MORRISON | FOERSTER

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Covered Bonds: Concepts and Topics

January 26, 2014

Presented By
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Background: What Are Covered Bonds?

What are Covered Bonds

Classic Covered Bond Characteristics

- Senior debt of a regulated financial entity
- Secured by a pool of financial assets
  - Mortgage loans – residential and 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 Issuers

Attributes of Covered Bonds

- Lower funding cost than senior debt
- Extension of WAM for funding
  - Typical maturities for covered bonds of three to five years.
- Diversification of funding base
  - Investors typically do not buy RMBS or senior debt
- Critical funding source in Europe in the sovereign debt crisis
  - Avoids “bail-in” risk
- Mortgage modifications to accommodate borrowers are easy; no competing interests
- Brings mortgage finance out of the ‘shadow banking’ world

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 should be less available with GSE reform
- Typically they will not buy senior debt
- They do not buy CMBS or ABS or RMBS
- To attract these investors it helps to have statutory covered bonds
- Predominantly banks, central banks, funds and insurance companies
- A €3 trillion market in Europe
- The US investor base is opening up; foreign banks issued almost $30 billion in covered bonds in the US in 2010, $40 billion in 2011, $45 billion in 2012 and $22 billion in 2013.

Benefits to Investors

Attributes of Covered Bonds

- High credit quality – most bonds are triple-A rated
- In Europe, favorable capital treatment for bank investors
  - 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 European jurisdictions
- More investor friendly than RMBS or CMBS
- 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 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.

Structured Covered Bonds

Covered Bond Issuance in the Absence of Enabling Legislation

Structured Covered Bonds

- In countries without enabling legislation, it has been possible to utilize technology developed for asset securitization as a means to create a structured covered bond under existing contractual law.
  - The key to such structures is the establishment of both primary recourse to the issuer and secondary recourse to a collateral pool in the event the issuer becomes unable to service the covered bonds.

Covered Bond Issuance in the Absence of Enabling Legislation

Structured Covered Bonds

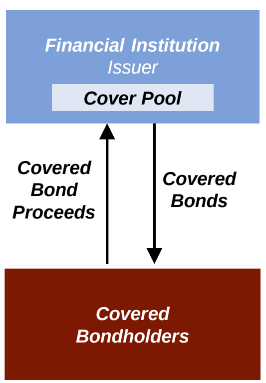
- The first structured covered bond was issued in the United Kingdom by HBOS in October 2003
- In September 2006, WaMu's inaugural covered bond transaction came to market, representing the first structured covered bond from a North American financial institution.
  - In March 2007, Bank of America launched the second US covered bond utilizing the same architecture developed for WaMu.
- In October 2007, RBC launched the inaugural Canadian covered bond program with a structure resembling the UK architecture.
  - Bank of Montreal, Bank of Nova Scotia, CIBC, Toronto Dominion, National Bank of Canada and Caisse Centrale DesJardins followed suit and accessed the market using the same architecture.

Covered Bond Architectures

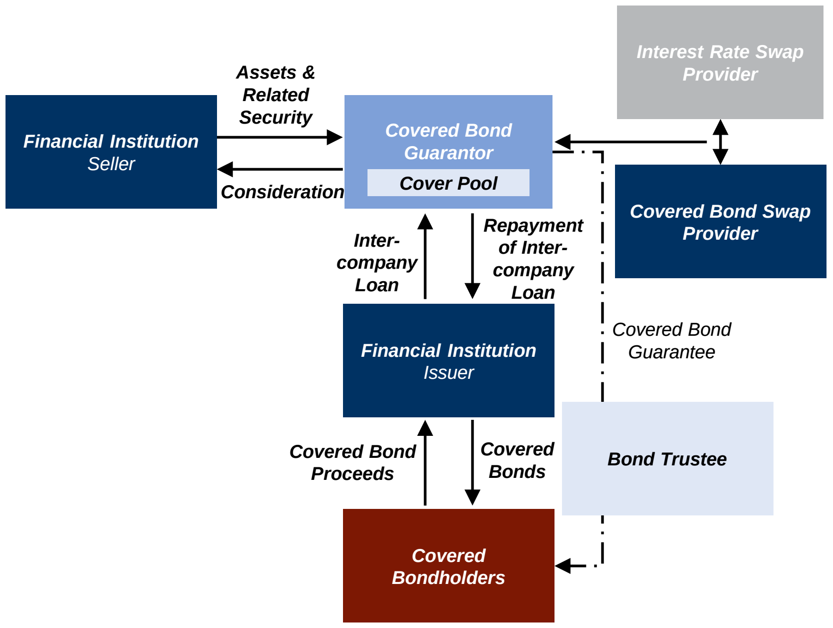
Legislatively Enabled Covered Bonds

- 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 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

