

# Foreign Bank Financings in the United States

**May 12, 2014**

**Presented by:  
Bradley Berman  
Jerry Marlatt**

# Topics for Presentation

---

- Rule 144A offerings
- Section 3(a)(2) offerings
- Covered bond offerings
- “Yankee” CDs

# Foreign Bank Debt Financing Activities

---

- Types of bank debt issuances
  - Senior unsecured debt
  - Senior secured debt (including covered bonds)
  - Subordinated debt
  - Structured debt (e.g., equity-linked and commodity-linked notes)
  - Deposit liabilities
- Issuing entities
  - Home offices
  - US bank subsidiaries
  - US branches
  - Other affiliated entities (e.g., financing SPVs)

# Financial Products Offered by Foreign Banks

---

- In recent months, non-U.S. banks have been active issuing:
  - Senior debt
  - Structured products
  - Covered bonds
    - 144A US-Dollar denominated
    - SEC-registered in reliance on SEC no-action letter guidance
  - Contingent capital products
    - Debt securities that convert to equity on breach of a regulatory capital trigger
    - Debt securities the principal of which gets written down on breach of a regulatory capital trigger

# Rule 144A Offering Alternative

# Why Are Rule 144A Offerings Attractive to Non-U.S. Banks?

---

- Rule 144A provides a clear safe harbor for offerings to institutional investors.
- Does not require extensive ongoing registration or disclosure requirements.
- “Benchmark” sized issuances may have liquidity in the Rule 144A market.

# Rule 144A Overview

---

- Rule 144A provides a non-exclusive safe harbor from the registration requirements of Section 5 of the Securities 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 Securities 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 of the same class as securities 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 Securities Act in connection with the resale of restricted securities (such as Reg S or Rule 144).

# Types of 144A Offerings

---

- 144A offering for an issuer that is not registered in the U.S. – usually a standalone
- 144A continuous offering program
  - Used for repeat offerings, often by financial institution and insurance company issuers, to institutional investors.
  - Often used for structured products and for covered bonds sold to QIBs.



# How are 144A Offerings Structured?

---

- The issuer initially sells restricted securities to investment bank(s) (i.e., the “Initial Purchasers”) in a Section 4(a)(2) private placement.
- The investment bank reoffers and immediately resells the securities to QIBs under Rule 144A.
- Often combined with a Regulation S offering.

# Rule 144A Offering Memorandum

---

- May contain similar information to a full “S-1/F-1” prospectus, or may be shorter.
- If the issuer is a public company, it may incorporate by reference the issuer’s filings from its home country.
- Scope of disclosure (whether included or incorporated by reference) may be comparable to a public offering, as the initial purchasers expect “10b-5” representations from the issuer, and legal opinions from counsel.
- Due diligence by counsel will often be similar to that performed in a public offering.
- For a non-U.S. offering, with a Rule 144A “tranche,” there may be a U.S. “Rule 144A wrapper” attached to the non-U.S. offering document.

# Additional Documentation for a Rule 144A Offering

---

- A purchase agreement between the issuer and the initial purchasers/underwriter(s)
  - Similar to an underwriting agreement in terms of representations, covenants, closing conditions and indemnities.
- Legal opinions
- 10b-5 negative assurance letters
- Comfort letters

# How Are Rule 144A Offerings Conducted?

---

- Often similar to a registered offering.
- “Road show” with a preliminary offering memorandum.
- Confirmation of orders with the final offering memorandum.
  - The offering memorandum may be delivered electronically.
- The purchase agreement is executed at pricing, together with the delivery of a comfort letter.
- Closing on a “T+3” basis, or as otherwise agreed with the investors.
- Publicity: historically, generally limited to a Rule 135c compliant press release – limited information about the offering. However, the new “general solicitation” rules enable broader announcements.

# Conditions for Rule 144A Offering

---

- Reoffers or resales only to a QIB, or to an offeree or purchaser that the reseller reasonably believes is a QIB.
- Reseller must take steps to ensure that the buyer is aware that the reseller may rely on Rule 144A in connection with such resale.
- The securities reoffered or resold (a) when issued were not of the same class as securities listed on a U.S. national securities exchange or quoted on a U.S. automated inter-dealer quotation system and (b) are not securities of an open-end investment company, UIT, etc.
- For an issuer that is not an Exchange Act reporting company or exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, the holder and a prospective buyer designated by the holder must have the right to obtain from the issuer, upon the holder's request, certain reasonably current information.

# What Is a QIB?

---

- An entity that is an “accredited investor” acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests at least \$100 million in securities of unaffiliated issuers (\$10 million for a broker-dealer).
- Banks and savings and loan associations with a net worth of at least \$25 million.
- A broker-dealer acting as a riskless principal for an identified QIB.
  - To qualify, the QIB must commit to the broker dealer that the QIB will simultaneously purchase the securities from the broker-dealer.
- A QIB can be formed solely for the purpose of conducting a Rule 144A transaction.

