The Acquisition and Leveraged Finance Review

Eighth Edition

Editor
Fernando Colomina Nebreda

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THE ACQUISITION AND LEVERAGED FINANCE REVIEW

EIGHTH EDITION

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PREFACE

It is fair to say that the acquisition and leveraged finance industry has shown resilience in relation to the difficult global situation arising from the covid-19 pandemic, particularly in comparison to the previous global crisis in 2008. Generally speaking, while in the first semester of 2020 the deal flow slowed as a result of covid-19 as private equity (PE) houses were forced to shift their focus onto already existing portfolios, there was a noteworthy increase in the acquisition and leveraged market activity in the second semester, predominantly in the last quarter. The following defensive industries have demonstrated their ability to withstand the covid-19 crisis: pharmceuticals; bio sanitary; food; technology, media and telecommunications; and logistics, among others.

Covid-19 vaccines are providing confidence to market players, therefore facilitating the ability to agree on valuations, and also reducing gaps between the expectations of both seller and buyer. The result is more mergers and acquisitions (M&A) activity. Besides, it is reasonable to expect that the emergency measures taken by governments worldwide to address the hardships caused by covid-19 (such as state aid measures or public restrictions regarding foreign direct investment) will gradually be removed. This should, in principle, also lead to more deal flow in the M&A sector.

We are currently witnessing fierce competition in the acquisition and leveraged finance market due to the following factors: (1) an abundance of liquidity (perhaps even more than the previous year since some PE houses now hold additional 'dry powder' that was allocated to 2020 but which they could not use because of covid-19); (2) a low-interest-rate environment, which is likely to persist for several years; and (3) the fact that US investors are increasingly entering EU markets seeking a higher yield and vice versa.

The above is, in turn, resulting in more flexible terms for sponsors. It is also helping to consolidate the trend on convergence between both high-yield structures and loan structures and US and European markets in the world's most sophisticated financial hubs. Once again, this means that careful and thoughtful monitoring of domestic circumstances is imperative.

Finally, as indicated by the European Leveraged Finance Association, it is worth remarking that 'the leveraged finance market is undergoing a seismic shift in approach to ESG [environmental, social and governance] and sustainability'. Indeed, ESG has emerged dramatically in the acquisition and leveraged finance industry as evidenced by the blossoming of loans and bonds linked to sustainability in 2021. Terms will continue to unfold as market players intend to develop broadly ESG terms that go beyond pricing considerations. To this end, transparency will be a key factor in the success of the cross-border expansion tied to this nascent trend.

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Many thanks to everybody who has participated in this publication, and a special thank you to Law Business Research.

We sincerely hope that this edition of *The Acquisition and Leveraged Finance Review* will be of assistance to you in this challenging era.

Fernando Colomina Nebreda
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November 2021

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Chapter 12

SWITZERLAND

Lukas Wyss and Maurus Winzap[1]

I OVERVIEW

i The covid-19 pandemic

In Switzerland, as in many other jurisdictions, financial markets struggled in 2020 as a result of the covid-19 pandemic. In March 2020, the Swiss Federal Council declared the 'extraordinary situation' and introduced stringent measures, including the lockdown of schools, shops, restaurants, bars and entertainment and leisure facilities. Most of these strict measures were lifted during the summer of 2020. From November 2020 until March 2021 certain measures were reimposed, but generally restrictions were relatively light as compared to other jurisdictions in Europe.

The Swiss government passed various regulations in response to the covid-19 pandemic, including measures to avoid bankruptcies of businesses that were expected to arise as a consequence of the covid-19 pandemic (e.g., availability of an emergency moratorium for small and mid-cap businesses of up to six months, subject to less formal requirements than a general composition moratorium and temporary standstill measures). Most of these regulations have been implemented into law and have been approved by Parliament (even though such laws are currently the subject of a referendum).

In many industries, the EBITDA of corporate borrowers declined dramatically during Q2 of 2020. According to the Swiss State Secretariat for Economic Affairs, Swiss GDP fell by approximately 8 per cent in Q2 of 2020, which is the biggest decline since the start of the collection of quarterly data in Switzerland. There were, however, certain industries that were not affected by the outbreak of the covid-19 pandemic or even benefited from it such as IT, the online sector and the pharma industries. Most industries recovered rapidly and in Q3 of 2020, Swiss GDP was only 2 per cent below pre-crisis level. While the Swiss economy has recovered quite well since then, certain industries continue to be heavily affected by the measures imposed in response to the covid-19 pandemic (e.g., the travel, tourism and event industries and restaurants).

