NEWSLETTER MARCH 2023

Acquisition of Credit Suisse by UBS – Order of Necessity, FINMA Decision(s) and Means of Actions for Bondholders AT1

I. INTRODUCTION

On March 10, 2023, Silicon Valley Bank was put into receivership by the US authorities. This resulted in a market panic, which led to Credit Suisse's stock tumbling. To stop the fall, on March 15, 2023, SNB provided liquidity of up to CHF 50 billion to Credit Suisse. At the same time, the Swiss Financial market Supervisory Authority (**FINMA**) and the Swiss National Bank (**SNB**) informed the market that the bank fulfilled the capital adequacy and solvency requirements for systemically important banks. However, the value of Credit Suisse shares continued to decline. In order to protect Switzerland's financial system and the international financial market, the Swiss authorities announced a series of measures to halt Credit Suisse's demise. The solution agreed upon by the negotiating parties has been a merger between Credit Suisse and UBS, which is facilitated by public loans to ensure its success and facilitated by various procedural exceptions.

This exceptional agreement required equally exceptional measures that were taken and announced on Sunday, March 19, 2023. These measures are based in particular on an "emergency" ordinance adopted by the Federal Council (CF) on March 16, 2023 (**Ordinance March 16**)[1].

On March 19, 2023, together with the announcement of the merger agreement between UBS and Credit Suisse, the CF amended the Ordinance March 16 to lay the ground for the completion of this transaction. The Ordinance of March 19 (the **March 19 Amendment**) now provides that FINMA may order the write-down of the AT1s at the time additional public credit facilities are approved. It also authorizes FINMA to approve a merger between UBS and Credit Suisse superseding the ordinary shareholders' meeting resolution. Finally, the March 19 Amendment introduces a federal guarantee of up to CHF 9 billion against losses, which UBS would incur as a result of the merger.

On the same date, FINMA announced its approval of the merger and announced that the government's exceptional funding triggered the full write-down of all Credit Suisse's AT1 bonds. The write-down affects a volume of around CHF 16 billion. To date, however, the FINMA decision(s) on approval of the merger and the write-down of the AT1 bonds has not (have not) been published.

The purpose of this newsletter is to highlight the means of actions available to holders of AT1 bonds against the decisions taken on or around March 19. Please note that this newsletter is not intended to be exhaustive and that a detailed version might be requested by our clients.

[1] Ordinance of March 16, 2023 on the supplementary liquidity assistance loans and the granting by the Confederation of default risk guarantees for liquidity assistance loans of the Swiss National Bank to systemically important banks (SR 952.03).

II. OVERVIEW OF THE LEGAL FRAMEWORK FOR CREDIT SUISSE AT1 BONDS

The AT1 bonds written down by FINMA are debt instruments. They are *convertible bonds* (**CoCos**) in the broad sense.

The CoCos' interest is to be able to become equity in the event of a trigger event (***Trigger event***). The occurrence of the *Trigger event* triggers the write-down of the investor's claim arising from the loan against the bank. In other words, the occurrence of the *Trigger event* is a condition precedent triggering a debt forgiveness within the meaning of art. 115 of the Swiss Code of Obligations.

In principle, the compulsory conversion or the debt forgiveness is triggered either by an emergency (***Contingency event***) or by a case of viability (***Viability event***).

The *Contingency event* is a limit set according to certain capital ratios consisting of CET1 and risk-weighted positions.

The *Viability event* takes place under certain circumstances in which there is a risk of insolvency.

The law does not expressly provide that FINMA may itself declare a *Trigger event*. The capital adequacy Ordinance sets out the conditions for such a decision, but does not define them precisely. In our opinion, prior to the March 19 Amendment, FINMA might only have ordered a write-down within the context of restructuring proceedings.

The terms and conditions of the Credit Suisse AT1 bonds encompass both *Contingency events* and *Viability events*. These cover two hypotheses:

- In the first scenario, a *Viability event* is essentially triggered when the regulatory authority notifies Credit Suisse that a write-down is an essential condition to prevent the bank from becoming insolvent, bankrupt, unable to pay a substantial portion of its debts when due or unable to operate. In order for the *Viability event* to be fulfilled, a legally valid order from FINMA shall be in place;

- In the second scenario, the *Viability event* is essentially fulfilled when Credit Suisse uses public funds that are supposed to improve Credit Suisse's capital adequacy. In our view, the condition precedent is not fulfilled in the present case given that the public funds made available to Credit Suisse did not improve its capital adequacy.

