Securitisation transactions in Switzerland are making a comeback

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Securitisation transactions represent a powerful means of refinancing for banks and other originators. Nevertheless, there are only very few securitisations that have been realised by Swiss originators post-financial crisis. We expect that the more stringent capital requirement regime applicable on systematically important banks linked with the abolition of the stamp duty on debentures, which are currently being discussed in the Swiss parliament, will likely result in an increase in securitisation transaction activities in Switzerland in the near future.

Background

In the past, securitisation transactions have never benefited from favourable Swiss legislation and regulation. Nevertheless, we have experienced quite a large amount of securitisation activities in Switzerland before the financial crisis. Especially between the years of 2005 and 2006, commercial mortgage-backed securities (CMBS) conduit lending became popular and Swiss assets have been included in many CMBS conduits that are active on a European level. Despite some tendencies to expand securitisation activities to credit card receivables, auto leases/loans and other asset classes, the business was mainly limited to residential mortgage and commercial real estate securitisations as well as trade receivables securitisations.

It does not come as a surprise that with the financial crisis of 2008 the securitisation activity in Switzerland collapsed almost entirely. The covered bond transactions, a child of the financial crisis, have not been able to keep up with the level of CMBS securitisations prior to the crisis. Nevertheless, UBS AG and Credit Suisse, both acting

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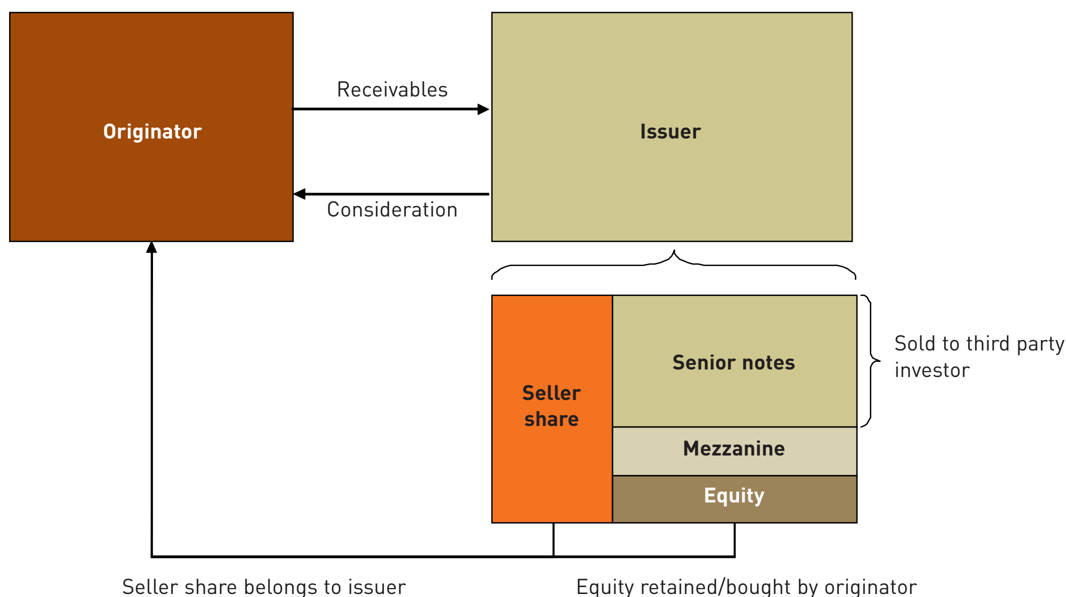
through their London and Guernsey branches respectively, have successfully implemented covered bond programmes, backed by Swiss residential mortgages. Furthermore, Credit Suisse has lately announced the issuance of a CHF6bn contingent convertible bond (CoCo Bond), qualifying as Tier 1 buffer capital notes under the Basel framework. With the issue of the CoCo Bond, Credit Suisse anticipated a possible trend on the Swiss bond market.

