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Covered Bonds Update in the United States

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Background: What Are Covered Bonds?

What are Covered Bonds?

Covered Bond Characteristics

- Senior debt of a regulated financial entity
    - Generally not subject to bail-in
- Secured by a pool of financial assets
    - Mortgage loans – residential or commercial
    - Public sector obligations
    - Ship loans
- Protected from acceleration in the event of issuer insolvency
    - By statute or legal structure
    - Collateral is isolated from insolvency estate of the issuer
    - Collateral pays bonds as scheduled through maturity
- A dynamic collateral pool – refreshed every month
- Typically bullet maturity, fixed rate bonds
- Repayment liabilities remain on the balance sheet of the originator
- Most countries have statutes enabling covered bonds
- Very strong implicit government support in many jurisdictions

Benefits to Issuing Banks

Attributes of Covered Bonds

- Lower funding cost than senior bank debt
- Extension of WAM for bank funding
  - Typical maturities for covered bonds in the EU of seven years or more.
- Diversification of funding base
  - Investors typically do not buy RMBS or senior bank debt
- Critical funding source in Europe in the sovereign debt crisis
  - The market was functional throughout the crisis
  - Avoids “bail-in” risk
- Mortgage modifications to accommodate borrower are easy; no competing interests
- Brings mortgage finance out of the ‘shadow banking’ world
- US legislation would level the playing field
  - Foreign banks currently have access to this investor base, including in the US, while US banks do not
  - Legislation no absolutely essential, but investors prefer

Covered Bond Investors

Covered Bond Investor Characteristics

- Covered bond investors buy sovereign and agency debt
- Some of these same investors buy FNMA, FHLMC, GNMA debt
    - GSE debt has been shrinking with FHFA actions
- Typically, they will not buy senior bank debt
- They do not buy CMBS or ABS or RMBS
- To attract these investors you need statutory covered bonds
- Predominantly investors are banks, central banks, funds and insurance companies
- A €3 trillion market in Europe
- The US investor base is consistently responsive to US$ covered bond offerings.

Benefits to Investors

Attributes of Covered Bonds

- High credit quality – most bonds are triple-A rated
- In Europe, favorable capital treatment for bank investors
  - Lower capital charge
  - Avoids “bail-in” risk
- Higher yield than sovereign debt
- Diversification – sovereign or agency debt is viewed as similar risk
- Good liquidity
- Issuance regulated by statute in many jurisdictions
- More investor friendly than RMBS or CMBS – simpler analysis
- Not an ‘originate-to-sell’ model
- No complex tranching – good transparency
- No negative convexity (prepayment) risk
- 100% ‘skin in the game’

Covered Bonds vs. Unsecured Bonds

Covered bonds are a unique asset class, sitting in between unsecured and asset-backed debt in terms of key characteristics.

	Covered Bonds	Senior Bonds
Ratings	▪ Structural or statutory protections and overcollateralization enable covered bonds to achieve ratings above the issuer's unsecured ratings.	▪ Unsecured bond ratings are dependent on the rating of the issuer.
Cost of Funding	▪ Due to their dual recourse nature, covered bonds provide a supplemental source of liquidity at a lower cost than senior bank funding.	▪ Unsecured bonds experience a greater level of volatility, especially during downturns in the credit cycle.
Collateral	▪ Assets are generally limited to mortgage or public sector assets (in the future there may also be a range of consumer assets). ▪ One cover pool maintains assets which supports all series of covered bonds. ▪ The cover pool is dynamic with the ability to substitute assets, e.g., remove non-performing loans.	▪ Unsecured bonds do not encumber assets, and consequently additional protection is not provided to investors in an unsecured transaction.
Maintenance	▪ A covered bond program requires a higher level of maintenance than unsecured bonds – e.g., ongoing maintenance of over-collateralization through an Asset Coverage Test.	▪ Minimal maintenance required.
Size	▪ Increased flexibility given recent developments in the US and Canadian markets.	▪ Flexibility in terms of deal size.

- The existing jumbo covered bond investor base is a global constituency comprised of banks, central banks, asset managers, and other financial institutions that are familiar with the product's nature, i.e., high rating profile, collateral maintenance, generic structures, etc.

Covered Bonds vs. Asset Backed Securities

The assets backing covered bond issuance are in place to support the obligation in the event the issuer is unable to service the covered bonds. Until such a time, the issuer is responsible for making payments on the outstanding debt.

	Covered Bonds	Asset Backed Securities
Issuer	▪ Issuer is generally a bank that is the originator of the assets and is a regulated financial institution.	▪ The issuer is a special purpose vehicle.
Collateral	▪ Assets are generally limited to mortgage or public sector assets (in the future there may also be a range of consumer assets). ▪ One cover pool maintains assets which supports all covered bonds. ▪ The cover pool is dynamic with the ability to substitute assets, e.g., remove non-performing loans.	▪ There are no restrictions on the type of underlying assets. ▪ Asset pool is often static, i.e. no substitution of assets.
Recourse	▪ Covered bonds are dual recourse with the originator ultimately being held responsible for repayment of the bonds, independent of the performance of the collateral.	▪ Only the cash flows from the collateral of each specific pool will repay investors.
Regulation	▪ Where they exist, legislative statutes, as well as regulation, of the issuer provide comfort to covered bond investors. ▪ An Asset Coverage Test of the cover pool monitors performance of the underlying assets.	▪ The issuers are generally not regulated. ▪ Asset pool transparency can be limited.
Characteristics	▪ Covered bonds are traditionally standard, i.e., fixed rate bullet repayment	▪ Securitization notes are either fixed or floating rate and the term and amortization profile of the notes depend on the type of collateral.

