

Canadian Structured Finance Newsletter

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SECURITIZATION IN CANADA: WHAT NEXT?

The last two years have been tumultuous for the structured finance business. Much has been written about the role played by U.S. mortgage-backed securities and CDO structures in pushing global financial markets into a deep freeze. In Canada, total ABS outstanding shrunk from a total of \$178 billion in August 2007 to approximately \$117 billion as of August 31, 2009. However, as the “green shoots” begin to emerge and economic indicators suggest that recovery is starting to take hold, now is a good time to ask: What’s next for securitization in Canada?

This was the very question considered by Jerry Marriott, DBRS Managing Director of Canadian RMBS/ABS, at his address to the Toronto CFA Society on October 20, 2009. Mr. Marriott’s presentation focused on the following themes.

Regulation: It is clear that the future will bring a higher level of regulation and oversight. Policymakers and regulators the world over have been busy examining financial markets with the stated goal of avoiding another crisis. What is essential is that any resulting policy framework and its interpretation be properly communicated to market participants.

Role of Securitization: Authorities around the world have recognized the importance of securitization to healthy financial markets. In Canada, actions taken have included the acceptance of ABCP as collateral for certain transactions with the Bank of Canada, increased purchases of mortgages by the Canada Mortgage and Housing Corporation and the creation of the Canadian Structured Credit Facility. These measures are important and have helped stabilize the securitization market. Yet the question remains: Are these actions best seen as temporary measures to mitigate a crisis or do they represent a more permanent policy that acknowledges the importance of maintaining liquidity in the securitization market?

Bank-Sponsored ABS: A decrease of \$40 billion in bank-sponsored ABCP outstanding between August 2007 and August 2009 is responsible for approximately half of the decrease in total Canadian ABS outstanding during this period. Some of the reduction can be explained by higher funding costs. Another factor is the increased internal allocation of capital by bank sponsors of ABCP to support securitization activities. These higher capital allocations are recognition by the banks of the risk represented by their contingent funding obligations in support of securitization programs and the bank’s role as both underwriter and originator. Changes to regulatory capital treatment upon implementation of the Basel II framework may reinforce this trend.

Transparency: Securitization must become more transparent. Regulators and investors alike will increasingly demand a higher level of transparency and insight into securitization products and the assets that ultimately stand behind an issuer’s obligation to pay. DBRS has been active in promoting greater transparency, making significant changes to its monthly reports and rating reports and ensuring that its criteria and methodologies for all major structured finance asset classes have been updated and are available online at www.dbrs.com.

Greater Analysis: It has become clear that a greater level of analysis will be a requirement for investors to participate in the structured finance market. ABS are different from – and generally more complex than – corporate or sovereign securities. While a credit rating will always be important, investors cannot rely on ratings for the totality of their research. Investors must conduct their own analysis to determine whether ABS are appropriate for their portfolio and investment requirements.

While it remains to be seen whether ABS issuance in Canada will return to pre-financial crisis levels, securitization in Canada does have a solid future. Individuals and businesses will continue to purchase real estate and vehicles, just as they will continue to use credit cards and generate receivables. And all of these activities must be financed. Securitization will remain a viable funding source for these financing needs.

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