KEY POINTS

- On 19 March, the Swiss Financial Market Supervisory Authority (FINMA) announced the approval of the takeover of Credit Suisse (CS) by UBS and the complete write-down of all CS's Additional Tier 1 bonds (AT1s) in the sum of CHF16bn.
- The financial markets, in particular fixed income investors, were shocked and the price of other banks' AT1s plummeted.
- The shock arose because under the deal AT1 bondholders received nothing, while shareholders received US$3.2bn. Shareholders usually rank below bondholders and the outcome for AT1 bondholders was contrary to the assumed capital hierarchy.
- Other financial regulators also appear to have been taken by surprise, and immediately sought to distance themselves from the actions taken in relation to the AT1s.
- There are several potential routes by which AT1 bondholders may be able to seek redress.
- This article focuses on potential investment treaty claims, including preliminary thoughts on the important issue of potential quantum.

Feature

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Credit Suisse, AT1 bonds and taking the BIT between the teeth

Given the huge losses suffered by Additional Tier 1 bondholders, it is unsurprising that lawyers are exploring various potential avenues for investors to obtain redress. This article focuses on investment treaty claims. In the authors' view, such claims provide a potentially attractive route for investors to recover losses.

I. INTRODUCTION

While a doctoral thesis could be written on relevant principles and their application, this article seeks to consider, at a high level, some points that appear to the authors to be relevant in the context of BIT claims.

Following a brief introduction to contingent convertible bonds, relevant events leading up to and in the aftermath of the write-down of the Additional Tier 1 bonds (AT1s) are covered. Next, the Swiss Financial Market Supervisory Authority's (FINMA's) justification of its actions is considered. In this context, the authors briefly consider the terms of the AT1s and then factors causing the market and regulators to be taken by surprise by the UBS deal. An introduction to investment treaty arbitrations is then provided, followed by an application of these principles to the AT1 scenario. Principles relating to quantum are provided and finally a variety of potential counterfactuals are considered to illustrate the potential range of awards.

II. AT1 BONDS

AT1s are part of a broader family of assets known as contingent convertible bonds (CoCos).

CoCos were born following the 2008 financial crisis and the requirement that banks hold more of their own (as opposed to borrowed) capital to provide a protective layer when they are in trouble, thus reducing the probability of taxpayer-funded bailouts. Banks were permitted to issue CoCos in order to strengthen their Tier 1 capital (in simple terms, their "permanent capital") and therefore comply with Basel III requirements.

Features of AT1s include:

- they have no maturity date (as they are considered a permanent component of the bank's capital similar to equity);
- they offer higher returns than plain vanilla debt instruments. However, while they pay regular coupons in the "good" state of the world, they convert into equity or are written down in the "bad" state of the world, namely when trigger points (related to capital ratios) are reached. When this occurs, the idea is that the bonds absorb the banks' losses; and
- banks can grant a call option on the bonds after (say) five years, at which point they may redeem the bonds.

III. CHRONOLOGY

The chronology in Table 1 overleaf provides a summary of relevant events leading up to (and in the immediate aftermath of) the write-down of the AT1s and provides context for some of Credit Suisse's (CS) significant share and bond price movements during this period. These events and prices are relevant to understanding the nature of potential investment treaty claims and quantum that may be awarded, as explained later in this article.

FINMA's justification of the write-down

In a press release on 23 March 2023,[4] FINMA sought to justify the write-down of the AT1 bonds on two bases:

- first, the "contractual basis": the "AT1 instruments … contractually provide that they will be completely written down in a 'Viability Event', in particular if extraordinary government support is provided. As Credit Suisse was granted extraordinary liquidity assistance loans secured by federal default guarantee on 19 March 2023, these contractual conditions were met [...]"; and
- second, by reference to the Federal Council's amended Additional Liquidity Ordinance of 19 March.

IV: TERMS OF THE NOTES

From the terms and conditions of the AT1 notes which the authors have seen, they appear, as relevant, to be in materially the same terms as those with ISIN CH0360172719,[5] which are governed by Swiss Law (T&Cs). In this section, the authors do not embark on a legal analysis of the terms and conditions under Swiss Law (in which the authors are not qualified), let alone the merits of potential contractual claims, but highlight points that may be relevant to the question of whether there was a contractual breach. This is relevant

