## 3.39.1 SWITZERLAND – SWISS PFANDBRIEFE®

By Robert Horat and Markus Müller, Pfandbriefbank schweizerischer Hypothekarinstitute AG

### I. FRAMEWORK

The legal framework for the Swiss Pfandbrief system is the Pfandbrief Act ("Pfandbriefgesetz", "PfG"). It is complemented by the Pfandbrief Ordinance ("Pfandbriefverordnung", "PfV"), the articles of association of the Pfandbrief institutes and the valuation regulations ("Schätzungsreglement"). The latter two have to be authorised by the Swiss Federal Council.

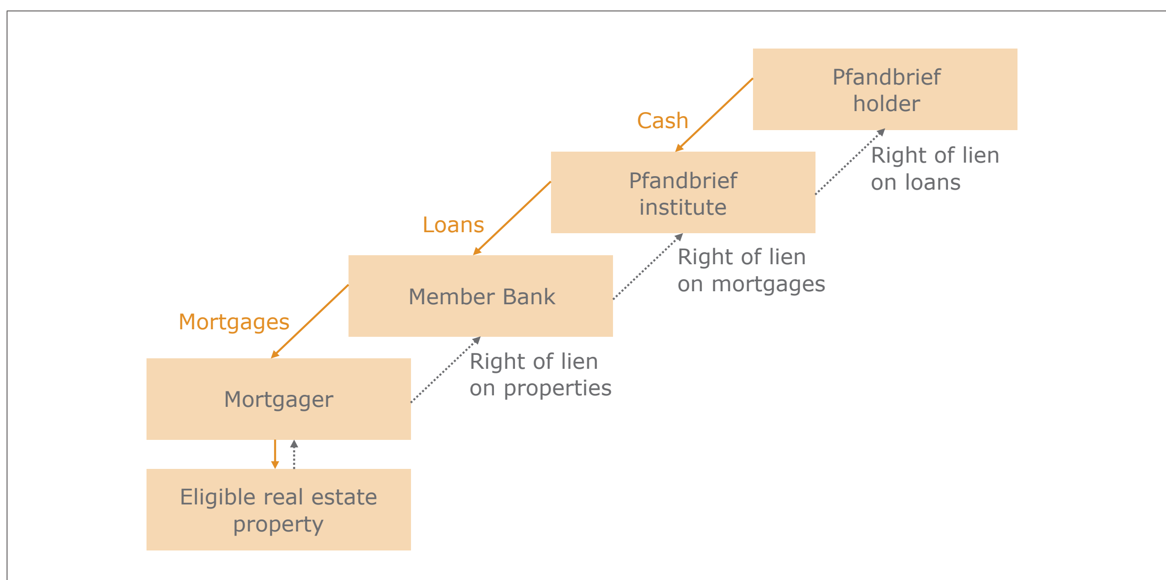
According to the PfG, the issuance of Swiss Pfandbriefe is reserved to two specialised Pfandbrief institutes, namely the "Pfandbriefzentrale der schweizerischen Kantonalbanken AG" (PZ) and the "Pfandbriefbank schweizerischer Hypothekarinstitute AG" (PB). They issue Swiss Pfandbriefe to refinance their member banks' Swiss mortgage business. As of article 1 of the PfG the purpose of the Pfandbrief institutes is to enable mortgages for real estate owners at interest rates which are as constant and favourable as possible. The "Swiss Pfandbrief" is a registered trademark. The reputation of this brand shall underpin its uniqueness within the world of covered bonds.

The Swiss Pfandbrief system is an indirect one: The Pfandbrief institutes raise money by issuing Swiss Pfandbriefe in order to grant Pfandbrief loans to their member banks. Sourced volume, currency and interest terms must be equal within each series of issuance. To get a loan, each member bank has to pledge first class Swiss mortgages to the Pfandbrief institute as a cover in advance. The Pfandbrief investors have a lien on the granted loans. The investors' lien on the loans as well as the issuers lien on the mortgages in the member banks' cover pool are determined by the Pfandbrief Act.

PfG came into effect in 1930. Its 52 articles are well balanced and the PfG had to be modified only marginally in the meantime. The fact that the Swiss Pfandbrief has a special legal basis, provides legal certainty as well as stability and predictability.

