June 2024

Primer on Canadian ABCP[1]

1. Introduction

Canadian money markets are undergoing a significant change due to the disappearance of Bankers Acceptances (BAs), which will cease to be issued with the cessation of CDOR after June 28, 2024.[2] With the cessation of CDOR's publication, the BA-based lending model, which has existed since the 1960's will be discontinued.[3]

As outlined in the White Paper published by Canadian Fixed Income Forum (CFIF) in January 2023, BAs are important short-term Canadian dollar money market assets. Given their importance, an orderly transition away from BAs is vital for the well functioning of the Canadian money market. To help with this effort, CFIF has formed a working group to support the transition away from BAs. The BA Transition Virtual Network (BATVN) is co-chaired by Elaine Lindhorst (TD Asset Management) and Charles Lesaux (RBC Capital Markets).

One of the key objectives of BATVN is to review potential alternative products to BAs and take actions towards educating, promoting, or removing barriers for market participants, where appropriate. Based on discussions with BATVN members, Canadian Asset-Backed Commercial Paper (ABCP) was identified as a product that could benefit from an educational primer. This primer has been created by the BATVN to fill that educational need and to provide background information on the structure of the Canadian ABCP market, including how it has changed since the Global Financial Crisis (GFC). ABCP is a type of commercial paper (CP) secured by specific collateral or pools of varied collateral, originated and sold by single or multiple sellers. Although Canadian ABCP has existed for decades, the type of ABCP issued in Canada has changed significantly since the GFC due to more stringent regulation and improved transparency.

This paper begins with an overview of why some Canadian investors choose to invest in ABCP. It then provides an overview of the size and composition of today's ABCP market as well as an overview of how the market is structured, traded and regulated.

This paper does not, and is not intended to, constitute investment or legal advice. It is provided for general information purposes only.

2. Why market participants invest in ABCP?

In general, securitization allows banks to convert their or their clients' non-tradeable medium-/long-term illiquid assets into short-term rated debt securities with improved liquidity, thereby providing a source of funding for those assets. In this vein, the ABCP conduits are used to securitize and hence provide funding

[1] The BA Transition Virtual Network (BATVN) would like to thank the following individuals for their contributions to the paper: Cathy Cheng and Andrew Sadurski at AIMCo; King Lam, Andrew Maciel and Julia Moynihan at CIBC; Sarah Bialas, Shubhreen Dosanjh, Tim O'Neil, Clara Vargas and Jiani Xi at Morningstar DBRS; Susan Calder at RBC Capital Markets; Bill Girard at 1832 Asset Management; Dave Bellemare at Desjardins; and Ganesh Kannan at NBC.

[2] On May 16, 2022, the CDOR's regulated administrator, Refinitiv Benchmark Services (UK) Limited (RBSL) announced that it would cease the publication of CDOR after June 28, 2024.

[3] Although the BA lending model used to be applied globally, Canada is the only major jurisdiction to retain this type of lending construct.

for assets such as auto loans, lease receivables, residential mortgages, commercial loans, and credit card receivables among others. In doing so, the creation of ABCP results in another type of money market product for investors.

For investors,[4] ABCP provides several key benefits:

- **Yield** – ABCP generally offers competitive yield relative to unsecured corporate CP or BAs.
- **Access to otherwise unavailable asset classes** – ABCP allows for the investment in assets that many investors would otherwise not be able to invest in, such as auto loans, residential mortgages, and credit card receivables. This is particularly useful where investors face constraints on the types of assets in which they are allowed to invest.
- **Portfolio diversification** – ABCP can provide enhanced risk diversification for investors by offering a broad range of securitized commercial paper programs that exhibit lower risk correlation with other investment types, such as corporate and agency securities.
- **Diversification in underlying assets** – Many investors seek to invest in ABCP that is itself diversified, particularly through multi-seller programs.[5] This diversification includes both being backed by a wide set of underlying assets (e.g. mortgages, auto loans, trade receivables), the assets themselves being diversified (e.g. auto loans covering a variety of makes and models, across a wide set of geographical regions, across a wide set of borrowers), and the originators of those assets being also diversified. Incorporating ABCP into investment portfolios could enable short-term investors to more effectively adhere to diversification mandates, thereby balancing their investment strategies while minimizing risk exposure.
- **Improved risk profile** – As ABCP matures, investors are repaid either directly from the cash flows on the underlying asset pool or if the ABCP is not fully rolled, through a draw on the liquidity facilities provided by the ABCP's sponsoring bank. The regulation around the capital and liquidity for those liquidity facilities has increased substantively since the GFC.[6]
- **Enhancements** – Each transaction in an ABCP conduit is structured to include credit enhancements that help improve the credit rating of Canadian ABCP (see Section 4.2). Sellers of the underlying assets provide first loss enhancement, helping align the interests of asset sellers and investors. Where this protection is found to be insufficient, the seller may be requested to provide further credit enhancement, for example through overcollateralization. In addition, the sponsoring bank may choose to provide further credit enhancement to a program or conduit.
- **Transparency** – In Canada, most issuers (i.e., ABCP conduits) of ABCP rely on the prospectus exemption for short-term securitized products (the ABCP Exemption) in section 2.35.1 of National Instrument 45-106 *Prospectus Exemptions* (NI 45-106), a rule adopted by the securities regulatory authorities in Canada.[7] The ABCP Exemption was designed to address certain issues that arose during the GFC. ABCP conduits relying on the ABCP Exemption must comply with initial,

[4] For corporates and banks, the primary benefits to securitizing their assets through ABCP is that it allows them to make better use of their balance sheet assets in a cost-effective manner while improving the diversity of funding sources. Banks can also continue to service the underlying assets, providing an additional source of revenue.
[5] Most Canadian bank-sponsored ABCP programs are multi-asset, multi-seller programs, which include assets from a variety of different sellers. In contrast, a single-seller program would only include assets from a single entity, typically the sponsoring bank. Most Canadian multi-seller conduits include third-party assets only.
[6] The liquidity and capital regulation on sponsoring banks is discussed in Section 4.4 of this paper.
[7] The ABCP Exemption is discussed in Section 4.4 of this paper.

continuous, and timely disclosure requirements, including information memorandums and monthly disclosure reports. In addition to investor reports by the bank sponsors, both DBRS and Moody's publish reports on the operations and performance of the ABCP conduits they rate.

- **Collateral** – ABCP can be pledged as collateral, with some limitations, in the Bank of Canada's (BoC) liquidity provision programs, including Standing Liquidity Facility (SLF), Standing Term Liquidity Facility (STLF), and Emergency Lending Assistance (ELA)[8].

