Swiss securitisation in 2003

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There were two ground-breaking transactions in the Swiss securitisation market in 2003: Switzerland's first commercial mortgage-backed transaction and the placement of a US$260m catastrophe bond transaction which transfers certain risks resulting from a cancellation of the FIFA World Cup competition in 2006. Earlier this year, Banca del Gottardo launched its European medium-term note platform with an actively-managed, collateralised debt issue and three other CDO issues. In the regulatory arena, the Swiss Federal Banking Commission recently has issued a circular on credit derivatives.

First Swiss CMBS Issue – "Eiger"

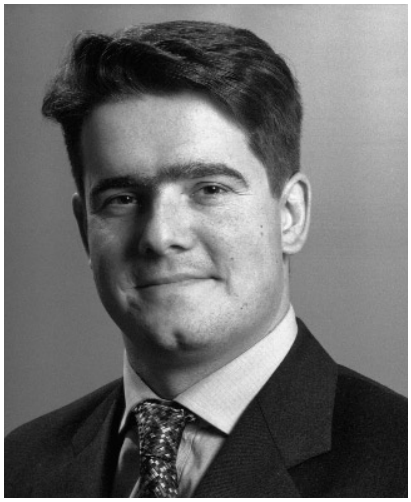
In Switzerland's first commercial mortgage-backed securities transaction, WTF Real Estate (Switzerland) and WTF Properties (Switzerland) refinanced a sale-and-lease back transaction in 2001 in which they acquired a portfolio of commercial properties from the privatised Swiss national telephone company, Swisscom AG. The refinancing for the portfolio of 112 properties was funded through an €699m issue of notes by the Jersey-based Eiger Trust. High loan-to-value ratios and attractive funding costs were among the key economic drivers for this transaction.

Farewell to "Tell"

In June 2003, the first Swiss residential mortgage-backed transaction ("Tell") came to a successful end and investors were repaid on the expected maturity date.

FIFA CAT Bond: Cancellation Risk

Fédération Internationale de Football Association ("FIFA"), the world governing body of football, closed a US$260m catastrophe bond transaction in the fourth quarter of 2003 which transfers the risk of cancellation of the final of the FIFA World Cup scheduled to be held in Germany in the summer of 2006 to the capital markets. This first-of-its-kind transaction filled the gap created by the global insurance industry's withdrawal of insurance products including coverage for losses caused by acts of terrorism after 11 September 2001. The bonds provide non-cancellable insurance coverage for certain losses resulting from the cancellation of the 2006 FIFA World Cup and include cover if cancellation results from terrorist attacks. Because FIFA retains absolute discretion to cancel the 2006 FIFA World Cup final match, a mechanism was needed to address so-called moral hazard concerns that FIFA could arbitrarily cause the event triggering a payment from the proceeds of the issue. This concern was resolved by creating a determination committee comprised of independent arbitrators that must confirm that defined criteria have been satisfied before any payment under the bonds is made. The arbitration procedures of this committee are governed by the Swiss Federal Act on Private International Law (Art. 176, et seq.) From a legal perspective, it was crucial to ensure that no transaction party, including investors in the issue, would be considered to be carrying on insurance business in any relevant jurisdiction. From a risk analysis perspective, the transaction required the development of a model that could estimate the probability of a catastrophic event, including a terrorist attack, affecting the 2006 FIFA World Cup. The issue was rated A3 by Moody's.



