.

In paragraph (2)(m), a description is required in respect of "whether in the event of a bankruptcy, receivership or similar proceeding with respect to the servicer, any of the issuer's assets will become part of the bankruptcy estate or subject to the bankruptcy, receivership or similar control of a third party". As per the discussion above under "1.6 Issuer" relating to paragraphs (h), (i) and (j) thereof, this phrase should be preceded by the words "any provisions or arrangements included to address.....".

Under paragraph (3), information would need to be provided "regarding the servicer's financial condition to the extent that there is a significant risk that the effect on one or more aspects of servicing resulting from such financial condition could have a material impact on pool performance or performance of the securitized product". The nature of the disclosure here is uncertain and, if applied to third party service providers, may be considered to be inappropriate for a couple of reasons. First, the third party may be a private corporation which would be troubled by the disclosure of its financial details. Second, the issuer would be unfairly liable in respect of disclosure for which it may not be able to conduct the requisite level of due diligence.

The foregoing are further examples of how the application of Instruction (1) may result in inappropriate disclosure requirements.

1.10 Affiliates and certain relationships and related transactions

Paragraph (a) requires disclosure of "whether any person described in the prospectus [which includes arrangers or underwriters] or any of its affiliates are engaged in, or have in the 12 months before the date of the prospectus been engaged in, any transaction that would involve or result in any material conflict of interest with respect to any investor in the securitized product being distributed."

Taken literally, this requirement would appear to impose upon issuers the obligation to investigate, determine and understand the activities of all other participants, including the underwriters and the investors (who of course would not yet be determined at the time the disclosure is required), over the last 12 months. Clarification is necessary to ensure that the reference to investors is to be given a generic meaning. Further, as a point of principle, issuers should not be impressed with prospectus-level liability with respect to the accuracy of disclosure relating to the activities of unaffiliated third parties, especially third parties, such as underwriters, who undertake a myriad of diverse activities in any given year. This disclosure should only be required of the issuer, the sponsor and related entities. Finally, the subject-matter of this provision should be restricted to the types of conflicts referenced in our answer to Question #3.

Item 2 Significant obligors of pool assets

It is noted that the significant obligor disclosure requirements do not apply in respect of pool assets that that are guaranteed by the Government of Canada. We query whether this exception should also extend to assets that are the subject of provincial government guarantees. Also, Reg AB also excludes pool assets backed by the full faith and credit of a foreign government if the pool assets are investment grade securities. By implication, disclosure is required under the CSA rules in respect of such assets.

Certain of the other items of disclosure required in respect of significant obligors may involve a somewhat disconcerting degree of reliance upon the obligor. Apart from the requirement to describe the character, history and development of its business, perhaps the most notable example of this is the requirement to disclose "any adverse financial developments since the date of the significant obligor's most recent financial statements".

In addition to the main category of significant obligors (i.e., obligors in respect of pool assets representing 10% or more of the asset pool) there are two other categories of significant obligors: first, a property or group of related properties and, second, a lessee or group of affiliated lessees, in each case, in respect of pool assets representing 10% or more of the asset pool. It is not immediately clear what the latter category adds to the general obligor category. As to the former, several of the required line items of disclosure are not readily applicable to properties as opposed to persons. Perhaps specific disclosure requirements should be crafted for this category.

Item 3 Pool assets

3.2 Pool characteristics

The only explicit asset-level disclosure requirements included in the Proposed Securitized Products Rules apply to CMBS (paragraph (2)(p)). While the specifics of the required disclosure are largely identical to the existing Reg AB requirements, there may be reasons why this amount of asset-level disclosure would not be appropriate in Canada. The primary concern is the public disclosure of confidential and sensitive property level information to market competitors. Compared to U.S. borrowers, Canadian commercial mortgage borrowers have many other available financing options where this information would not become public. Further, Canadian commercial borrowers have a much higher percentage of public company and/or institutional grade borrowers who will object to this disclosure. While several of the CMBS asset-level disclosure requirements may be uncontroversial in the U.S. market, they may materially and adversely affect the appeal of the CMBS product to Canadian borrowers and, as a result, may drive Canadian borrowers to Canadian institutional balance sheet lenders where this information will remain undisclosed, adversely affecting the Canadian securitization market.

