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**Lessons from the Credit-Anstalt Collapse**

By

Peter Coy

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In May 1931, a Viennese bank named Credit-Anstalt failed. Founded by the famous Rothschild banking family in 1855, Credit-Anstalt was one of the most important financial institutions of the Austro-Hungarian Empire, and its failure came as a shock because it was considered impregnable. The bank not only made loans; it acquired ownership stakes in all kinds of companies throughout the sprawling empire, from sugar producers to the new automobile makers. Its headquarters city, Vienna, was a place of wealth and splendor, famous for its opera, balls, chocolate, psychoanalysis, and the extravagant architecture of the Ringstrasse. The fall of Credit-Anstalt—and the dominoes it helped topple across Continental Europe and the confidence it shredded as far away as the U.S.—wasn't just the failure of a bank: It was a failure of civilization.

Once again, Europe's banking system, and by extension its social fabric, is threatened by bad loans. What had been slow-moving fiscal disasters in Greece, Ireland, and Portugal have gathered speed in recent weeks despite rescue packages designed to calm markets and prevent spreading the contagion to Spain, Belgium, and beyond. Portugal's 10-year borrowing costs hit a record 9.3 percent on Apr. 20, up from 7.4 percent just a month before, even as authorities met in Lisbon on an €80 billion ($116 billion) financing package. The higher that creditors drive up interest rates, the more unaffordable the debt becomes—creating the conditions for the very failure they fear. "All of the rescue packages don't really ensure that we can escape this adverse feedback loop that these countries are being trapped in," Christoph Rieger, head of fixed-income strategy at Frankfurt-based Commerzbank (CRZBY), told Bloomberg Television on Apr. 19. [2011]

With weak banking systems still resisting aggressive treatment, it's worth revisiting Credit-Anstalt to plumb for any applicable lessons. Long before 1931, Credit-Anstalt had begun to develop cracks that were invisible to the public. When the Austro-Hungarian Empire broke up after World War I, the bank continued to do business throughout the old empire without recognizing that the world had changed. Suddenly, more knowledgeable local lenders were getting the best deals, leaving Credit-Anstalt with the loans no one else would touch, says Aurel Schubert, an Austrian economist who wrote a 1991 book on the episode called *The Credit-Anstalt Crisis of 1931*. (There's a modern analogy in Greek banks' unwise loans in Bulgaria, Romania, and Serbia.)

The hyperinflation of 1921-23 that made the price of a beer rise to 4 billion marks badly damaged the finances of Credit-Anstalt as well as Austria itself. The nation was propped up by a 1923 loan from the League of Nations, the predecessor of the U.N. A Dutch citizen was appointed by the League to supervise the Austrian budget. He devised plans to raise taxes while cutting government jobs, pay, and pensions, the same prescription being urged on the weak members of the euro zone today. But Austria continued to stumble.

Bank regulation, meanwhile, was thin and getting thinner: Regulators began to demand a balance sheet just once a year, instead of every six months, says Schubert. As weaker banks failed, Credit-Anstalt took them over at regulators' insistence, becoming more bloated and less profitable with every merger. And the weakening of the economy was damaging lenders' ability to repay.

The tipping point came early in 1931 when a bank director named Zoltan Hajdu refused to sign off on Credit-Anstalt's books without a comprehensive reevaluation of the bank's assets. The bank revealed losses that it kept revising upward as the weeks passed. Depositors withdrew funds. The Austrian government stepped in to guarantee all the bank's deposits and other liabilities—but that only brought the government's own creditworthiness into question. "In today's language," says Schubert, "Credit-Anstalt was too big to fail, but too big to save." [But it **was** saved! Search "When Creditanstalt was rescued in 1931" below! -FNC]

Harold James, a British historian at Princeton University, described what happened next in his 2001 book *The End of Globalization: Lessons from the Great Depression*. "The Viennese panic brought down banks in Amsterdam and Warsaw. In June and July the scare spread to Germany, and from there immediately to Latvia, Turkey, and Egypt (and within a few months to England and the U.S.)." Austria got an undersized loan from the Bank for International Settlements and some help from the British branch of the Rothschild family. But French politicians rejected an international rescue without political concessions from Germany that weren't forthcoming.

Thus the failure of Credit-Anstalt accelerated the financial panic that turned a recession into a global depression. Economic distress in Austria contributed to the outbreak of violent conflict between socialists and fascists in 1934. Jews became scapegoats. In 1938, Nazi Germany occupied Austria, and Adolf Hitler was received by adoring crowds in Vienna. Albeit indirectly, the failure of Credit-Anstalt helped clear the path for some of the darkest events of the 20th century.  
  
  
**Today's Europe is far from a series of** events resembling this tragic cascade. But the experience of the 1930s and 1940s has made European policymakers and economists hyper-aware of historical precedents. The current debate is about how to avoid a repeat. To those who believe hyperinflation was the key policy mistake in Credit-Anstalt's fall, keeping a lid on inflation is priority No. 1. Others stress the lack of international coordination, or the failure to regulate, or even the handcuffs on government policies from adherence to the gold standard—represented today by the euro zone's reliance on a common currency. As in most car crashes, the witnesses have a hard time agreeing on just what they saw.