TABLE 1: SUMMARY OF RELEVANT EVENTS

DATE	EVENT	CLOSING SHARE PRICE	CLOSING BOND PRICE
9 Feb	CS announced its biggest ever financial loss (US$1.5bn).	3.02	77%
10 Mar	The banking sector in general was affected by the demise of SVB in the US.	2.66	63%
14 Mar	CS, in an investor presentation, described the Swiss resolution regime. The slides: ➨ specifically refer to "no creditor worse off than in liquidation" (NCWOL) rule; and ➨ state that the "[s]trict and complete hierarchy of losses is enforced by law".	2.51	53%
15 Mar (10:15)	The Saudi National Bank, a 9.9 % shareholder, announced it would cease support for CS.	2.16	53%
15 Mar (19:36)	FINMA and the Swiss National Bank (SNB) issued a joint press release: "Credit Suisse meets the capital and liquidity requirements imposed on systematically important banks. If necessary, the SNB will provide Credit Suisse with liquidity."[1]	2.16	53%
16 Mar	Analysts speculated that should the SNB be unsuccessful, then it was likely that UBS would buy CS. The SNB provided liquidity assistance to CS in the sum of US$54bn. The grant of the credit was reflected in Art 5 of the Ordinance on Additional Liquidity Assistance Loans and the Granting of Federal Default Guarantees for Liquidity Assistance Loans from the Swiss National Bank to Systemically Important Banks (the Additional Liquidity Ordinance).	2.16	30%
17 Mar	Friday before the weekend.	2.01	26%
19 Mar	The deal between CS and UBS was announced overnight. FINMA's press release includes:[2] "[FINMA] has approved the takeover of Credit Suisse by UBS … … *To protect depositors and the financial markets*, the offer by UBS to take over Credit Suisse has proven to be the most effective solution. FINMA has therefore approved this transaction. … In close coordination with FINMA, the Swiss Confederation and the SNB, UBS will take over Credit Suisse in full. *The extraordinary government support will trigger a complete write-down of the nominal value of all AT1 debt of Credit Suisse in the amount of around CHF 16 billion, and thus an increase in core capital.* …To ensure that all obligations can continue to be met at all times throughout the transaction, further liquidity assistance will be assured. This means that the banks involved will have substantial additional liquidity available to carry out the takeover. The Swiss Confederation will also provide guarantees for potential losses of certain assets that UBS will acquire as part of the transaction, if these losses exceed a specific threshold" (emphasis added). The Swiss Federal Council published an *amended Additional Liquidity Ordinance*, which added Art 5a "Additional Tier 1 capital": "At the time of the credit approval in accordance with Article 5, FINMA may order the borrower and the financial group to write down additional Tier 1 capital." The explanatory report to Art 5a states that the loans "constitute a decisive public measure to avert insolvency and thus a public assistance measure in favour of the bank concerned". Further, an order pursuant to Art 5a "may also be issued with regard to a takeover or sale scenario if insolvency would have occurred immediately without this takeover." (italics added)		

DATE	EVENT	CLOSING SHARE PRICE	CLOSING BOND PRICE
20 Mar	Prices cratered when markets opened on Monday. The Bank of England (BoE) and the European Central Bank (ECB) both issued statements distancing themselves from the Swiss authority's complete write-down of the AT1s. **BoE**: "The UK's bank resolution framework has a clear statutory order in which shareholders and creditors would bear losses in a resolution or insolvency scenario … AT1 instruments rank ahead of CET1 [Common Equity Tier 1; primarily ordinary shares] and behind T2 [Tier 2; more illiquid capital] in the hierarchy. Holders of such instruments should expect to be exposed to losses in resolution or insolvency in the order of their positions in this hierarchy."[3] **ECB**: "The resolution framework implementing in the European Union the reforms recommended by the Financial Stability Board after the Great Financial Crisis has established, among others, the order according to which shareholders and creditors of a troubled bank should bear losses. In particular, common equity instruments are the first ones to absorb losses, and only after their full use would Additional Tier 1 be required to be written down. This approach has been consistently applied in past cases and will continue to guide the actions of the SRB [Single Resolution Board] and ECB [European Central Bank] banking supervision in crisis interventions. Additional Tier 1 is and will remain an important component of the capital structure of European banks."	0.94	0%

to potential investment treaty claims because such contractual provisions, albeit not signed with the State itself, may give rise to legitimate expectations in that one would expect FINMA not to intervene in the contractual sphere, unless for regulatory purposes and then only in conformity and within the parameters of the Swiss law. See further section VI below.

Clause 7.b of the T&Cs provides that following the occurrence of a Viability Event,[6] among other things, the full principal amount of each "Note" will be written down to zero and permanently cancelled. Clause 7.a.iii (Write-down) of the T&Cs provides, among other things, that a "Viability Event" means that either:

> "(A) the Regulator has notified CSG [Credit Suisse Group] 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 any and all 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 CSG's capital adequacy are at the time inadequate or unfeasible, an essential requirement to prevent CSG 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
>
> (B) *customary measures* to improve CSG's *capital adequacy* being at the time inadequate or unfeasible, *CSG 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 CSG's *capital adequacy* and *without which, in the determination of the Regulator*, CSG 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." (italics added)

The wording of FINMA's press release of 23 March, and in particular the reference to "extraordinary government support", indicates that FINMA seeks to rely on trigger (B). Whether FINMA was entitled to do so includes considering:

- What constitutes "customary measures to improve … capital adequacy" and were these measures at the time *inadequate or unfeasible* to improve *capital adequacy?* It may be that the meaning and relevance of the term "capital adequacy" features in forthcoming litigation. This is because capital and liquidity are not the same, and nor are capital adequacy requirements and liquidity requirements.[7,8] It may therefore be relevant, that, on 15 March, FINMA and the SNB announced that CS met the required capital adequacy and liquidity requirements and if necessary, the SNB would provide liquidity – there was no mention of capital adequacy issues.[9] Further, FINMA's, the Federal Council's and the SNB's press releases on 19 March make it clear that the issue at that point was liquidity, not capital adequacy.
- Was a commitment of "extraordinary support" from the "Public Sector" both

irrevocable and given *to* CSG (within the meaning of the T&Cs)?[10] Might it be relevant that at least some of the support appears to be earmarked for UBS?

