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Asset Backed Securities Under the Financial Services Act

Reference: CapLaw-2019-01

The Financial Services Act of 15 June 2018 (FinSA) and the consultation draft Financial Services Ordinance (draft FinSO) dated 24 October 2018 include significant new rules for the distribution of financial instruments and the regulation of financial services in Switzerland. This article discusses the potential impact of the new rules on Asset-Backed Securities (ABS) in relation to the timing of prospectus review and approval, the obligation to prepare a Key Investor Document (KID) and the regulation of services typically provided by investment banks in connection with ABS transactions. The article is based on the version of draft FinSO published for public consultation.

By Daniel Adler / Daniel Bono

1) Introduction

The new rules do not contain a definition of Asset-Backed Securities. With the exception of very few mandatory minimum disclosure requirements (which substantially correspond to current SIX Swiss Exchange (SIX) rules), there are no new rules which specifically apply to ABS. Nevertheless, the new rules have an impact on ABS which are typically issued in the form of bonds. ABS can be very diverse in terms of structure and possible underlyings. This article is based on the most common type of ABS in the Swiss domestic market, *i.e.* ABS based on the cash flow of customer payments from a pool of car leases, so called Auto Lease ABSs. The current market practice for Swiss domestic Auto Lease ABS transactions has been developed for the inaugural Cembra (GE Money Bank) transaction in 2013 and has since been continually updated. Further transactions included additional Cembra transactions as well as transactions by MultiLease and AMAG Leasing. The most important features of a typical Auto Lease ABS transaction in Switzerland are summarized below.

The leasing company (as originator of the lease assets and seller) sells and transfers a pool of auto lease assets (including lease agreements) to a special purpose vehicle (SPV) which is newly incorporated in Switzerland. The SPV funds most of the purchase price through the issuance of SIX-listed bonds (ABS bonds), another part by issuing a subordinated certificate (subordinated to the ABS bonds) to the leasing company and other funding provided by the leasing company (credit enhancement by overcollateralization). The SPV uses the asset pool to secure its payment obligations under the ABS bonds. The ABS bonds may be split into tranches with varying degrees of subordination to appeal to different types of investors. The subordinated tranches carry greater risk and pay higher yields. Typically, the subordinated tranches have minimum denominations of CHF 100,000 and are, therefore, not for retail investors. The most senior tranche typically has an "AAA" rating from one or more of the three major rating agencies.

The payment obligations of the SPV under the ABS bonds are limited recourse obligations. Therefore, the ultimate source for payment of interest and repayment of principal of the ABS bonds are cash collections from the lease assets (mainly lease payments and proceeds from the sale of lease vehicles). Available cash collections are distributed subject to a priority of payments (the so called "waterfall"). During the so-called "Revolving Period", the SPV uses available cash collections from the lease assets, among other things, to pay interest under the ABS bonds and purchase additional lease assets. Following the end of the Revolving Period, the leasing company has the option to repurchase the entire portfolio. Upon exercise of the repurchase option, the SPV redeems the ABS bonds. If the repurchase option is not exercised (or the Revolving Period is terminated for another reason) the SPV ceases to purchase new lease assets and uses available cash collections to redeem the principal of the ABS bonds. Interest rates will then step-up. The leasing company will continue to service the asset pool on behalf of the SPV pursuant to a servicing agreement, subject to the appointment of a replacement servicer upon the occurrence of certain events of default with respect to the servicer. Swiss public ABS transactions do not include derivatives.

This article does not discuss non-Swiss rules that have an impact on structuring Swiss ABS transactions (*e.g.* through risk retention requirements and selling restrictions). These include the new EU Securitisation Regulation (Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardized securitisation and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012) that entered into force on 1 January 2019, the EU PRIIPs Regulation (Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs Regulation) that entered into force on 1 January 2018, and the Markets in Financial Instruments Directive (recast) – Directive 2014/65/EU of the European Parliament and of the Council (MiFID II) and related regulations.

2) New Prospectus Rules

a) Current Market Practice

Market practice for public Swiss ABS transactions with respect to prospectuses differs from other, more standard Swiss bonds. A stand-alone preliminary prospectus is used during the marketing and offering phase. Typically, a preliminary prospectus is identical to the final prospectus but for certain information that cannot be included in the preliminary prospectus because it is not yet known as at its date (this information is left blank in the preliminary prospectus and mainly consists of pricing information, *e.g.* nominal amount, interest rate, tenor of the bonds and issue price). Because it is not required under current rules, the preliminary prospectus (as offering prospectus) is not approved by the SIX. Following pricing of the ABS bonds, a final prospectus that completes the information left blank in the preliminary prospectus is made available to investors. Because the final prospectus is used as a listing prospectus, it is reviewed and approved by the SIX.

