

Blakes Bulletin

Securitization

Canadian Federal Budget Announces Structured Finance Developments

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The Canadian federal budget, which was unveiled on March 4, 2010 (the Budget), has several important announcements from a structured finance standpoint. Among other things, it confirms the expiry of the C\$12 billion Canadian Secured Credit Facility (CSCF) but at the same time introduces several smaller programmes which will provide new financing options for small and medium-sized financing companies. The federal government also promised to introduce legislation to permit financial institutions to issue covered bonds under a prescribed legislative framework, thereby providing greater legal certainty to the rights of covered bond investors.

These new initiatives are modest incremental changes to the Canadian structured finance landscape and, in that regard, are in keeping with the 2010 Budget as a whole. Following the federal government's January 2009 Economic Action Plan, which focused on new stimulus spending programmes, the Budget is concerned with deficit reduction and incremental improvements to the tax system and to the regulation of financial institutions, with few new spending initiatives.

TERMINATION OF CANADIAN SECURED CREDIT FACILITY

In 2009, as part of its economic stimulus and stability programme, the federal government committed to purchase under the CSCF up to C\$12 billion of newly issued term asset-backed securities (ABS) secured by loans and leases on vehicles and equipment and by dealer floorplan (inventory financing) loans. The programme was scheduled to expire at the end of March 2010, and although there was some hope that it would be extended, many thought this was unlikely in the current fiscal environment. The Budget documents confirm that the CSCF will terminate as scheduled at the end of March 2010.

To date, three originators have accessed the facility, with the federal government purchasing a total of almost C\$1.7 billion of ABS under offerings from CNH Capital Canada (C\$300 million backed by equipment floorplan loans), GMAC Canada (C\$1.26 billion backed by auto loans) and PHH Vehicle Management Services (C\$91 million backed by fleet leases). The CNH and PHH transactions also raised significant amounts from private investors. It appears that ultimately only a portion of the C\$12 billion available under the CSCF will be drawn, although the Budget documents indicate that a number of additional transactions are in process and are expected to be completed prior to expiration of the facility. The CSCF provides a "minimum bid" for ABS backed by eligible receivables in order to provide originators with assurances that government funding will be available if private investors are not.

EXPIRY OF OTHER GOVERNMENT SUPPORT PROGRAMMES

With domestic financial institutions and credit markets having come through 2009 on a stable footing, a number of other federal stimulus and support initiatives are also being withdrawn. In particular, the Canadian Lenders Assurance Facility and the Canadian Life Insurers Assurance Facility, which were available to permit federal deposit-taking institutions and insurers to issue debt backed by a federal government guarantee, both expired at the end of December 2009. Although these facilities were never used, they did provide some support to market confidence and helped contain borrowing spreads for Canadian financial institutions. Furthermore, the Bank of Canada has taken steps to exit from its extraordinary liquidity facilities, which were introduced during the credit crisis.

INTRODUCTION OF VEHICLE AND EQUIPMENT FINANCING PARTNERSHIP

An important new financing programme, called the Vehicle and Equipment Financing Partnership, was announced in the Budget. This programme will be available to smaller equipment and vehicle finance and leasing companies and is part of the Business

CONT'D ON PAGE 2

Securitization

CONT'D FROM PAGE 1

Credit Availability Program (BCAP). BCAP is intended to preserve jobs and fund growth by enhancing co-operation between private sector lenders, Export Development Canada and the Business Development Bank of Canada (BDC).

The federal government's view is that access to financing has normalized for larger finance and leasing companies, but that their smaller counterparts, despite being creditworthy, cannot obtain sufficient financing to meet growing customer demand. The goal of the Vehicle and Equipment Financing Partnership is to allow independent lenders and lessors to provide specialized financing to smaller businesses, and thereby supplement the credit available from banks and other large financing providers. As part of the Budget, the government has made an initial commitment of C\$500 million in funding for this new financing programme.

As was the case with the CSCF, the new programme will be funded and managed by BDC. Details are expected to be released over the coming weeks. The programme is described as a "partnership" and is intended to expand financing options for small and medium-sized finance and leasing companies in order to increase the availability of credit at market rates for dealers and users of vehicles and equipment. Industry observers expect that private sector securitization partners may establish vehicles with financing from BDC to securitize receivables of different financing companies. Other financing models, such as those currently being used by Canadian life insurance companies, may also be utilized.

LEGISLATIVE COVERED BOND FRAMEWORK IN THE WORKS

The Budget also responds to requests from the banking industry with a pledge to introduce covered bond legislation in Canada. The legislation would permit federally regulated financial institutions (FRFIs) to issue covered bonds under a legislative framework. This approach would be preferable in many respects to issuance under the structured contractual framework, which is currently used in Canada. Four major Canadian banks have established covered bond programmes which provide access to the very deep European market for these instruments, but the enactment of covered bond legislation will provide greater legal certainty and security to covered bond investors and foster

the expansion of this important and low-cost funding source.

Existing Canadian covered bond programmes provide for the issuance by Canadian banks of term debt which is guaranteed by a special-purpose vehicle holding a "cover pool" of residential mortgages. Relying upon securitization technology and the common law contractual framework developed by covered bond issuers in the United Kingdom, existing Canadian covered bond programmes are intended to ensure that the cover pool is bankruptcy-remote from the banks, thereby ensuring that the covered bonds can obtain the AAA credit ratings required in the market. Issuing under a legislative framework will provide statutory legal certainty for the rights of covered bond investors in the assets comprising the cover pool. Covered bond legislation also promises a clear and simple framework which can be easily digested by European investors who may not have adequate incentives to complete all of the necessary legal and commercial diligence required for contractual covered bond offerings by new issuers from countries which do not have a deep historic covered bond market.

The Canadian government's initial 2007 covered bond guidelines acknowledged the benefits of permitting FRFIs access to this important funding source, but also sought to limit the expansion of the amount of FRFI debt which would have preferential access to their assets. The balance struck in 2007 was to permit FRFIs to issue covered bonds with a principal amount not exceeding 4% of an institution's total assets. This 4% cap will likely stay in place for the time being, since to date no bank has been constricted by this limit. However, the withdrawal of certain other federal liquidity programmes, including the termination of the Insured Mortgage Purchase Programme in March 2010, and the ability to rely upon a clear and comprehensive legislative framework, should lead to increased reliance on financing under covered bond programmes. It remains to be seen whether market demand will permit Canadian FRFIs to extend the asset classes included in cover pools beyond residential mortgages to include commercial mortgages or even credit card debt, but it is useful to note that the Budget does suggest that the new legislative framework will accommodate other categories of high quality assets.

CONT'D ON PAGE 3

Securitization

CONT'D FROM PAGE 2

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