Credit Suisse on the Brink of the Abyss

Traders Run Amok. Lack of Control, Further Losses, $90 Billion of Distressed Debt

By FRCS
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Credit Suisse's ability to survive in its present form is threatened by the latest revelations of past mismanagement and dysfunctional trading.

Follow our Blog which will carry the latest updates as the drama unfolds.

CS CEO Tidjane Thiam [image left] admitted in a video interview that the bank had followed a Pursuit of Revenue "At All Costs" policy which had facilitated traders secretly holding high risk illiquid positions. Losses may eventually run into billions of dollars. Updates here and here point to fractured internal communications.

The drama is unfolding of a massive amount of illiquid debt scrip. (Illiquid scrip or illiquidity refers to investments for which there is no market, i.e. no buyers. Forced sales can result in massive price drops.) Credit Suisse wants to unload $90 billion of thinly traded debt scrip in unfavourable conditions.

CS's weak position is an ironic reversal for a bank which often strove to exploit weaker counterparties. Thousands of those exploited by the bank's greed will regard it as due comeuppance. Lisa Abramowicz's video report on Credit Suisse's woes highlights poor risk management by senior officers.

The bank's capital ratio was already down to 11.4% – after the $6 billion capital raising. Those investors lost badly in the massive drop in CS's share price. The bank can hardly expect further capital from that source.

The bank currently carries $380 billion of leverage. A loss of 10% on the $90 billion it is attempting to divest in the current difficult market would cost $9 billion and drive the bank close to junk territory.

A loss of 5% on its $380 billion of leverage would take $19 billion off its balance sheet and could have it looking for a bailout.

Both scenarios are conservative if the uncertainties described below eventuate. Bank of America has just reiterated its "Sell" Rating for Credit Suisse.

No Buffer from Credible Uncertainties

There is no buffer from credible uncertainties. The deflation cycle looks set in for a while and resource prices are heading down (again). China's stock market is teetering (again) and The Street is confident a Chinese crash is imminent. ISIS want to explode a dirty nuclear bomb and some respected experts are only surprised it hasn't already happened. Central banks are playing a dangerous game which has the probable outcome that deflation will morph into stagflation – for which there is no known remedy.

Any significant combination of these would turn Credit Suisse into junk or worse. Thiam now expects further Q1 losses following the bank's massive Q4 loss of $5.75 billion.

CS's Crazy Creation – It is Taking Out Catastrophe Insurance

Matt Levine has unpackaged the complexities of CS's drama. Here is a quick paraphrase: CS intends to sell its risk of a catastrophe so that it doesn't need extra capital to cover it. It includes risk of big losses from illiquid investments and rogue-trading. But it is more complex resembling a Möbius strip or a Klein bottle:

> "Credit Suisse packaged that risk into securities, gave some of the securities to its own bankers as part of their bonuses (surprise!), hedged the rest of them by buying yet another derivative from yet another counterparty, and then agreed to fund any amounts that the counterparty owed under the derivative."

It is projected to include rogue-trading risk at the same time it is under criminal investigation for allowing rogue-trading. It is projected to be sold as an Operational Risk insurance policy through Operational Re Ltd. (Bermuda!) claiming it is catastrophe insurance with a relatively remote risk, with the "expected loss said to be just 0.15%". My estimate of the risk is multiples of that and I wouldn't want to litigate any claim in Bermuda.

To understand it, first read Matt Levine, then this, and this and this and then that and then this post.

The upshot of this is that the bank's official 11.4% capital adequacy may be an over-estimate. Perhaps the bank is already on the brink of a Liquidity Death Spiral. Note that about 40 percent of the bonds in the $1.4 trillion U.S. junk-debt market didn't trade at all in the first two months of this year, and those that did were "absolutely crushed". An estimated loss of only 10% on the $90 billion fire sale may be over-optimistic.

The Insider's Version of the Story

Apart from Thiam's video – the other half is in the confessions of a top ex-Credit Suisse banker – Mr X – who managed some of its wealthiest billionaire clients. Mr X, who was identified as CS private banker Patrice Lescaudron, got the job because he could speak Russian. Banking experience? He had none before joining the bank. Less than two years after joining Credit Suisse, he said, he was handling the bank's biggest clients in the region. He reportedly became one of Credit Suisse's most successful bankers, until he was fired.

Credit Suisse said it suffered a 1.5 billion Swiss franc outflow of client funds. The bank has set aside 250 million Swiss francs in provisions for litigation related to the banker's case, a person familiar with the matter said.

Bank Ignored Warnings for Years

We repeatedly warned the bank of a similar situation in Credit Suisse – but they refused to accept our reports and covered up the illegal activity instead. An account manager who had no relevant experience, but was chosen because he could speak the right language. In our case, his banking ignorance was convenient because there was a huge securities scam going on between various bank people and entities in organized crime (outside the bank). The Swiss accomplice had an arrest warrant out for him for wire fraud and money laundering. However, the Swiss ignored the US arrest warrant.

