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Speech by **Sergio P. Ermotti**, Group Chief Executive Officer including Q&A session
Moderator: Alastair Ryan, Bank of America Merrill Lynch

Transcript.

Numbers for slides refer to the 2020 Bank of America Merrill Lynch Financials CEO Conference presentation. Materials and a webcast replay are available at www.ubs.com/investors

Alastair Ryan

Thank you, ladies and gentlemen. Welcome back. Great to be back with you.

I'm really delighted to be hosting Sergio Ermotti, a long-time presenter here, and long-time chief executive of UBS.

Sergio has a few slides, and we then have plenty of time for Q&A. And as through the day, please feel free to type your questions in, and I will edit and present them. I can't guarantee to ask word for word, but we can certainly aim to get the spirit of the questions across.

With that, Sergio, the floor is yours.

Sergio P. Ermotti

Slide 1 – Important information

Thank you, Alastair. Happy to be here. And before I start, please take note of the important information on the first slide.

Slide 2 – Winning strategy, delivering for clients

Moving to slide 2, the last few months have put many of us to the task personally and professionally. It has been good to see the resilience of the banking industry as a whole so far, though, and UBS in particular.

We were prepared. Of course, we didn't foresee the pandemic, but it was clear to us that the environment that we saw over the last few years was fragile. We used this time to build up strength. We continued to invest despite headwinds, and maintained our risk-reward discipline.

These choices are paying off now. Today, UBS is stronger than ever. We are highly capital generative, with a balanced risk profile, well diversified revenue streams, and a very strong financial position. We have always said our business model works well in a variety of market conditions. And today is no different.

Because of the financial and operational resilience we built up over the years, we are able to engage with our clients with no disruption. We quickly adapted to the new ways of working while focusing on their needs with full intensity. Most of our clients' relationships are long term by nature, and often span generations.

Our commitment to helping them navigate these unprecedented times will be remembered. Again, with volatility up from all-time lows, and liquidity scarcer, our clients tell us they value our advice even more. They also seize investment opportunities and adjust allocations resulting in higher business activity on our side.

That isn't to say that today's environment is perfect. Credit losses have increased from all-time lows too. These were comparatively modest at UBS, as one might expect with our strategy and underwriting and risk reward standards, but large enough to offset much of the benefits from increased client activity.

Headwinds from lower interest rates become even more intense too, and regulatory costs remain a drag on banks' profitability.

Slide 3 – Fast-changing client needs play to our strengths

While it's too early for final conclusions on the lasting impact of the pandemic, so far COVID has accelerated some pre-existing trends. I would highlight three of them on slide 3.

We are well positioned for each of these, and are adapting fast to the new normal. In my view, digital adoption and acceptance have gained between two and five years within a short time frame. Clients and employees alike have quickly adapted to the new work of virtual meetings, presentations, and conferences.

We are making it easier for our clients to engage with us. For example, we are integrating voice and video calling, as well as an AI-driven meeting scheduler into our digital banking app in the US. As the recognized leader in digital banking in Switzerland and with broad industry recognition for our wealth management platforms, we are able to build from strengths.

We just launched key4, a mobile first mortgage platform in Switzerland that connects retail clients with mortgage providers. In wealth management outside the US, we are having early success with UBS My Way, an intuitive portfolio management app for advisors to use together with clients, truly hybrid.

One of the defining issues for markets this year has been the growing importance of environmental and social factors being weighed into investment decisions. This has been an area where UBS has been a leader for some years. And from that position, we are constantly innovating our offering with a number of important developments over the past few months.

On the wealth management side, UBS is the first major global financial institution to recommend a 100% sustainable investment portfolio as the default for all clients. In Asset Management, we are following through on the promises we made at this year's World Economic Forum. We are rolling out climate aware strategies previously only available in equities across other asset classes.

We have also created the UBS Hub for Sustainable Finance to bring together the best of what UBS has to offer in this space, and facilitate the sharing of insights from experts across our firm and across our extensive network.

These actions cement our leading position in sustainable finance, and I'm confident UBS will build on this leadership further in the period ahead.

Lastly, the economic fallout from the pandemic is severe, and the monetary policy response means interest rates across developed markets will likely stay low or negative for longer. This is a challenge for us and for our clients. We see the returns on savings below the rate of inflation for the foreseeable future.

Investing is in our firm's DNA. So UBS is in a great position to help them face this headwind. We are broadening our offering for private clients and providing a wide range of investment opportunities.

Our wealth management and investment banking teams are working together to capture the opportunity in private markets. The potential here is substantial. Currently, our wealth management clients average allocation to this asset class with us is only just above 1%.

