

THE LENDING
AND SECURED
FINANCE REVIEW

FIFTH EDITION

Editor
Azadeh Nassiri

THE LAWREVIEWS

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CONTENTS

PREFACE.....	vii
<i>Azadeh Nassiri</i>	
Chapter 1 AUSTRIA.....	1
<i>Leopold Höber</i>	
Chapter 2 BELGIUM	12
<i>Yves Brosens and Britt Vanderschrick</i>	
Chapter 3 BRAZIL.....	22
<i>Bruno Balduccini and Roberto Panucci Filho</i>	
Chapter 4 CANADA.....	33
<i>Jean E Anderson, David Wiseman, David Nadler, Carrie B E Smit, Caroline Descours and Cathy Costa-Faria</i>	
Chapter 5 CHINA.....	50
<i>Gulong Ren</i>	
Chapter 6 ENGLAND AND WALES.....	61
<i>Azadeh Nassiri, Kathrine Meloni and Adam Burk</i>	
Chapter 7 FRANCE.....	78
<i>Karine Sultan, Yves Rutschmann, Charlotte Bonsch, Béna Mara, Gaël Rivière and Guillaume Wulfowicz</i>	
Chapter 8 GERMANY.....	93
<i>Christian Schmies, Nikolaus Vieten and Jens Wenzel</i>	
Chapter 9 HONG KONG	103
<i>Peter Lake</i>	

Contents

Chapter 10	INDIA	117
	<i>L Viswanathan and Dhananjay Kumar</i>	
Chapter 11	INDONESIA.....	133
	<i>Sri H Rahayu, Indra Prawina and Indriana Pramesti</i>	
Chapter 12	ITALY	147
	<i>Giuseppe Schiavello and Micol Mimun</i>	
Chapter 13	JAPAN	157
	<i>Hiroki Aoyama and Keigo Kubo</i>	
Chapter 14	LUXEMBOURG.....	165
	<i>Henri Wagner and François Guillaume de Liedekerke</i>	
Chapter 15	NETHERLANDS.....	183
	<i>Menno Stoffer and Pieter Hooghoudt</i>	
Chapter 16	NIGERIA.....	193
	<i>Kofo Dosekun, Oludare Senbore, Oritsemone Awala-Velly and Nafisa Adama</i>	
Chapter 17	NORWAY.....	204
	<i>Audun Nedrelid and Markus Nilssen</i>	
Chapter 18	PHILIPPINES	212
	<i>Vicente D Gerochi IV and Camille Angela M Espeleta</i>	
Chapter 19	SPAIN.....	221
	<i>Ángel Pérez López, Pedro Ravina Martín and Blanca Arlabán Gabeiras</i>	
Chapter 20	SWEDEN.....	234
	<i>Eric Halvarsson and Fredrik Gillgren</i>	
Chapter 21	SWITZERLAND	242
	<i>Patrick Hünerwadel, David Ledermann and Marcel Tranchet</i>	
Chapter 22	TAIWAN.....	251
	<i>Abe Sung and Mark Yu</i>	
Chapter 23	TURKEY.....	259
	<i>Sera Somay</i>	

Chapter 24	UNITED STATES	273
	<i>Monica K Thurmond</i>	
Chapter 25	VIETNAM.....	284
	<i>Duong Thu Ha, Vu Dieu Huyen and Pham Minh Thang</i>	
Appendix 1	ABOUT THE AUTHORS.....	297
Appendix 2	CONTRIBUTORS' CONTACT DETAILS.....	315

PREFACE

This fifth edition of *The Lending and Secured Finance Review* contains contributions from leading practitioners in 25 different countries, and I would like to thank each of the contributors for taking the time to share their expertise on the developments in the corporate lending and secured finance markets in their respective jurisdictions, and on the challenges and opportunities facing market participants. I would also like to thank our publishers without whom this review would not have been possible.

I hope that the commentary that follows will serve as a useful source for practitioners and other readers.

Azadeh Nassiri

Slaughter and May

London

June 2019

SWITZERLAND

*Patrick Hünérwadel, David Ledermann and Marcel Tranchet*¹

I OVERVIEW

With a competitive tax system, stable political environment and skilled workforce, Switzerland is home to a large number of corporations and to important subsidiaries of many large international groups across a broad range of industries. As a result, there is very frequently a Swiss component to lending and secured finance transactions.

