Sonntagszeitung 3 May 2015

Controversy over UBS' Investment Bank

US Department of Justice wants $ 1 billion from the Bank, a major shareholder the spin-off

Basel. When UBS president Axel Weber leads the General Assembly on Thursday, the currency scandal will still be floating over the bank like a black cloud. The US Department of Justice (DOJ) is still mulling over how high the fines for UBS' market manipulations should be. According to well-informed sources, the uncertainty could soon be over.

In May, probably during the week of the 18th, we should hear that UBS will once again have to pay almost one billion francs in fines as a result of the Investment Bank's dealers, and colleagues at other banks, having cheated customers on foreign exchange rates. It is still uncertain whether the fines will come with formal sentencing, which would increase the chance for potential civil lawsuits. It would also penalise UBS in its dealings with the EU regulators and Swiss competition authorities, which also seek to collect a fine.

The reputational risks associated with the above are not the only reason for which the Investment Bank will be a topic of discussion at the AGM. Eric Knight, whose Knight Vinke fund represents about one percent of the shares and is therefore amongst UBS' large shareholders, wishes to raise the question of whether this high-risk business is worth keeping at all, or whether it would not be better to spin it off and then merge it with the investment bank of CS or Deutsche Bank.

The same question was also raised by former CEO Luqman Arnold, Christoph Blocher or, in another way, by former Chairman Peter Kurer. According to UBS' official numbers, the Investment Bank is highly profitable, although in recent years profits have been greatly reduced and the business has repeatedly been plagued by fines resulting from sins of the past. During the financial crisis, UBS almost collapsed as a result of 80 billion francs of write-offs in real estate investment and needed a capital injection in addition to state aid. However, much has happened since then. Most people would agree that risks have been sharply reduced. Profits last year still only amounted to 87 million francs due to substantial fines, but in the previous year the profits amounted to 2.3 billion.

Subsidies from Wealth Management

According to Knight, the issue of profitability cannot be reduced to a question of reported numbers alone. It also raises the question of whether the bank should not focus more on the Wealth Management business and invest its capital there for its growth. Knight only wants to know from the bank what rate is charged to the Investment Bank for internal funding. He claims to have heard from the bank that were the Investment Bank to be spun off, its cost of funding would be much higher. From this he concludes, first, that the Investment Bank is being subsidized with cheap funding from Wealth Management and, secondly, that it would be much better to separate these two businesses.

Knight: "We believe this would lead to a massive revaluation of UBS' shares - with an uplift of 50 to 100 percent compared to the current share price. In our opinion, this is the only hope that shareholders have of recovering the losses incurred in 2008-2009."

According to Sonntagszeitung, UBS wants to hear nothing of this argument. UBS spokesman Marc Hengel says: "Knight fails to recognize that there are synergies between investment banking and wealth management. These include the fact that, as a Group, the bank can refinance itself at low rates. This has nothing to do with a subsidy for the Investment Bank." Both President Weber as well as UBS' CFO have made similar comments in the past.

A spin-off of the Investment Bank would also undermine its position in Wealth Management. Hengel: "We have sharply reduced the size of the Investment Bank. What we have kept reflects the needs of customers. We could not be the number one in Wealth Management if we had no Investment Bank." Knight, however, is not convinced by the arguments. He therefore wants to ask critical questions at the AGM.

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