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February 13, 2009

By E-mail

British Columbia Securities Commission
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Autorité des marchés financiers

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- and -

c/o Me Anne-Marie Beaudoin
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Dear Sirs/Mesdames:

Re: CSA Consultation Paper 11-405 *Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil* – Request for Comments

This submission is made by the Business Law Section of the Ontario Bar Association ("**OBA**") in response to the request by the Canadian Securities Administrators ("**CSA**") for comments on CSA Consultation Paper 11-405 *Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil* (the "Consultation Paper"). This letter was prepared by members of the Securities Law Subcommittee of the OBA Business Law Section.

The OBA Business Law Section supports review of the rules applicable to credit rating agencies ("**CRAs**"), prospectus exemptions and the roles of intermediaries and mutual funds. However, we believe that the focus should not be exclusively on asset-backed

commercial paper ("**ABCP**") but on complex securities in the exempt market generally. Any future crisis will likely involve securities that are not currently on anyone's radar. As instruments become more complex, the distinctions between various types of instruments begin to blur. In this regard, it appears advisable for securities regulators to meet and consult regularly with other financial sector regulators to identify potential areas of concern and create a coherent, comprehensive response.

The recent review by the Investment Industry Regulatory Organization of Canada ("**IIROC**") of the manufacture and distribution of ABCP by IIROC members noted that many dealers and registered representatives did not fully understand the risks inherent in ABCP. They assumed ABCP was no different from banker's acceptances or other forms of commercial paper. Many dealers did not subject ABCP to their new product review procedures, which were themselves often inadequate. We fully support the view that market participants and regulators must at an early stage identify and understand new products.

Set out below are comments on the specific issues raised by the Consultation Paper.

1. Credit Rating Agencies

Establishing a Framework for "Approved Credit Rating Organizations"

We agree that the CSA should establish a regulatory framework for CRAs through legislative amendments. CRAs should obtain recognition by the applicable securities commissions. As is the case in the United States, legislation should prohibit Canadian securities commissions from regulating the substance of credit ratings or the rating procedures and methodologies of CRAs.

The Consultation Paper considers whether to adopt rules similar to those of the U.S. It concludes that to do so would offer little or no benefit, as all Canadian CRAs are currently subject to the U.S. rules. The problem with this approach is that it would create a gap if a new CRA was formed that did not wish to register with the U.S. Securities and Exchange Commission (the "SEC"). We believe it would be preferable to adopt rules similar in effect to the U.S. rules, supplemented with the proposal that CRAs disclose how they comply with the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies. This should not create an undue burden for CRAs operating in both jurisdictions and would allow a Canadian enforcement action against a CRA that did not comply with such rules. It could also allow more efficient allocation of regulatory resources, as the SEC could choose to defer to Canadian oversight of Canadian CRAs if the standards were the same, and vice versa.

Require Public Disclosure of Information Provided to CRAs by Issuers of Asset-Backed Securities

We do not believe that investors will benefit from this proposal for the following reasons:

- Issuers often provide voluminous information to a CRA, making the ultimate disclosure meaningless as most market participants cannot digest and analyze the information.
- CRAs collect information to make a determination of the likelihood that an issuer of a debt security will pay all principal and interest owing. As the Consultation Paper notes, a credit rating does not measure liquidity, that is, a holder's ability to sell the debt prior to maturity.[1]
- The Consultation Paper gives no rationale why similar disclosure is not proposed for other types of securities. If the purpose is to shine light on the rating methodology for ABCP and other complex products, it may be more useful to require disclosure of certain aspects of the methodology. For example, the CSA could require disclosure of the number of years of historical information used in the rating.

We are of the view that IIROC members should address disclosure as part of their product due diligence procedures. This will allow dealers to appropriately categorize products and provide adequate information to customers to determine if the product is suitable for the customer's particular investment objectives and circumstances.

If the CSA is of the view that public disclosure of certain information would be useful to ABCP buyers in primary offerings, it should require public disclosure by the issuer prior to the time of sale, rather than by the CRA.

2. Review of the Exempt Market Regime

While we agree that ABCP should not be exempt automatically on the basis that it is short-term debt[2], removing that exemption alone is unlikely to prevent a new market crisis for the reasons set out at the beginning of this letter. We support the review of the entire exempt market regime.

A security or transaction should be exempt from the prospectus or registration requirements only where the parties are sophisticated enough to understand the risks involved or the risk of an investment is so low that the cost of regulation is not justified. –

[1] *See* §3.3(2) of National Instrument 51-201, which deems disclosure of material information to a CRA to be disclosure "in the necessary course of business" if the purpose is to formulate a publicly-available credit rating.

[2] The current exemption is at odds with the provisions of Part 4 of NI 44-102, which provides that issuers cannot issue asset-backed securities under a shelf prospectus without pre-clearance with the regulator.

The fact that ABCP was issued in the exempt market indicates that the current exemptions need to be reviewed.

