Chambers
AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Banking & Finance 2022

Definitive global law guides offering comparative analysis from top-ranked lawyers

Switzerland: Trends & Developments

Lukas Wyss, Theodor Härtsch, Maurus Winzap and David Borer
Walder Wyss Ltd

practiceguides.chambers.com

Trends and Developments

Contributed by:
Lukas Wyss, Theodor Härtsch, Maurus Winzap and David Borer
Walder Wyss Ltd **see p.8**

Overview – General Situation

Whilst financial markets in Switzerland struggled in 2020 due to the COVID-19 pandemic, markets stabilised in 2021 and into early 2022. While a number of transactions continued to be under a "covenant holiday" regime, as the Swiss economy recovered quickly, the situation in the banking and lending market also normalised.

Since February 2022, markets have been affected by the war in Ukraine and by worldwide inflation. However, as inflation in the Swiss franc market is significantly lower than in the eurozone, or in the UK and the USA, markets never really closed – as they did in other financial markets – for certain financing transactions. Still, the Swiss National Bank (SNB) tightened its monetary policy and raised the policy rate in a first step by 50 basis points from -0.75% to -0.25% and just recently by another 75 basis points to +0.50%. Accordingly, after more than seven years of negative interest rates, the SNB policy rate is positive again.

At this stage, there are only a limited number of Swiss financing transactions that have gone through a restructuring process, but it remains to be seen whether this will change if Switzerland falls into a severe recession, as is expected in relation to a number of other countries.

Swiss Withholding Tax

Political developments and the public vote of September 2022

Under the current Swiss withholding tax regime, 35% Swiss federal withholding tax is levied on interest paid to Swiss or foreign investors on bonds and similar collective debt. It should be noted that any financing (including credit financings) may be subject to such a treatment in the event that the number of non-bank creditors under such a financing exceeds ten.

On 3 April 2020, the Swiss Federal Council (*Bundesrat*) initiated a consultation process (*Vernehmlassung*) regarding a planned reform of the Swiss federal withholding tax. The reform originally intended to replace the current debtor-based regime applicable to interest payments with a paying agent-based regime for Swiss federal withholding tax. As a consequence of the consultation process, the Swiss Federal Council, on 11 September 2020, decided to abolish Swiss withholding tax on interest payments (with the exception of interest payments on domestic bank accounts and deposits to Swiss resident individuals) without substitution and it submitted a corresponding legislative project to Parliament on 14 April 2021.

The abolition of Swiss withholding tax on bonds and other collective debt financings aimed to strengthen Switzerland's position as a financial market and treasury centre. All types of financing and refinancing activities in Switzerland (eg, raising capital via bond issuances, crowdfunding platforms, ABS structures and other capital market transactions) would have been facilitated.

A referendum was initiated against such a legislative project (and the abolition of the Swiss withholding tax on interest payments) and the

project therefore brought to a public vote by the people of Switzerland. On 25 September 2022, the Swiss people declined the new legislative project with 52% of voters being against the reform.

Accordingly, the Swiss withholding tax regime remains unchanged and it is worthwhile summarising the current regime again.

Swiss withholding tax regime

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. According to the Swiss Federal Tax Administration (SFTA) and the relevant regulations, credit facilities will also qualify as collective debt instruments if syndicated outside of the banking market and, as a result, there are more than ten non-bank lenders in the syndicate.

International capital markets do not typically respond well to bonds subject to Swiss withholding tax. Therefore, the investor base is often limited to Swiss investors, or, in the case of Swiss multinational groups, bonds are issued through a foreign subsidiary or, alternatively, via multi-seller conduits or other platforms. However, the SFTA will reclassify 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 the context of syndicated credit-financing transactions, it must be ensured that no Swiss federal withholding tax will be incurred, as this would simply not be acceptable to lenders, even if the Swiss federal withholding tax could be recovered at some later point. In order to prevent Swiss federal withholding tax from being imposed on credit financing transactions (in contrast to bonds triggering such a 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 non-bank lenders would exceed ten; 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).

As a result, credit financing transactions that must be broadly syndicated outside the banking market, because the banking market would not absorb such a transaction, (such as TLB transactions) are unsuitable for a Swiss borrower and it is necessary to structure around this.

