



December 20, 2018

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UBS Group AG  
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Zurich, Switzerland

Mr. Thomas Naratil  
President, UBS Americas  
UBS Americas Holding, LLC  
1285 Avenue of the Americas, 14<sup>th</sup> Floor  
New York, New York 10019

Dear Messrs. Ermotti and Naratil:

On July 1, 2018, the Board of Governors of the Federal Reserve System (Board) and the Federal Deposit Insurance Corporation (FDIC) (together, the Agencies) received the annual resolution plan submission (2018 Plan) of UBS Group AG (UBS) required by section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, as amended (Dodd-Frank Act), 12 U.S.C. § 5365(d), and the jointly issued implementing regulation, 12 CFR Part 243 and 12 CFR Part 381 (Resolution Plan Rule). The Agencies have reviewed the 2018 Plan taking into consideration section 165(d) of the Dodd-Frank Act, the Resolution Plan Rule, the joint *“Guidance for 2018 § 165(d) Annual Resolution Plan Submissions By Foreign-based Covered Companies that Submitted Resolution Plans in July 2015”* (FBO Guidance), prior written

communications provided to UBS by the Agencies in August 2014; February 2015; June 2016 (2016 Letter); and March 2017(2017 Letter)<sup>2</sup>; as well as supervisory information available to the Agencies.

In addition, the staff of the Agencies met with UBS during the development of its 2018 Plan to answer questions regarding the Resolution Plan Rule and the FBO Guidance. Agency staffs also provided written FAQs that were made public on the Agencies' websites.

In July 2018, the Agencies received UBS's 2018 Plan and began their review to determine whether the 2018 Plan satisfies the requirements of section 165(d) of the Dodd-Frank Act and the Resolution Plan Rule. The Agencies also assessed whether the 2018 Plan satisfactorily addressed each of the key vulnerabilities in resolution identified in the FBO Guidance.

In reviewing the 2018 Plan, the Agencies noted meaningful improvements over the resolution plan filed in 2015 (2015 Plan), as described below. Nonetheless, based upon their review, the Agencies have identified one shortcoming in the 2018 Plan, as discussed in section II, below. The Agencies will review UBS's next resolution plan submission, presently due on July 1, 2020 (2020 Plan), to determine if UBS has satisfactorily addressed the shortcoming. If the Agencies jointly decide that these matters are not satisfactorily addressed in the 2020 Plan, the Agencies may determine jointly that the 2020 Plan is not credible or would not facilitate an orderly resolution under the U.S. Bankruptcy Code.

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<sup>2</sup> The 2016 Letter extended the submission date to July 1, 2017 in light of the significant restructuring the firm was then undertaking to come into compliance with the Board's Regulation YY and the impact that certain Regulation YY initiatives were expected to have on the firm's resolution plan and strategy. The 2017 Letter further extended the deadline to July 1, 2018.

## **I. Background and Progress**

Section 165(d) of the Dodd-Frank Act requires certain bank holding companies and each designated nonbank financial company to report to the Agencies the plan of such company for rapid and orderly resolution in the event of material financial distress or failure. With respect to a covered company such as UBS that is organized or incorporated in a jurisdiction other than the United States, the Resolution Plan Rule requires that the company's resolution plan include specified information with respect to subsidiaries, branches, and agencies, and critical operations and core business lines that are domiciled in the United States or conducted in whole or material part in the United States.<sup>3</sup>

Under the Dodd-Frank Act, the Agencies may jointly determine, based on their review, that the plan is “not credible or would not facilitate an orderly resolution of the company under Title 11, United States Code.”<sup>4</sup> For a covered company such as UBS that is incorporated or organized in a jurisdiction other than the United States, rapid and orderly resolution means the reorganization or liquidation of the company's subsidiaries and operations that are domiciled in the United States under the U.S. Bankruptcy Code that can be accomplished within a reasonable period of time and in a manner that substantially mitigates the risk that the failure of the company would have serious adverse effects on financial stability in the United States.<sup>5</sup> Section 165(d) of the Dodd-Frank Act and the Resolution Plan Rule provide a process by which the deficiencies jointly identified by the Agencies in a resolution plan may be remedied.

### *Interaction of U.S. Resolution Planning With Home Country Expectations*

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<sup>3</sup> 12 CFR Part 243.4(a)(2)(i); 12 CFR Part 381.4(a)(2)(i).

