

**Rating Action: Moody's affirms Aaa ratings assigned to Pfandbriefbank schweizerischer Hypothekarinstitute mortgage covered bonds**

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Frankfurt am Main, July 19, 2018 -- Moody's Investors Service ("Moody's") has affirmed the Aaa rating assigned to the mortgage covered bonds issued by Pfandbriefbank schweizerischer Hypothekarinstitute AG (the issuer/Pfandbriefbank), as part of its periodic review. The issuer's mortgage covered bonds are governed by the Swiss Pfandbrief Act, which was established in 1931.

**RATINGS RATIONALE**

A covered bond benefits from (1) the issuer's promise to pay interest and principal on the bonds; and (2) following a CB anchor event, the economic benefit of a collateral pool (the cover pool). The ratings therefore reflect the following factors:

(1) The credit strength of the issuer. Pfandbriefbank is a refinancing vehicle (specialised financial institution with a limited scope of business) whose sole purpose is to provide funding to Swiss banks. Over the past five years, Pfandbriefbank has increased the amount of funding to Swiss banks from CHF52 billion to CHF68 billion. During the same time period, the amount of member banks grew from 270 to 324. These banks use the funding to refinance their Swiss mortgages businesses. Pfandbriefbank and its member banks (which own it) are supervised by the Swiss financial supervisory authority (Eidgenössische Finanzmarktaufsicht or FINMA). Pfandbriefbank is one of two Swiss institutions that benefit from the legal privilege to issue Pfandbriefe according to the Swiss Pfandbrief Act. Moody's has assigned a private monitored rating to the issuer.

(2) Following a CB anchor event the value of the cover pool. The stressed level of losses on the cover pool assets following a CB anchor event (cover pool losses) for this transaction is on average 18.7%.

Moody's considered the following factors in its analysis of the cover pool's value:

(a) The credit quality of the assets backing the covered bonds. Pfandbriefbank's Swiss Pfandbriefe are collateralised by secured loans to its member banks. On average across the member banks the loans are mainly secured by residential and to a very small extent commercial mortgage loans. All properties securing the mortgage loans are located in Switzerland. The average collateral score for this cover pool is 5.1%.

(b) The legal framework for Swiss Pfandbriefe. The Swiss Pfandbrief legislation has several notable features. One of these is that there are certain property-type-specific loan to value (LTV) limits for mortgages, which secure the loans from the issuer to the member banks. These loans in turn secure the Swiss Pfandbrief. This chain of security (Sicherungskette) under the Swiss Pfandbrief Act therefore includes the issuer, the member banks, and the recourse to the mortgage loans. A further notable feature is that the Swiss Pfandbrief Act prevents any currency mismatch between the outstanding covered bonds and the cover assets. Both covered bonds and cover assets are denominated in Swiss francs.

(c) The average exposure to market risk, which is 15.3% for this cover pool.

(d) The over-collateralisation at the member-bank level. As of 31 March 2018, the level of over-collateralisation at the member bank level ranged from 19.7% to 171.3%.

The timely payment indicator assigned to this transaction is "very improbable".

**KEY RATING ASSUMPTIONS/FACTORS**

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

**EXPECTED LOSS:** Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the

cover pool assets following a CB anchor event.

The CB anchor for this programme is CR assessment plus 0 notches. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's has assigned a private monitored CR assessment to the issuer.

The average cover pool losses for this programme are 18.7%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 15.3% and collateral risk of 3.4%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 5.1% on average. As of 31 March 2018, there is no currency risk. All covered bonds and cover assets are denominated in Swiss francs.

As of 31 March 2018, the level of over-collateralisation at the member bank level ranged from 19.7% to 171.3%, of which 8.0% are provided on a "committed" basis. The minimum over-collateralisation levels, which are held at the member bank level and are consistent with the Aaa rating target vary between 8.5% to 15%. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly. All numbers in this section are based on Moody's most recent modelling based on data, as per 31 March 2018.

**TPI FRAMEWORK:** Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

Factors that would lead to a downgrade of the ratings:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to a downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints. As the issuer rating is private, the TPI Leeway is not published for this transaction.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

## RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in December 2016. Please see the Rating Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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