Notwithstanding these benefits, perhaps the event most associated with ABCP in investors' minds is their performance during the 2007-2009 financial crisis. However, it is important to note that Canadian ABCP has meaningfully changed since this event. Today's ABCP is more regulated (for ABCP conduits relying on the ABCP Exemption and/or OSFI's regulations for transactions meeting the Simple Transparent Comparable (STC) criteria[9]). It benefits from stronger liquidity support, is more transparent, has dual ratings, and is backed exclusively by traditional assets (no synthetic transactions). Additionally, the type of securitization that was most adversely affected by the crisis, non-bank sponsored ABCP, no longer exists (see Box).

Box – Canadian ABCP and the Global Financial Crisis (GFC)

Today's Canadian ABCP market cannot be fully understood without exploring how it was restructured and strengthened following the GFC.

In the years prior to the GFC, the market for Canadian ABCP had grown significantly. Although the market was initially dominated by the large Canadian banks, which sought the economic benefits[10] associated with securitization, by the mid-2000s a broad set of new market participants had established Canadian ABCP conduits. This included both smaller regulated banks and unregulated financial entities, the largest of which was Coventree Capital Group Inc.

As the demand for ABCP surpassed the traditional Canadian assets available for securitization, some non-bank administrators began backing ABCP with non-traditional assets such as derivatives, including credit default swaps with exposure to the US sub-prime residential mortgage market. Where the ABCP conduit

---

[8] Under the BoC's Standing Liquidity Facility, only Canadian dollar (CAD) denominated ABCP that satisfy the Bank's eligibility criteria are eligible to be pledged as collateral by eligible institutional investors subject to the terms set by the Bank. Financial Institutions that wish to pledge ABCP as collateral are subject to concentration limits and not allowed to pledge ABCP whereby they are the originator, sponsor or the financial services agent. More details can be seen at Assets Eligible as Collateral under the Bank of Canada's Standing Liquidity Facility. In addition, any marketable security eligible for the Standing Liquidity Facility (SLF) will in turn be eligible for Standing Term Liquidity Facility (STLF) and Emergency Lending Assistance (ELA).ABCP was also introduced as eligible collateral for the BoC's extended term repo facility (ETRF) on March 18, 2020, to support the functioning of financial markets during the COVID-19 stress period. This extraordinary program was discontinued on October 15, 2020, following significantly improved financial market conditions.

[9] See OSFI's Capital Adequacy Requirements, Chapter 6 – Securitization, Section 6.10. 'Simple, transparent, and comparable' (STC) securitizations [link].

[10] For example, releasing capital for higher margin businesses, diversifying balance sheet exposures, and generating new fees from securitizing the assets of third parties.

acquired synthetic exposures with derivatives, this type of ABCP is sometimes referred to as “synthetic ABCP”.

After the US subprime market began to falter, Coventree Capital Group Inc. acknowledged having exposure to US subprime assets in its ABCP conduits. At the time, there was a lack of transparency on the holdings of ABCP conduits, leaving noteholders uncertain as to which other ABCP conduits could also be affected. As a result, investor confidence in Canadian non-bank sponsored ABCP waned, and investors stopped buying Canadian non-bank ABCP. Demand for bank-sponsored ABCP was also impacted.

Since the assets in ABCP conduits are of longer maturity (>1yr) than the ABCP funding itself (<1yr), as ABCP matured and investors did not roll their exposure, non-bank sponsored ABCP conduits were left unable to fund their assets either by drawing on the liquidity facilities to repay the maturing ABCP or by extending the maturity on this ABCP.[11,12]

The liquidity facilities in place to support ABCP programs at that time required a general market disruption as a precondition for drawing on such facilities. Bank sponsored ABCP was not as affected by waning investor confidence as non-bank sponsored ABCP, and banks were able to continue to issue some ABCP to investors. As a result, some liquidity providers to the non-bank sponsored ABCP conduits saw the crisis as an issuer-specific disruption rather than a general market disruption, and therefore did not provide backstop liquidity requested by the non-bank sponsored ABCP conduit issuers to allow them to pay for maturing ABCP, or fund issuances of additional ABCP for collateral posting requirements. This resulted in a “freeze” in the non-bank sponsored ABCP market in Canada.

To resolve the issue, large ABCP investors and non-bank sponsored issuers agreed to the Montreal Accord, which froze the non-bank ABCP market for months as it was restructured and partially wound down. Non-bank issuers were forced to take these securities back onto their balance sheets as part of the restructuring. Non-bank sponsored ABCP was ultimately restructured through a proceeding under the Companies’ Creditors Arrangement Act (CCAA) and is no longer being issued in Canada.[13]

While the bank-sponsored segment of the ABCP market was less impacted, it experienced a temporary decline in demand during the crisis. Through the efforts of bank sponsors to restructure the product to improve transparency and investor reporting (e.g., by adding a second credit rating agency, and adjusting the liquidity backstop facilities to facilitate access when the conduit experiences liquidity challenges, whether caused by market illiquidity or nonperforming assets), demand returned to the bank-sponsored market, which continued to function normally through the rest of the financial crisis.

The size of the ABCP market in Canada has remained relatively small since the financial crisis due to shifts in banks’ securitization strategies, including towards a more relationship-based approach. Additionally, factors such as the reduced number of issuers and decreased investor interest in this sector, particularly

[11] This was via a form of ABCP referred to as extendible ABCP, or eCP that did not have a liquidity backstop associated with it.

[12] In addition, downgrades on the underlying credit default swap (CDS) exposures in some of the synthetic transactions required these ABCP conduits to post additional collateral, which those conduits attempted to achieve by issuing additional ABCP to investors. However, investors were unwilling to purchase the additional ABCP, leading those conduits to begin defaulting on the CDS contracts.

[13] More details can be found in Business Development Bank of Canada. (2020). Performance of traditional securitization transactions in Canada during and after the 2007-08 financial crisis.

from those investors adversely impacted by holdings of non-bank sponsored ABCP, have contributed to this trend, even though bank-sponsored conduits performed well during the GFC. Since the crisis, only bank-sponsored programs with primarily traditional assets, including auto related loans, residential mortgages, home equity lines of credit, consumer loans, credit card receivables and equipment leases, have issued ABCP in Canada.

Over the intervening years, Canadian ABCP has been made more robust (see Table 1). New regulations have been passed to enhance the regulatory treatment and transparency of Canadian ABCP (for STC-compliant programs and conduits relying on the ABCP Exemption, respectively). Further, discussions with Canadian ABCP administrators indicate that it is common market practice in Canada for ABCP issuers to adhere to both Canadian and American regulatory standards. The number of sponsors has declined, with only regulated banks now sponsoring ABCP conduits in Canada. While the size of the Canadian ABCP market has increased in recent years, it remains significantly smaller than it was before the financial crisis.

