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UBS purchases StabFund from the SNB

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Press release

Communications

P.O. Box, 8022 Zurich
Telephone +41 44 631 31 11
communications@snb.ch

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UBS purchases StabFund from the SNB

Profit of USD 3.762 billion for the SNB

On 7 November 2013, UBS signed a purchase agreement to acquire the StabFund from the Swiss National Bank (SNB). The purchase price amounts to USD 3.762 billion, corresponding to the SNB's contractual share in the StabFund equity as at end-September 2013 (the first billion is assigned to the SNB, while the remainder is split equally between the two parties). This amount will be transferred to the SNB parent company and will have a favourable impact on the 2013 annual result. From then on, the SNB no longer constitutes a group. Consequently, with effect from end-December 2013, it will not be presenting consolidated financial statements.

Background

The StabFund, or SNB StabFund Limited Partnership for Collective Investment (stabilisation fund), was established in October 2008 as part of a package of measures intended to stabilise UBS and thereby to strengthen the Swiss financial system. In the following months, the StabFund took over illiquid assets from UBS totalling USD 38.7 billion; the Swiss Confederation simultaneously strengthened UBS's capital base by subscribing to mandatory convertible notes in the amount of CHF 6 billion. The assets and contingent liabilities taken over by the StabFund were financed by an SNB loan amounting to USD 25.8 billion. At the same time, UBS provided USD 3.9 billion. This equity was intended to cover the first 10% of any loss incurred by the StabFund, which was fully owned by the SNB. The difference between the funds paid into the StabFund and the total sum of transferred assets was made up of contingent liabilities which, at that point, did not require any financing.

The announcement of the transaction in October 2008 and the transfer of the troubled assets finalised in April 2009 stabilised UBS's business situation, thereby achieving the objective of the package of measures. The next task was to manage and wind down the portfolio consisting of securities, loans and derivatives.

This was done by the SNB and UBS jointly. The Board of Directors of the StabFund consisted of three members from the SNB and two from UBS; the Chairman was always an SNB representative. The SNB was in charge of management and established a seven-person team for this purpose. At UBS, a group of about 70 staff implemented the specified guidelines for the management and sale of the assets. Since the success of the StabFund was in the interests of both parties, this cooperation worked well.

Once the assets had been transferred in three tranches, from October 2008 to April 2009, the task of reducing the exposure began. The StabFund based its work on the intrinsic values of the assets, which were calculated from the future cash flows to be expected. When the market situation was good, assets were sold rapidly, while restraint was exercised when market setbacks were experienced, such as in 2011. The cash flows which led to a gradual repayment of the SNB loan to the StabFund were made up – in essence – of principal repayments (USD 13.4 billion), interest payments (USD 3.9 billion) and sales (USD 15.8 billion). In mid-August 2013, the final repayment was made.

Once the loan was repaid, the option transaction was triggered, which made it possible for UBS to purchase the StabFund. After the remaining positions in the portfolio had been sold over the summer months, the StabFund was left with mostly cash equivalents at the end of September. At this time, the balance sheet showed equity of USD 6.523 billion. US securities, in particular, recorded cash flows over the entire life of the portfolio in excess of the purchase price paid to UBS at the outset. By contrast, the situation for European assets was less favourable, since the euro debt crisis from 2010 had a negative impact on the value of these positions.

For the SNB, the transfer of the StabFund to UBS represents the successful conclusion of a challenging undertaking and one which, for the SNB, was out of the normal run of business. From a financial point of view, it has gained interest income of a total of USD 1.6 billion over the term of the loan in addition to its USD 3.762 billion share in the equity. However, attaining a profit was never an objective in its own right. The prime reason for the establishment of the StabFund was its contribution to strengthening the Swiss financial system.

Winding up the SNB StabFund transaction

News conference of 8 November 2013

Thomas Jordan
Chairman of the SNB Governing Board and
President of the StabFund Board of Directors

Marcel Zimmermann
Head of StabFund unit and General Manager of StabFund

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Announcement on 16 October 2008

- Confederation, Swiss Federal Banking Commission (SFBC) and Swiss National Bank take measures to stabilise UBS and strengthen Swiss financial system:
  - Transfer of max. USD 60 billion in illiquid UBS assets to special purpose vehicle (SPV).
  - SNB: Secured loan to SPV of max. USD 54 billion.
  - Confederation: Strengthens UBS's capital base with CHF 6 billion.

Wind-up five years later

- On 15 August 2013, the StabFund repays the SNB loan in full.
- On 7 November 2013, UBS purchases the StabFund from the SNB.

- The SNB receives a purchase price of USD 3.762 billion for the StabFund.
- The SNB earns interest of USD 1.6 billion on the loan.

Programme

- Preparation and set-up phases, main features and challenges of operation
(Autumn 2007 to May 2009)
- Portfolio management and its results
(June 2009 to September 2013)
- Conclusion: Purchase by UBS and assessment of transaction
(August to November 2013)

Preparation and set-up phases, main features and challenges of operation

Thomas Jordan

Why were measures necessary?
General economic and financial conditions deteriorated sharply ...

- Market conditions worsen after Lehman collapse.
- High level of uncertainty.
- The financial crisis resulting from the situation in the US real estate market spreads to global financial markets.
- Capital and money markets dry up.

Why were measures necessary?
... and UBS's situation in October 2008 was critical

- High exposure to illiquid securitised loans and loans in the US and Europe:
  - Huge losses suffered due to fall in prices.
  - High level of uncertainty regarding valuation of such positions.
- Confidence in UBS crumbling:
  - Outflow of client funds increases sharply.
  - Liquidity situation deteriorates.
- Low capital base:
  - High risk that further losses could deplete remaining capital and threaten bank's solvency.
  - Inability to raise additional equity capital from market.

Exploring and preparing possible measures

- Autumn 2007: Authorities assess various measures to support systemically important financial institutions.
- Spring 2008, after Bear Stearns bailout: The SNB draws up strategy for possible takeover of illiquid UBS assets.
  - Attention focused primarily on secured longer-term loans or asset purchases.
  - Consultation with the Confederation and the SFBC on the strategy as part of the crisis organisation.

Intensive phase after Lehman collapse

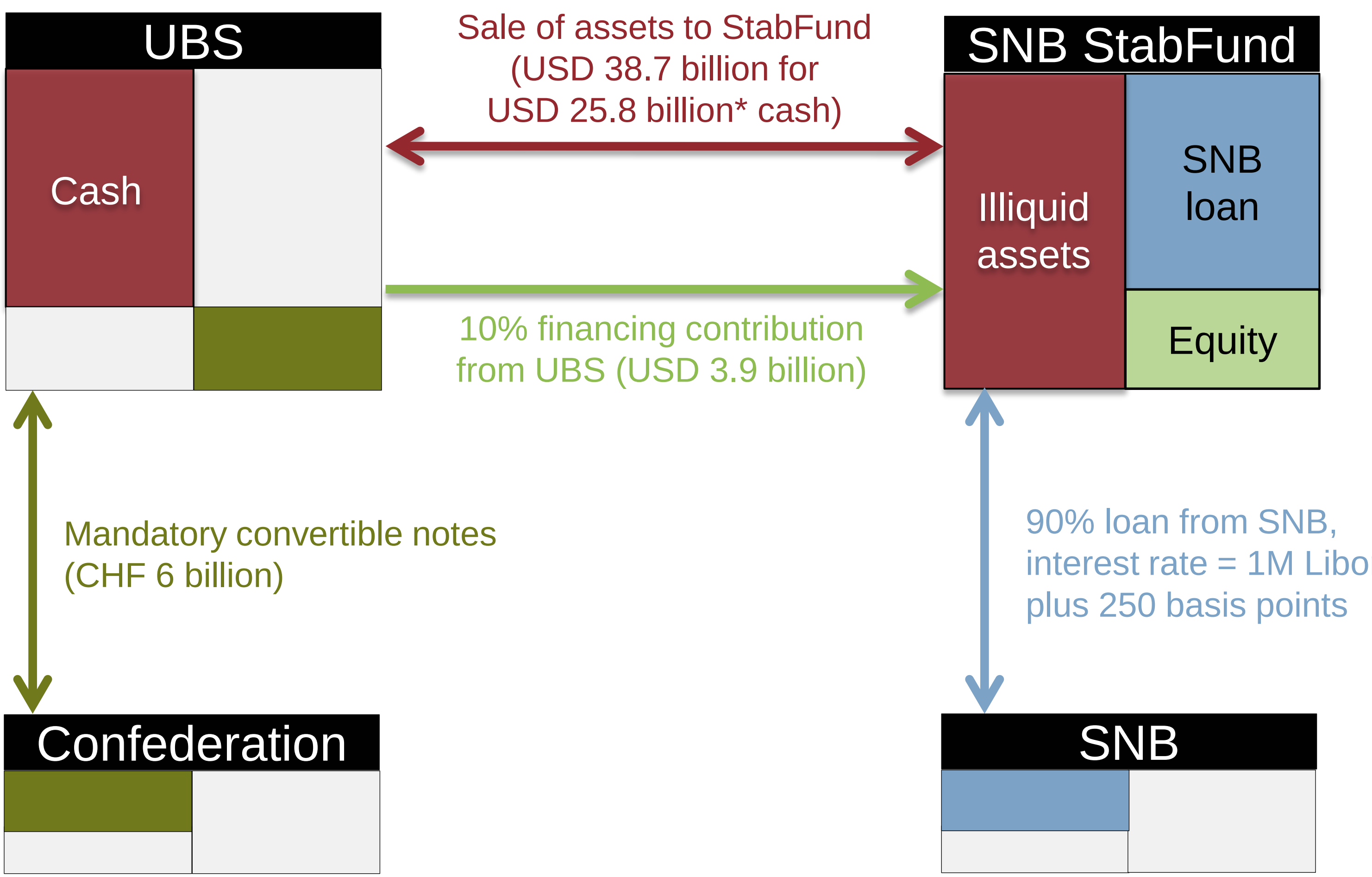
- Situation at UBS poses a risk to financial stability in Switzerland and globally.
- Details of package of measures worked out in close collaboration with UBS.
- Working against the clock to prevent impending illiquidity.
- Legal assessment of legitimacy (from a central bank law perspective) of the SNB’s involvement in the package of measures.

