Developments in Swiss debt capital markets – 2015

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Recently, the Swiss debt capital markets have been greatly influenced by the Swiss National Bank's (SNB) decision to discontinue the minimum exchange rate of CHF1.20 per €1. On the regulatory side, the contemplated overhaul of the Swiss regulatory framework (which includes a revision of the prospectus requirements) will affect markets quite significantly as well. Finally, there are ongoing discussions around revising the Swiss withholding tax regime by abandoning the withholding at source concept and introducing a regime that foresees deductions by paying agents. Even though the respective legislative process has been postponed, it can be expected that a revision will be further advanced in the near future.

General overview and recent developments in the Swiss debt capital market

Low interest rates in the Swiss franc market

On January 15, 2015, the Swiss National Bank (SNB) publicly announced that it discontinued the minimum exchange rate of CHF1.20 per €1. Simultaneously, the SNB lowered interest rates on larger sight 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 have been at historically low levels. In mid May 2015, the three-month 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 it is possibly just a question of time, the primary market is still reluctant to accept negative yields on new corporate issuances.

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Market activity

Unsurprisingly, the market has been largely driven by the low interest environment created by SNB's decision. One could think that low interest would boost issuance activities. However, issuers currently have to deal with various challenges:

- generally, issuers tried to further benefit from low interests and marketed further transactions;
- however, given that interest rates (in particular in the Swiss franc market) have been at low levels already for quite a while, many issuers successfully closed transactions during the last year already and had no imminent need for liquidity in 2015;
- as most Swiss banks now charge negative interest on (larger) sight deposits, issuers have a tendency to keep liquidity at low levels and to launch transactions only when there is an immanent need to finance; also, corporate issuers aim to refinance current transactions as late as possible;
- M&A activity in Switzerland cooled down in the first two quarters of 2015. The strong Swiss franc is likely to be one of the reasons for this. Obviously, this had a negative impact on the overall issuance activity.

Swiss financial market's new regulatory framework in general

A significant development in the Swiss financial industry in general and the Swiss debt capital market in particular, is the contemplated overhaul of the Swiss regulatory framework of financial markets.

In a general attempt to bring the Swiss regulatory framework in line with international regulations, such as EMIR MiFID II and the EU Prospectus Directive, it is suggested that the Financial Market Infrastructure Act (FinMIA), the Federal Financial Services Act (FinSA) and the Financial Institutions Act (FinIA) replace major portions of the existing regulations and implement new rules on financial services.

The FinMIA has already been approved by the Swiss parliament. As any other act approved by the Swiss parliament, it is now subject to the optional public referendum. Assuming that no referendum will be requested by October 8, 2015, the FinMIA is expected to enter into force soon thereafter. Drafts of the FinSA and the FinIA have been presented by the Swiss Federal Council for consultation in 2014 and, on the basis of feedback received in the consultation process, the drafts will be adopted and presented to the Swiss parliament likely in October 2015.

The FinSA and the FinIA shall strengthen client protection, promote competitiveness of the Swiss financial centre and, by creating a level playing field, competitive distortions between providers shall be minimised.

More specifically, the FinSA will govern the relationship between financial intermediaries and their clients with respect to all financial products. Financial service providers will have to seek and take into account necessary information on the financial situation, knowledge and experience of the client when rendering advice. Further, the FinSA will introduce new uniformed prospectus requirements for all securities that are publicly offered or traded on a Swiss trading platform.

Also, there will be a new general requirement to produce a basic information sheet for each financial product that can be presented to retail clients. It remains to be seen whether the Swiss law makes similar strict rules as proposed under the Regulation on key information documents for packaged retail and insurance based investments products (PRIIPs). Private actions in the event of misconduct by financial service providers shall be improved; this includes the introduction of an ombudsman service. The ombudsman is contemplated to act exclusively as a mediator and will not get any decision-making powers.