Slide 4 – Rising profits and high capital ratios

Successfully managing this environment also translated into strong results, which you can see on slide 4.

Net profit for the first half 2020 was 2.8 billions, and PBT was up 9% year on year. Driving operational leverage is a firm-wide priority. That's why I'm pleased to see revenues before credit losses up 7% in the first half, whilst costs were only 3% higher as we seek to deliver for shareholders.

Capital ratio remained above our guidance, supported by 3.6 billion of capital generation. Return on CET1 capital was 15.4%, or about 12% return on tangible equity.

Slide 5 – Delivering competitive returns

Turning to slide 5.

A guiding principle throughout my tenure has been and is to drive globally leading returns on active equity, CET1. It goes without saying this includes the full cost of credit that comes with a cycle. As we look at the first half, we delivered the highest return on active equity of our global peers. But moreover, we compare very well over the cycle.

When I started, I inherited a large stack of unutilized tax losses carried forward from the financial crisis. Our restructuring and business performance allowed us to recognize a substantial amount of carry-forward losses into our tangible equity. For shareholders, this means higher capital generation than may first meet the eye, which helps drive capital ratios, dividends, and buybacks.

On the other hand, deferred tax assets alongside accruals, large accruals for annual dividend payments, have created a gap between measuring returns on tangible equity. As you can see, both of these factors are idiosyncratic to UBS. As we continue to drive industry leading returns and use DTAs, this gap will narrow over the coming years.

Slide 6 – Committed to attractive capital returns

Moving on to slide 6.

Again, throughout my tenure, we have been focusing on restructuring, building, and maintaining a balance sheet for all seasons. Over the past five years, this meant organically building up 9 billion of CET1 capital.

But attractive capital returns to shareholders have also been a cornerstone of our strategy. Through dividends and buybacks we have returned 16 billion over the same period.

For the 2019 dividend, we are well-positioned to pay the second tranche later this year, as previously communicated. We will give you an update on this and on any other potential capital returns plans for the rest of the year with our third quarter results in October.

For 2020 and beyond, we will take a fresh look at the mix between cash dividends and buybacks, having a dividend payout ratio more in line with our most relevant US peers. Our intention is to continue to pay out excess capital and deliver total capital returns consistent with our previous levels, while rebalancing the mix between cash dividends and buybacks.

Slide 7 – Deploying our strengths while executing on our priorities

So to summarize on slide 7, UBS is in a position of strength strategically, financially, and operationally. While managing the challenge of adapting to the changing environment, we are driving hard on the priorities we laid out at the start for the year, executing our strategy with discipline.

Most importantly, we are staying close to clients with strong momentum across our franchises. UBS is stronger than ever today, and I'm confident it will also thrive going forward.

With that, we can move on to questions, Alistair.

Q&A

Alastair Ryan

Thank you, Sergio. Very clear and very powerful numbers in what's a difficult world. I guess the first thing for me then is clients. The ultra-high net worth individuals, the real core of your business. Have they been scarred by COVID, or have they been on the sidelines and missed out in is wonderful equity rally and fantastic bond market? How would you characterize behaviors, risk appetite amongst the core of the client base?

Sergio P. Ermotti

Well, thanks. I guess I would say that 2020, already late '19, but to be honest 2020, as we speak, is still the case, that we so a complete change in investor attitude towards their asset allocation in general. '18 and '19 it was very sticky, so clients were happy about their asset allocation in principle. They saw almost all asset classes going up. And while a concern about geopolitical risk and macroeconomic questions, they were basically passive in that sense.

2020 has brought a big change. As I said, partially was due to come in any case, but COVID has definitely increased the needs and the necessity of clients to interact with us and to seek advice on how to reposition their portfolios, because again, the economic consequences of COVID, but also the enhanced tensions from a geopolitical point of view. The upcoming events are seeing investors and clients starting to position, and take also advantage of the volatility in the market.

Alastair Ryan

Thank you, Sergio. And does that translate into asset flows? I mean, I guess those have held up very well through the crisis at UBS. But do you see people bring more money to the bank as your stability has been emphasized, or you know, after a period of reallocating portfolios, does that kind of calm down? Do things go quiet for a while?

Sergio P. Ermotti

Well, in the first half, we saw a very solid trend of inflows partially driven by new money, partially driven by even some pickup in leverage and risk by clients. I think that as you know, we are looking at inflows over the cycle, and most importantly, we want to also preserve the so-called quality of the inflows in terms of is this money coming to us because there is a intention to invest, or is it because we are seen as a safe haven.

