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BANKRUPTCY'S BROKEN RULEBOOK

EUROPE'S FRAGMENTED RESTRUCTURING FRAMEWORK IS A PROBLEM. BUT A SINGLE REGIME WON'T FIX IT

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lodged even if the applicant did not demonstrate that the bill was not issued in connection with a consumer contract. Before the new regulation, objections arising from the relationship between the bill debtor and the previous owners were inadmissible. The only exception was if in the acquisition of the bill the new owner of the bill of exchange acted deliberately to the detriment of the debtor. In the past, the party acquiring a bill of exchange did not have to concern themself with the previous relationships concerning the bill, so they did not have to worry about the legal basis on which the bill was issued. Now, however, the party acquiring the bill will have to be much more prudent and should ask the person from whom they are acquiring the bill for all the documents associated with it so that they can submit all those documents to the court. When enforcing a bill of exchange against an individual, failure to submit the required documents could result in a dismissal of the application. Only the decision-making practice of the courts will show the extent of evidence the courts will require from claimants as a condition for being successful in a dispute with an individual over the payment of a sum on a bill of exchange.

Another new development is that if the defendant is an individual who became obligated under a bill of exchange in association with a consumer contract, the court will take into account, *ex officio*, facts warranting objections that could be lodged by the defendant. So the court will, *ex officio*, take into account facts warranting objections even if the defendant themself does not lodge the objections and remains passive in the proceedings.

It will be interesting to see the effect the new regulation has on the use of bills of exchange in cases where the debtor is an individual.

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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).

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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 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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Implementing Basel III

On October 23 2015, the Banking Regulation and Supervision Agency (the BRSA) published amendments to the Regulation on the Equities of the Banks (the Regulation). These amendments are intended to harmonise the Turkish banking regulations with Basel III, the comprehensive reform package developed by the Basel Committee on Banking Supervision to strengthen the regulation and risk management of the banking sector. The amendments will enter into force on March 31 2016 (the Amending Regulation). The Amending Regulation introduces the following key changes:

- Profits derived from the cancellation of shares and free provisions reserved for potential risks are removed from the calculation of a bank's core capital. Share premiums of qualified shares, which are not included in the core capital, are included in Tier I capital;
- If a bank's core capital adequacy ratio or consolidated core capital adequacy ratio drops below 5.125%, the bank should be entitled to deduct the value of Tier I debt instruments or convert them into shares, to restore the ratio of 5.125%, without obtaining the BRSA's permission. Banks are obliged only to inform the BRSA immediately upon the occurrence of such an event;
- If it becomes probable that: (i) the bank's operating licence may be revoked; or (ii) management of the bank may be transferred to the Savings Deposit Insurance Fund, in each case pursuant to Article 71 of the Banking Law Number 5411 (the Banking Law), then the Tier I and Tier II debt instruments may be written down or converted into shares upon the decision of the BRSA. The Amending Regulation requires that: (i) these events occur as a result of the losses incurred by the bank; and (ii) the aforementioned write down or conversion into shares of debt instruments constituted in Tier I or Tier II capital is carried out to set-off such losses incurred by the bank;
- The loans and debt instruments included in the calculation of Tier I capital will not be taken into account among the bank's obligations in the case of the triggering of a non-viability event based on the implementation of the Article 71 of the Banking Law;
- The Amending Regulation clarifies that a prepayment of the principal of the Tier I and Tier II debt instrument shall be approved by the BRSA;
- Previously, pursuant to the Regulation, if the BRSA permitted, any amounts the shareholders had committed to increase the bank's capital, which was pledged in favour of the bank, subordinated, had not accrued any interest, and which was not collaterised or linked to any derivative, used to be included in calculation of Tier II capital. The Amending Regulation deletes this item;
- The Amending Regulation introduces new capital deduction items that will be applied to the calculation of a bank's equity, mostly relating to valuation techniques. It removes the provision stating that direct or indirect investments made by a bank into its own core capital, Tier I capital and Tier II capital shall be deducted from the same, respectively.

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It is expected that there will be further changes to the Regulation as the BRSA has also published a draft regulation that proposes certain other amendments.

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Vietnam

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Simplifying foreign investment

Several months after the new Investment and Enterprise Law came into effect, the Vietnamese government continues to demonstrate the spirit of administrative reform by adopting guidance on the implementation of the legislation.

Decree 78/2015 marks the first positive