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UBS CFO speaks at the Goldman Sachs European Financials Conference

Q&A discussion
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Speakers: Kirt Gardner, UBS Group AG CFO and Jernej Omahen, GS head of European financials research

Jernej Omahen:

I am delighted, genuinely delighted, to welcome Kirt Gardner, the CFO of UBS, to our conference. I said to myself, I have to see this until I believe it. Because I think it was Peter Wuffli that was the last person presenting from UBS at the Goldman Sachs Conference. Kirt, know that it is genuine when I say thank you for taking the time. I know you flew down from Zurich. Thank you for making the effort and for taking the time, to spend time here with us and with our clients.

Kirt Gardner:

Thank you Jernej. Actually, I am delighted to be here. It is a very high quality conference. *Inaudible* from Switzerland, and you combine this with Madrid.

Jernej Omahen:

We make it very difficult for UBS to say no to participation next year now.

I am sure you all know Kirt. He is the CFO of UBS and he has been basically since the start of last year so well into the job at this point. He essentially held a number of leadership positions in Citigroup. Particularly on the strategy side of things. He was the CFO and Head of Strategy of Global Transaction Services. He was Head of Strategy, Planning and Risk for the Corporate and Institutional Division. Finally, he was Head of Global Strategy and Cost Management for the Consumer Bank. Definitely a worse job than the CFO of UBS. I'm sure of that. Being in charge of cost management for predominantly a retail institution. But prior to that he had an extensive career. What I think it is particularly notable is that it spanned all continents. So you were in America, you were in Europe, in Asia as well as in Latin America. So I'm just going to stop the long introduction here and I'm going wait for the trickle of clients to continue. We are going to kick it off with Q&A.

Wealth Management. The area of strength for UBS. The area I think investors want to understand in a lot of detail. What was interesting about the first quarter results was that UBS presented, well you presented rather, the Wealth Management as a unit, as a combined business. Why was that a good idea? Why was that a good time to do so together with Q1?

Kirt Gardner:

We felt that it was important, and it is important, time to time, just to remind the market of the uniqueness and the power and the value of our Global Wealth Management franchise. And strategically that is how we look at it, we do look at it as global franchise. From a client perspective, from a value proposition perspective, from a business perspective. If you just look at the broad financial metrics. 2.2 trillion of invested assets that were up 13% year on year, 1.1 billion in pre-tax profit up 19% year on year, clearly we are the leading global wealth management franchise. I think that if you look at the four factors that I will consider unique that underpin the attractiveness of the franchise. Firstly, it is the fact that we are global. There is no one else that has a leadership position in the largest wealth market globally, the US. There is no one else that is dominant and leading in Asia, in Europe, in Switzerland and with a n° 2 position in the emerging markets. That uniqueness plays out in terms of the portfolio benefits that we have certainly seen over the last couple of years. I think secondly, importantly, we are by far the leader in Asia Pacific. It has been the fastest growing market. And despite what we saw last year, it is expected to continue to be the fastest growing wealth management market. And there we have a quite dominant position. We're more than a third larger than the second player. We generated 21 % growth in pre-tax profit over the last four years. In the fourth quarter we generated the largest pre-tax profit that we have ever had in that region. And also what's unique in our footprint we're leader in onshore Taiwan, onshore Japan. We are very committed to China and are building up our position in China. We are certainly the global leader in ultra-high net worth and that is strategically a course we think we're particularly differentiated. And with over a trillion in invested assets and with over 15 % growth in pre-tax profit in that segment over the last four years and importantly, that segment is actually more profitable and has a higher margin than the average margin over all with a cost income ratio of 68% vs 75%. And finally it is our focused investment banking franchise. That is a leader in areas very relevant to the Wealth Management franchise that includes we are the leading investment bank to global family offices and we are the leading equity franchise in Asia Pacific we are the fourth leading equity franchise globally. And we are n°3 in foreign exchange. And we have the second leading research franchise globally.

