Canadian Bond Investors' Association
Association canadienne des investisseurs obligataires

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To: Moody's Investors Service
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Re: Moody's Request for Comment on its proposed framework for rating Contractual Non-Viabilities Capital Securities and Subordinated Debt

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 Moody's with the CBIA's feedback on your proposed framework for rating "Contractual Non-Viabilities Capital Securities and Subordinated Debt". The letter includes our feedback on the three specific topics identified in the Request for Comment followed by a brief explanation. In addition, as further detailed below, we recommend you consider assigning 'recovery', 'loss given default', or 'loss given trigger' ratings to all bank debt to better reflect the risk parameters of various 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.

Topic #1: Remove systemic support for rating subordinated debt
We agree with Moody's proposed approach to remove systemic and government support from rating subordinated debt within its global rating criteria. Our understanding is that Moody's has completed its review of all Canadian banks and is currently not imputing any governmental support in subordinated debt ratings. A consistent global approach for rating subordinated bank debt is important to our members, many of whom invest outside of Canada, and we therefore

fully support Moody's rollout of this methodology to other jurisdictions. As highlighted in Moody's RFC, 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. Similarly, we believe this approach should be extended to non-viability capital securities, hybrid securities and bail-in securities regardless of whether they are issued under a contractual or statutory framework. 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.

Topic #2: Establish a Ba1 cap on ratings for contractual non-viability securities
We share Moody's view that contractual non-viability securities 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. However, in our view, differentiating between contractual and statutory non-viability securities, as well as capping the ratings for contractual securities at sub-investment grade, are somewhat arbitrary approaches. Within the Canadian context, these securities 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 Moody's take into consideration all planned regulatory changes before finalizing the rating methodology and application in Canada.

Topic # 3: Continue the current rating moratorium on 'high trigger' securities
We believe Moody's should refuse to rate, on a permanent basis, "high trigger" securities such as Barclays' contingent capital notes. As you are 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 in our view. As such, we believe Moody's is appropriately reflecting the inherent imprudence and risk associated with these instruments by refusing to rate them as debt or hybrid securities.

Introduction of recovery ratings (loss given default/trigger) on bank fixed-income securities
We find Moody's current loss given default (LGD) methodology with respect to rating securities and bank loans of sub-investment grade issuers to be a 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 to financial institutions would be valuable input to investors. There would clearly be very different levels of recovery for senior, subordinated and non-viable type instruments in a distress scenario for banks. The value to investors would be in highlighting the risk associated with subordinated debt and non-viable type instruments. 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, Moody's 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,

Joe Morin
Chair