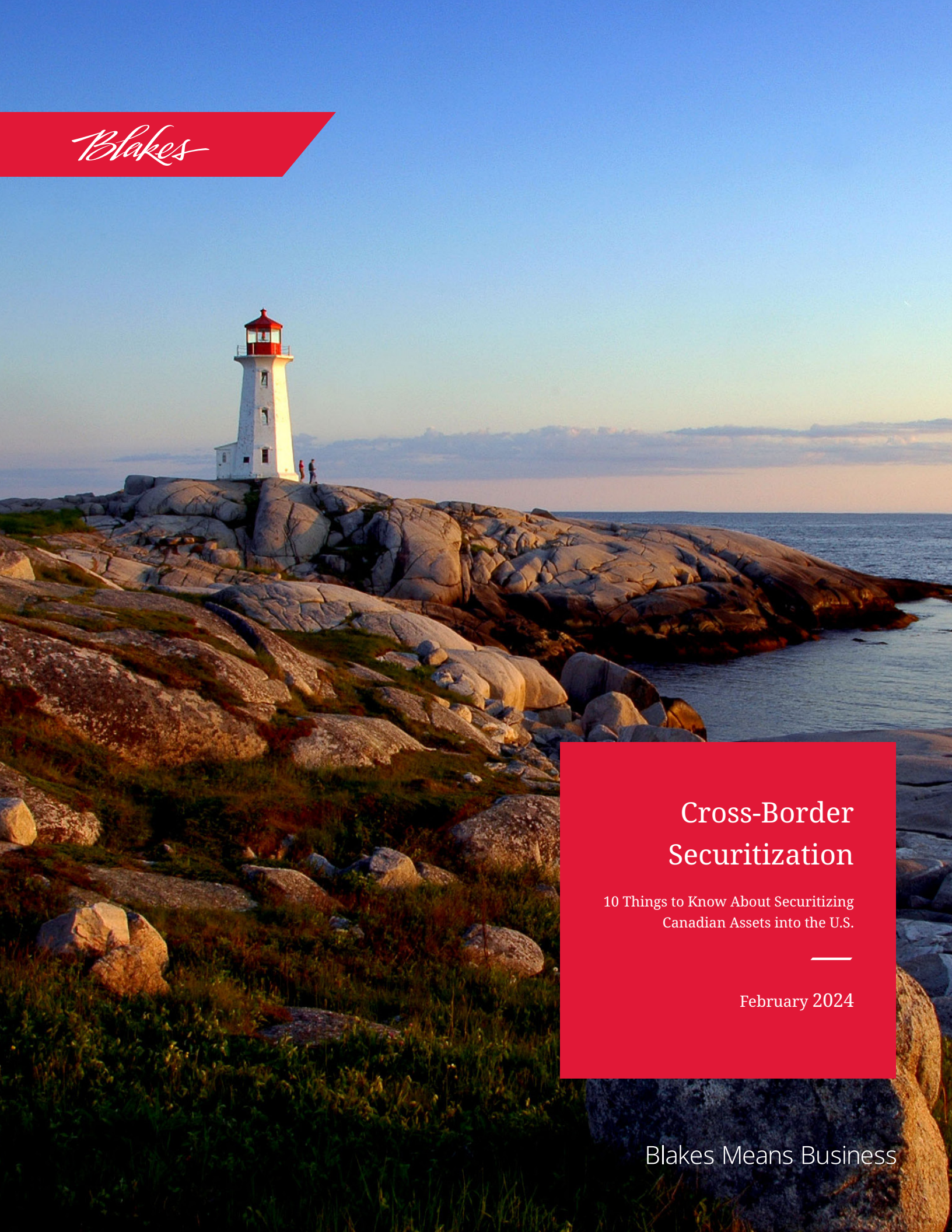




*Blakes*



## Cross-Border Securitization

10 Things to Know About Securitizing  
Canadian Assets into the U.S.

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February 2024

Blakes Means Business

## About Blakes

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As one of Canada's top business law firms, Blake, Cassels & Graydon LLP (Blakes) provides exceptional legal services to leading businesses in Canada and around the world. We focus on building long-term relationships with clients. We do this by providing unparalleled client service and the highest standard of legal advice, always informed by the business context.



## Cross-Border Securitization

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Cross-border securitizations involving Canadian assets can take various forms. For example:

- A U.S. originator may have sold products to Canadian customers and wants to include the related receivables (owing by Canadians) as part of an otherwise U.S. securitization.
- A Canadian originator may complete a Canadian securitization (selling to a Canadian special purpose entity (SPE)) but wants to fund it with notes sold in whole or in part to U.S. investors.
- A Canadian originator may sell its assets directly to a U.S. SPE, perhaps in conjunction with parallel sales by its U.S. affiliates.

Although the Canadian and U.S. legal systems largely share a common heritage, there are some important differences to note when securitizing Canadian assets on a cross-border basis.

This paper focuses on 10 important Canadian law considerations that apply to “southbound” securitizations of Canadian assets into the U.S.

