

# Securitisation in Switzerland – Country Report

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This country survey focuses in its first part on recent market developments, typical structures being used, as well as some exciting new asset classes being securitised. The second part looks at selected legal, tax and regulatory issues.

## **Recent market developments**

Securitisation is an established financial technique in Switzerland, albeit one used sporadically. It is used either to meet the special needs of an originator in an one-off transaction or when market conditions for a placement of asset-backed or asset-linked securities seem particularly attractive. The principal motivation for securitisation transactions has shifted over the last 24 months from balance sheet management to funding transactions. Widening spreads and the deteriorating credit ratings of some companies have made securitisation more attractive. In particular, bank loans are often seen by corporates as too risky to meet medium to long term funding needs. This is because some loans can be terminated early based on breaches of financial covenants or material adverse change clauses. Though the number of transactions remains rather small, new and exciting asset classes are being securitised. During the last 24 months, commodity inventory and commercial mortgage loans have been added to the list of successfully securitised assets.

## **Origination: RMBS - CMBS**

2003 has seen the first Swiss CMBS transaction (“**Eiger Trust**”) with the securitisation of loans financing a portfolio of real estate which was sold two years ago by Swisscom. The vendor remains the largest tenant. The transaction permitted high LTVs and attractive funding costs, thereby establishing an interesting alternative to straight bank debt. In November 2001, Zürcher Kantonalbank took a first step toward establishing a platform in Switzerland for repeat securitisation transactions by the same or similar issuers. Its “**Swissact**” mortgage securitisation used a special purpose vehicle established by the *Pfandbriefzentrale* on behalf of the cantonal banks. This platform is meant to allow the cantonal banks (and potentially other participants) to tap the euro markets through stand-alone or joint transactions. It has long-term strategic importance because many banks, especially smaller banks, face a gap between diminishing deposits and growing assets, while lacking direct access to the capital markets. In June 2003, the first Swiss RMBS transaction (“**Tell**”) came to a successful end and investors were repaid on the expected maturity date.

### **FIFA: Sports marketing rights**

Fédération Internationale de Football Association (“**FIFA**”), the world governing body of football, completed what is believed to be the first securitisation of sports marketing rights in November, 2001. In a two-step transaction, FIFA sold receivables under sponsorship agreements with the sponsors of its international football events, including the 2002 FIFA World Cup Korea/Japan and the 2006 FIFA World Cup Germany to a Swiss SPV. The transaction was privately placed. The international aspects of this transaction provided special challenges. The key events and all sponsors are located in countries different from FIFA and this had to be taken into account in the tax and the legal analysis, particularly in the area of competition law. FIFA enjoys the exclusive right to stage and commercially exploit certain international football events, foremost among them the football World Cup competition. The competition law analysis had to cover the jurisdictions of the 2002 World Cup (Korea and Japan), the 2006 World Cup (Germany and thus the EU), Switzerland as the domicile of FIFA and certain jurisdictions where the sponsors are domiciled. Also, for the first time in a Swiss securitisation, the receivables could be subject to taxation at their source in some countries and the applicable double taxation framework became a key element in analysing the cash flows. An additional challenge was presented in the legal review of the underlying assets themselves. Sports marketing rights, their exploitation and the exclusivity linked with the rights are analysed differently in different jurisdictions. In addition, there was news about a forthcoming securitisation transaction with respect to FIFA’s cancellation insurance for the FIFA World Cup 2006 Germany.

### **Lease receivables**

Dreieck Leasing AG, a subsidiary of Banca del Gottardo, securitised a portfolio of industrial equipment leases in May, 2002 in a true sale transaction. Some of the leases were assigned to the SPV with the consent of the lessees; other leases in the portfolio were originated under lease agreements which permitted the assignment of the leases but required notice of the assignment to be given to the lessees.

### **Trade receivables**

The securitisation of trade receivables still constitutes the bulk of securitisation transactions in Switzerland. Most are placed privately. Based on dozens of transactions involving trade receivables since 1994, securitisation structures have been developed which now can be considered standard, especially if the financing is provided by a securitisation conduit. Standalone SPVs outside Switzerland have proven to be difficult because of the tax regime applied by the Swiss federal tax authorities. Still, they have been used successfully in several transactions. With respect to the cross-border assignment of future receivables there is an uncertainty under applicable international private law rules as to whether the law of the receivables (*lex causae*) or the *lex concursus* would control in the event of a bankruptcy of the originator.

### **Synthetic transactions**

In 2000, UBS AG transferred a layer of credit risk embedded in a portfolio of loans made to small and medium-sized businesses located in Switzerland to the capital markets in the “**HAT**” transaction – the first Swiss synthetic securitisation. The portfolio is actively managed by UBS AG in order to allow it to manage credit risk in its loan portfolio. It is likely that banks will use synthetic securitisation in the future instead of true sale transactions. This is because no bank other than UBS AG has yet introduced transfer language in its loan documentation for commercial loans (see below for the regulatory treatment of synthetic transactions). A second transaction, “**HAT II**”, followed in early 2003. Further bank transactions are expected to come to the market in 2003. However, they are more likely to focus on funding or regulatory arbitrage than on risk management. In July 2003, Credit Suisse closed a synthetic CLO transaction, “**Chalet**”, whereby Chalet Finance 1 P.L.C., Ireland, issued different tranches of fixed-floating rate Swiss Residential Mortgage Linked Notes denominated in U.S. dollars, euro and Swiss francs.

### **Banking regulation**

The Federal Banking Commission (“**FBC**”) gave guidance on its position with respect to the regulatory treatment of the securitisation of bank assets in 1998 and has not published any further guidelines since. The following are the key elements of the aforementioned decision by the FBC:

- (i) There are no general guidelines on which regulated entities can rely. Each and every project has, for the time being, to be submitted to the FBC for its approval;
- (ii) Provided there is a "clean" transfer of credit risk, the securitised assets will be derecognised for capital adequacy purposes;
- (iii) The SPV does not need to be consolidated by the originator, provided it can be established that it is truly independent from the originator;
- (iv) The SPV does not fall within the ambit of the Banking Act and is, thus, not a regulated entity;
- (v) The originator may perform certain additional functions without bringing the transferred assets back on its balance sheet. These functions may include the provision of a liquidity facility, the provision of credit enhancement, acting as swap counterparty, placing the securities and the purchase of an option on a maximum of 10% of the securitised assets at the end of the transaction at market value (clean-up call). The FBC may, however, in its sole discretion, limit the permitted functions in any future transaction;
- (vi) The total amount of a subordinated loan provided (or committed) by the originator has to be deducted from the bank’s capital;

- (vii) The total amount of junior notes retained by the originator have to be deducted from the bank's capital.

The approach which the FBC is taking may generally be considered favourable. The guidelines are not binding, however, and each project must be submitted to the FBC for its approval. In a more recent decision, the FBC also has accepted credit-linked structures as a means to transfer credit risk which operate to give capital relief. The FBC is expected to issue guidance on the use of credit derivatives shortly to clarify the conditions for obtaining capital relief. The rules are expected to be based on the current Basel II proposal. Unfortunately, the rules deal only with credit derivatives and not with securitisation transactions, which means that some uncertainty will remain.

### **Data protection regulation**

The assignment and transfer of receivables entails a transfer of the related customer data which qualify as personal data under the Swiss Data Protection Act ("**DPA**") which applies also to personal data of legal entities. There is no case law available and the doctrine (including the practice of the Swiss Data Protection Commissioner (the "**Commissioner**") is very spare on the issue whether a seller/assignor of receivables (i.e. transferor of personal data of the obligors) must establish a level of data protection equivalent to the Swiss level to avoid potential infringement of privacy rights. If the recipient's jurisdiction does not provide for an equivalent level of data protection, which generally has to be ensured through contractual means. Irrespective of whether an equivalent level of data protection has been established by contractual means, the Seller can be under a duty to notify the Commissioner of the planned cross-border data transfer if the debtors (data subjects) have no knowledge of such transfer.

