Québec, January 15, 2009

Mr. Edward Greenspoon, Editor-in-chief
The Globe and Mail
444 Front Street
Toronto (Ontario) M5V 2S9

Dear Sir:

I am not in the habit of publicly correcting all inaccuracies written about the system I, with my colleagues of the Canadian Securities Administrators (CSA), administer or responding to every article written about the role of securities regulators, even when they discuss the need for a national securities commission, a topic dear to my heart and on which my position is clear and well-known. Let's agree to disagree.

However, the comment published in Wednesday's edition of The Globe and Mail under the somewhat patronizing title of "ABCP and the Hockin Report – National unity for capital markets", deserves an answer on my part, if only to rectify what I consider serious mistakes on the part of a most influential business newspaper.

First, to lead your readers to believe that "the asset-backed commercial paper collapse might well have been prevented" if the recommendations of the Hockin Report had been in place in 2007, is an explanation of a simplicity tantamount to thoughtlessness.

Second, to pretend that "if there had been a single national securities commission in Canada with a principles-based approach…the *Caisse de dépot et placement du Québec*…might not have suffered grave losses on ABCP" is an indication of a poor understanding of the basic functioning of capital markets, at least of the institutional segment.

I didn't think it should be necessary at this time to remind anyone of the magnitude of the financial crisis we are currently facing, a crisis impacting the market for all complex securities in all countries around the world. The misconceptions reflected in the statements quoted above, and throughout the article, lead me to believe that a clarification is in order.

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While many factors contributed to the turmoil in the credit markets in Canada and elsewhere, the following are generally accepted as the key factors.

- the disconnection of risk in the originate-to-distribute banking model where by packaging loans into pools and selling them into special purpose off-balance sheet vehicles, the originator no longer bears the contractual risk of default;
- the role of credit rating agencies;
- the undue reliance by investors and intermediaries on credit ratings;
- the lack of transparency and disclosure of underlying assets that made it difficult for market participants to determine which products were backed by subprime mortgages and what the underlying asset mix was for any specific product;
- the role of intermediaries and whether they complied with the "know your client" and "suitability" obligations when recommending structured products such as ABCP to their clients;
- poor risk management at banks and other financial institutions and whether risk management has kept up with innovations in lending and trading practices;
- accounting-related issues, more specifically off-balance sheet accounting and valuation.

England and the United States of America are seriously affected by this financial crisis. Yet England is host to a single securities regulator, the Financial Services Authority, that has long implemented a principles-based approach to regulation. And we all know of the Securities and Exchange Commission of the United States, where, commentators agree, the subprime mortgage market crisis ignited the continuing global credit turmoil that began in the summer of 2007. Are England and the U.S. two countries where "the… crisis would have been foreseeable… and … the risk of disaster would have been much less"?

Commentators also agree that in Canada, the August 2007 freezing of the market for non-bank sponsored ABCP has been one of the most visible effects of that turmoil. Let me remind you how ABCP developed in Canada.

In a typical ABCP structure, the difference in maturities between the outstanding short-term ABCP and the longer-term underlying assets held by the issuer creates a risk of default that could prevent issuers from "rolling over" or issuing new notes to finance maturing debt. ABCP issuers typically require a liquidity facility to mitigate this risk.

In Canada, liquidity facilities for ABCP issuers had a "general market disruption" standard, meaning liquidity was provided only if commercial paper could not be issued at any price by any issuer. These "Canadian-style" liquidity provisions were based on the Office of the Superintendent of Financial Institutions (OSFI) guideline B-5. Foreign banks and non-bank liquidity providers replicated this guideline in their contractual arrangements with ABCP issuers.

For the purposes of calculating the bank's required capital charge, this guideline excluded the undrawn portions of a liquidity facility if a drawdown was permitted only in the event of a "general

market disruption". Banks that provided broader "global-style" liquidity would have had capital charges applied to undrawn portions of the liquidity facilities they provided.

The whole Canadian ABCP market froze in August 2007. Bank-sponsored ABCP issuers were nonetheless able to continue rolling over their ABCP with minimal disruption because banks bought back much of the ABCP from their related conduits and brought significant amounts of ABCP back onto their balance sheets.

For the Canadian banks, protecting their reputation superceded contractual enforcement of the "general market disruption" clause. By standing up to their reputation, Canadian banks behaved exactly as if they had offered global style liquidity facilities. Albeit commendable and welcomed by the investors, this action created a situation where non-bank sponsored issuers were at a disadvantage : without liquidity support, the non-bank ABCP market in Canada ceased to operate. Could it have been avoided?

OSFI has since eliminated the zero percent conversion factor for general market disruption liquidity facilities. As a result, these liquidity facilities are now subject to the same capital treatment as global-style liquidity facilities.

Did we question the fact that our Canadian banks were allowed to enter any type of liquidity arrangements without the corresponding capital requirement? What would have happened if they had not been financially strong enough to buy back their ABCP conduits? Without compliance with the capital requirements (for global style liquidity facilities) imposed and monitored by OSFI, were depositors at risk at any time? And now that holders of bank ABCP have been made whole, should we question the impact of a good deal on the shareholders of these banks?

To those who still wonder "whether the [chairs of the four largest provincial securities commissions] worried to each other about ABCP", I suggest to read the Consultation Paper issued by the CSA in October 2008. I also welcome any constructive comment on the Paper, as the CSA extended the comment period until mid-February.

This document is a well researched, carefully thought-out and crafted summary of one year of work, in which the CSA discuss the main causes of the financial crisis and the solutions they are proposing. These include the removal of the existing exemption from the prospectus and registration requirements for the sale of products like ABCP to unsophisticated investors. To clarify one point about the "lamentable multiplicity" of the Canadian securities statutes, anyone looking for this exemption will find it in section 2.35 of National Instrument 45-106 *Prospectus and registration exemptions*, a **national** rule adopted across Canada in 2005.

Were we slow to react to the ABCP freeze? Maybe, maybe not. On Monday, Justice Colin Campbell gave his final consent to the implementation of the rescue plan that the Crawford Committee began to map out more than 17 months ago. The complexity of problems often calls for complexity of solutions.

To propose to the market what I think is a set of effective solutions, the CSA wanted to assess the regulatory impact of proposals put forward by the International Organization of Securities Commissions and the SEC, among others. We wanted to avoid proposing regulatory frameworks only to back away because there had not been enough reflection on our part or we were misreading market requirements. The SEC had to substantially amend its proposals on credit rating agencies because it was, perhaps, too eager in the beginning.

Finally, I wonder these days if I should laugh or cry whenever I hear a reference to the "natural attachment of Québec to its property-and-civil rights legislative powers". Perhaps I should just ignore the comment, and definitely not treat it as an insult to my intelligence.

The staff of the AMF are always available to answer any question members of your staff may have on securities law matters. Please do not hesitate to call upon any of them for any information.

Yours truly,

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President & Chief Executive Officer
Autorité des marchés financiers