Pfandbrief institutes have a strictly limited scope:

> FIGURE 1: THE SWISS PFANDBRIEF® FRAMEWORK



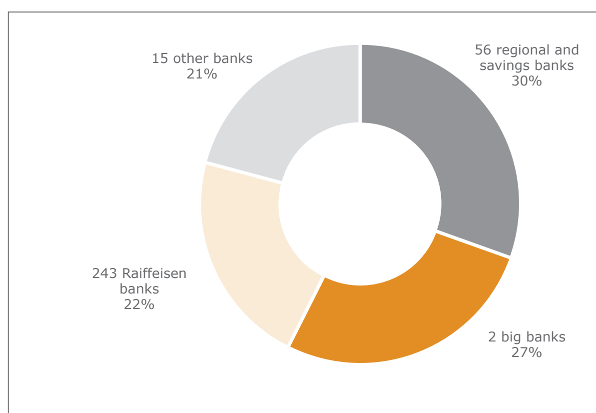

Source: Credit Suisse AG

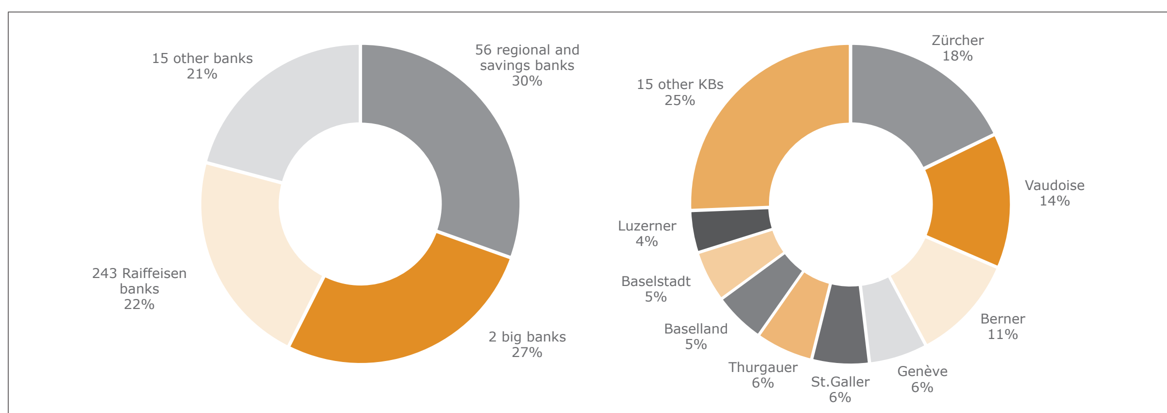
## II. STRUCTURE OF THE ISSUER

PZ operates as the Pfandbrief issuing vehicle of the Swiss cantonal banks and PB of all other Swiss banks. Both are special institutions with their business scope limited to the issuance of Swiss Pfandbriefe, to granting Pfandbrief loans to their member banks and to investing their share capital and reserves. Both Pfandbrief institutes are supervised by the Swiss financial market authority (FINMA). They are owned by their member banks. The chart below shows the structure of the shareholders:

> FIGURE 2: SHAREHOLDERS OF PB

> FIGURE 3: SHAREHOLDERS OF PZ




Source: PB as of 31.12.2021

Source: PZ as of 31.12.2021

PB was founded in 1931 and counts 286 banks with loans. Any Swiss bank has the right to become a member of PB, provided that it is headquartered in Switzerland and that Swiss mortgages account for at least 60% of the bank's balance sheet (Article 4 PfG). As of 31 December 2021 the total outstanding Swiss Pfandbriefe of PB amount to CHF 80.6 billion (EUR 78.0 billion).

PZ was also founded in 1931 and has 24 member banks. Only cantonal banks have the right to become members of the PZ (Article 3 PfG). PZ does not have its own staff but has fully outsourced its operations to Zürcher Kantonalbank. As of 31 December 2021 the total outstanding Swiss Pfandbriefe of PZ amount to CHF 70.2 billion (EUR 68.0 billion).

The total volume of all outstanding Swiss Pfandbriefe as of 31 December 2021 amounts to CHF 150.8 billion (EUR 146.0 billion). For years the two Swiss Pfandbrief institutes have been the major bond issuers in Switzerland, even more important than the government. In 2021 they issued Swiss Pfandbriefe amounting to CHF 18.5 billion (EUR 18.0 billion).

