



By Niederer Kraft & Frey

INCREASED, BUT STILL LOW MARKET PENETRATION

In recent years, securitization has become an established and recognized financial instrument in Switzerland, although it still has a certain reputation of undue complexity in both banking and legal circles. Market penetration is still not the same as in the English speaking countries. There are several reasons for this slow acceptance:

- the low cost of borrowing compared to the US or EU countries;
- little legislative support in the fields of taxation, listing rules and banking regulatory provisions (which has, however, somewhat improved recently);
- the limiting effects of the civil law system of mortgage loan financing; and
- stringent banking secrecy rules which require that bank customers consent before an assignment of bank loans to a SPV.

So far, the transactions shown in Figure 1 (see over) have been listed at the Swiss Stock Exchange (SWX).

Furthermore, a two digit number of repackaging transactions were privately placed, none of which involved the issue of securities in the public market, that is, none were listed on the SWX or on a foreign stock exchange. Among the privately placed transactions was the presumably first-ever securitization of sports marketing rights by the Zurich-based Fédération Internationale de Football Association (FIFA) in 2001. An interesting development was initiated by Zürcher Kantonalbank (the state-owned bank of the Canton of Zurich) in 2001: on behalf of the Swiss Cantonal Banks the Pfandbriefzentrale set up a platform under the name of SWISSACT to securitize mortgages and placed residential mortgage-based securities (RMBS) in the amount of €355 million (\$388 million) on the Eurobond market (SWISSACT 2001-1). The platform is available to all Swiss Cantonal Banks for mortgage securitization. Because refinancing costs through interbank loans and Pfandbriefe are still low, none of the other Cantonal banks have used the instrument yet.

REGULATORY FRAMEWORK

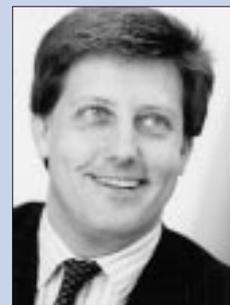
In Switzerland there is no special Act on ABS. Many regulatory issues have been decided by the respective competent authorities on a case-by-case basis. Some of the recurring issues of a Swiss ABS transaction are listed below.

Taxes

It is rare that Swiss issuers use Swiss SPVs, although the tax authorities may be prepared to accept its thin capitalization so that it only has to pay nominal taxes on its income. Securities issued by a Swiss issuer are subject to an issue stamp duty and interest paid is subject to 35% withholding tax (which can be fully reclaimed by Swiss taxpayers and may be partially reclaimed by foreign parties under applicable double taxation treaties). Under certain conditions, tax

About the authors

DR THOMAS A FRICK



Dr Thomas A Frick is a partner with Niederer Kraft & Frey, Zurich, Switzerland. Dr Frick qualified in Zurich and holds an LLM in European Law from the London School

of Economics. He worked with law firms in Zurich, Cape Town and Brussels and with the European Bank for Reconstruction and Development. Dr Frick is a member of the Swiss Bar and lectures on the LLM programme at Zurich university (Banking Law). He advises banks and other financial institutions on structured finance products on a regular basis and was counsel to the originator in various Swiss securitization transactions. Other areas of expertise include secured loan transactions, regulatory and compliance issues.

DR ULYSSES VON SALIS



Dr Ulysses von Salis is an associate with Niederer Kraft & Frey, Zurich, Switzerland. Dr von Salis qualified in Zurich and holds an LLM from Harvard Law School. Dr von Salis is a member

of the Swiss Bar and lectures at St Gall university (Contract Law). He advises banks and other financial institutions on structured finance products and was counsel to the originator in Swiss securitization transactions. Other areas of expertise include secured loan transactions and private equity.

