SWITZERLAND

Law and Practice

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Contents

1. Market p.3
1.1 Debt Finance Market Performance p.3
1.2 Market Players p.3
1.3 Geopolitical Considerations p.4

2. Types of Transactions p.4
2.1 Debt Finance Transactions p.4

3. Structure p.5
3.1 Debt Finance Transaction Structure p.5

4. Documentation p.6
4.1 Transaction Documentation p.6
4.2 Impact of Types of Investors p.6
4.3 Jurisdiction-Specific Terms p.7

5. Guarantees and Security p.8
5.1 Guarantee and Security Packages p.8
5.2 Key Considerations for Security and Guarantees p.10

6. Intercreditor Issues p.11
6.1 Role of Intercreditor Arrangements p.11
6.2 Contractual v Legal Subordination p.11

7. Enforcement p.12
7.1 Process for Enforcement of Security p.12
7.2 Enforcement of Foreign Judgments p.14

8. Lenders' Rights in Insolvency p.15
8.1 Rescue and Reorganisation Procedures p.15
8.2 Main Insolvency Law Considerations p.15

9. Tax & Regulatory Considerations p.17
9.1 Tax Considerations p.17
9.2 Regulatory Considerations p.18

10. Jurisdiction-Specific or Cross-Border Issues p.19
10.1 Additional Issues to Highlight p.19

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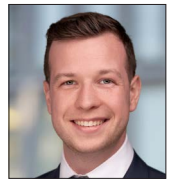

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1. Market

1.1 Debt Finance Market Performance

The environment of elevated and enduring inflation, the increase in nominal interest rates and the impact of rising energy costs led to a slowdown in global economic growth, which also put pressure on the Swiss debt finance market.

Although Switzerland is home to a large number of companies and serves as an important hub for key subsidiaries of various major international corporations spanning diverse industries, the size of the loan market stagnated after a long phase of above-average growth. Due to higher borrowing cost and more difficult lending conditions, volumes were lower throughout 2023 compared to 2022 and 2021. The decline affected secured loans more than unsecured loans.

Switzerland's debt capital markets, on the other hand, continued to perform strongly and grew further in 2023, with the volume raised by debt capital instruments on the main debt security exchange SIX Swiss Exchange (SIX) exceeding the CHF100 billion mark for the second consecutive year. Also, the number of green, sustainable, sustainability-linked and social bonds traded on the SIX increased from 108 in 2022 to 136 in 2023.

1.2 Market Players

The lending market is mainly in the hands of banks, with locally-headquartered banks being predominantly involved in bilateral lending, and international banks more active in relation to syndicated loans. Although banks are overall the main players in the Swiss corporate lending market, alternative lenders such as pension funds and insurance companies are becoming increasingly prominent. In international leveraged finance transactions, particularly those arranged in the United States but with a Swiss component, specialised debt funds are participating more frequently as well.

The global uncertainty in the banking sector in March 2023 led to emergency measures by the Swiss authorities and, eventually, the merger of UBS Group and Credit Suisse, two global systemically important banks. Both banks were independently major players in the Swiss and international debt finance markets. While this merger meant the loss of one major player, particularly in the syndicated financing space, it could also prove to be an opportunity for new entrants.

A more recent trend in Switzerland is marketplace lending, where platforms seek to connect institutional investors and borrowers. This form

of lending continued to grow in volume in both the small and medium-sized enterprises (SMEs) and large corporations segments, reaching a new high in 2023.

While European and North American issuers feature very prominently on the list of top-10 bond issuers on the SIX, local issuers account for more than two-thirds of the outstanding corporate bonds, led by UBS with a third of the market share. Banks are generally responsible for most of the SIX corporate bond issuances, followed by chemical and pharmaceutical companies and other service providers.

1.3 Geopolitical Considerations

Despite increased volatility in the financial markets due to risks and uncertainties caused by events such as the COVID-19 pandemic and the subsequent unwinding of aid programmes, the war in Ukraine and the conflict in the Middle East, the Swiss credit market proved to be stable. Although the Swiss National Bank (SNB) raised interest rates several times in order to combat inflation, rates and their impact remained moderate compared to international developments. Nevertheless, higher borrowing costs and fears of recession did have an impact on investors, leading to a slowdown in their activities.

Also, rising interest rates have fuelled a trend towards the increased use of combined bank loan and bond structures in transactions, as opposed to senior term loans alone.

Another notable impact has been the full package of economic sanctions imposed by the EU on Russia in response to its aggression against Ukraine which has been endorsed by the Swiss government. These include financial sanctions and restrictions such as a ban on the sale of securities to Russian citizens and entities. These measures are accompanied by enhanced due diligence and reporting requirements in the context of the fight against money laundering.

The US presidential elections in November will potentially have a large impact on US economic policy, regulatory frameworks and investor sentiment. A transition of power from one administration to another can lead to important shifts in fiscal, healthcare and environmental policies, international trade and foreign relations, affecting global trade flows, supply chains and investment behaviour.

Globally, 2024 can be considered as the ultimate election year with national elections in a minimum of 64 countries (as well as on EU level) representing 49% of the world's population. The outcomes of those elections will undoubtedly have significant macroeconomic and geopolitical implications.

2. Types of Transactions

2.1 Debt Finance Transactions

In Switzerland, the main types of debt finance transactions include:

- secured syndicated loans;
- acquisition finance; and
- securitisations.

The Swiss bank loan market is well developed with some major players in the international cross-border financing market. The international regulatory framework for banks, such as Basel III, provides for strict capital requirements when giving out loans, making it harder for smaller players to participate. The securitisation market in Switzerland continues to evolve with an increasing number of transactions.

The acquisition finance market in 2023 was largely driven by Swiss companies acquiring foreign entities, which accounted for almost half of all transactions. However, challenging market conditions have led to a general slowdown in acquisition financings, resulting in 25% fewer transactions and a drop of almost 50% in deal volume as compared to the previous year. The slowdown was particularly pronounced for transactions involving private equity firms. While market conditions eased during the second half of the year, future challenges remain in relation to the increasing complexity of transactions in terms of technological developments and risks, as well as increased sustainability requirements.

In the securitisations market, environmental, social, and governance (ESG) securitisations are expected to gain in significance going forward. Up until now, trade receivables, in particular, have been the subject of securitisations, with auto-leasing and credit card receivables forming the two main types of underlying assets. Frequently, securitisations are structured through a Luxembourg issuing vehicle that purchases Swiss receivables, mainly in order to avoid Swiss withholding tax. While private placements are most common, the Swiss public securitisations market is also fairly active.

As an alternative means to raise capital, Switzerland has seen an increase in marketplace lending in recent years. Crowdfunding or crowdlending activities in relation to SME loans have experienced significant growth. This is a popular way of funding projects, especially in the start-up sector. However, the biggest increase in marketplace lending in terms of volume has been in the segment of online loans to medium and large companies.

3. Structure

3.1 Debt Finance Transaction Structure

Revolving credit facilities and term loan facilities are the most common forms of bank loan facilities in Switzerland.

In acquisition financings, senior term loans are used to finance the purchase price of the acquisition itself, while high-yield notes are often used in addition to senior term loans in larger transactions. On the other hand, revolving credit facilities and term loans are the most common forms of bank loans to finance the working capital needs of the target company and bridge loans are often used in tight timeframes as syndication of bank loans can be time-consuming. Bank guarantees are frequently seen as well, whereas swingline facilities are less common. Debt packages consist of either senior debt only or of senior debt supplemented by one or more layers of junior debt in the form of mezzanine and high-yield debt.