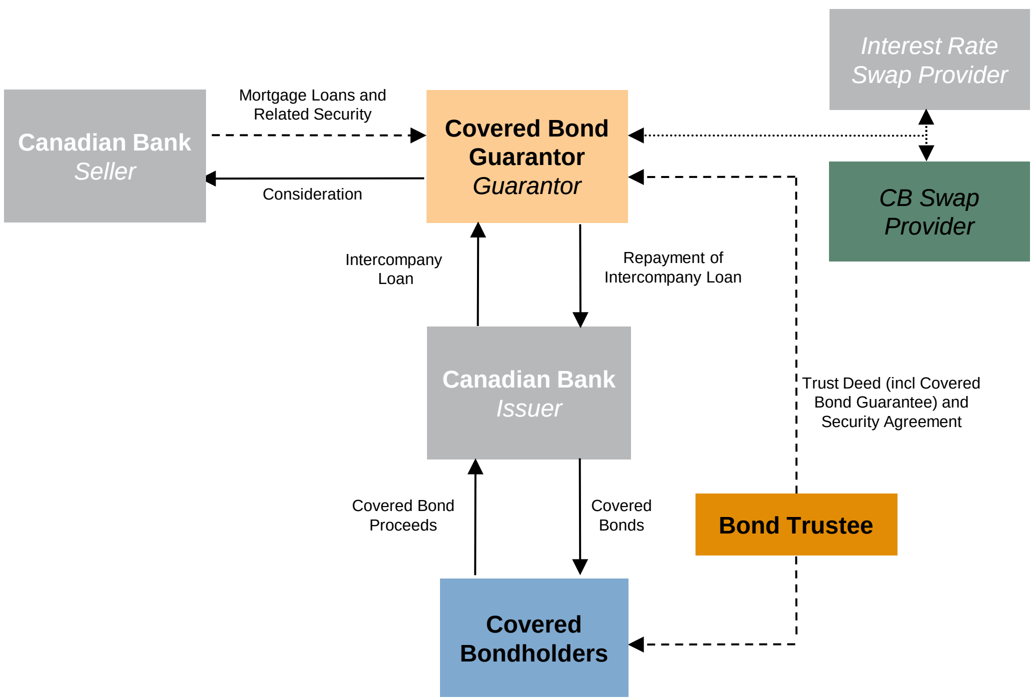


Segregated Issuance Architecture



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 and NBC utilizing the same basic structure.
- 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 guarantee to the covered bond investors.



Covered Bonds in the United States

Where are U.S. banks?

- U.S. banks are not currently participating in the U.S.$ market
  - Currently $150B outstanding all from foreign banks
  - Canadian banks (RBC, BNS and BMO) have filed registration statements with the SEC
  - U.S. banks need a statute to enable them to issue covered bonds

WaMu and BofA

- There has been some historic issuance by U.S. banks
  - Washington Mutual issued a covered bond in Europe in 2006
  - Bank of America followed with a covered bond issuance in 2007
  - 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 any bank would use this structure today
- Washington 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

Foreign Bank Issuances

- Foreign banks issuing into the US market have been relying on their domestic covered bond framework and have been using cover pool assets that are foreign (not in the United States).
- Issuances into the United States have been structured as program issuances (or syndicated takedowns) conducted on an exempt basis; that means that the foreign issuer is relying on exemptions from the U.S. securities laws requiring registration of public offerings of securities.
- As a result, offerings have been targeted at U.S. institutional investors and generally conducted in reliance on Rule 144A.
- On May 18, 2012, Royal Bank of Canada obtained a no-action letter from the SEC that permitted RBC to register its covered bond program on Form F-3.
- On July 30, 2012, RBC obtained SEC approval for a registration statement for its covered bond program (333-181552):
    - On September 19, 2012, RBC issued $2.5 B of 5 year covered bonds under this registration statement.
    - On December 6, 2012, RBC issued $1.5 B of 3 year covered bonds.

Issuance Alternatives

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, 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 other 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.

Possible 1940 Act Considerations

- Depending upon the structure of the issuing entity, there may be Investment Company Act (or "40 Act") issues:
  - 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.
    - A finance subsidiary may be exempt under Rule 3a-5.
    - Another exemption that may be relied upon is available if covered bonds are sold <u>only</u> to qualified purchasers.

