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Switzerland: Trends and Developments

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Trends and Developments

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Walder Wyss Ltd is a leading law firm in Switzerland with around 250 legal experts across offices in Zurich, Basel, Berne, Geneva, Lausanne and Lugano, including a team of 14 partners and an additional 30 legal experts in the area of banking and finance. The firm advises all major Swiss and international banks, other lenders and also borrowers in domestic and cross-border lending transactions. In addition, Walder Wyss Ltd assists a considerable number of private equity investors in leveraged acquisition finance transactions.

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Acquisition Finance in Switzerland: an Overview

The market for acquisition and leveraged finance transactions in Switzerland has seen constant growth in the past few years, supported by an increasing number of mid-sized or large M&A transactions involving private equity investors, mainly based in Switzerland and further European countries such as the United Kingdom, Germany and France.

Small and medium-sized acquisitions of Swiss targets are financed through the Swiss market and usually involve large Swiss banks such as UBS and Zurich Cantonal Bank acting as arrangers in M&A financing transactions or club deals. Smaller cantonal banks often also participate in a syndicate. Larger acquisitions of Swiss targets are mostly arranged through London or New York, and are led by international players such as Citibank, HSBC, Barclays, Deutsche Bank or BNP Paribas as lead arrangers; they often also involve the issuance of bonds placed internationally with other financial institutions or high-yield investors.

For the past two years, the financial markets have been affected by two world events: the emerging situation in Ukraine and global inflation.

Overall, the Swiss financial market has been significantly less affected by inflation than other countries, and has not been closed for certain financing transactions. Also, due to significantly lower inflationary pressure in Switzerland in the recent past, the Swiss National Bank (SNB) was one of the first major national banks to lower the key interest rate in March 2024 from 1.75% to 1.5%, and market participants note that further interest rate cuts are possible this year.

As a reaction to the situation in Ukraine, the Swiss Federal Council enacted the ordinance on measures relating to the situation in the Ukraine based on the powers assigned to it by the Swiss Federal Constitution and the Swiss Federal Embargo Act. Since 4 March 2022, the ordinance has been constantly revised and expanded. Generally, the Swiss sanction regime follows the sanction regime enacted by the European Union. However, there are some deviations, particularly regarding the list of sanctioned persons. In addition, the Swiss State Secretariat for Economic Affairs (SECO), which is in charge of implementing the ordinance, has published certain FAQs, providing further guidance to the market.

Despite some uncertainties, the market outlook is generally positive.

Transaction structures

Acquisition financing arrangements mostly consist of a combination of equity (such as share capital, capital contributions or quasi-equity in the form of subordinated shareholder loans) and debt elements. How the debt part is structured depends mostly on the required leverage for the transaction. It regularly consists of a senior debt structured as term loan facility providing the means to pay the purchase price of the targeted entity, combined with a revolving credit facility to meet the target's working capital needs. High leverage transactions are supplemented by mezzanine loans or high-yield bond instruments as part of second-lien senior debt or junior debt structures.

To give the borrowers more flexibility regarding the size of the financing, incremental debt can be added to the debt structure, allowing the extension of the total commitments in the form of an incremental facility.

Security and guarantees

When granting security, on the one hand the point in time is relevant: certain securities can already be provided at closing, while others are only eligible as post-closing items. On the other hand, the company granting the security plays a role: the security can be provided by the acquisition vehicle as well as the target (and their respective group companies).

A standard security package in an acquisition financing consists of the following:

- security over the shares of the acquisition vehicle and the target company;
- security over claims and rights under the target share purchase agreement and related documents (such as due diligence reports);
- pledges over bank accounts of the acquisition vehicle and the target company; and
- guarantees by material group companies.

These types of security can furthermore be extended on the target level by:

- security over shares in subsidiaries;
- the assignment of intercompany receivables and trade receivables;
- security over real estate; and
- intellectual property.

Most of the above-mentioned security can be provided pre-closing, except for a share pledge over the shares in the target company, which can only be perfected after the acquisition of its shares. The same applies for guarantees of material group companies of the target group, which can only be granted upon accession. The security at target level is therefore often structured as condition subsequent.

