

The ISDA Determination Committee has reached a decision

No government intervention constituting a credit event has occurred for Credit Default Swaps on Credit Suisse subordinated bonds

Par Jean-François Mion le 22 May 2023

Of course, the full consequences of the Credit Suisse rescue are not yet known. Between March 16 and 19, the Federal Council, the SNB, FINMA and the Boards of Directors of UBS and Credit Suisse took the decisions that enabled the two banks to merge (see <https://cdbf.ch/1272/>).

The SNB granted extraordinary loans to Credit Suisse, secured by two federal loans. A first urgent commitment credit was granted in the form of a default risk guarantee of up to CHF 100 billion, which could be called upon upon the conclusion of bankruptcy proceedings and in the event of default by the SNB. A second urgent commitment credit was granted in the form of a CHF 9 billion guarantee against losses related to assets to be liquidated.

These commitment credits were granted on the basis of the Ordinance on additional liquidity support loans and the granting of default risk guarantees by the Confederation for Swiss National Bank liquidity support loans to systemically important banks of March 16, 2023.

In accordance with Art. 5a of the revised Ordinance of March 19, FINMA has ordered Credit Suisse to fully amortize the Additional Tier 1 (AT1) subordinated bonds.

The granting of these commitment credits and the FINMA order resulted in a total amortization of the AT1 bonds in a nominal amount of around CHF 16 billion in accordance with section 7(b) of their conditions, triggered in the event of a Viability Event (section 7(a)(iii)). This event is characterized by a notification from the regulator (notably if it determines that an amortization of the bonds is an essential requirement to prevent bankruptcy) or extraordinary public support.

Certain purchasers of credit default swaps (CDS) on Credit Suisse subordinated bonds were waiting to find out whether a credit event had occurred, which would have enabled them to be indemnified by their protection sellers.

In this context, the Europe Middle East & Africa Credit Derivatives Determinations Committee (DC) of the International Swaps and Derivatives Association (ISDA) received a request on May 11 to establish whether a government intervention constituting a credit event under section 4.8 of the 2014 ISDA Credit Derivatives Definitions had occurred. This request was sent a few days

before the end of the 60-day limitation period (the look-back period), starting from the supposed credit event, the Credit Event Backstop Date of section 1.39.

It should be remembered that government intervention as a credit event was introduced in the new 2014 definitions to replace the old 2003 definitions, following the bail-out of Dutch bank SNS in 2013. The case of mandatory cancellation of reference obligations has also been added on this occasion under section 4.8(a)(iii) of the definitions in order to expressly cover cases of total amortization of obligations leading to their cancellation.

The role of the DC is to put the facts relating to specific events into perspective with the 2014 definitions and to establish whether a credit event has occurred as requested by the applicant, a decision binding on the counterparties (section 10.2).

The DC ruled on May 16 and 17 that no government intervention constituting a credit event had taken place. This decision was based on the level of subordination of the AT1 bonds to the reference obligation of the Credit Suisse subordinated bond CDSs, particularly in view of section 4(a) of their terms and conditions. In this case, the DC specified that the reference bond was also a subordinated bond issued in 2000 and maturing in 2020, but which it considered to be senior to the AT1 bonds.

The DC did not have to consider whether government intervention under the 2014 definitions had occurred, since its decision was based on the exclusion of AT1 bonds from the scope of the CDS. Finally, it should be noted that the DC verbalized that it had not determined whether AT1 bonds constitute Borrowed Money under the 2014 definitions – perhaps it wished to leave a door open.

In accordance with the 2018 Credit Derivatives Determinations Committees Rules, the DC will not be able to rule again on this specific issue, unless new information is revealed (section 2.5(b)).

A new request was submitted and accepted on May 18, one day before the end of the look-back period, this time to establish whether a bankruptcy constituting a credit event under section 4.2 of the 2014 Definitions has taken place. Unlike its predecessor, this request concerns both senior and subordinated bonds. To be continued.

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