Swiss Pfandbriefe are standardised to a great extent. They are a commodity, denominated only in Swiss francs, with an original time to maturity of up to 30 years. The size of an issuance depends either on the demand of the member banks for loans or on the demand of the investors for Swiss Pfandbriefe, whichever is smaller. Whenever possible, existing bonds are reopened.

Generally, Swiss Pfandbriefe are issued as public bonds through a banking syndicate at fixed term fees (the last private placement has been placed in 2011). All of these public issuances are listed on the SIX Swiss Exchange AG. In the domestic bond segment in Swiss Francs Pfandbriefe amount to 36%, followed by public sector (Swiss government, cantons, cities, regions) with 27%, the banking and insurance sector with 18% and other industries with 19%.

In total about 14% of all Swiss mortgages are refinanced through Swiss Pfandbriefe (10/2021).

## III./IV. COVER ASSETS, VALUATION AND LOAN TO VALUE (LTV) CRITERIA

As a principle, Pfandbrief loans are only granted against a pledge of eligible first class mortgages on Swiss properties.

PB has got an electronic cover pool system. Mortgages are pledged to PB by the member banks through entry of a complete "cover proposal" into the electronic pool register, which all member banks are linked to. The system immediately evaluates the member bank's cover proposal, which is then reviewed by one employee and authorised by another. PB valuates the mortgages independently from the member bank. Substantial cover proposals are additionally reviewed by a special cover pool committee.

The PfG defines a general maximum cover value LTV of two thirds (Article 5 PfG), however, the cover value is at most as high as the mortgage, but mostly lower. Member banks are obliged to replace impaired, non-performing and other ineligible mortgages. Furthermore, contractual repayments of the mortgage can also reduce the cover value of the asset pool. Therefore, the member banks and PB have to supervise overcollateralisation daily. If total cover value is below the overcollateralisation limit, latest by close of business new eligible mortgages have to be pledged by the member bank.

The "Pfandbriefbank pool" consists of approx. 202'000 mortgages all over Switzerland, which provides a good diversification. 100% are residential properties.

In case of a material change in macro-economic conditions, FINMA may request a new valuation of the real estate properties (Article 32 PfG).

## V. ASSET – LIABILITY MANAGEMENT

### Cover principles

The PfG stipulates that the principal amount as well as the interest payments of outstanding Swiss Pfandbriefe be at all times covered by an equivalent amount of Pfandbrief loans to the member banks (Article 14 PfG). The loans granted by Pfandbrief institutes to their member banks must be collateralised by liens on eligible real estate property (Article 19 PfG). If the interest proceeds of the pledged mortgages of a member bank are lower than its total Pfandbrief loan interest, the asset cover pool must be increased (Article 20 PfG).

### Overcollateralisation

In addition to eligibility and valuation principles (LTV legally at maximum 2/3, for PB the average LTV is lower than 50%), the cover value of the cover assets has to exceed the Pfandbrief loans given to member banks by at least 8% for PB and by 15% for PZ. The higher overcollaterisation of PZ compensates for the fact that PZ does not have a standardised electronic cover pool register.

### Additional Limits

Swiss Pfandbriefe are issued in individual series which must match the repayment profile of the Pfandbrief loans to member banks, eliminating interest rate and funding risks. Currency risk does not exist as both the loans to member banks and the Pfandbriefe are issued in Swiss Francs. Therefore there is no need for derivatives to hedge market risks. Liquidity concentration risk is limited by individual limits for each member bank. The investment policy for free assets limits credit and market risks on counterparty and portfolio level.

Growth of the Pfandbrief institutes is limited as the required capital must exceed 2% of the total Pfandbrief issuance volume of the respective institute (Article 10 PfG).

## VI. TRANSPARENCY

Although Switzerland does not yet participate in the "Covered Bond Label" self-certification programme, PB publishes the Pfandbriefbank Pool report (including member bank rating distribution, region, property type, property type by cover value size, loan to value) semi-annually on its home page (www.pfandbriefbank.ch).

## VII. COVER POOL MONITOR AND BANKING SUPERVISION

PB valuates and monitors the cover pool independently of the member bank (which grants the mortgage to the house owner) and monitors eligibility and overcollateralisation of the cover pool daily. Mortgages are back-tested by means of a hedonic valuation model. Additionally, a special cover pool committee reviews substantial mortgages and visits major properties.