The Swiss bank loan market allows for efficient and, if required, confidential (ie, "non-public") financing. Borrowers often maintain long-standing, close relationships with their *Hausbank* (relationship bank). Bank loans are sometimes also used in transactions with volumes that may be too large for the debt securities market. In addition, unlike debt securities, bank loans are not subject to various regulatory requirements relating to prospectus compliance, filing and registration. This is particularly true for listed debt securities. However, syndicated bank loans are generally subject to more stringent covenants and may have a greater impact on the borrower's operating flexibility.

The loan market is almost exclusively dominated by banks, while the investor base for debt secu-

rities transactions is much broader (insurance companies, pension funds, specialised debt funds). However, as banks have withdrawn to some degree from certain parts of the lending market amid the turmoil observed in the sector and the challenging lending environment, private lending has benefited, giving rise to non-bank lenders trying to fill the gap.

4. Documentation

4.1 Transaction Documentation

The documentation used for loan financing transactions in Switzerland depends on a number of factors. There are no legally required forms for secured finance transactions in Switzerland, but there are standard bank agreements or templates.

Large syndicated loans are often governed by either English law and based on Loan Market Association (LMA) standard documentation or New York law and based on the Loan Syndication and Tradition Association (LSTA) standard documentation, with Swiss law specific provisions incorporated into these templates.

Loan documentation under Swiss law also closely follows the LMA standard documentation to the extent permitted by local law. Security documentation for Swiss security interests is generally governed by Swiss law, taking into account Swiss law specifics (such as Swiss-specific forms of security, creation and perfection requirements). Intercreditor agreements also play an important role in debt financing transactions (see **6.1 Role of Intercreditor Arrangements**).

Bond documentation usually consists of a prospectus or other offering document together with a subscription agreement (in the case of a public offering) or just a subscription agreement or note purchase agreement (in the case of a private offering) as well as a note trust deed (for English law transactions) or an indenture (for US law transactions). There may also be an intercreditor or subordination agreement.

In the Swiss market, it is common practice for lenders' counsel to issue an enforceability opinion and for borrowers' counsel to issue a capacity opinion in loan financing transactions, whereas two sets of bond opinions are usually being issued. While legal opinions were traditionally required only in international transactions, they are increasingly being issued in domestic transactions as well.

In terms of corporate authorisations, board and shareholder resolutions are usually required together with the customary director's certificates.

For larger acquisition financings that may be suitable for international syndication, long-form letters of commitment are common, whereas for smaller, less complex transactions, especially those without cross-border involvement, banks may use only short-form letters of commitment, or even "highly confident letters".

4.2 Impact of Types of Investors

One reason why the loan market in Switzerland is predominantly in the hands of (Swiss) banks are the so-called Swiss "non-bank rules" which, in case breached, may lead to up to 35% Swiss withholding tax being imposed on interest payments made by Swiss borrowers or Swiss guarantors in respect of loan financings by non-banks. The Swiss "non-bank rules" basically limit the ability of lenders to sell their position in

a particular facility to more than ten non-bank lenders (see also **9.1 Tax Considerations**).

The general contraction in the credit market in 2023 was also accompanied by a sharp decline in private lending. With the exception of investment-grade deals, private lending has shifted to less traditional segments and become increasingly covenant lite in an attempt to capitalise on moderate bank lending activity. In particular, direct lenders have been increasingly seen to waive key financial covenants as they sought to participate in larger deals and take additional market share from traditional bank lenders.

4.3 Jurisdiction-Specific Terms

Swiss law does not generally prohibit or restrict the granting of collateral or guarantees to foreign lenders. There are, however, certain jurisdiction-specific considerations that need to be taken into account in cross-border loan documentation.

As far as non-Swiss lenders are concerned, it is important to ensure that there is no permanent physical presence in Switzerland, as this may require authorisation from the Swiss Financial Markets Authority (FINMA).

In order to ensure compliance with the Swiss "non-bank rules" and avoid Swiss withholding tax being levied on interest payments by a Swiss borrower or guarantor, a number of provisions are typically included in facility agreements with Swiss borrowers, guarantors or security providers. For example, depending on the structure, the ability of lenders to sell their position in the facility, sub-participate or otherwise enter into so-called damaging exposure transfers must be limited (to a total of ten non-banks under the specific facility) to avoid negative tax implications. Accordingly, assignment and transfer restrictions, as well as restrictions on damaging exposure transfers may need to be included in the facility agreements. An alternative, in the case where there is no Swiss borrower, would be to restrict the harmful use of proceeds from the facility in Switzerland. In either case, a recalculation of interest provision should be included from the lenders' perspective.

In the case where a Swiss subsidiary guarantor and/or security provider provides guarantees or security or incurs any other financial obligation in respect of obligations of its parent or sister company or companies, any such agreements may only be entered into at arm's length. Failure to comply with the arm's length requirement may result in the fulfilment of such financial obligation being treated as a (disguised or hidden) profit distribution with possible negative tax implications or, if such payment exceeds the amount of freely distributable reserves of the relevant Swiss company, as a repayment of capital. It is, therefore, common practice to include restrictive covenants and limitation language in the loan documentation and, in particular, in the security and guarantee documents entered into by a Swiss company in order to prevent the company from incurring an obligation in breach of its protected equity.

Under Swiss law, due to the accessory nature of a pledge, a valid security interest can only be created in favour of those persons who are the actual creditors of the secured obligations. Where a security interest under Swiss law is held by a security agent also for the benefit of the other secured parties, such a security agent will have to be appointed to act as direct representative of the other secured parties. Such appointment is usually included in the intercreditor agreement, failing which, the facility agreement. In addition, parallel debt is often used as

a "back-up". It should be noted that, as there is no legislation or case law on the parallel debt concept in Switzerland, there is no certainty that a security interest based on parallel debt obligations will be upheld by a Swiss court.

5. Guarantees and Security

5.1 Guarantee and Security Packages

In corporate lending transactions, a security package will typically consist of a pledge over shares or quotas, a security assignment of (certain) claims and receivables, such as intercompany loan receivables, insurance receivables, and/or trade receivables and a pledge or security assignment over bank accounts. In addition, if the security provider has valuable IP, a pledge over intellectual property rights may also be entered into, and, in case of a real estate financing, a security transfer of mortgage certificates.

The Swiss security provider will usually also grant a guarantee. Such guarantee is, in most cases where the Swiss entity is a subsidiary guarantor, included in the facility agreement (in the case of English law transactions) or a separate guaranty agreement (in most US law transactions). If the guarantee is provided by a Swiss parent company (which may not otherwise be a party to the financing), a separate Swiss law guarantee may be entered into.

It should be noted that floating charges and blanket liens (also called all-monies debentures) are not recognised under Swiss law.

Types of Assets

- Financial instruments (such as shares).
- Bank accounts.
- Movable assets.
- Intellectual property.
- Claims and receivables.
- Real estate.

Types of Security

- Pledge.
- Security Assignment.
- Guarantees.

Formalities and Perfection Requirements

Pledge

For the creation of a right of pledge, a security document is highly recommended but in general not required by law. Requirements for perfection on the other hand vary depending on the type of assets.

Movable assets

- In general, the pledged assets must be physically transferred to the secured party or to a third-party pledge-holder for perfection.
- For publicly registered aircraft and ships, entry of the right of pledge in the relevant register is required for perfection.