In paragraph (2)(r)(iv), if there are loans in the pool and a valuation has been performed on the collateral, then information is required on who performed the valuation, when it was performed or updated, and the standard used in measuring the valuation. Since such property valuations are conducted at the asset level and there may be thousands of properties in a typical RMBS transaction, the disclosure required here could be problematic and not particularly helpful in any case. It should be limited to material assets at the very least. Also query whether stipulations similar to those contained in NI 61-101 relating to prior valuations used in take-over bids would be germane here (namely that consents not be required).

3.5 Representations and warranties and repurchase obligations

Paragraph 3.5 requires disclosure relating to repurchase obligations as a result of a breach of representation and warranty. Paragraph (2) applies in respect of each "originator" that is required to repurchase or replace a pool asset while paragraph (3) applies, on exactly the same terms, to each "party" that is required to repurchase or replace a pool asset. Given the breadth of application of paragraph (3), paragraph (2) would seem to be redundant.

The disclosure is required in respect of "each of the three years prior [to] the date of the prospectus". In other contexts, Canadian securities rules are much more specific about the period(s) in respect of which historical financial disclosure is required (such as for the most recently completed one or two years ending more than 90 days before the date of the prospectus or for interim periods ending more than 45 before together with comparative prior period disclosure, with exemptions for more recently filed statements, etc.).

Item 7 Static pool information

7.5 Master trusts

There are references to master trust used throughout the proposals. While master trusts are used by some parties in Canada, most use a co-ownership structure in dealing with the same types of assets (e.g., credit cards). Therefore, a more general term should be used which would include both or an interpretative provision should be adopted.

Item 8 Credit enhancement and other support, excluding certain derivatives instruments

A significant credit enhancer is an entity (or group of affiliated entities) whose credit enhancement represents 10 - 20% of "the cash flow supporting one or more classes of the securitized products being distributed". It is not clear from this whether the supporting cash flow should be determined on a discounted or undiscounted basis. A simpler and clearer basis for measuring credit enhancement could be the principal balance of the pool assets or the principal value of the securitized products as is used for similar purposes for derivative instruments (see Item 9 below).

Also query whether financial disclosure in respect of private corporations is appropriate or whether it is relevant at all in situations where the credit enhancer has provided enhancement in the form of cash or a cash equivalent.

Item 9 Certain derivative instruments

Paragraph (1) applies to each derivative instrument used "to alter the payment characteristics of the payments made on the securitized products." The payment characteristics of the securities would not be altered by the derivative instrument. Only the payment characteristics of cash flow from the assets are, in a sense, altered. Thus the wording should be changed to each derivative instrument used "to alter the payment characteristics of the cash flow from the issuing entity". It may be even more accurate to refer to "each derivative instrument used to hedge a mismatch between the payment characteristics of the pool assets and the securitized products".

In the definition of "significance percentage", in paragraph (2)(a), the reference to the "exposure of the derivative counterparty" should instead be a reference to "the exposure to the derivative counterparty". In paragraph (2)(b), the amount used to calculate the percentage of the maximum probable exposure is the aggregate principal balance of the pool assets or, "if the derivative instrument relates only to certain classes of securitized products, of the aggregate principal of those classes." The phrase "only to certain classes" may result in a certain degree of ambiguity in a case where the derivative instrument relates to all classes of securitized products, as opposed to the underlying assets. We would suggest adopting the equivalent Reg AB wording, "only to one or more classes" or, better yet, "to one or more classes".

(c) The Proposed CD Rule and Proposed Certificate Amendments

Application to all outstanding series or class of securitized products issued by a reporting issuer

19. Transition. You have asked whether a "grandfathering" or transitional provision should be put in place in respect of the proposed continuous disclosure requirements. We believe that such a provision should be included since otherwise the costs associated with providing the continuous disclosure in respect of, in some cases, numerous previously completed transactions could be extremely burdensome and could adversely affect expected returns.