Furthermore, the SIX reserves the right to approve ABS transaction structures on a case-by-case basis. In the case of complex structures which deviate significantly from the ABS structures customary in the Swiss market, the approval process may be time critical.

b) *Ex-ante* Prospectus Approval Procedure

Pursuant to the new prospectus rules, a prospectus approved by a FINMA supervised review body must be published for any public offer of securities to investors in Switzerland (unless an exemption applies, *e.g.* an offering to professional clients only or a minimum denomination in of at least CHF 100,000) and the admission to trading on a stock exchange or a multilateral trading facility (MTF) in Switzerland (except where the securities are only admitted to a trading segment for professional clients). This is called *ex-ante* prospectus approval because the prospectus must be reviewed and approved by the review body prior to its publication. Because the SPVs that issue ABS bonds are typically newly incorporated entities, the review body may apply the minimum review period for new issuers of at least 20 calendar days. For inaugural issuances, in particular in case of complex structures, the minimum review period may fit well into the overall project timetable and *ex-ante* approval of the preliminary prospectus may be an option. The review bodies may not accept the term ***preliminary*** prospectus for the reviewed and approved prospectus.

Pricing information not included in a reviewed and approved prospectus can be completed (without triggering an obligation to prepare a formal supplement in the sense of article 56 FinSA) pursuant to article 40(4) FinSA. We note that the wording of article 40(4) FinSA appears to be too narrow for debt securities. However, it should be construed in such a way as to include all pricing information typical of bonds. Because article 40(4) FinSA does not define how a document that updates the pricing information should look like, a final prospectus in line with current market practice (as opposed to a pricing statement typically used for equity transactions) should be an option. This would be preferable for investors because they would then have a single document that includes all relevant information.

c) Ex-post Prospectus Approval Procedure

The new rules provide for an alternative review and approval procedure for debt (and certain other) securities based on article 51(2) FinSA and article 62 draft FinSO. The aim of the new review and approval procedure is to maintain key aspects of current Swiss market practice that shorten the time-to-market and are regarded as important competitive advantages for the Swiss bond markets. This will be achieved by allowing offerors to postpone review and approval until the date of admission to trading and to use (non-approved) offer documents for the public offer that, for typical debt offerings, is initiated with the announcement that books are open for orders (so-called called *ex-post* approval). Core elements of the *ex-post* approval procedure are a confirmation by a Swiss bank or securities firm that the most important information about the issuer and the securities is available at the time of publication and the statutory presumption that the most important information about the issuer is available if shares or debt securities of the issuer (guarantor or security provider) are listed on a Swiss or recognized foreign market (stock exchange or MTF) in article 62(3) draft FinSO.

Typical ABS bonds would qualify as bonds pursuant to article 3(a)(7) FinSA and, therefore, be eligible for *ex-post* review and approval. However, because ABS bonds are typically issued by newly incorporated SPVs, the statutory presumption discussed above would not be available. We expect that ABS bonds will be marketed on the basis of (preliminary) prospectuses in line with current market practice. Whether *ex-ante* or *ex-post* approval will be used will depend on the final wording of the relevant provisions in the FinSA (participants in the public consultation commented that the wording should clarify that the confirmation only concerns formal review for compliance with minimum disclosure requirements) and required time-to-market. Generally, the *ex-post* approval process should be more attractive because it offers greater flexibility.

d) Minimum disclosure requirements for ABS bonds

Annex 2 of the draft FinSA contains minimum disclosure requirements for debt securities and section 3.6 thereof specific disclosure requirements for Asset-Backed Securities. The minimum disclosure requirements are substantially based on the current minimum disclosure requirements set out in section 4 of the SIX circular no. 4 (practice regarding the listing of bonds). The main elements are that the prospectus must include a transaction summary as introduction to the prospectus that explains the main features of the transaction, followed by a transaction overview that gives an overview over certain elements of the transaction and the main risks related thereto.

3 Key Information Document

Subject to certain exemptions, the manufacturer of a financial instrument within the meaning of article 3(a) FinSA that is offered to retail clients domiciled in Switzerland must produce a Key Information Document (KID) (*Basisinformationsblatt* or BIB) (article 58(1) FinSA and article 80(1) draft FinSO). The offer does not have to be a public offer pursuant to article 3(h) FinSA. The new rules contain broad exemptions for financial instruments, typically issued by corporates for the purpose of financing. Most relevant for ABS bonds as debt securities is article 59(1) FinSA that exempts debt securities ***without derivative characteristics***.

The FinSO does not define debt securities without derivative characteristics directly, instead article 86(2) draft FinSO defines "debt securities ***with derivative***

characteristics" as "derivatives and debt instruments whose payoff profile is structured in the same manner as that of a derivative according to article 2(c) of the Financial Market Infrastructure Act of 19 June 2015 (FMIA)". In addition, article 86(3) draft FinSO contains a (non-exhaustive) list of examples for debt securities without derivative characteristics (*e.g.* bonds with early redemption rights). Pursuant to article 2(c) FMIA, derivatives are financial contracts whose value depends on the performance of one or more underlying values. While the performance and value of the underlying assets affect interest payments and principal repayments on ABS bonds and therefore their value (*as* the sole source of interest payments on ABS bonds are collections from the lease assets in the portfolio), there is no direct relationship on payoff and value typical of derivatives (*e.g.* Credit Linked Notes).

Therefore, an ABS bond would be exempt from the obligation to prepare a KID under the new rules as a debt security without derivative characteristics unless the terms and conditions of the ABS bond include other features that would result in an obligation to produce a KID. By contrast, under the PRIIPs Regulation, a Key Information Document would be required for an offer of Asset-Backed Securities to retail investors in any EEA country.

