Recent developments in the Swiss securitisation market in 2020/21

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In 2020 and 2021 the public Swiss securitisation and ABS market was impacted by the COVID-19 pandemic like capital markets in general. Still, the Swiss securitisation and ABS market has proven to be relatively robust compared to other debt markets. During that period, it became clear that securitisation and ABS transactions continue to be an important tool for purposes of diversifying funding sources. In situations of market disruptions, certain funding sources might become more expensive or might not be available at all. Therefore, during the COVID-19 pandemic, constant issuers continued to tab the securitisation, ABS and covered bond markets.

The Swiss securitisation market 2020/21 – Overview

In March 2020, Cembra Money Bank AG closed another public Swiss auto lease ABS transaction. The transaction was placed just when the COVID-19 pandemic hit Switzerland and pricing occurred just a couple of days before the lockdown in Switzerland; the transaction involved the issuance by Swiss Auto Lease ABS 2020-1 GmbH of CHF250m Notes with a coupon of 0.000% with an optional redemption date in March 2024.

In June 2020, Swisscard AECS GmbH closed another public Swiss credit card ABS transaction which was the first transaction following the outbreak of the COVID-19 pandemic. The transaction involved the issuance by Swiss Credit Card Issuance 2020-1 AG of CHF190m 0.625% Class A Notes, CHF6m 1.750% Class B Notes and CHF4m 2.500% Class C Notes (all with a scheduled redemption date in 2023).

On August 18, 2020, Crédit Agricole next bank (Suisse) SA launched its CHF2bn covered bond programme.

In September 2020, AMAG Leasing AG closed a public Swiss auto lease ABS transaction involving the issuance by Swiss Car ABS 2020-1 AG of CHF250mn Notes with a coupon of 0.625% due in 2030 and, in April 2021, another public Swiss auto lease ABS transaction involving the issuance by Swiss Car ABS 2021-1 AG of CHF200m Notes with a coupon of 0.50%, due in 2031.

Finally, in June 2021, Swisscard AECS GmbH closed its latest public Swiss credit card ABS. The transaction involved the issuance by Swiss Credit Card Issuance 2021-1 AG of CHF190m 0.350% Class A Notes, CHF6m 1.000% Class B Notes and CHF4m 2.375% Class C Notes (all with a scheduled redemption date in 2024).

A number of private ABS transactions (i.e. transactions that are refinanced through ABCP platforms or through direct investors or banks) have been extended and renewed. Also, the number of trade receivable securitisation transactions involving Swiss receivables and/or Swiss sellers remained stable.

Finally, there appears to be a lot of dynamic in the residential mortgage loan space. Various players in the market seek at refinancing their mortgage loan portfolios. Structures that have been implemented include one-to-one refinancing transactions, fund structures, pension funds structures and others. Also, originators are looking at covered bond and RMBS transactions and it can be expected that a number of transactions will come to market during the next 18 months.

The market during the COVID-19 pandemic

General situation in Switzerland

The COVID-19 pandemic has disrupted markets across the world and, obviously, Swiss debt and ABS capital markets were affected as well. On March 16, 2020, the Swiss Federal Council declared the "extraordinary situation" and introduced more stringent measures, including the lockdown of schools, shops, restaurants, bars, and entertainment and leisure facilities. Certain restrictions are still in force today, even though the restrictions are not as harsh as in other European countries.

The Swiss government passed various regulations in response to the COVID-19 pandemic, including measures to avoid bankruptcies of businesses which may arise as a consequence of the COVID-19 pandemic (e.g. availability of an emergency moratorium for small and mid-cap size businesses of up to six months, subject to less formal requirements than a general composition moratorium, temporary standstill measures and others). Most of these regulations have been implemented into law that has been approved by parliaments (even though such laws are currently the subject of a referendum).

Impact of the COVID-19 pandemic on portfolios and existing transactions

Following the announcement of the lockdown, originators, issuers, investments banks and rating agencies monitored the portfolios under ongoing transactions more closely. The outbreak of the COVID-19 pandemic had a massive impact on the ability of originators to originate new assets during the months of March, April and May 2020.

