

By Mark J. Selick and Michael E. Burke

After two years in a near-death state, Canada's securitization market appears to be coming round. This is no miraculous recovery, though: rehabilitation will be slow and steady.

## Canadian ABS Shows Signs of Life

In the film *Awakenings*, Robin Williams plays a doctor who, through creative medical treatment and after much trial and error, is able to bring patients out of long-lasting comas. The Canadian securitization market fell into its own coma in August 2007 but now seems to be coming to. It has been slow going. A combination of federal government support, new rules and improving market conditions, however, means the Canadian securitization market should be able to get back on its feet.

What put the market into a coma was Coventree Capital's inability to place new asset-backed commercial paper (ABCP) in August 2007. That quickly shut down most of the C\$32 billion (\$30.4 billion) non-bank-sponsored ABCP conduit market and the commercial mortgage bond market, while bank ABCP and term asset-backed deals slowed significantly.

It took more than a year of negotiations to reach for a resolution to the non-bank ABCP problems. In January 2009, new term notes were issued to replace the affected ABCP, and a modest secondary market for them has since started to develop — driven, apparently, by yield-hungry hedge funds.

As the general market crisis continued, though, calls for the Canadian federal government to get involved increased, culminating in the C\$12 billion Canadian Secured Credit Facility (CSCF), which was announced in January 2009. It went right to the heart of one of the most affected parts of the securitization market, vehicle and equipment financing and leasing. ABCP backed by such assets plummeted more than 60% in the two years since mid-2007 from C\$32 billion to just C\$12.3 billion. Term deals fell by more than two-fifths to C\$3.3 billion from C\$5.9 billion.

Ottawa characterized the CSCF as part of a support package promised to the auto industry in December 2008. But while limited to equipment and vehicle financing and leasing, it also served as an important statement of the government's desire to help restore confidence in the broader Canadian securitization market.

After consultations with industry, parameters for the CSCF were jointly developed by the Federal Department of Finance and the Business Development Bank of Canada (BDC), a Canadian federal government agency. BDC was also assigned responsibility for establishing and managing the CSCF.

Between them, they developed some creative and proactive medicine for the market. The CSCF has a two-tier structure: C\$11 billion was set aside for Large Enterprise Originators (LEOs) and C\$1 billion was set aside for Small Enterprise Originators



The Canadian government's support helped shock securitization back to life Getty

(SEOs). LEOs must commit to a minimum transaction size of C\$300 million and SEOs must commit to C\$100 million. All securities purchased by BDC must be publicly issued under a prospectus and must have two triple-A ratings. Eligible underlying assets are limited to vehicle and equipment loans and leases and floorplan loans for vehicle and equipment dealers.

### Minimum Requirements

BDC recognized that different factors affecting each originator may drive different transaction structures and so has largely avoided dictating what structure to use. It has, however, set out certain minimum requirements.

The first is the use of template documents for the basic deal documentation, including a template declaration of trust to establish the issuing entity — Canadian structures typically involve a trust as the issuing entity — and a template form of trust indenture under which the asset-backed debt is issued. BDC also imposed certain minimum terms for the conveyance documents, including minimum representations, covenants and eligibility criteria.

If these start to serve as market standards for future transactions outside the CSCF, the CSCF will have not only helped the current market, but also helped cut down on execution costs for other transactions.

One of the few structural requirements imposed under the CSCF deals with the uncertainty that had surrounded some vehicle lease securitizations. To achieve certain income tax objectives, Canadian lease securitizations generally use a structure involving a master lease of the relevant equipment from the originator to the issuing special purpose entity (SPE), leaving title to the equipment in the hands of the originator. But a recent change to the Canadian Bankruptcy and Insolvency Act (BIA) permits a restructuring debtor to, in effect, repudiate certain contracts including possibly personal property leases, with the approval of the monitor, trustee or the court. There have always been some concerns about the originator retaining title, but the perhaps unintended consequence of this new BIA change is that the originator may be able to repudiate the master lease underpinning the whole structure.

There's still debate about what this means. But the BDC is taking no chances for CSCF deals, requiring either that title to leased vehicles be initially moved to an intermediate SPE or that the ABS-issuing trust have a call right to acquire title to the vehicles if certain early warning triggers occur. Exercising such a call right, however, could expose the trust to significant income tax concerns and, therefore, while using an intermediate SPE upfront can add structuring costs to the transaction, it may be the preferred alternative.

While there was initially significant interest in the CSCF, the program was slow to take off because the industry ended up regarding the initial pricing — announced in late spring 2009 at 350 basis points over the applicable Government of Canada

bond benchmark — as too costly. The CSCF reduced its pricing to 150 basis points over the benchmark in September 2009, and the first deal was announced at the end of November when CNH Capital Canada sold a C\$300 million structure backed by loans to agricultural and construction equipment dealers.

There was other positive news for the market soon after the government first announced CSCF: starting in April, CIT, Nissan and BMW all placed private deals. And in June Ford Auto Securitization Trust sold a C\$600 million triple-A public deal without any assistance, only the third public securitization since the crisis began and the first in a year.

The private deals also benefited from having a much larger buyer base — U.S. investors. That was impractical until the 2008 change to Canada's Income Tax Act eliminated withholding tax on most arm's-length cross-border interest payments; tax on non-arm's-length payments between Canada and the U.S. was gradually phased out by the start of this year. Before 2008, such deals were either uneconomic or required a complex five-year-plus term loan structured to fit within various constraints.

U.S. conduits are also now looking at funding Canadian receivables. There are still some Canadian tax issues that need to be addressed, especially the new limitation on benefits rules contained in the recently revised Canada-U.S. tax treaty. But structures have been developed to work around them. There were 11 cross-border conduit deals worth more than C\$2.9 billion between March 2008 and April 2009, according to Standard & Poor's.

Two years ago, there were many who described the Canadian securitization market as dead and buried. Certainly, the past two years were exceptionally challenging. Many market professionals have moved on to other areas and companies that relied on securitization as a primary funding source are still struggling to find alternative sources of financing. Many smaller and mid-size finance and leasing companies, for example, still cannot access securitization funding, although the Canadian finance minister and the BDC are considering a number of ways to fix this.

But there is now, at last, a sense that the market didn't die after all. True, term deals are hardly coming at a furious pace and Canadian bank-sponsored ABCP conduits are only just starting to show interest in new deals. But at least there's some movement. And as more deals come to market, it gives hope that, unlike the patients in *Awakenings*, emerging from its coma won't be temporary. ▼

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