Advisory

Title	Securitization – Large Exposure Issues Pertaining to Liquidity Support Facilities
Category	Prudential Limits and Restrictions
Date	January 31, 2005
Sector	Banks Trust and Loan Companies Life Insurance and Fraternal Companies Foreign Bank Branches

Table of Contents

1. Purpose

Companies [1] provide liquidity support to Special Purpose Entities (SPEs) through various types of liquidity facilities having differing degrees of credit risk. Examples of such liquidity facilities may include loan facilities containing general market disruption clauses, Liquidity Asset Purchase Agreements (LAPAs), and loan facilities structured in a manner similar to those supporting the issuance of corporate commercial paper. OSFI expects companies to prudentially manage both their credit exposure and liquidity exposure to SPEs. This Advisory clarifies the treatment of exposures to SPEs through certain liquidity support facilities and should be read in conjunction with OSFI Guidelines B-2: *Large Exposure Limits (DTIs)*, and *Large Exposure Limits (Life)* and Guidelines B-5: *Asset Securitization* and B-5A *Asset Securitization (FBBs)*.

2. Liquidity Facilities Containing Market Disruption Clauses

For the purpose of calculating an exposure to a single counterparty under Guideline B-2, where the documentation for a liquidity facility contains a restriction that permits drawdown only in the event of a general market disruption, as defined in section 2.3 of Guideline B-5, the undrawn portion of the facility should be excluded from the calculation of the exposure to that single counterparty. For internal risk management and approval purposes, general market disruption liquidity exposure should be aggregated with all other exposures of a company to the SPE for which the liquidity facility has been granted. Where a liquidity facility contains multiple tranches, the exclusion from the calculation of the exposure to that SPE is restricted to those tranches that are available only in the event of a general market disruption.

3. Liquidity Asset Purchase Agreement (LAPAs)

For the purpose of this Advisory, LAPAs are facilities used in securitization activities referred to in Guideline B-5. When exercised, LAPAs require the company granting the facility to purchase specified assets from the SPE on a non-recourse basis (except for the normal legally actionable scenarios of fraud, misrepresentation, etc.). The exercise of the facility by the SPE is not a loan to the SPE. As such, the SPE has no liability for repayment to the company for assets purchased by the company and does not create a credit exposure to the SPE.

Recognizing that the company ultimately has an exposure to the assets purchased and not to the SPE, LAPAs should be excluded from the calculation of an exposure to the SPE under Guideline B-2. An exposure to the obligor against whom the company would have legal recourse if the LAPA were drawn should be aggregated with all other exposures to that obligor.

Footnotes

1 As defined in OSFI Guideline B-2: *Large Exposure Limits*.