UBS stabilisation explained

Author: | Published: 17 Mar 2014

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UBS's purchase of StabFund from Swiss National Bank ended the stabilisation transaction it launched in 2008. Here's what it means for Swiss banks

Prager Dreifuss advised Swiss National Bank (SNB) on the November 2013 sale of the stabilisation fund to end an undertaking launched at the height of the global financial crisis in 2008. It marked the successful conclusion of a transaction that saw Switzerland transform a situation that threatened economic stability into a success story. The team at Prager Dreifuss was led by Urs Bertschinger. In this interview, partners Urs Bertschinger and Daniel Hayek, head of the firm's corporate restructuring practice, tell IFLR how the transaction worked and what it means for Swiss banks.

Can you outline the background to the UBS stabilisation 2008? What led to the decision to implement it?

Hayek: The central issue in 2008 was that an insolvency of UBS would have had a crippling effect on the Swiss – and potentially the global – financial system. There was also a widely-held belief that the illiquid assets would recover and increase in value over time, which made it reasonable to envisage a restructuring implemented in the way it ultimately was.

What did the transaction involve?

Bertschinger: The transaction involved $38.7 billion in distressed assets. UBS sold the assets to a special purpose vehicle (SPV) that was wholly owned by Swiss National Bank**[A1]** . This SPV was known as the SNB stabilisation fund.

SNB granted 90% debt to the vehicle that purchased the assets. At that time the Swiss Confederation strengthened UBS's capital base by subscribing to CHF 6 billion worth of mandatory convertible notes.

UBS then financed the remaining 10% of the asset purchases in exchange for a call option to acquire the vehicle subject to certain conditions. That 10% was intended to cover the first 10% of any losses incurred by the vehicle. In total, that means that 100% of the purchase price was paid by the vehicle to UBS in the form of a true sale.

To effect the transfer, it was crucial that UBS and SNB cooperated. It was decided from the outset that UBS would be involved in managing the assets. After some debate, the vehicle had been structured as a Swiss limited partnership under Switzerland's Collective Investment Schemes Act, with representatives of both SNB and UBS sitting on the board of directors of the general partner of the SNB stabilisation fund. These representatives drafted the principles on how to liquidate the assets.

UBS remained the asset manager and, over a period of several years, sold the assets on the basis of these guidelines

What challenges did UBS and SNB face in implementing this transaction?

Bertschinger: The deal was completed in the midst of extremely challenging circumstances in 2008 following the failure of Lehman Brothers.

Initially the intention was that the SPV would be established abroad. However, as a result of debate focusing on political and legal issues, it was decided to establish the Swiss limited partnership as outlined above.

Another major challenge was the pricing of the assets. The prices defined by UBS by September 30 2008 formed the basis of the transaction, in conjunction with a second independent valuation to control those UBS prices.

What is the nature of the precedent it will likely set?

Bertschinger: We believe that it would be inappropriate to understand the transaction as a precedent for any situation that Switzerland may face in the future. At the time that the transaction was launched in 2008, Switzerland's regulatory environment was different to the present situation. Switzerland has been swift to enact a new regulation with respect to Sifis [systemically important financial institutions] and G-Sifis [global systemically important financial institutions]. Credit Suisse and UBS clearly fall within this group of institutions.

Speaking personally, I would not rule out another transaction like this in Switzerland. However, nobody can predict the future and in any given situation the Swiss authorities would need to find the right solution for that new situation.

What is the outcome of the stabilisation transaction for the parties involved?

Hayek: Ultimately, the Confederation made a significant gain on the CHF 6 billion convertible. SNB and UBS also made substantial gains. Additionally, SNB received $1.6 billion in interest on the facility granted to the SPV.

Bertschinger: Once the whole loan including interest had been paid back to SNB, the call option entitling UBS to purchase the vehicle was exercisable. UBS was interested in exercising the call option as it was in the money. The net asset value in the vehicle was more than $6 billion. The formula was that the first billion was assigned to SNB and the remainder divided equally between UBS and SNB. Therefore, SNB ended up with approximately $3.7 billion paid by UBS for the vehicle and UBS had approximately $2.7 billion. Needless to say, that for all parties involved it turned out to be a successful transaction.

What advice would you give to other banks in light of this development?

Hayek: There are some important lessons from the UBS deal in the sense that we now know a deal of this kind will work within Switzerland's legal, regulatory and tax framework. However, I would also tell banks that the solution devised in the UBS transaction is *sui generis*. Switzerland will have to look at any new situation on the basis of the new regulations implemented.

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