BÄR & KARRER

Briefing Update as of 10 November 2020

Liquidity Supply for the Swiss Economy in Response to COVID-19

The Swiss economy is severely affected by the consequences of the coronavirus pandemic. In order to overcome the challenges posed by this exceptional situation and prevent an economic crisis, the availability of credit to private companies and a liquid banking system are essential. The Federal Council, the Swiss National Bank ("**SNB**") and the Swiss Financial Market Supervisory Authority ("**FINMA**") have therefore joined forces with the Swiss banks to put together a package of measures to enhance liquidity supply.

Background

On 25 March 2020, the Federal Council adopted an emergency ordinance addressing the issue of liquidity assistance for Swiss SMEs (the "**Ordinance**"). The measures outlined within the Ordinance aim at mitigat- ing the economic consequences of the coronavirus epidemic and should give companies rapid and non- bureaucratic access to loans for the purpose of bridging liquidity bottlenecks caused by the effects of the coronavirus pandemic. The bridge loans were made available by the commercial banks and PostFinance AG and guaranteed by the Swiss Confederation. The Ordinance entered into force on 26 March 2020.

Bridge loans are intended to provide companies with sufficient liquidity so that they can cover their current fixed costs despite coronavirus-related sales losses. The Federal Council has also enacted measures in the area of short-time work and COVID-19 loss of earnings compensation to help cover wage costs. In order to implement the liquidity support measures set out in the Ordinance, the Finance Delegation of the Swiss Federal Assembly (FinDel) approved a funding commitment totalling CHF 20 billion on 23 March 2020. On 3 April 2020, the Federal Council decided to increase the available guarantee amount by CHF 20 billion to a total of CHF 40 billion. Upon request by the Federal Council, the FinDel on 7 April 2020 recognised CHF 10 billion of the additional amount as urgent and in the extraordinary parliamentary session held on 4 – 6 May 2020, the additional guarantee was approved by parliament.

Federal Council liquidity support

Types of loans

Two types of bridge credit facilities (the "**COVID-19 Bridge Facilities**") are made available. Both are limited by a Borrowing Base (as defined below) and a maximum amount:

a. "**COVID-19-CREDIT**": A loan up to CHF 500,000 with an interest rate of 0.0% fully guaranteed by the Swiss Confederation (indirectly through loan guarantee cooperatives)

b. "**COVID-19-CREDIT-PLUS**": If the COVID-19-CREDIT is fully utilised, an additional loan up to a maximum amount of CHF 19.5 million (for a maximum aggregate amount of COVID-19 Bridge Facilities of CHF 20 million per applicant with the extraordinary option of increase in case of hardship), of which (i) 85% is guaranteed by the Swiss Confederation (indirectly through loan guarantee cooperatives) with an interest rate of 0.5%, and (ii) the residual 15% is not guaranteed, with an interest rate to be agreed with the bank granting the loan (market expectations are currently that the unguaranteed tranche will have an interest rate of between 2% and 3%, resulting in an average overall interest rate for a COVID-19-CREDIT-PLUS of approx. 0.9%).

The borrowing base (the "**Borrowing Base**") is a maximum of 10% of the turnover of the applicant according to its (definitive or provisional) financial statements (standalone basis, not consolidated group figures) for the 2019 business year (or, if not yet available, its definitive financial statements for the 2018 business year), except for 'Start-Ups'. The Borrowing Base for a 'Start-Up' is 10% of three times its net salary bill (*Nettolohnsumme*) for one financial year, with a floor of CHF 100,000 and a maximum net salary bill of CHF 500,000 (for a COVID-19-CREDIT between CHF 10'000 and 50'000).

The term of COVID-19 Bridge Facilities is five years with the option to extend by another two years in cases of hardship. Both the borrower and the bank have the right to terminate a COVID-19-CREDIT at any time with immediate effect, although the bank may only exercise this right for limited reasons (e.g. in case of violation of regulatory provisions such as AML rules or in the event of a breach of the credit agreement). Furthermore, a right of the banks to introduce mandatory prepayments (*Amortisationen*) or partially cancel the maximum amount of the credit facility (*Limitenreduktion*) remains reserved. For facilities made available under COVID-19-CREDIT-PLUS, the banks may define further terms and conditions.

The interest rates of 0.0%/0.5% as determined by the Ordinance can be adjusted by the Swiss federal treasury department annually, for the first time on 31 March 2021, in line with market conditions.

The intention was that COVID-19-CREDITs should be paid out more or less instantly upon receipt by the bank of a fully completed standard loan agreement. The bank would only examine whether the agreement form was completed correctly. However, a COVID-19-CREDIT- PLUS required a credit risk assessment by the bank in a simplified, fast-track procedure with limited scope of review. In general, the timeline from application to payment of the loan was expected to be faster in cases where there was an existing client relationship with the bank given that KYC requirements continued to apply which in practice often cause delays in opening new bank relationships.

