Advice No. 12 | November 13, 2019
Important Information on the Canadian Registered Covered Bond Program

REVISED RATINGS REQUIREMENTS – CANADIAN REGISTERED COVERED BOND PROGRAM

1.0 PURPOSE

To advise registered issuers and potential issuers of the **revised ratings requirements** for the Canadian Registered Covered Bond Program ("Covered Bond Program").

Capitalized terms used and not otherwise defined in this advice have meanings ascribed to them in the Canadian Registered Covered Bond Programs Guide ("Guide").

2.0 BACKGROUND

Covered bonds are a strategically important source of funding for uninsured mortgages in Canada. Through continuous enhancements based on international best practices, CMHC plays an important role in ensuring that a robust, globally recognized legal framework is in place.

The Guide includes a number of provisions regarding the use of credit ratings, including the following requirements i) that no less than two Rating Agencies must at all times have current ratings assigned to at least one series or tranche of covered bonds outstanding, (ii) that Rating Triggers be prescribed for the collateralization of Covered Bond Collateral Hedges and coming into effect of Contingent Covered Bond Collateral Hedges and (iii) that the Rating Trigger for delivery of executed registrable forms of assignment in Quebec be set at BBB(high)/BBB+/BBB+/Baa1. These requirements were reviewed against global market practices and CMHC's securitization programs, to ensure a robust program standard continues to be in place.

3.0 REVISED RATINGS REQUIREMENTS

i. Revision to the minimum number of covered bond ratings

Since 2012, the covered bond market has evolved such that in Europe, a significant portion of benchmark size covered bond programs now have one covered bond rating. In examining international best practices and balancing market trends against mandatory program requirements, Guide section 3.5.1, which specifies that covered bonds must be rated by ***at least 2 rating agencies,*** will now be revised such that covered bonds must be rated by ***at least 1 rating agency.*** Revising the requirement from a minimum of 2 securities ratings to 1 rating will afford investors a greater latitude in driving the number of expected credit ratings, while recognizing the broader evolving market trend. Notwithstanding this Guide change, investors and other market participants may still require 2 or more covered bond ratings. See Annex below for revisions to the Guide 3.5.1

ii. New requirement that ratings for Collateral Hedge Rating Triggers be provided by a minimum of 2 rating agencies

Secondly, swap counterparties play an integral role in providing hedges, where a credit rating downgrade of the swap counterparty results in collateralisation, guarantee or replacement etc through "Ratings Triggers". In most cases, the issuer uses a swap counterparty from the same banking or issuer group. Given the important role of swap providers, the eligibility criteria are formalized such that the Swap Counterparty must maintain at all times applicable credit ratings from no less than two rating agencies. While this is a new requirement, the impact to issuers is negligible since swap providers currently in the market place already meet this criterion. See Annex below for revisions to the Guide 3.5.2

iii. Reduction in the Rating Trigger thresholds for delivery of registrable mortgage assignments in Quebec

As with CMHC's NHA MBS program, the Guide requires that should the issuer's credit rating fall below a specified ratings threshold, executed registrable forms of mortgage assignment be delivered in relation to Quebec originated loans. The ratings threshold is revised from *BBB(high)/BBB+/BBB+/Baa1* to ***BBB(low)/BBB-/BBB-/Baa3*** in order to align with those outlined under the NHA MBS program for consistency. There is no material difference in risks between the Covered Bond Program and NHA MBS program to warrant the former to have a higher ratings threshold. See Annex below for revisions to the Guide 3.6.12

Relevant revised Guide provisions, shown in Annex, are effective Jan 1, 2020 and will be included in the Guide's next release.

4.0 ENQUIRIES

For any enquiries related to the revised ratings requirements, please contact Lily Shum 416-218-3360 or lshum@cmhc-schl.gc.ca.

ANNEX: REVISED GUIDE PROVISIONS

Guide 3.5.1:

If there are covered bonds issued and outstanding under a registered covered bond program, ~~no less than two~~ a minimum of 1 Rating Agency must at all times have current ratings assigned to at least one series or tranche of covered bonds outstanding (which need not, for greater certainty, be the same series or tranche of covered bonds).

Guide 3.5.2:

In the transaction documents of a registered covered bond program, Ratings Triggers must be prescribed for:

(b) the collateralization of a Covered Bond Collateral Hedge Counterparty's obligations under a Covered Bond Collateral Hedge and/or the guarantee of such obligations or replacement of such Counterparty and such Rating Trigger must require that the Counterparty maintain at all times applicable Counterparty Reference Ratings from no less than two Rating Agencies;

(c) the coming into effect of Contingent Covered Bond Collateral Hedges (which must comply with Section 4.5.4(a) of this Guide) and such Rating Trigger must require that the Counterparty maintain at all times applicable Counterparty Reference Ratings from no less than two Rating Agencies.

Guide 3.6.12:

Where Eligible Loans forming part of covered bond collateral have been originated in the Province of Quebec, a registered issuer shall be required to deliver to the Custodian executed registrable forms of mortgage assignment in relation to each such Eligible Loan upon the earlier of:

(a) any Registered Title Event; and

(b) A Ratings Trigger based on the applicable Counterparty Reference Rating assigned to the registered issuer by one or more of the Rating Agencies falling below ~~BBB(high)/BBB+/BBB+/Baa1~~ BBB(low)/BBB-/BBB-/Baa3 as the case may be, which Ratings Trigger must be prescribed in transaction document for the registered covered bond programme.