20. Application to Exempt Distributions. You have asked whether the proposed continuous disclosure requirements should only apply in respect of securitized products that the reporting issuer distributed via prospectus. In our view the answer to this question must be yes. For a discussion of the negative impact that the imposition of public reporting requirements could have on the exempt market, see the discussion below in respect of Question #26.

21. **Legending**. You have asked whether a legending or notice requirement to explain resale restrictions for securitized products that have been distributed on an exempt basis should be included. We do not believe that this would be appropriate as most offerings of securitized products (other than short-term securitized products) utilize a book-entry system which, it has been found, does not easily accommodate legending.

24. **Certification**. The proposed certification requirements would appear to create a risk of individual personal liability unique to securitized products. As a matter of principle we do not believe that this sort of exceptionalism is appropriate nor do we believe it promotes any of the principles set out in the Proposed Securitized Products Rules. It would also likely lead to the certifying individual seeking increased indemnities and insurance, thus adversely affecting expected returns and generally building unnecessary inefficiencies into the system.

Report of fulfilled and unfulfilled repurchase/replacement requests

26. **Repurchase Requests**. You have asked whether it is necessary to have the type of disclosure required under the Dodd-Frank Act which would require disclosure of all fulfilled and unfulfilled repurchase requests for all securitizations in which an issuer has been involved (including those in the exempt market). We do not believe that this is necessary, nor do we think it to be advisable for the reasons discussed below.

One question among many which is raised by the Dodd-Frank rule involves the incentives that this regime creates for investors and issuers. It may be possible that the latters' imperative will be to preserve their reputation by complying with any repurchase request, no matter if unjustified, which may in turn encourage investors to view the repurchase mechanism as a possible exit strategy rather than a mere correction. While the SEC acknowledges such possibilities, its only response is that "securitizers may devise other disclosures and mechanisms to solve such problems in the long-run, if they occur".

But perhaps the most important reason why this sort of proposal should not be incorporated in Canada has been provided by the SEC itself in its release of October 4, 2010 in which it introduced the proposal:

> "In the aggregate, the proposed requirements are likely to affect unregistered ABS more significantly because traditionally these securities have provided less disclosure. Since, as discussed previously, the Act requires disclosures with respect to all ABS issued by a securitizer, registered and unregistered, the initial and ongoing disclosures may significantly increase the direct and particularly indirect costs of issuing unregistered ABS relative to their historical cost structure. The indirect costs include the possibility of revealing information about the quality of assets to

> competitors. A possible effect of these requirements is that such issuers may look towards alternative forms of financing. Given that those issuers have historically preferred ABS issues, they may consider more expensive and less efficient forms of financing. Some of these incremental financing costs are likely to be passed to consumers and other borrowers whose loans make up the underlying pools backing the ABS. While it is difficult to quantify such incremental costs, researchers have estimated that securitization has generally been beneficial in banking and mortgage industries. However, other factors may be more determinative in deciding what form of financing a business will pursue."
>
> ...
>
> "The purpose of the amendments is to increase transparency regarding the use of representations and warranties in asset-backed securities transactions. This should improve investors' ability to make informed investment decisions. Informed investor decisions generally promote market efficiency and capital formation. However, the proposals could have indirect adverse consequences by changing the willingness of issuers to access securitization markets. If the required disclosures results in revealing information that would benefit competitors, issuers may instead prefer to use other funding sources that do not require such public disclosures."

Notwithstanding these negative implications, the SEC was compelled to impose this rule as it was mandated by an Act of Congress. No such rationale exists in Canada, and we see no benefit to requiring such disclosure.

On a technical level, paragraph (3)(m) requires continuous disclosure in respect of demands made to a party with an obligation to repurchase or replace pool assets for breach of representation and warranty. To avoid interpretative problems, the disclosure requirement should be conformed to the original prospectus disclosure requirement in paragraph 3.5 of Form 41-103F1. Specifically, the words "pursuant to the transaction agreements" should be added to paragraph (i) so that it reads "the amount of pool assets that were the subject of outstanding demands pursuant to the transaction agreements at the end of the payment period, and the status of those demands".