Other Canadian legal issues arise in a “northbound” sale of U.S. assets or asset-backed securities into Canada, including regulatory, tax and securities law considerations. We do not address those in this paper. Also, we do not cover U.S. law considerations arising under “southbound” securitizations of Canadian assets into the U.S.

## 01 | Regulatory Considerations

Canada's federal banking laws impose restrictions on foreign banks, and certain entities associated with foreign banks, that carry on business in Canada, including through a nominee or agent. If a U.S. entity involved in a cross-border securitization is a "foreign bank" or an "entity associated with a foreign bank," it will be important to determine whether the foreign bank or the associated entity is carrying on business in Canada and, if so, whether any of the restrictions set out in Canada's federal banking laws apply.

The analysis of whether a foreign bank or an entity associated with a foreign bank is carrying on business in Canada is fact driven and subject to the decision of the Superintendent of Financial Institutions, the primary regulator of federal financial institutions in Canada. In most cases, the mere fact that a U.S. entity establishes a relationship with a Canadian originator will not, in and of itself, result in a contravention of Canada's banking laws, provided that the U.S. entity avoids certain Canadian-related activities. For example, the U.S. entity should avoid visits to Canada; negotiate, execute and deliver the agreements outside Canada; fund from outside Canada; and not receive any payments under the relevant agreements in Canada. Where it is not practical to structure a transaction in this way, it may be acceptable to obtain certain ancillary services in Canada, but this should be discussed with counsel.

Similar regulatory restrictions apply to other types of foreign financial institutions carrying on certain types of business in Canada (e.g., insurance and trustee services). As with foreign banks, however, it is usually possible to structure their activities to avoid a violation of these restrictions.

Other Canadian federal and provincial laws may apply in specific circumstances, including privacy, anti-spam, anti-money laundering and sanctions, consumer protection, disclosure of cost of credit requirements, motor vehicle dealer licensing legislation and mortgage broker legislation. Generally, these other regulatory laws would not prevent a cross-border transaction, but they may impact the structure and documentation for a cross-border securitization.

## 02 | Tax

Achieving tax neutrality is a key goal in most cross-border securitization structures. Canadian (and U.S.) tax issues can significantly impact the optimal structure of a transaction, including:

### (a) Canadian Withholding Tax

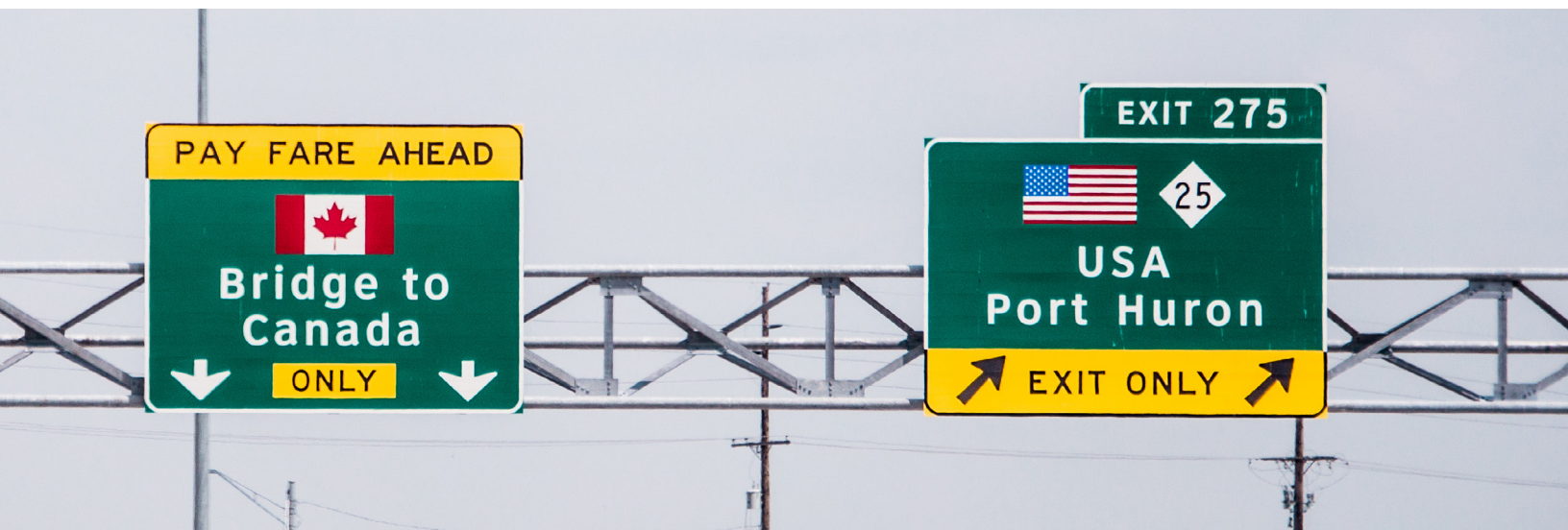


Despite Canadian withholding having been largely eliminated on most cross-border payments of interest, there are still some important withholding tax considerations that should be addressed.