Key Characteristics of Legislation

Various Legislative Frameworks

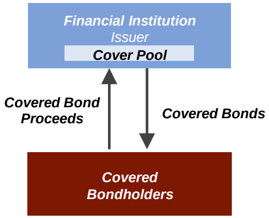
- In jurisdictions with covered bond legislation, statutes provide that in the event of an issuer insolvency, special privileges are granted to covered bond investors regarding the underlying assets. For example:
  - In Germany, Sweden, and Finland, the regulation is most favorable for the investor because the cover assets are legally separated.
  - In all other countries, the cover assets form part of the insolvency estate, but the holders of covered bonds have insolvency privileges which permit collections on the cover assets to continue to pay interest and ultimately principal to investors in accordance with the original bond schedules.
- In 2006, a viable contractual structure was created for U.S. banks that addressed the primary characteristics of covered bond issuance while respecting the discretion of the FDIC in order to ensure that US issuers could realize the benefits of covered bond issuance.
  - Washington Mutual and Bank of America issued covered bonds under this architecture, raising nearly $20 billion in funding.

Covered Bond Architectures

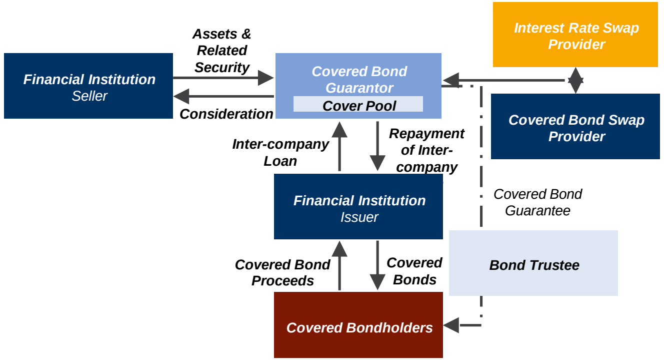
Legislatively Enabled Covered Bonds

- Twenty-nine European jurisdictions have passed covered bond legislation to ordain the insolvency remoteness and segregation of the asset pool on the issuer's balance sheet, almost all of these frameworks utilize a direct issuance architecture, with the UK and some other jurisdictions employing a segregated issuance architecture.
  - Covered bond legislation with either direct issuance or the segregated issuance architecture allows the issuer to issue covered bonds that will survive the potential insolvency of the issuer via a segregated pool of assets.
  - Specifically, legislation allows the underlying assets to continue to repay the covered bonds as originally scheduled.

Direct Issuance Architecture

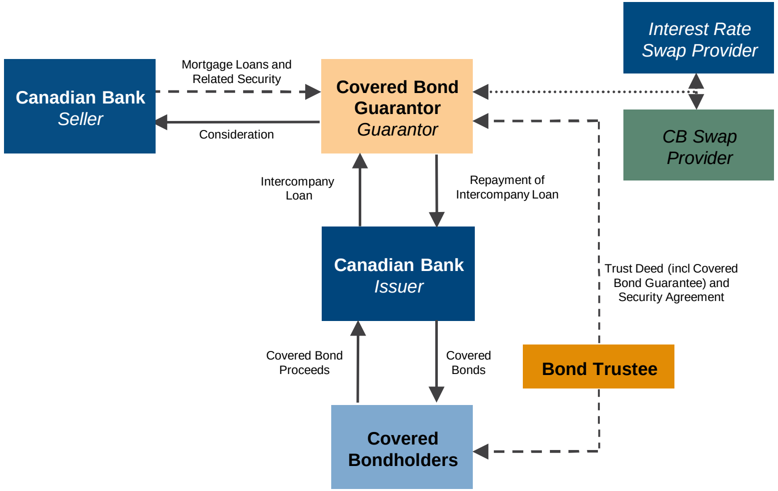


Segregated Issuance Architecture



Canadian Covered Bond Architecture

- The structure first launched by RBC has been established as the market standard for Canadian issuers with CIBC, BMO, BNS, TD, NBC, and HBCA utilizing the same basic structure. FCDQ uses a different structure because it is funding credit unions.
- The Canadian covered bond architecture below closely resembles the UK covered bond architecture:
  - Covered bonds are issued to investors with full recourse to the Issuer and the cover pool.
  - The issuer, as Seller, sells mortgage loan assets to the Guarantor, which uses proceeds from the Intercompany Loan to purchase the mortgage loans from the Issuer and provide a secured guarantee to the covered bond investors.



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WaMu and BofA

- There has been some issuance by U.S. banks
  - Washington Mutual issued its first series of covered bonds in Europe in 2006
  - Bank of America followed with a covered bond issuance in 2007
  - Both programs were curtailed by the financial crisis, in WaMu's case by insolvency.
  - In the absence of a statute, the structure used to emulate a statutory covered bond was expensive at the time and even more expensive today

- It is unlikely that a U.S. bank would use this structure todayWashington Mutual provides an example of the benefits of covered bonds
  - FDIC transferred the covered bonds and the collateral pool to JPMorgan
  - JPMorgan assumed the obligation on the outstanding covered bonds
  - The rating on the bonds instantly went up
  - Washington Mutual senior bondholders received pennies on the dollar

Issuance Alternatives

- In a private placement in reliance on U.S. private placement exemptions (generally Section 4(a)(2)).
- In an offering structured as a private placement, with resales under Rule 144A (to qualified institutional buyers, or QIBs).
- In an offering by a bank that is excepted from registration under Section 3(a)(2) (a 3(a)(2) offering).
- In an SEC registered offering, a public offering without restrictions.