Under current Swiss tax law, issuance stamp duty must be paid on the issuance of bonds by, among other categories, Swiss-resident companies and Swiss-registered branches of foreign companies. The duty is charged at either 0.12% for each full or partial year of its term on loan debentures or 0.06% for each full or partial year of its term on cash debentures (money market papers). Additionally, trading in the notes on the secondary market is subject to a 0.15% security transfer stamp duty, provided a Swiss securities dealer is involved in the transaction and no exemption applies. According to a 'too big to fail' (TBTF) Banking Act Reform Bill which has been proposed in April 2011, among some of the issues touched on, the issuance stamp duty on loans and cash debentures (not only on CoCo Bonds) will be abolished and systemically important banks will be required to hold equity of at least 19% of their risk-weighted assets (RWA). We expect that the Swiss securitisation market will benefit from both the abolition of the stamp duty on bonds as well as from the more stringent capital adequacy requirements for systematically important banks.

Typical structure of the securitisation transaction

The securitisation of assets usually involves the establishment of either a bankruptcy remote entity under Swiss law that serves as special purpose vehicle (SPV or issuer), or an SPV established in a jurisdiction other than Switzerland. The issuer purchases a portfolio of assets from one or several originators and will be funded with the

A typical structure of the securitisation of assets **Exhibit 1**



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proceeds of the issuance of senior and mezzanine notes as well as with equity capital. The equity capital is usually either contributed by the originator, making the issuer a wholly-owned subsidiary, or by independent third party shareholders, making the issuer a kind of orphan entity. A typical structure is illustrated in Exhibit 1.

The issuer

Corporate structure

There is no distinct corporate form for securitisation specific entities under Swiss law. Rather, the issuer, in principle, is incorporated as a newly established stock corporation (*Aktiengesellschaft* (AG)) or limited liability company (*Gesellschaft mit beschränkter Haftun* (GmbH)). The principal distinctions when establishing a stock corporation rather than a limited liability company are that an AG requires initial share capital of at least CHF100,000 (of which a minimum of CHF50,000 must be paid-in), while the GmbH requires only CHF20,000. While the transfer of shares in a GmbH is subject to the approval of two-thirds of its shareholders, the shares in an AG are generally freely transferable. The equity of a GmbH can, therefore, not be listed on a stock exchange. Furthermore, only an AG can issue non-voting stock. For the purposes of the securitisation transaction, the corporate form of the issuer is immaterial from a tax perspective, but may have corporate governance implications.

Bankruptcy remoteness

A fundamental principle of any securitisation is to legally isolate the securitised assets from being subject to the risks of insolvency proceedings. Specifically, if an SPV is properly structured to be bankruptcy-remote, it is less likely that the SPV will have to file for its own insolvency or have its assets and liabilities consolidated with those of its parent in the event that its parent becomes a debtor in an insolvency proceeding. Certain features of the issuer that may be implemented to ensure that it is structured to be bankruptcy-remote include, *inter alia*, restrictions on its corporate purpose and of corporate form, mergers, etc., as well as more generally on the amendment of any corporate document, independent directors and shareholders and, most importantly, the separation of the issuer from its parent company (via maintaining separate books and records, accounts in its own name, conducting its business in its own name, preparing its own financial statement, etc).

As a rule, Swiss law does not provide for a pooling of assets and liabilities for a corporate group in insolvency. Furthermore, insolvency proceedings are conducted separately so that the insolvency of the issuer's shareholder(s) should not, as a matter of Swiss law, automatically trigger the insolvency of any of its subsidiaries. However, in 2008 the Swiss Financial Markets Supervisory Authority (FINMA) extended the insolvency of a regulated financial institution to its non-regulated subsidiary (Lehman Brothers Finance AG). We believe, however, that this was an exception resulting from the financial crisis and will not establish as new practice for FINMA with respect to originators that are subject to its supervision.

