

Still too-big-to-fail?

Lessons from the failure of Credit Suisse

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Outline

I. Old lessons : 15 years of reforms (in Basel)

- Reforms dealing with too-big-to-fail
- The current (Swiss) framework too-big-to-fail

II. The case of Credit Suisse

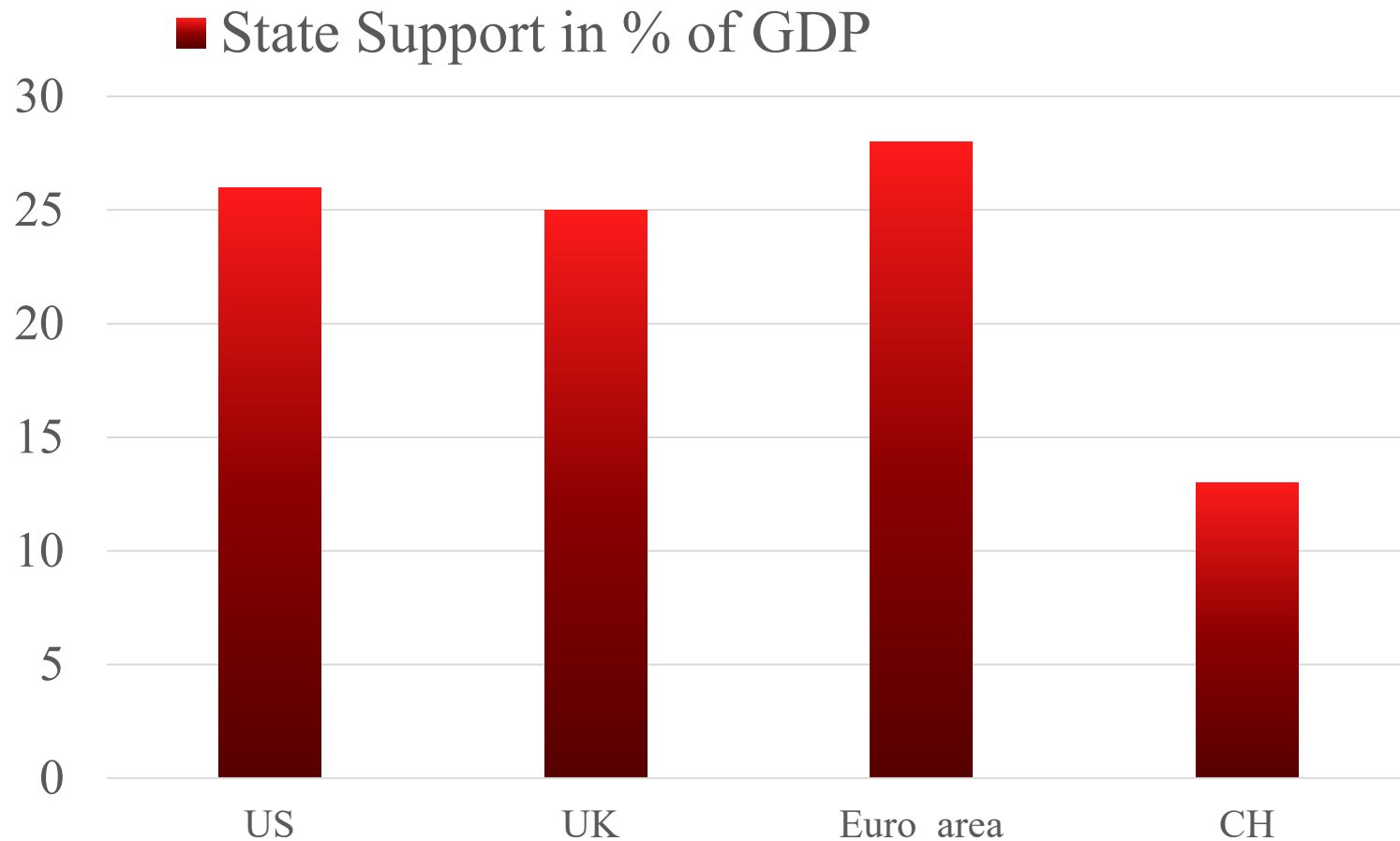
- The failure of too-big-to-fail ?

III. New lessons

- Improve robustness of resolution
- Introduce a recovery regime

The trauma of Lehman

Cost of bail-out, economic and political



“Never again ”

No bank should be TBTF

Basel Reforms



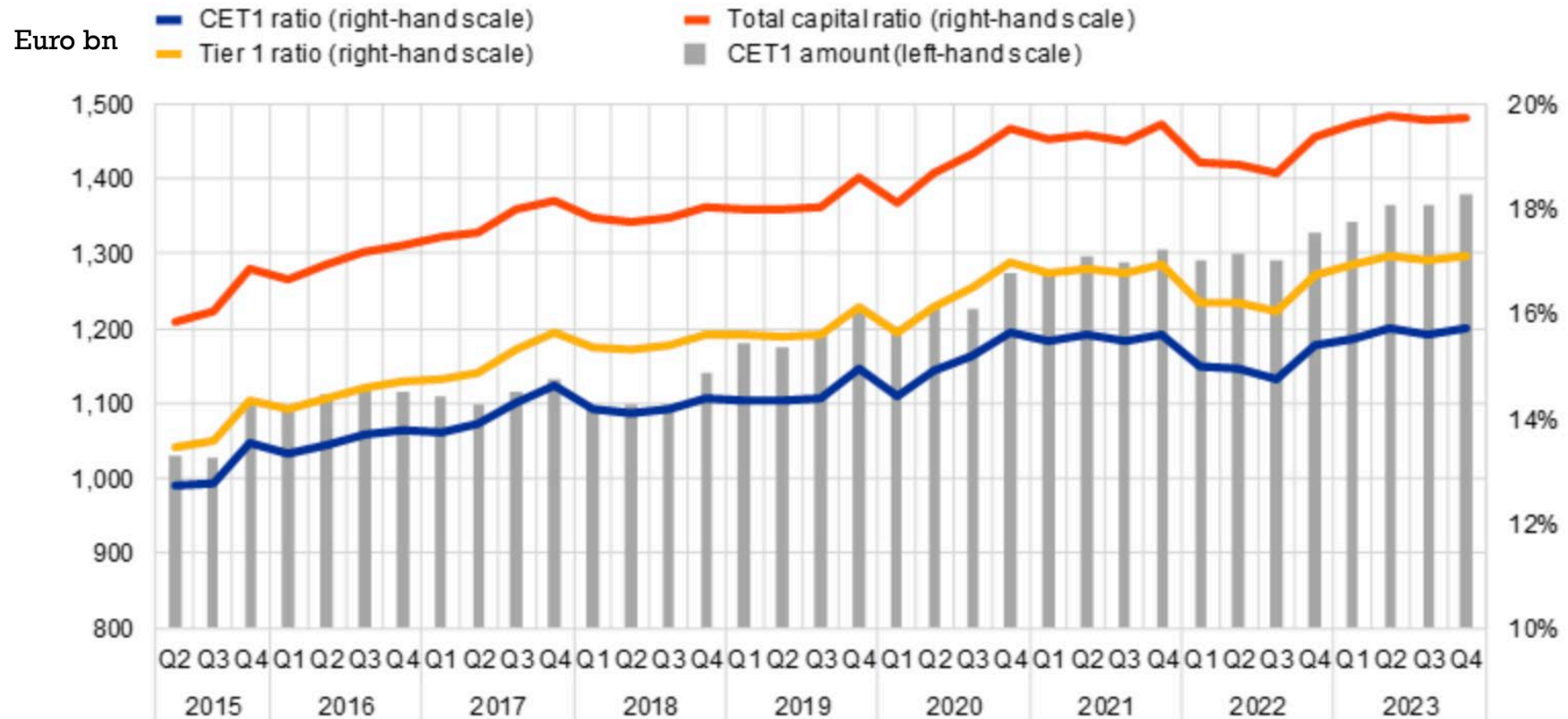
Focus on capital : (A crisis of solvency – “Its equity stupid”)