<sup>4</sup> 12 U.S.C. § 5365(d)(4). “Covered company,” “critical operations,” and “core business lines” have the meaning given in the Resolution Plan Rule. See 12 CFR Part 243.2(f), (g) & (d); 12 CFR Part 381.2(f), (g) & (d). Other terms including, but not limited to, FMU, RLEN and RCEN that are not otherwise defined herein have the meanings ascribed to them in the Resolution Plan Rule or in the FBO Guidance as appropriate.

<sup>5</sup> 12 CFR Part 243.2(o); 12 CFR Part 381.2(o).

Foreign covered companies, such as UBS, are subject to section 165(d) of the Dodd-Frank Act and the Resolution Plan Rule, as well as the resolvability expectations of their home country. Unlike the Resolution Plan Rule, which focuses on the company's U.S. operations and the impact of their resolution on financial stability in the United States, the home country's focus is on the resolvability of the entire group. The Swiss FINMA is responsible for developing UBS's preferred group resolution strategy, which is currently a single point of entry (SPOE) strategy. Under such a strategy, all of UBS's material operations, including its U.S. operations, would receive necessary support from the foreign parent and would not be required to enter resolution.

The preferred outcome for a failing foreign covered company is a successful home country resolution that prevents risks to financial stability in the United States, and the Agencies continue undertaking various proactive measures to support this objective. However, support from the foreign parent in stress cannot be ensured. The FBO Guidance indicates that the company should assume that the foreign parent would be unable or unwilling to provide sufficient support because the Resolution Plan Rule requires the company to address a situation where it enters bankruptcy in the United States. The Resolution Plan Rule also provides the Agencies with appropriate flexibility to address resolvability concerns specific to a foreign covered company's U.S. operations as cross-border resolution strategies for globally systemic banking firms remain untested. Ultimately, in stress, the Agencies expect to coordinate closely with the home country authorities to maximize the likelihood of a successful home country resolution that prevents risks to financial stability in the United States.

#### *Current Status of U.S. Operations*

UBS reduced its size considerably within the United States following the 2007-2008 financial crisis and in response to the implementation of Regulation YY.<sup>6</sup> UBS's combined U.S. total assets, which include its U.S. branches, were approximately \$372 billion on December 31, 2008<sup>7</sup> and have been reduced to approximately \$184 billion as of June 30, 2018.<sup>8</sup> The assets of the company's top-tier U.S. intermediate holding company, UBS Americas Holding LLC, which is the entity that, under the 2018 Plan, would enter bankruptcy in the United States, were \$136 billion as of June 30, 2018<sup>9</sup> (including the firm's lead U.S. broker-dealer, which shrank from \$253 billion on December 31, 2008<sup>10</sup> to \$56 billion on December 31, 2017<sup>11</sup>).

Beyond requiring the formation of UBS Americas Holding LLC, Regulation YY has had other significant effects on UBS's U.S. operations. UBS Americas Holding LLC organized as a parent to its U.S. subsidiaries, is required to comply with the Board's enhanced prudential standards, which mandate certain capital, liquidity, stress-testing, and risk management standards to ensure safety and soundness. In particular, the company has pre-positioned capital and liquidity in the United States to satisfy these requirements. For instance, UBS maintained a common equity tier 1 capital ratio of 20.9% as of June 30, 2018.<sup>12</sup> In addition, UBS has taken actions to comply with the Board's resolution-related rules regarding clean holding companies, stays of qualified financial contracts, and total loss-absorbing capacity, which include a

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<sup>6</sup> 12 C.F.R. Part 252.

<sup>7</sup> Staff estimate based on publicly available data.

<sup>8</sup> UBS Americas Holding LLC, The Capital and Asset Report for Foreign Banking Organizations—FR Y-7Q, As of June 30, 2018.

<sup>9</sup> UBS Americas Holding LLC, Consolidated Financial Statements for Holding Companies—FR Y-9C, Report Quarter 2018-06-30, Page 13.

<sup>10</sup> UBS Securities LLC and Subsidiaries, Form X-17A-5 – FOCUS Report, As of December 31, 2008, Available at <https://www.sec.gov/search/search.htm>

<sup>11</sup> UBS Securities LLC and Subsidiaries, Form X-17A-5 – FOCUS Report, As of December 31, 2017, Available at <https://www.sec.gov/search/search.htm>

<sup>12</sup> UBS Americas Holding LLC, Consolidated Financial Statements for Holding Companies—FR Y-9C, Report Quarter 2018-06-30, Page 46.

requirement to maintain outstanding a minimum amount of loss-absorbing instruments, including a minimum amount of unsecured long-term debt.

