

Not all commercial paper is alike

Responding to the new CSA proposals for asset-backed commercial paper

CANADIAN REGULATORS are quite rightly responding to the crisis that erupted in this country's asset-backed commercial paper market in the summer of 2007. The question is, are they going too far with their proposals — and unnecessarily compounding the difficulties issuers face in selling and trading straightforward ABCP?

Let's look at the issue. Last October, the **Canadian Securities Administrators** released a consultation paper with recommendations on securities regulations related to the ABCP market. Responding to the ABCP market crisis a year-and-a-half ago, the CSA paper recognized the need for a high standard of disclosure and more restrictive prospectus exemptions for traded derivative securities. The consultation paper also addressed more rigorous oversight of credit rating agencies, which are integral to the distribution of these ABCP securities, as well as the use of credit ratings in securities legislation and the eligibility of ABCP for mutual fund investments.

The CSA has brought forward constructive suggestions for prospectus exemption eligibility for ABCP and, through the comment

process, has created an effective forum to discuss these proposals. But it is important to examine closely how the CSA paper would deal with the most important prospectus exemption in the domestic money markets: the longstanding short-term debt exemption under sec. 2.35 of National Instrument 45-106. That section permits money market paper with a maturity of less than one year to be distributed without a prospectus, as long as it carries a credit rating by an accredited credit rating agency.

This short-term debt exemption is popular among money market issuers because it is not subject to Form 45-106 F1 and related fee requirements, nor subject to resale restrictions. It therefore provides a cost-effective form of financing for many money market issuers.

But the CSA proposals would disqualify all asset-backed securities from the short-term debt exemption. Asset-backed securities, whether of short- or long-term maturity, would still qualify for all other prospectus exemptions, including the accredited investor exemption.

The **Investment Industry Association of Canada** believes the CSA has overshot the mark. It

GUEST COLUMN BY IAN C. W. RUSSELL

makes sense to lift the short-term debt exemption from complex asset-backed commercial paper and paper backed by derivative and synthetic products. But plain vanilla asset-backed commercial paper, paper backed by bona fide marketable securities such as mortgages or credit card receivables, were not the source of the ABCP crisis and do not pose the same potential problems. They should continue to qualify for the short-term exemption, as long as the paper meets the criteria imposed by the **Bank of Canada** as eligible collateral with the central bank.

This distinction between complex and straightforward commercial paper would effectively address the problems in the ABCP market — while still allowing the issuers of conventional short-term asset-backed securities to continue to take advantage of the short-term debt exemption to distribute cost-effectively in the marketplace. The CSA-proposed prohibition of the short-term debt exemption would simply compound the difficulties

issuers face in selling and trading asset-backed product in the Canadian marketplace. These traditional asset-backed securities provide an important conduit for the transmission of credit to borrowers in the real economy and play a key role in stimulating economic activity and job creation.

The IIAC recognizes the importance of transparency in both the short-term and long-term debt markets. That is why the association is also recommending additional disclosure requirements on reporting issuers who make use of the short-term debt exemption for commercial paper, banker's acceptances or plain vanilla asset-backed paper. Issuers would be required to file an information memorandum that would provide the fundamental details on the borrowing terms of this short-term paper. The information memorandum would be subject to timely disclosure of material changes.

Moreover, for plain vanilla ABCP issuers, the IIAC would recommend a second level of mandated disclosure accompanying the information memorandum. Issuers would also file an Investor's Report that provides continuous disclosure on the details of the ABCP

securities. This requirement for the most part formalizes information on the content of plain vanilla ABCP paper that is already available in the market.

While it may seem contradictory to mandate any new disclosure requirements on prospectus-exempt distributions, recent events have indicated that even investors holding these products benefit from summary detail on complex financial instruments.

The IIAC recommendations regarding the CSA proposal achieves the right balance between meeting a high standard of disclosure and transparency for all types of asset-backed commercial paper, as well as other traded money market instruments, while at the same time ensuring cost-effective financing for the issuers of plain vanilla asset-backed paper to promote efficient capital-raising and the transmission of credit to needed borrowers.

Ian C.W. Russell is president and CEO of the Investment Industry Association of Canada.