Stabilisers suggest Swiss corporate distress will stay in same gear

Christoph Neeracher, Luca Jagmetti and Thomas Rohde of Bär & Karrer discuss Switzerland's restructuring and insolvency landscape for 2024 and beyond

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In early 2024, Switzerland's GDP continued a moderate growth, mostly due to the service economy. Most conjunctural indicators have stabilised in recent months. The Swiss federal government's Expert Group on Economic Forecasts therefore expects, **in its latest forecast**, growth for the Swiss economy in 2024 to be similar to 2023; i.e., a GDP growth rate of 1.2%, which is still significantly under average.

Such growth will mostly be due to consumption, which, in return, is supported by a continuously solid labour market and a lower inflation rate than in 2023. The expert group estimates inflation to be 1.4% on average in 2024 and just recently the Swiss National Bank has cut its key policy rate by 25 basis points to 1.25%, which shows confidence that inflation will not bounce back in the near future.

Compared with 2023, foreign trade may make a stronger contribution to the growth of the Swiss GDP due to the recent devaluation of the Swiss franc. While, according to the expert group, a variety of global risks – such as the ongoing conflicts in the Ukraine and the Middle East, the continuously high inflation rates outside Switzerland, global debt, and potential downward corrections in the real estate and financial markets – remain threats to foreign trade for Switzerland, the expert group generally expects a return to more average growth in 2025 of about 1.7% of GDP.

Due to the moderately falling costs of interest in Switzerland, which are in contrast to persistent global

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inflation and an unsecure landscape, a further rise in corporate distress cases is rather unlikely in Switzerland at this point.

Bankruptcy and recovery

In terms of restructuring transactions in Switzerland in the past year, the rescue of Credit Suisse Group AG by way of the state-facilitated merger into UBS Group AG is certainly the most prominent one. This restructuring transaction was unique in many ways, not only in terms of the challenges that had to be addressed, but also in terms of the toolbox used for the rescue. The transaction was facilitated, and potential obstacles cleared, by way of the issuance of **an emergency ordinance by the Swiss government**.

Apart from this exceptional restructuring transaction, the general restructuring activity over the past year continued the slightly increased use of composition proceedings (i.e., Swiss in-court restructuring proceedings) for pre-pack transactions and for a wind-down of the distressed debtor's business and thus a softer landing in bankruptcy. The use of composition proceedings for a restructuring of the distressed debtor itself, however, is still not too popular. This is especially in comparison with similar instruments in other jurisdictions – and distressed debtors still prefer to try to agree on an out-of-court restructuring with its stakeholders before they use composition proceedings, which are often only used as a 'plan B'.

Since a rise in corporate distress and restructuring activity is currently not expected, a sudden rise of in-court restructurings over the next 12 months is not expected, and distressed debtors will continue to prefer out-of-court restructurings to in-court restructurings. However, the Swiss corporate law reform that entered into force on January 1 2023 has limited the period within which an over-indebted debtor can attempt to achieve an out-of-court restructuring and after which the over-indebted debtor must file for composition proceedings or for bankruptcy. This new limitation will likely have a negative influence on the success rate of out-of-court restructuring attempts and the switch from out-of-court restructuring efforts to composition proceedings (and, thus, in-court restructuring proceedings) will now occur quicker and more often than previously.

Legislation and policy

Legal framework

Corporate restructuring and insolvency proceedings in Switzerland are mainly governed by the Swiss Debt Enforcement and Bankruptcy Act (DEBA). Several laws and ordinances other than the DEBA, however, contain additional provisions on corporate restructuring and insolvency. These provide special rules regarding certain types of insolvent debtors (e.g., banks, securities firms, insurance companies, collective investment schemes, and fund managers, as well as railway and shipping companies) or regarding specific aspects of an insolvency (e.g., the directors' duties in the event of insolvency, which are set forth in **the Swiss Code of Obligations**, or the CO).

