



**Dominion  
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## **Commentary on Criteria to Establish a Canadian Asset-Backed Commercial Paper Conduit**

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Dominion Bond Rating Service (“DBRS”) has established a minimum set of criteria that each sponsor (“Sponsor”) must meet to establish a Canadian asset-backed commercial paper (ABCP) conduit (the “Conduit”) that will issue DBRS-rated securities.

The following is a list of the minimum criteria required by DBRS to be submitted by the Sponsor in order for DBRS to commence its review of the application:

### **I. Capital Requirements**

A Sponsor that intends to establish a Conduit that is rated by DBRS shall generally comply with the following:

- Have a minimum of approximately Cdn\$7 million of equity capital (the “Capital”) to be used as follows:
  - (1) Cdn\$2 million to fund set-up costs, including information and operational systems.
  - (2) Cdn\$5 million for reserve capital that will remain as an asset of the Sponsor as ongoing capital that may be used for unexpected future expenses (both operational and credit-related).
- The Capital must be raised in full, prior to the Conduit being established. The source of the Capital and applicable documentation must be disclosed to DBRS.
- The Capital must be equity in nature (or akin to equity) and shall not, in any form, represent a financial liability of the trust.
- Full disclosure to DBRS of all beneficial owners of the Conduit is mandatory and DBRS must receive prior notice of any future change to the ownership or structure of the Conduit.
- DBRS will publish a report on the Conduit that will disclose, among other things, the ownership of the Conduit and its structure.
- DBRS may require that a portion of the Capital reside with the funding conduit in liquid assets to act as a reserve for unexpected future expenses (both operational and credit-related).

## II. Staff

Prior to the establishment of the Conduit, the Sponsor must have resources in place to manage the following functions:

- (1) Legal:** Legal structuring capabilities, with a proven track record in securitization transactions at a law firm, an investment bank, a buy-side investment firm, or a rating agency.
- (2) Quantitative:** Strong analytical and modeling capabilities, including expertise in pricing and surveillance.
- (3) Credit:** Proven track record in the fixed income and securitization market, with direct experience in managing/analyzing credits (either on an entity or portfolio basis).
- (4) Risk Management:** Experienced risk manager, with surveillance and monitoring experience in the credit market.
- (5) Liability Management:** Experience in managing treasury and funding of liabilities (Commercial Paper, Fixed-Rate Notes, or Medium-Term Notes), including distribution of Commercial Paper in the Canadian market and experience with liquidity planning.
- (6) Back Office/Servicing:** Experience in executing and servicing securitization transactions, including transaction reporting and settlements, record keeping, audit, payroll, security, and human resources.

One professional to manage each of the above functions must be employed by the Sponsor prior to the establishment of the Conduit. Professional staff filling the above roles must be experienced professionals, with a minimum of five years experience in the respective positions, and a proven ability to manage the above functions for the type of Conduit that is proposed to be established (i.e. a structured-asset Conduit or a mortgaged-backed-asset Conduit). In addition, staff employed in the above roles should be employed on a full-time basis. As part of DBRS's review of personnel, DBRS will take into account the reputation of the people and conduct background verifications.

After the Conduit is established, DBRS expects that the Sponsor will hire additional staff to perform the following functions:

- (1) I.T. Chief Information Officer:** Experience in developing and managing systems for financial analysts and, if necessary, a support team.
- (2) Strategic Planner:** Experienced in disaster recovery, planning, and business continuation planning.

## III. Systems

Prior to the establishment of the Conduit, the Sponsor must have set up the following systems infrastructure:

- (1) General:** Various hardware and software required to maintain an office (i.e. servers, computers, and software).
- (2) Quantitative:** Systems for quantitative review of transactions (i.e. spreadsheet programs and models for pricing and surveillance).
- (3) Reporting and Treasury Management:** Systems for tracking asset and liability management (i.e. Commercial Paper tracking systems).
- (4) Back-Office:** Systems to handle settlement and transfers.

#### **IV. Outsourcing of Functions**

DBRS understands that there are many different methods in which the above criteria can be satisfied. One possible method is to outsource key functions to third parties. Outsourcing of certain functions will be permitted in limited circumstances provided that: (1) the third party has significant expertise and/or is a highly rated entity; (2) the agreement between the Sponsor and the third party is well-documented and is approved by DBRS; and (3) the term of the agreement is greater than the longest term of any transaction entered into by the Sponsor. Provided that the above conditions are met, the amount of Capital and the level of staffing required by the Sponsor to establish a Conduit may be reduced accordingly.

#### **V. Ongoing Requirements**

The Sponsor will be required to provide DBRS with an annual certificate of compliance signed by an officer of the corporation. The certificate will generally provide among other things that, as of the last DBRS due diligence meeting, there have been no material changes within the organization. Material changes should be reported to DBRS immediately and may involve a follow-up meeting with the Sponsor if necessary. The certificate will also attest to the structure and beneficial ownership of the ABCP conduit. Any change to the beneficial ownership of the Conduit must be approved by DBRS. An audit by a large accounting firm may also be requested by DBRS on an annual basis.

#### **VI. Due Diligence Requirements**

As part of the approval process, senior DBRS staff members will perform on-site due diligence at the Sponsor's offices. The scope of investigation will be in-depth and will likely be performed over a one or two-day period. In general, the visit will cover the following subjects:

- Legal ownership and structure
- Overall business and investment strategy and objectives
- Staff
- Systems
- Internal controls, processes, and procedures
- Portfolio management, surveillance, and administration
- Third-party service providers

For each of the above area, where applicable, DBRS will focus on: (1) quality, (2) controls, (3) transparency, and (4) capacity. The following example is a brief illustration of this approach:

##### **(1) Quality of Staff**

Overall experience, background, and exposure to structured credit – generally the “intellectual bench strength” of the organization. Resumés and/or bios should be provided ahead of time and will be followed up by interviews.

##### **(2) Controls**

How are responsibilities, duties, and decision-making distributed among staff? Is there a credit committee in place? How are committee members selected? How are staff reviewed and evaluated?

##### **(3) Transparency**

Are staff policies and procedures documented and followed? How often are staff members audited? Are there any internal controls for conflicts of interest?

**(4) Capacity**

Are staff numbers adequate to cope with the volume of assets and the day-to-day running of the organization? How much dependence is placed on key individuals in the organization? What are the organization's future staffing plans? What incentives are available to retain staff? What resources are available to train staff?

**VII. Nature of the Application Process**

The above criteria are merely a minimum set of criteria and DBRS has the discretion to amend, modify, or change the criteria at its sole discretion at any time. Moreover, DBRS reserves the right to reject any Sponsor application, notwithstanding the fact that a Sponsor may meet the minimum criteria described above. The above criteria are not intended to apply to any Sponsor that is a financial institution (or affiliated with a financial institution) regulated by the Bank Act (Canada) that has a DBRS long-term rating of at least A (low).

**XIII. Conclusion**

The Canadian ABCP market has grown significantly over the past few years. The purpose of the Conduit Criteria is to explain the process that a Sponsor must follow for a Conduit to be approved by DBRS. As well, DBRS expects that by publishing this commentary, the Canadian ABCP market will continue to grow as new Sponsors will continue to strengthen the existing network of Canadian Conduit Sponsors. For further information please contact one of the authors of this commentary.