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## The pledge of moveable property in secured financing transactions



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**Swiss law lacks a broad system for creating security interests in moveable property which remains in the possession of the borrower, such as equipment, vehicles and inventory. The lack of a system of nonpossessory security interests make financing transactions which are to be secured with moveable property significantly more difficult and expensive to complete.**

A borrower in a real estate transaction can give the lender a security interest in the real property by delivering a mortgage note (*Schuldbrief*) to the lender and allowing the encumbrance to be recorded in the land register. Security interests in aircraft, railway rolling stock and ships can be established by a written pledge agreement recorded in a security interest register. A written security assignment of accounts receivable, even without notice to the obligors, will create an enforceable security interest in the receivables, and so will a written assignment of a bank account (*i.e.*, the depositor's claim for payment against the bank). All of these security interests can be created with little effort and at low cost.

A security interest in moveable property, however, requires more than a pledge agreement and there is no security interest register in which it can be recorded. An enforceable pledge of moveable property requires that the pledgor be deprived of the legal and factual ability to transfer the property by physically delivering it to the lender or a third-party collateral agent in compliance with the *Faustpfandprinzip* literally the 'fist-pledge-principle'. As a result, careful legal structuring is needed to make the secured financing of inventory, equipment and vehicles possible. This is especially true because Swiss courts will not consider a pledge to be perfected if the transaction structure is an obvious attempt to circumvent the *Faustpfandprinzip*.

### Approximations of nonpossessory security interests under Swiss law

There are at least five basic methods of approximating the benefits of a nonpossessory security interest under Swiss law: (1) collateral agent or pledgeholder structures, (2) the pledge of warehouse receipts, (3) finance lease transactions, (4) retained title transac-

tions and (5) transactions that rely on the use of special purpose vehicles (SPVs).

### Pledgeholder structures

If the pledging borrower does not need access to the moveable property on a daily basis, which may be possible with some kinds of inventory, then the pledge of the property may be perfected by delivering it to the lender or a third-party collateral agent or pledgeholder. Thereafter, when the borrower needs possession of the asset – for example, in order to sell it – the borrower must request its release. This may be an acceptable solution if transactions involving the moveable property are infrequent, but it probably becomes unworkable if there are a number of transactions in the moveable property in the course of a day.

### Pledge of warehouse receipts

If the borrower has commodities or bulk goods stored in a warehouse to offer as collateral for a loan, the warehouse need only deliver a warehouse receipt for the goods to the lender. The physical delivery of the warehouse receipt effects the pledge of the goods to the lender and the goods may be released from the warehouse only with the consent of the lender. This technique is primarily useful in transactions involving commodities dealers and trading companies which buy and sell in bulk and rarely need access to the goods.

### Finance leases

Under a finance lease transaction, the lender acquires the moveable property and leases it to the borrower. The purchase of the property is financed by the borrower/lessee's payments under the lease rather than instalment payments under a loan. The leasing arrangement allows the borrower to have possession of the property while the legal ownership

of the property is vested in the lender/lessor. If the borrower fails to meet its payment obligations under the lease, then the default entitles the lender/lessor to repossess the property. In Switzerland, this concept cannot be used in sale-and-lease-back transactions in which typically the borrower is the original owner of the asset. The borrower's sale and-lease-back of the property is usually considered a violation of the *Faustpfandprinzip*. Thus, when security for a lender is to be created through a leasing transaction, it is crucial that the lessee is not the original owner of the property. The property should be purchased by the lender/lessor and delivered directly to it by the manufacturer or supplier.

### Title retention arrangements

Some financing transactions rely on a deferred sales contract that provides that the lender/seller retains title to the moveable property until the borrower/buyer has paid the final instalment of the purchase price. The retention of title by the lender/seller must be recorded in a public retained-title register in order to perfect the retention of ownership by the lender/seller and avoid a transfer of title to the borrower/buyer when the property is delivered. This method of creating a security interest in moveable property is, of course, limited to transactions in which the lender can act as a seller and the borrower as a buyer. Further, some parties consider the registration process burdensome and therefore impractical.

### SPV structures

SPV structures provide the most elaborate solution to Switzerland's lack of nonpossessory liens for most kinds of moveable property. In an SPV-based secured financing transaction, a corporation or other legal entity – the SPV – is formed for the sole purpose of acquiring the moveable property and leasing it to the “borrower”. The bank then loans the purchase money for the property to the SPV. The SPV buys the property, pledges it to the bank as security for the loan and at the same time acts as the collateral agent or pledgeholder for the bank. Finally, the SPV leases the property to the “borrower”. This construction allows the “borrower” to use the property in conducting its business and still permits the property to secure the loan. The relative complexity of this solution – the SPV must be incorporated, capitalised, managed, pay taxes and enter into a lease with the “borrower” – means that it is significantly more costly and probably will be suitable for high-value transactions.

### Summary

The need to comply with the *Faustpfandprinzip* may make it difficult for lenders to obtain a security interest in moveable assets used by a borrower to conduct its business. Often this means valuable assets may not be used to secure a loan, resulting in a less efficient use of capital and a potential loss to the growth of the economy. This NewsLetter describes some of the most common solutions to this problem. The specific circumstances of a contemplated secured financing may permit the creation of other solutions, perhaps combining elements of the transaction described here. A careful case-by-case review is needed to find the most practical structure for the transaction parties.

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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