

Status of IESO's Asset Backed Commercial Paper Investments

The following is a status report on the IESO's current asset backed commercial paper investments. A more detailed account of the IESO's asset backed commercial paper investments and the restructuring of the Canadian asset backed commercial paper market is set out in the evidence filed as part of the IESO's 2009 fees case, a copy of which is attached hereto as Appendix A.

Background

For the purposes of its own operations and that of the IESO-Administered Markets, the IESO invests funds in highly rated, liquid, short term investments. In 2007, some of those short-term investments were in notes known as non-bank sponsored asset-backed commercial paper (ABCP). Specifically, the IESO invested the following in ABCP notes:

- Corporate investments: \$1.4 million
- Real-time market investments: \$23.1 million
- Transmission Rights market investments: \$35.0 million

In August of 2007, a liquidity crisis threatened the Canadian market for ABCP. This crisis was triggered primarily by a loss of confidence among investors related to the news of widespread defaults on U.S. sub-prime mortgages. As uncertainty spread through the market, investors stopped purchasing ABCP notes and existing note holders were unable to rollover their maturing notes. As a result of this lack of liquidity, the issuing ABCP trusts did not redeem their notes at maturity.

The liquidity crisis could have triggered a sell-off of the assets at significantly depressed prices. However, by agreement among major Canadian participants, this

market was frozen by a standstill agreement pending an attempt to resolve this crisis through a restructuring of the affected ABCP notes. The Pan-Canadian Investors Committee was formed and it filed a Plan of Compromise and Arrangement (“the Plan”) under the *Companies’ Creditors Arrangement Act* which was sanctioned by the Ontario Superior Court in June 2008 (subsequent appeals to the Ontario Court of Appeal and Supreme Court of Canada were dismissed). The Plan was structured to preserve the underlying long-term value of the assets while building and restoring confidence in the market.

In the fourth quarter of 2008, Canadian and international credit markets continued to experience significant volatility. Market conditions worsened and credit spreads widened. As a result of the widening of credit spreads, some parties to the Plan became concerned about implementation of the Plan because of potential margin calls and lower investment values of the restructured ABCP notes (a widening of credit spreads means that investors command a higher rate of interest on investments of the same risk class than previously). In response to these developments, amendments were negotiated to the Plan. The amendments were sanctioned by the Ontario Superior Court of Justice and implemented in January 2009.

In brief, the amendments to the Plan included additional margin funding facilities to be provided by the federal government, provincial governments and a few of the larger note holders. In addition, an 18 month moratorium (in effect until July 2010) on collateral calls combined with the move to spread-loss triggers on the new notes make the likelihood of short-term collateral calls more remote than under the

original Plan structure. These modifications and improvements to the Plan made it more robust and should add stability to the restructured notes.

The restructuring was implemented in January 2009 and the IESO received their restructured ABCP notes at that time.

As noted previously, a result of the widened interest rate spreads was a reduction in the market value of some ABCP investments, including some investments held by the IESO. Specifically, as of December 31, 2008, the real-time and the transmission rights market investments were estimated to have a market value of approximately 63% and the corporate investments were estimated to have a market value of 29% of their initial investment amount. Currently, the IESO is forecasting a market value of the real-time investments of 45%, a market value of the transmission rights investments of 45%, and a market value of the corporate investments of 22%.

Going Forward

Real-time Market Investments

The IESO had \$23.1 million of real-time market funds invested in ABCP. As a result of the estimated valuations discussed above, the IESO recognized zero market related investment income in 2008 and is forecasting zero market related investment income for 2009.

Due to expected low rates of return on non-ABCP market investments, it is forecast that insufficient investment income will have been earned since 2007 to fully offset losses on the real-time ABCP investments. Accordingly, no market-related investment income is forecast for 2010.

Corporate and Transmission Rights Market Investments

The IESO also has corporate investments of \$1.4 million in ABCP. As of the end of 2008, the IESO had estimated a market value of 29% of the initial purchase price of these corporate ABCP investments. As a result of final restructuring changes and the deterioration in the credit markets discussed above, the IESO is estimating a further reduction of 7% in market value, thereby resulting in an estimated market value equal to 22% of the initial investment. This reduction in value increases the forecast net interest expense for 2009.

Investment returns on transmission rights market investments remain with the transmission rights accounts and do not impact the corporate financial results and the IESO's fee application.