

The 2008 crisis and the rescue of UBS — overview and summary

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On the morning of Thursday, 16 October 2008, before the markets opened, the Federal Council, the Swiss National Bank and the Swiss Federal Banking Commission announced a package of measures designed to stabilise the Swiss financial system and to restore confidence in it.¹ Behind the institutional language stood a simple fact that few Swiss citizens had thought possible a year earlier. The largest bank of the country, whose head offices stood on the Bahnhofstrasse in Zurich and the Aeschenvorstadt in Basel, could no longer carry the losses of its American investment banking business without the help of the state. The Confederation subscribed CHF 6 billion of mandatory convertible notes issued by UBS, while the National Bank created a special purpose vehicle that was to take over up to USD 60 billion of illiquid assets from the bank's balance sheet.² On the same day Credit Suisse, the second of the two big banks, announced that it had raised CHF 10 billion from private investors and would manage without public money.³

The rescue of UBS, the central episode of the Swiss experience of the global financial crisis, shaped the Zurich financial centre more deeply than any event since the Second World War. It ended the belief, widely held in Switzerland, that the combination of a conservative domestic banking culture and a strict supervisory authority protected the country from the excesses of Anglo-American finance. It exposed how far the franchise that had been built on Swiss private banking had come to finance, through the balance sheet of a single group, a trading operation in London, New York and Stamford whose risks the bank's own management did not understand. It also gave the Swiss state a new role. Before 2008, the Confederation had never recapitalised a large bank, nor had the National Bank ever bought risk assets on such a scale. After 2008, both institutions carried the memory of an operation that succeeded financially but that nobody wished to repeat.

This chapter follows the story in five stages. It begins with the growth strategy that UBS adopted in 2005 and 2006, including the creation of the internal hedge fund Dillon Read Capital Management, and with the mechanics of the positions in American mortgage securities that produced the losses. It then examines the write-downs of 2007 and 2008, the bank's own report to its shareholders of April 2008, the capital raisings from sovereign investors and the changes at the top of the bank. The third and central part describes the rescue of 16 October 2008: the mandatory convertible notes, the SNB StabFund, the constitutional basis in emergency law and the parliamentary approval in December 2008, together with the parallel decision of Credit Suisse to rely on private capital. A fourth part follows the unwinding of the rescue, from the sale of the Confederation's stake in 2009 to the repurchase of the StabFund by UBS in November 2013. The last part asks who was held to account, through the reports of the Banking Commission, FINMA and the Parliamentary Control Committees, through the shareholder vote on discharge in 2010, through new rules on remuneration and through the popular initiative "against rip-off salaries" of 2013, before identifying the lessons that later informed the too-big-to-fail legislation discussed in chapter G.IV. The American tax investigations that ran in parallel, and that ended banking secrecy for foreign clients, belong to chapter G.III and are mentioned here only where they touch the rescue.

1 Notes

1. Swiss Federal Council, press release "Bundesrat beschliesst Massnahmen zur Stärkung des Schweizer Finanzsystems", 16 October 2008, <https://www.admin.ch/de/nsb?id=22019>. The release records that the Federal Council, the SNB and the Federal Banking Commission (EBK) had jointly adopted the package. ↩
2. Parliamentary Control Committees (GPK) of the National Council and the Council of States, Die Behörden unter dem Druck der Finanzkrise und der Herausgabe von UBS-Kundendaten an die USA, report of 30 May 2010, BBl 2010 3099, <https://www.parlament.ch/centers/documents/de/bericht-gpk-ns-ubs-kundendaten-usa-2010-05-30-d.pdf>. The report summarises the package as the transfer of illiquid assets into an SNB-financed vehicle combined with the subscription of a mandatory convertible bond by the Confederation. ↩
3. Business Standard (Bloomberg), "Switzerland bails out UBS; Credit Suisse raises funds", 17 October 2008, <https://www.business->

standard.com/amp/article/finance/switzerland-bails-out-ubs-credit-suisse-raises-funds-108101701074_1.html. ↩

2 Conclusion

The rescue of UBS in October 2008 was the product of a strategy that the bank had adopted with open eyes and of a risk management system that did not see what it was meant to see. The growth plan of 2005 and 2006 sought to close the gap to the leading American investment banks in fixed income, while the creation of Dillon Read Capital Management added an internal hedge fund to the group's balance sheet. The super senior tranches that UBS accumulated appeared almost riskless in the bank's models, earned a thin carry at internal funding costs and vanished from the risk reports once they were hedged, often only partially. When the American housing market turned, the bank lost around USD 50 billion. It raised close to CHF 30 billion from Singapore, the Middle East and its own shareholders before it had to turn to the state.

The rescue itself combined two instruments that were rarely used together elsewhere. The Confederation subscribed CHF 6 billion of mandatory convertible notes with a coupon of 12.5 per cent, on the basis of an emergency ordinance founded directly on the Constitution. The National Bank financed the StabFund, which bought USD 38.7 billion of illiquid assets at prices below their book value. Both operations ended with a profit. The Confederation sold its stake in August 2009 with a gain of about CHF 1.2 billion, whereas the National Bank earned about USD 5.2 billion from the StabFund before UBS repurchased it in November 2013. Credit Suisse chose the private route, relying on investors from Qatar and Saudi Arabia, and thereby set out on a path that ended fifteen years later.

Accountability remained incomplete. The Banking Commission found a grave violation of the requirement of proper business conduct without sanctioning individuals, FINMA acknowledged shortcomings in supervision without identifying specific misconduct, and the Control Committees criticised the governance of the Federal Council while accepting the substance of the rescue. Although the shareholders refused discharge for 2007, the board decided not to sue, and no one else brought a claim either. The political response came through general rules: a FINMA circular on remuneration in 2010, the Minder initiative in 2013 and the too-big-to-fail legislation of 2011. For Zurich, 2008 marked the moment at which the largest bank of the financial centre depended on the state, and at which the state resolved that this should never happen again.

3 In five sentences

1. Between 2005 and 2007 UBS pursued a growth strategy in fixed income that led it, through its investment bank and the internal hedge fund Dillon Read Capital Management, to accumulate some USD 50 billion of super senior CDO tranches that its risk models treated as almost riskless.
2. The resulting write-downs of around USD 50 billion forced the bank to raise capital from GIC, a Middle Eastern investor and its own shareholders, and led to the replacement of its chief executive Peter Wüfli in 2007 and of its chairman Marcel Ospel in 2008.
3. On 16 October 2008 the Confederation subscribed CHF 6 billion of mandatory convertible notes under an emergency ordinance based on Articles 184 and 185 of the Constitution, while the National Bank's StabFund took over USD 38.7 billion of illiquid assets. Credit Suisse avoided state aid by raising capital from Qatari, Saudi and other investors.
4. Both parts of the rescue ended with a profit for the public sector, about CHF 1.2 billion for the Confederation in 2009 and about USD 5.2 billion for the National Bank when UBS bought back the StabFund in November 2013.
5. The reports of the Banking Commission, FINMA and the Parliamentary Control Committees, the shareholders' refusal of discharge for 2007, the FINMA remuneration circular and the Minder initiative marked the reckoning with the crisis, whose lessons on capital, size and crisis management shaped the too-big-to-fail regime of 2011.

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