Swiss Banks rethink their ways after massive subprime losses

by Hui Min Neo

GENEVA, April 27, 2008 (AFP) - Switzerland's banking sector, once synonymous with stability and secrecy, is now under intense scrutiny and undergoing serious soul-searching after its two biggest banks got caught in the subprime crisis.

Industry leaders and the authorities, who until recently had stressed that the situation was under control, appear to have changed their tune as the country's biggest bank UBS has taken write-downs of more than 37 billion dollars, earning the dubious distinction of being the world's worst-hit group.

The country's second biggest bank, Credit Suisse, tumbled into the red in the first quarter as it too was badly hit, promising a more cautious approach in the future as some observers called for radical reforms in a system "rotten to the core".

In a speech on Friday to mark the Swiss National Bank's centenary, the country's top central banker Jean-Pierre Roth said a rethink of corporate governance and a strengthening of rules was vital to maintain the reputation of Switzerland as a top flight financial centre. "For a financial centre like ours -- which includes international banks whose private banking arms generate substantial revenue and consequently rely on having a spotless reputation -- such action is vital," Roth said.

Professor Didier Sornette from the Swiss Federal Institute of Technology in Zurich and a member of the Swiss Finance Institute warned that any action to address "this problem of greed" has to cut right across the industry to have any effect. "The system is rotten at the core. You can't blame Credit Suisse or UBS for chasing higher profits through higher risks because they were playing the same game as the rest of the sector." If they didn't take risks as Citigroup (or others) did, they would have fallen behind in the boom years," he said.

Credit Suisse chairman Walter Kielholz noted that the bank had increased the share-based component of its renumeration system in order to align shareholders and employees' interests. "In the long term, however, these efforts will only succeed if we have broad cooperation across the entire industry", he said.

For Professor Sornette, there is no better time for reform than now. "It's only in times of crisis that reforms can be made," he said. The shock to Switzerland of developments has been widely felt. Besides massive write-downs, UBS found itself short of cash and had to seek fresh funds twice, once from its own shareholders and another time from a Singapore sovereign wealth fund and an anonymous Middle Eastern investor.

For Professor Paul Strebel from Swiss business school IMD the uproar has been overdone and the underlying situation is better than suggested. In Credit Suisse's case, assets under management are still growing while at UBS, assets remain stable, Strebel said. "The economic impact ... seems to be limited," he said.

However, this cannot obscure the fact that Swiss banks find themselves in an extraordinary situation. "Switzerland's banks have always been known for their stability ... this situation currently facing the two big banks is clearly very exceptional", said Professor Sornette.

The changed circumstances have produced some unlikely steps. In an admission of failures, UBS published a 50-page report to shareholders, conceding that weak controls and a pay structure that encouraged risky deals were among key factors leading to its losses.

Raymond Baer, chairman of Swiss private bank Julius Baer which has largely escaped the crisis, warned earlier this month the fallout was likely to exceed that of the dramatic collapse of Switzerland's flagship airline Swissair in 2001. He said it would prompt a "paradigm shift" and that a focus on "clearly defined business areas" will be honoured more strongly in the future. "Big is beautiful' has lost its validity as a doctrine in a crisis. This definitely represents a paradigm shift." Baer said.