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Risk Mismanagement and Collapse: An Analysis of Credit Suisse's Downfall

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ABSTRACT
This study examines the collapse of Credit Suisse, a century-old global financial institution, and its implications for banking stability. Through a comprehensive analysis, we identify three core vulnerabilities that contributed to its downfall: reputational damage from repeated scandals, capital erosion due to excessive risk-taking and high operational costs, and strategic mismanagement characterized by erratic decision-making and inadequate risk controls. These weaknesses, compounded by the volatile post-pandemic financial landscape and regulatory gaps, accelerated the bank's demise. We delve into the weaknesses of Credit Suisse that undermined its solvency position, including a tarnished reputation, capital issues, and poor strategic management. Additionally, we explore the current financial environment and its impact on the banking sector. Finally, the article offers targeted recommendations for both banks and regulators to enhance resilience and prevent similar future failures.

KEYWORDS
Credit Suisse; UBS; Collapse

1 Introduction

Credit Suisse Group, founded in 1856, evolved into a pillar of global finance with operations spanning Europe, Asia, and the Americas. Despite weathering the 2008 financial crisis - largely due to prudent capital management - it imploded in 2023 under the weight of scandals and strategic blunders. Acquired by rival UBS in a fire-sale merger, the collapse reverberated across markets, wiping out $17 billion in investor value and prompting existential questions about Swiss banking's vaunted stability.

Credit Suisse has been established for more than 100 years, and gradually developed as a leading global financial institution with a strong presence across Europe, USA, and Asia. Even in the during the storm of financial crisis in 2008, Credit Suisse was one of the few banks that did not require bailout due to better capitalization and lower exposure to toxic subprime mortgages. At the end of 2021, Credit Suisse had assets under management (AUM) around 1.75 trillion dollars, which made it second-largest bank in Switzerland, just after UBS. However, after several unsuccessful attempts and heavy fines, Credit Suisse was finally purchased by its competitor UBS Group, ended its history.

The collapse of liquidation of Credit Suisse is wide range. Firstly, after being taken over by UBS, its original employees were uncertain about the future, either losing their jobs or joining UBS. Secondly, Switzerland government is impacted since it promoted the takeover of Credit Suisse and provided a large amount of money to ensure the deal is completed (Reiff 2023). Thirdly, for the financial system and financial market, the investors were suffering from loss of investment related with Credit Suisse, and the reputation of Switzerland's stable and strong banking industry was also seriously affected as one of the oldest financial institutions collapse.

2 Process of Collapse

For Credit Suisse, a series of high-profile scandals and failed investment strategies progressively eroded Credit Suisse's reputation and financial stability, culminating in its eventual collapse.

From one aspect, Credit Suisse's scandals spread across multiple continents and involve a variety of illegal and unethical activities. Starting from 2020, the CEO Tidjane Thiam resigned after spying scandal that the bank hired private detectives to investigate its former head of wealth management who left for UBS, and the financial regulator proved that Credit Suisse carried out similar operations between 2016 and 2019. In addition, investigations revealed Credit Suisse's involvement in processing funds linked to criminal activities. The bank has been linked to money laundering schemes for Japanese criminal syndicates and Bulgarian drug traffickers, involvement in kickback schemes in Mozambique, tax evasion in the United States. These scandals resulted in hefty regulatory fines and inflicted severe reputational damage on Credit Suisse.

From the other aspect, Credit Suisse's collapse was precipitated by two catastrophic investment failures (Stuart 2023), the Archegos capital meltdown and Greensill Capital insolvency, which led to 1 billion in losses. These two investment decisions led to extremely huge loss of the company and the high cost of reimbursement, accelerating the collapse of Credit Suisse. (Englundh, 2023)

During this period, the regulator, FINMA, implemented a series of escalating interventions:

FINMA examined the fitness and properness of the candidate for the executive board and members of board of directors and initiated eight enforcement proceedings against Credit Suisse ' s managers.

Transferring specific topics to an independent committee, creating internal reporting mechanisms to keep the Board of Directors informed about governance issues, implementing requirements to ensure the Board ' s composition included experienced individuals, and introducing a statement of responsibilities for senior managers.

As for the lack of transparency and insufficient information problem, FINMA kept intervening Credit Suisse frequently, and strengthened the intensity of the intervention. (FINMA, 2023)

3 Weakness and Management Actions

For Credit Suisse, the main issue was the bad reputation. Reputation serves as a vital intangible asset for a bank. It represents the collective perception of all stakeholders, including investors, clients, and even regulators. Good reputation would construct the client ' s confidence in the bank, and therefore improve the deposit stability. Also, reputation determines the cost of funding indirectly since it will affect the confidence of investors. Moreover, reputation would also affect the regulatory. A bank with bad reputation would receive stricter supervision. Credit Suisse continuously had scandals (Englundh 2023), seriously damaging its reputation in the market, resulting in loss of trust from clients and investors, which heavily influences its business, and consequently affect its solvency position.

