Recent developments in the Swiss ABS market – 2015

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Swiss securitisation is constantly developing with new issuances launched in the first half of 2015. Even though the arbitrage between ABS transactions and other financing transactions in terms of financing costs is currently rather small in the Swiss franc market, issuers continue to issue ABS for various reasons.

General market overview

Low interest rates in the Swiss franc market

On January 15, 2015, the Swiss National Bank (SNB) publicly announced that it discontinues the minimum exchange rate of CHF1.20 per euro. At the same time, the SNB lowered interest rates on larger-sized deposit account balances to –0.75% in an attempt to avoid "inappropriate tightening of monetary conditions". Since January 15, 2015, interest rates in the Swiss franc market are at historically low levels. In mid May 2015, the three-months CHF LIBOR was as low as –0.80%. The Swiss Confederation is now able to auction up to 10-year government bonds with a negative yield. Even the Swiss Pfandbrief has been issued at negative yields. Whilst possibly just a question of time, the primary market is still reluctant to accept negative yields on new corporate issuances and on ABS issuances.

Pressure on the ABS market?

The low interest rate environment seems to be heaven for Swiss franc issuers these days. Corporates with access to the unsecured bond capital market can finance at incredibly low interest rates.

On the other hand, spreads in the Swiss franc ABS market have been considerably low for quite some time already and it would appear that currently, originators are not able to further benefit from even lower interest rates, given the market's reluctance to accept negative yields upon issuance. One could think that, as a consequence, issuers would have a preference to tab the unsecured Swiss franc


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bond market (to the extent they generally have capital market readiness) or even the banking market, where margins are quite low these days, despite the increase of capital costs triggered by Basel III and related Swiss legislation (it should be noted, however, that most bank facilities have a base rate definition, which is floored at zero).

Still a growing number of ABS transactions in the Swiss market

Hence, one could believe that the Swiss franc ABS market is no longer attractive to issuers as compared to other capital and bank lending markets. However, there is still an increasing appetite for issuers to tap the ABS market. There are various reasons:

Longer terms

Back in 2012, the first public Swiss ABS transactions in the auto lease market (Cembra Money Bank) and the credit card market (Swisscard) were launched. Further deals followed in 2013. All these transactions featured a three-year revolving period. As there is little room to further benefit from low interest rates in the Swiss franc ABS market, issuers now tend to structure deals with longer durations. The recent CHF200m auto lease ABS originated by Cembra Moneay Bank has a term of four years. On June 15, 2015, Swisscard closed a dual tranche transaction with a CHF200m three-year and a CHF200m five-year tranche.

Diversification

Some issuers taping the Swiss ABS capital market do so under a general strategy to diversify their funding sources and thereby avoiding dependencies on single markets. In particular, this holds true for issuers that do not have access to the unsecured debt capital markets.

Keeping access to the ABS market

In particular those issuers that already have an established platform and access to the ABS capital markets have a strong preference to continue to be present in that market to avoid unnecessary re-entry costs. Also, it goes without saying that transaction costs are much lower for issuers that have a permanent presence in the ABS market.

Still attractive for issuers who do not generally have access to capital markets

For those issuers that do not have access to the unsecured debt capital markets, ABS is still a cost efficient way of financing, in particular if larger portfolios are to be refinanced. Also, on the bank lending side, it should be noted that most facilities have a base rate that is floored at zero, which might make those financings more expensive as compared to ABS transactions.

Other considerations

All issuers that are subject to capital adequacy requirements enter into ABS transactions not only with a view of raising liquidity, but possibly also with a view to receiving relief from capital adequacy requirements and to lower the need for regulatory capital. In these circumstances, the focus is more on the regulatory capital side, rather than on the funding costs side.

Selected legal considerations

In connection with the launch of the first Swiss ABS transactions back in 2011 and 2012, the suggested legal structures have been subject to close scrutiny and an intense analysis process by rating agencies and investors. Since then, the structures typically used in the Swiss market have generally become well established. However, rating agencies and investors continue, of course, applying their structural and legal analysis.

The following two points (among further points) have been subject to ongoing discussions on essentially all transactions.

Set off

Under Swiss law, set-off basically requires mutuality of claims. Accordingly, the basic rule is that a debtor cannot set-off a claim it holds against an originator against a securitised receivable held by a securitisation SPE against the debtor.

However, there is an exemption to that basic rule in the context of an assignment/transfer of a receivable from the originator to the SPE:

- In relation to an assigned/transferred receivable, all defences (including set-off) which were available to the debtor against the originator may be used by that debtor also against the securitisation SPE, if the defences were already in existence at the time of the assignment/transfer of the receivable or, if later, when the debtor obtained knowledge of the assignment/transfer. If a counterclaim of the debtor was not yet due at this time, the debtor may set-off the counterclaim only if it does not become due later than the assigned receivable. Hence, counterclaims that are in existence upon the relevant point in time are subject to set-off rights, assuming that such claims do not become due later than the assigned receivable. In this context, it should be noted that typically, third-party debtors of securitised receivables will only be notified, once the transaction goes into default or into early amortisation.
- Furthermore, in the event a receivable stems from an agreement that is subject to the Swiss Credit Consumer Act (CCA), the debtor (i.e. the consumer) may not be deprived of any defence (including set-off rights) that it has against the originator.