144A/SEC USD Covered Bonds

2012 — 2013 Issuance

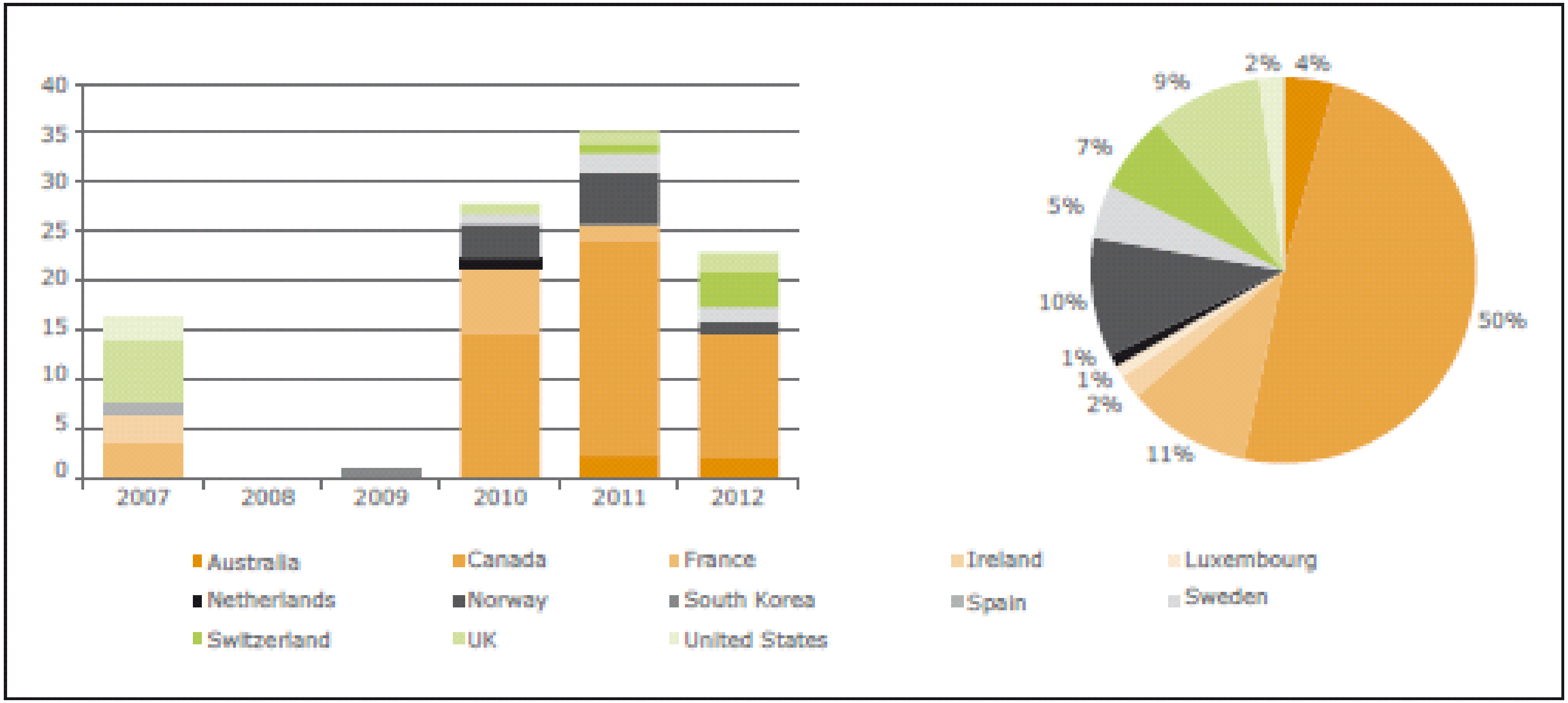
Date	Issuer	Region	Amount ($mm)	Coupon	Maturity	Tenor	New Issue Spread vs. MS
Select USD Covered Bond Transactions (2012 - 2013 YTD)							
19-Jan-12	UBS AG London	Switzerland	1,500	1.875	23-Jan-15	3yr	+135
20-Jan-12	Bank of Nova Scotia	Canada	2,500	1.950	30-Jan-17	5yr	+77
23-Jan-12	Bank of Montreal	Canada	2,000	1.950	30-Jan-17	5yr	+76
06-Feb-12	National Bank of Canada	Canada	600	2.200	19-Oct-16	5yr	+38
28-Feb-12	Caisse centrale Desjardins du Quebec	Canada	1,500	1.600	06-Mar-17	5yr	+51
01-Mar-12	Credit Suisse Guernsey	Switzerland	2,000	1.625	06-Mar-15	3yr	+105
05-Mar-12	Commonwealth Bank of Australia	Australia	2,000	2.250	16-Mar-17	5yr	+115
05-Mar-12	Toronto-Dominion Bank	Canada	3,000	1.500	13-Mar-17	5yr	+45
15-Mar-12	Bank of Nova Scotia	Canada	1,250	1.050	20-Mar-15	3yr	+28
15-Mar-12	Bank of Nova Scotia	Canada	1,500	1.750	20-Mar-17	5yr	+45
15-Mar-12	Bank of Nova Scotia	Canada	250	FRN	13-Mar-17	5yr	+42
16-Mar-12	Swedbank Hypotek AB	Sweden	1,500	2.375	17-Apr-17	5yr	+105
27-Mar-12	UBS AG London	Switzerland	2,000	2.250	30-Mar-17	5yr	+105
29-Mar-12	Sparebanken 1 Boligkreditt	Norway	1,250	2.300	30-Jun-17	5yr	+105
02-May-12	Barclays Bank PLC	United Kingdom	2,000	2.250	10-May-17	5yr	+153
04-May-12	Bank of Nova Scotia	Canada	250	FRN	13-Mar-17	5yr	+42
12-Jun-12	National Bank of Australia	Australia	1,250	2.000	20-Jun-17	5yr	+100
10-Jul-12	Westpac Banking Corp	Australia	500	FRN	17-Jul-15	3yr	+80
10-Jul-12	Westpac Banking Corp	Australia	1,500	1.375	17-Jul-15	3yr	+80
04-Sep-12	Australia & New Zealand Banking Group	Australia	750	FRN	06-Oct-15	3yr	+61
04-Sep-12	Australia & New Zealand Banking Group	Australia	1,500	1.000	06-Oct-15	3yr	+61