- Quantity and quality of capital buffers
- Risk weights vs. leverage ratio
- Structuring of the capital

Cross-border Resolution : (“ Keep your toxic assets”)

- Recovery & Resolution planning, living will, stress testing
- Multiple- vs. Single Point of Entry Strategy
- Cross-border coordination - Crisis management committees

Basel III: Building Capital at European Banks



Shrinking Balance Sheets

UBS&CS / Swiss GDP

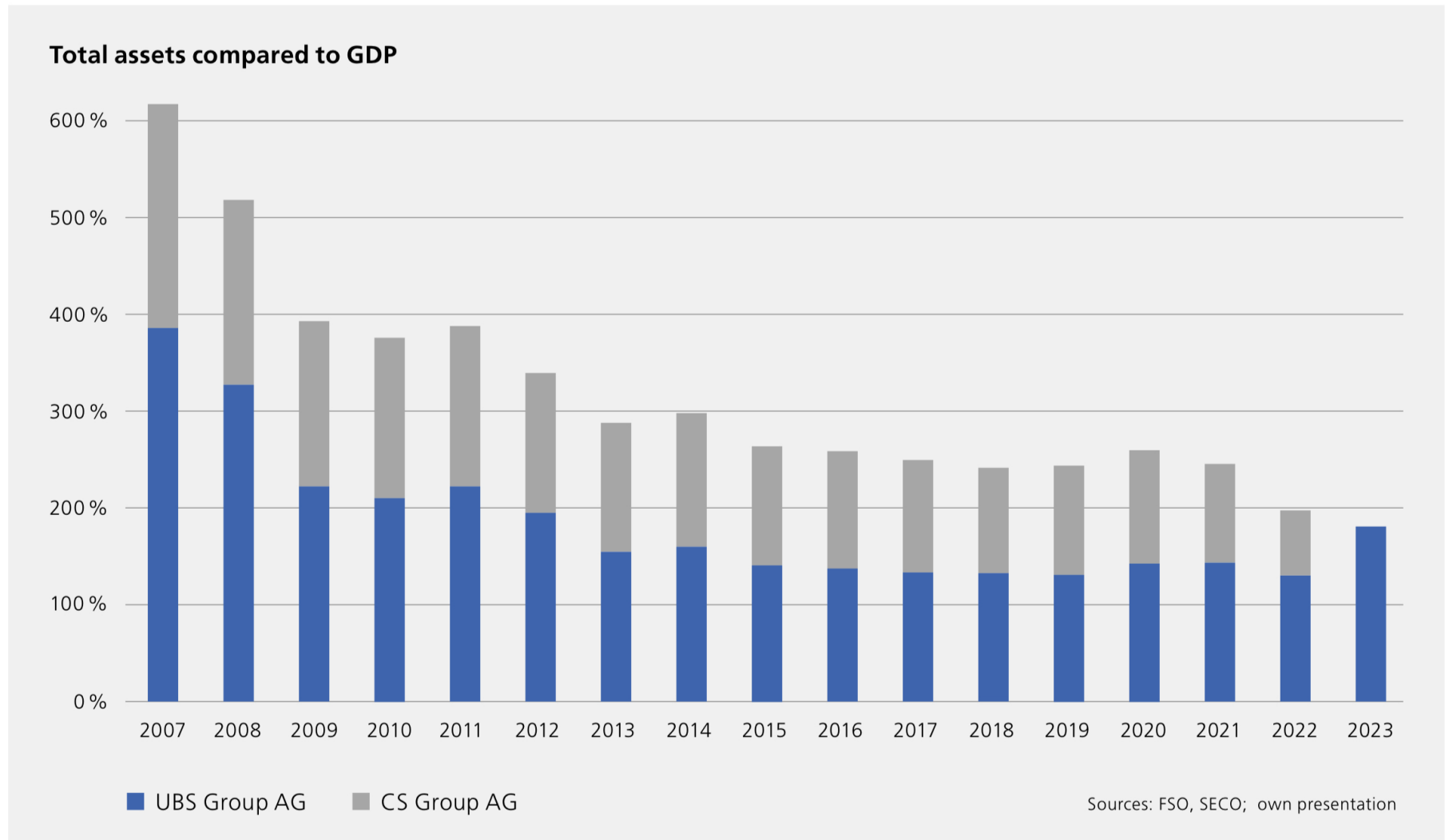
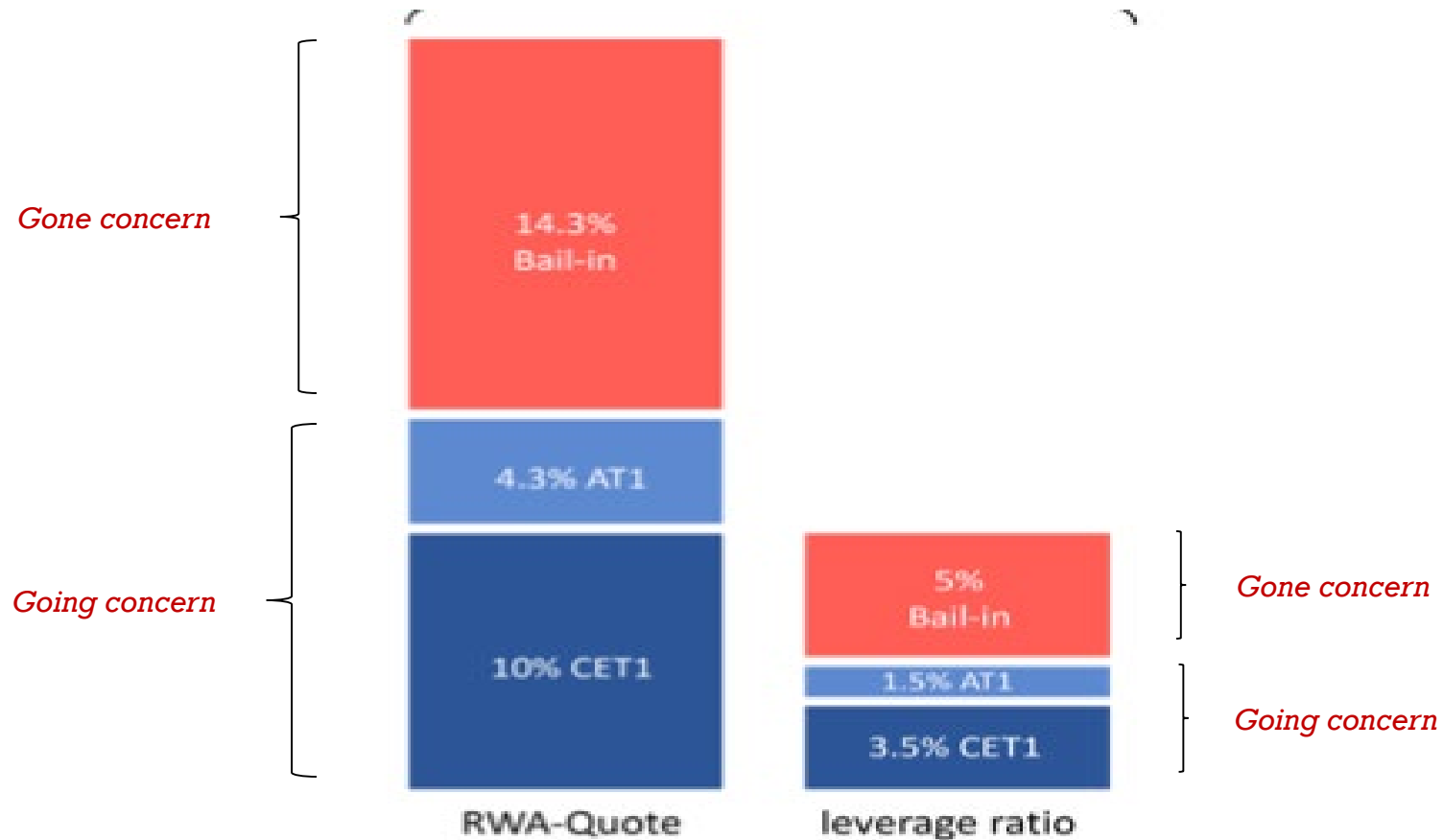


