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Opinion

What truly benefits the country and UBS

Pirmin Hotz

The recommendations of the parliamentary commission on the collapse of Credit Suisse are toothless and impractical. There is basically only one option left for Switzerland's last remaining major bank.

Two days before the release of the parliamentary commission's (PUK) report on the collapse of Credit Suisse, Christoph Mäder, President of Economiesuisse, stated in the NZZ: "CS did not fail due to a lack of equity capital or liquidity, but due to a crisis of confidence and the subsequent bank run." Now at the latest, we know that this widespread opinion is incorrect. CS collapsed due to the lack of equity capital and insufficient liquidity.

The Financial Market Supervisory Authority (Finma) has thrown sand in the public's eyes, maintaining the illusion that the bank was well-capitalised, even though the declining share price and skyrocketing risk premiums (Credit Default Swaps) had long since signalled that CS was on its deathbed, no longer creditworthy, and its book value, or equity, was no longer secure. CS was undercapitalised by 2021 at the latest. The Brunetti Committee developed a solution for the too-big-to-fail (TBTF) problem after the financial crisis, but it proved to be impractical. Fear of global contagion and a systemic crisis prevented the bank from being wound up. The authorities found themselves in a dreadful dilemma.

Had they communicated the truth about CS's health at an early stage and instructed CS to convert the AT1 bonds issued for restructuring into equity, it would have triggered market panic, hastening the bank's collapse. The lack of communication could prove costly for taxpayers in the context of the AT1 bonds, as plaintiffs will refer to the official statements from Finma and the Swiss National Bank (SNB) that everything was fine in terms of equity and liquidity until the end.

In the end, one gust of wind is enough

Over the last decade of its existence, CS accumulated a staggering CHF 32.7 billion in losses due to scandals and penalties, while simultaneously paying out CHF 31.7 billion in bonuses. When equity melts away like snow in the sun, the system eventually tips over, and investors rush for the exits in panic to secure their money. In the end, it takes only a small puff of wind to shatter trust and trigger a bank run – such as an inconsequential tweet from an unknown Australian journalist.

The public liquidity backstop is intended to make the provision of liquidity by the state easier going forward. However, it is subject to the same pitfalls as the ineffective TBTF rules. The public admission of state aid inevitably sends devastating signals and causes panic on capital markets. At that point, investors' trust completely breaks down, and shareholder activists drive down the struggling bank with short positions or take it over.

That is why CS wisely refrained from drawing on liquidity several times in the autumn of 2022. Moreover, the PUK report reveals that the collateral which CS posted at the SNB was insufficient to obtain the necessary loans. This suggests once again that there was too little equity. CS reported approximately 5% Common Equity Tier One on paper, but effectively only about 2 or 3% when relief measures are excluded – far too little to obtain loans or liquidity from the SNB without the central bank itself taking irresponsible risks.

Given their own dealings with clients, CS executives should have known that only those with sufficient equity capital can obtain credit. It is incomprehensible why the rules the bank dictates to its clients should not apply to itself. The main cause of the dramatic liquidity outflow is consequently CS's chronic undercapitalisation.

> "The dramatic outflow of liquidity was due to chronic undercapitalisation."

The PUK recommends reducing the stigma associated with granting state funds. However, given that the public has the right to know when a bank receives state aid, this demand is like trying to square the circle. In the shark tank of financial markets, admitting you're half dead means you will be fully dead almost instantly.

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A more powerful Finma and an SNB that is more generous with liquidity will not be able to prevent a theoretical collapse of UBS in the future. The PUK's demand to increase the number of staff handling supervision, impose fines, enforce the withdrawal of guarantees for incompetent managers, or ban bonuses only lulls bank clients and the public into a false sense of security. It is not regulatory officials who run a bank, but rather the bank's board of directors and executive management. They bear the responsibility – even for failure.

There should be less regulation, but it should be more efficient. UBS has by far the largest balance sheet total as a percentage of the annual economic output of a bank's home country worldwide. While the percentage for the US giant JPMorgan is 14% and for Deutsche Bank 32%, UBS has an astounding 175%. To survive larger crises, there is only one effective measure that can be deployed efficiently and easily controlled: high capitalisation.

According to renowned scholars Anat Admati, Martin Hellwig, and Nobel laureate Simon Johnson, UBS should have at least 15 to 20% Common Equity Tier One – three times what it currently has. Only in this way will there be a high probability of permanently preventing a bank run. If UBS is to be wound up in the event of a crisis and without having to call on the taxpayer, substantial buffers are also a prerequisite, as painful discounts on the book value will naturally have to be accepted in the case of fire sales.

Good job by Ermotti

It is proclaimed like a mantra that high equity would limit UBS's competitiveness and make loans more expensive – a myth that does not become trues merely by repetition. The opposite is actually true. The example of CS demonstrated clearly how undercapitalisation makes refinancing on the capital market more expensive or even impossible. A well-capitalised bank is perceived as safe and is more resilient and competitive. This is precisely what one wishes for UBS, its shareholders and clients. Cantonal banks have in some cases much higher equity ratios and are thus very successful.

Top bankers' pursuit of high returns on equity, which is naturally easier to achieve with low equity and serves as the basis for their exorbitant bonuses, must come to an end. When dealing with systemically important banks that effectively hold a state guarantee, this reckless game is unacceptable even for staunch advocates of the free market.

Undoubtedly, Colm Kelleher and Sergio Ermotti are currently doing a good job. However, we must not forget that just fifteen years ago UBS also had to be bailed out by the government. Who guarantees that this will not happen again in ten or twenty years with a new crew? For the rescue of CS, the public sector took on a risk of CHF 257 billion in an economically fair-weather phase. If a storm is raging, UBS – due to its sheer size – will be "too big to rescue". High equity is the simplest and most efficient protection against a future fiasco and strengthens UBS's competitiveness.

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