



Economy & Markets

Relief for retail holders of non-bank ABCP?

The federal government and three provinces sign an agreement to back a restructuring deal

By Laura Bobak | January 08, 2009 15:30

2008 year in review, part 8 of 8.

Investors sideswiped when the \$32-billion non-bank asset back commercial paper market froze got a glimmer of hope at the end of 2008, when the federal government and three provinces agreed to backstop a proposed restructuring deal that could see their cash returned early in 2009.

About 1,800 retail investors, including retirees, who thought they had purchased safe, fixed-income products are still waiting on a combined \$400 million they have been unable to withdraw since the market for the paper seized up in August, 2007.

The Pan-Canadian Investors Committee for Third-Party Structured ABCP, headed by Purdy Crawford of Osler, Hoskin and Harcourt LLP, and consisting of representatives of Canada's major financial institutions, worked since April to arrive at a solution that would save the troubled notes, and see small investors compensated through a conversion of the short-term debt to long-term notes. It recently sought and received an extension on court-ordered protection against litigation to Jan. 16, under the Companies' Creditors Arrangement Act.

In an effort to help vulnerable investors whose nest eggs got caught in the legal quagmire, the Crawford committee had singled out those holding less than \$1-million worth of frozen ABCP for full compensation. But a few critics — including some investor advocates themselves — opposed the distinction, arguing it is unfair to deny full compensation to retail investors with large ABCP holdings. Part of the dispute involves the definition of "retail investor" as applied to families with ABCP held in personal investment holding companies or family trusts.

This was just one of several stumbling blocks stalling resolution of the ABCP issue, and resulted in a legal dispute involving several players unhappy that the compensation plan favored some investors over others. The deal was also sideswiped by the global credit squeeze, market volatility and the ensuing recession.

Representatives of the retail investors, including Henry Juroviesky of Toronto-based Juroviesky and Ricci LLP and investor advocate Diane Urquhart, have urged the government to insist on full restitution with no conditions or limits (such as the \$1-million ceiling) to retail investors; they say the feds should have insisted on this before signing the agreement to guarantee the restructuring plan — also known as the Montreal Accord.

"Should this opportunity not be utilized to its fullest extent, many citizens may feel that [their] respective governments have abandoned those who fell victim to reckless securities practices by large well-heeled financial institutions that have not suffered any repercussions for their behavior. This could very well be characterized as a great injustice," says a statement released on Dec. 22 by Urquhart and Juroviesky

Urquhart and Juroviesky say clients could have grounds to sue advisors who sold them the paper, with the argument that the sale may have breached the Investment Industry Regulatory Organization of Canada's know-your-client bylaw. However, if the Montreal Accord takes away their right to sue, they say, regulators at least should be given room to order further compensation for some investors.

Urquhart estimates there are about 32 families affected by the cut-off, holding a total of roughly \$330 million. The investors include a 78-year-old Montreal widow who holds about \$19 million in notes, and a Calgary investment club of four investors.

"I find it particularly egregious that these particular cases are not settled," Urquhart says.

As details were sorted out throughout 2008, institutional note holders had been respecting a handshake standstill agreement by not making collateral calls (for example, calling in credit default swaps, which are credit derivative products purchased as insurance against the notes defaulting). But then the deal was threatened when a couple of foreign banks refused to sign on without government financial guarantees. Now that the feds, along with Quebec, Ontario and Alberta, have signed on the dotted line, it looks more promising for retail investors.

"They are pretty close to breaking individually in frustration and despair," says Arthur Jacques of Toronto's Shibley Righton LLP, who is also representing note holders. "I've never seen such a tragic mess. This is a series of unfortunate financial events that defy logic. We're still optimistic. I walk around with a rabbit's foot."

There have been several compensation arrangements made outside the Crawford proposal. Major institutions such as National Bank of Canada and Desjardins Group have already reimbursed small note holders. Compensation proposals have been made by both Vancouver-based Canaccord Capital Inc. who sold the non-bank ABCP directly to clients through advisors and Credential Financial Inc., the Vancouver-based securities company representing a consortium of Canadian credit unions. Both Canaccord and Credential have extended some loans to affected clients a hardship basis. Unlike the other institutions, Canaccord and Credential have made their compensation arrangements conditional on the approval of the Montreal Accord. (The Montreal accord would provide firms with protection from further client litigation for compensation.) In a letter to its affected clients, Canaccord said that new notes should be issued three to four days after the implementation date of the restructuring deal.

Of course, it's not only retail investors who are affected. Institutional note holders include Quebec's pension fund manager, the Caisse de dépôt et placement du Québec, which owns non-bank ABCP that was originally valued at \$12.6-billion. National Bank of Canada and financial cooperative group Desjardins Group together have ABCP that was originally valued at about \$4 billion. ATB Financial in Alberta owns more than \$1 billion in notes, and the Ontario provincial government has a stake of about \$645 million.

The whole debacle has sparked public debate about what could have been done to prevent it, including issues around the transparency of the assets underlying the structured products; the

suitability and safety of such products for conservative retail investors; the role of bond rating agencies which gave the notes a thumbs-up, all while being paid by the companies that issued the notes.

In January of 2008, IIROC conducted a compliance review of non-bank ABCP programs and the activities of dealer members who created or sold the notes to clients.

The discussion sparked the Canadian Securities Administrators to draft an Oct. 6 consultation paper entitled Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil and its Effect on the ABCP Market in Canada. A comment period on the paper was extended to Feb. 16, from Dec. 20.

The paper proposed several changes, including establishing a regulatory regime for credit rating agencies, reducing the reliance on credit rating agencies in securities law, reviewing the definition of “accredited investor” and the 10% concentration limit for mutual funds, as well as putting more restrictions the kinds of products eligible for investment by money market funds.

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