As a consequence of the covid-19 pandemic, there was a massive increase in liquidity needs for corporate borrowers, but the Swiss banking market and to some extent the capital market, with the support of the Swiss Confederation, the Swiss Cantons and the Swiss National Bank has been able to bridge such liquidity needs. Various programmes have been set up for these purposes.

1 Lukas Wyss and Maurus Winzap are partners at Walder Wyss Ltd.

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ii Effects of the covid-19 pandemic on the Swiss lending markets

Following the first lockdown by the Swiss Federal Council on 16 March 2020, corporate borrowers were in crisis mode. It became obvious that a large number of leveraged finance transactions would immediately become distressed and, depending on the industry, corporate debt finance transactions with relatively low leverage were also under pressure. The banks in Switzerland acted very responsibly and there was essentially no opportunistic behaviour of market participants. A huge number of transactions had to be amended. Covenant holidays and in some cases even payment holidays have been granted. Leverage ratio covenants have often been replaced by liquidity covenants. Also, the restrictions applying under the covid-19 loan programme had to be addressed, because the up-streaming of cash flows was restricted for those operating entities within a group that had borrowed under a state-guaranteed covid-19 loan (see below). Some borrowers had to be refinanced for the purposes of ensuring the continuation of the business. In some instances, transactions were supported by the Swiss Confederation and the Swiss National Bank.

It remains to be seen what the mid- and long-term impact of the covid-19 pandemic will be, both on the market and on market practice. However, it is remarkable that, with a few exceptions only, the Swiss debt financing market seems to be back on track. Of course, the continuing high level of liquidity in the market and the very low interest rates (currently, the Swiss National Bank continues to charge minus 75bps on sight deposits of banks) continue to be drivers in the market.

iii Covid-19 loan programme

In March 2020, only a week after the first lockdown had been ordered by the Swiss Federal Council, 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). The programme aimed to support SMEs with immediate liquidity needs (as a consequence of the pandemic). Rapid access to liquidity facilities was granted. Covid-19 loans were granted between 26 March and 31 July 2021. As of 19 December 2020, the Covid-19 Ordinance on Joint and Several Guarantees was transformed by Parliament into a formal federal act. Accordingly, on 1 January 2021, the Swiss Federal Act on Covid-19 Credits with Joint and Several Guarantees entered into force. Covid-19 loans were originated, disbursed and serviced by the Swiss banks.

Affected SMEs were able to apply for covid-19 loans in an amount of not more than 10 per cent of their maximum annual turnover and in any event not more than 20 million Swiss francs. Furthermore, it was a requirement that the SME be incorporated before 1 March 2020, not be in bankruptcy or under a moratorium, was affected by the covid-19 pandemic and did not receive any liquidity protection based on other emergency programmes. There are two different covid-19 loans: loans up to 500,000 Swiss francs (covid loans) and loans in amounts between 500,000 and 20 million Swiss francs (covid-plus loans). Covid-19 loans of up to 500,000 Swiss francs are fully backed by the Swiss Confederation and an interest rate of zero applies. Covid-19 loans have been granted without credit checks and have normally been paid out within hours. Covid-plus loans are 85 per cent baked by the Swiss Confederation. The remaining 15 per cent credit risk is taken by the bank. Therefore, a normal credit approval process is necessary. Those loans provide for an interest rate of 0.5 per cent per annum.

According to data provided by the Federal Department of Economic Affairs, Education and Research, 136,716 covid-19 loans (with an aggregate volume of roughly 14 billion Swiss francs and 1,134 covid-plus loans (with an aggregate volume of roughly 3 billion Swiss francs)

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have been granted between 26 March and 31 July 2021. As of mid-September 2021, about 3 billion Swiss francs have been fully repaid. The lending banks have drawn on the supporting guarantee form the Swiss Confederation in relation to covid-19 loans of approximately 240 million Swiss francs. There are relatively few actual or alleged cases of abuse as compared to the overall size of the programme.