# How Can a Reseller Ascertain a Person Is a QIB?

---

A reseller may rely on the following (as long as the information is no more than 16 months old):

- the purchaser's most recent publicly available annual financial statements;
- information filed with the SEC or another government agency or self-regulatory organization;
- information in a recognized securities manual, such as Moody's or S&P;
- certification by the purchaser's chief financial or other executive officer specifying the amount of securities owned and invested as of the end of the purchaser's most recent fiscal year; and
- a QIB questionnaire.

The SEC acknowledges that the reseller may use other information to establish a reasonable belief of eligibility.

# **How Will Reseller Make the Buyer Aware That Security Is a Rule 144A Security?**

- By legending the security
- By including an appropriate statement in the offering document
- By obtaining an agreement that the purchaser understands that the securities must be reoffered and resold pursuant to an exemption or registration under the Securities Act
- By obtaining a restricted CUSIP number



# Current Information Requirements

---

- For securities of a non-public company, the holder and a prospective purchaser designated by the holder have the right to obtain from the issuer, upon request, the following information:
  - A brief statement of the nature of the business of the issuer, and its products and services; and
  - The issuer's most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation.
  - The financial statements should be audited, to the extent reasonably available.
- The information must be “reasonably current.”

## Rule 159: “Time of Sale Information”

---

- Although Rule 159 is not expressly applicable to Rule 144A or Section 3(a)(2) offerings, many investment banks apply the same treatment, in order to help reduce the risk of liability.
- Use of term sheets and offering memoranda supplements, to ensure that all material information is conveyed to investors at the time of pricing.
- Counsel is typically expected to opine as to the “disclosure package,” as in the case of a public offering.

# Section 3(a)(2) Offerings

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

---

- Section 3(a)(2) of the Securities Act exempts from registration under the Securities 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 do not qualify:
  - Bank holding companies
  - Finance companies
  - Investment banks
  - Foreign banks
- Regulated U.S. branches and agencies of foreign banks may qualify

# Guarantees

---

- Another basis for qualification as a bank: securities *guaranteed* by a bank.
  - Not limited to a guaranty in a legal sense, but also includes arrangements in which the bank agrees to ensure the payment of a security.
  - The guaranty or assurance of payment, however has to cover the entire obligation; it cannot be a partial guarantee or promise of payment.
  - Again, guarantees by foreign banks (other than those of an eligible U.S. branch or agency) would not qualify for this exception.
  - The guarantee is a legal requirement to qualify for the Section 3(a)(2) exemption; investors will not be looking to the US branch guarantor for payment/credit. Investors will look to the home office.
  - Finance companies can issue under Section 3(a)(2), if the securities are guaranteed by a bank.

# Non-U.S. Banks/U.S. Offices

---

- U.S. branches/agencies of foreign banks are conditionally entitled to rely on the Section 3(a)(2) exemption.
- 1986: the SEC takes the position that a foreign branch/agency will be deemed to be a “national bank” or a “banking institution organized under the laws of any state” if “the nature and extent of federal and/or state regulation and supervision of that particular branch or agency is substantially equivalent to that applicable to federal or state chartered domestic banks doing business in the same jurisdiction.”
- As a result, U.S. branches/agencies of foreign banks are frequent issuers or guarantors of debt securities in the U.S. Most issuances or guarantees occur through the N.Y. branches of these banks.

# Non-U.S. Banks/U.S. Offices (cont'd)

---

## Examples of Issuing Entities:

- U.S. branch as direct issuer: ANZ, CBA, CS, NAB and UBS
- U.S. branch as guarantor, headquarters as issuer: BNP, CASA, Rabo, SocGen, Svenska
- U.S. branch as guarantor, SPV/Cayman branch as issuer: BNP, Fortis
  - More banks are using a guarantee structure to allow greater flexibility for use of proceeds

## Which Regulator?

- Most U.S. branches have elected the N.Y. State Banking Commissioner as their primary regulator with their secondary regulator the Federal Reserve.
- Some U.S. branches have opted for the Office of the Comptroller of the Currency as their primary regulator.



# OCC Registration/Disclosure

---

- National banks or federally licensed U.S. branches/agencies of foreign banks regulated by the Office of the Comptroller of the Currency (the “OCC”) are subject to OCC securities offering (Part 16) regulations.
- Part 16 of OCC regulations provides that these banks or banking offices may not offer and sell their securities until a registration statement has been filed and declared effective with the OCC, unless an exemption applies.
- An OCC registration statement is generally comparable in scope and detail to an SEC registration statement; as a result, most national bank issuers prefer to rely upon an exemption from the OCC’s registration requirements. Section 16.5 provides a list of exemptions, which includes:
  - Regulation D offerings
  - Rule 144A offerings
  - General solicitation would be allowed for Regulation D offerings and Rule 144A offerings; the Rule 506 “bad actor” disqualifications would also apply.