Eligibility criteria

Any sole proprietorship (*Einzelunternehmen*), partnership (*Personengesellschaft*) or legal entity (*juristische Person*) that is domiciled in Switzerland and has been established before 1 March 2020, including Swiss domiciled entities that are part of an international group of companies, could file an application for a COVID-19 Bridge Facility with a participating bank, starting from 26 March until 31 July 2020, if it was significantly affected by the COVID-19 pandemic.

Entities with a turnover exceeding CHF 500 million were not eligible to apply.

Conditions of and representations in relation to a COVID-19 Bridge Facility

A COVID-19-CREDIT was subject to the following conditions and each applicant had to give the following representations and warranties:

a. the applicant was established before 1 March 2020;

b. the applicant is not in bankruptcy or composition proceedings nor in liquidation at the time of filing the application;

c. the applicant is significantly impacted by the COVID-19 pandemic, in particular regarding its turnover; and

d. the applicant has not already secured liquidity, at the time of the submission of the application, under the emergency regulations referring to the fields of sport or culture.

A COVID-19-CREDIT-PLUS was subject to further conditions: The applicant had to have a company identification number (UID number) and had to pass a customary credit risk assessment by the bank.

A bank could decline to grant a COVID-19 Bridge Facility at its sole discretion. However, in the case of a COVID-19-CREDIT, it was expected that banks would only turn down applications from applicants with which they have previously had bad experiences.

COVID-19 Bridge Facility application process

As the application period expired on 31 July 2020 and no extension of the programme has been granted, applications are no longer possible.

Possible purposes and negative covenants

COVID-19 Bridge Facilities may only be used for the purpose of securing the current liquidity needs of the applicant. The use to fund new investments in fixed assets that are not replacements is explicitly excluded. Additionally, the following negative covenants apply for the duration of the facility (and the banks are obliged to incorporate them into their loan agreements):

- no distribution of dividends, bonuses and reimbursement of capital contributions;
- no granting of loans or refinancing of private and/or shareholder loans with the exception of the refinancing of bank overdrafts accumulated since 23 March 2020 with the bank granting the COVID-19 Bridge Facility;
- no repayment of group loans; and
- no transfer of the proceeds from a COVID-19 Bridge Facility to a direct or indirect affiliate of the borrower that is not domiciled in Switzerland.

Article 6 Paragraph 3 of the Ordinance appears to provide for a general prohibition of the above actions until termination and full repayment of the COVID-19 Bridge Facilities. However, Article 6 Paragraph 4 and the template of the guarantee agreement in Appendix 3 of the Ordinance only prohibit the use of the proceeds from the COVID-19 Bridge Facility for the above purposes. A clarification by the government in this respect would be desirable.

Effects on balance sheet of borrower

For the calculation of the coverage of capital and reserves in accordance with Article 725 Paragraph 1 of the Swiss Code of Obligations ("CO") and for the calculation of over-indebtedness in accordance with Article 725 Paragraph 2 CO, the COVID-19-CREDIT (not including a COVID-19-CREDIT-PLUS) will not be taken into account as borrowed capital until 31 March 2022. This serves to prevent borrowers from having to file for bankruptcy or take other restructuring measures prescribed by law due to the utilisation of a COVID-19-CREDIT.

Sanctions

A fine of up to CHF 100,000 shall be imposed on anyone who wilfully obtains a loan under the Ordinance on the basis of false declarations or uses the proceeds of the loan in contravention of the negative covenants outlined above. Such conduct may also constitute a more serious offence under the Swiss Criminal Code (such as fraud or forgery of a certificate).

Ordinance to be incorporated into ordinary law

Following a consultation process (*Vernehmlassungsprozess*), the Federal Council has adopted the dispatch on the Covid-19 Solidarity Guarantee Act (the "**Act**"). The Act is expected to come into force on 1 January 2021. The aim is to transfer the Ordinance into ordinary law, as the Ordinance has been issued as an emergency ordinance and was therefore valid until 25 September 2020. For this reason, the Federal Council extended the validity period of the Ordinance until the entry into force of the Act or at the latest until 25 September 2028 at the same time as it adopted the dispatch. This will avoid a regulatory gap until the new Act comes into force. The new Act includes provisions regarding (i) the rights and obligations of the four recognised guarantee organisations, in particular in view of the banks drawing on the guarantees and the credit claims passing to the guarantee cooperatives, (ii) important aspects during the term of the COVID-19-CREDITs (e.g. purpose of the solidarity guarantee, negative covenants, duration, prepayments (*Amortisationen*) of the COVID-19-CREDITs and interests), (iii) the instruments for combating abuse and (iv) the dealing with hardship cases. In order to avoid cases of hardship, the Act provides for the following:

– the existing 5-year repayment period is extended to 8 years;

– for the calculation of the coverage of capital and reserves in accordance with Article 725 Paragraph 1 CO and for the calculation of over-indebtedness in accordance with Article 725 Paragraph 2 CO, the COVID-19- CREDIT (with the exception of any COVID-19-CREDIT-PLUS) will not be taken into account as borrowed capital for the whole term of the COVID-19- CREDIT;

– the COVID-19- CREDITs are to remain interest-free until 31 March 2028;

– the guarantee cooperatives will be enabled to apply various instruments to avoid hardship cases in individual cases of hardship (especially subordination and participation in restructuring).

In contrast to the Ordinance, the Act will no longer contain any provisions on the application and the granting of COVID-19- CREDIT, as a subsequent extension of the programme has been rejected.

Participation of Swiss commercial banks and securing COVID-19 Bridge Facilities

In order to ensure rapid operational processing as well as providing sufficient liquidity, and taking into consideration that the supply of credit to the economy is a key function of the banking system, the Swiss Federal Council worked closely with the Swiss commercial banks and PostFinance AG to develop the liquidity support programme. To date, 113 Swiss banks (including PostFinance AG and Swiss branches of foreign banks) have agreed to participate in the liquidity support programme. Participating banks must accept the framework conditions laid down in Appendix 1 to the Ordinance by making a signed submission to the State Secretariat for Economic Affairs SECO before granting COVID-19 Bridge Facilities under the programme.

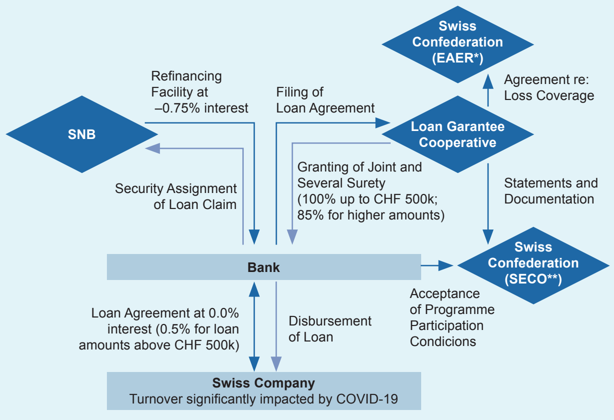
The Swiss Confederation will guarantee COVID-19-CREDITs (up to CHF 500,000) for 100% of the loan amount plus one year's interest. COVID-19-CREDITs-PLUS (in excess of CHF 500,000, up to CHF 20 million) are guaranteed for 85% of the loan amount plus one year's interest. In practical terms, the repayment of COVID-19 Bridge Facilities is secured by the four existing (regional) Swiss loan guarantee cooperatives, which will issue joint and several guarantees backed by the Swiss Confederation to the banks that lend the money to COVID-19 affected businesses under the programme.

Loan agreements for COVID-19-CREDITs which were accepted by the bank as being complete, establish *ex lege* a joint and several guarantee from one of the loan guarantee cooperatives, effective upon the bank forwarding the signed loan agreement to the loan guarantee cooperative (via the central office of the loan guarantee cooperatives) or upon the bank paying out the loan to the client. For loan requests relating to COVID-19-CREDITs-PLUS, a surety agreement in the form set out in Appendix 3 of the Ordinance must be concluded between the bank and the loan guarantee cooperative.

The Swiss Confederation will cover guarantee losses of the loan guarantee cooperatives under a public law agreement between each loan guarantee cooperative and the Federal Department of Economic Affairs, Education and Research (EAER).

For the refinancing of loan claims vis-à-vis the SNB, the participating banks as creditors can assign the guaranteed loan claims to the SNB as collateral to obtain additional liquidity (see below).

Graphical overview of the liquidity programme



* Federal Department of Economic Affairs, Education and Research
** State Secretariat for Economic Affairs

FINMA supportive measures

FINMA recognises the importance of the liquidity support measures taken by the Federal Council for the benefit of the Swiss economy. The governmental guarantees enable the banks to quickly, unbureaucratically and with limited additional risk fulfil their task as liquidity providers for the economy. FINMA also welcomes the newly established facility of the SNB safeguarding the ability of banks to refinance the loans granted under the programme and maintain their own liquidity position.

