The Securitisation Law Review

Third Edition

Editor
Michael Urschel

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THE SECURITISATION LAW REVIEW

THIRD EDITION

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PREFACE

Securitisation, broadly defined as the conversion of assets into marketable financial securities, has been used as a method of raising capital since as early as the 1970s in the United States. The use of securitisation as a form of borrowing has increased globally since then, and bodies of law have been established in many jurisdictions to allow borrowers to access capital in this manner, while protecting potential investors. Regulatory considerations include tax structuring, bankruptcy considerations and economic-driven regulation focused specifically on securitisation.

Securitisation regulatory frameworks have developed at different rates globally and largely depend on a variety of factors, including the economic state of a given jurisdiction, the broader legal frameworks already in existence (including tax and bankruptcy law), particular asset classes available to securitise and habits of local consumers. Although certain assets, such as mortgage loans, are frequently securitised across many jurisdictions, other asset classes can vary. For example, in the United States and many developed countries, in addition to mortgage loan securitisation, securitisation of automobile loans and consumer debt is extremely common and significant expansion into other operating assets such as leases and royalties is occurring. In certain other countries, more purpose-driven and asset-class specific monetisation transactions are relevant. Economic events, such as the 2008 recession in the United States, have had a great impact on the regulatory framework, not only in the United States, but also in jurisdictions such as Japan that were affected by the recession and the effects of the covid-19 pandemic and have led to certain government responses in bolstering the securitisation market. Nevertheless, 2020 and 2021 are showing to be robust years for the securitisation markets, with increased deal volume and substantial innovation in the asset class across the globe.

In this third edition of *The Securitisation Law Review*, we aim to provide securitisation attorneys, borrowers, lenders and other market participants with insight into a sample of structural frameworks and regulatory issues surrounding the industry in a broad array of jurisdictions – including a new jurisdiction, Switzerland, to this edition. This volume is not intended to be a comprehensive overview of securitisation regulation and structures in every jurisdiction, but rather to provide a frame of reference for, and a comparison of, the various structural features available and the regulatory considerations necessary in securitising assets globally. As the asset securitisation industry continues to develop and expand to new and more esoteric asset classes, such a comparison will undoubtedly be useful to those innovating in global securitisation markets.

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I would like to thank the contributors for the chapters that follow. I hope that this volume will produce grounds for continued discussion in the global securitisation industry.

Michael Urschel
King & Spalding LLP
New York
October 2021

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Chapter 3

CANADA

Francesca Guolo, Mark Surchin, Brian Empey and Jon Northup[1]

I OVERVIEW

Canada boasts a well-developed and sophisticated securitisation market, emulating larger markets in the United States and Europe.

As at 31 May 2021, the total amount outstanding in the Canadian securitisation market was estimated to be C$73.0 billion. Term asset-backed securities (ABS) and asset-backed commercial paper (ABCP) each accounted for approximately 45 per cent of that amount, with the balance in private placements. Of the total term ABS and ABCP market, auto-related transactions represented 29.3 per cent, credit card transactions represented 23.3 per cent, residential mortgage transactions represented 16.3 per cent, home equity credit line transactions represented 10.7 per cent and commercial mortgage transactions represented 6.6 per cent.[2]

Participation in the Canadian securitisation market is dominated by financial institutions subject to prudential regulation and oversight. That regulation influences issuance and investment behaviours and has generally led to a market characterised by conservative risk-focused approaches and decision making. The market is also limited in size relative to its US and European counterparts. These factors, together with the impact of the global financial crisis of 2008 and (in particular) the related US subprime mortgage crisis, have contributed to a securitisation market in Canada, which emphasises traditional products and simple structures differentiated from the complex and esoteric products and structures seen historically (and albeit perhaps less so, currently) in other markets.

Securitisation structures in Canada typically utilise a bankruptcy remote special purpose entity (SPV) to which the assets securitised are assigned or transferred. There are no specific legal requirements imposed on SPVs and no legal restrictions on the type of assets that may be securitised. A common law trust often serves as the SPV, but limited partnerships and corporations can also be used depending upon the circumstances. In Canada, limited partnerships are creatures of statute and, like trusts, are relationships (and not entities per se). If a trust is used, an institutional trust company will serve as the trustee holding title to the securitised asset portfolio. If a limited partnership is used, its general partner must also be a special purpose entity. A trust SPV will issue to investors co-ownership interests in, or notes secured by, the securitised assets. The beneficiaries of the trust will usually be non-profit or charitable entities. The originator of the securitised assets will commonly administer

1 Francesca Guolo, Mark Surchin, Brian Empey and Jon Northup are partners at Goodmans LLP. The authors acknowledge the assistance of Caterina Costa-Faria and Aryan Pour-Bahreini.