### Changes Made by UBS in Response to Resolution Plan Rule

Following submission of the 2015 Plan, UBS has modified its U.S. resolution strategy and taken important steps to enhance the firm's resolvability and facilitate its orderly resolution in bankruptcy. UBS's current U.S. resolution strategy is regional SPOE in the United States and consists of only UBS Americas Holding LLC entering a bankruptcy proceeding, with resources deployed to recapitalize or provide liquidity support to the operating subsidiaries as needed. This deployment of resources reduces the likelihood of multiple competing insolvencies in the United States.

The steps UBS has taken to enhance the firm's resolvability and facilitate its orderly resolution in bankruptcy include: (i) establishing a subsidiary that would allocate resources to material entities during resolution as needed; (ii) pre-positioning equity capital and liquidity at UBS Americas Holding LLC and developing a framework for pre-positioning loss absorbing capacity at its material entities; (iii) identifying an option for the sale of a discrete business under different market conditions; (iv) enhancing its collateral management capabilities through the development of its collateral management system to serve as an aggregate and cohesive source for collateral data; and settlement activities; (v) documenting a derivatives booking model and capabilities to track and monitor risk transfers and limits between legal entities.

## **II. Shortcomings**

The Agencies identified one shortcoming in the 2018 Plan.

## **GOVERNANCE MECHANISMS**

The Agencies identified a shortcoming regarding UBS's escalation triggers. As noted in the FBO Guidance, escalation triggers are designed to increase communication and coordination at the appropriate time between the appropriate U.S. and foreign governing bodies to confirm whether the foreign parent is able and willing to provide financial resources to support U.S. operations. Triggers should be based on the firm's methodology for forecasting the liquidity and capital needed to facilitate the U.S. resolution strategy, thereby helping ensure timely communication and coordination between the boards of UBS Americas Holding LLC and the foreign parent to facilitate, if needed, any preparatory resolution-related actions. In addition to informing the timing of resource requests, well-developed RLEN and RCEN capabilities can assist the firm and its foreign parent in calibrating the resources needed by the U.S. operations during resolution.

UBS lacks resolution triggers based on its methodology for forecasting liquidity and capital needed to facilitate its U.S. resolution strategy. UBS's final downstream trigger as presented in the 2018 Plan provides that a breach of the trigger would occur when the request for foreign parent support is either refused or insufficiently fulfilled by the foreign parent within 24 hours. The firm's exclusive reliance on management discretion for when to initiate such a request for parent support poses the risk that available resources may prove insufficient and that time may run too short for the board and senior management to complete the prerequisite actions for entering into resolution.

The firm's 2020 Plan should include substantive development of its trigger framework, including resolution triggers linked to the firm's methodology for forecasting the liquidity and capital needed to facilitate its U.S. resolution strategy (e.g., approaching RCEN/RLEN estimates,

with corresponding actions to confirm the foreign parent’s financial capability and willingness to provide sufficient support).

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### **III. Home and Host Cooperation**

Resolution of the U.S. operations of a firm domiciled outside the United States with significant global activities will require substantial coordination between home and host country authorities. The Agencies’ review of the 2018 Plan highlighted the importance of this coordination with respect to legal entity rationalization (LER)—including allocation and oversight of branch activities—payment, clearing, and settlement (PCS) activities, and derivatives booking practices.

*Legal Entity Rationalization.* The U.S. operations of a foreign covered company are part of the covered company’s global operations. The FBO Guidance indicated that companies should develop LER criteria designed to support their U.S. resolution strategy and minimize risk to U.S. financial stability in the event of resolution.

In reviewing the 2018 Plan, it became apparent that rationalization of U.S. entities is linked to a foreign covered company’s global legal entity framework, and that based on our experience as home country authorities for domestic firms, LER decisions in the host jurisdiction should be in alignment with the framework developed at the group-wide level. Given the global nature of the firm’s operations, U.S. LER should be aligned with the company’s global decision-making processes, and the Agencies would benefit from considering the views of the firm’s relevant home supervisory and resolution authorities regarding these linkages. Doing so would help ensure that the U.S. LER framework remains aligned with the

goals of the Resolution Plan Rule while also supporting the company's group-wide resolution strategy.

To increase the likelihood of success for both home authority and U.S. resolution strategies, the Agencies intend to engage with the firm's home country authorities and with the firm to explore ways for home country and U.S. resolvability concerns related to LER to be comprehensively addressed in the firm's U.S. resolution plan.

