

Lending and taking security in Switzerland: overview

Dr Alexander Vogel and Samuel Ljubicic
Meyrlustenberger Lachenal

global.practicallaw.com/4-500-9989

OVERVIEW OF THE LENDING MARKET

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

Certain amendments have been made to the minimum standards for mortgage financing issued by the Swiss Bankers Association (SBA), which were initiated by the Swiss Financial Market Supervisory Authority (FINMA) and entered into force on 1 September 2014.

The amendments have resulted in the following:

- Shortening the amortisation period (for repayments up to two thirds of the lending value of the mortgage) from 20 years to 15 years. Mortgage loans must be paid in regular and equal instalments from the start of the repayment period.
- Changes to the eligibility of second incomes when assessing financial sustainability. Second incomes are now generally eligible in the case of joint and several liability.
- Introduction of the "lower of cost or market" principle. The lending value of real estate is now based on the market value or the purchase price, whichever is lower.

Despite the stricter minimum requirements for mortgage financing, and the activation and increase of the countercyclical capital buffer, the volume of mortgage lending continued to grow strongly. The volume of mortgage lending grew faster than incomes, consumer prices and gross domestic product (GDP), mainly due to the continuing low level of interest rates. As a consequence, FINMA called for additional measures to further counteract this ongoing development, with a view to securing the financial sustainability of mortgage loans in the long term and bringing about more sustainable mortgage lending.

FORMS OF SECURITY OVER ASSETS

Real estate

2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

The definition of real estate under Swiss law includes:

- Parcels of land and the buildings on the land.
- Co-ownership shares in immovable property, such as apartments or entire floors of a building.

- Distinct and permanent rights recorded in the land register, such as the right to build on a parcel of land for a limited period of time (*Baurecht*).
- Mines.

Common forms of security

The following forms of security are commonly granted over immovable property:

- **Mortgage (*Grundpfandverschreibung*)**. A mortgage aims to secure any kind of debt, whether actual, future, or contingent (*Article 824, Civil Code*). The creditor of a claim secured by a mortgage assignment can demand an extract from the land register, for evidential purposes (this extract does not form a negotiable instrument).
- **Mortgage certificate (*Schuldbrief*)**. A mortgage certificate establishes a personal claim against the debtor, secured by a lien (*Article 842, Civil Code*). The mortgage certificate constitutes a negotiable instrument that can be pledged or transferred for security purposes. There are two types of mortgage certificates, paper mortgage certificates and paperless mortgage certificates (from 1 January 2012). A paper mortgage certificate can be issued in the form of a bearer or a registered certificate. In case of the paperless mortgage certificate only the form of a registered certificate is possible.

Formalities

Mortgages and mortgage certificates must take the form of a notarised deed, that is, the contract of the security needs to be executed in front of a notary public (this can be a clerk employed by the government administration or a private practitioner admitted as a notary public, depending on the canton where the real estate is situated). Additionally, the valid perfection of a mortgage and a mortgage certificate requires its registration with the land register (*Article 799, Civil Code*).

An (outright) transfer for security purposes is a common method for the creation of a security interest in respect of mortgage certificates. The valid creation of a security interest requires:

- A transfer agreement (not necessarily in writing, although this is strongly advisable).
- In case of a paper mortgage certificate, the transfer of the relevant mortgage certificate is required in respect of bearer certificates. If the mortgage certificate is in registered form, an endorsement to the creditor is required. The endorsement must not be blank (that is, the transferor must write the name of the transferee and must sign the back of the mortgage certificate).
- In case of a paperless mortgage certificate, the transferee must be registered with the land register by written notice by the transferor.



Tangible movable property

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property

In Switzerland, taking security is common in the context of corporate lending and structured finance and can involve assets such as:

- Shares in a corporation or quotas of a LLC.
- Other financial interests embodied in a negotiable instrument.
- Bank accounts.
- Real estate.
- Claims and receivables.
- Intellectual property.
- Machinery (in exceptional cases).

Common forms of security

The main types of security interests under Swiss law are:

- Pledges (*Pfandrechte*).
- Outright transfers or assignments for security purposes (*Sicherungsübereignung und -abtretung*).
- Mortgages over aircrafts and ships (*Luftfahrzeugverschreibung und Schiffsverschreibung*).

Formalities

Generally, the perfection of a pledge or an outright transfer requires both:

- A valid security agreement (not necessarily in writing, although this is strongly advisable).
- The transfer of the possession of the pledged asset to the secured party (or to his security agent) in order that the pledgee obtains actual possession of the relevant assets or at least de-possession of the security provider. This means that the security provider cannot continue to have sole control over the pledged/transferred assets, and therefore cannot dispose of that asset without the consent of the secured party. Therefore, a security (particularly with regard to a security interest over stock in trade, inventory or work in progress such as material in the manufacturing process or assets in transit) can only be granted to the extent that such assets can be physically segregated and transferred to the secured party. A pledge may therefore not always be a practical solution.

A security interest over the collateral is not validly created if the security provider retains possession and control over the assets (*Articles 714 and 884, Civil Code*). However, this principle does not apply to certain movable property, such as:

- Aircraft.
- Ships.
- Railroads.

With these assets, the security is perfected by the entry of the security in the relevant register.

Additionally, it is required that the assets which are pledged are specifically identified in the security documentation. Under Swiss law, a floating charge over all the assets of a Swiss security provider is not valid.