- Did the irrevocable support given to CSG have the effect of improving CSG's *capital adequacy* (at the very least "imminently")?
- Did FINMA make a "determination" that CSG would have become insolvent, bankrupt, unable to pay a material part of its debts as they fell due or unable to carry on its business without the "extraordinary support"? It may be argued that FINMA's press release on 19 March indicates that FINMA did not go so far as to determine that but for the support package, CSG would have become insolvent or unable to carry on its business, etc.

It may be that FINMA seeks to rely, further or alternatively, on trigger (A). While it was certainly open to FINMA to clarify on 23 March which Viability Event it was relying upon, it appears to have hedged its bets and has not in fact specified which contractual condition it has met. However, trigger (A) is not without issues either:

- The AT1 bonds needed to be capable of being written down "pursuant to their terms or by operation of law". Had the aforementioned triggers for conversion into equity been met in each of the AT1s? It is not entirely clear. The authors suspect that FINMA will rely on the latter clause "by operation of law", by reference to Art 5a of the amended Additional Liquidity Ordinance on 19 March 2023 making the AT1s "capable of" being written down in Swiss law. However, even that route may be challenged. At the time of writing this article, it is understood that the Swiss Parliament is convening an extraordinary assembly after Swiss government representatives demanded to discuss the constitutionality of the amended Additional Liquidity Ordinance.
- The same questions that arise with trigger (B), such as what the customary measures are, questions of CS' capital adequacy, whether the write-downs were an essential requirement to prevent CSG 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, also arise in relation to trigger (A).

V: MARKET EXPECTATIONS

It was a surprise to seasoned investors and regulators that the AT1s were "zeroed". This is apparent from the fact that the market had not priced in this risk as at the close of trading on Friday 16 March, and perhaps even more starkly from regulators' swift attempt to distance themselves in the immediate aftermath of the weekend.

The authors have identified several reasons for this surprise: Swiss law prior to the announcement of the write-down; assurances by CS, FINMA and the SNB; the creditor hierarchy set out in the contractual documentation of the AT1s; and the understanding of the risk factors set out in the AT1s' investor memoranda. As explained below when considering investment treaty claims, at least some of these factors may be relevant to the merits of such claims, not least in relation to a claim for non-observance or frustration of investors' legitimate expectations, failure to offer a stable and predictable legal framework, and/or failure to act in a transparent, non-arbitrary and non-discriminatory manner.

The Swiss law prior to the announcement

AT1 bondholders are likely to argue that the Swiss legislative landscape in the run-up to the complete write-down supports their (then) expectations that their interests would take precedence over shareholders' interests.

For example, the Capital Adequacy Ordinance (CAO)[11] contains banks' capital requirements to ensure they have sufficient capital to withstand the risks inherent in their businesses. Importantly, Art 19(1) (titled 'Bearing of losses') provides that:

> "Capital components shall absorb losses in accordance with the following principles:
> a. Common Equity Tier 1 capital shall absorb losses before Additional Tier 1 capital.
> b. Additional Tier 1 capital shall absorb losses before Tier 2 capital."

Further, investors may seek to allege that a takeover would constitute a special resolution procedure known as a bank restructuring pursuant to Chapter 3 of the FINMA Banking Insolvency Ordinance (BIO-FINMA),[12] such that they reasonably expected that any takeover would comply with Chapter 3. This provides, among other things, as follows:

- FINMA does not have an automatic entitlement to open restructuring proceedings (Art 40.2).
- To open restructuring proceedings, there must be sufficient evidence that creditors are likely to fare better from the restructuring than from bankruptcy (more commonly known as the NCWOL rule) (Art 40.1.a). FINMA's own website (in a section titled 'The no creditor worse off principle') reiterates this fundamental principle, whilst also stating that, to ensure compliance "FINMA must carry out an evaluation before approving the restructuring plan".
- Section 3 (Art 47 to 50) allows for restructuring plans under which FINMA may order a debt-for-equity swap (Arts 48 and 49) and/or a reduction of claims (Art 50). In a debt-for-equity swap, the bank's entire share capital is written down before the debt capital is converted to equity and debt. Under Art 50, FINMA may order a partial or full reduction in creditor claims. However, if either or both of these approaches are taken, "it is necessary to ensure that … creditors' interests take precedence over the interests of the owners and the hierarchy of creditors is respected" (Art 47.1.a).

Accordingly, insofar as a takeover of CS by UBS was envisaged, investors may seek to argue that: (a) the conditions in Chapter 3 of BIO-FINMA were not satisfied. Plainly AT1 holders' interests did not take precedence over shareholders' interests. Further, investors may seek to allege that the NCWOL rule was ignored and/or that FINMA did not carry out any or a proper evaluation of this prior to approving the takeover; and (b) therefore, the write-down was inconsistent with their well-founded expectations about how a takeover would impact their investments.

