

Analysis of the Reasons for the Collapse of Credit Suisse and Its Implications for the Chinese Banking Industry

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Abstract. Credit Suisse Bank is an international financial institution with a history of over a century. In March 2023, it announced a huge loss, and the Swiss federal government and regulatory authorities took multiple rescue measures to facilitate the acquisition of Credit Suisse by Credit Suisse Group, which effectively suppressed systemic financial risks and maintained stability in domestic and international financial markets. The main reasons for this event include the damage to their own credit, deepening operational difficulties, imbalance in asset-liability structure, increasing risks in international financial markets, and insufficient support from major shareholders, among other internal and external factors. This event has attracted market attention, and against the backdrop of turbulence in the global financial market, the Chinese banking industry can draw inspiration from this crisis, adapt to changing times, optimize development strategies, and strengthen their own capacity building.

Keywords: Credit Suisse; Financial risk; Global systemically important banks.

1. Introduction

Since March 2023, the banking crisis in Europe and the United States has been intensifying, leading to a sharp fall in European and American stock markets. In particular, the plummeting share prices of representative small and medium-sized banks such as Silicon Valley Bank in the United States have triggered a sharp rise in the operational risk of Credit Suisse, an important bank in the Western financial system. As the second largest bank in Switzerland, Credit Suisse has a long history of 166 years and is an important and indispensable member of the Western financial system. As of 2020, the bank had more than CHF 1.4 trillion (\$1.41 trillion) in assets under management. However, since 2021, the bank's financial risks have been increasing, with losses exceeding USD 7 billion for the year 2022. On 19 March 2023, UBS announced the acquisition of Credit Suisse for a total of CHF 3 billion, with the support of the Swiss government, the Central Bank of Switzerland (CBS) and the Swiss Financial Market Supervisory Authority (SFSMA), amidst the urgent need to stabilise the financial markets. In this acquisition, the Swiss regulators wrote down Credit Suisse's AT1 bonds to zero while retaining some shareholders' equity, breaking the previous loss-sharing practice of giving priority to debt over equity. The occurrence of this incident not only triggered shocks in the financial markets of Europe and the United States, but also gave a heavy warning to the global financial system.

2. Reasons for the collapse of Credit Suisse Bank

2.1. Internal causes

2.1.1. Frequent occurrence of risky events of Credit Suisse.

Credit Suisse in recent years due to the lack of risk control mechanism, management loopholes, continuous operating losses, regulatory penalties, facing public opinion risk. Since 2012, Credit Suisse has cumulatively been massively investigated more than six times by regulators in various countries and fined more than US\$7 billion. The list of problems began in 2021 with the insolvency of Greensil, a UK finance company that specialised in short-term corporate lending through a



complex and opaque business model. Greensil's insolvency left a number of firms reeling, with the most affected being Credit Suisse, which had a particularly large investment in the company. Following Greensil's declaration of insolvency in March 2021, the Credit Suisse closed four related funds in which it had invested approximately \$10 billion. Just four weeks after Greensil's bankruptcy, Credit Suisse was again rocked by the collapse of US hedge fund Archegos, which led to losses of more than \$5bn. In addition, Credit Suisse was involved in several cases of bribery, money laundering, data breaches, etc., and its credit was severely damaged.

2.1.2. Continuous loss of operating income.

Since 2011, the lack of growth in operating income and net profit forced Credit Suisse to continue to try to adjust its business, but with little effect, the pressure on profitability has been highlighted year by year and concentrated in 2022. Following a small loss of 1.8 billion U.S. dollars in 2021, a further huge loss of nearly 8 billion U.S. dollars in 2022, a sharp decline in operating income has become the biggest drag on Credit Suisse's operating problems. Investment banking and wealth management are Credit Suisse's traditional strengths, with a business contribution of more than 70%, but in 2022, these two business segments declined the most year-on-year, 55% and 33%, respectively. The Americas has always been one of Credit Suisse's key markets, with an operating income contribution even higher than that of its home market in Switzerland. However, in 2022, Credit Suisse's operations in the U.S. showed all the signs of decline, with annual operating income down 31.4% year-on-year.

At the same time, Credit Suisse's cost-to-income ratio has remained high, in contrast to the weak growth in operating income and profit, and the number of Credit Suisse employees has reached a record high in recent years. In addition, restructuring and transformation risks have increased the cost of organisational restructuring, resulting in low profitability for Credit Suisse in the medium term, which will be slowed down by continued losses.

