# Global Securitisation Yearbook

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**Securitisation of Swiss assets is at present only in the early stages of development. Given the regulatory progress in the capital markets and the general tax environment, however, securitisation today represents a viable option of refinancing in the Swiss banking and non-banking sectors.**

## Low market penetration

In Switzerland, as in many other countries, securitisation has acquired a reputation for undue complexity in both banking and legal circles and has not yet achieved the level of market penetration attained in the US. The reason for this slow acceptance of asset securitisation in Switzerland is primarily the result of:

- the low cost of borrowing as compared to the US or EU countries;
- rather adverse legislation in the fields of taxation, listing and bank supervision which has, however, been gradually eliminated over recent years (see below); and
- the German system of financing mortgage loans adopted by Switzerland, as by many other European countries, which ultimately proved less flexible than the Anglo-American system in the context of securitisation (see below).

In the banking sector only a limited number of transactions have been completed, mainly due to the following three reasons. Firstly, the transfer of customer loans to the issuer of securities (generally a special purpose vehicle, SPV) requires that customers explicitly waive Swiss banking secrecy (only some banks include a transfer–and waiver clause in their standard loan agreements). Secondly, pledges securing the loan may only be re-pledged to the SPV by the bank with the customer's explicit consent in a special deed. Thirdly, the transfer of general pledges to the SPV, as are commonly used in Switzerland, deprives the bank of the opportunity to use such a general pledge for other outstanding debts of the customer.

In the non-banking sector the number of transactions executed is into double figures, most of which were private placements. Generally, conduits (i.e. SPVs designed to provide finance against the purchase of receivables from a number of originators) were used to reduce costs. The assets used in these securitisation transactions were primarily trade receivables, and the transactions were, as a rule, refinanced outside of Switzerland.

So far the transactions detailed in figure 1 have been listed at the Swiss Stock Exchange, either by Credit Suisse First Boston (CSFB) or by UBS Warburg (UBSW).

**figure 1: securitisation transactions listed in Switzerland**

| Date | Coupon, issuer, term | Rating | Amount Sfr million | Asset class | Arranger |
|---|---|---|---|---|---|
| 12.10.2000 | $4^1/8$% MBNA Master Credit Card Trust II 2000/2007 | Aaa/AAA | 1000 | Credit cards | CSFB |
| 02.08.2000 | $4^5/8$% Helvetic Asset Trust 2000/2005 (class A) | Aa1 | 250 | Small business loans | UBSW |
| | $6^3/4$ % Helvetic Asset Trust 2000/2005 (class B) | Baa3 | 100 | Small business loans | UBSW |
| 27.06.2000 | GMAC Swift Trust 2000/2003 (floater) | AAA | 850 | Car dealer loans | CSFB |
| 07.10.1999 | $3^1/4$% GMAC Swift Trust 1999/2004 | AAA | 1000 | Car dealer loans | CSFB |
| 25.05.1999 | Citibank Credit Card Master Trust 1999/2003 (floater) | Aaa | 1250 | Credit cards | CSFB |
| 16.04.1998 | $3^1/4$% Citibank Credit Card Master Trust 1998/2006 | Aaa | 750 | Credit cards | CSFB |
| 25.11.1997 | $3^1/4$% Citibank Credit Card Master Trust 1997/2002 (class A) | Aaa/AAA | 1000 | Credit cards | CSFB |
| | $3^1/2$% Citibank Credit Card Master Trust 1997/2002 (class B) | A2/A | 64 | Credit cards | CSFB |

## Substantial advantages

The reasons for an originator to securitise certain assets are principally the following:

- Increased liquidity. As consideration for the transfer of assets to the SPV, the originator receives substantial liquidity that may be used to repay debt or equity or may be invested in other assets.
- Lower cost of funds. The originator may have assets on its books of a greater quality than itself. By borrowing money against the credit risk of such assets it will obtain cheaper cost of funds. In other words, the originator is realising an arbitrage between its credit rating and the credit rating of its debtors.
- Free up balance sheet. By removing the securitised receivables from its balance sheet a bank originator can improve its ratio for capital adequacy purposes.
- Diversification of funding. The originator gains access to new sources of funds provided by an investor base that may well be wider than that to which he normally has access, such as traditional bank finance. Sale of asset backed securities can take place on a worldwide basis with investors purchasing notes or bonds in a number of jurisdictions.
- Access to capital market. Given the relatively high transaction costs of asset securitisation, it is mostly of interest for originators that would otherwise have no access to the capital markets.

