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Structured Finance & Derivatives

Switzerland: Law & Practice
Baker McKenzie

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Baker McKenzie has a Swiss structured finance and derivatives team consisting of seven partners and 11 associates. The key office location in Switzerland is in Zurich, but a smaller part of the team is based in Geneva. The firm also has offices all over Europe, with those in the UK, the Netherlands, Belgium, Germany and Spain having a substantial focus on structured finance and derivatives. Key practice areas are syndicated finance, acquisition and leveraged finance, structured and other financial products, ABS, securitised debt and other secured bonds. The team regularly provides advice regarding OTC derivatives and credit-linked notes, including synthetic securitisations for capital relief purposes. Baker McKenzie is a member of the International Capital Markets Association and the Swiss Association for Structured Products.

Authors

Dr Matthias Courvoisier heads the corporate finance practice group and co-leads the capital markets and structured finance and derivatives team. His practice focuses on secured bonds and structured products, aside from his focus on capital markets work. Dr Courvoisier, who is recognised as an authorised issuer's representative at the SIX Swiss Exchange, holds an MSc degree in finance from London Business School, during which he strongly focused on derivative pricing.

Dr Philip Spoerlé is a senior associate in the Zurich office and a member of the banking and finance, and capital markets practice groups. His practice focuses on syndicated financing, with an emphasis on acquisition and leveraged finance; debt capital markets, including structured products and other financial instruments; securitised debt; and derivatives. Dr Spoerlé is recognised as an authorised issuer's representative at the SIX Swiss Exchange. He graduated from the University of St Gallen (HSG) with an MA in law & economics before he obtained a PhD (Dr iur) for a thesis in the area of corporate law.

1. Structured Finance

1.1 Market Overview

The Swiss lending and structured finance market in general has been picking up greater speed in the last twelve months with high demand for the whole set of debt structures, including syndicated lending structures, true sale securitisations and synthetic balance sheet securitisation transactions for capital relief purposes. Demand for acquisition finance was supported by a high number of mid-market and larger M&A transactions with significant activity of Swiss and foreign private equity investors looking for investment opportunities. In 2017/18 several public securitisation transactions involving Swiss auto leases were closed, including a second ABS transaction launched by Multilease AG in December 2017 and an auto lease transaction launched by AMAG Leasing AG in April 2018. Furthermore, there were several trade and loan receivables securitisation transactions involving Swiss originators as well as placements of covered bonds by Swiss banks. The Swiss market has finally seen a number of public and non-public synthetic balance sheet securitisations conducted by larger, systemically important banks ("SIBs") with the aim of reducing the institutions' Risk Weighted Assets ("RWA") either generally or in respect of a specific asset class. Such transactions are typically structured as credit default swaps ("CDS") or credit-linked notes ("CLNs") or a combination of both, and include a transfer of credit risk relating to an asset portfolio (such as, for example, part of an originating bank's corporate loan book) to a protection seller.

2. Acquisition Finance/Leveraged Finance

2.1 Transaction Structure, Players and Legal Regime

As in other markets, acquisitions in Switzerland are either financed by equity or quasi-equity (such as subordinated shareholder loans) or by debt. As debt providers typically ask for a minimum equity component, transactions are often financed by a combination of equity and debt. The debt financing structure depends on the targeted leverage. In a low or medium leverage scenario, the debt package regularly consists of senior debt which is structured as a term loan to finance the purchase price of the acquisition. If the acquisition financing is combined with a refinancing of the acquirer's existing debt, if a (partial) refinancing of the target group's debt is necessary, or if there are working capital needs on the level of the target and/or its group companies, the lenders regularly also provide a working capital facility. In a high leverage scenario, further layers of second lien senior debt or junior debt (eg, taking the form of mezzanine loans or high-yield notes) are added. Junior debt may also include a payment-in-kind ("PIK") component, which by its nature provides that any interest is deferred until maturity. Over the past couple of years there have not been any substantial developments in the structuring of acquisition or leveraged finance transactions in Switzerland besides the fact that credit institutions seem to be more and more willing to offer substantial debt packages without taking comprehensive collateral.

Smaller and mid-sized domestic acquisition financing transactions are often financed by one single bank or a small syndicate of banks. The main players in the Swiss market are Credit Suisse, UBS and Zürcher Kantonalbank, which regularly act as lead arrangers of the transaction. In the syndication phase, smaller cantonal banks and other local banks are invited to participate in the financing. Large acquisition transactions or transactions involving a big industrial buyer are often arranged out of the London market or are at least placed within an international banking syndicate. Such transactions also often provide for a capital market element such as the issuance of a high-yield bond. The capital market instrument can either be issued at the same time the loan structure is implemented or be used as a take-out instrument. In the last twelve months, we have seen significant activity of private equity investors based in the United States, the United Kingdom, Germany and also Switzerland, looking for investment opportunities in Switzerland. A further trend is an increased participation of private debt funds in acquisition financings. Debt funds usually take the second lien senior debt or junior debt tranche.

There is no specific law or regulation governing acquisition finance or leveraged finance transactions in Switzerland. Lending transactions are subject to the general legal framework, which in particular includes the Swiss Code of Obligations. Special rules apply to public takeover transactions where Swiss takeover law requires the bidder to ensure that the funds required for the takeover bid will be available (see **2.7 Certain Funds Concept** below). Furthermore, professional lenders are subject to applicable anti-money laundering regulation.

2.2 Documentation

In the Swiss market, larger acquisition finance/leveraged finance transactions are typically documented on the basis of the Loan Market Association ("LMA") recommended form of the senior multicurrency term and revolving facilities agreement for leveraged acquisition finance transactions. Strong borrowers may manage to have the transaction documented under the LMA investment grade documentation. For smaller transactions and certain bridge financings, major Swiss banks also regularly use their own standard bilateral facility documentation. At the point in time the acquirer has to submit a binding offer, usually a commitment letter will be in place which is often based on a "light" version of the LMA standard Mandate Letter or another standard established by the relevant underwriters. Acquisition finance transactions, which are arranged by Swiss banks, are typically documented under an agreement governed by Swiss law. The vast majority of the transactions are documented under an agreement in the English language. In cases where the banking syndicate includes several smaller (local) banks or where the borrower has a specific preference for an agreement in the German language, the transaction may be documented using the German language.