2 https://www.dbrsmorningstar.com/research/382519/dbrs-morningstar-releases-may-2021-canadian-securitization-market-overview-report.

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and manage the pool of securitised assets. Currency and interest rate risks associated with the asset pool will normally be mitigated through the use of derivatives. Forms of credit enhancement used will align with those used in other jurisdictions. There is no requirement for risk retention on the part of a sponsor or seller in a Canadian securitisation.

The market for retail investor involvement in securitisations in Canada is limited, with the one exception being residential mortgage securitisations. Canada Mortgage and Housing Corporation (CMHC) is Canada's national housing agency and its mandate is to provide mortgage liquidity to Canadian lenders while also facilitating a sustainable, affordable and stable housing market.[3] To accomplish this broad mandate, CMHC offers or administers a number of programmes that are constantly evolving to respond to broader economic changes. Of these programmes, four are of key relevance to Canada's securitisation industry.[4]

The first is the CMHC insurance programme, which provides insurance against default for high loan-to-value mortgages. The second is the National Housing Act Mortgage-Backed Securities (NHA MBS) Program, which affords financial institutions the opportunity to offer securities to the market that are backed by pools of residential mortgages insured by CMHC. The third is the Canada Mortgage Bonds (CMB) Program, under which bonds backed by a CMHC guarantee are issued and the proceeds used to acquire pools of NHA MBS securities. Finally, CMHC also administers the registered covered bond programmes pursuant to which nine of Canada's chartered banks offer bonds backed by uninsured residential mortgage portfolios. NHA MBS and CMB investments are effectively considered government-backed securities and are more accessible and appealing to the retail investor base.

II REGULATION

Canada is a federation with legislative authority divided between the federal government and the various provincial and territorial governments.[5] Each of Canada's provinces also operates as a common law jurisdiction with judicial decisions informing certain aspects of the regulatory framework (other than Québec, a civil law jurisdiction).

There is neither a single regulator, nor a single body of legislation or regulation governing securitisations in Canada. Certain aspects of the Canadian securitisation market and its products fall within the federal purview and others fall within the provincial purview. The type of assets securitised, the nature and domicile of the participants to a securitisation and the manner of offering to investors will each influence the legislation, regulations and regulatory oversight applicable to the transaction. Generally:

a provincial securities legislation will govern the offering of securitised products;

b federal banking legislation, regulatory guidance for financial institutions and anti-money laundering legislation imposes requirements on a securitisation and its participants;

c federal insolvency legislation and provincial fraudulent conveyances and preferences legislation will dictate the status of an SPV as bankruptcy remote;

d provincial personal property security legislation and land registration systems will apply to the grant of security over a securitised asset portfolio;

3 https://www.cmhc-schl.gc.ca/.

4 https://www.bankofcanada.ca/wp-content/uploads/2015/12/fsr-december2015-mordel.pdf.

5 The federation of Canada consists of 10 provinces and three territories. In this Chapter, references to the Canadian provinces should be construed to also be references to the Canadian territories.

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e federal and provincial consumer protection and privacy legislation may impose requirements on a securitisation based on the type of assets securitised; and
f federal and provincial tax legislation will influence the choice of SPV and structure of a securitisation.

i Offerings of securitised products

The regulation of asset-backed securities and the securitisation market has been swept into the regulation of securities and capital markets generally in Canada, with infrequent distinctions drawn for securitisations.

The regulation of securities is a matter of provincial jurisdiction, with each province enacting its own securities legislation and each province mandating its own securities regulator to oversee capital markets activities in the jurisdiction. While each province has autonomous authority, effort has been made to harmonise securities regulation across the country (often through national or multi-lateral instruments) and the provincial regulators coordinate their efforts through the auspices of their umbrella organisation, the Canadian Securities Administrators (CSA).