The Swiss Federal Council approves the articles of association and valuation regulations and nominates one member of the board of directors.

Swiss Pfandbrief institutes as well as their member banks are supervised by FINMA and audited by external audit firms.

In addition, Moody's rates all Swiss Pfandbriefe with Triple A, investors analyse the annual reports of the Pfandbrief institutes, various analysts publish research reports and/or ratings and last but not least the capital market values Swiss Pfandbriefe.

## VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS

In the event of a member bank's insolvency, the Pfandbrief institute has a priority claim on the registered collateral (Article 23 PfG). The insolvency of a member bank does not directly trigger the acceleration of outstanding Pfandbriefe. In this respect, the Pfandbrief institute functions as a buffer between the investors and the member banks. The Pfandbrief institutes have own funds at their disposal and maintain an unencumbered SNB-/repo-eligible bond portfolio within their free assets.

Should there be justified concern that a member bank is overindebted, has serious liquidity problems or that the bank no longer fulfils the capital adequacy provisions (Article 25 Banking Act, BankG), FINMA can order:

a) protective measures pursuant to Article 26 BankG. However, FINMA can order deferment of payments or payment extension, except for mortgage-secured receivables of the Pfandbrief institutes (Article 26 h BankG). FINMA can also order the delivery of the cover assets and then act as fiduciary (Article 40 PfG).

b) restructuring procedures pursuant to Article 28 – 32 BankG: If it appears likely that the member bank can continue to provide individual banking services (regardless of the continued existence of the bank concerned) or can recover, FINMA can issue the necessary provisions and restructuring orders (Article 28 BankG):

> Convertibility of claims (Article 49 Banking Insolvency Ordinance, BIV): All bank debt capital may be converted into equity capital, **explicitly excluding** a) defined "privileged claims", **b) "secured claims to the extent that they are secured" (including pfandbrief loans)** and "offsettable claims to the extent that they are offsettable."

> Reduction in claims (Article 50 BIV): In addition to or instead of converting bank debt capital into bank equity capital, FINMA may order a partial or full reduction in claims, again excluding the aforementioned letters a and b (of Article 49 BIV) and letters a to c of Article 48 BIV.

> In our view, this framework leads to the Swiss bank loss absorption waterfall as shown on the right hand figure (source: resolution of global systemically important banks, FINMA, 7 August 2013).

Swiss Banks - Loss absorption waterfall

<table>
<tr><th>Common equity tier 1 (CET1)</th><th>Equity</th><th>Full loss absorbency</th></tr>
<tr><td>Additional tier 1 (AT1)</td><td rowspan="4">Subordinated debt</td><td rowspan="2">Automatic loss absorbency or contractual bail-in</td></tr>
<tr><td>Tier 2 point of non-viability (PONV, incl. CoCo)</td></tr>
<tr><td>Old style tier 1 and tier 2</td><td rowspan="4">Statutory bail-in</td></tr>
<tr><td>Other</td></tr>
<tr><td>Senior unsecured liabilities</td><td rowspan="2">3rd insolvency debt class</td></tr>
<tr><td>Non priviledged deposits</td></tr>
<tr><td>Priviledged claims/deposits, secured claims (incl. pfandbrief loans) and offsettable claims)</td><td>Debt</td><td>No bail-in</td></tr>
</table>

c) the member bank's liquidation due to bankruptcy pursuant to Article 33 - 37 g BankG: Should there be no prospect of restructuring or if a restructuring were to fail, FINMA will have to revoke the bank's licence, order its liquidation and make this public (Article 33 BankG). The BIV defines restructuring proceedings and bankruptcy proceedings under Article 28 – 37 g BankG in detail. This includes that FINMA may draw up a separate schedule of claims for claims secured by a registered pledge of the Pfandbrief institutes, if systemic risks can only be restricted by doing so (Article 27 BIV).

On 17 December 2021, the Swiss Parliament passed a revision of the BankG, updating bank insolvency law and revising article 40 PfG. The new article 40a PfG now explicitly states that Pfandbrief loans do not become due as a result of the opening of bankruptcy proceedings at the member bank. In addition, the person appointed by FINMA to manage the separated loans and covers must take all necessary measures to ensure that the Pfandbrief loans are serviced in full and on time.

