

International Insolvency & Restructuring Report

2020/21



capital
markets
intelligence

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Quick and unbureaucratic – The Swiss answer to prevent a wave of bankruptcies because of the Corona Pandemic: COVID-19 Insolvency Law Ordinance

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On April 16, 2020, the Swiss Federal Council adopted a new “Ordinance on Insolvency Law Measures to Cope with the Corona Crisis” (the COVID-19 Insolvency Law Ordinance) with targeted measures to prevent Corona related bankruptcies and the associated loss of jobs.¹ The COVID-19 Insolvency Law Ordinance provides for (i) a temporary suspension of the obligation of directors to notify over-indebtedness; (ii) amendments to the “ordinary” composition proceedings; and (iii) the option of a temporary, pragmatic COVID-19 moratorium, particularly for small and medium-sized entities (SMEs). The COVID-19 Insolvency Law Ordinance entered into force on April 20, 2020 and currently applies for a period of six months.²



Directors’ duties of a company in financial distress

According to the Swiss Code of Obligation, the board of directors has specific duties if its company encounters financial difficulties.³ The two main tasks are based on a balance-sheet test:

Capital loss

If the last annual balance sheet of a company shows that half of the share capital and the legal reserves are no longer covered by the company’s net asset value (at going-concern value), the board of directors shall without delay call a general meeting of shareholders and propose adequate measures for restructuring. Concrete options for restructuring need to be considered based on the specific financial situation of the individual Swiss company concerned.

Over-indebtedness

In case of substantiated concern of over-indebtedness an interim balance sheet must be prepared and submitted to the company’s auditors for examination. If the interim balance sheet shows that the claims of the creditors are neither covered if the assets are appraised at ongoing business values nor at liquidation values (balance-sheet test), the board of directors is obliged to notify the bankruptcy or composition court. To maintain going-concern value, a sound cash-flow plan securing operations for a reasonable period (typically 12 months) is requested.

There are two exceptions to this:

- a) no notification is required if creditors

subordinate their claims to the claims of all other creditors in the amount of the over-indebtedness;

- b) the board of directors can refrain from notifying the bankruptcy or composition court for a short period of time if it has sufficient reasons to believe that the company can successfully be restructured. However, mere hope or a vague expectation of a restructuring does not justify the postponement of the filing for bankruptcy.

COVID-19 reliefs

Given the extraordinary circumstances and the drastic measures limiting economic activities, the Swiss Federal Council acting on the basis of constitutional emergency law decided to order an additional set of exceptions:

- a) Any loan of up to CHF500,000 guaranteed by the Swiss Confederation in accordance with the Credit Programme (see below) shall not be considered a liability in the company’s balance sheet. Therefore, such a loan is not taken into account in the over-indebtedness test (this relief is valid until March 31, 2022 only).
- b) In case of substantiated concern of over-indebtedness an interim balance sheet must still be prepared. However, the board of directors is released from the duty to submit this interim balance sheet for examination by the auditors (this relief came into effect on April 20, 2020 and will remain in force for the duration of six months).
- c) In case of over-indebtedness the board of directors does not have to notify the

bankruptcy or composition court, provided the company was not over-indebted as per December 31, 2019 and there are sufficient reasons to believe that the company will overcome over-indebtedness by December 31, 2020 (this relief came into effect on April 20, 2020 and will remain in force for the duration of six months). The board of directors must justify and document the decision in writing.

In addition, the board of directors can file for composition proceedings (instead of bankruptcy). The Swiss Federal Council also simplified some requirements in order to allow companies suffering from the financial impact of the COVID-19 measures to file for composition proceedings.

Therefore, under the current and modified regimes, companies in financial distress are not out of options; however, their strategy should be planned carefully.

COVID-19 bridge loans

On March 25, 2020, the Swiss Federal Council adopted an unprecedented, massive liquidity support programme funded with CHF40bn for SMEs (hereinafter the Credit Programme): COVID-19 affected companies can apply for loans from their respective “house” banks up to a maximum of 10% of their annual turnover achieved in 2019 and up to a maximum of CHF20m. Certain minimum criteria must be met; in particular, the company must declare that it will suffer a significant loss of sales as a result of the Corona pandemic.

Classes of loans

Loans of up to CHF500,000 (so-called COVID-19 Credits) are non-interest bearing and fully guaranteed by the Swiss Confederation to the granting banks. Due to the use of an existing banking relationship they are paid out on the basis of the borrower’s commitments only without closer examination and within a short period of time, usually within less than a day.

Bridge loans exceeding the amount of CHF 500,000 (so-called COVID-19 Credits Plus) will be guaranteed to the granting bank in the amount of 85% by the Swiss Confederation. Such loans can amount up to CHF20m per company and therefore require a more comprehensive bank examination. For these loans, the interest

rate is currently 0.5%. Companies with a turnover of more than CHF500m are not covered by the Credit Programme.

The loans guaranteed by the Swiss Confederation shall be used to meet liquidity shortages resulting during the pandemic phase; they may not be used to invest in new fixed assets, to pay dividends to shareholders or repurchase a company’s own shares, to repay existing loans, or to grant a private loan or a loan to a shareholder (including the use of cash pools). The restrictions and covenants shall incentivise borrowers to repay the loans, which are granted for five years, in exceptional cases for seven years. The board of directors must ensure that the company strictly complies with these restrictions and covenants.