2.2. External causes

2.2.1. Continued spillover of risks from international financial markets.

The international political and economic environment was complex and volatile after COVID-19. The Credit Suisse incident was in the context of successive interest rate hikes by global central banks led by the Federal Reserve. The Federal Reserve's increase in the federal benchmark interest rate means that banks are borrowing money from each other at a higher interest rate, and when banks borrow money at a higher interest rate, then the interest rate on bank deposits and loans will subsequently become higher. The liquidity in the market will then go back to the banks, thereby reducing the amount of money flowing in the market. Moreover, the relief policy in Europe at the beginning of COVID-19 was less vigorous, and the economic recovery lagged behind that of the United States. Against the backdrop of tightening liquidity, European economic growth slowed rapidly, and the financial system and asset prices came under enormous pressure, which exacerbated the decline in Credit Suisse's business and increased the degree of asset quality impairment. Superimposed on the impact of the energy crisis brought about by the Russian-Ukrainian conflict, Switzerland's abandonment of its neutrality status, Credit Suisse cooperated with the West to freeze 17.6 billion Swiss francs of Russian financial assets in the first round of sanctions, which severely impacted the bank's credibility. In addition, the collapse of Silicon Valley Bank in the United States became a black swan event in the global financial market in 2023, and the risk spillover spread to the European banking industry, impacting Credit Suisse's operating environment.

2.2.2. Major shareholders indicate that they cannot continue to provide support.

Generally speaking, when a bank is in crisis and has insufficient blood-creation capacity, it can replenish its blood by raising capital and selling assets, and the injection of support from major shareholders is the last chance for the bank to save itself. In recent years, Credit Suisse's major shareholders have changed significantly, which has laid a hidden risk of crisis. 2021 end, the original top shareholder Qatar Investment Authority reduced its holdings of Credit Suisse shares to the second

largest shareholder, and the Norwegian bank is out of the top five sequence. This phenomenon indicates that some shareholders have begun to recognise Credit Suisse's operational problems and risks, and are reducing their holdings to mitigate possible risks. By the end of 2022, the new Saudi National Bank's shareholding in Credit Suisse reaches 9.88 per cent, making it the largest shareholder. But against the backdrop of market concerns about Credit Suisse's business conditions, Credit Suisse's largest shareholder, Saudi National Bank, said it was constrained by regulatory factors and could not continue to give financial support to Credit Suisse. The lack of support from major shareholders has caused Credit Suisse to lose its last chance to save itself.

3. Implications for the Chinese Banking Industry

The century-old Credit Suisse is in crisis, and its lessons are worth learning from the global banking industry. Although Chinese banking system is different from Europe and the United States. Bureau top position for the central bank, called the People's Bank of China in China, it resides in the dominant position of Chinese financial system, is the state intervention and regulation of the national economic development of an important tool. It is mainly responsible for the formulation and implementation of national monetary and credit policies, and has the sole right to issue currency and exercise financial supervision. A large number of commercial banks are the foundation and basis of Chinese financial system, and Chinese commercial banks are mainly composed of three parts, including wholly state-owned banks, other joint-stock commercial banks and foreign commercial banks, of which wholly state-owned banks are the mainstay of Chinese financial system. In addition, there are policy banks such as the Agricultural Development Bank of China and the Export-Import Bank of China, which mainly support the development of infrastructure, infrastructures, agriculture and import and export trade that are related to national economy and people's livelihood. However, at present, the global financial market is still turbulent, and Chinese banks are facing challenges, and it is urgent for them to change with the times, optimise their development strategies and strengthen their own capacity building.

3.1. Continuous optimisation of business structure and steady improvement of operating results

Credit Suisse's business is highly related to the capital market, with the investment banking, asset management and wealth management businesses accounting for more than 80 per cent of its revenue, which will lead to difficulties for the bank in the event of significant volatility and sustained downturns in the financial markets. Generally speaking, capital market-related business has different revenue characteristics from traditional commercial banking business. For example, while traditional commercial banking business benefits from widening interest rate spreads when interest rates rise, capital market business may be impaired by falling financial asset prices and sluggish underwriting business. Therefore, in the face of volatile global financial markets, Chinese banking industry, especially large commercial banks, should build a more resilient business layout. On the basis of adhering to their strategic focus and traditional strengths, they should optimise the proportionality between their traditional commercial banking and capital market-related businesses, so as to reduce business shocks due to interest rate changes and other factors. Within the traditional commercial banking business, we will maintain an appropriate ratio of public business to retail business, and within the capital market-related business, we will maintain an appropriate ratio of investment banking to wealth and asset management business. In addition, in terms of international development, the Bank will make forward-looking and targeted adjustments to the layout of its overseas business in accordance with its own characteristics, covering developed countries, international financial centres and emerging markets with greater growth potential, and extending its services to follow domestic clients in their “going out”, while balancing the regional distribution of revenue and steadily improving its operating results.

