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Fireside chat with George Athanasopoulos, Head of FX, Rates & Credit, and Jason Barron, Head of Cash Equities
Moderated by Daniele Brupbacher, UBS European Banks Research

Daniele Brupbacher

Let's get started. Good afternoon. Welcome, ladies and gentlemen. Thank-you very much for your time. I hope you've had a good conference so far. I'm Daniele Brupbacher. For those of you who don't know me, I'm from UBS Research, the European Banks Team. I would like to introduce you to Jason Barron and George Athanasopoulos.

Jason is deputy Head of Global Equities and global Head of Cash Equities at UBS. He is responsible for the day-to-day management of Equities, as well as the management and development of UBS's equity advisory, execution, and electronic businesses. Prior to this, Jason ran Global Financing Services, and before that, Global Equity Derivatives.

George is the global Head of FRC, our FX, Rates, and Credit businesses here at UBS, which he has run since 2016. Prior to that, he was co-Head of the business, and previously ran FX at UBS.

I gave you these details, because we think it's quite relevant also to understand where they're coming from in their explanations. And I will go through a couple of questions now and we would then also like to open it up for Q&A if there's enough time and interest.

So I wanted to start really making also a bit the link to our recent Investor Update, which we had about a month ago. We heard a lot about tech opportunities from Rob and Piero, the two co-Heads of the Investment Bank, and I wanted to kick off with that area. So, can you give us some specific examples of what it means to be a, what we call, Digital Investment Bank?

George Athanasopoulos

Sure, thank you. Well, obviously, the conversion to Digital Investment Bank is a journey. It's not an instant – it's not a one-step process, and the way I would describe the model within the Investment Bank is one of what I would call decentralized innovation with central oversight. So we try to promote innovation within the businesses and they innovate independently of each other. There is central oversight to make sure that as a firm, we focus on what is most important at any one time.

Within FRC, within my business, we have created what we call the Strategic Development Lab [SDL] this year. Effectively, we have separated R&D from manufacturing and distribution, and the reason we have done that, is we wanted SDL to focus on the evolution of our digital model, which will happen over the next three years, while not disrupting the revenue engine that we currently operate.

SDL is still mostly focused on electronic trading but we're also looking at applications of machine learning, of artificial intelligence and of data science on everything from the design, delivery, and also the risk management of our product base. We use technology as much as we can; with Equities, for example, our Algo suite was based on technology that we had already developed within the Equities business. And we also use similar technology we're using in other parts of the bank; like for example within CCS, in order to do deliver differentiated advice, so on and so forth.

You all know Neo. We continue to develop Neo. It's our award-winning multichannel platform. We now have 1.5 million users on Neo across more than a hundred countries ranging over more than 60 applications, and the footprint is growing all the time.

And I would say finally one there thing and I'll leave it to Jason to discuss, obviously, Equities, and Research. One other thing that is important is we've set up an Innovation Lab centrally and that lab fulfills a very important function of doing rapid prototyping for the businesses, doing proofs of concepts for every new idea that we have, in order to speed the pace of innovation across the firm.

Jason Barron

So I think for the IB, this is one of the initiatives I'm most excited about. We've got a long tradition, particularly in Equities, of being strong in the electronic space, which dates back to our first Algos in 1997. I think by most metrics, we're number one sell-side electronic firm. As George mentioned, we work across the ICS business. So we're number three in electronic FX, leveraging a similar platform to Equities, according to Euromoney.

We're touching on more interesting – going forward, on some of our initiatives. So you probably heard [inaudible] talk about Evidence Lab I think earlier today and how we're using swathes of data support fundamental recommendations and that data now is something that we're looking to make available externally. The analysts in these recommendations and in speaking to clients are supported by a smart telephony system. So when a client calls up, they can help the analyst know and be in a position to cover the client effectively.

To support that initiative, we've also launched, I think as Rob mentioned in the Investor Day, a Data Solutions business, which is basically a centralized business, basically to satisfy client needs around financial and alternative data, such as Evidence Lab and other sources. We also have a quant solutions business, which is basically direct market access, which is something that we've built to satisfy demand from hedge funds.

We have, in this business, probably the lowest latency solution for direct market access of all of our competitors, and not only that, we've deployed it quite innovatively, I feel, into new markets. So we've deployed it into China, for example, and I think we only have the only ultra-low latency solution there. We've also deployed it into Australia, as well as obviously, the bigger markets, US and Europe, and it's going live in Japan in Q1, which is also an area of interest to quant funds.

