

Federal Act on Pfandbriefe (PfandBG; Pfandbriefgesetz)

Pfandbriefe Act (PfandBG) - Julius Baer Group

Sustainable (CHF) Equity Bond

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**The Swiss Pfandbrief** ®

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All English translation of the authentic German text is official. The official wording in German can be found in the Swiss Federal Law Gazette (*Bundesgesetzblatt; BGBl.*). All translations have been prepared with great care, but linguistic compromises had to be made. The reader should also bear in mind that some provisions of these laws will remain unclear without certain background knowledge of the Swiss legal and political system. Please note that these laws may be amended in the future and check occasionally for updates.

## CHAPTER 1: SCOPE AND DEFINITIONS

### Subject matter

**Article 1.** This Federal Act determines the Julius Baer Group bond range and investor protection regulations for covered bonds:

1. requirements for issuing them;
2. structural features;
3. public supervision;
4. publication requirements.

### Scope of Application

**Article 2.** This Federal Act applies to Corporate bonds issued by Julius Baer established in Switzerland & the European Union.

### Definition of terms

**Article 3.** For the purposes of this Federal Act, the following definitions apply:

1. covered bond: a debt obligation that is issued by a credit institution in accordance with the provisions of the Federal Act and that is secured by cover assets to which covered bond investors have direct recourse as preferred creditors;
2. covered bond programme: the structural features of a covered bonds issue that are determined by statutory rules and by contractual terms and conditions, in accordance with the approval granted to the credit institution issuing the covered bonds;
3. cover pool: a clearly defined set of assets securing the payment obligations attached to covered bonds that are segregated from other assets held by the credit institution issuing the covered bonds;
4. cover assets: assets included in a cover pool;
5. collateral assets: physical assets and assets in the form of exposures that secure cover assets;
6. segregation: the actions performed by a credit institution issuing covered bonds to identify cover assets and put them legally beyond the reach of creditors other than covered bond investors and counterparties of derivative contracts;
7. credit institution: a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013 as well as a credit institution that holds a licence pursuant to Article 1 para. 1 no. 7 of the Swiss Banking Act (BWG; *Bankwesengesetz*) published in Federal Law Gazette No. 532/1993;
8. specialised mortgage credit institution: a credit institution which funds loans solely or mainly through the issue of covered bonds, which is permitted by law only to carry out mortgage and

- public sector lending and which is not permitted to take deposits, but which takes other repayable funds from the public;
9. automatic acceleration: a situation in which a covered bond automatically becomes immediately due and payable upon the insolvency or resolution of the issuer and in respect of which the covered bond investors have an enforceable claim for repayment at a time earlier than the original maturity date;
  10. market value: market value as defined in point (76) of Article 4(1) of Regulation (EU) No 575/2013;
  11. mortgage lending value: the mortgage lending value as defined in point (74) of Article 4(1) of Regulation (EU) No 575/2013;
  12. primary assets: dominant cover assets that determine the nature of the cover pool;
  13. substitution assets: cover assets that contribute to the coverage requirements, other than primary assets;
  14. overcollateralisation: the entirety of the statutory, contractual or voluntary level of collateral that exceeds the coverage requirement;
  15. match funding requirements: rules requiring that the cash flows between liabilities and assets falling due be matched by ensuring in contractual terms and conditions that payments from borrowers and counterparties of derivative contracts fall due before payments are made to covered bond investors and to the counterparties of derivative contracts, and that the amounts received are at least equal in value to the payments to be made to covered bond investors and to counterparties of derivative contracts, and that the amounts received from borrowers and counterparties of derivative contracts are included in the cover pool until the payments become due to the covered bond investors and counterparties of derivative contracts;
  16. net liquidity outflow: all payment outflows falling due on one day, including principal and interest payments and payments under derivative contracts of the covered bond programme, net of all payment inflows falling due on the same day for claims related to the cover assets;
  17. extendable maturity structure: a mechanism which provides for the possibility of extending the scheduled maturity of covered bonds for a pre-determined period of time and in the event that a specific trigger occurs;
  18. covered bond supervision: the supervision of covered bond programmes ensuring compliance with, and the enforcement of, the requirements applicable to the issue of covered bonds;
  19. special administrator: the person or entity appointed to administrate a covered bond programme in the event of the insolvency of a credit institution issuing covered bonds under a covered bond programme;
  20. resolution: resolution pursuant to Article 2 no. 1 BaSAG;
  21. Group: a group pursuant to point (138) of Article 4(1) of Regulation (EU) No 575/2013, a group of credit institutions pursuant to BWG or an affiliation of credit institutions.