*Payment, Clearing, and Settlement Activities.* A loss of access with respect to the firm's PCS activities including access to PCS providers and for PCS clients (which include affiliates), is a key vulnerability to the orderly resolution of the firm. However, similar to the LER discussion above, the firm's approach to ensuring continuity of access provided in its U.S. resolution plan should align with a continuity strategy developed at the group level that considers the objectives of the firm's group-wide SPOE resolution strategy and the Resolution Plan Rule. The Agencies intend to engage with the firm and its home country authorities to minimize any differences in expectations regarding the continuity of access to FMUs, particularly with regard to where that access is indirect.

*Derivatives Booking Practices.* The Agencies have observed that the FBOs are increasingly booking derivatives positions that originate from the U.S. business to non-U.S. affiliates rather than its U.S. entities. As a result, derivatives booking activities regularly occur across jurisdictions. It can be difficult to evaluate a firm's derivatives business and the related risk in resolution, without considering these activities on a group-wide basis. Uncertainty about the allocation of losses could contribute to a loss of confidence in the firm's U.S. resolution strategy. The Agencies intend to coordinate with home country authorities and with the firm on booking practices and derivatives wind-down strategies in an effort to increase the likelihood

that a firm's financial and operational resources will be transparent, and positioned appropriately, at the time of resolution.

#### **IV. Remaining Projects**

UBS's 2018 Plan described ongoing resolvability enhancement initiatives that were developed in response to the FBO Guidance. It is critical that UBS continue to make progress to improve the resolvability of its U.S. operations under the U.S. Bankruptcy Code and, while resolution planning has been an iterative process, ongoing enhancement initiatives must be completed prior to July 1, 2020.<sup>13</sup> To that end, UBS should develop and submit to the Agencies by April 5, 2019, detailed project plans for (i) the completion prior to July 1, 2020 of the ongoing enhancement initiatives described in this section and (ii) any additional enhancement initiatives identified in the 2018 Plan, or in writing by firm management during the 2018 Plan review. These enhancement initiatives broadly focused on continuing efforts to improve financial, operational, and structural capabilities, and included but are not limited to the matters below.

UBS has developed frameworks for the estimation of RLEN and RCEN. Effective RLEN and RCEN frameworks require sufficient data capture and reporting systems that can produce reliable and timely forecasts of resource needs in resolution. UBS should complete the build out of its RLEN and RCEN frameworks by making the necessary enhancements to increase the automation, transparency, and reliability of their forecasting capabilities. These

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<sup>13</sup> In the event impediments arise that are outside the firm's control (e.g., regulatory approvals) and UBS believes a different schedule for completion is necessary for one or more planned future actions, UBS should provide detailed support for the revised schedule, and the Agencies will determine whether a different schedule is consistent with the requirements of the Resolution Plan Rule.

enhancements should include improvements that: (i) increase forecasting and reporting frequencies of RLEN and RCEN, (ii) formalize a process to reduce the variance in cash flow forecast errors, and (iii) extend back-testing of the firm's cash-flow forecasts to capture longer horizons than just same day back-testing.

UBS should complete efforts identified in the 2018 Plan with respect to its LER framework. Consistent with section III above, it is important that UBS evidence over time how the firm implements its LER criteria into its ongoing operations, including how the firm's efforts facilitate resolvability of the firm in the U.S. while also supporting the company's group-wide resolution strategy.

UBS has made progress on amending contracts with critical vendors to include resolution-friendly language. The firm should finish amending contracts with critical vendors to include terms and conditions that are designed to prevent termination upon commencement of resolution proceedings.

## **V. Conclusion**

Next year the Agencies intend to clarify improvements that should be reflected in the firms' next resolution plans, which are presently due on July 1, 2020.

The Agencies note that the 2018 Plan includes an unsecured support agreement structure involving a Contingent Capital Share Purchase Agreement between the top tier U.S. entity (UBS Americas Holding LLC) and its subsidiary, UBS Americas, Inc. The structure is designed to utilize one or more of the safe harbor provisions in the U.S. Bankruptcy Code. The Agencies will continue to consider the policy implications of a Contingent Capital Share Purchase Agreement and anticipate further engagement with UBS on the matter.

The Agencies are also considering ways to streamline the resolution plan submission process to allow more time for firms to make progress on resolvability before submitting plans to the Agencies.

The resolvability of firms will change as markets change and as firms' activities, structures, and risk profiles change. The Agencies expect firms to continue to address the resolution consequences of their day-to-day management decisions.

If you have any questions about the information communicated in this letter, please contact the Agencies.

Sincerely,

*(Signed)*

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Ann E. Misback  
Secretary of the Board  
Board of Governors of the Federal  
Reserve System

Sincerely,

*(Signed)*

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Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation