



*Insight beyond the rating.*

April 23, 2014

**To: Members of the Canadian Securities Administrators (the CSA)**

British Columbia Securities Commission  
Alberta Securities Commission  
Financial and Consumer Affairs Authority of Saskatchewan  
The Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
Financial and Consumer Services Commission of New Brunswick  
Superintendent of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Nunavut

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**Re: Request for Comments on Proposed Amendments to National Instrument 45-106  
Prospectus and Registration Exemptions Relating to the Short-term Debt Prospectus  
Exemption and Proposed Securitized Products Amendments (Proposed Amendments to NI  
45-106 or Proposed Amendments)**

Dear CSA:

DBRS<sup>1</sup> welcomes the opportunity to provide its comments on the Proposed Amendments to NI 45-106. The Proposed Amendments would, among other things: change the requirements that short term debt securities, notably commercial paper (CP), must satisfy in order to be distributed under the short term debt prospectus exemption; make such exemption unavailable to securitized products such as asset-backed commercial paper (ABCP); and introduce a new prospectus exemption for ABCP backed by traditional or conventional assets.

By way of background, DBRS is the only Canadian based global credit rating agency (CRA). With headquarters in Toronto and offices in Chicago, London and New York, DBRS's credit ratings, research and financial analysis help investors make informed financial decisions. DBRS' role in Canada is of particular significance, with comprehensive ratings coverage for all provinces, virtually all corporate entities, major banks and insurance companies and asset-backed securities including ABCP. DBRS is the primary CRA for CP, term securities and preferred shares. As the only Canadian based CRA, DBRS believes it has a deep understanding of and plays a unique role in the Canadian capital markets.

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<sup>1</sup> DBRS is a global credit rating agency consisting of three affiliated companies: DBRS Limited (Canada), DBRS, Inc. (U.S.) and DBRS Ratings Limited (Europe).

In October 2012, along with its three globally active peers, DBRS was approved as a Designated Rating Organization (DRO) in accordance with the new Canadian regulatory framework for credit rating organizations<sup>2</sup>. The DRO regulatory framework imposes high registration and ongoing compliance standards regarding objectivity, integrity and transparency for those CRAs who wish to have their ratings eligible for use in Canadian securities legislation. At present, there are only four DROs in Canada whose ratings are eligible for use. DRO ratings are also eligible for use in the EU market as the Canadian DRO framework was considered equivalent by the European Securities and Markets Authority.

It is on this basis that DBRS offers its comments on the Proposed Amendments.

The Proposed Amendments follow a Request for Comment in April 2011 from the CSA regarding the Proposed Securitized Product Rules for which DBRS filed comments<sup>3</sup>. The Proposed Amendments reflect significant positive changes to the 2011 disclosures and reporting proposals for securitization products that would be bought on a prospectus-exempt basis. However, the Proposed Amendments now single out ABCP as a special securitized asset class and propose certain requirements including rating thresholds, liquidity and disclosures that are inconsistent with market practice and international developments. In addition, the Proposed Amendments propose a revised split rating condition for CP intended to remove the regulatory disincentive to obtain additional credit ratings. However, it reflects inconsistent treatment between the DROs where none is warranted.

In short, while there are positive aspects in each of the CP and ABCP proposals, there are also requirements that could have significant negative unintended consequences for investors, the debt market and regulators. DBRS encourages the CSA to revisit these areas to ensure the effective and proper functioning of the Canadian CP and ABCP markets.

## **CP**

### *Rating Thresholds*

The CSA acknowledge that CP is an important short term funding instrument and can generally be viewed as a lower-cost financing alternative to bank debt for issuers. CP is generally distributed in reliance on the Short-Term Debt Prospectus Exemption, commonly referred to as the “exempt market”, and among other conditions, must carry at least one designated rating from a DRO or a DRO affiliate at or above specific rating threshold levels (referred to as the Rating Threshold Condition or first test). The Rating Threshold Condition requires at least one credit rating at or above the following levels: DBRS R-1(low), S&P A-1(low), Moody’s P-1, Fitch F1. This first test reflects ratings equivalency between DROs.