4) Financial Services and Rules of Conduct

The FinSA defines "financial service" in article 3(c), *inter alia*, as the acquisition or disposal of financial instruments or the giving of personal recommendations on transactions with financial instruments (investment advice), provided that each such activity is carried out for a client. Financial services are subject to the applicable regulation under the FinSA, including rules of conduct.

In Asset-Backed Securities transactions, the originator (*e.g.* the leasing company in Auto Lease ABS) appoints one or more investment banks to provide certain services. These services typically include (i) advice on transaction and offering structure (Advisory Services) and (ii) the subscription (Underwriting) of the issued Asset-Backed Securities by the investment bank(s) as first taker(s) from the issuer (Initial Purchase). We believe that these services should not qualify as "financial services" pursuant to article 3(c) FinSA.

– Advisory Services do not qualify as a purchase/sale of a financial instrument under article 3(c)(1) and (2) FinSA or investment advice within the meaning of article 3(c)(4) FinSA. The purpose and subject matter of the Advisory Services is not a personal recommendation to make an investment, *i.e.* to either buy, sell or hold a specific financial instrument, but rather advice to a borrowing client with respect to how and when to raise funds from the capital markets; in short, on how to turn a planned issue of new securities into action.

– Initial Purchase does not fall under the provisions of article 3(c)(1) and (2) FinSA on the acquisition or disposal of financial instruments for clients or the transmission of respective client orders. These provisions regulate securities trading activities that a financial services provider carries out for its clients. The Initial Purchase of securities by an investment bank constitutes a securities trade between issuer and syndicate banks who act on their own behalf and for their own account and such a transaction is therefore not an order or an instruction from the issuer to trade a financial instrument on its behalf. By contrast, the sale of Asset-Backed Securities by a bank to its investing clients would constitute the execution of a client order and, therefore, a financial service under FinSA.

Unfortunately, the wording of article 3(1) draft FinSO creates some ambiguity on this point. It specifies that the acquisition or disposal of financial instruments is deemed to be *any activity* which, such as intermediation, is specifically aimed at the acquisition or disposal of a financial instrument. Based on the statements made in the explanatory report of the Federal Council dated 24 October 2018 on the draft FinSO, we understand that the main rationale of article 3(1) FinSO is to regulate certain activities in relation to the marketing and distribution of foreign investment funds to investors in Switzerland. This should be clarified in the final version of the FinSO.

By contrast, the scope of the EU MiFID II Directive expressly covers, *inter alia*, the underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis (referred to as "Investment Services and Activities" in section A of annex I) and advice to undertakings on capital structure and services related to underwriting ("Ancillary Services" in section B of annex I).

Therefore, in order for corporate finance advisory services (*i.e.* Advisory and Initial Purchase in connection with capital market financing through the issuance and placement of securities) to qualify as financial services pursuant to FinSA and be subject to the rules of conduct under FinSA, such activities should have been explicitly listed in article 3(c) FinSA in observation of the legality principle.

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The Rise of Green, Social and Sustainability Bonds – The Swiss Perspective

Reference: CapLaw-2019-02

The global market for green, social and sustainable investment is growing at an increasing rate. This is the result of considerable growth of both the demand for, and the supply of, capital for green, social and sustainable projects. Despite Switzerland having a highly developed and efficient capital market and being one of the world's largest cross-border wealth management centres, the Swiss market for green, social and sustainability bonds is only just beginning to gain momentum. In view of this, the author expects this sector to significantly grow in the coming years.

By Andreas Josuran

The global market for green, social and sustainable investment is growing at an increasing rate. Back in 2007, the European Investment Bank issued the first green bond. Today, an aggregate amount of roughly USD 1.45 trillion climate-aligned bonds is outstanding according to a report by the Climate Bond Initiative (CBI) published in September 2018. For the full year 2018, CBI reports a total green bond issuance volume of USD 167.3 billion and for the year 2019, an increase to USD 250 billion is expected. The rapid growth of the global market for green, social and sustainable investment is the result of an increase of both the demand for, and the supply of, capital for green, social and sustainable projects:

- On one side (demand for capital), in particular in view of recent global endeavours to tackle climate change, there is an increasing demand for capital dedicated for green, social and sustainable purposes. According to an estimate by the European Council published in May 2018, around EUR 180 billion of additional investments in energy efficiency and renewable energy are needed per year in the EU area alone to achieve its 2030 climate targets. Against this background, the EU put in place an action plan with a view to adopt specific legislation in the near future that aims at mobilising private capital to fund sustainable investment. Other jurisdictions have launched similar campaigns or are offering subsidies to companies active in green, social or sustainable projects.

- On the other side (supply of capital), investors are increasingly seeking for sustainable investment opportunities, which has driven the creation of a considerable range of investment products in that sector over the past few years. Assets under management of green, social or sustainable funds as well as other investment vehicles are increasing at a remarkable rate.

Despite Switzerland being one of the world's largest cross-border wealth management centres, the Swiss market for green, social and sustainability bonds is only just beginning to gain momentum. SIX Swiss Exchange currently reports 15 SIX-listed green bonds in an aggregate nominal amount of CHF 11.6 billion. Eight of these green bonds are denominated in Swiss francs. Globally, only about 1% of all outstanding green bonds are denominated in Swiss francs, while the most commonly used currencies are EUR, USD (each 26%) and CNY (22%) according to CBI. In view of this, it seems that there is still potential for significant growth in this sector in Switzerland. The combination of Switzerland's highly developed and efficient capital markets and its large wealth management sector certainly offers ideal circumstances to facilitate such growth.