There are mitigants available to the set-off questions as follows:

- Rating agencies and investors often apply a factual analysis, thus assessing the factual likelihood of counterclaims against an originator being available to debtors of a securitised receivable at all. On the basis that such risk is generally slim for any corporate entity engaged in consumer financing (given that it is generally a limited field of activity), the set-off often is unproblematic. The factual risk of counterclaims being available against originators can further be reduced by

tightening the eligibility criteria so that (i) no receivables against employees will be securitised; (ii) the underlying agreements do not contain obligations on the originator that are unsatisfied upon assignment/transfer of the receivable to the securitisation SPV (e.g. maintenance, other services or insurance); or (iii) there are no, outside of the underlying agreements, separate maintenance or service contracts with the originator. Additional eligibility criteria may of course be designed, depending on factual background.

- Waiver of set-off: Ideally, in the underlying agreement a debtor waives any right of set-off that it may have against the originator and such waiver of set-off would also protect the securitisation SPV. Whilst a waiver of set-off is generally valid and binding under Swiss law, there are some points that generally need to be considered: (i) there is an older body of learned writing which suggests that a waiver of set-off may not be recognised in the insolvency of any of the parties to such waiver or their assignees; whilst most of the legal scholars tend to disagree with that position and confirm the validity of waiver of set-offs also in an insolvency, that position still needs to be flagged; (ii) few Swiss legal scholars interpret article 19 CCA (see above) as prohibiting a general waiver of set-off with the originator in a consumer credit agreement; despite some inconsistencies amongst Swiss scholars in this regard, there is in our view no basis in Swiss law for such Interpretation as article 19 CCA, if applicable, aims at keeping the debtor in the same legal position subject to any assignment and accordingly, the waiver of set-off would be generally enforceable under Swiss law. Whilst this might result in some uncertainties, it should still be noted that rating agencies and investors got comfortable on this topic.

Set-off might further become relevant and needs specific structuring, where an originator wants to securitise receivables that stem from a mixed service/finance agreement. Whilst not yet reflected in Swiss transactions, it should be noted that originators have been able to structure around this and that structures satisfactory to rating agencies have been seen in the market. We are confident, that similar structures can be developed under the Swiss legal framework.

Bankruptcy remoteness of SPE

The securitisation SPE must comply with certain requirements set up by rating agencies and investors. These generally include (i) bankruptcy remoteness; (ii) isolation of the assets; (iii) clear cash-flow allocation; (iv) operational capacity; and (v) robust legal support in the form of opinions to give comfort on fundamentals such as the valid formation of the SPE, limitations on tax obligations and other liabilities, and enforceability of the transaction documents to which the SPE is a party.

If the transaction involves a Swiss vehicle (which can be set up in the corporate form of a limited liability stock corporation (*Aktiengesellschaft*) or a limited liability company (*Gesellschaft mit beschränkter Haftung*) under Swiss law), these requirements are generally addressed to the satisfaction of rating agencies by the following features:

- limited purpose of the SPE reflected in its articles to ensure that restrictions on activities apply on the basis of corporate law;
- transaction documents to contain limited recourse, non-petition and no set-off provisions, restrictions on activities, separateness covenants, priorities of noteholders;
- transaction documents to further contain clear definitions of responsibilities of the SPE's key operational counterparties;
- to the extent there might be creditors not signing up to limited recourse, non-petition and no set-off provisions, effects have to be mitigated (most importantly, in the case of taxes, by getting tax ruling confirmations by relevant tax authorities);
- independent board members (satisfying independency

standards as per the Swiss code of conduct) with such board members being given veto rights in relation to certain reserved matters as per the articles.

A Swiss SPE can either be set up as an orphan SPE (i.e. its shares are fully held by independent third parties) or as a subsidiary of the originator. When setting up the SPE as a subsidiary, investors or rating agencies sometimes consider requesting a "golden shareholder structure" where a minority stake is held by independent shareholders with such independent shareholders being given veto rights in relation to certain reserved matters as per the articles of the SPE.

However, from a legal point of view, there are arguments to say that a "golden shareholder structure" does not add much comfort for the following reasons: (i) the originator is generally a party to certain key transaction documents and is bound by all positive and negative covenants, which also cover SPE related matters; an independent shareholder is not party to the transaction documents as such and will be mainly involved through a shareholders agreement; (ii) the originator as shareholder has certain of its delegates on the board of directors (other than independent board members) and hence, any action in breach of the transaction documents would also expose its own board members to substantial liability risks; and (iii) a shareholder insolvency can be closely monitored; given that the SPE would legally not be affected by the insolvency of the originator as such, its shares will form part of the bankrupt estate of the relevant shareholder that has become insolvency; in the framework of an insolvency of the originator, the likelihood that such shares will be placed with an efficient investor appears to be higher than for insolvency of an independent shareholder.

Outlook

The Swiss ABS market has been very active in the past three years (considering the limited numbers of originators with securitisation friendly assets) and it can be expected that the market remains quite dynamic in the next 12 to 24 months. Should interest rates in the Swiss franc market generally increase at some point, it can be expected that this will provide another boost for Swiss ABS transactions.

Also, the current withholding tax on interest payments is expected to be replaced in the near future by a new paying agent tax system. So far, interest payments on bonds issued by Swiss issuers (also in the context of ABS transactions) are subject to a 35% withholding tax, which, for certain foreign investors, is not recoverable. This limits distribution of Swiss domestic bonds outside of Switzerland. Under the new regime, a Swiss paying agent would only need to withhold the Swiss withholding tax, if the payment would be made to a Swiss resident individual (or to a company registered abroad with a Swiss resident individual as the economic beneficiary). Interest payments to all other investors (including funds) would not be subject to the Swiss withholding tax system. It can be expected that this change in regime (which generally applies to bonds and other instruments) will give the market another boost.

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