Private Placements: Section 4(a)(2)

- Private Placements: Section 4(a)(2) of the Securities Act
  - Under Section 4(a)(2), registration requirements and related prospectus delivery requirements under Section 5 of the Securities Act do not apply to “transactions by an issuer not involving any public offering”.

Rule 144A - Overview

- Rule 144A provides a non-exclusive safe harbor from the registration requirements of Section 5 of the 1933 Act for resales of restricted securities to "qualified institutional buyers" (QIBs).
- The rule recognizes that not all investors are in need of the protections of the prospectus requirements of the 1933 Act.
- The rule applies to offers made by persons <u>other</u> than the issuer of the securities. (i.e., "resales").
- The rule applies to securities that are not listed on a U.S. securities exchange or quoted on an automated inter-dealer quotation system.
- A reseller may rely on any applicable exemption from the registration requirements of the 1933 Act in connection with the resale of restricted securities (such as Reg S or Rule 144).

Section 3(a)(2) and Offerings by Banks

- Section 3(a)(2) of the Securities Act exempts from registration under the 1933 Act any security issued or guaranteed by a bank.
- Basis: banks are highly regulated, and provide adequate disclosure to investors about their finances in the absence of federal securities registration requirements. Banks are also subject to various capital requirements that may increase the likelihood that holders of their debt securities will receive timely payments of principal and interest.

What Is a "Bank"?

- Under Section 3(a)(2), the institution must meet both of the following requirements:
  - it must be a national bank or any institution supervised by a state banking commission or similar authority; and
  - its business must be substantially confined to banking.

- Examples of entities that *don't* qualify:
  - Bank holding companies
  - Finance companies
  - Investment banks
  - Foreign banks (*but a U.S. branch of a foreign bank qualifies under Rel. 33-6661*)

SEC Registered CBs

- In 2012, RBC obtained a no-action letter from the SEC staff permitting RBC to file a registration statement for its covered bond program
- BNS and BMO followed this lead by filing their own registration statements for covered bonds – BMO withdrew its filing prior to effectiveness.
- Between 2012 and 2016, RBC and BNS issued nearly $21 billion of covered bonds in SEC registered format, reaching a much broader investor base than they could reach through their Rule 144A offerings.
- In 2014, after adoption of amendments to Regulation AB, the SEC staff took the position that the loan-level disclosure requirements of Reg AB applied to SEC registered covered bonds.
- When these disclosure requirements came into effect in late 2016, RBC and BNS ceased issuing registered covered bonds. In the four years since, they have each issued only two series of covered bonds into the United States under Rule 144A.
- It is noteworthy that since the loan-level disclosure rules for mortgage loans became effective in 2016, no SEC registered RMBS has been issued.
- Apparently, even for U.S. issuers the disclosure rules have been found too burdensome.

Possible 1940 Act Considerations

- Depending upon the structure of the issuing entity, there may be Investment Company Act (or "40 Act") considerations:
  - Under U.S. law an "investment company" is subject to special and somewhat separate and extensive registration requirements.
  - The issuing entity will want to avoid being characterized as a 40 Act entity.
  - Foreign banks are exempt from registration under Rule 3a-6:
    - Rule 3a-6 does not exempt holding companies and non-bank subsidiaries.
    - Also Rule 3a-6 does not exempt a separate covered bond guarantor
    - A finance subsidiary may be exempt under Rule 3a-5.
    - Another exemption that may be relied upon is available if covered bonds are sold only to qualified purchasers.

144A/Reg S/SEC USD Covered Bonds

- The table on the next slide shows the USD covered bonds issued by Canadian banks since 2012.
- This issuance totals $54.9 billion over seven years
- Canadian banks represent about 50% of USD issuance
- Total USD issuance since 2010 has been more than $203 billion
- As we will show you later, the decision by foreign issuers to issue in USD is determined in large part by cross currency swap costs.

USD Issuance:

2017 — 2020

Pricing	Issuer	Region	Series	Cur.	(mm)	Coupon	Maturity	Tenor	Spread	Type
2020-05-07	HSBC Bank Canada	Canada	CBL4	$	1000	0.950	2023-05-14	3yr	+72	144A/Reg S
2020-04-16	National Bank of Canada	Canada	CBL13	$	200	3mL+45	2021-10-20	1.5yr	+45	Reg S
2020-03-27	Toronto-Dominion Bank	Canada	CBL32	$	1250	1.450	2023-04-03	3yr	+100	144A
2020-03-25	Bank of Nova Scotia	Canada	CBL30	$	900	1.500	2023-03-31	3yr	+100	144A
2020-02-05	Nationwide Building Society	U.K.	2020-02	$	1000	1.700	2023-02-13	3yr	+27	144A
2020-02-04	Santander UK	U.K.	Series 75	$	1250	1.625	2023-02-12	3yr	+28	144A
2019-10-29	Sumitomo Mitsui Banking Corporation	Japan	**	$	500	2.014	2022-11-07	3yr	+38	144A/Reg S
2019-10-09	Commonwealth Bank of Australia	Australia	**	$	1250	1.625	2022-10-17	3yr	+30	144A/Reg S
2019-09-23	Fédération des caisses Desjardins du Quebec	Canada	CBL6	$	1000	1.950	2022-09-26	3yr	+34	144A/Reg S
2019-09-17	Royal Bank of Canada	Canada	CB44	$	1500	1.900	2022-09-23	3yr	+31	144A/Reg S
2019-09-03	HSBC Bank Canada	Canada	CBL2	$	1000	1.650	2022-09-10	3yr	+35	144A/Reg S
2019-08-30	United Overseas Bank	Singapore	7	$	500	1.625	2022-09-05	3yr	**	144A/Reg S
2019-07-17	Lloyds Bank plc	U.K.	**	$	1000	2.000	2022-07-24	3yr	+36	Reg S
2019-07-16	Muenchener Hypothekenbank eG	Germany	**	$	600	2.000	2022-12-07	3+yr	+26	Reg S
2019-07-08	Toronto-Dominion Bank	Canada	CBL26	$	1750	2.100	2022-07-15	3yr	+28	144A
2019-07-08	Toronto-Dominion Bank	Canada	CBL27	$	400	2.111	2022-07-15	3yr	+20	144A
2019-06-19	HypoVereinsbank AG	Germany	**	$	500	1.875	2022-07-05	3yr	+32	Reg S
2019-06-13	National Bank of Canada	Canada	CBL11	$	1000	2.050	2022-06-20	3yr	+30	144A
2019-06-12	Bank of Montreal	Canada	CBL17	$	1750	2.100	2022-06-15	3yr	+29	144A
2019-06-11	Sumitomo Mitsui Banking Corporation	Japan	**	$	1000	2.440	2024-06-18	5yr	+50	Reg S
2019-05-23	Deutsche Pfandbriefbank	Germany	**	$	600	2.125	2022-05-31	3yr	+32	144A
2019-05-21	LBBW	Germany	**	$	750	2.375	2022-05-31	3yr	+24	Reg S
2019-04-10	Aareal Bank	Germany	**	$	600	**	0000-00-00	2+yr	+28	Reg S
2019-01-07	Westpac Banking Corp	Australia	**	$	2000	3.150	2024-01-14	5yr	+58	144A
2018-12-07	National Bank of Canada	Canada	CBL9	$	270	3mL-ICE+18	2020-12-14	2yr	+18	144A
2018-12-05	Kookmin Bank	Korea	2019-1	$	100	3.409	2020-12-05	2yr	**	Reg S
2018-11-26	National Australia Bank	Australia	Series-33	$	1150	3.450	2023-12-04	5yr	+45	144A
2018-11-20	HSBC Bank Canada	Canada	CBL1	$	750	3.300	2021-11-28	3yr	+33	144A/Reg S
2018-11-19	DBS Bank Ltd	Singapore	**	$	1250	3.300	2021-11-27	3yr	+331	144A/Reg S
2018-11-13	Deutsche Pfandbriefbank	Germany	15286	$	600	3.375	2021-11-22	3yr	+35	Reg S
2018-11-05	Lloyds Bank plc	U.K.	Series 2018-5	$	750	3.375	2021-11-15	3yr	+32	Reg S
2018-10-16	Toronto-Dominion Bank	Canada	CBL23	$	2000	3.350	2021-10-22	3yr	+25	144A/Reg S
2018-10-15	Royal Bank of Canada	Canada	CB39	$	1700	3.350	2021-10-22	3yr	+25	144A/Reg S
2018-07-09	Commonwealth Bank of Australia	Australia	**	$	1250	3.250	2023-07-23	5yr	+40	144A/Reg S
2018-06-21	DnB Boligkreditt	Norway	**	$	1000	3.250	2023-06-28	5yr	+38	144A
2018-06-20	Canadian Imperial Bank of Commerce	Canada	CBL21	$	1750	3.150	2021-06-28	3yr	+30	144A
2018-02-06	Nord/LB CBB	Luxembourg	**	$	650	2.875	2021-02-13	3yr	+45	Reg S
2017-10-24	Korea Housing Finance Co	Korea	**	$	500	3.000	2022-10-31	5yr	+100	144A/Reg S
2017-09-06	Aareal Bank	Germany	**	$	625	**	2020-09-15	3yr	+38	Reg S
2017-07-20	Canadian Imperial Bank of Commerce	Canada	CBL17	$	1750	2.350	2022-07-27	5yr	+47	144A/Reg S
2017-04-25	Deutsche Pfandbriefbank AG	Germany	**	$	600	2.250	2020-05-04	3yr	+55	Reg S
2017-04-05	SR Boligkreditt	Norway	10	$	600	2.500	2022-04-12	5yr	+55	Reg S
2017-03-29	Stadshypotek AB	Sweden	**	$	1250	2.500	2022-04-05	5yr	+48	144A/Reg S
2017-03-21	DnB Boligkreditt	Norway	**	$	1500	2.500	2022-03-28	5yr	+50	Reg S
2017-02-22	United Overseas Bank	Singapore	**	$	500	2.215	2020-03-02	3yr	+45	144A/Reg S
2017-01-23	LBBW	Germany	**	$	750	2.125	2022-01-30	5yr	+47	Reg S
2017-01-17	Deutsche Pfandbriefbank AG	Germany	**	$	100	1.625	2019-08-30	r-3yr	+55	Reg S
2017-01-09	Toronto-Dominion Bank	Canada	CBL15	$	1750	2.500	2022-01-18	5yr	+60	144A/Reg S
2017-01-04	Bank of Montreal	Canada	CBL11	$	1750	2.500	2022-01-11	5yr	+60	144A/Reg S