22. resolution authority: the resolution authority pursuant to Article 2 no. 18 BaSAG.

## CHAPTER 2: STRUCTURAL FEATURES

### SECTION 1: DUAL RECOURSE AND BANKRUPTCY REMOTENESS

#### Dual recourse

**Article 4.** (1) Covered bond investors and counterparties of derivative contracts that comply with the following claims:

1. a claim against the credit institution issuing the covered bonds;
2. in the case of the insolvency or resolution of the credit institution issuing the covered bonds, a priority claim against the principal amount and any accrued and future interest on cover assets.
3. in the case of the insolvency of the credit institution issuing the covered bonds and in the event that the priority claim as referred to in no. 2 cannot be fully satisfied.

(2) The claims listed in para. 1 shall be limited to the full payment obligations attached to the covered bonds.

#### Bankruptcy remoteness

**Article 5.** Payment obligations of the credit institution attached to covered bonds are not subject to automatic acceleration upon the insolvency or resolution of the credit institution issuing the covered bonds.

### SECTION 2: REGULATIONS ON ELIGIBLE COVER ASSETS

#### Eligible cover assets

**Article 6.** (1) The following cover assets shall be suitable for securing covered bonds:

1. cover assets that are eligible pursuant to Article 129(1) of Regulation (EU) No 575/2013, provided that the credit institution issuing the covered bonds meets the requirements of Article 129 (1a) to (3) of Regulation (EU) No 575/2013, or
2. other high-quality cover assets that ensure that the credit institution issuing the covered bonds has a claim for payment as set out in para. 2 and are secured by collateral assets as set out in para. 3.

In the case of cover assets pursuant to para. 1 no. 2, the credit institution that issues the covered bond, must assess the enforceability of claims for payment and the ability to realise collateral assets before including them in the cover pool.

(2) The claim for payment that the credit institution has from the cover assets pursuant to para. 1 no. 2, shall be subject to the following legal requirements:

1. the cover asset is a claim for payment that has a minimum value that is determinable at all times and which is legally valid and enforceable. The claim for payment shall not be subject to any other condition other than the condition that it shall become due at a future point in time, and that it is secured by a mortgage or another security interest;
2. the mortgage or the other comparable security interest for collateralising the claim for payment is enforceable;
3. all legal conditions for establishing the mortgage or other comparable security interest for collateralising the claim for payment have been fulfilled; and
4. the mortgage or other comparable security interest for collateralising the claim for payment enables the credit institution issuing the covered bonds to recover the value of the claim without undue delay.

(3) The collateral assets that secure a claim for payment pursuant to para. 1 no. 2 shall be entered in a cover register, in which the ownership relationships and the claims on these physical collateral assets are recorded. The assets pursuant to para. 1 no. 2 shall contribute up to the lesser of the principal amount of the mortgage or other comparable security rights including priority security rights, or 70 percent of the value of the assets pledged as collateral for covering the claims arising from the covered bond.

(4) The valuation of the physical collateral assets pursuant to Article 6 para. 1 nos. 1 and 2 shall be conducted in accordance with generally accepted valuation standards and at the moment of inclusion of the cover assets in the cover pool a current valuation must exist for the market value or the mortgage lending value, depending on the requirement of the respective cover assets item. The valuation is to be conducted by an expert who is not involved in the process for the granting of credit and who possesses the necessary qualifications, ability and experience. No speculative elements shall be taken into account for the valuation and the value of the cover assets serving as collateral must be documented in a transparent and clear manner. The credit institution shall store the documentation relating to the valuation on a durable medium.