- *Withholding Tax on Rent, Lease Payments and Certain Other Payments.* Withholding tax still applies to certain cross-border payments, including rent or lease payments (subject to certain exceptions for aircraft leases and rolling stock) and dividends. Accordingly, it is most common for a Canadian originator to securitize lease receivables in a two-step transaction: first, by selling the lease receivables and the underlying leased equipment within Canada to a Canadian SPE and, second, by funding the SPE with a cross-border loan. If lease receivables are sold directly to a U.S. SPE, “back-to-back” and “character substitution” rules may, in certain circumstances, deem lease payments to be made directly to investors in the U.S., which could result in a higher withholding tax rate than would apply to the lease payments themselves.
- *Deemed Dividend for Cross-Border Notes.* Canadian withholding tax may arise where a Canadian originator of financial assets that is ultimately owned by a non-Canadian sells financial assets to a U.S. SPE for consideration that includes a promissory note payable by the acquiring U.S. SPE. Unless the Canadian originator holds shares in the U.S. SPE, which may raise other Canadian tax issues, the entire amount of the intercompany note can be deemed to be a dividend under Canadian tax rules if it remains outstanding

over a year-end. Since dividends are still subject to Canadian withholding tax, that “deemed dividend” will also be subject to Canadian withholding tax. While that tax would be refundable when the promissory note is ultimately repaid, the refund would be without interest so there would be an indirect cost. There are ways to structure a transaction to address such withholding taxes, but they need to be contemplated at the outset. For example, such withholding taxes may be avoided if the Canadian originator elects to include in its income for Canadian tax purposes interest on the promissory note at a prescribed quarterly rate (currently 9.16%).

- *Services Rendered in Canada.* Withholding tax applies to amounts paid to a non-Canadian in respect of services rendered in Canada. The withholding tax is 15% of such payment. For services rendered in the province of Quebec, there is an additional 9% withholding. This withholding tax will need to be considered where the service-fee component of any receivables is sold cross-border to a non-Canadian purchaser if the service fee was for services rendered in Canada.
- *Withholding Tax on Interest.* Withholding tax will generally not apply on interest paid from a Canadian on a debt owing to an arm’s length person. Withholding tax will, however, apply on certain cross-border payments of interest between related parties. For example, withholding taxes may arise if a U.S. entity who is not entitled to the benefits of the Canada-U.S. Tax Convention lends to a related Canadian person. In addition, certain domestic tax rules limit the



deductibility of interest paid by a Canadian person, and in certain circumstances where the deduction is denied on interest paid to a non-resident, the interest is deemed to be a dividend for withholding tax purposes.

The normal withholding tax rate for related-party interest, rents, lease payments and dividends, where it applies, is 25% unless reduced by treaty. Where a U.S. payee is entitled to the benefits of the Canada-U.S. Tax Convention (note that not all U.S. payees are entitled to these benefits), the rates are typically 0% for interest, 10% for rents on tangible personal property (e.g., equipment lease payment) and 15% for dividends, unless the recipient owns at least 10% of the voting stock of the company paying or deemed to be paying the dividend, in which case the dividend withholding tax rate is reduced to 5%. In cases where withholding taxes apply, a Canadian resident payor is required to withhold the applicable percentage of the interest (or other applicable amount being paid, such as rent) and remit the withheld amount to the Canadian tax authorities. If the payor fails to do so, both it and the non-resident payee (e.g., a U.S. conduit or investor) will be jointly and severally liable for the amount that should have been withheld. While a U.S. payee may be able to claim certain U.S. tax credits on withheld amounts, those credits may not be a full answer.

### **(b) Taxes on Income From Carrying on Business in Canada**

U.S. investors and U.S. asset purchasers in a cross-border securitization (e.g., U.S. SPEs) may be liable for Canadian income tax and/or be required to file a Canadian tax return, if and to the extent that they are considered to be “carrying on business in Canada.” Merely holding Canadian debt should not give rise to such liability or requirements, but the complete answer will turn on what else the investor is doing (or has done) in Canada and what type of entity it is. Generally, so long as the investor does not already have a presence in Canada, and provided that the securitization transaction does not itself create an agency relationship between the investor/purchaser and a Canadian entity, there should not be a “carrying on business in Canada” issue. For example, a U.S. purchaser of Canadian assets that are serviced by a Canadian servicer may raise questions regarding the existence of such an agency relationship. In such cases, it is best to address the underlying servicing relationship at an early stage to address potential concerns.

### **(c) Sales Tax**

Depending on the types of assets that are being securitized

and where they are located, sales taxes may arise as a result of a Canadian securitization. In Canada, value-added taxes are imposed at the federal level (goods and services tax (GST) or, in provinces that have harmonized their sales taxes with the GST, harmonized sales tax (HST)) and in Quebec (Quebec sales tax or QST). There are also single-stage sales taxes applicable in three provinces (provincial sales tax or PST).

