

Restructuring Plan for non- bank ABCP

Background

In the Western pension plans for Academic and Administrative Staff and in the Western Retirement Income Funds Program each member allocates the investment of their account among the available fund options. The Joint Pension Board determines the investment funds to make available to members. The Board then hires professional investment managers who are given a particular goal and limitations on how they can invest. Their performance is then monitored, and changes are made as needed.

Western has 11 different investment managers who each invest retirement plan funds within the framework set by the Board. One manager, Northwater Capital Management, who invests in U.S. Equities for 5 of the University of Western Ontario pension investment funds, invested a portion of these pension funds in non-bank asset backed commercial paper ("non-bank ABCP"). This meant that members of the retirement plans who held units in any of these 5 funds had exposure to non-bank ABCP.

Non-bank Asset-backed Commercial Paper

Non-bank ABCP is short-term debt issued by financial institutions for terms of generally less than a year. There are underlying assets that back such paper (typically car loans, mortgages, and credit-card receivables and complex securities called collateralized debt obligations). Each non- bank ABCP was issued an investment rating by an agency called DBRS (Dominion Bond Rating Service). The rating helps investors determine the quality and risk of the investment. The scale is from to R-1 High (there's also R-1 Mid and R-1 Low) to R-5, in order from highest to lowest quality (10 ratings in total). Ratings from R-1 High to R-3 are considered to be "investment grade", which means that these securities are not speculative and that repayment can reasonably be expected. Ratings of R-4 and R-5 are for speculative securities and a security gets rated "D" when its issuer has not met a scheduled payment. All non-bank ABCP purchased by Northwater were rated R-1 High.

In August 2007, non - bank ABCP became illiquid, which means it stopped trading in the market. The term "liquid market" or "liquidity" simply refers to the ease in which an investor can buy or sell a particular investment. If there are a limited number of buyers (as is the case here), the market is described as "illiquid." If there are a sufficient number of buyers, then it is a "liquid" market.

You will likely recall that 2007 marked a period of heightened concern about "debt"; many of us heard news reports of sub-prime mortgages, bankruptcies,

foreclosures and losses in the US. This affected the Canadian market in various ways, including through concerns about exposure to US sub-prime mortgages as part of the debt in non-bank ABCP. The uncertainty over the perceived risk due to possible exposure to the US sub prime mortgages meant that sponsors of non-bank ABCP were unable to sell or re-finance this commercial paper. Financial institutions who were to provide cash to keep the non- bank ABCP liquid did not provide this collateral and consequently the market for non -bank ABCP collapsed and these investments became illiquid.

In September 6, 2007 the Pan Canadian Investors Committee was formed to find a possible resolution. It took from September 2007 to January 2009 for a plan to restructure 32 billion in non-bank ABCP to be developed and approved by the court. As part of that plan, in January 2009, all non-bank ABCP was exchanged for restructured notes that are due to mature in 2017. One of the goals in the restructuring of non –bank ABCP was to match the maturity date of the restructured notes with the long term nature of the underlying assets held by these notes.

Impact of Western's Retirement Plans

When market for non-bank ABCP froze in September 2007, retirement plan members were holding an exposure of \$26.3 million in their retirement accounts (the equivalent of 2.2% of the total value of the Western Retirement Plans). There are US Equity investments (and therefore exposure to the non-bank ABCP investment) within 5 of the Western Retirement Plan investment funds. These Affected Investment Accounts are:

- Balanced Growth Fund
- Balanced Income Fund
- Diversified Equity Fund
- US Equity- Hedged Fund and
- US Equity-Unhedged Fund

Redemption Restrictions

Being unable to sell this one type of investment within the US Equity funds resulted in Northwater imposing redemption restrictions on the 5 Affected Investment Accounts since September 2007. This essentially says that since (Northwater) could not sell this particular investment, neither could the Western Retirement Plans. In turn, these redemption restrictions applied to the individual members of our plans and their respective holdings in the Balanced Growth Fund, Balanced Income Fund, Diversified Equity Fund, US Equity – Hedged Fund and US Equity Unhedged Fund.