Moreover, the AT1 holders are likely to argue that the very fact of the amended Additional Liquidity Ordinance of 19 March supports a contention that it was recognised that FINMA did not have the power to cancel the AT1s.

Assurances

It may be argued that assurances given by CS, FINMA and the SNB provided further comfort to investors, alternatively served to confirm their understanding as to their rights. In particular, as already mentioned, on 14 March, CS assured investors by referring to the NCWOL rule and stating that the "[s]trict and complete hierarchy of losses is enforced by law". Further, on 15 March, FINMA and the SNB issued a press release assuring the market that CS met its capital and liquidity requirements and that, if necessary, the SNB would provide CS with liquidity. None of CS, FINMA or the SNB corrected these assurances prior to 19 March.

The contractual hierarchy

The standard creditor hierarchy in insolvency is reflected in cl 4 (Subordination) of the AT1s: where there is an effective resolution or order for liquidation of CS, claims of AT1 bondholders would rank junior to unsubordinated debt claims, *pari passu* with other CS Tier 1 bonds but importantly "senior to the rights and claims of all holders of Junior Capital", which refers to holders of "classes of paid-in capital in relation to shares".[13]

Risk factors in Information Memoranda

Some commentators have opined that the "risk factors" section in the Information Memoranda of certain AT1s made it clear that a complete write-down in the same circumstances as actually occurred was possible.

For example, the Information Memorandum for the 9.750% AT1 (ISIN: US225401AX66), provides, in a section titled 'The obligations of the Issuer under the Notes are subordinated':

> "[…] **under certain circumstances,** *FINMA has the power to open restructuring proceedings with respect to CSG under Swiss banking laws* […] *and, if the Notes have not already been subject to a Write down, could* **convert the Notes into equity** *or cancel the Notes*, **in each case, in whole or in part. Holders should be aware that, in the case of any such conversion into equity, FINMA would** *follow the order of priority* **set out under Swiss banking laws, which means** […] **that the Notes would have to be converted prior to the conversion of any of CSG's subordinated debt that does not qualify as regulatory capital with a contractual write-down or conversion feature. Furthermore, in the case of any such cancellation,** *FINMA may not be required to follow any order of priority, which means, among 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*." **(emphasis added)**

In a section titled 'Since 1 January 2016, CSG is subject to the resolution regime under Swiss banking laws and regulations', the Information Memorandum refers to FINMA's "broad statutory powers …" and that "Resolution powers that may be exercised during restructuring proceedings … include the power to … partially or fully convert into equity of CSG and/or write-down the obligations of CSG, including the Notes …".

Therefore, the Information Memorandum sets out, in black and white, the risk that FINMA may cancel the AT1s and FINMA may not be required to follow any order of priority. However, it may be argued that the Information Memorandum envisions that FINMA has the power to "cancel the Notes" only in the context of restructuring proceedings. If so, FINMA may open restructuring proceedings at the same time as approving a restructuring plan and FINMA's announcement on 19 March states it has "approved the takeover of Credit Suisse by UBS". However, FINMA on 19 or 23 March did not refer to restructuring or the BIO-FINMA at all. In any event, it is unclear on what basis FINMA would have been entitled to ignore the precedence given to creditors' interests under of BIO-FINMA (specifically Art 47.1.a).

VI. POTENTIAL TREATY CLAIMS AGAINST SWITZERLAND

Investment treaty arbitrations: an overview

When a host State (including its regulatory bodies) interferes with foreign investment in its territory and a dispute escalates, treaty arbitration can be an effective means to obtain redress. In addition to "traditional" contractual remedies and/or domestic litigation, foreign investors can sue States under international law (BITs and/or multilateral investment treaties (MITs)) by submitting claims to international arbitration.

Historically, investment treaty arbitrations have concerned "traditional" investments like major infrastructure projects. The general view was that arbitration was unsuitable for banking and finance disputes. The tide is turning for various reasons such as: the unique characteristics of international arbitration (eg the global enforceability of arbitral awards); the possibility of using finance experts as arbitrators to adjudicate financial disputes; and, the increasing involvement of parties from a multitude of jurisdictions (including emerging market jurisdictions), leading to parties seeking to resolve disputes in neutral fora.[14]

Barring a particular carve-out in the applicable investment treaty, elements to consider when initiating treaty claims include:

- **Procedure**: whether there is a fork-in-the-road provision which forces the investor to make a binding choice between litigation in the host State's domestic courts or through international arbitration;
- **Jurisdiction**: the investor must be a national of the other State party to an investment treaty with the respondent State party; it must be either an individual who is a national of, or a company incorporated in, the other State party. Further, the investor must have made a qualifying investment. It is important to remember it would be an abuse of process (and thus, inadmissible) to restructure an investment after the dispute arose in an attempt to gain treaty protection;
- **Merits:** the protections provided under the applicable BIT, bearing in mind that protections against expropriation/