Table 1 – Canadian ABCP before and after the GFC

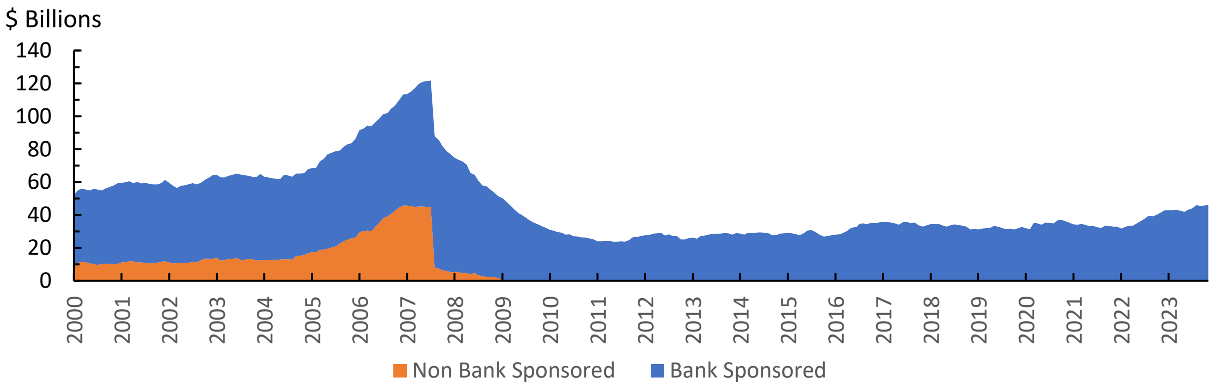
Pre-GFC	Pre-GFC		Post-GFC[14]
ABCP administrators	Regulated banks & unregulated financial entities	►	Regulated banks
Liquidity providers	Domestic banks provided a liquidity backstop to their own ABCP conduits. Domestic and foreign banks provided liquidity backstop to ABCP conduits of unregulated financial entities	►	Domestic banks provide a liquidity backstop to their own ABCP conduits.[15] For conduits relying on the ABCP Exemption, there are minimum requirements for liquidity providers set out in the regulations
Style of liquidity backstop/ provision	Liquidity was only provided when there was a "general market disruption" (i.e., when the whole Canadian ABCP market was disrupted & Canadian issuers could not issue new paper)[16]	►	"Global Liquidity Standard (GLS)" liquidity that is provided for any reason other than bankruptcy of the Trust or insufficient asset coverage or "Full wrap" liquidity that is provided in all circumstances other than the credit risk of the Full Wrap liquidity provider
Ratings agencies	Only DBRS rated Canadian ABCP conduits	►	Canadian ABCP conduits must be rated by two agencies at minimum
Program-wide credit enhancement	Not required by DBRS	►	Not required by Moody's & DBRS
Reporting standards	None	►	For conduits relying on the ABCP Exemption, there are standard reporting forms for Canadian ABCP[17]

[14] This column is in respect of conduits relying on the ABCP Exemption.
[15] With the exception that the liquidity backstop for the series 1997-1 ABCP issued by Glacier Credit Card Trust is provided by other Canadian banks,
[16] Some banks, however, provided "GLS" liquidity pre GFC.
[17] Those ABCP programs that are eligible for BoC's SLF are subject to BoC's transparency requirements. More details in [Assets Eligible as Collateral under the Bank of Canada's Standing Liquidity Facility](#).

3. Canada's ABCP market

The global market for ABCP is highly concentrated in the US, which is home to about US$352 billion (as of May 2024). In contrast, the size of the Canadian market for ABCP was about CA$47 billion at the end of January 2024 (Figure 1). ABCP is the second-largest Canadian money market instrument issued by the private sector, after BAs, comprising just over 10 per cent of the market. With the disappearance of BAs, ABCP will likely become the largest private sector money market product.

Figure 1 – Canadian ABCP market over time



Source: DBRS
Last observation: December 31, 2023

The size of the Canadian ABCP market has ranged from $33-$46 billion over the last five years. Similar to many asset classes, Canadian ABCP was affected by the COVID 19-related market turmoil in early 2020. During the start of the crisis, there was an unprecedented "dash for cash", where households, firms and investors not only sold financial assets but also drew down committed lines of credit to the full extent possible, fearing that these credit lines could be cut in the future. Many ABCP investors, recognizing the uncertainty in the markets, chose not to roll over their ABCP exposures in order to preserve cash. This resulted in reduced demand from ABCP investors. To address market liquidity concerns, the Bank of Canada unveiled ten extraordinary programs[18] aimed at supporting Canada's financial system. ABCP was included in one of these programs, the Commercial Paper Purchase Program (CPPP),[19] which aimed to

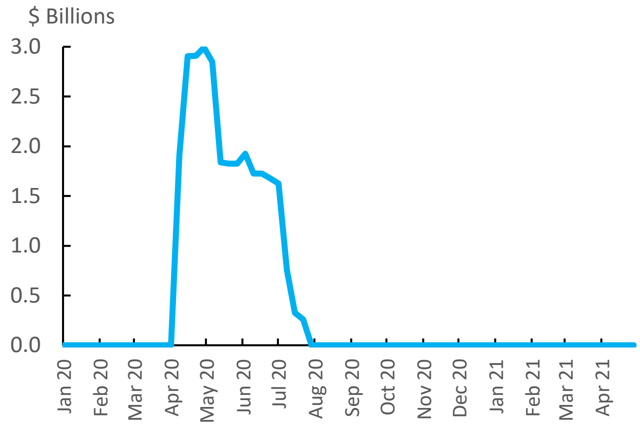
---

[18] The 10 extraordinary programs are: 1) Bankers' Acceptance Purchase Facility (BAPF); 2) incremental Government of Canada treasury bill purchases (TBILL); 3) Provincial Money Market Purchase Program (PMMP); 4) Commercial Paper Purchase Program (CPPP); 5) Government of Canada Bond Purchase Program (GBPP); 6) Canada Mortgage Bond Purchase Program (CMBP); 7) Provincial Bond Purchase Program (PBPP); 8) Corporate Bond Purchase Program (CBPP); 9) Extended Term Repo Facility (ETRF); and 10) Contingent Term Repo Facility (CTRF).

[19] Under the BoC's discontinued CPPP, eligible issuers were Canadian issuers of commercial paper (CP), including those issuing ABCP. The program targeted up to three-month CAD-denominated CP, with a minimum short-term credit rating of R-1 High/Mid/Low from DBRS Morningstar. A distinctive feature of the CPPP was its penalty pricing mechanism, which applied a spread of 130-160 basis points above the 3-month Canadian Overnight Index Swap rate (OIS). Rather than setting an initial size cap, the program's participation was naturally constrained by its

support the flow of credit to the economy by alleviating strains in Canada's commercial paper markets. At its initiation in April 2020, the CPPP saw some activity, which quickly and substantially dropped off by August 2020, as banks' use of the CPPP was largely limited to testing its functionality rather than as a substantial means of support. The Bank of Canada's balance sheet reflected this activity, with commercial paper holdings reaching a high of $3 billion (including $0.6 billion of ABCP) on April 29, 2020, before dropping to zero by July 29, 2020 (Figure 2).