Many issuers in the exempt market carry only one rating, typically a DBRS rating that satisfies the Rating Threshold Condition. Sometimes, issuers choose to obtain additional ratings. At present,

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<sup>2</sup> <http://www.dbrs.com/research/252161/dbrs-is-approved-in-canada-as-a-designated-rating-organization.html>

<sup>3</sup> <http://www.dbrs.com/research/241734/dbrs-comment-letter-on-canadian-proposed-securitized-products-rules.pdf>

where an additional rating might be requested, the CP cannot have a rating below the ratings in the Rating Threshold Condition (referred to as the Split Rating Condition or second test). That is, the first and second tests for distribution of CP in the exempt market are the same.

Since 2006 or eight years ago when the Short-Term Debt Prospectus Exemption became effective, the CSA has received forty applications to grant relief from the second test. The CSA has granted such exemptive relief so long as the CP's additional rating was at or above the following levels: DBRS R-1(low), S&P A-2, Moody's P-2 or Fitch F2. DBRS was unaware of this ratings treatment. But in any case, the basis for such relief does not accurately reflect how short-term ratings correlate across these firms.

Appropriately, the Proposed Amendments retain the current Rating Threshold Condition. There is no reason to change this first test. At present, Canadian CP is generally an R-1 market (i.e. either R-1(high), R-1(mid) or R-1(low)) that typically carries one rating and at this level, DRO short-term rating levels are equivalent. However, the CSA now proposes to codify an inconsistent ratings treatment in a revised second test (the Modified Split Rating Condition).

DBRS questions whether a second test is needed. The pool of DROs from which issuers can select a designated rating is small and consists of well-known firms with globally established track records subject to formal regulation by the CSA. The rating of one DRO, therefore, should be sufficient.

If, however, the CSA believe that a second test is required, as proposed, the Modified Split Rating Condition, in the view of DBRS, is inappropriate and could create investor confusion.

At the proposed A2<sup>4</sup>/P2/F2 rating levels for DRO peers, the correct DBRS rating for the revised second test should be R-2(high). Based on public rating definitions, the proposed short term ratings are equivalent to "no long term rating below BBB+/Baa1"<sup>5</sup>. As outlined in its public policy for Short Term and Long Term Rating Relationships<sup>6</sup>, the DBRS equivalent long term rating of BBBH correlates to the short-term rating of R-2(high). As proposed, the Modified Split Rating Condition would also differ from equivalent rating threshold levels established by other regulators including OSFI<sup>7</sup>. It is unlikely that the CSA intended to create an inconsistent or non-neutral playing field for the DROs it regulates. In addition, an R-2(high)/A2/P2/F2 threshold would support the development of an alternative lower-rated but still investment grade, CP market.

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<sup>4</sup> DBRS notes that the A-2 rating suggested by the CSA for S&P is from their global rating scale which equates to an A-1 (low) on their Canadian scale. On this basis, the appropriate DRO equivalency for the Modified Split Rating Condition is A-1(low)/P2/F-2/R-2(High).

<sup>5</sup> Included at the back of this comment letter is a table that outlines the short term and long term rating equivalency between the DROs.

<sup>6</sup> <http://www.dbrs.com/research/236758/short-term-and-long-term-rating-relationships.pdf>

<sup>7</sup> OSFI Capital Adequacy Guidelines – Section 3.6.2.5, Paragraph 114  
[http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-lid/Pages/CAR\\_chpt3.aspx](http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-lid/Pages/CAR_chpt3.aspx)

DBRS believes the Short-Term Debt Prospectus Exemption should remain available even when a DRO has announced that a credit rating it has issued for the CP is under review and may be downgraded. Such a situation could be used as a flag, however, where the issuer could be placed on an internal CSA watch list for monitoring.

