3.41.1 SWITZERLAND – SWISS PFANDBRIEFE®

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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 must be authorised by the Swiss Federal Council.

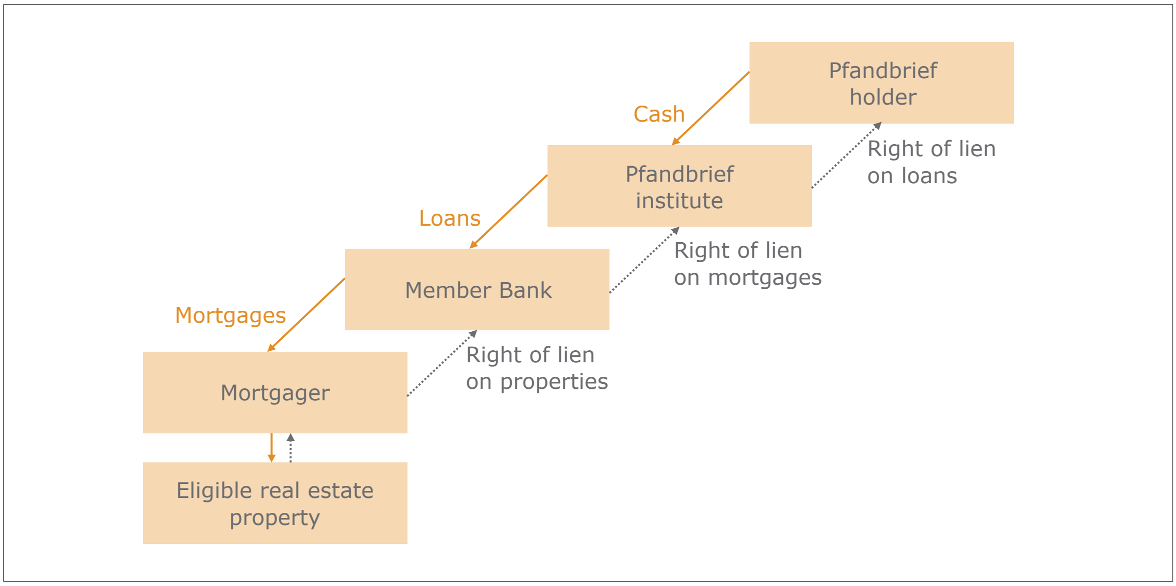
According to the PfG, the issuance of Swiss Pfandbriefe is reserved to two specialised Pfandbrief institutes, namely the "Pfandbriefzentrale der schweizerischen Kantonalbanken AG" (PZ) and the "Pfandbriefbank schweizerischer Hypothekarinstitute AG" (PB). They issue Swiss Pfandbriefe to refinance their 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

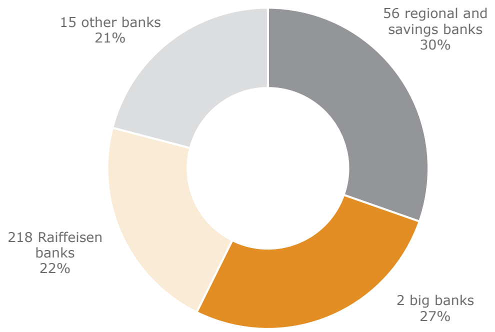


Source: Credit Suisse AG

II. STRUCTURE OF THE ISSUER

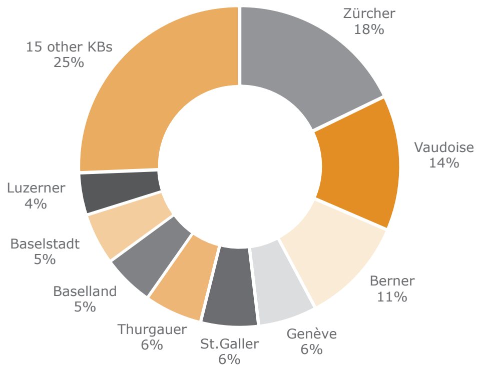
PZ operates as the Pfandbrief issuing vehicle of the Swiss cantonal banks and PB of all other Swiss banks. Both are special institutions with their business scope limited to the issuance of Swiss Pfandbriefe, to granting Pfandbrief loans to their member banks and to investing their share capital and 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



Source: PB as of 31.12.2022

> Figure 3: Shareholders of PZ



Source: PZ as of 31.12.2022

PB was founded in 1931 and counts 288 banks with loans. Any Swiss bank has the right to become a member of PB, if 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 2022, the total outstanding Swiss Pfandbriefe of PB amount to CHF 85.0 billion (EUR 86.4 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 2022, the total outstanding Swiss Pfandbriefe of PZ amount to CHF 77.0 billion (EUR 78.1 billion).