Mr X's inside information

Mr X's inside information (courtesy of Matt Levine) makes for good TV drama:

He joined Credit Suisse at age 40 with no prior banking experience, and almost immediately got some big clients, including Georgian politician-tycoon Bidzina Ivanishvili.

"Around April-May, I told myself that all my clients had to make profits so they would stop annoying me with their criticism about lack of performance," he told bank investigators.

Can you imagine? Mr. X is new to banking, he's good at client relationships, he picks up some big clients, he has fun going out to dinner with them or whatever. "Within weeks, he said, he was actively trading without permission, using Ivanishvili's credit line to buy about $100 million in Russian stocks and bonds." And: "With markets around the world surging, he had soon more than made up the missed gains, he said."

But: a trade lost money, there were margin calls to clients who weren't aware they were trading on margin, and the whole thing unraveled. He told investigators he could have prevented the margin calls with more unauthorized trading. But he was trying to enjoy the last day of his Italian vacation, he said. "I had had enough of this situation that had upset me so much."

Was It Pursuit of Revenue or Illegal Profit – "At All Costs"?

It is apparent that the bank's criminal convictions, its fractured internal communications and its bloated distressed debt were intimately intertwined. The burning question is:

Were they all caused by policies designed to protect corporate crime – through ingrained deliberate ignorance and wilful blindness?

Thiam's 7 minute video interview has inspired a multitude of media comments:

It is going from bad to worse for Credit Suisse.

Mr. Thiam said the problems in the investment bank were connected to the pursuit of revenue "at all costs."

Credit Suisse Chief Says Risky Bets Were a 'Surprise'

A Credit Suisse wealth manager made rogue trades for 6 years just to keep his clients off his back

Liquidity Death Spiral Traps Credit Suisse

Credit Suisse CEO Blindsided as Bank Added to Risky Positions

There was clearly an active decision to retain illiquids that CS took which other firms didn't take

Thiam said he was blindsided by a buildup of illiquid trading positions that will probably spark a first-quarter loss, and pledged to make deeper cost cuts.

For him to say he was surprised by the size of the position is clearly not good ….. It highlights, at best, historic control failures and is not good for confidence.

The shares dropped to the lowest since 1989 last month and are down 33 percent this year.

Thiam also warned trading revenues are expected to fall by up to 45 percent in the first quarter from a year earlier.

But investors should know there is no quick fix for a bank the size of Credit Suisse.

Fixed-income revenue was down 61 percent year-on-year in the fourth quarter

Thiam says his bank will report a bad first quarter

CFTC Fines Credit Suisse $665,000 Over Futures Debacle and giving the regulator false information.

The bank suffered $258 million of writedowns this year through March 11, and $495 million of losses in the fourth quarter, because of its holdings of distressed debt, leveraged loans and securitized products.

Apparently people at Credit Suisse don't talk to each other?

… if I ever got hired by an investment bank to be its CEO, I would spend my first week or two just sort of wandering around the trading floors, sidling up to people to ask questions like "so do you have any illiquid credit positions that might trigger oh say $1 billion of write-downs?"

Credit Suisse Confusion on Costly Trades Adds to CEO's Woes

Credit Suisse's $90 Billion Bitter Pill

As any trader knows, when a big player like Credit Suisse exits, it's a shock for everyone involved. That's even more true when the market is highly illiquid.

How is the bank going to reduce leverage in its global markets unit to $290 billion from $380 billion by the end of 2016?

That's $90 billion of assets that may be unloaded at fire-sale prices. If these positions are illiquid, which some of them seem to be, it could have a major impact on several markets.

Illiquid Positions Add to Credit Suisse Confusion

China's Stock Market Is About to Crash — Sell Before It's Too Late

Many U.S. experts consider the eventual detonation by terrorists of a dirty bomb containing radiological materials to be inevitable, because the mechanics of such a device are simple and widely-known.

The fuel for a nuclear bomb is in the hands of an unknown black marketeer

A distressed credit index touched a level not seen since 2009 in February as oil traded at $30/barrel

Credit Suisse `A Drag' for Herro Awaiting Overhaul Success

Marvel At The Derivative On Its Derivatives That Credit Suisse Wrote To Itself

Mourn For The Derivative On Its Derivatives That Credit Suisse Wrote To Itself

CS turns to bonds to hedge rogue trader risk

Don't believe or buy this: CS Operational Risk insurance policy has a relatively remote risk, with the expected loss said to be just 0.15%.

If you make money you're a trader but if you don't you're a rogue trader.

Fitch hasn't changed the banks ratings yet but warned that the bank's "Accelerated Restructuring Adds to Execution Risks". It made a detailed release outlining possible consequences of the current upheavals which may lead to ratings adjustments.

The Bank's Solution

Credit Suisse plans to monitor employee behavior to catch rogue trading through Artificial Intelligence surveillance, see: Signac – a 50/50 partnership with AI firm Palantir Technologies Inc.

KISS: Why not Read Your Mail?

Considering that the bank ignored repeated warnings of rogue activity, is it naive to suggest that the bank should read its mail?

For media inquiries: publications@globalresearch.ca