The corporate lending market in Switzerland is a well-developed and stable market with experienced participants (banks, borrowers and advisers). Where Swiss borrowers are involved, the market is largely in the hands of banks (Swiss and non-Swiss). On occasion, certain other professional investors (e.g., pension funds and insurance companies) are involved in the corporate lending market in Switzerland. On leveraged finance transactions (especially transactions arranged in the United States but with a Swiss component), it is not uncommon to see specialised lending entities (e.g., debt funds) participate.

Over the past few years, including during the financial crisis, the Swiss corporate lending market has managed to remain stable. It has not had much of a downturn during and after the financial crisis and has seen a low number of distressed borrower situations. Recently, a significant uptrend in acquisition financing transactions could be observed in Switzerland and a high availability of debt generally.

II LEGAL AND REGULATORY DEVELOPMENTS

Regulatory developments have not recently had a major impact on the corporate lending market in Switzerland or on documentation. Increased capital and liquidity requirements did have somewhat of an impact in that the regulatory efforts aimed at reducing the balance sheets of major banks (e.g., the leverage ratio) have the effect of putting a limit on the overall volume of available credit. Also, increased attention is, on occasion, paid to collateral aspects of lending transactions to ensure that the particular transaction can be treated as a secured transaction for regulatory purposes. Other areas that have gained more attention in the context of corporate lending transactions generally are the areas of sanctions and anti-corruption regimes, and the expected discontinuation of LIBOR and other interbank offered rates.

¹ Patrick Hünérwadel, David Ledermann and Marcel Tranchet are partners at Lenz & Staehelin.

III TAX CONSIDERATIONS

Under Swiss domestic tax laws, interest payments by a Swiss borrower under a bilateral or syndicated financing are, as a rule, not subject to Swiss withholding tax if the Swiss tax law rules commonly referred to as the Swiss non-bank rules are complied with.

These rules address, among other things, a potential tax recharacterisation of a borrowing that is not subject to Swiss withholding tax into a public bond issue that is subject to withholding tax. This Swiss withholding tax law issue is triggered where:

- a* a syndicate consists of more than 10 lenders that are not licensed as banks (the 10 non-bank rule);
- b* a Swiss obligor has, on an aggregate level (i.e., not on a transaction-specific level), more than 20 creditors that are not licensed as banks (the 20 non-bank rule); or
- c* a Swiss obligor has, on an aggregate level (i.e., not on a transaction-specific level), more than 100 creditors that are licensed as banks, under financings that qualify as deposits within the meaning of the relevant rules (the 100 non-bank rule).

A breach of the Swiss non-bank rules can result in the applicability of Swiss withholding tax (currently at a rate of 35 per cent). Such tax would have to be withheld by the Swiss obligor.

A standard tax gross-up clause may, in light of a related prohibition in the Swiss Withholding Tax Act, not be valid and enforceable in Switzerland, in particular where the reason for the withholding tax is a breach of any of the Swiss non-bank rules. To tackle this issue, there is, in practice, an attempt to achieve the same commercial result by means of a clause that provides for a recalculation of the applicable rate of interest, rather than the payment of a grossed-up amount, if a tax deduction is triggered. It is untested in courts where such clauses are valid and enforceable.

A particular tax at source applies to payments secured by Swiss real estate when made to non-Swiss lenders, unless exempted under the applicable double taxation treaty.

No stamp or documentary taxes are payable in Switzerland in respect of the execution or delivery of loan and security documentations as a condition to the legality, validity, enforceability or admissibility in evidence thereof in Switzerland. Notary fees and registration duties may be payable with respect to documents that are drawn up as public deeds, or need to be filed with a registry (e.g., security on real estate, title retention).

Where participations in a loan are evidenced by debt recognitions or instruments that are taxable under the Swiss Stamp Tax Act, a transfer thereof made by securities dealers (as defined in the Swiss Stamp Tax Act) as a principal or intermediary are subject to Swiss federal turnover taxes.

Finally, it is common practice in the Swiss market to insert Foreign Account Tax Compliance Act provisions in finance documents. These provisions are typically largely based on the corresponding recommendations published by the Loan Market Association but typically provide for certain changes reflecting market practice in Switzerland.