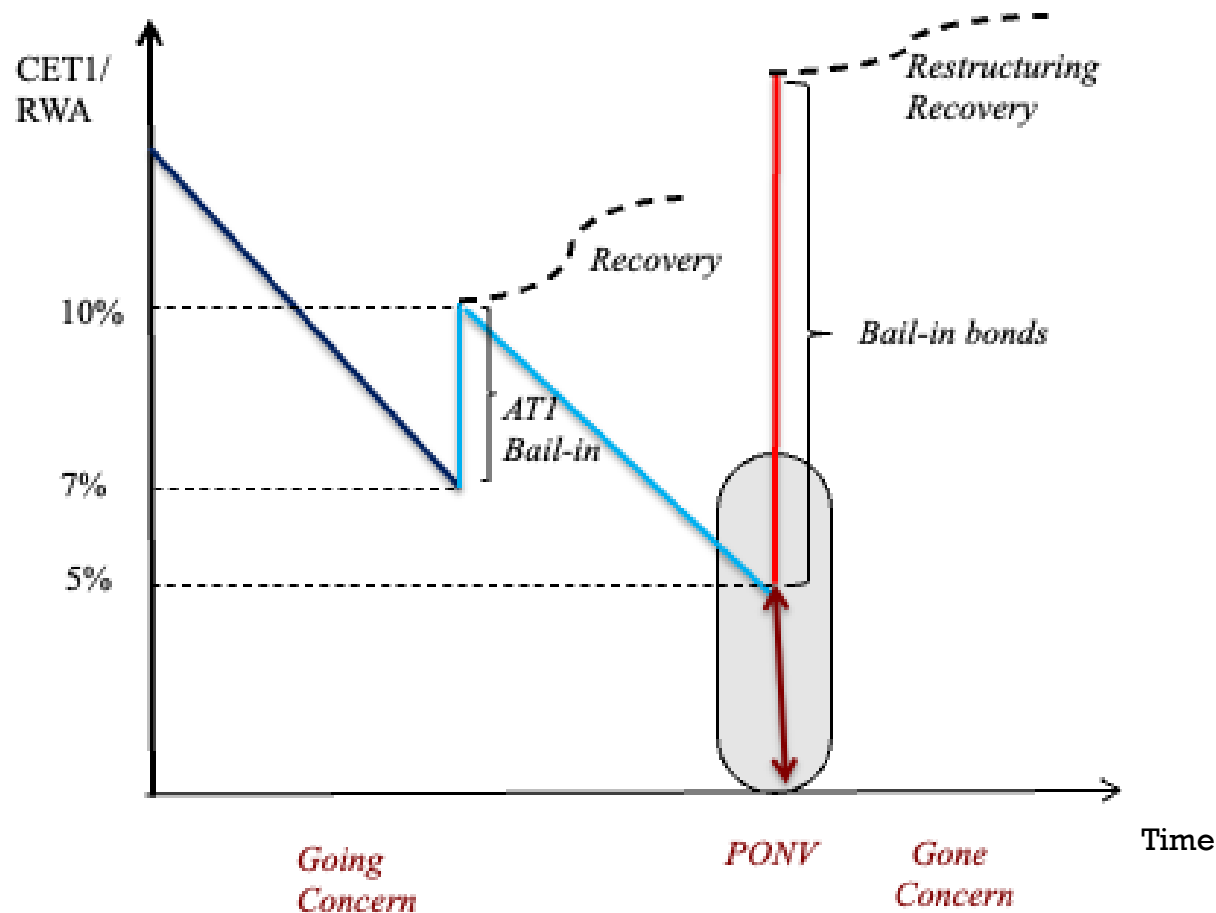
Figure 2: Development of the size of Swiss G-SIBs compared to GDP

Structure of Total Loss Absorbing Capital (TLAC)