And this is something that I don't need to explain to you that in this environment, you know, cash sitting on the side, almost in any currency by now, including the dollar, it can be costly. And therefore, we are also paying attention, again, as we did in the past on the quality of the inflows.

Alastair Ryan

And I'm smiling, because I recognize, it's been a very consistent message over your time. And I guess then, thinking about doing business. So COVID has deeply affected clients, changed the way that industries operate. You can do much more remotely. But pushing companies to look for efficiencies and pressuring their revenues. What do you think about the operational side that you can do to offset the revenue pressures from through low rates and smaller GDP?

Are there things that UBS could be stepping up? I mean, real estate is one thing that springs to mind. But there's a world, you know. You've been investing digitally. You mentioned this moves you forward. How do we think about that?

Sergio P. Ermotti

Look, to be honest, I don't-- COVID has, as I mentioned in my remarks, COVID has de facto more confirmed the trends, and what we were anticipating would come over the years through digitalization, and then different ways to interact with clients.

The COVID emergency on how we operate within the bank has indicated that, of course, there are lessons to be learned about how to manage our internal processes maybe in the future in a more effective way, because you know, I think that without compromising on control and regulatory requirements, we have seen areas where we are able to function more efficiently, and so we will need to see how this can be translated into a more around the bank normal time activity whenever they come.

In terms of footprint and, you know, I have to say that, first of all, of course this acceleration of digitalization and the fact that clients and employees are embracing technology is definitely highlighting even more the necessity to invest in technology as we did in the last few years. Even if we see some headwinds on the top line, we cannot run short of investment in technology.

In the cloud, for example, we made very good progress against our targets of getting up to 33%, a third of our data being managed through the cloud, and in the private cloud. So we are almost half way on-- sorry, we are almost halfway on the public one, at 15%. We see that's coming more and more.

So that translates all into, you mentioned the footprint and the physical footprint. Yes, this will also accelerate, of course. And it's not just about the usual topic of branches. I mean, we have around 270 branches in Switzerland. And of course, there is an ongoing review of what to do.

But by the way, we do it always looking at the P&L and the bottom line, and not to lose clients and profitability while executing the long-term strategy. But it's very important to understand that the flexibility we gain through technology in managing our footprint is there, and it's going to probably take down the necessity of real estate over the cycle.

But by the way, I don't believe that the current situation is sustainable with 80%, 85% of the people working from home. You know? Eventually we're going to swap the other way around with a lot - 20%, 30% of the people regularly working from home. And very few people always working from home. I don't believe you can run a bank and keep a culture and create the right dynamics with people working always from home.

Alastair Ryan

Thank you. Well, that's even as the [INAUDIBLE] technology where it reach out [INAUDIBLE] myself. But thank you. I guess one of the hallmarks of your time with UBS has been a real focus on building the Asian wealth management business. And you've been particularly successful in Greater China. Clearly, the market leader there now. Which cuts two ways at a time like this.

China, US, Hong Kong-- I mean, I can hardly keep up with who's sanctioning whom and all the rest. How does that drive your business? Because both sides of flows, there's I guess some people might want to look

inwards. There's other people who might want to move money away from mainland China into Hong Kong, from Hong Kong to elsewhere.

I mean, how are you thinking about people's actions? Have you seen them protecting their wealth or taking opportunities to invest, because of course, if the trade flows are going to be different, then there might be other ways of making money for your wealthy clients.

Sergio P. Ermotti

Well, generally speaking, as you know, we have been pioneering in Asia and in China in particular, and so our commitment to the Greater China topic is there to stay, and we always said in the last few years that the next wave of growth in Greater China and China itself is definitely going to be more bumpy, less predictable than we saw in the previous 10, 15 years. But still very promising. A lot of opportunities there for our franchisees to grow and develop.

So in a sense, of course, we have to be tactical in the way we look at how we implement our plans. But three or four years ago we said we're going to double our headcount in China, and we did so in the last three, four years. In the foreseeable future, I do expect that continuous interest in China. Of course, these dynamics that you describe may or may not slow down the pace. I don't think they're going to stop the pace.

And we are definitely committed to do both China and Hong Kong in that sense. Still a very strong and viable part of our business. And we also see our clients in the region. Of course, they are concerned about those geopolitical developments, but they didn't really-- they didn't really took measures to basically exit. Of course, they may consider what kind of contingency plan they need to have in place. But if I also look at the business environment in the first nine months of the year, I have to say business is quite robust and positive.