Furthermore, **the Swiss Private International Law Act** contains the relevant rules regarding the recognition of foreign restructuring and insolvency proceedings and decrees in Switzerland. The European regulations regarding restructuring and insolvency are, however, not applicable in Switzerland, as Switzerland is not a member of the EU.

The DEBA provides for two main types of insolvency proceedings: bankruptcy proceedings and composition proceedings, which are Swiss in-court restructuring proceedings. Composition proceedings protect the distressed debtor from its creditors to enable the debtor to attempt to reach a court-approved debt restructuring agreement with its creditors (a so-called composition agreement) or to restructure outside a court-approved debt restructuring agreement. The composition agreement can take the form of:

- An 'ordinary composition agreement', in which the debtor and its creditors agree on a specific payment plan, a haircut, or a combination thereof (and thus the survival of the debtor); or
- A 'composition agreement with assignment of assets', which assigns the debtor's assets to its creditors, for realisation by a liquidator elected by the creditors in satisfaction of the creditors' claim and which leads to the dissolution of the debtor.

Policy changes

The last major changes to composition proceedings were implemented in 2014 and were aimed at facilitating the restructuring of financially distressed companies in the context of composition proceedings. As mentioned, even though these changes were designed to make composition proceedings more attractive, they still do not have the same significance in Switzerland as in-court restructuring proceedings in other jurisdictions, such as Chapter 11 in the US. Often, distressed companies try to restructure without the involvement of the courts and thus outside composition proceedings in Switzerland.

The legal framework for out-of-court restructurings is mainly contained in the CO, which sets forth the duties for directors of Swiss companies in the event of financial distress and provides for most of the instruments available for balance sheet restructurings. This framework has been somewhat adjusted with the revision of Swiss corporate law that came into force on January 1 2023:

- As was the case before the revision, the board of a Swiss company must prepare audited interim financial statements if it has a substantiated concern that the liabilities of the company are no longer covered by its assets (over-indebtedness). If the financial statements do show an over-indebtedness, the board must file for bankruptcy or for composition proceedings, unless creditors subordinate their claims in an amount sufficient to cover the over-indebtedness.
- According to existing case law, in the case of over-indebtedness, the board can delay such a filing for a grace period of four to six weeks if it promptly implements restructuring measures and if there is a realistic prospect of financial recovery. This concept of a grace period has been codified via the corporate law reform, and the CO now states that the board may delay the filing if there is a realistic prospect that the over-indebtedness is resolved within 90 days of receipt of the audited interim financial statements. This codification presents difficulties, as the over-indebtedness must be resolved within the grace period (i.e., a delay is not permitted, even if the effect of the implemented measures unfolds later than 90 days or if – due to specific circumstances – a longer grace period would be adequate), and this will likely have a negative influence on the success rate of out-of-court restructurings in Switzerland.
- Codifying existing case law, the revised CO also introduces an explicit duty of the board to supervise the liquidity of the company and if there is a threat of illiquidity, to take appropriate measures. In this context, a provision was introduced stating that "the board files for composition proceedings if required". Legal doctrine is rightfully of the view that this provision does not introduce an additional obligation of the board to file for composition proceedings in the case of impending liquidity problems. Should courts come to another conclusion, then this could trigger a shift from out-of-court restructurings to in-court restructurings.
- The revised corporate law also clarifies that a debt-equity swap is permitted even in situations where the company is over-indebted (which was disputed by some scholars under the previous law), which will likely lead to a more widespread use of this expedient restructuring instrument.
- The revised law also abolished the so-called corporate law moratorium (i.e., the possibility of the bankruptcy court to postpone bankruptcy to allow the debtor to implement an out-of-court restructuring), given that the composition proceedings can be used for the same goal.

In addition to the above adjustments, the rules applicable to the restructuring and insolvencies of banks have also been amended as of January 1 2023. Furthermore, a revised legislation regarding the insolvency of insurance companies, which allows an insurance company to be restructured rather than be left to go bankrupt in the event of insolvency, entered into force on January 1 2024.

