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Securitisation

Switzerland
Trends & Developments
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Trends and Developments

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The year 2020 has been a very challenging one in many respects. Like others around the globe, Swiss capital markets have been heavily impacted by the COVID-19 pandemic. However, following very difficult weeks in March, April and May 2020, markets picked up again and a fair number of securitisation transactions have since come to market in Switzerland. Also, there have been very few securitisation transactions with Swiss underlying assets that became distressed. There are a number of other hot topics that will be relevant for securitisation markets in the upcoming months and years.

The COVID-19 Pandemic

General situation in Switzerland

More recently, the emergence of the novel coronavirus (SARS-CoV-2) and related respiratory disease (COVID-19) has had an adverse impact on the Swiss economy in general, even though it has been less affected than others. Swiss GDP dropped by 8.2% in Q2 2020 as compared to the Q2 2019, but was only 2% lower in Q3 2020 as compared to Q3 2019.

On 16 March 2020, the Swiss Federal Council declared Switzerland to be in an "Extraordinary Situation" pursuant to the Swiss Epidemics Act and introduced measures to protect the public from COVID-19. Measures included the closing of shops, bars, restaurants and entertainment and leisure facilities until 19 April 2020 and beyond. Schools were closed and public and private events were prohibited until June 2020. Whilst most measures were relaxed during June until October, the second wave hit Switzerland quite severely in November and December and certain restrictions were reimposed.

In addition, the Swiss government passed various regulations in response to the pandemic, including measures to avoid bankruptcies of businesses which may arise as a consequence of the COVID-19 pandemic (eg, availability of an emergency moratorium for small and mid-cap size businesses of up to six months, subject to less formal requirements than a general composition moratorium, temporary standstill measures and others). In addition, a COVID-19 loan programme has been established under which bridge loans have been made available, which are backed by Swiss governmental guarantees. According to publicly available information from the Swiss government, CHF16.9 billion of Swiss COVID-19 loans had been granted by the end of July 2020. As of December 2020, there is an ongoing debate as to whether or not the programme should be resumed.

Impact of the COVID-19 pandemic on portfolios

Since the outbreak of the COVID-19 pandemic, originators that issue ABS to the Swiss capital market as well as investment banks have monitored the relevant portfolios very closely. However, in the consumer lending space, the number of reminder letters sent out to customers remained stable and no increase in delinquency rates has been identified so far. Default rates are, for most originators, even at record lows. It remains to be seen, whether this will remain the same during the second or even a third wave.

Still, the outbreak of the COVID-19 pandemic had a massive impact on the ability of originators to originate new assets, but only during the months of March, April and May 2020. Since essentially all structures in Switzerland are revolving transactions, originators in Switzerland started working on contingency plans for the purposes of ensuring a proper replenishment of the portfolios, or for the purposes of allowing the substitution of assets by cash in larger amounts. However, already in June 2020, business picked up quite heavily and portfolios started to grow again. In the auto lease sector, June, July and August 2020 have been record months for some originators. Accordingly, public ABS transactions proved to be very robust, even during the crisis and the situation in Switzerland appears to be under control so far.

Response of capital markets to the COVID-19 pandemic

Capital markets in Switzerland reacted quite dramatically and, as in most European countries, April and May 2020 were very difficult months for the Swiss capital markets in general. However, already in June 2020, the first public ABS transaction since the lockdown was successfully marketed in Switzerland, followed by further auto lease ABS transactions in October and November. Whilst coupons have been higher than in previous transactions, it was important for originators and the market more generally that these transactions were successfully placed.

Focus of rating agencies

Recently, during the structuring process of the latest Swiss ABS transactions, rating agencies have had a strong focus on the collection policies around granting payment holidays to customers and on governments imposing mandatory payment holidays through emergency legislation.

So far, the Swiss government has not imposed emergency legislation that would impose obligations on originators to grant payment holidays to private customers or businesses. Also, it appears that voluntary payment holidays have been granted by originators only in very exceptional cases. Finally, payment holidays have been granted such that the underlying credit arrangement would not be extended. Rather, instalments have been shifted by a couple of months. Accordingly, deal structures have accommodated rating agencies' concerns over recent transactions.

New Prospectus Requirements under the FinSA

Another novelty in the Swiss market is the new prospectus regime that applies as from 1 December 2020 and that has been introduced by the Federal Financial Services Act (FinSA).

In a general attempt to bring the Swiss regulatory framework in line with international regulations, such as MiFID II and the EU Prospectus Directive, the Financial Market Infrastructure Act (FinMIA), the FinSA and the Financial Institutions Act (FinIA) replaced major portions of the existing regulations. The FinSA and the FinIA entered into force on 1 January 2020 along with the explanatory Financial Services Ordinance (FinSO, relating to the FinSA) and the Financial Institutions Ordinance (FinIO, relating to the FinIA).

For the first time in Switzerland, the FinSA introduces a new comprehensive prospectus regime that covers and harmonises disclosure requirements for different types of financial instruments and establishes a level playing field with the EU Prospectus Directive. This also affects the issuance of instruments to the capital markets in securitisation transactions.

