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Capital, capital and once again capital

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It is repeatedly warned that higher capitalisation would put banks such as UBS at a disadvantage. In the long term, the opposite is the case.

There is a consensus in the public debate that the only remaining major Swiss bank should be internationally competitive and stable. There must not be another state bailout. There is disagreement regarding the appropriate measures to achieve this goal.

The collapse of Credit Suisse is a textbook example of emergency measures that will not work in the event of a potential crisis at UBS. Firstly, the unwinding of a systemically important bank proves to be impractical, because in such a case the fear of a systemic crisis is rampant worldwide and pressure from abroad, especially from the USA, makes this scenario impossible. Secondly, the idea of converting the AT-1 bonds created for restructuring purposes into equity at an early stage is proving to be illusory. Such a conversion sends devastating signals to the capital market about the state of the bank – and thus accelerates its collapse.

Nice theory – but in practice…

Thirdly, the future planned Public Liquidity Backstop will work only in theory, not in practice. We now know that Credit Suisse voluntarily refrained from drawing on liquidity from the SNB in autumn 2022, when the crisis threatened its very existence. As soon as it becomes public that a bank is receiving billions in state liquidity assistance, panic breaks out on the market, which is further fuelled by shareholder activists and hedge funds.

If you want to understand the causes of a bank's collapse, you have to understand the logic of the chronological sequence. Firstly, years of mismanagement lead to chronic losses and eroding equity. As a result, the confidence of nervous savers who fear for their money gradually dwindles. At some point, the famous straw breaks the camel's back – in the case of Credit Suisse, it was a tweet from an unknown Australian journalist. A panic ensues, which ends in a bank run. It is important to realise that a loss of confidence never comes out of the blue, but is always the result of fatal mismanagement that threatens the substance of the bank. This is what happened at Credit Suisse.

UBS points out that it has adjusted its strategy and reduced risks. However, this is not a guarantee that a future disaster can be ruled out. Kelleher and Ermotti will leave their posts in a few years' time at the latest, and new executives will review the bank's strategy and adapt it if necessary. Experience shows that old mistakes are repeated under new leadership. Bad decisions and mismanagement are only a matter of time. The most effective protection to cushion the associated risks is a high equity ratio.

A solid "Swiss finish"

UBS currently has unweighted equity of 4.7 per cent of total assets. The new "Basel III" regulations require the bank to hold additional capital of around 19 billion dollars, which will increase the ratio to 5.9 per cent. Federal Councillor Karin Keller-Sutter is calling for a further 15 to 25 billion, which would increase the hard equity ratio to 6.9 to 7.6 per cent. It is doubtful that this will be enough. Credit Suisse collapsed in an almost cloudless economic period.

Renowned economists such as Anat Admati, Martin Hellwig and Nobel Prize winner Simon Johnson have been advocating Common Equity Tier 1 of 15 to 20 per cent for many years – two to three times what the Federal Council wants. From the taxpayers' point of view, a "Swiss Finish" is necessary simply because UBS's total assets are twice the size of Switzerland's domestic product. JP Morgan, the largest bank in the United States of America, represents just 14 per cent of US economic output. The option of UBS moving abroad would be regrettable, but is solely a matter for the shareholders.

UBS warns that higher capital requirements would limit its competitiveness and make the lending rates for its clients more expensive. This thesis, repeatedly proclaimed by bankers like a mantra, must be contradicted. As the collapse of Credit Suisse shows, the opposite is true in the long term. Low equity means that, in the event of a crisis, the bank can only refinance itself at

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horrendous interest rates or not at all, making its business unprofitable to the detriment of its shareholders and clients. Low levels of equity also encourage a questionable bonus and risk culture among managers, which primarily attracts risk-takers as shareholders.

In order to minimise the potential risk of bankruptcy, there is no alternative to a significantly higher capitalisation of UBS, which has an implicit state guarantee. That will improve its refinancing conditions, competitiveness and resilience. This benefits not only Swiss taxpayers but also the bank's clients and long-term shareholders.

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