With regard to plant and machinery, the creation of security will depend on whether or not they are characterised as real estate (see *Question 2*).

Financial instruments

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial instruments

Financial instruments (both in a certificated and dematerialised form) over which security is commonly granted are:

- Equity securities (such as shares).
- Debt securities.
- Units in collective investment schemes.

Common forms of security

Subject to the special provisions applying to book-entry securities (see *below*), the security interests granted over financial instruments under Swiss law are:

- Pledges (*Pfandrechte*).
- Outright transfers or assignments for security purposes (*Sicherungsübereignung und -abtretung*).

As of 1 January 2010, when the new Swiss Federal Intermediated Securities Act (FISA) entered into force, security interests over book-entry securities must comply with the provisions of the FISA. The FISA provisions also apply to security interests created before 1 January 2010 over securities that qualify as book-entry securities.

The FISA introduced a new category of rights: intermediated securities or book-entry securities (*Bucheffekten*), which includes all intermediated securities, whether the underlying securities are certificated or uncertificated.

Book-entry securities are fungible claims against, or membership rights in, an issuer that are credited to a securities account (*Effektenkonto*) of an intermediary (*Verwahrungsstelle*). The intermediary must be a regulated entity, for example, a bank or securities dealer. Any transfer of claims or membership rights that qualify as book-entry securities (in particular any transfers of or the creation of security interests over such book-entry securities) must comply with the provisions of the FISA.

There are three ways to create a security interest over book-entry securities (FISA):

- Transfer (Article 24, FISA).
- Control agreement (Article 25, FISA), which also provides for the creation of a limited security interest covering either:
 - all book-entry securities credited to an account;
 - a certain quota and/or a defined maximum value of book-entry securities credited to an account; or
 - specified book-entry securities credited to the securities account.
- Grant to the intermediary (Article 26, FISA).

These are the exclusive possibilities to create security interest over intermediated securities.

Formalities

Before 1 January 2010, the creation of security interests over book-entry securities followed either the principles of:

- Property law applicable to movable property (in the case of certificated securities).
- General contract law applicable to claims (in the case of uncertificated securities).

These principles still apply to non-book-entry securities. The valid creation of a security interest requires a valid security agreement. In respect to the perfection of a security interest, different rules apply, depending on whether the shares and financial instruments are certificated or uncertificated:

- **Certificated.** The perfection of a security on certificated bearer instruments requires only the delivery of the certificate to the secured party (for example, the pledgee). In the case of certificated registered instruments, the certificate must be delivered and either endorsed or accompanied by a declaration of assignment (*Article 901, Civil Code*).
- **Uncertificated.** Uncertificated shares and financial instruments must be pledged, transferred or assigned in writing, that is, by way of a signed pledge agreement.

The articles of association of the corporate entity whose shares are being pledged or transferred or assigned as security can include additional requirements for the creation and/or perfection of the security interest.

Special provisions apply to security over book-entry securities

Security interests created under the FISA are (according to the majority view) considered to be non-accessory, which means that they are valid regardless of the existence and extent of the secured claim.

Transfer (Article 24, FISA). The security provider must instruct the intermediary (with whom the security account in which the relevant securities are booked is held) to transfer the relevant book-entry securities into the secured party's security account. The book-entry securities are credited to the securities account of the secured party and either becomes the property of the secured party or the secured party obtains partial rights on them depending on the security agreement between the security provider and the secured person once the credit entry (*Gutschrift*) is made. The secured party can transfer and dispose of the book-entry security, regardless of whether it is entitled to under the security agreement and a third party can also validly acquire the book-entry securities to the extent it acts in good faith (*Article 29, FISA*). The security provider is exposed if the secured party becomes bankrupt and full legal title to the book-entry securities has been transferred to the secured party. On the other hand, if only limited security rights were granted, the security provider can claim the restitution of the book-entry securities. Additionally, it needs to be considered that the disclosure obligations under Article 20 of the Stock Exchange Act (SESTA) may be triggered, if a relevant threshold (for example, 3%, or 5%) is exceeded or undercut as a result of the full title transfer.

When the security agreement ends, the secured party must return to the security provider the same quantity, type and quality of book-entry securities received as collateral.

Control agreement. An irrevocable control agreement is entered between the security provider and the intermediary with whom the security account is held (*Article 25, FISA*). The control agreement must state that the intermediary must follow the secured party's instructions without the need for prior consent or co-operation on the part of the account holder (and/or security provider). In practice, the agreement is often made as a tripartite agreement including the secured party. The existing security interests of an intermediary will subordinate to the book-entry security if the secured party is not informed about the existing security interest at the signing of the control agreement, at the latest (*Article 30, paragraph 2, FISA*). Such notification can be included in the control agreement and acknowledged by signing the agreement.

Unlike a security interest created by transfer under Article 24 (see above, *Transfer*), the book-entry securities remain credited to the securities account of the security provider. Disclosure obligations under the SESTA are not applicable if the security interest only concerns limited security rights and the security provider is not exposed if the secured party faces bankruptcy or insolvency procedures. The security provider can (within the limitations of the control agreement, if any), dispose of the securities. Therefore, it is advisable to ensure that the control agreement defines in sufficient detail the right of the security provider to sell or exchange securities to the extent of the security interest.