The analysis should therefore cover the first hypothesis. If FINMA's decision is flawed, which we think to be the case as explained below, it is therefore conceivable to challenge it and hence the occurrence of the *Viability event*. If the write-down of the AT1 bonds does not comply with the prospectus conditions (*i.e.*, lack for valid FINMA decision), this paves the way for a contractual claim against Credit Suisse or its successor to bring the financial institution into compliance with its obligations. Since the write-down was caused by an authority, the question also arises as to whether an action for damages against Switzerland is conceivable. Assessing the appropriateness of such an action is, however, difficult at such an early stage and we already point out that the illegality of the State action shall be qualified to trigger a potential State liability.

III. REVIEW OF THE VALIDITY OF FINMA DECISION

As mentioned above, in order for the contractual terms to be complied with, the FINMA decision shall be valid. Even if we were to assume that FINMA decision complied with the contractual terms of issue for the AT1 bonds, this would not exempt us from reviewing whether that decision complied with Swiss law. The decision-making powers of an authority may not be based exclusively on a contract. It must be based on the law.

According to this bulletin, FINMA's decision may not have been made on the basis of the legislation applicable prior to March 19, 2023, as a write-down might only have been decided within the specific context of the resolution rules for banks contained in the Federal Act on Banks and Savings Banks of 8 November 1934 (**Bank Act**). To our knowledge, the merger with UBS did not take place within such a context. In addition, in such an event, the creditors of the AT1 bonds should have in principle been served in priority over the shareholders.

To address this point, the authorities have created an express legal basis for FINMA to order the write-down (art. 5a of the March 19 Amendment).

On the one hand, it is legitimate to wonder whether the March 19 Amendment satisfies the conditions for passing such emergency piece of legislation. Case law and legal scholars infer from art. 184 para. 3 and 185 para. 3 of the Federal Constitution (**CST**) that an emergency order (i) shall aim to protect public order, external or internal security, (ii) against existing or threatening troubles, (iii) representing (a threat) serious harm, and (IV) such harm may not be copped with under the laws currently in force.

In any event, the majority of case law and legal scholars hold that an emergency order may not depart from the Federal Constitution. It is hence, on the other hand, possible to examine whether FINMA's decision is consistent with the principles of state activity, specifically the principles of legality (CST art. 5 (1)) and proportionality (CST art. 5 (2)). Such requirements apply in the present case all the more (CST art. 36, paras. 1 and 3) as the decision affects the guarantee of property (CST art. 26), or even economic freedom (CST art. 27).

From the standpoint of legality, art. 5a of the March 19 Amendment on which FINMA has relied to take its decision is flawed in several respects.

First, it is questionable whether it is actually a legislative act. Notwithstanding its precise wording and the powers of discretion conferred on FINMA, this provision appears to in fact dealing with a specific case.

Second, this provision is unsatisfactory in terms of normative density: with the exception of the requirement that FINMA decision must be taken at the time of approving the credit support, it does not provide for any conditions to which the write-down is subject or indicate any criteria that would allow the authority to exercise its discretion.

Thirdly, it seems to us doubtful that art. 5a of the March 19 Amendment complies with higher Federal law (particularly the Banking Act art. 11 and 13 as understood and implemented to date, as well as with the Bank restructuring rules) and thus be substantively valid. Although some legal scholars believe that emergency laws may deviate from Federal law, we are of the opinion that such laws may not contradict existing rules specifically dealing with the intended course of events. Dealing with bank solvency and capital adequacy issues is exactly the purpose of the Bank Act (in particular its restructuring provisions) and the capital adequacy Ordinance. Hence, the new emergency rules appear to circumvent the will of the legislative power, thereby encroaching upon the principle of legal certainty.

Finally, and most decisively, we question the proportionality of FINMA decision. We are of the opinion that a less invasive measure for holders of AT1 bonds could have been implemented with the same expected benefits. The existing resolution rules, which give the holders of CoCos priority over the shareholders, should have guided FINMA in its decision.

IV. LEGAL REMEDIES AND STEPS TO BE TAKEN

In our view, AT1 bondholders may challenge the FINMA decision in front of the Federal Administrative Court until 3 May 2023.

Creditors affected by FINMA decision may request that they be notified of the decision affecting their rights in order to safeguard the possibility to challenge the FINMA decision. We recommend that AT1 bondholders do so in order to preserve their rights, particularly in view of a potential government liability suit and, above all, a contractual suit against Credit Suisse and, following the merger, UBS.

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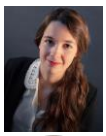

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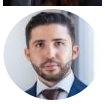

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