We have no specific recommendations in this regard, but urge the CSA to consider the following:

- Generally, risk increases with the complexity of a product. To the extent that a particular product is exempt solely because of the size of the transaction or the net worth of the purchaser, it should be a "plain vanilla" version where the maximum downside risk is easily quantifiable.
- Current Value at Risk metrics do not necessarily work in times of market crisis, as they do not account for extreme events that are highly unlikely.[3] When assessing the appropriateness of exemptions for complex products, the CSA should consider the worst-case scenario, no matter how remote.
- The CSA should consider grouping exempt purchasers in tiers. Some products might only be appropriate to be traded among banks and securities dealers. Other products may be appropriate for institutional buyers, while others may be appropriate for retail customers.
- The CSA should consider removing exemptions from the registration requirements for certain prospectus-exempt transactions so that purchasers get the benefit of advice, as a particular investment will not be suitable for all investors. In particular, concerns arise in situations where a large portion of an investor's net worth is tied up in one security, or where an investor will need to liquidate the position in the near term to obtain funds for other purposes.[4]

The Consultation Paper asks whether disclosure should be required for ABCP, but concludes that if a product or transaction should not be exempt from the prospectus requirements because of the nature of the product, requiring additional disclosure is not a substitute. We agree. Particularly for complex products, disclosure will be meaningless for many investors. Those investors who can understand the product should be able to obtain the information they require to assess it. For this reason, we again urge the CSA to consider tiers of exempt purchasers for particular products. We also note that IIROC has identified product due diligence by its members and product transparency as areas needing improvement, to ensure that the appropriate information is supplied to purchasers.

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[3] *See* Nocera, Risk Mismanagement, New York Times Magazine (January 4, 2009) available online at http://www.nytimes.com/2009/01/04/magazine/04risk-t.html?ref=magazine

[4] A significant number of holders of ABCP bought it because they only wanted a short-term lock up of the funds and received a better return than on other commercial paper.

3. Reducing Reliance on Credit Ratings

Credit ratings provide valuable information in many instances, provided they are not a basis to assume that a market in a particular security will be liquid or efficient. In this regard, disclosure of credit ratings should be accompanied by a clear explanation of their significance and limitations.

- *Short Form and Shelf Prospectus Eligibility*: While there is a justification for allowing only very creditworthy debt issuers to use the short form and shelf prospectus, we support the proposal to broaden the availability of the short form and shelf prospectus regimes by removing the requirement for a credit rating.

- *Guaranteed Debt Exemption*: The Consultation Paper suggests that the CSA replace the current requirement that foreign government debt securities have an approved credit rating with a requirement that the issuer's risk of default be comparable to that of Canadian governments. Without a credit rating requirement, an issuer using the exemption risks being second-guessed by regulators.[5]

- *Alternative Credit Support*: The Consultation Paper proposes removing the requirement in §13.4 of NI 51-102 that securities have at least as high a credit rating under alternative credit support as they would have if they had a full and unconditional guarantee. It proposes to require the issuer to make an independent assessment of relative risk, with the expectation that credit ratings will inform the issuer's analysis but not be the sole basis for the determination. We do not support this proposal, since a CRA will have far greater expertise in assessing relative risk than most, if not all, issuers.

4. Co-ordination with IIROC

Suitability and Know-Your Client Obligations

We strongly urge the CSA to work with IIROC on strengthening know-your-client and suitability obligations, not just for ABCP but for complex securities generally. In that regard, we note that in October 2008, IIROC requested comment on a draft guidance note relating to best practices for product due diligence by its Dealer Members. The CSA should be proactive in co-ordinating with IIROC so that any resulting rules or policies are implemented in a timely manner.

Conflict of Interest

We agree that the CSA should review the current underwriting conflict rules to ensure they are adequate. Again, the CSA should focus not only on ABCP, but on complex securities generally.

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[5] For example, would an issuer with the same credit rating as the lowest-rated provincial government be "comparable"?

However, we are not aware of any underwriter conflicts underlying the ABCP market crisis. In fact, the IIROC Review of ABCP origination and distribution practices notes that some IIROC dealer members felt obligated to make third-party ABCP available to their customers. If they did not, they were concerned that their customers would think the dealer was trying to force them to buy lower-return commercial paper issued by the dealer's parent bank.

5. Investments by Mutual Funds in ABCP

We are of the view that investors perceive money market funds as liquid, low-risk investments and that the funds are sold on this basis. If a particular instrument is not truly liquid, then it appears that it does not belong in a money market fund and accordingly we support measures that would ensure that only liquid, low-risk short-term instruments may be included in a money market fund.

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Thank you for the opportunity to comment. If you have any questions, please direct them to Timothy Baikie (416-995-7844; tim@tsbaikie.com) or Susan K. Goscoe (416-307-4101; sgoscoe@langmichener.ca).

Yours truly,

Jamie K. Trimble
President
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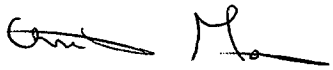

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