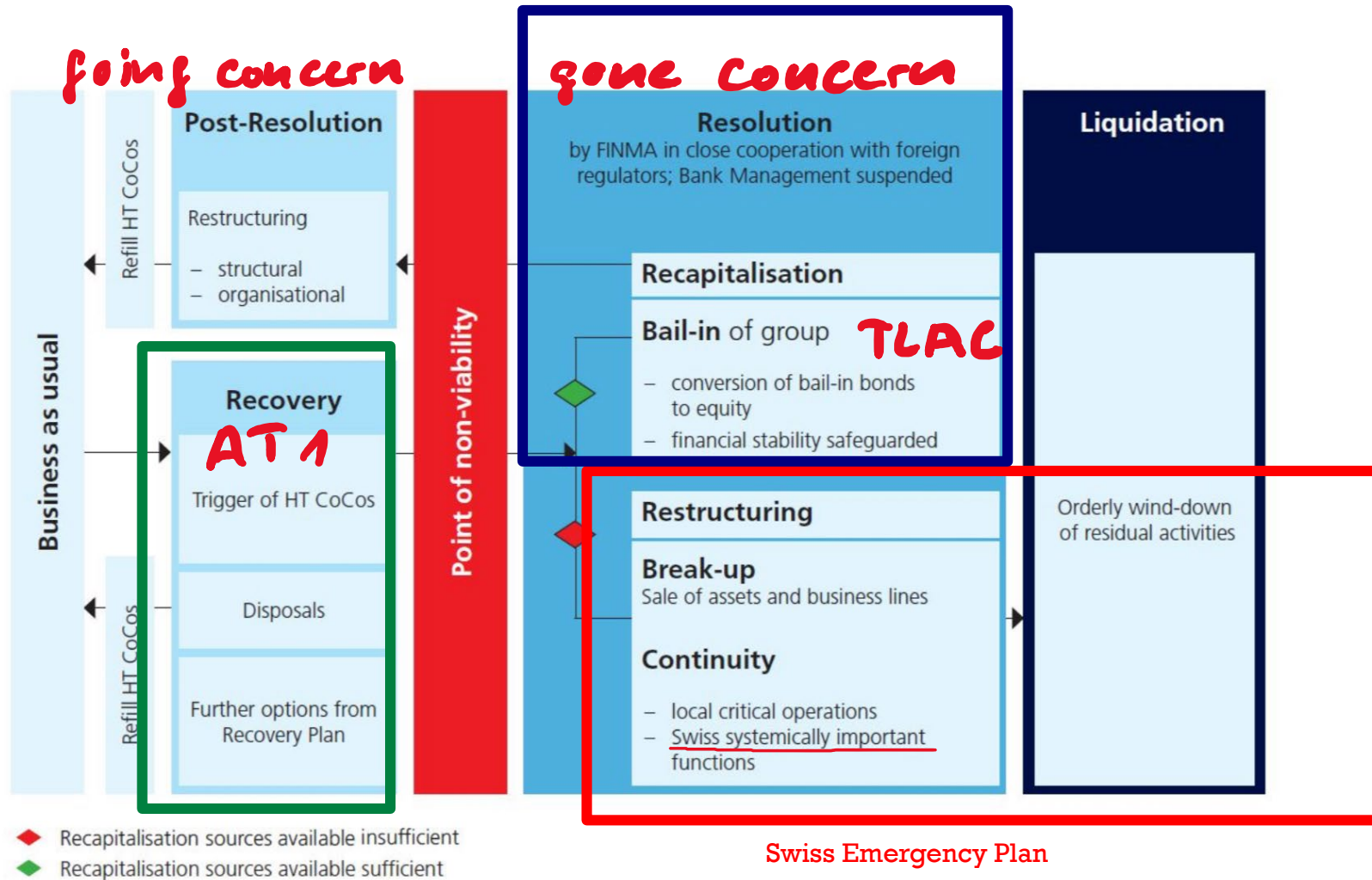
Swiss Capital Requirements for GSIBs



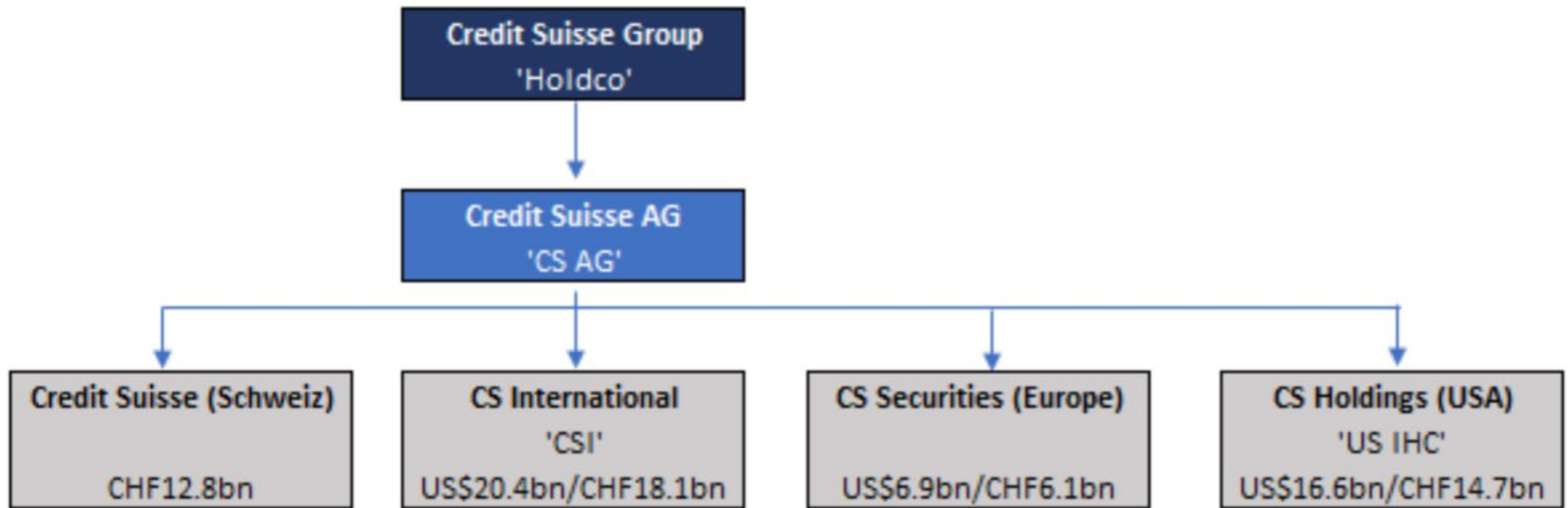
Stylized recovery and resolution in a solvency crisis



Swiss TBTF – Playbook



Single Point of Entry Resolution (SPE) of a global systemically important banks (GSIBs)



II. The first real-life test



Credit Suisse – UBS 2023

3 bn for shares

16 bn bail-in of AT1

+ Public Liquidity Backstop, 100 bn

+ Emergency law

+ 9 bn second loss guarantee

Total liquidity needs of 170 bn (CHF)