While no major changes to the general restructuring and insolvency regime in Switzerland are to be expected soon, it is worth noting two (potential) further changes in policy.

- On January 1 2025, amendments to Swiss corporate law will enter into force intending to better protect creditors of Swiss companies. Key points of the new regulations are a prohibition to transfer shares of an over-indebted company and the abolition of the possibility for SMEs to retroactively opt out from audit obligations.
- Following a European trend, the Swiss parliament will discuss a further increase of transparency rules for beneficial owners. In particular, a federal register of beneficial owners shall be introduced, which can be consulted by, for example, financial intermediaries that have know-your-customer obligations under **the Anti-Money Laundering Act**.

Foreign trends

Based on **the EU directive on preventive restructuring frameworks**, certain jurisdictions have recently implemented the possibility of a cross-class cramdown outside insolvency proceedings, to facilitate the implementation of a preventive debt restructuring (like the English scheme of arrangement). The introduction of such a concept is currently not being discussed in Switzerland, neither within nor outside insolvency proceedings:

- While the possibility of a cramdown exists in Switzerland for composition proceedings, the creditors that are subject to the composition agreement form one class and a cramdown of an entire class of creditors (i.e., against the will of most of a specific class of creditors) is thus impossible in the context of composition proceedings; and
- The possibility of a cramdown exists in Switzerland outside composition proceedings in the context of bond restructurings. However, in such

proceedings, a cross-class cramdown (if different bonds have been issued by the same debtor and are subject to the restructuring) is neither provided for by Swiss law nor currently being discussed.

Also, with respect to certain other aspects of insolvency law, where the EU is pushing for a harmonisation – and thus changes – across its member states, Switzerland currently does not plan to amend its rules:

- Deadline for filing – as mentioned, since implementing the corporate law reform on January 1 2023, the CO imposes a duty for the board to file for bankruptcy (or composition proceedings) within 90 days of the date the interim financial statements are available that show the over-indebtedness of the company.
- Creditors committees – in Switzerland, a creditors committee may be established for ordinary bankruptcy proceedings by the first creditors meeting. Such a committee has the following competencies:
  - Supervision of the bankruptcy administration;
  - Approval of accounts, authorisation of the continuation of court proceedings, and conclusion of settlements;
  - Objection to claims in the bankruptcy that the bankruptcy administration has admitted; and
  - Ordering payment on accounts to be made to the creditors during the bankruptcy proceedings.
- A creditors committee can also be appointed for composition proceedings by the composition court for the duration of the debt moratorium. This creditors committee must be regularly informed by the administrator regarding the status of the proceedings, but, unlike the creditors committee in bankruptcy proceedings, it has only a few competencies:
  - Supervision of the administrator;
  - Making recommendations to the administrator; and
  - Authorisation of the divestment, encumbrance, or pledge of certain assets that are affected to the debtor's business, or of the provision of guarantees (i.e., pledges or sureties) or gifts by the debtor.

In general, changes are currently not contemplated for the Swiss insolvency rules for corporate debtors.

While there are no major misconceptions around Swiss insolvency proceedings, it should be remembered that Swiss insolvency law does not provide for a special treatment for group insolvencies. Even though the DEBA requires that composition proceedings and bankruptcy proceedings over different group companies are coordinated, every entity is treated in a separate proceeding.

Looking ahead

As mentioned, a further rise in bankruptcy and restructuring cases in Switzerland is not expected at this point. Furthermore, distressed corporate debtors will continue to prefer out-of-court restructurings to in-court restructurings. It is not yet clear if the newly introduced 90-day period for implementing an out-of-court restructuring will, in practice, cause corporate debtors to switch quicker, and more often, from out-of-court restructuring efforts to composition (in-court) restructuring proceedings.