For example, in a typical lease securitization, where leased equipment is sold to an SPE, GST/HST and QST will generally apply to the sale (based on the province in which the equipment is situated), unless an election applies. As such, sales taxes may ultimately be recoverable by the SPE through the claiming of input tax credits or refunds, and the impact of a securitization can usually be managed through proactive planning. The SPE should be registered for all applicable sales taxes. The SPE must charge and collect any GST/HST, QST and PST from obligors in connection with the leased equipment that it purchases. Such sales taxes are held in trust for the government and must be remitted to the tax authorities; they cannot form any part of the monies paid to noteholders or other stakeholders.

While no sales tax will apply to a sale of financial instruments to an SPE, such as trade receivables or loans, a securitization may still raise important sales tax considerations. For example, sales taxes payable by the obligor are often included in the amount owing under a trade receivable. Care should be taken to ensure that special deeming rules will be available to relieve an SPE purchaser from any potential obligation to remit the sales tax component of the acquired receivable. Also, servicing fees charged by a servicer to an SPE may attract GST/HST. Since such tax amounts would be unrecoverable where the securitized assets are financial instruments, it will be important to consider whether these potential taxes can be addressed in structuring the securitization. For example, the judicial concept of a “single supply” may be relied upon to characterize the transaction as the sale of an exempt “fully serviced” financial instrument, although this characterization may have some risk associated with it, depending on the circumstances.



### 03 | True Sale in Canada

In Canada, we are fortunate to have a specific case, commonly referred to as the “BC Tel case,” that sets out a clear path for structuring securitization transactions and analyzing the judicial basis for re-characterizing a structured sale as a loan or a secured loan transaction. As a result, structured finance transactions can be confidently assessed as a true sale under Canadian law.

Generally, Canadian case law indicates that if a transaction is structured as a sale and the parties consistently treat it and refer to it as a sale, then absent a small number of potentially fatal features, the transaction will be accepted as a sale under our law. While repurchase rights are problematic to our re-characterization analysis, features such as recourse as to collectibility of a receivable may have less weight than in the U.S. true sale context.

Since Canada’s laws on this point are clear, Canadian securitizations often involve a structured sale directly from the originator to the securitization vehicle. Unlike in the U.S., we typically do not need two-step transactions to achieve a clean isolation of the transferred assets, although two-step transactions may be useful to address certain other Canadian issues (discussed below in Item 4 of this paper under the heading “Equipment Lease Securitizations”). Legal opinions regarding the existence of a true sale are typically more straightforward than U.S. counterpart opinions.

Some additional issues, however, can arise where the purchase agreement is not governed by Canadian law. In many transactions, a Canadian originator/seller may sell its assets under a purchase agreement governed by the laws of a jurisdiction outside Canada. In those cases, the “true sale” should be analyzed under the law that governs the purchase document (the foreign law), but it is also usually prudent to consider the true sale and bankruptcy analysis under the applicable Canadian law.

The fact that Canadian law often makes it easier to reach a true-sale conclusion produces one other difference in Canadian-law-governed purchase agreements. Unlike in the U.S. for U.S.-law-governed purchase agreements, it is not common in Canada to routinely insert a “back-up security interest.” In other words, we often see clauses in U.S.-law-governed purchase agreements that address what happens if a court refuses to recognize the transaction as a sale. Such clauses provide that, in such event, the seller grants a security interest in favour of the purchaser on the assets in question.

The prevailing view in Canada is that such a back-up security interest is not necessary. Indeed, unless carefully drafted, it is preferable from a true-sale standpoint not to have a grant of a back-up security interest.

## 04 | Equipment Lease Securitizations

The structures used in Canada for equipment lease securitizations are often unfamiliar to Americans, as they are uniquely designed to address Canadian income tax considerations. Canadian lease securitizations are structured to preserve the originator's ability to utilize tax depreciation in respect of the underlying leased equipment while providing for a bankruptcy remote transfer of the lease receivables on a basis that does not trigger an acceleration of taxable income. Three basic structures have been developed for this purpose: (i) a "sale leaseback" transaction; (ii) a "concurrent lease" transaction; and (iii) a two-step sale/financing transaction. The two-step sale/financing structure is most commonly used today to address current rating agency requirements. In the two-step structure, the SPE typically takes the form of a limited partnership, which allows the benefits of tax depreciation on the equipment to flow back to the originator, although other types of entities (such as a corporation) may be preferred to achieve other tax and planning objectives. Ultimately, the question of whether to use a one-step or two-step transaction, and the types of entities to involve, will turn on the types of leases in question and a variety of tax and financing considerations.

## 05 | Real Estate Securitizations

Real property mortgages, whether commercial or residential, have traditionally been an important asset class for Canadian securitizations.

The most common securitization vehicle for commercial mortgages has been term commercial mortgage-backed securities transactions. Recent deals have included tranches aimed at both Canadian and U.S. investors.