Largely in USD

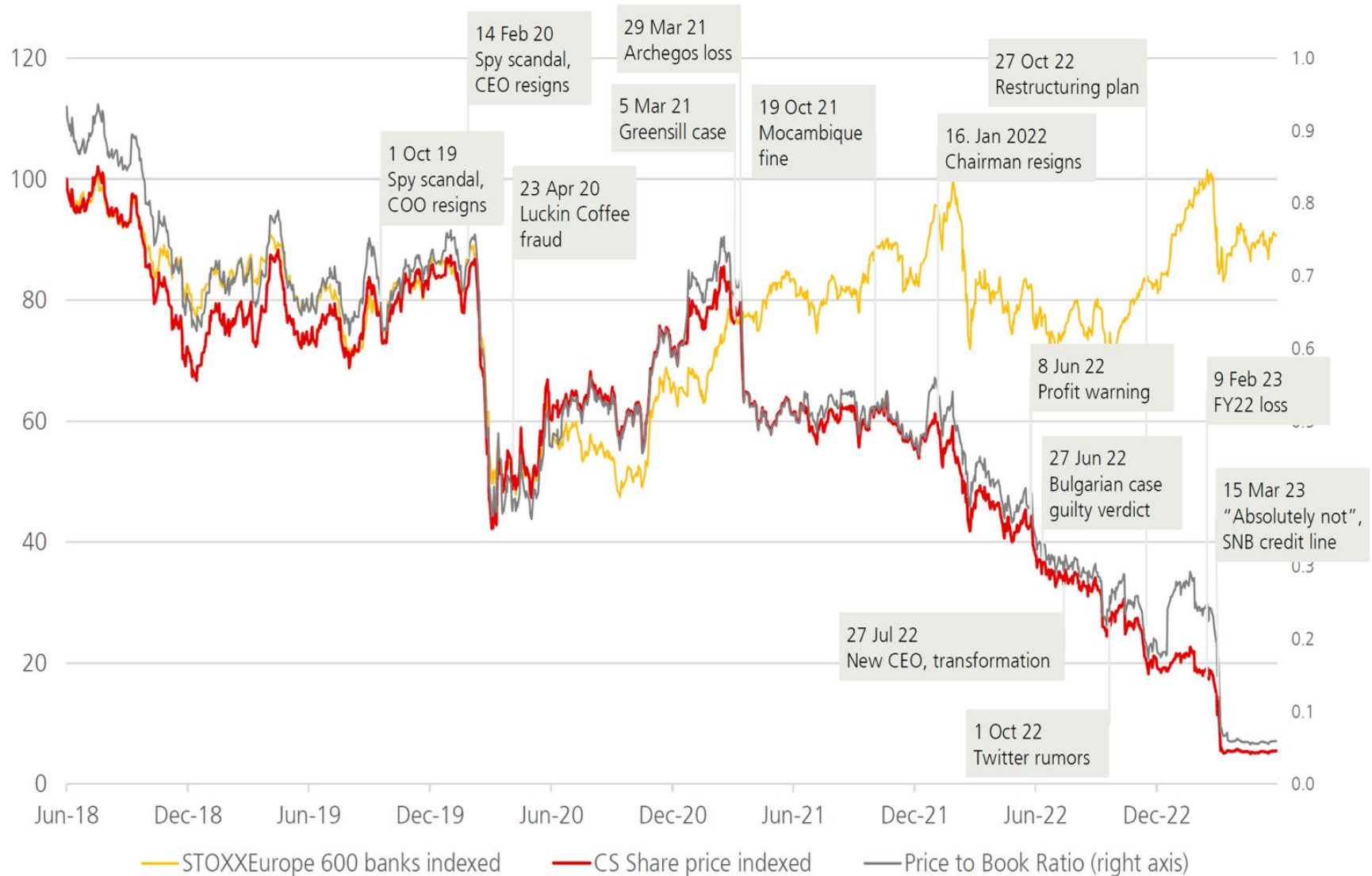
Credit Suisse Capital at Demise

Billion	Q1 2023		Q4 2022		Q3 2022		Min.
Capital, risk-weighted							
CET1	35.8	14.7%	36.7	14.6%	39.9	14.6%	10.0%
CET1 + AT1 (going concern)	49.4	20.3%	50.0	19.9%	50.1	18.3%	14.3%
TLAC (going and gone concern)	97.9	40.2%	99.1	39.5%	97.4	35.5%	28.6%
Risk-weighted assets	243.8		251.0		274.1		

Credit Suisse Capital at Demise

Billion	Q1 2023		Q4 2022		Q3 2022		Min.
Capital, unweighted							
Leverage ratio CET1	32.8	5.0%	32.7	5.0%	41.7	4.9%	3.5%
LR CET1 and AT1 (going concern)	49.4	7.6%	50.0	7.7%	50.1	5.9%	5.0%
TLAC (going and gone concern)	97.9	15.0%	99.1	15.2%	97.4	11.5%	10.0%
LR denominator	653.0		650.5		836.9		
Total assets	540.3		531.4		700.4		

CS Business Model (Franchise Value)



CS Business Model (Franchise Value)