Borrowers of covid loans are subject to certain restrictions as the purpose of such loans is, in short, limited to ensuring continuity of the business. While the restrictions under the Swiss Federal Act on Covid-19 Credits with Joint and Several Guarantee are more relaxed than under the emergency ordinance, certain key restrictions still apply. Hence, a borrower of a covid-19 loan must not:

a pay dividends or bonuses to shareholders or repay equity capital to shareholders;
b grant loans or repay loans or other obligations to affiliated parties, unless such loan or other obligation was pre-existing;
c refinance intra group loans, except for pre-existing obligations for the payment of interest and amortisations; or
d on-lend or make otherwise available the proceeds of covid-19 loans to group companies outside 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, where the group relies on cash flows generated by these operating entities. Debt servicing at the top level of a group becomes difficult where the operating entities are restricted to up-stream cash flows. Hence, borrowers are incentivised to repay covid-19 loans sooner rather than later. Also, where group financing transactions had to be renegotiated and covenant or even payment holidays have been granted by the lenders, the lenders normally insisted on a clear roadmap towards early repayment of the covid-19 loans.

II LIBOR CESSATION

i Overview

The London Interbank Offered Rate (LIBOR) will be discontinued for most currencies, including the Swiss franc LIBOR, by the end of 2021 and the financial markets are transitioning to using risk-free rates. On 4 December 2020, the Swiss Financial Market Supervisory Authority (FINMA) issued its LIBOR transition roadmap as FINMA Guidance 10/2020. According to this roadmap, lenders have been asked to determine which contracts and what volume are potentially 'tough legacy' as they mature after 2021 and do not contain robust fallback clauses by no later than March 2021 and to amend relevant contracts ideally by 30 June 2021. In the Swiss franc market, the Swiss Average Rate Overnight (SARON) was recommended by the National Working Group on Swiss Franc Reference Rates (NWG). Larger Swiss financial institutions started the process of amending an existing syndicated credit facilities agreement in early 2021 and in the meantime a fair volume of deals has been successfully amended. Also, since June of this year, new deals introduced the SARON from the outset of the transaction without any rate switch mechanism being applicable.

ii Certain market observations

While parties mostly follow the guidance and template agreements provided by the NWG, a certain standard has evolved during the last couple of months:

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a Lookback with observation shift: While various methods for calculating the compounded SARON are available, the Swiss domestic syndicated lending market clearly focused on the method 'look back with observation shift' with a period of five RFR business days.

b Calculation of compounded SARON: In the Swiss domestic market, the compounded SARON is typically calculated on the basis of the 'cumulative compounded SARON' as recommended by the NWG. The compounded daily rates are accumulated and only one interest calculation will occur in relation to each interest period. However, as this calculation methodology differs from the methodology applied by the Loan Market Association (LMA) and reflected in the LMA recommend form rate switch documentation (i.e., daily non-cumulative compounded rate), non-Swiss banks and lenders are not very familiar with the Swiss approach. Hence, in situations where there are non-Swiss financial institutions in the syndicate, the LMA concept is normally applied and the compounded SARON is calculated based on the daily non-cumulative compounded rate. Also, in multicurrency facilities agreements, in order to prevent different methodologies from being implemented in one facilities agreement, the daily non-cumulative compounded rate is used for calculating interest on a daily basis. As mentioned, under the cumulative compounded SARON concept, interest will only be calculated once at the end of the interest period. However, upon a prepayment, the calculation of interest will have to be advanced and the standard clauses that evolved address this by introducing a concept of 'shortening of interest periods', which at the same time results in a shortening of the observation period.

c 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 loans and potentially suffers a loss in case 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 burdens. 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 the year for the purposes of preventing revolving facilities from being used almost as overdraft facilities.

iii Outlook

While all transactions must switch to the risk-free rates before the end of the year, Swiss banks are already trying to implement the switch in September or October. Currently, the market approaches the endgame of the LIBOR transition. Conceptually, market standards have evolved, but the latest statistical data from the FINMA suggests that a fair number of transactions will still have to go through the amendment process for the introduction of SARON as a new reference rate. Still, the Swiss lending market appears to be ready for the cessation of the Swiss franc LIBOR by the end of 2021.

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III REGULATORY AND TAX MATTERS

i Regulatory matters

The mere provision of acquisition finance does not itself trigger a licensing requirement under Swiss laws. A licensing requirement would only be triggered if lenders would refinance themselves in Switzerland by means of accepting money from the public or via a number of unrelated banks. Lending into Switzerland on a strict cross-border basis is currently not subject to licensing and supervision by the Swiss Financial Market Supervisory Authority FINMA.