(d) The Proposed Exempt Distribution Rules

General Approach

27. **Product-Centered Approach.** You have asked whether a product-centered approach is appropriate or whether you should instead be focusing on the exempt market as a whole. We strongly believe that, as the issues at hand relate solely to the asset-backed market, it is not necessary or appropriate to interfere with the workings of the exempt market as a whole.

28. **Exempt Market Access.** You have asked whether securitized products should be allowed to be sold in the exempt market or whether they should only be sold under a prospectus. To so limit them would be an uncalled for intrusion upon the right of parties to contract freely and would be materially detrimental to the private market and would be especially crippling to the ABCP market. It would deprive many issuers of the ability to securitize their assets at all, especially those who access the private market because they are unable to satisfy all public market requirements. If investors want public-level disclosure they can restrict themselves to investing in the public market. Otherwise relatively sophisticated investors should be free to accept reduced disclosure.

We strongly support the view that securitized products should be allowed to be sold in the exempt market. This has been an essential component of the market for securitized products. If it were to be eliminated, an important source of credit in the Canadian market would most certainty be irreparably damaged.

Who can buy?

29, 32. **Limitation of Exemptions.** You have asked whether you should permit securitized products to continue to be sold through some existing exemptions. The danger of limiting the exemptions under which these products can be sold, especially existing securitized products, is that this could have very adverse effects on liquidity and thus on the value of existing products and on the willingness of investors to invest in the securitization market and, by extension, the Canadian economy. We would therefore suggest that certain exemptions be modified to reflect the special attributes of securitized products. For instance we would recommend, as per your Question #32 B, that the minimum amount investment prospectus exemption, set at a reasonable amount, be retained. In addition, an equivalent to the private issuer exemption would also be useful. Reducing saleability will adversely affect the securitization market and should be approached carefully, especially given the unclear scope of the definition of securitized product.

30. **Registrants.** You have asked whether you should allow investors to purchase securitized products in the exempt market through a registrant subject to suitability obligations in respect of the purchaser. We do not believe that mandatory dealer involvement is always appropriate as the prospective purchaser may want to purchase the securities but may not be or want to be a customer of the dealer in question with a corresponding obligation to respond to detailed know-your-client

inquiries. A similar concern applies to recent OSC Staff Notice 33-735. Investors will not want to provide detailed financial information to a dealer with whom they do not have an account just to buy a security, and should not be required to do so.

33. **Further Limitations**. You have asked whether you should provide for more limited access to securitized products than has been proposed. In response, we reiterate our general concerns over the effect which reduced liquidity would be likely to have on the securitization market and the Canadian economy.

Disclosure

35. **Exempt Purchasers.** You have asked whether there is a class of investor for whom it is not necessary to require that some form of disclosure be provided in connection with the purchase of securitized products on a prospectus-exempt basis. A number of transactions involve a single-seller trust established by an originator which purchases or leases underlying assets and then issues a medium-term note to, for example, an ABCP conduit. Under the proposals, the note issued to the ABCP conduit would be a securitized product for which an information memorandum would be required. This is unnecessary as the purchaser is someone whose business it is to structure and thus understand these products. This is the very model of a sophisticated purchaser who does not need regulatory protection and can, and should have the freedom to, fend for itself. The only effect of requiring the delivery of an information memorandum in such circumstances would be to vastly increase the cost of doing business. In other circumstances, highly sophisticated investors may make a reverse enquiry, basically initiating the creation and sale to them of a tailored securitized product by an issuer. Once again we do not see the utility of imposing a requirement to deliver an information memorandum. Generally speaking, there are numerous parties who have extensive expertise in analyzing and purchasing securitized products and who are in a position to know, and directly demand, whatever they need to make an informed investment decision. Accordingly, we believe that it is essential that appropriate exceptions be created to this requirement for "highly sophisticated" investors such as financial institutions and entities administered by them as well as other entities with extensive investment experience specifically in securitized products. Perhaps the most effective way to provide for this is to allow investors (or certain of them) to waive the requirement to deliver an information memorandum.