Grant to the intermediary. The security provider can grant a security interest to the intermediary (*Article 26, FISA*). The security interest is created by an agreement between the security provider and the intermediary, which does not require any particular form or content (and can even be set out in the intermediary's general terms and conditions). A security under Article 26 of the FISA can only be created with the intermediary with whom the security account is held. If the security will be granted to an other intermediary with whom the security account is not held, the security needs to be granted by way of a control agreement (*Article 25, FISA*) or by way of transfer (*Article 24, FISA*).

Claims and receivables

5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and receivables

Claims and receivables over which security is commonly granted are (in each case existing and future):

- Accounts receivables.
- Positive balances in bank accounts (see *Question 6*).
- Claims under contracts in general.

Common forms of security

The granting of security over claims and receivables takes the form of:

- Pledges (*Pfandrechte*).
- Assignments for security purposes (*Sicherungsübereignung und-abtretung*).

Security over claims and receivables

The grant of a security on claims and receivables is based on similar principles as security over movable property (see *Question 3*). However, there are some important differences when compared to movable property (*Article 900, paragraph 1, Civil Code*):

- The pledge of claims is established by written agreement (typically, the same instrument as the undertaking to grant a pledge (*Verpflichtungsgeschäft*)). The essential terms of the pledge agreement must be in writing. This requirement is satisfied if the pledge agreement is signed by the pledgor. The signature of the pledgee is not required as its acceptance is assumed by law. If there is a promissory note or similar instrument with regard to the pledged claim, the promissory note must be handed over to the pledgee for the completion and perfection of the pledge. A promissory note is a unilateral written confirmation of the debtor evidencing that a specific debt exists (*Article 900, Civil Code*). The loan agreement does not qualify as a promissory note and, therefore, does not, according to leading Swiss doctrine and case law, need to be transferred.

- An assignor must sign an assignment of receivables or other claims, and not just a related undertaking in the assignment agreement. Notification to the third party debtor is generally not required for valid creation, but is required for perfection of the security interest and enforceability as against the third party debtor. Transfer restrictions in the underlying arrangements governing the assigned receivables or rights can jeopardise the valid creation of the assignment and may require the consent of the third party debtor.

With regard to insurance policies, insurance relating to goods and persons must be distinguished. In case of a pledge over insurance related to persons special requirements apply, the policy must be delivered to the secured party and the insurance company must be notified of the pledge. However, the general business conditions of Swiss insurance companies usually contain restrictions that either limit the effectiveness of pledges or assignments of insurance policies.

Cash deposits

6. What are the most common forms of security over cash deposits? How are they created and perfected?

Common forms of security

Cash deposits held in bank accounts are treated as claims of the beneficiary against the bank (amounting to the positive balance on the account). Therefore, the same principles apply as with respect of granting security over claims (see *Question 5*).

Formalities

The valid creation of a right of pledge over a bank account requires a written pledge agreement. To enforce the pledge against the account bank, the pledge must also be notified to the account bank. However, under Swiss law, notification is not necessary to perfect the pledge. It should be noted that the agreements between the account bank and the pledgor often provide for a security interest (or rights with a similar commercial effect) for the benefit of the account bank with respect to the balance on the bank account, which would take precedence over any subsequent security interest unless a waiver is obtained.

Intellectual property

7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual property

Intellectual property rights over which security is commonly granted are:

- Patents.
- Trade marks.
- Copyrights.
- Designs.

Common forms of security

The granting of security over intellectual property rights takes the form of:

- Pledges (*Pfandrechte*).
- Outright transfers for security purposes (*Sicherungsübereignung*).

Formalities

In relation to intellectual property, transfers and pledges are created by a written agreement. Registration of the agreement is not required. However, registration can be advisable, depending on the circumstances, taking into account the value attributable to such intellectual property rights, the countries involved and the administrative burden related to registration. This is because only a registered security holder can enforce its security interest against another party that is relying (in good faith) on information registered in the relevant public register.

Problem assets

8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

Future assets

If future assets are to be used as security, they must be determined or at least determinable at any relevant point in time to allow for the taking of security over future assets. Swiss law only permits non-possessory security over tangible assets for very limited groups of assets (for example, aircrafts, trains, ships, book-entry securities) (see *Question 3*). This means that a pledge over future or fungible assets is only effective when the relevant asset comes into existence, and is transferred into the possession of the secured party (or at least under his control or of a security agent acting for the secured party). Until these preconditions are fulfilled, the security is only pending and not yet perfected. Under Swiss law, it is not possible to implement a floating charge.

The requirement that an asset has to come into existence before the security interest becomes valid, also applies to future claims or receivables that are pledged. Since it is also required that the assets that are to be pledged need to be specified (see *Question 3*) it is advisable to request in the pledge documentation that the secured creditor is provided with an updated list of the receivables on a periodic basis. Additionally, with respect to a pledge or an assignment of future claims, such security will only be valid for claims that come into existence before the opening of bankruptcy or a similar proceeding against the assignor, because any claims or other assets that come into existence after the opening of such proceedings will fall into the debtor's bankruptcy estate.

Fungible assets

See above, *Future assets*.

