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CUBS: The new Swiss investment bank?

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It's a tough time to run an investment bank in Switzerland. UBS is expected to restructure its operations at an investor day on November 17 following a tough summer that has included a rogue trading scandal. Even Credit Suisse's investment bank, which had a relatively healthy financial crisis, has been looking to pulling out of capital-intensive operations following a decline in trading revenues and regulatory pressures.

So JP Morgan analysts led by Kian Abouhossein have a radical solution: combine their two operations.

The analysts are not being flippant either. They have published a detailed 48-page report in favour of a joint venture in investment banking between UBS and Credit Suisse this morning. The joint venture would involve the two banks keeping their independence, but merging their investment banks. They even went so far as to divvy up which bank would run which business – with UBS running flow fixed income, currencies and commodities and Credit Suisse structured FICC, for example.

The rationale for the combination is that it "would be beneficial to both banks in a post Basel III market environment, with material release of capital for both banks and synergies in some key product areas especially in FICC".

They added that in the current climate they were unconvinced of Credit Suisse's ability to generate adequate returns FICC on a stand-alone basis, while UBS was under pressure to convince investors on its expected restructuring plan on November 17.

Meanwhile, the key arguments in favour of a joint venture are threefold.

First, a tie-up would propel the merged entity into the top five investment banking players by revenues globally, with the second largest equities business by revenues, and the sixth largest FICC business. The two businesses would complement each other geographically and in terms of business mix, they argued.

Second, the analysts predicted that risk weighted assets would fall sharply, declining almost a half, implying reduced risk and lower capital requirements. Nearly Sfr15bn in capital would be released due to the fall in RWAs because of a joint venture, according to the analysts.

Third, cost reductions equivalent to Sfr7.5bn would help push investment banking return on equity to 20%. In addition, a combined entity would be better placed to monetise UBS' deferred tax assets.

As for the headquarter of the new entity: well, potentially London, as they argue that the joint venture over time would have to be funded separately, giving a rationale for moving the legal entity to the UK.

Clearly, there are also a number of arguments against. While such a move might make business sense, it is unclear whether regulators in Switzerland, or indeed the UK, would welcome such a joint venture.

Further, a tie-up would most likely prove unpalatable to management at UBS and Credit Suisse, with the concept of two wealth management arms which are in daily competition sharing the same investment bank likely to prove unpopular with staff and clients alike.

But as the analysts argued: "Should both investment banks fail to show adequate progress to acceptable returns and ongoing cost management ability in the investment bank, we believe this scenario analysis as a possible next step in restructuring could gain momentum."

UBS and Credit Suisse declined to comment.

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