Alastair Ryan

Thank you. Thank you. Then shifting to the other side of that, in the US. I guess, so Morgan Stanley made a big move the day before COVID kicked off. So it's almost a delayed question. There's been a lot of aggressive hiring by competitors. You've had a very clear focus on protecting profitability, which has been successful. But then the industry may be changing. Certainly one of your competitors there threw a lot of money at the idea that the industry was changing. I mean, how do you see the US wealth management market for UBS right now?

Sergio P. Ermotti

Well, first of all, I think that in terms of our leadership in wealth management globally, US is the largest market by far in terms of wealth management. And the fact that we are one of the leader there, I mean, makes it an integral part of our narrative on our leadership in wealth management. It's also profitable.

In terms of both the quality of our performance, but also when particularly I referred before about the deferred tax assets advantage. Every dollar we make in the US goes down to the bottom. So in that sense, it is both strategic, but also very compelling financial case for us.

Now, in terms of strategy, of course we watch constantly our competitors' strategic moves. We have defined our space as being a large player there, but with a very focused emphasis on a high net worth and ultra. So you see many of our competitors, because of pre-existing capabilities or opportunities they see, they go probably more downstream. We are looking to be more upstream and focus alongside our global strategy.

Of course, we know we need to capture the opportunities to improve our margins in the US, which we are working on. And I'm confident that over the cycle, this will come. Better mandate penetration, enhancing our banking products' capabilities, having a deeper penetration with our ultra clients, and lending, and so on.

And last but not least, by the way, this issue about scaled, you know, we always find it a little bit interesting debates, because we have scale globally. We are able to take some of the scale effects from outside the US into the US, and vice versa.

And last but not least, we are also investing in technology with broad reach, an external provider, in order to create a platform that we believe is going to be extremely competitive also for other people, other asset, wealth managers to join on. So giving us in the future that scale effect.

Alastair Ryan

Thank you. So is it-- so you don't look at yourselves as being as-- I mean, going back and-- going back into the mist of time, I mean, before even your time at UBS, but the PaineWebber acquisition. PaineWebber is one of the big four brokerages. And that's not the right way of thinking about it now, I guess, that UBS isn't a smaller one of the big four. It's that your client position is different. So the scale issue isn't weighing on you from that perspective.

Sergio P. Ermotti

No, no. I mean, as I mentioned, we are very focused on improving, but the scale-- I mean, we look at having the most profitable and most productive financial advisors in the US. We have the one-- we have the highest number of assets per financial advisor. We want to differentiate ourselves from our so-called peers that have the higher scale and critical mass.

So I'm not a big believer that we would be successful with a "me too" strategy in the US. I mean, in that sense, you saw us over the last few years focusing on the kind of profile of a phase we have in the US, going from around 7,000 to closer to 6,000, which we believe is the right number for us. So in that sense, we want to be a big player, but big defined in a more narrow way that fits into our narrative globally.

Alastair Ryan

Thank you. And European banking, Switzerland's always a little European and a little not European. So I guess we've we touched on acquisitions by payers in the US. But the European market has been fragmented and stale. Do you think the recent announced talks between Caixa Bank and Bankia, the announced acquisition between the Caixa Bank and Bankia, is a sign things are about to change in Europe? There's a lot of regulatory obstacles that were a key factor of that, and in that broad context, should we think that UBS is in any way part of that potential consolidation?

Sergio P. Ermotti

Well, of course I will abstain to talk about UBS. And I guess I can reiterate and give you maybe some of what we already heard me saying in public, and to you, maybe from time to time about those kind of topics.

So you heard me over last years, and particularly in the last two or two years, that I felt that the debate in Europe was too focused on too big to fail, and rather it should have been too small to survive, too small to compete, too small to whatever.

So I mean, now I think that already late '19 and since COVID things are crystal clear. So as I mentioned a few quarters ago, the train left the station in that sense, and consolidation is inevitable. It's good for the markets, but scale per se means nothing. You have to have focused scales, complementary scales where you create really added value and sustainable shareholder creation.

So of course, I would point out that it's quite clear also on the record that the regulators are open and willing to consider that. It's very positive that they analyze the developments of the last few years and that they are

now able to address this issue, trade-off between too big to fail and what is good to create sustainable banking sector.

And in that sense, I don't believe that per se regulators over time are an obstacle. Actually, they have been quite vocal in the last few months in respect of being open to things that make sense. Of course, they are right to stop things that don't make sense.

You are on mute.

Alastair Ryan

That's an excellent spot, Sergio. Thank you. Just testing. One of the things you talked about in the past was whether it was realistic for banks to have their own front end and consolidate some of the costs of their business. And I guess that's an attractive idea. But nobody's been willing to play that game yet. I mean, with your-- is that still an angle that could be pursued, or realistically just nobody wants to give up that piece, even if they can't really afford it?

