



Reference: Banks/BHC/T&L/
Life/IHC/P&C/Co-ops

June 19, 2008

To: Banks
Bank Holding Companies
Federally Regulated Trust and Loan Companies
Federally Regulated Life Insurance Companies
Federally Regulated Property & Casualty Insurance Companies
Insurance Holding Companies
Foreign Bank Branches
Co-Operative Credit Associations
Fraternal Benefit Societies
(collectively, FREs)¹

Subject: Draft Advisory – Securitization – Expected Practices

In our Backgrounder “OSFI’s Role in the ABCP Market Issue” issued April 22, 2008, OSFI provided an overview of OSFI’s regulation of securitization activities and discussed the action OSFI was taking to address turmoil in the asset-backed commercial paper (ABCP) markets. These actions included working, via the Basel Committee on Banking Supervision, with international bank regulators to make the banking system more resilient to financial shocks. As noted in the Backgrounder, OSFI has recommended to its international counterparts that zero capital charges for market disruption liquidity lines should be removed and that a capital charge should be imposed for all types of liquidity support provided to ABCP conduits. OSFI continues to participate in these international deliberations.

To provide guidance to Canadian financial institutions regulated by OSFI, OSFI is issuing the attached draft Advisory on securitization for consultation with the industry and other stakeholders. While the additional guidance is summarized below, three themes highlight how this guidance will contribute to the soundness of our financial institutions and the better functioning of our financial markets.

¹ In this letter and the attached Advisory, the term FRE refers, as circumstances permit, to bank holding companies, banks, foreign bank branches, federally regulated trust and loan companies, federally regulated co-operative credit associations, fraternal benefit societies and federally incorporated or regulated life insurance and property and casualty insurance companies and insurance holding companies. If a FRE is not directly subject to the existing guidance which is updated by this Advisory, the general principles enunciated herein nevertheless apply to such FRE’s securitization activities (e.g. matters of prudent management and reputational risk).

- First, capital charges for liquidity facilities and other securitization activities (including securitization sponsorship) need to accurately reflect FRE risks.
- Second, FREs need to carefully assess the risks arising from securitization structures and their assets and must exercise caution when relying on external credit ratings.
- Third, more capital is required to support complex securitization exposures such as re-securitizations.

In particular, the attached draft Advisory updates existing guidance related to FRE securitization exposures and their capital treatment pursuant to the following OSFI guidance:

- Guideline A, *Capital Adequacy Requirements* (CAR A) Banks/T&L
- Guideline A-1, *Capital Adequacy Requirements* (CAR A-1) Banks/T&L
- Guideline B-5, Asset Securitization²

Further, there are seven key areas where existing guidance is being reinforced or changed:

1. Additional information is provided concerning OSFI's expectations with respect to the establishment and review of exposure limits for securitizations and the need for stress testing and consideration of risk correlations;
2. The zero percent credit conversion factor for general market disruption liquidity facilities is being eliminated, effective immediately, and such facilities will receive the same capital treatment as global style liquidity facilities;
3. FREs are expected to ensure that short-term liquidity facilities (i.e. one year or less) are indeed short term exposures and, if not, FREs should be establishing higher capital charges to support such facilities;
4. Clarification of the sponsorship roles that FREs may play with respect to a securitization special purpose entity (SPE) and the impact of those roles on reputational risk, including the addition of ongoing disclosure with respect to SPE sponsorship³;
5. FREs are reminded that external credit assessments are only one indication of the quality of exposures and, effective September 15, 2008, two external credit assessments will be required to apply ratings-related risk weights to most securitization exposures;
6. Additional guidance is being provided with respect to implicit support of SPEs and the potential consequences of such support, including when such support is provided by purchasing securities issued by a SPE in lieu of funding under a liquidity facility; and

² Upon implementation of CAR A and CAR A-1, Guideline B-5 is no longer applicable to the regulatory framework and capital treatment of securitization exposures for banks, bank holding companies, federally regulated trust and loan companies and federally incorporated cooperative credit associations. Guideline B-5 continues to apply to federally regulated life insurance and property and casualty insurance companies and other cooperative credit associations.

³ The Advisory is in addition to, and FRE's are encouraged to comply with, the requirements of the April 7, 2008 Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience.

7. Additional risk assessment practices are encouraged for re-securitization exposures and the risk weights applicable to re-securitizations are being increased.

Please note that further guidance in this area may be forthcoming to address changes in international capital rules or market developments.

While OSFI recognizes that much of the Advisory is specific to FREs subject to CAR A and CAR A-1 (and, to a lesser extent, Guideline B-5), OSFI expects all FREs, where practicable, to apply the principles enunciated in the Advisory in their securitization-related activities.

Questions or comments concerning the draft Advisory should be addressed to Paul Melaschenko, Capital, Accounting and Research Division, at (613) 990-6429, by facsimile at (613) 991-6822 or by e-mail at paul.melaschenko@osfi-bsif.gc.ca before July 31, 2008. A final version of the Advisory will be posted on OSFI's website on or before September 15, 2008, at which point it will take effect.

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