Bank Crises Past and Present

Did the Swiss TBTF Regime Fail?

P.R.I.M.E. Finance AGM
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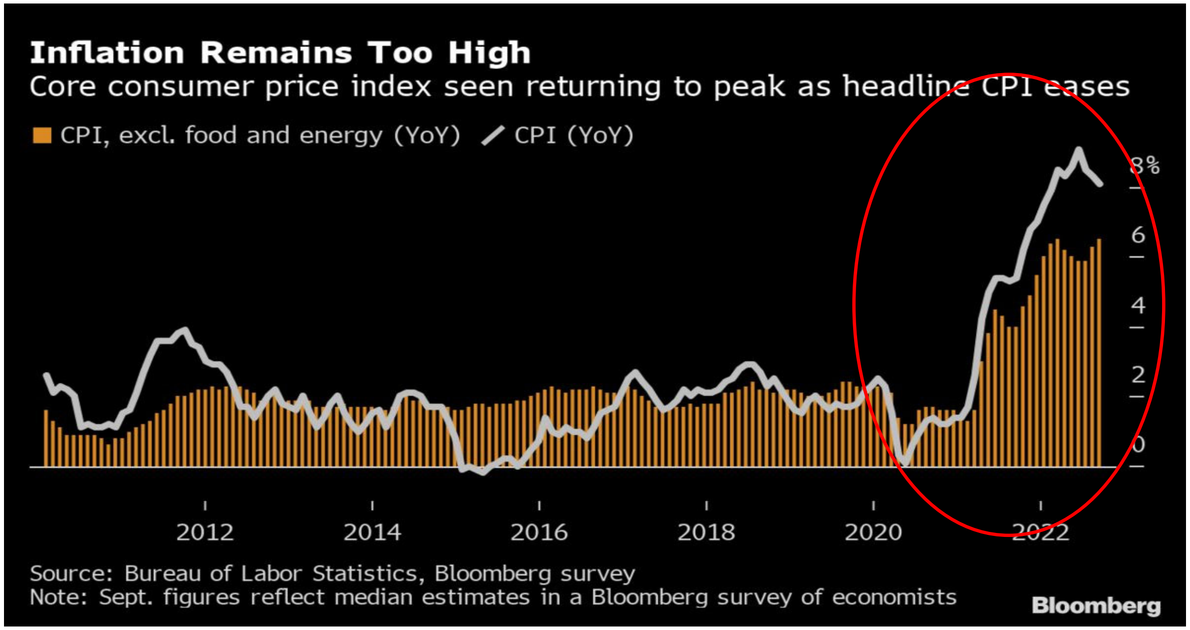
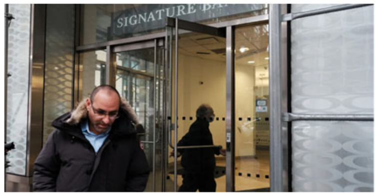
While certain US regional banks were in turmoil …