Residential mortgages are securitized in Canada various ways, including most often through offerings under covered bond programs, through asset-backed commercial paper conduits and, in the case of insured mortgages, through Government of Canada-backed securitization programs. In 2016, rules were adopted to prohibit the use of insured mortgages as collateral in securitization vehicles that are not sponsored by the Canadian government (subject to a few exceptions). While term residential mortgage-backed securities (RMBS) may be used to securitize uninsured mortgages, they have struggled since the financial crisis. Term RMBS have come back somewhat over the last few years, with new issuers entering the market, but the market remains limited.

While there are many similarities between Canadian and U.S. mortgage securitizations, there are many important differences and issues to consider. Some differences arise from our different land registration systems and rules regarding title to real property. For example, rules in some provinces require any foreign lender that takes security over real estate in Canada to register as an "extra-provincial corporation" if it wishes to be the secured party of record. Some non-Canadian lenders have preferred not to complete such registrations and have appointed a Canadian trust company to act as the mortgagee of record on their behalf. The use of a custodian or nominee to hold registered title also routinely serves to avoid the costs and complexities of transferring registered title with each step of a securitization. The usual practice in Canada is for residential mortgages to have a term of no more than five years, even though the amortization period may be 25 years or more. Accordingly, mortgagors must renew or refinance a residential mortgage at the end of the term. This unusual feature of the Canadian mortgage market requires risk and tax mitigation strategies, especially for U.S. issuers and investors, which will impact the structure of Canadian mortgage securitizations, especially ones with a U.S. nexus.





## 06 | Currency Issues

Canadian receivables will typically be denominated in Canadian dollars, giving rise to an inherent currency risk in any cross-border securitization that is ultimately funded with U.S. dollars. This currency risk is usually addressed through some sort of currency hedging arrangement (either direct or indirect), currency reserves or a combination of the two. In some cross-border deals, however, U.S. investors may have an appetite for Canadian dollars and will be willing to purchase Canadian-dollar-denominated asset-backed securities without the need for any currency hedging.

Where a Canadian SPE holds Canadian assets and borrows cross-border, the SPE may enter into currency hedges in the form of over-the-counter (OTC) swaps or caps. Like other G20 countries, OTC derivatives are now regulated in Canada in several respects, including trade reporting requirements, mandatory clearing of certain OTC derivatives through regulated central counterparties and mandatory margin posting requirements for certain uncleared derivatives. In September 2024, new “business conduct requirements” for derivatives business activities will impose a range of fair dealing, conflicts of interest, know your counterparty, suitability, reporting and compliance requirements on “derivatives dealers” and “derivatives advisors.” These new requirements are subject to a range of exclusions and exceptions, which should minimize their impact on the sorts of customized derivatives required by Canadian SPEs. However, derivatives providers may seek to mute the impact of these new compliance requirements in the securitization context by requesting waivers and other accommodations. Canada’s regulators have not yet foreclosed regulatory initiatives paralleling those implemented in the U.S. in relation to Title VII of the Dodd-Frank Act. Such potential initiatives include requiring the registration of derivatives dealers and advisors and mandating the execution of trades for certain classes of derivatives through derivatives trading facilities (analogous to swap execution facilities). While still possible, it appears unlikely that those other initiatives will be actively pursued on an equivalent basis to the U.S.

Canadian requirements for margin posting for non-centrally cleared derivatives involving Canadian financial institutions (including branches of foreign banks) have been implemented in respect of “variation margin” and “initial margin”. While the Canadian margin requirements are closely aligned with the framework and requirements developed internationally by the Basel Committee on Banking Supervision, they include some unique accommodations to avoid subjecting SPEs to margin posting requirements in relation to typical securitizations. Specifically, exclusions apply for any “special purpose entity”

established for the purpose of financing a specific pool or pools of assets or underwriting a specific set of risk exposures, in each case, by incurring indebtedness; provided that the indebtedness of the SPE, including obligations owing to the SPE’s swap counterparties, is secured by the specific pool or pools of financial assets. This carve-out was introduced during the commenting phase when the margin requirements were first introduced, and favourably distinguishes Canada’s margin requirements from those applicable in other G20 countries, including the U.S., by recognizing the unique credit and liquidity aspects and strength of securitization structures, which are already well collateralized and highly structured in terms of the sources and required applications of cash flows.

A separate currency-related issue is that Canadian courts can only give judgment in Canadian dollars, even if the obligation in question is denominated in another currency. If a Canadian originator owes U.S. dollar amounts under a securitization agreement (such as indemnity payments or deemed collections), a Canadian court will convert the U.S. dollar amount owing to a Canadian dollar amount for purposes of any judgment. If exchange rates shift between the date of the judgment and the date payment is made, the creditor may suffer a currency loss. For this reason, the relevant securitization agreements will typically also provide a separate indemnity for any such exchange losses.

## 07 | Personal Property Security Laws in Canada (Outside Quebec)

The mostly good news is that the Canadian provinces and territories (other than Quebec) have all adopted a *Personal Property Security Act* (PPSA) that is largely based on the 1972 version of Article 9 of the Uniform Commercial Code (UCC). While the PPSAs are similar, there are subtle distinctions that may be relevant for particular securitizations.

