NORTHERN LIGHTS

CANADIAN COVERED BOND ISSUERS

U.S. CAPITAL MARKETS participants have read and heard a great deal about covered bonds over the last three years. But they have seen little by way of issuances of covered bonds in the U.S. market. That may be about to change if covered bond legislation pending in Congress is passed. However, up to now, it has been the major Canadian banks that have shed light on the potential size of this market and on what it will take to interest U.S. investors in covered bonds.

Covered bonds were first used by Canadian banks in 2007. Covered bonds were recognized as an important financing alternative, providing another way for Canadian banks to fund their residential mortgage originations. Although Canada does not have a legislative framework for covered bonds, most Canadian programs have come to use a well-established contractual structure. The bank that originates the mortgage loans is the issuer of the covered bonds and sells the loans to a bankruptcy-remote special purpose vehicle (in most cases, a limited partnership), which provides a payment guarantee. In 2010, Canadian banks have accessed the U.S. institutional market in force—issuing covered bonds in the United States pursuant to Rule 144A. We have advised Bank of Nova Scotia, Royal Bank of Canada and Toronto Dominion on their blockbuster covered bonds offerings.

Given that the origins of the financial crisis may in large measure be traced to a bet on the continued housing boom in the United States and to an extremely heavy reliance on the capital markets to finance home ownership through securitization techniques, this is a particularly appropriate time to contemplate financing alternatives. Covered bonds have the potential to supplement securitization and to form a part of a well-diversified liquidity management program. Covered bonds also may provide investors with an asset-backed debt instrument that protects against many of the risks recently experienced in the originate-to-distribute securitization model.