Other assets

Subject to certain limitations (see *Questions 2 and 6*) security interests can, in principle, be granted over any asset. However, a security interest over movable property is not validly created if the security provider retains possession and control over the assets (*Articles 714 and 884, Civil Code*). According to case law, the security provider must not be able to access the pledged inventory in order to repossess the pledged assets. If, for instance, the pledge assets are physically segregated and locked away, yet the pledgor is technically able to access the assets easily (for example, by accessing the premises via a back entrance or a cellar) the pledge over such inventory will not be considered effective by Swiss courts. Accordingly, such arrangements are only practical if the security provider does not need access to the pledged moveable property on a regular basis and the pledged property can be delivered to a third-party collateral agent or pledge holder acting on behalf of the lender. As a result, lenders often do not take or accept security over movable assets such as inventory and machinery where operating companies are concerned.

RELEASE OF SECURITY OVER ASSETS

9. How are common forms of security released? Are any formalities required?

The formalities required for the release of a security interest depend on the nature of the security interest. In line with the accessory nature of a pledge, such security interest will cease to exist on full discharge of all secured obligations. With respect to non-accessory security interests, the security interest needs to be dealt with separately from the secured obligations. For example, transferred assets or assigned claims and/or rights need to be transferred or assigned back to the security provider.

SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

It is not common in Switzerland to set up an SPV holding certain of the debtor's assets in order to take security over the shares in such SPV held by the debtor for the purposes of secured lending transactions. This is with the exception of certain special cases, for example, securitisation.

QUASI-SECURITY

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

Sale and leaseback

Sale and leaseback transactions are common in Switzerland in respect of certain assets of significant value (for example, aircraft and real estate) although certain restrictions apply. Such transactions need to be dealt with carefully, as the finance provider runs the risk that the sale and leaseback transaction will be recharacterised as a mere pledge. This can mean that it will not be considered to be validly perfected due to the prerequisite requiring depossession of the security provider in respect of any pledged movable property (see *Question 3*).

Factoring

Factoring, in particular relating to receivables, is commonly used in Switzerland. However, the quasi-security interest will only extend to such claims that come into existence prior to the opening of bankruptcy proceedings against the assignor.

Hire purchase

Both hire purchase agreements and leasing arrangements are very common in Switzerland. Under a finance leasing arrangement, the lender acquires the moveable property and leases it to the borrower. As opposed to a secured loan, the leasing arrangement allows the borrower to have possession of the property (while the legal ownership remains with the lender). As opposed to a sale and leaseback transaction where the borrower is usually the original owner of the asset, ownership of the asset is directly acquired by the lender from the manufacturer or supplier.

Retention of title

Retention of title (*Eigentumsvorbehalt*) is commonly used, but needs to be contractually agreed between the parties and registered with the retention of ownership register at the purchaser's domicile. However, due to the limited effects of

retention of title, it is advisable to combine it with other measures to safeguard the seller's claims.

Other structures

Swiss contract law provides for a legal right of set-off, if certain requirements are met (unless a set-off has been contractually excluded). Furthermore, within certain limits, it is possible to contractually extend the legal right of set-off in order to set-off claims across the counterparty's group of companies. For example, a right can be conferred on the lender to set-off a claim against a debtor with regards to a positive balance of a bank account held with the lender in the name of the debtor's parent company.

GUARANTEES

12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are widely used in lending transactions. Under Swiss law, a guarantee is an undertaking of the guarantor to compensate for damages if the third party fails to perform. Unlike (accessory) sureties, which are subject to stringent conditions as to form and content, there are no specific requirements on the form of a guarantee agreement. Guarantees are, in principle, non-accessory and independent of the existence of the secured obligation. However, in particular with respect to private individuals providing a guarantee, there is a significant risk that such a guarantee may be recharacterised as a surety. Therefore, it is advisable to adhere to the more onerous formal requirements relating to sureties.

RISK AREAS FOR LENDERS

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial assistance

Swiss company law does not have specific provisions that deal with financial assistance. However, potential issues of directors' liability (criminal or civil), bankruptcy laws, and upstream securities by a target company for the benefit of a new shareholder will only be granted against adequate consideration based on market conditions.

The granting of upstream security can be regarded as a distribution to the shareholders (to the extent that it is not considered as being entered into at arm's length). It is advisable to obtain resolutions of the board of directors and the general meeting of the shareholders approving the granting of the security.

Similarly, there is considerable risk that any security granted in favour of an upstream or side-stream entity (for example, a direct or indirect parent company or any other entity that is not a direct or indirect subsidiary of the security provider) can be challenged by third party creditors of the security provider. This is provided the security provider does not have sufficient net equity distributable to its shareholder(s). This is because the enforcement of a guarantee, indemnity, third party pledge or other obligation of the security provider for, or with respect to, any obligation of its shareholder(s) or any of its affiliates is limited to the freely disposable shareholder equity of the security provider.

Corporate benefit

Swiss company law provides for a general duty of the directors to act in the best interest of the company in relation to all actions taken on behalf of the company. In this respect, it is advisable that the company's purpose clause (which is contained in its articles of association) explicitly permits the granting of security within the group.

Swiss company law does not provide specific provisions dealing with security granted in respect of a loan to a subsidiary. However, from a tax point of view, a downstream security may be treated as a contribution to the subsidiary that is subject to tax at a rate of 1%.

Numerous provisions (particularly in company and bankruptcy law) can significantly affect the value of a security granted by a Swiss company in favour of its shareholder(s), any affiliate or related party (see above, *Financial assistance*). Additionally, upstream, side-stream and in certain cases, downstream security can involve issues of directors' liability (criminal or civil). However, these restrictions do not apply if the security is granted against adequate consideration based on market conditions (at arm's length).