Each PPSA jurisdiction recognizes the basic Article 9 concepts of security interest, attachment, perfection and purchase-money security interest, and each has analogous rules as to the filing of financing statements and priorities. As is the case under Revised Article 9-109(a)(3), each of the PPSAs generally provides that a transfer of accounts and chattel paper will be subject to its registration, perfection, priority and conflict of laws provisions. As a result, lawyers on both sides of the border will use a similar vocabulary and be familiar with each other’s concepts.

Nevertheless, the U.S. and Canadian rules are not identical. There are a number of potentially important distinctions relevant to securitization transactions:

- The rules on the assignability of receivables are somewhat different in Canada — see the discussion under Item 9 below.
- Unlike Revised Article 9, all of the PPSAs (other than those in Ontario, British Columbia, Saskatchewan and, from June 1, 2024, Alberta) still look to the location of the debtor's or seller's chief executive office to determine the validity, perfection, effect of perfection and non-perfection and priority of certain types of security interests (e.g., a security interest in intangibles and certain goods used in more than one jurisdiction or a non-possessory security interest in negotiable or quasi-negotiable documents and a transfer of accounts and chattel paper). Ontario and the other provinces listed above have moved closer to the U.S. approach for these types of security interests or transfers, looking essentially to the debtor's jurisdiction of formation. For security interests in most other types of collateral (essentially a security interest in tangible personal property that is not mobile goods or a possessory security interest in negotiable and quasi-negotiable documents), the conflict of laws rules look to the location of such collateral. As such, registrations (and searches) may be required in several Canadian jurisdictions. It is, therefore, important to identify early in the transaction where any tangible personal property (other than mobile goods) and the underlying obligors are located and where the debtor (i.e., the originator) has its chief executive office and jurisdiction of formation, so that appropriate searches can be conducted and registrations made.
- The PPSAs do not currently require a creditor to have "control" over a bank account in order to take security in it. As a result, lockboxes and blocked account agreements are used for their commercial benefits, rather than to perfect a security interest in a bank account.
- Unlike Revised Article 9, under which UCC filings may only be made for a period of five years, it is possible under the PPSAs to file financing statements for a period of one to 25 years and, in most PPSA jurisdictions, for a perpetual period.
- PPSA registrations do not become unperfected because of a change in the debtor's name until 15 days (30 days in Ontario) after the secured party learns of the name change and the debtor's new name. This has led to a Canadian practice of conducting personal property security searches against all former names of a debtor. If cost considerations

become relevant, then the decision regarding how far back searches should be conducted will often depend on the number of former names the debtor has, how long such former names have not been used and the number of jurisdictions in which personal property security searches need to be conducted.

There are other differences in Canadian personal property security practice, but perhaps the key one for securitization purposes is the practice of dealing with priority considerations by obtaining "estoppel letters" from secured parties that have registered against a common debtor before the securitization. By way of background, as part of normal due diligence on a financing transaction, personal property security searches are carried out in Canada against the originator in each applicable province or territory. However, the search results may not always provide sufficient information to determine whether any pre-existing registrations are an issue. This is particularly true in Ontario, which currently employs a "tick the box" system in which a secured party may identify the classes of collateral in which it has a security interest (the options in a business context being "accounts," "equipment," "inventory," "other" and "motor vehicles") but is not required to provide a more detailed collateral description, unless the debtor named in that filing demands that a general collateral description be added to that filing. To address the possible uncertainty of such registrations, it is typical for creditors to require debtors to deliver "no interest" or "estoppel letters" from secured parties having potentially conflicting registrations. These letters often take a long time to obtain, so it is important to identify any need for such letters as early as possible. In view of this practice, many of the larger financing companies in Canada have standard form estoppel letters that typically will be satisfactory.





## 08 | Quebec

The legal system in Quebec is based upon the French Civil Code, as opposed to English common law. Although Quebec has a registration system for personal property security comparable to those in other Canadian jurisdictions, there are fundamental differences between the two systems. Nevertheless, the net result is often simply a matter of form and procedure, with the secured party's rights being substantially the same as if the debtor or collateral were located in another Canadian jurisdiction. Given the different procedural requirements, it is prudent to allot additional time for transactions that include Quebec obligors or originators.

Some specific differences include the following:

- To “perfect” a sale of receivables in Quebec, either notice must be given to the Quebec obligors (which, apart from certain factoring transactions, is often unacceptable to the seller) or a registration can be made if the receivables being sold constitute a “universality” (in effect, all receivables or all receivables of a specified class or having in common objective and identifiable criteria). It may be difficult to find an appropriate universality for deals structured in other jurisdictions. This can be a particular problem for deals that rely on discrete monthly sales of specified receivables or that contemplate daily sales.
- Quebec’s conflict of laws rules look to the location of the debtor’s domicile (e.g., in the case of a corporation, the location of its registered office as specified in its articles) for “hypothecs” (i.e., conventional security interests that secure

the payment or performance of the grantor’s obligations) granted in intangibles or goods ordinarily used in more than one jurisdiction. These conflict of laws rules, however, are less clear in the case of an absolute assignment of a receivable and, in order to determine if Quebec law applies, it may be necessary to examine various factors, such as where a receivable is payable, where the obligor is located and what law governs the receivable.