1) What is a Green, Social or Sustainable Bond?

There is no legal definition of what is a green bond, a social bond or a sustainable bond. Rather, these terms are sometimes used inconsistently and to describe different types of debt instruments. To increase integrity and transparency, the International Capital Market Association (ICMA) prepared principles and guidelines for each of these categories: the ICMA Green Bond Principles (GBP), the ICMA Social Bond Principles (SBP) and the ICMA Sustainability Bond Guidelines (SBG) (current versions all dated June 2018). These principles are (voluntarily) complied with by a rising number of issuers, thereby contributing to increased transparency by more standardized disclosure and reporting.

According to these principles:

- *Green Bonds* are any type of bond instrument (i) where the proceeds will be exclusively applied to finance or re-finance new or existing eligible Green Projects (see below) and (ii) that are aligned with the four core components of the ICMA GBP (see below).

- *Social Bonds* are any type of bond instrument (i) where the proceeds will be exclusively applied to finance or re-finance new or existing eligible Social Projects (see below) and (ii) that are aligned with the four core components of the ICMA SBP (see below).

- *Sustainability Bonds* are any type of bond instrument (i) where the proceeds will be exclusively applied to finance or re-finance a combination of both eligible Green Projects and Social Projects and (ii) that are aligned with the four core components of the ICMA GBP/SBP. Bonds that intentionally mix green and social projects are referred to as sustainability bonds, and specific guidance for these is provided separately in the Sustainability Bond Guidelines.

"*Green Projects*" are projects within the eligible green project categories identified by ICMA in the ICMA GBP. These categories currently include (without limitation): renewable energy, energy efficiency, pollution prevention and control, environmentally sustainable management of living natural resources and land use, terrestrial and aquatic biodiversity conservation, clean transportation, sustainable water and waste-water management, climate change adaption, eco-efficient and/or circular economy adapted products, production technologies and processes and green buildings.

"*Social Projects*" are projects within the eligible social project categories identified by ICMA in the ICMA SBP. These categories currently include (without limitation): affordable basic infrastructure (*e.g.* clean drinking water, sewers, sanitation and transport energy), access to essential services (*e.g.* health, education and vocational training, healthcare, financing and financial services), affordable housing, employment generation, food security, socioeconomic advancement and empowerment.

The *four core components of the GBP/SBP* that have to be met by any green, social or sustainability bond issued in compliance with the ICMA standards are the following:

1. *Use of Proceeds*: The cornerstone of a green, social or sustainable bond is that the proceeds of the bond issuance are used for Green Projects (green bond), Social Projects (social bond) or a combination of the two (sustainability bond).

2. *Process for Project Evaluation and Selection*: The issuer of a green, social or sustainable bond should clearly communicate to investors: (i) the environmental sustainability/social objectives, (ii) the process by which the issuer determines how the projects fit within the eligible green/social project categories and (iii) the specific eligibility criteria, *e.g.* the process applied to identify and manage potential risks associated with the projects.

3. *Management of Proceeds*: The net proceeds of the bond offering, or an amount equal to these net proceeds, should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner so as to be formally linked to the issuer's lending and investment operations for green/social projects.

4. *Reporting*: Issuers should make and keep readily available up to date information on the use of proceeds to be renewed annually until full allocation and on a timely basis in case of material developments. The annual report should contain a list of projects and the amounts that have been allocated, as well as the expected impact. If non-disclosure requirements apply, the information should be presented generically.

2) Types of Green, Social or Sustainable Bonds

The variety of issuance structures used by green, social and sustainable bond issuers is wide and it seems fair to say that a large part of the capital market ABC is used in this respect: According to CBI's market report published in September 2018, besides more traditional options such as senior bonds, available options include packaging and re-packaging green bonds/loans/leases by way of securitization (MBS, ABS etc.), issuing green covered bonds, green hybrid bonds, green *Schuldscheine*, green *sukuk* (Sharia-compliant Islamic bonds) – just to name a few.

3) Requirements under Swiss law

As in most other jurisdictions, there are no specific legal rules or requirements under Swiss law for green, social or sustainability bonds. Rather, the general principles of law both under private law as well as under public law apply also to these types of bonds. Generally speaking, issuers are well advised to carefully manage investors' expectations as to the investment of the proceeds and to avoid creating wrong expectations.

One important aspect of this is risk disclosure in the prospectus and potential other offering or marketing materials. Under Swiss law, this can be expected to become even more important in the future, given that the new Financial Services Act (FinSA) will specifically require that the prospectus contains information on the main risks related to the instrument (article 40(1)(a)(4) FinSA). Depending on the specific instrument, this may include information on risks related to the instrument being a "green", "social" or "sustainable" investment. Similarly, for instruments that are listed on the SIX Swiss Exchange, the SIX listing rules already currently require that any special risks must be specifically mentioned (article 27(2) SIX Listing Rules).

