MODESTY IN FINANCE
BETWEEN CREDIT SUISSE AND UBS

There is a problem with the noun 'modesty'. It carries a positive connotation because it expresses the knowledge of one's own possibilities and manifests itself mostly through a shy, disinterested or timid attitude ('her modesty is equal to her talent'). But there is another meaning that demeans the first: limitedness, mediocrity ('the modesty of his condition, of his achievements'). Modesty as a moral quality, is opposed to vanity and conceit. Well, the first quarter of 2023 certainly exposed those who, according to Buffet's metaphor, swam naked as the tide receded. But at the same time it has forced everyone into a bath of humility.

The first to have to revise granitic certainties were those who harboured the belief at the end of 2022 that stock markets would continue to fall in the new year, victims of persistent inflation. January surprised them with a powerful rebound. But was this a lack of modesty or simply the obligatory attempt to read the trends and take an investment position, right or wrong? Signs that inflation reversed course as early as October, at least in the US, prompted many to espouse the idea that not only would the Federal Reserve soon stop raising rates, but that it would even cut them in the second half of the year. A belief that has struggled to be confirmed both by the data and by Jerome Powell's words to the effect that the central bank's work will only stop in the face of a persistent change of scenario, even at the cost of setting the stage for a recession. In so doing, or so saying, the president of the world's most powerful central bank chose not to consider the possible effects of years of zero or negative rates on the financial system, particularly on banks. On the contrary, he was comforted in his positions by the traditional notion that rising rates would benefit the very banks, which gain by borrowing in the short term in order to lend at higher rates in the long term. Many banks, particularly smaller ones focused on this type of revenue, thought they could even exaggerate, given the certainty that historically underpins this approach. Exaggeration, an expression of analytical mediocrity, led to error. Indeed,

rates have risen in the short term, well above 4% (at times with expectations even around 6%), but have fallen in the long term. The market is becoming increasingly convinced that the turbo-acceleration of interest rates will cause recession: it is preparing itself by buying long-term bonds, driving yields down. In the US, the state guarantee on deposits up to 250,000 usd has curbed fears of bankruptcy among institutions. But it has not solved another problem: many savers have chosen to no longer be satisfied with receiving 0.5% interest on their current account when they can easily invest in a money market fund at 4%. Banks found themselves short of liquidity and the Federal Reserve had to open lending windows, effectively increasing the money supply that it actually wanted to reduce.

Central banks were probably under the illusion that it would be relatively easy to return to normal by removing the core of what they had provided so generously for the rescue from the 2008 financial crisis and then for Covid. It takes a lot of modesty to admit how problematic it is to detoxify a system that has been accustomed to free money for years. Jerome Powell's predecessor, Ben Bernanke, realised this at the time. He too had begun to reduce the balance sheet. Then, however, on the violent reaction of the markets, he realised that more than taking away, it was necessary to manage: he had to work on the rate curve (operation twist), modulating on which maturities to act. Perhaps even today the Fed will have to be inspired by some such action. But, unlike in Bernanke's time, today we are in an inflation context: everything is more complicated.

Even the European Central Bank (ECB) has basked in the belief that the balance sheets of European credit institutions are strong. This is probably true. In fact, at the time, a new category of bank bonds was invented that, thanks to moderately higher rates, in the event of a bank malfunctioning, the bondholder accepts to take a type of risk that normally belongs to the shareholder. It has, however, been underestimated with little modesty that banks are the primary expression of trust. If this is even the slightest bit shaken - in a system as financially bloated as the one that is taking us into the new millennium - there is a real risk of infecting other institutions.

In the same vein, the ECB also took a stand regarding the fate of the Confederation's now former second-largest bank: 'Even if it is a systemic bank,' said Christine Lagarde, 'its problems do not affect us, Switzerland must solve them on its own. Then, when the Credit Suisse crisis revealed the destructive potential of the particular AT1 bond segment, she had to react by promising, together with the Federal Reserve, liquidity lines to allow the Swiss authorities and UBS to orchestrate the resolution of the problem.

The causes of the Credit Suisse debacle were well outlined by Franco Müller in an interview with the newspaper 'Il Mattino della Domenica'[1]. His approach mirrors what a well-known international financier (one of the oldest still in business) wrote to a close friend of his from the Swiss Confederation: 'The Swiss banks started having problems when they landed in New York. I saw them at work when I was there myself. I already knew the level of sophistication of the Swiss bankers ... They came to the US and were 'eaten' by the wolves of Wall Street and never learned ... a lot of arrogance and, internationally speaking, also naive'. On the Credit Suisse executives who led to the catastrophe, one can hardly say that 'their modesty was equal to their talent'. It is easier to say that 'the modesty of their conditions was reflected in the results they achieved'.

The new CEO, Sergio Ermotti, brings with him the experience of the UBS rescue and the confidence of the authorities and financial markets. The idea of concentrating on private banking, i.e. on what Swiss banks do best, is, as the rebirth of UBS shows, probably the only way forward. The curriculum vitae of UBS's chairman of the board, Colm Kelleher, is also promising: a wealth of experience in global finance (Morgan Stanley) and a background as a historian: the ideal mix for keeping perspective!

However, the risks for Switzerland are enormous, as the new UBS has a balance sheet that makes the Confederation itself blush (intimidates). Having the world's largest wealth management institution in Switzerland is inherently dangerous. It is an industry that appeals to American big

[1] Franco Müller, “La fine di Credit Suisse ci faccia tornare alle origini”, *Il Mattino della Domenica*, 26 March 2023.

finance, to the wolves of Wall Street who once considered this business bureaucratic and boring. But who are now happy to develop an industry where their own assets are less at risk. The new management of UBS and the Swiss political authorities will have to assess whether there is a real capacity to manage and control such a large and complex organisation, given Credit Suisse's experience. Or whether a new governance should be considered, perhaps with a holding company for UBS in Switzerland and the partial listing of subsidiaries on the stock exchanges of the various countries where this major multinational operates. This would involve sharing control and responsibility for the entire structure with other supervisory systems and central banks. What will be the best way forward? It will be time and vicissitudes that will outline it. What is important is that we never forget that the strength of the Swiss financial centre lies in the solidity of the franc, an expression of prudence, productivity, modesty and seriousness. One can only hope that of the managers and authorities who have taken on this great responsibility, it will one day be possible to say that 'their modesty is equal to their talent'.

Translated with ww.DeepL.com/Translator/CSM