The scariest thing about the Credit-Anstalt default is that it occurred in a small, peripheral country, just as today's worst problems are concentrated so far in Greece, Ireland, and Portugal, which combined make up just 5 percent of the 27-nation European Union's gross domestic product. "Austria is a tiny, tiny little place, and you wouldn't imagine it could set off a chain of domino reactions. But it did. I do see exactly that potential now," says James.

For that reason, German economist Holger Schmieding says Europe should do everything in its power to prevent or at least delay defaults by national governments. Schmieding, chief economist of the German private bank Joh. Berenberg Gossler, says keeping Greece and others from defaulting for as long as possible—if not forever—will give banks in Germany, France, and other nations that have lent to them the time they need to rebuild their capital so they can withstand the hit from loan losses. The Bank for International Settlements says that as of last September, German banks had over €220 billion worth of exposure to Greece, Ireland, and Portugal, and French banks had over €150 billion worth.

For all of Europe's bickering over aid to Greece, Ireland, and Portugal, the Continent is more united and financially stable now than in the interwar period. "Unlike Austria in 1931, the euro zone has the resources to bail out the threatened banks without really triggering a full-blown debt crisis," says Michael D. Bordo, a Rutgers University economic historian. The more Europe takes the lessons of Credit-Anstalt to heart, the less likely it is to make the same mistakes again. The introduction of Schubert's book begins with the famous line of George Santayana, the Spanish philosopher, who said, "Those who cannot remember the past are condemned to repeat it." J. Bradford DeLong, an economist at the University of California at Berkeley, thinks Europe has absorbed Santayana's message—to an extent. "Because we remember the Credit-Anstalt, we will not make that mistake," DeLong says. "We will make different ones."

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Creditanstalt-Bankverein: Death of a bank By: Published on: Saturday, March 01, 1997

When Austria's coalition partners horse-traded the sale of Creditanstalt in January, it spelled the end of a venerable bank. [1997 !!!! Whaaat?? -FNC] But Gerhard Randa, chairman of predator Bank Austria, sees its absorption as a chance to put an Austrian bank into the big league. Not everyone agrees. And they don't like the way Austria's politicians stitched up a deal that had nothing to do with market forces and everything to do with Viennese power games. David Shirreff reports on a very Austrian privatization. Additional reporting by John McGrath. The 17-point agreement of January 12 Stages in Creditanstalt's "privatization" January 11 was the night of Bank Austria's annual ball in the Rathaus, Vienna. The bank's chairman, Gerhard Randa, was in good form and showing as much excitement as this reputedly cold, calculating man can. He knew that only 400 metres away in a smoke-filled room at the federal chancellery, Austria's coalition politicians were hammering out a deal. If it went his way it would make him undisputed number one banker in Austria. In the 19th district of Vienna another bank chairman, Guido Schmidt-Chiari, waited nervously at home. After his six-year often single-handed battle to keep the 140-year-old Creditanstalt-Bankverein independent, those politicians were about to decide its fate. Would it survive as a partner in a complex consortium of financial and industrial companies, or would it be bought and ultimately swallowed by Randa's Bank Austria? He expected a summons for last-minute discussions or at least to be told how they had decided. The meeting had started at 3pm. Chancellor Franz Vranitzky and his finance minister, Viktor Klima, both of the socialist party (SPÖ), and Vienna finance chief Robert Edlinger, were head-to-head with their coalition partners, deputy chancellor Walter Schüssel, economics minister Johann Farnleitner and conservative People's Party (ÖVP) chief whip Andreas Khol. Creditanstalt, traditionally a conservative bank, seemed destined to pass into the hands of Bank Austria, popularly regarded as a stronghold of the socialist left. Bank Austria had put in the highest bid, outclassing an offer by a consortium led by top savings bank First Austrian and insurance company Erste Allgemeine- (EA-) Generali. On price alone it was logical to accept Bank Austria's bid, but it would be a merger fraught with political difficulty and hostility since it would upset the balance of power between right and left in Vienna. Nevertheless both sides knew they couldn't leave the room without a deal. The so-called privatization of Creditanstalt, initiated in 1991, had dragged on long enough ­ possibly the longest privatization saga in history.