12-Sep-12	Royal Bank of Canada	Canada	2,500	1.200	19-Sep-17	5yr	+35
20-Sep-12	National Australia Bank	Australia	250	FRN	27-Sep-17	5yr	+72
20-Sep-12	National Australia Bank	Australia	1,250	2.000	27-Sep-17	5yr	+72
25-Sep-12	Stadshypotek AB	Sweden	1,500	1.875	02-Oct-19	7yr	+72
07-Nov-12	Sparebanken 1 Boligkreditt	Norway	1,000	1.750	15-Nov-19	7yr	+70
08-Nov-12	Credit Mutuel	France	1,000	1.500	16-Nov-17	5yr	+82
27-Nov-12	ING Bank NV	Netherlands	1,500	2.625	05-Dec-22	10yr	+98
29-Nov-12	Royal Bank of Canada	Canada	1,500	0.625	04-Dec-15	3yr	+20
11-Dec-12	Westpac Banking Corp	Australia	2,000	1.250	15-Dec-17	5yr	+50
Total 2012 Issuance $43,100,000							
09-Jan-13	Commonwealth Bank of Australia	Australia	2,000	0.750	15-Jan-16	3yr	+32
28-Feb-13	National Australia Bank	Australia	1,750	1.250	08-Mar-18	5yr	+42
14-Mar-13	DnB Boligkreditt	Norway	2,000	1.450	21-Mar-18	5yr	+48
21-Mar-13	Swedbank Hypotek AB	Sweden	1,000	1.375	28-Mar-18	5yr	+46
21-Mar-13	UBS AG London	Switzerland	1,250	0.750	24-Mar-16	3yr	+30
24-Apr-13	Sparebanken 1 Boligkreditt	Norway	1,000	1.250	02-May-18	5yr	+50
16-May-13	Stadshypotek AB	Sweden	1,250	1.250	23-May-18	5yr	+42
21-May-13	SEB	Sweden	1,500	1.375	29-May-18	5yr	+43
22-May-13	Westpac Banking Corp	Australia	1,250	1.375	30-May-18	5yr	+35
16-Jul-13	Royal Bank of Canada	Canada	1,750	1.125	22-Jul-16	3yr	+35
24-Sep-13	Royal Bank of Canada	Canada	2,000	2.000	01-Oct-18	5yr	+43
29-Oct-13	Nord/LB	Germany	1,000	2.000	05-Feb-19	5yr	+49
18-Nov-13	Westpac Banking Corp	Australia	1,500	1.850	26-Nov-18	5yr	+46
21-Nov-13	National Australia Bank	Australia	1,250	2.000	22-Feb-19	5yr	+47
02-Dec-13	Commonwealth Bank of Australia	Australia	1,500	1.875	11-Dec-18	5yr	+45
Total 2013 Issuance $22,000,000							
Total 2012 - 2013 Issuance $65,100,000,000							