Risk disclosure used in offering documentation of green bonds placed on the international capital markets varies, but seems to be gradually becoming more standardized. Some of the main risks flagged to investors typically include (among others):

- general uncertainty in many respects due to lack of a clear legal or regulatory definition of "green", "social" or "sustainable";
- use of proceeds may not meet expectations of the investors;
- high dependency on third party opinions (providers of evaluations) in respect of the status as "green", "social" or "sustainable" investment;
- providers of green/social/sustainable evaluations are generally not regulated; and
- a negative change or a withdrawal of the designation as a "green", "social" or "sustainable" investment may have adverse consequences for investors (such as green investment funds) with specific portfolio mandates to invest in green, social or sustainable assets.

Whether or not specific risk disclosure should be included in the prospectus and/or related documentation and, if so, what aspects should be specifically described therein, must be determined on a case by case basis, taking into account the specificities of the relevant instrument. As always with risk disclosure in capital market instruments, it is also important to carefully take risk disclosure in similar already outstanding instruments into consideration.

4) Requirements for a listing on the SIX Swiss Exchange

From a technical perspective, as far as requirements for a listing on the SIX Swiss Exchange are concerned, a green, social or sustainable bond is not treated differently from other debt instruments to be listed on the SIX Swiss Exchange. The listing prospectus has to meet the requirements set out in the listing rules as well as the additional implementing rules, directives and schemes. There are no separate rules or special requirements for green, social or sustainability bonds as far as the SIX listing process is concerned. That said, SIX relatively recently introduced a so-called "green bond flag" in order to increase visibility of green bonds and help investors to quickly identify green bonds listed on the SIX. For the purposes of verification, SIX collaborates with its partner CBI: Bonds that are listed on the SIX Swiss Exchange and that appear on the relevant CBI lists of green bonds will get the "green bond flag" from SIX.

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Corporate Tax Reform – Capital Contribution Principle for Swiss-listed Companies

Reference: CapLaw-2019-03

On 28 September 2018 the Swiss Parliament approved the final draft bill regarding the corporate tax reform which includes major changes for Swiss-listed companies in relation to the distribution of dividends paid by repayment of capital contribution reserves. It is proposed that Swiss-listed companies may only pay withholding tax-free capital contribution reserves if in the same amount a dividend will be paid from taxable distributable reserves (so-called 50/50 rule).

By Elga Reana Tozzi

1) Corporate Tax Reform in General

The objective of the proposed corporate tax reform is to ensure that the Swiss corporate tax system is in line with the international minimal standards, which recognises as harmful the cantonal preferential tax regimes for holding, domicile and mixed companies. Accordingly, these privileged tax regimes need to be abolished. It is proposed that in order to remain attractive business locations for international groups, the cantons would reduce their corporate tax rates. Furthermore, various other measures have been proposed, *e.g.* introduction of a patent box, R&D super deduction, notional interest deduction in case of the Canton of Zurich. Also, further adjustments would be necessary to ensure additional fiscal revenues to compensate some of the expected shortfall due to the general reduction of the corporate tax rates. Amongst others, one of these measures would be the introduction of a distribution restriction and partial liquidation rules for capital contribution reserves of Swiss-listed companies.

The corporate tax reform is subject to public vote which will take place on 19 May 2019. Some of the new tax provisions could enter into force in 2019, with the main part in 2020. If the corporate tax reform were to be rejected, the Swiss Government has announced its plan to abolish the privileged tax regimes by the end of 2020 otherwise the OECD/EU will put Switzerland on their blacklist, which would result in adverse tax treatments of cross-border transactions for Swiss tax resident companies.

2) Adjustments of Capital Contribution Reserves Tax Provisions for Swiss-listed Companies

As of 1 January 2011, dividends could be paid out of capital contribution reserves without being subject to 35% withholding tax and therefore, be income tax-free for Swiss tax resident individual shareholders. In practice most of the Swiss-listed companies use this possibility and pay dividends without withholding tax instead of paying dividends from their distributable reserves which would be subject to withholding tax. The capital contribution reserves principle has been extensively discussed due to the fact that as a consequence of the implementation the fiscal revenues have decreased substantially. The parliament has reviewed the capital contribution principle in more detail in view of the shortfall resulting from the proposed reduction of the corporate tax rates and proposed new rules regarding the use and repayment of capital contribution reserves.

The proposed new rules regarding the distribution restriction of capital contribution reserves would only affect Swiss-listed companies, *i.e.* Swiss tax resident companies which are not Swiss-listed or listed on a foreign stock exchange could still pay dividends out of capital contribution reserves without any deduction of withholding tax (*e.g.*, Glencore Plc). The proposed distribution restriction would be limited only to Swiss-listed companies given from a fiscal revenue perspective there would have been no substantial advantage to include foreign-listed Swiss tax resident companies.