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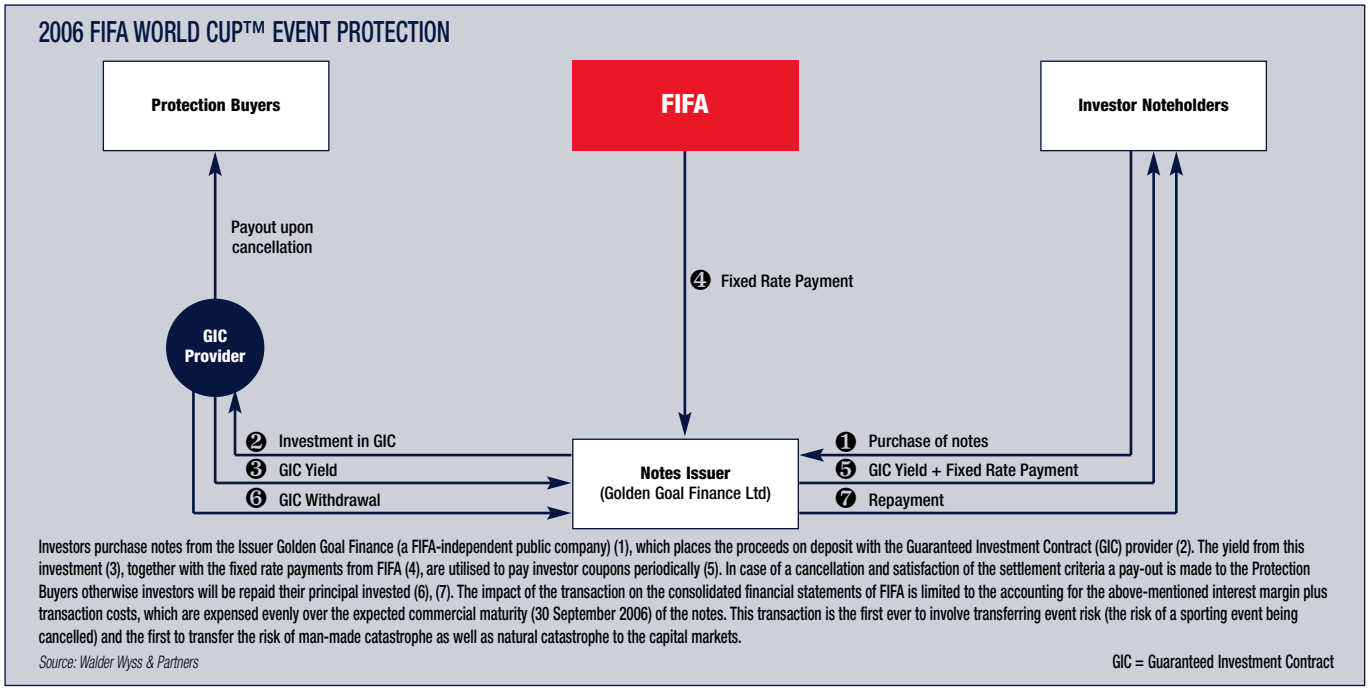


EMTN Programme of Banca del Gottardo

In February of this year, Banca del Gottardo, a Swiss-based bank specialising in private banking and asset management, placed the first issue notes under its €2bn European medium-term note programme established with Integer Investment PCC, a protected cell company incorporated in Guernsey. The proceeds of the issue were invested in a portfolio of triple-A rated corporate, government and asset-backed securities which is actively managed by Banque du Gothard (Luxembourg) S.A. Since then, Integer has issued three further CDO issues.

Banca del Gottardo's first asset-backed transaction was the securitisation of a portfolio of industrial equipment leases originated by its leasing subsidiary, Dreieck Leasing AG, in a true-sale transaction in May, 2002.

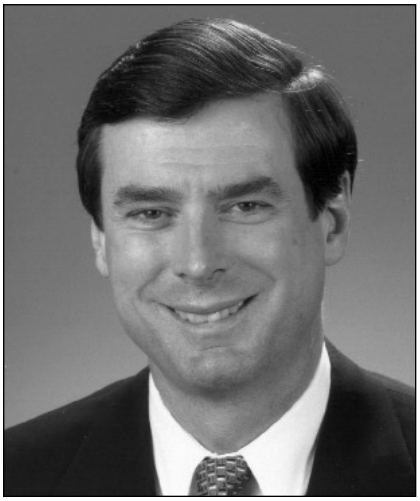
Trade receivables

The securitisation of trade receivables still constitutes the bulk of securitisation transactions in Switzerland and most are placed privately. These transactions, in use since 1994, can be considered standard, especially if the financing is provided by a securitisation conduit. Stand-alone SPVs outside Switzerland have sometimes proven to be difficult because of Swiss tax law issues. With respect to the cross-border assignment of future receivables there is an uncertainty under applicable international private law rules as to whether the law of the receivables (lex causae) or the lex concursus would control in the event of a bankruptcy of the originator.