Something that's particularly close to my heart is something we're calling Smart Coverage, where we're using everything that we know about the clients to service that client better. And this is, I think, particularly exciting when it comes to some of the middle market clients, where we might not have the resource to understand exactly what the client might be interested in, in terms of stocks, or products, or advisory. But also in particular, I think it pertains to cross-border. So a salesperson in Asia for example might not really know that well a client in Europe, but through this initiative, we'll be able to electronically send them relevant liquidity advice, derivative products, et cetera.

In the electronic execution space, we're looking to deploy AI around and including news feeds, et cetera, and also, we're looking at – we're doing a pilot at the moment using natural language processing. So one of the most time occupying activities for our electronic sales people is updating clients on the status of their orders. We're piloting a chatbot, so clients can ask the chatbot for the order update and obviously, this will help with our resources.

But it's not just about digital ideas and created by a number of streams. I think that's probably something you would also get from our competitors. I think one of the things that we feel will really differentiate us is that it's really changing our whole approach to the business.

And we're targeting what I would call a lot of people who are "bilingual" and trying to create within our existing team people who are "bilingual" – o people who are fluent in the language of finance, but also fluent in the language of data and programming. And this doesn't just apply to our trading businesses, where would always have groups of technical people, but also to sales and to investment banking.

And last but not least, it's probably also important to add that we recognize that this is not just about the front. This is about the front to back and we're working very closely with operations and finance to make sure that the Digital IB extends to process efficiencies in the back end, and we're exploring opportunities around Blockchain, et cetera.

Daniele Brupbacher

Thank you. That's an impressive number of initiatives. Very promising.

I would like to focus a little bit on the regional footprint as a next area and think at the Investor Day, it became very clear that the US and also Asia-Pacific – I would say across UBS – is clearly a focus area. And so I was wondering whether you could give us a few examples of what you're doing there to drive growth and really in your businesses.

George Athanasopoulos

Sure. First of all, I think it's important to say that in both Asia-Pacific and in the US, as we are in the rest of the world, we're a major foreign exchange player, and that we are very interested in maintaining. That means across all products, across G10 in FX, across voice and electronics, and across all client segments.

Now, outside of foreign exchange, what we tried to do is we tried to grow selectively in segments that are first of all relevant for the rest of UBS Group; and second, segments in which we can excel. If I look at Asia-Pacific, we are major players in Australian fixed income, again, across products. We have recently over the last couple of years invested in our Asian flow credit trading businesses and with excellent results in 2018. Our market share is growing steadily. And we have also invested over the last year or so in solutions and structured products. And again, I can talk about this perhaps later on if you're interested. We think it's a growing trend, solutions and structured products in the recent credit space, in the FX and credit space, and we see that it's a growth area.

Outside of Asia-Pacific, moving to the US, the US is a different story for us. I should mention first of all on Asia-Pacific, we are continuing to monitor and plan for growing further in China. China is going to be one of the largest markets globally for our products. We need to be there. It's also a major strategic initiative for the entire group, not just for FRC or just the investment bank. So it's very much a "watch this space". We are interested. We are going to grow in that space and we'd love to develop more product.

Moving to the US. The US is a very different exercise for us and I think it's important to grow selectively but it is also important to avoid segments that result in large scale, large balance sheet exercises that run against our strategy and our business model. So we are major players in inflation and we have been for a while. We're growing our credit business selectively. We're growing our credit business in areas where we believe quant and technology can actually allow us to differentiate ourselves. And some of those growth initiatives, like efforts into the leveraged loan space, have led to a trebling of our market share in that space over the last two years. And that gives you an idea of how we approach the United States. It's a very important market, but we are not keen to play in everything.

Jason Barron

To set the scene for Equities. We are ranked number one in APAC according to coalition. We're seeing huge opportunities for growth coming out of China, where we have the number one spot. Just as an example, earlier in the year, when we saw 5% inclusion on the MSCI for China, we had north of 20% market share, and given that the MSCI is talking about potentially 20% weight next year, that's a significant opportunity for us. And we're also number three pretty much or at least top three across all of the ASEAN countries and number one in Australia.

I think that this gives us an opportunity to leverage that business into the US, moving onto the US, but also helps us leverage our global strength with US clients and drive US revenues, which is what we've been doing over the last three years and expect that to continue. So we've moved from number nine to number six according to Coalition, which I'm very pleased with. This year, actually, we won Derivatives out for the year for 2018 according to American Derivative Awards. We're equal number one non-domestic player and I'd be disappointed if I couldn’t drop the word "equal" from that the next time the survey comes out.