Figure 2: CPPP usage



Note: The CPPP is discontinued effective April 2, 2021.
Source: Bank of Canada assets and liabilities
Last observation: April 28, 2021

Today, the Canadian ABCP market is dominated by the major Canadian banks, with the "Big-6" banks currently sponsoring and providing financial services to 99% of issued paper (Figure 3a).[20] These bank-sponsored conduits issue ABCP backed predominantly by assets from financial and non-financial bank clients. As a result, even though almost all Canadian ABCP is sponsored by Canadian banks, the assets backing the ABCP are from a wider set of firms.

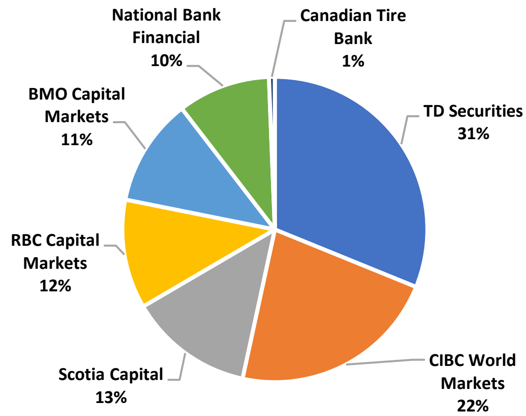
Nearly 90% of Canadian ABCP (Figure 3b) are backed by either residential secured lending (residential mortgages and home equity loans, 41.1%) or auto-related loans (including loans, leases, rental and fleet, 47.3%).

The biggest investors of Canadian ABCP appear to be asset managers, pension funds, insurance companies and hedge funds (Figure 4).

penalty pricing structure and individual issuer limits. However, by the time the CPPP was fully operational, market conditions had seen significant improvement, leading to relatively small utilization of the program.
More detail can be seen at [Commercial Paper Purchase Program (CPPP) – Term Sheet].

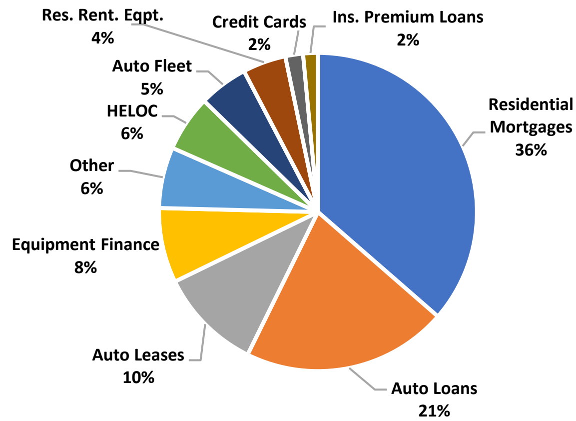
[20] As of July 2023. Source: DBRS.

Figure 3a – Canadian ABCP by issuer



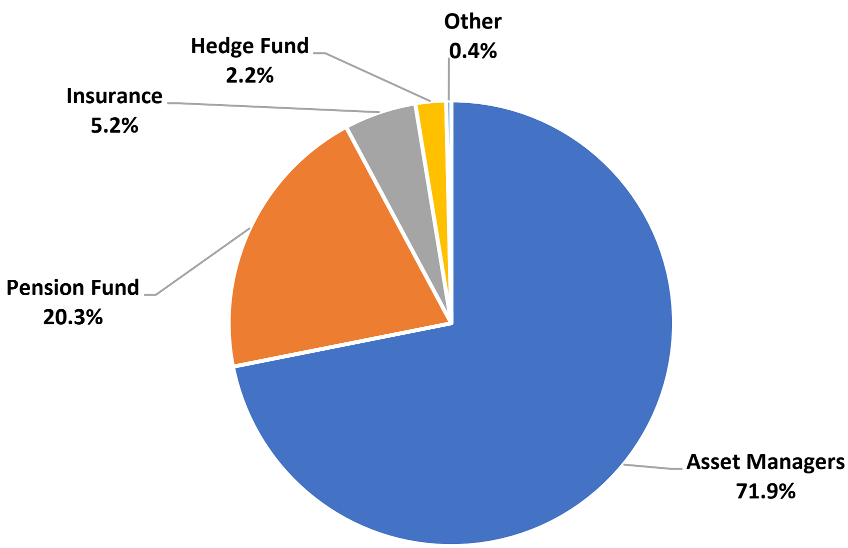
Source: DBRS

Figure 3b – Composition of assets backing Canadian ABCP



Last observation: January 2024

Figure 4 – Net purchases of ABCP from dealers in 2023



Source: MTRS, Bank of Canada calculations

Last observation: 01/01/2024

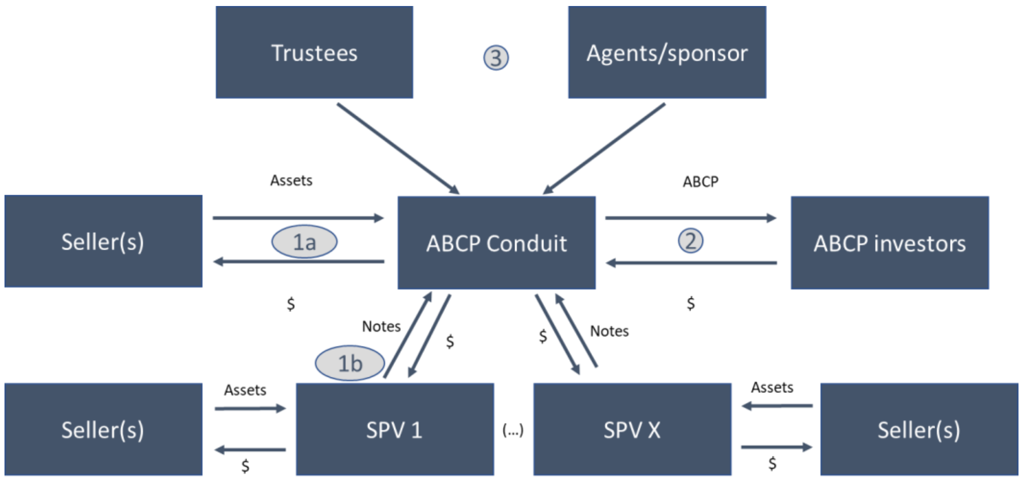
4. Key features of ABCP

ABCP are short-term securitizations with maturities under one year, backed by longer-term assets. In a typical securitization, the sponsoring bank establishes an ABCP conduit, which is a bankruptcy-remote special purpose vehicle (SPV), and the sponsoring bank will play the role of financial services agent and liquidity provider to the conduit.[21] The ABCP conduit, like all bankruptcy-remote SPVs, is used to segregate the securitized assets from the sellers, the sponsoring bank and their respective creditors. Within the ABCP conduit, there will be multiple loans or notes backed by assets that were sold to the ABCP conduit either from a seller directly or from an SPV established by a seller. The underlying assets backing each of the transactions in the ABCP conduit are bankruptcy remote from the originator or seller of the asset.

