CORPORATE FINANCE/M&A - SWITZERLAND

Legal framework for group financings under Swiss law

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General requirements for group financings in corporate law
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Although Switzerland recently decided to facilitate the financing activities of groups operating in or out of Switzerland by easing some restrictions under the Withholding Tax Ordinance, the rather stringent requirements regarding group financings according to corporate law, as well as the rules under banking law and bankruptcy law, remain the same.

General requirements for group financings in corporate law

Generally, every entity can participate in group financing, particularly cash-pooling arrangements, as either pool leader or participating pool member.

Prohibitions and restrictions regarding board of director decisions

Swiss corporate law does not typically recognise the legal concept of a consolidated view for groups of companies. Certain provisions take into account the fact that a company may be wholly owned by another company or a member of a corporate group, but generally each legal entity within a corporate group must maintain its separate legal and financial structure and destiny. Consequently, directors and officers of a Swiss subsidiary acting as a pool member cannot rely on a consolidated group view and act based on considering only the overall interests of the entire group, those of the parent or, if a different group entity, the pool leader. The financial status of the Swiss pool member must be assessed and secured independently, focusing on the distinct identity and status of the pool member as a legally separate Swiss corporate entity.

The Swiss pool member contributing a positive credit balance to a cash pool in most cases grants an upstream loan if the pool leader is a direct or indirect parent of the Swiss entity or another subsidiary of the parent. Such an upstream loan into a cash pool is admissible only if made according to arm's-length principles. The following conditions must be followed to meet such principles:

- a written loan agreement between the Swiss pool member and pool leader;
- the loan agreement must have customary terms of duration, termination, interest and amortisation;
- entering into the loan agreement must be in the interests of the Swiss pool member;
- the upstream loan must be adequately secured by the pool leader (eg, by a third-party guarantee); and
- the members of the board of directors must continuously monitor the pool leader's creditworthiness, as well as its willingness and ability to repay the upstream loan, should it be required.

An automatic physical zero-balance cash pool is highly unlikely to fully comply with the arm's-length principle. This is particularly the case if the pool member is requested to provide an upstream security to the pool bank without getting adequate consideration. Therefore, the following principles must be followed to ensure that the board of directors of a Swiss pool member can comply with its duties:

- The corporate purpose provision in the articles of association of the Swiss pool member should authorise such a Swiss pool member to participate in group financing transactions, particularly by providing loans to its direct or indirect parent or other group companies or by providing credit support (eg, in the form of collateral, guarantees or sureties) for obligations of the latter to third parties (eg, the pool bank).
- The directors and officers of a Swiss pool member must secure an adequate risk diversification and avoid any undue risk concentration. This requirement is not fulfilled if, for example, the balance sheet assets of the Swiss pool member consist mainly of an upstream loan to an upstream cash pool.
- The directors and officers of the Swiss pool member must ensure that the company is always in a position to meet its liquidity needs, even if the pool leader is likely to head towards financial distress. The pool member may thus have to preserve an adequate portion of its liquidity outside of the cash pool and refuse to be submitted to automatic cash pooling.
- The Swiss pool member must ensure that it has access to appropriate information and a monitoring system to continually assess the financial strength of the pool leader. In addition, it must take precautionary measures to react within a reasonable timeframe in line with the standards of corporate diligence and financial reporting cycles, and if necessary:
    - cancel the further pooling of its liquidity;
    - cancel the inclusion of its bank accounts in the cash-pool system; and
    - recover its outstanding credit balance in the cash pool if the creditworthiness of the pool leader becomes questionable.

  It must thereby be taken into account that the repayment of the upstream loan may be inhibited by applicable insolvency laws.

- Any exposure of a Swiss pool member under a cash-pool agreement (eg, similar to any intra-group upstream or cross-stream loans, advances, credit balances and securities for group companies) must be limited to the freely disposable shareholder equity of the relevant Swiss pool member (as determined based on the last available audited financial statements of the relevant Swiss pool member). Further, each Swiss pool member should provide for a special reserve in its balance sheet in the amount of its exposure under the cash-pool agreement.
- It is advisable that the participation of a Swiss pool member in an upstream cash pool be formally approved at a shareholders' meeting. This may help to prevent participation in the cash pool from being deemed to be a (non-authorised) constructive dividend.