In the event the loan is used for prohibited purposes, the members of the board of directors will be held jointly and severally liable for the repayment of the loan guaranteed by the Swiss Confederation. In addition, they could become subject to criminal sanctions.

Qualification on the balance sheet

Loans under the Credit Programme must be booked by the borrower as normal liabilities (debt). They are not subordinated to other claims. However, COVID-19 Credits are not considered debt when applying the balance-sheet test (see above; Article 725 Swiss Code of Obligations). This rule is intended to prevent companies from getting into a capital loss or over-indebtedness situation as a result of financing under the Credit Programme. However, this relief is valid until March 31, 2022 only. After that date such loans will be considered debt again when applying the balance-sheet test. In contrast, COVID-19 Credits Plus are considered normal debt with respect to Article 725 Swiss Code of Obligations and can, therefore, result in a capital loss or even over-indebtedness situation for the company.

Credit programme in practice

At the beginning of June 2020, roughly 125,000 COVID-19 Credits with a total volume of CHF13.5bn had been granted and requests for 582 Covid-19 Credits Plus for a total of CHF1.6bn had been filed. The Credit Programme put in place in short time was much acclaimed by the local and international financial community for its quick and unbureaucratic handling. Interestingly enough, while such

loan applications had been submitted and granted, the actual drawdown of these loans is much smaller. According to Swiss newspaper reports, by mid-May 2020, the vast majority of enterprises had not yet used their approved Covid-19 Credits.^{4,5} This means that a vast majority of entrepreneurs have arranged for a fall-back credit under the Credit Programme but keep this option for liquidity in reserve.

COVID-19 Moratorium

The COVID-19 Insolvency Law Ordinance introduces a new moratorium for small and medium-sized enterprises that run into liquidity problems due to the Corona crisis (COVID-19 Moratorium). With this measure, SMEs can be granted a temporary moratorium of up to three months by the composition court in a fast and pragmatic manner without the need to submit a restructuring plan. The moratorium can be extended for an additional three months.

Prerequisites

The conditions to have a COVID-19 Moratorium approved by the court are deliberately low in order to grant access to this moratorium for as many affected companies as possible. Any company may file for a COVID-19 Moratorium, provided that the company was not over-indebted as per December 31, 2019 or had subordinated its debt according to Article 725(2) Swiss Code of Obligations in the amount covering the over-indebtedness. Excluded from the scope of the COVID-19 Moratorium are larger undertakings, that is, (i) public listed companies; (ii) and companies that exceeded two of the following thresholds in 2019: (a) a balance-sheet total of CHF20m; (b) sales revenue of CHF40m; or (c) 250 full-time positions on annual average.

Application to composition court

The board of directors of the company must submit a written request to the composition court at the place of its registered office accompanied by evidence of its financial situation as per December 31, 2019.

Effects

During a period of three months starting from the decision of the composition court, the debts covered by the COVID-19 Moratorium (i.e. the debts existing prior to the COVID-19 Moratorium

decision only) are under moratorium and creditors may not enforce these claims (with some exceptions such as claims of employees). Moreover, the company must not settle the debts that are under moratorium but is only allowed to pay the debts that arose after the court granted the COVID-19 Moratorium. This allows companies to focus on the running business. In addition, creditors may not request a court to issue freezing orders.

Amendments to composition proceedings

The Swiss Federal Council ordered specific amendments to provisions regarding "ordinary" composition proceedings. These amendments came into effect on April 20, 2020 and remain in force for the duration of six months:

- a) During the crisis, the prerequisites for filing for composition proceedings are lower and the company does not have to file a draft restructuring plan with its request for composition proceedings. Moreover, the court will not declare the company bankrupt if the company fails to establish that there are sufficient reasons to believe that the company may be restructured (as would be the case under normal circumstances).
- b) The temporary composition moratorium (the phase that allows the company to consider whether it is able to take measures such as restructuring or whether there is a chance that the creditors agree on the principle of a composition agreement) may last up to six months (as opposed to four months under normal circumstances).

Notes:

¹ SR 281.242; Accessible at: <https://www.admin.ch/opc/de/classified-compilation/20201083/index.html>.

² Parallel to the COVID-19 Insolvency Law Ordinance, the Swiss Federal Council expanded the pre-existing state sponsored system of short-time work compensation and adopted numerous formal facilitations to further mitigate the economic consequences of the COVID-19 pandemic. The Swiss Federal Council currently expects costs of around CHF20bn for short-time work compensation. For details see: <https://www.walderwyss.com/>

user_assets/downloads/FAQ-Employment.pdf.

- ³ The terms “directors” and “company” refer to the legal form of a corporation (*Aktiengesellschaft*) whereby the same duties and conditions apply *mutatis mutandis* to the limited liability company (*Gesellschaft mit beschränkter Haftung*).
- ⁴ <https://www.derbund.ch/die-meisten-unternehmen-fassen-ihre-covid-19-kredite-nicht-an-338282581639>.
- ⁵ <https://www.luzernerzeitung.ch/news-service/wirtschaft/trotz-coronakrise-viele-unternehmen-tasten-kredite-gar-nicht-an-ld.1220517>.

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