Under the Swiss Financial Services Act (FinSA), financial advisers are required to register and accordingly, financial advisers of foreign financial institutions may only be active in the Swiss market once they are registered in the register of financial advisers. However, a person advising exclusively in the context of finance (lending) transaction will be out of scope of the registration requirement.

ii Tax matters

10/20 non-bank rules – Swiss withholding tax

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 per cent 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 and the relevant regulations, credit facilities also qualify as collective debt instruments, if syndicated outside of the banking market and, as a result, there are more than 10 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 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 (i.e., 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 in case 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 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 '10/20 non-bank rules' and stating that:

a 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 ten non-bank lenders would be exceeded; and

b 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).

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

On 3 April 2020, the Swiss Federal Council initiated a consultation process regarding a planned reform of the Swiss federal withholding tax. The reform originally intended replacing the current debtor-based regime applicable to interest payments with a paying agent-based regime for Swiss federal withholding tax. Under such a paying agent-based regime, if introduced, a Swiss paying agent would need to levy and pay Swiss federal withholding tax on interest payments on bonds (or loans), if the beneficiary were an individual resident in Switzerland. As a consequence of the consultation process, the Swiss Federal Council, on 11 September 2020, formally suggested abolishing 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 the parliamentary process on 14 April 2021.

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 (e.g., raising of capital via bond issuances, crowdfunding platforms, ABS structures and other capital market transactions) will be facilitated. In the context of syndicated credit financing transactions, structuring will become more straight-forward as Swiss borrower structures would no longer have to address the '10/20 non-bank rules' and broader syndication outside the banking market would no longer be restricted.

It is unlikely that this fundamental change of the Swiss withholding tax regime will enter into force before 1 January 2024.

Deductibility of interest expense

Under Swiss tax law, interest incurred at the level of the acquisition vehicle is not available for set-off against income generated at the Swiss target company level for income tax purposes. This is because there is generally no tax consolidation under Swiss tax law (neither in Swiss domestic nor cross-border situations). However, there are means to (indirectly) 'push down' the acquisition debt portion, particularly if the existing debt can be refinanced at the target level. For the purposes of the Swiss Non-Bank Rules, this would need to be structured as a downstream loan from the acquisition vehicle to the target level (or by refinancing the existing debt at the target level, although that would result in a limitation of the number of non-banks to 10 for that portion of the debt in any event). However, since the proceeds of the acquisition debt may be lent on, the Swiss Non-Bank Rules have to be carefully addressed.

Alternatively, an (indirect) pushdown can be achieved by way of an equity-to-debt swap, where equity (freely distributable reserves or even share capital that can be reduced) is distributed (but not actually paid out) and converted into a downstream loan. In recent transactions, additional pushdown of debt potential has been created by some post-acquisition restructuring steps (such as group internal sales of assets generating additional earnings and the respective debt capacity).

If such a pushdown can be achieved, some of the interest incurred on the acquisition debt may be brought to the target company level and become available for set-off against income generated at the target level. The security package structure may be improved in connection with such pushdown at the same time.

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IV SECURITY AND GUARANTEES

i Standard security package at closing

In leveraged acquisition finance transactions involving Swiss target companies, the acquisition debt portion usually benefits from the share pledge over the top Swiss target company. In most cases, the security package is completed by other security provided by the acquisition vehicle, such as security over:

a claims and rights under the share purchase agreement;
b claims and rights under due diligence reports;
c claims and rights under insurances (in particular, M&A insurances, if any); and
d bank accounts.

Share pledge

Under Swiss law, shares in stock corporations and limited liability companies may be pledged by written agreement and if share certificates have been issued by handing over the certificate to the pledgee (duly endorsed or assigned (as applicable) in blank in the case of registered shares). If certificates have been issued, the handover of such certificates is a perfection requirement for the pledge. While a pledge over shares can be perfected, even if no certificates have been issued, the issuance and handover of certificates it is generally considered to bring the pledgees into a factually stronger position in the event of enforcement. In addition, it is standard that any transfer restrictions in the target company's articles of association are removed. Provisions in the articles of association limiting the representation of shareholders at shareholders' meetings to other shareholders must also be lifted to ensure full flexibility once control over the shares has been gained. Given the lack of control over the target company pre-closing, the issuance of certificates and the amendment of the articles of association are generally accepted as conditions subsequent.