Figure 1: Securitization transactions on the Swiss capital market

Date of Issue	Coupon, Issuer, Term	Rating	Amount CHF mio	Asset Class	Arranger
25.11.1997	3¼% Citibank Credit Card Master Trust 1997/2002 (class A)	Aaa/AAA	1'000	Credit Cards	CSFB
25.11.1997	3½% Citibank Credit Card Master Trust 1997/2002 (class A)	A2/A	64	Credit Cards	CSFB
16.4.1998	3¼% Citibank Credit Card Master Trust 1998/2006	Aaa	750	Credit Cards	CSFB
25.5.1999	Citibank Credit Card Master Trust 1998/2006 (floater)	Aaa	1'250	Credit Cards	CSFB
7.10.1999	3¼% GMAC Swift Trust 1999/2004	AAA	1'000	Car Dealer Loans	CSFB
27.6.2000	GMAC Swift Trust 2000/2003 (floater)	AAA	850	Car Dealer Loans	CSFB
2.8.2000	4⅝% Helvetic Asset Trust 2000/2005 (class A)	Aa1	250	Small Business Loans	UBS
2.8.2000	6¾% Helvetic Asset Trust 2000/2005 (class B)	Baa3	100	Small Business Loans	UBS
5.7.2001	3½% Holmes Financing 2001/2006 (class A)	Aaa/AAA	850	Mortgage Loans	CSFB
7.11.2002	2½% Holmes Financing 2002/2007	Aaa/AAA	300	Mortgage Loans	UBS
8.11.2002	3% ABN Amro (Iboxx 40) 2002/2007	A3	500	Undertakings	ABN Amro
24.7.2003	1½% Chalet Finance 1 2003/2007	Aaa/AAA	500	Mortgage Loans	CSFB
7.8.2003 2003/2008	2% Chess II (Chess 35)	Aa3	125	Undertakings	ABN Amro

authorities will not consider the use of offshore entities as issuer as abusive tax evasion. However, the tax authorities assess the transactions on a case-by-case basis. It is, therefore, necessary to obtain an advance tax ruling.

Lex Koller

The Federal Act on the Acquisition of Swiss Real Estate by Foreigners (formerly called Lex Friedrich) was recently liberalized and today permits the acquisition of commercial real estate by foreigners. However, restrictions with respect to residential mortgages remain in place.

Banking regulations

The Swiss Federal Banking Commission (FBC) has issued decisions approving several transactions

involving Swiss banks. However, there are no general guidelines for Swiss banks. Each transaction of a Swiss bank must be submitted to the FBC for prior approval. In its decisions, the FBC confirmed that the securitized assets will no longer be taken into account for capital adequacy purposes (provided there is a full and bankruptcy-proof transfer of credit risk), that the SPV will not be deemed a regulated entity and will not need to be consolidated by the originator and that the originator may perform additional functions (such as swap counterparty, credit enhancements and so on). A recurring issue discussed by the originator and the FBC is the risk weighting of junior notes. If bank loans are assigned to a SPV, each bank customer concerned needs to have granted prior approval. Hence, synthetic transaction (for which no customer names need to be disclosed to the SPV) become more attractive for banks.

Insurance regulations

The Federal Office for Insurance Supervision repeatedly held that synthetic transactions under which credit protection is sold to the originator by the issuer under a credit default swap are not considered as an insurance activity. However, as there are no general guidelines, negative clearance should be obtained for each synthetic transaction.

SWX listing

In 1997, the SWX issued special guidelines on the listing of ABS.

