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SEC Registered Covered Bonds

We recently advised Royal Bank of Canada on its filing of a registration statement[1] with the United States Securities and Exchange Commission for the first public offer of covered bonds in the United States. This filing was made in reliance on a no action letter[2] issued by the SEC staff that addresses the conditions under which the covered bonds could be registered with the SEC.

The covered bonds to be registered will be issued under the Bank's existing Global Covered Bond Programme, utilizing the same cover pool that supports the covered bonds previously issued by the Bank. The Bank may continue to issue covered bonds outside the United States under the Programme pursuant to a prospectus listed with the UKLA.

Why Register?

To date, all offerings of covered bonds in the U.S. have been offered under Rule 144A. There are several considerations with Rule 144A offerings:

- Rule 144A offerings involve private offerings
- All communications must be carefully controlled
- Resales are limited by transfer restrictions on the bonds
- The bonds are restricted securities, which limits the secondary market
- Many buyers have a limited capacity to purchase restricted securities
- Restricted securities are not included in the major bond indices like the Barclays Aggregate Bond Index, which limits the secondary market.

Using Section 3(a)(2)

Covered bonds could be offered under Section 3(a)(2) of the Securities Act of 1933. To issue under Section 3(a)(2), an issuing bank must have a U.S. branch or agency, and the branch or agency must guarantee or issue the bonds. There are several considerations with an offering under Section 3(a)(2):

- There are capital implications for the branch or agency
- Discussions would be required with the U.S. banking regulator
- Repatriation of offering proceeds may be limited
- Sales would likely be limited to "accredited investors."

Advantages of Registration

With SEC registration, covered bonds become a mainstream capital markets product. There are several advantages to issuing SEC registered covered bonds:

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

RBC uses a contractual structure to issue covered bonds, utilizing a separate entity to hold the cover pool and act as the guarantor. The SEC staff views a guarantee from a separate entity as a separate

[1] 333-181552
[2] *Royal Bank of Canada*, available May 18, 2012

security requiring registration. While RBC qualifies for shelf registration on Form F-3, the guarantor does not. This meant that the Bank needed relief from the SEC staff in order to enable the guarantor to register on Form F-3. The no action letter issued by the SEC staff provides this relief and sets forth the conditions to including the guarantor as a co-registrant on the registration statement. The significant items of the no action letter are:

- The covered bonds are not deemed to be ABS, however disclosure that is consistent with Regulation AB is required
- Disclosure regarding the cover pool assets is similar to the disclosure for a credit card or UK RMBS master trust
- No loan level disclosure is required for the cover pool
- Financial statements of the guarantor are not required.

Each prospectus supplement will provide static pool disclosure of the cover pool assets, stratified by vintage year of origination, and statistical characteristics of the expected cover pool. The guarantor will file annual reports with the SEC and copies of monthly reports to investors under Form 10-D, consistent with the requirements of Regulation AB.

Upon the effectiveness of the registration statement, the Bank will be in a position to issue covered bonds under its Global Covered Bond Programme publicly in the United States. The Bank has previously issued covered bonds publicly in Canada under a short form base shelf prospectus and in Europe under a UKLA-listed prospectus.

Eligibility to Register

The RBC registration statement is filed on Form F-3, as a shelf registration statement. Shelf registration permits the registration of securities that are to be sold from time to time over a three-year period. At the end of three years, a new registration statement would need to be filed. Additionally, Form F-3 permits the incorporation by reference into the registration statement information previously filed with the SEC, such as annual reports and periodic filings.

Eligibility for Form F-3 requires the issuer to have been filing annual and periodic reports with the SEC for at least a year. Those issuers that have existing senior debt programs on Form F-3 will already qualify. Those issuers that are not currently filing with the SEC would need to file on Form F-1 for each offering of covered bonds and the bonds could not be sold until the registration statement had been declared effective by the SEC. However, after one year of filing annual and periodic reports with the SEC, a registration statement could be filed on Form F-3.

Covered bond issuers that do not utilize the two-tier contractual structure to segregate the cover pool, such as German pfandbrief issuers, would not fit within the structure contemplated by the no action letter and present different considerations that would require discussion with the SEC staff.

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Morrison & Foerster can serve as your covered bond resource. We are available to answer any questions you may have regarding the no action letter or the registration process. For further information, please contact:

Jerry Marlatt +1 (212) 468-8024
jmarlatt@mofo.com

Anna Pinedo +1 (212) 468-8179
apinedo@mofo.com

David Lynn +1 (202) 887-1563
dlynn@mofo.com

Melissa Beck +1 (212) 336-4319
mbeck@mofo.com

Or visit
http://www.mofo.com/Covered-Bonds-Services/