Write-down of Credit Suisse's AT1s – A Singapore Perspective

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There has been much ado about additional Tier 1 instruments (**AT1s**) in the wake of the wipeout of CHF16 billion worth of AT1s issued by Credit Suisse Group AG (**Credit Suisse**) ordered by the Swiss Financial Market Supervisory Authority (**FINMA**). We set out below a brief on what AT1s are and what has happened to Credit Suisse's AT1s, and share our views on locally-issued AT1s and the stance of the Monetary Authority of Singapore (**MAS**).

What are AT1s?

AT1s are a type of hybrid capital instrument that banks issue to meet capital adequacy requirements set by regulators. They are designed to absorb losses in the event of a bank's financial distress. Their principal features are that they are deeply subordinated, typically perpetual (meaning they have no fixed maturity date) and, while they are usually callable by the bank after a specified period, may be redeemed only with the approval of the supervising central bank. Other key differentiating factors from other perpetual securities issued by normal corporate entities are the inclusion of specific provisions to ensure their loss absorbency at the point of non-viability (PONV) and the fact that AT1s are subject to the resolution powers of the supervising central bank. We elaborate more on the loss absorbency feature below.

What has happened with Credit Suisse's AT1s?

On 19 March 2023, Credit Suisse was notified by the FINMA that Credit Suisse's AT1s would be written off to zero. This took place alongside the merger between Credit Suisse and UBS Group AG (**UBS**) brokered by the Swiss Federal Department of Finance, Swiss National Bank and the FINMA. What took the market by surprise was that, while the holders of Credit Suisse's AT1s faced a complete wipeout of their investment, shareholders of the embattled bank stand to receive one share in UBS for every 22.48 shares in Credit Suisse, a not unsubstantial level of recovery considering that shareholders are technically junior in ranking to AT1 holders. The write-off of the AT1s by the FINMA appears to have upended the traditional order of hierarchy when it comes to taking losses. One may be forgiven for thinking that, if there was any recovery for shareholders, there would be even greater recovery for AT1 holders.

Having said that, a closer inspection of the information memorandum for Credit Suisse's S$750 million 5.625% AT1s (**Notes**) discloses that "*FINMA may not be required to follow any order of priority, which means, amongst other things, that the Notes could be cancelled in whole or in part prior to the cancellation of any or all of CSG's equity capital*" – although this risk factor was made in the context of what could happen if restructuring proceedings were commenced by the FINMA. To wit, there are three ways in which the Notes could be written off: (a) first, where the ratio of the Common Equity Tier 1 Capital of the Credit Suisse Group to the aggregate amount of its riskweighted assets falls below 7%; (b) second, if a "Viability Event"[1] occurs; and (c) third, if the FINMA opens restructuring proceedings with respect to Credit Suisse under Swiss banking laws.

On 23 March 2023, the FINMA clarified that, as Credit Suisse was granted extraordinary liquidity assistance loans secured by a federal default guarantee on 19 March 2023, the contractual conditions for the occurrence of a "Viability Event" under the terms of the AT1 instruments issued by the bank were met. In addition, the FINMA clarified that the Emergency Ordinance (on Additional Liquidity Assistance Loans and the Granting of Federal Default Guarantees for Liquidity Assistance Loans by the Swiss National Bank to Systemically Important Banks) enacted on 19 March 2023 (**Emergency Ordinance**) authorised the FINMA to order Credit Suisse to write down its AT1 instruments. Based on the contractual agreements and the Emergency Ordinance, the FINMA instructed Credit Suisse to write down its AT1 instruments. It is not entirely clear why the FINMA found it necessary to include such additional authority under the Emergency Ordinance when it would ostensibly have sufficed to trigger a "Viability Event" to write-down the AT1s, but it is welcomed that the legal basis for the FINMA's action has been laid bare for future reference and analysis.

Local AT1s – a Singapore perspective

As mentioned earlier, AT1s complying with the AT1 eligibility conditions set out under MAS Notice 637 (on Risk Based Capital Adequacy Requirements for Banks Incorporated in Singapore) must contain provisions to ensure their loss absorbency at the point of non-viability, which is very similar to the second way Credit Suisse's Notes can be written off. This means that AT1s must, at the option of the MAS, be either written off or converted into ordinary shares upon the occurrence of a trigger event. That trigger event is defined as the earlier of:

(a) The MAS notifying the bank in writing that it is of the opinion that a write-off or conversion is necessary, without which the bank would become non-viable; and

(b) The MAS' decision to make a public sector injection of capital, or equivalent support, without which the bank would have become non-viable, as determined by the MAS.