Sources: RBC Capital Markets, as of December 4th 2013

Countries In USD Market

US$-Denominated Benchmark Issuance by Country End-May (US bn)

Outstanding US$-Denominated Benchmark by Country (%)



Source: BofA Merrill Lynch Global Research; [1] Excluding FRNs

Source: BofA Merrill Lynch Global Research

SEC Registered Covered Bonds

- In May 2012, RBC filed the first ever SEC registered covered bond
- The registration statement became effective on July 30, 2012 enabling RBC to issue fully registered covered bonds (rather than 144A)
- This initiative was undertaken following extensive dialogue with US investors with the intention to deliver the greatest breadth of distribution and pricing transparency for the product

SEC Registered Covered Bonds

- RBC obtained a no action letter from the SEC.
  - SEC link http://www.sec.gov/divisions/corpfin/cf-noaction/2012/rbc051812-f3.htm
- RBC filed its registration statement of Form F-3 (333-181552).
  - A shelf registration statement.
    - SEC link http://www.sec.gov/cgi-bin/browse-edgar?filenum=333-181552&action=getcompany
  - There are eligibility requirements for Form F-3, including at least 12 months of SEC reporting history.
  - Form F-9 or Form F-10 issuers generally would be eligible for Form F-3.

SEC Registered Covered Bonds (cont)

- The covered bonds were not deemed to be ABS, although disclosure consistent with Regulation AB was required.
- Disclosure about the cover pool assets is similar to a credit card trust or UK RMBS master trust.
- No loan level disclosure for loans in the cover pool.
- No financial statements required for the Guarantor.

SEC Registration (cont)

- Registration broadened the investor base leading to a deeper, more transparent primary and secondary market for the product
- The registration statement leveraged RBC’s existing 144A global covered bond program and the existing SEC registered unsecured shelf
- BNS and BMO have followed RBC in filing registration statements for covered bonds

Why a No Action Letter

- Required by Canadian/U.K. structure:
  - Separate Guarantor deemed to be issuing a separate security, the guarantee.
  - The guarantee needs to be registered with the SEC.
  - The Guarantor is not an SEC reporting company.
  - Nor is it a wholly-owned subsidiary.
  - So Guarantor does not qualify for a shelf registration statement.
  - No action letter from SEC permits both Bank and Guarantor to register on a shelf registration statement.
- This would not be a requirement for a Pfandbrief-type structure.

Advantages of Registration

- No offering restrictions; no transfer restrictions.
- No investment restrictions; the bonds are not restricted securities.
- Eligible for inclusion in the bond indices, including the Barclays Aggregate Bond Index.
- No requirement for the issuing bank to have a U.S. branch or agency; no capital impact on a U.S. branch or agency.
- No discussion required with U.S. banking regulators.
- No private placement restrictions on communications.
- No limits on repatriation of proceeds.

Advantages of Registration

- Wider investor base
  - Includes State retirement funds
    - ~ 200 investors compared to 50 to 75 in a typical 144A offering
- Attractive pricing
  - 10 – 12 basis points savings compared to a 144A offering
    - RBC $2.5 billion 5 year offering
- Better secondary market
  - Eligible for the major bond indices – e.g., Barclays Aggregate Bond Index
  - TRACE Reporting System – Trade Reporting and Compliance Engine – FINRA
    - Pricing transparency for trades in the secondary market

Benefits of SEC Registration

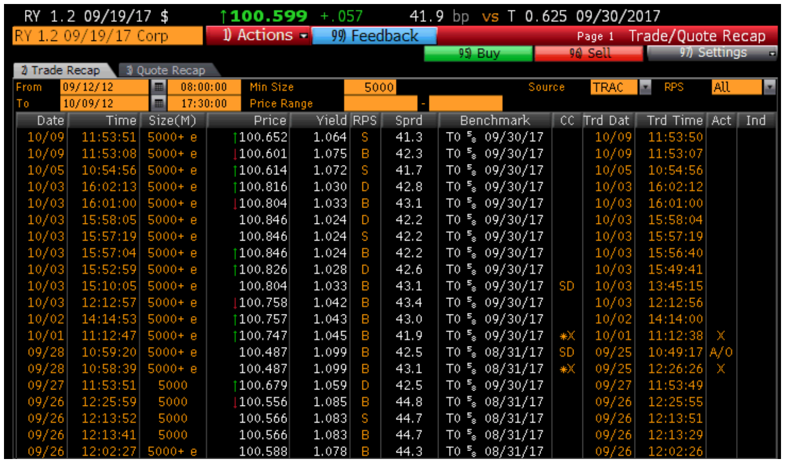
Benefits of SEC Registration

Distribution
- Expands investor base and ensures broadest distribution of USD debt possible
  – Minimum denomination of $1,000 x $1,000

Liquidity
- TRACE eligible
- Index eligible (Barclays Capital Aggregate Bond Index)