# Part 16.6 of the OCC Regulations

---

- 12 CFR 16.6 provides a separate partial exemption for offerings of “non-convertible debt” to accredited investors in denominations of \$250,000 or more.
- Federal branches/agencies may rely on this exemption by furnishing to the OCC parent bank information which is required under Exchange Act Rule 12g3-2(b), and to purchasers the information required under Securities Act Rule 144A(d)(4)(i).
- The securities are “investment grade” – the new definition focuses on the probability of repayment, rather than an external investment-grade rating (Dodd-Frank Act requirement).
- The offering document and any amendments are filed with the OCC no later than the fifth business day after they are first used.

# Denominations

---

- The 3(a)(2) exemption does not require specific minimum denominations in order to obtain the exemption.
- However, for a variety of reasons, denominations may at times be significantly higher than in retail transactions, including:
  - Offerings targeted to institutional investors.
  - Complex securities.
  - Relationship to 16.6's requirement of \$250,000 minimum denominations.

# Deposits Versus Other Liabilities

---

- Foreign banks may elect to issue debt instruments in the form of deposit liabilities as opposed to “pure” debt:
  - Yankee CDs (US\$-denominated deposit liabilities of a foreign bank or its US branch).
  - Other types of deposits (e.g., structured deposits).
- What are the legal differences between deposit liabilities and other debt issuances?
  - In the case of foreign banks, less than meets the eye.
  - Foreign banking organization (“FBO”) deposit liabilities are not insured and generally are issued in large denominations (minimum \$100,000 and usually higher).
  - For capital equivalency/asset segregation purposes, deposits and non-deposit liabilities generally are treated in the same manner.

# Certificates of Deposit

---

- FDIC insured branches may issue CDs that benefit from FDIC insurance.
- “Yankee CDs” - typically do not have the benefit of FDIC insurance, but designed to have the preferences for deposits that apply under applicable banking laws.
  - Are they securities? Answer depends upon terms of instrument and marketing.
  - However, even if they are securities, an exemption from SEC registration (and OCC registration) can typically be found.
  - Typically offered in large denominations, in transactions that are privately negotiated with sophisticated investors.
  - Generally, minimal documentation.

# FINRA Requirements

---

- Even though securities offerings under Section 3(a)(2) are exempt from registration under the Securities Act, public securities offerings conducted by banks must be filed with the Financial Industry Regulatory Authority (“FINRA”) for review under Rule 5110(b)(9), unless an exemption is available.
- Exemption: the issuer has outstanding investment grade rated unsecured non-convertible debt with a term of issue of at least four years, or the non-convertible debt securities are so rated.

# FINRA Requirements (cont'd)

---

- If an affiliated dealer is an agent for the offering, there is “prominent disclosure” in the offering document with respect to the conflict of interest caused by that affiliation and the bank notes are rated investment grade or in the same series that have equal rights and obligations as investment grade rated securities, then no filing will be required.
- Transactions under Section 3(a)(2) must also be reported through FINRA’s Trade Reporting and Compliance Engine (“TRACE”). TRACE eligibility provides greater transparency for investors. Currently, Rule 144A securities are not TRACE reported, but rules have been approved for them to be so reported, effective June 30, 2014.

# Blue Sky Regulation

---

- Securities issued under Section 3(a)(2) are considered “covered securities” under Section 18 of the Securities Act.
- However, because bank notes are not listed on a national securities exchange, states may require a notice filing and a fee in connection with an offering of bank notes.
- Generally, blue sky filings are not needed in any state in which the securities are offered.
- State blue sky laws should be examined to ensure that either no notice filing or fee is required, or the state’s existing exemption for securities issued by banks does not require a filing.
- A state may not view an agency of a foreign bank, whose securities are eligible for the Section 3(a)(2) exemption, as within the state’s exemption for securities issued by banks.
- Rule 144A offerings of bank notes will fall within a state’s institutional purchaser exemption.



## Section 3(a)(2) Offering Documentation

---

- The offering documentation for bank notes is similar to that of a registered offering.
- Base offering document, which may be an “offering memorandum” or an “offering circular” (instead of a “prospectus”).
- For foreign issuers, IFRS financials or “home country” GAAP financials are acceptable.

# Section 3(a)(2) Offering Documentation (cont'd)

---

- Annual audited and at least semi-annual unaudited financial statements; and
- Consider including Guide 3 statistical disclosures.
- The base document is supplemented for a particular offering by one or more “pricing supplements” and/or “product supplements.”
- These offering documents may be supplemented by additional offering materials, including term sheets and brochures.