With a formal regulatory framework for CRAs in place in Canada that is also recognized internationally, DBRS believes that it is not inappropriate for ratings to continue to serve as the primary condition for the Short-Term Debt Prospectus Exemption. Such use is not counter to the G20 and Financial Stability Board's commitment to reduce the mechanistic reliance on ratings<sup>8</sup>. At present, there are no viable tested alternatives to credit ratings, and they are but one risk management tool available to investors in their decision-making. As the primary condition, it is therefore critical that the CSA codify appropriate rating thresholds.

## **ABCP**

As acknowledged by the CSA and more recently by the European Central Bank (ECB) and the Bank of England<sup>9</sup>, securitization is an important complementary funding tool to support the real economy as it provides diversity of funding to sellers of consumer goods/services and lowers the overall cost of funding for these companies. As such, securitization, in effect, increases availability of consumer credit, which is an important component of economic growth and financial stability.

As also cited by the CSA, ABCP differs significantly from term securitized products and offers a relatively safe provision of alternative short term funding. In its Request for Comments, the CSA outlines the types of ABCP - conventional and non-bank or credit arbitrage ABCP - and notes that the latter type is no longer being issued in Canada. Hence, it is the traditional type of bank-sponsored ABCP holding asset classes such as trade receivables, equipment leases and loans residential mortgages, home equity lines of credit and automobile loans offered in the exempt market that is the subject of the Proposed Amendments. And yet the CSA has proposed some fairly punitive measures that are inconsistent with market practice to regulate the distribution of ABCP that is backed by relatively low risk securitized asset classes.

DBRS has concerns with the Proposed Amendments for ABCP in four main areas. Firstly, similar to DBRS's comments for CP, the proposed rating threshold levels for ABCP are inconsistent between DROs. More fundamentally, DBRS would argue that the threshold should be consistent with that for CP noting that ABCP investors are primarily sophisticated institutions and the market is beginning to evolve beyond the current DBRS rating threshold. Secondly, the proposed list of asset classes is too prescriptive and may stifle product innovation in an already tenuous ABCP market. Thirdly, the proposed liquidity requirements diverge from DRO rating requirements and potentially compromise the issuance of an eligible rating which is a key component of the prospectus exempt distribution of ABCP. And finally, the proposed disclosure requirements do not reflect or accommodate the way such deals work and may force originators and/or sponsors of ABCP to withdraw from the market.

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<sup>8</sup> Principles for Reducing Reliance on CRA Ratings issued on October 27, 2010  
[http://www.financialstabilityboard.org/publications/r\\_101027.pdf](http://www.financialstabilityboard.org/publications/r_101027.pdf)

<sup>9</sup> On April 11th, 2014, the ECB and the Bank of England jointly recommended promoting high-quality securitization in regulatory treatment and adjusting regulations to be commensurate with reduced risk of high-quality transactions.

### *Rating Thresholds*

By way of practice, ABCP typically requires two ratings which the CSA proposal appropriately reflects. However, the (two) ratings requirement proposed in section 2.35.2(a)(i) would codify a threshold of R-1(high) from DBRS while permitting a lower rating from any one of the other DROs. The CSA may have intended to reference the “highest short-term credit rating levels” from all DROs. However, in effect, the CSA instead appears to be comfortable - from a credit perspective - with the prospectus-exempt distribution of ABCP at a rating threshold of R-1 (middle) or R-1(low) from any DRO other than DBRS. DBRS does not think the CSA intended to create an unequal and preferential treatment of ratings of other DROs (in comparison to those of DBRS’s) given that all four DROs have achieved the DRO designation.

DBRS submits that from a credit perspective, properly structured ABCP does not pose a higher risk to investors than equivalently rated CP. As such, DBRS sees no reason why the (two) ratings threshold for ABCP should not be consistent with the (unchanged) Rating Threshold Condition for CP.