Disclosure
- More comprehensive bank level and cover pool level disclosure

Pricing Transparency Matters to Investors



Date	Time	Size(M)	Price	Yield	RPS	Sprd	Benchmark	CC	Trd Dat	Trd Time	Act	Ind
10/09	11:53:51	5000+ e	↑100.652	1.064	S	41.3	T0 5/8 09/30/17		10/09	11:53:50		
10/09	11:53:08	5000+ e	↓100.601	1.075	B	42.3	T0 5/8 09/30/17		10/09	11:53:07		
10/05	10:54:56	5000+ e	↑100.614	1.072	S	41.7	T0 5/8 09/30/17		10/05	10:54:56		
10/03	16:02:13	5000+ e	↑100.816	1.030	D	42.8	T0 5/8 09/30/17		10/03	16:02:12		
10/03	16:01:00	5000+ e	↓100.804	1.033	B	43.1	T0 5/8 09/30/17		10/03	16:01:00		
10/03	15:58:05	5000+ e	100.846	1.024	D	42.2	T0 5/8 09/30/17		10/03	15:58:04		
10/03	15:57:19	5000+ e	100.846	1.024	S	42.2	T0 5/8 09/30/17		10/03	15:57:19		
10/03	15:57:04	5000+ e	↑100.846	1.024	B	42.2	T0 5/8 09/30/17		10/03	15:56:40		
10/03	15:52:59	5000+ e	↑100.826	1.028	D	42.6	T0 5/8 09/30/17		10/03	15:49:41		
10/03	15:10:05	5000+ e	100.804	1.033	B	43.1	T0 5/8 09/30/17	SD	10/03	13:45:15		
10/03	12:12:57	5000+ e	↓100.758	1.042	B	43.4	T0 5/8 09/30/17		10/03	12:12:56		
10/02	14:14:53	5000+ e	↑100.757	1.043	B	43.0	T0 5/8 09/30/17		10/02	14:14:00		
10/01	11:12:47	5000+ e	↑100.747	1.045	B	41.9	T0 5/8 09/30/17	*X	10/01	11:12:38	X	
09/28	10:59:20	5000+ e	100.487	1.099	B	42.5	T0 5/8 08/31/17	SD	09/25	10:49:17	A/O	
09/28	10:58:39	5000+ e	100.487	1.099	B	43.1	T0 5/8 08/31/17	*X	09/25	12:26:26	X	
09/27	11:53:51	5000	↑100.679	1.059	D	42.5	T0 5/8 09/30/17		09/27	11:53:49		
09/26	12:25:59	5000	↓100.556	1.085	B	44.8	T0 5/8 08/31/17		09/26	12:25:55		
09/26	12:13:52	5000	100.566	1.083	S	44.7	T0 5/8 08/31/17		09/26	12:13:51		
09/26	12:13:41	5000	100.566	1.083	B	44.7	T0 5/8 08/31/17		09/26	12:13:29		
09/26	12:02:27	5000+ e	100.588	1.078	B	44.3	T0 5/8 08/31/17		09/26	12:02:26		

RBC's Covered Bond Index Listings

- **Barclays Global Aggregate Index**
  – Sub-index: Barclays Global Aggregate Securitized Index
  – Sub-index: Barclays Covered Bonds Global Index
  – Sub-index: Barclays Covered Bonds USD Index
- **Barclays US Aggregate Index**
  – Sub-index: Barclays US Securitized Index
  – Sub-index: Barclays US Covered Bonds Index

SEC registered covered bond are both TRACE eligible and Index eligible, providing investors with enhanced price transparency