2.3 Security

The most commonly used forms of security taken in acquisition finance and leveraged finance transactions are: guarantees by material group companies of the buyer and, upon accession, the target and its (material) group companies; pledges over shares in the target company and certain material group companies; security assignments of certain trade or other receivables as well as intercompany loans; assignments of claims or rights under the acquisition agreement; and pledges over bank accounts of the acquirer and/or the target group. In certain cases, security is taken over real estate which is usually created by way of a pledge or security transfer of mortgage certificates. Fixed charges or floating charges are not available under Swiss law, but there are ways to establish securities over inventory which, however, are barely seen in the Swiss market (see **2.4 Restrictions and Limitations**). Short-term bridge financings may also be completely unsecured, in particular in instances of strong borrowers and an acquisition which is seen as a strategic fit by the lenders.

The procedures for the creation and perfection of a security interest under Swiss law depend on the form of the security as well as the type of asset which serves as collateral.

As a general rule, the granting of a security interest over movable assets requires that possession of those assets passes from the security provider(s) to the secured party(ies) or a security agent. In general, no security over movable assets can be created by registration of the security interest in a public register (certain exceptions exist for some assets that define ownership based on a register such as aircrafts and ships). Due to the requirement that the security provider has to give up exclusive control over the movable asset serving as collateral, Swiss security packages will typically not include any transfer for security purposes or pledge of inventory as this may on the one hand lead to a disruption of the daily business of the security provider and on the other hand not be manageable for the secured parties. In respect of the creation of a security interest over movable assets, Swiss law generally does not provide for any approval, filing or registration requirements. As stated above, certain exceptions exist for security interests in relation to specific assets such as aircrafts and ships, which require the registration of the security interest in a public register.

A special regime applies to real estate securities: while no registration or notarisation requirements exist for the security transfer or pledge of mortgage certificates themselves, the creation of mortgage certificates and any increase of the nominal value of a mortgage certificate have to be recorded in the Land Registry.

Swiss law also does not provide for any renewal procedures to keep a security interest valid or for specific works council or similar consents, as is the case in other jurisdictions. Finally, it has to be noted that, although notification is generally not required under Swiss law to establish a security interest, a notification of third parties may, depending on the type of asset which is subject to the security, be advisable in order to prevent such third parties (such as the underlying debtors in case of a receivable assignment or bank account pledge) from being able to validly discharge their obligations by means of payment to the security provider.

As regards the enforcement of security interests in Switzerland, one has to differentiate between private and official enforcement proceedings. In general, private enforcement is more favourable for the secured parties as it is less cumbersome than an official enforcement proceeding and can be completed rather quickly. In case of collateral that is not characterised by the fact that legal title to the asset is transferred to the secured parties or a security agent acting on their behalf (such as, for example, a pledge over shares or other assets), private enforcement is only permitted if the security provider has consented to this method of enforcement in advance and provided that no official debt enforcement proceedings have been opened. In the acquisition finance context (and in syndicated finance in general), security agreements governed by Swiss law therefore always contain permission for the security agent to initiate private enforcement proceedings. In case of collateral where legal title to the collateral asset was transferred to the secured parties (such as, for example, an assignment for security purposes of certain trade receivables), the collateral may only be enforced through private enforcement. The secured parties have substantial discretion when it comes to private enforcement and may enforce the security in such a way and at such a time and place as they see fit.

Official enforcement proceedings are governed by the rules of the Federal Act on Debt Enforcement and Bankruptcy. Official enforcement of a security interest (other than a security interest which may only be enforced through private enforcement; see above) will take place if:

- bankruptcy proceedings have been opened with respect to the relevant obligor;
- the relevant assets serving as collateral have been seized in a debt enforcement proceeding; or
- the secured parties, for some reason, choose to initiate official enforcement proceedings instead of conducting private enforcement.

The enforcement typically takes the form of a public auction. However, the Federal Act on Debt Enforcement and Bankruptcy provides for the possibility that the debt enforcement officials may conduct a private sale if:

- all parties expressly agree to such private sale;
- securities or other assets with a market price are to be realised and the price offered in the private sale at least corresponds to the market price;
- the value of the assets to be realised decreases quickly; or
- the maintenance of the relevant assets is costly and time-consuming or the safekeeping costs are unreasonably high.

2.4 Restrictions and Limitations

Swiss corporate law does not have any particular rules on financial assistance and also does not provide for any specific thin-capitalisation rules. However, it provides for several provisions protecting the nominal capital and the reserves of a Swiss corporation. Based on these provisions, a Swiss corporation may not make any payment to its parent company unless such payment is made as a formal dividend, in the course of a reduction of the relevant company's share capital or on the basis of an agreement which meets the arm's length test. The same applies to any payments to sister companies. No restrictions apply to any downstream payments to a subsidiary unless the subsidiary is not wholly owned by the company making the relevant payment or the subsidiary is in financial distress and certain further conditions are fulfilled. It is the prevailing view in Switzerland that the granting of a security interest or a guarantee to a third party such as a lender under an acquisition finance agreement for obligations of a parent or a sister company (upstream or cross-stream security interest) as well as certain other acts of a similar nature (such as, for example, indemnities) are subject to the same limitations as an actual payment. This ultimately has the effect that any guarantee or security interest granted for the benefit of a parent or sister company – such as, in the acquisition financing context, a security interest for obligations of the buyer – is limited to the amount the security provider could distribute to its shareholders as a dividend at the time a payment is demanded under the guarantee or the security interest is enforced. Payments under any upstream and cross-stream guarantee or security interest may further have certain tax implications. They may, for example, trigger Swiss withholding tax (at a current rate of 35%) if they do not meet the arm's length test.

Swiss law does not provide for any whitewash or similar measures to avoid the consequences of an upstream or cross-stream security. However, in order to mitigate the imperfections of such security interests from a Swiss law perspective, certain steps are taken in accordance with standard market practice. First of all, the lenders will usually require that the articles of association of the Swiss entity(ies) explicitly permit the granting of upstream or cross-stream security. In addition, it is typically ensured that the transaction documents and the relevant upstream and/or cross-stream transactions are properly approved by the competent corporate bodies, which includes an approval by the shareholders' meeting of the security provider. Further, the financing documentation usually contains limitation language which addresses the free equity limitation. For both corporate and tax law reasons, the parties having the benefit of an upstream and cross-stream transaction finally often compensate the security provider for granting the security by paying a guarantee or security fee, at least if they are not (directly or indirectly) benefiting from the financing themselves.

2.5 Lender Liability
There are no specific lender-liability issues to be considered from a Swiss law perspective. In general, a lender can only be liable if it does not act in compliance with general rules and applicable Swiss laws – for example if it does not act in good faith when exercising its rights under the finance documents or if it substantially interferes with the business decisions of the borrower.

2.6 Debt Purchase Transactions and Debt Trading
There are no specific rules under Swiss law which govern debt buy-back transactions. Furthermore, to our knowledge there is also no real market in Switzerland for borrowers or financial sponsors to engage in debt purchase transactions. In mid-market and larger acquisition finance transactions, the topic of debt buy-backs is usually addressed in the finance documentation which often contains a prohibition or at least certain restrictions with respect to debt purchase transactions carried out by a borrower or financial sponsor with a tendency for less strict rules for debt buy-backs by financial sponsors. Typical restrictions include prohibitions to entering into a debt buy-back at a time when an event of default is continuing, and rules that require such transactions to be funded from excess cash flow, which is not required to be applied in prepayment of the facilities or from new equity or additional subordinated shareholder loans. Furthermore, the finance documentation usually provides that any commitment (beneficially) owned by or subject to a sub-participation for the benefit of a borrower or financial sponsor is disregarded for the purposes of any voting matters under the credit agreement.

2.7 Certain Funds Concept
For public takeover transactions, Swiss takeover law provides that the offer prospectus must contain the material information on the financing of the offer as well as confirmation by the independent review body (which is typically a Big Four audit firm) that the offeror has taken the necessary steps to ensure that the funds required for the takeover bid will be available at settlement. In order to provide sufficient comfort to the review body to issue the relevant confirmation, the latter usually closely follows the negotiation of the facility documentation (in particular the facility agreement). Although the law does not provide for detailed certain fund rules to be applied in the context of public takeovers in Switzerland, a certain market standard has developed over the last couple of years. For private M&A transactions, there are no 'certain funds' requirements stipulated by the applicable Swiss law. Therefore, depending on the structure of the transaction and the parties involved, there is a certain variety of certain funds standards applied in the market. However, in particular in larger transactions or transactions where a private equity buyer is involved, the parties usually agree to a quite high certain funds threshold. Typical major representations in such transactions include status, binding obligations, non-conflict, power and authority, validity and admissibility in evidence and insolvency. Major defaults typically include non-payment, the breach of certain selected major obligations, and misrepresentation insofar as it relates to a breach of a major representation or selected additional representations.

2.8 Financial Restructuring
Within the last twelve months, there have been a couple of significant (private) financial restructurings of debtors in Switzerland.

Financial creditors may approve a private restructuring arrangement if they come to the conclusion that their loss would be smaller in a successful restructuring than in composition or bankruptcy proceedings. Restructuring measures may include the granting of a bridge loan, the subordination of claims, debt-equity or debt-asset swaps or a full or partial waiver of claims. In particular, in case of larger syndicates or in a situation where the borrower has outstanding debt under several credit arrangements, the main challenge for a successful financial restructuring is the alignment of the interests of all creditors involved. From a legal perspective, one of the main challenges is the risk that certain measures taken in the restructuring may be challenged by other creditors or the bankruptcy administration if the creditor enters into bankruptcy proceedings at a later stage. For example, uncertainty exists as to the legality of repayment of a bridge loan immediately prior to the opening of bankruptcy proceedings. In order to ensure the lawful repayment of bridge loans prior to the opening of bankruptcy proceedings, such loans are typically only granted on a secured basis and the borrower must ensure that the proceeds of the bridge loan are only used to pay the borrower's accounts payable, but not financial indebtedness.

2.9 Reform
There are currently no pending reforms or legislative proposals that would have a major impact on acquisition finance/leveraged finance transactions in Switzerland.

3. Securitised Debt

3.1 General
Switzerland does not have specific securitisation or asset-backed securities ("ABS") legislation, nor does it stipulate any registration requirements for a securitisation, or define which types of transactions constitute securitisation transactions. Instead, the general legal framework applies to such transactions. Relevant legislation includes the Swiss Code of Obligations and the Swiss Civil Code which contain the rules for the setting up of a special purpose vehicle ("SPV") in Switzerland as well as the requirements for a valid transfer of receivables and assets from the originator to the SPV. Furthermore, when structuring a securitisation transaction, one has to take into account general capital market regulations and – in case of a listing at the SIX Swiss Exchange – the SIX listing rules or, as the case may be, the rules of any other applicable exchange. However, the SIX listing rules do not contain specific rules for securitised debt, and securitisation transactions are generally treated in the same way as issuances of straight bonds.

In the last couple of years, the vast majority of public 'true sale' securitisation transactions in Switzerland related to the securitisation of auto lease receivables and loans and credit card receivables. There have also been public and non-public transactions involving commercial and consumer loans, residential and commercial mortgage loans, commodity warehouse receipts and trade receivables. In principle, any type of asset may be subject to a securitisation transaction from a Swiss law perspective. Thus, the limiting factor is the view of the market on whether a specific asset is suitable in the securitisation context. To our knowledge, securitisation transactions in Switzerland do not usually encompass distressed debt.

As to whether the laws of jurisdiction provide for any "skin in the game" or similar risk-retention requirements for originators, see **3.2 Asset Transfer.** As Switzerland has not enacted securitisation-specific legislation, no such rules apply.

3.2 Asset Transfer
The transfer of receivables is usually achieved by the originator and the SPV entering into a receivables purchase agreement which includes a declaration of assignment. In order for the actual assignment to be valid from a Swiss law perspective, it must be in writing. Due to the fact that, under Swiss law, future receivables which have been assigned to an SPV fall into the bankruptcy estate of the originator once bankruptcy or similar insolvency proceedings are opened against the originator, the parties sometimes decide to transfer the receivables by way of an assumption of contract, which has the effect that the relevant future receivables are (directly) part of the SPV's assets upon their existence.

Provided that the underlying agreement governing the receivables does not contain a non-assignment clause (pactum de non cedendo), the notification of the underlying creditors of the assignment is no perfection requirement. However, the parties to the securitisation transaction may have an incentive to notify the underlying creditors, as a notification will prevent the latter from being able to validly discharge their obligations by making payment to the originator. In order for the assignment to be valid, the agreement on the assignment and transfer has to provide that the originator as assignee may at any time notify the underlying creditor even if it is the understanding of the parties that the assignment shall not be disclosed to the creditors or any other third party. If the receivables are transferred by way of an assumption of contract, the consent of the underlying creditors is required in order for the transfer to be effective. In many cases (in particular in the context of the transfer of auto lease receivables or loans and credit card receivables), the consent to such a transfer of contract is already included in the general terms and conditions governing the underlying contract. If the relevant consent is drafted properly, such consent is generally considered to be valid from a Swiss law perspective.

There are no specific requirements or obstacles in relation to the sale and transfer of receivables that are of particular relevance in practice in the light of applicable consumer protection legislation.

The rights of the underlying obligor under Swiss data protection laws are usually addressed by obtaining a waiver from the creditor (which in most cases is already included in the underlying agreement governing the receivables). In any case, a breach of any rights under applicable data protection legislation does not have an effect on the validity of the assignment.

As there is no general securitisation legislation, in contrast to other jurisdictions such as the European Union or the United States, there are no specific credit risk retention or other so-called "skin in the game" rules in Switzerland. However, securitisation structures governed by Swiss law typically provide that part of the risk associated with the underlying asset portfolio has to remain with the originator in order to fulfil certain rating requirements.

The concept of "true sale" as such is not known under Swiss law as is the case in other jurisdictions and neither Swiss statutory law nor Swiss case law provide for a straightforward test to define whether the sale of receivables for the purpose of a securitisation transaction is to be considered as a "true sale" transaction or a secured loan. In both a securitisation transaction and a secured finance transaction, where the security interest is established by a transfer of title, the transferee becomes the legal owner of the claims with full ownership rights. However, in a secured financing the transferee has certain (contractually agreed) fiduciary duties towards the transferor and may only proceed to the enforcement of the assigned claims if an event of default occurs with respect to the security provider or another obligor. In order to mitigate the risk that the transfer of receivables in a securitisation transaction is recharacterised by a court, the parties lay particular emphasis on the actual transfer of the credit/collection risk from the originator to the SPV. The fact that the originator will, from a technical point of view, still be responsible for the collection of the receivables does not lead to a requalification of the transaction as not being a true sale transaction as long as the SPV, as purchaser, has the right to notify the underlying creditors at any time and request them to discharge their obligations by payment to the SPV only (also see **3.1 Securitised Debt** above). Finally, an important element to be considered is whether the transfer of receivables meets the arm's length test. Problematic elements include repurchase obligations of the originator (other than repurchase obligations for ineligible receivables), whereas the option for the originator to repurchase receivables is not considered to be in conflict with the true sale qualification of the transaction.

3.3 Issuance Vehicle

In Switzerland, we see both securitisation structures which involve a trust, and securitisation structures which make use of an SPV. Although the concept of a trust is not available under Swiss law, trust structures governed by foreign law are generally recognised in Switzerland. If the parties wish to use a trust structure, such structure is typically established in a common-law jurisdiction (mostly in the UK) and the transaction documents relating to the trustee and its rights and obligations are governed by the laws of such jurisdiction. If the establishment of a trust set-up is not an option for the parties, they often use a Swiss SPV. This is, in particular, the case for transactions where the underlying asset portfolio relates to real estate located in Switzerland as in this case the use of a foreign SPV may lead to the incurrence of cantonal withholding taxes on interest payment under securitised debt secured by Swiss real estate. The parties may also wish to use a Swiss SPV in order to avoid that data being transferred abroad.

Swiss SPVs either take the legal form of a stock corporation (*Aktiengesellschaft*) or a limited liability company (*Gesellschaft mit beschränkter Haftung*). The minimum capitalisation for a stock corporation is CHF100,000 (of which a minimum of CHF50,000 has to be paid in), whereas only CHF20,000 is required to establish a limited liability company. In practice, in the securitisation context, it is not material whether the parties decide to use a stock corporation or a limited liability company.

In order to make the SPV bankruptcy remote, the corporate purpose of the SPV set out in the articles of association is usually limited to the specific securitisation transaction (also see **3.4 Bankruptcy Remoteness**). Furthermore, as Swiss SPVs typically have to be held by the originator itself, due to the unavailability of trust or similar structures, some rating agencies request the implementation of golden shareholder structures where the independent shareholder has certain veto rights in the shareholders' meeting of the SPV. Furthermore, it is standard practice to provide for the appointment of independent board members who have certain control rights at the level of the SPV's board of directors.

Under Swiss law, it is not possible to set up compartment structures. Although it would, from a corporate law perspective, be possible for an SPV to act as a multi-issuance vehicle, the SPV is typically established for the purpose of conducting one specific securitisation transaction.

3.4 Bankruptcy Remoteness

The items used to make the SPV "bankruptcy remote" from a Swiss law perspective include a limitation of the corporate purpose of the SPV to the specific securitisation transaction as well as restrictions on the change of the legal form or any amendments to the constitutional documents of the SPV. Further important elements are limited recourse and non-petition provisions as well as general waivers of set-off provisions which will apply to counterparties dealing with the SPV. As a general rule and subject to certain exceptional circumstances, Swiss law does not provide for the concept of consolidation in an insolvency which means that, in case of bankruptcy of a direct or indirect shareholder of the SPV, the assets and liabilities of the group of companies would not be pooled. Furthermore, as a matter of Swiss law, bankruptcy proceedings are conducted on an entity level and the bankruptcy of a shareholder of the SPV will not automatically lead to the opening of bankruptcy proceedings on the level of the SPV itself. However, in order to mitigate any consolidation risk, the parties to a securitisation transaction will usually establish a structure where the SPV and its shareholder(s) (ie, the originator) are managed independently and cannot be viewed as being part of the same group of companies. This is, inter alia, achieved by making sure that the SPV conducts its business in its own name, maintains its own books and records, and has independent accounting.

Under Swiss law, the bankruptcy or insolvency officials may have the right to reverse, avoid or set aside an assignment of receivables if the transaction falls within a suspect period which is between one and five years before the opening of the bankruptcy or insolvency proceedings. However, as a general rule, there is no substantial reversal or avoidance risk if the transaction meets the arm's length test. Furthermore, as discussed above, if the originator is also the shareholder of the SPV, as is typically the case in Swiss securitisation transactions involving an SPV, the insolvency of the originator would not lead to the opening of bankruptcy proceedings with respect to the SPV. In this case, the shares in the SPV would be sold in the course of the bankruptcy proceedings relating to the originator; this sale would, however, not have a (direct) effect on the dealings of the SPV and its rights and obligations in the context of the securitisation.

3.5 Reform

There are currently no pending reforms or legislative proposals that would have a major impact on securitisation or ABS transactions in Switzerland.

4. Other Asset-based Lending

4.1 Factoring

Switzerland does not have a specific law or regulation governing the transfer and sale of assets in connection with a factoring transaction. Rather, the general rules on transfer and sale of assets set out in the Swiss Code of Obligations apply.

There are different types of factoring transactions that apply in practice. In recourse factoring transactions, the risk of non-payment is fully borne by the customer. Therefore recourse factoring is often not qualified as being a real factoring. That type of factoring is also offered through financing platforms where companies with surplus cash can efficiently invest their funds. In non-recourse factoring, the risk of non-payment is entirely borne by the factor. There are mixed forms where the risk is assumed by the factor up to a pre-defined limit per debtor. Further, in most instances advance factoring applies. This means that the factor pays the invoiced amount promptly upon the issuance of the invoice by its client. There is also the possibility of maturity factoring, which is characterised by the fact that the factor will pay the invoiced amount at the due date of the invoice. In this situation, there is no crediting of the invoice; only the risk of non-payment is borne by the factor.

For the assignment of receivables, Swiss law requires the assignment declaration to be in writing (wet-ink signature). In theory, an electronic signature would also be sufficient, but e-signatures are almost never used in practice. The assignment may, however, be a so-called general assignment, which encompasses both current and future receivables. A general assignment is considered to be valid under Swiss law, provided that the receivables to be assigned are sufficiently specified.

Depending on the factoring agreement, the transfer of the receivables may or may not be notified to the debtor at the time of transfer. The notification limits the objections available to the debtor. For example, changes to the receivables subsequently agreed with the client are not opposable to the factor. The debtor cannot set off its own receivables arising subsequent to the notification with the assigned receivables. Therefore notification gives an additional certainty to the factor.

If there is no agreement between the factor and the client, Swiss law provides that the sale of receivables is a true sale, ie the risk that the debtor does not pay passes on to the factor. However, factoring agreements normally specify who bears the risk and to what extent. In a country as small as Switzerland, it is important to understand that it may well be the case that not all aspects of the assignment are subject to Swiss law. It may be that foreign law applies to certain aspects. That is normally not the case with respect to the question of whether it is a true sale, but may apply to the question of what the effect of notification is. Currently, there is no pending reform in Switzerland that would have an impact on factoring transactions.

4.2 Covered Bonds

In 1931, Switzerland introduced the so-called Swiss Pfandbrief system by means of the Mortgage Bond Act, which is supplemented by the Mortgage Bond Ordinance containing the implementing provisions. The Mortgage Bond Act provides that there are only two mortgage bond issuers in Switzerland. One is the Pfandbriefzentrale held by the Swiss Cantonal banks; the other one is the Pfandbriefbank held by the vast majority of the other Swiss banks. These two institutions have a monopoly on issuing mortgage bonds in Switzerland. Essentially, they issue mortgage bonds and grant loans to their member banks (and, under special conditions, to other banks) who in turn grant mortgage loans to their customers in Switzerland. The two mortgage bond issuers have liens on the mortgages granted by its members (or the other banks), while the bondholders have liens on the loans granted by the institution concerned. The liens are established by registers maintained by the two issuing institutions and the banks that receive the loans from them. The bonds issued by the Pfandbriefzentrale or the Pfandbriefbank rank pari passu. There are a number of provisions that make sure that there is always sufficient collateral to cover the bonds. Both the Pfandbriefzentrale and the Pfandbriefbank are supervised by FINMA. If bankruptcy proceedings are opened against a borrowing bank, the respective mortgage bond issuer has a priority claim with respect to the registered collateral. The outstanding bonds are not accelerated as a result of a bank defaulting.

There are also issuances of contractual (structured) covered bonds aside from the Swiss Pfandbrief system. UBS and Credit Suisse, the two major Swiss banks, have set up corresponding issuance platforms upon which they issue covered bonds through one of their branches located outside Switzerland. The covered bonds are secured by a guarantee provided by a special purpose vehicle ("SPV"). The SPV issues the guarantee under a guarantee mandate agreement with the issuing bank. Under the guarantee mandate agreement the issuing bank is obligated to indemnify the guarantor for any guarantee payment the guarantor would have to make. That indemnity claim is secured by mortgage loans and corresponding mortgages transferred as a security to the guarantor, which form the core of the cover pool.

Under the bonds issued within the framework of the Swiss Pfandbrief system, the collateral consists of mortgage-backed loans. If the value of the collateral does not correspond to the requirements, it needs to be enhanced. Such a credit enhancement may include the purchase of high quality liquid assets, such as Swiss government bonds or cash. The underlying collateral of covered bonds issued by the two major Swiss banks mainly consists of mortgage loans and the corresponding mortgages. Cash and certain government bonds may form part of the collateral as substitute assets, but only up to a certain limit.

Under the Swiss Pfandbrief system, the loans granted to the members and other banks serve as collateral for the mortgage bonds issued. If bankruptcy proceedings are opened against one of the credit institutions acting as lender, FINMA, as responsible authority for such proceedings, will make sure that the loans granted only cover the outstanding bonds plus interest. In case of covered bonds issued by UBS or Credit Suisse, there is indirect access to the collateral through the right of the SPV to be indemnified under the guarantee mandate agreement. The mortgage loans and the mortgages granted as securities are segregated from the other assets of the issuing bank and serve as security for the guarantor and thus indirectly for the holders of the covered bonds.

The SPVs used by the two major Swiss banks in connection with their covered bond structures are Swiss entities which are ultimately controlled by the respective credit institution. They are formed as stock corporations (*Aktiengesellschaften*) under Swiss law. Given the restrictions that apply to the purchase of Swiss real estate by non-Swiss persons, another structure will usually not be acceptable. To ensure that the issuer does not alter the security provided to the holders of the covered bonds, the SPV should be set up so as to avoid any impairment of the security of the holders. This includes the appointment of independent directors that have a veto right in the board of directors by being granted half of the board seats and the granting of a minimal equity interest that is coupled with a veto right for decisions that can only be taken by the shareholders' meeting, such as changes to the articles of association. Moreover, the articles of association are usually designed in a way to ensure that the purpose of the SPV is limited to the entity's functions as guarantor.

In case of an insolvency of the issuer, be it one of the issuers under the Pfandbrief system or one of the major banks issuing covered bonds, FINMA will conduct the insolvency proceedings. In either case, the collateral provided under the covered bonds is segregated from the other assets of the insolvent issuer. The collateral only serves as security for the bondholders. There is no possibility of directly enforcing it into the underlying properties.

There are currently no pending reforms or legislative proposals that would have a major impact on covered bond transactions in Switzerland.

4.3 Other Secured Bonds

When Swiss companies issue other secured bonds, they generally structure the issue through a foreign subsidiary as issuer, while the Swiss company, at best, guarantees the bond, and has other subsidiaries granting additional collateral.

A typical structure is, for example, that a Luxembourg subsidiary of the originating entity issues the secured bonds which are guaranteed and/or secured by the ultimate parent domiciled in Switzerland and other subsidiaries.

Typical types of collateral are pledged shares in subsidiaries, intercompany receivables, bank accounts, and trade receivables. These securities are normally provided to a security trustee under a respective trust deed or similar agreement which is typically not governed by Swiss law.

5. Credit-linked Notes

5.1 Main Structures

The main issuers of credit-linked notes ("CLNs") in Switzerland are the two largest Swiss banks, UBS and Credit Suisse, as well as Bank Vontobel, which is very active in the structured products market in general. Further issuers include Zürcher Kantonalbank and some smaller players in the market as well as foreign credit institutions targeting the Swiss market. Smaller credit institutions often collaborate with larger banks for the structuring of the issuance. CLNs placed in Switzerland are typically structured as single-name CLNs which account for the largest part of the issuance volume in this product category. Further structures include basket or portfolio CLNs, including CLNs referencing loan portfolios of the issuer (see **5.5 CLN Transactions**), as well as CLNs referencing iTraxx or similar indices. Nth-to-default structures are barely seen in the Swiss market.

5.2 Parties Acting as Protection Seller/Issuer/Investors

Parties acting as protection buyers and issuers of CLNs are typically banks or other credit institutions and, in some cases, special purpose vehicles ("SPVs") or issuance platforms set up by banks for the purpose of issuing and distributing CLNs. The main category of investors investing in this product category are family offices and high net worth individuals. Other typical investors include pension and hedge funds and larger asset managers who are, based on their investment policies, able to invest in financial instruments which are subject to a higher default risk and a possible write-down of principal.

5.3 Structures Involving Issuances via an SPV and/or a Trust

Issuances of CLNs are usually conducted by banks or other credit institutions which either act as issuer themselves or use an investment banking entity as issuance vehicle. In certain cases, the issuance takes place via a branch located in an offshore jurisdiction. SPV issuance structures are less common as the market for notes and other debt instruments issued by entities which are not known to the public is rather limited in Switzerland. In case of SPV issuances, the cash flows and credit risk are typically transferred to the SPV via a credit default swap ("CDS") between the SPV and the originating credit institution which mirrors the credit-linked notes structure. The funds raised by the SPV are often used for the purchase of bonds, including high-quality liquid assets, which serve as collateral asset in the transaction. Trust structures are not used in the Swiss CLN market at all.

5.4 Reference Portfolios

There are basically two types of reference portfolio assets typically included in credit-linked debt issuances covering the Swiss market: the majority of the structures can be qualified as "Arbitrage CLNs" which reference an ordinary ISDA credit default swap. Reference entities include large corporates which are traded in the dealer market such as Nestlé, Barclays, Bombardier, Daimler, Siemens or BT, to name but a few. The second type of CLNs reference a balance sheet portfolio or a single balance sheet position (typically an exposure of the originating credit institution to loans granted to small and mid-sized enterprises) and are used as balance sheet hedges (see also **5.5 CLN Transactions**).

5.5 CLN Transactions

The issuance of CLNs and the associated risk transfer may enable originating credit institutions to reduce their Risk Weighted Assets ("RWA") and thus may have a capital relief function. A synthetic balance sheet securitisation with the objective of reducing capital requirements typically consists of (i) a CDS entered into between the originating bank and an SPV (or another separate entity) and (ii) CLNs issued by the SPV or such other entity to investors. If no credit event occurs during the term of the notes, they will be repaid at their nominal amount. If a credit event occurs, the issuing SPV pays a cash settlement amount to the originating credit institution and writes down the outstanding nominal amount of the credit-linked notes by a corresponding amount.

From a Swiss law perspective, the eligibility of CLNs for capital relief purposes requires that the structure of the transaction fulfills the respective requirements set forth in the Federal Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers (which implemented the revised Basel III regulations on credit risk capital requirements for derivatives, fund investments and securitisations for banks) as well as in the implementing FINMA Circular 2017/7 "Credit risks – banks", which entered into force on 1 January 2017. A key requirement for the eligibility of a CLN transaction for RWA reduction purposes is that the credit risk is actually transferred to the protection seller. Further minimum requirements include, inter alia, the following:

- the credit protection must constitute a direct claim towards the protection seller. This is not an issue in the CLN context since the investor as protection seller has already fulfilled its obligations by purchasing the notes and paying the issue price;
- the CLNs have to be linked to a specific reference obligation or a basket of reference obligations in order to make sure that the scope of the protection is clearly defined;
- the investors as protection sellers may not have a put option under the terms of the CLN other than in cases where the issuer does not meet its payment obligations or fails to meet any other material obligation under the notes. Regulatory or tax calls are permissible if they may only be exercised by the issuer;
- under the terms of the CLN, the credit events 'failure to pay', 'bankruptcy' and 'restructuring' have to be specified as being applicable and the responsibility for the determination of whether or not a credit event has occurred has to be clearly defined.

If there are any mismatches between the currency or, more importantly, the maturity of the credit-linked note and the reference obligations, specific haircuts will be applied. Therefore, ideally, the term of the CLN matches the term of the reference obligations which may however be difficult if the CLN references an asset portfolio. CLNs which reference obligations with a maturity of less than one year are not eligible for RWA reduction purposes.

Besides meeting the requirements for the transaction to have a capital relief function, further key challenges which have to be addressed when structuring the transaction include:

- the definition of an adequate verification procedure and the appointment of an (independent) verification agent for the purpose of determining whether or not a credit event has occurred;
- dealing with potential data protection and banking secrecy issues, in particular if the reference obligations relate to small and mid-sized enterprise loan portfolios; and
- the structuring of the workout and cash flows to investors (interim protection payments with true-up when workout is complete versus final payment when the obligations are worked out only).

5.6 Privately Placed or Publicly Offered CLNs
In the Swiss market, CLNs are usually privately placed rather than offered to the public. Furthermore, the notes typically provide for a rather high denomination (a common denomination is CHF125,000) which has the effect that CLNs cannot be offered to retail investors at all.