Non-compliance with the above principles may lead to the invalidity of the upstream loan, as well as to personal liability of directors and officers. Further, non-compliance may have adverse tax implications and, under certain conditions in very severe cases, constitute fraudulent conveyance under applicable bankruptcy laws or even a criminal offence (eg, creditor preference or disloyal management). This applies *mutatis mutandis* if the Swiss pool member grants a cross-stream loan to a sister company (or a subsidiary of the latter) that acts as pool leader.

Prohibitions and restrictions regarding corporate authorisations

Nature of corporate authorisations

The corporate purpose provision in the articles of association of the Swiss pool member should authorise a Swiss pool member to participate in group finance transactions, in particular by providing loans to its direct or indirect parent or other group companies, or by providing credit support (in the form of collateral, guarantees or sureties) for obligations of the latter to third parties, particularly the pool bank.

Further, it is advisable that the participation of a Swiss pool member in an upstream or cross-stream cash pool be formally approved at a shareholders' meeting in order to avoid participation in the cash pool later being deemed to be a (non-authorised) constructive dividend. In addition, shareholder approval gives the directors and officers of the pool member a certain degree of protection against potential liability claims of the consenting shareholder and legal successor, in particular a bankruptcy trustee of such shareholder. However, such approval does not shelter the directors and officers of the pool member against potential claims of creditors of such pool members that suffer a loss in the case of a potential bankruptcy of a pool member.

Relevant evidence
Up-to-date articles of association of the Swiss pool member should authorise that member to participate in group finance transactions, in particular by providing loans to its direct or indirect parent or other group companies or by providing credit support (in the form of collateral, guarantees or sureties) for obligations of the latter to third parties.

Further, the shareholder's meeting and the board of directors of the Swiss pool member should both approve the participation in the cash-pool arrangement of the group financing.

Filing or registration requirements
No filing or registration requirements apply to any local pool participant in Switzerland. If in the context of entering into the cash-pool arrangement the articles of association of the Swiss pool member are amended, the amended articles of association must be filed by the Swiss pool member with the competent commercial register.

Cash-pooling arrangements

In general, if the cash-pooling arrangements generate compensating claims against other pool members, there are usually normal counterparty risks regarding claims in connection with other cash-pool members. However, in exceptional cases, claims against other cash-pooling members that already had a negative equity before a potential insolvency can be treated in the insolvency procedures of the receiving pool member as equitably subordinated. The biggest risk in a cash-pooling system results from a potential insolvency of the pool leader itself.

Prohibitions and restrictions regarding (nearly) insolvent pool members
If the transfer of sums to a physical cash pool or the granting of, or payment under, an intra-group guarantee is made in contravention of the capital maintenance and profit distribution provisions under Swiss mandatory corporate law, or as a result of these actions the Swiss pool member becomes insolvent due to a lack of liquidity, the members of the board of directors and the management of the Swiss pool member may become personally liable for the shortfall. In certain circumstances, the immediate parent and the ultimate group parent may also become liable as *de facto* directors or may also be requested to repay certain amounts they received during the applicable clawback periods.

Prohibitions and restrictions regarding set-off mechanism in insolvency proceedings
Where the debtor is bankrupt, its creditors may set-off its claims, even if they are not due, against the claims that the adjudicated bankrupt holds against them. The exclusion or challenge of set-off in the event of the debtor's bankruptcy is governed by the provisions of debt collection and bankruptcy law.

Specific rules govern the set-off of a creditor's claims against a bankrupt and such bankrupt's claims against that creditor. As a matter of principle, the set-off of mutual debt obligations is allowed, provided that:

- at the time that the debtor is declared bankrupt, the debtor of the bankrupt is already its creditor; and
- such creditor has not acquired its claim against the bankrupt in order to gain an undue advantage by way of set-off.

It is generally accepted that any debt due from the bankrupt arising out of termination of a contract post-bankruptcy is eligible for set-off, provided that the contract was entered into before the proceedings opened.