Since essentially all structures in Switzerland are revolving transactions, originators in Switzerland started working on contingency plans for purposes of ensuring a proper replenishment of the portfolios or for purposes of further allowing the substitution of assets by cash. However, in June 2020, business picked up quite heavily and portfolios started to grow again. For example, in the auto lease sector, June, July and August 2020 were again record months for some originators. Accordingly, public ABS transactions proved to be very robust, even during the crisis and the situation in Switzerland appears to be under control.

Since Spring 2021, the situation is different again and auto lease companies are experiencing difficulties covering a very high demand as a consequence of disruptions in the supply chains and the delay in delivery of new vehicles.

Responses of capital markets to the COVID-19 pandemic

Capital markets in Switzerland reacted quite heavily and, as in most European countries, April and May 2020 have been very difficult months for the Swiss capital markets in general. However, already in June 2020, the first ABS transaction since the lockdown has been successfully marketed in Switzerland. Whilst coupons have been higher than in previous transactions, it was important for originators and the market more generally that this transaction was successfully placed. It would appear that the market for unsecured bonds was more difficult at that time. Accordingly, ABS has proven to be a solid and crisis resistant source of funding. In the latest transactions, coupons were lower again, even though the level remains slightly higher than prior to the outbreak of the COVID-19 pandemic.

Low interest environment in general

Swiss markets continue to be driven by the negative interest environment. The Swiss National Bank (SNB) continues to charge negative interest on bank deposits at currently minus 75bps. This is not expected to change in the near future.

As the liquidity in the markets remains at very high levels, corporate bonds and government bonds provide for very low yields and continue to be an extremely efficient funding source for corporate issuers. This holds true even in the case of a relatively low rating of the issuer. In addition, for asset managers, unsecured bonds are simple instruments and internal processes for getting to an investment decision are very efficient.

On the other hand, securitisation transactions and ABS are slightly more complex. The process for asset managers to get to an investment decision is normally more burdensome. As a result, the interest levels for securitisation transactions and ABS are relatively high compared to straight bonds, considering the lower risk profile and the higher rating.

However, it is important for issuers under securitisation transactions and ABS to continue to be present in the market and to continue being diversified. The COVID-19 pandemic and other disruptive events in the past have shown that securitisation transactions and ABS are a stable and reliable source of funding.

New prospectus regime

In a general attempt to bring the Swiss regulatory framework in line with international regulations, such as MiFID II and the EU Prospectus Directive, the Financial Market Infrastructure Act (FinMIA), the Federal Financial Services Act (FinSA) and the Financial Institutions Act (FinIA) replaced major portions of the previous regulations. The FinSA and the FinIA entered into force on January 1, 2020 along with the explanatory Financial Services Ordinance (FinSO, relating to the FinSA) and the Financial Insititutions Ordinance (FinIO, relating to the FinIA).

For the first time in Switzerland, the FinSA introduced a new comprehensive prospectus regime that covers and harmonises disclosure requirement for different types of financial instruments and establishes a level playing field with the EU Prospectus Directive. This also affects the issuance of instruments to the capital markets in securitisation transactions.

The most important novelties introduced by the FinSA in relation to the prospectus requirements are the following:

- a prospectus must also be published in secondary offerings;
- prospectus must be published in the event of any admission for trading of securities on a trading platform (not only in the case of a listing);
- a prospectus must be pre-approved prior to publication by a new regulatory body licensed as such by FINMA (reviewing body); in an attempt to keep "time to market" short, certain exemptions have been introduce for bonds and ABS issuances; accordingly, for those type of instruments, issuers are at liberty to opt for an ex post approval process and submit the prospectus for approval only post settlement;
- there are now (further) codified exemptions from prospectus requirements.


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Exemptions are based either on the type of offering, the type of securities offered or, in the case of the admission to trading only, related to the admission.

On June 1, 2020, namely five months after the introduction of the new regulatory regime, FINMA designated and granted a licence to BX Swiss AG (the Berne Stock Exchange) and SIX Exchange Regulation AG (Zurich) to act as prospectus review bodies. Hence, until December 1, 2020, issuers have been able to benefit from a transitional period and the new approval process only become mandatory from December 1, 2020.

Initially, there have been some uncertainties about the practical aspects of the prospectus approval process. However, between December 1, 2020 and August 2021, a larger number of bond transactions and ABS transactions have gone through the approval process and prospectuses have been approved by the reviewing bodies. It turned out that the approval process is relatively slim and the reviewing bodies, as contemplated by the relevant legislation, are applying a very formal approval regime (i.e. there is no review of the prospectus as to substance). Thus, some initial uncertainties around the format of the prospectuses and the practical elements of the process have been eliminated.