## Securitisation structure

A simplified transaction structure of asset securitisation is set out in figure 2.

The arranger, usually an investment bank, establishes a special purpose vehicle (SPV). The SPV purchases assets, typically the receivables, from the originator. The SPV funds the purchase price by issuing securities, typically notes or bonds.

The assets acquired by the SPV generate a cash flow that is used to pay interest on the notes or bonds. The redemption proceeds of the assets are used by the SPV to redeem the notes or bonds upon maturity.

The transfer of the receivables to the SPV will generally not be notified to the debtors, and the originator will collect all claims against the debtors as servicer (provided that such mandate may be terminated upon default of the servicer by the SPV).

The arranger must create some form of security over the assets in favour of the investors (credit enhancement) in order to achieve a high rating of the asset backed securities.

## Capital market requirements

The asset securitisation must meet the following requirements of the capital markets and of the rating agencies:

- The sale of the assets to the SPV must be irreversible. The rating agencies will make an assumption that the originator will go bankrupt immediately after the sale. The test is whether or not the transfer of receivables will survive the liquidation of the originator, and that the liquidator cannot claw back the receivables.
- Bankruptcy of the originator/servicer must not have a negative impact on the SPV's ability to service the asset backed securities.
- The SPV must be bankruptcy remote i.e. neither creditors nor shareholders shall be in a position to prompt the SPV's bankruptcy.
- If the transfer of receivables (assignment) is not being notified to the debtors, adequate measures must be taken in order to ensure that the SPV can itself enforce the creditor rights at any time, if necessary.
- Securitisation is designed to (irreversibly) remove assets from the originator's balance sheet and, therefore, the SPV shall have no or only limited recourse against the originator.
- The transaction must not trigger substantial additional taxes.

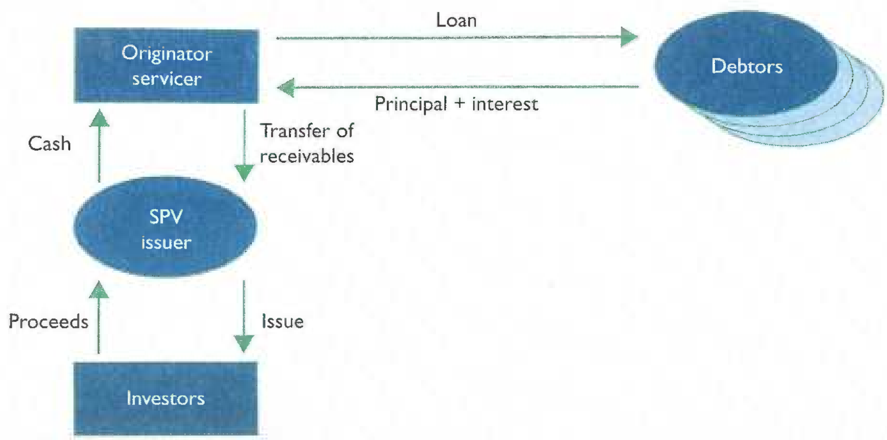
The following changes in the Swiss federal capital market laws and federal tax laws have now significantly improved the attractiveness of securitisation of Swiss assets.

## Taxation

Obviously, one of the crucial questions in securitisation transactions is how the SPV is to be treated for tax purposes. Adverse tax implications, in particular in the field of withholding taxes, stamp duties and value added taxes, must be avoided:

- Withholding taxes and stamp duties. As a rule, the SPV is located offshore i.e. outside the jurisdiction of the originator (particularly in the Channel Islands, Ireland, Luxembourg or the Cayman Islands). In general, based on its interpretation of the tax avoidance criteria as set out by the Swiss Federal Court, the Swiss Federal Tax Administration takes the view that even though an SPV is located outside of Switzerland, notes issued by it may nevertheless be subject to both withholding taxes and stamp duties if the proceeds of the securities issued by the foreign-based SPV are being used in Switzerland.

  Such taxes are rather substantial: Withholding taxes are as high as 35%; they are refunded to foreign investors (totally or partially) pursuant to the applicable double taxation treaties. For bond issues a stamp duty (Securities Issue Duty) of 1.2‰ for each year of the maximum duration of the bonds will be levied at the issue. In addition, a transfer stamp duty (Securities Transfer Duty) of 1.5‰ for Swiss securities and of 3‰ for foreign securities will be levied on each transfer in which a figure 2: simplified transaction structure for an asset securitisation




Swiss registered securities dealer is either party or intermediary to the transfer.