**Scribbled agreement**

Shortly before 2am they had something. Elisabeth Hagen, a finance ministry official, and Walter Schuster, head of JP Morgan's advisory team, were summoned into the meeting. So were Bank Austria's two negotiators, board members Fritz Kadrnoska and Franz Zwickl. Before them was a hastily scribbled agreement. It appeared to award Creditanstalt to Bank Austria, but under terms so hedged about with hands-off clauses and no-lay-off stipulations that Bank Austria would be unable to get its hands on the prize for five years, let alone merge the two into a fighting unit. Could Bank Austria possibly agree to such terms? Randa was called from the Bank Austria ball. As he read the agreement he could see that it was long on political expediency, to save the face of the ÖVP, but short on legal constraints. Once Creditanstalt was his there was plenty of scope to interpret the terms any way he liked. The politicians signed, and Randa, standing out in his smart tuxedo, added his signature at the bottom. In his modest Jugendstil house Schmidt-Chiari waited for the call that never came. His alleged allies, the ÖVP politicians, were perhaps too ashamed to invite him to a meeting which had concluded in a death sentence for his bank. Only six days before, at the ÖVP's traditional Twelfth Night rally in Salzburg, oaths had been sworn not to let Creditanstalt die. "One day we'll know what happened to the ÖVP on the 9th and 10th of January," says a Creditanstalt board member, "because on the 6th they were in a fighting mood." One possibility is that the ÖVP were scared of breaking Austria's fragile coalition and precipitating new elections. The Creditanstalt deal was so important that the senior coalition partners had staked everything. Its conclusion allowed a long-planned change in the Austrian leadership: chancellor Vranitzky stepped down, making way for a triumphant Klima with Creditanstalt under his belt. The deal gives impetus to a much-needed consolidation of the Austrian banking sector. Randa has been waiting for the competition commission in Brussels to give the go-ahead, possibly as soon as March 10, before outlining how the combination will work. It may be five years before the integration is anywhere near complete ­ Bank Austria itself is the product of a merger of two big banks in 1991, and they are still running separate customer account systems. But however long the integration takes, it spells the death of a once great institution. In its heyday, before World War 1, the Credit-Anstalt für Handel und Gewerbe was the financial hub of a resplendent Habsburg empire with dealings all over the world. But as war, republicanism, hyperinflation and industrial decline hit Austria, the bank's fortunes declined too and its sphere of influence shrank. It suffered a near-fatal blow in 1931 when its insolvency triggered a five-year Austrian banking crisis with global repercussions. As Dieter Stiefel wrote in his history of the episode: "Out of the rubble of a large international bank based in Vienna, directed at purely private commercial business, arose a partly nationalized bank which was an integral component of the Austrian banking system." [Die Krise der Credit-Anstalt für Handel und Gewerbe 1931, by Dieter Stiefel, Frankfurt 1989] Although it fought hard, particularly in the last six years under Schmidt-Chiari, Creditanstalt was never able to escape the clutches of state ownership. Ironically even now it has passed into the ownership of another state-controlled bank, although the government's intention is to reduce the state's share below 25%. Critics complain that the Bank Austria option was not a privatization at all and that politics continue to dominate the banking sector. That game of politics began after the 1934 civil war, as an extension of warfare by other, slightly more civilized means. The socialists and the conservatives over the years have carved up the country's economic units into areas of influence. Socialists dominate the savings bank sector, conservatives the cooperative and rural Raiffeisenkassen. Creditanstalt, though 70% state-owned, is traditionally the bank of conservative big business. Bank Austria is owned 45% by Anteilsverwaltung Zentralsparkasse (AVZ), 18.9% by the Republic of Austria and 6.3% by Wiener Städtische insurance, and so is reputedly under the influence of the City of Vienna whose socialist officials dominate the AVZ's governing council, the Sparkassenrat. But in the web of banking relationships and supervisory and managing board appointments there are many confusing mixtures of red (socialist) and black (conservative). Walter Fremuth, chairman of Creditanstalt's supervisory board, is a socialist, so is Schmidt-Chiari's deputy, Max Kothbauer, although the bank is close to the industrial wing of the conservative ÖVP and to the Federation of Austrian Industrialists. Former finance minister Ferdinand Lacina heads GiroCredit's managing board with fellow socialist Johann Kernbauer and two conservatives: deputy chairman Gerold Piringer and Rudolf Penz. Other banks are more firmly aligned. Randa is a socialist, so are most of the Bank Austria board. Konrad Fuchs, outgoing chairman of First Austrian, is a conservative, so is most of his managing board; Raiffeisenzentralbank (RZB) is a stronghold of rural conservatism. Would-be liberals say politics is retreating from the banking sector and pragmatism is taking over. But the more cynical see the Creditanstalt deal as a political trade-off to be succeeded by others, as the conservatives claim their reward. For example they predict that black First Austrian will buy GiroCredit from red Bank Austria, and that black RZB will get some of Creditanstalt's now unwanted regional banks. Since the agreement bars Bank Austria from bidding for the Postsparkasse, this might now go to Bank für Arbeit und Wirtschaft (Bawag) or RZB.

