

It's Gonna Be an 8 Cup of Coffee Type of Day!

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If the morning headlines are any indication, it is going to take a lot of coffee to make it through a long day (at the end of a long week). Since I average about 1 T-Report for every 2 to 3 cups of coffee, it could be a long day for the readers!

UBS Announces an Offer to Buy CS

The FT reported that UBS offered to buy CS for 0.25 Swiss Francs per share. There was also a line in the report stating that a Material Adverse Change clause (MAC) was linked to UBS CDS spreads widening by 100 bps. I for one haven't seen a MAC clause linked to CDS spreads.

There are also headlines that said CS "initially pushed back" on UBS's offer.

Bear Stearns and JP Morgan

When that deal hit the tape it was a fait accompli. There was little to no doubt that a deal was getting done. The price of \$2 dollars/share may have seemed low (and it changed over time), but there was clarity that a deal was done. However, I keep harking back to the language that JPM was guaranteeing/taking over the Bear Stearns swap books regardless of whether the deal closed or not. That is in stark comparison to headlines crossing the tape right now where there is significant uncertainty.

The CDS MAC Clause

One line in the FT's report said that the deal includes a MAC clause linked to UBS CDS going 100 bps wider.

What we don't know about the clause:

- **What maturity CDS?** I am assuming it is the 5-year as it is typically the most liquid.
- **How is CDS measured?** If it trades 100 wider once? Closes above 100 wider? Some number of trades at 100 wider?
- **What is the base CDS spread?** UBS 5-year CDS averaged 68 bps this year. It was 71 bps on Friday, March 10, but closed at 133 bps on Friday, March 17 as markets started to price in the probability that UBS would buy CS and assume a lot of existing debt.
- **How long does this MAC exist for?** Is it a Monday only MAC? Does it last for a few days? Weeks? Months? Somewhere between a few days to a week or so seems "about right" to me, but we really don't know.

A weird "game theory" dynamic

For now, we can talk generically about 100 bps wider without knowing the details. However, I'm assuming 100 bps wider (from something lower than Friday's close) that lasts about a week before falling off.

- **CS bond holders want to sell UBS protection.** If you are a CS bond holder (especially if you are a subordinated debt holder or even lower down in the cap structure) you want this deal to go through. Europe is busy trading this morning and I'm hearing that some Jr. Sub paper is trading up from around 30 bps to nearly 60 (this bond was basically 90 the week before). **This is one reason CDS, from a "game theory" perspective, shouldn't go 100 wider.**
- **Buying up 100 bps seems "counterproductive".** Even if you think that UBS is overpaying and taking on too much risk, driving the CDS spread 100 bps wider is incredibly counterproductive.

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At 99 bps there would be a deal (if CS agrees to the terms), but at 100 bps there would be no deal, so UBS should scream back tighter. To pay 100 bps higher, you almost have to believe that the deal gets done no matter what with no additional support (seems unlikely) or that even if the deal doesn't get consummated, the CDS only tightens back a little bit. **Another reason from a "game theory" viewpoint for it not to go 100 wider.**

- **Where do generic bank spreads trade without a deal?** If you think that bank spreads in general in Europe will widen with no deal, then you can bid up UBS CDS more easily. If you think there is a "contagion" type of risk, where with no UBS deal the market will look to identify the next set of banks to go after causing even the biggest and safest banks to widen, then maybe the risk reward of paying up 100 bps changes.
- **What does the clause tell us, if anything?** While CS has allegedly pushed back, from a "game theory" perspective UBS included this clause as a safeguard in case the market thinks it is missing something in the valuation. It does not inspire confidence in the deal, which may weigh on bank spreads even with an apparent solution.

More from the government?

- Will the Swiss government or central bank have to step in with additional backstops? Maybe even capital injections? Who knows, but they are caught in the middle of this and will be pushed hard to deliver more.

Europe Solved?

No, not by a long shot. I'm sure there will be another T-Report later today as headlines are coming in fast and furious (i.e., the WSJ just reported that CS AT1s will face a haircut). From a pure "absolute priority of payment", many may have assumed that as equity increases, the AT1s should not be impaired and anyone working on that assumption might have to rethink positions in other institutions.

One question that I think people had hoped would be put to rest this weekend is **whether European markets can move on if CS is solved.**

For those of you who lived through the GFC and the European Debt Crisis, we are still scarred by the memories of "epic turning points" that sometimes lasted less than 24 hours. What is going on so far does not inspire the greatest confidence (at least not for me) that we can rally and not look back, but the day is young!

All Quiet on the U.S. Front

As we sent in a Bloomberg IB on Friday, a "plane tracker" reported on Twitter that a lot of private jets were showing up in Omaha. There are stories that Buffett is talking to Biden. He was very involved in the GFC taking direct positions and indirectly supporting companies with his "seal of approval". Will that be the case this time? Will it work?

I saw a headline that some banks were pushing for a "temporary" (in this case 2-year) extension of FDIC insurance to all deposits of any size. As written yesterday in [Gasp, Gulp, Glug](#), **we need much broader deposit insurance to stabilize the situation.**

That will give us the breathing room to get capital infusions where necessary.

Smaller banks, well below Wall Street's radar, are bearing the brunt of this and that can become problematic for the economy.

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Bottom Line

The day is young, the coffee is flowing, and there is a lot more time to see some truly positive and supportive news before U.S. futures open at 6 pm ET (or the cash markets open at 9:30 am ET tomorrow).

So, I am optimistic that we will see more accomplished and I am looking forward to being on Bloomberg TV tonight at 6:30 pm ET as they ramp up special coverage on the global banking industry!

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