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An Analysis of the Collapse of Credit Suisse: Historical Context, Underlying Causes, and Risk Management Strategies

Jingyang Li

The University of New South Wales, Kensington, Sydney, New South Wales

Abstract: This paper not only discusses the circumstances of the collapse of Credit Suisse, but also deeply explores how and why Credit Suisse collapsed step by step based on the historical background and the relationship between Credit Suisse and the Swiss government, and finally gives the corresponding risk management strategy.

Keywords: Risk Management; Credit Suisse; Operational Risk

1. Introduction

On March 19, 2023, Credit Suisse was acquired by UBS for a bargain price of $3.2 billion[1]. The trigger for the collapse of Credit Suisse, one of the world's 30 systemically important banks[2] with more than $1.5 trillion in assets under management, equivalent to two years of Swiss GDP, was a "Absolutely Not" statement from the National Bank of Saudi Arabia[3].

1.1 Historical Background

Credit Suisse was founded in 1856. In 1934, Switzerland passed the Swiss Federal Banking Act, which required Swiss banks not to disclose personal information to anyone, including any third party (including the Swiss government and the U.S. government). As long as the customer does not agree to provide personal information, even if there are criminal proceedings, Swiss banks have to refuse to provide personal information, otherwise it will be in violation of the federal banking law[4], and this is why we often hear that Swiss banks are safer than banks in other regions or countries, but this involves a lot of money laundering, tax evasion, drug dealing and other illegal income.

1.2 The beginning of Credit Suisse's collapse

In the early 2000s, Credit Suisse also had some global influence, ranking in the top five in the 2007 League Table in High Yield, IPO and Mortgage-Backed. Credit Suisse 's proudest business is its private banking and wealth management business, which grew by 20% between the start of 2000 and the 2008 financial crisis, giving it a market value of $80 billion[5]. But after the financial crisis, Credit Suisse's share price fell and its market value melted[6].

2. The Type of Risks

2.1 Country risk (Political Risk)

As a result of Credit Suisse's protection of various dark and gray industries, various countries launched business investigations in early 2000 for Credit Suisse's assistance in tax evasion. In May 2014, Credit Suisse was convicted of helping American citizens cheat on their taxes and fined $2.6 billion, a conviction that marked the beginning of its unraveling. In the same year, Switzerland signed FATCA[7], an American law that requires the United States to provide information about American taxpayers' accounts to prevent tax evasion, forcing Switzerland to break its previous federal banking law. Such measures reflect the country risks faced by Credit Suisse. As a result, the Swiss government and the US government signed FATCA Act, Credit Suisse was unable to help US citizens provide some services, so Credit Suisse suffered losses due to this part of risks[8].

2.2 Operational Risk (Macro)①

In March 2015, a CEO of Credit Suisse came -- Tidjane Thiam, and then the spy incident occurred in Credit Suisse. Thiam and a senior executive of Credit Suisse didn't like each other, and they were neighbors. In a family party at the beginning of 2019, the two had an argument over some small things[9]. In order to find evidence that the executive was soliciting other Credit Suisse executives to leave, Credit Suisse hired private investigators to follow him, and it was revealed that there had been five instances of monitoring the executive and other third parties. Although this incident is not related to the business of Credit Suisse, the impact is very bad, and this is the operational risk generated by the CEO of Credit Suisse in the daily and work process, which has aroused certain public opinion and will also lead to market confidence problems.

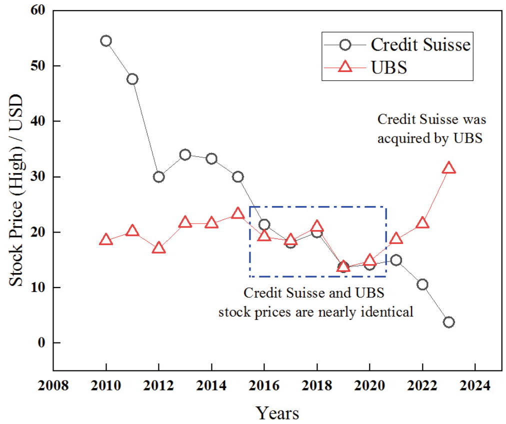

Fig 1: Comparison of Credit Suisse and UBS Stock Prices

Then Greensill, a big Credit Suisse bank client, blew up, causing Credit Suisse clients to lose $2.3 billion[10]. Archegos Capital Management, a family fund, lost $20 billion in two days, and its investment manager, Bill Huang, became the fastest money-losing man in history. Credit Suisse had given Bill Huang high leverage to make super-large derivatives trades, but then in 2021, due to the size of derivatives trades, caused a stampede of six investment banks, and among them, Credit Suisse position is the largest, run the slowest loss of $5.5 billion.