Generally speaking, Canadian securities laws impose prospectus requirements on securities offerings to the public and require intermediaries facilitating, or advising in relation to, these offerings to be registered as broker-dealers or advisers. However, exemptions from the prospectus requirements are available. Among the widely-used prospectus exemptions is an exemption for offerings to institutions or to individuals that possesses a stipulated net worth (accredited investors).[6] Securities offered in reliance on an exemption from the prospectus requirements are subject to resale restrictions.

In Canada, offerings of asset-backed securities typically take place in the exempt market as the vast majority of investors are institutions and, accordingly, qualify as accredited investors.

While less common, public offerings of asset-backed securities must generally comply with the prospectus requirements of applicable provincial securities legislation, which prescribe specific disclosure and mandate full, plain and true disclosure of all material facts.[7] Issuers of asset-backed securities offered by way of prospectus will also be subject to continuous disclosure requirements. Exception is made for offerings of highly rated short-term securitised products (such as asset-backed commercial paper) and offerings of NHA MBS and CMB securities (to which the prospectus requirements do not apply). Issuers of short-term securitised products are required to prepare and provide to investors an information memorandum, monthly reports and updated disclosure, each in prescribed form.[8] NHA MBS and CMB securities are effectively considered Government of Canada securities and need only comply with the disclosure requirements imposed on these offerings by CMHC.

Credit rating agencies that provide ratings of securities offered under a prospectus at non-fixed prices or offered in reliance upon the exemption from the prospectus requirements for short-term securitised products must apply for designation under National Instrument 25-101 – Designated Rating Organizations (NI 25-101) of Canadian securities legislation. NI 25-101 imposes governance, independence, record keeping and disclosure requirements on designated rating organisations.

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6 National Instrument 45-106 – Prospectus Exemptions.
7 National Instrument 41-101 – General Prospectus Requirements.
8 National Instrument 45-106 – Prospectus Exemptions.

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ii Federally regulated financial institutions

The preponderance of originators, service providers and investors in Canadian securitisations are financial institutions (such as banks, trust and loan companies, insurance companies and pension plans) subject to the prudential regulation and oversight of the Office of the Superintendent of Financial Institutions (OSFI). OSFI promulgates rules and guidance in relation to the capital adequacy, accounting practices, risk management and governance of regulated entities as well as their participation in specific transactions such as securitisations. In particular, OSFI's Capital Adequacy Requirements (CAR) Guideline and Guidelines B-5 and B-5A set out the capital treatment of securitisation exposures and investments in securitisations. The Guidelines are designed to align with the recommendations of the Basel Committee on Banking Supervision Basel II and III frameworks.[9]

Originators, issuers and service providers in NHA MBS and CMB securitisations are also required to comply with the requirements established by CMHC for those programmes.

iii Anti-money laundering legislation

Canada's anti-money laundering and terrorist financing legislative regime is embodied primarily in Canada's Criminal Code and Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA). The Criminal Code applies to all persons. The PCMLTFA applies only to certain specified entities, among them federally regulated financial institutions. Neither statute includes provisions expressly applicable to securitisation transactions. Under these statutes, however, financial institutions involved in the Canadian securitisation market are obligated to monitor all flows of funds for suspicious activity and maintain robust records in relation to all their activities, including their participation in securitisation transactions.

iv Consumer protection

Where the assets of a securitisation in Canada consist of consumer receivables, federal and provincial legislative provisions designed to protect consumers may require structural or operational accommodations in the transaction. These legislative provisions can be found in provincial consumer protection statutes, the governing statutes of financial institutions, the Criminal Code and Canada's Interest Act. In relation to consumer receivables, these statutorily enshrined consumer protections can impose disclosure requirements, afford rescission and prepayment rights, and limit interest rates, fees and penalties.

v Privacy

Again, where the assets of a securitisation in Canada consist of consumer receivables, regard must be had for Canadian privacy legislation. Canada's federal Personal Information Protection and Electronic Documents Act and certain provincial privacy legislation regulate the use, collection and disclosure of personal information of an identifiable individual. To the extent consumer data containing such personal information is required to be stored, managed, transmitted or otherwise disclosed for purposes of a securitisation in Canada, steps must be taken to anonymise this information or obtain the prescribed consents.

9 https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR19_chpt7.aspx#7.4;
https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b5-19.aspx;
https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b5a.aspx.