Source: us-covered-bonds.com

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Canadian Bank Issuance:

March – April 2020

Date	Issuer	Region	Series	Cur.	(mm)	Coupon	Maturity	Tenor	Spread	Type
2020-06-01	Royal Bank of Canada	Canada	CB58	C$	5000	3mCDOR+45	2023-12-01	2.5yr	+45	BoC
2020-06-01	Royal Bank of Canada	Canada	CB59	C$	5000	3mCDOR+45	2024-03-01	2.75yr	+45	BoC
2020-05-07	HSBC Bank Canada	Canada	CBL4	$	1000	0.950	2023-05-14	3yr	+72	144A/Reg S
2020-04-16	National Bank of Canada	Canada	CBL13	$	200	3mL+45	2021-10-20	1.5yr	+45	Reg S
2020-04-15	Royal Bank of Canada	Canada	CB57	A$	2250	3mBBSW+100	2023-04-24	3yr	+100	Reg S
2020-04-13	Fédération des caisses Desjardins du Quebec	Canada	CBL9	C$	1500	1mBAR+140	2023-04-14	3yr	+140	BoC
2020-04-09	Bank of Nova Scotia	Canada	CBL13-2	€	1250	0.375	2023-03-10	3yr	+55	Reg S
2020-04-07	Bank of Montreal	Canada	CBL23	A$	2000	3mBBSW+120	2023-04-17	3yr	+120	Reg S
2020-04-03	Bank of Montreal	Canada	CBL22	CHF	325	0.096	2023-12-22	3+yr	-58	Reg S
2020-04-03	Bank of Nova Scotia	Canada	CBL23-3	CHF	355	0.200	2025-11-19	5+yr	+63	Reg S
2020-04-03	Canadian Imperial Bank of Commerce	Canada	CBL26	CHF	100	0.1412	2028-10-09	8.5yr	**	Reg S
2020-04-02	Toronto-Dominion Bank	Canada	CBL33	A$	1250	3mBBSW+125	2023-04-09	3yr	+125	Reg S
2020-04-02	Canadian Imperial Bank of Commerce	Canada	CBL30	A$	600	3mBBSW+125	0000-00-00	3yr	+125	Reg S
2020-04-01	Bank of Nova Scotia	Canada	CBL27	CHF	180	0.2975	2028-04-03	8yr	+46	Reg S
2020-03-31	Bank of Nova Scotia	Canada	CBL31	CHF	355	0.200	2025-11-19	5.5yr	+63	Reg S
2020-03-30	HSBC Bank Canada	Canada	CBL3	C$	1500	3mBAR+140	2024-03-31	4yr	+140	BoC
2020-03-30	Canadian Imperial Bank of Commerce	Canada	CBL28	C$	4000	3mCDOR+75	2022-04-02	2yr	+75	BoC
2020-03-27	Royal Bank of Canada	Canada	CB53	C$	5000	3mCDOR+20	2021-09-26	1.5yr	+20	BoC
2020-03-27	Royal Bank of Canada	Canada	CB54	C$	5000	3mCDOR+45	2022-09-26	2.5yr	+45	BoC
2020-03-27	Royal Bank of Canada	Canada	CB55	C$	5000	3mCDOR+50	2023-09-26	3.5yr	+50	BoC
2020-03-27	Royal Bank of Canada	Canada	CB56	C$	5000	3mCDOR+60	2023-09-26	3.5yr	+60	BoC
2020-03-27	Toronto-Dominion Bank	Canada	CBL32	$	1250	1.450	2023-04-03	3yr	+100	144A
2020-03-27	Royal Bank of Canada	Canada	CB52	CHF	200	0.155	2027-04-06	7yr	+70	Reg S
2020-03-27	Fédération des caisses Desjardins du Quebec	Canada	CBL8	C$	2500	1mBAR+170	2021-09-30	1.5yr	+170	BoC
2020-03-27	National Bank of Canada	Canada	CBL12	C$	2000	3mBAR+85	2023-06-30	3+yr	+85	BoC
2020-03-25	Bank of Nova Scotia	Canada	CBL28	C$	2750	2.394	2022-03-22	2yr	**	BoC
2020-03-25	Bank of Montreal	Canada	CBL20	C$	1500	1mCDOR+85	2023-03-27	3yr	+85	BoC
2020-03-25	Bank of Nova Scotia	Canada	CBL29	C$	2750	3mCDOR+165	2023-03-22	3yr	+165	BoC
2020-03-25	Bank of Nova Scotia	Canada	CBL30	$	900	1.500	2023-03-31	3yr	+100	144A
2020-03-25	Canadian Imperial Bank of Commerce	Canada	CBL27	C$	2250	3mCDOR+70	2021-09-30	1.5yr	+70	BoC
2020-03-23	Bank of Montreal	Canada	CBL21	CHF	160	0.035	2026-04-07	6yr	+45	Reg S
2020-03-20	Royal Bank of Canada	Canada	CB51	C$	2500	3mCDOR+10	2021-04-24	1yr	+10	BoC
2020-03-20	Canadian Imperial Bank of Commerce	Canada	CBL25	€	750	3mEuribor+63	2023-09-27	3.5yr	+63	Reg S
2020-03-20	Toronto-Dominion Bank	Canada	CBL30	C$	5000	1mCDOR+200	2021-09-23	1.5yr	+200	BoC
2020-03-20	Toronto-Dominion Bank	Canada	CBL31	C$	5000	1mCDOR+170	2023-03-23	3yr	+170	BoC
2020-03-19	Bank of Montreal	Canada	CBL18	€	1250	0.125	2023-03-26	3yr	+45	Reg S
2020-03-19	Toronto-Dominion Bank	Canada	CBL29	€	1000	0.125	2024-03-26	4yr	+50	Reg S
2020-03-17	Royal Bank of Canada	Canada	CB50	€	1000	0.125	2025-03-24	5yr	+40	Reg S
2020-03-17	Canadian Imperial Bank of Commerce	Canada	CBL24-2	£	125	SONIA+48	2022-10-28	tap	+82	Reg S
2020-03-11	Bank of Nova Scotia	Canada	CBL26	€	1250	0.010	2025-03-18	5yr	+20	Reg S