IV CREDIT SUPPORT AND SUBORDINATION

i Security

Taking a valid and enforceable security interest over assets and rights located in Switzerland or governed by Swiss law typically requires that appropriate security agreements governed by Swiss law be entered into.

As a matter of Swiss conflict of laws rules, the security provider and the secured party are generally free to choose the governing law of the security documents (with certain exceptions). However, Swiss conflict of laws rules typically provide that such a choice of law is not enforceable against third parties, including the creditors of the security provider. Given the importance of enforceability of collateral, it is, therefore, market practice for assets and rights located in Switzerland or governed by Swiss law to put in place Swiss law-governed security documents, providing for jurisdiction in Switzerland.

Swiss law does not allow the taking of a floating charge or 'blanket' security (or similar security concepts), namely the granting of a security interest over all or substantially all assets and rights of the security provider, irrespective of their type or nature. Swiss law provides that, for a security interest to be validly granted, the assets and rights to be covered by the security interest have to be clearly identified or identifiable, and the substantive requirements for each type of asset or right have to be complied with. This is one of the reasons for which it is market practice in Switzerland that separate security documents are prepared for each security asset class and one does not see, in the Swiss market, single security documents in relation to all or various asset classes.

The scope of a Swiss security package is determined on a case-by-case basis and is driven by a number of factors, including what the meaningful assets of the particular security provider or group are. The following asset classes are typically considered: shares, bank accounts, receivables and other contractual rights, real estate, intellectual property rights and, on occasion, tangible movable property.

Shares

The creation of a security interest over shares of a Swiss company (either a corporation limited by shares or a limited liability company) takes the form of a pledge. The creation of a valid pledge over shares of a Swiss company requires the parties to enter into a written pledge agreement. There is no requirement for such an agreement to be notarised and it can be entered into in counterparts.

The requirements for creating a share pledge governed by Swiss law depend on whether the shares are certificated or dematerialised. Also, certain special rules apply where shares constitute book-entry securities within the meaning of the Swiss Book-Entry Securities Act.

If the relevant shares are certificated, the creation of the pledge requires that the physical share certificates be delivered to the pledgee or its agent. If the shares are registered shares, the share certificate must be endorsed or assigned (and it is customary to require that the share certificate delivered to the pledgee be endorsed in blank by the pledgor).

If the relevant shares are dematerialised (i.e., not certificated), the perfection of the pledge requires that the pledgee and the bank holding the pledged shares in custody enter into a written control agreement, whereby the bank will act for all practical purposes as pledge holder for the benefit of the pledgee.

Registered shares of Swiss corporations are often subject to share transfer restrictions (i.e., provisions that condition the transfer of title to the shares to the approval of the board of directors of the issuer of the pledged shares). As the board of directors of the issuer may not be cooperative in an enforcement scenario, it is customary for secured lenders to require that any such transfer restrictions be removed prior to the pledge being granted. Eliminating share transfer restrictions requires an amendment to the articles of association, which requires, among other things, a shareholders' meeting held before a notary public. This process takes some time and it is, therefore, best to address this issue early in the process.

Share pledge agreements typically also contain provisions dealing with the exercise of voting rights and rights to any dividend payments. Typically, the pledgor retains the right to vote the pledged shares as long as no event of default (or similar event) has occurred. Voting rights can then be exercised by the pledgee or its agent upon the occurrence and during the continuance of such an event. With respect to dividend rights, these rights are also typically pledged, but it is customary to provide that the pledgor is entitled to collect dividends as long as no event of default has occurred. It is often also provided that dividend payments are to be made to a pledged account.

Bank accounts

The creation of a security interest over a bank account is somewhat a misnomer in that the actual asset on which a security interest is created is the claim of the bank account holder against the bank for any amount standing to the credit of the bank account. Creating a security interest over a bank account can take the form of a pledge or of an assignment for security purposes. Both types of security interests require a written agreement (no notarisation is required), and no other step is legally required for perfecting such a security interest. However, until the account bank is notified of the security interest, it may freely pay any amount due to the account holder or to a designated payee. It is, therefore, customary to notify the account bank of the creation of the security interest with the result that the account bank may then only discharge its payment obligations towards the account holder with the consent of the secured creditor.