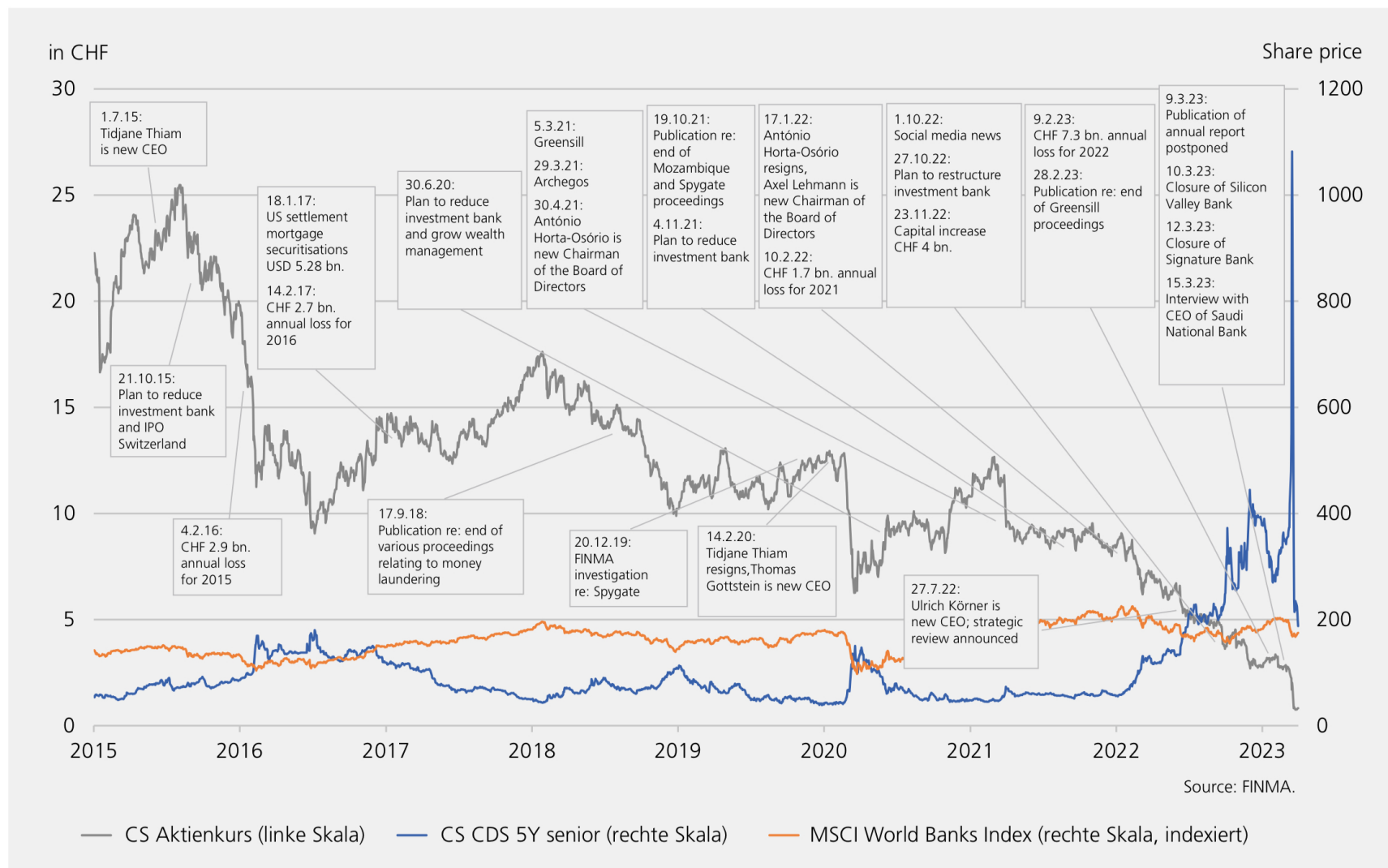


Figure 3: Share price trend and CDS of Credit Suisse Group

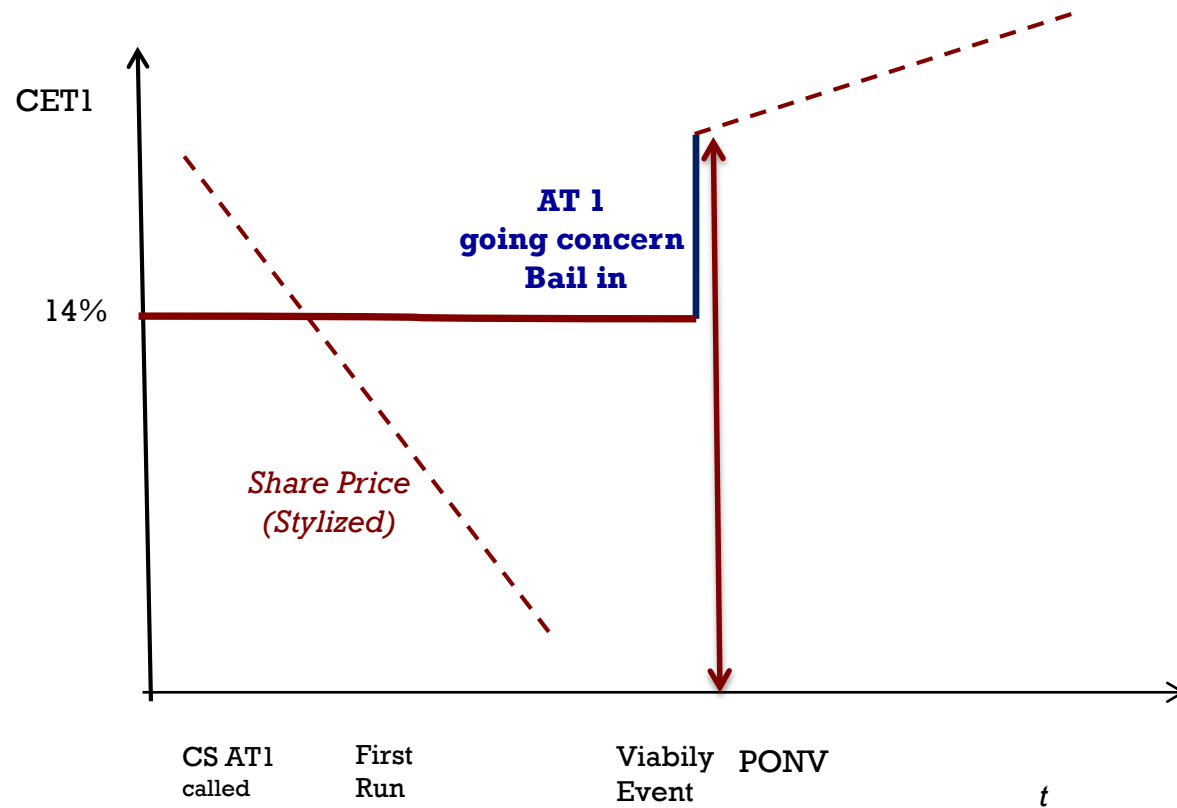
CS Risk management ...

excerpt is from the Special Board Committee Report (2021)

“The U.S.-based Co-Head stated that he had responsibility for Prime Brokerage and did not supervise or have responsibilities for Prime Financing in the United States or elsewhere. The U.K.-based Co-Head asserted that the division of labor between the two Co-Heads became more regional during the COVID-19 pandemic and that he was in charge of all EMEA businesses, while the U.S.-based Co-Head was in charge of all businesses in the United States. In all events, neither of the Co-Heads of Prime Services believed he was specifically responsible for supervising CS’s relationship with Prime Financing clients in the United States—including Archegos. Indeed, neither claimed any particular familiarity with Archegos (including its persistent limit breaches) before the default, notwithstanding that Archegos was among Prime Services’ top 10 clients throughout the period, ultimately becoming its third largest hedge fund counterparty by gross exposure before its default.”

The Credit Suisse Case

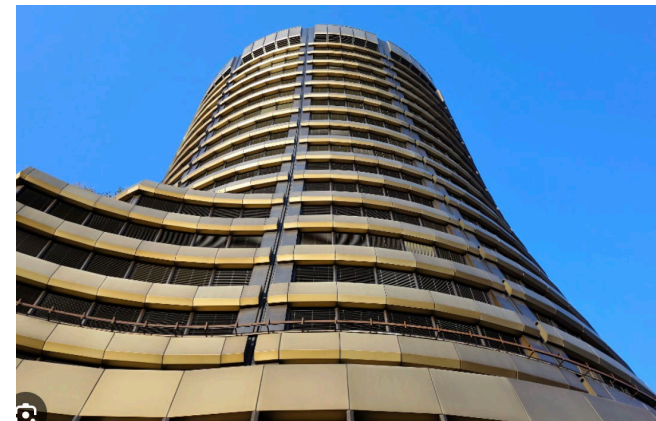
- Recovery options did not work
- AT1s activated by viability event
- Point of non viability (PONV) not activated



Credibility of end game - Why not activated PONV?

Four possibilities

1. There was a less risky alternative – OK, well done
→ Need more optionality in resolution
2. The full bail-in was considered too risky
→ Need to fix the TBTF regime – put in place the necessary conditions
→ Funding in Resolution
→ Legal challenge to bail-in (SEC)
3. Bail-in resolution was poorly understood (outside the BIS tower)
Need MUCH better information, and preparation
4. All of the above...



Credibility of Recovery

Why did the recovery plans not work?

1. Sudden runs, loss of trust in business model and some bad luck
2. Strategic limits to restructuring – intra-group capital allocation
3. Management resistance – gambling for resurrection
4. Supervisor did not / could not intervene enough
5. Avoiding negative signaling – do not trigger a run