3.2. Control cost effectively and reduce high-cost liabilities

In recent years, with the global economic slowdown, the economy of China has also been under tremendous pressure. Finding new economic growth points, activating the creativity of the real economy, effectively reducing the financing costs of enterprises and giving full play to their ability to absorb employment are not only the key to promoting stable economic growth, but also an important reliance on safeguarding the livelihood of the country's people. Due to its focus on capital market-related businesses, Credit Suisse's cost-to-income ratio is at a high level and there is expenditure rigidity, making it difficult to act as a cushion against declining bank revenue. Comparatively speaking, the cost of Chinese banking industry is at a low level, with the cost-to-income ratio of commercial banks at 33.97% in 2022. Going forward, Chinese banking industry will need to further strengthen cost management and keep the cost-to-income ratio stable. It will optimise the deposit structure and reduce costs on the liability side by building an integrated service industry with products, channels and scenarios. It will continue to optimise the construction of the customer ecosystem in terms of digital operation, mechanism innovation and service guarantee, and strive to expand lower-cost and stable sources of funding for liabilities, optimise the liability structure and stabilise its own liability costs. At the same time, we accelerated digital transformation and made full use of technologies such as big data, artificial intelligence and blockchain to improve cost efficiency.

3.3. Strengthen risk identification ability and improve the comprehensive level of risk management personnel

In recent years, liquidity depletion has become one of the important factors for risk events in financial derivatives and a direct cause of the Swiss credit risk events. Therefore, for financial derivatives, banking institutions should pay more attention to market liquidity risk on the basis of fully identifying and measuring market risk, counterparty credit risk, operational risk, moral risk and legal risk. The banking industry must establish effective internal control mechanisms, including auditing and risk management, to identify and prevent potential risks in daily operations. Meanwhile, strict risk management policies and processes are formulated to clarify various types of risks and risk tolerance, develop corresponding risk assessment methods and control measures, and incorporate them into all aspects of daily operations. In financial derivatives risk control management, an intelligent, standardised and efficient risk control management mechanism should be established on the basis of comprehensive integration of business and management chain data. One is to optimise software and hardware technology, and the other is to apply AI technology to identify and judge derivatives risks in real time through accurate modelling and artificial intelligence recognition technology, and simultaneously push the changes in risk level to the business department, so as to enhance the quality and efficiency of the bank's overall work. Thirdly, we actively promoted the optimisation and transformation of the derivatives trading system and risk management system to achieve the organic integration of risk management with the planning requirements of business systems. Accelerate the development of the trading ex-ante system, promote the upgrading of the trading risk control system, and realise the system to automatically forewarn the risks and reduce the trading risks.

At present, market risk management personnel in Chinese banking industry face problems such as insufficient specialisation, lack of market trading experience and lack of sensitivity to changes in market risks. In order to further improve the comprehensive risk management capability of financial derivatives, Chinese banking institutions need to continue to strengthen the construction of risk management personnel, strengthen the training of professional risk knowledge, and enhance the risk management personnel's risk pre-warning capability. On the one hand, it is to change the traditional business promotion mode of risk management lagging behind, so as to achieve business development, risk first, and effectively improve the risk management personnel's ability of risk pre-study and judgement, so as to avoid the disconnection between risk management and business development; on the other hand, it is to further promote the dynamic rotation mechanism of the risk post and the market development post, so as to strengthen the risk management personnel's full cognition of the derivative market, and to better cultivate the comprehensive financial talents.

3.4. Implement the bank's risk control responsibility and strictly abide by the risk limit bottom line

In the transaction process, banking institutions need to implement the main responsibility of controlling financial derivatives, strictly implement the process of measuring, assessing, monitoring and reporting the risks of the products, ensure investors' right to know the risks, and eliminate the impact of information asymmetry. At present, domestic investors, including enterprises and individuals, still have limited knowledge of financial derivatives, and lack the ability to independently research and analyse the structure, trading model and rules of derivatives. At the same time, most investors do not have the ability and conditions to effectively assess and judge market risks. Therefore, banking institutions need to take the initiative to assume risk management responsibilities for financial derivatives business and products, pay attention to market dynamics in a timely manner, and inform their clients of risk matters.

Although Chinese banking industry has generally set risk limits for derivatives transactions at the institutional level, the management of the limits is lax. Under the premise of ensuring clear risk appetite and exposure limits, banking institutions should strictly comply with risk control measures such as limit setting, and regard exceeding the limits as a risk situation. Firstly, over-limit situations should be dealt with in a timely and appropriate manner, and clear reporting paths should be set up. Repeated, long-term and significant over-limit situations and customers should be focused on and restricted from trading. Secondly, banks need to strengthen their ability to deal with various types of risk events and formulate complete emergency response plans. Ensure that in the event of significant market volatility or even a small probability of tail risk, the bank's important business continuity will not be interrupted.