It is proposed that Swiss-listed companies could only pay tax-free capital contribution reserves if they pay taxable dividends in the same amount. Not affected by this new tax provision would be intra-group dividends and capital contribution reserves from assets transferred from abroad after 24 February 2008 and in the case of a liquidation or transfer of place of incorporation or effective management and control to abroad. The above rules would also apply to the issue of bonus shares and bonus increases in the par value from capital contribution reserves.

a) Proposed Distribution Restriction Rule

If a Swiss-listed company having distributable reserves declares a dividend only from its capital contribution reserves, a withholding tax would be due on 50% of the repayment of the capital contribution reserves, however, not more than the amount of the available distributable reserves. In the case of such a tax adjustment the amount of distributable reserves subject to withholding tax would be credited for tax purposes to the capital contribution reserves. In other words, the available capital contribution reserves amount would not be affected by such a tax correction and would still be available for a later repayment, in particular in case no further taxable distributable reserves would be available (*i.e.*, deferral on the timeline for tax purposes). This would result in the available amount of capital contribution reserves in the stand-alone statutory balance sheet would differ from the amount available for tax purposes. However, in practice it might be that no such tax corrections arise given the distributing companies should be aware in advance of the proposed distribution restriction rule and declare any dividends in line with the new distribution restriction rule.

For Swiss-listed companies not having any distributable reserves, the distribution restriction would not affect them. Such companies could still pay dividends out of capital contribution reserves which would not be subject to withholding tax and be income tax-free for Swiss tax resident individual shareholders.

i. Proposed Exemptions for "Foreign" Capital Contribution Reserves

The proposed distribution restriction rule would not apply for capital contribution reserves of non-Swiss tax resident companies created abroad and transferred to Switzerland. This exemption is applied to all qualifying capital contribution reserves created after 24 February 2008, which were transferred to Switzerland either through:

(1) a share for share exchange transactions (so-called quasi merger) whereby shares of non-Swiss companies are contributed to a Swiss-listed company in exchange for shares or through; or

(2) cross-border mergers whereby a non-Swiss company is merged into a Swiss-listed company.

Also, Swiss-listed companies which have become Swiss tax resident through the migration by way of transferring its place of incorporation or effective management and control to Switzerland could distribute dividends out of capital contribution reserves created abroad. For benefiting from this exemption the foreign capital contribution reserves need to be reflected in a separate balance sheet account. This exemption rules applies not only for new Swiss-listed companies but also for existing Swiss-listed companies which have "foreign" capital contribution reserves.

b) Introduction of Partial Liquidation Rule

The new proposed partial liquidation rules requires that at least 50% of the surplus amount would need to be debited to capital contribution reserves in case of repurchase of own shares either for the purposes of a capital reduction or to keep the repurchased shares as treasury shares which would deemed to be liquidated if held longer than 6 years (or 12 years in case of employees shares).

The repurchase of own shares by a Swiss-listed company for the purpose of a share capital reduction (direct partial liquidation) would result in the received surplus being the difference between the purchase price and the nominal value would be subject to withholding tax. Since the introduction of the capital contribution principle the surplus amount could also be debited to the capital contribution reserves which would not be subject to withholding tax.

In practice often a second trade line would be opened through which a bank or a broker would repurchase the shares. This has the advantage that the purchaser is known and the withholding tax due could be refunded and the capital contribution reserves would not be required for the purposes of repurchase of own shares and could be used for ordinary dividend distributions. The new partial liquidation rules have been proposed to eliminate this tax planning possibility and to ensure equal treatment of all such transactions.

3) Adjustments of Income Taxation of Dividends from Qualifying Investments for Swiss Tax Resident Individual Shareholders

The distribution restriction rules would result a Swiss tax resident individual shareholder could no longer benefit from dividends which would not be subject to withholding tax and be income tax-free if paid out of capital contribution reserves (in case that distributable reserves would be available).

However, dividend income of Swiss tax resident individuals from qualifying investments (holding at least 10% in the capital of a company) is currently partially exempt from taxation in order to mitigate double taxation at the shareholder level. At the federal tax level, the taxation rate increases from 50% (business investments) and 60% (private investments), respectively, to a standard rate of 70%. At the cantonal level, there is a harmonization of the relief method and an introduction of a minimum taxation rate of 50% (rate at the discretion of the cantons).

4) Summary and Recommendation

The introduction of the new distribution restriction and partial liquidation rules for the repayment of capital contribution reserves would not affect non-Swiss listed companies being Swiss tax resident or companies listed on a foreign stock exchange. Also, capital contribution reserves resulting from the transfer of non-Swiss assets to

Switzerland could still benefit from a tax-free treatment of the repayment. Therefore, Switzerland would remain competitive as holding jurisdiction from an international tax perspective.

It is very difficult to assess whether the proposed corporate tax reform will pass the public vote on 19 May 2019. However, Swiss-listed companies need to monitor the position closely regarding:

– the repurchase of own shares through the second trade line. If such a share repurchase program were to be considered it might be advisable to implement such a program before the new partial liquidation rule would enter into force; and

– the upstreaming of cash from subsidiaries by dividend payments resulting in distributable reserves which would be affected by the new distribution restriction rule. Therefore, other ways for financing distributions to the public shareholders could be explored and analysed in more detail.

If the corporate tax reform were entering into force, Swiss-listed companies would need to consider the 50/50 distribution restriction rule if distributable reserves were available. A repayment of capital contribution reserves that would result in a tax correction should be avoided even if it would be only a tax deferral in the timeline (the capital contribution reserves would remain available for tax purposes).

