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When a banking crisis is not a banking crisis

Sam Theodore | March 2023

The market panic that took hold yesterday does not reflect reality. There is no rational basis to the view that the European banking sector is in crisis. The opposite is true. Failed SVB, Silvergate Capital and Signature Bank in the US have no connection and no similarity with Credit Suisse. Nor is the troubled Swiss group representative of Europe's large banks as a whole.

You could be forgiven for ignoring this when professional prophets of doom and talking heads remote from the realities on the ground scream from the rooftops that European banks are close to insolvency and riddled with liquidity problems (very much not the case), that they are poorly regulated (the opposite is true), or that Credit Suisse is "too big to fail but also too big to be saved" (catchy but nonsensical).

I know of no serious banking expert knowledgeable about the European landscape saying anything remotely like the system is in crisis. Having covered the sector since its deregulation 35 years ago, I consider that on balance the European banking sector is with few exceptions in its best shape in decades.

With hindsight, it is clear that the supervision of the three US banks that were closed down (specialists in crypto and high-tech financing) was sub-optimal, in no small measure due to the political decision a few years ago to relax regulatory requirements for US banks with assets under USD 250 bn. This is the opposite of the European regulatory system, where the Basel rules are applied to all supervised financial entities.

CS an outlier for years

Credit Suisse has been an outlier in the European banking landscape for years now. In fact, it is the last remaining outlier in the continent's large-bank peer group; Deutsche Bank having relatively successfully graduated from this category. There is still a lot of work in progress to restructure the group and adjust its business model. In the meantime, net money outflows continue to bleed the wealth management business.

But there is nothing materially worse this week regarding Credit Suisse that was not existent in the recent past; the gnashing of teeth last week around the delay to the publication of the bank's 2022 annual report after the SEC's comments about 2019 and 2020 cash flow statements and internal controls rather theatrical.

After yesterday's SNB and FINMA statements, Credit Suisse's restructuring will be sped up and, if history is a good indicator, it is not far-fetched to assume that parts of the group could be merged into UBS.

Those in the market trenches for longer will remember that UBS itself is the result of a forced merger with Swiss Bank Corp in 1997. As another useful reminder, though, besides being a troubled investment bank and a wounded giant in wealth management, Credit Suisse is also one of the two large retail and commercial banks in Switzerland, a relatively wealthy and stable banking market in the centre of Europe. Its domestic banking activities display stability and stickiness.

Fixed-income investors fear that the Credit Suisse restructuring could lead to regulators preventing the group from paying AT1 coupons. I doubt this will be the case. First, the group continues to display adequate regulatory capitalisation. Second, Swiss regulators will be fully aware of the highly negative impact of such a decision on the entire AT1 market and on bank debt in general.

As for the European banking sector as a whole, almost all large banks demonstrate the kind of prudential and financial strength they have not had in decades, in no small measure thanks to robust regulations and more effective supervision. But also very much owing to the banks' own post-GFC de-risking and adjustment of business models to shun adrenaline-boosting adventures just for the sake of hiking short-term ROE.

Liquidity and funding stability remain reassuring, with LCR and NSFR ratios well above regulatory floors. I do not expect these fundamentals to meaningfully deteriorate.

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