



# To the point!

Cross-Asset- and Strategy-Research

## Turmoil in Zurich

### Credit Suisse rescue reassures and alarms in equal measure

For years, the major Swiss bank Credit Suisse (CS) had to digest one self-inflicted mishap after another. On Sunday evening, however, more than one and a half centuries of illustrious banking history finally came to an end. After months of creeping loss of confidence and deposit diarrhea, CS was absorbed into the larger UBS. This followed a week in which the U.S. banking crisis fueled distrust of banks. CS, through its own fault, poured on oil on that fire that eventually led to its demise.

#### Take a breath!

Initially, the orderly wind-down caused the capital markets to breathe a sigh of relief. A veritable run on CS would have been all but inevitable, had regulators, politicians and management not arranged the shotgun wedding in an emergency meeting. Further obvious victims are unlikely. Bank shares have recovered. The whiff of Lehman Brothers has gone away.

#### Wonder!

For all the relief, however, the CS settlement also comes with several wrinkles that raise concerns. First, there is why, despite many warnings about the health of CS, regulators had failed to develop and implement a feasible resolution plan. After the 2008 banking crisis, this was actually mandatory in order to save the healthy part of an institution and amputate the unhealthy part as risk-free as possible. Instead, there were again references to "too big to fail." A frenetic weekend session became necessary. There, UBS was able to determine the terms and conditions. The authorities simply had no credible alternative.

This raises the question of whether we can believe that working resolution plans are in place for other major banks. Skepticism



Moritz Kraemer -- Chief Economist

LBBWResearch@LBBW.de

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### A far-reaching banking crisis prevented for the time being

#### Market capitalization Credit Suisse and UBS, in CHF billion



Source: Bloomberg, LBBW Research

is certainly appropriate. The CS debacle underscores the urgent need for regulators to actually hold these "living wills".

### Rub eyes!

Also of concern has been the perceived change in the rules of the game for investors. After the financial crisis, convertible bonds were created, the so-called AT1 bonds (Additional Tier 1 Bonds). These subordinated bonds are intended to absorb losses incurred by the Bank. They are automatically converted into equity when capitalization falls below a critical level. But only after shareholders have lost their money.

In contrast, the CS bailout deal was set up so that all AT1 investors lose everything (in this case \$16 billion), but shareholders "only" lose a large part of their stake. The pecking order that was actually expected was thus turned upside down. AT1 bonds were supposed to be the airbag for capital, but in the case of CS they were turned into a bumper taking the first hit.

This decision was probably legal for Swiss banks. But it is likely to have far-reaching consequences nonetheless. AT1 bonds, of which more than \$250 billion are currently in circulation, will probably only be able to be sold to investors at higher coupons in the future. This would mean that one of the main pillars of balance sheet stability would be shaken. Banking crises would become more likely in the future.

The relevant EU institutions immediately assured that a comparable action would never happen in Europe. But the seeds of distrust were sown. Zurich has done a disservice to financial market stability.

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An executable  
wind-down plan  
for Credit Suisse  
was missing

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