The FinIA will unify the supervision of all financial service providers that are active in the asset management business in whatever form. Existing licensing requirements for financial service providers and financial institutions that are now widespread in various bodies of law will be embedded in the FinIA, while essentially remaining unchanged as to substance, safe for further alignments, as appropriate. In addition, new licensing requirements will

likely be introduced for managers of individual client assets and managers of assets of Swiss occupational benefits schemes. Asset managers shall be supervised by the Swiss Financial Market Supervisory Authority FINMA (FINMA) or be subject to supervision by self regulatory organisation. The licensing of asset managers is still under debate.

New prospectus requirements under Swiss law in particular

The revision of the prospectus requirements contemplated by the FinSA will affect debt capital markets quite significantly.

Current Swiss prospectus regime and regulations

Under the current Swiss legal regime, the relevant rules applicable to debt securities offerings depend on whether the offering is private or public. Private offerings are not regulated and, accordingly, there is no obligation to publish or provide for a prospectus. Nevertheless, prospectus or information memoranda are typically prepared in private offerings on a voluntary basis, in accordance with market standards and investor expectations.

The prospectus requirements for public offerings are generally set out in the Swiss Code of Obligations (CO). Given that Switzerland is not a member of either the EU or the EEA, the EU Prospectus Directive, the PRIIPs and other EU/EEA capital market regulations do not apply. The content requirements for such prospectus are rather slim and only cover, essentially, disclosures on the issuer (and guarantor, if relevant) relating to corporate form, capital structure, board members, dividends distributed in the past five years and latest annual audited accounts (not older than nine months; otherwise, interim accounts will have to be established).

If debt securities are to be listed on a stock exchange in Switzerland, the respective listing requirements and rules of the relevant stock exchange will have to be complied with. In Switzerland, the most important stock exchange is the SIX Swiss Exchange in Zurich (SIX). Given that the prospectus requirements under the CO are rather slim, a listing prospectus that complies with SIX's regulations most often covers the CO requirements for an offering prospectus as well. Therefore, when issuing debt securities to be listed on the SIX, it is standard to produce one prospectus only which qualifies as an offering prospectus under the rules of the CO and as a listing prospectus under the rules of SIX.

In the framework of examining the listing application for debt securities, SIX will examine whether the prospectus meets the listing rules. Other than that, there are no general filing or approval requirements under Swiss law. In addition, it is important to note that SIX generally allows for a provisional admission to trading of debt securities (on the basis of an online short form application for provisional trading). The final listing application only needs to be filed with SIX within two months after the first trading day. Hence, a transaction can be closed and admitted to provisional trading, without any authorities or any stock exchange having formally approved the prospectus. This makes issuances and listings of debt securities extremely efficient in Switzerland.

Regime under the new Federal Financial Services Act (FinSA)

The regime suggested by the FinSA will differ significantly from the current Swiss law regime reflected in the CO and, accordingly, will influence the Swiss debt capital market.

Requirement to issue prospectus

Articles 37 *et seq*. of the consultation draft of the FinSA deal with the prospectus requirements for securities, including debt securities. The new rules state that "any person who offers securities for sale or subscription in a public offer in Switzerland or any person who seeks the admission of securities for trading in a trading venue as defined in the FinMIA must first publish a prospectus." The FinSA further provides for exemptions from the prospectus requirements, which are very similar to the exemptions provided by the EU Prospectus Directive (i.e. (i) addressed solely to investors classified as professional clients; (ii) addressed to less than 150 investors classified

as retail clients; (iii) addressed to investors acquiring securities at a value of at least CHF100,000; (iv) minimum denomination per unit of CHF100,000; or (v) not to exceed an overall value of CHF100,000 over a 12-month period). There are further exemptions that apply depending on the type of securities to be issued.

Requirements as to content of prospectus

Contrary to the current rules, the draft FinSA imposes quite extensive requirements as to the content of a prospectus. These requirements are generally in line with standard market practice and international regulations.