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nationalisation and a fair and equitable treatment (FET) standard are typical treaty protections:

- **Expropriation** is the taking by a State of property or investment, for which compensation must be paid. It is the sovereign right of every State to expropriate, provided it pays compensation. Expropriation can be direct (formal takeover of investment) or indirect (actions equivalent to depriving the investor of the benefit of the investment); and, lawful or unlawful (it is unsettled whether a failure or the absence of intention to pay compensation alone renders the expropriation unlawful).
- **FET** is one of the most widely invoked standards of investment protection. Tribunals have identified situations giving rise to a violation of the FET standard including: absence of transparency; arbitrary and discriminatory treatment; lack of respect for the obligation of vigilance and protection; failure to offer a stable and predictable legal framework; and, non-observance or frustration of investors' legitimate expectations. If a host State regulator interferes with an investment and breaches these protections without a lawful justification (such as a bona fide and non-discriminatory measure taken in the public interest), an investment treaty claim can be brought to seek redress; and
- **Quantum**: the measure of damages an investor can claim will depend on the treaty provisions and the type of breach.

A protected investor under an applicable BIT can either: (a) initiate investment arbitration proceedings against the host State under international law (including by joining other foreign investors via a "mass claim"); or (b) sell/assign its treaty claim rights to an arm's-length buyer who would step into the original investor's shoes.[15] The country of incorporation of an assignee is irrelevant for the purpose of establishing BIT jurisdiction as the claim originates and crystallises at the time of the host State's violation.

Some points relevant to the AT1s

Jurisdiction

As summarised above, to benefit from treaty protection, a *non-Swiss* AT1 bondholder must:

- be a national of the other State party to an investment treaty with Switzerland (ie be a "foreign investor"). In this regard, it is noted that Switzerland has signed over 100 BITs, including with Singapore, Hong Kong, UAE, Saudi Arabia, and Qatar, although not with the US, and over 30 MITs as an EFTA Member State, including with Singapore and Hong Kong ;[16] and
- have made a qualifying *investment* in Switzerland:
  - The term "investment" is broadly defined in investment treaties, and covers "every kind of asset" or "every form of investment", and requires: (i) a "contribution" (any contribution in money, in kind and in industry with an economic value); (ii) a specific duration (interpreted in case law as a minimum of one to two years) and; (iii) a risk taken by the foreign investor.
  - Investment arbitration awards have determined that negotiable instruments acquired in the secondary market, sovereign bonds, dematerialised government bonds, bank guarantees and derivatives are qualifying, protected investments.[17,18] Given this wide interpretation of forms of investment, assuming other criteria for a qualifying investment are met (eg contribution), it is likely that the AT1s would constitute qualifying investments.

Merits

Recent awards have allowed foreign investors to seek redress for expropriation or discriminatory actions by national bank regulators, such as in relation to State bailouts and the compulsory administration of banks.[19] In *Bank Melli Iran and Bank Saderat Iran v Bahrain*,[20] the bank was placed into administration by Bahraini authorities in order to "protect the rights of depositors and policy holders"; the tribunal found that Bahrain had breached its obligations against unlawful expropriation under the Bahrain-Iran BIT. Expropriation claims have also arisen from instances of nationalisation and compulsory acquisition of local banks.[21] Similarly, investment tribunals have held that a critical level of alteration of the regulatory framework may cause extensive damages to investors and violate their legitimate expectations under the FET standard.[22]

More specifically, in relation to the AT1s, there are at least *two* potential treaty breaches that could be considered:

- **Expropriation claim**: Switzerland may be liable under investment treaties if it can be shown that the State *unlawfully* expropriated their assets without fair compensation. To determine whether Switzerland's measures constituted expropriation, a tribunal will assess whether FINMA took the measures within the recognised limits of the State's *regulatory powers*, designed to protect the stability of the financial sector and public welfare:
  - If the measures were a non-discriminatory and proportionate answer to avoid Credit Suisse's purported insolvency risks, such measures would not qualify as an expropriation and would not require Switzerland to pay compensation.
  - However, depending on the ultimate factual findings, a tribunal may hold that, while FINMA was entitled to take such measures as part of its regulatory powers, such actions were *discriminatory* (taking into account the favourable treatment provided to the shareholders to the detriment of the bondholders), or at least not a *proportionate* answer, by considering that the same objective could have been achieved by less arbitrary and/or discriminatory measures (such as a debt-for-equity swap or conversion into equities and paying the US$3.2bn to AT1 bondholders and shareholders combined). In this regard, the authors note the speculation in the media and by market commentators that the State may have been influenced by a desire to appease Saudi and Qatari shareholders.