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Replacement of LIBOR – An Approach for the Swiss retail lending market

Reference: CapLaw-2019-04

The discontinuation of LIBOR, announced for the end of 2021, is foreseeable. At the same time, for lack of suitable alternatives, LIBOR is still the dominant reference rate in the Swiss retail lending market for floating rate borrowings. As a result, Swiss banks active in the mortgage lending market already now face the challenge to provide for a transition to a successor rate when entering into new contracts. And the same challenge exists generally, both in the retail and the institutional market.

By René Bösch / Benedikt Maurenbrecher

It is estimated that in Switzerland currently LIBOR related mortgages amount to approx. CHF 150 billion. Quite many of these mortgages have a term of 3 years or more, which means that more and more of such mortgages coming up for renewal should address the expected discontinuation of LIBOR during the term of the renewed mortgage. Internationally several organizations such as the International Swaps and Derivatives Association (ISDA), the Loan Market Association (LMA) or the Alternative Reference Rate Committee (ARRC) have been working on proposals for model clauses addressing the replacement of LIBOR, but all these efforts were focusing on the institutional markets. Various proposed model LIBOR replacement clauses have been developed under the auspices of these organizations, but because of their complexity these model clauses are not suitable for the Swiss retail market.

In Switzerland the National Working Group on Swiss Franc Reference Rates last year proposed the Swiss Average Rate Overnight (SARON) as new reference rate for Swiss franc denominated lendings. This rate is determined on the basis of historic overnight transactions in the Swiss repo market, but in contrast to LIBOR it is an entirely risk-free rate with a one-day term only. Therefore, for an economically neutral switch from LIBOR to a new reference rate in the Swiss franc lending market, SARON as such is not suitable as a successor rate. Rather when using SARON as basis for such purposes, an adjustment must be made.

Under Swiss law a few fundamental elements of contract law should be considered when developing a successor clause for LIBOR in the retail lending market: Firstly, the parameters for a switch from LIBOR to a new reference rate need to be as clearly specified as possible. Quite obviously, this poses a significant issue at a time when neither the when nor the how of the discontinuation of LIBOR are known. Second, it would be preferable to accept a successor clause that has been developed by an independent third party and has received, or is about to receive, widespread or even universal acceptance in the markets – only to acknowledge that currently we are far away from such situation having materialized. Thirdly, the switch from LIBOR to a successor reference rate must not put the customers at an undue disadvantage, meaning that it should be as economically neutral as ever possible and not be used by banks / lenders to achieve an economic benefit. And finally, the contractual clause regulating the succession of LIBOR should be as easily readable and comprehensible as possible.

Having faced these challenges, last year we developed an idea how a LIBOR successor clause could look like for the Swiss retail lending market. The aim was to craft a simple, easy-to-read clause for retail clients that provides for a fair transition to a successor rate. The clause is embedded in well established principles of Swiss law. On 31 October 2018 we presented a proposed clause, together with a few underlying considerations, to the National Working Group on Swiss Franc Reference Rates on October 31, 2018 – in German and French, with an English translation.

The LIBOR replacement clause developed by us focuses on two key elements:

- Trigger – when will LIBOR be replaced?

- Waterfall – how will LIBOR Replacement Rate be determined?

As regards the trigger, the "discontinuation" of LIBOR, we came to the conclusion that no hardwired formulation is possible today because of the many uncertainties still existing. The approach taken by the international organizations, refering to official announcements of regulators or sponsors etc., did not seem appropriate to us because of the complexity of respective formulations. Accordingly we found it easier to simply refer to either a situation when the relevant Swiss Franc LIBOR is not longer available as a recognized reference rate or is no longer published. Admittedly, the respective formulations are rather open ended, but we trust in a meaningful interpretation of these wordings by market participants and their advisers on the basis of concrete factual circumstances at the time.

For the consequences of the disappearance of LIBOR we came to the conclusion that the most suitable approach to deal with existing circumstances would be a "waterfall provision":

- Firstly, the reference rate that is economically as equivalent as possible and quoted by a third party should be chosen.

- Secondly, if no such reference rate is available, we propose to rely on an add-on (which can be a positive or negative number) calculated and published by a third party with a view to bridge the gap to a new (un-)equivalent reference rate such as SARON.

- And thirdly, if neither a new third party reference rate nor a third party add-on is available, the bank shall calculate the relevant addition | deduction itself and apply such add-on in determining the new interest. Banks not prepared or equipped to take on such task could alternatively fall back on the historical levels of LIBOR prior to discontinuation, adjusted for developments in interest rates for the relevant duration since discontinuation.

Based on these considerations we have developed the following model clause that market participants may consider for the retail lending market:

1) In case that CHF-LIBOR [*is no longer available as recognized reference rate | is no longer published*], the parties agree that BANK will determine the interest rate on the basis of another reference rate that is economically as equivalent as possible. Equivalent may in particular be recognized reference rates that are calculated with a view to provide a value-neutral replacement for CHF-LIBOR denominated loans.

2) Is no such an equivalent reference rate available from a third party, and there neither is a recognized addition or deduction for an economically neutral replacement of CHF-LIBOR published, then [Alternative A: BANK shall itself determine such addition | deduction and apply it in fixing the new reference rate.] [Alternative B: the new interest rate will be determined by reference to the [average] [median] historic CHF-LIBOR rates for the last ▪ bank working days prior to the discontinuation of CHF-LIBOR, adjusted to reflect the general fluctuation of the interest rate level since the discontinuation of the CHF-LIBOR.]