**Urge to privatize**

When Creditanstalt was rescued in 1931 there was great resistance to nationalizing it, even among the politicians. As early as 1956 the politicians showed privatizing instincts: they passed a law empowering the finance minister to reduce the government's stake in Creditanstalt to 60%. In 1987 another law reduced that threshold to 51% and for the first time lifted the ban on foreign shareholders. The next year small stakes of 4% and 3% were sold respectively to Sumitomo Life and Mitsubishi Trust. EA-Generali increased its 1.5% stake, bought in the late 1950s, to 4.9%. In 1985 the government had been obliged to pour in Sch7 billion ($635 million) to sanitize, not Creditanstalt itself, but four companies in its industrial holdings, including Stey-Daimler-Puch. That cost, and later problems with Österreichische Länderbank (ÖLB) gave the government a big incentive to make sure the next bail-out would not be its responsibility. In April 1991 it passed a law empowering the finance minister to sell, "on the best terms possible", its stakes in Creditanstalt and ÖLB. ÖLB was folded into Zentralsparkasse und Kommerzialbank Wien (Z-Bank) to form Bank Austria. Randa, who headed ÖLB, became deputy chairman of the newly merged entity, then chairman in April 1995. The law encouraged the use of capital markets for the placement of Creditanstalt shares. But Creditanstalt's first proposal to make a secondary share offering was turned down by finance minister Ferdinand Lacina. "Even Creditanstalt wasn't international enough to be internationally placeable," reflects a former Creditanstalt employee. "We had tried to sell participation certificates in Switzerland [in 1986] but within six months 80% of them had come back to Vienna." Attempts to place more shares in Japan ran foul of a general downturn in the banking industry. Over the next four years Creditanstalt developed various concepts for a secondary share offering, with the help of Goldman Sachs. Among the proposals was one to unify Creditanstalt's preference shares (30% of capital) with its common (voting) shares (70% of capital) to ensure greater liquidity. But the government turned it down, fearing that it would lose its voting majority without being paid a premium. That was the government's attitude to all proposals which didn't involve selling its majority voting interest for a "control" premium. Although Creditanstalt was stronger and healthier than ÖLB, the government favoured a single large buyer. Creditanstalt, led by Schmidt-Chiari, did not. Schmidt-Chiari favoured a wide distribution of shareholders as enjoyed by Deutsche Bank or Commerzbank. He didn't like the idea of a large controlling shareholder, especially another bank. But a bad year for the bank in 1992 meant that he had other things uppermost in his mind. The first suitor at the end of 1992 was GE Capital Corporation (GECC), which considered buying a 22% stake, although talks never got that serious. Schmidt-Chiari feared that GECC was interested only in the consumer finance aspects of Creditanstalt. Its treatment of Budapest Bank, which it bought in December 1995 and has streamlined into a consumer finance vehicle, bears Schmidt-Chiari out. Lacina, finance minister at the time, reflects that he was uneasy about an American partner. "Because of the marginal size of the Austrian market the strategy of American joint-venture partners seems to be rather volatile," Lacina says. "Chase, Bank of America have ceased their operations in Austria." Bayerische Vereinsbank (BV) was also a possibility. The two banks had always been close. They had 50-50 joint ventures: Bank von Ernst in Switzerland and Associated European Capital in New York. "We had discussions but they didn't show any interest," says Schmidt-Chiari. In the end Creditanstalt sold its stakes in those ventures to BV, in return for BV stakes in a pair of regional Austrian banks. "Joint ventures often cause problems," says Schmidt-Chiari.

**Farmers and peasants**

he first concrete offer came in April 1993 from the Austrian Raiffeisenbank group, although the then head of Raiffeisenzentralbank (RZB), Klaus Liebscher, recalls the approach as having been "only a letter of intent". RZB suggested a reverse takeover, with Creditanstalt financing part of the transaction, and with further backing from an unnamed foreign partner ­ thought by some to be DG Bank in Frankfurt. The Creditanstalt board rejected the offer as a diminution of the bank's capital. Finance minister Lacina also turned it down because RZB wouldn't reveal the name of its foreign partner ­ it still won't. On another level there was indignation among the patrician Creditanstalters that the RZB organization, made up of farmers and peasants, would have the nerve to consider such a takeover. "Perhaps it wasn't the right timing," reflects Liebscher, now in charge of the central bank. But considering their later fate, Creditanstalters might now wish they had pursued an offer that would have put their bank at the head of the powerful cooperative sector. Sadly, part of the blame for Creditanstalt's later demise must rest with the arrogance of the management, which didn't see how bad things could become strategically. Running a profitable, respected bank, which the Creditanstalt board certainly did, was not enough to secure its future. That needed vision and a strategy. Some inside and outside the bank now blame Schmidt-Chiari for lacking both. His style is "chin-down management" comments one insider bitterly. Schmidt-Chiari rewarded supervisory board deputy chairman Rudolf Gruber, who had encouraged the RZB concept, by engineering his removal. In December that year Creditanstalt and Goldman once again tried to interest Lacina in a secondary offering. Once again he turned it down. Lacina favoured a strong international partner ­ whose identity was known ­ that would bring some outside strength to the Austrian banking sector. Credit Suisse appeared on the horizon in early 1994. At the same time EA-Generali, a close partner of Creditanstalt ­ they have two joint ventures ­ began to construct a defensive, largely domestic consortium. First it was a handful of Austrian firms keen to support Creditanstalt by taking small shareholdings. Their thinking may have been as follows: further consolidation of the Austrian banking sector, or a sale to Credit Suisse, threatened to widen the prevailing thin lending margins. Keeping Creditanstalt independent would help maintain a source of cheap credit. Schmidt-Chiari was bringing together his best clients into a defensive circle.