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- **FET claim**: a tribunal will:
  - pay particular attention to the regulatory process which led to the AT1s being wiped out under the takeover (in particular, whether it was made in accordance with BIO-FINMA and in a transparent, non-arbitrary and non-discriminatory manner); and
  - assess whether FINMA/Switzerland failed to honour the bondholders' legitimate expectations. Assessing whether there has been a failure to honour such expectations involves considering whether the State's conduct created reasonable and justifiable expectations on the part of an investor to act on reliance on the said conduct, such that the failure by the State to honour those expectations could cause the investor to suffer damages. Tribunals have found that an investor has legitimate expectations to be treated impartially, fairly and/or even-handedly. Situations that are typically recognised by tribunals as giving rise to legitimate expectations include representations made to investors and the regulatory framework in force at the time of the investment. However, the obligation of a State to maintain a stable, predictable regulatory framework is limited by the State's prerogative to regulate domestic matters in the public interest. Nonetheless, as foreshadowed above, a critical level of alteration to the framework may constitute a breach of investors' legitimate expectations.

A tribunal may hold that there are grounds that give rise to a FET breach if it finds, for example, that: there was an absence of transparency and unilateral conduct without any warnings and within a very short time period; on 15 March FINMA and the SNB took positive steps to assure investors about CS's capital and liquidity position, and that further liquidity would be provided if necessary. Further, having made these assurances, they failed to correct this impression until 19 March; the sudden and complete write-down of the AT1s were inconsistent with FINMA's powers under the BIO-FINMA; the sudden introduction of the amended Additional Liquidity Ordinance on 19 March gave FINMA the power to completely write-down the AT1s – a power that, to that point, FINMA did not possess or had (as far as the authors are aware) ever exercised; in all the circumstances, the favourable and unexpected treatment provided to the shareholders as compared to the AT1 bondholders; a "Viability Event" had not in fact occurred under the T&Cs; and, the State took a disproportionate measure when it decided to take such an extreme write-down action, not least in circumstances in which there had been no suggestion that this would occur.

Quantum

While a detailed analysis of issues relating to quantum is outside the scope of this article, the authors attempt to set out some basic principles and preliminary thoughts on counterfactuals.

High level principles

Under international investment treaty law, the approach to quantum depends on the type of claim (lawful expropriation vs other breaches of international law), with this distinction being relevant to the methodology, the valuation date, and the potential compensation for any subsequent increase in value of the investment and consequential damages.

Most modern investment treaties provide compensation for lawful expropriation pursuant to the *Hull formula* which requires compensation: (i) to be "prompt, adequate, and effective"; and (ii) amount to the "fair market value" (FMV) of the investment expropriated, unless this would lead to a manifestly unfair result.[23] Many different valuation methods are employed to calculate the FMV, including income-based methods such as the discounted cash-flow method (DCF) and adjusted present value, as well as asset-based methods such as book value.

In contrast, compensation for other breaches of international law by the State (such as FET or unlawful expropriation) is generally "full reparation" as stated in the *Chorzów Factory* case:

> "The essential principle contained in the actual notion of an illegal act ... is that reparation must, as far as possible, wipe-out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind of payment in place of it – such are the principles which should serve to determine the amount of compensation due for an act contrary to international law."[24]

However, some tribunals have applied the standard of compensation set out in the treaty, irrespective of whether an expropriation was lawful or unlawful (on the basis that the treaty did not distinguish between lawful and unlawful expropriation). Other tribunals have held that the FMV standard should be applied if the steps the State took had the same effect as expropriation.

Preliminary thoughts on quantum, particularly counterfactuals

Figure 1 overleaf shows CS's recent share and bond (as represented by the 5.25% Perpetual AT1 traded on the Frankfurt Börse) prices.

CS's share and bond prices were generally trending downwards on global banking malaise, specific problems with CS, and reverberations of the SVB and Signature Bank troubles. The withdrawal of support from the Saudi National Bank (15 March) appears to have been the final straw. The analysis of events leading up to the SNB brokered transaction is important when addressing the question of damages.

Let us assume that the tribunal seeks to award the investors a sum equivalent to that which would put them back into the position had the breach not occurred. Albeit at the risk of oversimplification, several counterfactuals can readily be discussed, both prior and post the announcement of the UBS

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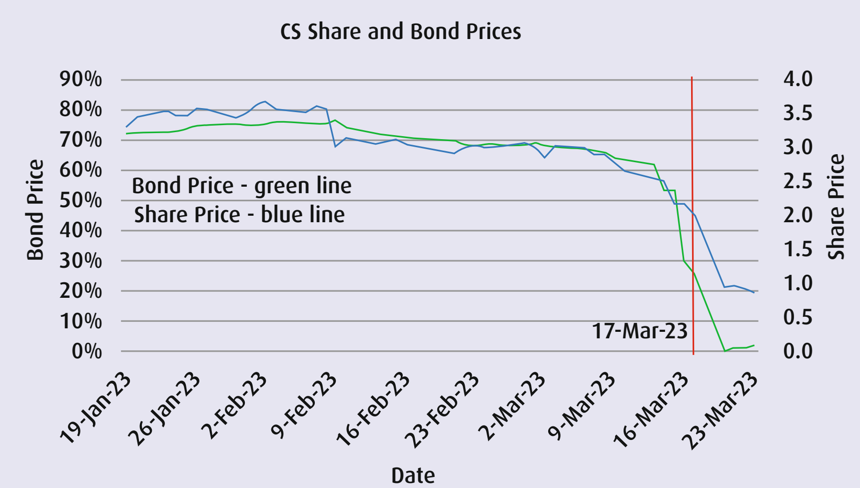
deal (approximate, rounded figures are used to illustrate the calculation technique, rather than belabouring the exact details which may cloud the underlying concepts):