# Comparison of Section 3(a)(2) to Rule 144A

	Section 3(a)(2)	Rule 144A
<b>Required issuer:</b>	Need a US state or federal licensed bank as issuer or as guarantor	No specific issuer or guarantor is required
<b>Exemption from the Securities Act:</b>	Section 3(a)(2)	Section 4(a)(2) / Rule 144A
<b>FINRA Filing Requirement (Corporate Financing Rule)</b>	Subject to filing requirement and payment of filing fee (but an investment grade rating exemption is available)	Not subject to FINRA filing
<b>Blue Sky:</b>	Generally exempt from blue sky regulation	Generally exempt from blue sky regulation
<b>Listing on a non-U.S. exchange:</b>	May be listed if issued in compliance with Part 16.6	No
<b>“Restricted”</b>	No; considered “public” and therefore eligible for bond indices, TRACE reporting	Yes, but subject to TRACE reporting

# Comparison of Section 3(a)(2) to Rule 144A (cont'd)

	Section 3(a)(2)	Rule 144A
<b>Required governmental approvals:</b>	Banks licensed by the OCC are subject to the Part 16.6 limitations, unless an exemption is available.	Generally none.
<b>Permitted Offerees:</b>	All investors, which means that there is a broader market. 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.
<b>Minimum denominations:</b>	All denominations. However, banks licensed by the OCC are subject to minimum denomination requirement.	No minimum denominations requirement.
<b>Role of Manager/ Underwriter:</b>	Either agented or principal basis.	Must purchase as principal.
<b>1940 Act:</b>	“Banks” not considered investment companies. Foreign banks will want to review 1940 Act guidance.	Non-bank issuer should consider whether there is a 1940 Act issue.
<b>Settlement:</b>	Through DTC, Euroclear/Clearstream.	Through DTC, Euroclear/Clearstream

# 1940 Act Issues

---

Investment companies are subject to registration under the Investment Company Act of 1940, unless an exemption is available.

An investment company is defined broadly as an entity that holds itself out as being engaged primarily, or proposing to engage, in “investing, reinvesting or trading in securities” and also includes entities engaged, or that propose to engage, in the business of investing, reinvesting, owning, holding or trading in securities if securities represent 40% or more of the value of its total assets (excluding cash and government securities).

- As a result, issuers that are banks or specialized finance companies may inadvertently fall within the definition of an “investment company.”

# 1940 Act Issues – Exemptions

---

## Exemptions:

- U.S. banks are exempted under Section 3(c)(3) of the 1940 Act.
- Foreign banks are exempted under Rule 3a-6 under the 1940 Act, subject to certain conditions.
- U.S. branches or agencies of foreign banks are exempted under an interpretive release (1940 Act Release No. 17681 (Aug. 17, 1990)).
- Finance subsidiaries of U.S. or foreign banks are exempted under Rule 3a-5, subject to certain conditions.

Rule 3a-6 defines a “foreign bank” as a banking institution incorporated or organized under the laws of a country other than the United States, or a political subdivision of a country other than the United States, that is:

- Regulated as such by that country's or subdivision's government or any agency thereof;
- Engaged substantially in commercial banking activity; and
- Not operated for the purpose of evading the provisions of the Act.

## Opinion Issues – Section 3(a)(2) and U.S. Branches of Foreign Banks

---

In the SEC's 1986 release confirming that securities issued by a U.S. branch or agency of a foreign bank are within the Section 3(a)(2) exemption, reference was made to a series of previous no-action letters confirming that debt securities sold in minimum denominations ranging from \$25,000 to \$100,000 or sold only to certain types of sophisticated investors were exempt under Section 3(a)(2).

The release also stated that the SEC would no longer express any view, or issue any no-action letters, regarding whether debt securities issued or guaranteed by a U.S. branch or agency of a foreign bank must satisfy any minimum denomination requirement, be sold to any type of investor or be principal protected, nor does the release require that such debt securities be subject to any of those limitations.

Consequently, in opining on the availability of the Section 3(a)(2) exemption for notes issued or guaranteed by a U.S. branch or agency of a foreign bank, many firms will issue an opinion stating that the notes “should be exempt,” rather than the notes “are exempt.”

# Securities Liability – Rule 144A and Section 3(a)(2)

---

- Neither Rule 144A offerings or securities offerings of, or guaranteed by, a bank under Section 3(a)(2) are subject to the civil liability provisions under Section 11 and Section 12(a)(2) of the Securities Act.
- Rule 144A offerings and offerings under Section 3(a)(2) are subject to Section 10(b) of the Exchange Act and the anti-fraud provisions of Rule 10b-5 of the Exchange Act.
- Impact on offering documents, and use of offering circulars to convey material information and risk factors.