Loans to directors

No specific restrictions apply in relation to loans to directors. However, the general principles need to be observed (for example, principles relating to market conditions, see above, *Corporate benefit*).

Usury

No specific limits apply in respect of maximum interest rates charged on loans (with some exceptions for consumer credits). In respect of other loans, excessive interest rates can create civil and criminal law issues if a creditor takes advantage of the debtor's current predicament or inexperience.

Others

Bankruptcy and insolvency laws, in particular with respect to voidable preferences, must be taken into account whenever security interests are granted. This applies particularly if the security provider is not in a financially sound position.

Additionally, general private law principles can limit the creditors' ability to enforce their rights, including:

- Contractual rights.
- The ability to prohibit abusive use of rights.
- The generally applicable principle requiring parties to act in good faith.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

Generally, Swiss environmental laws provide that the party causing the pollution (for example, if landfills and other polluted sites require decontamination) is liable. However, besides the polluter (for example, a tenant running a factory), the owner of the land can also incur liability. Therefore, if a secured party takes possession over the property on enforcement (rather than initiating the sale of the property in order for the proceeds of sale to be applied against the secured debt) the secured party can incur environmental liability. Other than that, in particular by holding a mortgage, the secured party is not exposed to environmental liability.

STRUCTURING THE PRIORITY OF DEBTS

15. What methods of subordination are there?

Contractual subordination

Contractual subordination of debt is possible under Swiss law. Swiss corporate law provides that the board of directors of a financially troubled company incorporated in Switzerland must notify the judge in cases of over-indebtedness (complete loss of equity or negative equity), unless creditors subordinate their claims to all other creditors of the subsidiary to cover the amount of the negative equity (plus the amount of foreseeable losses in the short term). It is sufficient for the creditor and the respective creditor(s)

to execute such an agreement. Other creditors benefiting from such subordination do not need to be informed or to sign as a party to the agreement. This is provided that such contractual subordination cannot be revocable unless the debtor has managed to overcome its over-indebtedness, that is, to build up equity again.

Additionally, contractual subordination in investment agreements among several creditors proving senior, mezzanine and/or junior debt on the one part and the debtor on the other part, is common in Switzerland.

As subordination agreements are, in principle, held up by the respective authorities in case of an insolvent liquidation for the benefit of all unsubordinated creditors, it is also possible in a bilateral subordination agreement to provide for an obligation of a junior creditor to forward proceeds from an insolvent liquidation to a senior creditor. However, such a bilateral subordination agreement cannot be used to remedy an over-indebtedness situation (see above).

Structural subordination

Structural subordination is common in Switzerland and can be achieved by providing junior debt or loans granted to a holding company while the senior loans are granted to the operating (cash-producing) subsidiaries.

Inter-creditor arrangements

It is common in Switzerland that several lenders and the debtor enter into an inter-creditor arrangement in case of structured financing. Such inter-creditor agreements contain provisions with regard to the flow of amortisations and interest payments, and the priority rights of the lenders providing different layers of senior, mezzanine and junior debts. Due to the accessory nature of certain security interests and the lack of a trust concept under Swiss law (even though foreign trusts are recognised and upheld under Swiss law), the security interest is usually not conferred to a trustee holding the security interest in its own name but to the lenders' account (see *Questions 18 and 19*).

DEBT TRADING AND TRANSFER MECHANISMS

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Unsecured debt

Under Swiss law, loans can be traded and are transferred by way of assignment without the debtor's consent, provided that there are no contractual limitations in the loan agreement. However, in Switzerland the market for the trading of unsecured debt is not very active and is mainly restricted to restructuring.

Debt securities

Debt securities are normally issued in bearer form and certificated in a permanent global note which is then deposited with a depository that is recognised by the Swiss Exchange (SIX). On registration of the securities, the securities constitute book-entry securities and are transferred and traded on the stock exchange.

Mortgage certificates

The mortgage (*Grundpfandverschreibung*) aims to secure debt owed to a particular creditor and is not eligible for trading (unless the claim itself is traded).

Mortgage certificates (*Schuldbriefe*) establish a personal claim against the debtor, secured by a lien. They usually represent an interest besides the principal amount and constitute a negotiable and tradable instrument (see *Question 2*). However, the holder of a mortgage certificate that has been transferred for security purposes will usually undertake not to trade such mortgage

certificate for as long as the debtor complies with the terms of the loan agreement.

Mortgage bonds are debt securities used for the long-term financing of senior mortgage loans granted by banks. In Switzerland the issue of mortgage bonds is restricted to two institutions, the Mortgage Bond Bank of Swiss Mortgage Lenders and the Central Mortgage Bond Institution of Swiss Cantonal Banks. Unlike conventional bonds, Swiss mortgage bonds offer extensive protection by law. The issuer and the lending banks are liable with their own assets, while the debtors are also liable towards the banks with their mortgaged properties.

Guarantees

Due to the non-accessory nature of a guarantee, the benefit of a guarantee will not automatically vest in the transferee when the secured obligation itself is transferred. Therefore, unless the guarantee provides for a wide definition of the beneficiary, the guarantor's consent is required in case of a transfer of the guaranteed debt.