And last but not least, I do think the investments that we're seeing from CCS into ECM will also help our Cash Equities in the US, which it's still -- it's the biggest wallet and the biggest opportunity for us. So it's great to have so much momentum.

Daniele Brupbacher

So we heard about the digital investment bank initiatives there. We heard about APAC. We heard about the Americas. So what does it mean all together for your businesses? How do you see Equities and FRC evolving from here the next couple of years, quarters?

Jason Barron

So again, to set the scene, we've been preparing for MiFID. That obviously went live this year. We've seen a lot of pressure on margins this year. We've seen channel migration from high-touch to electronic, which is obviously lower-margin. We've also seen in the advisory space accounting changes necessitated a delay in the recognition of revenues by three to six months.

But yet, despite all of this, as you'll have seen from our numbers, our revenues actually and profitability is actually significantly up. So why is this? This is because we're seeing consolidation, particularly under MiFID in Europe, but I think across the board, from a client perspective, and they're really focusing on their top providers.

And this is a trend that I expect to continue. Clients will continue to cut the tail. If you speak to clients, as obviously I do all the time, a lot of our top clients have over 100 providers and even they recognize it's not sustainable. And the burden to having so many providers just increase exponentially under the MiFID.

I have to be honest, I think the volumes and volatility have helped us this year with particular the Cash and Derivative businesses. But I don't think that volatility has been exceptional. In fact, I went onto the CBOE website over the weekend and downloaded all the VIX prints since 1990. And actually, the average price of the VIX since 1990 was 19.2 and the average this year was 19.5. So it feels like it's been more volatile this year but actually, I think it's just been a return to the norm.

So I think there's a good chance this volatility that we've seen, which is good for our business, continues. And even if it doesn't and vols fall off, I feel from an Equities perspective the momentum that we have within our GFS business, and I talked about the quant solutions and the pipeline there, will offset some of the volatility or offset Cash and Derivatives in a lower vol environment.

George Athanasopoulos

I think in FRC, obviously, the business over the first nine months of the year have done rather well. And we have certainly benefited from the business mix. As you know, our business is – the majority of the business is FX or FX-linked. However, we have also enjoyed market share increases in several areas of our products, including areas like electronic foreign exchange.

The industry, from my perspective, first of all is struggling with wallet shrinkage over the last few years and it's also suffering from relatively low returns, mainly in Rates and Credit. And I don't actually think these dynamics are likely to reverse in the coming quarters. I think some of the macro environment may change. I think we have a rather interesting macro scene ahead of us. We remain to see whether policy normalization will accelerate outside the US. I think we're getting one step closer to the end of the cycle. It's not necessarily <u>the</u> end of the cycle, but I think we could put pressure on credit spreads and usually, in this sort of environment, volatility rises.

So one would think that these are better conditions for a macro driven model like ours. However, I think there's also both a structural and cyclical issues related to the client base we service. This industry has grown through the growth of active managers of assets, be it levered or some unlevered, and also banks. And I think both sectors have experienced reduction in trading volumes, and some of it is down to market structure change, some of it is down to regulation. Some of it is also cyclical, but I don't personally anticipate massive wallet change in the coming year.

I think it's important for us to continue to diversify our client base. Historically, we've been very heavily institutionally focused. We don't have a very large corporate client base outside Switzerland. We need to grow that. We also need to grow our coverage of family offices further. It's a very important sector for us and one in which we're growing fast.

I think we also need to continue evolving the business model. I think we need to continue using technology to evolve the business model, and I think this will materially change our production costs if we do it well.

The one dynamic that I think is going to change – and is the reason why we decided this year to grow our solutions business – is that I think at this point in the cycle and given the path of rates, you're likely to start seeing a change in demand for yield enhancement products shifting away from spread product and from equity-linked product back into currency and rates linked product. And I think this hasn't happened for a long time. We have invested. We're prepared and we're starting to see rapidly rising demand starting from Asia-Pacific.

Daniele Brupbacher

Thank you. Collaboration is another area. I think collaboration is important at UBS. It's a source of revenues and opportunities in general. One of the things which we've also presented also at Investor Day, the Global Family Office joint venture between the IB and Global Wealth Management. How big a growth opportunity is this? It must be a big one. Can you comment on this?

George Athanasopoulos

It's hugely important. I've been close to the initiative from the start and I've seen it evolve over the years. It's clients that get introduced to our GFO coverage, enjoy the full breadth of products and services from the Group. And historically, about two-thirds of the revenues come from the Investment Bank.