- **Value of bonds prior the UBS deal:** a first approach is that CS could have continued as a going concern and the AT1 bondholders' loss is equal to the value of the bonds immediately prior to the weekend of the 18/19 March. From Table 1 it can be seen that extraneous events unrelated to the action of the SNB led to the sharp decline in AT1 prices from around 70% to around 26%. Assuming a total notional value of AT1s of US$16bn (CS issued bonds in several currencies), the damages due to bondholders is *US$4.2bn* (26% x US$16bn). However, bond trading on and around 17 March would have been panicked and illiquid so it could be argued that 26% is not the correct measure;
- **UBS funds paid to AT1 holders:** a second approach is linked to the deal agreed by UBS to pay US$3.2bn. In the event, the AT1 bondholders received none of this. Since the AT1s ordinarily ranked above the ordinary shares, it might be said that a "fairer" apportionment would have been to allocate the *US$3.2bn* entirely to AT1s and none to the shares. Coincidentally, this would imply a value of AT1s of 20% (US$3.2bn ÷ US$16bn), not far from the market value of 26% on 17 March;
- **Conversion of bonds to equity:** a third approach is based on the AT1s being converted to ordinary shares, and the bondholders sharing in the US$3.2bn that was in fact all allocated to shareholders. It is not inconceivable that FINMA could have forced conversion if it had wanted to treat AT1 bondholders similarly to shareholders (who ordinarily ranked below bondholders in seniority of repayment on default). How much of the US$3.2bn would the AT1 bondholders have received? The answer depends on the precise terms of the conversion. There are several ways in which this method could be applied. One example is as follows: suppose there were 2.5 billion shares outstanding prior to the conversion of the AT1s and the market share price prior to the UBS deal was US$2 per share. This implies a market capitalisation of US$5bn. The market value of the AT1s was US$4.2bn (26% x US$16bn) which, on this method, equates to 2.1 billion new shares allocated to the AT1 bondholders (4.2 x 2.5 billion ÷ 5.0). This gives the total number of outstanding shares of 4.6 billion which share the US$3.2bn that UBS was willing to pay. In other words, each share receives 70 cents (US$3.2bn ÷ 4.6 billion). The original shareholders receive US$1.7bn (0.7 x 2.5 billion) and the AT1 holders receive *US$1.5bn* (0.7 x 2.1 billion). The method of using the market value of the securities to determine the number of shares allocated to AT1 bondholders is only one of several possible methods. We have used it only to demonstrate the principle of the calculation;
- **CS would have defaulted:** further or alternatively, had the takeover not occurred, it can be argued that CS would have survived but only in the short term, and ultimately it would have defaulted. At this stage it is near impossible to estimate the default value of AT1s. We note the SNB's comment that the issues faced by CS were related to liquidity rather than capital, and so it is not out of the question that the AT1s could be redeemed without any loss, ie a repayment of US$16bn. It is noted that unsecured creditors in the liquidation of Lehman Brothers' are reported to have received around 41 cents on the dollar;[25]
- **UBS takeover on better terms:** the analysis above assumes that the US$3.2bn paid by UBS was the best that CS could have achieved. However, this figure was agreed in the context of having to complete the deal during the weekend, no voting by the shareholders of either CS or UBS, and no competition from other potential buyers. Absent these constraints, could a higher price have been achieved? If so, the quantum of damages will change in line.

FIGURE 1:



VII. CONCLUSION

Investment treaty arbitration provides a neutral forum for investors to recover their losses. Given the various factors outlined above, the potential for expropriation and breaches of fair and equitable treatment in relevant BITs is well worth exploring.

Disclaimer

The authors have relied on publicly available translations of Swiss law. However, English is not an official language of the Swiss Confederation, the translations are provided purely for information purposes and specialist Swiss law advice should be sought on its full meaning and effect.

More broadly this article is not advice, the authors are not qualified in Swiss law and the authors accepts no liability for reliance upon any of the facts or matters stated. Financial and legal advice on the issues discussed should be sought in the ordinary way. ■

Biog box

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1 https://www.finma.ch/en/news/2023/03/20230315-mm-statement/

2 FINMA press release: https://www.finma.ch/en/news/2023/03/20230319-mm-cs-ubs/ Federal Council's press release: https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-93793.html

3 https://www.bankofengland.co.uk/news/2023/march/boe-statement-uk-creditor-hierarchy https://www.bankingsupervision.europa.eu/press/pr/date/2023/html/ssm.pr230320~9f0ae34dc5.en.html

4 https://www.finma.ch/en/news/2023/03/20230323-mm-at1-kapitalinstrumente/

5 CHR200m 3.875% Perpetual Tier 1 Contingent Write-down Capital Notes. See: https://www.credit-suisse.com/about-us/en/investor-relations/financial-regulatory-disclosures/regulatory-disclosures/capital-instruments.html

