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focus

March Madness: **Banking Tremors Cross the Atlantic**

Ructions across the global banking sector has spread to Europe. On the heels of the collapse of Silicon Valley Bank and Signature Bank, the biggest US bank failures since the Global Financial Crisis, Credit Suisse has been rescued by Swiss rival UBS. The failure of one of the world's 30 systemically important banks is both remarkable and disconcerting. That said, all the banks that have failed in recent weeks faced idiosyncratic issues that are not widespread across the industry. Credit Suisse had been plagued by a series of scandals which had undermined customer confidence in the bank. **While further failures are possible, even likely, we do not expect the crisis will become systemic across the industry.**

FORSYTH BARR

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Banking panic crosses the Atlantic

Following high profile bank failures in the US, investors scoured the global banking landscape for others who might be vulnerable. Focus landed on Credit Suisse, Switzerland's venerable second-largest bank, which has long been dogged by issues.

Credit Suisse has been a pillar of the Swiss banking system since 1856 when it was founded to help fund the development of the Swiss railway system. Following the Global Financial Crisis (GFC) the bank increasingly focused on its wealth management business, managing money for affluent clients around the world.

Credit Suisse is one of 30 global systemically important banks, a financial institution that is considered critical to the functioning of the overall financial system due to its size, global reach, interconnectedness with other financial institutions, complexity of operations, and importance in providing critical financial services.

Plagued by scandal

Credit Suisse's list of scandals is long and infamous, but you only have to look back over the past few years to get a picture of how these weighed on the bank's performance and reputation, and raised questions about the bank's culture and management practices.

In 2020 then CEO Tidjane Thiam resigned and the bank was fined after it was discovered, since 2016, it had hired private detectives to spy on seven former executives.

Later that year the bank was implicated in a money laundering scandal involving drug dealers in Bulgaria, and fined for not conducting adequate due diligence on its clients.

In 2021 Credit Suisse became embroiled in the collapse of Greensill Capital, a company which provided short-term financing to businesses, to which it loaned, and is still trying to recover, around US$10 billion of client funds. And only four weeks later Credit Suisse lost US$5 billion in the implosion of family office Archegos Capital Management.

Later in 2021 Credit Suisse was fined £350 million and agreed to forgive US$200 million owed by Mozambique to settle the bank's role in the "tuna bonds" loan bribery scandal. The loans were meant to finance maritime projects in Mozambique, including a fishing fleet and coastal protection. However, it later emerged that a significant portion was used to purchase military equipment, without the knowledge of investors. Three former Credit Suisse bankers who arranged the bonds pleaded guilty to receiving kickbacks of US$50 million.

In January 2022 board Chair António Horta-Osório, who'd only been appointed in 2020 to clean up Credit Suisse's culture issues, resigned after twice breaking COVID quarantine rules in Switzerland and the UK, including to attend football and tennis matches in London. In February, a massive data leak of 18,000 accounts showed that criminals, alleged human rights abusers, and sanctioned persons were clients of the bank.

...for Credit Suisse market jitters came at just the wrong time...

It's hardly surprising confidence in the bank amongst its wealthy clients tumbled. It saw unprecedented withdrawals, losing SFr111 billion (around NZ$190 billion) in the final three months of last year alone.

At the wrong place at the wrong time

Credit Suisse countered with a massive public relations campaign, reaching out to wealthy clients to reassure them of the bank's health and pledge reform and restructuring. It looked like it may have been working — in January it reported "net positive" deposits growth.

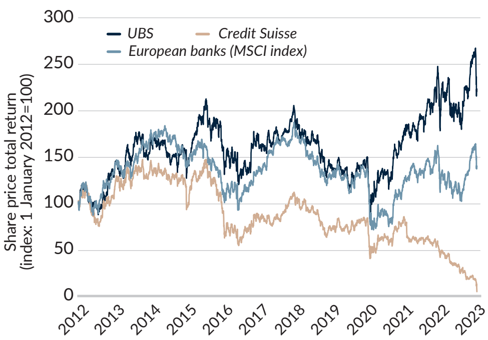
Unfortunately for Credit Suisse, market jitters coupled with its latest misstep, came at just the wrong time. In early March the US Securities and Exchange Commission identified "material weaknesses" in Credit Suisse's internal controls and a "failure to design and maintain effective risk assessment processes" which delayed the publication of its annual report.

