

# IFLR

INTERNATIONAL FINANCIAL LAW REVIEW

## INTERNATIONAL BRIEFINGS 2016



### Switzerland

Bär &amp; Karrer

## Intra-group financing

Pursuant to a decision of the Swiss Federal Supreme Court rendered in October 2014, up-stream loans extended by a Swiss company must be entered into on arm's length terms. If they are not provided on arm's length terms, up-stream loans may constitute *de facto* distributions and, therefore, may only be granted for an amount not exceeding the lender's freely distributable reserves. In addition, the court held that, as a result, the lender's ability for future dividend distributions is reduced by an amount corresponding to the loan amount. The court also imposed stringent requirements that needed to be met to satisfy the arm's length test. According to the view of most legal scholars, this decision constitutes a change in practice. It has raised a number of queries both at Swiss companies and among practitioners and scholars in Switzerland.

In a more recent decision rendered in November 2015, the Swiss Federal Supreme Court ruled on intra-group financing arrangements again. The decision was long awaited as practitioners expected to get more guidance on the queries raised in the decision of 2014. Unfortunately, the latest decision does not make the court's view on the subject matter any clearer, except that it seems to suggest that up-stream financing arrangements and cash pooling arrangements are not *per se* impermissible.

In short, the situation remains unsatisfactory for Swiss companies. Given that intra-group financing is of great importance in practice, we believe it is worthwhile to summarise the key parameters for Swiss companies:

### High standards for up-stream loans

In contrast with the practice before the court's decision in October 2014, it must be assumed that up-stream loans have to meet relatively high standards to pass the arm's length test. While the Swiss Federal Supreme Court did not specify what constitutes arm's length terms, it held that the loans under scrutiny did not pass the arm's length test because they were unsecured and the creditor allegedly did not analyse the debtors' credit-worthiness at the time it entered into the loan. The court did not perform any further analysis or take into consideration the indirect benefits of the intra-group financing arrangement (or the fact that the relevant loans had already been repaid).

Although the second decision seems to suggest that the court will take into account the specific circumstances, it remains relatively unclear to what extent the court is willing to consider the particularities of a specific case.

### What it means for Swiss companies

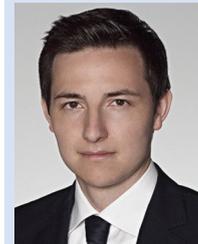
Generally, up-stream loans should only be granted on arm's length terms. Since neither Swiss law nor the decisions referred to above provide any meaningful guidance or so-called safe harbour rules, we recommend that companies perform a comprehensive analysis and consider, *inter alia*, the following criteria:

- security for the loan;
- the credit-worthiness of the borrower;
- the significance of the loan amount;
- at arm's length interest rate;
- the possibility of terminating at short notice;
- customary representations and warranties;
- customary financial and information covenants.

In addition, intra-group financing arrangements, as well as the underlying resolutions, should be made in writing. The resolutions should reflect that



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entering into the up-stream loan has been carefully assessed and that, based on this assessment, the terms are considered to be made at arm's length. Furthermore, the credit-worthiness and willingness of the borrower to repay the loan should be monitored on a regular basis.

In view of the considerable risk that the arm's length nature of up-stream loans is denied with hindsight, it may be advisable to take precautionary measures in advance. In particular:

- up-stream loans should not exceed freely distributable reserves at any time;
- freely distributable reserves should be blocked in a corresponding amount;
- provide for short termination rights in case of a material adverse change in the financial condition of the borrower;
- avoid a large exposure relative to the balance sheet of the lending company;
- ensure board and shareholders' approval on a well-documented basis;
- introduce a group and financing clause in the company's articles of association.

After the first decision referred to above, EXPERTsuisse, the Swiss specialist association for auditing, taxes and fiduciary (formerly the Swiss Institute of Certified Accountants and Tax Consultants) issued a Q&A for selected topics on intra-group receivables, cash pooling and dividends, which also touches on the arm's length test. According to this Q&A, intra-group financings will also be scrutinised by the company's statutory auditors. Therefore, Swiss companies should also consider consulting their auditors before entering into intra-group financing arrangements to mitigate the risk of lengthy discussions on the arm's length nature in connection with the audit.

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