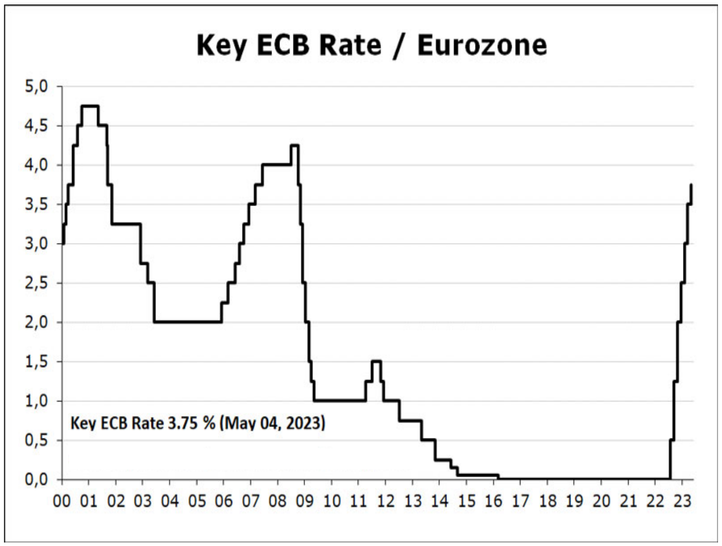
Silicon Valley Bank



Signature Bank

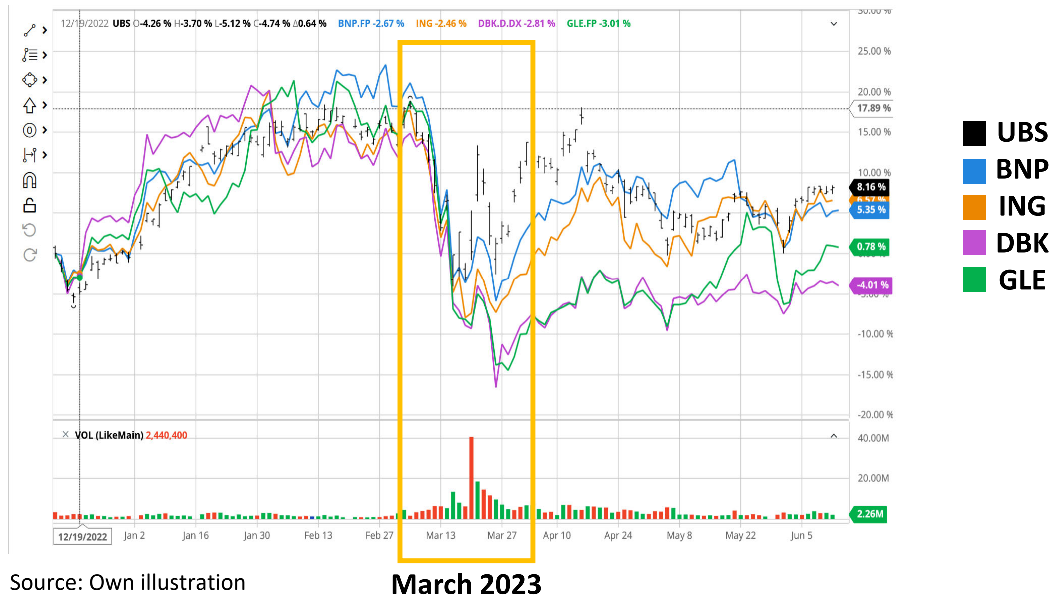
First Republic Bank

… EU and UK banks' shares dipped …



Source: https://www.cbrates.com/eurozone/

Also ECB increases interest rates to tame inflation



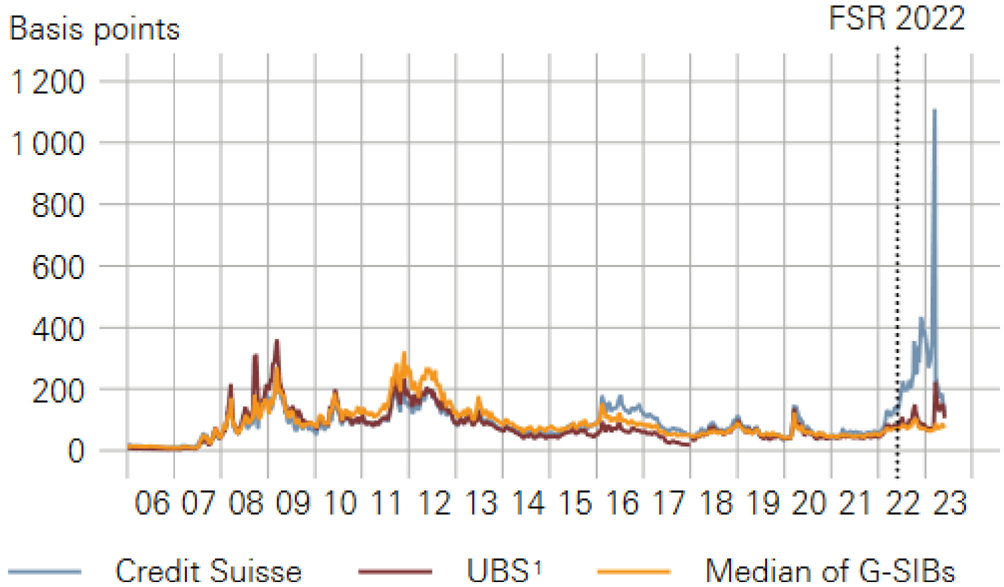
Source: Own illustration

Influenced by interest rate rise and shock in US banking market, share prices of EU, UK, and Swiss banks take a dive

