

Recent developments in the Swiss securitisation market in 2021/2022

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IN 2021 AND 2022 THE PUBLIC AND PRIVATE SWISS SECURITISATION AND ABS MARKET HAS PROVEN TO BE RELATIVELY ROBUST AS COMPARED TO OTHER DEBT MARKETS. DURING THAT PERIOD, IT BECAME CLEAR THAT SECURITISATION AND ABS TRANSACTIONS CONTINUE TO BE AN IMPORTANT TOOL FOR THE PURPOSES OF DIVERSIFYING FUNDING SOURCES.

In situations of market disruption, certain funding sources might become more expensive or might not be available at all. Also, whilst the arbitrage between interest rates for ABS and straight bonds was not appropriate during the low interest period, there are reasonable grounds to believe that this will change as central banks are increasing policy rates.

CHF4m 2.375% Class C Notes (all with a scheduled redemption date in 2024).

In November 2022, AMAG Leasing AG established a new auto covered bond program and issued an initial tranche CHF260m 0.00% due 2025; further issuances followed.

Overview

In April 2021, AMAG Leasing AG closed a public Swiss auto lease ABS transaction involving the issuance by Swiss Car ABS 202-1 AG of CHF200m Notes with a coupon of 0.50%, due in 2031.

In June 2021, Swisscard AECS GmbH closed a 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).

In June 2022, Swisscard AECS GmbH closed a public Swiss credit card ABS. The transaction involved the issuance by Swiss Credit Card Issuance 2022-1 AG of CHF190m 0.350% Class A Notes, CHF6m 1.000% Class B Notes and



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A number of mortgage-backed covered bond transactions have been brought to market. As an example, in September 2022, Corner Banca SA established its new covered bond program and issued an initial tranche CHF100m 2.25% fixed rate notes due 2027.

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.

There is considerable activity in new asset categories, such as royalty cash flows securitisations, asset subscription securitisations and others. All of these transactions are, however, set up as non-public transaction.

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 transactions and in addition to those covered bond issuers already present in the market, it can be expected that a number of additional transactions will come to market during the next 12 months.

Increasing interests

During the last couple of years, corporate and government bonds provided for very low coupons and yields. In addition, under the Swiss prospectus regime, straight bonds can be issued very efficiently and time to market is very short. Hence, transaction costs are considerably lower. Finally, 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. Transaction costs are higher and time to market is, even for repeating issuers, significantly longer. Also, the process for asset managers to get to an investment decision is normally more burdensome.

As a result, issuers and investors focused on straight bonds and, consequently, the pricing on straight bonds was very attractive. ABS transactions, even with AAA senior tranches, priced relatively high. Markets did not correctly price the higher rating and the lower risk profile of the ABS.

Since June 2022, the Swiss National Bank has increased the policy rate from -0.75% to -0.25% in a first step and to +0.50% in a second step.

It is a fair expectation that higher interest rates are likely to restore an appropriate arbitrage between straight bonds and ABS. Also, it continues to be important for issuers under securitisation transactions and ABS to continue to be present in the ABS 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 and listing rules

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 Institutions 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.

Following the designation of BX Swiss AG (the Berne Stock Exchange) and SIX Exchange Regulation AG (Zurich) by FINMA to act as prospectus review bodies, the new prospectus regime mandatorily applied since December 1, 2020.

Initially, there have been some uncertainties about the practical aspects of the prospectus approval process, but 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.

As the Swiss regime treats securitisation transactions, including asset backed securities like bonds, prospectus for securitisation transactions generally have to meet the requirements of a prospectus for bonds. Still, a number of special rules apply to securitisation transactions.

Disclosure rules (prospectus) as per the Swiss Financial Services Ordinance: In addition to the general prospectus requirements, a prospectus for ABS must contain certain additional disclosure information:

- Transaction summary that summarises the key elements and characteristics of the transaction structure, the risks associated to the investment in the notes (by reference) and the possibility and manner how to enforce the investors' rights;
- Reference to the detailed information in the prospectus and description of transaction documents;
- Transaction overview, including:
 - o key elements of transaction structure, transaction parties, interests of parties involved, cash flows, credit enhancement and early amortisation events and events of default;
 - o description of assets that back the notes and associated risks;
 - o three year historical data on asset pool, including delinquency and default rates and information on

the advance rate, risks, including counterparty risks;

- o legal risks;
- o other significant risks related to the structure and the asset pool.

There remain a number of uncertainties for securitisation 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, but given that ABS is 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 have so far decided to go through the process of auditing the opening balance sheet of the issuing SPV and disclose it in the prospectus.

Three year track record and minimum equity capital.

According to the listing rules issued by the SIX Swiss Exchange, an issuer of debt securities must be pre-existing for three years. However, ABS issuers (which are typically newly incorporated SPVs) benefit from an exemption.

According to the listing rules issued by the SIX Swiss Exchange, an issuer of debt securities must have a minimum equity capital of CHF25m. However, ABS issuers benefit from an exemption and that requirement does not apply.

Tax

10/20 non-bank rules – Political developments and the public vote of September 2022. Under the current Swiss withholding tax regime, 35% Swiss Federal withholding tax

is levied on interest paid to Swiss or foreign investors on bonds and similar collective debt (including ABS). It should be noted that any financing (including credit financings) may be subject to such a treatment in the event that the number of non-bank creditors under such a financing exceeds ten.

On April 3, 2020, the Swiss Federal Council initiated a consultation process (Vernehmlassung) regarding a planned reform of the Swiss Federal withholding tax. The reform originally intended to replace the current debtor-based regime applicable to interest payments with a paying agent-based regime for Swiss Federal withholding tax. As a consequence of the consultation process, the Swiss Federal Council, on September 11, 2020, decided to abolish 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 Parliament on April 14, 2021.

The abolition of Swiss withholding tax on bonds and other collective debt financings aimed to strengthen Switzerland's position as a financial market and treasury centre. All types of financing and refinancing activities in Switzerland (eg, raising capital via bond issuances, crowdfunding platforms, ABS structures and other capital market transactions) would have been facilitated.

A referendum was initiated against such a legislative project (and the abolition of the Swiss withholding tax on interest payments) and the project therefore brought to a public vote by the people of Switzerland. On September 25, 2022, the Swiss people declined the new legislative project with 52% of voters being against the reform.

Accordingly, the Swiss withholding tax regime remains unchanged and it is worthwhile summarising the current regime again.

10/20 non-bank rules – Swiss withholding tax. Unlike most other countries, under the current Swiss withholding tax regime, 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. According to the Swiss Federal Tax Administration and the relevant regulations, credit facilities also qualify as collective debt instruments, if syndicated outside of the banking market and, as a result, there are more than 10 non-bank lenders in the syndicate.

International capital markets do not typically respond well to bonds subject to Swiss withholding tax. Therefore, the investor base 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 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).

Swiss withholding tax may be structured away in case a single entity is interposed between the Swiss originator/ issuer and the investors. However, this entity must qualify as real (single) counterparty and be confirmed as such by the Swiss federal tax administration by tax ruling confirmation. In that case, the transaction would no longer qualify as a collective debt funding, but rather as single counterparty transaction. In case it is not qualified as real (single) counterparty, the Swiss federal tax administration would apply a look through approach and the issue of Swiss withholding tax would arise again.

Typically, an entity is regarded as real (single) counterparty in case it is pre-existing (i.e. it has not been incorporated for purposes of a specific transaction), several transactions have been or will be set up using that counterparty and the volume of (expected) transactions is substantial as compared to the volume of the relevant single transaction.

As mentioned, that analysis must be confirmed by a tax ruling issued by the Swiss federal tax administration on a case by case basis for each single transaction.

From experience, pre-existing conduit platforms, ABCP platforms, funds and similar counterparties would qualify as real (single) counterparty for tax purposes and tax rulings have been confirmed regularly in such situations.

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