



**Canadian Bond
Investors' Association**
**Association canadienne des
investisseurs obligataires**

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May 10, 2013

To: DBRS
DBRS_Bank_Methodology@DBRS.com
Cc: mgoetz@dbrs.com

Re: DBRS Request for Comment on its proposed framework for rating Bank Capital Securities-Subordinated, Hybrids and Preferred Securities

I am writing this letter on behalf of the members of the Canadian Bond Investors' Association (CBIA). The CBIA was established in 2011 and represents over 20 of the largest fixed income institutional investor organizations in Canada, including those from the banking, insurance, pension and investment counsel sectors. Our membership includes only the "buy-side" operations affiliated with banking and insurance companies. As such, the CBIA is the independent voice of Canadian bond investors, and hence of the millions of pensioners, policy holders and retail investors who depend on us for the sound management of these investments.

The purpose of this letter is to provide DBRS with the CBIA's feedback on your proposed framework for rating "Bank Capital Securities - Subordinated, Hybrids and Preferred Securities". The letter includes our feedback on your proposed criteria. In addition, as further detailed below, we recommend you consider assigning 'recovery', 'loss given default', or 'loss given trigger' ratings to all bank instruments to better reflect the risk parameters of various bank instruments. Finally, we provide you with some additional context that we believe should be taken into consideration for the rating of subordinated debt and hybrid instruments in the Canadian market.

Remove external/government support for rating bank subordinated debt, preferred shares and contingent capital instruments (CoCaps)

We agree with DBRS' proposed approach to remove external/government support from rating a bank's preferred shares and contingent capital instruments. This approach may better reflect the recent developments on regulatory and political fronts, whereby governments globally would be loath to provide tax funded bail-outs to bank investors in future. We also believe this approach should be extended to normal subordinated debt instruments, hybrid securities and bail-in securities regardless of whether they are issued by systemically important banks or not.

Consideration should also be given to removing systemic support for senior bonds depending on jurisdiction, in particular for those jurisdictions that institute a bail-in regime.

Notching on contingent capital instruments (CoCaps)

Although we agree with your proposed approach of capping contingent capital instruments (CoCaps) ratings below preferred shares ratings, the application of different levels of notching from preferred shares ratings (1 to 3 notches depending upon DBRS' assessment on conversion risk and recovery assessment) appears to be somewhat arbitrary. Furthermore, in our view, CoCaps and regulatory responses associated with these securities have not been tested through a full credit cycle, which introduces additional uncertainty as to ultimate credit quality. As you may know, within the Canadian context, CoCaps are generally referred to as non-viable contingent capital (NVCC). For reasons we state under "Additional Commentary on Bank Regulation in Canada" we request that DBRS take into consideration all planned regulatory changes before finalizing the rating methodology and application in Canada.

Moratorium on rating 'high trigger' CoCaps

We believe DBRS should refuse to rate, on a permanent basis, "high trigger" CoCaps such as Barclays' contingent capital notes. As you are likely aware, these notes can be written down to zero if Barclays' common equity Tier 1 hits 7%, or less. In our view, it is absurd that an instrument disguised as debt can be treated worse than a bank's common equity, and its value reduced to zero, in a scenario where that bank may still be very much a viable entity. These types of instruments have the potential to significantly distort the credit markets, similar to what we experienced in Canada in late 2007 with overrated Asset Backed Commercial Paper. As you may be aware, Moody's is already appropriately reflecting the inherent imprudence and risk associated with these instruments by refusing to rate them as debt or hybrid securities on a global scale, a position which we fully support.

Introduction of recovery ratings (loss given default/trigger) on bank fixed-income securities

We find DBRS' current recovery rating methodology with respect to rating securities and bank loans of sub-investment grade issuers to be very valuable input into the investment decision process. While rating agencies have not extended this methodology to investment grade issuers, we believe that, given the increasing complexity of bank securities and bank regulation, extending this methodology would be valuable input to investors. There would clearly be very different levels of recovery for senior debt, subordinated debt, and CoCaps in a distress scenario for banks. The value to investors would be in highlighting the risk associated with subordinated debt and CoCaps. While the probability of default/trigger may be low or very low for these instruments, the potential loss given default/trigger could be very high. Recovery ratings would provide much better insight into how these instruments would behave in a downside scenario, as opposed to the historical notching approach. For example, the current assumption of most investors is that if a bank were to be wound up under current legislation in Canada, there would likely be a very high recovery for senior debt. However, under a bail-in regime, this may no longer be the case; the recovery on senior debt could be negatively affected. Consequently, recovery on subordinated debt and NVCC would become lower than it is under most regimes currently.

Additional Commentary on Bank Regulation in Canada

We have two major concerns with respect to NVCC in the Canadian market: 1) the lack of transparency and conversion features around the point of non-viability; and 2) Canada is considering additional changes to the bank regulations, and in particular is considering bail-in debt.

We have attached a letter addressed to OSFI from the CBIA dated January 23, 2012. In summary, we requested in that letter that OSFI not permit the issuance of NVCC, until the government provides full clarity and transparency on other planned changes to the regulatory environment.

OSFI has assured investors, verbally, that the point of 'non-viability' would be a low probability event; however, it is clear to us that the point at which OSFI declares a financial institution to be non-viable will be largely a subjective, judgmental call. Our suggestion is that in assigning ratings, DBRS take into account the subjective nature of such a determination by OSFI, if/when ratings are assigned to NVCC and subordinated debt.

Secondly, and more importantly, Canada is mid-way through a number of significant regulatory changes. Potentially, the most significant change is the introduction of bail-in debt, which is currently being contemplated by the government of Canada. Bail-in debt could substantively change the credit quality of all bank debt instruments, including NVCC. There remains a high level of uncertainty surrounding how the introduction of bail-in debt would affect the ultimate trigger point, seniority and recovery prospects of NVCC within a bank's capital structure.

Further, we are concerned that NVCC could be issued by Canadian banks in the near term, and that if a bail-in regime is subsequently introduced it will result in future methodology changes, thereby resulting in rating changes on NVCC. Accordingly, we question whether it is appropriate to rate NVCC while a bail-in regime is under consideration in Canada.

I hope this letter clarifies the CBIA's views on your proposed methodologies on rating relevant bank capital securities. If you have any questions, please feel free to contact me at 905-881-8853.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Joe Morin', with a large, stylized initial 'J'.

Joe Morin
Chair