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First Brands bankruptcy weakens major bank

A déjà vu for UBS: Does the First Brands case awaken the ghosts of Greensill?

The bankruptcy of US auto supplier First Brands has left a hole of over \$0.5 billion in the books of UBS funds. The case casts a harsh light on the bank's risk management—amid the heated debate over its capitalization.



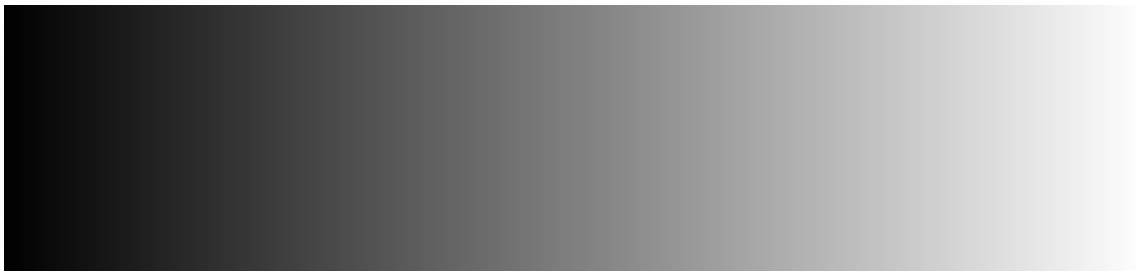
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Published today at 08:24



The First Brands case undermines UBS's arguments against the \$26 billion safety cushion demanded by the Federal Council.

Photo: Iris C. Ritter



Shortly :

- The bankruptcy of US auto supplier First Brands leaves UBS clients with losses of over \$500 million.
- Cantor Fitzgerald plans to renegotiate the O'Connor purchase agreement due to First Brands' losses.
- The case shows disturbing parallels to the Greensill scandal at Credit Suisse.

A US auto supplier goes bankrupt, and UBS in Zurich is faltering—not financially, but politically. First Brands' insolvency leaves a gap

of over \$500 million in UBS clients' portfolios and provides regulators with a perfect argument in the dispute over higher capital requirements .

The "structural similarities" between First Brands and Greensill suggest that this is "more than just a credit event," writes the law firm Lalive in its assessment of the case. The \$10 billion Greensill scandal at Credit Suisse led to criminal investigations, civil lawsuits, and regulatory inquiries. Lalive successfully represented a large group of institutional investors in clawback actions. "Should First Brands follow a similar course, affected investors could take legal action."

Parallels to Greensill

Although the financial scope is smaller, the First Brands case for UBS draws alarming parallels to Greensill. Both cases revolve around supply chain financing and the "significant risks associated with it," as Lalive explains. These arrangements allowed financing to be held off-balance sheet, making it "difficult to accurately assess the true extent of the credit risk."

UBS's exposure was through funds managed by its hedge fund and asset management units, just as Credit Suisse's Greensill-linked funds were structured through its asset management division.

In fact, there are even personal ties to Greensill. As the Financial Times reported, UBS invested in First Brands through a technology platform called Raistone. Raistone was founded in 2019 by former Greensill employee David Skirzenski.

According to media reports, UBS funds – similar to the Greensill case – took on a significant concentration risk. A UBS O'Connor fund, the Working Capital Fund, had a total exposure of 30.5% to First Brands, reports the New York Times. This was despite the fact that investors had previously been informed in documents that they would have a 20% limit per individual position.

UBS justifies this concentration of risk with a twist: The exposure is divided into 9.1% direct financing (based on invoices First Brands had to pay) and 21.4% indirect exposure (based on invoices First Brands' clients had to pay). The latter is spread across various clients, many of whom have an investment-grade rating.

According to UBS, the working capital fund therefore does not violate any applicable investment restrictions or guidelines. The official limit of 20% per individual position was not exceeded – an interpretation that is likely to cause concern among investors.

Risk information insufficient?

Although such concentration in an alternative investment fund may be legally permissible for professional investors, it casts a negative light on the internal risk control and supervisory mechanisms within UBS's specialized units.

Whether legal action is taken depends on how the funds were actually sold to investors: Was the risk sufficiently explained, was the suitability assessed, and were the controls adequate?

According to the New York Times, O'Connor's funds invested in a First Brands supply chain financing program that offered a 17% return on 60-day investments. Such an extraordinarily high interest rate should have been a clear warning sign of the borrower's financial distress.

It's definitely worth "reviewing the fund documents and assessing possible repayment options," Lalive advises. Although the situation is still fluid, early action could be crucial.

It is still unclear exactly which investors are affected. Although US creditor lists are available, they do not reveal who invested directly and who invested through UBS funds.

UBS said on Wednesday: "The situation is constantly evolving, and we are currently analyzing the impact on our few affected funds,"

adding that every effort would be made to protect the interests of clients.

Separation from O'Connor

The affected hedge fund unit, O'Connor, is currently being sold by UBS to Cantor Fitzgerald, a Wall Street brokerage firm whose long-time head, Howard Lutnick, resigned as chairman and CEO in February to become Donald Trump's Commerce Secretary. The sale includes six investment strategies with approximately \$11 billion in assets under management.

UBS announced the sale of O'Connor to Cantor Fitzgerald in May – just months before First Brands' problems escalated in late summer and led to insolvency in September.

The sale fits with the bank's overall strategy of divesting non-core or risky units following the Credit Suisse acquisition. Officially, the sale was justified as "reducing balance sheet risks."

However, since the losses affect only clients and do not burden UBS's balance sheet, another suspicion arises: The bank recognized a growing operational and reputational problem and wanted to outsource it in a timely manner through the sale.

The transaction was expected to close in the fourth quarter. Financial details were not disclosed. UBS itself expected an "immaterial gain" upon completion, suggesting that the financial gain was not the primary objective.

Now Cantor Fitzgerald intends to renegotiate the terms, Bloomberg reported on Wednesday. The reason for this is the significant losses that the O'Connor unit faces due to the insolvency of the auto supplier First Brands. Cantor is proposing to remove the problematic business unit from the deal and reduce the purchase price. This is a setback for UBS.

Ammunition for the critics

UBS is still grappling with the consequences of the Greensill scandal, which contributed significantly to the downfall of Credit Su-

isse. Now, the next disruption in its supply chain business has occurred. The case comes amid the highly political debate about stricter capital requirements for UBS.

The debacle provides a powerful argument for advocates of stricter regulations. It shifts the discussion from abstract risk models to a real example of a failed risk culture. The key question is: If UBS's controls fail even in a small hedge fund unit, how can one be confident that the risks of the entire systemically important bank are under control?

The incident undermines the credibility of UBS and its management in the fight against higher capital requirements. It is therefore less a financial than a strategic-political problem, significantly weakening the bank's negotiating position with regulators and politicians.

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