Jernej Omahen:

So, let's assume that at some point I make enough money to be a client of UBS. A billionaire comes to you, what do you say that is different to your prime competitors? So call it Credit Suisse and some of the US banks, that makes that newly minted ultra-high net worth clients say 'I want to bank with UBS and not somebody else'?

Kirt Gardner:

Well first of all it is just the attractiveness of what we are. The fact that we have been helping wealthy clients meet their needs for 150 years. It is the UBS brand. The strength of our franchise. The capital strength. It is the "Swissness" of the business overall. And that's the starting point. And then it is the value proposition that we were able to deliver. Particularly to wealthy clients. First of all, importantly, we run our family offices and our Ultra business on a global basis. No one else does that. And so we treat you as a global client and we expect that you have global requirements and global needs. You want to invest globally. We have the largest and the broadest product solution platform of any wealth manager. We have what we believe is the best CIO office of any wealth manager. So we're able to offer you superior content on how we can advise you to invest, allocate your assets. And then what we can select in terms of the right solution and meet your unique requirements. And very importantly it can go beyond just the investment proposition. It is the other aspects of what we offer. We do have that global community, we can allow you and help you interact with other like-minded global investors to have frank and open conversations about your needs and your areas of interest. We have the largest philanthropy. We are a leader in sustainable investing. And we know that's a scenario particularly important to you. And obviously, we think about you as a person, about your family, the next generation and how we ensure that we care for that as part of the relationship. And as I mentioned before, it is the investment bank so that we can also meet those other requirements you might have that extend beyond wealth management.

Jernej Omahen:

Is it true, one of your high-net worth clients, an Asian based client, suggested to me that UBS private banking provides the best advice on wine investing and art investing. Is that true?

Kirt Gardner:

Well, we have traditionally…art obviously is something that defines us. We sponsor Art Basel. We have always been a leader in art. And what is interesting is not just helping you potentially to purchase art. But it is advice. So we do have an advisory capability in helping you to think about art. And we can do that not only based on understanding your needs. But we can help to execute. We can bring you to Art Basel. We can help you to find unique pieces.

Jernej Omahen:

And wine?

Kirt Gardner:

Wine, I am not sure about.

Jernej Omahen:

I have to admit I actually checked it with the Head of Private Banking at Goldman. And we definitely do not provide it. I thought it was a good idea.

Kirt Gardner:

I wouldn't mind that service too.

Jernej Omahen:

When I started covering UBS which was, I think, investment banks just in general at a time UBS was more an investment bank than today. I still remember my first client call. I called someone up from the results. I did not know much about UBS. I said, look the revenue line in the US is really strong. And he said to me, why are you calling me on this? They make no money in the US. That question obviously is no longer asked as directly, but it still asked sometimes. Which is, why do they need to be there? What is the answer to that?

Kirt Gardner:

Our US franchise is vitally important. I mentioned it at the outset. It is our global business. We are a leader in the US market. If you look at our US franchise and you see the power of the portfolio impact, our US businesses in particular has being growing over the last year and a half, in a time when our international franchise, in particular because of what we have seen in Asia, has struggled, they've experienced headwinds. Our US business year on year in 2016 was up over 40%. Year on year, first quarter, we were up well over 30%. We took the franchise from actually being loss-making post-crisis to hitting that magic billion mark. We are now on a run-rate well above 1.2 billion. And we have really attractive tail winds. We have the US interest rates that are going to continue to benefit from that business as we go through the year. We continue to build up our lending portfolio and our lending business. And we are quite a unique franchise amongst the other large wealth players in that we're very focused on the upper end of the wealthier segment of the market. It allows us to have the most productive FAs. It allows us to what we say is to play small but feel big. I should say feel small and play big. And that it is also quite unique. And, importantly, we actually just repositioned our strategy that we think will give us even greater opportunity for growth and enhanced profitability. And what we did is, we focused away from recruiting towards retention. That is a huge issue in the US marketplace. The economics of the broker packages can be very dilutive in a large drag on capital as well as on the P&L. We did that by revamping our pay grades. We pay higher productive FAs more. We did that through emphasizing recruiting within our branch managers. We are going to spend some money on that. But it will become very accretive as we get into next year. Towards the end of this year, into early next year. And you start to see the result. Our employee forgivable loans are down 8 % year on year. Our regretted attrition is down from 4.2 to 2.4 %. So it actually it is actually starting flow through to the business in a favorable way.

