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Credit Suisse, Swiss under indictment Torrent of complaints from bondholders

Bank bailouts

ECB and EBA distance themselves from bailout that favours shareholders

On the markets, Lagarde's levee holds: European banks remain stable with low exposure

Doubts and controversy after the CHF 3 billion bailout of Credit Suisse (stock down 55% on the Swiss exchange) by rival UBS.

The governors of the European Central Banks have criticised the decision to write off €16 billion in AT1 bonds issued by Credit Suisse, while shareholders miss out. In response, the ECB and EBA have distanced themselves from the Swiss approach, and Swiss pension funds are threatening legal action. — Services on pages 2, 3, 4 and 5

Bonds written off, investors threaten collective legal action

The impact

€16 billion in hybrid securities, evaporated, the biggest ever loss for this type of asset
Reversal of the stock/bond hierarchy

Luca Davi

Shocking move by the Swiss authorities? Or misstep by investors, who were unprepared for a write-off of Credit Suisse's Additional Tier 1 bonds? Both aspects are likely at play in the affair involving the Swiss bank's hybrid bonds worth €16 billion, totally wiped out by the rescue merger with UBS over the weekend.

The facts are plain: to save Credit Suisse, the Swiss authorities opted to wipe out all of the Swiss bank's Additional Tier 1 bonds. Completely. This is the largest loss ever on the AT1 debt market, valued at €260 billion on the global market, dwarfing the €1.35 billion lost by bondholders in the bailout of Banco Popular in 2017.

Now, AT1 bondholders, who are typically institutional investors, have little to complaint, given that these instruments, introduced after the global financial crash, are the riskiest instrument after stocks and consequently yield high returns. These bonds are designed to act as a cushion if a bank's capital falls below a certain threshold, in which case they can be converted into shares or cancelled. Yet the paradox of the Credit Suisse affair is that, while bondholders will see their entire investment wiped out, equity investors, who typically rank lower than bondholders when a bank defaults,will get something in return: around CHF 3 billion, thanks to the share exchange built into the equity merger with UBS.

It goes without saying that the decision of the Swiss authorities has been seen as a genuine upheaval of the standard rules, and it's no surprise that this has sent shockwaves through the market. "When investors buy AT1s, they know they're down the capital structure compared to seniors. But they assume they're above equity," explained Steven Major, global head of Fixed Income Research at HSBC. The surprise among operators was reflected in the AT1 bond trend of giants such as Deutsche Bank, HSBC, UBS and BNP Paribas, whose prices yesterday tumbled 9-12 points.

But reactions aside, the key question remains: who is right? The Swiss authorities, who took drastic but lawful action, or investors, left empty-handed and threatening mass legal proceedings? One thing is certain — the agreement has upended the standard hierarchy in which, in the event of bankruptcy, equity investors are the first to suffer write-downs. "The CoCo AT1 bailout is a shock for investors and can be seen as unfair at a time when the shareholders are recovering CHF 3 billion. On the other hand, it's completely legal and was even mentioned in the prospectus and discussed by Credit Suisse in a recent presentation," explains Francesco Castelli, head of Fixed Income at Banor Capital.

The prospectus of Credit Suisse's Additional Tier 1 bonds noted that, should bankruptcy strike, hybrid AT1 bondholders would not recover any value. In the event of a potential write-down, the prospectus, reported yesterday by Reuters, states, "interest on the Notes shall cease to accrue, the full principal amount of each Note will automatically and permanently be written-down to zero, Holders will lose their entire investment in the Notes..."

The crux of the matter lies in the particular bank resolution scheme adopted in Switzerland, which, unlike the European BRRD, can provide for the wipe-out of AT1 bonds before equity. Essentially, the situation in Switzerland couldn't happen in the rest of Europe. The response from Europe was an immediate clarification from Lagarde, President of the ECB, who yesterday hurried to reassure the markets by reiterating that, "The rules that apply in Europe, under the directive frameworks that we have concerning resolution, notably, are not the rules that have been applied by other institutions, notably by the Swiss authorities", an effort to calm investors and avoid a possible contagion effect with potentially uncontrollable effects.