# Liability Under the Exchange Act

---

- Rule 10b-5 applies to registered and exempt offerings.
- Rule 10b-5 of the Exchange Act prohibits:
  - the use of any device, scheme, or artifice to defraud;
  - the making of any untrue statement of a material fact or the omission of a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; or
  - the engaging in any act, practice, or course of business that would operate to deceive any person in connection with the purchase or sale of any securities.
- To bring a successful cause of action under Rule 10b-5, the plaintiff must prove:
  - that there was a misrepresentation or failure to disclose a material fact,
  - that was made in connection with plaintiffs' purchase or sale of a security,
  - that defendants acted with "scienter," or the intent or knowledge of the violation,
  - that plaintiffs "relied" on defendants' misrepresentation or omission, and
  - that such misrepresentation or omission caused plaintiffs' damages.

# Covered Bond Offerings

# What are Covered Bonds?

---

- 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

# Covered Bond Investors

---

## Covered Bond Characteristics

- Covered bond investors buy sovereign and agency debt
- Some of these same investors buy FNMA, FHLMC, GNMA debt
- 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 banks, central banks, funds and insurance companies
- A €3 trillion market in Europe
- The US investor base is opening up; foreign banks have issued about \$150 billion in covered bonds in the US since 2010; however in 2014 there have been no offerings

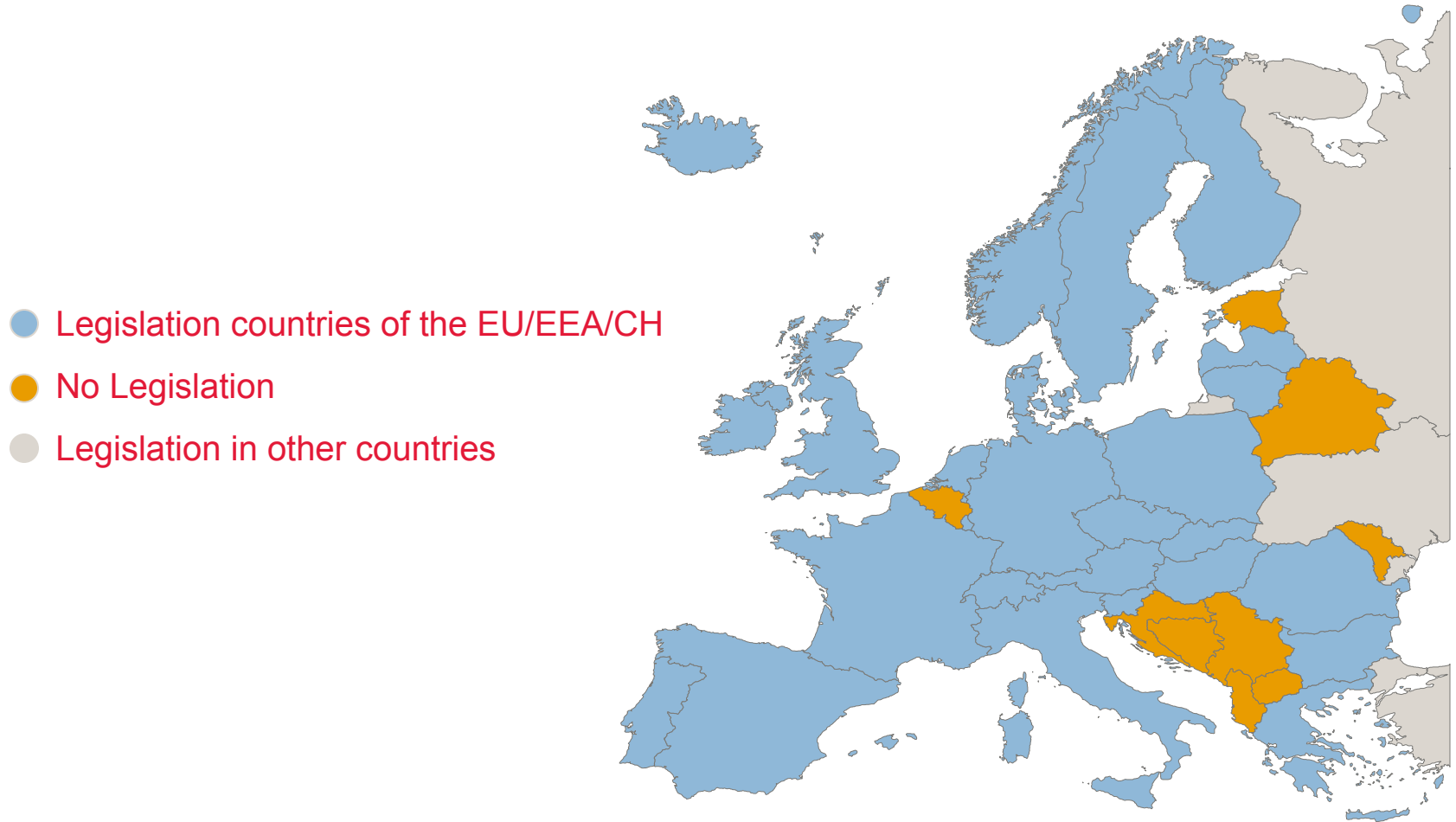
# Benefits to Investors

---

## Attributes of Covered Bonds

- High credit quality – most bonds are triple-A rated.
- In Europe, favorable capital treatment for bank investors.
- 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.’