[21] With the exception of the Glacier Credit Card Trust

The ABCP conduit issues commercial paper backed by the assets, loans and notes and tranched into different levels of seniority. Once purchased by investors, the money from their sale is used to pay the seller or SPV for the assets put into the securitizations, often being used for further loan originations or to fund working capital.

Figure 5 – Stylized ABCP diagram



In general, ABCP in Canada is structured as follows:

1. One or more sellers provide assets to the ABCP conduit either directly or through intermediary SPVs. In the latter case, the assets are within the SPV which then provides a note or loan to the ABCP conduit.
2. The ABCP conduit issues commercial paper (backed[22] by the assets received from sellers or the loans/notes from the intermediary SPVs) to investors. The proceeds from the ABCP issuance are provided to the seller or SPV. Note that the ABCP proceeds might not match the total value of the assets as, in many transactions, the ABCP conduit could establish a cash buffer and/or overcollateralization. Other forms of enhancement are also possible (see Section 4.2).
3. The trustees of the conduit oversee its operations. Appointed by the issuer trustees, the agent/sponsor manages the daily operations of the conduit and provides various financial services, such as reporting on the ABCP conduit activities and serving as a swap counterparty, hiring a broker to distribute the ABCP, and providing liquidity. In Canada, since the GFC, this entity is a regulated bank.

The asset pools underlying each transaction within the ABCP conduits are segregated from each other and benefit from transaction-specific credit enhancement. Credit rating agencies generally evaluate the credit quality of the ABCP conduit on a transaction-by-transaction basis, as well as the form of and credit

[22] To "back" the commercial paper, legal rights to cashflows from the underlying assets are transferred to the SPV, out of reach of the seller's creditors. This protects ABCP investors based on the seniority of their interests.

strength of the liquidity provider when assigning the credit rating of the ABCP notes. The sponsor of the ABCP conduit may provide additional credit enhancement ("program-wide credit enhancement") to support the conduit or to support certain transactions to ensure the overall conduit achieves a desired credit rating. While the transaction-specific credit enhancement enables the seller to absorb first loss, losses above this amount will be absorbed by the conduit sponsor through the program-wide enhancement. In addition to transaction-by-transaction enhancements, conduit sponsors also provide liquidity facilities in case they are unable to find investors to buy newly issued ABCP. These liquidity facilities, while not designed explicitly to absorb default risk as full-wrap facilities are (see Section 4.2), are available for draws in the event the conduit is exposed to cash shortfalls, including from maturing ABCP.

4.1 Complexity of ABCP relative to BAs or BDNs

The securitization structure of ABCP can appear daunting, but it is worthwhile comparing ABCP's complexity with that of other well-known Canadian money market instruments such as BAs and bearer deposit notes (BDNs).

In a sense BAs and BDNs are simple instruments: they are unsecured, short-term securities with a value dependent on the credit quality of the issuer. Investors in these instruments are typically not given complex cash flow diagrams that map the structure of a bank's cash flows.

In another sense, however, the underlying credit profile of the BDNs and BAs can be seen as more complex than ABCP.[23] Like the current situation with ABCP, BDNs and BAs are only issued by the Big-6 regulated banks in Canada. They represent a part of the funding structure of a bank (i.e., a claim on the bank's cash flows and, in the event of bankruptcy, a residual claim on the bank's assets). A bank's cash flows are significantly more complex than those underlying ABCP, representing a broader set of activities including derivatives and structured finance. A diagram of the cash flows within a bank would be significantly more complicated than the diagram for ABCP (except where the ABCP has full wrap liquidity, in which case the ABCP also represents a residual claim on the banks assets).

Of course, complexity nor simplicity are synonymous with investment quality. Investors should carefully examine all characteristics and underlying exposures of potential investments.

4.2 Enhancement for ABCPs

ABCP sponsors try to ensure that their sponsored ABCP is attractive to investors by maintaining a particular credit quality or rating. This is largely achieved by ensuring only high-quality assets from long-standing bank clients are added to the conduit, establishing credit enhancement requirements that reflect the credit quality of the underlying assets, (or by voluntarily removing assets with significant deterioration from the conduit). For conduits relying on the ABCP Exemption, each of these transactions is then reviewed by two different credit rating agencies.[24]

In addition to carefully selecting sellers and asset pools, each transaction in an ABCP conduit is structured to include credit enhancement, which could include any combination of the following:

---

[23] This is not to argue that bank debt is either more or less risky than ABCP. Banks, like ABCP, are regulated to mitigate the risks that arise from their complexity. Investors should consider all relevant factors, including complexity and degree of regulation, when deciding whether to invest in a particular asset.

[24] Except where full-wrap liquidity is provided and the sponsoring bank's credit rating is equal to the desired credit rating of the ABCP.

- **Excess spread** – This is the difference between the yield on underlying assets held by the ABCP conduit and the aggregate expenses and interest owed by the transaction. Excess spread can range by product type and is as low as 2% for assets such as auto loans and as high as the high teens for credit card receivables. Excess spread collections are available to provide protection against monthly payment shortfalls in a transaction, and can be returned to the seller, or used to pay down the debt.
- **Overcollateralization** – Represents a negotiated buffer of assets exceeding the value of the ABCP outstanding, that the seller must transfer upon securitization. Where non-performance arises in the asset pool, the premise is that the aggregate cash collections, including those from the overcollateralization, will be sufficient to absorb losses. Essentially it is a mechanism for the seller to take first loss. The ABCP conduit has rights to the collections on all receivables, including the overcollateralization, to help with payment of principal and interest to ABCP investors, as well as program-related expenses. The overcollateralization percentage is based on the historical performance and types of assets being securitized.[25]
- **Cash reserve account or letter of credit** – This is an extra cash buffer or letter of credit that the seller of the asset maintains to pay shortfalls of interest or principal that may occur from time to time. The amount of cash reserve or letter of credit is based on the quality and type of assets.

In addition to these general credit enhancement features, the bank sponsors may choose to provide additional program-specific or program-wide credit enhancement to absorb losses above those provided by the seller described above. Note that while both the seller and sponsor may offer various layers of credit enhancement, circumstances may arise where losses exceed total credit enhancement. This would expose the conduit to cash shortfalls, leaving it challenged to repay ABCP investors.