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vi Tax

Canada's tax regime is governed by the federal Income Tax Act (ITA) and its regulations, as well as the sales and other tax laws of Canada and its provinces. The primary basis for income taxation in Canada is the taxpayer's residence. Canadian residents (including corporations and trusts) generally are subject to Canadian tax on their worldwide income. A partnership generally is not itself subject to tax in Canada, but the partnership's income is allocated to its members based on their respective partnership interests.

Non-residents of Canada generally are subject to Canadian income tax only on certain types of Canadian-source income, including income from carrying on business in Canada and withholding tax in respect of certain types of Canadian-source passive income.

The specific structure adopted for a particular securitisation will depend on a number of factors, including the income and sales tax issues arising from the types of assets being securitised and the nature and domicile of the participants, including the originator, issuer and investors. The characterisation and treatment of securitisation arrangements for Canadian tax purposes largely will follow the bona fide legal arrangements put in place (and should not be re-characterised based on their economic substance).

Absent a specific provision in the ITA to the contrary, or a finding that the arrangements are a sham, legal arrangements normally will be respected for Canadian tax purposes.

In cross-border securitisations, there is no Canadian withholding tax on interest payments paid by a resident of Canada to an arm's length non-resident, other than participating debt interest (which is typically not a feature of securitisations).

Cross-border payments of rent, royalties and dividends are generally subject to 25 per cent Canadian withholding tax, subject to certain specified exemptions and relief available under applicable tax treaties.

Transactions involving these payments are typically structured with a Canadian SPV holding the securitised assets and a cross-border loan from the foreign issuer or investor. Non-resident issuers participating in a cross-border securitisation involving Canada will need to restrict their activities in Canada to ensure the issuer could not be considered to be carrying on business in Canada (and, accordingly, be subject to tax in Canada) by virtue of acquiring, holding and/or servicing the underlying Canadian assets, and will often similarly use an intermediate Canadian SPV to hold the assets.

Canada's 2021 federal budget announced the proposed introduction of earnings-stripping rules that are intended to limit the amount of net interest expense that may be deducted to a fixed share of earnings. Draft legislation with respect to these proposals has not yet been released and accordingly the impact, if any, of the proposed rules on particular securitisation transactions is not yet certain.

Canada's Goods and Services Tax (GST) is a comprehensive value-added tax on the consumption of nearly all property and services in Canada, but generally excludes financial instruments. The rate of GST is currently 5 per cent.

Each province in Canada (other than Alberta) also levies a sales tax on most sales of property and services provided within the province. Several provinces (including Ontario) have harmonised their provincial sales taxes with the GST to form a single Harmonized Sales Tax (HST). The tax regime for the GST and the HST is ordinarily the same. Québec's provincial sales tax mirrors, but is not harmonised with, the federal GST. Each of Manitoba, Saskatchewan and British Columbia retains an independent retail sales tax.

Sales of financial instruments (such as loans and receivables) generally are exempt from GST/HST as well as provincial sales taxes.

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To the extent possible, securitised assets in Canada are usually sold or contributed to the SPV on a fully serviced basis, so that there is not a separate supply of these services that would be subject to non-recoverable GST/HST. Other services fees, such as collection agent services, generally will be subject to GST/HST.

III SECURITY AND GUARANTEES

In a typical Canadian securitisation, the SPV holding title to the securitised assets will grant a charge or lien over those assets in favour of the investors as security for its obligations under the notes issued to them. The credit support or credit enhancement in a Canadian securitisation may include a guarantee.

Security in Canada can be taken over all types of assets: real (or immovable) property and personal (or movable) property (both tangible and intangible), with a different regime applicable to each.

Again, under Canada's federal system, the powers of government are shared between the federal government and the provincial governments. Canada's provinces are responsible for 'property and civil rights' in their respective jurisdictions. Matters pertaining to security and guarantees therefore fall within the purview of the provinces.[10]

The validity and enforceability of personal property security interests are governed by provincial statute, as supplemented by the common law (in all provinces other than Québec as a civil law jurisdiction). Guarantees are interpreted in accordance with general common law principles of contractual interpretation (again, other than in Québec).

Generally, the SPV will enter into a trust indenture with a professional trustee contemplating both the issuance of the notes and the grant of the security interest. The indenture trustee will hold the benefit of the security granted for the investors as beneficiaries.