Financial instruments (shares)

These are pledged by way of a written pledge agreement and, in addition:

- in the case of bearer shares, the share certificates are physically transferred to the secured party or the security agent; and
- in the case of registered certificated shares, the share certificates, duly endorsed in blank, are physically transferred to the secured party or the security agent (which has a similar function as a stock transfer form in the UK).

Bank accounts

Bank accounts are typically pledged, although security assignments are also common. Notification of the account bank is a perfection requirement in the case of a pledge, as such

pledge is (technically) second ranking due to the prior ranking right of pledge usually contained in the account bank's applicable general terms and conditions, and such notification has also become standard practice in the case of a security assignment. The parties will often also seek confirmation from the account bank that it waives any such priority rights in relation to the bank account.

Real estate

Real estate may be used as security in the form of mortgage certificates, which may be pledged and transferred for security purposes, or as a mortgage (land charge).

If the mortgage certificate has not been issued yet, its creation requires a written agreement in the form of a notarial deed and can take the form of a bearer mortgage certificate, registered mortgage certificate, or paperless mortgage certificate. Perfection requires the physical transfer of possession in the case of bearer and registered certificates, while in the case of paperless mortgage certificates, the transfer of legal title must be registered in the land register.

The land charge requires a written mortgage agreement in the form of a notarial deed which itself must be filed with the land register for perfection.

Intellectual property

This is usually secured by way of pledge, which requires a written pledge agreement specifying the intellectual property. While, technically, registration is not required for perfection, a lack of registration would allow a third party to acquire the intellectual property in good faith.

Security assignment

The assignability of claims and receivables for security purposes is generally accepted under Swiss law and requires a written agreement for creation and perfection. However, it is important to ascertain that the relevant underlying agreements giving rise to the claim or receivable do not contain a prohibition on assignment as, in such case, the assignment for security purposes would be invalid.

Guarantees

There are generally no formal requirements for guarantees. However, it is advisable to obtain the approval of both the board of directors and the shareholders of the Swiss guarantor in order to grant an upstream or cross-stream guarantee.

In addition, it is important that guarantees are drafted in such a way as to avoid their requalification as a Swiss law suretyship. This is because such requalification would give the guarantor the same rights of objection and defence as the debtor and would impose formal requirements that may not have been met with respect to the intended guarantee.

5.2 Key Considerations for Security and Guarantees

Agent and Trust Concepts

Under Swiss law, security may be granted to and held by an authorised agent which, in syndicated financings or hybrid bond/loan transactions, would be the security agent or English law security trustee.

If the security interest is an assignment or transfer by way of security – ie, a non-accessory security interest, the security interest may be granted to and held by an authorised agent acting in its own name and on its own behalf as indirect representative of the other secured parties. How-

ever, as mentioned in **4.3 Jurisdiction-Specific Terms**, a right of pledge, which constitutes an accessory security interest, can only be created in favour of those persons who are the actual creditors of the secured obligations. As Swiss law does not generally recognise a trust set up by contractual arrangement, the security agent will have to be expressly appointed by the other secured parties to act as their direct representative for the purposes of taking and holding (and releasing) the security.

Such appointment is usually included in the intercreditor agreement, failing which, the facility agreement.

Parallel Debt

Parallel debt is often used as a "back-up" to direct representation where an accessory security interest under Swiss law is held by a security agent for the benefit of the secured parties. As the parallel debt structures remain untested in Switzerland, it is unclear whether the concept would be upheld by a Swiss court, although practitioners tend to assume that it would.

Restrictions on Upstream Security

The granting of a security interest, guarantee or other financial obligation by a Swiss company for the obligations of its (direct or indirect) parent company (upstream liability) or its sister companies (cross-stream liability) is subject to certain restrictions. The relevant agreement needs to provide for arm's length terms and the articles of association should expressly permit such upstream/cross-stream liabilities. As, under Swiss law, payments made to or on behalf of a direct or indirect parent or sister company are considered akin to the distribution of a dividend, a shareholder resolution should also be obtained which expressly approves the distribution of the Swiss subsidiary's assets in the case of enforcement.

In addition, upstream or cross-stream guarantees and security are – just like a dividend – limited to the amount of freely distributable equity and reserves of the security provider or guarantor, as any sums paid in excess of this amount may be considered an impermissible return of capital. Finally, Swiss dividend withholding tax (of currently 35%) may have to be deducted from any such guarantee payment or the proceeds from the enforcement of any such security.

Corporate Benefit

In addition to the specific requirements in respect of upstream and cross-stream liabilities, board resolutions should be obtained confirming that the proposed transaction is in the best interests of, and would materially benefit, the Swiss company.

The purpose clause in the articles of association of the Swiss company should ideally expressly permit the company to grant financings, cash-pooling, guarantees and security to or for the benefit of its group companies (be it its shareholders, sister companies or subsidiaries) as well as third parties, whether for consideration or not, and even if such transaction is to the exclusive benefit of such other person.

Nevertheless, for both corporate law and tax reasons, the granting of loans, guarantees or other security to or for the benefit of group companies should always be carried out on arm's length terms – ie, on third-party conditions. The Swiss company should also carefully assess the creditworthiness of the intra-group obligor and the ability of such obligor to meet its primary obligations.

Financial Assistance

In Switzerland, there is no general prohibition of financial assistance – ie, the assistance by a

company through the granting of a loan, security, guarantee or otherwise for the purpose of the acquisition of its own shares. However, the above-referenced limitations on upstream and cross-stream liabilities apply. In addition, for corporate and tax reasons, it is recommended that the Swiss company be compensated for providing the upstream security or guarantees by receiving a guarantee fee or a security commission.

Requirement for Guarantee Fees

As the granting or taking of guarantees and security between related parties must be carried out on arm's length terms, a guarantee fee or security commission should be paid to the guarantor or security provider. The Swiss Federal Tax Administration has also generally required that Swiss companies providing guarantees to their parent companies receive appropriate remuneration for such guarantees.

6. Intercreditor Issues

6.1 Role of Intercreditor Arrangements

Intercreditor agreements play an important role in financing transactions in Switzerland by allowing the parties to contractually (i) establish certain rights of the different classes of creditors, (ii) agree on the priority of claims, and (iii) select mechanisms in the event of an enforcement of the collateral. Such agreements are common in relation to multi-layered debt financings where a combination of senior loans, second-lien loans, mezzanine loans and high-yield bonds are used.

6.2 Contractual v Legal Subordination

In the case of secured claims, priority is determined by the order of creation and perfection of the individual security interests (the so-called time priority concept). For unregistered assets, the parties may contractually alter the order by means of an intercreditor agreement. For registered assets, such as real estate, the priority of the security interest is determined by its entry/ranking in the relevant register.

Swiss law provides for the legal subordination of certain creditors in the event of the bankruptcy of a Swiss company. Secured creditors always have priority over unsecured creditors to the extent that their claims are fully covered by the security. Unsecured claims are divided into three different classes and are satisfied from the proceeds of the bankruptcy estate.

An intercreditor agreement, on the other hand, makes it possible to contractually agree on the priority of claims between certain creditors; whether such agreements are also binding on the liquidator during bankruptcy proceedings remains untested in Switzerland.

Another type of contractual subordination in Switzerland is based on statute (Article 725(b) of the Swiss Code of Obligations) and applies to creditors of over-indebted companies. Unless a statutory exception applies, the board of directors of the Swiss company must notify the court of the company's over-indebtedness, with the latter then initiating bankruptcy proceedings. One such exception is where one of the company's creditors subordinates its claims to those of all other creditors to the extent of the over-indebtedness. Such subordination is usually agreed by the shareholder of the over-indebted Swiss company in respect of its shareholder loans. The amount of the subordinated debt must cover both the principal and any interest due.