Licensing and regulatory treatment

BA, CISA and CCA

SPVs established for the mere purpose of securitisations are neither characterised as a bank under the Swiss Banking Act (BA) nor as a collective investment scheme, according to the regulations of the Swiss Collective Investment Schemes Act (CISA). First, there is no financing of an unlimited number of parties (characteristic of a bank under the BA); and second, no active investment activity on behalf of the investors is being provided by the SPV (characteristic of a collective investment scheme under the CISA). The SPV rather serves as financing vehicle for the benefit of the originator.

However, a recent decision of the Swiss Federal Supreme Court appears to broaden the potential scope of application of the CISA and, although a financially secured SPV should generally fall outside of the scope of the CISA, it would be advisable to obtain a corresponding regulatory confirmation of FINMA.

Should the portfolio of the issuer contain leasing receivables, the provisions of the Swiss Consumer Credit Act (CCA) will finally have to be considered. Generally, any

person that grants consumer credits on a professional basis must be licensed. Amongst other requirements, minimum capital, professional liability insurance and a fit and proper standard for the individuals responsible for the lender business are needed for a licence. However, in the past the relevant authorities have exempted issuers in a securitisation transaction from licensing, should the issuer have acquired ownership of the leased vehicles and conducted no other business subject to a CCA licence other than leasing.

Banking secrecy and data protection

If the originator is a bank, the client's data is subject to bank secrecy requirements, which, amongst other things, prohibit the data from being transferred to any third party, unless the bank client expressly consents or in any other way waives his right to confidentiality prior to the disclosure. Furthermore, data protection considerations are of importance and apply to any Swiss originator and issuer. For instance, by assigning lease receivables or transferring lease agreements, as the case may be, client data that qualifies as personal data under the Swiss Data Protection Act is passed on, which requires an express consent or waiver by the lessee, too. Where necessary, the general terms and conditions of the lease agreements will have to be adapted to consider the mentioned regulation prior to the transfer of the portfolio to the issuer.

The portfolio

The portfolio to be transferred by the originator to the SPV may of course include residential mortgages, commercial real estate, credit card, leasing or other receivables. In a typical auto lease receivables securitisation for instance, the issuer would acquire a portfolio comprising lease receivables, lease agreements, sale agreements with the car dealers, the vehicles and further ancillary rights. In general, the ownership of the vehicle remains unrestrainedly with the lessor – the lessee does neither have the right nor the option to purchase the vehicle at any time during or after the contract. Usually, the car dealers undertake to buy back the car upon expiry of the lease agreement (put option of the lessor against the car dealer) and, hence, these sale agreements as well as the sale-back receivables may also be part of the portfolio.

As a matter of Swiss law, future receivables are owned by the assignor preceding any transfer to the assignee, notwithstanding the transfer being automatic and immediate. Consequently, future receivables fall into the assignor's insolvency estate once they accrue. With respect to lease receivables in particular, there is some uncertainty whether future lease instalments might be considered as future receivables (even though there are some convincing arguments against this view). It might, therefore, be advisable not only to assign the lease receivables, but also to transfer the entire lease agreement from the originator to the SPV. In doing so, the risk of the receivables falling into the insolvency estate of the originator will be mitigated to a certain extent.

Typically, such transfer of an agreement will require consent of the customers, which in principle can be given in advance. An authority to transfer agreements to third parties may be provided for in the general terms and conditions of the originator. Such provision may potentially be regarded as an unusual provision and for that reason may not be valid against the customers according to the Swiss Unfair Competition Act, which is currently being amended. At this stage however, it is difficult to assess the practical consequences of this legal reform. Nevertheless, there may be alternative transfer mechanisms available that would allow transferring agreements even in cases where no such customer consent is available.

Additionally, in order to achieve an insolvency-remote 'true sale' of the assets, a transfer of the vehicles is to be recommended in a lease receivables securitisation. In a true sale transaction, notification of lessees is not a necessary requirement under Swiss law to perfect the transfer of legal title to the vehicles from the originator to the issuer.