## IX. RISK-WEIGHTING & COMPLIANCE WITH INTERNATIONAL LEGISLATION

The Bank for International Settlements regularly assesses the consistency of implementation of Basel standards. Within the jurisdictional "Regulatory Consistency Assessment Programme" (RCAP) the "Basel Committee on Banking Supervision" (BCBS) rated Switzerland with an overall "compliant" grade for the risk based capital standards (June 2013), for G/D-SIB standards (June 2016) and for the Liquidity (LCR) standards (October 2017). The "large exposure framework" and the "Net Stable Funding Ratio" (NSFR) have not yet been assessed by BCBS.

### Basel III – capital standards

Switzerland implements Basel III capital requirements by means of the "Banking Act" and the "Swiss Capital Adequacy Ordinance" (CAO) into national law. The CAO has two approaches to measure credit risks in banking books: The BIS standard approach and the internal ratings-based approach.

According to the BIS standard approach, Swiss Pfandbriefe have a 20% risk weighting. However, as part of the current planning for the national implementation of Basel III final, it is intended that Swiss Pfandbriefe will receive a 10% risk weighting.

"The countercyclical capital buffer [CCyB] is a (preventative) macroprudential measure for financial stability within the Basel III framework […]. If the capital buffer is activated, banks are required to carry out a temporary and gradual increase in their capital in the event of vulnerabilities on the mortgage and residential real estate markets. The aim is to protect the banking industry from the consequences of excessive lending growth by increasing banks' loss-absorbing capacity. Moreover, a capitalisation means that the costs of lending rise, and this can counter the build-up of vulnerabilities. The capital buffer may be activated for the entire credit market or just for one sector, for instance the mortgage market, and is set at a maximum level of 2.5% of the entire domestic risk-weighted assets of a bank. […] In January 2022, the Federal Council reactivated the sectoral CCyB at the proposal of the SNB, and set it at 2.5% of risk-weighted exposures secured by residential property mortgages in Switzerland. It did so because the reasons that had led to it being deactivated no longer existed and because the vulnerabilities on the mortgage and residential real estate markets had also increased since the deactivation." (www.snb.ch, glossary, CCyB, 18 February 2022)

### Basel III – liquidity standards

Switzerland implements Basel III liquidity requirements by means of the "Banking Act" and the "Liquidity Ordinance" (LiqO) into national law. Swiss Pfandbriefe fulfil the Liquidity Coverage Ratio criteria for high-quality liquid assets (Article 15b of LiqO for LCR HQLA 2a: Covered bonds, not self-issued, rated AAA or AA). As a second minimum liquidity requirement for Swiss banks, the "Net Stable Funding Ratio" (NSFR) has been put into effect on 1 July 2021 to ensure long-term stable funding.

### Basel III – future standards

Following the 2009 financial crisis, BCBS addressed the final Basel III risk reduction measures in December 2017, which include the structure and process organization for calculating capital requirements for credit, market, liquidity, concentration and operational risks, the output floor for modelled approaches, the leverage ratio and disclosures. The regulatory authority plans to publish the landmark requirements by 2024.

Beyond the Basel risk framework, Article 9 of the National Bank Act also lists the open market operations and standing facilities that the Swiss National Bank (SNB) may contract. The preconditions for entering into a standing intraday or liquidity facility are the granting of a limit by the SNB and the provision of eligible collateral. Only securities included in the latest SNB GC basket may be pledged as collateral for repo transactions (www.snb.ch, financial markets, monetary policy operations, collateral eligible for SNB repos). Swiss Pfandbriefe are part of the SNB GC list and are therefore eligible.

## X. INVESTORS BENEFITS

An investor in Swiss Pfandbriefe benefits from

> the special institute principle with strictly limited scope.

> Swiss legislation applicable for all contracts within the Swiss Pfandbrief collateral chain.

> the cover pool, which only includes eligible Swiss franc mortgages on Swiss real estate properties.

> the fourfold security which is 1) the creditworthiness of the Pfandbrief institute, 2) the creditworthiness of the member bank, 3) the creditworthiness of the mortgager and 4) the market value of the real estate property itself.

> in the case of PB: The value of the real estate property is independently determined by PB and not by the member bank.