Tax issues in Swiss ABS transactions

A Swiss SPV is fully subject to income and capital tax, but only has to pay nominal taxes because the tax authorities have accepted the thin capitalisation of the SPV and the deductibility of all its expenses.

In addition, securities issued by a Swiss issuer are subject to an up-front issue stamp tax of 12bp if the debt issue is placed with more than 10 investors under identical commercial terms or 6bp if the debt issue is placed with more than 20 investors (regardless of any differences in the term, coupon or other characteristics of the securities comprising the issues within a series of issues). Interest paid to investors under the securities of a Swiss issuer also is subject to withholding tax at a rate of 35%. Although the withholding tax can be reclaimed and offset against Swiss income taxes by Swiss taxpayers, and sometimes can be fully or partially reclaimed by foreign taxpayers when permitted by a double-taxation treaty, the stamp taxes are a cost to the issue. Thus issuers have long avoided these problems by issuing securities through a non-Swiss entity. Structures are available which will not trigger either Swiss withholding tax on the (deemed) interest element of funds flowing to the originator and they will not incur issue stamp duty on the total amount of the financing. The requirements for exemption from these taxes are, however, stringent and the tax authorities consider transactions on a case-by-case basis. An advance tax ruling is therefore recommended.



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Data protection

The assignment and transfer of e.g. receivables entails a transfer of the related customer data, including the personal data of legal entities, which are classified as personal data under the Swiss Data Protection Act ("DPA"). There is no case law available and there is little guidance from the practice of the Swiss Data Protection Commissioner (the "Commissioner") on the issue of whether a seller/assignor of receivables (a transferor of personal data of the obligors) must establish a level of data protection equivalent to the level required by Swiss law to avoid potential infringement of privacy rights. Irrespective of whether an equivalent level of data protection has been established by contractual means, the seller can be under a duty to notify the Commissioner of the planned cross-border data transfer if the debtors (data subjects) have no knowledge of such transfer.

Anti-money-laundering regulations

The Swiss Money Laundering Commissioner (the "ML-Commissioner") has recently started to expand the interpretative discretion provided to it by the Money Laundering Act (the "MLA"). The ML-Commissioner now takes the view that certain factoring and financing transactions characterise as financial intermediaries activities under the MLA, and as a consequence, require appropriate licensing by the ML-Commissioner or a recognised self-regulatory organisation.

Very recently, the ML-Commissioner has released additional interpretative guidance pursuant to which the territorial reach of the MLA, under certain circumstances, is expanded to non-Swiss financial intermediaries which de facto conduct their activities in or out of Switzerland. In light of this constantly changing regulatory environment, due consideration must be given on MLA issues, as currently interpreted by the ML-Commissioner. Unfortunately, the ML-Commissioner, unlike other Swiss regulatory bodies, is not prepared to issue advance rulings or comfort letters.

Synthetic transactions

We have noted continuing interest in synthetic transactions. In July 2003, Credit Suisse closed its first synthetic transaction, "Chalet I", a US$2.4bn fully funded CLO referenced to a portfolio of residential mortgaged loans held by Credit Suisse, followed by "Chalet II", a US$2bn follow-up transaction in the fourth quarter of 2003. These transactions followed the first Swiss synthetic transaction, in which UBS AG transferred a layer of credit risk embedded in a portfolio of loans made to small- and medium-sized businesses located in Switzerland to the capital markets through its "HAT" transaction in 2000. The portfolio related to that transaction is actively managed by UBS AG in order to allow it to manage credit risk in its loan portfolio. UBS completed "HAT II" in early 2003.

SUMMARY OF LEGAL ISSUES IN TYPICAL TRUE SALE TRANSACTIONS

The following table summarises typical legal issues and how they can be addressed in a true sale securitisation transaction from a Swiss legal perspective.