Security over shares and quotas

Shares in stock corporations (*Aktiengesellschaften*) and quotas in limited liability companies (*Gesellschaften mit beschränkter Haftung*) are generally pledged rather than assigned, to avoid the assignee (or security agent in the case of syndicated financings) becoming the formal share or quotaholder with full legal title. The perfection of the pledge requires a written agreement and usually also provides for the handing over of the share or quota certificates. Therefore, it is standard to issue share or quota certificates if none had yet been issued, and to endorse or duly assign them in blank. If share or quota certificates are issued, the transfer of the certificates duly endorsed or assigned in blank is required for the perfection of the security.

If the company's articles of association contain restrictions on the transfer of shares or quotas, it is advisable to amend the articles in this regard and lift the transfer restrictions, which will give a potential third-party acquirer more confidence than a mere board resolution approving the transfer of the pledged shares or quotas, because such resolution may be changed or amended at any time. The issuance of share or quota certificates and the amendment of the articles of association can be structured as conditions subsequent.

Bank accounts

For the same reason shares or quotas are commonly pledged instead of assigned or transferred, bank accounts – or, more precisely, the claims an account holder has against a bank – are pledged rather than assigned, even though the latter would be permitted under Swiss law as well. It is a perfection requirement for the security to notify the account bank after the bank account pledge agreement has been entered into. In addition, it is common practice to request a waiver from the

account bank regarding any priority claims it may have over the bank account in question, according to its general terms and conditions.

Another argument against the assignment of a bank account holder claim is that account banks became more concerned about know-your-customer and beneficial owner identification matters, which are relevant if a claim is assigned (and thus concludes a full legal transfer), whereas a pledge only provides for a limited right in rem. However, for the opposite reason, some account banks are not prepared to accept a pledge and threaten to terminate the client relationship and close the respective bank account because they cannot fully identify the ultimate beneficial owner behind a pledgee.

One feasible solution to avoid the risk of termination of a client–bank relationship is to enter into a tripartite agreement between the bank involved, the pledgor and the security agent (in syndicated financings), and thus directly involve the account bank as party to the pledge agreement, instead of merely informing it about the existence of a pledge.

Claims and receivables

A common type of security is the assignment of claims, especially of the target, where they constitute a substantial part of the target's business.

Security over receivables is mostly taken by way of a general assignment, and can also include future claims if they are clearly identifiable. Prior to the assignment, it is paramount to make sure that the contracts underlying the claims do not contain a clause prohibiting the assignment of the claim (pactum de non cedendo). It is even recommended to explicitly state in important finance documents (such as the share purchase agreement) that assignments of claims resulting thereof are allowed.

As with the pledging of bank account claims, it is also recommended in the case of assignments of claims and receivables to notify the debtors of the assignment of such claim or receivable, as otherwise they can still discharge their obligation in good faith via payment to the assignee.

Real estate

Swiss law does not generally provide for any filing, registration or approval requirement in connection with the creation of security. An exception applies to security over real estate, which is usually created by way of taking security over mortgage certificates (*Schuldbriefe*), establishing a personal claim against the debtor secured by a property lien. Alternatively, a mortgage assignment (*Grundpfandverschreibung*) can be used to secure a debt. The advantage of the latter is that it can be used to secure any type of debt, even future or contingent debt. However, a mortgage assignment, in contrast to the pledge or transfer of a mortgage certificate, does not constitute a negotiable security, which is why mortgage securities are more common in practice.

The creation of a new mortgage certificate requires a notarised deed and an entry into the land register, but such certificates are then freely transferable without further notarisation or land register entry.

When security is provided over real estate, tax law implications must be considered in each case. If the borrower is a Swiss entity, real estate should only be used as security for those foreign lenders situated in countries with favourable double taxation agreements with Switzerland (so-called Swiss treaty lenders), as loans secured by real estate are subject to withholding tax at source. The same issue exists for foreign borrowers but can usually be settled by obtaining a respective tax ruling.

Intellectual property

Intellectual property rights are normally only considered to serve as security if they are material to the business of the security provider or its group companies, and are of certain value. Intellectual property such as trade marks, patents or designs can be taken as security by way of a pledge or security transfer. A written agreement is sufficient to create the security. Nonetheless, it is highly recommended for the security to be registered in the relevant public register due to its publicity function, and to provide the security holder with a stronger claim in case of enforcement.

Movable assets

Under Swiss law, the creation of a security interest over movable assets can generally only be achieved if such assets come into the sole possession of the pledgee or if the security provider gives up exclusive control over the assets – ie, can no longer access them without the assistance of the pledgee. However, since the movable assets that could be pledged are usually inventory, machines or fleets of vehicles that are indispensable for the pledgor to continue its daily business, the provision of security over movable assets is, in practice, most likely ruled out for practical reasons. An exception to this strict de-possession requirement applies to ships and aircraft, for which a lien can be established by means of an entry in a public ownership register.