In addition, the Swiss Federal Tax Administration may reclassify a syndicated credit financing transaction raised by a non-Swiss affiliate in the event that (i) the proceeds are (directly or indirectly) used in Switzerland and (ii) a Swiss group entity provides security or a guarantee to secure such a credit financing. In the event that the security or guarantee provided by the Swiss

group entity is only of an up-stream or cross-stream nature, this doctrine of the SFTA does not normally apply, but this must be confirmed by the SFTA by way of a tax ruling confirmation on a case-by-case basis. Acquisition bonds issued for Swiss acquisitions will thus be issued abroad on a higher-tier level and on-lent through the acquisition structure down to the Swiss buying entities.

COVID-19 Loan Programme

In March 2020, the Swiss COVID-19 Loan Programme was set up by the Swiss Federal Council under an emergency ordinance (the COVID-19 Ordinance on Joint and Several Guarantees). COVID-19 loans with an aggregate volume of over CHF17 billion were granted under the programme. COVID-19 loans with an aggregate volume of approximately CHF6 billion were repaid by September 2022 and loans amounting to roughly CHF500 million have been honoured by the guarantee provided by the Swiss authorities. Hence, a significant amount of COVID-19 loans are still outstanding. Whilst no further COVID-19 loans were granted after July 2020, it should still be noted that a number of important restrictions apply to companies that continue to be financed by COVID-19 loans. This is because the purpose of such loans is, in short, limited to ensuring continuity of the business. Whilst the restrictions under the Swiss Federal Act on COVID-19 Credits with Joint and Several Guarantee are more relaxed than under the original emergency ordinance, certain key restrictions still apply. Hence, a borrower of a COVID-19 loan must not:

- pay dividends or bonuses to shareholders or repay equity capital to shareholders;
- grant loans or repay loans or other obligations to affiliated parties, unless such loan or other obligation was pre-existing;
- refinance intra group loans, except for pre-existing obligations for the payment of interest and amortisations; or
- on-lend, or otherwise make available, the proceeds of COVID-19 loans to group companies outside of Switzerland, except for pre-existing obligations for the payment of interest and amortisations.

These restrictions are problematic for operating entities that form part of a larger group of companies, where the group relies on cash flows generated by these operating entities. Debt servicing on the top level of a group becomes difficult where the operating entities are restricted to up-stream cash flows. Also, there remains uncertainty over whether the sole granting of a guarantee, or the granting of security to guarantee or secure liabilities of a shareholder, could be considered as "paying dividends". If so, such a security or guarantee might be affected as to its validity by the provisions of the Swiss Federal Act on COVID-19 Credits with a Joint and Several Guarantee.

These restrictions affect the structuring of financing transactions and, accordingly, borrowers are incentivised to repay COVID-19 loans sooner rather than later to rid themselves of such restrictions. Also, where group financing transactions have had to be re-negotiated and covenant or even payment holidays have been granted by the lenders, the lenders have normally insisted on a clear roadmap towards early repayment of the COVID-19 loans.

LIBOR Cessation

Status of the transition

The London Interbank Offered Rate (LIBOR) for Swiss francs and other currencies was phased out on 31 December 2021 and has been replaced by alternative benchmarks in the form

of risk-free rates. In Switzerland, the most comment risk-free rate used in the lending market is the Swiss Average Rate Overnight (SARON).

Hence, throughout the last year, banks have been intensively working on the transition of their loan portfolios from LIBOR to SARON and on updating the respective legal documentation. It seems that the Swiss lending market has adapted to this change quite well, and it appears that the transition process has been relatively smooth in most instances.

However, whilst the transition process is complete for some currencies (including Swiss francs), the process is ongoing, as other currencies (including the US dollar) are still to be phased out and replaced by alternative benchmarks. Most importantly for the Swiss market, EURIBOR continues to be used as a euro-based rate for now, but upcoming developments need to be closely monitored.