The total volume of all outstanding Swiss Pfandbriefe as of 31 December 2022 amounts to CHF 162.0 billion (EUR 164.5 billion). For years the two Swiss Pfandbrief institutes have been the major bond issuers in Switzerland, even more important than the government. In 2022 they issued Swiss Pfandbriefe amounting to CHF 20.9 billion (EUR 21.2 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. Existing bonds are often 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 these public issuances are listed on the SIX Swiss Exchange AG. In the domestic Swiss Francs bond segment Pfandbriefe amount to 36%, followed by public sector (Swiss government, cantons, cities, regions) with 26%, the banking and insurance sector with 19% and other industries with 19%.

In total about 14% of all Swiss mortgages are refinanced through Swiss Pfandbriefe (11/2022).

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 proposal, which is then either automatically checked with electronic rules (by a hedonic model) or manually in a four-eye system. 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 34 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 overcollateralization daily. If total cover value is below the overcollateralization limit, latest by close of business new eligible mortgages have to be pledged by the member bank.

The "Pfandbriefbank pool" consists of approx. 207'000 mortgages all over Switzerland, which provides a good diversification. 100% are residential properties.

In case of a material change in macroeconomic 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 collateralized 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).

Overcollateralization

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 overcollateralization 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 overcollateralization of the cover pool daily. The mortgages are subject to backtesting, e.g. using 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

As of 1st January 2023, several amendments to the Swiss Banking Act ("Bankgengesetz", BankG) and Banking Ordinance ("Bankenverordnung", BankV) regarding bank insolvency came into force. This essentially anchors the insolvency provisions for Swiss banks at the federal bank law level, strengthens Swiss deposit insurance, ensures full segregation of intermediated securities ("Bucheffekten") in the custody chain, and enables the resolvability for global systemically important banks.

Should there be justified concern that a 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. The protective measures may be ordered independently or in connection with a restructuring or bankruptcy liquidation. Among other protective measures, FINMA can order deferment of payments or payment extension, **except for secured claims of the Pfandbrief institutes (Article 26 (1 h) BankG)**.

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 make the necessary provisions and restructuring orders (Article 28 BankG et seq.):

   > the recovery plan may contain the reduction of the existing bank equity, the creation of new equity, the conversion of debt into equity or the reduction in debt claims (Article 30b (1) BankG et seq.);

   > **explicitly excluded from a debt to equity conversion or reduction in debt claims are in particular** a) defined privileged claims, **b) secured debt claims** [including pfandbrief loans], c) offsettable claims (Article 30b (3) BankG);

   > the conditional conversion of debt into bank equity and the conditional reduction in claims shall be made in the following order: a) subordinated claims, b) claims based on debt instruments for loss absorption in the event of insolvency measures (e.g. bail-in bonds), c) other claims (except for customer deposits) and d) customer deposits (Article 30b (7)-(9) BankG).

c) the 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 et seq.).

At the same time as the amendments to the Swiss Banking Act, the Pfandbrief Act (PfG) was further refined:

Article 40 PfG: Audit and Management of the Cover Pool Assets

(1) If a Pfandbrief institute or a member bank that is in debt to a Pfandbrief institute violates statutory provisions, in particular capital adequacy requirements, or if confidence in it is materially affected, FINMA may appoint an investigating official and may order the transfer of the cover pool assets.

(2) FINMA may mandate the investigating official with the audit and management of the cover pool assets at the expense of the Pfandbrief institute or the member bank.

If a member bank gets into difficulties, FINMA may, based on this article, reinstall the control over the correctness of the collateral management on a situational and risk-adequate basis. In particular, FINMA must assure that the legal and regulative requirements for the cover pool assets are met with at all times.

Article 40a PfG: Separation of Pfandbrief Loans and Cover Pool Assets

(1) If bankruptcy proceedings are opened against a member bank, FINMA orders the separation of the Pfandbrief loans and the cover pool assets, including the incoming interest and repayments. The Pfandbrief loans shall explicitly not become due because of the opening of bankruptcy proceedings.

(2) FINMA appoints an administrator to manage the Pfandbrief loans and the corresponding cover pool. The administrator takes all necessary measures to ensure the full and timely execution of the contractual obligations arising from the Pfandbrief loans, including interests and repayments.

(3) FINMA may approve the full or partial transfer of Pfandbrief loans and Cover Pool Assets.

(4) After repayment or transfer of the Pfandbrief loans, the representative shall account to which extent the cover pool assets have been exercised.

This new article deals with Pfandbrief-related aspects in the liquidation of a failed member bank. To ensure the equilibrium principle and the cover principle at the Pfandbrief institute, the explicit non-maturity of the Pfandbrief loans upon the opening of bankruptcy proceedings is crucial.

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.

In January 2022, the Swiss Federal Council reactivated the sectoral "the countercyclical capital buffer" (CCyB) at the proposal of the SNB and set it at 2.5% of risk-weighted exposures secured by residential property mortgages in Switzerland (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). 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 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 or via the following QR code:

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).