OP-ED: The Dysfunction Of The Canadian ABCP Clean-Up
867 words
7 November 2007
11:04
Dow Jones Capital Markets Report
English

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(This is one in a series of occasional opinion columns by market participants.)

NEW YORK (Dow Jones)--U.S. banks aren't the only ones banding together to sort out the credit mess that has roiled markets.

While much attention - and criticism - has focused the super fund initiated by Citigroup (C), Bank of America (BAC) and JPMorgan (JPM), among others, another cabal of banks north of the U.S. border also has decided to clean up the Canadian asset-backed commercial paper.

Too bad their efforts are thwarting transparency and hurting investors.

Canadian investors in the ABCP market who want to sell their defaulted ABCP notes and finding they cannot readily do so because of a cartel known as the "pan-Canadian committee."

Starting in August, concerns about possible contagion from the sub-prime situation in the U.S. made investors in Canadian ABCP reluctant to roll over their ABCP investments. Investors in Canadian bank-sponsored ABCP programs got paid in full as their paper matured. The sponsoring banks provided all the necessary liquidity to retire their programs' outstanding obligations.

The situation was worse for investors in programs sponsored by non-banks. Although those programs had liquidity facilities, the liquidity providers refused to make advances. They asserted that the key condition for doing so - a "market disruption" - had not occurred. The upshot: much of the maturing paper defaulted.

More specifically, many of the non-bank-sponsored Canadian ABCP programs issued two series of ABCP, designated series A notes and series E notes.

The series A notes were ordinary ABCP, with fixed maturity dates. The programs had liquidity facilities supposedly to support timely repayment of those notes.

The series E paper notes included extendibility features that allowed the issuers to extend the maturities if the notes could not be rolled over on their originally targeted maturity dates. Series E notes generally did not need support from liquidity facilities based on the notion that the extensions would provide time to liquidate assets in an orderly fashion before the extended (final) maturities.

After the Series A notes started defaulting in mid-August, things went from bad to worse.

A number of the major players in the Canadian ABCP market banded together to organize a "standstill" while they tried to figure out a plan to address the problem. Caisse de depot et placement du Quebec (CDP), the giant Quebecois pension fund manager and a big ABCP investor, was the main organizer of the effort. Other participants included members from each of the key groups involved in the situation: investors, liquidity facility providers, companies that financed assets (i.e., borrowed) through the programs, the sponsors of the programs, and dealers.

The standstill arrangement came to be known as the "Montreal Proposal" or "Montreal Accord" and the participating parties came to be called the "pan-Canadian committee." The original standstill agreement was adopted on Aug. 16 and was supposed to last for 60 days. However, the problems had not been solved by mid-October and the pan-Canadian committee extended the standstill for another 60 days.

The proposed "solution" for the defaulted ABCP is to convert the short-term ABCP notes into medium-term instruments, which presumably would be repaid from the cash flows of the assets financed through the related ABCP programs.

In the meantime, the pan-Canadian committee has established a lockdown on information about the defaulted notes and the related programs. Investors who need cash in the short run and who want to sell their notes are having difficulty doing so. Third parties who might offer to buy the notes have scant information upon which to base bids. For some of the defaulted notes, it is not clear whether a fair bid would be closer to the area of 10 cents on the dollar or the area of 90 cents on the dollar.

The fact that the non-bank sponsored Canadian ABCP has defaulted is not the main issue. The main issue is that the pan-Canadian committee is undermining the smooth operation of the capital markets by preventing the free flow of information that would allow the market to operate properly. If information could flow freely, investors who want to sell their defaulted notes would have an easier time doing so.

This behavior of the pan-Canadian committee is not what one expects to find in a capitalist economy, and certainly not in the closest neighbor of the U.S.

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