TC Insights

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# Supervisory Lessons from the Collapse of Credit Suisse

This Toronto Centre Insight draws out some lessons for financial supervisors from the collapse of Credit Suisse.[1]

Many of these lessons are applicable to supervisors of all types of financial institutions, not just banks.

> *"Now may be an appropriate point to declare victory over too-big-to-fail."*
>
> Bank Policy Institute, July 2020.

## Lesson 1 – Even a Global Systemically Important Financial Institution Can Collapse

Despite all the post-Global Financial Crisis reforms, including those introduced specifically for systemically important financial institutions, Credit Suisse collapsed.

It was one of the 30 banks on the Financial Stability Board's November 2022 list of global systemically important banks (G-SIBs). As such it was subject to additional capital requirements, higher expected standards of governance and risk management, recovery and resolution planning, and more intensive and intrusive supervision.

So why did Credit Suisse collapse?

For many years Credit Suisse found itself mired in controversy, with a series of scandals (including accusations of money laundering, sanctions-busting, facilitating tax evasion by its clients, manipulation of foreign exchange rates, filing false tax returns, and secret loans); poor risk management (including loss-making exposures to Archegos Capital and Greensill Capital); frequent shifts in business strategy; and irregular senior management practices (including accusations of spying on employees). These are all suggestive of a weak corporate culture and weak corporate governance.

This resulted in both poor profitability and the steady loss of both depositors and wealth management clients. Matters came to a head when Credit Suisse reported in February 2023 its largest annual loss (in 2022) since the financial crisis in 2008, and reports circulated that securities regulators were questioning the bank's reporting practices. The steady erosion of business turned into a panic after the failure of Silicon Valley Bank (see earlier TC Insights) eroded confidence in the banking sector, and the chairman of the bank's largest shareholder, Saudi National Bank, ruled out further investment in Credit Suisse.

The Swiss central bank provided a large liquidity facility for Credit Suisse, but even this proved insufficient, and in the end Credit Suisse was sold to UBS.

## Lesson 2 – The Importance of Liquidity

As with Silicon Valley Bank (see earlier TC Insights) there can come a point where a lack of confidence in a bank (for whatever reasons) results in an unsustainably large withdrawal of deposits, be they retail or wholesale. This can occur even if a bank is solvent, and however much the bank itself, or its supervisors, state publicly that it is solvent. And although the minimum liquidity ratios (the LCR and the NSFR) introduced after the Global Financial Crisis provide a buffer and limit to some extent a bank's maturity mismatch between its liabilities

[1] This TC Insight is written by Clive Briault, Chair, Toronto Centre Banking Advisory Board.

(usually short term) and its assets (usually longer term), this can provide only limited protection.

The lesson here, for both supervisors and financial institutions, is the need to understand how liquidity pressures might arise; to assess whether a financial institution's recovery plans could provide a credible response to liquidity pressures; and to consider how the institution's assets and liabilities could be structured, and funding commitments from third parties could be put into place, to provide greater protection against funding stresses.

## Lesson 3 – Using the Resolution Options

To some extent the resolution of Credit Suisse met the objectives of a successful resolution. The continuity of Credit Suisse's critical functions was preserved; an orderly sale was facilitated; the creditors of Credit Suisse absorbed the immediate losses; and in the medium term there is scope to restructure Credit Suisse in a controlled and orderly manner.

However, three concerns remain about the resolution.

First, even if justifiable under the contractual terms of the debt, it is interesting that the holders of contingent convertible bonds (part of Credit Suisse's pre-positioned "Total Loss Absorbing Capacity") were written off ahead of holders of equity. Shareholders received CHF 3 billion (around US$ 3.3 billion) in the form of a conversion into UBS shares, even if this was well below the market value of their shares immediately ahead of the collapse. This may make it more expensive for banks to issue loss absorbing bonds. The more usual approach to resolution would be write off equity first, before writing off subordinated debt instruments (or converting them into new equity to support a recapitalisation).

Second, as part of the sale to UBS, the Swiss government granted a guarantee to meet losses up to CHF 9 billion from specific assets, if the losses on these assets exceed a preset threshold. This is interesting because one of the objectives of the Financial Stability Board's recommendations for effective resolution was to avoid any payment or commitment of public funds and to avoid the moral hazard that government support can create. Moreover, it is not entirely clear why a government guarantee was required when Credit Suisse had ample loss absorbing capacity available. An alternative approach, more consistent with an FSB-style resolution, would have been to implement a larger bailing-in (writing off) of equity and subordinated debt to provide a larger buffer to meet potential future losses, with a commitment to repay these funds if the losses did not materialise.

Third, perhaps inevitably because of the shortage of willing and sufficiently well-resourced acquirers of a large financial institution at very short notice, the sale of Credit Suisse to UBS creates an even more concentrated banking sector – both domestically in Switzerland and in terms of the number and size of G-SIBs. This also constrains future options.

Further guidance for supervisors on governance, recovery planning and resolution can be found in these Toronto Centre Notes:

Supervising Corporate Governance: Pushing the Boundaries

Recovery Planning

Resolution: Implications for Supervisors

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