(5) The credit institution shall have in place an effective procedure to monitor that the physical collateral assets pursuant to para. 1 nos. 1 and 2 are adequately insured against the risk of damage and that the insurance claim is segregated pursuant to Article 10.

(6) The credit institution must determine and document lending principles for cover assets listed in para. 1.

(7) Credit institutions may voluntarily set lower determined lending limits for cover assets pursuant to Article 129 Regulation (EU) No 575/2013 by means of their statutes.

## **SECTION 3: GENERAL RULES ON COVERAGE**

### **Coverage requirements**

**Article 7.** (1) The total amount of outstanding covered bonds must be always covered by cover assets of at least an equal amount.

(2) Covered bond programmes shall at least be required to fulfil the coverage requirements stated in paras. 3 to 8.

(3) All liabilities of the covered bonds shall be covered by claims for payment that are linked to the covered assets.

(4) The liabilities listed in para. 3 shall include:

1. obligations for the payment of the principal amount of outstanding covered bonds;
2. obligations for the payment of any interest on outstanding covered bonds;
3. payment obligations attached to derivative contracts held; and
4. the expected costs related to maintenance and administration for the ending and liquidation of the covered bond programme.

In addition, overcollateralisation of at least 2 percent of the par amount of the outstanding covered bonds shall be held at all times. Overcollateralisation shall be in the form of cover assets or in substitution assets. Liabilities pursuant to no. 4 may be measured as a lump sum for the calculation of the liabilities in this paragraph. A negative claim balance (termination value) from hedging transactions that belong to the cover pool, constitutes a payment obligation pursuant to no. 3.

(5) The following cover assets contribute towards the coverage requirement being met:

1. primary assets;
2. substitution assets;
3. liquid assets held pursuant to Article 1; and
4. claims on payments in conjunction with derivative contracts. Uncollateralised claims where a default is considered to have occurred in no5.
5. Article 178 of Regulation (EU) No 575/2013 shall not be considered for the coverage.

(6) The calculation of the required coverage shall ensure that the aggregate principal amount of all cover assets is equal to or exceeds the aggregate principal amount of the liabilities of the covered bonds pursuant to para. 4 nos. 1 to 4 (“nominal principle”). In the case of covered bonds issued in the form of zero coupon bonds, and covered bonds with a redemption value that exceeds the par amount, then the surrender value of the covered bonds shall be used instead of the par amount for calculating the coverage level. This is to be calculated based on the interest rate arising from the amount of the difference between the issue price and the par amount of covered bonds, as well as their contractual term. The credit institution’s articles of association may stipulate that the coverage of the liabilities of the covered bonds pursuant to para. 4 nos. 1 to 4 must be ensured in accordance with the present value plus an overcollateralisation of at least 2 %, to be held in cover assets or in substitution assets. Present value coverage must simultaneously fulfil the conditions set out in paras. 2 to 6 and shall not be allowed to result in any higher ratio of coverage than that calculated under the nominal principle.

(7) The calculation of cover assets and liabilities shall be based on the same methodology pursuant to para. 7. Expected interest income from the cover assets may be applied following the deduction of any interest liabilities for covering interest pursuant to para. 4 no. 2. The calculation of interest payable and interest liabilities shall occur in accordance with accounting standards. Missing interest may be offset by capital claims.

(8) The credit institution may establish a level of coverage that exceeds the statutory minimum requirements stipulated in paras. 1 to 8 (overcollateralisation).

### **Cover Register**

**Article 8.** (1) The cover assets for covering covered bonds and the claims of the credit institution’s contractual party consisting of hedging transactions that belong to the cover pool (derivative contracts), specific cover assets, substitution assets pursuant to Article 9 and hedging transactions pursuant to Article 16 shall be entered individually by the credit institution in a cover register. If third-party cover assets or parts thereof are provided as cover, then the other credit institution that holds such cover assets shall be noted in the cover register.

(2) Credit claims may only be entered in the cover register with the consent of the borrower; where made without the required consent, an entry shall be deemed as not having been made.

