Market Commentary
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English Version

Insigneo Weekly Dispatch

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In a historical, government brokered deal that some called a "shotgun wedding", UBS agreed to acquire Credit Suisse in a deal valued at 3 billion Swiss Francs (CHF), or $3.25 billion, over the weekend. The deal also includes guarantees from the Swiss government, as well as liquidity provisions. Specifically, the Swiss National Bank will offer UBS CHF 100 billion in liquidity assistance, while the government will offer a CHF 9 billion guarantee to cover potential losses stemming from Credit Suisse's investment portfolio. As the deal is structured, UBS will absorb the first CHF 5 billion, the government the next CHF 9 billion, then anything over that will also be absorbed by UBS. In order to assure the completion of the deal, the Swiss government is using an emergency ordinance that waives the need for shareholder approval. The new company will retain the name of UBS and will be under the leadership of UBS's chairman Colm Kelleher. The deal is expected to close by year end, although Kelleher believes that it will take approximately 3-4 years to fully integrate Credit Suisse, a move that will include the removal of approximately USD 8 billion of the combined company's yearly cost base by the end of 2027. The combined entity will manage approximately USD 5 trillion of invested assets.

As we mentioned in our note last week, we expected the Swiss government to intervene and also expected a possible acquisition. This has now occurred through an orchestrated acquisition. As

Mohamed El-Erian said on Bloomberg earlier today, this "wasn't the best solution, but it was the most reasonable option available." In our note, we also highlighted the possibility that if the Swiss government intervened, regulators could force the bank to cancel its debt to receive public sector funding, possibly through the forceful write-down or cancelation of the company's Additional Tier 1 (AT1) junior bonds, or CoCos, as they are most commonly known. These bonds had a provision that if the Capital Equity Tier 1 ratio broke 7%, it could force their write down or an outright cancelation of these bonds. However, the bank's CET1 ratio as of last week, stood close to 13%. This theoretical buffer did not matter in today's transaction as Credit Suisse's full outstanding amount of CHF 16 billion in AT1 notes will be cancelled and are now essentially worthless.

This is an important point of contention among investors, as creditors are furious at the fact that, given the implied valuation of Credit Suisse at CHF 3 billion, shareholders will be receiving something in return for their shares, whereas holders of the AT1 notes are essentially wiped out. This appears to violate the normal waterfall of seniority among investors and creditors, where equity is the most junior of all investments and last in line to attain any sort of capital in a situation such as this one. This is the largest cancelation of AT1 instruments in the history of this particular industry segment, estimated to comprise over USD 200 billion of financial assets. As can be expected, this will force the reevaluation of the industry by holders of this type of bonds. This will potentially lead to a reduction in the value of these holdings, as an increased risk premium will push up yields on these instruments, in turn reducing their value. This move will also lead to increased costs of capital for European Banks. As of this writing, BNP Paribas and Societe Generale appeared to hold the most AT1 bonds, among European banks. It is important to note that OpCo debt and structured note activity, are the most senior investments in what is known as the capital stack.

We reached out to an old friend and colleague at a bank in Switzerland today, to get a sense of the situation in the country. The general commentary revolved around this move being the best possible option to restore confidence in the Swiss banking system. However, concern for the significantly larger size of the combined company was also top of mind.

Notes from the Insigneo Structured Products Group

- Structure Notes issued by Credit Suisse will be treated equivalently as OpCo debt.
- It follows that Structured Notes, as equivalents, are senior to CET1, AT1, HoldCo debt and other Gone Concern Capital.
- Based on initial conversations with the CS desk in NY, we should not expect liquidity issues after the opening of the market on Monday in all issued notes

Notes from the Insigneo Sales & Trading Desk

The Credit Suisse Contingent Collateral (CoCo) notes spent much of the end of the week under a great amount pressure, given the uncertainty on how the government would treat the riskier debt. Some of this was answered over the weekend with an unprecedented write-down of the bonds. The Credit Suisse AT1 bonds were quoted at 25 on the close of business Friday. In addition to the volatility we would normally see emerging from a weekend with such actions, we would caution vigilance for other CoCos and spillover volatility.

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