7. Enforcement

7.1 Process for Enforcement of Security

A security interest becomes enforceable when the secured obligations become due and payable and are not paid within the required timeframe or as otherwise contractually agreed between the parties (eg, upon the occurrence of an event of default). The specific circumstances under which a security interest may be enforced depend on the terms mutually agreed between the parties and are subject to certain minimum legal requirements designed to protect the interests of the security provider.

Security interests can be enforced through formal debt enforcement proceedings under the Federal Debt Enforcement and Bankruptcy Act (DEBA) or through private enforcement. In practice, parties often contractually provide for the secured party's right to choose between private enforcement without court intervention and formal debt enforcement proceedings. Unless otherwise agreed, prior notice must be given to the security provider of a pending enforcement of the security. The parties are free to waive the requirement for prior notice.

In addition to the choice of the type of enforcement, the time of enforcement of the security is also at the secured party's discretion, unless the security agreement contains a provision to the contrary. However, the secured party must act diligently and in good faith. It is usually expressly stated in the security agreement that the secured party has the right, but not the obligation, to enforce the security and realise the collateral.

Debt Enforcement Proceedings Under the DEBA

The DEBA is the primary source of legislation governing enforcement and insolvency proceedings in Switzerland. As Switzerland is not a member of the EU, any EU directives or regulations are not directly applicable to Swiss enforcement proceedings. Under the DEBA, the situation is slightly different to the EU position.

A security right in the form of a right of pledge may be enforced pursuant to the DEBA (i) via debt enforcement proceedings upon pledge realisation (*Betreibung auf Pfandverwertung*) or (ii) in the course of bankruptcy proceedings.

Debt enforcement proceedings upon pledge realisation (Betreibung auf Pfandverwertung)

Commencing debt enforcement proceedings

Debt enforcement proceedings upon pledge realisation (*Betreibung auf Pfandverwertung*) means realising a specific pledge without bankruptcy proceedings being opened against the company in question. In order to initiate this kind of proceeding, the secured party needs to file an application (*Betreibungsbegehren*) with the competent debt collection office in Switzerland. After the application has been filed, the debt collection office will issue a summons to pay (*Zahlungsbefehl*), giving the debtor a deadline of one month to pay the claimed amount.

The debtor has the possibility to raise an objection (*Rechtsvorschlag*) within ten days after receipt of the summons to pay, whereupon the debt enforcement proceedings will be suspended until the objection is set aside. It is then for the secured party to assert its claim in court proceedings in order to obtain a court judgement. This is an ordinary litigation in which the debtor is free to dispute the existence or the amount of the claim. Only after obtaining a court decision, can the objection be set aside and debt enforcement proceedings be continued. If the creditor has a written acknowledgment of the debt or if the debt arises clearly out of a contract (such

as a loan agreement), the objection can also be set aside provisionally in summary proceedings. The debtor would then need to commence ordinary proceedings against the creditor and would have to prove that the claim does not exist or no longer exists.

If the debtor raises no objection or the objection has been set aside by a Swiss court, the creditor will be able to demand realisation of the pledge at the earliest after one month and at the latest one year after the summons to pay has been served. The debt collection office in charge then carries out the realisation.

Realisation of the pledge

(i) Public auction

The DEBA provides that the collateral to be realised will be realised by the debt collection office in a pre-announced public auction in which everyone interested is free to bid. The debt collection office is obliged to obtain the highest possible realisation proceeds under the circumstance and to safeguard the interests of the creditor to the best possible extent. The possibilities for the parties to exert influence are limited.

However, since there is hardly any market for shares of companies that are not publicly traded, debt collection offices favour free sales (*Freihandverkauf* ie, a private sale of the collateral by the debt collection office) over auctions, as experience has shown that they generate higher proceeds than public auctions. Whether a free sale is to be given preference over a public auction depends on the case at hand, whereby the debt collection office is granted considerable discretion.

(ii) Free sale

A free sale is in principle only possible if all parties expressly agree. In practice, however, the debt collection office will often decide itself if the pledge is to be realised by free sale and if so, the manner of execution. A free sale is usually considered (i) if a willing buyer has made itself known to the debt collection office and made a reasonable offer, (ii) if the bids at public auction are expected to be low, or (iii) if the circle of interested parties is limited from the outset. If an asset of a certain value is sold by way of a free sale, the debt collection office typically notifies interested parties of the terms of the offer it considers accepting and gives them an opportunity to place a higher bid.

The creditor is not entitled (even if the legal requirements are met) to demand that the realisation be carried out by free sale. This remains at the discretion of the debt collection office. If the debtor is of the opinion that the debt collection office violated its duty to obtain the highest possible amount of proceeds by the free sale, the order accepting the offer (*Zuschlag mittels betreibungsrechtlicher Verfügung*) can be challenged with an appeal pursuant to Article 17 of the DEBA.

Distribution of the proceeds

The costs of administration, realisation and distribution are paid in advance from the proceeds of the realisation of the pledged assets. The remaining proceeds would then be paid to the secured party/-ies up to the amount of their claim including interest and debt collection costs incurred. Any surplus is payable to the pledgor.

Private enforcement

Out-of-court private enforcement is usually quicker and less burdensome. However, the secured party is obliged to realise the collateral in a manner that ensures that the best possible

price for the collateral is obtained, whether by private sale (including self-sale or the sale to another secured party or a third party) or auction.

There is generally no correct selling price that must be achieved. However, a low price may expose the secured party to a claim that the realisation was not conducted carefully and may result in potential liability. There are certain mechanisms that can limit the risk of such liability – eg, a fairness opinion or valuation by an independent third party or a contractual mechanism for valuing the collateral and determining the price. However, including such detail may not be in the interest of the secured party as it potentially limits its discretion when it comes to enforcement, and it might give the security provider the possibility to delay or disrupt security enforcement by claiming that the secured party has not complied with the specific requirements.

Once official debt enforcement proceedings have been commenced or the debtor has been declared bankrupt, private enforcement of certain security interests is no longer possible as co-operation with enforcement and bankruptcy officials is required.

7.2 Enforcement of Foreign Judgments

Foreign judgments are principally recognised and enforced in Switzerland, subject to certain restrictions set forth in:

- the Convention on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters (the Lugano Convention);
- other international treaties to which Switzerland is a party; and
- the Swiss Federal Act on Private International Law (PILA). The procedure for the enforcement of foreign judgments in Switzerland, therefore, depends on whether there is a special regime applicable under an international treaty, such as the Lugano Convention, and is otherwise governed by the PILA.

The recognition of a foreign judgment is a prerequisite for its enforcement. In general, a foreign judgment will be recognised in Switzerland (subject to certain exceptions) if:

- the jurisdiction of the courts or authorities of the state in which the judgment was given was well founded;
- no ordinary legal remedy can be invoked against the decision or if it is final; and
- the recognition would not be manifestly incompatible with Swiss legal principles and public policy.

In the case of Lugano Convention judgments, the jurisdiction of the foreign court may generally not be reviewed and preliminary decisions are enforceable as well.

An arbitral award issued by a foreign arbitral tribunal must also be recognised in Switzerland before it can be enforced. According to the PILA, foreign arbitral awards are subject to recognition and enforcement in accordance with the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards (Convention). This applies even if the award originates from a non-signatory state of the Convention.