AGENT AND TRUST CONCEPTS

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The agent concept is recognised and frequently used, in particular in syndicated loans and security agency arrangements. Most security interests granted under Swiss law are accessory in nature and are also automatically transferred together with the secured obligations. Therefore, any new lender accessing the facility agreement by virtue of an assignment of the rights of another lender will automatically benefit from the security, without the need for any additional steps to be undertaken with regard to the security documents. As a consequence, under Swiss law the security interests are often granted in favour of a security agent acting as a direct representative for all the secured parties under the financing arrangements (for example, under a facility agreement).

18. Is the trust concept recognised in your jurisdiction?

Trust concept

In Switzerland, no substantive trust law exists and it is not possible to set up a trust under Swiss law. However, since July 2007, the HCCH Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trusts Convention) applies in Switzerland. The ratification of the Hague Trusts Convention involved modifications to certain provisions of the Swiss Federal Act on International Private Law and the Bankruptcy Law (PILA). As a consequence, foreign trusts that are entered into voluntarily and evidenced in writing are, in principle, recognised in Switzerland.

Security trustee

Generally, a security trustee of a foreign trust can enforce its rights. However, certain limitations must be observed to the extent such security interest is governed by Swiss law. In particular, most security rights under Swiss law are considered to be accessory security interests (*akzessorische Sicherungsrechte*). This means, among other things, that a pledge or mortgage cannot be vested in a third party acting as a security holder in its own name and right. However, a third party can be entrusted to represent the lenders with regard to accessory security interests (see *above*). However, non-accessory security interests (such as outright transfers and/or assignments for security purposes) can be vested in a trustee holding the security interest in its own name. Alternatively, in order to overcome the limitations described above, the concept of "parallel debt" can be employed, whereby the credit documentation provides that the security trustee will be a joint and

several creditor of the debtor alongside the lenders under the facility agreement.

ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

The legal framework concerning the enforcement of claims, insolvency and bankruptcy is set out in the Federal Act on Debt Enforcement and Bankruptcy (DEBA). The enforcement of claims involves different proceedings depending on the:

- Legal status of the debtor.
- Nature of the collateral.

Generally, claims against companies must be pursued in enforcement proceedings leading to a declaration of bankruptcy (*Konkurs*) and a general liquidation of all assets and liabilities of the debtor. This is with the exception that, unless a bankruptcy has been declared, creditors who are secured by a pledge can either:

- Pursue special enforcement proceedings limited to the liquidation of the relevant collateral (*Betreibung auf Pfandverwertung*).
- Realise the pledged assets by a private enforcement (*Privatverwertung*), provided the parties have agreed on this in the security agreement.

To enforce an (accessory) security interest, the secured claim needs to be due. The relevant security agreement can set out additional conditions for the enforcement of the security, such as specified events of default.

Due to the non-accessory nature of guarantees, enforcement (theoretically) does not require that an underlying claim must exist or be due. Only the prerequisites for enforcement set out in the guarantee need to be fulfilled. This usually allows the secured party to enforce the guarantee in case of an event of default (including but not limited to the invalidity or unenforceability of the facility agreement).

Methods of enforcement

20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

Pledged assets

There are two main forms of enforcement.

Private enforcement. Private enforcement can take place by a private sale or a (privately organised) public auction. It is generally only permitted where the parties have agreed to the private enforcement (for example, in the pledge agreement) and only for as long as the debtor is not declared insolvent by the competent court, that is, insolvency procedures have not been ordered by the court. Private enforcement is possible for all forms of assets. In practice, movable assets are realised more often by private enforcement.

If there is a market value of the assets (for example, listed securities), the security holder can also take private enforcement action by purchasing the pledged assets and applying the proceeds to its claim.

In all forms of private enforcement, the security holder must protect the interests of the security provider and in particular must:

- Obtain the best price possible in the sale of the pledged assets or claims.
- Fully document the enforcement and provide the documentation to the security provider.
- Return any surplus that remains after the application of the proceeds to the secured debt to the security provider.

Enforcement based on the Federal Act on Debt Enforcement and Bankruptcy (DEBA). If the security interest is enforced according to the DEBA, the secured party initiates proceedings against the security provider by filing a debt collection request with the competent debt enforcement authority (*Betreibungsamt*). In this case, the common form of realisation is the sale of the pledged assets in a public auction by the competent debt enforcement authority. If special circumstances apply, an open sale (*Freihandverkauf*) is possible, in particular if:

- All involved parties agree to the sale.
- The pledged asset has a market price and the selling price is equal to it.
- The asset is subject to fast depreciation or has disproportionate maintenance or storage costs.

Special provisions apply in relation to the private enforcement of book-entry securities (*Article 31, FISA*):

- If a security interest has been created in book-entry securities, the secured party can realise the intermediate securities according to the terms and conditions provided in the security agreement by:
 - selling the book-entry securities and offsetting the proceeds against the secured debt; or
 - appropriating the book-entry securities (to the extent their value can be determined objectively, either by way of reference to a price quoted on a representative market or otherwise) and offsetting their value against the secured debt.

Under the FISA, private enforcement is also possible if the debtor has been declared insolvent by the competent court and insolvency procedures have been ordered by the court.