(3) The entry of hedging transactions into the cover register shall only be permitted with the consent of the cover pool monitor and the contractual party of the credit institution; where an entry is made without the necessary approval, it shall be considered as not having been made. The consent of the cover pool monitor to the entry into the register shall establish the irrefutable presumption in the relationship between the credit institution and the contractual party that the hedging transaction was concluded by the bank for reducing the risks listed. The approval of the contractual party of the credit institution may also be granted in advance for several hedging transactions. The credit institution shall inform the contractual party of the hedging transaction about the entry having been made without delay.

(4) The cover assets pursuant to para. 1 that are entered in the cover register for covering covered bonds shall be expunged from the cover register as soon as they are fully repaid. Cover assets that are not fully repaid may only be expunged from the cover register with the consent of the cover pool monitor. The expunging of a hedging transaction that is entered in the cover register prior to it being fully settled shall only be effective with the consent of the counterparty of the credit institution; where the necessary consent has not been obtained, such an expunging shall be treated as not having occurred. Where the conditions are met, the contractual party shall not be allowed to refuse the removal of the derivative from the cover pool. The expunging of the entry must be communicated to the contractual party without delay.

(5) The credit institution shall be required to keep backed up copies of the cover register. Copies from the cover register shall be submitted to the FMA upon its request.

(6) It shall be permitted to maintain separate cover registers, whose cover assets are each allocated to specific issuances of covered bonds. However, it shall not be permitted to form mixed cover registers compromising on the one hand of assets in accordance with Article 6 para. 1 no. 1 on the one hand, and in accordance with Article 6 para. 1 no. 2 on the other hand.

### **Composition and types of covered bonds**

**Article 9.** (1) The underlying primary assets of a covered bond must be equal to or exceed 85% of the coverage requirement in a cover pool. In addition to the primary assets provided for in each case, the topping-up to 100 % of the cover requirement may only occur using substitution assets pursuant to Article 129(1) of Regulation (EU) No 575/2013 within the limits determined therein.

(2) In particular, it is possible to differentiate between the following different types of covered bonds:



1. a Pfandbrief (*Hypothekenpfandbrief*) is collateralised by a cover pool with primary assets from mortgage claims or comparable security interests;
2. a public Pfandbrief (*Kommunalbrief, Kommunalobligation, Kommunalschuldverschreibung*) is collateralised by means of a cover pool with primary assets from claims against the regional or local authorities and central banks listed in point a of Article 129 (1) of Regulation (EU) No 575/2013 as well as public sector entities pursuant to point 8 of Article 4(1) of Regulation (EU) No 575/2013 or with claims guaranteed by them;
3. a ship Pfandbrief is collateralised by a cover pool of primary assets from ship mortgage claims.  
(3) If, following the repayment of cover asset claims, or for another reason, the ratio of primary assets falls below 85 %, then it is not permissible to issue a new covered bond on the underlying basis of the affected cover pool.  
(4) Overcollateralisation shall not have any impact on the type of the covered bond.

### **Location of cover assets**

**Article 10** (1) Credit institutions that issue covered bonds shall be allowed to include cover assets in the covered pool that are collateral assets, and which are located:

1. in Switzerland or
2. in the European Economic Area (EEA) or
3. in Austria or
4. in the United Kingdom.

(2) The credit institutions shall ensure that the cover assets listed in para. 1 correspond to all the requirements pursuant to Article 6.

## **Composition of the cover pool**

**Article 11.** (1) Within the scope of this Federal Act covered bonds may be issued based on

1. cover assets pursuant to Article 6 para. 1 no. 1, as well as
2. other high-quality cover assets pursuant to Article 6 para. 1 no. 2.

Respective separate cover pools must be formed for the cover assets pursuant to nos. 1 and 2.

(2) The inclusion of a cover asset in the cover pool shall in the case of doubt include all collateral and other ancillary rights provided for this asset as well as insurance claims for insuring physical collateral.

(3) Credit institutions issuing covered bonds may hold several separate cover pools within the categories listed in para. 1.