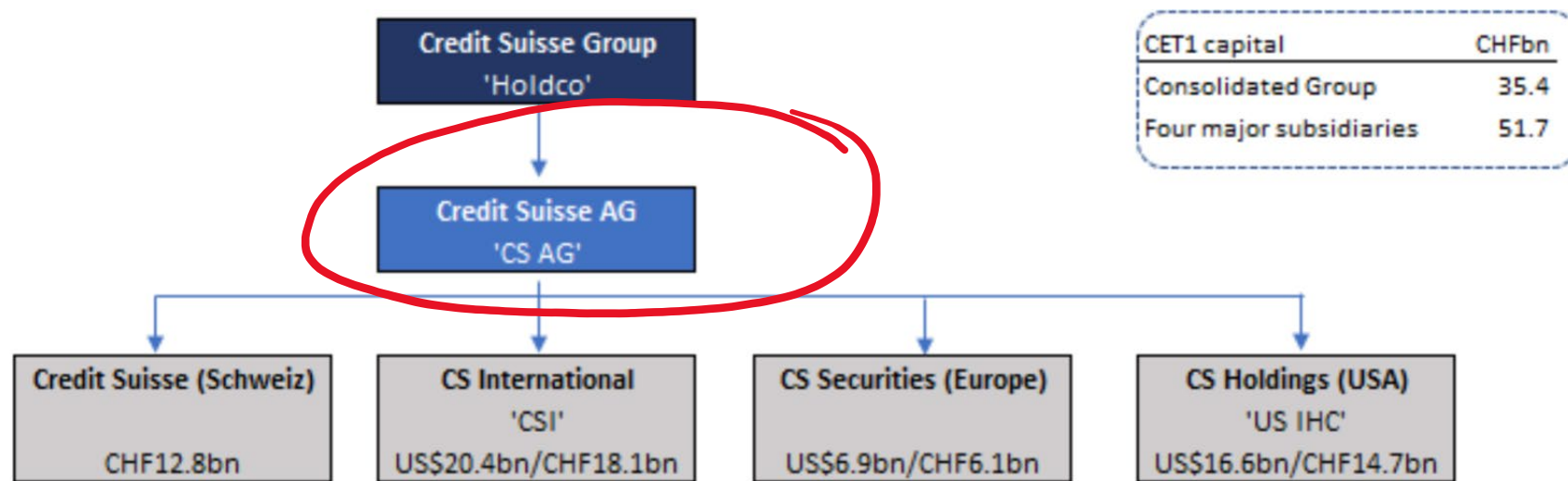
All of the above...

Strategic Options and Intra-Group Distribution Issues

Capital trapping, double leverage and the parent bank capital

Procyclical Elements in accounting and AT1

Regulatory Filter, RWA Transition



Source: Company data, Autonomous Research

AT1s recapitalization in going concern

In theory :

AT1 instruments Tier 1 are equity because they are:

- perpetual,
- interest and repayment are discretionary
- loss absorbing in going concern
- sold only to institutional investors (200 000.-)

In practice: they are not

- usually called at earliest call date
 - interest paid even in difficult times
- => especially then ! avoid negative **signaling**

Need to "fix" AT1s

Swiss AT1 design – going concern

But NOT expected

CREDIT SUISSE 

Credit Suisse Group AG

(incorporated with limited liability in Switzerland)

U.S.\$1,650,000,000 9.750 per cent. Perpetual Tier 1 Contingent Write-down Capital Notes

IMPORTANT NOTICE

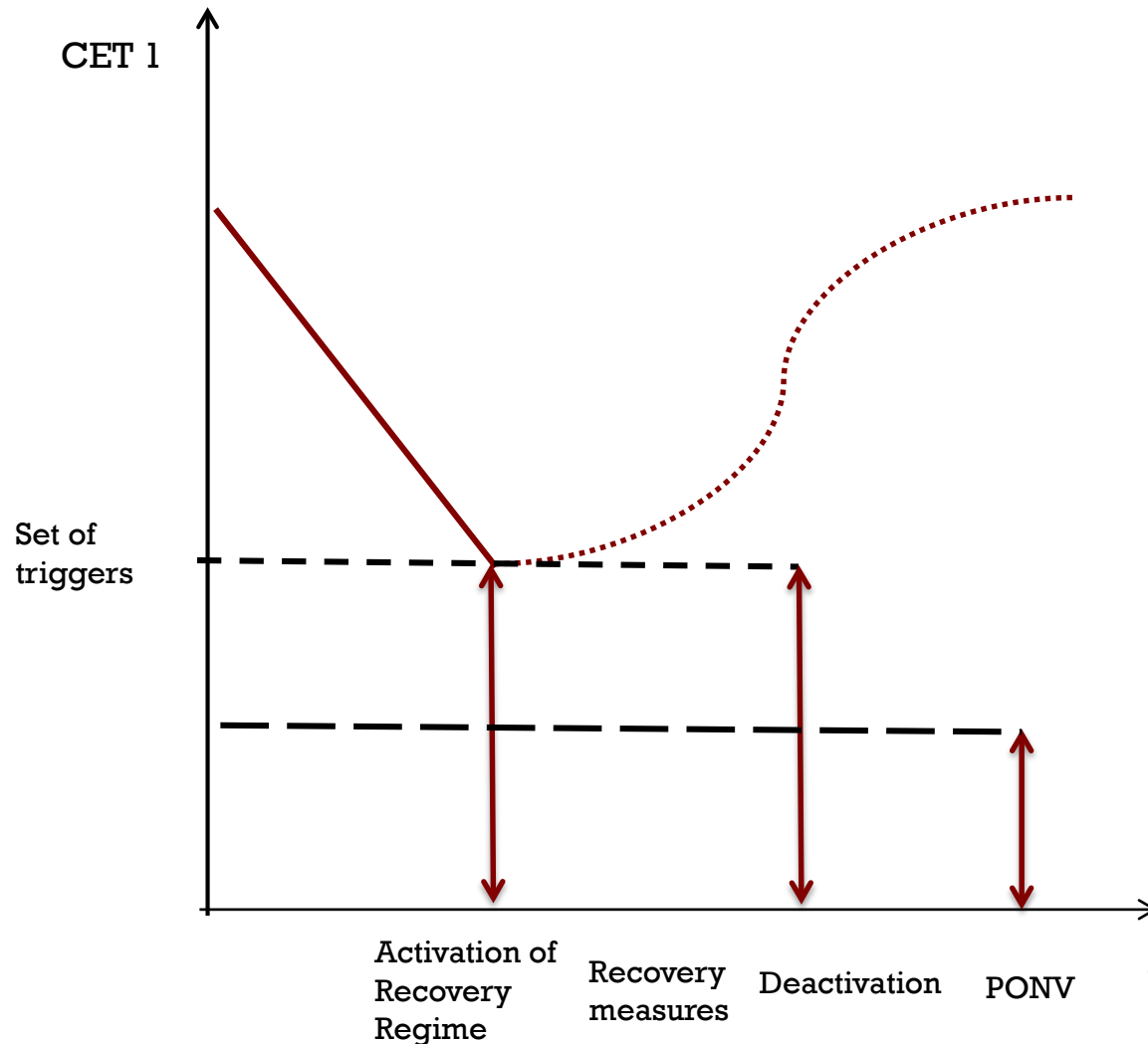
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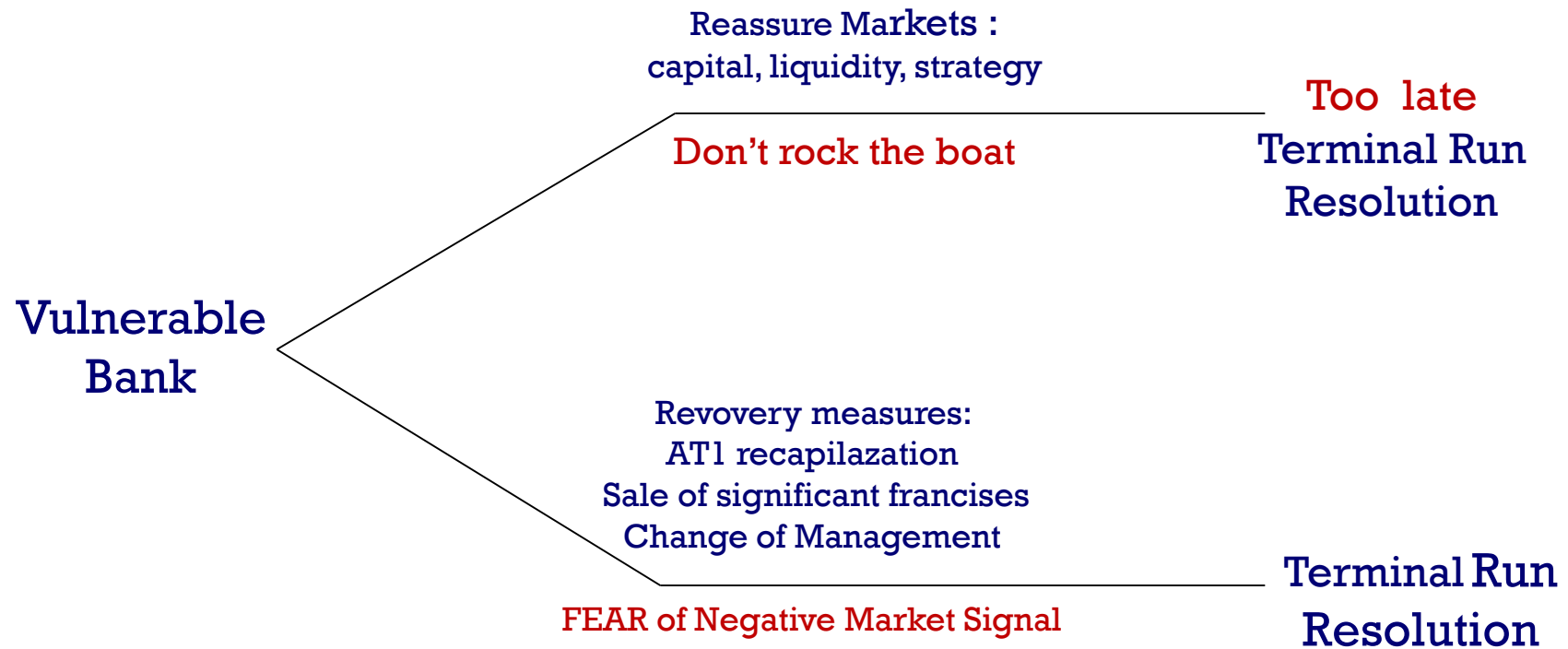
A “**Viability Event**” will occur if prior to a Statutory Loss

