BÄR & KARRER

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Compliance and Criminal Law Related Risks in Connection with COVID-19 Loans

In order to bridge liquidity shortfalls caused by the COVID-19 pandemic, the Federal Council has decided to provide liquidity assistance for affected Swiss SMEs. The non-bureaucratic and swift credit approval process, however, entails a considerable potential for credit abuse; that is why violations of the *COVID-19 ordinance on granting of credits with joint and several federal guarantees* are subject to prosecution. Lending banks have to assess how wrongdoings pertaining to COVID-19 related loans might affect their compliance regime, their anti-money laundering obligations as well as their operational processes.

Background

On 25 March 2020, based on emergency law, the Federal Council adopted the ordinance on granting of bridging loans to companies with joint and several federal guarantees (the "Ordinance") to mitigate the economic implications caused by COVID-19.

Bridging loans as per the Ordinance

A Swiss domiciled company is entitled to a bridging loan under the following conditions: the company applying for the loan was established before 1 March 2020, it is significantly impacted by the COVID-19 pandemic, is financially sound and has not already secured liquidity under another emergency regulation. COVID-19 related loans may only be used for the purpose of meeting liquidity shortfalls. Additionally, the applicant is subject to certain restrictions with regard to the actual usage of the COVID-19 loan. The loan is capped at 10% of the applicant's annual turnover; credits up to CHF 500,000 are granted interest-free (at least until 31 March 2021) with a credit duration of five years.

The creditor banks review and grant the bridging loan. However, to ensure that companies applying for a loan receive access to the required liquidity as quickly as possible, simplified lending procedures apply.

Based on the applicant's self-declaration, the banks simply examine if the information provided by the applicant (i.e. a standardised credit application and a few additional documents) is complete and whether the applicant fulfils the general requirements. Subject to a positive assessment of those criteria, the COVID-19 credit is paid out to the company usually within just a few hours.

The loans are backed by guarantee organisations which are recognised by law and which act as joint and several guarantors. The Swiss Confederation ultimately covers any credit defaults.

Criminal abuse of the bridging loans

The applicable non-bureaucratic and swift lending procedures do involve considerable potential for misuse. For example, companies acting in bad faith, which do not face the financial distress required by the Ordinance, might view COVID-19 loans as an easy way (improperly) to obtain an interest-free loan.

Unless more serious offences as per the Swiss Criminal Code ("SCC") apply, article 23 of the Ordinance stipulates that fines 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 loan in breach of the conditions stipulated in article 6 para. 3 of the Ordinance.

Depending on the facts of the case as well as the use of the credit funds, the following more serious offences could potentially apply: forgery (Art. 251 SCC), fraud (Art. 146 SCC), misappropriation (Art. 138 SCC), criminal mismanagement (Art. 158 SCC) and bankruptcy offences (Art. 163 *et seqq.* SCC). However, an individual assessment has to be undertaken for each case, taking into account the specific factual and legal circumstances.

To prevent the abuse of these COVID-19 related loans, the Swiss Confederation has implemented a control system which is currently being further refined by the Federal Department of Finance. Also, the Federal Council has repeatedly stated that the misuse of COVID-19 related loans will be rigorously prosecuted and punished. All of this, however, is mainly designed as *ex post* controls.

To date, over 94,000 loans amounting to a total of around CHF 15.7 billion have already been granted. Due to the high demand for COVID-19 loans, the Federal Council has further increased the public funds made available to back the respective loans to a maximum of CHF 40 billion. Taking into consideration the overall situation outlined above, it is possible that some of the companies applying for a COVID-19 loan might misuse the programme and that individuals involved in wrongdoings might subsequently face prosecution. In this context, we recommend defining, implementing and then monitoring control measures to mitigate the risks of wrongdoings within the affected company.

Compliance and due diligence obligations of banks

A lending financial institution continuously monitors transactions and its clients by way of automated or *ad hoc* controls. Such checks might identify that one or more of its clients intends to or has already misuse(d) a loan. Under this scenario, the financial institution faces an array of legal and organisational questions.

The prime focus lies on the financial institution's reporting obligations/rights based on Swiss anti-money laundering laws (Art. 9 AMLA or Art. 305ter para. 2 SCC). Related to this, the question arises of whether the loan funds in the borrower's bank account stem from a predicate offence which might consequently trigger a suspicious activity report ("SAR"). *Prima vista*, a potential report based on the criminal provision (article 23) of the Ordnance does not qualify as a predicate offence to money laundering, since this provision is designed as a contravention. Instead, financial institutions must base their SAR on felonies, such as the above-mentioned criminal offences set out in the SCC: forgery, fraud, misappropriation and aggravated criminal mismanagement. Whether a bank has the obligation or the right to file a SAR is subject to a case-by-case analysis. With regard to the questions at hand, the recommendation is to expand on certain "scenarios" to follow a uniform approach within the financial institution. Also, it is important to note that the Ordinance does not exempt the bank or financial institution from its duties of due diligence and care as per the Swiss money laundering legislation. As a result, these ongoing duties remain fully applicable to cases related to COVID-19 loans.

The Federal Council has issued a FAQ providing further guidance around certain practical questions raised in connection with the Ordinance. According to such guidelines, banks are required to "report any identified abuse or attempted fraud to the competent cantonal prosecutor's office".

This reporting obligation, however, is not set out in the Ordinance itself. It therefore remains unclear whether this directive ought to be viewed as a recommendation or an instruction and how – if at all – this instruction would interplay with the anti-money laundering reporting obligations based on Swiss statutory law. This rather loose instruction to notify the cantonal prosecutor's office – which is not implemented into statutory law – also raises a number of issues from a Swiss banking secrecy perspective. Furthermore, it triggers the question as to whether a bank, which deliberately or negligently fails to report suspicious activity to the cantonal prosecutor's office (and/or to the Swiss Money Laundering Reporting Office), runs the risk of being deprived of its right to recoup its losses based on the federal guarantee, in the event of a credit default due to the non-reported (criminal) activities of its clients.

Finally, the Ordinance fails to address the question of whether domiciliary companies are (also) entitled to COVID-19 related loans or whether this is limited to operational companies.

Conclusion

The measures implemented by the Federal Council to bridge liquidity shortfalls caused by the coronavirus pandemic are based on a non-bureaucratic and swift credit approval process which creates considerable potential for abuse. It is possible that some of the companies applying for a COVID-19 related loan might misuse the programme and individuals involved in respective wrongdoings might be prosecuted. Banks granting COVID-19 related loans could potentially face a significant increase in compliance cases and SAR activity. In addition, this could impact on operations within the financial institution's compliance department, as well as its processes related to the approval of COVID-19 related loans.

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