To protect the conduit from liquidity risk, bank sponsors in Canada provide liquidity facilities to the ABCP conduits. ABCP are short-term instruments (but up to 364 days) that are backed by longer-term assets (generally loans of over 1 year maturity). Typically, as ABCP matures, ABCP sponsors issue new ABCP to investors and use those proceeds to repay the maturing ABCP. In this way, the short-term ABCP funds the longer-term assets. If, however, not enough maturing ABCP is rolled into new ABCP on a given date, the conduit may not be able to repay investors. In these transactions, the assets in the ABCP conduit generally cannot be sold or liquidated quickly enough to repay the ABCP investors, except in certain limited circumstances, so there could be a cash flow shortfall that results from this asset-liability mismatch.[26] If the ABCP conduit is unable to find investors to purchase that ABCP, it has a cash flow shortfall.

To address this potential situation, ABCP sponsors provide one of two types of liquidity facilities: Global Liquidity Standard (GLS) or full wrap liquidity facilities.

- **GLS liquidity** – The liquidity provider commits to fund good assets (i.e., non-defaulted assets) of at least 102% of each individual transaction limit, which covers the face value plus accrued interest on outstanding ABCP. This liquidity will generally not provide support for defaulted assets (net of

[25] For example, prime retail auto loans will typically have about 5% of credit enhancement and prime retail auto leases will typically have around 20%.

[26] A similar situation also occurs for committed transactions that are funded in the ABCP conduits. If there is a draw on the transactions, the ABCP conduit would issue additional ABCP to investors to raise cash to fund that draw (purchase the incremental assets).

assumed recoveries on those assets).[27] The liquidity provider will also have no obligation to fund if the conduit is insolvent.

- **Full wrap liquidity** – The liquidity provider explicitly commits to fully protect holders of the ABCP from any risk related to or arising from the underlying transaction, including defaulted assets. As a result of this type of liquidity support, the credit rating for an ABCP conduit will be floored at the rating of the liquidity provider but could be higher if the implied ratings on the underlying transactions exceed the rating of the issuer. Banks sponsoring ABCP with full wrap liquidity are indifferent, from the perspective of capital and leverage regulations, between putting a given securitization asset on their own balance sheet or in the conduit (i.e., they must set aside the same amount of leverage and capital).

Both types of liquidity facilities would provide funding to either repay any maturing ABCP or to fund additional asset purchases under committed transactions.

Since the GFC, the securities regulators have also enhanced their regulatory framework for ABCP (in the case of conduits relying on the ABCP Exemption), including improved requirements related to transparency. These requirements include disclosure and monthly reporting standards designed to ensure more stringent oversight and clearer communication of financial activities within the ABCP market in Canada.

4.3 Trading and pricing of ABCP

Canadian ABCP is mostly traded in a relationship-centric market. Dealers issue ABCP sponsored by their affiliated administered ABCP conduits to investor clients with whom they have well-established relationships, reflecting the costs of onboarding new clients as well as the desire to continually roll maturing ABCP into new exposures with either the same or different investors. (Both considerations reflect the needs of investor clients to keep their cash continually invested and the banks' desire to avoid providing liquidity to support their sponsored ABCP conduits.) As a result, banks typically have a book of clients interested in investing in ABCP whose aggregate demand is greater than the ABCP available to sell. At the same time, banks are reluctant to purchase more assets for their ABCP conduits unless they are reasonably confident there will be sufficient demand for the resulting ABCP throughout the entire business cycle. Banks report that they are actively expanding their investor client base and endeavoring to attract new investors to their ABCP client list especially with the disappearance of BAs.

Given the relationship-centric nature of ABCP and the frequency with which it is rolled at maturity, Canadian ABCP is not sold over an exchange. Most new purchases occur as the result of discussions between bank-affiliated dealers and their investor clients, while the cash from maturing ABCP being rolled into new exposure is the result of dealers contacting their investor clients to determine whether they want to maintain their ABCP exposure or, if not, whether another ABCP investor is interested in increasing their exposure.

ABCP is mostly traded on the primary market, with most investors seeking to reduce their exposure doing so at the roll (i.e., when the notes mature), given the relatively short maturities of ABCP. Nonetheless, ABCP is listed on some electronic platforms such as CanDeal, with sponsors often making markets in their own papers.

[27] Each conduit is different and some might cover a portion of the defaulted assets.

Among money market instruments, bank-sponsored ABCP typically trades at the widest spread to T-bills (Table 2). This is perhaps surprising, given that ABCP is generally secured by high quality assets, receives the highest short-term ratings from rating agencies, and benefits from a number of credit enhancements as well as liquidity facilities (see Section 4.2), while assets like commercial paper or bankers' acceptances are unsecured and have no equivalent credit enhancements. This likely reflects continued reluctance by some investors to purchase ABCP, as well as the perceived more complex structure of ABCP.

Although backed by Canadian assets, investors can typically buy ABCP denominated in either CAD or USD (with the program sponsor providing swapped currency exposure).

Table 2 – Trading characteristics of Canadian Money Market Instruments

	ABCP	CP	BAs	BDNs	T-bills
Settlement timing	T+0[28]	T+0	T+0	T+0	T+0
Issuer(s)	Bank-sponsored conduits	Canadian corporations, including banks	Canadian banks	Canadian banks	Government of Canada
Secured or unsecured	Secured	Unsecured	Unsecured	Unsecured	Unsecured
Diversified exposure	Yes	No	No	No	No
Risk-free	No	No	No	No	Yes
Currency	CAD, USD	CAD	CAD	CAD	CAD

4.4 Regulation of ABCP

4.4.1 Securities legislation

Under applicable securities legislation in the jurisdictions of Canada, if an issuer wants to issue securities to investors, it must file a prospectus with securities regulators or rely on an exemption from the prospectus requirements.

In Canada, most issuers (i.e., conduits) of ABCP rely on the prospectus exemption for short-term securitized products (the ABCP Exemption) in section 2.35.1 of National Instrument 45-106 *Prospectus Exemptions* (NI 45-106), as qualified by sections 2.35.2 to 2.35.4.[29]

[28] Note that ABCP can be issued at a discount or interest-bearing basis, either at a fixed or floating rate. Floating rate ABCP may require more time from trade to settlement.
[29] For more details, please visit: Unofficial Consolidation: National Instrument 45-106 - Prospectus Exemptions (osc.ca)

In order to rely on the ABCP Exemption, an issuer must comply with the terms and conditions of the ABCP Exemption,[30] which include the following:

- the conduit has a "GLS" or "full wrap" liquidity agreement with deposit-taking provincially or federally regulated financial institution(s) (FRFI);
- there are no synthetic assets in any of the conduit's asset pools (the ABCP Exemption is only available for conventional or traditional ABCP);[31]
- minimum credit rating threshold from at least two designated rating organizations[32] is in place to qualify for the exemption;[33]
- there is continuous and timely disclosure about:
    - the conduit's structure, business and operations,
    - the performance of the assets in the conduit's asset pools, and
    - events that impact the payment of interest or principal.