Tax treatment

Corporate income and capital tax

Provided that the issuer is considered an entity residing in Switzerland for tax purposes, the issuer is subject to corporate income and equity capital tax. As the issuer

serves merely as a secured financing instrument, the equity capital required for capital tax and thin cap purposes should be kept as low as possible.

Withholding tax

Interest payments on the notes of a Swiss issuer are subject to a 35% withholding tax, regardless to whom they are made, as is any original issue discount or premium upon redemption. This leads to recipients residing in a country with which Switzerland did not conclude a double taxation treaty, for example, Bahamas or the British Virgin Islands (BVI), and so being unable to obtain the whole interest payment. The creation of investor SPVs might, however, alleviate these consequences. Furthermore, dividend distributions by the issuer are subject to the 35% withholding tax as well. However, if the issuer is a group company (which is usually the case), an internal notification procedure for cash dividends should be available and as a consequence, payment of the withholding tax obligation may be substituted by a notification.

Stamp duty

The initial equity capital of the issuer upon incorporation will be exempt from the 1% Swiss equity issuance stamp duty, provided that the initial equity capital is equal to or less than CHF1m. However, the issuance of the notes is subject to a 0.12% per annum stamp duty on the principal amount. In addition, trading in the notes on the secondary market is subject to a 0.15% security transfer stamp duty, provided a Swiss securities dealer is involved in the transaction and no exemption applies.

In December 2010, the Swiss Federal Government has, in the context of the TBTF discussion (and the introduction of CoCo Bonds for the satisfaction of increased regulatory

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capital requirements for certain financial institutions) proposed to abolish the Swiss federal stamp duty on the issuance of certain debt instruments, including loan and cash debentures. In June 2011, the first chamber of the parliament has voted in favour of this new legislation. The second chamber will sit on the new legislation in its fall session in September 2011 and if accepted, which is likely, the legislative proposal may become effective as soon as January 2012.

If a foreign issuer is to be established, it is not subject to the Swiss federal stamp duty on the principle of notes (and debentures and the like) issued to the market and to Swiss federal interest withholdings on interest payments thereof, as long as the issuer does not have a taxable presence in Switzerland (i.e., is and remains effectively managed and administered outside of Switzerland). In the context of a securitisation transaction, the existence of a foreign issuer is respected and the issuance of debt instruments by such foreign issuer to the market is not constructively attributed to a Swiss originator (as its own capital raising transaction) if the transfer of assets from the originator to the foreign issuer meets the standard of a true sale for Swiss tax purposes.

Basically, the true sale standard for tax purposes is met if:

i. all economic risks linked to the portfolio have been transferred from the originator to the foreign issuer;
ii. the originator is not obliged to buy back non-performing assets;
iii. the originator does not grant a guarantee;
iv. the originator has no other obligation to cover any loss of the (foreign) issuer; and finally
v. the originator does not grant any subordinated loans or any form of credit enhancement.

Value-added tax (VAT)

VAT aspects of a transaction must be considered to ensure that the assignment of receivables or the transfer of other assets do not trigger negative VAT consequences, such as acceleration of VAT claims, joint liability of the assignee and disadvantages in relation to available bad debt relief. Servicing fees may be subject to Swiss VAT. While solutions could usually be found for any such VAT issues, it is important to address these concerns early on in the transaction.

Outlook

Although there are certain obstacles under current Swiss law, securitisation transactions have proved before the financial crisis to be an efficient means to refinance portfolios, such as residential mortgages, commercial real estate, credit card and lease receivables or the like. Securitisation may now benefit from a more favourable tax regime, should the proposed abolition of the Swiss stamp duty on notes become effective in 2012 according to the new TBTF regime. The more stringent capital adequacy requirements, as another consequence of the TBTF proposals, will stimulate systematically important banks to reduce the RWA on their balance sheets. Securitisation transactions may represent one possible tool to achieve this goal.

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