

## A brief update on Credit Suisse and “CoCos”



**Eric Savoie, MBA, CFA**  
Investment Strategist  
RBC Global Asset Management Inc.



**Daniel E. Chornous, CFA**  
Chief Investment Officer  
RBC Global Asset Management Inc.

Concerns that began in U.S. regional banking have made their way to Europe where Credit Suisse (CS) became the central focus for investors, adding to worries around systemic risks in the financial system. Troubles are not new to the Swiss bank which has been undergoing a difficult restructuring. Last week, investors and depositors ran out of patience given concern over the impact of rate hikes, the prospect of a slowing economy and the issues surfaced with the failure of Silicon Valley Bank. CS’s stock was already ravaged, with shares down 68% last year and price declines accelerating in recent weeks. Moreover, doubts over CS’s ability to service its debts surfaced as the cost of insuring against default, measured by credit default swap spreads, surged to more than four times the levels seen at the height of the European Debt Crisis and the Global Financial Crisis. Given its status as a systemically important financial institution, a solution for CS needed to be found quickly. Swiss National Bank intervened last week to provide near-term liquidity and late Sunday evening UBS agreed to take over CS.

An important aspect of the crisis at CS was the treatment of Additional Tier 1 (AT1) bonds, also known as contingent convertible bonds or CoCos. These bonds were created following the Global Financial Crisis as a way to help banks meet their capital requirements. If a bank runs into trouble, the CoCos could be converted into equity in order to shore up the bank’s balance sheet. Fixed income investors believed that in a wind-down scenario, these securities would be positioned between more

senior debt and equity. However, in this particular case, Swiss National Bank placed the AT1 bonds behind equity, resulting in a 100% loss for the US\$17 billion of CoCos issued by CS. Investors responded viscerally as this decision raised questions for the broader market about the riskiness of these AT1 bonds. This situation has since calmed significantly following a statement by European and UK banking regulators, reassuring investors that under normal circumstances equity securities would be the first to absorb losses, and only after equity is fully depleted would AT1 bonds be written down. While that is small comfort to the holders of CS CoCos, it appears that the instrument and the AT1 market will survive the current crisis.

Although the fear of contagion is proving difficult to suppress, the situation with respect to CS appears to have been resolved with the merger with UBS. While these events serve as a reminder of the instability and stresses that can appear from time to time, regulators are also showing that they have a broad set of tools available to them during these periods. Nevertheless, we recognize that markets are particularly skittish following a year of rapid rate increases and the resulting stresses in the financial system. Financial conditions have tightened in recent weeks, no doubt providing room for central banks to re-assess their policy options. We are maintaining our below-consensus view for economic growth and believe that a cautious approach to risk taking remains warranted.

# Disclosure

This document is provided by RBC Global Asset Management (RBC GAM) for informational purposes only and may not be reproduced, distributed or published without the written consent of RBC GAM or its affiliated entities listed herein. This document does not constitute an offer or a solicitation to buy or to sell any security, product or service in any jurisdiction; nor is it intended to provide investment, financial, legal, accounting, tax, or other advice and such information should not be relied or acted upon for providing such advice. This document is not available for distribution to people in jurisdictions where such distribution would be prohibited.

RBC GAM is the asset management division of Royal Bank of Canada (RBC) which includes RBC Global Asset Management Inc., RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management (UK) Limited, RBC Global Asset Management (Asia) Limited, and BlueBay Asset Management LLP, which are separate, but affiliated subsidiaries of RBC.

In Canada, this document is provided by RBC Global Asset Management Inc. (including PH&N Institutional) which is regulated by each provincial and territorial securities commission with which it is registered. In the United States, this document is provided by RBC Global Asset Management (U.S.) Inc., a federally registered investment adviser. In Europe this document is provided by RBC Global Asset Management (UK) Limited, which is authorised and regulated by the UK Financial Conduct Authority. In Asia, this document is provided by RBC Global Asset Management (Asia) Limited, which is registered with the Securities and Futures Commission (SFC) in Hong Kong.

Additional information about RBC GAM may be found at [www.rbcgam.com](http://www.rbcgam.com).

This document has not been reviewed by, and is not registered with any securities or other regulatory authority, and may, where appropriate, be distributed by the above-listed entities in their respective jurisdictions.

Any investment and economic outlook information contained in this document has been compiled by RBC GAM from various sources. Information obtained from third parties is believed to be reliable, but no representation or warranty, express or implied, is made by RBC GAM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC GAM and its affiliates assume no responsibility for any errors or omissions.

Opinions contained herein reflect the judgment and thought leadership of RBC GAM and are subject to change at any time. Such opinions are for informational purposes only and are not intended to be investment or financial advice and should not be relied or acted upon for providing such advice. RBC GAM does not undertake any obligation or responsibility to update such opinions.

RBC GAM reserves the right at any time and without notice to change, amend or cease publication of this information.

Past performance is not indicative of future results. With all investments there is a risk of loss of all or a portion of the amount invested. Where return estimates are shown, these are provided for illustrative purposes only and should not be construed as a prediction of returns; actual returns may be higher or lower than those shown and may vary substantially, especially over shorter time periods. It is not possible to invest directly in an index.

Some of the statements contained in this document may be considered forward-looking statements which provide current expectations or forecasts of future results or events. Forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Do not place undue reliance on these statements because actual results or events may differ materially from those described in such forward-looking statements as a result of various factors. Before making any investment decisions, we encourage you to consider all relevant factors carefully.