Helaba

Focus on: Credit
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European banks: Déjà vu in a crisis environment?

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Once again, the banking industry has been in a state of crisis. First, some smaller banks in the US were affected, then the turbulence spilled over into Europe and culminated in the takeover of Credit Suisse Group (CS) by its competitor UBS Group (UBS), which was announced with government involvement. Is the industry once again in a financial market crisis comparable to that of 2008/2009? What exactly happened? Where is there a need for action by regulators and banks?

It all started with the collapse of California-based **Silicon Valley Bank (SVB)**, which was forced to close its doors on March 10 following outflows of customer deposits. The bank's business model was based primarily on lending to start-up companies with relatively high credit risk. At the same time, a relatively high proportion of the bank's **customer deposits** were in excess of the U.S. deposit insurance threshold of USD 250 thousand. When customers became aware of the rapidly increasing problems for SVB's business model in an environment of rising interest rates, many withdrew their funds. The bank then had to sell bonds to ensure liquidity, whose value had fallen significantly due to the change in the interest rate environment. Government support measures did not help any more, and within a few days the bank was insolvent.

In the meantime, other smaller banks in the US have stumbled. On March 16, for example, 11 major institutions, with the cooperation of U.S. regulators, provided a coordinated $30 billion to the troubled First Republic Bank.

But probably the most spectacular case is taking place in Europe: On the weekend of March 18/19, the Swiss industry leader UBS and Swiss supervisors put together an emergency package for the severely troubled Credit Suisse Group (CS); the result of which includes the **takeover of CS by UBS**. Since the financial market crisis, in which UBS was one of the first banks to come under the spotlight due to its high subprime exposure at the time, UBS has undergone a rigorous restructuring and, in particular, scaled back its investment banking. The current management under CEO Ralph Hamers - previously CEO of ING Groep for many years - has an excellent reputation.

CS, on the other hand, took the opposite route: In recent years, it has made a name for itself with management mistakes, including scandals and failed business activities that severely damaged its reputation. Credit transactions with Archegos, for example, resulted in a loss of around CHF 5 billion in 2022. The Greensill fund turned out to be far riskier than marketed to customers. The end result was a record loss for the Group of CHF 7.3 billion in 2022. Although the newly appointed management attempted a turnaround, this was still in an early stage.

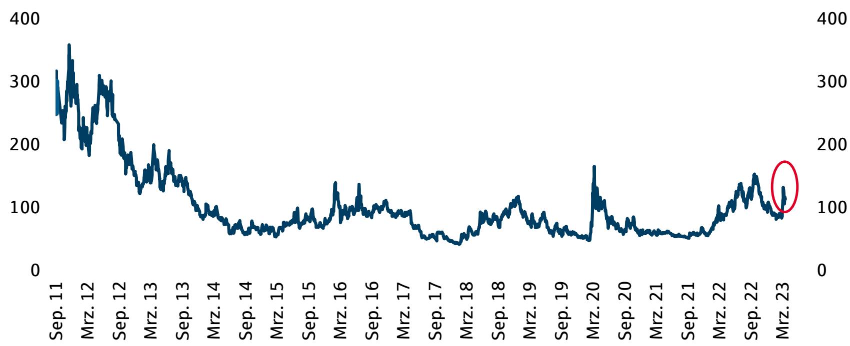
CS's problems were thus largely homemade. Rumors of liquidity problems were doing the rounds after customer deposits of more than CHF 120 billion had already been withdrawn in 2022. A postponement of the publication of the annual report due to inquiries by the US Securities and Exchange Commission (SEC) about risk management fit the picture. Only one spark was missing that finally ignited the fire: When the president of the major shareholder Saudi National Bank, Al Khudairy, said in an interview that his institution could not inject further capital into the bank for regulatory reasons, the bank's share price plummeted. Quickly provided support measures by the SNB on March 16 did not bring the hoped-for calming of market participants, followed by the announcement of the takeover by UBS on March 19.

Risk-off mode dominates

On the fine line between benefits and burdens for banks as a result of rising interest rates, the pendulum in the perception of market participants now seems to be swinging quite clearly toward the burdens. (see **Markets and Trends 2023: Global economy on a ridge walk**): These are in particular declining market values of assets and shrinking new business. This is offset by rising interest rate gains on the benefits side. However, an excessively rapid rise in interest rates in particular outweighs the negative effects. (see **European banks: An optimistic outlook for 2023**) So far, the banks have been able to report stable, low problem loan ratios, but here, too, we expect an increase in the foreseeable future.

Risk perception for bank bonds has recently risen noticeably

iTraxx EUR Sr. Financial, basis points



Sources: Bloomberg, Helaba Research & Advisory

Déjà vu financial market crisis?

After all, the industry is in a much better position than it was at the start of the financial market crisis in 2008/2009, having undergone comprehensive regulatory reforms since then. With the single supervisory framework and the single recovery and resolution system, improved instruments are available for crisis prevention and, for the first time, also for crisis management. Furthermore, in addition to equity capital, all liable capital including liabilities is now subject to regulation. Furthermore, newly introduced liquidity ratios are under supervisory scrutiny. In general, the industry has reduced high-risk activities.

In 2008, the crisis emanated from U.S. subprime real estate loans with highly complex financing structures that were not transparent to investors (or at least not understood by many). This time, the problems are less complex: in the low interest rate environment, activities were financed that are simply no longer viable at the now higher interest rates. **The sector however remains highly complex and interconnected** despite the great strides made to reduce risk in recent years. Even if the vast majority of institutions have done their homework and are now well positioned in terms of their risk buffers, incidents at individual institutions can quickly trigger knock-on effects. We are also extremely concerned to see that the **bank-sovereign nexus** continues to exist; according to our observations, the risks posed to the banking industry by the accumulation of sovereign debt worldwide have increased further in recent years.

It should be noted that it remains the business model of banks to manage risks, especially liquidity risks: While interest rate risks are usually hedged to a large extent, the management of **liquidity risks remains a central component of the business model of banks**, despite all the improvements made to manage them.

Further need for action

Despite all the encouraging progress made in recent years with regulatory reforms, we believe there is still a need for action on the part of framework setters and banks:

(1) There should be an ongoing development of accounting standards, especially with regard to the reconciliation of **book value and market value approaches**.

(2) **Sovereign exposures** should be backed by (more) equity.

(3) Contingency solutions should be designed **in line with market conditions**. Institutions should be able to make their own decisions on sovereign exposures and takeovers as saviors in distress.

(4) The regulatory framework for crisis prevention and management of **smaller banks**, which have so far fallen through the cracks of the Basel-based regulatory reforms, should be reviewed on an ongoing basis.

Bondholders of banks are once again faced with a major challenge in selecting their investments. They are left to rely on the high creditworthiness of the issuers and the good ranking of the securities in the liability chain. In our opinion, the current market situation, however, also offers opportunities.

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