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Research Update:

UBS Group AG And UBS AG Upgraded On Stable Business Model And Revenues; Outlooks Stable

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Research Update:

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Overview

- We believe that Switzerland-based UBS Group AG's wealth-management-focused business model, cohesive group strategy, and successful deleveraging have improved the underlying creditworthiness of the group and its core subsidiaries.
- We are therefore raising our long-term rating on UBS Group AG to 'A-' from 'BBB+' and our long-term ratings on UBS AG and other core operating subsidiaries to 'A+' from 'A'.
- The stable outlooks on UBS Group AG and its core subsidiaries reflect our view that, even with possibly higher group capitalization, they could only merit a higher rating once legacy litigation subsides, and the bank is comfortably hitting its financial targets.

Rating Action

On June 6, 2016, S&P Global Ratings upgraded Switzerland-based UBS Group AG and its core operating subsidiaries.

For the core operating subsidiaries, including UBS AG, we raised the long-term counterparty credit ratings to 'A+' from 'A' and affirmed the 'A-1' short-term ratings, where relevant.

At the same time, we upgraded the long-term counterparty credit rating on UBS Group AG to 'A-' from 'BBB+' and affirmed the 'A-2' short-term rating.

The outlook for all these entities is stable.

We also raised by one notch our issue credit ratings on subordinated and hybrid capital instruments issued by these entities and related entities in the group.

Rationale

The rating actions reflect our view that UBS Group AG's wealth-management-focused business model and still-strengthening balance sheet continue to improve the group's intrinsic creditworthiness. In particular, we believe that, despite pressure from low and negative interest rates, high volatility and relatively low client activity in global capital markets, and the group's high and still-growing capitalization, UBS will be able to generate satisfactory capital and shareholders returns from its diverse business lines and global footprint. We acknowledge that some revenue volatility will remain due to the group's dependence on flow and transaction volumes in its global business lines, but that downside risks are reducing and restructuring costs are declining. As such, we have revised upward our assessment of the group's business position to strong from adequate. This results in a higher unsupported group credit profile (UGCP) of 'a', compared with 'a-' previously.

We note that the group strategy has experienced only moderate adjustments since 2012, and that execution has largely matched targets set at that time. We believe this stability has contributed to improved cross-divisional cooperation, using the investment bank to support its wealthy clients and corporate customers. While most divisions operate at the weaker end of group efficiency targets, we believe that this is largely due to the low and negative interest rate environment, and note continued efforts and investment to sustainably reduce the cost base. While the group's loss-absorbing capacity is improving, we note that associated higher funding and capital costs (described below) will affect management's ability to achieve its financial guidance of adjusted return on tangible equity of approximately 15% by 2017 and a longer term cost-to-income ratio of 60%-70%. However, we note that many banks are facing these challenges while trying to align their business model, and believe that UBS will likely be able produce returns that are, for now, satisfactory to its shareholders without making substantial further changes to the business model.

In December 2015, we highlighted three areas of improvement that contributed to the positive outlook (see "UBS Group, UBS AG Outlooks To Positive On Stronger Fundamentals And Completion Of Resolution Framework; Ratings Affirmed, " published Dec. 3, 2015, on RatingsDirect). In addition to the validation of the business model, we anticipated improvements in key capital and loss-absorbing capacity metrics. Despite two difficult quarters, we see better-than-anticipated improvement in both areas, since exposures in the Non-Core and Legacy Portfolio divisions have fallen further, capital generation has outpaced our expectations, and finalization of the Swiss Too Big To Fail (TBTF) regime solidified the bank's capital and funding strategy without requiring further substantial business model change.

At end-2015, the risk-adjusted capital (RAC) ratio was 13.8%, compared with 10.2% at end-2014. This improvement is largely explained by Swiss franc (CHF) 5.2 billion (about $5.2 billion) in new additional tier 1 capital (and an additional CHF1.5 billion in the first quarter of 2016), a reduction in credit and market risk exposure, and a CHF3 billion increase in adjusted common equity, even after a CHF3.2 billion dividend payment. As of March 2016, the group's fully-loaded common equity Tier 1 (CET1) ratio was 14.0%, clearly above its 13% target.

However, with the implementation of TBTF, the group's leverage ratio requirement will likely require the bank to accrue approximately CHF3 billion-CHF4 billion in additional CET1 and about CHF8 billion in further high-trigger additional tier 1 instruments, in our view. As such, we project the RAC ratio could conceivably approach 16% in the next 18-24 months. That said, we note that the TBTF requirement will be fully applied only as of end-2019, and we recognize that there is still meaningful litigation risk associated with legacy cross-border tax and residential mortgage-backed security litigation, among other cases. We anticipate that the bank's dividend policy will be aligned to any significant fines despite plans to pay out over 50% of net profit in the form of dividends.