Claims and receivables

Claims and receivables (claims under the share purchase agreement, insurance claims, claims under due diligence reports, etc.) may be assigned under Swiss law for security purposes by means of a written agreement between assignor and assignee. The agreement must specify the relevant claims and may cover future claims as well, provided claims are described in a manner that allows for clear identification once such claims come into existence. However, it must be noted that claims arising post-bankruptcy with a Swiss assignor would no longer be validly assigned and would be trapped in the bankrupt estate.

While assignability is generally given under Swiss law in the event that the underlying agreement is tacit as regards or explicitly allows for an assignment, it is important that the underlying agreement does not contain a ban on assignment. Therefore, during the pre-signing phase, the parties must ensure that all relevant documents do not contain any restrictions on assignment (particularly the share purchase agreement, insurances, etc.) and, for the sake of clarity, it is even recommended that important agreements explicitly allow for an assignment for security purposes to financing parties. The same applies to any due diligence reports, although getting the benefit through reliance will also be satisfactory in most circumstances (either directly derived from the report or through additional reliance letters).

Although the requirement to notify third-party debtors (such as the sellers) is not a perfection requirement under Swiss law, it is strongly recommended that these parties are

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notified of the assignment for security purposes and the transaction as a whole, because a third-party debtor might, prior to notification, validly discharge its obligation by paying to the assignor.

Bank accounts

Security over Swiss bank accounts is typically provided by pledging the claims the account holder has against the account bank. An assignment for security purposes would also be possible (and would even be a slightly more direct security right), but account banks have become increasingly concerned in the past two years about 'know your customer' and beneficial owner identification issues, because the assignment is, legally, a full legal transfer, while the pledge only provides for a limited right *in rem*. Again, a notification of the account bank is not a perfection requirement, but it is standard practice in the Swiss market to notify the account bank and seek its confirmation as to waiving all priority rights in relation to the relevant bank accounts on the basis of its general terms and conditions and otherwise. Such a confirmation should also outline the mechanisms on blocking the account upon further notification.

Timing of providing security on closing

The security interest provided by the acquisition vehicle may be entered into and perfected pre-closing, except for the share pledge, which may only be perfected upon closing of the transaction, immediately after the acquisition of the shares by the acquisition vehicle. From a Swiss point of view, there is nothing that would make it overly burdensome or impossible to perfect the security interest as soon as the transaction is completed or closed. However, some items (such as the amendment of articles of association or notices) will have to become post-closing items, but, as described above, that does not prevent the perfection of the security interest as such.

ii Standard target-level security package

Security is typically granted by the Swiss target companies. The target-level security package is similar to fully fledged security packages in other jurisdictions and may include, inter alia, security over:

a shares in subsidiaries;
b trade receivables;
c intercompany receivables;
d insurance claims;
e bank accounts;
f intellectual property; and
g real estate.

See above for a description of security over most of these assets.

However, in smaller transactions and depending on the level of leverage provided, sponsors are sometimes able to negotiate a slimmer security package for purposes of avoiding transaction costs. This is particularly true in pure Swiss domestic deals and in case the taking of security would require involvement of additional foreign counsel. In addition, in Swiss domestic finance transactions, borrowers often are successful in negotiating slim security packages as a consequence of the strong negotiation power that borrowers currently have in the finance market.

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Real estate

Security over real estate is typically taken by way of taking security over mortgage certificates. A mortgage certificate is issued either in bearer or in registered form. Alternatively, since January 2012, a paperless version of a mortgage note can be created which is evidenced by electronic registration in the relevant land register. A mortgage note creates personal, non-accessory claim against the debtor, which is secured by a property lien. Unless preexisting mortgage certificates are available, the creation of new mortgage certificates requires a notarised deed and registration of the mortgage certificate in the land register. Once created, the mortgage certificates will be transferred for security purposes under a written security agreement without further notarisation or entry into the land register (except in the case of paperless mortgage certificates).