Credit Suisse was the first serious outside suitor. In May, in a deal discussed only with finance minister Lacina, not the bank, it offered to buy an initial 25% of Creditanstalt ­ for Sch5 billion ­ with a five-year call option on the rest of the government's stake. Credit Suisse chairman Rainer Gut said openly, at a June press conference in Vienna, that he intended Creditanstalt to be an operating unit of the Credit Suisse group covering Austria and the former communist countries. This was too much for nationalist Austrian feelings. In the employees' council of Creditanstalt in August there were calls for a mass walkout. Mayor of Vienna Helmut Zilk was horrified by the idea of the bank as a branch of Credit Suisse, and central bank governor Maria Schaumayer declared that the flag flying over Creditanstalt should be Austrian. Klima, at that time minister of transport and nationalized industries, said he believed it was "very important to have banks not necessarily owned by the state, but which can still develop along majority Austrian lines". In September, Gut tactfully withdrew. Credit Suisse didn't want to embroil itself in Austrian politics, although it heard encouraging voices, even some within Creditanstalt. "I was very much in favour of Credit Suisse," says Lacina, "but it would almost have been a hostile takeover."

With hindsight, critics say that finance minister Lacina should never have negotiated directly with Gut: he should have used an investment bank, especially in dealing with such things as a five-year option. Lacina responded in October by hiring management consultants Booz-Allen & Hamilton.

Back in May, the Consortium had offered Sch7.2 billion for 37% of Creditanstalt. The offer was still on the table, although members of the Consortium were being added and subtracted the whole time. They included EA-Generali, First Austrian, Banca Commerciale Italiana, Commerzbank, Wüstenrot and various Austrian companies.

Towards the end of 1994 there were reports that German insurer Allianz was interested. In March 1995, Diethart Breipohl, finance director of Allianz, and Klaus Geiger, board member of Bayerische Hypotheken- und Wechselbank (Hypobank ­ in which Allianz has a 22.6% stake), came to Vienna. They met Schmidt-Chiari and Kothbauer of Creditanstalt, together with representatives from government advisers Booz-Allen and Christoph Kraus, general manager of Constantia Privatbank. Allianz and Hypo were interested in a minority shareholding. Schmidt-Chiari suspected Allianz was most interested in Creditanstalt as an outlet for insurance products, but Creditanstalt already had such a deal, and two joint ventures, with EA-Generali. "Their main point of interest," recalls Schmidt-Chiari, "was to get information on our joint venture CA-Generali. We said that before giving such information we'd have to consult our partner." It was a stand-off. Allianz sensed the hostility and withdrew a few days later.

Schmidt-Chiari had seen off four possible foreign suitors. Some blame him for having such strong views on the independence of the bank that he saw a privatization only in terms of non-core shareholders. They say his hostility when meeting potential partners was by itself enough to alienate them. He acted as if he were the owner of a private bank, not the custodian of an asset which the majority-owner, the state, wanted to sell. Schmidt-Chiari always argued that the bank had other shareholders besides the state. The state controlled 70% of the voting rights but only 49% of the capital. Schmidt-Chiari saw himself as the champion of all shareholders and of shareholder value. A placement of shares in the market was his obsession to the exclusion of practically all other ideas, except perhaps the defensive Consortium. Lacina was in despair: the Consortium's offer was the only one on the table and the privatization was stalling. He called in JP Morgan for informal advice. In April 1995 there was a change of finance minister: Andreas Staribacher replaced Lacina. Staribacher hired JP Morgan formally as adviser ­ a step in the right direction after the Credit Suisse debacle. And Morgan produced a valuation of Creditanstalt, putting its worth between Sch17.5 billion and Sch18.7 billion, including a control premium of Sch6 billion. On September 7, in a move humiliating for Creditanstalt, an invitation to tender was published in the Financial Times and the Wiener Zeitung. Commerzbank found the valuation too high and threatened to leave the Consortium. The government coalition collapsed at the end of the year and there was a call for new elections. Moves to privatize Creditanstalt were put on ice until January 1996, when Klima replaced Staribacher as finance minister. Klima immediately resumed talks with the Consortium. He also revisited the idea of a secondary offering of Creditanstalt shares.