One other point as well, which is critical to us obviously it's the US business that drives our ability to utilize DTA. And that is a huge asset. And without that business we'd have to write off a very large of part of our capital.

Jernej Omahen:

67 Billions of tax losses carried forward

What is the unactivated DTA number now in the US?

Kirt Gardner:

The off-balance sheet amount for temporary differences is like 15 billion. Still a large number.

Jernej Omahen:

UBS would never pay tax in the United States ever again, for the period of our careers.

Here is the question that we agreed with Kirt that would be definitely be asked. And I will try to make it come across as spontaneous as possible, which is, how has the performance been so far, in this quarter? How does it compare?

Kirt Gardner:

Let me just put that into context. In the first quarter, when we described the performance of the first quarter, we described client activity as being uneven. And what that meant is we have seen consistent high activity levels out of the US that has really been in place for six quarters and actually post-election, we saw greater levels of optimism ithrough the survey that we perform. And in the first quarter though, what changed is that after six quarters of low level of activity, particularly driven out of Asia, and a high degree of risk aversion we actually saw our Asian clients become a bit more confident about the market environment. And I think what changed there was the view on the question how China is going to transition. It is starting to become a bit clearer and their growth trajectory which is yes, only 6 to 8%, not 10 to 15%, still 6 to 8%. And the volatility around China dissipated a bit and that I think gave greater confidence amongst our Asian clients. And that was reflected in their transaction activity levels in the first quarter, and helped to contribute to the quarter. We also saw a very strong performance in primary markets, in our investment bank. But what we did not see was a lot of institutional investor activity because volatility levels were extremely low. Since our investment banking model is one where we don't carry a lot of inventory, we do not benefit from that carry-trade that was definitely present during the first quarter. As we have gone into the second quarter, consistent with our outlook statement, where we stated that enhanced confidence levels have not yet resulted in sustained client activity levels. That is in fact what we are seeing in the second quarter. The volatility levels remain very, very low, in fact hovering around 10, slightly below 10, so at levels that we have not seen since the early 1990s. That translates obviously into particular institutional clients in their appetite for trading. That impacts the investment bank. It also impacts the upper end of our wealth management business, where family offices and wealthy individuals behave like institutions. And it is particularly impactful for us, because as an investment banking franchise we again don't have large trading positions. We are very reliant on institutions, more weighted to the institutional side than the corporate side. And clearly at the start of the quarter, the lack of volatility is playing through obviously on that uneven activity. And I think it is quite consistent with what you have heard from the US banks and the statements they've recently made.

Jernej Omahen:

Excellent. OK. I am going to ask one more question. But then I suggest that we turn it to our investors, and we can cover other topics that way. We have your competitor presenting right after you. The person presenting is focused on Asia. And I just wanted to pick up on this angle. So that we can contrast and compare. You made some passing statements before. You are very happy with your business in Asia. It is growing. You can do things other people are unable to do or at least not to the same extent. How do you think about your Asian Business? How important is it? Can you elaborate a bit on that?

Kirt Gardner:

Asia for us is vitally important for the franchise. In many ways we are a leveraged play on Asia. That really drives a lot of the upside in our wealth management franchise. It drives a lot of the upside and the downside and the volatility of our investment bank. As I highlighted, we're by far and away the leading wealth manager in Asia Pacific. We are doing some things in a way unique in order to stay in that leadership position. We started a program not long ago to focus on small and medium entrepreneurs. We actually hired commercial bankers and we trained them to be wealth managers. We set up an office in Kowloon, that has been incredibly successful we are rolling that out across regions. We are very committed to China. We have two legal entities in China. We are adding licenses to allow us to be able to distribute our wealth management products. We were just licensed to distribute insurance. We fully intend to build, this is a long game obviously, an important presence in the China market. We also are looking at ways to address that market electronically. We are not going to that just through traditional means. We are looking at internet in other channels. Within the investment bank, we have the leading equities franchise. One of the things that we've done, is we were very focused on the public sector on China. We've diversified a bit to balance that out, to focus more on the private sector. We have also extended our industry organization across the region. I think in short, you will see, we will continue to invest and ensure that we maintain a strong leadership in Asia. And that will help out to find what we are going to be in the next five, six, seven, ten years.

Jernej Omahen:

Kirt, just a follow up before we go to our Q&A. Why do you think that large US investment banks are coming to the opposite conclusions when it comes to the Asian opportunity but the private banking opportunity in particular? I mean JP Morgan in a very, surprisingly, high profile manner, reduced the number of private banking front office employees last year. I think Citi did the same but perhaps with less pomp. Why is that?

Kirt Gardner:

If you look at the Asian market, first of all, it's one where you need scale. If you don't have scale it is very hard to make the economics work. And I think secondly just the six quarter period where you saw a very substantial reduction in primary activity around investment banking. Which is vitally important to the type of wealth management J.P. Morgan does and City does in the high-end. In the absence of that, I know it was an economic drain on their franchises. They had to look at the cost side of the business. I think you also saw a number of other global franchises have pulled out of the region for those reasons. On the one hand, you can actually monetize that franchise at a pretty high multiple. And if you are not a scale player and you need capital, it's not a bad asset to sell. There has been some consolidation amongst global players, which is a good thing. On the other hand, the domestic and regional players have become stronger, and are starting to invest in wealth management.

Jernej Omahen:

Let’s use this as a pause, and take some questions from the floor .

Inaudible question from the audience

Kirt Gardner:

Yes, what we said before is every one per cent reduction in the US Tax rate would imply a hundred and fifty million impairment to our DTA so depending on where they end up, obviously it could result in a fairly substantial impairment. Now part of it also depends on whether or not, because there is talk about not only reducing tax rates but potentially actually extending the period of which you have to use NOLs and DTAs, that clearly would impact how that would play out, whether it would end up being one hundred and fifty million or something different. Now importantly, just given the accounting of DTAs if we had a large write-off there would be zero impact on our capital.

there would be no impact at all to shareholder equity and you could be assured that when I look at that even though it would be a P&L hit because it would flow through our tax line it would not impact our dividend policy, importantly.

Jernej Omahen:

But there would be an impact on tangible net asset value right? Tangible book value per share technically.

Kirt Gardner:

Yes, correct, but not shareholder. Perversely what would happen is we would take a write-off and our return on tangible equity would increase. One of the things we point out, if you look our return on tangible equity in the first quarter was 12.4 per cent but if you look at our tangible shareholder equity we have 22 per cent of that is DTA balance which is well above anyone else. If you adjust the numerator and the denominator of the DTA that return increases to 17.4 per cent for the first quarter.

Inaudible question from the audience

Kirt Gardner:

If we had no firm evidence that that was something that had gone through congress and then ratified we would actually not take that into account, we

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would just look at our normal 3 year planning process, our earnings potential that would flow through what we do with our DTAs.

Jernej Omahen:

Dirk is clearly assuming that the new administration will get their act together and put through a corporate tax reform this year. Anyway let's take the next question.

