UOB Investment Insights

Thinking Ahead

21 March 2023

What does the Credit Suisse takeover by UBS mean for the banking sector and broader markets?

- UBS agreed to buy Credit Suisse in a historic deal brokered by the Swiss government to prevent confidence in the banking sector from further eroding.
- However, markets remain choppy after the takeover was announced. While we do not expect systemic risk to the banking system, banks will face increasing scrutiny and confidence in the sector will remain fragile for the time being. Investors should expect further volatility ahead.

How the Credit Suisse takeover unfolded

The UBS-Credit Suisse deal, explained

- UBS agreed to buy Credit Suisse for CHF 3 billion (USD 3.3 billion) in an all-share deal brokered by the Swiss financial regulator, in which existing Credit Suisse shareholders will receive UBS stock.
- The deal is expected to close by the end of this year, and there is no option for UBS to back out. Swiss authorities used an emergency order to bypass a Credit Suisse shareholder vote on the transaction.
- The combined firm will have USD 5 trillion in client assets, with UBS looking to retain Credit Suisse's profitable Swiss banking unit and wealth management business, while downsizing its investment banking arm. This is meant to bring the overall business model closer to UBS's focus on wealth management and its conservative risk culture.
- As part of the deal, the Swiss government will cover potential losses on certain assets UBS is taking over. UBS will cover the first CHF 5 billion in losses that arise, with the Swiss government assuming the next CHF 9 billion. Any losses beyond that will be borne by UBS.
- The final prong of the deal is that both banks will have unrestricted access to liquidity provided by the Swiss national bank, which has also made available an additional "liquidity assistance loan" of up to CHF 100 billion to UBS, if necessary.

Why did the government push for the UBS-Credit Suisse merger?

- There was internal opposition to the merger in both the Credit Suisse and UBS camps initially, but both sides were ultimately pushed by the Swiss government to complete the deal before markets opened this week.

- The merger was aimed at containing the crisis of confidence faced by Credit Suisse, especially with recent client outflows and counterparties curbing their dealings with the bank.
    - Prior to the deal, Reuters reported that at least four big banks had limited their trading with Credit Suisse.
    - Clients withdrew more than USD 100 billion in assets from Credit Suisse in 4Q 2022, and outflows continued this year despite the bank raising fresh equity capital and gaining emergency liquidity support.
    - Morningstar Direct also reported that Credit Suisse saw more than USD 450 million in net outflows from its US- and European-managed funds from 13 to 15 March 2023.
- The move is also meant to prevent further erosion of confidence in the broader banking sector, given that Credit Suisse is designated as a globally systemically important bank.

The market reaction

- As public funds were used in the rescue of Credit Suisse, around CHF 16 billion of Credit Suisse's additional Tier 1 (AT1) bonds will be written off completely to zero. Bondholders have reacted angrily to the Swiss government's decision to go against market convention, in which shareholders are typically the first to suffer losses in a buyout, followed by bondholders.
- Banking shares across markets fell as trading resumed after the deal, with the wipe-out of Credit Suisse's AT1 bonds triggering wider concerns about the wider USD 275 billion AT1 bond market.

What you can do

- Despite the negative developments surrounding the banking sector over the past week, full-blown systemic risk remains unlikely.
- The reason is that banking regulators, central banks and governments are stepping in to prevent wider fallout, with this government-led Credit Suisse deal serving as a prime example. The United States Federal Reserve and five other central banks have also announced coordinated actions to support the financial system.
- However, confidence in the banking sector will remain fragile for the time being. Once market confidence is shaken, it naturally takes time to recover, and banks in general will continue to face increased scrutiny and volatility.
- We downgraded US Financials from a Top Idea to neutral on 13 March. Clients holding investments in Financials should review their portfolios, and investors should consider rebalancing their portfolios into lower-volatility solutions in accordance with their risk appetite.
- Investors should build resilient portfolios to work towards their long-term financial goals and avoid concentrating their investments in any one sector or market.
- Speak to a UOB Advisor to learn more.

Right By You

IMPORTANT NOTICE AND DISCLAIMERS:

The information contained in this publication is given on a general basis without obligation and is strictly for information purposes only. This publication is not intended to be, and should not be regarded as, an offer, recommendation, solicitation or advice to buy or sell any investment or insurance product and shall not be transmitted, disclosed, copied or relied upon by any person for whatever purpose. Any description of investment or insurance products, if any, is qualified in its entirety by the terms and conditions of the investment or insurance product and if applicable, the prospectus or constituting document of the investment or insurance product. Nothing in this publication constitutes accounting, legal, regulatory, tax, financial or other advice. If in doubt, you should consult your own professional advisers about issues discussed herein.

The information contained in this publication, including any data, projections and underlying assumptions, are based on certain assumptions, management forecasts and analysis of known information and reflects prevailing conditions as of the date of the publication, all of which are subject to change at any time without notice. Although every reasonable care has been taken to ensure the accuracy and objectivity of the information contained in this publication, United Overseas Bank Limited ("UOB") and its employees make no representation or warranty of any kind, express, implied or statutory, and shall not be responsible or liable for its completeness or accuracy. As such, UOB and its employees accept no liability for any error, inaccuracy, omission or any consequence or any loss/damage howsoever suffered by any person, arising from any reliance by any person on the views expressed or information contained in this publication.

Any opinions, projections and other forward looking statements contained in this publication regarding future events or performance of, including but not limited to, countries, markets or companies are not necessarily indicative of, and may differ from actual events or results. The information herein has no regard to the specific objectives, financial situation and particular needs of any specific person. Investors may wish to seek advice from an independent financial advisor before investing in any investment or insurance product. Should you choose not to seek such advice, you should consider whether the investment or insurance product in question is suitable for you.