As a special purpose vehicle, each Canadian ABCP conduit has a prescribed purpose, and is authorized to carry on a very limited scope of activities and is bankruptcy remote from its sponsor (and the originators that obtain funding from each such conduit). As a result, different from investors of CP, ABCP investors are in a much better position to limit their risk/exposure to the operating entities that are related to any of these conduits. In addition, the true sale of the assets to the ABCP conduits, among other things, means that ABCP conduits own such assets, which situates ABCP conduits and investors thereof in a much better position from an enforcement perspective (whereby in direct contrast, in a commercial lending or secured debt offering, the lenders do not have ownership interest in the collateral). As such, DBRS submits that is not appropriate to subject high quality ABCP to tougher legislative requirements than those applicable to equivalently rated CP. Alignment between the minimum rating thresholds for the exempt distribution of CP and ABCP would, in fact, be less confusing for investors. Therefore, DBRS suggests that section 2.35.2(a)(i) of the Proposed Amendments should reflect the following: R-1(low)/A1(low)/P1/F1, each of these modified by (sf).

As a final note, DBRS is mindful that the (two) ratings requirement proposed for ABCP is consistent with the eligibility criteria (the Criteria) for Bank of Canada’s Standing Liquidity Facility (SLF). Although the Criteria for the SLF may have been recently confirmed, DBRS submits that strict adherence to a portion of the Criteria that was originally developed under unique circumstances to address a particular issue (that is materially different from the rationale for the Proposed Amendments) and can be amended any time is not appropriate in developing the legislative framework that would shape the future of Canadian ABCP.

### *Permitted Assets*

With respect to section 2.35.2(c) or permitted assets, DBRS understands the regulatory imperative to restrict funding of synthetic assets/structured credit transactions through ABCP distributed pursuant to the proposed prospectus exemption. However, DBRS is concerned that the “enumerated permitted asset class” approach is unduly restrictive, creating doubt with respect to eligibility of some of the transactions currently funded by ABCP conduits. In addition, the proposed list does not include all traditional/conventional/non-synthetic asset classes DBRS has considered

in the past and are funded by conventional ABCP conduits outside of Canada. DBRS understands that other prospectus exemptions would be available to ABCP conduit sponsors for distribution of ABCP backed by these “other” asset classes. However, given the nature of ABCP conduit structures, forcing ABCP conduits to use different prospectus exemptions would effectively increase the administrative burden on the conduit sponsors, cost of funding for originators and attach undue stigma to “not-on-the-list” conventional asset classes. DBRS is concerned that the proposed approach could limit the growth of Canadian ABCP market for “not-on-the-list” conventional asset classes. DBRS would invite the CSA to revisit its approach either by way of adding a catch-all paragraph (viii) that would allow funding of asset classes that are sufficiently/substantively similar to those expressly mentioned in paragraphs (i) through (vii) or listing the “not-permitted” asset classes.

DBRS also cautions the CSA that the requirement set out in section 2.35.2(b) is unduly punitive and singles out ABCP. DBRS submits that so long as seniority of a particular Class of ABCP and the rights of holders of any Class of ABCP are adequately disclosed to investors, unfavorable treatment of lower ranked ABCP pursuant to securities legislation would not necessarily protect ABCP investors. There does not appear to be a comparable legislative requirement applicable to distribution of “lower ranked” securities issued by operating entities (equity, being the most subordinate component of the capital structure of an operating entity, or subordinated debt). The proposed approach by the CSA will add to the administrative burden of conduit sponsors that may wish to employ multi-tiered ABCP transactions, limit innovation or change in the Canadian ABCP market and increase cost of funding available to originators without any meaningful benefit to the ABCP investors.

#### *Liquidity requirements*

DBRS underscores that liquidity related requirements are fundamental components of the rating approach utilized by the DROs and are generally more restrictive than those proposed by the CSA. Given the granular and prescriptive nature of the proposed requirements applicable to liquidity providers and liquidity arrangements, inconsistency between the regulatory framework and rating agency criteria could compromise the DRO’s ability to maintain their criteria as they deem appropriate on a go-forward basis.