8. Lenders' Rights in Insolvency

8.1 Rescue and Reorganisation Procedures

In addition to insolvency proceedings, Swiss law provides for composition proceedings (*Nachlassverfahren*) in the DEBA, which allow for

a more flexible and advantageous restructuring of the company than insolvency proceedings.

Composition proceedings offer debtors several restructuring options. It is possible to initiate the proceedings and to use such proceedings as a restructuring moratorium, subject to court approval. In this case, individual agreements between the debtor and its creditors must be reached, with the possibility of the court terminating the moratorium once the debtor has achieved financial recovery. If financial recovery cannot be achieved by the use of restructuring measures or individual agreements with creditors, a composition agreement may include a debt rescheduling (*Stundungsvergleich*) or dividend agreement (*Prozent- oder Dividendenvergleich*). The debtor retains control after the agreement is approved, thus avoiding liquidation. A composition agreement must be approved by a majority of creditors representing at least two-thirds of the total debt or by one-quarter of creditors representing three-quarters of the total debt (privileged and secured creditors excluded). The composition court confirms the agreement, making it enforceable against all creditors.

Secured creditors are satisfied directly from the net proceeds generated by the realisation of the collateral. If these proceeds prove to be insufficient to fulfil a secured creditor's claim, the remaining portion of the claim is then classified as an unsecured and non-privileged claim that is subject to the composition agreement, if any.

8.2 Main Insolvency Law Considerations

Lenders' Rights to Enforce a Loan, Guarantee or Security in Insolvency

Financial claims generally

The opening of insolvency proceedings against a Swiss debtor results in the acceleration of all claims against such debtor, whether secured or unsecured (except for those secured by mortgage on the debtor's real estate), and all such claims become due and payable. The creditor's claim will consist of the principal amount of the debt, any accrued interest until the date of insolvency, and the costs of enforcement. It should be noted that, upon insolvency, interest on unsecured claims no longer accrues. In case of claims secured by a pledge, interest that would have accrued until the realisation of the collateral can be claimed.

All creditors wanting to assert a claim against the insolvent debtor need to participate in the Swiss insolvency proceedings. Insolvency proceedings constitute collective proceedings and creditors can generally no longer pursue individual claims separately but only in accordance with, and subject to the restrictions of, Swiss insolvency laws.

Assigned claims

Assets that have been legally transferred for security purposes (usually by way of a security assignment) – ie, legal title which has passed to the secured party, prior to the opening of the bankruptcy proceedings against the Swiss debtor do not form part of the bankruptcy estate of the security provider and, as such, can be realised by the secured party by way of private enforcement.

However, future claims and rights which have been assigned for security purposes, but which have only come into existence after the opening of bankruptcy proceedings against the assignor, will fall within the bankruptcy estate of the assignor and be treated in the same way as assets subject to a pledge (see below).

Pledged assets

The opening of bankruptcy proceedings deprives the debtor of the ability to dispose of its assets as they form part of the bankruptcy estate. This includes assets which are the subject of a pledge. From that moment on, private enforcement is, therefore, no longer permitted in respect of these assets. Instead, the enforcement of assets forming part of the bankruptcy estate may only be carried out in accordance with the DEBA, which requires co-operation with the bankruptcy administrator. However, the opening of bankruptcy proceedings does not affect the right of the secured creditor to be satisfied first from the sale of the pledged assets. Only if the proceeds from the sale of the pledged assets exceed the secured claims will the remainder be distributed among the unsecured creditors.

Claw-Back Risks

Claw-back actions aim to recover assets transferred or disposed of by an insolvent debtor and are intended to benefit the insolvency estate and ultimately its creditors as a whole. Transactions may be subject to claw-back actions if:

- within one year before the commencement of bankruptcy or insolvency proceedings, assets were given away for free or transferred without adequate consideration;
- within one year before the commencement of bankruptcy or insolvency proceedings, an over-indebted debtor (i) provided security for existing obligations without a prior-existing obligation to do so, (ii) settled a monetary debt by means other than cash or ordinary means of payment, or (iii) discharged a debt not yet due; and/or
- within five years before the commencement of bankruptcy or insolvency proceedings, a transaction was carried out by the debtor with the intention of harming its creditors or favouring a particular creditor, and the party benefiting from such a transaction knew or should have known of the debtor's intention.

Equitable Subordination

While, in Switzerland, the concept of equitable subordination is not codified in law and there is no established case law, Swiss doctrine supports the concept of equitable subordination with respect to shareholder loans in insolvency situations. The general view is that shareholder loans granted to a Swiss company at a time when it is already in financial distress or over-indebted and no other third-party financing would be available risk being treated as equity and hence being subordinated to the claims of all other creditors and satisfied last. This is especially the case if such shareholder loan is not granted on arm's length terms.

Order of Payment

In Swiss insolvency proceedings there are different classes of creditors that are satisfied according to their rank.

Secured creditors

Secured creditors always have priority over unsecured creditors to the extent that their claims are fully covered by the security.

Unsecured creditors

Unsecured creditors are divided into three classes:

- the first class of legally preferred claims consists, in particular, of claims of employees;
- the second class of legally preferred claims consists of claims relating to social insurances, contributions to the family compensation fund and privileged bank deposits up to a maximum amount of CHF100,000 per creditor; and

• the third class includes all other claims.

Creditors within the same class have equal rights. If the proceeds are not sufficient to satisfy all creditors within a particular class in full, they are distributed in proportion to the amount of each creditor's claim, known as the bankruptcy dividend (*Konkursdividende*). Proceeds are not allocated to creditors in a subsequent class until the creditors in the preceding class have been fully satisfied.

If the secured claims cannot be fully satisfied from the proceeds of the relevant collateral, the secured creditor assumes the status of "ordinary" bankruptcy creditor. It is then assigned to one of the three bankruptcy classes mentioned above, depending on the nature of its claim, but most likely, the third class.

9. Tax & Regulatory Considerations

9.1 Tax Considerations

Interest Withholding Tax

Interest paid by a Swiss borrower on a loan is generally not subject to Swiss withholding tax. However, interest on bonds is subject to Swiss withholding tax at a rate of currently 35%. In order to avoid a loan granted to a Swiss borrower being requalified as a bond, the so-called Swiss "non-bank rules" must be complied with. The following circumstances may trigger a requalification:

- if more than ten non-bank lenders participate (either as lenders of record or sub-participants) in the same loan agreement (the so-called "ten non-bank rule");
- if a Swiss borrower has more than 20 non-bank creditors on aggregate (ie, all of its creditors and not just the lenders under the particular loan agreement) (the so-called "20 non-bank rule"); and
- if a Swiss obligor has, on aggregate, more than 100 non-bank creditors under financings that qualify as deposits within the guidelines issued by the Swiss federal tax administration, it is subject to (the so-called "100 non-bank rule").

Similarly, such interest withholding tax may also apply to financings with a non-Swiss borrower which are guaranteed and/or secured by a Swiss parent or subsidiary guarantor. In the case of a harmful use of proceeds in Switzerland, interest payments under the relevant loan may also be subject to 35% Swiss withholding tax. It is possible to obtain an advance tax ruling from the Swiss federal tax administration to confirm (i) in the case of a Swiss subsidiary guarantor, that such upstream or cross-stream guarantee or security which is limited to the amount of distributable reserves of the Swiss subsidiary is not harmful for Swiss withholding tax purposes or (ii) in the case of a Swiss parent guarantor, the amount of proceeds from the financing which may be used in Switzerland without negative interest withholding tax consequences.