In addition, Credit Suisse had some problems regarding capital. Firstly, Credit Suisse always kept a high level of variable remuneration, even during periods of significant financial distress, creating perverse incentives that ultimately exacerbated the bank's risk-taking culture and financial instability. It results in the high cost of labor even when Credit Suisse was suffering from huge losses. Secondly, Credit Suisse suffered from high operational costs, fines, losses and other issues which weakened the capital of Credit Suisse, leading to the frequent capital raising in the market. These affect the solvency position of Credit Suisse.

Moreover, Credit Suisse had some issues in strategy management. Credit Suisse showed excessive risk preference, but the risk management team could not properly and efficiently identify and manage the increasing risk, which made the operation of Credit Suisse become increasingly riskier but lack of sufficient control approach. Also, Credit Suisse didn ' t have a stable long-term strategy. The management changed the strategy frequently, leads to an unstable development, and high volatility of the income.

All these risks, weaknesses, and issues affected the solvency position of Credit Suisse. The management did perform some adjustments trying to improve the situation, including introducing two new divisions, Swiss Universal Bank and Asia Pacific, which mainly provided products and services, and reducing the dividend to secure the equity. (FINMA, 2023)

The results show that these efforts are not effective. They didn ' t solve the problem fundamentally. Constructing a more stable risk management system might be a better approach to management.

4 Current Financial Market Environment

Our society and the financial market are undergoing accelerated transformation at an unprecedented pace. Especially with the invention and innovation of technology, the financial market is transforming at breakneck speed. There are more new financial products developed in the market, enabling financial institutions to have more complicated, efficient and accurate investment strategies. One of the main changes is the decreasing use of cash. Online payments or card payments have become the major payment method, replacing cash payments. Especially in China, online payments such as WeChat Pay and Alipay are almost unavoidable in the daily lives. In addition, financial institutions could use Artificial Intelligence to analyze the risk preference of customers and provide customized investment advice according to the market data, decreasing the entry barrier for investors. The new technology is a double-edged sword. For the advantage, it does provide more opportunities for both investors and financial institutions in the market by new products and new methods. For example, online payments and card payments significantly increase the transaction efficiency, and also provide an accessible way for regulators to supervise illegal transactions. By utilizing new techniques, it is possible to achieve a much higher rate of return. However, new technology also introduces new risks. For example, the online payment also makes it more convenient for criminals to carry out fraud. Additionally, new technology enables more efficient operations and update in the market, increasing the volatility of the market, which suggests higher risks.

In addition to the direct impact of new technology, the current financial market is more volatile due to some external factors. On the one hand, the financial product is highly related to some particular industry. For example, the stock price is highly related to the company ' s real value and business condition. In today ' s rapidly evolving technological landscape, breakthroughs like corporate patent approvals can trigger immediate market reactions, making the financial market more volatile indirectly. On the other hand, some events such as extreme weather, pandemic, wars, and change of policy would also make the market more volatile.

5 Recommendations

From the experience of Credit Suisse, it is important to set up a solvency regulation to prevent similar events. Basically, I would recommend the 3-pillar approach.

The first pillar focuses on quantitative calculation for required capital, the second pillar focuses on qualitative risk management, and the third pillar focuses on disclosure and transparency of information, allowing investors to make a judgement. On top of three pillar approach, there are also many other concerns that the government needs to consider and make a cautious decision. The government should determine which method to measure the assets (fair value or market value), which kind of assets should be excluded (e.g. intangible assets), the method to measure liabilities, the time horizon to measure insolvency, the proportion of Tier 1 and Tier 2 capital required, the discretion allowed for companies.

For Credit Suisse, it didn't have a reliable internal management system, resulting in a series of scandals and fines. Firstly, the bank should set up a compliance management system, ensuring that all the operations, transactions, and investments are legal and reasonable. It can help to avoid the situation which relates the bank to the criminal behaviors and consequent heavy fines, also help to rebuild the reputation. Secondly, the bank should have proper risk management. Credit Suisse suffered from two failed investments, and these might be avoided by properly assessing the risk before making the investment.

For government, to prevent future collapse under today's more volatile market environment, government could set a stricter capital requirement. For example, setting a higher minimum capital level to prevent investment with unreasonable risk and defense adverse price movement.

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