**Fierce arguments**

First Austrian began to develop other ideas for a future relationship with Creditanstalt. It suggested creating a holding company that would own both First Austrian and Creditanstalt. Under the complex structure, First Austrian/Anteilsverwaltung Sparbank (the owner of First Austrian) would have taken 68% of a joint-venture holding company, and the rest of the Consortium 32%. The joint-venture holding company would own 59% of a bank holding company which in turn would own 75% of First Austrian and 100% of Creditanstalt. Existing shares in Creditanstalt and First Austrian would be converted into shares of the bank holding company. But there were fierce arguments between Consortium members about how to arrive at this structure. Some members felt that First Austrian was getting control without paying for it. Schmidt-Chiari objected that Creditanstalt shareholders would not be getting fair value unless First Austrian and Creditanstalt were subjected to a simultaneous valuation according to international standards. He said so in public at Creditanstalt's annual general meeting on June 10. Some Consortium members now feel that, had they sorted out their differences then, they would have won Creditanstalt without fuss and for a price much lower than the JP Morgan valuation: "for Sch6.5 billion they would have had control of the bank," says an informed source. One member puts the blame fairly and squarely on Schmidt-Chiari: "He screwed it up, with his stupid valuation." Klima was losing patience with the Consortium and asked for a final offer by the end of August. If Klima wasn't yet looking for alternatives, frustrated onlookers were. In June there had been a few press rumours that Bank Austria might be interested. Until then most observers had assumed it was too busy digesting its 1991 merger of Länderbank into Z-Bank, and then its takeover of GiroCredit in April 1994. But fantasists supposed that Bank Austria, plus its new shareholder Westdeutsche Landesbank (which had taken a 10% stake in December 1995), and Italian Cariplo (which had a 5.6% stake), might have an interest in bringing Creditanstalt into the group. Bank Austria chairman Gerhard Randa says his first ideas on Creditanstalt came later, in July: "We started with some internal studies, together with Salomon Brothers. The first results looked promising." Randa could draw on his experience of the Z-Bank/ÖLB merger, and also the less happy tussle with GiroCredit where he was unable to exercise absolute control. Randa had another advantage. For four years he had been a board member of Creditanstalt, more than two of them as Schmidt-Chiari's deputy until October 1990. He knew the bank's inner workings and its intrinsic value. He also knew who he was up against ­ a chairman who would never willingly sell to Bank Austria. It was vital that news of Randa's interest didn't get out until the last possible minute. In the meantime First Austrian had pulled out of the Consortium which then put a bid together on its own, submitted in early September. Klima rejected it. Rumours began to circulate about a Bank Austria bid, but they weren't taken seriously. Most observers thought it was a ruse to drive up the Consortium's offer price. There was only one clue which might have alerted a lateral thinker: Bank Austria had lost interest in integrating GiroCredit and was leaving it to its own devices. But not even Lacina, now head of GiroCredit, or any of his staff put that interpretation on it.

**Business secrets**

In October, JP Morgan prepared an update of its blue offering memorandum and Bank Austria obtained a copy. Apart from Morgan, and a handful of people at the ministry, nobody knew what Bank Austria was up to. On November 15, when challenged about a pre-qualifying bid, and whether WestLB and Cariplo would be joining it, Randa dismissed the rumour as a "carnival joke". This is his one act in the entire affair that he has said he regrets. How much did WestLB chairman Friedl Neuber know about Randa's intentions? Randa won't say. Klima must have known about Bank Austria's interest. That didn't prevent him, during a Savings Day visit to Creditanstalt on October 31, from reassuring the board: "Everything will be done in the interests of Creditanstalt. You will be very happy." Schmidt-Chiari wasn't there to hear these comforting words. Perhaps Klima even then believed an improved bid from the Consortium, which was the Creditanstalt board's favoured solution, would win the day. The Consortium begged First Austrian to rejoin them, which it did, and by mid-November they had put together a new offer. The Consortium and other potential bidders were invited to spend seven days at Creditanstalt to do due diligence. The Consortium sent in 32 people, working day and night. "We had to bare ourselves to the knuckle," says a Creditanstalt board member, "giving away our banking secrets and business secrets." But the Consortium was the only one to take up the due diligence offer. Two other bidders had appeared but didn't go as far as doing due diligence, Karl Wlaschek who had just sold his Billa food empire for Sch15 billion, and an unnamed US buyer. Wlaschek's motive was mysterious ­ perhaps the man who played the piano in bars after World War 2 before starting Austria's biggest foodstore group was looking for a lost cause to support, or he had his eyes on Creditanstalt's real estate. Anyway, it looked as though the Consortium was in a one-horse race. Why did Randa not send in a due diligence team? As far as he was concerned this was no offer of due diligence at all: "You had four days to look at papers and talk to management. You couldn't go into the bank and look at everything." Randa contented himself with the 270-page Morgan memorandum which had "very detailed information", and used Bank Austria's own figures and the experiences of the Z-Bank/ÖLB merger. "Randa can't complain if he doesn't like what he's bought," quips a local journalist. According to one source, Salomon Brothers and the Bank Austria team worked seven days a week from August to December to prepare the bid. Informed sources suggest that due diligence would not have added much more to Bank Austria's shared experience of Creditantalt's known domestic clients and the Morgan memorandum, which had a detailed account of Creditanstalt's foreign risks. The due diligence offered would have been more useful to a foreign bidder. Randa is described by many as "a cold fish". His former colleagues at Creditanstalt remember him as intelligent, efficient and a good strategist. Those qualities came into play when he masterminded the Z-Bank/ÖLB merger in 1991. And as chairman of Bank Austria he has pushed through changes efficiently and sometimes ruthlessly. Although he came to the merger as chairman of ÖLB he is the only Länderbank alumnus left on the Bank Austria board ­ there were only three board members to choose from on the ÖLB board, he points out. Except in treasury and capital markets there are no senior Länderbank managers left. The others are either from Z-Bank, or outside recruits. Randa says defensively: "There was Z-Bank dominance in the branch network and their sales force was much stronger. But in treasury and securities it's Länderbank people." Randa has also been prompt to deal with incidents at his bank which could possibly be called politically incorrect. Early last year he fired two board members for positioning the bank in some high-yielding deposits offered to retail clients by rival Bawag. Although this might be regarded by some as fair arbitrage, Randa judged it anti-social and moved board member Helmut Horvath to run the investment bank, Investmentbank Austria. The other board member, Thomas Aistleitner, was also relocated within the group. Randa's decision, taken within hours, impressed the market: it showed who was in charge. In October he fired his head of securities trading Tony Imre for activities that might have been praised in a more developed market. One of Imre's traders dumped stocks minutes before the market closed in response to the action of another bank, in a bid to influence the settlement price of the ATX index. Randa, as chairman of the stock exchange, was embarrassed by this perfectly legal action. Others might say it was a fair strategy, but for Randa a whiff of indelicacy was enough, and Imre walked. In early December, Randa knew that his Creditanstalt bid was close to becoming public knowledge. The bid deadline was December 16 and he would need clearance from the supervisory board at the next meeting fixed for December 11. Then the cat would be out of the bag: supervisory board members are notorious gossips and networkers ­ that's part of their function. The rumours were getting stronger, even though JP Morgan and the ministry could be trusted to keep a secret. "The finance ministry leaks only what it wants to leak," says an insider. Knowledge of Bank Austria's interest broke earlier than expected on December 10 and hit the news-stands the next morning. On December 16 Bank Austria made an offer to the government of Sch836 a share. The Consortium could manage only Sch730 a share for 14.7 million shares and Sch580 for the remaining 5.2 million. A third bid came in from the Karl Wlaschek Foundation which valued Creditanstalt at Sch14 billion. Says one finance ministry source: "We didn't want to sell to a buyer who would not be responsible. There was an offer of over $2 billion from a foreign individual who we knew had the money. But he wouldn't outline his proposals for Creditanstalt. That was unacceptable to us and we ignored his bid, even though he was willing to raise his offer." Half of Vienna was up in arms at the Bank Austria bid. The Creditanstalt board were furious at not being consulted and at the notion of being swallowed up by the red giant. Their allies, the ÖVP politicians, made a point of voting that day with the opposition Freedom Party (FPÖ) instead of with their coalition partners. They argued that this was not a privatization at all, since Bank Austria itself was majority state-owned. Given the shakiness of the coalition, Randa was wise to have kept the bombshell from them for so long. Randa argued coolly, with the help of his renowned lawyer Ewald Weninger, that there was nothing in the 1991 law that stipulated how Creditanstalt should be sold. The word "privatization" was hardly mentioned.