Bank accounts held with Swiss account banks are governed by the general terms and conditions of the relevant bank. The general terms and conditions typically provide for a general right of pledge and a right of set-off (and sometimes for certain additional similar rights) in favour of the bank. Unless the general pledge and right of set-off are waived by the account bank, they rank senior to the security interest of the secured lenders. It is, therefore, customary for secured lenders to request that such rights be waived. As banks are often reluctant to waive such rights, it is best to address this issue early in the process, and the compromise is often to seek and obtain a waiver, which carves out claims for reasonable fees of the account bank from the waiver.

Receivables and other contractual rights

Creating a security interest over receivables or other contractual rights can take the form of a pledge or of an assignment for security purposes. Both types of security interests require a written agreement (no notarisation is required) and no other step is legally required for creating such a security interest. Same as for a bank account security, the notification of the security interest to the debtor of the receivables is not a requirement for the validity of the security interest, but is advisable to protect the secured lenders. There are two other reasons for which an early notification is in the interest of the secured lenders: without notification, the assigned debtor can (1) validly raise against the assignee any defence or objection (including set-off) it could have raised against the assigned debtor at the time of the assignment notification; and (2) validly set off against the assignee a claim that was not due at the time of the assignment notification, provided the claim did not become due after the assigned claim.

It is, therefore, market practice that the security interest be notified to the assigned debtor, but the timing of the notification depends on the types of receivables or rights.

For trade receivables for which there is often some sensitivity on the part of the security provider to see its clients and customers being notified of a security interest, it is often the case that notification is made upon the occurrence of an event of default only, or upon it otherwise becoming necessary in the discretion of the secured party to protect the security interest. Also, the security provider is often required to grant a security interest over the bank accounts to which payments are made by the assigned debtors.

With respect to intercompany receivables or other rights where there is less sensitivity to immediately disclose the existence of a security interest (such as a security interest over insurance claims), it is customary to provide that the existence of the security interest is notified to the relevant assigned debtor concurrently with the entering into of the security document.

Under Swiss law, it is possible to create a security interest not only in relation to existing receivables but also in relation to future receivables, provided they can be identified upon coming into existence. This requirement is satisfied when such future receivables are identified as arising in the ordinary course of the business of the assignor. However, from a practical standpoint, this designation would be of little use to the secured creditors without a periodic reporting of the grantor of the outstanding receivables, identifying the amount, nature and debtors of the receivables covered by the security interest. Without this information, it may be not be possible for the secured creditors (or their security agent) to notify the security interest to the relevant debtors, or enforce or collect the receivables or rights.

Tangible movable property

Creating a security interest over tangible movable property would take the form of a pledge and requires a written pledge agreement (no notarisation is required).

As perfection of the pledge over tangible movable property requires the security provider to transfer possession over the pledged assets to the secured lenders (or their security agent). It is because of this requirement that taking a security interest over operational movable assets (such as inventory, work in progress or industrial tooling) is usually not compatible with operational requirements of the security provider and is therefore an infrequent form of security in Switzerland.

Where the security provider stores tangible movable property with third parties (e.g., an oil refiner storing crude or refined products in storage capacities owned by a storage operator), it may be possible to create a valid security interest over the tangible movable property with the third parties acting as pledge holders.

Real estate

In the context of secured lending, taking a security interest over real estate located in Switzerland usually takes the form of a transfer for security purposes of a mortgage note charging the relevant real estate property. Secured lenders should pay attention to restrictions that may affect residential real estate deriving from the Swiss Federal Law on Acquisition of Real Property by Foreigners. Also, as mentioned in Section III, a tax at source may apply to interest payments secured by Swiss real estate when made to non-Swiss lenders (exceptions under applicable double taxation treaties).

Intellectual property rights

Creating a security interest over intellectual property rights would take the form of a pledge and requires a written pledge agreement (no notarisation is required). From a Swiss law perspective, no other step is generally required for perfecting such a security interest, bearing

in mind that with respect to registered intellectual property rights (trademark, patents, design rights) the pledge would only become enforceable towards good-faith third parties upon the pledge being registered with the relevant intellectual property register. In practice, such a registration is often a post-closing item.

Security agent

It is possible under Swiss law that security is granted to, and held by, an agent, and security documents can be drafted so that it is not necessary to amend them upon a change of the secured parties. Where the security interest is a security assignment or a security transfer, the security agent can act in its own name for the benefit of the secured parties. Where the security interest is a right of pledge, it is necessary that the security agent act as direct representative of the secured parties (i.e., in the name and on behalf of the secured parties). The reason for this is that a Swiss law pledge is accessory in nature, meaning, among other things, that the secured party must be identical to the creditor. This can be achieved by having the security agent act as a direct representative, which is the standard approach in Switzerland when accessory security interests are involved (with exceptions for very specific transactions, where it might be necessary to adopt another approach). An alternative approach would be to create a parallel debt and to secure this parallel debt, as this is done in a number of other jurisdictions. However, the concept of parallel debt remains untested in Switzerland and doctrine is scarce. It is for this reason that the parallel debt concept is not frequently used in Swiss security documents (at least not on a stand-alone basis).

ii Guarantees and other forms of credit support

There are two types of guarantee instruments: the guarantee (Article 111 of the Swiss Code of Obligations) and the suretyship (Article 492 et seq. of the Swiss Code of Obligations).

Guarantee

Article 111 of the Swiss Code of Obligations provides that whoever promises to another person the performance by a third person of a certain act is obligated to compensate such person for the financial prejudice arising therefrom if the performance does not occur. Under Swiss law, a guarantee is an undertaking independent of the validity of the guaranteed obligation between the debtor and the creditor; in other words, it constitutes a primary and independent obligation that typically is not subject to any defence or objection that relates to the guaranteed obligation. No specific form is required under Swiss law for a guarantee, although the written form is usual. The indication of the maximum amount guaranteed is not required.

Suretyship

A suretyship is an obligation that is accessory in nature. Its validity depends on the validity of the underlying obligation. Therefore, a guaranteed party is only in a position to exercise its rights under a suretyship to the extent the underlying obligation is valid, due and enforceable. As a result, a surety is subject to the defences and objections of the debtor of the underlying obligation. A 'simple suretyship' requires that the principal debtor be adjudicated bankrupt or subject to composition proceedings before it can be acted upon. A 'joint suretyship' allows

the guaranteed party to act upon default of the debtor under its primary obligation. Formal requirements are required in connection with suretyship agreements, such as that it be made in writing and provide for a maximum amount.

In practice, the form of the guarantee is the dominant form in a corporate lending context. Also, in the context of international secured financing transactions where the facility agreement would often be governed by English or New York law, a guarantee provided by a Swiss guarantor would often also be governed by English or New York law. There is no requirement under Swiss law that the guarantee issued by a Swiss guarantor be governed by Swiss law.

iii Priorities and subordination

The priority of a security interest depends on the types of assets considered:

- a* with respect to real estate, the priority results from the entry of the mortgage or mortgage note into the land registry;
- b* with respect to certificated shares, the perfection of a security interest is subject to a transfer of possession, so that third parties should not be able to take subsequent security over these assets without the consent of the pledgee; and
- c* with respect to trade receivables or other receivables, the order of priority is set by chronological order with the first security interest granted being senior to any security interest granted subsequently.

Where applicable, subordination is typically effected by contractual agreement in an intercreditor agreement. Also, in line with international practice, it is not uncommon to provide for structural subordination in financing transactions with different layers of debt.

V LEGAL RESERVATIONS AND OPINIONS PRACTICE

In the context of group-wide financing transactions and acquisition financing transactions, lenders frequently request that all significant group companies provide guarantees or other security interests.

It is the prevailing view in Switzerland that the provision of upstream guarantees (i.e., guarantees for obligations of direct or indirect shareholders of the guarantor) and cross-stream guarantees (i.e., guarantees for obligations of sister companies of the guarantor) is subject to a number of requirements and restrictions.

Essentially, it is held that these guarantees should be treated as the equivalent of a dividend distribution as far as formal and substantive requirements and limitations are concerned. The key implication of this is that upstream and cross-stream guarantees are, in practice, limited to the amount that the guarantor could distribute to its shareholders as a dividend at the time payment is demanded under the guarantee. This limitation is sometimes referred to as the 'free equity limitation'. Also, payments under upstream or cross-stream guarantees may be subject to tax implications, including Swiss withholding tax implications.

Downstream guarantees (i.e., guarantees for obligations of subsidiaries of the guarantor) are not typically subject to restrictions. Exceptions are possible under certain circumstances, for instance, if the subsidiary is not a wholly owned subsidiary of the guarantor or if it is in significant financial distress.

The requirements and limitations applicable to upstream and cross-stream guarantees, as referred to above, are also applicable to upstream and cross-stream security interests.

Where, in the context of an acquisition, a Swiss entity (e.g., the target) provides guarantees and security interests for obligations of the acquirer (which will become the parent company of the Swiss target as a result of the acquisition), the Swiss security package would be upstream in nature and thus subject to the various requirements and limitations, including the free equity limitation. Other issues may arise in such transactions, especially where there are minority shareholders at the level of the target.

A number of steps are taken in practice to bolster the validity of an upstream security package and to mitigate, as far as possible, the imperfections of such security packages. The starting point is to make sure that the articles of association of the Swiss entity explicitly permit upstream undertakings. It is also important to ensure that the finance documents and the transactions contemplated thereby are properly approved by the relevant corporate bodies. In addition, finance documents will typically address the free equity limitation and certain Swiss withholding tax law points, and they will also typically provide for certain undertakings and assurances by the security provider to mitigate, as far as possible, the upstream limitations. Furthermore, parties are typically advised, for corporate law and tax law reasons, to compensate the Swiss entity for the granting of the upstream security package by means of a guarantee fee or security fee.

Under Swiss conflict of laws rules, parties have extensive freedom to agree on the law that should govern their loan documentation, along with the pertaining security documentation. With respect to the latter, certain limitations apply as set out under Section IV. Further, parties have flexibility to agree on a foreign jurisdiction with respect to their loan and security documentation. Final decisions for monetary claims of competent foreign courts are recognised in Switzerland on the basis of either a particular treaty law (such as the Lugano Convention) or Swiss international private law, provided that the proceedings leading up to the decision comply with basic principles of fair process (as described under the treaty or Swiss international private law), and the decision as to its substance does not violate Swiss public policy.

Generally, finance parties request legal opinions in international financing transactions, but it is also standard practice for domestic syndicated financing transactions and for certain domestic bilateral financing transactions. Such opinions may be limited to the capacity of a Swiss party to enter into a financing transaction, but often the request for such opinions will be to (also) cover validity and enforceability matters. Tax opinions are frequently requested as well. There are no strict rules as to which counsel renders what opinion. Market practice in Switzerland is that the enforceability opinion is rendered by counsel to the lenders. At times, capacity, due authorisation and execution are carved out from the enforceability opinion and covered in a separate capacity opinion rendered by counsel to the obligors. The addressees of these opinions are the finance parties at signing and with limitations (e.g., primary syndication) persons that become finance parties after signing. Opinions may typically be disclosed, but not be relied upon, where legally required, to regulators or advisers of a finance party, and also to affiliates of a finance party.

VI LOAN TRADING

In Switzerland, the most common methods of loan trading are assignments of the rights of an existing lender under a particular financing to a new lender (or to another existing lender), and transfers of all rights and obligations of an existing lender under a particular financing to a new lender (or to another existing lender).

Sub-participations and other forms of credit risk exposure transactions are also seen in practice but less frequently.

No institutionalised markets exist in Switzerland for loan trading. The loan trading market in Switzerland is a bilateral market. Also, borrowers very typically have a consent right to any trading transactions in their loans (except in the case of an event of default), meaning that borrowers very typically need to get involved when loans are traded.

Also, in light of the Swiss non-bank rules (see Section III), facility agreements will typically provide for certain restrictions applicable to loan trading transactions (e.g., a limitation on the maximum number of non-bank lenders in the syndicate and restrictions on the types of permissible credit risk exposure transactions). Also, in structured transactions, tax rulings are obtained on occasion.

VII OUTLOOK AND CONCLUSIONS

No legal or regulatory developments are currently pending in Switzerland that are expected to have a material impact on the Swiss lending market or its documentation. The low interest rate environment will likely continue to be a factor that has an impact on the corporate lending market. Also, the debt capital markets have been fairly open for a while and continue to be open, including to issuers that may not have been able to tap the debt capital market in the past.

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