- (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

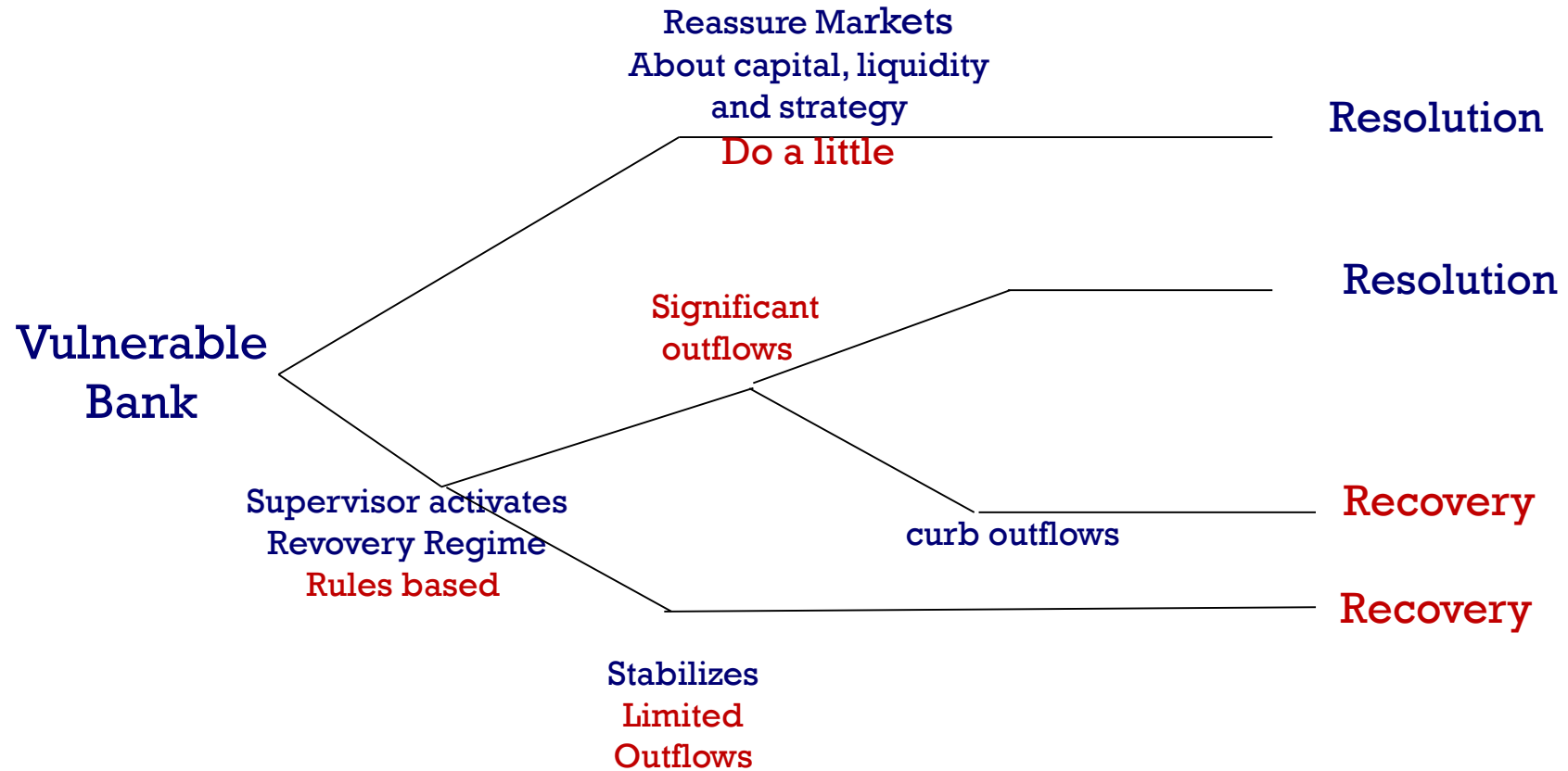
Improving the Recovery Probability through Early Intervention : A Special Recovery Regime



The problem of too-little-too-late Management & Supervisor



A Special Recovery Regime (Management & Supervisor)



Triggers for Activation

Rules versus Discretion

	Capital Triggers	Supervisory Ratings	Material Changes	Significant Events
US PCA 1991	Y	N	N	N
EU EIM 2014	Y	Y	Y	Y

TBTF – Reform Needs

- **Make Resolution Credible**

- Legal certainty of SPE bail-in
- Funding in resolution
- Reconsider open bank bail-in and optionality in resolution
- Communicate, educate, practice resolution playbook

- **A Special Recovery Regime**

- Mandatory activation – powers to curb runs
- Strengthen AT1 in going concern
- Address intra-group capital structure

Thank you