> in the case of PZ: Explicit state guarantee for most of its member banks[1].

> the fact that since the establishment of the PfG in 1930 neither an investor nor a Pfandbrief institute have ever suffered a loss.

**Issuers:** Pfandbriefbank schweizerischer Hypothekarinstitute AG (PB) and Pfandbriefzentrale der schweizerischen Kantonalbanken AG (PZ).

**For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com.**

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website (www.coveredbondlabel.com/legislation/comparative_database).

For further national information on the Swiss Pfandbriefe market, please see compare.coveredbondlabel.com/frameworks. To access the "Country Comparison" feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.

1 Three of PZ's member banks do not benefit from a cantonal guarantee, namely Banque Cantonale Vaudoise AG (VD), Berner Kantonalbank AG (BE) and Banque Cantonale de Genève AG (GE).

## 3.39.2 SWITZERLAND – CONTRACTUAL LAW BASED COVERED BONDS

By Marco Brück, Valiant Bank, and Michael McCormick, Credit Suisse

### I. FRAMEWORK

In 2009 and 2010 respectively, UBS AG (UBS) and Credit Suisse AG (Credit Suisse) established contractual covered bond programmes in order to access covered bond funding in the EUR and USD markets. The UBS and Credit Suisse programmes use Swiss and English law contractual provisions to implement structural features that are standard in the covered bond market. However, in response to evolving regulatory environment and to comply with the Swiss "too big to fail" requirements, Credit Suisse and UBS have since implemented changes to their legal entity structures. Among the required changes were the establishment of new Swiss banking subsidiaries intended to hold (among other businesses) their retail mortgage businesses. These changes necessitated structural changes to the covered bond programmes which UBS and Credit Suisse implemented in June 2015 and November 2016, respectively. Following these changes, Credit Suisse and UBS no longer issue covered bonds out of these programmes.

Starting in 2017, new contractual covered bond programmes were established by Valiant Bank AG (Valiant), Credit Suisse (Schweiz) AG (CS Schweiz) and Crédit Agricole next bank (Suisse) SA (CAnb) in order to diversify their funding sources. As with UBS and Credit Suisse legacy covered bond programmes, these are structured programmes that are not subject to the Swiss Pfandbriefe legislation. However, in contrast to UBS and Credit Suisse's legacy programmes, all of these programmes exclusively use Swiss law provisions and have so far only issued CHF-denominated series.

### II. STRUCTURE OF THE ISSUER

In line with the guarantor Special Purpose Vehicle (SPV) model used in the United Kingdom and the Netherlands (among other jurisdictions), the issuers have established Swiss based special purpose companies to guarantee their payment obligations for the benefit of the covered bondholders. All programmes feature direct recourse to the issuer, which remains primarily responsible for payments on the bonds. These guarantor entities hold security over the programmes' respective cover pools and may use the cover pool assets to make payments on the covered bonds should the issuer fail to do so. In case of Valiant, in addition to mortgage claims, the covered bondholders benefit from accessory preferential claims pledged by the mortgagor for the benefit of the issuer and transferred to the guarantor by way of security. The guarantee comes into operation following an issuer event of default, subject to certain conditions. All covered bonds issued under the respective programmes rank *pari passu* with each other and benefit equally from the guarantee. The guarantors are ring-fenced, bankruptcy-remote entities designed to be unaffected by the insolvency of the group to which they are consolidated (guarantors are majority-owned by their respective issuer). All issuers are financial institutions regulated by the Swiss banking regulator, the Swiss Financial Market Supervisory Authority (FINMA).

As part of their legal entity restructurings, UBS and Credit Suisse transferred their residential mortgage businesses to UBS Switzerland AG and CS Schweiz, their newly established domestic subsidiaries. Concurrently, a joint and several liability arrangements were put in place under which these subsidiaries assumed joint and several liability for all contractual obligations of the issuers under the programme, including the covered bonds themselves.

### III. COVER ASSETS

The collateral of Swiss contractual law based covered bonds consists of Swiss residential mortgage loans to private individuals and the related mortgage certificates securing such mortgage loans. In case of Valiant, in addition to mortgage claims, the covered bondholders benefit from accessory preferential claims pledged by the mortgagor for the benefit of the issuer and transferred to the guarantor by way of security. The acces-

sory preferential claims are second and third pillar pension fund assets and are not taken into account in the cover pool and in the calculation of the asset coverage test. Substitution assets can also be used as collateral of the covered bonds as long as their aggregate value does not exceed 15% of the cover pool. They comprise deposits in CHF (foreign currencies eligible only for hedging purpose) and authorised investments. The latter need to comply with stringent ratings to be cover pool eligible.