Additional detail can be found in Annex 1.

4.4.2 OSFI liquidity and capital guidelines on banks sponsoring ABCP

In Canada, the Office of the Superintendent of Financial Institutions (OSFI) is the prudential regulator and supervisor of all banks operating in the country, with the goal to ensure public confidence in Canada's financial system and the financial soundness of banks. For conduits relying on the ABCP Exemption, their sponsoring banks are therefore required to comply with OSFI's the Capital Adequacy Requirements (CAR) and Liquidity Adequacy Requirements (LAR), among other guidelines.

Since 2014, the liquidity coverage ratio (LCR) has required banks to maintain sufficient high quality liquid assets (HQLAs) to cover all possible net cash outflows within a 30-day period. For bank-sponsored ABCP

---

[30] ABCP issued in compliance with the terms and conditions of the ABCP Exemption is not subject to resale restrictions under National Instrument 45-102 *Resale of Securities*. Some issuers of ABCP may decide not to rely on the ABCP Exemption and may instead choose to rely on another exemption from the prospectus requirements in NI 45-106 if one is available for use (certain prospectus exemptions in NI 45-106 are not available for the distribution of ABCP). If an issuer relies on certain prospectus exemptions in NI 45-106 to issue ABCP, the ABCP may be subject to resale restrictions.
The Canadian Derivatives Clearing Corporation is the promoter for a proposed program for secured general collateral notes (SGC Notes) to be offered by the Secured General Collateral Note Trust (the Trust). While the SGC Notes have some similar features to ABCP, the SGC Notes are fundamentally different from ABCP as the assets backing the SGC Notes are highly liquid government and corporate bonds which are transferred to the Trust using repurchase agreements cleared through a clearing agency. The Trust will not be relying on the ABCP Exemption and will instead only offer the SGC Notes to certain "accredited investors" pursuant to the accredited investor exemption from the prospectus requirements in NI 45-106 (those accredited investors must also be "permitted clients" under National Instrument 31-103—Registration Requirements, Exemptions and Ongoing Registrant Obligations). As a result, the SGC Notes will be subject to resale restrictions.

[31] This requirement generally does not preclude the use of standard derivatives for hedging (e.g., interest rate/foreign exchange risk).

[32] Designated rating organizations are subject to regulatory oversight by securities regulatory authorities in Canada under National Instrument 25-101 – Designated Rating Organizations (NI 25-101). Under NI 25-101, designated rating organizations are required to adhere to rules concerning conflicts of interest, governance, conduct, compliance and required filings. See Annex 3 for more detail.

[33] ABCP issued under the ABCP Exemption must have at least two credit ratings, but only one will need to be at the higher rating category. The second and any additional credit rating cannot be lower than a specified level. See s. 2.35.1(a)(i) and (ii) of NI 45-106.

conduits, the sponsor provides a liquidity backstop for the ABCP and is typically required to assume that all the maturing ABCP is not able to be re-issued to money market investors and is hence repaid by drawing down on the liquidity facilities provided by the bank. Consequently, the sponsors, as liquidity providers, must hold HQLA equal to an assumed outflow equal to 100% of ABCP maturing within the 30-day window (net of paydowns). In addition, the capital required for transactions funded in the ABCP conduits is generally equivalent to the capital a bank would hold if the transaction were funded on the bank sponsor/liquidity provider's balance sheet. This requirement applies to both GLS and full-wrap liquidity facilities. See Annex 2 for more details.

Annex 1 – Additional details on ABCP in securities regulation

- A conduit relying on the ABCP Exemption would have to contractually agree that its asset pool would consist only of traditional asset classes such as bonds, leases, conventional mortgages and receivables.[34]
- ABCP issued under the ABCP Exemption must have at least two credit ratings, but only one will need to be at a higher rating category.[35] The second and any additional credit rating cannot be lower than a specified level.[36]
- In particular, one credit rating must be at or above the following level:
    - R-1(high)(sf) if issued by DBRS Limited,
    - F1+sf if issued by Fitch Ratings, Inc.,
    - P-1(sf) if issued by Moody's Canada Inc.,
    - A-1(High)(sf) (Canada national scale) or A-1+(sf) (global scale) if issued by S&P Global Ratings Canada.
- The second and any additional credit rating cannot be lower than the following level:
    - R-1(low)(sf) if issued by DBRS Limited,
    - F2sf if issued by Fitch Ratings, Inc.,
    - P-2(sf) if issued by Moody's Canada Inc.,
    - A-1(Low)(sf) (Canada national scale) or A-2(sf) (global scale) if issued by S&P Global Ratings Canada.
- The ABCP Exemption is conditional on a number of liquidity support requirements, including:
    - the conduit entering into agreements with one or more liquidity providers,[37]
    - restrictions on who may act as a liquidity provider,[38] and
    - credit rating requirements for liquidity providers.[39]
- While the design of these facilities is to backstop timing mismatches in the conduit's cashflows, GLS facilities can be drawn for reasons other than bankruptcy of the conduit itself, including credit deterioration in underlying assets up to an amount equal to the sum of non-defaulted assets and applicable credit enhancement.
- Certain FRFIs have converted from GLS facilities to full-wrap facilities which fully protect ABCP investors from any risk arising from the underlying assets, including default (other than the credit risk of the FRFI providing liquidity).
- However, for a conduit relying on the ABCP Exemption, we note the permitted exceptions related to liquidity agreements in section 2.35.3 of NI 45-106 for situations where a liquidity provider is not obligated to advance funds.
- Conduits that distribute ABCP under the ABCP Exemption must disclose the following:
    - information about the conduit, including its structure, business and operations, in Form 45-106F7 *Information Memorandum for Short-term Securitized Products Distributed under*

[34] See s. 2.35.2(c) of NI 45-106.
[35] See s. 2.35.2(a)(i) of NI 45-106.
[36] See s. 2.35.2(a)(ii) of NI 45-106.
[37] See s. 2.35.2(a)(iii) of NI 45-106.
[38] See s. 2.35.2(a)(iv)(A) and (B) of NI 45-106.
[39] See s. 2.35.2(a)(iv)(C) of NI 45-106.