- Security and assignments of receivables cannot be pre-filed in Quebec. The applicable Quebec documents must be executed and delivered before filing a registration. As a result of recent changes in Quebec French-language laws, registrations in Quebec must be filed in French. This change requires French translations of the description of the assigned receivables (and the collateral description in hypothecs) contained within the related English transaction documents to be prepared in advance.
- Terminology is somewhat different. For example, “hypothecs” are used, rather than “security agreements,” and registration makes a hypothec or sale “opposable” rather than “perfected.”
- Following recent changes in Quebec French-language laws, standard form contracts in Quebec must be executed in French, subject to some exceptions (including for loan agreements). As a general rule, standard form contracts can only be executed in a language other than French to the extent that (a) a French version has been remitted to the customer and (b) the contract contains a clause

in French and such other language in which the parties expressly agree to the use of such other language. These changes require revisiting contract procedures when English standard form agreements are entered into in Quebec or with a Quebec entity. Fully negotiated commercial contracts in any language other than French between two contracting parties represented by counsel would not be subject to the requirement described in clause (a) above.

- Quebec is the only Canadian jurisdiction to permit a secured party to perfect security in bank accounts by control. Quebec's regime is in substance similar to Revised Article 9's rules for perfection of security interests in deposit accounts, with the exception that it is also possible in Quebec to perfect security over deposit accounts by filing. Under Quebec's rules, a secured party with control over a deposit account has priority over any other secured party who has perfected its security over the same deposit account by filing.

## 09 | Due Diligence of Canadian Assets

The due diligence process for Canadian assets can also differ in many respects from what might be seen in other jurisdictions. Among other things:

- We do not have any motor vehicle title registries. Accordingly, we do not use titling trusts. While motor vehicles need to be registered in the owner's name, that registration simply addresses regulatory requirements and does not confer any actual ownership interest.
- Except for certain short-term leases (true leases whose term will be one year or less), equipment leases in Canada generally require registration under the applicable PPSA or Quebec law. Each of the PPSA's registration, perfection, priority and conflict of laws provisions apply equally to "security leases" and "true leases" where the lease is for a term of more than one year (which includes a lease with a term that is less than one year but is automatically renewable beyond one year).
- Given the differences between Quebec law and the PPSAs, it is critical to know early on in a proposed securitization what Quebec connections exist, whether at the obligor level or the originator level, so that the right steps can be taken to ensure that the securitization is properly protected under Quebec law.
- As noted earlier, there are unique issues for cross-border sales of receivables for the sale of services, and for rental receivables.

- Anti-assignment clauses are typically more of an issue in Canada than might be the case in the U.S. For example:
  - i. such clauses may still be enforceable under Quebec law;
  - ii. while, like Revised Article 9, various PPSAs have anti-assignment overrides, such overrides only apply to the assignment of accounts and chattel paper and not to other contract rights or assignments of partial interests; and
  - iii. even where the PPSA anti-assignment override applies, the obligor under the account or chattel paper is permitted to claim damages from the assignor for any actual loss or damage caused by a breach of the anti-assignment clause.
- Receivables owing by the Government of Canada or governments of certain provinces and territories (or their respective agencies) are not assignable without consent or compliance with certain formalities.

## 10 | U.S. Offerings

Most of our discussion to this point has focused on selling Canadian assets across the border into the U.S. Where a Canadian issuer distributes asset-backed securities (ABS) into the U.S., various additional challenges may arise, including in relation to a sale of ABS to a U.S. conduit, a standalone U.S. offering under an existing Canadian securitization program, or a concurrent U.S. offering as part of a mainly domestic Canadian ABS offering:

- *Disclosure and Due Diligence.* Canadian disclosure documents for single-seller transactions are typically patterned after U.S. precedents. That said, the disclosure for U.S. offerings may in certain circumstances be more extensive and prescriptive than that for Canadian counterpart offerings. While the adaptation of Canadian disclosure precedents to accommodate a U.S. ABS offering can be time-consuming, the two standards can usually be accommodated in a harmonized disclosure format. U.S. due diligence requirements, practices and expectations also differ. For example, Canadian domestic issues typically do not contemplate the delivery of 10b-5 letters from counsel and certain other U.S.-based formalities, so these should be anticipated in the timeline and work allocations for an offering by a Canadian issuer that includes a southbound component.