It's a hugely important segment for the IB. It's one that is going to be a very, very big focus for 2019. In many respects, these are the most multifaceted clients we have. They can be active and passive managers of assets. They can be corporate-like in their needs for advisory, in their needs for financing, in their needs for risk management that – they encompass everything that we do for our entire client base. And the fantastic thing here is that we're in an ideal position as a bank to service them.

Daniele Brupbacher

And in Equities, is there any specific opportunities, growth opportunities we could highlight?

Jason Barron

I talked generally about some of the specifics, but I do feel one of the big opportunities actually is based on the diversification of the Equities business. So within Equities, which obviously, if you've seen our results, which is up 16% to the end of Q3. We're pretty much evenly split both by products, Derivatives, GFS, Cash, and by region. In terms of the performance, every region and every product was not just highly profitable, but actually increased revenues. So Derivatives was up 27%, Cash 9%, GFS 16%. Our biggest growth, pleasingly, was in the Americas, which is where I think we have the biggest opportunity. For Asia, it was also double-digit growth and we're positive in EMEA despite MiFID.

I think the big opportunity for us is that because of this diversification, and also because I believe UBS is an incredibly collegiate place, we have the opportunity – and I think are starting to be perceived by clients as being actually a very productive global player to interact with.

I think we've invested a lot of time as a management team going line by line on clients, on trying to understand what clients want and focusing our ability to import/export between the region to satisfy demand, which I think is really one of the reasons why we've seen so much growth in the US. It's not just on the strength of our US offering, which I feel is robust, but it's really because US, with the biggest wallet, a lot of those clients aren't just focusing inwardly on the US, and we're delivering to them from our European and Asian platforms.

In addition to that, I think I mentioned the GFS pipeline, which I think is very strong. We have balance sheets to deploy to the right clients. The quant pipeline is very strong.

As I mentioned, I expect the consolidation of client wallet to continue with some big players such as ours and recent survey by Greenwich listed us as one of the two big winners coming out of MiFID. And that is our job to make sure that we not just get out fair share of that consolidation, but we get more than our fair share, which is definitely what we're seeing at the moment.

And then I did mention China so I probably don't need to mention that again.

Daniele Brupbacher

We talked at the digital investment bank already, but I just wanted to deepen a little bit the FRC model. Can you explain how the UBS FRC model differs to your peers a bit more in detail?

George Athanasopoulos

How long have we got? Listen, I think first of all, it's very important to highlight here: we're FRC. We're not FICC. It's a very, very different model to that of the competitors. We decided now six years ago, when we accelerated the strategy of our Investment Bank, we made a decision to change direction in fixed income. And that is driven by, first of all, a conviction and I think it's been proven by the way the market is developing that we're living in an era of abundance, of products and services.

And when you have abundance, what is important is not the size of the factory, but the excellence of the product. And I'm saying the size of the factory and I'm not saying the size of the shelf, because I think shelf means network, and I think networks are becoming very important for banks and something that we're looking at very closely. We just don't think that on our shelf, everything that we produce has to necessarily be manufactured by us. We think that what we produce and put on the shelf has to be excellent.

So if you look at our business, we split our business into four areas, and very quickly, FX is obviously the biggest one. In FX, you can think of us as a supermarket. We are doing all products, linear and non-linear. We're present in all regions. We cover all client segments. We're leaders in electronic trading. We do foreign exchange prime brokerage. We are growing in the algorithmic execution space. So pretty much a full-service house.

Our Rates strategy is very different. So we have a couple of markets, where we're a top provider across the board, and those are Switzerland and I already mentioned Australia. Outside the markets where we are a full-service provider, we focus mainly on products where the market structure change and also changes in technology are actually causing a convergence with our business model. Cleared derivatives would be one of them, where we're very interested to participate across the board. We're developing capability and our footprint is growing, and that includes all the major markets.

Outside derivatives, we have smaller, more niche businesses, like inflation, where again, we have considerable strength. But Rates is and will remain a low balance sheet, capital-light exercise for UBS.

If I look at Credit. In credit, there is a very significant alignment with our origination business. So we tend to work mainly on the areas where we have a strong primary franchise.

And also, we look very closely at the evolution of technology protocols within the credit space. I think this is the next area to electronify. We already have some electronic offering out there. We do quote several thousand bonds and European investment grade electronically. We are looking at the development of protocols there, both in terms of algorithmic trading, and also in terms of wall-to-wall trading, which I think is also developing. And we do have one of the growing match principle platforms in BondPort out there. But I think Credit for us is an exercise in aligning with CCS and also following the evolution of the market.

