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Satisfaction of the Rating Agency Condition for Trustees and Custodians in Canadian Structured Finance Transactions

Trustees and custodians play vital roles in securitization transactions, and may be responsible for holding large sums of money to which investors are entitled. It is therefore essential that these transaction parties possess abilities commensurate with their responsibilities and demonstrate sufficient financial wherewithal to mitigate any liabilities that may arise from their role in the transaction. To this end, in *Legal Criteria for Canadian Structured Finance*, DBRS outlined the requirements that custodians, indenture trustees and issuer trustees must meet in order to participate in a DBRS-rated Canadian securitization transaction. In each case, the proposed trustee or custodian must hold a rating of A (low) or R-1 (low) or higher or satisfy the Rating Agency Condition.¹

While it is expected that the majority of trustees and custodians would satisfy DBRS criteria by meeting the rating requirement, the inclusion of an alternative method of satisfying the criteria, by satisfaction of the Rating Agency Condition, allows otherwise suitable entities that do not hold the required rating to act as trustees and/or custodians in DBRS-rated Canadian structured finance transactions. As a number of Canadian trustees and custodians are unrated, it has become appropriate for DBRS to publish the factors that it will consider when determining if the Rating Agency Condition will be satisfied. These factors include:

Regulatory oversight – Trustees and custodians must be incorporated under the federal *Trust and Loan Companies Act* and subject to regulatory oversight by the Office of the Superintendent of Financial Institutions. DBRS will require confirmation in this regard.

Ownership – The trustee or custodian in question will often be a subsidiary of a financial institution or other corporation that holds the required rating and is of substantial financial wherewithal and capacity. In these circumstances, the execution by the parent of a satisfactory guarantee of its subsidiary's obligations would allow DBRS to look to the parent's rating to satisfy the rating requirement. However, in the absence of a parental guarantee, DBRS will recognize a level of implicit support flowing from the parent to its subsidiary. How much weight will be placed on this implicit support is subject to a number of considerations, including the financial strength of the parent, the interconnectedness of the two businesses, the identifiability of the two entities as members of the same corporate family by virtue of conducting business under the same or similar trade names and the reputational impact that a default of the subsidiary trustee or custodian would have on the parent. To this end, DBRS will require information on the ownership structure of the trustee or custodian.

History – DBRS will require information on the experience of the firm when acting as a trustee or custodian. For example, how long has the entity acted in this capacity? On how many transactions are they currently engaged in these capacities? What asset classes and dollar figures are involved?

1. A Rating Agency Condition is a requirement that prior to a certain action being taken, DBRS must confirm in writing that no negative rating action will result from that action. In this context the action in question would be the appointment of the proposed trustee/custodian.



Capacity – The proposed trustee or custodian must be legally entitled to act in the proposed capacity in all relevant jurisdictions. DBRS will require confirmation in this regard.

Based on this information, and any other factor that it deems relevant, DBRS will determine if the proposed entity is of sufficient capability and wherewithal to act as a trustee or custodian in a DBRS-rated Canadian structured finance transaction. If the determination is made in the affirmative, DBRS will issue a letter to the applicable trustee or custodian confirming that the Rating Agency Condition will be satisfied with respect to transactions in which it acts in such capacity. The satisfaction of the Rating Agency Condition will not be transaction specific, but will rather be specific to the trustee or custodian and, in the absence of an intervening material event, will remain effective for 24 months. In order to renew the effectiveness of satisfaction of the Rating Agency Condition on a biennial basis, DBRS will require confirmation from the trustee or custodian that there have been no material changes to the information initially provided to DBRS.

Note: All figures are in Canadian dollars unless otherwise noted.

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