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Global banking turmoil from an Asian perspective

Asian institutions seen to be fundamentally stronger relative to their developed market peers

By the Asian Fixed Income Team
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What happened to Credit Suisse?

The swift collapse of Silicon Valley Bank (SVB) in early March prompted investors to scour for signs of contagion in the global banking industry. This triggered a selloff in shares and bonds of global banks, including Credit Suisse (CS). Troubles for the Swiss lender quickly escalated to crucial levels following a series of events that started with the announcement of a delay in the publication of its annual reports following last-minute queries from US regulators over previous years' financial statements. A few days later, CS announced that it found "material weaknesses" in its reporting and control procedures for the past two years. Soon after, Saudi National Bank, its largest shareholder, ruled out further financial help for the lender. The declaration—made in an environment of continued stress in the global banking sector—further intensified expectations of a possible default, and potentially a collapse, of CS.

In a deal brokered by the Swiss government, UBS merged with CS in a US dollar (USD) 3.1 billion all-share transaction. While this averted the worst-case scenario of a sudden and disorderly collapse of the latter, the emergency transaction announced on 19 March included the write-down of Swiss franc 15.8 billion (about USD 17.3 billion) of all Additional Tier 1 bonds (AT1s) of CS. This was the central feature that triggered an outsized negative reaction in the financial community following announcement of the takeover.

AT1s are securities that can be written down (partially or completely) or converted to equity in specified scenarios, outlined by the terms of these bonds issued by individual banks. AT1s carry a higher coupon than senior bonds as they are ranked below senior bonds and Tier-2 capital in a bank's capital structure. Conventional norms also put AT1 securities above common equity instruments in the capital structure, a point that has been reiterated by banking regulators across Europe, the UK, Hong Kong and Singapore this week. Hence, the complete write-down of CS's AT1s, while common shareholders received some compensation, rattled confidence in the global AT1 market. Within the region, there was a knee-jerk reaction with spreads of Asia Pacific financial sector senior debt widening about 5-20 basis points (bps), with Tier 2 capital bonds (T2) widening around 10-30 bps and prices of AT1s falling about 2-10 points. Spreads of instruments issued by stronger banks—including Singapore banks or those from more bondholder-friendly jurisdictions—widened less.

Separately, while arguably tighter financial conditions—prompted by the aggressive rate hikes by global central banks—were central to the ongoing stress in the global financial sector, underlying idiosyncratic reasons are seen to have played critical roles in the collapse of both SVB and CS. In the case of SVB, weaker regulation and supervision for US regional banks, together with SVB's very niche source of deposits, reportedly led to its insolvency. As for CS, the Swiss lender had been struggling for years. The bank's franchise and long-term business were seen to have been weakened by its own failings and not by exposure to a systematically problematic sector like the US real estate market during the 2008 Global Financial Crisis (GFC). In contrast, bank-specific lapses in governance and risk control in recent years and an inability to restore investor confidence in its risk culture and business transformation plan reportedly led to rising outflows from CS's wealth management and domestic bank deposits.

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Where to from here?

The decision by the Swiss regulator (FINMA) to fully write down the value of all CS AT1 securities spurred losses among investors and triggered elevated uncertainty for the asset class. That said, we do not expect such losses to cause a systemic crisis similar to the GFC. It should be noted that although the turmoil in the US regional banking sector triggered by the collapse of SVB and resulting market volatility likely were catalysts for the sudden loss of confidence in CS, the problems faced by the two banks are quite distinct, suggesting that a broader global financial crisis is unlikely to develop.

In addition, most of the global systemically important banks (G-SIBs) and financial institutions (G-SIFI) have very robust capitalisation and liquidity, generated respectable profits in the most recent reporting period and do not face any major asset quality/credit risk issues—as demonstrated by their resilience through the COVID-19 pandemic. Asian banks in particular are considered to be generally much stronger fundamentally vis-à-vis their counterparts in the developed markets. The regulatory regimes in Asia are considered much more robust, resulting in banks that are well capitalised and have conservative business models, with well-diversified sector exposure in terms of loans and investments, competently-managed duration exposures in the liquid investment portfolios and a broad and relatively stickier depositor base. A good number of Asian banks are also partially owned by their respective governments.

It could be some time before the market stabilises, and investor appetite toward financial subordinated debt will likely be weak in the near term. Some additional valuation premium (wider spread) may be required until regulators in Europe and the US manage to effectively stabilise their respective banking sectors. That said, considering the current valuations of fundamentally stronger Asian banks, we believe that a large part of such concerns are already reflected in their spreads/price following the re-pricing on 20 March.

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