Relaxed standards

The draft FinSA suggests that the Swiss Federal Council may, in the form of a federal ordinance, introduce relaxed standards on the prospectus requirements for small- and mid-size enterprises (i.e. enterprises not exceeding any two or all of the following: (i) balance sheet of CHF20,000,000; (ii) turnover of CHF40,000,000 per year; or (iii) 250 employees – full-time equivalent).

Review of prospectus by review authority

The new rules on the requirements to issue a prospectus, as well as the requirements as to its content are not fundamentally different from SIX's listing rules. Whilst the FinSA will provide for a more explicit and possibly stricter legal framework, these elements do not provide for fundamental changes.

However, under the FinSA, the issuance of a prospectus is subject to prior examination by a reviewing authority. In the review process, completeness, coherence and comprehensibility of the prospectus are checked against the requirements of the FinSA. The reviewing authority shall render its decision within 10 business days or, in case of first time issuers, 20 business days.

Once the FinSA will be implemented, FINMA will appoint the reviewing authority. The reviewing authority further needs to meet certain requirements, such as independence, due organisation, reputation, infrastructure and knowledge. Given the lack of infrastructure and personnel, it is expected that a private organisation or organisations will be appointed (such as SIX).

Key information document

Under current regulations, it is a requirement that a key information document be produced in relation to certain collective investment schemes. The FinSA will introduce a general obligation to produce and publish a key information document for any financial instrument offered to retail clients. This will generally be the case for debt securities.

Outlook

It is not entirely clear yet, when the FinSA and the FinIA will be enacted. An implementation prior to 2017 is not expected. Also, whilst it is expected that the FinSA and the FinIA will be enacted generally in the current draft form, it cannot be excluded that certain elements will still be adapted and some requirements will be dropped. However, given the international political pressure to bring the Swiss regulatory framework in line with the EU regulatory framework, it can be expected that the basic framework as per the current consultation drafts will remain.

Taxes

Interest payments by Swiss issuers and borrowers under collective fundraising transactions (such as bonds) are subject to Swiss withholding tax at a rate of 35%. Whilst Swiss investors may claim back the 35% relatively easily – but with a delay as to timing, the reimbursement process for foreign investors is more burdensome. Also, depending on the jurisdiction of the investors and further depending on the legal structure of the investors, Swiss withholding tax may be claimed back only in part, if at all. This imposes a limitation on Swiss issuers to access the international debt capital markets. Exemptions are only available (temporarily) for certain types of debt qualifying as regulatory capital (such as CoCos issued by systemic relevant banks ("too big to fail" banks) as well as certain write-off and bail-in bonds).

In an attempt to discourage bond issuances by Swiss groups abroad and to strengthen the Swiss market, Switzerland is about to consider fundamental changes to its withholding tax system. On August 24, 2011, the Swiss

Federal Council proposed new legislation under which the current deduction of Swiss withholding tax of 35% by the issuer of bonds on interest payments at source would have been substituted for by a respective deduction by Swiss paying agents (subject, in principle, to an exception for foreign investors). It was initially expected that the new regime would enter into force in the course of 2015 or 2016. However, in view of the negative outcome of the consultation on the draft legislation in the course of 2014 and 2015, the Swiss Federal Council decided, on June 24, 2015, to postpone a complete overhaul of the Swiss withholding tax regime, as originally planned. It now remains to be seen when and, if so, under which form, the withholding tax reform will be launched again. The paying agent principle should be discussed again before the planned exemptions for CoCos, write-off and bail-in bonds expire.

Further, bonds, like any other taxable securities, are subject to a Swiss transfer stamp duty at 0.15% for domestic bonds and 0.3% for foreign bonds if a transfer of title occurs for consideration and a Swiss securities dealer is involved as a party or as an intermediary to the transaction.

For direct tax purposes of Swiss resident individual bondholders, most of the returns of bonds are subject to Swiss income tax. Upon sale and redemption of structured products, the theoretical bond component is subject to pro rata Swiss income taxation. Until now, accrued interest is tax-free income upon sale of a bond; however, this could change if the revised draft legislation project from the Swiss Federal Council is enacted.

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