Source: us-covered-bonds.com

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CB vs. TLAC Funding for CDN Banks

- In September 2018, new capital rules and resolution rules for Canadian banks came into effect that provide for bail-in of senior debt. These rules include a requirement for the banks to maintain a minimum amount of total loss absorbing capital (TLAC) and the establishment of a "bail-in" regime.
- The TLAC requirement becomes fully effective in 2021 and there had been concern in some quarters that TLAC issuance would take precedence over covered bond issuance. Most banks, however, report that normal run off of their senior debt and replacement by TLAC eligible debt will occur in the ordinary course and not impact covered bond issuance.
- Covered bonds are *not* subject to the bail-in rules.

EU Legislative Initiatives

- Recent EU legislative initiatives related to covered bonds and the impact on non-EU issuers.
  - The Covered Bond Directive became effective last year and is intended to harmonize covered bonds across the EU.
  - The CRD was amended to provide that only covered bonds complying with the directive would receive preferable capital treatment when held by banks.
  - This preferential treatment applies only to covered bonds issued by credit institutions established in the EU.
  - The directive calls for a report on the need and relevance for an equivalence regime for covered bonds issued by third country issuers.
  - Thus, AAA rated Canadian covered bonds would not be eligible for preferential capital treatment, although covered bonds of lower rated EU issuers would be.

U.S. Market Developments and Trends

RBC Capital Markets

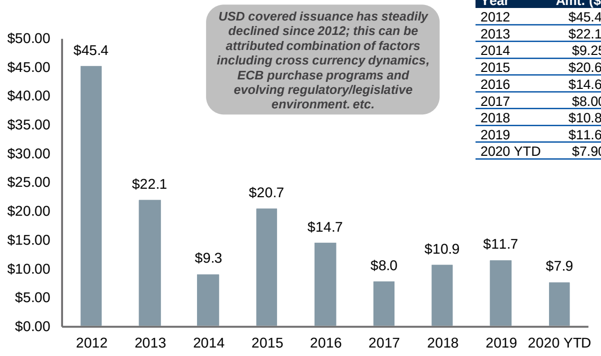
October 20, 2020

STRICTLY PRIVATE AND CONFIDENTIAL

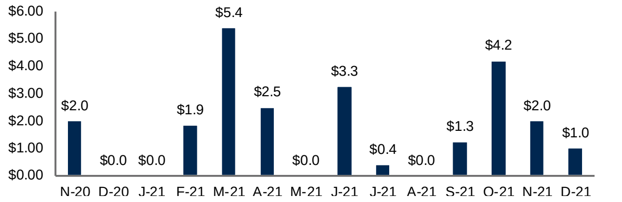
USD Covered Bond Landscape & Considerations

USD Covered Bond Issuance 2012 – 2020 YTD ($bn)

Year	Amt. ($bn)
2012	$45.40
2013	$22.10
2014	$9.25
2015	$20.65
2016	$14.65
2017	$8.00
2018	$10.85
2019	$11.65
2020 YTD	$7.90

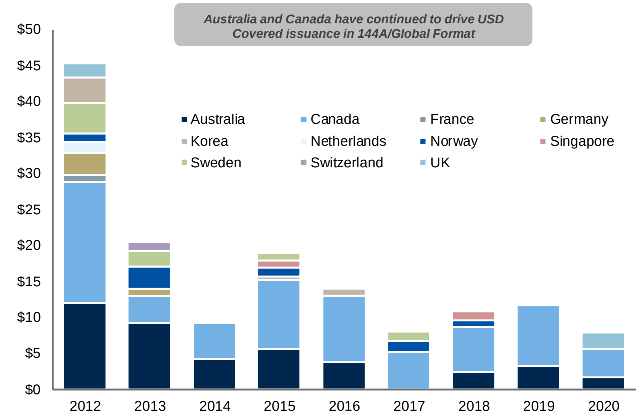


Upcoming USD Covered Bond Maturities by Month ($bn)

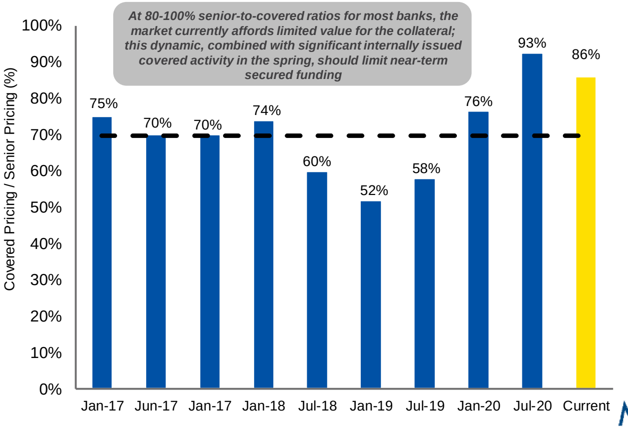


EUR-USD 5-Year Basis Swap (3m Euribor vs. 3M LIBOR, bps)

USD Covered Bond Issuance by Jurisdiction 2012 – 2020YTD ($bn)



Relative Value Snapshot: 5Y Covered vs. Senior Pricing (as % of Senior)*



Source: Bloomberg, RBC Capital Markets
Issuance totals reflect benchmark "144A/Global" transactions, excluding EMTN/RegS Only
**Represents average ratio among Canadian Issuers*

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Covered Bonds in the U.S.