RECENT MARKET DEVELOPMENTS

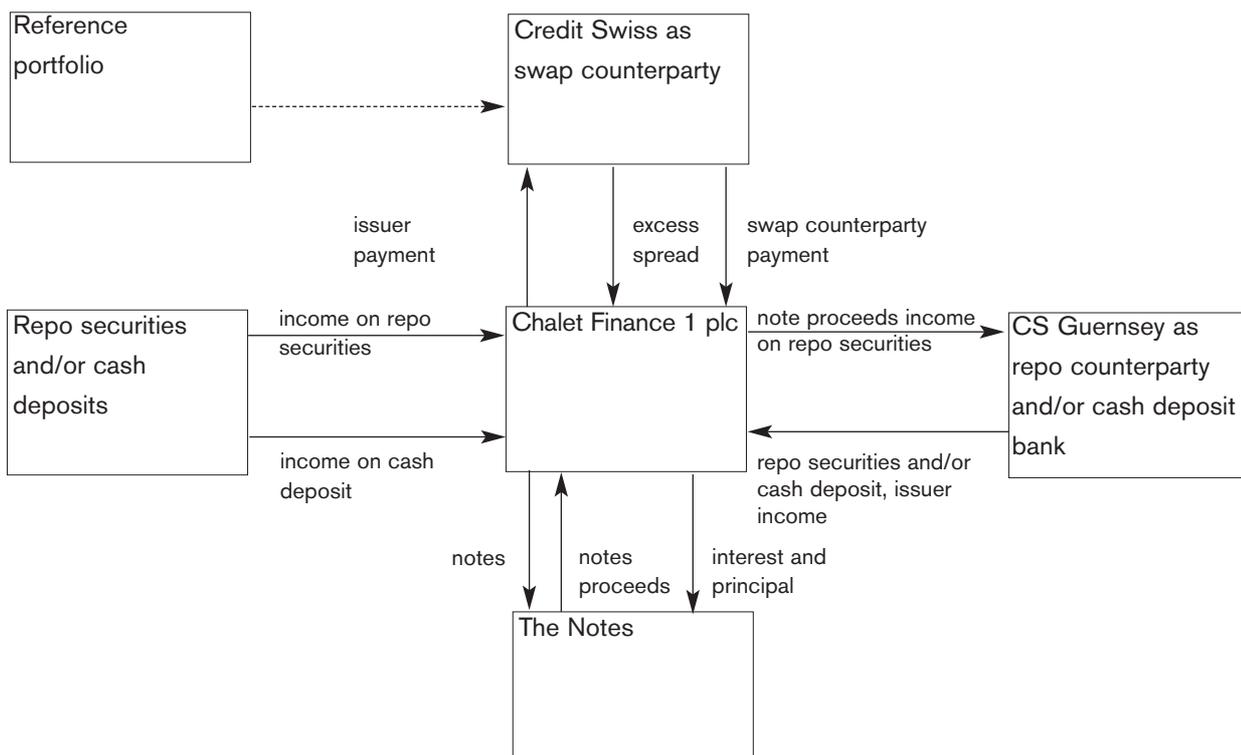
General market trends

The market for securitization transactions was very quiet in the first halves of both 2002 and 2003, but picked up in the second halves. Recently, ABS transactions have become more attractive for Swiss companies due to the widening of credit spreads and due



to credits becoming more difficult to obtain for lower rated borrowers. The number and the volume

Figure 2: The structure of the Chalet Finance 1 transaction





of transactions issued in or in preparation for 2003 is substantial, and it can be expected that further transactions will follow.

Recent transactions

Among the transactions in the first half of 2003 were the following: UBS launched another synthetic transaction (HAT II) in March 2003, securitizing part of the risks attached to Swiss small-business loans. The €160 million notes are listed on the Irish Stock Exchange. Also in spring 2003, Glencore International closed a \$750 million securitization of certain of its base metal inventory holdings in Belgium, Germany, Italy and the Netherlands.

In June 2003, WTF Holdings (Switzerland) launched a multi-tranche commercial mortgage-backed securities (CMBS) benchmark issue in the amount of €699 million through the SPV Eiger Trust. The issue is backed by 112 commercially-used properties spread throughout Switzerland and is the first CMBS issue in Switzerland.

By far the largest transaction this year is the \$2,400 million synthetic RMBS transaction of the Credit Suisse Group. In July 2003, Chalet Finance 1 plc issued Swiss franc, euro and dollar denominated notes backed by a portfolio of Swiss residential mortgage loans held by Credit Suisse. Chalet Finance 1 is not only Credit Suisse's first public securitization

transaction, it is also the largest public securitization transaction made on the Swiss market. The reference portfolio is made up of more than 13,000 loans secured on owner-occupied properties, the aggregate principal balance of which is approximately SFr4.5 billion (\$3.2 billion). Chalet Finance 1 issued several credit-linked notes, the return on which will be linked to a credit default swap transaction entered into between the issuer and the swap counterparty. Under this swap, the issuer sells credit protection to the swap counterparty Credit Suisse in relation to the reference portfolio. As collateral, the issuer places the funds raised under the notes issued either in a cash deposit or enters into a repo agreement, so that the securities purchased under the repo agreement serve as collateral.

DRAFT NEW CIRCULAR OF THE FBC ON CREDIT DERIVATIVES

The FBC intends to issue a circular on how credit derivatives and guarantees are to be taken into account in determining minimum bank capital requirements for Swiss banks, which is supposed to come into force on December 31 2003. The circular covers organizational requirements for risk management, requirements for recognition of guarantees and credit derivatives securing claims on the balance sheet and in the trading books and calculation of the credit equivalent for credit derivatives.

Differences to Basel II

The circular is based on the Third Consultative Paper dated April 29, 2003 of the Basel Committee on Banking Supervision on the New Basel Banking Accord (Basel II), with the following exception: the circular requires the guarantee or the credit derivative to cover the full term of the underlying claim, whereas the Basle II proposal also recognizes covers of parts of the term only. The reason for this difference is technical as current law and systems make it difficult to apply the Basel II proposal today. For similar reasons the add-ons and credit conversion factors for shares will be applied instead of credit derivative specific add-ons and factors.

