



June 27, 2007

To: All Deposit Taking Institutions

Subject: Limited Issuance of “Covered Bonds” by Canadian Institutions

In a letter to the industry dated February 27, 2007, OSFI requested that financial institutions refrain from issuing covered bonds while potential regulatory and policy concerns associated with these instruments were reviewed.

We have now concluded our initial review of the regulatory considerations. We note that covered bonds -- debt obligations issued by a deposit taking institution (DTI) and secured by assets of the DTI or of any of its subsidiaries -- provide a number of benefits but also raise concerns. For example, covered bonds can improve funding diversification and lower costs. However, they also create a preferred class of depositors, reducing the residual level of assets available to be used to repay unsecured depositors (including the Canada Deposit Insurance Corporation) or other creditors in the event of insolvency, depending on the amount issued and the nature of credit enhancements.

To balance the benefits and concerns associated with covered bonds, OSFI has decided at this time to limit the issuance of covered bonds, and to impose the following conditions:

1. Covered bonds must not, at the time of issuance, make up more than 4 per cent of the total assets of the DTI. If at any time after issuance the 4 per cent limit is exceeded, the DTI must immediately notify OSFI. Excesses due to factors not under the control of the issuing institution, such as foreign exchange fluctuations, will not require the DTI to take action to reduce the amount outstanding. For other excesses, the DTI must provide a plan showing how the DTI proposes to eliminate the excess quickly.
2. Total assets for the purpose of the limit will be equal to the numerator of the asset-to-capital multiple.
3. OSFI expects DTIs' current pledging policies to be amended to specifically take into account the issuance of these instruments, consistent with the limits and conditions contained in this letter. OSFI also expects board or committee approval of these specific changes prior to the issuance of covered bonds.



OSFI
BSIF

255 Albert Street
Ottawa, Canada
K1A 0H2

www.osfi-bsif.gc.ca

Canada

For more information, please contact Gilbert Ménard, Capital Division at gilbert.menard@osfi-bsif.gc.ca or by phone at 613 990-8081.

Robert J. Hanna
Acting Assistant Superintendent
Regulation Sector

Cc: Canada Deposit Insurance Corporation
Department of Finance
Bank of Canada