Main features of package of measures

Objective: Stabilisation of UBS by strengthening its capital base and liquidity, and by reducing its balance sheet risks.

- The Confederation subscribes to mandatory convertible notes in the amount of CHF 6 billion to strengthen UBS's capital base.
- UBS's solvency, which is secured by this move, serves as a prerequisite for the SNB's liquidity assistance in its role as lender of last resort.
- Purchase of UBS assets by the SNB for max. USD 60 billion; prices as at 30 September 2008.

Specifics of package of measures



* Corresponds to overall portfolio less contingent liabilities and UBS financing contribution (cf. slide 19).
The proportions depicted above do not reflect the actual proportions.

Emergency liquidity assistance provided via stabilisation fund (StabFund)

- StabFund extends beyond traditional liquidity assistance due to the transfer of risk.
- Liquidity aspect takes precedence for following reasons:
  - Exchange of illiquid assets for liquid assets (cash).
  - According to the SFBC, UBS was solvent.
  - Recapitalisation of UBS by the Confederation.
- SNB liquidity assistance secured by:
  - Careful valuation of illiquid assets (by external experts).
  - UBS injection of capital into StabFund of 10% of the assets serves as primary loss protection.
  - SPV fully owned by the SNB; its assets serve as loan collateral.

Further features of StabFund solution

- The interest paid on the SNB loan to the StabFund is the one-month Libor plus 250 basis points.
- Term of loan is 8 years (extension to 12 years possible).
- UBS has option to purchase SPV after full repayment of SNB loan.
- Any remaining equity will be divided as follows: the first USD 1 billion shall accrue to the SNB, the rest will be split equally between the SNB and UBS.
- Secondary loss protection for the SNB in the event of a loss on the loan is provided by the warrant to purchase 100 million UBS shares at nominal value (10 cents).

Objective achieved with announcement: UBS and consequently Swiss financial system stabilised

- Reduction in balance sheet risks, liquidity injection and increase in equity combine to stabilise UBS and strengthen confidence.
- Threat to Swiss financial system and Swiss economy is averted.

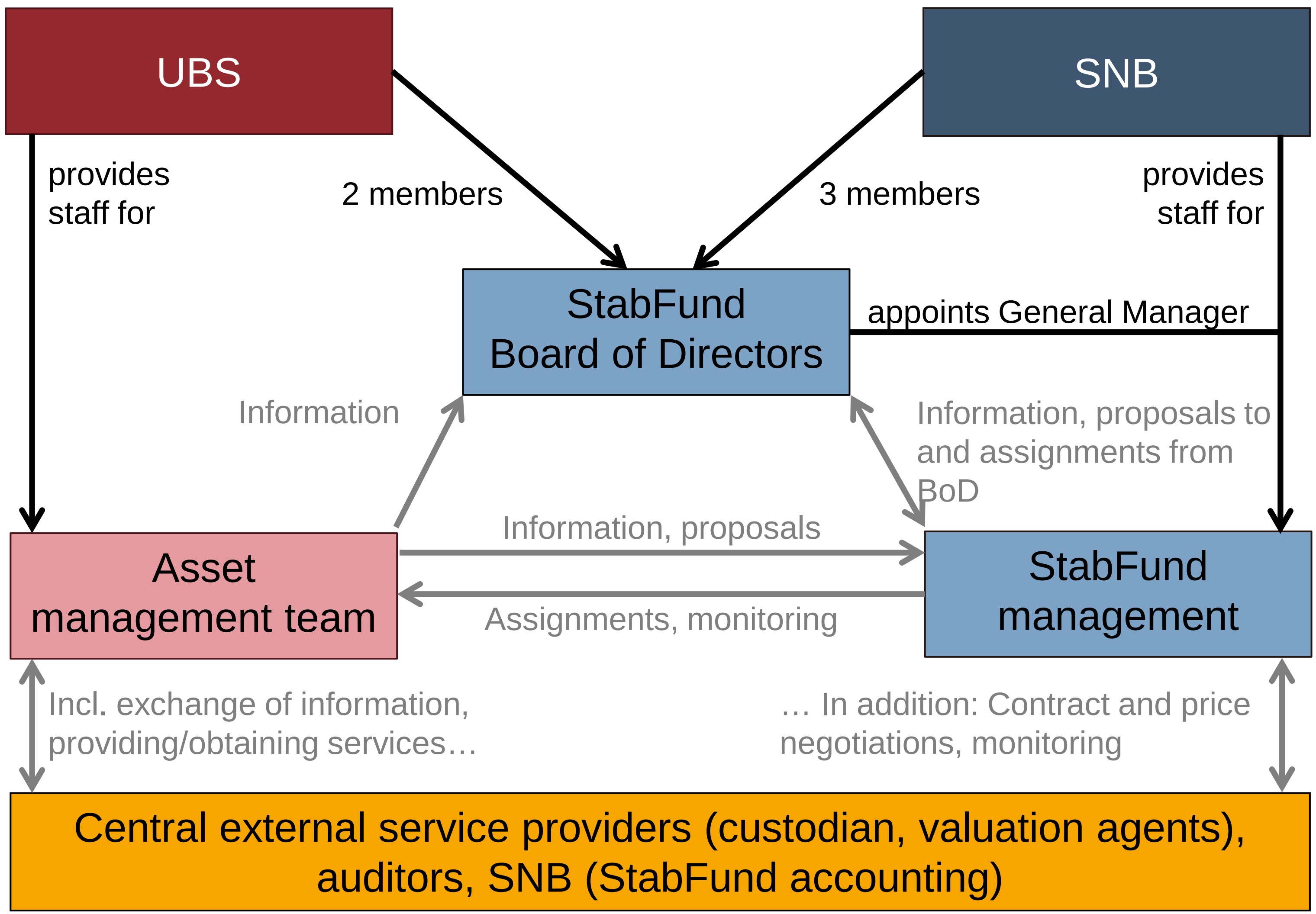
The hard work begins

- Implementation of announced measures poses major challenges:
  - Legal requirements and organisational structure
  - Selecting and contracting custodian and valuation agents
  - Pricing and transfer of assets
  - Refinancing in US dollars
  - Accounting and risk management
  - Asset management

Laying the legal foundations

- Political opposition to the SPV's originally planned domicile on the Cayman Islands.
- Intensive search for Swiss alternative.
- In the end: SNB StabFund Limited Partnership for Collective Investment.
- Creation of several sub-companies to manage the acquired assets in different countries.
- Ensuring tax exemption.
- Drawing up contracts with external service providers.