In Québec, the security interest will be granted to the trustee through a prescribed document known as a hypothec, accompanied by specific formal requirements. There is no prescribed form of trust indenture in the other provinces of Canada. Similarly, there are no special formalities to be observed in providing a guarantee.

i Statutory framework for secured interests

Ontario and Canada's other common law provinces have personal property security legislation (PPSA) modelled on Article 9 of the pre-2002 Uniform Commercial Code (UCC) in the United States. While the specifics of each province's PPSA may differ, they are consistent in basic concepts and overall structure. Québec does not have a PPSA; however, its Civil Code contains provisions that function in a manner similar to the PPSA, including a public registration system for security granted on personal property.

The PPSA applies to every transaction involving personal property, regardless of form, that in substance creates a 'security interest'. This includes financing leases and conditional sales agreements. The PPSA sets out various rules for establishing priority among secured parties. It contains provisions specifying the rights of debtors who grant security interests and those of secured parties who hold and enforce their security. These statutory provisions supplement the terms of the parties' negotiated documentation.

10 However, Canada's federal government has jurisdiction in respect of certain types of property (e.g., marine vessels, aircraft and certain intellectual property).

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In general, to protect its rights in personal property as against third parties, a secured party (in a typical Canadian securitisation, the indenture trustee on behalf of the investors) must have a written security agreement, which grants it a security interest in the identified collateral (e.g., the portfolio of securitised assets). The security interest must both 'attach' to the collateral and be perfected.[11] Attachment generally requires that the debtor granting the security interest (namely, the SPV in a typical Canadian securitisation) has rights in the collateral, that value has been given and that the parties sign a valid security agreement adequately describing the collateral. A secured party perfects its security interest by taking control of the secured collateral (either by possession or a control agreement) or by registering its interest against the debtor in a central computerised registration system. Secured parties must register against the correct debtor name and ensure other required information is accurate. Registrations should be amended as circumstances change, including if the debtor changes its name. Notably, any postponement and assignment of claims by a guarantor contained in a guarantee can be characterised as a security interest that should be registered under the PPSA against the guarantor.[12]

In a typical Canadian securitisation, where accounts receivable are to be securitised, those accounts receivable are sold or assigned by the originator to a SPV. In relation to such sale or assignment, a financing statement is registered under the PPSA, with the originator identified as the 'debtor', so that those searching the computerised central registry system are notified that a sale has occurred. Under Québec civil law, a securitisation transaction cannot be perfected unless the transaction encompasses all receivables of a certain type that have been generated by the originator in the specified time period (a 'universality of claims').

Cash collateral is a common feature of Canadian securitisation transactions. As with any other asset over which security is granted, a valid and enforceable security interest over a deposit account or any other cash collateral requires attachment and perfection. While an account control agreement is not required to achieve perfection, deposit account control agreements are common. These allow the account bank and the secured party to agree as to their respective rights in the cash held in the bank account. Over the past several years, there has been an organised movement to amend the PPSA so that secured parties can perfect by control over a bank account. This would harmonise Canada's system with the UCC system in the US.

The PPSA in some provinces has been amended to allow for perfection by control in respect of electronic chattel paper, thereby affording 'perfection by control' priority over 'perfection by registration' in that context. This amendment is relevant where the collateral of a securitisation includes car loans and other like assets and is an example of the PPSA being amended over time to align with similar provisions of the UCC.

Securities transfer legislation and related amendments to the PPSA (together, the STA) came into force in January 2007 in Ontario and Alberta and have since been adopted by all Canadian provinces. The STA implements rules governing property rights that exist whenever investment property (such as securities, futures and other financial assets) is bought, sold or used as collateral to secure obligations. The rules are based on Revised Article 8 of the UCC. Among other things, they address perfection steps in connection with any security

11 Certain assets will require additional registration/perfection (e.g., certain intellectual property, aircraft, maritime vessels and ships, railcars and rolling stock, and life insurance policies).

12 The process for taking security over real estate differs. A party taking security in real property (by way of a mortgage or hypothec) must register such security on title to the property.

