Principal Asset Management℠

Principal Fixed Income

Update on Credit Suisse: Principal Fixed Income perspective and impact

March 20, 2023

Overview

As highlighted in our March 17th communication, an amalgam of factors contributed to the sudden and sharp fall of Credit Suisse's (CS) fortune; however, the two factors that ultimately weighed the most in our view were timing and tension. While the market wouldn't have necessarily ignored the recent CS headlines had they come ahead of the Silicon Valley Bank (SIVB) fallout, it would've likely taken the news in stride and not triggered the bank's ultimate downfall. However, as the headlines came on the heels of the collapse of SIVB and Signature Bank (SBNY), the market's patience for bearing with any big bank blemish had worn thin. In the end, CS no longer had the luxury of time on its side to conclude its rehabilitation efforts, including the planned IPO of its investment bank. Capital and liquidity sufficiency – as well as success at adhering to rigorous annual stress tests recently affirmed by the Swiss National Bank (SNB) – no longer mattered. As it turned out, confidence superseded capital in this case; the bank's common equity tier 1 ratio of more than 2x the trigger level for its AT1 contingent capital securities became irrelevant, and FINMA exercised their right to cancel those notes even as equity holders retained some value, a move surprising market participants. At the same time, we saw UBS buying CS over the weekend, a move orchestrated by regulators and aimed at restoring trust in the banking system.

What happened?

Over the weekend, UBS agreed to acquire the company in an all-share transaction expected to close in 2Q23. UBS remains well capitalized above its target of 13%. As part of the transaction, the regulator has triggered a complete write-down of the firm's AT1 contingent capital securities. The rest of CS's fixed income capital stack remains intact. It's expected that CS holdco and opco paper will move over to their respective entity at UBS. The SNB is also providing liquidity support in the form of loans up to CHF100 billion with preferential rights in bankruptcy. The justification for the transaction, which occurred in close coordination with the Swiss regulators, was the significant outflows that threatened CS's viability.

What's next?

In anticipation of a likely recession in 2023, we had already been de-risking and positioning portfolios more defensively across sectors, including banks, for the last few months. With CS being a constituent of many industry-preferred investment grade benchmarks, Principal Fixed Income does have exposure to CS within applicable portfolios. Ahead of the news over the weekend, our exposure to AT1s, to CS as well as other issuers, was already small and most of our exposure to CS was in senior holdco paper. Considering the news, we have exited all CS AT1 exposure and have minimal exposure to other AT1 across client accounts. For accounts where we maintain exposure it is in US or UK domiciled banks where we have high conviction on underlying fundamentals. We continue to hold CS senior holdco paper and we'll continue to monitor the situation.

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