Banks in turmoil

Opinion **The FT View**

A very Swiss bank rescue

UBS takeover of Credit Suisse eases market rout, but the deal will have repercussions

THE EDITORIAL BOARD

A Credit Suisse branch in Geneva. If the bank on its own was deemed too big too fail, the new entity of UBS-Credit Suisse will take on even greater global systemic importance © Jose Cendon/Bloomberg

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To paraphrase the former Bank of England governor Mervyn King, most banks are global in life but national in death. This is certainly true for Credit Suisse. After a weekend of intense negotiations, Swiss authorities brokered an emergency deal to sell the troubled 167-year-old institution to its more successful Swiss rival, UBS. A SFr50bn ($54bn) liquidity lifeline from the Swiss National Bank last week failed to stem the crisis of confidence facing Credit Suisse following Silicon Valley Bank's collapse: its share price slumped and the flight of deposits accelerated. The deal has prevented a globally important bank from failing. But by putting Swiss interests at the heart of how the deal was structured, it has potentially troubling repercussions.

Given the collapse of faith in Credit Suisse, it would have been unable to open for business on Monday morning. UBS was a ready buyer. The only alternative, a state-administered resolution, would have been messy and would have caused alarm to already febrile global markets. But as the only viable Swiss buyer, UBS was able to drive a hard bargain. Credit Suisse was sold for $3.2bn — a huge discount to its prior market value. The government guaranteed SFr9bn of the joint entity's losses it may suffer on certain portfolios of assets. Swiss regulator Finma also demanded that $17.3bn of Credit Suisse's additional tier one (AT1) bonds, debt that is designed to take losses during a crisis, be written off. It meant AT1 debtholders lost out more than shareholders.

The wipeout of AT1 bonds is the most controversial element of the deal. It cast doubt on the hierarchy of claims in the event of a bank failure: common equity is usually considered subordinate to these bonds in the capital structure, yet shareholders received a small sum at their expense. Finma cites a clause in the bond prospectus allowing this, but bondholders are now threatening a legal challenge. The surprise decision also sparked concerns that other AT1 investments posed similar risks: there was an initial sharp sell-off of other banks' AT1 instruments. European authorities restored some calm by reassuring AT1 bondholders in eurozone and UK banks that they would not suffer the same fate.

The payout to shareholders is regrettable, though this may have been an attempt by the Swiss authorities to extend an olive branch to international equity holders, particularly from the Middle East, which is an important location for the banks' wealth management operations. Legal challenges could add to uncertainty around the deal: shareholders are already miffed they did not get a vote on it and Swiss politicians have complained that the hefty government backstop, risking taxpayers' money once UBS bears initial losses, was not debated in parliament.

The combined UBS-Credit Suisse will be a behemoth: its combined assets will be roughly twice the size of the Swiss economy. If Credit Suisse on its own was deemed too big too fail, the new entity will take on even greater global systemic importance — which makes its success crucial. In its domestic Swiss operations it will have a vast market share, which could distort competition and give it huge pricing power to the potential disadvantage of retail customers. Antitrust measures were waived on the grounds of preserving financial stability.

The reputational damage to Swiss banking will be significant. This is also a wake-up call that even banks with apparently healthy capital and liquidity ratios can tumble if confidence evaporates. Fear finds weakness, and Credit Suisse was long blighted by poor management. The Swiss authorities have helped to limit the market turmoil, to the relief of the financial world, but this expedient deal will still have repercussions. It should not have been allowed to get to this stage in the first place.

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