DBRS submits that the Bank of Canada requirements with respect to liquidity providers are appropriate in the context of the overall mandate of prudential regulators overseeing such financial institutions and/or the financial system. DBRS notes the differences between the primary mandate of Bank of Canada and the CSA and queries the applicability of the Bank of Canada requirements in the context of this proposal.

More importantly, DBRS agrees that ABCP investors must be afforded the opportunity to do proper due diligence and make informed decisions with respect to any investment instrument, including ABCP. DBRS submits that provision of meaningful disclosure to ABCP investors – as opposed to incorporation of prescriptive liquidity requirements that are hard coded into securities legislation would better equip ABCP investors to carry out any due diligence they may deem necessary. From that perspective, DBRS submits that focusing on disclosure of pertinent aspects of liquidity arrangements that support ABCP would be a more meaningful way of achieving the ultimate statutory objective of investor protection and transparency.



### *Disclosure and Reporting Obligations*

DBRS agrees that meaningful disclosure with respect to ABCP conduits is integral to the proper functioning and further growth of the Canadian ABCP market. DBRS has demonstrated its commitment to the Canadian market in this regard through provision of timely and meaningful disclosure on the DBRS rated Canadian ABCP conduits and has expanded its disclosure and reporting over the course of the past several years. In addition to providing mandated ratings disclosure on ABCP ratings, DBRS publishes an “ABCP Transaction Summary” that sets out pertinent aspects of each ABCP transaction funded by the ABCP conduits rated by DBRS. However, DBRS is concerned that the level of disclosure contemplated in the proposal could have an adverse effect on the Canadian ABCP market.

The true sale of the assets to the ABCP conduits achieves a degree of separation of the assets from the originator thereby allowing ABCP programs to achieve higher credit rating levels than those of the originators that obtain funding through these programs. Given the separation of the assets from the originator of those assets, the identity of the originator and/or the credit rating level of the originator is of limited value, if any, for ABCP investors. The fact that investors have not demanded disclosure of this information by conduit sponsors or rating agencies further substantiates this point. DBRS does not consider this requirement particularly meaningful or useful for investors.

As noted above, in addition to the disclosure of the identity of the originator/servicer not being relevant, DBRS is concerned that provision of such information could be detrimental as it could result in investor concentration limits (with respect to originators/servicers) being breached, thereby leading to further shrinkage in demand and supply of Canadian ABCP and limiting access of certain originators to liquidity.

Moreover, DBRS submits that in a properly structured ABCP conduit, anonymity of the originators is not necessarily a risk factor that needs to be mitigated by disclosure. As such, DBRS cautions that disclosing the names of the originators could result in unwarranted and premature market reaction to one or more ABCP conduits upon occurrence of a trigger event affecting an originator. DBRS notes that ensuing market upheaval under such circumstances would not only adversely affect the “affected originator” but also all originators funded by the affected ABCP conduit(s), as well as the sponsor/liquidity provider of that conduit and might create a contagion effect in the financial system.

DBRS would query the different treatment of “borrower identity” risk pursuant to securities legislation. DBRS understands that financial institutions that are engaged in secured lending and are reporting issuers are not required to disclose the names of their respective borrowers. Given that ABCP funding, in essence, is an enhanced form of secured lending, the legislative rationale for subjecting highly rated ABCP conduits to tougher legislative requirements (compared to those applicable to reporting issuers that are rated lower than the ABCP issued by their respective conduits) is not consistent with the general approach taken by regulators outside of Canada.