Legal requirements for credit derivatives

For the purpose of minimum regulatory capital requirement the credit risk of claims on the balance

europa

France

Allen & Overy

26 boulevard des Capuchines
75009 Paris
France

Tel: +331 4006 5400

Fax: +331 4006 5454

Ireland

Matheson Ormsby Prentice

30 Herbert Street
Dublin 2
Ireland

Tel: +353 1 619 9000

Fax: +353 1 619 9010

The Netherlands

Loyens & Loeff

100 Fred Roeskestraat
PO Box 71170
1008 BD Amsterdam
The Netherlands

Tel: +31 20 578 5785

Fax: +31 20 578 5812

Portugal

Macedo Vitorino E Associados

Rua Garrett 12
Lisbon 1200-204
Portugal

Tel: +351 21 324 1900

Fax: +351 21 324 1929

Spain

Garrigues Abogados y Ascsores Tributarios

Jose Abascal 45
Madrid 28003
Spain

Tel: +34 91 514 5200

Fax: +34 91 399 2408

Switzerland

Niederer Kraft & Frey

Bahnhofstrasse 13
CH – 8001 Zurich
Switzerland

Tel: +41 1 217 1000

Fax: +41 1 217 1400

the americas

Canada

Blake, Cassels & Graydon LLP

Suite 2800
199 Bay Street
Toronto, ON M5L 1A9
Canada

Tel: +1 416 863 2638

Fax: +1 416 863 2653

Cayman Islands

Maples and Calder

Ugland House
South Church Street
Grand Cayman
Cayman Islands

Tel: +345 949 8066

Fax: +345 949 8080

Colombia

Brigard & Urrutia

Calle 70 No. 4-60,
Bogota
Colombia

Tel: +571 3462011

Fax: +571 3100609

Panama

Arias, Fabrega & Fabrega

16th Floor, Plaza 2000 Building,
50th Street
Panama City
Panama

Tel: +507 205 7000

Fax: +507 205 7001

Paraguay

Berkemeyer, Attorneys & Counselors

Offices at Benjamin Constant 835,
Edificio
Jacaranda, 4th Floor,
Paraguay

Tel: +595 21 498 708

Fax: +595 21 496 179

United States

Foley & Lardner

321 North Clark Street
Suite 2800
Chicago 60610
USA

Tel: +1 312 832 4784

Fax: +1 312 832 4700

sheet (secured claims) may be substituted by the counterparty risk weighting of the credit derivative claims if the credit derivative agreement between the bank and the securing counterparty does the following:

- entitles the bank to a direct claim;
- contains explicit and specific reference to the underlying claim;
- is irrevocable (except for termination upon default of the bank);
- is non-conditional;
- is in writing;
- covers the full term of the underlying claim;
- is entered into with an OECD country, a bank of an OECD country, a multilateral development bank or a counterparty having at least an A Rating from Dominion Bond Rating Services, Fitch, Mikuni, Moody's Investors Service, Standard & Poor's Rating Services or Thomson Bank Watch;
- includes at least the following credit events: default, insolvency and other events resulting in the inability to make timely payments, restructuring of the underlying claim by way of release, moratorium and similar events resulting in loss of value;
- includes a clear definition of who determines the occurrence of a credit event; this determination right not to be vested solely in the securing counterparty; additionally, there must be a right to inform the counterparty of the occurrence of a credit event; and
- includes a right to transfer the underlying claim

to counterparty, if this transfer is necessary for settlement (these consents not to be withheld unreasonably).

If an agreement provides for a cash settlement the recognition requires the existence of a stable valuation method allowing for reliable estimation of the loss. Furthermore, there must be a specific period after the occurrence of a credit event within which the valuation of the secured claim has to be made.

If the underlying claim does not match the secured claim (asset mismatch) the additional requirements are:

- secured claim and underlying claim must be issued by the same legal entity;
- the underlying claim must be of equal or subordinated ranking to the secured claim; and
- a valid cross-default clause or cross-acceleration clause must exist.

CONCLUSION

Swiss banks and companies are increasingly recognizing the advantages of securitization structures, but the market continues to be slow to develop. The regulatory framework has been improved by several decisions by the FBC and the insurance regulators, by the ABS Listing Guidelines of the SWX and by the recent draft of the FBC's circular on Credit Derivatives. With the rules becoming more transparent, the market should continue to develop.

NIEDERER KRAFT & FREY		
Bahnhofstrasse 13, CH-8001 Zurich, Switzerland		E-Mail: nkf@nkf.ch Website: www.nkf.ch
Phone: +41-1-217-1000 Fax: +41-1-217-1400		
<ul style="list-style-type: none"> • Banking, securities and finance • Company and commercial • Mergers and Acquisitions • Competition and antitrust • Tax • EC law • IT and telecommunications • Arbitration, litigation and judicial assistance 	<ul style="list-style-type: none"> • Insolvency and restructurings • Insurance • Intellectual property • Project finance (including aircraft finance) • Private Equity • Wills, trusts and estate planning • Environmental and healthcare law • Sports law 	Languages spoken: German, English, French, Italian, Spanish and Dutch Established: 1936 Number of lawyers: 65