Organisational structure of StabFund

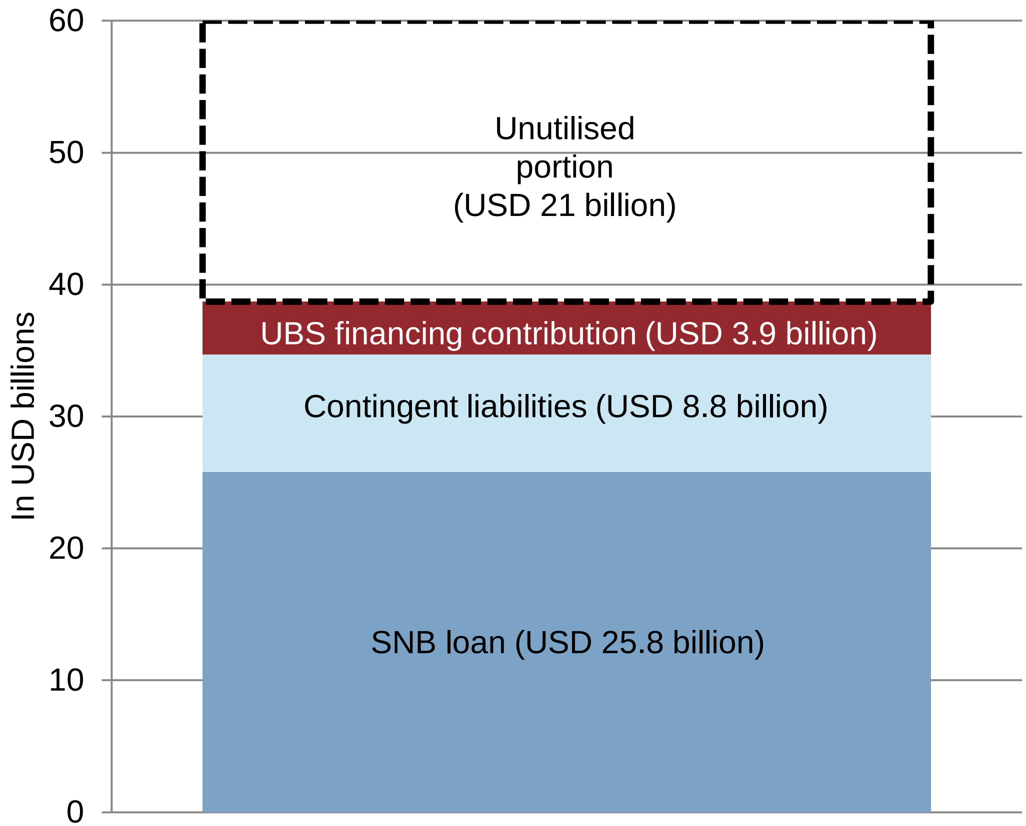


Transfer of assets and setting of prices

- Pricing:
  - External valuation (6 valuation agents, over 5,000 portfolio positions valued as at 30 September 2008).
  - Transfer of assets and contingent liabilities amounting to USD 38.7 billion; discount of approx. USD 1 billion on valuation in UBS balance sheet.
- Transfer:
  - Three tranches between December 2008 and April 2009.
  - Electronic and physical delivery to custodian.

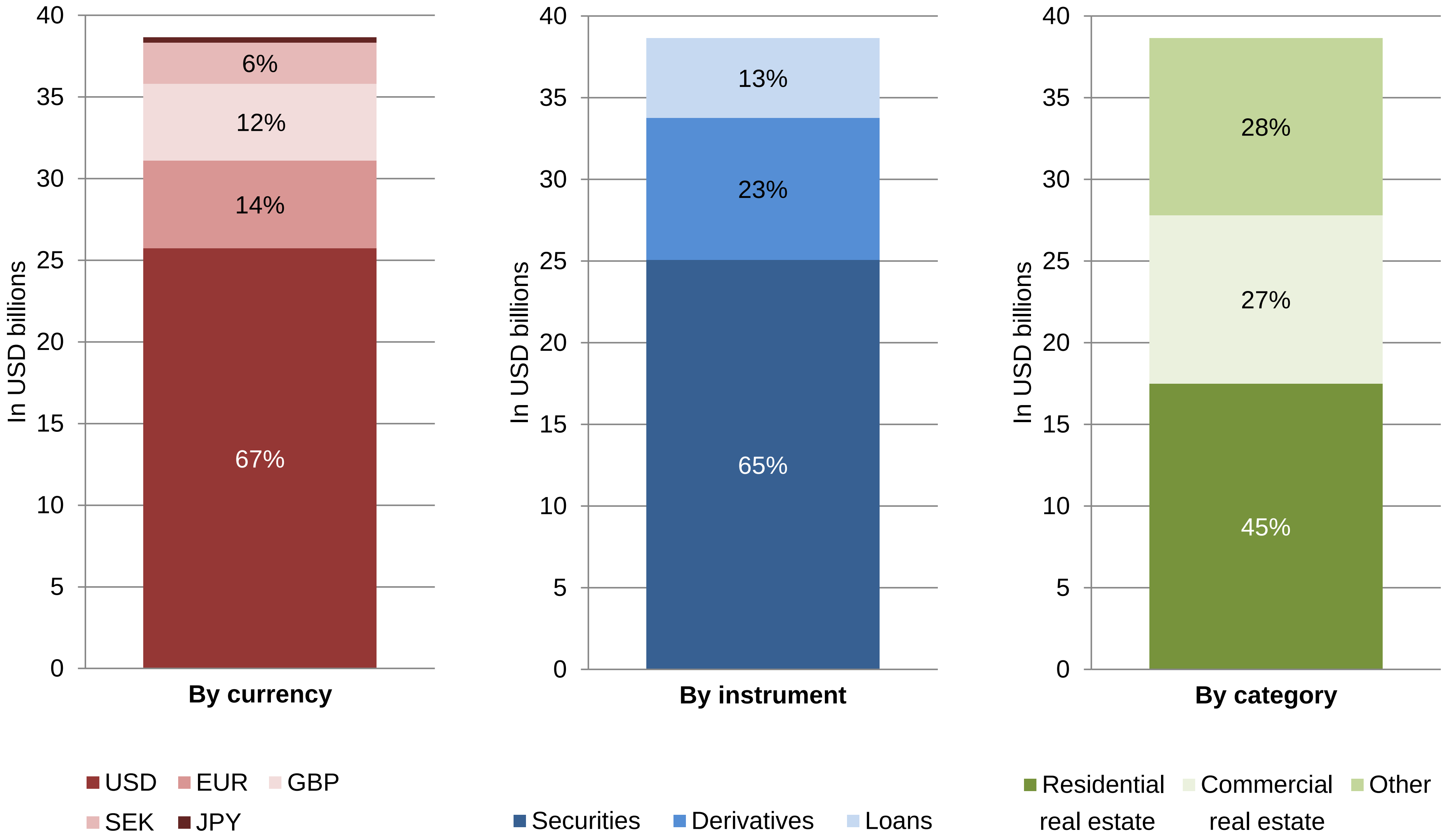
Original parameters and risks acquired

Originally max. USD 60 billion



- Assets worth USD 38.7 billion transferred.
- UBS financing contribution is 10% of purchase price.
- SNB risk consisted of loan and contingent liabilities.

Composition of portfolio



Refinancing and balance sheet risks

- Refinancing the foreign currency loan to the StabFund:
  - Firstly, by making use of the existing USD swap arrangement with the US Federal Reserve.
  - Next, by issuing USD Bills via the SNB.
  - Finally, by financing at the expense of foreign exchange reserves.
- Significant increase in the SNB’s balance sheet risks:
  - USD 34.7 billion in transferred risks corresponds to roughly one-fifth of the SNB’s balance sheet total at the time.
  - Introduction of group accounting for the SNB (both parent company and consolidated financial statements).