Still, a number of uncertainties remain for securitisation transactions and ABS transactions. As an example, the FinSO requires issuers to disclose in the prospectus the financial statements of the past two years. There is not really a clear exemption for securitisation SPVs (which are typically just newly incorporated prior to the launch of a transaction) but given that ABS are explicitly referred to in the FinSO, it must be concluded that not disclosing such financial statements is permissible, if not available.

Also, the FinSO requires newly incorporated issuers to disclose in the prospectus an audited opening balance sheet. Normally, in the context of a securitisation or ABS transaction, assets are only transferred to the issuer on settlement. Accordingly, the opening balance sheet only shows the (initial) paid-in capital and a small amount of cash and that information is obviously not relevant at all for investors to make an investment decision. Still, as the requirement is quite explicit, most issuers decided so far to go through the process of auditing the opening balance sheet of the issuing SPV and disclose it in the prospectus.

Tax

Current status

Unlike most other countries, Switzerland does not levy withholding tax on interest paid on private and commercial loans (including on arm's-length inter-company loans). Rather, 35% Swiss Federal withholding tax is levied on interest paid to Swiss or foreign investors on bonds and similar collective debt instruments issued by or on behalf of Swiss resident issuers (such as Swiss ABS), as well as on interest paid by Swiss banks.

International capital markets do not typically respond well to bonds subject to Swiss withholding tax. Therefore, the investor based is relatively often limited to Swiss investors, or, in the case of Swiss multinational groups, bonds are issued through a foreign subsidiary.

However, the Swiss Federal Tax Administration (SFTA) reclassifies such foreign bonds into domestic bonds if the amount of proceeds used in Switzerland exceeds certain thresholds (i.e. the combined accounting equity of all non-Swiss subsidiaries of the Swiss parent company and the aggregate amount of loans granted by the Swiss parent and its Swiss subsidiaries to non-Swiss affiliates).

In order to prevent Swiss Federal withholding tax from being imposed on normal loans (in contrast to bonds triggering such tax anyway), credit facility agreements entered into by a Swiss borrower, or a non-Swiss borrower under a guarantee from a Swiss parent company, must contractually restrict free transferability and syndication by invoking the so-called '10/20 non-bank rules' and stating that:

(i) the lenders must ensure that while the loan in question is outstanding, no assignments, transfers or relevant sub-participations of loan tranches will be made, as a result of which the number of 10 non-bank lenders would be exceeded; and

(ii) the borrower must ensure that it will at no time have more than 20 non-bank lenders under any of its borrowings (in both cases generally disregarding any affiliated lenders). In the context of securitisation transactions, this is relevant in the case of single investor transactions and transactions with very few investors (less than 10), ABCP transactions that are refinanced through a single multi-issuances platform.

Fundamental changes envisaged by Federal Council

The Federal Council will, in response to its consultation document, submit a request to Swiss Parliament that withholding tax on bonds be abolished.

On April 3, 2020, the Swiss Federal Council initiated a consultation process (*Vernehmlassung*) regarding the planned reform of the Swiss Federal withholding tax. The reform originally intended replacing the current debtor-based regime applicable to interest payments with a paying agent-based regime for Swiss Federal withholding tax. Under such a paying agent-based regime, if introduced, a Swiss paying agent would need to levy and pay Swiss Federal withholding tax on interest payments on the Notes, if the beneficiary were an individual resident in Switzerland.

As a consequence of the consultation process, the Swiss Federal Council, on September 11, 2020, resolved on an abolishment of Swiss withholding tax on interest payments (with the exception of interest payments on domestic bank accounts and deposits to Swiss resident individuals), without substitution, and it submitted a corresponding legislative project to the parliamentary process on April 14, 2021.

Comment

The abolition of Swiss withholding tax on bonds and other collective debt financings should significantly strengthen Switzerland's position as financial market and treasury centre. All types of financing and refinancing activity in Switzerland (e.g. raising of capital via bond issuances, crowdfunding platforms, ABS structures and other capital market transactions) will be facilitated. This fundamental change of the Swiss withholding tax regime is expected to come into force not before January 1, 2022.

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