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Credit Suisse: The Party is Over

Professor Marc Chesney of the University of Zurich examines the collapse of Credit Suisse and the ensuing banking crisis.

By Marc Chesney

The house lights are up and the party is over for Credit Suisse. The members of the Executive Board and the Board of Directors are stepping off the green carpet of the casino for the time being, wearing serious expressions on their faces, with full pockets and light hearts. Regrets and apologies are the order of th`e day. They really did do their best! After all, that is why they were paid so much. But, convince yourselves, dear readers: bad luck, rumors, and even plots from abroad jeopardized such a carefully crafted business model. Even the best risk management in the world could in the end be no match for these unforeseen hazards — true “Black Swans”! — and thus the bank were unable in the end to “regain the confidence of the financial markets”. This is what we have been told over and over again lately, and this is what is said to be the name of the game: the markets must be appeased at all costs, their fickle trust won back. This trust, above all, is the key to the thing and the reason why huge amounts of public money must be put on the line. Winning the confidence of the population by protecting it from the excesses of finance and its roulette-wheel spinners is obviously not on the agenda.

Let us go back in time to retrace how this tragic tale unfolded.

Almost 35 years of casino finance

The purchase of investment bank First Boston in 1988 sealed the entrée of Credit Suisse into the big league of casino finance and VIP high-roller bets. With this purchase, the bank’s business model changed: instead of just earning interest on staid old loans, the focus shifted to mergers, acquisitions, and new derivatives dreamed up in huge trading rooms. The objective was to generate vast profits, and quickly. With taxpayers ultimately on the hook for any losses, this new model became the standard for the big banks of the West, including Credit Suisse.

Fifteen years of wilful blindness

The collapse of Lehman Brothers, and the Global Financial Crisis of 2008 more generally, highlighted both the harmful and moribund nature of this model. A cocktail of complex and toxic financial products, huge debt, grotesque Remuneration for management and traders, not to mention unlimited cynicism, and we had the recipe for what nearly became a global implosion.

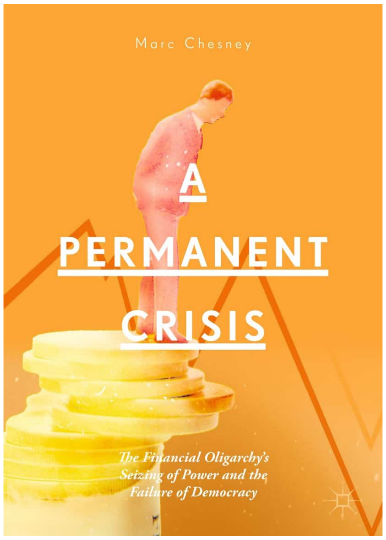
And just then, a funny thing happened: two separate sets of actors nominally working in the public interest seemed to abdicate their responsibilities. First, those in the political sphere chose the perspective of powerful banks over the interests of the taxpayer and the citizen. Second, the academic disciplines of economics and finance also largely looked the other way. Unbridled finance was thus able to continue to freewheel, to the great pleasure of its defenders and lobbyists. I drew attention to these and other problems in my opinion pieces in 2018 and 2022 , with a special* focus on derivative exposures. By 2020, the nominal value of derivatives held by Credit Suisse alone was already 25 times larger than the GDP of its home country of Switzerland.

One week of panic

From 13 to 19 March 2023, confusion and panic reigned in Switzerland, punctuated with the assurance on Wednesday 15 March from the Swiss National Bank and regulator FINMA that "Credit Suisse meets the strict capital and liquidity requirements imposed on systemically important banks". This declaration, however, did not dissuade the bank from asking shortly after for a public loan of CHF 50 billion (GBP 44.5 billion), supposedly to reassure the financial markets. Markets did not stay reassured for long: just a few hours. Fifty billion was not enough reassurance. More was needed.

Two days to cobble together a solution

Under pressure from American leaders, who feared that the domino effect initiated in their country with the collapse of Silicon Valley Bank would continue to spread, a quick-fix "solution" was cobbled together in a hurried and opaque manner during the weekend of 18-19 March. This culminated with the announcement that systemically important UBS would buy systemically important Credit Suisse for a symbolic price, thus ensuring that tiny Switzerland's two giant banking institutions were now fused into one. Due to the use of a new emergency law, essential features of the contract remain secret. All the regulations put in place since 2008 have been ignored and a behemoth has been created, which will control Switzerland, rather than being controlled by it. The balance sheet of this new UBS will be on the order of two times the GDP of Switzerland, and the nominal value of its derivatives about 30 to 40 times that GDP. Every man, woman, and child in the country is today on the hook for nearly CHF 30,000 (GBP 26,500) in new guarantees demanded by UBS as part of the deal.



90 minutes of unconvincing communication

The last act of this farce, which would be comical if it were not so pathetic, consisted in gathering the main protagonists of this affair together in one room. These were the same people who had explained a few days before that the situation of Credit Suisse was well under control. Now during a press conference late on a Sunday evening, they explained with serious faces that this takeover was the best solution for Switzerland, in order to restore the confidence of the financial markets…

Beyond the fall of Credit Suisse, we are thus also witnessing the bankruptcy of a casino finance system, a political elite that kept it running for 15 years, and that of the academic world, which, too often, has shown an unwarranted complacency towards the biggest financial institutions. Citizens must be vigilant, otherwise the decadent parties, the inevitable and messy crashes, and the taxpayer-backed clean-ups will keep repeating.

Marc Chesney is Professor of Mathematical Finance at the University of Zurich and author of A Permanent Crisis (2018). A version of this article appeared in French in Le Temps on 26 March 2023.

* 2018 : La faillite de Lehman Brothers est celle d’un système (Le Temps)
Lehman Brothers: der Bankrott einer Bank und derjenige eines Systems (NZZ)
2022 : CS: la débâcle de Casino Suisse (Le Temps)
Die Credit Suisse oder das Debakel von Casino Suisse (Infosperber)
Das Problem ist die Finanz-Casino-Mentalität sowie Die Vergütungen
der verantwortungslosen CS-Chefs sind skandalös (Tages-Anzeiger)