Advantages of Registration - TRACE

RY 1.2 09/19/17 $ ↑99.850 +.017 36.9 bp vs T 0.875 01/31/2018

RY 1.2 09/19/17 Corp | 1) Actions | 99) Feedback | Page 1 Trade/Quote Recap

95) Buy | 96) Sell | 97) Settings

2) Trade Recap | 3) Quote Recap

From 02/13/13 08:00:00 Min Size Source TRAC RPS All

To 02/20/13 17:30:00 Price Range -

Date	Time	Size(M)	Price	Yield	RPS	Sprd	Benchmark	CC	Trd Dat	Trd Time	Act	Ind
02/20	12:47:22	5000+ e	↑99.850	1.234	S	36.9	T0 7/8 01/31/18		02/20	12:47:21		
02/20	10:50:17	480	↑99.766	1.253	S	37.4	T0 7/8 01/31/18	*C	02/20	10:50:06	N/W	
02/20	10:50:17	480	↑99.766	1.253	S	37.4	T0 7/8 01/31/18	*X	02/20	10:50:06	X	
02/20	10:23:55	5000	↓99.762	1.254	B	37.1	T0 7/8 01/31/18		02/20	10:23:54		
02/20	10:18:13	5000+ e	↓99.774	1.251	D	37.2	T0 7/8 01/31/18		02/20	10:18:11		
02/20	10:08:31	2000	↑99.800	1.245	S	36.6	T0 7/8 01/31/18		02/20	10:07:27		
02/20	10:07:37	10	↑99.731	1.261	B	38.2	T0 7/8 01/31/18		02/20	10:02:37		
02/20	09:21:44	10	99.642	1.281	B	38.9	T0 7/8 01/31/18		02/20	09:21:18		
02/20	09:21:43	10	↓99.642	1.281	S	38.9	T0 7/8 01/31/18		02/20	09:21:18		
02/20	08:59:44	3000	↓99.803	1.245	S	35.3	T0 7/8 01/31/18		02/20	08:54:44		
02/19	17:20:11		99.833	1.238				OC	02/19	17:20:11		
02/19	12:11:42	5000	↑99.833	1.238	B	37.6	T0 7/8 01/31/18		02/19	12:11:41		
02/19	11:05:47	61	↓99.777	1.250	B	38.7	T0 7/8 01/31/18		02/19	11:05:44		
02/19	10:19:12	65	99.782	1.249	S	38.5	T0 7/8 01/31/18		02/19	10:19:12		
02/19	10:18:51	65	↓99.782	1.249	B	38.5	T0 7/8 01/31/18		02/19	10:16:42		
02/19	09:16:18	5000+ e	↓99.806	1.244	S	38.6	T0 7/8 01/31/18		02/19	09:12:48		
02/19	09:15:58	5000+ e	99.827	1.239	S	38.1	T0 7/8 01/31/18		02/19	09:14:08		
02/19	09:11:44	5000+ e	99.827	1.239	D	38.1	T0 7/8 01/31/18		02/19	09:11:26		
02/19	09:09:52	5000+ e	↑99.827	1.239	D	37.9	T0 7/8 01/31/18		02/19	09:09:06		
02/19	09:04:23	3000	↓99.821	1.240	S	38.2	T0 7/8 01/31/18		02/19	09:04:20		

Zoom 100%

Disclosure

- Bank disclosure
  - Typical bank disclosure for senior debt program, plus
  - Mortgage origination program.
  - Mortgage servicing program.
    - Statistical disclosure of servicing portfolio.
- Covered bonds
  - Summary of fees and expenses of Guarantor.
  - Characteristics of the Loans.
  - Statistical disclosure of cover pool.
  - Static pool disclosure of cover pool (by vintage year of origination).
  - SEC filing of monthly investor report, including delinquency information.
  - Rule 193 disclosure of cover pool audit.

Ongoing Reporting Requirements

- The bank would file annual and interim reports and current reports.
  - Form 40-F, Form 6-K and Form 8-K.
- The guarantor would file annual and interim reports.
  - Annual reports on Form 10-K .
  - Monthly reports on Form 10-D related to distributions of proceeds from the cover pool.
  - Current reports on Form 8-K.

Comparison of Alternatives

	SEC Registered	Section 3(a)(2)	Rule 144A
Required issuer:	No specific issuer or guarantor is required.	Need a US state or federal licensed bank as issuer or as guarantor.	No specific issuer or guarantor is required.
Exemption from the Securities Act:	No. Bonds are publicly offered and registered with the SEC.	Section 3(a)(2).	Section 4(a)(2) / Rule 144A.
No Action Letter:	Required.	Not required.	Not required.
FINRA Filing Requirement:	Subject to filing requirement and payment of filing fee.	Subject to filing requirement and payment of filing fee.	Not subject to FINRA filing.
Blue Sky:	Generally exempt from blue sky regulation.	Generally exempt from blue sky regulation.	Generally exempt from blue sky regulation.
Listing on an exchange:	May be listed if desired.	May be listed if issued in compliance with Part 16.6.	Not in the U.S., but may be listed on UKLA or other European exchange.
“Restricted”	No.	No.	Yes.

Comparison of Alternatives

	SEC Registered	Section 3(a)(2)	Rule 144A
Required governmental approvals:	SEC filing and registration fee.	Banks licensed by the OCC are subject to the Part 16.6 limitations, unless an exemption is available.	Generally none.
Permitted Offerees:	All investors.	All investors. However, banks licensed by the OCC are subject to the Part 16.6 limitations, unless an exemption is available. Generally, sales to “accredited investors.”	Only to QIBs. No retail.
Resale restrictions:	None	None	Only to QIBs. No retail.
Investment Restrictions:	None	Generally none	Restricted securities; a limited bucket for some investors.
Minimum denominations:	All denominations.	All denominations. However, banks licensed by the OCC are subject to a minimum denomination requirement.	Typically $100,000 or more
Role of Manager/ Underwriter:	Either agented or principal basis.	Either agented or principal basis.	Must purchase as principal.