In addition, interest payments to non-Swiss lenders may also be subject to Swiss withholding tax if the payments are secured by Swiss real estate.

Swiss withholding tax may be partially or fully refundable depending on any applicable double taxation treaties.

Thin Capitalisation Rules and Dividend Withholding Tax

Swiss thin capitalisation rules generally only apply to related parties, in which case, the related party debt may be treated as taxable equity.

The relevant circular letter issued by the Swiss federal tax administration provides for debt-to-equity ratios as safe harbours. Interest paid on loans in excess of the relevant ratios is generally not tax deductible, but is treated as a dividend distribution subject to Swiss dividend withholding tax of 35%. There are no limitations on the financings of Swiss companies by independent third parties such as banks.

As mentioned above, payments made under upstream or cross-stream guarantees or security are generally also subject to Swiss dividend withholding tax (generally at 35%).

Stamp Duties

In Switzerland, no stamp duty or documentary taxes are levied on the execution or delivery of loan or security documents. However, notary fees and registration fees may be payable for documents that are drawn up as public deeds or need to be filed with a registry.

In addition, the issuance or transfer of certain securities such as notes, bonds or shares evidencing or securing a loan, may be subject to Swiss stamp duty if a Swiss bank or securities dealer is involved as a principal or intermediary.

9.2 Regulatory Considerations

In Switzerland, lending activities are generally unregulated as long as the lender does not accept deposits from the public or refinances itself through a number of banks.

As a general rule, foreign regulated entities operating on a strict cross-border basis do not require FINMA authorisation. This does not apply if these activities involve a physical presence (such as personnel or physical infrastructure) in Switzerland on a permanent basis, as the cross-border exemption would generally not apply. FINMA may also assume a Swiss presence based on the volume of business in Switzerland or the use of teams specifically dedicated to the Swiss market.

The Swiss Federal Act on Financial Services (FinSA) and the Swiss Federal Act on Financial Institutions (FinIA) were introduced in response to the "third-country rules" of MiFID II (the EU's Markets in Financial Instruments Directive 2014) and require foreign financial services providers that would be subject to authorisation in Switzerland to register in Switzerland before providing financial services to Swiss-based investors. Certain exemptions are available for regulated financial institutions that exclusively target institutional and professional clients in Switzerland.

It is important to note that lending to individuals for purposes other than business or commercial activities may qualify as consumer credit, which is regulated by the Swiss Federal Act on Consumer Credit.

10. Jurisdiction-Specific or Cross-Border Issues

10.1 Additional Issues to Highlight

Certain restrictions may affect the enforcement of a security interest by a foreign secured creditor, depending on the type of collateral, the nature of the security interest and the industry.

One notable example is real estate financing transactions involving residential real estate located in Switzerland. The Swiss Federal Act on the Acquisition of Real Estate by Persons Aboard, also known as Lex Koller, imposes restrictions on the direct acquisition of residential real estate by foreign nationals or entities as

well as on the acquisition of pledged shares in real estate companies.

In addition, the creation of certain security interests (such as over real property, aircraft, and ships) may require registration with a public register and certain restrictions may apply in relation to security interests granted by companies active in regulated industries.

The consent of the works council is not required for financing transactions unless employees are affected in certain ways (eg, labour safety, mass dismissals, transfer of a business or of pension plans).

Trends and Developments

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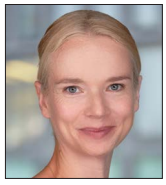
Loyens & Loeff is a leading continental European law and tax firm with over 1,000 advisers, and is the logical choice for companies doing business in or from the Netherlands, Belgium, Luxembourg and Switzerland, its home markets. The banking environment is constantly evolving. Financing solutions are multiplying and legal implications related to financial products are becoming more complex. Due to the ever-changing economic, political, environmental and regulatory worlds, financial markets will continue to be a challenge in the years ahead. Loyens & Loeff keeps track of the developments and helps its clients to navigate the increasingly complex debt and financial markets. It also goes a step further – guiding its clients in identifying opportunities and innovative ways to access the funding most suitable for them, whilst also managing risk. It is the firm's job to stay ahead of these changes for its clients, allowing them to stay focused on their core business.

Author



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Inflation, the Economy and Interest Rates

Following record rates of inflation in 2022, inflationary pressures now appear to have eased. While advanced economies started 2023 with inflation rates averaging 7.5% at the beginning of this year, these have dropped to 3.2%. For emerging economies, rates dropped from 8.1% to 4.1% over the same period. In Switzerland, inflation now stands at 1.2%. However, as it is still above central bank targets in most countries, it needs to fall further.

Economic growth is still slow. In the Eurozone, economic activity in 2023 is estimated to have expanded by only 0.5% and the growth outlook for 2024 has been revised downwards to 0.9%. We now know that the UK economy entered a technical recession in the fourth quarter of 2023, but the expectation is still that its GDP will grow by 0.9% in 2024. Meanwhile, economic growth in the US was 2.5% last year and is estimated at between 2.2% and 2.4% for 2024. In Switzerland, whose economy grew at 1.2% in 2023, the expected growth rate for 2024 lies at 1.3%.

In recognition of falling inflation, the consistent raising of policy interest rates over the past two years, described by the BIS as "the largest and most synchronized global monetary policy tightening in a generation", seems to have been brought to an end.

On 7 March 2024, the ECB announced that it would keep its key interest rates unchanged at 4.5%, 4.75% and 4.0%, respectively, with a first reduction being expected in June this year. On 20 March, the US Federal Reserve also decided to maintain its current range of 5.25% to 5.5% and, a day later, the Bank of England said that it would keep its interest rate unchanged at 5.25% for the fifth time in a row. But both US and UK policymakers signalled three interest rate cuts later this year after seeing "encouraging signs" of falling inflation. The SNB, as the first major central bank, felt that it could already act and, on 21 March, cut its main interest rate by 25 basis points to 1.5% with the expectation for this to be reduced further in the course of the year. This marks the first rate cut by the SNB in nine years.

Market Performance

Swiss capital markets

In 2023, the SIX Swiss Exchange (SIX) saw the lowest trading activity in over a decade. It recorded a trading turnover of CHF1,046.3 billion, 13.4% lower than in 2022, and a 24.2% drop in transactions.

There were only ten new listings of equity securities, most prominently, that of the Novartis spin-off Sandoz and of the first Swiss special purpose acquisition company, R&S Group, with eight listings of global depository receipts by

Chinese issuers. In addition, existing issuers raised around CHF8.3 billion via capital increases (CHF1.3 billion more than in 2022).

On the debt capital side, there were 436 new bond issuances, 90% of which were denominated in Swiss francs, and the total volume of debt capital instruments (bonds and money market papers) was around CHF116 billion (up from CHF114 billion in 2022).

Also, the number of outstanding green, sustainability, sustainability-linked and social bonds traded on SIX increased from 108 with a volume of CHF28 billion in 2022 to 136 and a volume of CHF31 billion in 2023. Green bonds are also becoming more prominent on both federal and municipal levels in Switzerland. In August 2022, the Swiss Federal Council adopted a framework for the issuance of green Confederation bonds, which is based on the Green Bond Principles developed by ICMA. The first green CHF766 million Confederation bond was issued in October 2022. A second CHF346 million green Confederation bond followed in March 2023 and a third CHF325 million green Confederation bond in September 2023. Also, in June 2023 and September 2023, respectively, the cities of Zurich and Geneva published their green bond frameworks.