Avoidance actions affecting claims under cash-pooling arrangements
The following circumstances could lead to the avoidance of a transaction (*actio pauliana*) in the context of a Swiss bankruptcy:

- Out-of-proportion transactions – any relevant transaction which the debtor made during a suspect one-year period before the opening of bankruptcy proceedings is voidable. Relevant transactions are undervalued transactions, those of no consideration or voluntary settlements, as well as transactions equivalent to the latter (eg, transactions in which the

debtor accepted a consideration out of proportion to its own or transactions of very disadvantageous terms). Generally, a cash-pool member receives a compensating claim of another cash-pool member within a group cash-pool arrangement. According to the purpose of the group cash-pooling arrangement, group cash-pool members should get better conditions in connection with its liquidity management. Therefore, there are no intentions for out-of-proportion transactions. However, a new provision was introduced in 2014 which lead to the burden of proving that a non-out-of-proportion transaction within a group cash-pool arrangement lies with the addressees of such a claim and not the claimant.

- Transactions by over-indebted debtor – the granting of collateral for existing liabilities without the obligation to do so, the discharge of an obligation by unusual means and the payment of an obligation not yet due for payment may be avoided if:
    - the transaction occurred during a suspect one-year period before the opening of bankruptcy or similar proceedings; and
    - the person was over-indebted (balance-sheet test) at the time that the transaction occurred, unless the beneficiary proves that he or she was unaware of the other person's impending insolvency. Generally, it is rare for this argument to be used in failed group cash-pooling transactions.
- Fraudulent or discriminating acts – all transactions that the relevant debtor conducted during a suspect five-year period before the adjudication of bankruptcy or similar proceedings with the intention to damage or discriminate against its creditors or privilege some of its creditors to the detriment of others may be subject to avoidance. Court precedents have found for the discriminating behaviour of a pool member if the latter has used the proceeds from divestments of assets primarily or exclusively for the repayments of its debts towards the cash pool or the group, thereby discriminating and damaging the other creditors of such pool members.

Prohibitions and restrictions regarding derogation of banking monopoly

A company is considered to be a bank if it is mainly active in the financial sector and in particular:

- accepts deposits from the public or publicly recommends itself for such activity; or
- refinances itself on a large scale with loans from banks that hold no significant participation in it, in order to finance for its own account and in any manner possible any number of persons or companies with which it does not form an economic unit.

In general, an institution or person is deemed to act commercially and therefore qualifies as a bank if it accepts on an ongoing basis more than 20 deposits from the public or recommends itself publicly to accept deposits from the public, even if in doing so, fewer than 20 deposits result (Article 6 of the Banking Ordinance). A person or institution accepting public funds up to Sfr1 million is not acting commercially if it does not invest the funds or pay any interest on them, and if it informs the clients that it is not supervised by the Swiss Financial Market Supervisory Authority and that the funds are not subject to the protection scheme for bank depositors.

Deposits of shareholders holding a qualifying equity interest (ie, at least 10%) in the relevant pool member and deposits of persons that are connected to the latter either economically or as affiliates (eg, parents, subsidiaries and other affiliate companies) are not considered to be deposits from the public (Article 5(2) lit (b) and (c) of the Banking Ordinance). Therefore, loans between group companies and cash-pooling arrangements are generally not subject to the banking monopoly.

Facilitated group financing

The Federal Council decided to facilitate the financing activities of groups – particularly cash-pooling arrangements in Switzerland, which entered into force in April 2017. It therefore approved the respective changes to the Withholding Tax Ordinance relating to those groups in which a Swiss group company (guarantor) provides a guarantee for a bond of a foreign group company (issuer) belonging to the same group. Forwarding funds from the foreign issuer to a group company established in Switzerland will be possible up to the maximum amount of the equity capital of the issuer without the interest payments related to those forwarded funds being subject to withholding tax. The amendment of the ordinance is therefore meant to strengthen the establishment of headquarter activities with further central corporate functions, as well as treasury activities, particularly those performed outside Switzerland.

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