Calculation methodology used in the Swiss market

In Switzerland, during the initial phase of the transition, the calculation methodology "cumulative compounded SARON" has been frequently used as an alternative benchmark for the new compounded SARON as recommended by the Swiss National Working Group on Swiss Franc Reference Rates (NWG). The legal documentation has been updated accordingly. This calculation methodology differs from the methodology applied by the Loan Market Association (LMA) and is reflected in the LMA-recommend form rate switch documentation (ie, daily non-cumulative compounded rate). Therefore, it turned out that non-Swiss banks and lenders are not very familiar with the Swiss approach. As a consequence, during a later phase of the transition process and in situations where there are non-Swiss financial institutions in the syndicate of lenders, the LMA calculation methodology has typically been introduced in the legal documentation. Also, in multicurrency facilities agreements, in order to avoid different methodologies being implemented in relation to the different facilities, the daily non-cumulative compounded rate is used for calculating interest on a daily basis.

Running two different regimes in the same market is not very efficient and it seems that the market in Switzerland is now shifting away from the "Swiss solution" to the more common international standard suggested by the LMA. Even in new lending transactions that are purely domestic, the calculation methodology used is now most often the daily non-cumulative compounded rate.

Break costs

In transactions where LIBOR applies or applied, the borrower was under an obligation to pay break costs to the lenders upon prepayment of a loan during an interest period. The break cost concept assumes that each lender matches the funding of its loans to the actual term of the respective interest period of a loan and potentially suffers a loss if the interest which a lender should have received for the remainder of the interest period exceeds the actual amount which a lender would be able to obtain by redepositing the money for the period from prepayment of the loan until the last day of the interest period.

This rationale does not apply where a loan references risk-free rates, as risk- free rates accrue on a daily basis and are not an approximation of the cost to the bank of maintaining the loan over the interest period. Nevertheless, the agent and lenders may incur a loss if their funding arrangements for maintaining a loan are interrupted by a prepayment and for any administrative bur-

dens. There are different ways to address this. A prepayment could trigger a one-time fee per prepayment or a portion of the margin could still be due for the remainder of the interest period. Alternatively, the number of voluntary prepayments could be limited during a year for purposes of avoiding revolving facilities being used almost as overdraft facilities. It now seems that a standard has evolved for the Swiss market, which is a combination of a limitation of the prepayments allowed and a one-time fee to be paid by the borrower upon prepayment, but it should be noted that there are still various options to play around with these elements.

Debt Funds

Debt funds continue to be active in the Swiss market and it appears that the number of leveraged finance transactions involving debt funds is continuing to increase. However, the market share of debt funds has not yet reached a level close to other jurisdictions such as Germany or the UK.

Whilst there is no exact data available, the reasons for such relatively low market share of debt funds in the Swiss lending market could be the following.

- Swiss banks continue to be very active in the market and are normally able to offer attractive rates and overall conditions.
- Debt funds tend to accept higher leverages compared to banks and accept certain other very attractive terms (eg, no equity requirement for permitted acquisitions and no limitation of permitted acquisitions – subject to leverage test only); however, Swiss banks have become more flexible in this regard as well.
- Whilst the documentation suggested by debt funds normally provides for more flexibility, Swiss banks are still considered to be reliable partners that are reasonable in granting waivers and that offer pragmatic and flexible solutions upon commercially justified request.

ESG

The number of ESG-linked credit financing transactions is constantly increasing in the Swiss lending market. However, compared to the Swiss bond market, where sustainability-linked bonds, sustainable bonds, a large number of green bonds and even social bonds have been issued and listed on the SIX Swiss Exchange, the number of ESG-linked credit financing transactions is still relatively low and mostly limited to corporate credit financing transaction. It is, however, clear that the topic has a high priority on banks' agendas. It seems that in private equity-sponsored Swiss leveraged finance transactions (that are mainly mid or small-cap transactions), ESG is not (yet) a hot topic.

Typically, Swiss ESG-linked credit financing transactions do not provide for a "use of proceeds" concept where the funds raised shall exclusively finance specific green, sustainable or social business transactions or assets. This provides the borrower with some flexibility, which is still important in revolving credit financing transactions where funds raised can be used for any corporate purposes. Rather, certain key performance indicators (KPIs) are defined in the documentation. The basis for such KPIs differs from industry to industry. Typically, there is no hard requirement to meet certain KPIs. Rather, the borrowers benefit from a reduction of the margin if the KPIs are met or even exceeded and are punished by an increase of the margin if the KPIs are not met. A challenging element of the ESG-linked transactions continues to be the monitoring, reporting and auditing of compliance with ESG criteria.