One important tax point has to be considered as interest payments to non-Swiss resident creditors of loans secured by Swiss real estate are subject to withholding tax at source, unless the lender is located in a jurisdiction that benefits from a double tax treaty with Switzerland providing for a zero rate. Accordingly, if a Swiss borrower is involved, it must be ensured that only 'Swiss treaty lenders' will be secured by real property to avoid the risk of withholding tax being applied to interest payments. Swiss treaty lenders are persons:

a having their corporate seat in Switzerland or are lending through a facility office (which qualifies as a permanent establishment for tax purposes) in Switzerland, and that are entitled to receive any payments of interest without any deduction under Swiss tax law; or

b lending in a jurisdiction having a double tax treaty with Switzerland providing for a zero per cent withholding tax rate on interest payments.

In particular, owing to these tax issues, security over real estate is normally only considered if there is substantial real estate located in Switzerland.

If a foreign borrower is involved (such as a foreign acquisition vehicle), the issue basically remains the same, but an application for an exemption through a tax ruling application may be considered. While such a tax ruling has been obtained very recently in a few cantons, the process of being granted such a ruling in other cantons might be quite lengthy and, therefore, costly (while the outcome is possibly vague). Without a satisfactory tax ruling, real estate located in Switzerland cannot be granted as security owing to the risk of potential withholding tax on interest payments.

Intellectual property

Under Swiss law, security over intellectual property is typically taken by way of pledge. A written pledge agreement is required, specifying the intellectual property right. As a matter of Swiss law, no registration is required for the valid perfection of the pledge over intellectual property. However, if not registered, the intellectual property may be acquired by a bona fide third-party acquirer, in which case the pledge would become extinct. While a Swiss law pledge over foreign intellectual property is valid as a matter of Swiss law, it should be double-checked whether the validity of the security interest would also be recognised under relevant foreign law, or whether – as an example – its registration would be a perfection requirement. Accordingly, with regard to foreign intellectual property of certain importance and value, it is advisable to register the pledge in the relevant register. Security agreements

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typically provide for a registration obligation for the pledge over important intellectual property on day one and for all other intellectual property upon the occurrence of an event of default.

Difficulties in taking security over movable assets

Owing to strict repossession requirements under Swiss law, taking of security over movable assets (such as an inventory or equipment) without substantially disturbing the daily business of the security provider is difficult. There are structuring solutions surrounding this issue (such as pledge holder structures or opco or propco structures), but these solutions are usually only implemented in situations where there is a specific focus on a specific asset (raw materials with substantial value, larger car fleets, aircraft parts, etc.).

Timing of providing target-level security

Unless there is some cooperation on the part of the seller to start preparing target-level security pre-closing (and depending on the exact release mechanisms from existing financings), target-level security might only be available post-closing, and it is usually agreed that target-level security might be completed as a condition subsequent.

iii Financial assistance and upstream and cross-stream security/guarantees

Standard upstream and cross-stream limitations will apply to Swiss target-level guarantees and security. Essentially, the amount of proceeds under upstream and cross-stream security or guarantees that is available to lenders is limited to the amount that the guarantor/security provider could distribute to its shareholders as dividends at the point in time of enforcement. In addition, certain formal requirements will have to be followed both, upon granting and enforcement of the security or guarantee. These limitations may affect the security substantially, particularly in situations of financial distress. However, if structured properly and if using all available mitigants, such limitations are generally accepted by investors and lenders.

In October 2014, the Swiss Federal Supreme Court ruled, that upstream and cross-stream loans that do not meet the at arm's-length test will also reduce the distributable amounts of the lender. However, at the same time, the Swiss Federal Supreme Court ruled that paid in surplus is generally available for distribution to shareholders. It would appear that parties have applied a more cautious approach around the granting of upstream and cross-stream loans since October 2014, but transaction structures generally remained unchanged. It remains to be seen whether further court rulings will be issued in this respect.

If the structure also includes a downstream loan from the acquisition vehicle to the Swiss target companies (often used for tax purposes as a pushdown of debt and for the repatriation of the cash flows), the Swiss target company may provide (unrestricted) security to secure such a downstream loan, because it would secure its own rather than parent debt. Accordingly, this would not qualify as upstream security. The acquisition vehicle in turn may provide security over the downstream loan, along with the (unrestricted) security package securing such a downstream loan. From a Swiss corporate law perspective, there is a good chance that upstream limitations will not apply to that security structure. However, such a security structure should be discussed with the SFTA in the light of the Swiss Non-Bank Rules.