True Sale	
Limitation on amount of recourse?	No (however, for tax true sale purposes direct/ indirect recourse should not exceed 15%)
Limitation on permitted forms of recourse?	No
Need notice to debtors?	No
Need written transfer document?	Yes (assignment must be in writing)
Need public filing?	No
Can make public filing?	No
Can take backup security against seller?	Legally possible, but is likely to make transaction a secured financing (still bankruptcy remote) which may lead to negative tax implications.
Automatic transfer of related assets?	Yes generally, but not all assets
Contractual prohibition on transfer binding?	Yes, a pactum de non cedendo is binding for both "consumer" and "commercial" receivables.
Assignment cuts off debtor defences?	No
Notice cuts off new debtor defences?	Yes (existing set-off defence remains possible if debtor's claim becomes due before assignor's claim against such debtor). Under the Swiss Consumer Credit Act (if applicable), any waiver related to such debtor defences would be invalid.
Continuous sale of receivables possible?	Yes (if general assignment without further action, if assignment of certain receivables only, a transfer agreement needs to be executed).
Tax	
Stamp duty or other tax on transfer?	No (as long as a tax true sale is given). However, a source tax on interest payments under a loan secured by Swiss real estate will apply.
VAT on transfer?	No
VAT on servicing fee?	Yes, if servicing provided by Swiss servicer to Swiss SPV. No, if servicing provided by non Swiss servicer to non Swiss SPV. Case by case review if servicing provided by Swiss servicer to non Swiss SPV.
Withholding tax on remittance of non-interest bearing payments to offshore recipient?	No (if true sale)
Withholding tax on remittance of interest bearing payments to offshore recipient?	No, unless the underlying qualifies as (i) a Swiss bond, (ii) a deposit with a Swiss bank, or (iii) a mortgaged loan.
Taxation of buyer in seller's country if no permanent establishment in country?	No
Bankruptcy	
Stay of actions after insolvency?	Yes
Rejection of executory contracts after insolvency?	Yes, at the choice of the liquidator (cherry picking)
Transfers voidable if for less than fair value?	Yes
Transfers voidable if fraud on creditors?	Yes
Length of claw-back period	1 year (undervalue, overindebtedness), 5 years (fraudulent conveyance).
Substantive consolidation?	No
Other Legal or Regulatory	
Special securitisation law?	No
Buyer needs banking license in seller's jurisdiction?	No
Seller or buyer needs license to collect receivables?	No
Seller or buyer needs other license in seller's country?	Generally no, but consumer credit license may be required to acquire consumer credit contracts.
Data protection laws?	Yes, for both consumer and corporate receivables.
Bank secrecy laws?	Yes if seller is a bank.
Money laundering regulations?	Yes

Regulatory issues in the securitisation of bank assets and synthetic transactions

The Swiss Federal Banking Commission ("FBC") gave guidance on its position with respect to the regulatory treatment of the securitisation of bank assets in 1998 and has not published any further guidelines since. The approach which the FBC has taken is generally favourable. The guidelines are not binding, however, and each project must be submitted to the FBC for its approval.

There is no common regulatory approach to derivatives by the insurance and the banking regulators. Thus uncertainty remains as to whether certain credit derivatives constitute regulated insurance activities and the FBC's guidelines do not to address this issue. In the past, rulings were obtained from the Federal Office for Insurance Supervision, which, on a case-by-case basis, concluded that synthetic securitisations are not a regulated insurance activity.

New framework for credit derivatives

In the past, each credit risk transfer transaction – funded with an issue of notes or unfunded – and the resulting capital relief had to be approved by the FBC on a case-by-case basis. To respond to the vast increase in volume of credit derivatives and to match the need for predictability of capital relief transactions, the FBC has issued a circular for the use of credit derivatives (the "Circular") that entered into force on 31 March 2004. The Circular covers organisational requirements for risk management, the recognition of guarantees and credit derivatives securing claims on the balance sheet and in the trading books and addresses the calculation of the credit equivalent for credit derivatives. The Circular requires the guarantee or the credit derivative to cover the full term of the underlying claim; in contrast, Basel II recognises partial coverage only. Furthermore, the add-ons and credit conversion factors for shares will apply instead of specific ones for credit derivatives. It is yet unclear whether these deviations from the Basel II proposals will be temporary or permanent. Adoption of the Basel II proposals will require an amendment ofthe corresponding regulation adopted under the Swiss Banking Code.

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