- The custodian is not bound or entitled to verify whether the conditions for realisation of the book-entry securities are fulfilled. However, a beneficiary of a security interest that realises book-entry securities where the conditions for realisation are not fulfilled will be liable. The secured party must give notice to the provider of the security interest before realisation. A provider of a security interest who is a custodian or a qualified investor can waive the notice requirement. The secured party must account to the provider of the security interest and remit any excess proceeds of the realisation.

Outright transfer or assignment for security purposes

Where an asset is transferred or assigned as security, enforcement is unnecessary, as the secured party already has ownership of the asset. To enforce, it is only necessary that the assets are not required to be returned under the agreement. In that case, the secured party must follow similar rules to the private enforcement of a pledge, particularly in relation to book-entry securities (see above, *Security over book-entry securities*). The secured party must:

- Value the assets fairly and document that valuation.
- Apply the proceeds to the secured claims.
- Return any surplus.

Additionally, in the case of an outright transfer or assignment for security purposes, as opposed to a pledge, but similar to a security interest granted over book-entry securities, a private enforcement is still possible if the debtor has been declared insolvent by the

competent court and insolvency procedures have been ordered by the court.

Rescue, reorganisation and insolvency

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

Swiss law provides for a rescue and reorganisation procedure (*Nachlassverfahren*) in the Federal Act on Debt Enforcement and Bankruptcy (DEBA) that can be applied for by the debtor (or, in certain circumstances, a creditor).

If the preconditions are met, the competent court can grant a moratorium (*Nachlassstundung*) allowing the debtor and its creditors to negotiate a composition agreement (*Nachlassvertrag*) that is binding on all creditors but will only affect unsecured claims.

Pledged assets will not be liquidated (except in certain exceptional cases) as long as the moratorium is in effect. It is disputed, as to whether secured creditors are still allowed to enforce their security interest by way of private enforcement (if the security agreement provides for a private enforcement) during a moratorium.

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

On bankruptcy, pledged assets form part of the bankrupt estate. The private enforcement of those assets is not permitted and enforcement can only occur under the Federal Act on Debt Enforcement and Bankruptcy (DEBA). The secured party participates with the other creditors in the bankruptcy proceedings. The pledged assets and claims are liquidated by the receiver in bankruptcy in the same manner as the other assets of the estate, but the pledgees retain their privilege to be satisfied from the proceeds of the liquidation of the assets pledged to them with priority over unsecured creditors.

With regard to book entry securities, the power of private enforcement is (as opposed to the pledge based on the Civil Code), not affected by the commencement of debt enforcement, reorganisation or protective proceedings in respect of the provider of the security interest.

The enforcement of guarantees and outright transfers and/or assigned claims is generally not affected by insolvency proceedings.

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

Swiss bankruptcy law contains actions against certain transactions of the debtor prior to bankruptcy. In particular, the following principles can affect security interests:

- The granting of collateral for existing obligations that the debtor was not previously bound to secure is voidable if the debtor who granted such collateral during the one-year period prior to the seizure of assets or the opening of bankruptcy was at the time of the act already insolvent. According to Swiss law, the secured party is deemed to have knowledge of the security provider's overindebtedness. Therefore, the secured party bears the burden of proof that it has acted in good faith.

- All transactions are voidable that the debtor carried out during the five years prior to the seizure of assets or the opening of bankruptcy proceedings with the intention, apparent to the other party, of disadvantaging his creditors or of favouring certain creditors to the disadvantage of others.
- The grantor or the guarantor disposes of assets for free or for inadequate consideration (not at arm's length) in the year before the adjudication of bankruptcy or an equivalent event.

24. In what order are creditors paid on the borrower's insolvency?

The proceeds from the realisation of any pledged assets are applied against the secured claims of the creditors.

Unless the parties agree differently (for example in an inter-creditor agreement) the ranking of security is generally determined in chronological order, that is, the security granted earlier in time has priority, if a security interest in the same asset secures more than one creditor's claims. In respect of security interests granted over certain assets (real estate, aircrafts, ships) the security interest must be registered and the ranking of the security interests forms part of the registration.

If, for example by mutual agreement, several security interests over the same asset rank equally, the proceeds from a realisation of the security are (absent any different agreement) applied proportionally to these secured claims.

CROSS-BORDER ISSUES ON LOANS

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders?

The granting of loans by foreign lenders to Swiss residents is not restricted in Switzerland, other than in relation to consumer credits.

The acquisition of residential real estate (as opposed to commercial property) by persons abroad is subject to an authorisation by the respective authority. Therefore, certain provisions of the Act on the Acquisition of Real Estate by Persons Abroad (Authorisation Act) must be taken into account when granting loans and taking security over Swiss real estate by foreign lenders. Generally, (mortgage-backed) loans granted by foreign lenders do not qualify as an acquisition of real estate in accordance with the provisions of the Authorisation Act.

However, particularly in the case of unusual loan terms (for example, very onerous covenants, or consent requirements of the bank) or in case of an exceptionally high loan amount, the debtor may become dependent on the lender, giving the lender control over the property. Therefore, in certain circumstances the creation of such a mortgage may become subject to clearance by the competent authority. A foreign lender granting mortgages in Switzerland therefore needs to consider obtaining a decree from the competent authority, confirming that the transaction is exempted from the scope of the Authorisation Act (*Nichtunterstellungsverfügung*) and/or refrain from applying provisions in the mortgage documentation conferring extensive rights on the lender.

Additionally, a tax levied on the interest payable to a foreign lender on a loan secured by real estate can apply (see *Question 27*).

