CENTRE DE DROIT
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Too big to fail.

Innovations in abundance in the rescue of Credit Suisse

Par Luc Thévenoz le 20 March 2023

The measures adopted by the Federal Council to ensure the takeover of Credit Suisse by UBS represent a significant change of approach from the principles that guided the regulation of systemically important banks after the 2008 financial crisis. The scale of these changes is commensurate with the new crisis that the authorities are seeking to avert. It is all the more astonishing given that, despite the endless list of Credit Suisse defaults revealed in recent years, FINMA and the Swiss National Bank confirmed on March 15 that the bank had sufficient capital and increased the liquidity available. This was not enough to reassure the bank's customers and investors.

In this brief commentary, we analyze the Federal Council Ordinance of March 16, 2023, as amended on March 19, in terms of its deviation from the principles that have guided the regulation of systemically important banks to date.

The UBS and Credit Suisse groups were restructured a few years ago to create two Swiss banks that combine systemically important functions (public deposits, payment transactions, etc.) in an area protected from international vicissitudes. Both banks are profitable. As these measures were designed to allow, Credit Suisse (Suisse) SA could have been saved by its own efforts, with the probable sacrifice of the rest of the Group. But the impact of such a resolution on London, New York and the global financial system was too high a price to pay for the reputation of Switzerland and its financial center. How high the stakes were, and how much pressure the Federal Council, the SNB and FINMA were under, will probably become clear much later. Clearly, the Swiss bank could not be saved by letting the rest of the group go to the auction block.

On Sunday evening, at the same time as a press conference at which the authorities were seated at the same table as the chairmen of the boards of directors of the two banks, the publication in the Recueil officiel of an ordinance secretly put into effect last Thursday and hastily revised on Sunday gave the measure of the changes in course.

Contrary to the principle laid down by Walter Bagehot at the end of the 19th century, according to which, in its role as lender of last resort, a central bank provides liquidity loans only to a solvent bank and against full security, this ordinance introduces extraordinary SNB loans, additional loans guaranteed by a new class "2b" bankruptcy privilege (art. 3), and even SNB loans backed by a default guarantee from the Confederation, collocated in class "2c" and remunerated by various premiums reflecting the dual risk-taking of the SNB and the

Confederation (art. 4). As this latter instrument potentially involves taxpayers' money, it requires urgent budgetary authorization, granted on Sunday by the Federal Assembly's Finance Delegation. At the press conference and in the commentary on the ordinance, the Federal Council presented this new public liquidity backstop, planned for March 2022 but created ad hoc, as a tool already in use elsewhere. This in no way detracts from the radically new nature of the instrument, which has yet to be evaluated.

Furthermore, on the basis of art. 14a, "Guarantee against losses", drafted in a hurry after the adoption of the first version of its ordinance, the Federal Council agrees to guarantee a second risk of CHF 9 billion on a portfolio of assets of uncertain value, for which UBS bears the first risk to the tune of CHF 5 billion. This instrument, too, is innovative and has the merit of being targeted. Here again, urgent budgetary authorization was required, and has been granted.

How, finally, is a merger to be carried out, for which UBS will pay Credit Suisse shareholders with its own shares, and on which the two shareholders' meetings would normally have had to vote, according to a timetable incompatible with the current rescue, and which they could have caused to fail ? Art. 10a, hastily introduced on Sunday, provides the solution. The merger is decided by the two Boards of Directors ; FINMA's approval replaces that of the two General Meetings.

Our purpose here is not to criticize the decisions taken between March 16 and 19, 2023, but to assess the extent to which they deviate from the very aims of the huge reform of too-big-to-fail banks undertaken by Switzerland after 2008. One of the stated aims was "where necessary, to eliminate systemically important banks from the market, while maintaining their systemic functions without state support" (FF 2011 4405). Crises always develop differently from the plans made to prepare for them. The current crisis highlights issues of international interconnection and reputation that had been underestimated.