In addition, while appreciating the importance of timely disclosure of the occurrence of material events, DBRS notes that striking the right balance with respect to the timing and manner of such disclosure is critical. DBRS agrees that occurrence of certain transaction level trigger events, such as poor performance of assets owned by an ABCP conduit or an originator’s or servicer’s financial



distress, unless mitigated, could be expected to have material adverse effect on the ABCP holders. However, ABCP program documents customarily include early repayment/warning triggers that are designed to mitigate the risk to holders of highly rated ABCP upon occurrence of such events in a timely and expedient manner. As such, DBRS cautions that premature disclosure of a transaction level trigger event that is mitigated or provided for in the underlying transactions prior to all such structural and legal mitigants have been exhausted could have unintended consequences and may not be in the best interest of ABCP investors. DBRS suggests that an orderly wind-down of a “triggered” ABCP transaction, in accordance with its terms, could produce more favorable results for the investors. As such, DBRS would encourage the CSA to revisit the scope and timing of the “timely disclosure” requirements such that ABCP investors would get the full benefit of structural protections included in the ABCP conduit documents and timely disclosure obligations would focus on “conduit level” trigger events.

As a final general comment, DBRS suggests it would be more user-friendly to have two separate rules for each of the Short-Term Debt Prospectus Exemption and the Short-Term Securitized Products Prospectus Exemption and the related new forms instead of together in NI 45-106.

In closing, DBRS appreciates the considerable work the CSA has undertaken to produce these Proposed Amendments. DBRS would be pleased to answer any questions the CSA may have regarding its views.

Very truly yours,

A handwritten signature in purple ink, appearing to read "Mary Keogh", is positioned above the typed name.

Mary Keogh  
Managing Director  
Global Regulatory Affairs  
DBRS



## SHORT TERM AND LONG TERM RATING EQUIVALENCY

DBRS		Moody's		S&P		Fitch	
Long-Term	Short-Term	Long-Term	Short-Term	Long-Term	Short-Term	Long-Term	Short-Term
AAA	R-1 (high)	Aaa	P-1	AAA	A-1+	AAA	F1+
AA (high)	R-1 (high)	Aa1	P-1	AA+	A-1+	AA+	F1+
AA	R-1 (mid)	Aa2	P-1	AA	A-1+	AA	F1+
AA (low)	R-1 (mid)	Aa3	P-1	AA-	A-1+	AA-	F1+
A (high)	R-1 (low)	A1	P-1	A+	A-1	A+	F1 or F1+
A	R-1 (low)	A2	P-1 or P-2	A	A-1 or A-2	A	F1
A (low)	R-1 (low)	A3	P-1 or P-2	A-	A-2	A-	F1 or F2
BBB (high)	R-2 (high)	Baa1	P-2	BBB+	A-2	BBB+	F2
BBB	R-2 (mid)	Baa2	P-2 or P-3	BBB	A-2 or A-3	BBB	F2 or F3
BBB (low)	R-2 (low) or R-3	Baa3	P-3	BBB-	A-3	BBB-	F3

This table shows the usual mapping of short-term to long-term ratings according to each CRA per the links below, although, depending upon the CRA, exceptions may occur (and are not included in the table).

DBRS – Rating Scales – Short-Term and Long-Term Rating Relationships (page 3)

<http://www.dbrs.com/research/236758/short-term-and-long-term-rating-relationships.pdf>

Moody's – Rating Symbols and Definitions – Short-Term vs Long-Term Ratings (page 10)

<https://www.moodys.com/sites/products/AboutMoodyRatingsAttachments/MoodysRatingsSymbolsand%20Definitions.pdf>

Standard & Poor's – About Credit Ratings – Standard & Poor's Rating Correlation Scales (see roughly middle of article)

[http://www.standardandpoors.com/aboutcreditratings/RatingsManual\\_PrintGuide.html](http://www.standardandpoors.com/aboutcreditratings/RatingsManual_PrintGuide.html)

Fitch – Definitions of Ratings – Ratings Correspondence Table (page 20)

[https://www.fitchratings.com/web\\_content/ratings/fitch\\_ratings\\_definitions\\_and\\_scales.pdf](https://www.fitchratings.com/web_content/ratings/fitch_ratings_definitions_and_scales.pdf)