## IV. VALUATION AND LTV CRITERIA

The eligibility criteria for initial inclusion the Credit Suisse, CS Schweiz and CAnb cover pool limit mortgages to those with a loan-to-value (LTV) of less than or equal to 100%, while the UBS and Valiant programmes limit eligible mortgages to those with LTV of less than or equal to 80%. Certain provisions within the programmes' asset coverage test (ACT) implement LTV limits by capping the value of each mortgage loan at a specified current LTV. This limit is 70% LTV in the Credit Suisse programme and 80% in the CS Schweiz, UBS, Valiant and CAnb programmes.

Mortgage LTVs are regularly calculated using current market values. In case of both Credit Suisse and Valiant programmes, appraisals are undertaken for each mortgage loan application by a valuation model (the IAZI). This comparative approach is one of the main methods used for the appraisal of real estate properties in Switzerland. The property is compared with thousands of other objects previously sold on the market. The price of the object is statistically estimated by comparing the price of properties with similar attributes in comparable locations. The credit risk management department, responsible for the continuous monitoring of the bank's mortgage portfolio, has the discretionary power to trigger a revaluation based on its analysis outcomes. UBS and CAnb conduct similar estimations of the collateral value for residential mortgages based on the Wüest & Partner valuation model, which is also a hedonic regression model. Other valuation methods may be used at the discretion of the lenders in specific circumstances and taken into consideration.

## V. ASSET – LIABILITY MANAGEMEMT

The ACT determines whether the value of the cover pool assets is sufficient for the timely payment of capital and interest owed under the covered bonds and confirms that the minimum overcollateralization (OC) requirements are met. The test is carried out monthly and the results are disclosed in the investor reporting. In addition to the LTV limitations described above, a second part of the ACT haircuts the full balance of the mortgages using an asset percentage (AP). The AP is derived from periodic rating agency feedback and sized to maintain a triple-A rating. The value given to the mortgage assets under the ACT is the lower of (i) the result when applying the LTV limits described above or (ii) the value of the mortgage assets multiplied by the AP. In addition, credit is given to cash and substitute assets while further deductions are made for loans in arrears, borrower set-off risk and potential negative carry. The resulting value must be equal to or exceed the value of the covered bonds outstanding for the test to be passed.

The APs in UBS, Credit Suisse, CS Schweiz and CAnb programmes may fluctuate over time, but are constrained by a maximum value. Valiant uses an alternative ACT ("Aktivendeckungstest"), including a minimum OC. The adjusted value of the Valiant cover pool always has to be equal to at least the nominal value of the outstanding covered bonds including a minimum OC, corresponding to the OC required to maintain the actual ratings up to a maximum committed level capped by contractual provisions at 50%.

The Swiss contractual law covered bond programmes benefit from additional safeguards:

> Exposure to interest rate and currency risks are mitigated by use of derivatives in the UBS programme and legacy Credit Suisse programme. In case of Valiant, CS Schweiz and CAnb, the option to implement derivative instruments is available but has not been to date.

> Liquidity risk is mitigated by the requirements to establish reserve funds, pass an interest coverage test (ICT), maintain pre-maturity liquidity (for hard bullet covered bonds) and the inclusion of 12-months

extension periods (for soft bullet covered bonds). In case of Valiant, the soft bullet structure may not only be applied to a covered bond series after an issuer event of default but may also applied to all outstanding covered bond series after a guarantor event of default (to reduce fire sale risk).

> Minimum rating requirements are in place for the third parties that support the transaction, including the account bank, corporate services provider, servicer and cash manager.

> Commingling risk is mitigated by the requirement of all collections arising from the cover pool assets to be transferred into guarantor cover pool bank account after a specific rating downgrade of the issuer.

> Independent audits of the calculations undertaken on a regular basis by a cover pool monitor.

