UBS Group AG: Issuing Senior Unsecured Debt to Strengthen TLAC

Since September 2015, UBS Group AG has regularly issued senior unsecured debt to meet its total loss-absorbing capacity requirement (TLAC). As a general rule, Scope rates senior unsecured debt specifically allocated to or eligible for TLAC and/or MREL at least one notch below the issuer credit-strength rating (ICSR) – whether issued by a top holding company or an operating bank of the group. We rate the TLAC eligible senior unsecured debt of UBS at A, one notch below its ICSR of A+.

The TLAC eligible senior unsecured debt issued by UBS has loss-absorbing features. The Swiss Resolution Authority may write down and cancel and/or convert into equity the principal amount of the securities. Due to restructuring measures, the payment of principal and/or interest on the securities may also be deferred.

Scope considers that a credible resolution and recovery regime should inherently strengthen the stability and predictability of ICSRs over time – as insolvency scenarios become more remote. This is especially the case when accompanied by enhanced supervisory rules and practices as in Switzerland.

TLAC requirement comprising of going and gone concern requirements is being phased in

Under the revised Swiss Systemically Relevant Bank (SRB) framework which became effective 1 July 2016 and which is being phased in until end-2019, UBS will need to fulfil both going concern and gone concern requirements; together comprising the group's TLAC requirement. Going concern capital requirements consist of a minimum capital requirement of 14.3% of risk-weighted assets (RWAs), of which 10% must be met with CET1 capital and the remainder with high-trigger AT1 instruments; and a leverage ratio of 5%, of which at least 3.5% must be met with CET1 capital and the remainder with high-trigger AT1 instruments. Gone concern requirements mirror going concern requirements, i.e. 14.3% of RWAs and 5% leverage ratio but may also be met with bail-in debt instruments.

UBS intends to use the four-year phase-in period to fully implement the new requirements. As of end-June 2016, the bulk of the group's gone concern loss-absorbing capacity was comprised of CHF 11.9bn in TLAC eligible senior unsecured debt.

Figure 1: Going and gone concern requirements (fully applied basis)

	Capital and loss-absorbing capacity ratio (%)		Leverage ratio (%)	
	2Q 2016 pro-forma	Jan 2020 requirement	2Q 2016 pro-forma	Jan 2020 requirement
Going concern	17.8%	14.3%	4.2%	5.0%
o/w CET1	*14.2%*	*10.0%*	*3.4%*	*3.5%*
Gone concern	11.5%	14.3%	2.7%	5.0%
Total loss-absorbing capacity (TLAC)	29.2%	28.6%	7.0%	10.0%

Note: Pro-forma figures include transitional arrangements.
Source: Company data, Scope Ratings

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Transitional arrangements

The framework provides for the grandfathering of low-trigger AT1 securities as well as low- and high-trigger Tier 2 securities. Low-trigger AT1 securities qualify as going concern capital until the first call date and thereafter may be used to meet gone concern requirements. Low- and high-trigger Tier 2 securities also qualify as going concern capital until the earlier of their maturity or first call date or 31 December 2019. From 1 January 2020, they may be used to meet gone concern requirements until one year before maturity, with a haircut of 50% applied in the last year of eligibility.

Final gone concern requirements may be lower

Gone concern requirements may be reduced by up to 2% if actions are taken to facilitate recovery and resolvability beyond minimum requirements. In addition, where low-trigger AT1 or Tier 2 capital instruments are used to meet gone concern requirements, such requirements may be reduced by up to 2.86% for the RWA-based requirement and up to 1% for the leverage requirement. The combined reduction for resolvability measures and the use of low-trigger AT1 or Tier 2 securities cannot exceed 5.7% for the RWA-based requirement and 2% for the leverage requirement. When the revised Swiss SRB framework becomes fully effective as of 1 January 2020, UBS aims to operate with a gone concern leverage ratio of less than 4%.

Key features of TLAC eligible senior unsecured debt

As stated clearly in the offering documents, investors in the group's TLAC eligible senior unsecured debt acknowledge, agree to be bound by, and consent to the following:

- the exercise of, any Swiss Resolution Power that results in the write-down and cancellation and/or conversion into equity of the entire, or a portion of the, principal amount of, and/or accrued interest on, the securities,
- the ordering of, any Restructuring Protective Measure that results in the deferral of payments of principal and/or interest under the securities, and
- rights are subject to, and, if necessary, will be altered without consent, including by amending or modifying the securities so as to give effect to any such exercise of any Swiss Resolution Power or any such ordering of Restructuring Protective Measures.

Since 1 January 2016, the Swiss bank resolution regime has been extended to Swiss parent companies of financial groups, such as UBS Group AG. The resolution authority has broad statutory powers, including ordering Protective Measures, opening Restructuring Proceedings (and any Swiss Resolution Power in connection therewith), and instituting liquidation proceedings. Protective Measures include the power to instruct or change management, limiting or closing business activities and ordering a moratorium or deferral of payments.

The Swiss Resolution Authority retains significant discretion. It may consider factors such as the results of operations, financial condition, liquidity profile and regulatory capital adequacy when determining whether to exercise any Swiss Resolution Power.

View on bank holding companies

While less widespread than in the US banking system, some European banking groups have holding company (HC) structures – notably in the UK, Switzerland as well as in some Benelux countries. Scope considers, all things being equal, that as long as there are no grounds in a stress scenario to believe that HC creditors would be treated differently from operating bank creditors, the rating of HC senior unsecured debt with similar terms and conditions as operating bank senior unsecured debt should be the same. This would not be the case in the US, where the regulatory status of bank HCs has been different for many decades. However, in Europe, we take the view that regulators supervise HCs and operating banks as unified entities.

Senior unsecured debt vs. MREL/TLAC eligible senior unsecured debt

Resolvable banks in the UK and Switzerland have been issuing liabilities to meet TLAC and/or MREL requirements. In addition to capital instruments, these include senior unsecured debt issued out of HCs. Since this HC senior unsecured debt is intended for TLAC and/or MREL it would be less remote from a bail-in situation than other senior unsecured liabilities.

As a general rule, senior unsecured debt specifically allocated to or eligible for TLAC and/or MREL would be rated at least one notch below the ICSR – whether issued by a top holding company or an operating bank of the group. This rating differentiation aims to provide investors increased clarity and transparency in assessing the ranking of bank credit risk in an environment of evolving regulations.

At the same time, senior unsecured debt and other unsecured long-term liabilities which are not specifically allocated to, or eligible for TLAC and/or MREL (e.g. outstanding senior debt issued by the operating bank, wholesale deposits), can be placed at the same level as the ICSR for groups in the AAA-BB rating ranges. This takes into account the material level of protection for this category of debt provided by TLAC and/or MREL liabilities as well as resolution funds.

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