5.7 Main Transparency Requirements
If CLNs are offered to the public in Switzerland, the offering has to be conducted on the basis of an offering prospectus which fulfils the requirements of the Swiss Code of Obligations. Many regular Swiss issuers use standardised general terms and conditions ("GTCs") which meet these requirements rather than a formal issuance prospectus. As CLNs that are issued primarily for investment purposes are – according to the Guidelines on informing investors about structured products issued by the Swiss Bankers Association – to be qualified as structured products, the GTCs are usually supplemented by a simplified prospectus (term sheet) which meets the requirements of article 5 of the Federal Act on Collective Investment Schemes. If the notes are to be offered to the public in the European Union, they are documented on the basis of a prospectus meeting the requirements of the European Prospectus Directive. Larger issuers have comprehensive issuance programmes in place which cover a wide range of structured products, including CLNs. In a listing of the notes on a regulated exchange, the prospectus has to meet the applicable listing requirements. However, Swiss issuers rarely decide to list CLNs on a regulated exchange and, if they do so (which is mainly for taxation reasons), the listing usually does not take place in Switzerland. From a Swiss law perspective, there are no further ongoing transparency requirements after the issuance of credit-linked notes.

5.8 Pending Reform
There are currently no pending reforms or legislative proposals that would have a major impact on CLN transactions in Switzerland other than the enactment of a Financial Services Act which is further described in **6.7 Reform and Trends**.

6. Structured Products – Notes, Warrants and Certificates

6.1 General
In Switzerland, the whole breadth of structured products is issued and offered to the public. Examples are tracker certificates that follow the performance of the underlying asset; barrier reverse convertibles that pay a coupon and provide for the delivery of the underlying shares if the barrier is touched or crossed during the term of the product, provided the market price of the underlying is below the exercise price at expiration; and capital protection certificates that provide 100% capital protection with partial participation in the upside.

A large number of issuers are active in Switzerland. All larger Swiss banks issue structured products. Further, a number of foreign banks are also active in the Swiss structured product market and some securities traders.

6.2 Legal and Regulatory Regime
To date, structured product regulation in Switzerland is rather limited. The only provision under Swiss law dealing with structured products is Article 5 of the Federal Act on Collective Investment Schemes which contains certain limitations for the distribution of structured products to non-qualified investors, including the requirement to publish a simplified prospectus for products offered to such investors. The content of the simplified prospectus is defined by the Swiss Bankers Association in their guidelines on informing investors about structured products. Although these guidelines do not have the quality of a formal law, they are of general application and will be taken as a benchmark by FINMA when determining whether a simplified prospectus meets the required standard.

Structured products must not be distributed to non-qualified investors unless they are issued or guaranteed or otherwise secured by a licensed bank, a licensed securities dealer, a licensed insurance broker or similar foreign institution that is subject to prudential supervision. No such limitations apply to the issuance and distribution of structured products to qualified investors. Also, anyone may act as manufacturer of structured products to be offered to non-qualified investors, provided the products are guaranteed by any of the above-mentioned financial institutions. Foreign institutions that wish to distribute structured products not listed at a regulated exchange in Switzerland must have a subsidiary or branch or representative office which forms part of the consolidated foreign supervision in Switzerland. If SPVs are used for the issuance of structured products, the distribution needs to take place via a licensed or regulated entity and the structured products must be issued on a secured basis. The relevant security may be a guarantee of a supervised financial institution or an undertaking of a supervised financial institution to support the SPV or valuable collateral assets serving as security for the benefit of the investors.

Essentially, there are no limits regarding the admissibility with respect to the type of structured products offered. However, the form of structured products must not be used to circumvent other product restrictions. For example, a structured product which depends to more than one third on a foreign collective investment scheme that is not admitted to distribution in Switzerland must not be distributed in Switzerland.

6.3 Documentation
Typically, the key elements of a structured product are set out in an indicative term sheet. The indicative term sheet has to meet the requirements of a simplified prospectus

as set out in the guidelines on informing investors about structured products issued by the Swiss Bankers Association, excepting parameters that depend on market prices. Most products are offered on the basis of such an indicative term sheet which has to be provided to prospective investors before subscription takes place. Upon the final allocation of the structured products a final simplified prospectus is issued. If a structured product is to be listed on the stock exchange, a prospectus meeting the requirements of the relevant stock exchange is required, which in this case also replaces the simplified prospectus. However, it is standard market practice that issuers of structured products issue a term sheet meeting the requirements of a simplified prospectus irrespective of whether or not the product is listed at a stock exchange.

6.4 Distribution

In Switzerland, structured products are widely distributed, and so distribution agreements play an important role. Key elements of distribution agreements are the right and the obligation to distribute structured products, compliance with applicable laws, and compensation-related matters.

The right to distribute the structured product covered by the distribution agreement is normally non-exclusive and so the incentive for the distributor to show activity results from the fees the distributor can earn. The distribution agreement normally emphasises compliance with applicable laws, in particular that the required licences are in place to distribute the products, that the products are only offered to investors to whom and in jurisdictions where such distribution is admissible, and that the distributor serves the necessary documentation to the investors and takes into account the limitations set out in the product documentation when conducting its marketing activities.

Distributors normally receive a remuneration for their distribution activities. They have to be mindful with respect to their possible duty towards their own customers to disclose and to surrender the fees received under the distribution agreement to their own customers. In their customer agreements, distributors normally cater for this and deviate from the rules that would otherwise apply.

6.5 Listing and Trading Distribution

Structured products may be listed and traded at SIX Swiss Exchange. The main rationale for a listing of structured products at SIX Swiss Exchange is to provide liquidity to the investors. In case of a listing, the assets referenced by the structured product have to meet certain criteria which primarily aim at making sure that the referenced assets have a liquid market and prices which are published on a regular basis. Furthermore, in case of a listing, a prospectus which meets the requirements of the SIX Swiss Exchange has to be published. Often, structured products are issued on the basis of an issuance programme which has been separately approved by the stock exchange. Structured products may be and often are admitted to provisional trading with only a subsequent listing application to allow fast market access.

6.6 Prospectus Liability, Regulatory and Criminal Sanctions

Under Swiss law the issuers and distributors are subject to prospectus liability in the same way as an equity issuer. That means that those persons who are responsible for the drafting and the distribution of the prospectus are liable for any damage resulting from incorrect, incomplete or misleading information and information that is not in line with statutory requirements, provided they acted negligently or wilfully. To the extent a person participating in the distribution of structured products needs a FINMA licence to do so, but does not have such licence, FINMA can take supervisory measures against that person. Further, whoever distributes a structured product to non-qualified investors without complying with the rules on the issuer or the guarantor, without providing a simplified prospectus, or without making clear that the structured product is neither a collective investment scheme nor regulated by FINMA, may be fined.