Finally, the takeover of Credit Suisse by UBS is also likely to have a significant impact on Swiss capital markets as the two banks were the most prominent players in both equity and debt capital markets transactions. It is expected that new players, especially foreign investment banks, will step into the gap.

M&A activity

After two record-breaking years, 2023 saw 25% fewer M&A transactions in Switzerland than in the previous year (484 transactions with a deal volume of around USD72 billion in 2023 compared to 647 transactions and a deal volume of USD139 billion in 2022), with the highest levels of activity in the industrial goods, media, technology and telecommunications and the pharmaceuticals and life sciences sectors. Conversely, the acquisition of foreign assets by Swiss companies hit an all-time high.

For 2024, expectations are positive, however. While the market still needs to adjust to higher interest rates and tightening lending standards on the one hand and the increasing complexity of M&A transactions, due to both higher sustainability requirements and technological developments, on the other, early indicators point to a gradual increase in dealmaking as the year progresses.

Optimism in the Swiss banking sector

EY Switzerland gave its Banking Barometer 2024 the subtitle “Confidence” which, on the one hand, was intended to allude to its overall positive assessment of 2023 and its optimistic outlook for 2024 but also to the pivotal role confidence plays in the financial system.

It is true that (with one notable exception) Swiss banks did well in 2023. For the first time since the 2008 financial crisis, banks recorded a rise in their interest rate margin in the previous 18 months resulting in a notable increase in profitability. Also contributing to the positive outlook is the expectation of the majority of Swiss banks that impairment losses on residential mortgages and SMEs will remain low. Mortgages notably make up around 75% of the loan portfolio of Swiss banks and, despite the challenging environment, the forecast for SME credit defaults is considerably lower than in previous years.

New SIX Disclosure Rules

On 1 November 2023, SIX Exchange Regulation revised its Listing Rules as well as the Directive on the Disclosure of Management Transactions and the Directive on Ad Hoc Publicity. The revised rules entered into force on 1 February 2024.

As a result, issuers face more comprehensive reporting obligations in respect of management transactions involving related parties. The changes apply to transactions in equity securities and related financial instruments between members of the board of directors and executive management and their related parties (the latter including domestic partners and controlled entities).

Based on the revised Directive on Ad Hoc Publicity, annual and interim reports of issuers of SIX-listed bonds or other debt instruments (without primary listed equity securities) are no longer considered per se as ad hoc relevant facts. Instead, issuers of debt securities are required to determine on a case-by-case basis whether such reports contain price-sensitive information which they are obliged to disclose via ad hoc announcement by Article 53 of the Listing Rules.

An International Minimum Tax

An important development for Swiss issuers, borrowers and lenders is the implementation of international minimum tax rules.

In December 2021, the members of the OECD's Inclusive Framework on Base Erosion and Profit Shifting reached an agreement on reforms to the international tax system (Pillar Two). One of the agreed measures consisted of the introduction of top-up tax rules to ensure a minimum effective taxation of 15% in each jurisdiction where multinational enterprises with a minimum global turnover of EUR750 million have a taxable presence (the Global Anti-Base Erosion Rules/GloBE Rules). Pillar Two consists of a series of interwoven measures, including an Income Inclusion Rule (IIR), an optional Qualified Domestic Top-up Tax (QDMTT) and an Undertaxed Profits Rule (UTTPR). The introduction of these measures will significantly change the international tax system.

Switzerland, together with 139 other countries, committed to implement Pillar Two. The domestic implementation of the GloBE Rules in Switzerland required a national referendum to approve the necessary constitutional amendment. It was approved on 18 June 2023. On 22 December 2023, the Federal Council decided to implement the QDMTT as of 1 January 2024. The introduction of IRR and UTTPR will be decided upon at a later date.

The Rejection of the Swiss Withholding Tax Reform – A Missed Opportunity

Another vital development in the area of taxation was a non-development: The rejection of the Swiss withholding tax reform by the Swiss electorate in 2022.

Contrary to many other countries, there is no withholding tax in Switzerland on interest payments in respect of private and commercial loans (including arm's length intragroup loans). However, Swiss federal withholding tax, at a current rate of 35%, is imposed on interest paid to Swiss or foreign investors on bonds and other forms of collective debt issued by or on behalf of Swiss tax-resident issuers. While Swiss interest withholding tax is generally recoverable by Swiss investors and foreign investors that benefit from double tax treaties, the recovery process might be lengthy and burdensome. As a result, the investor base for bonds issued by Swiss issuers is often limited to Swiss investors

or bonds are issued through a foreign (often a Luxembourg) subsidiary. Credit financings may be subject to the same treatment if the number of non-bank creditors under such financing exceeds ten or the total number of creditors of a Swiss borrower exceeds 20 (the so-called Swiss 10/20 non-bank rules).

In order to strengthen Switzerland's position as a financial market and treasury centre, the Federal Council decided, in September 2020, to abolish Swiss withholding tax on interest payments (except for interest payments to Swiss resident individuals on domestic bank accounts and deposits). However, a referendum was initiated against such legislative proposal and it was rejected in September 2022 by 52% of voters. Hence, an important opportunity to reform Switzerland's withholding tax regime was missed, bonds issued by Swiss issuers remain largely unattractive to foreign investors and the Swiss 10/20 non-bank rules continue to have to be considered when structuring loan financings for Swiss borrowers and, in certain circumstances, Swiss guarantors.

ESG Reporting and Due Diligence Requirements in Switzerland

New ESG reporting and due diligence requirements will affect Swiss issuers, borrowers and lenders alike.

Non-financial reporting

In November 2020, the so-called "Responsible Business Initiative" – which had aimed to strengthen respect for human rights and environmental standards by introducing a vicarious liability regime for Swiss companies for harm caused by controlled entities abroad – failed to win a majority of the Swiss cantons and was thus rejected. Instead, EU-style ESG reporting and due diligence requirements were introduced in the form of new provisions included in the Swiss Code of Obligations (CO) (Articles 964 et seqq. CO) which entered into force on 1 January 2022 for the 2023 financial year, with the first report having to be published this year.

The new reporting requirements, which are modelled on the European Non-Financial Reporting Directive (NFRD), apply to Swiss-domiciled public interest companies (including banks, insurance companies and securities firms) which, together with their controlled companies in Switzerland and abroad, (i) have at least 500 full-time employees on annual average and (ii) assets in excess of CHF20 million or revenue in excess of CHF40 million in two consecutive years.

Companies need to report on environmental (in particular, climate – ie, CO2 targets), social and labour matters, human rights and anti-corruption measures. The annual report, which must be approved by the company's AGM, has to address the company's business model, the concepts which it applies with respect to the relevant ESG matters, including a description of its due diligence procedures, the measures taken by it, as well as an assessment of the efficacy of such measures, KPIs, the impact of its activities on the relevant ESG matters, as well as the risks of such matters on the company (double materiality). The Swiss reporting requirements currently use a "comply or explain" approach – ie, it is possible that some companies may choose not to report on certain topics if they are of the view that a certain topic or matter is not relevant to their business. What will be considered acceptable will also very much depend on investor expectations and it is expected that certain industry-specific standards will develop.

In the area of climate disclosure at least, the Swiss legislature has offered additional guid-

ance. On 23 November 2022, the Swiss Federal Council adopted its Ordinance on Climate Disclosures which governs disclosures on climate issues in accordance with Article 964b CO and requires in-scope companies to publish their climate risks based on the recommendations of the Task Force on Climate-Related Financial Disclosure (TCFD). The ordinance entered into force 1 January 2024.