Upon an issuer event of default following the service of a notice to pay, the Amortisation Test (AT) is run on each calculation date instead of the ACT, and the ICT is no longer run. The AT is similar to the ACT and is designed to mitigate time subordination between the covered bond series therefore ensuring that the cover pool will be sufficient to make payments as required under the guarantee. Upon failure of the test, all covered bonds accelerate against the guarantor.

## VI. TRANSPARENCY

The issuers have committed to publishing monthly investor reports on a timely basis. These reports provide information relevant to investors including:

> The monthly calculations of the ACT and the ICT.

> Details of outstanding covered bonds and list of parties involved in the transaction.

> The current balance of programme accounts.

> A mortgage portfolio summary disclosing total balances, average loan balance, number of properties, WA remaining terms and WA LTVs.

> Tables showing number properties and mortgages by remaining term, current LTV, total balance, interest rate type, property region, property type, and arrears.

## VII. COVER POOL MONITOR AND BANKING SUPERVISION

The issuers are regulated Swiss financial institutions, which are subject to regulation and supervision by FINMA. The cover pool tests comprising the ACT and the ICT as well as AT in case of an issuer's event of default, are checked and verified on a regular basis by an independent cover pool monitor. The results of his review are summarised in cover pool monitor reports for the attention of the guarantor, the issuer and the administrator. The administrator, independent from the issuer, has the duty to advise the bondholder representative (trustee) inter alia upon the breach of a cover pool test. The administrator is responsible for an ongoing monitoring of the cover pool. His main task comprises confirming the accuracy of the inclusion in or the removal from the cover pool, inter alia ensuring that the eligibility criteria are met and verifying that the registered amount in the cover pool is correct. In order to constitute a valid security interest the issuer will no longer be able to dispose over the mortgage certificates by its sole acts. The mortgage certificates can only be accessed with the presence and approbation of the administrator. In addition, rating agencies regularly monitor the programme.

## VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

Upon the insolvency of the issuer, the mortgage receivables and the related mortgage certificates and substitute assets would not form part of the issuer's estate. Accordingly, the asset cover pool may be managed and enforced by the guarantors independently from the corporate insolvency proceedings of the issuers. There are a number of trigger events for default, the first being an issuer event of default. This can occur in a number of situations including the following:

> Failure to pay any interest or principal amount when due.

> Bankruptcy proceedings being ordered by a court or authority against the issuer.

> Failure to rectify any breach of the ACT or ICT.

An issuer event of default would not accelerate payments to covered bondholders, but would allow the trustee to activate the guarantee by serving a notice to pay on the guarantor. Upon the guarantee activation, the cover pool is frozen losing its dynamic nature and no further covered bonds may be issued. The guarantor is required to meet the covered bond obligations using the cash flows generated from the cover pool.

With the exception of one outstanding series issued under the legacy Credit Suisse programme, the covered bonds have a non-discretionary soft-bullet structure, a maximal 12-months extension of the principal repayment, in order to allow the realisation of the cover pool. The repayment extension is only granted if the bondholder representative (trustee) has served a notice to pay and neither the issuer nor the guarantor have sufficient liquidity for the repayment of the covered bond series concerned. In case of Valiant Bank, the soft bullet structure may not only applied to a covered bond series after an issuer event of default but may also applied to all outstanding covered bond series after a guarantor event of default in order to reduce fire sale risk.

The second event of default is the guarantor event of default. This would arise after an issuer event of default if the guarantor failed to make any payments when due, failure of the amortisation test or bankruptcy of the guarantor. A guarantor event of default would cause the acceleration of payments to covered bondholders and their early redemption at the amount relevant to that particular covered bonds series.

## IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

Swiss contractual-law based covered bonds have a 20% risk weighting under the standardised approach in accordance with the EU Capital Requirement Regulation (CRR) because they have not been issued by an EU credit institution. As of 1 January 2021, Swiss contractual-law based covered bonds cannot qualify for ECB repo eligibility because they are not subject to a legislative framework. Lack of legislation also means that Swiss contractual law based covered bonds are not eligible as level 1 or 2 assets under the European Commission LCR Delegated Act.

**Issuers:** Credit Suisse AG, Valiant Bank AG, Credit Suisse (Schweiz) AG, Crédit Agricole next bank (Suisse) SA and UBS AG.

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For further national information on the Swiss contractual law market, please see compare.coveredbondlabel.com/frameworks. To access the "Country Comparison" feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.