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Book Review for Canadian Business History Association

Paul Halpern, Caroline Cakebread, Christopher C. Nicholls and Poonam Puri, *Back From the Brink: Lessons from the Canadian Asset-Backed Commercial Paper Crisis*. Toronto, ON: Rotman-UTP Publishing, University of Toronto Press [www.utppublishing.com], 2016. xv + 251 pp., figures, tables, notes, index. Cloth; ISBN 978-1-4426-1, Cdn \$35.95.

Those familiar with Canadian securities industry history will appreciate the difficulty of penetrating the veil of secrecy surrounding much of the ‘wheeling-and-dealing’ capital raising process in a lightly regulated environment. This difficulty is particularly acute in the market for exempt securities. As such, there is much of value in this fascinating behind the scenes peek at the decade long debacle in the non-bank asset backed commercial paper (ABCP) market provided by a team composed of two eminent law professors, an editor of a Canadian finance practitioner journal and an emeritus professor from the Rotman school. The text spans a recent time line that begins with the collapse of ABCP trading in August 2007, continuing until publication of the book in 2016 that coincides with resolution of a court case pitting Barclays bank against Devonshire Trust, one of the ABCP conduits involved in the debacle. It is inevitable there is some bias in a narrative guided by information from industry insiders used to assemble fine detail about contentious negotiations among numerous parties involved at various steps in reorganizing the market following the collapse of trading. This fine detail information is both a strength and a weakness of the narrative.

It would be relatively easy to be critical of this effort. The deals involved in creating, trading and distributing the ABCP conduits are complex, making it difficult to determine sometimes overlapping roles of dealers and brokers, liquidity providers, conduits and trust sponsors, collateral and asset providers, and investors. In turn, construction of various ABCP conduits requires progressive understanding of collateralized debt obligations (CDOs), credit default swaps (CDSs), and, finally, synthetic CDOs that use investor funds to obtain collateral that is combined with the sale of CDS creating a supposedly high grade security that can be used to generate the cash flows for the ABCP investors; about two-thirds of ABCP that had to be restructured was based on synthetic CDOs. Layering of the synthetic CDOs depend on whether the CDS is ‘bespoke’ where the reference portfolio for the CDS is determined by either the buy or sell side of the CDS or, alternatively, the CDS reference portfolio can be based on a benchmark index of high yield and investment grade bonds. In turn, the reference portfolio can be decomposed into a ‘stack’ of tranches with different loss characteristics. This tranche decomposition allowed for leveraging of CDS associated with the ‘senior securities’ in the stack (an LSS) by the ABCP conduits. An average LSS leverage of ten times was associated with the ABCP conduits that required restructuring.

In effect, many of the problematic ABCP conduits used collateral obtained using investor funds to support a CDS position that was ten times the value of the senior securities in the reference index, generating additional premium income from ‘selling insurance’ on the senior portion of the reference portfolio. To protect against the possibility of margin calls on the CDS positions as the market values changed, the ABCP conduits purchased liquidity protection. The unusual contractual wording of this protection became a key element in the ABCP restructuring negotiations. Such trades would

not be profitable without the use of the leveraging and the ABCP securities could not have been sold to retail and other unsophisticated investors without a high enough rating from the Dominion Bond Rating Service (DBRS) to obtain exemption from prospectus filing requirements in provincial securities laws. It is essential to recognize that investors in ABCP were involved in cash management decisions seeking to gain a few basis points over money alternatives such as treasury bills or bankers' acceptances. The collapse of trade in ABCP in August 2007 was not resolved until after a CCAA restructuring plan that was implemented in January 2009. During this time many smaller investors were unable to access funds and following the plan were obliged to take securities with long maturity dates. As recognized (p.192), it was "the smaller commercial/corporate investors – and especially the retail investors" that were the biggest losers in the ABCP debacle.

Back from the Brink provides considerable minutiae on the restructuring negotiations and ultimate filing for CCAA protection to resolve the mess, complete with releases from liability for those involved in creating, distributing and failing to fulfill contractual obligations associated with the problematic ABCP. It is obvious that much of this detail could not have been obtained without personal interaction with important individuals involved, including the Caisse CEO, the chair of the large investors group, the executives at Coventry and so on. It is not surprising that much of the detail in the narrative surrounds the actions of these individuals, leaving other aspects of the "crisis" largely unexplored, e.g., details on ABCP composition and strategies of those Canadian banks that exited the ABCP market successfully and were not involved in the restructuring. Despite the "Lessons from the ... Crisis" subtitle, the narrative is decidedly short on 'Lessons' and long on generally positive presentation of the key players in the restructuring negotiations. There is vacuous reference to the need for "creative rethinking" (p.214) of Canadian securities regulation and reference to ABCP as an "innovative" (p.212) product. Suggestions to "encourage investors to seek multiple ratings" (p.208) and the observation that credit ratings are no "substitute for basic due diligence" (p.207) are at odds with the almost complete absence of information about ABCP due to the exemption from prospectus filings and the secretive ABCP contracts.

There is a strong possibility that, decades from now, *Back from the Brink* will be a valuable source for historians seeking insights into the workings of the Canadian securities markets in the first decade of the 21st century. The 'fleecing of the lambs' by an army of lawyers, investment dealers, brokers and financial advisors that compose the old-boys network that is the Canadian securities market is there for those willing to read between the lines. The incompetence or inability of regulators and rating agencies to protect the investing public from 'financial experts' undermining the functioning of capital markets by introducing 'toxic' complex securities promoted as "innovative" products raises substantive questions about the sometimes dramatic compensation earned by the individuals involved. With such provisos, *Back from the Brink* is a more than recommended effort for a wide audience. Those with a derivative securities background will gain much from discussion surrounding the structure and failings of the conduits; those in the legal profession will find numerous well reasoned and useful details on the legal deliberations; and, those with a sociological bent will find ample evidence on the internal working of the Canadian securities industry.

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