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V PRIORITY OF CLAIMS

i Statutory priority of claims

Upon bankruptcy over a Swiss entity, certain creditors would benefit from statutory priority:

a secured claims are satisfied with priority directly out of the enforcement proceeds; any surplus will be shared among (unsecured) creditors generally, and any shortfall would be treated as a third-class claim; and

b claims incurred by the bankruptcy or liquidation estate or during a debt restructuring moratorium with the administrator's consent rank above unsecured claims.

In relation to unsecured claims, there are three priority classes: the first class mainly consists of certain claims of employees as well as claims of pension funds; the second class consists of claims regarding various contributions to social insurances and tax claims; and the third class consists of all other unsecured claims.

ii Contractual structuring of priority of claims

Within the third class, creditors and the debtor are free to contract on the ranking of such claims among themselves. Typically, in Swiss acquisition finance transactions, the priority of claims among various debt investors is reflected on the basis of intercreditor arrangements rather than on the basis of structural subordination. It should be noted, however, that in larger transactions, the acquisition structure is most often set up outside Switzerland. In addition, where the investor base would expect a structural subordination, such a structure is implemented, but rather for marketing purposes.

Under Swiss law, intercreditor arrangements that provide for the priority of claims are generally binding on the parties involved and also on insolvency officials of an estate. However, given that there are hardly any relevant precedents, it cannot be ruled out that an insolvency official would treat all non-secured creditors indiscriminately as third-class creditors, and consider the priority of payments as a mere arrangement among creditors of the estate in relation to their respective claims in relation to the estate and pay them out on a pro rata and *pari passu* basis. Such being the case, the parties to the intercreditor arrangement may have to rely on the redistribution by the creditors among themselves.

iii Equitable subordination

The concept of equitable subordination is neither reflected in codified Swiss law nor well established in Switzerland. Even though there are no conclusive precedents, equitable subordination is generally only discussed in connection with shareholder loans. It is unclear whether the holding of a very small equity stake would be sufficient for a qualification of a loan as shareholder loan. It would appear that the terms of the loan and the circumstances under which it has been granted are more relevant than the specific percentage of shareholding. Against this background, it may be concluded that a loan granted in proportion to the shareholding of a small shareholder (together with all other shareholders) could be problematic, while the holding of a portion in a larger (syndicated) loan (at arm's length) by a bank seems to be unproblematic, even if that bank would hold an equity stake in the relevant Swiss company.

Basically, a parent company will be treated as any other third-party creditor of such Swiss subsidiary in the framework of a Swiss bankruptcy proceeding. The risk of a shareholder loan

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being deemed to be either subordinated against all other (non-subordinated) creditors, or to be treated like equity (in which case, the parent company would only be satisfied together with all other equity contributors), arises only under very specific circumstances.

Elements that could be relevant are:

a that the shareholder loan is granted in a situation where the Swiss subsidiary is already over-indebted;

b that the parent company had (or should have had) knowledge of the over-indebtedness of its Swiss subsidiary while granting the shareholder loan;

c that the granting of the shareholder loan resulted in the Swiss subsidiary having upheld its business activities, and accordingly in a deferral of the opening of bankruptcy proceedings over the Swiss subsidiary; and

d that the deferral of the opening of bankruptcy proceedings results in a (potential) damage of other creditors of the Swiss subsidiary.

A few scholars suggest applying a stricter regime (per se subordination of shareholder loans in bankruptcy; application to the concept to third-party loans, etc.), but it must be noted that court decisions where the concept of equitable subordination has been applied are fairly rare and, accordingly, that this concept cannot be regarded as well established as such. Therefore, we see little leeway for the application of such a concept, in particular, where loans are granted on an arm's-lengths basis and to Swiss companies that are not over-indebted.

VI JURISDICTION

The submission by a Swiss company to the exclusive jurisdiction of the courts of any other non-Swiss forum is generally binding on such a Swiss company. It should be noted, however, that under Swiss law, jurisdiction clauses may have no effect as regards actions relating to, or in connection with, insolvency procedures that, as a rule, must be brought before the court at the place of such an insolvency procedure. Furthermore, contractual submissions to a particular jurisdiction are subject to the mandatory provisions on the protection of consumers, insured persons and employees pursuant to the Lugano Convention, the Swiss Federal Private International Law Act (PILA) and such other international treaties by which Switzerland is bound. Pursuant to the PILA and the Lugano Convention, Swiss courts may also order preliminary measures even if they do not have jurisdiction over the substance of the matter.