In September 2007 it was not anticipated that the restructuring plan would take 17 months. Some factors which contributed to the delay included court challenges, the complexity of non –bank ABCP and the difficult market conditions in the last quarter of 2008 and the first quarter of 2009.

Each of the investment funds in the Western Retirement Plans is made up of many individual investments, sometimes hundreds of investments. When members invest in a particular fund, each member, in effect, owns a little piece of each of those investments included in the fund. It is important that each investor have a share of the fund that is identical to every other share so that it can be valued equally for each member.

For the Retirement Plans these “shares” are fund units. Under normal conditions, and for the 10 funds unaffected by this redemption restriction, it is easy to buy and sell units of the funds and members are permitted to freely change their investment between the funds. Liquidity in the market enables buying and selling to occur.

However, when a member chose to redeem or sell their units in one of the 5 Affected Investment Accounts, there was a liquidity issue. Most of the investments in the fund could be sold and the money then used to buy into another fund. The piece of the fund that could not be sold (the non-bank ABCP investment) was split out of the “unit” and set aside in a fund called Liquidating Trust. The Liquidating Trust Fund only holds non-bank ABCP. To date, there has not been sufficient liquidity in the market to allow for the sale of the units of the liquidating trust.

The redemption restrictions restrict a member holding units in any of the Affected Fund from cashing 100% of their account in those funds. These redemption restrictions are not on the entire fund rather there is a different partial restriction on each fund that represents the proportionate holding of non-bank ABCP.

“B” Funds

Western opened 5 new funds, denoted with a “B” and beginning in September 2007 pension contributions and investment changes by members directed to the Balanced Growth Fund, Balanced Income Fund , Diversified Equity Fund, US Equity- Hedged Fund and US Equity-Unhedged Fund were directed to the “B” Funds. The “B” funds were set up to parallel each of the 5 Affected Investment Accounts with exception that the “B” Funds have no non-bank ABCP exposure. The purpose of the “B” funds was to prevent new money, not previously exposed to non-bank ABCP, from becoming exposed.

Current Situation

Prior to the court finalizing the new plan for non –bank ABCP in January 2009 members with investments in the any of the 5 Affected Investment Accounts held non-bank ABCP. After the Pan Canadian Investors Committee ‘s plan was approved by the courts members’ with non-bank ABCP exposure now have exposure to restructured notes. This is because the court approved plan replaced all the non- bank ABCP in the market with these restructured notes

For the period between September 2007 and January 2009 no one could sell their non –bank ABCP even if they wanted to because the court had a stay in place that prevented anyone from trading with their non –bank ABCP. Though the stay has been removed by the courts the redemption restrictions remain in place because there is only a very limited market for the restructured notes. This means that unless we find a new approach for dealing with the restructured notes, the best information we have leads us to conclude that it is very likely that the redemption restrictions will continue on the Affected Investment Accounts for the foreseeable future.

Although the restructuring plan was finalized by the courts in January 2009 there is no liquid market likely to develop in the short term for the restructured notes. Consequently, an approach for the handling of the restructured notes in the best interest of all members needed to be identified that recognizes there is little prospect for a market for these notes to develop in the near term but that members invested in the Affected Investment Accounts should be given options, if a suitable buyer can be found, to sell or hold their notes.

Consequently an approach has been identified by the Joint Pension Board that would:

- would enable the removal of restrictions on the Affected Investment Accounts, though redemption restrictions will remain in place for the Liquidating Trust;
- would provide members the option to choose to sell or hold their restructured notes held in the Liquidating Trust in the event that a suitable buyer is located, without having to sell their units in any of the Affected Investment Accounts; and
- would enable the Affected Investment Accounts and their companion “B” Funds to be merged.

A decision as to whether to proceed is expected to be made in September after the feedback period is completed.