Section 2.35.1 (the Information Memorandum) on or before the date that an investor purchases ABCP,[40]
  - monthly information about the conduit, including asset transactions, asset pools and their performance, in Form 45-106F8 *Monthly Disclosure Report for Short-term Securitized Products Distributed under Section 2.35.1* (the Monthly Disclosure Report) no later than 50 days from the end of the most recent month,[41] and
  - timely information about certain significant events relating to the conduit's credit rating and the payment of principal or interest no later than the second business day after the conduit becomes aware of the change or event.[42]

Annex 2 – Additional detail on OSFI liquidity and capital regulation[43]

- LCR – Liquidity Coverage Ratio
  - The LCR aims to ensure that institutions have an adequate stock of unencumbered high-quality liquid assets (HQLA) to meet their liquidity needs for a liquidity stress event that lasts 30 calendar days.
  - $\frac{\text{Stock of HQLA + Eligible non-operational demand and overnight deposits}}{\text{Total net cash outflows over the next 30 calendar days}} \geq 100\%$
  - For bank-sponsored conduits, the sponsoring bank is deemed to have issued the ABCP and is required to recognize an outflow equal to 100% of ABCP maturing within 30 days.
  - Held as an asset, ABCP issued by a financial institution or any of its affiliated entities is not considered part of HQLA. If the ABCP is not issued by a financial institution it may qualify as a Level 2A asset with a 15% haircut applied (see Liquidity Adequacy Requirements (LAR) Chapter 2 section 2.2.A.).
  - Inflows from non-HQLA ABCP holdings may still be considered as an offset to net cash outflows if scheduled to mature within the 30-day horizon.
- NSFR – Net Stable Funding Ratio
  - The NSFR will require banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. The NSFR limits overreliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance sheet items, and promotes funding stability.
  - $\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \geq 100\%$
  - ABCP issued by a financial institution or any of its affiliated entities is assigned a 50% required stable funding (RSF) factor, as non-HQLA. ABCP which qualifies as a Level 2A asset and which has

[40] See s. 2.35.4(1)(a) of NI 45-106.
[41] See s. 2.35.4(5) of NI 45-106.
[42] See s. 2.35.4(6) of NI 45-106.
[43] Additional information is available on the websites of the Office of the Superintendent of Financial Institutions (OSFI) and the Basel Committee on Banking Supervision (BCBS).

a credit rating equal or equivalent to at least AA– is assigned a 15% RSF factor instead (see LAR Chapter 3 sections 3.3.7. and 3.3.8.).

- NCCF – Net Cumulative Cash Flow
    - The NCCF is a liquidity-horizon metric that measures an institution's net cumulative cash flow to capture the risk posed by funding mismatches between assets and liabilities over 12 months.
    - Under NCCF, ABCP assets receive liquidity value commensurate with their eligibility and haircut at central bank standing liquidity facilities. ABCP liabilities are assigned 100% outflow rates upon maturity. Additionally, a 100% outflow rate is applied to the unutilized capacity of any facilities backstopping ABCPs that can be drawn within 30 days.
- Capital Adequacy Requirements
    - Drawn from the BCBS framework, OSFI's securitization framework [link] is to be applied in determining the risk-weighted capital treatment applicable to all securitization exposures for credit risk, including ABCP. In addition, OSFI's market risk framework [link] is to be applied to all ABCP held in the trading book.

Annex 3 – Additional detail on the regulatory oversight of Designated Rating Organizations (DROs)

Background on NI 25-101 and IOSCO

In response to the Global Financial Crisis, on April 20, 2012, National Instrument 25-101 – Designated Rating Organizations (NI 25-101) came into force. NI 25-101, a rule adopted by the securities regulatory authorities in Canada, established a regulatory framework for the oversight of credit rating organizations that have been designated by a securities regulatory authority in Canada.

There are currently five credit rating organizations that have been designated as designated rating organizations (DROs) in Canada under NI 25-101:

1. DBRS Limited
2. Fitch Ratings, Inc.
3. Kroll Bond Rating Agency, LLC (Kroll)
4. Moody's Canada Inc.
5. S&P Global Ratings Canada

Kroll has only been designated as a DRO for the purposes of the alternative eligibility criteria in section 2.6 of National Instrument 44-101 *Short Form Prospectus Distributions* and section 2.6 of National Instrument 44-102 *Shelf Distributions* for Issuers of asset-backed securities to file a short-form prospectus or shelf prospectus, respectively. Kroll has not been designated for purposes of the ABCP Exemption.

NI 25-101 sets out a framework for Designated Rating Organizations (DROs) with requirements based substantially on the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (the IOSCO Code), as supplemented to meet international standards and to clarify Canadian Securities Administrators' expectations of DROs. Of note, the IOSCO Code was a *voluntary* compliance regime that set international supervisory standards for credit rating agencies, with the objectives of: (i) protecting investors, (ii) ensuring markets are fair, efficient and transparent and (iii) reducing systemic risk. As a result of the Global Financial Crisis, NI 25-101 departed from the voluntary, “comply or explain” model that was employed by the IOSCO Code, and instead mandated that unless a DRO received exemptive relief, its code of conduct could not deviate from NI 25-101.

NI 25-101

NI 25-101 requires, among other things, that:

- A DRO establish, maintain and ensure compliance with a code of conduct, which includes matters relating to:
    - the quality and integrity of the rating process;
    - the independence and avoidance of conflicts of interest by the DRO; and
    - the DRO's responsibilities to the investing public and issuers of debt securities.
- A DRO must appoint a compliance officer to monitor compliance with the code of conduct and applicable securities laws.
- The DRO must publicly disclose its policies for distributing ratings, ratings reports and updates.
- All rating reports include certain disclosures, including but not limited to:
    a. when the rating was first released and when it was last updated;
    b. the principal methodology used in determining the rating;
    c. the meaning of each rating category and the definition of default or recovery, and the time horizon the DRO used when making a rating decision;
    d. any attributes and limitations of the credit rating.
- All rating reports in respect of a structured finance product include certain disclosure with respect to the following:
    a. All information about loss and cash-flow analysis it has performed or is relying upon and an indication of any expected change in the credit rating. The DRO must also disclose the degree to which it analyzes how sensitive a rating of a structured finance product is to changes in the DRO's underlying rating assumptions;
    b. the level of assessment the DRO has performed concerning the due diligence processes carried out at the level of underlying financial instruments or other assets of structured finance products. The DRO must also disclose whether it has undertaken any assessment of such due diligence processes or whether it has relied on a third-party assessment and how the outcome of such assessment impacts the credit rating.
- A DRO must disclose on an ongoing basis information about all structured finance products submitted to it for its initial review or for a preliminary rating, including whether the issuer requested the DRO provide a final rating.

- DROs must differentiate ratings of structured finance products from traditional corporate bond ratings through a different rating symbology.
- Every year, the DRO must publicly disclose data about the historical default rates of its rating categories and whether the default rates of these categories have changed over time.
- For each rating, the DRO must disclose whether the rated entity participated in the rating process and whether the DRO had access to the accounts and other relevant internal documents of the rated entity or its related entities. Each rating not initiated at the request of the rated entity will be identified as such.