# European Jurisdictions with Legislation

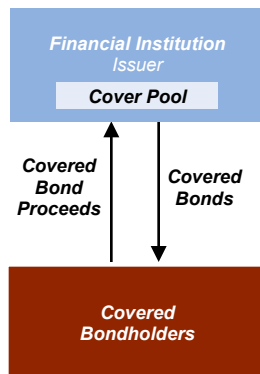


# Covered Bond Architectures

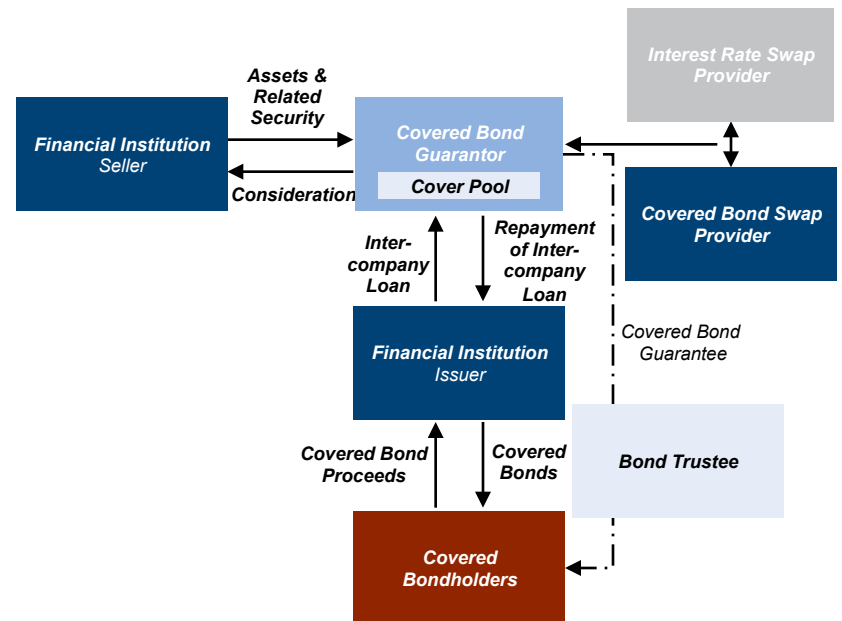
## Legislatively Enabled Covered Bonds

- 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 employing a segregated issuance architecture.
  - Covered bond legislation be it with 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

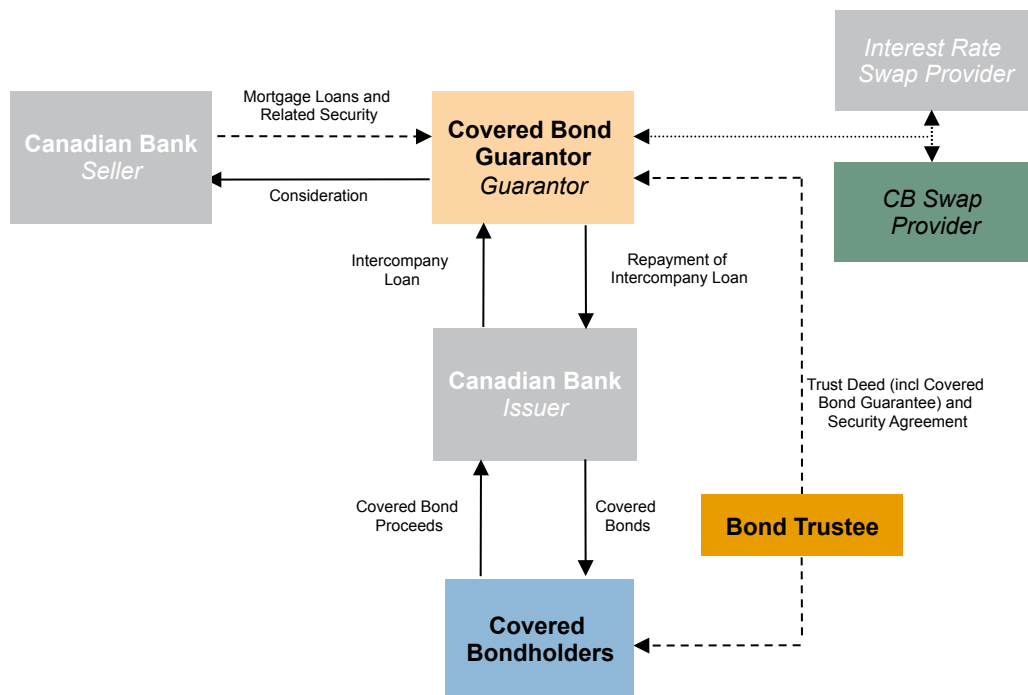






# Canadian Covered Bond Architecture

- 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.
- Given the legal similarities between Canada and the UK, 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.