6 And on the "relevant Write-down Date".

7 Extensive literature could be cited in support. The authors have found a relatively dated (2013) Bank of England publication to be particularly clear in explaining the distinction: https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2013/bank-capital-and-liquidity.pdf

8 Further, research indicates that capital and liquidity to at least some extent act as substitutes, although when uncertainty is high and the value of assets is particularly uncertain, a bank's level of capital matters less as liquidity risk increases sharply. In this case, capital and liquidity requirement act in a more complementary manner. See, eg Jonathan Acosta-Smith, Guillaume Arnould, Kristoffer Milonas and Qunnh-Anh Vo, September 2019 'Capital and Liquidity Interaction in Banking', September 2019: https://www.frbsf.org/economic-research/wp-content/uploads/sites/4/2020-01-02-Arnould-paper.pdf

9 https://www.finma.ch/en/news/2023/03/20230315-mm-statement/

10 As to the support package, see the media releases by the Federal Council: https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-93793.html and the SNB: https://www.snb.ch/en/mmr/reference/pre_20230319/source/pre_20230319.en.pdf

11 *Eigenmittelverordnung*: https://www.fedlex.admin.ch/eli/cc/2012/629/de

12 https://www.fedlex.admin.ch/eli/cc/2012/648/en

13 http://www.kcllc.net/document/8871900230401000000000001

14 'LIDW 2019: The Rise of Arbitration in Financial Services Disputes', 7 May 2019, Matteo Zambelli (University of West London): https://arbitrationblog.kluwerarbitration.com/2019/05/08/lidw-2019-the-rise-of-arbitration-in-financial-services-disputes-7-may-2019/

15 A claim may be assigned either before or after proceedings have commenced, including once an arbitral award has been rendered. In *Daimler v Argentina* (ICSID Case No. ARB/05/1, Award dated 22 August 2012) the tribunal accepted that "most jurisdictions allow for legal claims to be either sold along with or reserved separately from the underlying assets from which they are derived" and "no rule of general or customary international law … would prohibit a similar result from obtaining for ICSID claims". It is noted, however, that in a confidential award (*Russian Fund v Lithuania*, PCA Case No. 2019-48, Award dated 1 July 2022), an UNCITRAL tribunal dismissed the claim on jurisdictional grounds after ruling that a Russian fund (assignee) could not bring the claim on behalf of a former shareholder/investor (assignor) which sold the rights to his BIT claim in 2019 (it is not clear whether the issue was related to the original investment itself or to the assignment of the treaty claim).

16 https://investmentpolicy.unctad.org/international-investment-agreements/countries/203/switzerland.

17 'Arbitration in banking and finance deconstructed', by Guest Blogger, 28 March 2018: https://www.lexisnexis.co.uk/blog/dispute-resolution/arbitration-in-banking-finance-deconstructed

18 For example, *Abaclat and Others v Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility of 4 August 2011, concerned a mass claim brought by some 60,000 Italian bond holders. The tribunal found that dematerialised government bonds were qualifying, protected investments.In this matter, a consent award was concluded in 2016 between the claimants' agent Task Force Argentina (an association of eight major Italian banks) and the government of Argentina.

19 'Arbitration in banking and finance deconstructed', by Guest Blogger, 28 March 2018: https://www.lexisnexis.co.uk/blog/dispute-resolution/arbitration-in-banking-finance-deconstructed

20 *Bank Melli Iran and Bank Saderat Iran v Bahrain*, PCA Case No. 2017-25, Award dated 9 November 2021.

21 See *KT Asia Investment Group B.V. v Republic of Kazakhstan*, ICSID Case No. ARB/09/8, Award dated 17 October 2013. However, the tribunal ruled that the claimant had not made a qualifying investment in BTA Bank in which KT Asia owned a 9.96% shareholding because the claimant failed to satisfy the definition of investment (no payment for the acquired shares).

22 Examples of arbitration proceedings brought on the basis of a State's subsequent alteration of its legal framework include the 2001-2002 Argentine crisis and the recent amendments to renewable energy incentives in Spain, Italy and the Czech Republic.

23 For further details see 'Quantification of ISDS Claims: Theory' by Mino Han, Konstantin Christie and Charis Tan of Peter & Kim, article dated 14 January 2022: https://globalarbitrationreview.com/guide/the-guide-investment-treaty-protection-and-enforcement/first-edition/article/quantification-of-isds-claims-theory#footnote-073

24 *Chorzow Factory (Claim for Indemnity) (Merits), Germany v Poland, PCIJ Series A, No 17 (1928)* at [125].

25 https://www.reuters.com/markets/us/after-14-years-lehman-brothers-brokerage-ends-liquidation-2022-09-28/

Further Reading:

- On the regulatory discretion to write-off AT1 capital (2023) 5 JIBFL 302.
- From bail-out to bail-in: are banks becoming safe to fail? (2014) 8 JIBFL 494.
- Lexis+® UK: Credit Suisse and UBS merger – exploring the "emergency rescue".