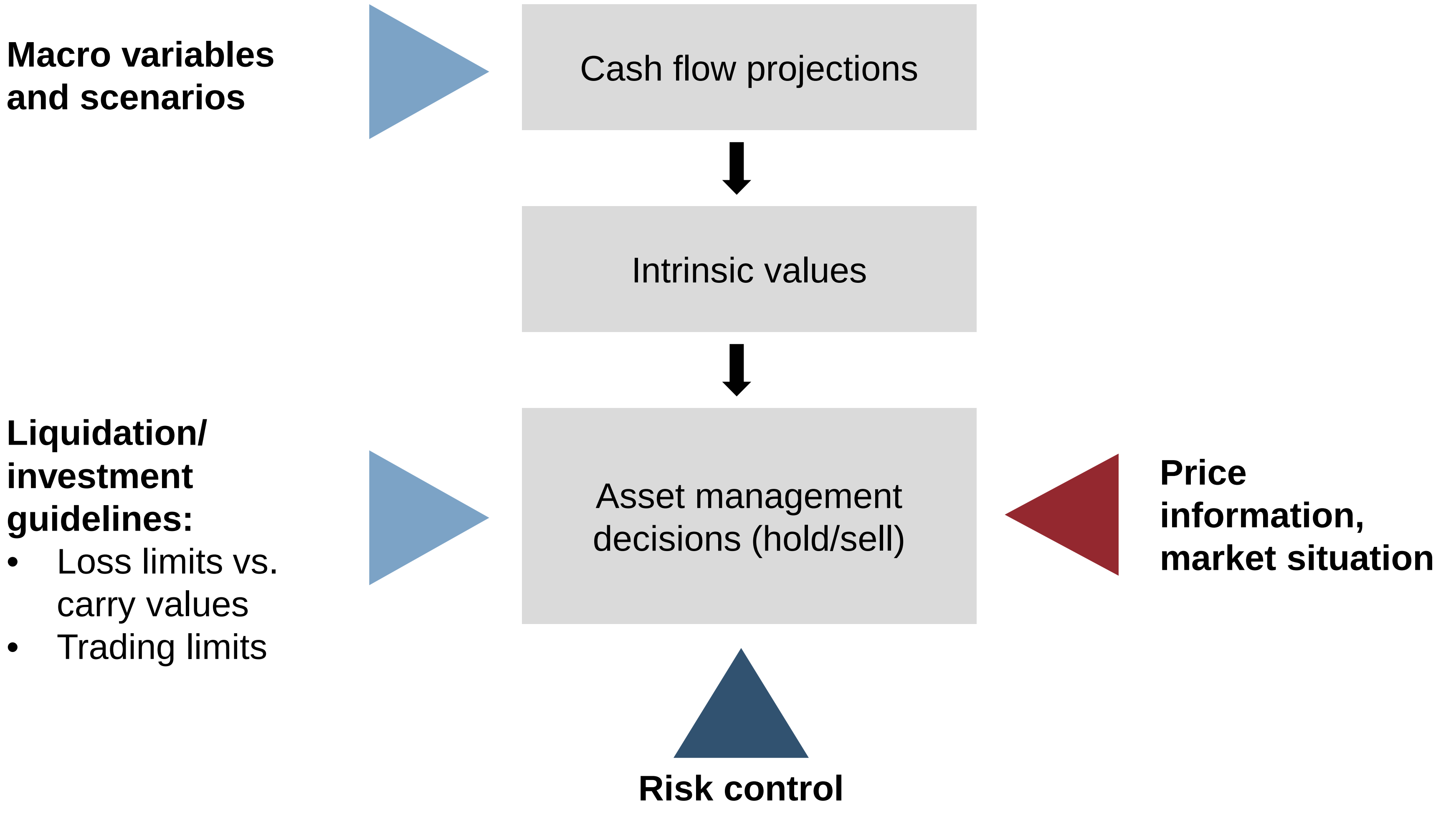
Asset management

- Define strategy for liquidating assets
- Manage complex assets effectively
- Create knowledge base