… but banks remained robust …

INTERNATIONAL COMPARISON OF CDS PREMIA

Premia for credit protection (five-year senior) Chart 31



1 Up to end-2017, at operating company level (UBS AG); from 2018, at holding company level (UBS Group AG).

Source: SNB, Financial Stability Report 2023, p. 35

... except Credit Suisse who was failing

2022

2023

October 2022: Rumour that CS is about to fail spreads online; CS faces substantial withdrawals of deposits

Q1 2023: Share price falls to historic law; substantial net asset/deposit outflows

March 15, 2023:

- (Then) Head of Saudi National Bank says that bank was "*absolutely not*" prepare to provide further capital
- Swiss Government summons Swiss National Bank (**SNB**), FINMA, CS and UBS for emergency meetings
- SNB and FINMA issue a press release, stating that CS meets capital and liquidity requirements for a systemic bank and that "*there is no indication of a direct risk of contagion for Swiss institutions due to the current turmoil in the US banking market*"

March 16, 2023:

- CS requests and SNB provides CHF 39 bn. of emergency liquidity assistance (**ELA**)
- Swiss government adopts emergency law to provide emergency liquidity (**Emergency Ordinance**) to provide liquidity

March 17, 2023:

- CS requests and SNB provides CHF 20 bn. emergency liquidity assistance with bankruptcy privilege of SNB (**ELA+**)

March 18, 2023:

- UBS and CS management and Swiss Government representatives meet several times to find solution

March 19, 2023: Announcement of forced merger

Credit Suisse's problems

Poor (risk) management

Loss of trust by shareholders / clients

Bank run

Liquidity-problem

The TBTF regime would have foreseen restructuring and bankruptcy …

Liabilities CSG	Restructuring	Bankruptcy
Liabilities of CS Schweiz AG	OK	OK
Liabilities of CS AG	OK	At risk (bankruptcy dividend)
Other Liabilities	OK	(…)
Bail-in Bonds	Converted to CSG Shares	Heavily endangered (bankruptcy dividend)
AT1	Written-down	Written-down
Share Capital	Written-down	Worthless

Table partially based on FINMA presentation of April 5, 2023 showing the possible options for the rescue of Credit Suisse «*Handlungsoptionen und Kapital CS*»

- After the 2008 financial crisis Switzerland implemented a comprehensive Too-big-to-Fail (**TBTF**) regime.
- **The TBTF** regime **aimed** at:
  - Reducing probability of default
  - Reduce the impact of default
  - Improve prospects for resolution or liquidation
- **Measures** taken were:
  - Increased capital and liquidity requirements
  - Implementation of recovery plans for recovery proceedings and resolution plans for bankruptcy proceedings

… but the TBTF regime was not applied – why?

- Rescue was not based on the TBTF regime
- Why?

1. TBTF regime foresees that domestic bank is saved
    - Pressure from US and UK not to spin-off Swiss bank and liquidate rest of Credit Suisse Group

2. Recovery plan considered unsuitable as might not have solved confidence and liquidity issues

    → Federal Council and FINMA said that "*client confidence had been eroded to such an extent that a spin-off would have carried considerable risks for the Swiss business arm as well.*"

3. Risk of contagion?

The solution of a merger …

Liabilities CSG	Merger with UBS	Restructuring	Bankruptcy
Liabilities of CS Schweiz AG	OK	OK	OK
Liabilities of CS AG	OK	OK	At risk (bankruptcy dividend)
Other Liabilities	OK	OK	(…)
Bail-in Bonds	OK	Converted to CSG Shares	Heavily endangered (bankruptcy dividend)
AT1	Written-down (?)	Written-down	Written-down
Share Capital	Bought with UBS Shares	Written-down	Worthless

Table partially based on FINMA presentation of April 5, 2023 showing the possible options for for the rescue of Credit Suisse «*Handlungsoptionen und Kapital CS*»

… based on the Emergency Ordinance

March 19, 2023: Publication of **March 16 Emergency Ordinance** (as amended on March 19)

In addition to the write-down of the AT1s, the Emergency Ordinance provided the basis for

- No shareholders approval required
- No application of the Merger Act

952.3

Verordnung

über zusätzliche Liquiditätshilfe-Darlehen und die Gewährung von Ausfallgarantien des Bundes für Liquiditätshilfe-Darlehen der Schweizerischen Nationalbank an systemrelevante Banken

vom 16. März 2023 (Stand am 20. März 2023)

Der Schweizerische Bundesrat,

gestützt auf die Artikel 184 Absatz 3 und 185 Absatz 3 der Bundesverfassung[1],

verordnet:

1. Abschnitt: Allgemeine Bestimmungen

Art. 1 Gegenstand und Zweck

[1] Diese Verordnung regelt:

a. die zusätzlichen Liquiditätshilfe-Darlehen der Schweizerischen Nationalbank (Nationalbank) an eine systemrelevante Bank;

Conclusions and questions

- Forced merger as novel solution
- Downside: use of government's emergency powers
- Upside: confidence issue addressed (but resulting in one huge bank)
- Political consequences
  - Parliamentary inquiry (only 5th such inquiry in Swiss history)
  - Group of experts to overhaul TBTF regime

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Backup

Shareholders received compensation while the AT1 bondholders faced a total loss …

- UBS paid CHF 3 bn. consideration for all CS shares
- 1 UBS shares per every 22.48 CS share
- By decree of March 19, 2023 FINMA (**FINMA Decree**) writes-down AT1-bonds allegedly based on
  - Emergency Law and
  - Trigger of contractual triggering event (“Viability Event”)

Single Resolution Board

Home › News and media › SRB, EBA and ECB Banking Supervision statement on the announcement on 19 March 2023 by Swiss authorities

SRB, EBA and ECB Banking Supervision statement on the announcement on 19 March 2023 by Swiss authorities

Press releases | Monday, 20 March 2023 | **Also available in**
Bulgarian Croatian Czech Danish Dutch Estonian Finnish French German Greek Hungarian Irish Italian Latvian Lithuanian Maltese Polish

The Single Resolution Board, the European Banking Authority and ECB Banking Supervision welcome the comprehensive set of actions taken yesterday by the Swiss authorities in order to ensure financial stability. The European banking sector is resilient, with robust levels of capital and liquidity.

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 and ECB banking supervision in crisis interventions.

Additional Tier 1 is and will remain an important component of the capital structure of European banks.

