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Credit Suisse: The Continuing Saga

By Peter Koenig
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The "case" Credit Suisse (CS), referring to the Swiss Government's forced merger of UBS and CS on 18/19 March 2023 the Dark Banking Weekend, has by no means reached an end, and much less a happy end.

According to *Swissinfo*, as of 3 April 2023, the takeover has been agreed but not yet carried out. Some hesitation and reservation may have grown within the Swiss Government, receiving top-expert-advice from many corners, but especially from within Switzerland, mostly regarding the legality of the deal.

Professor Arturo Bris, teaching finance at the IMD Business school in Lausanne, who has examined 1,000 deals between 2002 and 2022 says

> "Mergers between established banks like UBS and CS, which are no longer growing rapidly and are less profitable than their competitors, almost never work."

The CEO of the Swiss Julius Bär Bank, Philipp Rickenbacher, sees a long road ahead before the takeover can be deemed a success.

"An integration of that order of magnitude in Switzerland is going to take a lot of resources and effort, and a lot of complexity," he told the *Financial Times*.

Julius Bär has seen inflows of client assets from both Credit Suisse and UBS in magnitudes of above CHF 60 billion in recent weeks. And the private banking group has been contacted by many Credit Suisse staff asking for job opportunities.

Both Professor Bris and CEO Rickenbacher believe that states should not have to intervene to save banks from collapsing. Rickenbacher adds, "My gut feeling and moral compass says that a private institution should be able to fail."

According to a recent poll, many Swiss economists found that the takeover of Credit Suisse is not the best solution and warned that the situation has dented Switzerland's reputation as an international banking center.

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This is the on-the-surface visible critique of the government-forced take-over. Underneath remains a myriad of questions, mostly of a legal nature, which are yet to be answered. A Big One is over the validity of the deal.

The government prompted takeover was carried out under a legally shady "emergency" measure. This *emergency measure* is being questioned by lawyers and legal experts in Switzerland and around the world.

It is also questioned by major shareholders of CS, as well as AT1 Bondholders. AT1 stands for Additional Tier 1 Bonds. They were created after the 2008 financial crisis, and are a type of hybrid debt issued by banks. They are a kind of quasi-capital and are supposed to protect a bank from tax-payer bailouts.

AT1 bonds can offer high returns, but they are riskier than regular bonds.

In the case of CS, neither the shareholders or the AT1 bondholders were consulted before the compulsory takeover. This is particularly problematic, because on Friday before the "emergency merger", the Swiss Central Bank granted CS a "bail-out" line of credit of CHF 50 billion, which, according to CS inside and outside analysts, as well as FINMA, the Swiss Financial Market Regulator, would have been sufficient to bring back CS to normal banking within less than a year.

CS had apparently no serious liquidity problem. It had a trust problem growing out of rumors that the bank may fail. And rumors can be planted. A case in point is the Californian Silicon Valley Bank (SVB). Banking experts say, the trust issue could have been resolved with this Government bailout line of credit which would also have helped CS to get rid of old skeletons.

Under the emergency merger, CS shares dropped by more than 50% on Monday, 20 March, from what they were on Friday, 17 March, i.e. on March 15, they were CHF 1.76 and rose to CHF 2.05 on Friday, with the prospect of the bailout credit, dropping to CHF 0.91 on Monday, March 20.

Shareholders were not at all happy.

AT1 bondholders were even unhappier, not to say angry, when they learned on Monday, 20 March, that under the government-enforced deal, all AT1 bonds of CHF 16 billion ($17.24 *billion*) were written down to zero.

According to the *Financial Times*, the Swiss *Tages-Anzeiger* and the *NZZ,* three class-action suits by AT1 bondholders against the Swiss Government are being prepared by attorneys in the US and Singapore. It is likely that shareholders will either join them or launch their own class action suit.

Major shareholders include:

- Saudi National Bank 10%

- Olayan Group, Saudi Arabia 5%
- Qatar Holding LLC 5%
- Black Rock 5%

The Saudi National Bank has already announced they will sue the Swiss government. It is likely that the Saudi Olayan Group and Qatar Holding will join the lawsuit. That makes 20% of Arabian shareholders suing the Swiss government for its hardly justified *emergency measure*, that supposedly prevents the Swiss government from having to consult with shareholders. After all, the Swiss Central Bank had granted CS a CHF 50 billion "bail-out" line of credit, just on Friday 17 March, before the dark, "Black Box" weekend of 18/19 March.

See also this and this.

It is well possible that other shareholders may join the Class Action "club". For example, the Pension Fund of the largest Swiss retailer, MIGROS, which lost CHF 100 million in the AT1 write-off, has told the Swiss *Tages-Anzeiger* they will join a Class Action suit.

Will these legal procedures be successful? Depends whom you ask. Standard & Poor's predicts the law suits will unlikely succeed. On the other hand, Goldman Sachs believes these lawsuits may thrive to the point where GS is ready to purchasing CS AT1 bonds, to make money if the plaintiffs win their case, and the AT1 bonds have to be revalued.

The forced UBS / CS merger is far from finished for Switzerland. It is possible that it may cost the government or UBS another CHF 30 billion (about US$ 34 billion, at current exchange rates). That would be ten times more than UBS agreed to pay under this emergency action, namely only CHF 3 billion.

Among the four major shareholders listed above is BlackRock (5%). They have been watching from the sidelines. There are rumors that initially they advanced the possibility of taking over CS. But the rumors were quickly dispelled, as the Swiss government expressed concern that CS should stay in Switzerland.

The combined UBS / CS would have some US$ 5 trillion of managed assets.

The former head of the Swiss Central Bank, Philipp Hildebrand, joined BlackRock in 2012 as Vice-Chairman in charge of investments. He knows the ropes and wheeling and dealing of Switzerland inside-out.

It is quite possible that for now Hildebrand watches from the sidelines how this "CS case" evolves. If the plaintiffs win with a claim of say CHF 20 to CHF 30 billion against the Swiss Government, Switzerland could not simply absorb the debt with taxpayers money. So, they would pass it on to UBS. Yet, UBS was already reluctant to accept the take-over precisely because such mergers are complex and require lengthy processes before they may succeed, as per Philipp Rickenbacher, CEO of the Julius Bär Bank.

UBS would unlikely be able to absorb such a debt. In which case, a scenario where BlackRock jumps in from the sideline to help and take over UBS, is not to be excluded. That would add another US$ 5 trillion to BlackRock's already at least US$ 10 trillion of managed assets and make the giant financial rock even more powerful.

Just a thought. Not to be discarded.

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Peter Koenig is a geopolitical analyst and a former Senior Economist at the World Bank and the World Health Organization (WHO), where he worked for over 30 years around the world. He lectures at universities in the US, Europe and South America. He writes regularly for online journals and is the author of Implosion – An Economic Thriller about War, Environmental Destruction and Corporate Greed; and co-author of Cynthia McKinney's book "When China Sneezes: From the Coronavirus Lockdown to the Global Politico-Economic Crisis" (Clarity Press – November 1, 2020).

Peter is a Research Associate of the Centre for Research on Globalization (CRG). He is also a non-resident Senior Fellow of the Chongyang Institute of Renmin University, Beijing.

Articles by: Peter Koenig