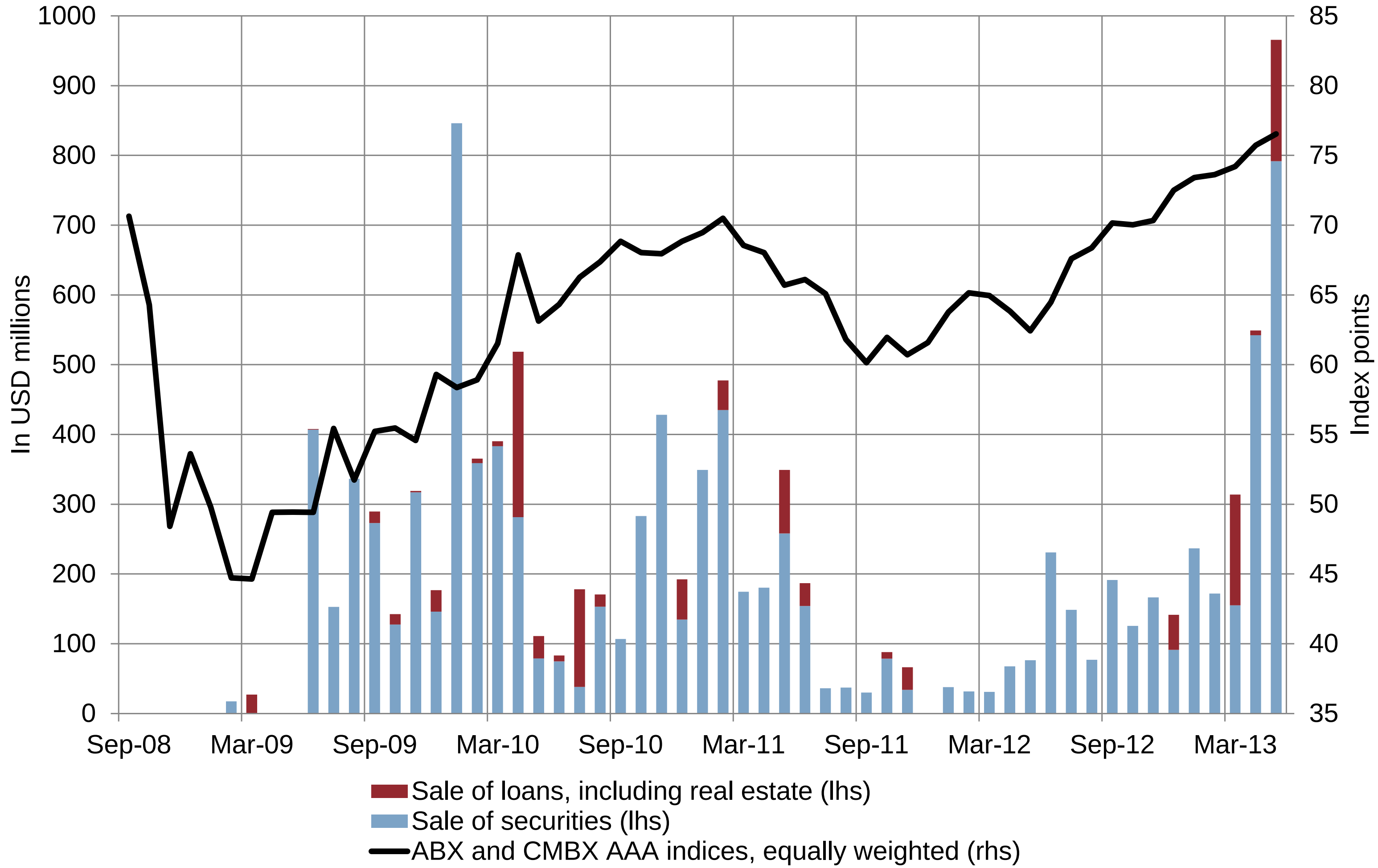
Portfolio management and its results

Marcel Zimmermann

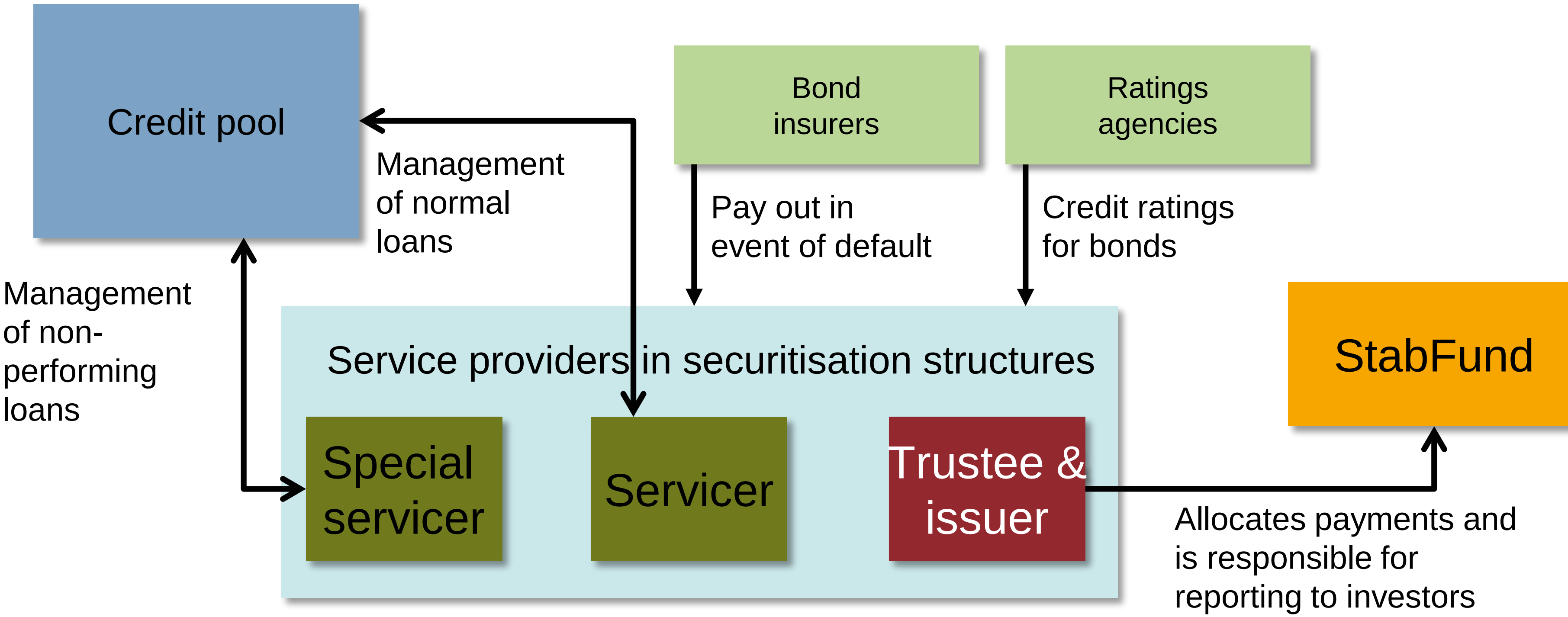
Asset management concept



Asset sales and market performance up to end-May 2013



Management of securities positions

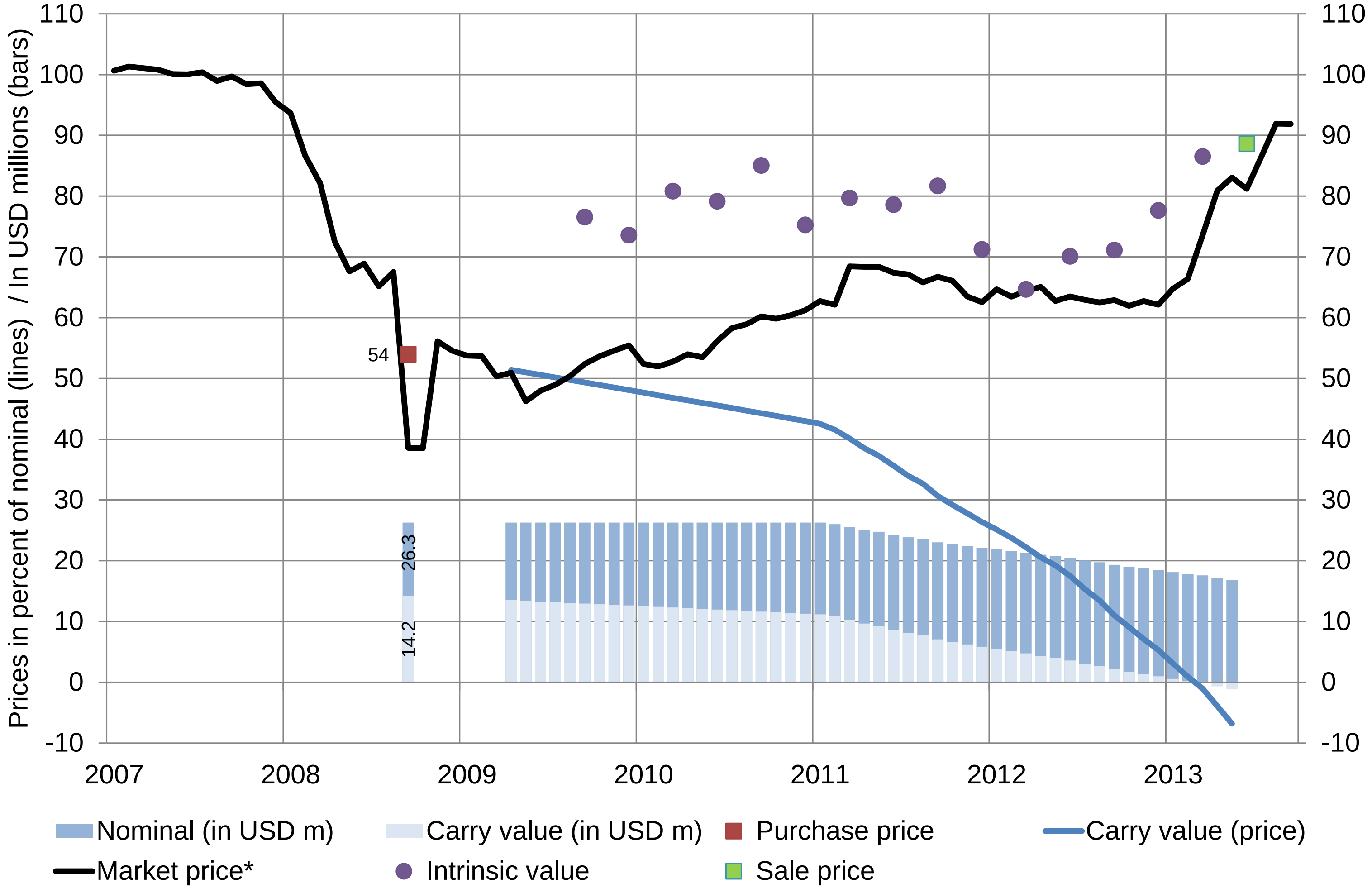


Main tasks of StabFund:

- Valuation of securitisation, using information on the credit pool and any payouts made by the bond insurer.
- Monitoring payment flows.
- Legal action, e.g. in cases of trustee misconduct.

Example of a securitisation sale

Collateral: Variable-rate US residential mortgages with high loan-to-value ratios; issued in 2006 with AAA rating, currently rated as CCC (S&P).



* Source: Bloomberg

Loan portfolio management

Heterogenous loan portfolios:

- Residential mortgage loans in the US, UK and Spain
- Commercial mortgages in the US, Japan and the EU
- Student loan portfolio in the US

Active credit management:

- Loan modifications
- Foreclosures
- Operation and repositioning of properties
- Auctioning of loans/properties
- Establishment of real estate company