Covered bonds in the United States

- Historically, housing finance in the United States has depended on other sources (*other than covered bonds*). For example,
  - the GSEs. The GSEs were essential to the growth of the securitization market in the United States.
  - Securitization. U.S. banks became dependent on securitization. There was a significant market for securitization and securitization provided off-balance sheet treatment for regulatory capital and GAAP accounting purposes.
  - FHLB funding. U.S. banks had access to funding from the Federal Home Loan Bank system.

- Given the combination of the financial crisis, GSE financial circumstances, market forces, accounting developments and regulatory changes, new housing finance alternatives are becoming more important
- Covered bonds have been in the news in the United States since 2006.
  - In September 2006, Washington Mutual became the first North American financial institution to offer covered bonds in an offering in Europe.
  - In 2007, Bank of America followed with its own covered bond offering in Europe.

U.S. Bank Issuance

- Favorable outcome for WaMu CB holders
- WaMu structure is too expensive and complicated post crisis
- Perhaps the Canadian structure, but true sale questions could exist
- Probably legislation is necessary
- GSE reform first
- Dodd-Frank limits on bank investments and activities; no cash shortfalls at banks
- Little RMBS activity; but it is finally starting to grow

The Emergence of US Domestic Supply was Anticipated – Subject to the Establishment of US Covered Bond Legislation

- In 2011, Covered Bond legislation was introduced in the House as H.R. 940 and passed the Financial Services Committee by a strong bi-partisan vote of 44-7.
- Covered Bonds legislation was introduced in the Senate in 2011 as S. 1835. No hearings were held on the bill.
- In 2013, H.R. 2767 was introduced in the House and S.1217 in the Senate. Both bills included provisions for GSE reform. Only the House bill contained covered bond legislation. H.R. 2767 was reported out of committee on a strictly party line vote.
- In 2014, an amendment to S.1217 was introduced in the Senate, but never enacted.
- The passage of US covered bond legislation would resolve existing uncertainty around the ability of covered bonds to survive an FDIC receivership and would allow US issuers to begin accessing this cost efficient funding source soon thereafter.

2006
WaMu issues first North American covered bond into Euro market

2007
Bank of America issues first USD covered bond by a US bank

2007
RBC launches the first Canadian covered bond program

January 2010
CIBC issues the first USD 144A covered bond since 2007

March 2011
US Covered Bond Act introduced by Rep. Scott Garrett

November 2011
US Covered Bond Act introduced by Senators Hagan and Corker

2012
No significant legislative developments – SEC registered covered bond

2013
Anticipated completion of US covered bond legislation

Proposed Legislation in the U.S.

Where is U.S. Legislation

- In the early days of the Trump administration, there was some quiet indications that covered bonds were back on the agenda. Since then, there has been no discussion.
- In 2018, the White House released a proposal on U.S. government reorganization
  - On page 79 there is a section on reforming the GSEs. Under the proposal, the GSEs would be privatized.
  - There is also a proposal to transfer responsibility for financing for low income housing to the Department of Housing and Urban Development.
  - That transfer could defuse the Democrat-Republican tension over reforming the GSEs.
  - There is little appetite among the banks that originate mortgage loans for covered bond legislation prior to resolution of the GSEs as the GSEs have always provided the most profitable financing alternative for the banks.
- However, with the 2018 election giving us a split Congress, it was less likely that GSE reform would occur.

Advantages of a statute

- Improve funding efficiency
  - Simple structure; reduces costs
  - Increases certainty of FDIC outcome
  - Does NOT force liquidation of the cover pool at insolvency
  - Collateral continues to pay interest
  - Collateral standards improve liquidity
  - Improves temporary investment flexibility
- More certainty for investors means a lower coupon
- More uniformity means an improved secondary market
  - Improved secondary market means a lower coupon

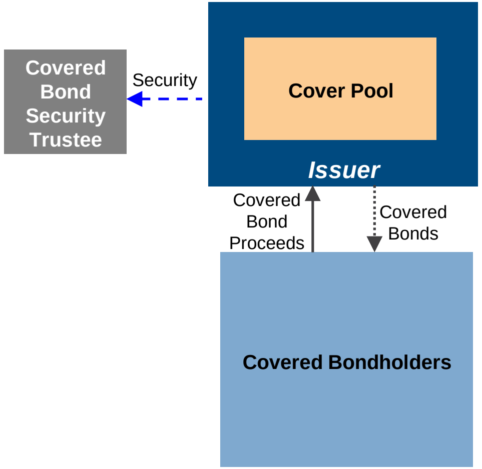
Essential legal elements

- Federal legislation
- Creation of a separate insolvency estate
    - Necessary to protect the maturity of the bond
    - We have a ‘unitary’ insolvency system
        - Only a single estate to meet the claims of creditors
- Priority claim for bondholders
- Covered bond regulator
    - Regulatory oversight of the quality of covered bonds
    - Regulatory approval of issuance
    - Regulatory oversight of the administration of the separate estate
- No tax on separate estate or its activities

Proposed U.S. Structure

Proposed Issuance Structure under Prior Legislation

- Legislation enabled direct issuance from the bank to investors while ensuring the assets are segregated in the event of an issuer insolvency
- The statute generally enabled cash flow from the collateral to continue to pay Covered Bonds as scheduled notwithstanding the insolvency of the issuer.