Credit Suisse's share price went into freefall when its largest shareholder, the Saudi National Bank (SNB), which owned 9.9% of Credit Suisse, ruled out investing any more in the company. SNB later clarified that regulatory restrictions prevented it increasing its stake, but the damage was done.

Credit Suisse turned to the Swiss National Bank for support. After a day of umming and ahhing, it provided a statement of confidence and a line of liquidity. Credit Suisse drew down Sfr54 billion (US$50 billion). By then, however, it was too late.

Swiss regulators scrambled to protect the country's banking system, and forced through a rescue acquisition by Switzerland's largest bank, UBS. At its peak Credit Suisse was valued at US$96 billion. UBS paid US$3 billion, effectively valuing it at **negative** US$14 billion after US$17 billion of bonds were written down to zero.

CREDIT SUISSE'S PERFORMANCE HAS LAGGED ITS RIVAL UBS AND OTHER EUROPEAN BANKS



Source: Refinitiv, Forsyth Barr analysis

More to come? Maybe, but that's somewhat normal

Bank runs can start in a number of different ways. But they all typically end the same way — quickly. Especially in the modern era where you can withdraw funds sitting at your desk or even on your mobile phone.

In normal markets, Credit Suisse might have survived. It was actually relatively lowly geared for a bank. And unlike Silicon Valley Bank, it didn't have a big chunk of unrealised bond losses, it had hedged interest rate moves, and it had significant liquidity available to meet withdrawals. Depositors jumped anyway — withdrawals shot to over SFr10 billion a day — and once it starts, it's self-fulfilling, no one wants to be the last person at the party. No bank can survive a run if it's big enough.

Given the series of bank failures in the past week or so it's easy to jump to the conclusion there must be systemic issues across the entire sector. We don't believe this is likely the case. To date, the banks that have failed all faced idiosyncratic issues that are not widespread across the industry. That doesn't mean we won't see more collapses — it's likely we will (and that's not uncommon — in the past 90 years there have only been five in which there hasn't been a US bank failure). However, generally banks' balance sheets are in a much stronger shape than they were heading into the GFC, and regulators are focused on limiting contagion. US Secretary of the Treasury Janet Yellen has declared the government stood ready to provide further support for banks if required.

MARCH MADNESS

8 March

Silvergate Capital, a crypto currency-focused bank, announces it will cease operations after a bank run.

SVB sells a bond portfolio at a US$1.8 billion loss; announces plan to raise around US$2 billion in fresh equity capital to shore up its balance sheet. Moody's downgrades SVB's bonds to "junk".

9 March

SVB sees US$42 billion of customer deposit withdrawals. Stock plunges 60%.

Credit Suisse delays release of its annual report after queries from US Securities and Exchange Commission.

10 March

SVB fails after a run on deposits; the largest bank collapse since 2008. Bank stocks plunge.

Signature Bank, which lent largely to real estate companies and law firms, experiences large withdrawals.

12 March

Regulators seize Signature Bank.

The Federal Reserve and the FDIC announce all SVB and Signature depositors will be insured, i.e. will be able to recover their funds. Bank Term Funding Programme (BTFP) introduced to provide additional funding to banks.

13 March

SVB's British subsidiary is sold to **HSBC** for £1.

Credit Suisse published delayed annual report noting "material weaknesses" found in its financial reporting processes.

14 March

Credit Suisse's largest shareholder, **Saudi National Bank**, says it won't provide any more cash to the bank because of regulatory restrictions.

15 March

Credit Suisse shares collapse 24%. **Swiss National Bank** says it will provide financial support if necessary.

16 March

First Republic San Francisco receives US$30 billion from eleven of the US's biggest banks.

Credit Suisse borrows US$54 billion from the **Swiss National Bank**.

19 March

UBS agrees to acquire rival **Credit Suisse** for US$3 billion.

New York Community Bancorp agrees to buy the majority of **Signature Bank's** assets.

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The banking turmoil will have implications for the broader economy. Banks are likely to be more conservative, look to preserve cash, and be less willing to offer credit. That will contribute to a slowing economy. A key unknown is how central banks will respond? That largely leaves markets back where they started the month, deliberating on the questions of how quickly will inflation slow, how far will central banks hike interest rates, and will economies avoid or fall into recession? The path ahead remains uncertain. Our key message remains, investors need to ensure they have a robust portfolio that can navigate a wide range of different potential paths ahead.

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If at any time you wish to discuss current market events or the composition of your portfolio, your Forsyth Barr Investment Adviser is available to provide assistance and advice.

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