The Swiss Federal Tax Administration, (contrary to German tax authorities, for example), is willing to issue formal tax rulings. A favourable tax ruling confirming that a securitisation structure does not represent a tax avoidance scheme may be obtained even though proceeds are being used in Switzerland provided the following particular conditions are met: The transfer of the assets to the SPV must be at arm's length i.e. a true sale; the assets transferred must be eliminated from the financial statements of the originator and must be replaced by the sales price; the risk for the assets, in particular the bad debt risk, must be fully borne by the SPV; accordingly, there is no obligation on the part of the originator to take back the assets. In other words: There must be an irrevocable transfer of the assets and of all related risks.

- Value Added Tax (VAT). If the receivables that are transferred from the originator to the SPV are neither tax-exempt nor zero-rated and therefore subject to VAT in Switzerland, for example leasing payments of Swiss resident lessees (but not credit card receivables, mortgage loans, or any other form of loans), an additional tax ruling is required to avoid substantial adverse VAT consequences.

  The Federal Tax Administration has issued guidelines relating to factoring. However, it is unclear to what extent they apply to securitisation as well. Under these guidelines, securitisation would be regarded as a financing mechanism that generally will not affect the levying of taxes with the originator and the debtors (no triangular transaction). However, securitisation may necessitate an instant substantial pre-financing of VAT as the originator is by definition receiving substantial liquidity at once. Until now no ruling has been issued by the Federal Tax Administration regarding whether VAT would be levied on the net i.e. discounted, cash flow or rather on the grossed-up receivables, and whether the debtors may claim for refund of corresponding input VAT simultaneously.

## Listing

In October 1997, the Swiss Exchange (SWX) introduced guidelines specifically designed to regulate the issuance of asset backed securities, taking into account the special needs of both originators and investors. They include the following rules:

- SPV need not have a minimum existence of three years, as usually required for issuers listed on SWX.
- Minimum capital requirements do not apply to SPV as issuer of asset backed securities.
- Asset backed securities may only be listed on SWX if they are rated by at least one recognised rating agency (Standard & Poor's Rating Service, Moody's Investors Service, Fitch's Rating Service, Duff & Phelps Credit Rating). However, no minimum debt rating is required.
- The offering circular or prospectus must, in addition to the usual listing particulars, contain both a transaction summary and a transaction overview. The transaction summary must convey the overall picture to potential investors, however a detailed risk analysis is not required. The transaction overview must provide a description of the deal structure (including the parties involved, their functions, the flow of funds, security measures and the termination procedure) as well as an outline of the various risks (collateral, structural, legal and other significant risks).

These new rules are expected to make a SWX listing attractive for SPV, although as of summer 2000 only a handful of SPVs were listed at SWX (namely the Citibank Credit Card Master Trust, the General Motors Acceptance Corporation Swift Trust and the Helvetic Asset Trust, see above).

## Asset securitisation by banks

In March 1998 the Federal Banking Commission (FBC) rendered a landmark decision allowing a bank to securitise certain of its assets. This ruling, which has not been published, appears to be generally in line with the international practice of bank supervisory bodies and may be summarised as follows:

- Any bank seeking to securitise its assets must first consult with the FBC.
- The bank transferring the assets may act as servicer i.e. may continue to perform the services vis-à-vis its customers regarding the administration of the assets.
- There is no need for the bank to consolidate the SPV i.e. the bank need not provide capital against the transferred assets. For avoidance of doubt, there must not be any obligation of the bank to provide financial assistance to the SPV whatsoever (true sale).
- The SPV, if established in Switzerland, is not considered as conducting banking business and, therefore, does not require a banking licence.
- The statutory auditor must comment on the bank's remaining assets in its annual report. This requirement has been added to avoid cherry picking that would leave the bank with second choice assets after the securitisation.

Furthermore, Swiss banks must comply with Swiss banking secrecy rules when transferring customer loans or otherwise disclosing customer names, which will usually require customers to explicitly waive Swiss banking secrecy.

## Securitisation of mortgages

Securitisation of Swiss mortgage loan portfolios by a bank (originator) prompts the following additional issues:

- (Re)Pledging. The security to be transferred to the SPV is either a mortgage note (*Schuldbrief/cédule hypothécaire*) i.e. a negotiable instrument certifying the validity of the claim, or a mortgage (*Grundpfandverschreibung/hypothèque*) in which case no negotiable instrument is being issued. Generally, the mortgage note or the mortgage, as the case may be, will also secure other customer loans in addition to those being transferred to the SPV. The bank will seek to retain the benefit of such security.