**Final round**

On December 18 the ÖVP demanded a change in the privatization law, stipulating the delivery of Creditanstalt into truly private hands. Over the next week or so the conservatives hurriedly worked on another concept: distributing shares to the public at a discount, a Volkstaktie, as was done in Germany with Volkswagen in 1961. On December 27 Klima announced that the bids weren't satisfactory: there would be another round, closing on January 10. The Consortium was in disarray. Bank Austria had factored in a takeover premium as suggested by JP Morgan. Since individual members of the consortium weren't taking controlling stakes they saw no call for such a premium. First Austrian and EA-Generali were willing to go over Sch800 a share, but that didn't even match Bank Austria's previous bid. On January 10 the Consortium bid Sch750 a share and Bank Austria came in with Sch850 a share. The numbers were on the table. Schuster of JP Morgan notes: "The law governing the Creditanstalt privatization process says that you have to sell to the highest bidder. We were crystal-clear about that from the start. Klima asked for a legal opinion to make certain. The lawyer shared our view." But another part of the law stipulated that the deal must be done "while safeguarding national interests in relation to a restructuring of the banking sector". In other words, the politicians had to reconcile two possibly conflicting criteria. The Bank Austria bid was the highest, but First Austrian was theoretically a much better partner for Creditanstalt: there was less overlap at home and abroad, investment banking at First Austrian is embryonic whereas Creditanstalt and Bank Austria have market-leading investment banks. A further consideration is size: Bank Austria and Creditanstalt create a bank that is six times bigger than its nearest domestic competitor. However, even together they have only around a 22% share of the Austrian market ­ ABN Amro has around 40% of the Dutch market. And Bank Austria and Creditanstalt combined are still only the 33rd largest bank in Europe, by shareholders' equity. Randa insists that Austria needs a bank of at least this size to compete in a single-currency Europe. "This is all about the euro," he says. The politicians' choice was made easier by the weakness of the Consortium, the history of which has been described as a "bürgerliches Trauerspiel" ­ a middle-class tragedy. Says Schuster at JP Morgan: "The structure proposed by EA-Generali would have transformed Creditanstalt into a joint-venture bank ­ 10 banks and several small investors in the form of Austrian corporations. From a corporate governance point of view joint-venture banks are not necessarily the best." A Creditanstalt board member describes the Consortium wryly as "an interesting exercise in group dynamics. The interests were too diverse, there was no centre of gravity. First Austrian and EA-Generali must often have asked themselves 'Why am I doing this?'" Ultimately the Consortium spent too much time number-crunching when what was needed was "a manly decision", he concludes. The Consortium's political backers weren't much manlier. On the night of January 11 they still had a chance to block the deal. "It would have been cleaner if [conservative] Schüssel had walked out," says a Creditanstalt board member. "It would have shown character." Instead, the only resistance offered was a last-minute suggestion that RZB should buy a stake in Bank Austria, say sources who were at the meeting. But that led to fierce disagreements in the conservative camp ­ "black against black". Finance minister Klima's mission was to "deliver something to the country" before becoming chancellor, says a Consortium member. Klima was prepared to break the coalition over the deal, the conservatives weren't. They all put their names to a 17-point agreement, parts of which will be near-impossible to keep, for example:

3 Creditanstalt will remain an independent company for a period of at least five years (except partial functions ­ Teilfunktionen).

