

# How UBS mismanaged its way to a profit

The good news from UBS today is that they expect to post a modest profit for the third quarter. This is in spite of losing \$2.3 billion through the unauthorized trading of Kweku Adoboli. On top of that, the woefully inadequate risk oversight that Mr. Adoboli so painfully exposed has forced UBS to hasten the shrinking of their investment bank, incurring restructuring charges. However, in spite of these twin blows to their results, UBS expects to include a \$1.5 billion Swiss franc profit from widening credit spreads on their debt. That's right, because the company's self-inflicted wound has soured investors on the bank's prospects and therefore raised the yield on their debt, in the topsy-turvy world of accounting this is counted towards their profit. The green eye-shade logic is that because UBS owes money (on the bonds they've issued) the lower price for the bonds implies the value of what UBS owes has gone down. It's the same as if the investors in those bonds just decided to forgive 5% of the face value.

Of course, UBS still owes the same amount of money, and borrowing just became more expensive for them. But the Looking Glass world of liability accounting regards this differently. So when UBS announces a profit for the third quarter, remember that it came about through the market's recognition of their weak risk management structure.