For the largest Swiss banks and insurance companies which fall into FINMA's supervisory categories 1 and 2, these obligations have already been in force since July 2021 under revised FINMA Circular 2016/1, which will be the subject of a further review this year. Also, on 1 February 2024, FINMA has launched a consultation on a new "nature-related financial risks" circular which is due to enter into force on 1 January 2025 and will specify risk management requirements for banks and insurance companies in relation to material financial risks resulting from climate change and nature degradation.

Credit Defaults and Bankruptcies and the Failure of "Too-Big-to-Fail"

Corporate insolvencies

Alongside the worldwide increase of government debt, companies have also significantly boosted their debt ratios in recent years. The impact of such high debt on the economy was apparent again in 2023 with the number of corporate defaults up 80% (from 85 defaults in 2022 to 153 defaults in 2023). The US accounted for 63% of all defaults globally with 96 defaults, whereas Europe saw 30. Prominent corporate defaults include WeWork, Covis, Diamond Sports, Bausch, Mallinckrodt and Adler Group, as well as the bankruptcies of Rite Aid, Bed Bath & Beyond, Yellow Corp. and Signa. For 2024, S&P are expecting further global credit deterioration, particularly at the lower end of the rating scale ("B-" or below), where almost 40% of issuers risk further downgrades. Financing costs are expected to remain elevated despite anticipated rate cuts and there are upcoming maturity walls for a considerable amount of speculative-grade debt in 2025 and 2026.

In Switzerland too, a slowdown in economic growth, a drop in share prices and higher interest rates have been creating a challenging environment for many companies, in particular, those that were already reliant on government support to get them through the COVID-19 pandemic and that now find that loan financing is becoming more difficult and more expensive. According to Dun & Bradstreet, corporate insolvencies in Switzerland increased by 8% in the first three quarters of 2023. Between 1 January and 30 September 2023, 3,845 Swiss companies had to file for bankruptcy, compared to 3,552 in the same period in 2022.

Nevertheless, as mentioned above, the majority of Swiss banks surveyed for EY's Banking Barometer 2024 expect SME credit defaults in 2024 to be considerably lower than in previous years. It should also be noted that the overall increase in corporate insolvencies in Switzerland has been accompanied by a slight rise in the incorporation of new businesses.

Credit Suisse – a failure of "too-big-to-fail"?

In March 2023, the Swiss Federal Council, the Swiss National Bank and FINMA intervened amidst a growing crisis of confidence and instituted various measures in order to safeguard Credit Suisse's solvency and assist its acquisition by UBS, which was announced on 19 March 2023, and took legal effect on 12 June 2023. The Swiss financial services sector and the country as a whole not only had to come to terms with the disappearance of one of Switzerland's

two large global banks but also the reality that, after the bail-out of UBS in 2008, the carefully designed "too-big-to-fail" regulations had once again failed. A thorough analysis of events was demanded and very much warranted.

On 1 September 2023, the group of experts on banking stability, under Professor Lengwiler, submitted its eagerly awaited report entitled "Need for reform after the decline of Credit Suisse", requested by the Swiss Federal Department of Finance. The report stresses the macroeconomic significance of systemically important banks and the financial centre as a whole and notes that the government-supported takeover of Credit Suisse by UBS represented a key contribution to international financial stability. It notes that the fact that the restructuring option was not chosen in the case of Credit Suisse did not mean that resolution planning had failed and that the existing "too-big-to-fail" regulations were certainly helpful in terms of ensuring adequate levels of capital and liquidity. The expert group believes that no regulation can rule out a crisis with complete certainty and recommends reforms in crisis management, the broadening of liquidity provision and a significant strengthening of the tools and authorities of the financial supervisor.

This assessment was shared by FINMA itself which, on 19 December 2023, published its report on "Lessons Learned from the CS Crisis" in which it analyses the development of Credit Suisse between 2008 and 2023 with regard to the bank's strategy, business performance, management decisions, risk management and crises preparation as well as FINMA's supervisory work with the bank.

In the report, FINMA identifies the main reasons for the failure of Credit Suisse. According to the supervisory authority, certain required strategic changes (such as downsizing the investment bank, reducing earnings volatility and a greater focus on asset management) were not consistently implemented. FINMA states that Credit Suisse's reputation was undermined by recurrent scandals resulting in irreparable reputational damage. Despite extensive adjustments over the years, deficiencies in risk management identified by FINMA were never sustainably remedied. FINMA also notes that, although the bank met regulatory capital and liquidity requirements, neither the regulatory capital nor the liquidity buffer could contain the loss of confidence in the bank.

Using Credit Suisse as an example, FINMA further examines problematic areas in its supervisory practice and suggests potential solutions. It notes, among other things, its limited influence in matters of strategy and governance. According to FINMA, these deficiencies could be remedied by establishing a stronger legal basis; eg, through (i) a senior managers regime, (ii) powers to impose fines, or (iii) the option of publishing enforcement proceedings on a regular basis. In addition, FINMA will also adapt its supervisory approach and step up its review of whether stabilisation measures are ready for implementation.

On 10 April 2024, the Swiss Federal Council published its report on banking stability which, this time, combined its regular two-year assessment of the Swiss TBTG regime with its assessment and analysis of the Credit Suisse crisis. While acknowledging that a number of measures where already in place to safeguard financial stability, it identified 22 additional measures across six areas: (i) corporate governance and prudential supervision, (ii) capital requirements, (iii) early intervention and recovery, (iv) ensuring liquidity in a crisis, (v) resolution planning and

(vi) crisis organisation and co-operation between authorities.

For the Swiss lending market, the disappearance of Credit Suisse may well lead to the major cantonal and regional banks increasingly using syndicated lending to jointly finance larger loans. A number of foreign banks may also consider expanding their activities in the Swiss corporate client business.

Impact on the AT1 bond market

In order to secure Credit Suisse's takeover by UBS, the Swiss government passed emergency legislation allowing FINMA to write down USD17 billion of the bank's AT1 bonds to zero, leading to at least USD9 billion of legal claims, including against Credit Suisse (now UBS), in the form of civil proceedings, FINMA, in the form of administrative proceedings, and Switzerland itself (by way of investor-state arbitration).

Additional Tier 1 bonds were introduced in many countries after the global financial crisis in 2008 in order to ensure that bondholders would share in the losses from a bank's failure, rather than depositors or the taxpayer. AT1 bonds are a type of high-risk bank debt that can be converted into equity or written down if the capital ratio of the issuing bank falls below a certain level or another trigger event (usually, non-viability) occurs. AT1 bonds rank below other bonds and deposits but above equity capital held by shareholders.

In the aftermath of the Credit Suisse restructuring where this hierarchy was not respected and shareholders retained around USD3.4 billion of their investment while that of the AT1 bondholders was written off entirely, both the ECB and the Bank England announced that they would not have wiped out the AT1 bonds. This reassured both banks and investors in the Eurozone and a number of AT1 bonds were placed in Europe during the summer of 2023. In November 2023, UBS also managed to raise USD3.5 billion of new AT1 bonds following strong investor demand.

Recognising the importance of the AT1 bond market as a financing option for Swiss banks, which amounted to nearly CHF18 billion in Q3 of 2023, Swiss financial market experts and authorities are looking at further options such as the possibility of permitting AT1 bonds which are only partially convertible or amortisable.