3) The new reference rate will be applied for the first time for the immediately following interest period. Should the disappearance of CHF-LIBOR time-wise be very close to the commencement of the immediately following interest period, BANK may utilize [*for such next interest period | for a next interest period with a duration to be determined*] an interest rate that is based on the last available CHF-LIBOR rate.

Whatever language will be chosen by banks in the Swiss retail lending market, it will be imperative for banks and other lenders to actively and transparently communicate the manner in which they propose to manage the switch from LIBOR to a successor reference rate.

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Liberty Global to sell its Swiss operation, UPC Switzerland, to Sunrise

Reference: CapLaw-2019-05

On 27 February 2019, Liberty Global plc (Liberty Global) (NASDAQ: LBTYA, LBTYB AND LBTYK) announced that it has reached a binding agreement to sell its Swiss operation, UPC Switzerland, to Sunrise Communications Group AG (Sunrise) (SIX: SRCG). At 31 December 2018, UPC Switzerland's network passed 2.3 m homes and served 1.1 m customers. Liberty Global will sell UPC Switzerland for a total enterprise value of CHF 6.3 bn. Sunrise will acquire the business inclusive of indebtedness and other debt items with an aggregate value of approximately CHF 3.7 bn at 31 December 2018. Closing of the transaction is subject to regulatory approval and approval by Sunrise's shareholders with respect to an associated capital increase.

Oerlikon completes the divestment of its Drive Systems Segment to Dana

Reference: CapLaw-2019-06

On 28 February 2019, Oerlikon (SIX: OERL), a leading technology and engineering group, completed the divestment of its Drive Systems Segment to Dana Incorporated (NYSE: DAN) for an enterprise value of CHF 600 m, which is approximately the same amount of cash proceeds expected from the sale. Based on nearly 100 years of experience, Oerlikon Drive Systems is a global leader in providing high-performance gears, market-leading shifting solutions, power transfer units (PTUs), differentials and planetary drives, as well as innovative solutions for hybrids and e-drives.

ASSA ABLOY acquires controlling stake in agta record

Reference: CapLaw-2019-07

ASSA ABLOY AB (publ), the largest global supplier of intelligent door opening solutions listed on Stockholm Stock Exchange, indirectly acquired a 54% controlling interest in agta record ag. The share price per agta record share is EUR 70. The transaction value amounts to approx. EUR 933m. Agta record group is one of the top players in the global market for automatic pedestrian doors headquartered in Switzerland and listed on Euronext in Paris. The completion of the acquisition is subject to approval of the competition authorities. If the acquisition of the controlling interest is successful ASSA ABLOY intends to launch a public tender offer to buy out remaining shareholders.

Gyrus to acquire DuPont Sustainable Solutions (DSS)

Reference: CapLaw-2019-08

On 25 February 2019, Gyrus 1 LP, a Guernsey limited partnership acting through its general partner, Gyrus GP Guernsey Limited (Gyrus), announced that it has signed an agreement with E. I. du Pont de Nemours and Company and other selling subsidiaries of the group (DuPont) to acquire the DuPont Sustainable Solutions (DSS) business, which will be divested from DuPont to create a new, independent global operations management consulting firm. The new firm will be led and operated by the existing DSS management and supported by Gyrus Capital, an investment firm based in Geneva, Switzerland. DSS is a leading provider of world-class operations management consulting services to help organizations transform and optimize their processes, technologies and capabilities. It has more than 600 consultants and subject matter experts worldwide, serving clients in over 60 countries. Its clients come from industries such as oil and gas, chemicals/petrochemicals, mining and metals, and manufacturing. The transaction is expected to close in July 2019 pending the completion of all closing conditions.

CMA CGM declares public tender offer for CEVA Logistics successful

Reference: CapLaw-2019-09

On 28 January 2019, CMA CGM, the French shipping group, published a public tender offer for all publicly held registered shares of CEVA Logistics at an offer price of CHF 30 per share. On 19 March 2019, after the end of the acceptance period, CMA CGM announced the interim result of the public tender offer pursuant to which it held 89.47% of the share capital of CEVA Logistics. Accordingly, the offer was declared successful. The additional acceptance will run until 2 April 2019 and settlement is expected to occur on 16 April 2019.

FinSA/FinIA – Challenges, Duties, Ways of Implementation (FIDLEG/FINIG – Herausforderungen, Pflichten, Gestaltungsmöglichkeiten)

Friday, 10 May 2019, SIX ConventionPoint Zurich

https://irphsg.ch/weiterbildung/tagungen/2019-2/fidleg-finig-2019/

St. Gallen Corporate Law Day (St.Galler Gesellschaftsrechtstag)

Thursday, 23 May 2019, SIX ConventionPoint Zurich

https://irphsg.ch/weiterbildung/tagungen/2019-2/st-galler-gesellschaftsre-chtstag-2019/

In light of the changing data protection laws, CapLaw has recently released a privacy statement. The privacy statement, as updated from time to time, is available on our website (see http://www.caplaw.ch/privacy-statement/). For any questions you may have in connection with our data processing, please feel free to contact us at privacy@caplaw.ch.