There are structural solutions around this issue (like pledgeholder structures or OpCo/PropCo structures) but these solutions are rarely used in practice: on the one hand, because they only make sense if very valuable assets are involved, and on the other hand because there is a risk that these structures could be regarded as circumvention by a court of law and therefore not recognised in case of enforcement.

Limitations on financial assistance

Although Swiss law does not provide for any specific provisions on financial assistance, Swiss company law contains capital maintenance provisions that are mandatory to safeguard the nominal capital and reserves of a company. Under these provisions, upstream and cross-stream security and guarantees for the benefit of a parent or sister company are only permitted if certain requirements are fulfilled, such as:

- the agreement provides for arm's length terms;
- the security does not exceed the value of the freely distributable equity capital and reserves of the security provider or guarantor; and
- the articles of association of the security provider or guarantor explicitly permit such undertakings.

Furthermore, the planned transaction documents need to be validly approved by the relevant corporate bodies and must contain provisions addressing certain Swiss withholding tax law matters ("Swiss limitation language").

In contrast, security for downstream loans is not restricted (as long as the fully owned subsidiary is not in financial distress), as in this case the target company secures its own debt.

Insolvency and enforcement

Swiss law-governed security can be enforced by way of private enforcement (*Privatverwertung*) or official enforcement proceedings under Swiss debt collection and bankruptcy law. A private enforcement is only permitted if the security provider has given its consent to this type of enforcement (which is standard practice in Swiss security agreements) and where the relevant asset serving as security (for example, the shares certificates in case of a share pledge

agreement) has been transferred to the secured party or a security agent acting on behalf of multiple secured parties.

In the case of assignment agreements where the full legal title has been transferred to the secured party, private enforcement is the only available enforcement method.

Official enforcement proceedings are often lengthy and usually require court involvement, which makes private enforcement more favourable in most cases. For certain creditors, official enforcement proceedings can be beneficial because Swiss bankruptcy law provides for a clear order of priority of claims, prioritising secured claims and claims incurred by the bankruptcy or liquidation estate above unsecured claims. Within the unsecured claims, claims of employees and pension funds rank higher than claims relating to social insurances and tax claims, followed by all other unsecured claims. Within this last class of claims only, debtors can freely agree on a ranking amongst themselves by written agreement ("intercreditor agreement").

Legal framework

Governing law and jurisdiction

Small transactions financed by a single bank or a small number of banks are mostly concluded by simple and straightforward Swiss law-governed loan agreements in the respective language of the borrower and lender, whereas large (syndicated) financings are mainly based on the English Loan Market Association (LMA) standard agreements, including specific Swiss law-related provisions ("Swiss finish"), and are governed by English law.

Jurisdiction clauses, such as the "courts of England and Wales, situated in London", are generally binding on Swiss borrowers, with few exceptions provided by the Lugano Convention, the Swiss Federal Private International Law Act (as applicable) or the Swiss debt collection and bankruptcy law. Furthermore, Swiss courts might order preliminary measures even if they have no jurisdiction over the matter themselves.

Regulatory matters

Foreign entities are generally not restricted in financing acquisitions in Switzerland and do not require a licence, unless they fall under the Banking Act or Financial Services Act for other reasons or unless the transactions are performed in Switzerland (such as accepting money from the public to refinance themselves).

Lending into Switzerland on a cross-border basis without the physical presence of the lender in Switzerland remains generally unregulated, apart from "Lombard (margin) loans", which are regarded as financial services within the scope of the Financial Services Act, or consumer credits, which fall under the Consumer Credit Act.

Taxation

In 2020, the Swiss Federal Council resolved to abolish Swiss withholding tax on interest payments to foreign investors, with effect as of January 2023. However, this reform was rejected in a popular referendum by the people of Switzerland in 2023 and has thus not come to pass.

To ensure that no withholding tax applies to interest payments by a Swiss obligor to foreign investors (currently at a rate of 35%), the "Swiss non-bank rules" must therefore continue to be observed and complied with, meaning that no more than ten lenders can participate in a financing and qualify as banks, and that no more than 20 creditors of any Swiss obligor can not qualify as banks.

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