- Read the press release in Mandarin Chinese

… even though Credit Suisse had a solid capital basis …

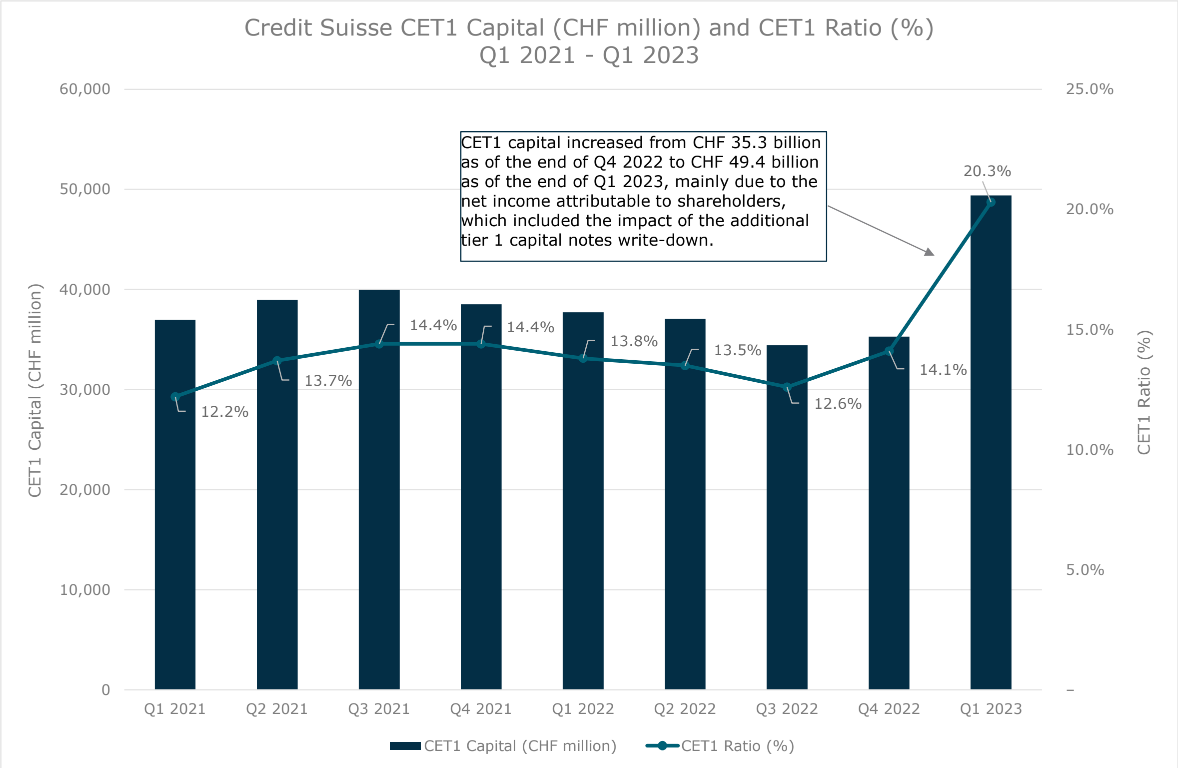

Illustration by AlixPartners

… and the Liquidity Coverage Ratio exceeded minimum requirements

KM1 – Key metrics

end of	1Q23	4Q22	3Q22	2Q22	1Q22
Capital (CHF million)					
Swiss CET1 capital	49,401	35,290	34,423	37,049	37,713
Fully loaded CECL accounting model Swiss CET1 capital [1]	49,401	35,290	34,423	37,049	37,713
Swiss tier 1 capital	49,401	50,026	50,110	52,736	53,204
Fully loaded CECL accounting model Swiss tier 1 capital [1]	49,401	50,026	50,110	52,736	53,204
Swiss total eligible capital	49,401	50,026	50,110	53,217	53,676
Fully loaded CECL accounting model Swiss total eligible capital [1]	49,401	50,026	50,110	53,217	53,676
Minimum capital requirement (8% of Swiss risk-weighted assets) [2]	19,506	20,077	21,931	22,000	21,889
Risk-weighted assets (CHF million)					
Swiss risk-weighted assets	243,826	250,963	274,138	274,997	273,609
Risk-based capital ratios as a percentage of risk-weighted assets (%)					
Swiss CET1 capital ratio	20.3	14.1	12.6	13.5	13.8
Fully loaded CECL accounting model Swiss CET1 capital ratio [1]	20.3	14.1	12.6	13.5	13.8
Swiss tier 1 capital ratio	20.3	19.9	18.3	19.2	19.4
Fully loaded CECL accounting model Swiss tier 1 capital ratio [1]	20.3	19.9	18.3	19.2	19.4
Swiss total capital ratio	20.3	19.9	18.3	19.4	19.6
Fully loaded CECL accounting model Swiss total capital ratio [1]	20.3	19.9	18.3	19.4	19.6
BIS CET1 buffer requirements (%) [3]					
Capital conservation buffer	2.5	2.5	2.5	2.5	2.5
Extended countercyclical buffer	0.110	0.080	0.026	0.025	0.023
Progressive buffer for G-SIB and/or D-SIB	1.0	1.0	1.0	1.0	1.0
Total BIS CET1 buffer requirement	3.610	3.580	3.526	3.525	3.523
Additional Swiss sectoral countercyclical buffer	0.250	0.235	0.227	–	–
CET1 capital ratio available after meeting the bank's minimum capital requirements [4]	12.3	9.6	8.1	9.0	9.3
Basel III leverage ratio (CHF million)					
Leverage exposure	653,047	650,551	836,881	862,737	878,023
Basel III leverage ratio (%)	7.6	7.7	6.0	6.1	6.1
Fully loaded CECL accounting model Basel III leverage ratio (%) [1]	7.6	7.7	6.0	6.1	6.1
Liquidity coverage ratio (CHF million) [5]					
High-quality liquid assets	118,086	119,954	226,839	234,931	225,572
Net cash outflows	66,488	83,202	118,144	123,312	114,869
Liquidity coverage ratio (%)	178	144	192	191	196

Credit Suisse Group AG, Pillar 3 and regulatory disclosures 1Q23, p. 8.

Questions regarding the write-down

Fundamental	• AT1-bonds are capital not liquidity instruments
Emergency Law	• Was the Emergency Ordinance Law a sufficient basis for the write-down? • Did FINMA violate the principle of proportionality? • Was the write-down against the constitution? Expropriation? • FINMA alleges that the write-down a protective measure; did the write-down protect CS?
Contractual Trigger	• Was a Viability Event according to the T&C present on March 19? Even CS says otherwise • The loans provided by the government (ELA, ELA+, PLB) did not improve "capital adequacy"

A Viability Event according to the Terms & Conditions

(iii) Viability Event

As used in these Conditions, a "**Viability Event**" means that either:

(A) the Regulator has notified CSG 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.