Sergio P. Ermotti

Well, realistically to beat big banks on back office and infrastructure is very difficult. Not necessarily always for the right reason. But it is what it is. But we made some good inroads in smaller topics as an industry, being across, you know, if you look at blockchain. If you look at, I mentioned before, Broadridge for technology in working with third parties. So across the board, I would say that we made good progress in smaller fields, in some areas of payments and capabilities that we can share.

I think that the big items probably are going to be difficult to be addressed through that system in the foreseeable future, because of the inevitable tensions that you have between banks not wanting to give up their own system, thinking that-- each other thinks that their system is better than the other.

And number two, there is also in many cases a write off associated with those kind of situations. And in some cases, many banks cannot really afford the J-curve effect on doing something like that.

But over time, I'm convinced that a combination of smaller topics that can be worked together, and as we mentioned before, M&A will create critical mass and scale effects.

Alastair Ryan

Thank you. Thank you. And to cap it all, if I could please, on two fronts. First, how do you think about the trade-off between distributions and investment? I mean, your share price has done incredibly well versus a sector which has not been good. But your share price is still pretty low, I guess. So returning capital is attractive. But there's opportunities to grow is the first thing.

And the second thing, can you imagine getting credit in your capital requirements from the fact that you had a stress test this year. It was a big stress test. And actually, the bank did pretty well. It didn't draw down the capital in a way that people might have feared. Thank you.

Sergio P. Ermotti

Well, I guess the lessons learned is that the crisis, you know, first of all the system was not really designed to respond to a crisis like COVID. The system was designed to try to avoid a repeat of the same global financial crisis, which of course never happened that the same crisis comes, but has been quite instrumental in stabilizing the market and the banking system.

I do think that, when there is a post-mortem after now almost nine months, or six, nine months, I hope that in general, shareholders and regulators will be able to assess that the reliability and solidity of each banks and the needs of each banks in respect of capital, further capital, versus potential shareholder returns.

In that sense, while the situation will continue to be very fragile and very uncertain around COVID, I do think that-- and the fact that the vast majority, if not all, banks are trading below tangible book. It's only good to have a mix of shareholder capital returns to shareholders through traditional dividend and share buyback.

And in that sense, I really believe that share buyback are the perfect tool to create value and flexibility, even for regulators, because it's much easier to recreate or keep capital by stopping share buyback than cutting dividends, as you know. It's almost a taboo for any company to cut dividends. So in that sense, going forward I do believe that-- and as far as shares are below tangible book, it's quite clear when you are able to return capital to shareholders, you should favor that.

Alastair Ryan

Thank you. And in terms of whether the regulators would-- because I mean looking back at old annual reports, you know, UBS was always one of the better capitalized companies. You used to have Tier 1 ratio of 8% back in the days when 8% was a big number. Now, the CET1 is, you know, 13 is the number you've been running.

Do you think there's any possibility that regulators might say, well, that's fine. We can take that down, or we should just be used to it being over that number is about the right way to go?

Sergio P. Ermotti

No, I think that's-- well, if you-- if I remember back when I started, the pro-forma CET1 ratio in November 11 was 6.5% Basel III [based] ours, right? And today, if I look at a like for like, we would be at around 18%. Because you have to think about all the risk weighted assets, inflation, and adjusting of models that we are through. The 13% stayed fairly stable.

I think that around this level is a good level. As going forward, I think that there is absolutely no advantage to have much more capital. By the way, the CET1 ratio is only one important element in assessing the solidity of the bank. The stress, the post-stress capital is much more important. That's why we always looked at post stress as the most meaningful element, although a lot of attention is given to the CET1 ratio. The post stress in my view is much more important. Definitely much more important than the leverage ratio.

And in that sense, we should also pay attention that, you know, keeping too much of capital buffers will only put investors away from the banking sector. I mean, we all see it. It is very, very challenging for the vast majority of the banks to get even close to pay for the cost of capital. And if you keep putting more cost, either through capital or liquidity requirements, or any order cost that is not really seen so visibly, the sector will lose its attractiveness, and its vital importance for economies, because we can't expect the banking sector to be-- to sustain the economies and the markets if it's not profitable in a sustainable way.

Alastair Ryan

Thank you. Thank you. Sergio, we're just about out of time. All that remains is to say, look, thank you for joining us today. Thank you for joining us so many times over the last nine years. It's been an absolute pleasure. We wish you the very best. I know you're very focused on your last few weeks at UBS, but after that in your time as chairman of Swiss Re. Thank you again.

Sergio P. Ermotti

Thank you, Alistair.

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