2.3 Reputational risk

Credit Suisse lost 1/3 of its savings in one quarter, about $140 billion. By the end of 2022, the five-year credit spread of Credit Suisse once soared to more than 300. But then Credit Suisse enlisted a major client, the Saudi state Fund, to invest $1.5 billion in Credit Suisse and get a 9.9 percent stake. Then, on March 15, 2023, the chairman of the Saudi state fund was asked in an interview whether Credit Suisse would consider a further bailout because of its liquidity crunch. The chairman replied, “The answer is absolutely not.” As a result, Credit Suisse’s stock plunged 20% that day, triggering a crisis of confidence.

3. Main Reasons

There are two main reasons in the process of the collapse of Credit Suisse, one of which is the immediate cause of the collapse of Credit Suisse, while the other is the root cause in the whole collapse.

3.1 Direct Reason

The direct reason is that the chairman of the National Bank of Saudi Arabia refused to rescue Credit Suisse, which led to a sharp decline in the market’s confidence in Credit Suisse. Subsequently, although the Swiss government announced that it would rescue Credit Suisse, it secretly required Credit Suisse and UBS to reach a contract for UBS to acquire Credit Suisse within three days. The government opted to wipe out Credit Suisse’s AT1 bonds, with a face value of $17 billion, to facilitate the deal. As the media reported, it was “Absolutely Not” that led to the collapse of Credit Suisse.

3.2 Essential Reason

In this case, the essential reason lies in Credit Suisse’s lack of business management ability and risk grasp ability. Credit Suisse did not measure risks well in various businesses, and increased leverage and expanded black and gray businesses. These wrong business development decisions ultimately led to the decline of market confidence and the collapse of Credit Suisse.

3.3 The Risk with the Most Impact

Credit Suisse’s collapse was triggered by multiple governance and strategic failures, including the significant risk management failures involved, poor strategy execution, and heavy fines from regulators. Specific incidents include the 2019 CEO spy scandal, which severely damaged the bank’s reputation and internal trust; The tie-up with Greensill Capital revealed serious deficiencies in the bank’s risk management, and Credit Suisse suffered huge financial losses when Greensill collapsed; And the failure of risk Management exhibited in its relationship with Archegos Capital Management that led to billions of dollars in losses. These events reflected fundamental problems in Credit Suisse’s leadership decisions, risk control, and market adaptability, which ultimately led to the bank’s inability to save itself and forced sale. And it all boils down to operational risk broadly defined.

4. Risk Management Strategy

Fig 2: Risk Management Process

4.1 Corporate Governance

Part of the risk of Credit Suisse is caused by the improper way of CEO, so the behavior of senior executives, CEO and other personnel needs to be paid attention to. In order to prevent such a bank run among senior executives, a regulatory layer can be established to regularly review and evaluate risk management strategies and activities, and a strong risk culture can be established. Ensure that senior management leads and drives risk management practices.

4.2 Line Management

Ensure that the strategic planning and daily operations of business units are consistent with the overall risk management framework, especially when considering country risks (such as macroeconomic changes, changes in laws and regulations, etc.). Stress test business processes, assess operational risks, and design resilience plans to deal with potential bottlenecks and failures.

4.3 Portfolio Management

Diversifying risk, for example by building a portfolio, rather than making money by giving Yellow Bill too much leverage to trade derivatives, would result in systemic risk not being diversified. You end up losing a lot in a failure.

4.4 Stakeholder Management

Credit Suisse's failure to manage the dangerous statements of its major shareholder, the chairman of the Saudi National Fund, led to the collapse of market confidence. Credit Suisse needs to pay attention to the inclusion and maintenance of risk management regulations in shareholder contracts, and maintain transparent and open communication with investors, clients, regulators and other stakeholders to enhance trust and market confidence.

Notes

① Broad Defining of Operational Risk: operational risk is everything that is not credit or market risk.

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