# How are Foreign Banks Structuring their Issuances?

# 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.
- As indicated above, SEC registration statements have been filed by RBC, BMO and BNS.

# 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).
- SEC registered offering.

# Considerations Relating to a Rule 144A Offering

---

The securities that are sold will be “restricted securities” so that the securities will remain in the hands of QIBs; this means that there will likely be a limited secondary market for the covered bonds.

- Because the securities are “restricted”, the covered bonds will not be eligible for purchase by all funds (certain fund buyers may be subject to a cap on the percentage of restricted securities that they can purchase).
- Also, because the securities are restricted, they cannot be included in the major bond indices, like the Barclays Aggregate Bond Index.

# Possible '40 Act Considerations

---

- As indicated above, a foreign bank issuing covered bonds can usually rely on Rule 3a-6 for an exemption under the Investment Company Act.
- In a two-tier structure, however, the non-bank entity holding the cover pool also needs an exemption and cannot use Rule 3a-6.
- Other possibilities are Section 3(c)(5)(C), Rule 3a-7 and Section 3(c)(7).
- Section 3(c)(7) however will raise issues under the Volcker Rule.
  - Examine the rights of a covered bond holder to determine if the covered bond represents an “ownership interest” in a “covered fund.”

# Considerations Relating to a 3(a)(2) Offering

---

- For a bank issuer of covered bonds, the considerations are the same as discussed previously.
  - Issuance directly through the branch, or
  - Issuance from the home jurisdiction guaranteed by the branch
    - The choice will be determined by the covered bond laws of the home jurisdiction and the regulatory considerations at the branch
  - Additionally, cover pool assets should be located outside the United States
    - If located within the United States there will be additional considerations
- For a non-bank issuer of covered bonds, or guarantees in the case of UK-type structures, a 3(a)(2) offering can be used if there is a US branch that can guarantee the covered bonds and the guarantee in the case of the UK-type structures.

# Benefits of 3(a)(2)

---

- Depending on applicable requirements, by relying on 3(a)(2), an entity can reach a broader array of investors
- Resales will not be limited to QIBs
- Section 3(a)(2) securities are generally not subject to blue sky (state securities law) requirements
- 3(a)(2) securities are not considered “restricted securities” which means that:
  - funds would not count 3(a)(2) covered bonds for their restricted basket
  - Bloomberg and other quotation systems would not identify the securities as restricted securities
  - 3(a)(2) securities may be included in the major bond indices
  - 3(a)(2) securities will be reported in TRACE



# Bank Regulatory and Other Considerations

---

- The process will entail careful consideration of a number of regulatory matters that will affect structuring, including, for example:
  - Where the cover pool is booked
  - Capital adequacy questions
  - Repatriation issues

# SEC Registration

# 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.

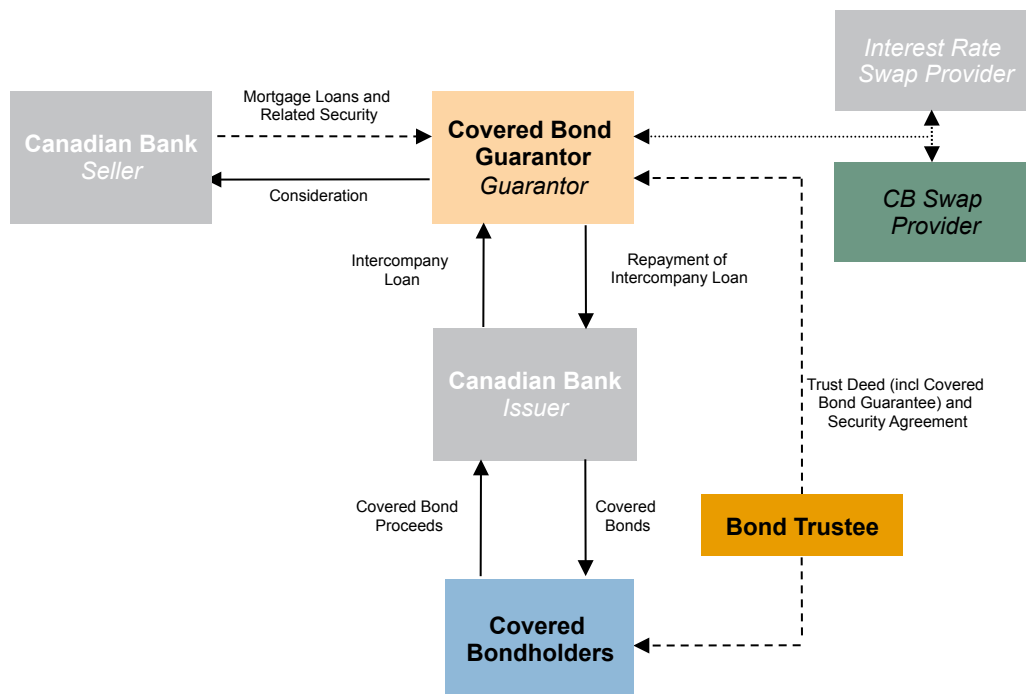
## SEC Registered Covered Bonds (cont'd)

---

- 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.

