

# CREDIT SUISSE MERGER: AT1s and BEYOND

## Looking at avenues for those who have (and will) lose out

Unpicking the Credit Suisse merger with UBS will take some considerable time but the likely losers from the situation are already looking for ways to claw back their losses. Much of the immediate attention has focussed on holders of the CHF16 billion additional tier 1 (AT1) bonds that were immediately written down to zero but the wider position remains precarious and other claims will emerge over time. Here, we look at some of the claims most likely to arise and what those set to lose out from the merger can potentially do about it.

### AT1 BONDS

AT1 bonds (often known as contingent convertible or coco bonds) are designed to provide a buffer for tax payers when a bank runs into trouble. They allow the bank's capital position to be improved, providing a potential solution before taxpayer money needs to be deployed.

Holders of Credit Suisse AT1 bonds might have expected to lose their investment in the event of a required bail-in. The complaint here, however, is that the AT1 bonds were wiped out in circumstances where equity holders recouped some CHF3 billion in value. This caused surprise in the market which expected equity holders to be the first to be wiped out with AT1 bondholders impacted only once the equity had been exhausted. Indeed, both the Bank of England and the EU banking authorities moved swiftly to confirm that such a result would not be possible under their regimes.

The challenge for holders of the Credit Suisse AT1 bonds is that the Swiss Banking Act allows its regulator, FINMA, significant flexibility to amend the generally accepted hierarchy in which shareholders and creditors should bear losses. This, however, has not stopped distressed players moving in on the bonds with a view to litigation with the bonds trading well below their value a few weeks ago.

Possible claims against FINMA are being mooted in

Switzerland but investment treaty arbitration presents another potentially viable avenue. Switzerland is party to more than 100 bilateral investment treaties, the majority of which contain the standard suite of substantive protections such as fair and equitable treatment; full protection and security; and a prohibition on direct and indirect expropriation without appropriate compensation. While FINMA's actions do appear to be permitted under the Swiss Banking Act, they subvert the generally understood order or priority and have left overseas investors out of pocket in an arguably discriminatory and arbitrary manner. There are echos from the 2014 bailout of Banco Espírito Santo in 2014 which gave rise to significant investment treaty claims on which members of our team advised.

Aggrieved bondholders are also looking carefully at the representations and advice given to them at the time they entered into the AT1 bonds. Although the information memorandums for at least some of Credit Suisse's AT1 bonds included amongst their risk factors the possibility of the bonds being written down where the equity is not, others did not and we are also aware of bondholders being provided with advice and representations to the effect that the anticipated order of priority upon rescue would be respected. Bondholders are considering claims against the service providers and advisors concerned.



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## Securities Actions

The rescue of Credit Suisse comes following a tumultuous time for the bank in which it has been embroiled in a number of high-profile cases. The so-called ‘Tuna Bond’ litigation continues before the English High Court<sup>1</sup>, FINMA recently released a damning press release criticising Credit Suisse’s control mechanisms and highlighting “*serious deficiencies in the bank’s organisational structures*”. The bank also finds itself at the centre of further proceedings in England surrounding the inclusion of fraudulent RMBS deals in certain CDO transactions. Serious questions were being asked of senior management even prior to the UBS merger but the clamour for answers has only risen.

Investors, counterparties, shareholders and employees alike are asking how it came to this. More detail of operational failure will no doubt hit the public domain following the rescue deal and as FINMA’s investigation into the Greensill affair progresses.

<sup>1</sup> Signature Litigation represents a number of the defendants in the proceedings.

## Other Credit Suisse Products

The structure and terms of the UBS merger will have been designed, insofar as possible, to preserve existing structures and ensure defaults are kept, at the very least, to a minimum.

The most likely candidates for events of default appear for the moment to be under the ratings covenants and change of control provisions on relevant documents. Investors who are concerned about the current state of investments with Credit Suisse are keeping under review the legal terms of their deals and seeking advice now to better understand their options should their positions move against them.

## Existing Claims Against Credit Suisse

As mentioned above, there are already many parties with existing litigation or contemplated claims against Credit Suisse. The structure of the Credit Suisse rescue means that the position for those counterparties should remain largely unchanged. Credit Suisse continues to exist as an entity and those with existing claims against it should continue as they would have done otherwise.

That said, while the rescue deal appears to have staved off the immediate risk of collapse, those with contemplated claims that

There are already numerous claims against the bank arising from these issues with more in the pipeline. Holders of derivative products linked to Credit Suisse’s Greensill funds feel particularly aggrieved.

In addition to claims for mis-selling and mismanagement of Credit Suisse products, there will no doubt also be derivative claims against the senior management of the company. For many years, it has been commonplace for certain banking employees to receive part of their remuneration in bonds that allow them to participate in the fortunes of the company but those bonds are now widely reported to be worth nothing. Those employees are already exploring their litigation options against senior management. Equity holders who, while fairsing better than the ATIs have still suffered significant losses, are also reviewing options.

have yet to be brought may wish to bring forward the timeframe for taking action.

## The Wider Market

The Credit Suisse rescue comes hot on the heels of Silicon Valley Bank’s collapse and it appears highly likely that further turmoil will follow. Luke Ellis, CEO at Man Group recently predicted that a significant number of additional banks will cease to exist in their present form within the next 12-24 months. Whether those changes will be by way of merger, bail-in or disappearance remains to be seen and rests largely on how the regulators in each jurisdiction will respond.

However, investors of all types would be well advised to keep their positions and the legal terms and structures behind them under review to best protect themselves, particularly if they anticipate their banking counterparty is not one that will be backed by the state in a crisis. For example, debt service and solvency covenants may be triggered prior to a full-scale rescue being required. If spotted early enough, these can provide a valuable escape route before a full-scale rescue is required. Similarly investors and counterparties should remain vigilant for potential defaults on other deals which, in addition to serving as a potential canary in the coal mine, may give rise to cross-defaults that allow termination.



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