  Joint benefit, both of the SPV and of the bank, may be achieved by transferring the mortgage note or mortgage to a third party acting as collateral holding agent. Nonetheless, the SPV should be in a position to enforce the mortgage note or mortgage

**figure 3: the Tell listing (London)**

| Date | Issuer, coupon, term | Rating | Amount Dm million | Asset class | Arranger |
|---|---|---|---|---|---|
| 15.06.1998 | Tell Floating Rate Certificates 1998/2004 (class 1A) | Aaa/ AAA | 200 | Mortgage loans | SBC-WDR (now: UBSW) |
| 15.06.1998 | Tell Floating Rate Certificates 1998/2006 (class 2A) | Aaa/ AAA | 100 | Mortgage loans | SBC-WDR (now: UBSW) |
| 15.06.1998 | Tell Floating Rate Certificates 1998/2004 (class 1B) | A2/A | 9 | Mortgage loans | SBC-WDR (now: UBSW) |
| 15.06.1998 | Tell Floating Rate Certificates 1998/2006 (class 2B) | A2/A | 5 | Mortgage loans | SBC-WDR (now: UBSW) |

in its own name and without the cooperation of the originator (note should be taken in this context that forfeiture clauses, as used under the Anglo-American system, are not possible under the German mortgage system that is followed also by Switzerland).

The pledging of mortgage notes to the SPV might potentially infringe on the banking law which states that pledges may only be repledged by the bank to a third party with the customers' explicit consent in a special deed. In most instances of securitisation of mortgages, restrictions on repledging should not apply since the mortgage note will continue to secure the customer's debt (i.e. it will not be misused to secure other debts) and may be returned to the customer upon repayment of its debt.

- Lex Koller: Any SPV domiciled outside of Switzerland, controlled by foreigners, or raising funds outside of Switzerland with the purpose of securitising Swiss mortgage loan portfolios must abide by the federal law relating to the acquisition of real estate by foreigners, so-called *Lex Koller*. This law aims at controlling and limiting the acquisition of Swiss real estate by foreigners; the financing of real estate against substantial mortgage may also qualify as an acquisition under the law. If the loan-to-value ratio exceeds 80% i.e. if the real estate is being mortgaged more than 80%, the foreign lender is deemed to acquire an 'owner-like position' which, as a rule, requires special authorisation.

In October 1997 the field of application of *Lex Koller* was substantially narrowed. To the extent that the real estate in question is used for commercial (as opposed to residential) purposes, foreigners no longer require any special authorisation.

The mortgage sale agreement between the originator and the SPV should contain very clear-cut eligibility criteria for mortgage notes and mortgages that may be submitted to the Federal Department of Justice for approval.

**figure 4: the structure of the Tell transaction**

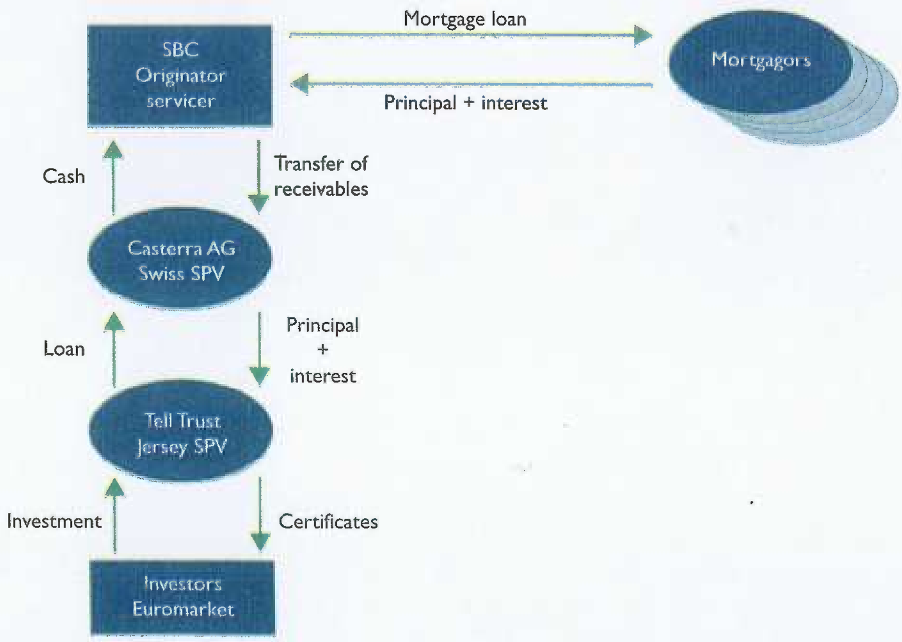
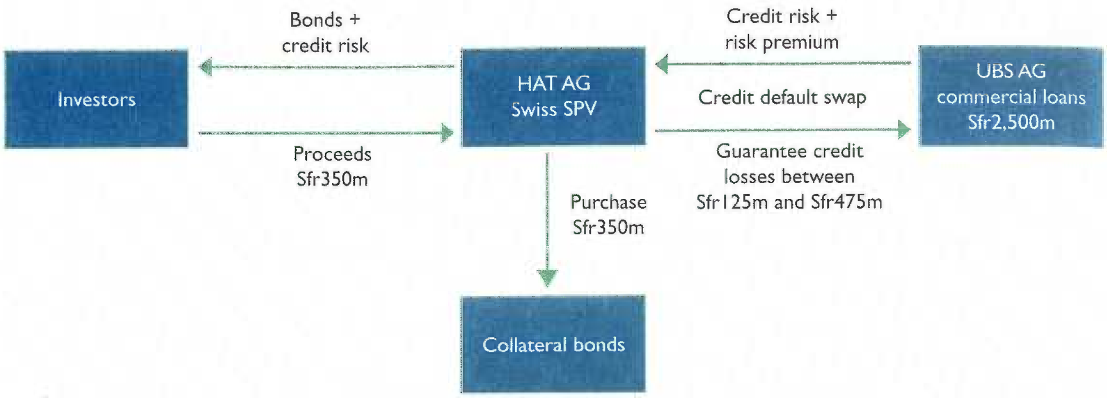