Two examples of commercial real estate mortgages

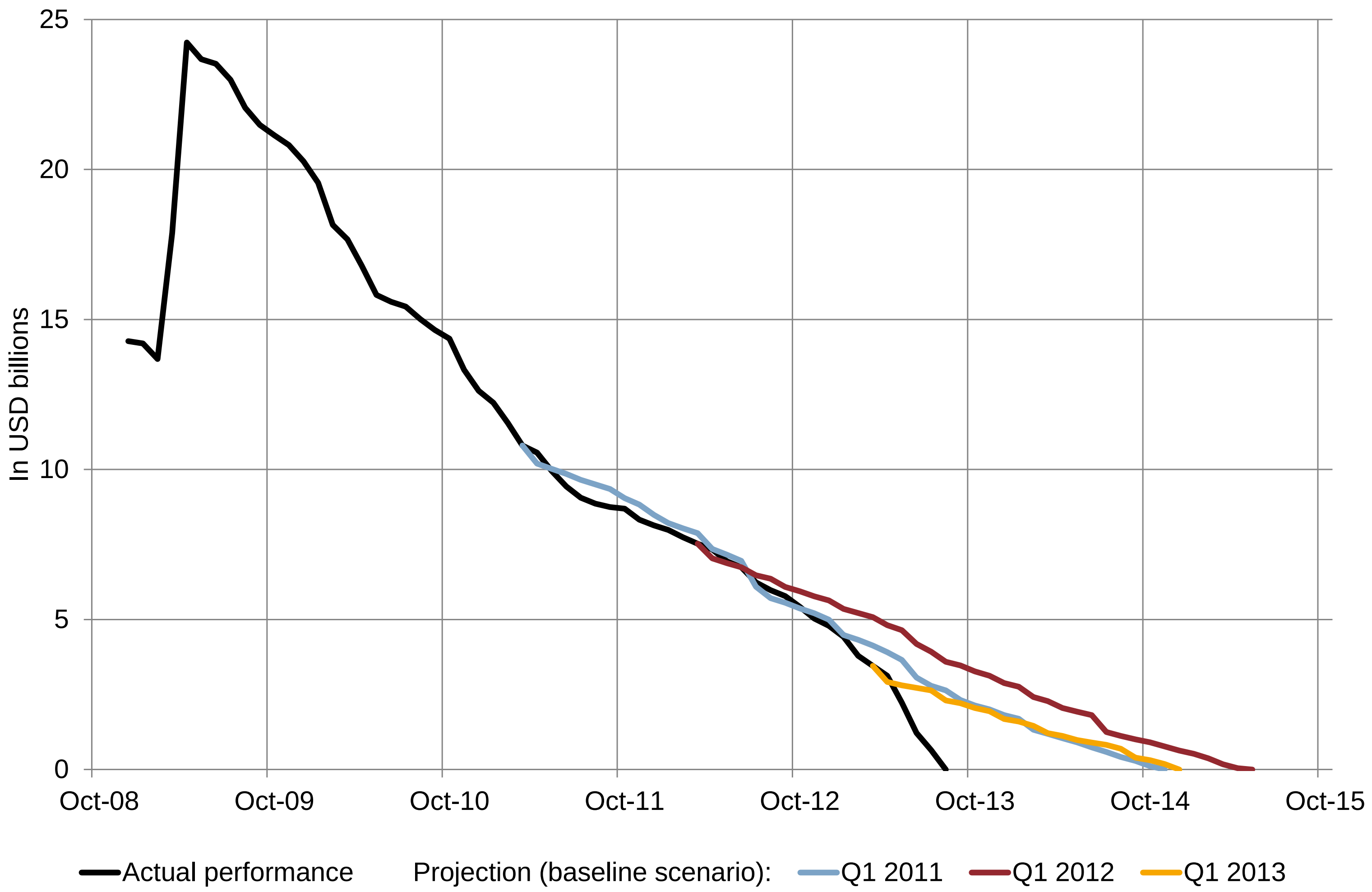
Repositioning – hotel in Florida

- Foreclosure in 2009 and takeover
- Mould-infested rooms refurbished
- Positive cash flow once again as of 2012
- Property sold in August 2013
- Loss minimised compared to a sale in 2009

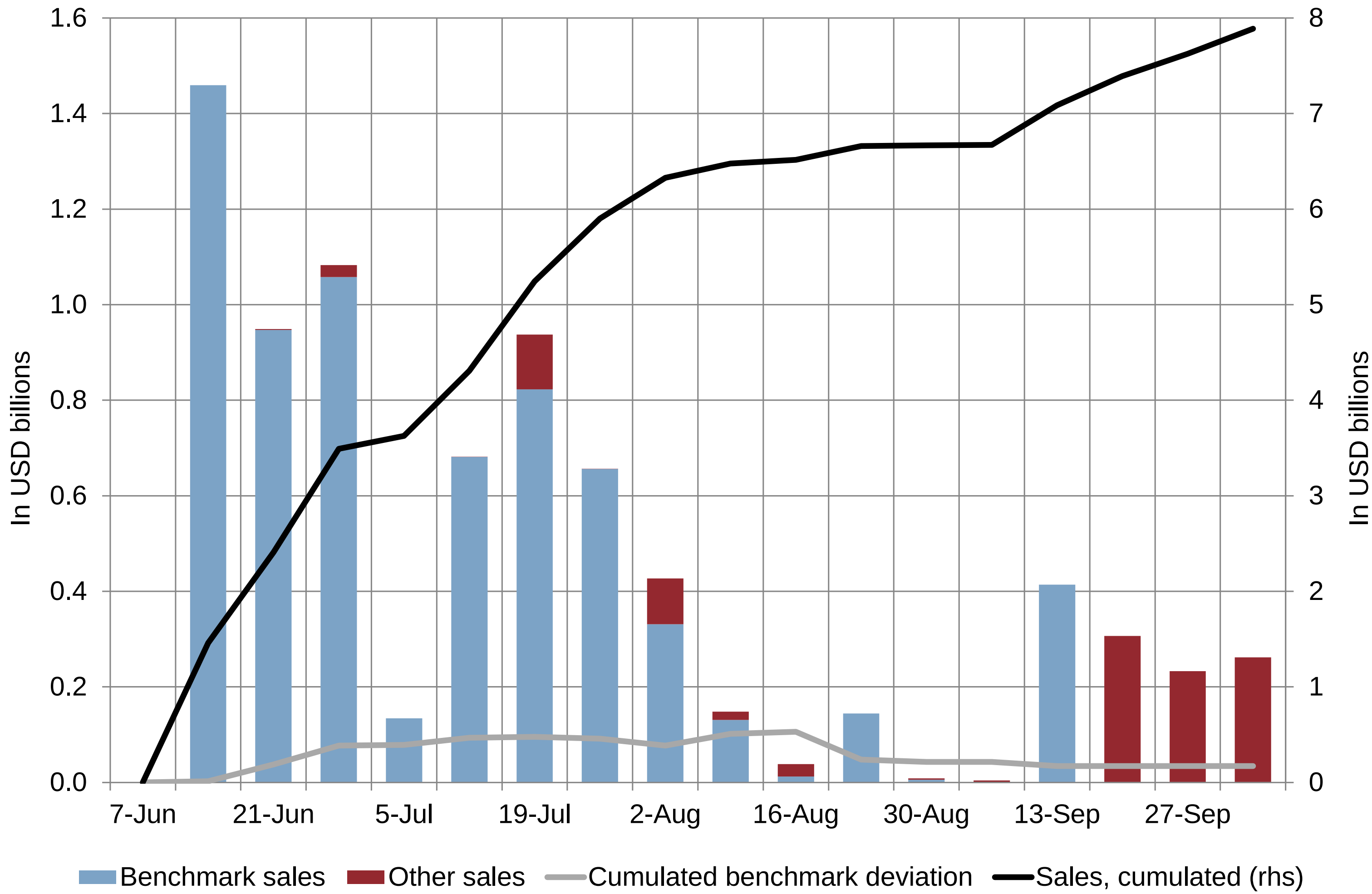
Wait and see – the Sears/Willis Tower loan

- Assumption of loan at a discount on the nominal value
- Loan always paid interest over its lifetime (6.3% fixed)
- Sale of loan above par in May 2013