Inaudible question from the audience

Kirt Gardner:

First of all, in terms of how I view digital in general and so on, this onslaught of robo-advisors, I don't believe that digital is a threat to our core wealth management business and certainly the client research that we have done validates that. I don't think anyone with more than five million in assets is ever going to completely turn over the relationship to a robo-advisor, there's too much of a human quotient involved in there and there's many other aspects that go into making that relationship rich in value. Now having said that though, we are firmly committed to ensuring that we are a global leader in digital within our wealth management franchise. What does that mean? It means adopting and investing in digitizing our own platforms, it means investing in other digital capabilities like we made an investment in SigFig in the US which is a business-to-business offering. It allows us to enhance the experience to our clients, allows us to improve the productivity to our FAs and very importantly it allows us to transform our front to back process, and I think there is where you are going to see a substantial… to me digital in a large part is not just a client proposition and a channel play, it is a transformation play, it is one that will allow us to fundamentally change the cost structure of the industry. And for us it becomes easier, we are the only one that is committed to a global wealth management strategy – that means we're actually building out a, one global platform. Within two years almost the entirety of our international business will be on one global platform which makes it a lot easier for us to deploy digital solutions across that platform. The other area where we are doing some experimenting we launched Smart Wealth in the UK which is a robo-advisor like platform but it plugs into our CIO office and it is targeting the lower end of the affluent market with a ten thousand pound minimum investment. We are experimenting to see actually how that goes. I said before we fully expect to address the China market through digital channels so we are looking at partnerships to actually do that.

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Jernej Omahen:

Ok great

Inaudible question from the audience

Kirt Gardner:

So if we look at MIFID II and we think about it in the context of our wealth management business, firstly we have already addressed what is one of the bigger areas of impact and that is retrocessions and so we are retrocession-free across our entire platform in Europe and Switzerland. Beyond that I actually don't see a lot of the fiduciary, a lot of the other MIFID II rules will not have a profound impact on our wealth management business and I'm pretty confident we are now beyond the full cross-border transformation, our European business is fully regularized, we actually have the headwinds of retrocessions behind us. We are actually at a point now where that business should be in a much better more stable quarter on quarter growth trajectory so we'll continue to be committed to the onshore market as well the off-shore market going forward. MIFID II is going to be much more impactful to the investment banking market and it will of course also have an impact on the asset management business, we can talk about that separately if you like, in terms of our asset management business, clearly the asset management industry is going through a significant period of structural change particularly with the movement out of active into passive. From our perspective I like our asset management business for all the reasons you have heard others talk about, it's capital light, cash-rich, not a lot of ops exposure, very high returning so we are committed to asset management. Having said that, we are looking at how we should position ourselves given the transformation, a third of our invested assets in that business are in passive, we have a large passive platform, we're number 4 in Europe, we're top 10 globally, we continue to invest in that platform to enhance it. We will look at inorganic opportunities and we are looking at other ways to thinking about how can we enhance that asset.

Jernej Omahen:

Let's take the next question

Inaudible question from the audience

Kirt Gardner:

Yes absolutely – our family office offering, which is unique is a full joint venture between wealth management and the investment bank. That means that we jointly serve those clients with both platforms and with the joint relationship management structure, it also means we share that P&L and that capital allocation on a fifty-fifty basis and it is run truly as a global franchise as it should be. So what we're doing is, we recently reorganized, we globalized our ultra-high net worth business as well, so what that is doing is, before those clients were quite fragmented across a large number of CAs so it was hard for us to expose those clients to our more sophisticated investment banking offering but by consolidating that end of the global business we are able to ensure we have the right CAs that have the right level of sophistication that are serving those clients then we are also able to more easily expose them more economically some of the investment banking solutions so what you sort of see that the GFO offering it will actually provide a GFO light like offering to the more sophisticated ultra-clients and we'll see the corresponding benefit in terms of additional wallet share and additional revenue.

Jernej Omahen:

Can I change back a bit because you mentioned it before, and we hear it from other private banks as well obviously, and even banks that are trying to make in-roads into private banking, the liability-led structure, strategy is becoming increasingly important, so you need to be able to provide leverage to your clients and I think particularly in Asia if I understand correctly that is an absolutely critical product. Two questions here, number one, why are banks including UBS seemingly rediscovering the concept of the Lombard loan the fact that it's low-risk but on a risk adjusted basis, quite a high margin product, why is that happening now? And given the reasonably rapid growth of Lombard loans at UBS and for the industry, what is the risk that we are embedding if we have a down-turn in the credit cycle at some point in the future?

Kirt Gardner:

So firstly, it's not for us a rediscovering, I mean Lombard lending and mortgage lending, asset financing has always been an important part of our wealth management offering. And actually we had very very strong loan growth in that business leading up to the third quarter 2015 and for us it is an intrical part of our wealth offering, so a way that clients can use leverage to enhance returns and obviously address some of their lifetime requirements in terms of asset purchasing. What did happen though is when clients went risk-adverse we saw a deleveraging so it wasn't because we pulled back from lending it was more because their appetite for loans actually diminished, less confidence, less willingness to pay for the leverage.

Now as we went through the year though what we recognized is that we still felt that there were lending opportunities and we were not actually being as proactive as we should be, so we did reenergize our loan strategy, we relaunched that at the beginning of this year, we hired a very senior banker from JP Morgan to run our banking products group, we deployed lending capitals across the regions, we reeducated our CAs, we introduced solutions that had embedded leverage and you saw a pick-up in loans, 2.4 billion in fourth quarter, nice year on year trajectory, also more importantly in the more structured end which is lending against particularly illiquid stocks, single shares, un-public stock, private stock, which requires investment banking capabilities we always struggled with that because of the organizational crossing that we have so we have actually set up a wealth management desk within the IB to facilitate that lending so you start to see some growth there. From a risk perspective we are an ultra-conservative organization, and we are not going to change that risk orientation, so I feel very confident in our ability to sustain that business and to have limited, contained losses in a market downturn and we've had some good examples once again, if you go back to the third quarter 2015, the Asian markets dropped really sharply, we had no losses.

Jernej Omahen:

UBS didn't.

Kirt Gardner:

UBS had no losses.

Jernej Omahen:

One of your competitors in Switzerland remarkably lost a lot of money on a Lombard loan.

Kirt Gardner:

Different banks perhaps have different risk orientations, for example we are never going to cash-flow lend, to me to lend money to a factory in Indonesia is not part of a core wealth proposition and I certainly wouldn't want two billion of cashflow loans sitting in my wealth business. That might be a loan that the IB decides to make because of the potential access to fees but that is just not business that we are going to undertake.

Jernej Omahen:

Kirt, is your assessment that we are at the start of an uptick in the activity Lombard loans or is this a trend?

Kirt Gardner:

I think lending has always been part of the business, for example in our US business, one of the big differences between us and the other US players is that we are underpenetrated in the banking products, so we are purposely trying to increase our loans and we will continue to see that, but if you look at the loan to invested asset ratios I think that we have been as high as just above 14 or 15 per cent. To me, that is probably about as high as you would go if you think about the natural wallet to wealthy individuals are likely to have, if you are pushing beyond that it is almost like you are forcing yourself to go into areas that aren't part of real wealth management franchise. To me it is just staying consistent to what you are and what you do.

Jernej Omahen:

Ok. Let's see if there are any other questions… There we go, one in the back?

Inaudible question from the audience

Kirt Gardner:

To the first part of your question first of all I would encourage you to de-emphasize net new money. I just think it is not that of an important metric in terms of what drives growth overall. Our invested assets are year on year in the first quarter we're up 13 per cent. The vast majority of that was not due to net new money inflows and quality makes a big difference. Net new money is going to be volatile, yes it's important, we expect to continue to be a leader in generating that positive growth but I'll give you a very good example: one of the things that we did early in the second quarter is that, our Euro deposits are currently dilutive on capital and dilutive on P&L because we have a very small loan book and so we have a large liability overhang in Euro. So clients that have large concentrations of Euro deposits for us are economic loss making. So we went out repricing all of our wealth management Euro deposit holders. And that is going to result in three, three and a half billion of net outflows. Those net outflows will be accretive to the business overall but they might show up as impairment to net new money. It is where it's a a good example where net new money alone can be misleading if it is not in context. The second part of your question in terms of the cross-border process, this started with the US, with cross border settlement between the UBS and the US , sort of started the industry chain reaction of what was leading to full open transparency and that is going to be finished and finalized with the automated exchange of information. From there all the European markets they launched cross-border amnesty programs in which we very actively participated. We indicated we expected 30 billion of outflows – we have since then become more transparent we said at the end of last year we realized 50 billion in outflows, Europe is largely done, Italy was the last market to go. This has now extended into the emerging markets. What we've seen in the emerging markets are amnesty programs across Russia, Brazil, Mexico, Argentina, Chile, Israel, South Africa, Indonesia, in addition to that because of the automated exchange of information we are going out to all of our clients in written form and asking them to validate and confirm their tax status and that also results in outflows. We estimated 14 billion to go this year, we saw 1.4 billion that flowed out in the first quarter so that is still what we expect between now until the end of the year and then it will substantially be done. The good news there is that that is a major drag on our current revenue line, once we complete this program, we'll have much more stability in our recurring revenue going forward.

Jernej Omahen:

We talked a lot about the private bank, as we should but what I said at the beginning is that UBS fell in the investment banking bucket so the investment bank has been scaled back a lot – those changes in capacity seem permanent – do you ever think to yourself 'we have overshot in certain areas? We should add more balance sheet, more capital or more capacity' or is the investment bank that we are seeing today the new investment banking unit of UBS?

Kirt Gardner:

To be very clear the strategy that we have for our investment bank is one that fits our business portfolio and it will endure. And I think that if you look at the basic parameters it's never going to make sense for us because of the proposition of what we are to investors to have more than a third of our balance sheet, of our capital footprint of the investment bank. Because once we get above that, you said before that you started to cover UBS when they were more of an investment bank, we started to get actually more capital allocate, become more like an investment bank and we're not a unique wealth manager and also it works, the strategy works, if you look at the last 10 quarters, we only have one quarter where we dipped below 15 per cent return on attributed equity over the 10, and that was 12 per cent. The first quarter this year with our new attributed equity framework we were over 24 per cent and that business consistently has the highest return on RWA within the industry by a large margin so it actually shows it can be very capital efficient with this strategy, very client centric and yet it retains its leadership position in the areas that it chooses. I think it is a strategy that fits us really, really well, and it's one that we expect to fully continue to support and sustain over time.

Jernej Omahen:

I asked our CEO of Goldman Sachs International what part of the investment banking business he is most excited about, which sub-segment and he kind of dodged the question so I am going to try my luck again here. If you had to think about a sub-segment of investment banking where you say, 'you know what, the returns here are really attractive? I see growth options, I'm going to commit more capital' could you come up with a few ideas?

Kirt Gardner:

Part of the problem is that it is hard to actually state what that is now, I think that finalizing Basel III is going to have an impact on the capital consumptions of the sub-segments of our investment bank.

And so will NSFR. And NSFR might take a business today, along with a fundamental review of the training book which actually returns really well on resources deployed and turn it into a marginal returner. And then MIFID II is the other element that is going to have an important impact in particular on the European trading businesses. Having said that I think that one of the things that we are doing is rebalancing in the investing in the US because one of the things we acknowledge is our portfolio has been overweighted in Asia and in Europe and in Structured Products, not enough weighted in flow, traded derivatives in the US and so we are, we have been trying to build up also our advisory franchise in the US, which is important to us.

Jernej Omahen:

Does that come with balance sheet usage? Because I thought that the last, your US balance sheet usage has been doing this, including in the last two quarters. Is that about to change?

Kirt Gardner:

No. We actually have been allocating a bit more balance sheet to our CCS franchise. What we have been doing on the US side is with the reduction of NCLs so a lot of non-core legacy have been built in the US, the balance sheet reduction that we have seen over the last three years is really getting out of legacy businesses. We've been building up a little bit in capital support in the CCS franchise

Jernej Omahen:

The IHC accounts – we should expect to see a stabilization?

Kirt Gardner:

I don't expect us to increase significantly at all the footprint in that business. We will though increase our banking products, we'll increase our lending in the US.

Jernej Omahen:

I think we have time for the last question and I … so you brought up the question of Basel, we had the general manager of BIS here yesterday, Jaime Caruana, and I thought somebody from the audience asked him a very brave question. He basically said 'look, there is a bank in Europe called Unicredit, that are guiding for a 150 BPS hit to capital when the Basel III rules are finalized, do you think that that's the kind of magnitude we should be expecting across the big banks?' Caruana said (his answer was remarkable): 'look, regardless of what they are guided for, the number's going to be less because the way the compromise is currently being put together dilution occurs, he wouldn't identify where dilution and calibration is coming through, but indicated he is. When you refer to Basel III finalization I got the sense, hopefully accurately, that you are more cautious as to what the final rules would be.

Kirt Gardner:

We've always been very clear there have been a number out there that have actually made statements about what the impact will be. We have always said 'how can you make that statement'? We have no idea what the rules are going to be. No ide at all. All we said was if you take the rules that were originally guided and apply them to our business we would have a substantial increase in risk density. To put this into perspective, our risk density is now about 24 per cent. Within the laws of the industry. To become completely to the point where RWA becomes our binding constraint, first of all on an equal footing it would be 35 per cent, that is 3.5 ten CET1 ratio but actually before we get to 35, because we hold a higher buffer on RWA to deal with stress, probably a 20 per cent higher buffer I would hold, on RWA versus LRD we are talking about 28 percentage…29, at that point it is sort of equally binding for us. Now, what will the impact be? Again I still cannot speculate even with what was linked to the press they are making broad statements like we allow for greater risk sensitivity – what does that mean? Who knows? Mortgages will actually be treated in a differentiated way and then of course the comments that it will be discretionary at the local regulatory level. How you have anything that would work out what it is likely to be is completely unknown to me but I would agree, I do think, the US has come back, they are going to advocate, they are not going walk away from the table without agreeing to floors, so floors are reality so what I think the Europeans are coming back with is to negotiate around definition of standard and I think that is where you are going to have flexibility and softening – the standard definitions will definitely, I think result in a little bit of a backing off of what the impact could be.

Jernej Omahen:

It's going to be a non-standard definition of a standard model

Kirt Gardner:

Exactly right, a risk-sensitive standard

Jernej Omahen:

Exactly, a non-standard standard. A standard non-standard. So typically dilution in regulation around definitions which is a different word for exemptions, timeline to implementation, and then phase-in period. Another indication that we got is that the timeline to implementation to use the general manager's words, would be 'ridiculously long'. If Basel comes to UBS and says 'here's the floor, the output floor is 70 etc etc but you have got 15 years to meet this, and we are not going to start phasing in immediately, we are going to have a moratorium period of 4 years', as a group CFO, would that concern you, or would you just say 'time is a great healer in finance, by 2030 we are going to be fine on this'?

Kirt Gardner:

Part of the problem here as you well know, is once they set the standard, that becomes the yard stick, so if in addition to that they require, we're going to give you 15 years then you have to start to report on the fully implemented standard today, that becomes a big problem because that transparency already creates pressure for us to be able to adopt and to meet the standards in a much quicker glide path so I think it really depends on how that is implemented, you don't have to report according to the new standard and I think naturally we would want to take advantage of the glide path, but also that we would want to be conservative, we would want to hit the target well before the 15 year period. We've done that with 'Too big to fail' 2.

Jernej Omahen:

Do you think this can happen that they say you don't have to report it in a certain period of time?

Kirt Gardner:

I think that would be a negotiation point. Certainly that is what we have already have put on the table – if you're going to provide long implementation periods then we think you should exempt the need to report according to the new standards. But then what happens is that they might come out with the guidance but once some of the banks start to report on that basis you're forced to report anyway. So it is a bit of a challenging position to be in so I don't believe the extra-long glide path is going to be extremely useful.

Jernej Omahen:

Excellent. We are out of time, thank you so much for being here.

Kirt Gardner:

My pleasure

Jernej Omahen:

Hope to see you next year!

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