

Spectrum Asset Management

March 20, 2023

UBS agrees to purchase Credit Suisse

Making sense when AT1 securities are written down and common stock lives on

Credit comments: The *de facto* failure of Credit Suisse, and full write-down of its CHF 15.8 billion of AT1 securities, without a similar write-down of Credit Suisse’s common stock—an upside-down seniority structure—has the market perplexed. The rule, and market expectations, in Europe has been that common equity is the first to absorb losses, followed by AT1 securities. This rule was reiterated in a release today by the EU’s Single Resolution Board (SRB), whose mission is to “ensure an orderly resolution of failing banks,” in which it stated that “in particular, common equity instruments are the first ones to absorb losses, and *only* [emphasis added] after their full use would Additional Tier 1 be required to be written down. This approach has been consistently applied in past cases and will continue to guide the actions of the SRB and ECB banking supervision in crisis interventions.”

So, why did the Swiss authorities decide to write down Credit Suisse’s AT1 securities, but not its common equity, or its subordinated debt, as part of Credit Suisse’s planned sale to UBS and the receipt of Swiss Government support, with Credit Suisse’s equity holders receiving CHF 3 billion in UBS shares for their Credit Suisse shares? Recall that Switzerland is not an EU member, and so it does not need to abide by rules such as those noted by the SRB. In addition, given the importance of Credit Suisse to the Swiss financial center, a more bespoke solution was needed.

Note as well that Credit Suisse’s common shares have been held widely among Swiss citizens for many years, and imposing even more burdens on them was doubtless a political priority. Furthermore, in recognition of the cost to Swiss citizens of the liquidity and other support being provided by the Swiss authorities, an investor class needed to ‘take a hit’ and AT1 holders were an obvious target. In addition, the wipeout of AT1 holders boosted the capital of Credit Suisse, thereby making its acquisition by UBS even more financially attractive to UBS—a clear goal of the Swiss authorities.

Spectrum liquidated all Credit Suisse positions during market trading on Saturday, March 18, 2023, before the AT1 securities were written down to zero.

Market observations as of 10:00am NY on March 20, 2023: AT1/CoCos opened in Asia today off as much as 20 points following significant selling. Since then, and following the announcements described above, AT1/CoCos have rallied from the bottom and are currently only 6-10 points off from Friday’s close.

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