6.7 Reform and Trends

Currently, the Swiss parliament is in the course of finalising the Financial Services Act, which impacts the Swiss financial markets in general. Inter alia, the Financial Services Act will introduce rules of conduct and transparency rules applicable to the distribution of structured products. Furthermore, the Financial Services Act will provide for a general prospectus review requirement by a licensed review body. In addition, a key information document will be required if structured products are offered to private investors. However, although the new Financial Services Act will likely have a certain impact on the issuance and distribution of structured products, it is expected that the implementing ordinances will make sure that the structured products regulation in Switzerland still allows for sufficient flexibility.

7. OTC Derivatives

7.1 Regulatory Restrictions

In general, the entering into OTC derivatives requires neither a licence nor an approval. A licence is only required if derivatives are publicly offered on a professional basis.

Whereas, generally, the market for OTC derivatives is open to any party with access to a trading platform or a professional market player willing to enter into a derivatives contract with it, there exist certain restrictions for specific counterparties.

For example, certain restrictions apply to collective investment schemes which intend to enter into OTC derivative contracts, including the following:

- the derivative positions held by collective investment schemes must not change the nature of the scheme;
- the organisation, the risk management, and the qualification of the persons handling the derivatives must be appropriate;
- the counterparty of the scheme needs to be a supervised financial intermediary specialised in derivatives;
- limits regarding the counterparty risk need to be observed;
- netting agreements need to comply with requirements set forth by the regulator;
- OTC derivatives positions held by collective investment schemes must be either tradeable on a daily basis or redeemable at any time and be subject to a standardised framework agreement which complies with international standards, such as the ISDA master agreement;
- it must be possible to value OTC derivatives reliably and in a verifiable way on a daily basis;
- it must be possible to sell, liquidate or terminate the OTC derivatives at any time; and
- the counterparty of the collective investment scheme needs to meet minimum rating requirements.

For pension funds, a number of limitations are also to be observed:

- there are certain limitations with respect to the admissible underlyings;
- the pension fund needs to carefully assess the creditworthiness and tradeability of the OTC derivatives positions held by it;
- the OTC derivatives held by pension funds must always be fully covered and there must be no leverage effect on the total assets of the pension fund;
- the limits applicable with respect to debt issuers, equity issuers, the size of real estate investments and different asset classes have to be observed, taking derivatives into account;
- coverage of the pension obligations is to be determined under the most extreme possible derivative conversion scenario.

Finally, certain limitations apply to insurance companies with respect to their committed assets and also to health insurers for the mandatory insurance part as well as the non-mandatory part (where they are treated the same way as insurers). The restrictions are similar (but not identical) to those of pension funds.

7.2 Standardised Master Agreements/Security Agreements

Except for the international standardised agreements, domestic Swiss transactions are also regularly documented under the Swiss Master Agreement for Over-the-Counter Derivative Instruments issued by the Swiss Bankers Association. The Swiss Master Agreement is mostly used in relation to small and medium-sized counterparties who may be reluctant to enter into more voluminous international standard agreements.

There is no standard practice in Switzerland with respect to legal opinions in relation to the Swiss Master Agreement. Opinions may mostly be obtained with respect to close-out netting and collateral. Close-out netting is generally recognised outside and within an insolvency, but calculation of the lump sum may not take into account any fluctuations to the detriment of the insolvent party or any interest after adjudication of bankruptcy. Under the credit support annex to the Swiss Master Agreement, ownership in the collateral is fully transferred. There might be a risk that the granting of collateral is voided within a bankruptcy, but the risk is generally small.

7.3 Netting and Close-out Provisions

It is recommendable to select automatic early termination under an ISDA Master Agreement where the agreement is entered into with a Swiss counterparty. The reason is that there is legal uncertainty in cases where the counterparty of a bankrupt entity terminates the agreement with effect after the opening of the bankruptcy proceedings. In this case, the bankruptcy administration might not accept the termination and might not comply with the agreement until termination. To remove that uncertainty, automatic early termination should be elected.

There is a standard opinion available for Switzerland which, inter alia, covers the enforceability of the netting and close-out provisions and which is updated on a yearly basis. The material qualifications do not concern the situation outside of a bankruptcy scenario but relate to counterparties subject to bankruptcy proceedings. One material qualification included in the opinion relates to the fact that there exists no Swiss case law as to whether the statutory step-in rights of the bankruptcy administration may be excluded or not. The prevailing doctrine takes the view that a contractual exclusion of such step-in rights is also binding to the bankruptcy administration. Further, even if the parties select an automatic termination to be applicable, there exists some uncertainty regarding whether the relevant termination must be accepted by the bankruptcy administration in case of an opening of bankruptcy proceedings. Further qualifications relate to the close-out netting by calculating a single lump sum amount: a calculation made as of a date after the opening of the bankruptcy proceedings or the confirmation of a composition agreement would likely not be accepted by the bankruptcy administration if it is to the detriment of the bankruptcy estate. In this case, the relevant administrator would request a more favourable amount to be applied. Finally, if the currency chosen for the termination is not in Swiss francs, for bankruptcy purposes the foreign currency has to be converted into Swiss francs as per the date of the opening of the bankruptcy proceedings or, respectively, the confirmation of a composition agreement.

7.4 Stay Acknowledgment

Since 2016, Swiss law has required that certain agreements (or amendments thereto) which are subject to foreign law or foreign jurisdiction may only be entered into by banks and securities dealers if they include a contractual recognition of the stay powers of FINMA by the relevant counterparty. The same rule applies to financial market infrastructures, such as stock exchanges, multilateral trading facilities and central counterparties. In-scope agreements include, inter alia, agreements relating to the purchase and sale of securities, commodities and their indices, interest rate swaps, currencies and credit agreements between banks, including master agreements with respect to such contracts. There are a number of exceptions where the inclusion of a stay recognition clause is not required, such as, for example, with respect to agreements regarding the placing of financial instruments in the market or agreements of group companies that are not active in the financial markets.

The stay power of FINMA comes into play when there is a risk of over-indebtedness or insolvency or if a financial institution does not comply with applicable capital adequacy requirements. The stay may be ordered for a maximum of two business days. The effect of the stay is that termination, netting, realisation and transfer rights must not be invoked. If, after the relevant period of two business days, the financial institution complies with the requirements to continue to operate its business, any such rights that arose cannot be invoked and the contracts concerned continue to apply.

Baker McKenzie
Holbeinstrasse 30
P.O. Box
8034 Zurich
Switzerland

Tel: +41 44 384 14 14
Fax: +41 44 384 12 84
Email: Matthias.Courvoisier@bakermckenzie.com
Web: www.bakermckenzie.com