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

In Switzerland, there are no exchange controls restricting payments to a foreign lender.

TAXES AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

27. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

The granting or enforcement of a loan, guarantee or security does not trigger any Swiss taxes. However, certain transactions require the payment of tax.

The confederation and the cantons or communes where the respective property is located levy an interest withholding tax on interest payments to foreign lenders, if a loan is secured by a mortgage over Swiss real estate (the aggregate rate varying from 11.6% to 24.7%). However, this is provided that such withholding tax is waived under certain double taxation treaties.

Subject to exemptions that may be available in certain circumstances, a transfer stamp duty of 0.15 to 0.3% applies to the transfer of securities if a Swiss bank or other securities dealer (as defined in the Swiss stamp tax law) is involved as a party or intermediary.

Additionally, loans and/or securities granted within a group or for the benefit of an affiliate can trigger certain tax issues if the transaction(s) are not entered into by following market conditions. For example, if an entity provides a guarantee to its parent company at no consideration, this may be treated as a dividend, thereby triggering withholding tax at a rate of 35% (resulting in a tax burden of up to 54% if not declared properly).

Documentary taxes

Taking security interest in real estate can involve the following fees, depending on the structure of the transaction:

- Notary fees.
- Registration fees (land register).
- Stamp duties levied by the respective canton and/or community.

The rates, fees and levies vary widely from region to region and depend on the security's face value.

Registration fees

See above, *Documentary taxes*.

Notaries' fees

See above, *Documentary taxes*.

28. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

The granting or enforcement of a loan, guarantee or security does not trigger the payment of Swiss taxes (see *Question 27*).

ONLINE RESOURCES

Civil Code

W www.admin.ch/opc/de/classified-compilation/19070042/index.html#a80

Description. The website of the Civil Code, available in German and English.

Swiss Federal Intermediated Securities Act (FISA)

W www.admin.ch/opc/de/classified-compilation/20061735/index.html

Description. The website of the FISA, available in English and German.

HCCH Convention on the Law Applicable to Trusts and on their Recognition 1985

W www.hcch.net/en/instruments/conventions/full-text/?cid=59

Description. The website is only available in English.

Swiss Federal Act on International Private Law and the Bankruptcy Law (PILA)

W www.admin.ch/opc/de/classified-compilation/19870312/index.html

Description. The PILA website is available in German and English.

Federal Act on Debt Enforcement and Bankruptcy (DEBA).

W www.admin.ch/opc/de/classified-compilation/18890002/index.html

Description. The DEBA website is only available in German.

Swiss Banking Association Directive mortgage

W www.swissbanking.org/en/shop_popup.htm?ID=1000009

Description. The website is only available in German.

Practical Law Contributor profiles



Dr Alexander Vogel, Partner, Head of Corporate & Finance Department, Zurich and Zug

Meyerlustenberger Lachenal
T +41 44 396 91 91
F +41 44 396 91 92
E alexander.vogel@mll-legal.com
W www.mll-legal.com

Professional qualifications. Attorney at law, Switzerland, 1992; New York Bar, 1994; University of St Gallen Law School, Master of law, Northwestern University School of Law

Areas of practice. Corporate finance/banking; leveraged transactions; capital market transactions; cross-border mergers and acquisitions; public takeovers; investment funds; corporate governance; private equity transactions; real estate.

Recent transactions

- Various secured and unsecured loan facilities and similar financing arrangements.
- Various national and cross-border acquisitions and acquisition financing structures for Swiss and international clients.
- Advising clients and creditors in work-out negotiations and defence strategies for companies and groups in financial distress.

Languages. German, English, French

Professional associations/memberships. Member of the board of directors of several Swiss companies; involved in several research projects with the Swiss National Research Fund in the area of national and international corporate law.

Publications

- "Act leads to amendments of public takeover law", International Law Office (ILO), February 2016.
- "New rules for publication of documents relating to public tender offers", International Law Office (ILO), February 2016.
- Mergers & Acquisitions Report 2015 in Switzerland, IFLR - International Financial Law Review.



Samuel Ljubicic, Senior Associate

Meyerlustenberger Lachenal
T +41 44 396 91 91
F +41 44 396 91 92
E samuel.ljubicic@mll-legal.com
W www.mll-legal.com

Professional qualifications. Attorney at law, Switzerland, 2010; University of Lucerne, Master in International Financial Law, King's College London

Areas of practice. Cross-border mergers and acquisitions; banking and finance; acquisition financing transaction; structured financing; credit and equity derivative transactions; real estate financing; capital market; real estate development and transactions.

Recent transactions

- Various cross-border asset backed financing structures, secured by various asset classes, for example, fund interests, private shares that will be converted into American depository shares on enforcement, Islamic bonds (for example, sukuks); Swiss counsel in Islamic finance transactions for Swiss and international clients.
- Advising clients and creditors in work-out negotiations and defence strategies for companies and groups in financial distress.

Languages. German, English

Professional associations/memberships. Swiss and Zurich Bar Association, International Association of Young Lawyers (AIJA)

Publications

- "Act leads to amendments of public takeover law", International Law Office (ILO), February 2016.
- "New rules for publication of documents relating to public tender offers", International Law Office (ILO), February 2016.
- Mergers & Acquisitions Report 2015 in Switzerland, IFLR - International Financial Law Review.