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interest granted in securities directly held by a debtor, and securities and other financial assets that are indirectly held through a securities intermediary. The rules are intended to accommodate modern securities settlement systems where securities are held indirectly through intermediaries and where computerised book entries are relied on for settlement. The STA also provides additional certainty with respect to priority of perfection by allowing secured parties to perfect by control.

ii Impact of insolvency on secured interests

If an SPV becomes subject to an insolvency proceeding after granting a security interest in the underlying assets of the securitisation, the transaction may be scrutinised under Canada's Bankruptcy and Insolvency Act or Companies' Creditors Arrangement Act by the insolvency official (e.g., the trustee in bankruptcy or monitor) appointed in respect of the SPV's estate. The insolvency official, sometimes with the assistance of the court, will determine whether the transaction preferred one creditor of the SPV over its other creditors, or whether the SPV transferred its assets for conspicuously less than fair market value.

Assuming the debtor (e.g., the SPV) and the secured creditor (e.g., the indenture trustee on behalf of the investors) deal at arm's length and the security interest only secures newly issued debt, it is unlikely there would be a basis for attacking the securitisation as a preference or transfer at undervalue. The look-back periods for arm's-length transactions are three months before the commencement of insolvency proceedings for a preference and 12 months before the commencement of insolvency proceedings for a transfer at undervalue.

IV PRIORITY OF PAYMENTS AND WATERFALLS

Priorities among creditors are governed primarily by the PPSA, subject to contractual arrangements among creditors (including inter-creditor agreements and subordination agreements). In the case of securitisations, the trust indenture will often address respective priorities (as would any necessary deed of hypothec in Québec).

The ranking and priority of security interests in personal property are central features of the PPSA. The priority of security interests perfected by registration generally is a matter of 'who registered first', with certain exceptions (including an exception for a secured party that has a 'purchase money security interest' in certain collateral). A security interest perfected by possession or control (e.g., where a share certificate is delivered as part of a pledge of shares) generally has priority over a security interest in the same collateral that is perfected by registration.

Unperfected security interests commonly rank last as the PPSA generally gives priority to secured creditors having security in the same collateral based on the order in which their respective security interests attached to the collateral.

Notably, the PPSA does not address all priorities of payments as between secured and unsecured creditors. In particular, waterfall priorities as they relate to unsecured creditors are generally dealt with by other pieces of legislation in addition to long established common law doctrines (in all provinces other than Québec). Various federal and other provincial statutes additionally provide statutory priority to specific creditors that do not have security interests perfected under the PPSA, such as various tax and other governmental authorities.

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V ISOLATION OF ASSETS AND BANKRUPTCY REMOTENESS

Fundamental to a typical Canadian securitisation is the sale (or contribution) of assets by the originator of the assets to the SPV that, in turn, will issue a debt instrument to investors. Care is taken to ensure the sale or contribution is 'true' so the transaction will not be re-characterised, for example, as a grant of a security interest by the originator in favour of the SPV.

Bankruptcy remoteness is achieved through the 'true sale' and the separateness of the SPV from the originator. For the investor in the securitisation, bankruptcy remoteness ensures that, if the originator enters insolvency, the assets of the SPV will not be available to satisfy claims of the originator's other creditors. For the originator, it means that investors in the securitisation will not have recourse to the originator for any losses suffered except as expressly provided in the documentation.

The trust indenture will require compliance with 'separateness covenants' included in governing or constating documents of the SPV, which serve to limit the business of the SPV to that of owning and holding the securitisation assets and performing its obligations under the securitisation's transaction agreements.

Bankruptcy remoteness would be defeated by an order for substantive consolidation of the SPV and the originator (or other parties that are not also special purpose entities). In Canada, substantive consolidation is an extraordinary remedy and is rarely ordered over the objection of third party creditors. Nevertheless, separateness covenants and other aspects of a securitisation's transaction documents will be aimed at preventing or limiting actions that Canadian courts have identified as factors to be considered for purposes of substantive consolidation:

a difficulty in segregating assets;
b presence of consolidated financial statements;
c profitability of consolidation at a single location;
d commingling of assets and business functions;
e unity of interests in ownership;
f existence of intercorporate loan guarantees; and
g transfer of assets without observing corporate formalities.[13]

The presence of any one or more of these factors will not necessarily be determinative as the court will consider the entire context of the transaction. For instance, the originator and SPV in a Canadian securitisation can be, and often are, related entities within a corporate group and that relationship will not, of itself, lead to substantive consolidation.