37. **Specific Disclosure for Non Short-Term Securitized Products**. You have asked whether it is appropriate that you not prescribe specific disclosure for the initial distribution of non-short-term securitized products and what the impact of doing so would be on costs, timing and market access. We believe that to prescribe such specific disclosure would exacerbate the adverse effects on liquidity and the efficacy of the securitized product market described above. This would essentially conflate the exempt and non-exempt markets and we would object for the same reasons provided in our answer to Question #28.

38, 39. **Short-Term Securitized Products.** You have asked whether it is appropriate to prescribe certain disclosure (both initial and ongoing) for short-term securitized products and what the impact will be on costs, timing and market access of requiring such disclosure. Under the proposed regime, ABCP conduits would need to provide detailed disclosure relating to transaction descriptions, asset pool characteristics and performance and other matters which by definition will change on a regular basis. The cumulative effect of the proposed rules would seem to require ABCP conduits to maintain current disclosure on a virtually daily basis. The strain on resources, not to mention the effect on costs which would ultimately be passed on to originators, may well be sufficient to effectively destroy an economic model which has been a crucial source of credit in the Canadian market. Disclosure of such matters should only be required as elements of ongoing monthly disclosure.

Statutory Civil Liability

44. **Withdrawal Rights.** You have asked whether rights of withdrawal should apply to the information memoranda used for the distribution of securitized products. The right of withdrawal on distributions under prospectus are cumbersome and can lead to significant unwinding difficulties. We do not believe that it is desirable to expand these rights to the exempt market especially given the presumption of relative sophistication on the part of the investors.

Resale

45. **First Trade.** You have asked whether the resale treatment reflected in the Proposed Securitized Product Rules is appropriate. As indicated above, we think that to unduly limit secondary resales will affect value and liquidity in, and thus ultimately harm, the securitization market. Also, given our concerns expressed above relating to the uncertain breadth of the definition of securitized product, this treatment could adversely affect the broader securities market.

Registration

46. **Registration Categories.** You have asked whether there are any existing registration categories or registration exemptions that should be modified or made unavailable for the distribution and resale of securitized products in the exempt market. We answer in the negative for the reasons expressed above in respect of Question #45.

We conclude by setting out below a few technical comments to proposed National Instrument 45-106.

1. We note that the definition of "eligible securitized product investor" in 45-106 is the same as the definition of "permitted investor" in National Instrument 31-103 - Registration Requirements (31-103), although without the references to dealers and advisers in paragraphs (m) and (n) of the definition of "permitted investor". Absent this difference, we would have suggested referring to "permitted investor" definition or perhaps moving that definition to National Instrument 14-101 - Definition (14-101) for both purposes. We note that the July 11, 2011 amendments to 31-103 make minor drafting changes to paragraph (d) of the definition of "permitted investor", which presumably should be reflected in the definition of "eligible securitized products investor" here for conformity. There are also minor drafting differences in paragraph (l) of the two definitions which do not

appear to affect the substance, but might be conformed for clarity. In paragraph (n) of the definition of "eligible securitized products investor" the words ", as defined in section 1.1" can presumably be omitted as were similar words after "eligibility adviser" in paragraph (m). As a substantive matter the words "or company" need to be inserted in paragraphs (o), (p) and (q) of the definition of "eligible securitized product investor" after "a person" to conform to the "permitted investor" definition. This is necessary as a substantive matter because, in Ontario for example, the definition of "person" in the Securities Act (Ontario) does not include incorporated entities and there is a separate definition of "company". For reference see also the definition of "person or company" in 14-101.

2. The definition of "sponsor" references the definition in National Instrument 41-103 whereas the definition actually occurs in Form 41-103F1.

3. The reference in section 2.44(2) should be to paragraph (j) of the definition of "eligible securitized product investor" and in section 2.44(4) to paragraph (k) of that definition.

4. Section 2.46(7)(b) should refer to the date the information memorandum is delivered by the issuer to the purchaser to avoid any confusion with a resale where the investor may be selling to another eligible securitized product investor and in connection therewith providing a copy of the offering memorandum. The requirement under section 2.44(1)(c) to deliver an offering memorandum only applies to distributions by the issuer.

We would be pleased to respond to any inquiries regarding this letter or our views on the Proposed Securitized Product Rules generally. Please contact Michael Rumball at 416-869-5671.

Yours truly,

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