Until 31 December 2020, the Lugano Convention was applicable for jurisdiction and the recognition and enforcement of judgments in civil and commercial matters also in relation to England. Under the Lugano Convention, jurisdiction clauses referring to the 'courts of England' were valid since there is no specific requirement under the Lugano Convention to refer to a specific forum or a forum of a specific place. As a consequence of Brexit, the Lugano Convention no longer applies in matters involving England as from 1 January 2021 and any jurisdiction clause entered into by a Swiss company and to be reviewed by Swiss courts would be reviewed under the Swiss Private International Law Act (PILA). Other than under the Lugano Convention, under the PILA, a jurisdiction clause must at least determine a place or city, rather than just a country. If a jurisdiction clause does not meet these requirements and refers to the courts of a country only, there is some uncertainty about whether it would be held valid and enforceable in Switzerland. Therefore, it is advisable that such jurisdiction clauses refer to a specific city, rather than just to the courts of a country.

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Enforceability in Switzerland of a foreign judgment rendered against a Swiss company is subject to certain limitations set forth in: (1) the Lugano Convention; (2) the other international treaties under which Switzerland is bound; and (3) the PILA. In particular, a judgment rendered by a foreign court may only be enforced in Switzerland if:

a in the case of (2) and (3) and, in certain exceptional cases, (1), the foreign court has jurisdiction;

b the judgment of such foreign court has become final and is non-appealable or, in the case of (1), has become enforceable at an earlier stage;

c the court procedures leading to the judgment followed the principles of due process of law, including proper service of process; and

d the judgment of the foreign court on its merits does not violate Swiss law principles of public policy.

In addition, enforceability of a judgment by a non-Swiss court in Switzerland may be limited if the Swiss company demonstrates that it has not been effectively served with process (a service of process on the Swiss company will have to be made in accordance with the Hague Convention).[2]

VII OUTLOOK

The most important change of law currently under discussion that would affect lending in Switzerland generally (and in particular leveraged acquisition finance transactions) relates to Swiss withholding tax as discussed above. It is expected that the abolition of the Swiss withholding tax on interest payments will significantly facilitate the structuring of leveraged acquisition finance transaction. However, it is unlikely that this fundamental change to the Swiss withholding tax regime will enter into force before 1 January 2024.

2 The Hague Convention of 15 November 1965 on service of judicial or extrajudicial documents abroad in civil and commercial matters.

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Appendix 1

ABOUT THE AUTHORS

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Lukas Wyss is a partner in the Walder Wyss banking and finance team. He advises banks, insurers and other companies in connection with finance transactions and debt capital market transactions. In finance, he focuses on corporate debt finance, leveraged finance, asset finance (including real estate finance), acquisition finance and structured finance and securitisation. Lukas was educated at Zurich University and Lausanne University (lic iur 2000) and Columbia University, New York (LLM 2006, James Kent scholar). He was admitted to the Zurich Bar in 2002. Before joining Walder Wyss in 2007, he gained working experience as a district court law clerk (Meilen, ZH) and as attorney at major law firms in Zurich and New York.

Mr Wyss speaks German, English and French. He is member of the board and vice president of the Zurich Bar Association. He is admitted to practise in Switzerland.

MAURUS WINZAP

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Maurus Winzap is a partner and heads Walder Wyss' tax team. He focuses on domestic and international tax issues, particularly in corporate reorganisations, restructurings, structured finance, acquisitions and divestments. Other areas of expertise include tax planning for collective capital investments and cross-border relocations. He lectures and publishes regularly in the field of taxation. Mr Winzap is a lecturer in international tax at the Swiss Institute of Taxation. He was the chair of the organising committee of the 69th congress of the International Fiscal Association (IFA), which took place in Switzerland in 2015. In addition, he is a member of the executive board of the Swiss Tax Law Association (Swiss branch of the IFA). Mr Winzap was awarded his degree in law from the University of Zurich in 1997 and his Master of Law degree from the University of Virginia in 2002. He was admitted as a Swiss-certified tax expert in 2004. Mr Winzap speaks German and English. He is registered with the Zurich Bar Registry and admitted to practise in Switzerland.

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