**figure 5: the structure of the HAT transaction**




So far, no mortgage backed securities have been listed at the SWX. The only listed securitisation of Swiss mortgages, the so-called Tell transaction, was denominated in deutschmark and listed at the London Stock Exchange with the parameters shown in figure 3.

In the Tell transaction structure (see figure 4) very lengthy eligibility criteria required, inter alia, that the mortgagors had provided prior written waiver of banking secrecy, that the mortgage notes had been given to SBC by way of title transfer (*Sicherungsübereignung/transfert de propriété à fin de garantie*) and that the loan-to value ratio did not exceed 80%.

## Repackaging

In Switzerland, a two digit number of repackaging transactions were privately placed, none of which involved the issue of securities in the public market i.e. none were listed on the SWX or on a foreign stock exchange.

The motivation of repackaging, a special form of asset backed securities, is not financing of the issuer and the originator, respectively, but rather arbitrage of different markets. Repackaging transactions focus on tailor-made needs of the market, such as the lack of bonds of a certain issuer in a specific currency. In this situation, existing securities may be pooled and reissued in the new currency as so-called 'synthetic' securities having the same credit risk and features of one security. Most repackaging deals are issued by a bankruptcy remote SPV that purchases the bonds to be repackaged in a different currency and enters into a swap agreement with an institution having a debt rating at least as high as that of the resulting synthetic securities.

## Synthetic collateralised loan obligations

If a portfolio of commercial loans is acquired by the SPV that issues notes or bonds against collateral, the securitisation qualifies as a collateralised loan obligation (CLO). In August 2000, the first CLO backed by Swiss assets was listed on the SWX. The bonds, issued by Helvetic Asset Trust (HAT) were backed by a loan portfolio of UBS AG to the amount of Sfr2,500m. However, the HAT transaction deviated from the traditional CLO structure for a number of reasons:

- The loan receivables were not sold to HAT, the SPV, and hence not removed from the balance sheet of UBS.
- Instead, UBS and HAT entered into a credit default swap pursuant to which HAT assumed certain specific credit risks (Sfr475m), after UBS' own share in the risk (Sfr125m).
- The proceeds of the public offering (Sfr350m) were not used to purchase loan receivables from UBS, but rather to purchase high quality collateral bonds (with a rating of at least Aa1/AA+).
- The investors will not receive interest and principal deriving from the underlying loan portfolio, but rather the coupon of the collateral bonds plus the risk premium paid by UBS.

Hence, the HAT transaction is in fact a 'synthetic' CLO since it combines the techniques of securitisation with those of credit default swap. The deal structure is set out in figure 5.

## Outlook

Securitisation of Swiss assets is at present only in the early stages of development. Given the regulatory progress in the capital markets and the general tax environment, however, securitisation today represents a viable option of refinancing in the Swiss banking and non-banking sectors.

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