In addition to further capital accumulation, UBS is committed to increasing its buffer of additional loss-absorbing capacity (ALAC) as it fulfils the gone-concern portion of the TBTF requirements. Since removing explicit government support from the rating in December 2015, we include one notch of uplift within UBS' group credit profile (GCP), and the long-term ratings on UBS AG and core subsidiaries), because of a sizable volume of ALAC. While we expect this will increase, we do not give more than one notch of ALAC support to issuers when the UGCP is 'a' or above. We calculate that the ALAC ratio was 8.5% at December 2015 and estimate a figure approaching 12.5% by end-2016 given our expectations of further issuance of ALAC eligible instruments during 2016, primarily senior unsecured issuance from the holding company.

Our upward revision of the UGCP to 'a' from 'a-' results in an upgrade of all the rated hybrid capital instruments within the group.

Outlook

The stable outlook on UBS Group AG, UBS AG, and other core subsidiaries reflects our view that the group's improved intrinsic creditworthiness is likely to be fully reflected in the revised 'a' UGCP in the coming two years. While we anticipate further improvement in the group's capital metrics, we are cautious given the uncertainty of litigation costs over the next few years and the continued, yet falling, restructuring costs. We also note that an 'a' UGCP already positions the bank as one of the most intrinsically creditworthy commercial banks globally, and that management still has work to do to comfortably hit its self-set financial targets.

We could revise upward the UGCP, and possibly raise our issuer credit ratings (ICRs) on UBS Group AG and its core operating companies if the RAC ratio moves sustainably and comfortably above 15%, and the uncertainty associated with litigation charges is reduced further. However, to merit higher ICRs on these companies in comparison with global bank peers, management would also have to make further progress in achieving its efficiency goals across the business and generate stable returns in line with target of an adjusted return on tangible equity exceeding 15%.

We do not anticipate lowering our ICRs on the core operating companies, given the improving ALAC buffers and the additional notch of ALAC support which would be available if we were to revise our assessment of the UGCP to 'a-'. However, we would likely lower the ICR on UBS Group AG if we revised the UGCP to 'a-'. While a downward revision of the UGCP is unlikely given expected capital improvements, it may happen if, for example, UBS experiences a substantial increase in unexpected losses, risk appetite increases substantially, or we anticipate further material changes to the business model.

Ratings Score Snapshot

	To	From
Counterparty Credit Rating*	A+/Stable/A-1	A/Positive/A-1
Unsupported GCP	a	a-
Anchor	a-	a-
Business Position	Strong (+1)	Adequate (0)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	(+1)	(+1)
ALAC Support	(+1)	(+1)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)

*Refers to the rating level of UBS AG and other core subsidiaries of UBS.

Related Criteria And Research

Related Criteria

- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks - March 23, 2004
- Criteria - Financial Institutions - Banks: Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks - May 04, 2010
- Criteria - Financial Institutions - Banks: Assessing Bank Branch Creditworthiness - October 14, 2013
- General Criteria: National And Regional Scale Mapping Tables - June 1, 2016
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises - December 19, 2014
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Group Rating Methodology - November 19, 2013

- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity - April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010

Related Research

- UBS Group, UBS AG Outlooks To Positive On Stronger Fundamentals And Completion Of Resolution Framework; Ratings Affirmed, Dec. 3, 2015

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

	To	From
UBS Group AG		
Counterparty Credit Rating	A-/Stable/A-2	BBB+/Positive/A-2
UBS AG		
UBS Switzerland AG		
UBS Securities LLC		
UBS Ltd.		
UBS AG (London Branch)		
UBS AG (Jersey Branch)		
Counterparty Credit Rating	A+/Stable/A-1	A/Positive/A-1

Ratings Affirmed

UBS AG	
Certificate Of Deposit	A-1
Commercial Paper	A-1
UBS Americas Inc.	
Commercial Paper*	A-1
UBS Finance (Delaware) LLC	
Commercial Paper*	A-1
UBS Bank USA	
Counterparty Credit Rating	A-1

Upgraded

	To	From
UBS AG		
Certificate Of Deposit	A+	A
UBS Group AG		
Junior Subordinated	BB+	BB
UBS AG		
Senior Unsecured	A+	A
Subordinated	BBB+	BBB
UBS AG (Jersey Branch)		
Senior Unsecured*	A+	A
Senior Unsecured	A+p	Ap
Subordinated	BBB+	BBB
UBS Capital Securities (Jersey) Ltd.		
Preferred Stock*	BBB-	BB+
UBS Finance (Curacao) N.V.		
Senior Unsecured*	A+	A
UBS Group Funding (Jersey) Ltd.		
Senior Unsecured***	A-	BBB+
UBS Preferred Funding (Jersey) Ltd.		
Preferred Stock**	BBB-	BB+
UBS Preferred Funding Trust IV		
Preferred Stock*	BBB-	BB+
UBS Preferred Funding Trust V		
Preferred Stock*	BBB-	BB+

Upgraded; CreditWatch/Outlook Action

	To	From
UBS AG (NY Branch)		
Counterparty Credit Rating	A+/Stable/--	A/Positive/--

*Guaranteed by UBS AG.
**Guaranteed by UBS AG (Jersey branch).
***Guaranteed by UBS Group AG.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.