Loan repayment and cash flow projections

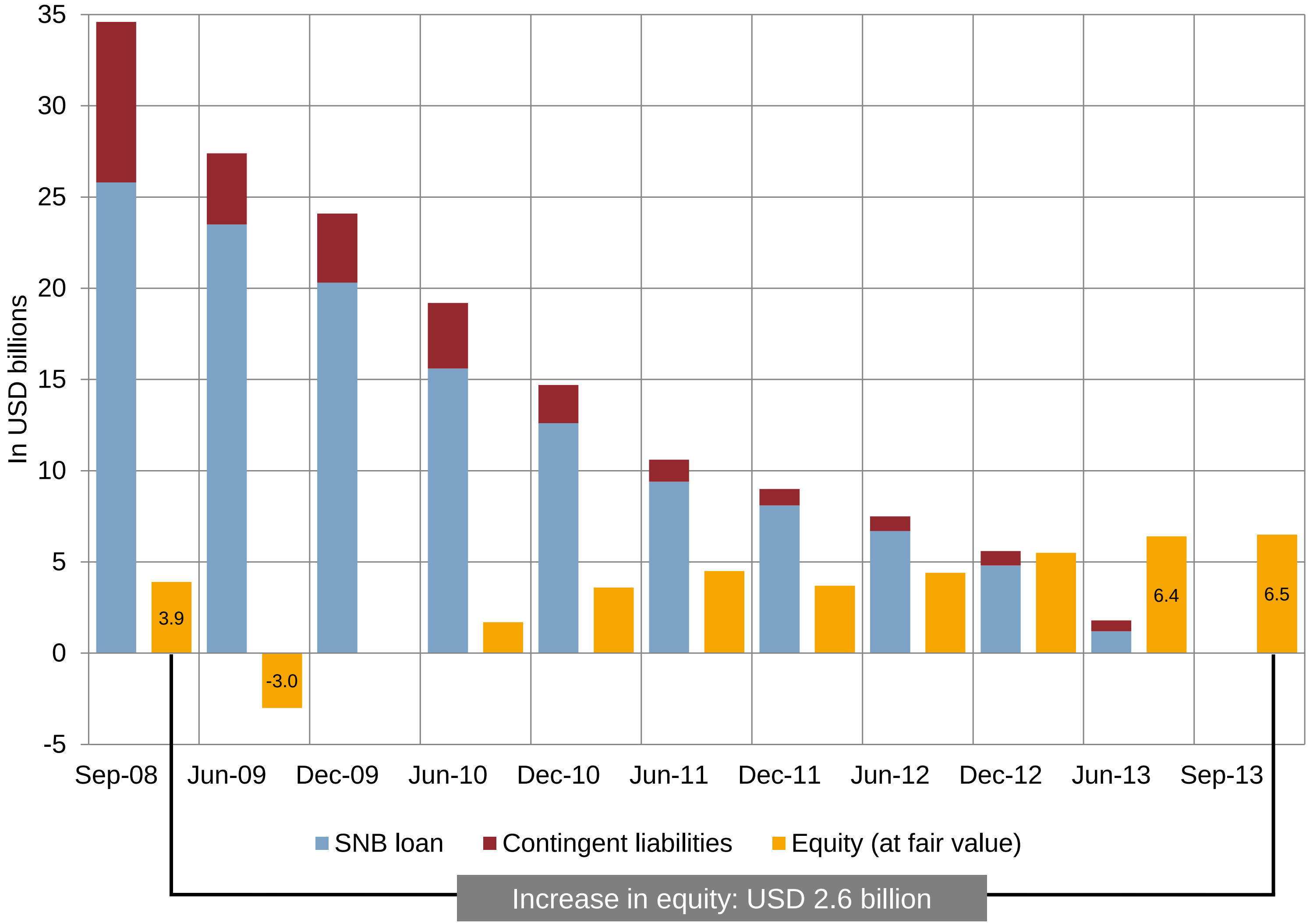


Pickup in sales activity in 2013

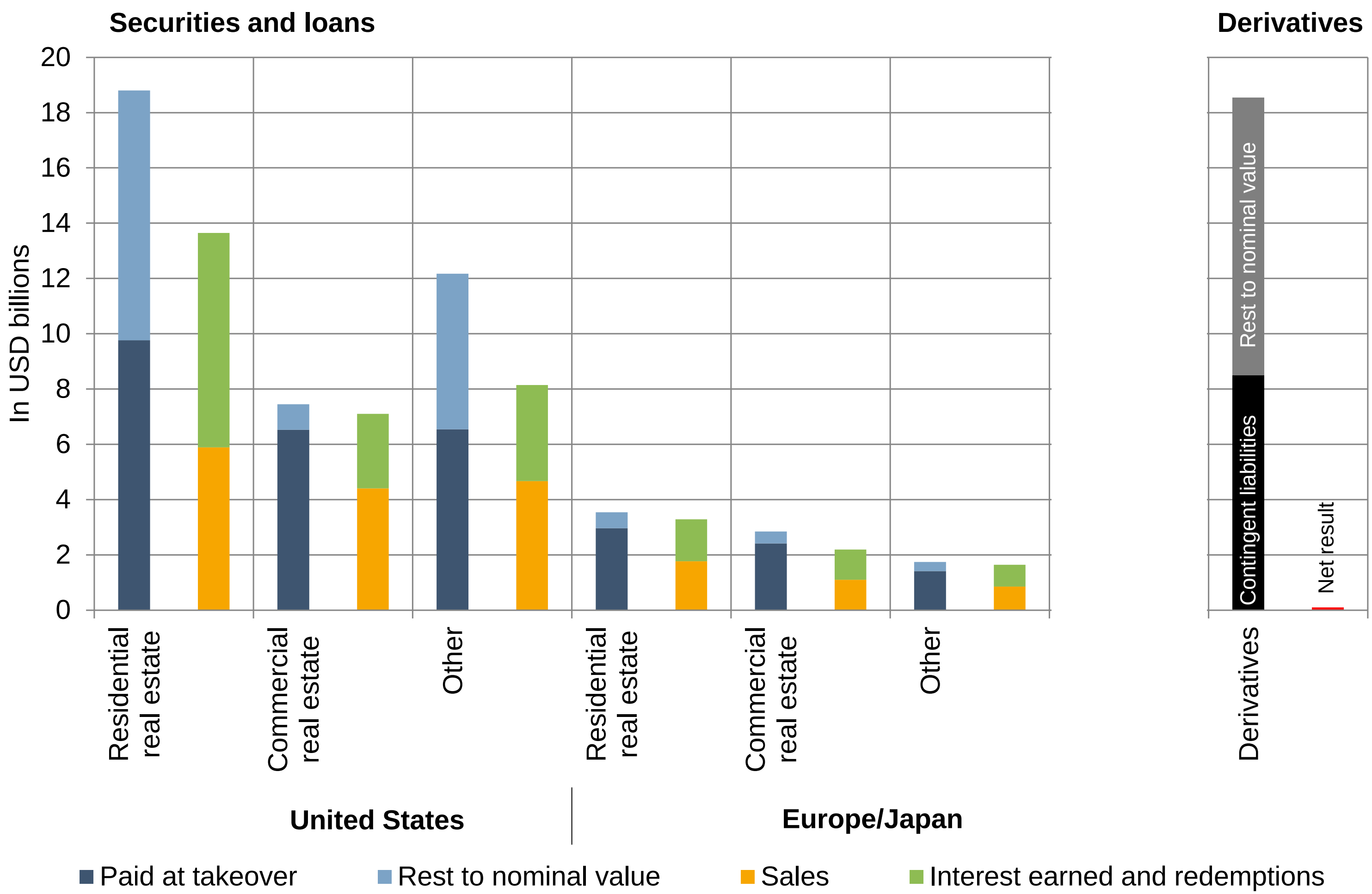


Weekly totals, as per end-week

Developments in risk and equity



Final results, broken down by instrument category and asset class



Conclusion: Purchase by UBS and assessment of transaction

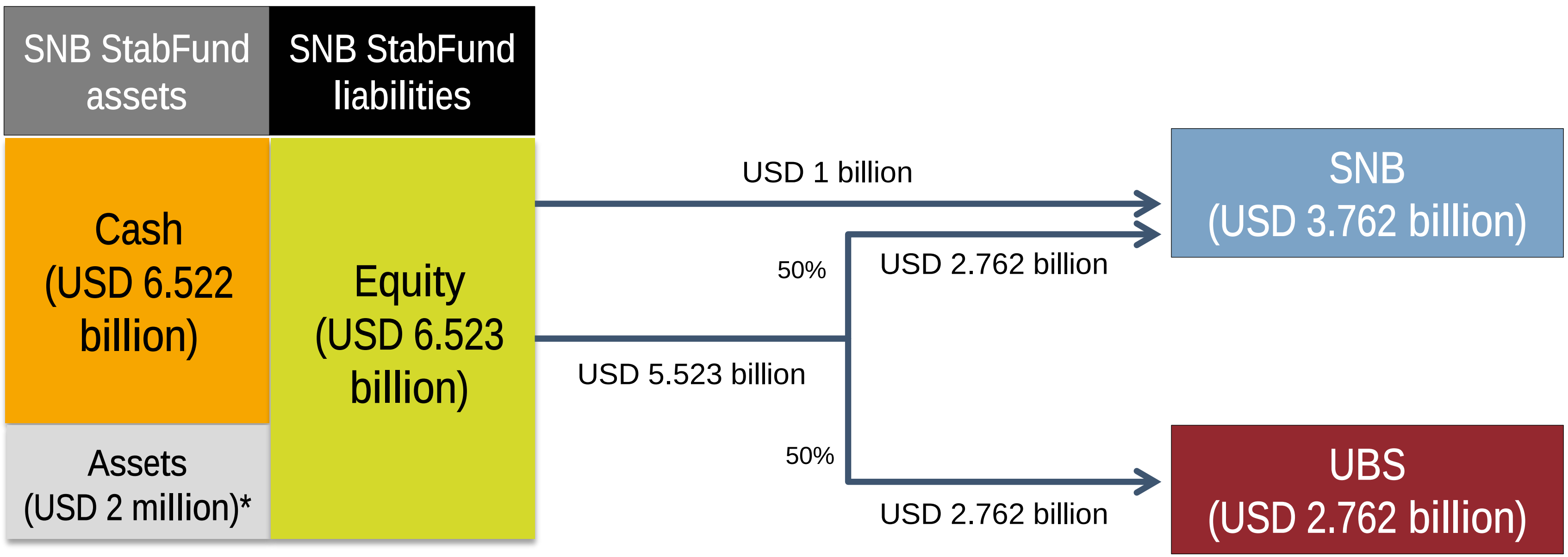
Thomas Jordan

Loan performance and developments in overall risk

In USD billions	Loan	Contingent liabilities	Overall risk
Assets	29.8	8.8	38.7
Equity contribution	–3.9		–3.9
Total as at 30 September 2008	25.8	8.8	34.7
Interest on SNB loan	1.6		1.6
Sales[1]	–15.8	–6.6	–22.4
Repayments	–13.4	–0.3	–13.7
Interest received	–3.9		–3.9
Other factors[2]	–0.9	–1.9	–2.8
Total as at 30 September 2013[3]	–6.5	0.0	–6.5