On 31 March 2020, FINMA published the FINMA Guidance 02/2020 "Temporary exemptions for banks due to the COVID-19 crisis" providing for the following measures:

– **Capital requirements for COVID-19 Bridge Facilities with federal guarantees:** When calculating the minimum regulatory capital requirements of loan granting banks, COVID 19 Bridge Facilities can be treated as guaranteed by the Swiss Confederation for the applicable level of guarantee coverage (i.e. 100% or 85%). For the part not covered by a guarantee, the exposure must be treated with the counterparty's risk weighting.

– **LCR calculation taking into account the SNB COVID-19 Refinancing Facility:** For COVID 19 Bridge Facilities granted to companies, no outflow has to be recorded in the calculation of the short-term liquidity coverage ratio (LCR) for the part covered by the SNB Refinancing Facility CRF (see explanations below). The refinancing facility can be considered as collateral.

– **Temporary relaxation of leverage ratio requirements:** Until 1 July 2020, cash deposits held by a bank with the central banks do not have to be taken into account in the leverage ratio calculation. The capital released by the relaxation of the leverage ratio is not intended for distribution. If banks nevertheless decide to make a distribution for the 2019 financial year, the capital released by the relaxation will be deemed reduced by the amount of the planned or actual distribution.

In a press release of 25 March 2020, FINMA further recommended that the supervised financial institutions carefully consider their level of upcoming dividend distributions in the light of the current situation.

On 7 April 2020, FINMA published the FINMA Guidance 03/2020 "Exemptions for supervised institutions due to the COVID-19 crisis" ("**FINMA Guidance 03/2020**") with the following additional measures:

– **Reduction of the relief regarding the leverage ratio calculation in the event of dividend distributions:** Banks that have to consider a reduced capital relief as a result of dividend payments (see above) are required to include such reduction in the calculation basis of the leverage ratio in the amount of the dividend paid out in CHF divided by a percentage specified by FINMA based on the bank's systemic relevance. The reduction may not exceed the relief granted by the exemption for central bank deposits. Special provisions apply to companies that are part of a supervised Swiss financial group or Swiss sub-group of a foreign financial group.

– **Treatment of COVID-19 Bridge Facilities for financial accounting purposes:** COVID-19 Bridge Facilities must be reported by banks under the item "Amounts due from customers". In the required breakdown by type of cover according to FINMA Circular 2020/1 "Accounting – Banks", the guarantees granted by the loan guarantee cooperatives are to be recorded as "other collateral". Amounts not covered by such guarantee must be recorded in accordance with the applicable type of cover.

– **Treatment of COVID-19 Bridge Facilities in the interest risk report:** FINMA takes into account the fact that COVID-19 Bridge Facilities have a repricing maturity period, which must be reported accordingly in the interest risk report to the SNB.

SNB supportive measures

Within the framework of the coronavirus liquidity support programme and generally to counter the effects of the pandemic, the SNB has taken the following measures:

– **Continuation of expansive monetary policy and an increase of the banks' negative interest rate allowance**: The SNB will leave the key interest rate and the interest rate on sight deposits at the SNB unchanged at -0.75%. However, the SNB will from 1 April 2020 increase the banks' allowance for sight deposits to be exempt from negative interest in order to reduce the negative interest burden for the banking system. To this effect, the so-called allowance factor (which relates to the minimum reserve requirements of the banks) will be increased from 25 to 30. The SNB has also stated its intention to intervene more intensively on the foreign exchange market to help stabilise the situation on the financial markets.

– **Establishing a new SNB COVID-19 Refinancing Facility ("CRF")**: This measure aims to strengthen credit supply to the Swiss economy by making additional liquidity available to the banking system. The CRF is unlimited in amount and drawdowns can be made at any time. The CRF operates in connection with the Federal Council's guarantees for COVID-19 Bridge Facilities. The facility allows banks to obtain liquidity in return for depositing the loans guaranteed by the Confederation as collateral with the SNB. In this way, the SNB enables the banks to expand their lending rapidly on a large scale, while at the same time having the necessary liquidity at their disposal. The CRF is available to banks domiciled in Switzerland (including the Principality of Liechtenstein) that are connected to the Swiss Interbank Clearing system. So that banks can draw down the facility quickly, the credit claims serving as collateral must be validly transferred to the SNB within a reasonable period of time and in the simplest possible manner. The Ordinance therefore provides that the assign- ment of credit claims to the SNB and the retransfer to the relevant bank can be done without following any formal requirements.

– **Reduction of countercyclical capital buffer**: In order to adapt the regulatory requirements to the changed situation, the SNB has also requested the Federal Council, after consultation with FINMA, to reduce the countercyclical capital buffer to 0%. On 27 March 2020, the Federal Council agreed with the proposal and decided to deactivate the countercyclical capital buffer with immediate effect. The measure increases the banks' manoeuvring space in view of their lending activity to cushion the economic consequences of the coronavirus.

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