

Asset Backed Commercial Paper Liquidity Crisis

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Asset Backed Commercial Paper Defined

Asset backed commercial paper (ABCP) is short-term debt, generally limited to a term of no more than 270 days, and issued either on an interest bearing or a discount basis. The short-term debt is structured and issued by a conduit that uses the proceeds to purchase various types of assets.

Refinancing Process

The ABCP conduit invests and holds securitized financial assets. These assets may include auto loans, credit card receivables, commercial loans, equipment leases, home equity loans along with additional assets. The commercial paper issued by the conduit to finance the purchase of these assets normally has a term that is less than that of the underlying assets. For this reason, the conduit will normally issue additional commercial paper and use the proceeds from these secondary offerings to retire maturing commercial paper issues. In the event that a conduit is unable to retire maturing commercial paper through its available cash holdings or new issues of commercial paper, it is required by the responsible rating agency to maintain a back up liquidity facility to ensure that funds will be available to repay the maturing commercial paper.

Liquidity Crisis

On August 13, 2007, investors in Canada experienced a major disruption in the asset backed commercial paper market. The driver of this issue was that a significant portion of the ABCP issued that day failed to find buyers. The conduits had back up liquidity facilities in place but the legal community had determined that these facilities could not be drawn down unless a "Market Disruption Event" had been declared. The result of this legal interpretation was that the ABCP market in Canada no longer had the requisite liquidity, leaving the market in Canada very uncertain.

It is important to understand how the Canadian ABCP liquidity crunch differs from the sub-prime mortgage crisis that is happening in the United States. The big difference is in the credit quality of the underlying assets which represent the collateral that supports the client's investment. The asset backed commercial paper market in Canada is supported by issues which contain high grade investments.

Scotia Money Market Fund

The Scotia Money Market Fund is managed in a very conservative manner. The credit team at Scotia Cassels, led by Bill Girard, maintains a list of short-term corporate credits that may be included in the fund, while co-portfolio manager, Cecilia Chan, manages the fund on a day-to-day basis. The managers constantly balance the need to generate an attractive yield with the requirement to manage downside risk.

This approach is reflected in the fact that the fund did not hold any ABCP and thus has not been affected by the liquidity crunch that impacted the ABCP market in Canada. In these times of market volatility, the Scotia Money Market Fund remains a great option for clients who are looking to invest their short-term cash balances in a very liquid investment. With the managers' focus on downside risk, our clients can feel confident that their money is in good hands

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