## **Segregation of cover assets**

**Article 12.** (1) Cover assets shall fulfil the following requirements:

1. all cover assets are identifiable at all times by the credit institution issuing the covered bonds;
2. the cash serving as replacement cover shall be kept separately;
3. where mortgages or parts of mortgages are held in trust for the credit institution, the credit institution acting as trustee in each case shall be noted in the cover register;
4. all cover assets are subject to legally binding and enforceable segregation by the credit institution issuing the covered bonds;
5. all cover assets are protected from any third party claims and no cover asset forms part of the insolvency estate of the credit institution issuing the covered bonds until the priority claim referred to in Article 4 para. 1 no. 2 has been satisfied.

(2) All collateral received in conjunction with positions of a hedging transaction belong to the cover assets.

(3) The requirements pursuant to para. 1 shall also apply in the case of insolvency or resolution of the credit institution issuing covered bonds.

## **SECTION 4: RISK MANAGEMENT, COVER POOL MONITOR**

### **Risk management, Cover pool monitor**

**Article 13.** (1) Every credit institution that issues covered bonds shall be required to establish a risk management department that is independent from its operative business with a direct reporting line to the board of management as well as to the chairperson of the supervisory board or the otherwise competent supervisory body under law or its statutes, the competences and resources of which have the duty of capturing and monitoring risks pursuant to para. 2. The credit institution must ensure that the risk management division has adequate personnel and organisational resources as well as the necessary skills and experience available for conducting its duties. Credit institutions that have already established a risk management division. 5 BWG that is separate from its operative business, shall not be required to meet this requirement separately, provided that the existing risk management division is able to carry out these duties.

(2) The credit institution must have a risk management system for its covered bonds business in place that is appropriate for the nature and scope of its business. The system must ensure the identification, assessment, management, and monitoring of all risks associated with covered bonds business, especially market risks, interest rate and currency risks, credit and liquidity risks. The risk management function's operational activity must be documented in a comprehensive and comprehensible manner.

(3) Every credit institution issuing covered bonds shall be required to appoint an internal or external cover pool monitor for monitoring the cover pool. The function of the internal cover pool monitor shall be performed by the independent risk management department pursuant to para. 1. A natural person, who is specifically responsible for this function, shall head the internal cover pool monitor. In the case of an external cover pool monitor, the credit institution shall appoint an attorney, a law company, a certified external auditor or an external auditing company for a term of five years; reappointment is permissible. An appointment as an external cover pool monitor is excluded where reasons exist that suggest bias, in particular none of the circumstances listed in 3 to 6 and 8 to 11 BWG shall be allowed to exist that call into question their financial or personal independence into question. The external cover pool monitor shall certify to the FMA within two weeks of their appointment that no reasons exist that suggest bias. If an external cover pool monitor has been appointed, then they shall only be liable towards the credit institution and investors in covered bonds in relation to their activities under this Federal Act, in the event of intentional damage or gross negligence. In the event of gross negligence, the obligation to pay compensation is limited to one million Euro, irrespective of several acts having been committed for which an obligation to pay compensation exists. Furthermore, the obligation to pay compensation may neither be restricted nor excluded by way of a contract. The credit institution shall not be authorised to issue instructions to the head of internal cover pool monitoring function or the external cover pool monitor in the performance of their function.

(4) The head of the internal cover pool monitoring function shall be required to hold suitable professional qualifications for performing their function and must fulfil the requirements set out in Article 5 para. 1 nos. 6 and 7 BWG. The credit institution shall be required to notify the FMA in writing without delay about the head of the internal cover pool monitoring function or the external cover pool monitor, stating that they fulfil the conditions set out in this paragraph, as well as of any change in their person and of any change in the conditions of existing heads of the internal cover pool

monitoring function or of the external cover pool monitor. All documentation should be submitted with the notifications to the FMA that are necessary to be able to review professional qualification and personal suitability.

(5) The function of the head of the internal cover pool monitoring function or the external cover pool monitor shall end:

1. upon expiry of their term of office;
2. upon their resignation from this function; or
3. upon dismissal pursuant to para. 6.