The fourth area, which is Solutions, is actually a collaboration with the other two divisions of the Investment Bank, with CCS, and with Equities. We focus on mainly three areas, and those are yield enhancement, financing, and what I call factor investing or dynamic strategies, that we call it internally. And I think that business is actually going to evolve into one of the important pillars of economic profitability for FRC, especially as fixed income markets come back and rates, yield curves normalize.

I should mention also in closing that although we are a top player and we very much like that in precious metals – it's been a historically very powerful business for UBS – we do not have a broader commodities business, and we do not aspire to develop one.

Daniele Brupbacher

We have two more minutes or so. Can I just ask one more topic, which also was pretty prominent at the Investor Day. It's about the more capital and costs being allocated to the divisions. What does that mean for your business? What does it mean for the Investment Bank overall?

George Athanasopoulos

Look, we don’t have that much time. So it would be good if you have a moment to look through our slides from the Investor Day from both the IB and CFO presentations. The short summary is that the increased allocations are actually driving a pro forma 600 basis point reduction in return on attributed equity for the Investment Bank.

I think we can manage it. I think if you look at our track record of optimizing resources, within both our businesses over the past few years, I think it's very strong. We're very confident we can manage the costs and we are very confident that we can continue to increase market share.

And I think if you look at how our targets have changed to “about 15% through the cycle” versus “greater than 15%”, it shows you we still aspire to deliver attractive returns to shareholders. So I don’t think it's an issue.

Jason Barron

I would just agree with that. I think we're confident that we can exceed our cost of equity through the cycle and as George says, it does have an impact on costs, round about a 2-percentage point hit. But I do feel that over time, we can optimize that, and I think if we've proven anything over the last few years, I think we've proven that we're diligent and effective in terms of managing our resources.

Daniele Brupbacher

Let's see briefly whether there is any questions from the audience, a quick one. If not, I have a very last one. So we heard a lot about systems opportunities, growth opportunities, collaboration. What's the three key takeaways you want the audience to take home? Who wants to start?

Jason Barron

I think from an Equities perspective, we kind of covered it, but the digital IB is real. It's very real for Equities and I think that there's a significant amount of upside.

The other one is we have a broad, well-established business, but that doesn't necessarily mean that it's mature and doesn't have upside. Certainly, I genuinely think we've carved out a niche for ourselves in the firm of our globality.

And I think I'd also add to that our people, and I think we have great people and we're retaining our talent.

Daniele Brupbacher

George?

George Athanasopoulos

I would say first of all, the business has had a good nine months, is doing well, and we believe the strategy will serve us very well for the type of challenge I expect to see in the coming quarters.

The second, to reiterate, we're FRC. We're not FICC. The model is different. That doesn't mean that the model is static. We continue to question it and we continue to evolve it every day. We're very focused on the technological evolution that we're going to see in our business. I think the fixed income markets will transform over the next few years and we want to get to the forefront of that.

And the third thing is that we will continue striving to improve returns and we believe we can manage the perceived headwinds that the increased allocations are bringing and do well.

Daniele Brupbacher

Thank you very much. We have to stop here. Thank you for coming to our conference, for giving us all these insights. Thank you all for listening. Have a good day.

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(xi) the effects on UBS's cross-border banking business of tax or regulatory developments and of possible changes in UBS's policies and practices relating to this business; (xii) UBS's ability to retain and attract the employees necessary to generate revenues and to manage, support and control its businesses, which may be affected by competitive factors including differences in compensation practices; (xiii) changes in accounting or tax standards or policies, and determinations or interpretations affecting the recognition of gain or loss, the valuation of goodwill, the recognition of deferred tax assets and other matters, including from changes to US taxation under the Tax Cuts and Jobs Act; (xiv) UBS's ability to implement new technologies and business methods, including digital services and technologies and ability to successfully compete with both existing and new financial service providers, some of which may not be regulated to the same extent; (xv) limitations on the effectiveness of UBS's internal processes for risk management, risk control, measurement and modeling, and of financial models generally; 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Use of adjusted numbers
Adjusted results are a non-GAAP financial measure as defined by SEC regulations. Refer to pages 9-11 of the 3Q18 report which is available in the section "Quarterly reporting" at www.ubs.com/investors for an overview of adjusted numbers.

If applicable for a given adjusted KPI (i.e., adjusted return on tangible equity), adjustment items are calculated on an after-tax basis by applying an indicative tax rate.
Refer to page 18 of the 3Q18 report for more information..