Typically, a non-consolidation opinion is provided as part of the closing of a securitisation transaction in Canada to provide comfort that the SPV and originator (or other transaction parties) are not likely to be the subject of substantive consolidation.

A Canadian securitisation transaction also raises the issue of 'true-sale', which generally relates to the characterisation of the transaction as a sale of an asset or, conversely, as some form of financing transaction. The Supreme Court of Canada has concluded that in characterising a transaction or instrument for commercial purposes, the starting point is the

13 *Northland Properties Ltd., Re* [1988] BCJ No 1210 (SC), aff'd [1989] BCJ No 63 (CA), in which the court considered the 'elements of consolidation' set out in the US Bankruptcy Court case *Vecco Const. Indust. Inc., Re* 4 BR 407 (US Bankr ED Va 1980).

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parties' intention, objectively determined. Unless proven otherwise, the parties' intention is to be found in the words that they have used in the transaction documents. As a general rule, Canadian courts will only re-characterise the legal nature of a transaction or instrument if the label attached to it by the parties does not properly reflect its actual legal effect. The parties are entitled to structure their contractual relationships as they see fit, absent a sham or public policy considerations. Canada is therefore different from other jurisdictions where the comparable test is focused on the economic effect of the applicable documents, as opposed to the legal effect.

In determining the 'real nature' of a transfer of financial assets (e.g., whether the transfer constitutes a sale or a loan), courts generally consider the following relevant factors, with items (e), (f) and (g) applying only in the case of a sale of receivables:

a the parties' intention as evidenced by the language of the applicable agreement, the factual circumstances and purpose of the agreement (including the desired commercial result);

b whether the risks of ownership are transferred to the purchaser and the extent and nature of recourse to the seller;

c certainty of determination of the purchase price;

d the extent to which the purchased assets are identifiable;

e the right of the seller to surplus collections;

f responsibility of the seller in collecting the receivables; and

g whether the seller has a right to redeem the receivables on paying a specified amount.[14]

Typically, a true sale opinion is provided as part of the closing of a securitisation transaction in Canada to provide comfort that the transaction is not likely to be re-characterised.

VI OUTLOOK

Canada arguably fared far better than its US and European counterparts in the 2008 global financial crisis. However, Canada's securitisation market was not left unscathed. In the short term, securitisation transactions (other than government- or bank-sponsored transactions) virtually disappeared from the landscape.

The crisis underscored the idiosyncrasies of the Canadian securitisation market, including its diminutive size relative to other markets, the predominance of prudentially regulated participants in the market and the significant proportion of the market represented by asset-backed securities backstopped by the government. The imperative for Canada to emulate and harmonise with global standards and practices in the securitisation market was reinforced.

While regulatory reforms in the Canadian securitisation market were less extensive than those in key global markets, Canada certainly enacted significant regulatory changes designed to implement the recommendations of the Basel Committee on Banking Supervision, enhance marketplace disclosure and align with global standards in liquidity and credit support. The regulatory and policy outlook for the Canadian securitisation market continues to be focused on transparency, simplification and efficiency.

14 *Metropolitan Toronto Police Widows and Orphans Fund v. Telus Communications Inc.* (2003), 30 BLR 3d 288 (Ont Sup Ct J).

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A number of recent legislative, regulatory and policy initiatives are anticipated to affect the Canadian securitisation market in the future. Some of these are as follows.

Implementation of the final Basel III reforms in relation to capital adequacy may impact investment decisions by federally regulated financial institutions in securitised products.

From and after 31 December 2021, CMHC-insured loans will no longer be eligible for inclusion in securitisations other than NHA MBS and CMB securitisations. This will inevitably constrain lenders' ability to rely on securitisations to fund their mortgage loan portfolios.

In keeping with the government's stated desire to see the development of a private mortgage-backed securities market offering a more flexible source of funding for lenders and reducing reliance on government-sponsored programmes,[15] a number of 'private label' residential mortgage securitisations have come to market in recent years and this trend is expected to continue.

Evolving derivatives regulation may impose increased compliance obligations on securitisation structures, which rely on derivatives to mitigate currency and interest rate risk.