- *U.S. Compliance Rules.* The Canadian securitization program may become subject to certain U.S. compliance requirements, such as Rule 17g-5. If a U.S. offering is a possibility, it will be important to ensure that necessary compliance mechanisms have been put in place.
- *U.S. Credit Risk Retention Rules.* Complying with the U.S. risk retention rules may, in certain circumstances, have significant structuring and regulatory implications for existing Canadian securitization programs, and may in turn introduce additional Canadian tax consequences. Canada's regulators have not themselves introduced credit risk retention rules equivalent to those applicable in the U.S. under section 15G of the Securities Exchange Act of 1934 (as added by section 941 of the Dodd-Frank Act), although Canada's securities regulatory reforms, in response to the 2008 financial crisis, did specifically consider the propriety of those requirements in light of Canada's particular securitization market. In the absence of specific domestic risk retention requirements, Canadian-only transactions are not constrained by the complex structuring requirements and interpretive considerations that have arisen in the context of the U.S. credit risk retention rules. Adding a U.S. offering to an existing Canadian securitization program or otherwise accommodating a U.S. ABS tranche offering may therefore lead to implementation delays and significant structuring considerations.
- *Settlement.* Canadian securitization programs are generally able to benefit from the well-developed cross-border securities settlement system that exists between the U.S. and Canada. Canadian securities transactions typically settle through the Canadian clearing system operated by CDS Clearing and Depository Services Inc. (CDS). Cross-border settlement can be facilitated through established links and procedures between CDS and The Depository Trust Company. In our experience, these existing mechanics for cross-border settlement work fairly well, although some logistical challenges involving the back offices of the various transaction intermediaries and dealers are common. Because these mechanics can significantly impact closing deliveries and money transfers, they should be anticipated well in advance.
- *Other Documentation Requirements.* Adding U.S. investors to a Canadian securitization program will generally result in the need to adapt existing Canadian documents to anticipate specific U.S. regulatory requirements. For example, U.S. securities requirements may require legends on all securities, including those sold domestically in Canada concurrently with a U.S. offering. Also, U.S. investors may

be unfamiliar with certain structural elements of Canadian transactions, such as the use of Canadian law as the applicable governing law, the governance and status of Canadian SPEs, the use of non-U.S. indenture trustees and intermediaries and other common "nuts and bolts" considerations. It is good practice to identify these sorts of considerations up front and plan for the additional time that may be required to work through them.

## Other Issues

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**While we have highlighted 10 issues of importance for Canada-U.S. securitizations, other uniquely Canadian issues could become relevant on a particular set of facts. Here are just a few others:**

- Case law in Canada raises, and recent changes to Canada's bankruptcy and insolvency laws may raise, some special and potentially difficult priority issues for sales from originators with defined benefit pension plans.
- Canadian GAAP derecognition and consolidation rules are typically based on International Financial Reporting Standards, and so differ from U.S. GAAP. It can be difficult to achieve derecognition under the Canadian rules.
- Interest rates in Canada must be expressed as an "annual" rate, based on a full year. Therefore, if interest is calculated on a basis that is less than a full year (such as a rate per month or one that is based on a 360-day year), the document must contain language to convert rates to a per annum equivalent.
- Canadian courts require explicit provisions for interest to accrue after maturity, default or judgment, or if overdue interest is itself to bear interest. As well, it may not always be possible to increase the interest rate following default, especially where the debtor's obligations are secured by real property.
- Usury laws in Canada tend to be less stringent than in the U.S. They only kick in at an effective annual rate of 60% per annum (which is equivalent to an annual percentage rate (APR) of 48%). In calculating the rate of interest for purposes of this 60% test, it is necessary to include all charges and expenses payable by the debtor in connection with the subject transaction, including fees, fines, penalties and commissions. The U.S. practice of charging an obligor a late fee if the obligor's payment is overdue by a certain period of time could, on an annualized basis, exceed the 60% test and as such would be unenforceable. In 2023, the federal government passed legislation (which is not yet in force) to reduce the maximum permitted interest rate to an APR of 35%.
- Canada is not party to the Automated Clearing House Network, and documentation may have to provide for specified electronic-transfer arrangements instead.
- Canadian withholding tax and possibly income tax liability may apply to structuring or other fees paid to U.S. participants that render any part of their services in Canada, and there are issues regarding withholding from the remuneration of U.S. employees who travel to Canada. All of this may lead to practical limitations on the ability of these employees to attend meetings or perform services in Canada. In addition, Canadian transfer pricing rules require that fees and purchase price be paid to a related U.S. participant on arm's-length terms and that certain related contemporaneous documentation requirements be met.
- U.S. fraudulent conveyance rules generally do not apply to Canadian guarantees, although a few provinces in Canada do require a guarantor to meet specified solvency tests for its guarantee to be valid in particular circumstances.

In our experience, Canadian issues that arise on a cross-border securitization can usually be addressed successfully and expeditiously. However, because dealing with these issues may require additional documentation, planning and possibly even restructuring, they should be addressed early in the process.

# Contacts

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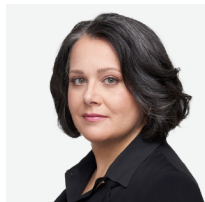
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