According to the FinSA, "any person offering securities for sale or subscription in a public offering in Switzerland or any person seeking the admission of securities for trading in a trading venue as defined in the FinMIA must first publish a prospectus".

The most important novelties introduced by the FinSA in relation to the prospectus requirements are the following.

- A prospectus must be published also in secondary offerings.
- A prospectus must be published in the event of any admission for trading of securities on a trading platform (not only in case of a listing).
- A prospectus must be pre-approved prior to publication by a new regulatory body licensed as such by FINMA.
- Certain exemptions apply also in relation to ABS securities, allowing for an ex post approval as under the current regime.
- There are now (further) codified exemptions from prospectus requirements.

Exemptions are based either on the type of offering, the type of securities offered or, in the case of the admission to trading only, related to the admission.

Type of offering

No prospectus is required if securities are offered:

- to professional clients, insurance companies or companies with a professional treasury;
- to not more than 500 investors;
- with minimum investments or minimum denominations of CHF100,000; and
- with an aggregate volume (over the last 12 months) of not more than CHF8 million.

Type of securities

No prospectus is required in the case of exchange of equity securities, offerings in the context of a merger, spin-off, conversion or asset transfer transaction (to the extent equivalent information is available) or in case of offerings to executives or employees.

Finally, certain exemptions apply for admissions to trading.

Under the newly introduced prospectus pre-approval regime, the FinSA grants the Swiss Financial Market Supervisory Authority FINMA the authority to designate and grant licences to the reviewing bodies for prospectuses. Only on 1 June 2020, FINMA designated and granted a licence to each of BX Swiss AG (the Berne Stock Exchange) and SIX Exchange Regulation AG (Zurich) to act as prospectus review body. Hence, even though in force since 1 January 2020, the mandatory pre-approval process applies only once a six-month period lapsed following 1 June 2020 as per the transitional provisions of the FinSA. Nevertheless, some issuers have recently already gone through the approval process.

Repo Eligibility

A substantial number of Swiss franc bonds are trading at negative yields in secondary markets, but hardly any ABS issuers were able to issue Swiss franc debt securities to primary markets at negative yields. In fact, it was only Multilease AG that was able to place its latest ABS transaction at a negative yield just before the COVID-19 pandemic crisis. Investment bankers close to the industry are of the view that the main reason for this is the fact that ABS are not included in the list of eligible collateral for repo transactions with the Swiss National Bank (SNB). The discussion is not only linked to the portfolio quality and the risk profile and rating, but also to the liquidity of the securities. There is still a hope that the SNB will accept ABS as eligible collateral at some point and follow the position of the European Central

Bank (ECB) and other central banks. This would broaden the investor base substantially.

Negative Interest Rates

Background

Swiss markets continue to be driven by the negative interest environment. Since January 2015, the Swiss National Bank (SNB) has charged negative interest on bank deposits (currently minus 75 basis points). Even though interest rates have increased in the US market in the interim, it cannot be expected that rates will rise in Switzerland in the near future, given the dependence on the euro markets. The SNB policy rate (which substituted, as from 13 June 2019, the target range for the three-month LIBOR used previously) remains at -75bps. In the last couple of months, the three-months LIBOR CHF fluctuated between -70 bps and -80bps, but was as low as -85bps in late August 2019.

Structural challenges as a consequence of negative interest rates and mitigants

Structurally, rating agencies have become more and more concerned about negative interest rates being charged on transaction accounts. Negative interest rates exert downward pressure on cash amounts or eligible investments held within a deal structure. However, rating agencies generally consider this impact to be negligible because cash amounts tend to be small compared to the note amounts. Still, for deal structures with higher cash amounts standing to the credit of reserve accounts, deposit accounts or similar accounts, rating agencies kept a close eye on the account bank arrangements. Account banks normally refuse to agree to a floor on their interest rates, given the exposure they have themselves to fluctuations in interest charged by the SNB on bank deposits.

As a consequence, structural features have been developed to address negative interest rates. As an example, some originators structured the transaction to avoid high cash amounts by accepting lower advance rates on the asset pool, which results in lower reserve amounts being required.

Also, account banks are sometimes willing to offer account products with more attractive interest rates. However, these accounts normally provide for longer notice periods for withdrawals. Therefore, the structuring process for the account mechanics are relatively challenging, as longer notice periods are normally of concern in light of liquidity requirements. Therefore, the reserve and deposit cash amounts that are permitted to stand to the credit of such special accounts are typically subject to rather complex calculation and monitoring mechanisms.

Withholding Tax on Bonds and Other Collective Debt Financings

Current status

Unlike most other countries, Switzerland does not levy withholding tax on interest paid on private and commercial loans (including on arm's-length inter-company loans). Rather, 35% Swiss federal withholding tax is levied on interest paid to Swiss or foreign investors on bonds and similar collective debt instruments issued by or on behalf of Swiss resident issuers (such as Swiss ABS), as well as on interest paid by Swiss banks.