Clearly, the market for ESG-linked credit financings is rapidly growing and is becoming more and more sophisticated also in Switzerland.

Sanctions

Following the invasion of Ukraine by Russian military forces, the Swiss Federal Council enacted the ordinance on measures relating to the situation in the Ukraine on 4 March 2022 based on the powers assigned to it by the Swiss Federal Constitution and the Swiss Federal Embargo Act. Since 4 March 2022, the ordinance has been constantly revised and expanded.

Generally, the Swiss sanction regime follows the sanction regime enacted by the European Union. However, there are some deviations, in particular as regards the list of sanctioned persons. In addition, the Swiss State Secretariat for Economic Affairs (SECO), which is in charge of implementing the ordinance, has published certain FAQs thereby providing further guidance to the market.

The ordinance is applicable to all people and companies within Switzerland, but, other than the EU and the US sanctions rules, is not addressed to Swiss citizens living outside of Switzerland.

Like the EU sanctions regime, the ordinance addresses and covers the following elements:

- commercial restrictions, preventing the sale of certain goods to Russia (eg, weapons, dual use goods, certain technology goods, goods related to the aerospace sector and the shipping sector (including the rendering of services), goods related to the oil and energy production sector, energy, luxury goods and gold);
- a general asset freeze of assets held by sanctioned persons;
- reporting obligations in relation to such assets held by sanctioned persons;
- a ban on taking deposits from Russian citizens and certain institutions;
- a ban on the rendering of financial, financing, trading and investment services to – and the financing of – certain counterparties;
- travel bans for sanctioned persons and a general ban on air traffic for aircraft registered in Russia;
- limitations on dealing with certain counterparties, such as the Russian Central Bank and other government authorities;
- a ban on honouring and paying certain claims if they arise under an agreement that is otherwise limited by the Swiss sanction rules;
- a ban on establishing trusts if the beneficial owners are specific persons or entities; and
- a ban on rendering services in the areas of tax, accounting, auditing and certain other services to entities located in Russia.

Along with the sanction regimes of other countries, the Swiss regime will continue to evolve and expand. Also, the interpretation of the sanctions rules will continue to be highly dynamic. Hence, close monitoring is key, in particular as the time periods in which such updates enter into force are normally extremely short.

Walder Wyss Ltd 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 14 partners and additional 30 legal experts in the area of banking and finance. Walder Wyss advises all major Swiss and international banks as well as borrowers in domestic and cross-border lending transactions. Further, Walder Wyss advises a considerable number of private equity investors in leveraged acquisition finance transactions. Another core competence of the team is its knowledge of and experience in refinancing transactions of credit portfolios through various public and private structures.

Authors

Lukas Wyss is a partner in the Walder Wyss banking and finance team. His practice focuses on debt financing transactions, including asset finance, structured finance, such as ABS, covered bonds and securitisation more generally. During the last three years, he has been involved in all public Swiss ABS transactions involving Swiss underlying assets. He gained working experience as an attorney at major law firms in Zurich and New York.

Theodor Härtsch is a partner in the Walder Wyss banking and finance team in Zurich. He advises banks and corporate clients in financing matters (debt and equity financings). In addition, he counsels on capital markets law (initial public offerings, rights issues), public M&A matters as well as corporate and capital markets compliance. Furthermore, he advises financial institutions on regulatory matters. In the area of collective investment schemes, he supports clients in licensing and distribution matters. He regularly publishes in his practice areas.

Maurus Winzap is a partner and heads Walder Wyss' tax team. He acts for a broad range of corporate and financial clients and has developed significant expertise in planning and advising on structured financings and securitisation transactions (including ABS, RMBS and covered bonds). He was admitted to the Zurich Bar in 1999 and became a Swiss Certified Tax Expert in 2004.

David Borer is a partner in the Walder Wyss banking and finance team. His practice focuses on complex national and international financing and capital markets transactions such as leveraged and acquisition financings (private and public takeovers), real estate financings, export financings, asset-backed financings (securitizations and covered bonds) and bond issuances.

Walder Wyss Ltd

Seefeldstrasse 123
P.O Box
8034 Zurich
Switzerland

Tel: +41 58 658 58 58
Email: lukas.wyss@walderwyss.com
Web: www.walderwyss.com

walderwyss attorneys at law

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com