Comparison of Alternatives

	SEC Registered	Section 3(a)(2)	Rule 144A
40 Act:	Banks not considered investment companies; consideration must be given to 40 Act treatment of a guarantor.	Banks not considered investment companies; consideration must be given to 40 Act treatment of a guarantor.	Non-bank issuer should consider whether there is a 40 Act issue; consideration must be given to 40 Act treatment of a guarantor.
Settlement:	Through DTC, Euroclear/Clearstream	Through DTC, Euroclear/Clearstream.	Through DTC, Euroclear/Clearstream
Repatriation of Proceeds:	No restrictions.	May be restrictions.	No restrictions
Eligible for Bond Index:	Yes	Yes	No.
Orphan Bonds:	No	Not fungible with 144A bonds or later SEC registered bonds	Not fungible with 3(a)(2) bonds or SEC registered bonds
Prospectus Compatibility:	May be different from UKLA prospectus	Similar to UKLA prospectus, but with a wrapper for branch/agency guarantee	Similar to UKLA prospectus, but with tax and offering and transfer restriction disclosure

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

The Development of US Domestic Covered Bonds in the USD Market

- Covered Bond legislation was introduced in the House in 2011 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 Novembe 2011 as S. 1835. No hearings were held.
- There were no developments in Covered Bond legislation in 2012
- In 2013, the House included Covered Bond legislation in H.R. 2767, which was passed by the Financial Services Committee by a strict party line vote
- It is expected that legislation resolution of the GSEs will occur in 2014 and it is expected that the House will include Covered Bond legislation in the GSE Reform bill in conference committee.

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

2013
US covered bond legislation included in H.R. 2767 GSE Reform bill

2014
Anticipated completion of US covered bond legislation

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.

House Legislation

- As noted above, covered bond provisions have been included in the current House bill for GSE Reform, H.R. 2767
- As draft, the legislation contemplated on financial institutions as eligible issuers
- Eligible assets include
  - Residential mortgage loans
  - Commercial mortgage loans
  - Loans to or securities issued by states or municipalities
  - Student loans
  - Consumer revolving credit
  - Small business loans
  - Any other asset designated by the Secretary of the Treasury

Senate Legislation

- Senators Corker (R-TN) and Warner (D-VA) released a draft of a bill to wind down the GSEs and create a new federal insurance program for housing S. 1217
  - *Secondary Mortgage Market Reform and Taxpayer Protection Act of 2013*
  - The bill would create the Federal Mortgage Insurance Corporation and the operations and personnel of FHFA would be transferred into the new entity
    - The new entity would provide insurance to cover losses <u>after</u> a first loss position held by private sector investors had been wiped out
    - Establish and maintain a Mortgage Insurance Fund
    - An “eligible mortgage” must satisfy the CFPB definition of Qualified Mortgage
      - LTV must not exceed 80% unless the private mortgage insurance covers the amount in excess of 80%
      - Minimum down payment of 5%
  - HUD to establish a “Market Access Fund”
    - The fund would be used to provide incentives for multi-family housing

Senate (cont)

- The bill provides for the final dissolution of FNMA and FHLMC not later than five years after passage of the bill
  - The multi-family operations of the GSEs would be transferred to the Federal Mortgage Insurance Corporation
- Proceeds from the winddown of FNMA and FHLMC would be applied first to pay outstanding debt, second to preferred holders and lastly to common stock holders

Statute (cont)

Prospects for S.1217

- S.1217 was developed on a strongly bi-partisan basis
- Hearings related to the bill have been held in the Senate throughout the fall
- There appears to be a bi-partisan desire to resolve the GSEs in 2014
- President Obama has spoken in favor of resolving the GSEs
- S.1217 appears to be the vehicle for achieving resolution as opposed to the House bill H.R.2767
- But it is likely that in resolving the differences between the two bills, the covered bond legislation in the House bill would be added to S.1217

Absence of a Statute

- Is a statute necessary?
  - If a statute is not adopted what does it mean?
- While a statute is preferable, a statute is not essential, particularly for non-bank issuers
- The structure utilized by Canadian and U.K. covered bond issuers is easily adaptable, particularly for non-bank issuers
- For a bank issuer, discussions with the FDIC would be necessary
- Let’s review that structure:

Structured Covered Bond Architecture

- This is the Canadian covered bond issuing structure
- 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 guarantee to the covered bond investors.