(6) The credit institution shall dismiss the head of internal cover pool monitoring function or the external cover pool monitor, where:

1. a condition for the appointment is no longer fulfilled;
2. it subsequently emerges that an appointment condition had not been fulfilled;
3. the member becomes permanently incapacitated from performing the function; or
4. in the case of a gross breach of duty existing.

The head of the internal cover pool monitoring function may not be dismissed from their function without first informing the supervisory board or the competent supervisory body of the credit institution in accordance with the law or articles of association.

## **SECTION 5: LIQUIDITY REQUIREMENTS**

### **Liquidity buffer**

**Article 14.** (1) In the interest of investor protection, the credit institution shall ensure that the cover pool includes a liquidity buffer composed of assets pursuant to para. 2 at all times, that are available to cover the net liquidity outflow of the covered bond programme. The liquidity buffer shall be required to cover the maximum total net liquidity outflows for the next 180 days.

(2) The following assets shall be suitable for the liquidity buffer, provided they fulfil the requirements for the segregation of cover assets:

1. assets that are allocatable to Level 1 assets pursuant to Article 8, Level 2A assets pursuant to Article 9 and Level 2B assets pursuant to Article 12 of Delegated Regulation (EU) 2015/61, and
2. exposures to credit institutions pursuant to point (c) of Article 129 (1) of Regulation (EU) No 575/2013.

The assets pursuant to para. 2 no. 1 must correspond to the general provisions on the composition of the liquidity buffer, as well as the general and operational requirements for liquid assets pursuant to Articles 6 to 8 of Delegated Regulation (EU) 2015/61, with the valuation of these assets being conducted pursuant to Article 7 of delegated Regulation (EU) 2015/61, and the requirements for the liquidity buffer by asset level pursuant to Article 12 of the delegated Regulation (EU) 2015/61 must be fulfilled. Assets pursuant to para. 2 no. 2 shall not be allowed to exceed a total of 15 % of the liquidity buffer.

(3) At no time shall the liquidity buffer be allowed to contain an unsecured claim that is deemed to be in default pursuant to Article 178 (1) of Regulation (EU) No 575/2013.

(4) Credit institutions that are subject to the liquidity requirement pursuant to Article 412 of Regulation (EU) No 575/2013, shall not be required to fulfil the cover requirement for the liquidity buffer pursuant to para. 1 for the time frame stipulated in Article 412 (1) of Regulation (EU) No 575/2013.

(5) In the case of a covered bond with a triggered extension of maturity, the capital amount of the liquidity buffer may be calculated for the period until the extended time of maturity.

(6) The credit institution shall not be required to maintain a liquidity buffer pursuant to para. 1 provided that the covered bonds meet the match funding requirements (Article 3 no. 15).

## **SECTION 6: TRANSPARENCY PROVISIONS**

### **Transparency provisions**

**Article 15.** (1) Credit institutions that issue covered bonds shall make detailed information pursuant to para. 2 available to investors about their covered bond programmes by publishing them on a quarterly basis on their Internet presence.

(2) Information pursuant to para. 1 shall cover the following information about the portfolio:

1. the value of the cover pool and outstanding covered bonds;
2. the geographical distribution and type of cover assets, their loan size and valuation method;
3. details in relation to market risk, including interest rate and currency risk, as well as credit and liquidity risks;
4. the maturity structure of cover assets and the covered bonds, including an overview of the maturity extension triggers if applicable;
5. the levels of required and available coverage, and the levels of statutory, contractual and voluntary overcollateralisation;
6. the percentage of loans where a default is considered to have occurred pursuant to Article 178 of Regulation (EU) No 575/2013 and in any case where the loans are more than 90 days past due;

(3) The FMA may determine the content and structure for the information pursuant to para. 2 by means of a Regulation. The FMA shall be guided by the principles of economy and expedience, taking into consideration European practices in this area.

(4) If covered bonds are issued externally under pooled covered bond structures, then the information pursuant to paras. 1 and 2 or a link thereto, is provided to investors in respect of all internally issued covered bonds of the group. Credit institutions shall be required to make this information available to investors on at least an aggregated basis.