The anticipated transition from the Canadian Dollar Offered Rate (CDOR) to the Canadian Overnight Repo Rate Average (CORRA) as the key Canadian dollar interest rate benchmark may impact the risk management and supporting infrastructure of securitisations.[16]

Generally, Canada's securitisation market can be expected to look to, and follow, regulatory developments and product trends in the US and European securitisation markets.

15 https://www.bankofcanada.ca/2019/05/poloz-talks-mortgages-innovation-could-improve-flexibility/.

16 On 11 August 2021, CMHC announced that it will only be offering the floating rate CMB in which the coupon is based on the CORRA (with preliminary CORRA fallback provisions introduced to reduce uncertainty around the future of CORRA).

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Appendix 1

ABOUT THE AUTHORS

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Francesca Guolo is a partner and head of the structured finance and derivatives and financial services regulatory groups at Goodmans. She is also co-chair of the firm's opinions committee. Francesca is a pre-eminent financial services lawyer with particular expertise in structured finance, securitisation, derivatives, wealth management and the regulation of financial services market participants and products. Her experience spans North American and European markets, including capital markets and M&A transactions. She often advises in the negotiation and execution of innovative, complex transactions driven by strategic, economic, tax or regulatory considerations. Francesca led the Goodmans legal team that represented the Pan-Canadian Third Party Asset-Backed Commercial Paper Investors Committee in the successful restructuring of Canada's C$32 billion non-bank sponsored asset-backed commercial paper market.

Francesca has been recognised as a leading lawyer by *Best Lawyers in Canada*, *Who's Who Legal*, *Euromoney's Guide to the World's Leading Women in Business Law*, *Euromoney's Banking*, *Finance and Transactional Expert Guide*, *Lexpert Special Edition: Canada's Leading Finance and M&A Lawyers* and *The Canadian Legal Lexpert Directory*. Francesca holds the Regulatory Compliance and Legal Risk Management for Financial Institutions Certificate from Osgoode Hall Law School. She has served on boards of profit and not-for-profit corporations, including a wholly-owned Canadian financing subsidiary of a global bank. She was admitted to the Ontario Bar in 1989.

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Brian Empey is a partner in the corporate restructuring group at Goodmans, which is consistently and widely recognised as Canada's best and leading corporate restructuring practice. Brian's practice involves all aspects of corporate restructuring including bankruptcy, insolvency, liquidations and creditor remedies, as well as secured transactions and structured financings, including derivatives and asset-backed securitisations and regulatory compliance in the financial services and payments industry. Brian has particular expertise in complex and cross-border restructurings under the Companies' Creditors Arrangement Act (CCAA) and in insolvencies of securities firms and financial institutions. He has advised debtor companies, creditors, regulators, committees and court-appointed officers, and has appeared in all levels of courts, including the Supreme Court of Canada. Brian is recognised as a leading insolvency and financial restructuring lawyer by *Chambers Canada*, *Chambers Global*, *The Canadian Legal Lexpert Directory*, *IFLR 1000*, *Who's Who Legal Canada*, *Euromoney's Guide to the World's Leading Insolvency and Restructuring Lawyers* and is BV Peer Review Rated by *LexisNexis Martindale-Hubbell*. Brian is also recognised in *Euromoney's Banking, Finance & Transactional Law Expert Guide 10th edition* and in the areas of banking and finance law and insolvency and financial restructuring law in *The Best Lawyers in Canada*. He was admitted to the Ontario Bar in 1990.

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Jon Northup is a partner in the tax group and a member of the Executive Committee at Goodmans. Jon's practice focuses on mergers and acquisitions, corporate finance and investment funds, with a particular expertise in structuring cross-border transactions. He provides clients with dynamic, strategic and practical tax advice, frequently developing innovative structures and planning to address complex transactions and structuring challenges. Jon is also vice-chair of the firm's Aging & Healthcare (including Seniors Housing) practice group and chair of SenbridGe, a division of Goodmans that provides specialised advisory, education and networking programmes to the healthcare and ageing sector. Jon is recognised as a leading practitioner of tax law by *Chambers Global*, *Legal 500 Canada*, *Best Lawyers in Canada* and *The Canadian Legal Lexpert Directory*. *Lexpert Magazine* named Jon one of Canada's *Top 40 Under 40 Lawyers* in 2006 and one of the *20 Corporate Lawyers to Watch* in 2007. He was admitted to the Ontario Bar in 2000.

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