3.5. Pay high attention to shareholders' demands and strengthen the mutual trust relationship with shareholders

The support of shareholders is an important guarantee for the sound operation of banks. Chinese banking industry should always adhere to the concept of creating value for shareholders and attach great importance to shareholders' interests, so that investors can effectively share the dividends of the bank's good operation. At the same time, it should strengthen information exchange with shareholders, especially major shareholders, so that they can fully understand and recognise the bank's corporate culture, development strategy, business model and operating results, and establish a good relationship of mutual trust, so that they can jointly cope with the volatility of the financial market on the basis of long-term cooperation interests.

3.6. Cultivate a compliance culture of sound management

Credit Suisse has been in the spotlight as a “problem bank” in recent years, and the public and customers have little confidence in it. Once the financial market fluctuates and the banking system faces shocks, Credit Suisse will inevitably be the first to become a target of risk. Currently, Chinese banking industry is developing steadily, but some banks still have serious compliance problems. Chinese financial system should take the cultivation of a compliance culture for sound operation as the starting point, and the control of compliance risk should start from the system construction, in order to cultivate a good compliance culture, to help the control of compliance risk, to set up an independent compliance department, and then to gradually form a brand new tradition of compliance culture. Responding to compliance risk cannot be separated from the efforts of both banks and practitioners. From the bank level, system construction and policy guidance should be strengthened. The first is to establish an assessment system for compliance performance of management personnel as an important part of fostering a compliance culture; the second is to establish an effective compliance accountability and error correction system, and to revise the relevant policies, procedures and operating guidelines in due course; the third is to formulate compliance policies that are in line with Chinese national conditions and to set up a compliance audit department, so that compliance auditors can promptly participate in the process of reengineering the bank's organisational structure

and business processes, and to ensure that the principle of operating according to law is truly implemented in day-to-day business operations. The principle of operating in accordance with the law will be truly implemented in the daily business.

4. Conclusion

With the continuous opening of Chinese financial market, Chinese banking system is no longer satisfied with earning profits by pulling deposits and lending money, but more intermediate businesses such as agency sales and custody to help the stable development of the national economy. Compared with the traditional business where the risk is concentrated at the level of credit risk, the number of risk points in banking business today has proliferated and become more dispersed, and in the event of a risk event, commercial banks will face greater losses. The UBS and Credit Suisse acquisition was the first global acquisition involving two G-SIBs since the international financial crisis in 2008. After the exposure of Credit Suisse's risk, the Swiss regulatory authorities dealt with it decisively and took strong measures to facilitate the merger and acquisition between Credit Suisse and UBS, which better curbed the occurrence of systemic financial risks and maintained the stability of the national and international financial markets. In order to prevent and resolve systemic financial risks, national regulators may further strengthen their supervision and impose higher requirements on systemically important banks.

In the merger case between UBS and Credit Suisse, the regulators exercised their discretion to write down the full amount of AT1 bonds in order to conclude the deal, which is conducive to mitigating systemic financial risks, but this practice is not in line with the market habits, and will have a greater impact on investor confidence in the global capital instruments market, especially the AT1 bond market in the short term, and in the long term, it may change the valuation rules of the AT1 bonds. In the long run, it may change the pricing rules of AT1 bonds. Chinese commercial banks need to do a good job in managing capital instruments, fully carry out investor communication, stabilise market expectations, boost market confidence, and keep the secondary market price of the stock of capital instruments at a reasonable level. At the same time, the issue of new capital instruments should be carried out in a prudent manner to prevent the issue price from rising due to the spillover of risk aversion. For investors, when investing in overseas bonds, they should carefully understand the laws of the location of the bond market and the terms and conditions applicable to the bond business, and should not make investment judgements based on market practice alone. For regulators, when dealing with banking crises, they should comprehensively weigh the wide range of possible impacts of the measures taken, especially the need to properly deal with possible conflicts between contractual agreements and market practices, and prudently use the discretionary power of statutory measures to prevent the spillover of financial risks.

To sum up, Chinese banking industry should take Credit Suisse as a warning, establish a multi-dimensional and three-dimensional risk management and control system, actively take risk management measures, establish and improve its own risk prevention and control mechanism, legally and compliantly carry out financial derivatives trading activities, reasonably carry out the business layout, pay attention to the shareholders' demands, and comprehensively enhance the foresight, global and proactive risk management of Chinese banking industry to prevent systemic financial risks arising from the drastic fluctuations in the market. systemic financial risks.

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