Managers weigh impact of Credit Suisse takeover on debt markets

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An unusual feature of the takeover of Credit Suisse by UBS, leading to 16 billion Swiss francs ($17.4 billion) in debt being completely written down, is worrying money managers.

The Swiss Financial Market Supervisory Authority, or FINMA, on Sunday approved the takeover of Credit Suisse, which was hit by a crisis of confidence stemming from the collapse of U.S. banks in recent weeks. That crisis came on top of months of difficulties for the banking group, including the fallout of its relationship with Greensill Capital and changes in senior leadership.

Last week, Credit Suisse's share price dropped more than 30% amid the fallout in the banking sector following the collapse of U.S. banks including Silicon Valley Bank.

FINMA said it had been monitoring Credit Suisse "intensively for several months," and that there had been a risk of the bank becoming illiquid amid considerable client outflows. Authorities took action "in order to prevent serious damage to the Swiss and international financial markets," with the banking group being offered liquidity by the central bank and support from the Swiss government.

However, one part of the takeover relates to Credit Suisse's additional tier 1 debt — known as AT1s — part of the contingent convertibles asset class, also known as CoCos. The securities are designed to help support bank capital.

FINMA said "the extraordinary government support will trigger a complete write-down of the nominal value of all AT1 debt of Credit Suisse," totaling about 16 billion Swiss francs.

While Credit Suisse said in a news release that the takeover transaction is not expected to disrupt client services, money managers cited the AT1 write-downs as a potentially long-lasting issue for European banks and credit markets.

Holders of Credit Suisse AT1 bonds include Pacific Investment Management Co., which held $807 million in securities, and Invesco, which holds around $370 million, according to Bloomberg. A spokeswoman for PIMCO declined to comment. Spokeswomen for Invesco could not immediately be reached for comment.

In a note published Tuesday, BlackRock Investment Institute said it has retained a risk-off stance, but the "ongoing bank tumult on both sides of the Atlantic" has led it to stay nimble and underweight most equities, downgrade credit to neutral on tighter credit supply for borrowers, and prefer very short-maturity government bonds for income.

The institute said the writing down of AT1 bonds to zero was an "unusual feature" of the deal, with the measure triggered by the government's support.

While these terms are rare outside Switzerland and unlikely to occur elsewhere, the BII warned that issuance costs will increase as a result of the situation.

TwentyFour Asset Management executives also see long-lasting ramifications for bank debt markets following the Credit Suisse move.

Writing in a blog Monday, Eoin Walsh, TwentyFour founding partner and portfolio manager, said AT1 bondholders "are wiped out, which is unprecedented."

While acknowledging that the situation is very fluid, Mr. Walsh said it is "very difficult to say how badly damaged investor confidence will be in the short term though. We do however think that it is important to keep in mind that this was a bank, in a specific regime, facing large deposit outflows, where we think the regulator made a highly questionable decision, and one that could end up in court — in some cases, bonds are now bid with a 'Claim Transfer Agreement', suggesting this option is open."

The Credit Suisse situation should "serve as a warning of a potentially deeper crisis," said Eric Vanraes, portfolio manager of the Strategic Bond Opportunities Fund at Eric Sturdza Investments, in written comments Tuesday.

Regarding the writing down of Credit Suisse's AT1 bonds, Mr. Vanraes said investors have "discovered that their Credit Suisse AT1's were subordinated to equities, and now worthless. This is unprecedented and discredits subordinated debt in banks and the asset class in general. In the short term, the AT1 market will suffer. In the medium term, it will undoubtedly offer opportunities to those specialists who can analyze this type of instrument and read a prospectus' fine print."

However, Davide Serra, founder and CEO at Algebris Investments, said in emailed comments Monday that the firm does not expect a "long-term structural impact on AT1s in Europe, outside of Switzerland. These are G20 capital structures that exist around the world. These loss-absorbing bonds are part of the fabric of bank debt, and they will remain so in Europe, and the U.S., under Basel III."

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