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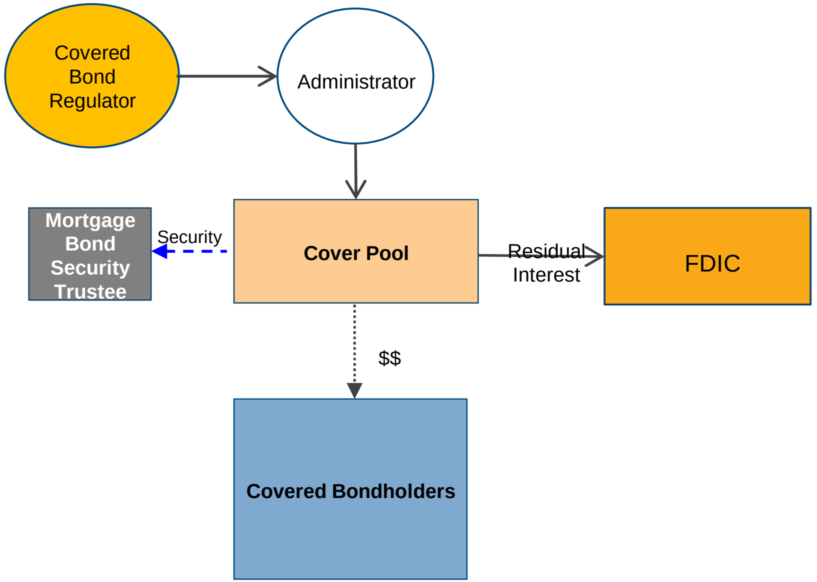
Proposed U.S. Structure

Post-Insolvency Structure



Key Elements of prior Legislation

Defining Covered Bonds

- *"Covered Bond"*
  - Senior full recourse bond of an "eligible issuer"
  - Secured by a "cover pool" of "eligible assets" owned by the issuer
  - Issued under a "covered bond program"

- *"Covered Bond Program"*
  - Approved by the covered bond regulator
  - One or more series or tranches of bonds issued against a cover pool
  - An issuer can have more than one covered bond program

Key Elements of prior Legislation *(cont'd)*

Who Can Issue Covered Bonds?

- *"Eligible Issuer"*
  - Any insured institution or subsidiary
  - Bank holding company or subsidiary
  - S&L holding company or subsidiary
  - Any nonbank financial company supervised by the Fed, including any intermediate holding company supervised as a nonbank financial company and any subsidiary of such nonbank financial company
  - An entity sponsored by an eligible issuer for pooled issuance

Key Elements of prior Legislation *(cont'd)*

Cover Pool Assets

- *"Eligible Asset"*
  - Complying first-lien residential mortgage loan
  - Complying commercial mortgage loan
  - Loans or securities of States or municipalities
  - Complying auto loans or leases
  - Complying student loans
  - Complying revolving credit receivable
  - Any loan made or guaranteed under a Small Business Administration program
  - Any other asset designated by the covered bond regulator in consultation with the primary financial regulatory agency of the issuer
  - "Substitute Asset" – Cash, overnight Federal funds, US Government obligations and GSE obligations ≤20% of pool

Key Elements of prior Legislation *(cont'd)*

Legal Attributes of Statutory U.S. Covered Bonds

- Only one asset type permitted in a cover pool.
- The Issuer's primary Federal financial regulator to be the covered bond regulator.
  - The regulator is required to set a limit for each issuer on the amount of covered bonds an issuer may have outstanding based on total assets
  - Cease and desist authority if program does not comply with legislation
- Upon insolvency of a bank issuer, 180 days for the FDIC to transfer the covered bonds to another bank.
- The cover pool becomes a separate "estate" if the covered bonds are not transferred or if the FDIC is not the receiver.
- Upon default prior to insolvency, the cover pool becomes a separate estate immediately.

Key Elements of prior Legislation *(cont'd)*

Legal Attributes of Statutory U.S. Covered Bonds

- The covered bond regulator as the trustee of the pool
  - Appoints one or more servicers or administrators
  - Administers the estate for the benefit of the bondholders and other secured parties (e.g., swap counterparties)
- Authority for the cover pool to borrow for liquidity purposes
- FDIC granted a residual interest in the cover pool
- Covered bonds issued by a bank are deemed to be issued under Section 3(a)(2) of the Securities Act
  - Covered bonds are not an "asset-backed security" and, therefore, should not be subject to SEC Regulation AB

Key Elements of prior Legislation *(cont'd)*

Legal Attributes of Statutory U.S. Covered Bonds

- Tax treatment
  - Separate estate not taxable as a separate entity
  - Sale of assets not taxable event
  - Foreign investors are not engaged in a U.S. lending business
  - The Treasury may limit state and local taxes on the separate estate
- Legal protection
  - No court may take any action to affect or restrain the resolution of the separate estate and may not issue an attachment or execution on any asset

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