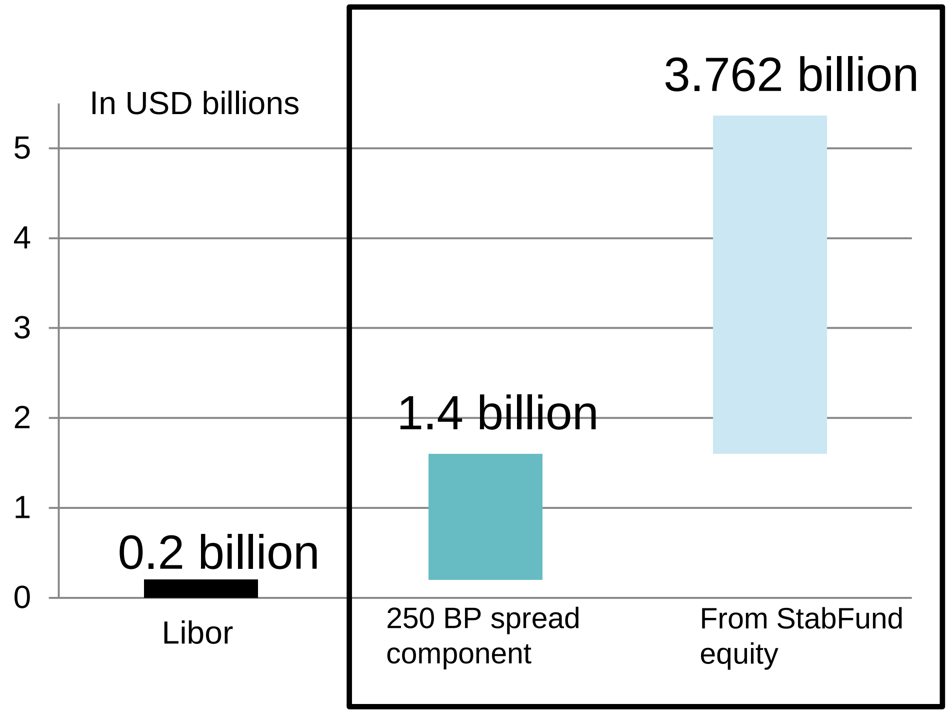
[1] Including active liquidation of CDS (net).
[2] Including operating expenses of USD 242 million, of which a management fee of USD 75 million was paid to UBS.
[3] Including sales of over USD 0.5 billion which were effected in September and not settled until October.

Proceeds from option transaction



* Unsold assets with market value of USD 2 million according to external valuation as at 30 September 2013, the option reference date.
The proportions depicted above do not reflect the actual proportions of the various components.

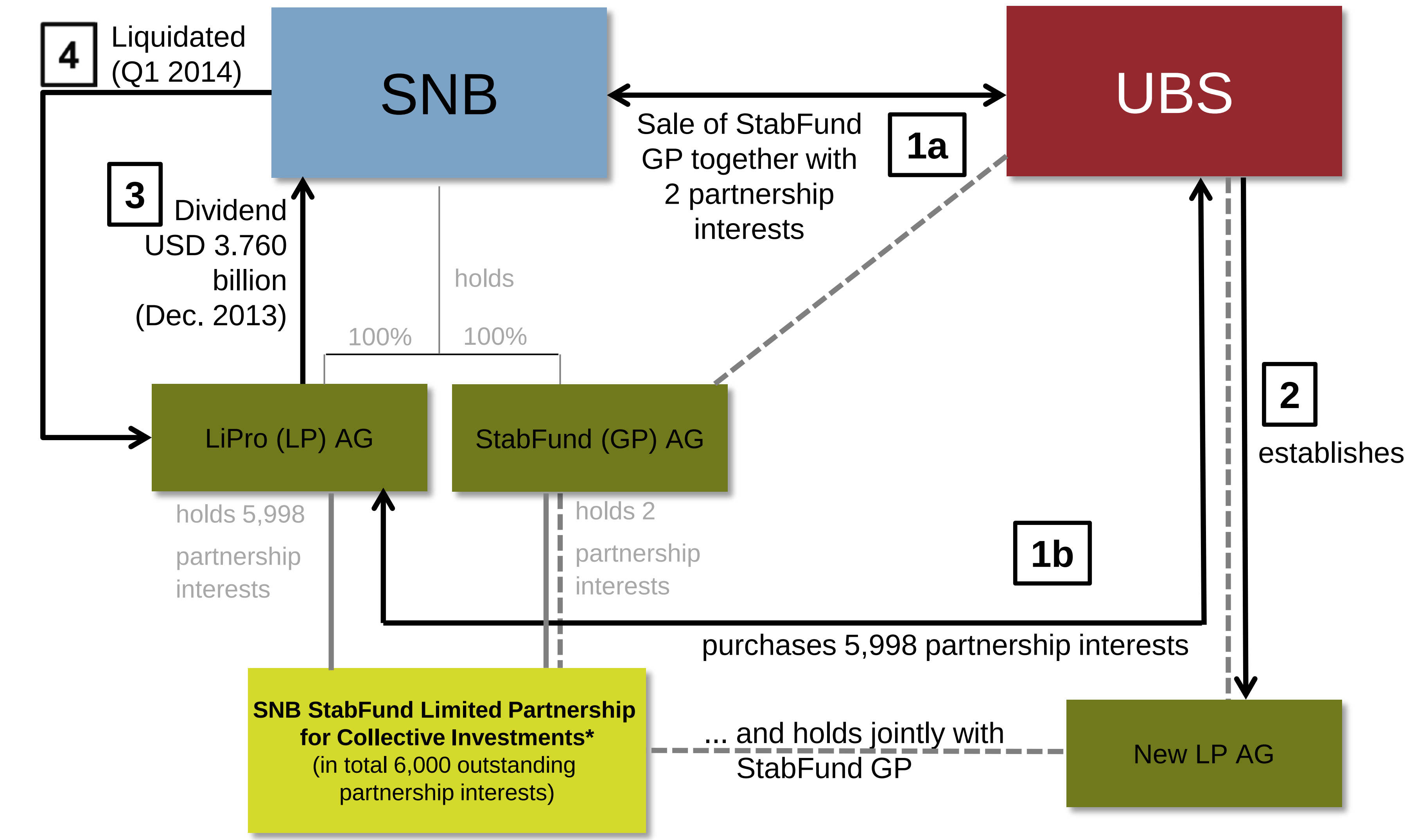
Returns from SNB perspective



Compensation for risk of USD 5.2 billion corresponds to:

- a yield of 8.0% p.a. on average loan.
- a yield of 6.1% p.a. on average risk exposure.

Wind-up of option transaction



Previous control arrangements (SNB) New control arrangements (UBS) Actions

* Simplified presentation excluding foreign subsidiaries of Limited Partnership for Collective Investment.

The end of an arduous journey

- StabFund company successfully wound up:
  - Sooner than expected.
  - No financial loss for the SNB.
  - No troubled assets returned to UBS.
- Factors for success:
  - Market recovery.
  - Liquidation of assets not carried out under time pressure.
  - Assets managed in a disciplined manner.
  - Good collaboration with UBS.

Conclusion

- Objective achieved: UBS and Swiss financial system stabilised.
- Financial success is not reason enough to endorse government bailout of banks.
- SNB liquidity assistance only provided in absolutely exceptional cases.
- Prevention of recurrence through ‘too big to fail’ legislation and its implementation.

Thank you for your attention.

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