# 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.



# 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 (cont'd)

---

- 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



# 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

99) Buy 99) Sell 97) Settings

Trade Recap 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	To 7/8 01/31/18		02/20	12:47:21		
02/20	10:50:17	480	↑99.766	1.253	S	37.4	To 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	To 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	To 7/8 01/31/18		02/20	10:23:54		
02/20	10:18:13	5000+ e	↓99.774	1.251	D	37.2	To 7/8 01/31/18		02/20	10:18:11		
02/20	10:08:31	2000	↑99.800	1.245	S	36.6	To 7/8 01/31/18		02/20	10:07:27		
02/20	10:07:37	10	↑99.731	1.261	B	38.2	To 7/8 01/31/18		02/20	10:02:37		
02/20	09:21:44	10	99.642	1.281	B	38.9	To 7/8 01/31/18		02/20	09:21:18		
02/20	09:21:43	10	↓99.642	1.281	S	38.9	To 7/8 01/31/18		02/20	09:21:18		
02/20	08:59:44	3000	↓99.803	1.245	S	35.3	To 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	To 7/8 01/31/18		02/19	12:11:41		
02/19	11:05:47	61	↓99.777	1.250	B	38.7	To 7/8 01/31/18		02/19	11:05:44		
02/19	10:19:12	65	99.782	1.249	S	38.5	To 7/8 01/31/18		02/19	10:19:12		
02/19	10:18:51	65	↓99.782	1.249	B	38.5	To 7/8 01/31/18		02/19	10:16:42		
02/19	09:16:18	5000+ e	↓99.806	1.244	S	38.6	To 7/8 01/31/18		02/19	09:12:48		
02/19	09:15:58	5000+ e	99.827	1.239	S	38.1	To 7/8 01/31/18		02/19	09:14:08		
02/19	09:11:44	5000+ e	99.827	1.239	D	38.1	To 7/8 01/31/18		02/19	09:11:26		
02/19	09:09:52	5000+ e	↑99.827	1.239	D	37.9	To 7/8 01/31/18		02/19	09:09:06		
02/19	09:04:23	3000	↓99.821	1.240	S	38.2	To 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 20-F/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
<b>Required issuer:</b>	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.
<b>Exemption from the Securities Act:</b>	No. Bonds are publicly offered and registered with the SEC.	Section 3(a)(2).	Section 4(a)(2) / Rule 144A.
<b>No Action Letter:</b>	Required.	Not required.	Not required.
<b>FINRA Filing Requirement:</b>	Subject to filing requirement and payment of filing fee.	Subject to filing requirement and payment of filing fee.	Not subject to FINRA filing.
<b>Blue Sky:</b>	Generally exempt from blue sky regulation.	Generally exempt from blue sky regulation.	Generally exempt from blue sky regulation.
<b>Listing on an exchange:</b>	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.
<b>“Restricted”</b>	No.	No.	Yes.

# Comparison of Alternatives (cont'd)

	SEC Registered	Section 3(a)(2)	Rule 144A
<b>Required governmental approvals:</b>	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.
<b>Permitted Offerees:</b>	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.
<b>Resale restrictions:</b>	None	None	Only to QIBs. No retail.
<b>Investment Restrictions:</b>	None	Generally none	Restricted securities; a limited bucket for some investors.
<b>Minimum denominations:</b>	All denominations.	All denominations. However, banks licensed by the OCC and issuing under Part 16.6 are subject to a minimum denomination requirement.	Typically \$200,000 or more
<b>Role of Manager/ Underwriter:</b>	Either agented or principal basis.	Either agented or principal basis.	Must purchase as principal.

# Comparison of Alternatives (cont'd)

	SEC Registered	Section 3(a)(2)	Rule 144A
<b>40 Act:</b>	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.
<b>Settlement:</b>	Through DTC, Euroclear/Clearstream	Through DTC, Euroclear/Clearstream.	Through DTC, Euroclear/Clearstream
<b>Repatriation of Proceeds:</b>	No restrictions.	May be restrictions.	No restrictions
<b>Eligible for Bond Index:</b>	Yes	Yes	No.
<b>Orphan Bonds:</b>	No	Not fungible with 144A bonds or later SEC registered bonds	Not fungible with 3(a)(2) bonds or SEC registered bonds
<b>Prospectus Compatibility:</b>	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