Diane Urquhart

Subject: Industry Canada Says New Reg on Credit Default Swaps Improved Canada's Derivatives Market

Industry Canada Industrie Canada

INTERNET

Ms. Diane Urquhart
Independent Analyst
(urquhart@rogers.com)

Dear Ms. Urquhart:

Thank you for your e-mail of June 30, 2008, addressed to the Honourable Jim Prentice, Minister of Industry. I have been asked to reply on his behalf.

In chapter 5 of Budget 2007, "A Stronger Canada Through a Stronger Economy", the government indicated its commitment to improving Canada's derivatives market. This lead to Bill C-52, *An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2007*, which was introduced in Parliament on March 29, 2007.

Further to the adoption of Bill C-52, the proposed EFC General Rules were pre-published in the *Canada Gazette Part I* on August 4, 2007 for a 30 day comment period. The stakeholder comments received were considered and certain changes were made to the proposed EFC General Rules. They then followed the normal regulatory process and were published in the *Canada Gazette Part II* on November 28, 2007. The EFC General Rules came into force on November 17, 2007.

In considering stakeholder comments received during the regulatory process, the government strived for a solution which was most consistent with its underlying policy objectives and fairest to the collective interests of all stakeholders.

Once again, thank you for writing to the Minister of Industry. I trust that this information is of assistance.

Sincerely,

Susan Bincoletto
Director General
Marketplace Framework Policy Branch

Canada

-----Original Message-----

From: Diane Urquhart [mailto:urquhart@rogers.com]
Sent: Monday, June 30, 2008 2:40 PM
To: 'Jim Prentice'
Subject: Credit Default Contract Became Eligible Financial Contract Under CCAA on November 17, 2007

Jim Prentice
Minister of Industry
Conservative MP
Calgary Centre-North

There is another Federal Government regulation that acted in the interest of the international banks and contrary to the interests of the Non Bank ABCP owners that I have been researching and have finally got to the bottom of as noted below. This will also have to be raised in the September 2008 ABCP Finance Committee hearing.

Here is the new Federal Government regulation that specifically defines credit default swaps as an eligible financial contract under the Federal Companies' Creditors Arrangement Act. This new regulation went into effect on November 17, 2007, the day on which subsection 104(2) of the *Budget Implementation Act, 2007*, chapter 29 of the Statutes of Canada, 2007 came into force. This new regulation implements the CCAA Act amendment that received Royal Assent on December 14, 2007. The CCAA Act amendment replaced a list of eligible financial contracts that did not include credit default swaps with the following: "eligible financial contract" means an agreement of a prescribed kind. This regulation amendment that prescribes credit default swaps as an eligible financial contract was done separately from the other regulation amendments in Bill C-12 that have not yet been drafted. This new regulation explains why Justice Campbell did not have the authority to stay the Asset Provider counterparties' right to collect on their collateral assets under their credit default swap contracts. The judge lost his authority to stay this creditors' group right to seize collateral assets on November 17, 2007.

The timing of these CCAA legislation and regulation amendments beg the question about why the Federal Government would make this change in the middle of negotiations on the largest restructuring of credit in Canadian history amounting to $32 billion. In the midst of closed room negotiations for the restructuring of non Bank ABCP trusts, the Federal Government gave the international and Canadian banks, involved as asset providers to the Canadian ABCP trusts, significant power and advantage over the Canadian ABCP owners in these negotiations and in the subsequent CCAA court process.

The Non Bank ABCP asset providers have consistently held the loaded gun, of exercising their right under credit default swap contracts to sieze collateral assets, towards the Non Bank ABCP owners and the Ontario Superior Court of Justice, with the goal of these entities accepting deeper compromises than would have otherwise occurred in a balanced situation where both classes of creditors in the trusts are stayed. Had these CCAA Act and regulation amendments governing eligible financial contracts not been implemented, the judge would have had the authority to stay both classes of creditors to the Non Bank ABCP trusts, the asset providers,who were counterparties to the credit default swaps, and the ABCP owners. Thus under the protection of stays on all creditors, the judge would have had greater authority to determine the fairness and reasonableness of the legal release covering third parties, who did not make a concession or a contribution to the compromise or arrangement. It would not likely have been the case that the judge would have had to admit that ABCP dealers are getting legal releases because the asset providers making compromises want these third parties to be covered by the legal release. The CCAA judge's decision admitted he accepted that the asset providers would withdraw support from the ABCP CCAA Restructuring Plan if he decided that the amended legal release was not fair and reasonable and needed further amendment. The next step after withdrawal of support for the plan would likely be the asset providers exercising their right to seize collateral assets, and not to renegotiate the terms of the legal release in the plan.

There are no further legal implications in the ABCP CCAA Restructuring for the credit default swaps being definitively prescribed to be eligible financial contracts under CCAA on November 17, 2007. However, the political implications are very significant. Why was it urgent for the following Order in Council to be made on November 15, 2007?: "Her Excellency the Governor General in Council, on the recommendation of the

Minister of Industry, pursuant to subsection 18(1) of the *Companies⸗ Creditors Arrangement Act*, hereby makes the annexed *Eligible Financial Contract General Rules (Companies⸗ Creditors Arrangement Act)*."

If Julie Dickson says OSFI did not have the jurisdiction to regulate the international banks who signed the "no use" liquidity agreements backing the Canadian Non Bank ABCP, then would it not have been wise for the Federal Government to delay the signing of the Order in Council defining the credit default contracts of these international banks as eligible financial contracts under the CCAA. The Federal Government gave the international banks additional creditor protections that adversely impacted Canadian owners of Non Bank ABCP, after it knew that there were credit defaults in the Canadian Non Bank ABCP marketplace and negotiations for restructuring were underway. Also, by November 15, 2007, the Federal Government knew there was a problem with the market disruption clause in Canadian style liquidity agreements that the international banks signed.

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