4 Jobs within Creditanstalt will be preserved. Staff reduction only through natural attrition.

6 No asset stripping ­ does not apply to regional banks, investment bank, ÖRAG (a real-estate company).

**Two pairs of shoes**

The political agreement, and the purchase of the Creditanstalt stakes, says Randa, are "two pairs of shoes". The agreement mentions things that are nothing to do with Creditanstalt. It calls for the reform of the takeover code and the Vienna stock exchange. As Randa understands it point three of the agreement means that "for at least five years there will be an existing independent Creditanstalt unit. Hiving off part functions is possible from day one." But there's no doubt that the wording of the agreement caused unnecessary uncertainty among Creditanstalt staff, particularly at the investment bank, which seemed destined to be sold off. And the unions seized on the promise of job security. Randa qualifies it: "We can improve productivity by using natural attrition. It's a successful principle we've followed [with the Z-Bank/ÖLB merger]." It took Randa nearly a month after January 12 to visit Creditanstalt and reassure Schmidt-Chiari that the Creditanstalt Investment Bank (CAIB) wouldn't be sold but merged with Investmentbank Austria. Bank Austria would be starting this year to merge existing functions, he said. "Investmentbank Austria is strong in privatizations," says Randa, "and CAIB is successful in the reforming [former communist] countries." The investment bank was mentioned in the agreement, he explains, because "we were asked if we would sell and we said: 'Yes, if there's someone interested to buy'. We're not the right person to talk to, and so far no one has shown up. Anyway, he'd need a big chequebook". Randa doesn't appear to feel bound by the 17-point agreement he put his name to. He says he was a little astonished at the quality of the political discussion when the document was drawn up: "It didn't focus on the economics of the bid. It didn't see the positive side that it would strengthen competitiveness and the potential for a truly Austrian institution. There was only minimal discussion on these crucial questions and then only in the sense of black and red." But the severest critics of the deal focus on various points that outside Austria would have been regarded as glaringly unfair. First, Creditanstalt was always a target, never a potential predator. As a commercial bank it had no chance of defensively acquiring other banks in Austria. (However, it recoiled from the one chance of acquisition it did have, Budapest Bank in 1995, because of "disagreements in the managing board".) Second, because of shortcomings in Austria's takeover code a bidder for a controlling stake doesn't have to offer a uniform price for the shares. The small shareholders of Creditanstalt voting stock will be offered Sch722.50 not Sch850 a share. Third, Bank Austria was able to finance the deal cheaply because of its triple-A rating backed by the guarantee of the City of Vienna. These last two shortcomings will now be addressed as part of the 17-point agreement: the takeover code is being reformed and AVZ will reduce its 19% stake in Bank Austria and withdraw, or charge money for, its guarantee. But that won't affect the Creditanstalt deal. The Consortium wrote to the European Commission in January protesting that Bank Austria could bid higher because of its unfair rating advantage. But even Consortium members don't believe that protest will get far. "The difference in price would never be covered by their advantage in the money market," admits Dietrich Karner, chairman of EA-Generali. Competitors are aiming the same criticism at Germany's Landesbanks and that is a political potato too hot for Brussels to touch at the moment. Randa is relaxed about the fairness of the fight. "We are absolutely on the ground with existing Austrian law," he says. "If someone is discontent he should attempt to change the law. We've even gone beyond the requirements of the law by offering the small shareholder a cash alternative. I feel quite comfortable." For the old guard at Creditanstalt the future looks bleak. Schmidt-Chiari is expected to resign on April 29 at the annual general meeting, so is spokesman of the board Joachim Kuehnert. Supervisory board chairman Walter Fremuth offered his resignation in January but so far it hasn't been accepted. The most senior likely survivor is the board member responsible for international business Alarich Fenyves. Although he's sad to see the end of the bank's independence Fenyves got on well with Randa at Creditanstalt. EA-Generali is hoping it can continue its joint ventures with Creditanstalt, although the chances are that Wiener Städtische insurance will use its close relationship with Bank Austria to muscle in. Creditanstalt's old guard believe the takeover spells the death of the bank. Randa is already thinking along the lines of a Chase/Chemical- or ABN/Amro-style merger. It's not clear what role WestLB will play in the new bank but Randa is clear he wants the relationship to intensify. The Creditanstalt name is unlikely to survive, except in a few units such as fund management or central European joint ventures until its market value is used up. Says a former Creditanstalter: "It's always been a problematic name. It doesn't have the word 'bank' in it, and Anstalt has awkward meanings even in German ­ it can mean 'jail'.  
  
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