While the MAS has set out a list of factors it may take into account for the purposes of determining the point of non-viability, the list is non-exhaustive. Ultimately, the MAS retains a substantial degree of discretion in terms of when a trigger event occurs.

[1] Under the terms of the Notes, a "Viability Event" is defined to mean either: (i) FINMA has notified Credit Suisse that it has determined that a write-down of the Notes, together with the conversion or write-down/off of holders' claims in respect of other Going Concern Capital Instruments, Tier 1 Instruments and Tier 2 Instruments that, pursuant to their terms or by operation of law, are capable of being converted into equity or written down/off at that time, is, because customary measures to improve Credit Suisse's capital adequacy are at the time inadequate or unfeasible, an essential requirement to prevent Credit Suisse from becoming insolvent, bankrupt or unable to pay a material part of its debts as they fall due, or from ceasing to carry on its business; or (ii) customary measures to improve Credit Suisse' capital adequacy being at the time inadequate or unfeasible, Credit Suisse has received an irrevocable commitment of extraordinary support from the Public Sector (beyond customary transactions and arrangements in the ordinary course) that has, or imminently will have, the effect of improving Credit Suisse's capital adequacy and without which, in the determination of FINMA, Credit Suisse would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business.

In addition, locally-issued AT1s can also be written down pursuant to an exercise of the MAS' Bail-in Powers under Division 4A of the Monetary Authority of Singapore Act 1970 (**MAS Act**). In this connection, the MAS may issue a bail-in certificate under section 75 of the MAS Act which can have one or more of the following effects:

(a) The cancellation of the whole or a part of the AT1s;

(b) The modification, conversion or change in form of the whole or a part of the AT1s;

(c) The AT1s are to have effect as if a right of modification, conversion or change of their form had been exercised under them; and

(d) Any incidental, consequential or supplementary matters, including a requirement that the issuing bank or any other person must comply with a general or specific direction set out in the bail-in certificate.

What is clear is that the terms of locally-issued AT1s do not specifically require Common Equity Tier 1 to be written down first before effecting a write-down of AT1s.

What is the MAS' stance on AT1s?

Significantly, the Bank of England and other European regulators (the European Banking Authority, the Single Resolution Board and the European Central Bank) have, in the wake of the Notes write-down, come out on 20 March 2023 to assure investors of their resolution approach, which is essentially to respect the creditor hierarchy where equity instruments stand as first loss absorbers before any AT1 write-downs.

Following on closely, the MAS issued a statement on 22 March 2023 stating that, in exercising its powers to resolve a financial institution (**FI**), it intends to abide by the hierarchy of claims in liquidation, which means that equity holders will absorb losses before holders of AT1 and Tier 2 capital instruments. Furthermore, creditors who receive less in a resolution compared to what they would have received had the FI been liquidated would be able to claim the difference from a resolution fund that would be funded by the financial industry. The MAS also stated that the creditor compensation framework would also apply in the exceptional situation where the MAS departs from the creditor hierarchy to contain any potential systemic impact of the FI's failure or to maximise the value of the FI for the benefit of all creditors as a whole.

Given the critical role of AT1s to the banking sector, we appreciate the MAS' swift endeavours to assuage investors' concerns. We believe that the commitments by the MAS in its communique will go some way to mitigate the confusion created by the Credit Suisse AT1 fallout and support the re-opening of the AT1 market. However, one question that might still linger in the minds of potential AT1 investors is what might happen if, in a liquidation scenario, it is assessed that the AT1s would have been wiped out anyway. In such a scenario, what would be the amount of such claim? We have to be mindful that, under section 114(2) of the MAS Act, the amount of compensation that a creditor is eligible for is the difference between what that creditor would have received had winding-up proceedings been commenced against the FI immediately before the resolution date and what the creditor received or is likely to receive as a result of the resolution action. Section 114(2) of the MAS

Act does not appear to take into account what other creditors or equity holders might be receiving following such action. While there are no easy answers, such a risk appears remote with the MAS clearly signalling its intention to respect the normal credit hierarchy and the comfort we can take in the strength and resilience of Singapore's banking system, with its well-capitalised banks that enjoy healthy liquidity positions underpinned by a stable and diversified funding base, reinforced by regular stress testing against interest rate and other risks.

If you would like information or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or any of the following Partners:

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