International capital markets do not typically respond well to bonds subject to Swiss withholding tax. Therefore, the investor base is relatively often limited to Swiss investors, or, in the case of Swiss multinational groups, bonds are issued through a foreign subsidiary. However, the Swiss Federal Tax Administration (SFTA) reclassifies such foreign bonds into domestic bonds if the amount of proceeds used in Switzerland exceeds certain thresholds (ie, the combined accounting equity of all non-Swiss subsidiaries of the Swiss parent company and the aggregate amount of loans granted by the Swiss parent and its Swiss subsidiaries to non-Swiss affiliates).

In order to prevent Swiss federal withholding tax from being imposed on normal loans (in contrast to bonds triggering such tax anyway), credit facility agreements entered into by a Swiss borrower, or a non-Swiss borrower under a guarantee from a Swiss parent company, must contractually restrict free transferability and syndication by invoking the so-called "10/20 non-bank rules" and stating that:

- the lenders must ensure that while the loan in question is outstanding, no assignments, transfers or relevant sub-participations of loan tranches will be made, as a result of which the number of 10 non-bank lenders would be exceeded; and
- the borrower must ensure that it will at no time have more than 20 non-bank lenders under any of its borrowings (in both cases generally disregarding any affiliated lenders).

In the context of securitisation transactions, this is relevant in the case of single investor transactions and transactions with very few investors (less than 10), ABCP transactions that are refinanced through a single multi-issuances platform.

Fundamental changes envisaged by Federal Council

The Federal Council will, in response to its consultation document, submit a request to Swiss Parliament that withholding tax on bonds be abolished. The corresponding message to the Federal Assembly will likely be issued in Q2 of 2021.

On 3 April 2020, the Federal Council opened the consultation process for the withholding tax reform. The purpose of this proposal is twofold. On the one hand, the Swiss debt capital market (including ABS and covered bonds) should be strengthened. Issuers domiciled in Switzerland should be given the opportunity of raising debt capital from within Switzerland on competitive terms and conditions. To this end, Swiss issuers and all foreign investors should be exempt from withholding tax on interest.

On the other hand, the safeguard purpose of the Swiss withholding tax should be extended at the domestic level. For natural persons resident in Switzerland, withholding tax on interest should continue to be levied (as a backup tax) and be imposed on foreign bonds and other securities. Technically, this would require a change to the so-called paying agent principle, under which the paying agent (usually a bank) levies the withholding tax due, in accordance with the investor's status.

During the consultation process, many participants have supported the desired strengthening of the Swiss debt capital market and the necessary exemption of domestic legal entities and foreign investors from withholding tax. However, there was some controversy around withholding tax as a means of securing taxes due from natural persons living in Switzerland. The Federal Council's proposal was deemed to be administratively burdensome by various parties, especially in the area of foreign collective investment schemes. These parties advocated a solution that was easier to administer.

On 11 September 2020, the Federal Council changed its course and set out its policy. It decided to go ahead with the reform and continue strengthening the Swiss debt capital market. However, in light of the consultation process, the Federal Council has decided to discontinue its backup withholding tax system in relation to interest on bonds and other collective debt financings paid to individual persons resident in Switzerland.

Rather, it has requested Parliament to abolish withholding tax on interest in its entirety on bonds and suchlike (excluding bank deposits of natural persons resident in Switzerland).

The Federal Council is expected to present its dispatch to Parliament in Q2 of 2021. Once this has been adopted, it will also decide on the remaining key issues of the reform. This concerns the abolition of securities transfer tax on domestic bonds, which was also proposed during the consultation.

Comment

The abolition of Swiss withholding tax on bonds and other collective debt financings should significantly strengthen Switzerland's position as financial market and treasury centre. All types of financing and refinancing activity in Switzerland (eg, raising of capital via bond issuances, crowdfunding platforms, ABS structures and other capital market transactions) will be facilitated. This fundamental change to the Swiss withholding tax regime is expected to come into force not before 1 January 2022.

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Walder Wyss is a leading law firm in Switzerland with around 240 legal experts across offices in Zurich, Basel, Berne, Geneva, Lausanne and Lugano, including a team of 6 partners and 12 associates for Swiss securitisation transactions. The firm has been involved in almost all Swiss first-time transactions (first Swiss RMBS transaction for Zürcher Kantonalbank 2001, first covered bond transaction for UBS AG 2009, first insurance-linked synthetic transaction for FIFA 2006, etc) and continues to be involved in most public and private ABS transactions, synthetic transactions, covered bond transactions and other securitisations. In particular in auto lease ABS (and consumer lending more generally) and mortgage loan transactions. Accordingly, Walder Wyss is regularly retained by market participants, including Swisscard, Cembra Money Bank, AMAG Leasing, Multilease, Ford Credit, PSA, BMW Schweiz, Credit Suisse, UBS and Goldman Sachs. Walder Wyss is also active in relation to various regulatory initiatives in the structured finance area and is part of a larger working group led by the Swiss Bankers Association.

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