### **Banking secrecy**

The relationship between a customer and a bank - and all its details - is subject to a strict duty of confidentiality, which if breached (even negligently) is a criminal offence. This means that banks need prior consent from their customers to allow the bank to securitise the related assets in a true sale transaction. Banks which do not want to get such a consent for administrative or marketing reasons now have recourse to credit derivatives to transfer credit risk. However, only a few banks are rated (and few are expected to be rated above "A") and few would be able to collateralise a funded transaction. It can therefore be expected that a limited waiver of the banking secrecy obligation will become standard in Swiss credit documentation.

## **Taxes**

A Swiss SPV is fully subject to income and capital tax, but only has to pay nominal taxes because the tax authorities have accepted the thin capitalisation of the SPV and the deductibility of all its expenses. In addition, securities issued by a Swiss issuer are subject to an up-front issue stamp duty at a rate of 12 basis points per annum. The interest paid to investors on the securities is subject to a 35% withholding tax. Although the withholding tax can be fully reclaimed by Swiss taxpayers (and sometimes only partially by foreign investors, subject to the availability of a double taxation treaty), the stamp duty is a cost to the issue. Issuers have long tried to overcome this cost through an issue of securities by a non-Swiss entity. Despite a long-established practice by the tax authorities which treated most structured financings involving the issue of securities outside of Switzerland as tax abusive, structures are now available which will not trigger either Swiss withholding tax on the (deemed) interest element of funds flowing to the originator. Nor will they incur issue stamp duty on the total amount of the financing. The requirements for exemption from these taxes are, however, stringent and the tax authorities consider transactions on a case-by-case basis. An advance tax ruling is therefore recommended.

## **Lex Friedrich**

The Federal Act on the Acquisition of Swiss Real Estate by Foreign Persons, the so called Lex Friedrich, has been further liberalised with respect to commercial real estate (defined as real estate used by its occupants for business purposes). This has created significant interest among non-Swiss investors.

## **Other issues**

In general, there are no legal issues which have a severe negative impact on securitisation transactions. For instance, under Swiss contract law no notification of the debtor is necessary to perfect the assignment (sale) of the receivables. Only the securitisation of future cash flows is exposed to some legal uncertainty. In addition, if goods secure the securitised receivables, the account debtors must be notified and may have to give their consent to the sale of receivables, which is often seen in Switzerland as a sign that a borrower is in difficulty. It is therefore advantageous to structure the transaction to avoid giving notice of the transaction to account debtors. Now that thinly-capitalised SPVs have been accepted by the tax authorities, a Swiss corporation (*Aktiengesellschaft*) can be used as a pay-through, on-shore SPV.

Alternatively, investment funds could be used as pass-through SPVs, but investment funds are subject to the Investment Fund Act and are supervised by the Federal Banking Commission. A burdensome licensing procedure, reporting requirements and structural restrictions for investment funds may explain why they have not been used to date. Also, only very large portfolios justify the expense of establishing and

maintaining an investment fund. From a tax point of view, Swiss investment funds are attractive (they are not subject to tax) except for the withholding tax on distributions. In many cases, there is no need to have a Swiss SPV.

## **Placement**

The placement of securities backed by or linked to assets originated outside of Switzerland continues at a slow pace. Major ABS issuers place Swiss franc tranches in Switzerland when the market environment seems attractive. A listing at the SWX Swiss Exchange follows a special set of listing rules which require detailed disclosure with respect to the assets, the structure and the risks involved. These listing rules are currently under review.

## **Conclusion**

The market moves on but, except for trade receivables transactions, it is far from being standardised and most transactions are still one-off deals. It seems, however, that Swiss banks and corporates are increasingly recognising securitisation as a powerful tool for asset and liability, risk and capital management and that this will increase the supply side of the market. The ability to list ABS securities on the Swiss Exchange makes these instruments acceptable to more than just institutional investors, thereby creating the necessary demand. The market has grown steadily and we expect that growth to now accelerate.

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