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Fireside chat with Tom Naratil, Co-President Global Wealth Management and President UBS Americas; Moderator: Amit Goel, Barclays

Transcript. Replay is available at www.ubs.com/investors

Amit Goel

Hey, thank you and welcome, everybody. I'm delighted to welcome Tom Naratil from UBS, Co-President of Global Wealth Management and President of the Americas. We're going to run through the audience poll first before having our fireside chat. So please if you could find the survey option on the side of your screen and select your responses to the questions. There are six questions in total. Question one is on what would make you more positive on the shares. Number two is on the revenue drivers that you think are most relevant. Number three, on cost expectations. Question four is on capital, question five is on ESG, and question six is specifically on GWM and where you think that management should focus their energy. So, I'll give you a few seconds to complete that. Just waiting for some responses to come through.

All right. So I'll go through some of the answers. On question one, what would make you more positive on the shares, so two main responses. One, higher capital pay-out and number two, positive revenue surprise. And a smaller answer for cost savings.

In terms of question two, what do you think the biggest influence on revenues will be in the coming 12 months? The main response is fee and commission income with a small response for policy rates. Question three, how do you think about UBS cost development versus expectations? So, actually most of the answers are for either likely to meet expectations or actually likely to miss expectations due to cost inflation. Question four. How do you see UBS Group positions on capital and dividends? Here, the majority of answers are on upside surprise from better earnings in future years, with a few people responding downside surprise from increases in regulatory requirements. Question five. How do you see UBS Group positioned on ESG? Here, overwhelming response for above average with a few people saying, in line with average.

And then question six, where do you think UBS management should focus their efforts in GWM? With the options being one organic growth through hiring advisors, number two, organic growth through leveraging the existing client base more, number three, inorganic growth, and number four, reducing the cost base. And the vast majority of people said organic growth in AUM through hiring advisors, followed by organic growth through leveraging the existing client base more e.g. more structured lending. So those are the poll questions. I don't know, Tom, if you've got any remarks on what you've just heard.

Tom Naratil

Those are not too surprising to hear some of those answers and I think we'll probably touch on it in some of the questions that you've got lined up for me.

Amit Goel

Yeah. Perfect. Okay. So we'll commence the fireside chat. So the first question is what is on clients' minds at the moment? How would you describe your client's risk appetite and how are you advising them? Are they willing to put money to work? Take on leverage?

Tom Naratil

Sure. So to that one I'm going to have to say first, clients, are definitely really engaged now. And one of the ways they're engaged is very engaged around content. And that's certainly one of the changes that we saw during the pandemic was in the way we transmit information, very similar to the way you're doing this conference over the next few days. Virtual people can interact digitally, and they find that they're able to pick to choose what they consume, but it's also helping to drive a lot of interest. And what we clearly see in survey work we do with investors is that they are still very much risk on. I'd probably contrast two asset classes for you. Fixed income is the asset class everyone loves to hate and equities as the asset class where you see about three quarters of high net worth and ultra-high net worth investors globally focused on increasing their exposure over the course of the next six months.

One of the other things that we see, we use a real time client feedback tool. So it allows us to test how do clients feel about how we're doing for them, but also to tell us what are they interested in. And what you really see, in particular in the US not surprisingly, is a focus around taxes, a focus around what are some of the impacts of the way that they should be managing cash in a low interest rate environment. And then also how they should be optimizing things like the structure of their borrowings in the most effective way. So overall, I'd say engaged client base. If we want to pick the points of worry on a global basis, inflation is one of those things that pops up quite frequently, politics in their home country, and then interestingly and certainly over the course of the past six months or so, we've seen a big uptick in concerns around cyber security.

Amit Goel

Thank you. And so moving into the second question, how much of GWM's current momentum reflects the kind of unique macro backdrop versus how much do you think is reflective of a step change in growth? Do you believe GWM can still do well if markets correct, or we end up in a period where we're less wealth is created?

Tom Naratil

So I think I'd characterize the wealth management businesses as one that's a very emotional business. And so it's not necessarily a great market environment or a volatile market environment that really is going to correlate with our future success. What it really is about is that demand for advice and counsel. And I also think that as we look forward, there also, even as you're using more digital tools with clients, you certainly see a need for that human connect. Who's that person that can help me to validate some of the things that I'm thinking, to help dissuade me maybe from some of the other things that I'm thinking. So clearly, when we think about environments, it's not just solely a question of what's the level of the MSCI World Index or the S&P 500 that's a driving our performance.

I do think that several of the changes that Iqbal and I focused on going back 18 or 19 months ago with our elevate program really were focused on how do we take some of that cyclicality out of what we're seeing in our business. And some of those things were around how do we set up and tailor our client coverage in ways that are more meaningful to our clients? How do we make sure that we bring ourselves closer to our clients was a little bit about operational effectiveness, removing layers, trying to make sure that we're faster and more responsive to clients. And then the other thing that I would say is, as we look at the advice that our CIO team gives, our focus on UBS Wealth Way, which really is around clients' needs in their liquidity, longevity, and legacy buckets. And it really gets into the behavioral economics part of what we do in terms of advice.

And so if you think about that, what are we doing? We're helping clients to answer three questions. What should our family do to maintain our lifestyle? What should our family do to improve our lifestyle? And what should our family do to improve the lives of others? And we're fortunate enough to be able to work with families who can very quickly move through those first two questions, but that third question on what we can do to improve the lives of others. What can we do to think about our legacy? Those are things that, again, don't depend on market cycles. Those are things that are very important to our clients and things that help to build lifetime relationships.

And just touch on one really great example, the need for advice, so philanthropic advisory, is one of the areas where we see clients increasingly engaged. We've got over 75 people globally, who that is their full-time job, advising clients on philanthropy. And one of the things that we've developed over the course of the last 12 months are collectives where we have groups of clients getting together and three-year projects where they've committed funding, where they're committed to a learning program to learn about a particular topic, and then committed to a course of action following that. And we see collectives built around social finance, so reducing inequality. We see collectives in the area of climate change. And we also see collectives in the area of global child protection, protecting children around the world from things like trafficking. So, when you think about engagement with clients and the things that we're doing, philanthropic advisory certainly isn't market dependent.

Amit Goel

Thank you. And then they go on to lending. So lending has been a strategic focus area for some time, you've had good momentum across GWM, but especially in the US, are you confident that you can continue this momentum? And how do you alleviate investor concerns that there's been a change in risk profile?

Tom Naratil

So certainly the opportunity is still there for us, Amit, in terms of lending around globe. And it doesn't matter whether we're taking our US business and measuring it against our peers in terms of lending penetration as a percentage of invested assets, or whether it's our global peers in terms of our penetration. We are in the middle of the pack and we still have more room to grow and more opportunity for us within the risk appetite that we have Amit. It doesn't require us to take on substantial amounts of risk. And if you look at our business today, really only about 5% of that lending book is heavily structured loans on an overall basis. And if you look at our growth, our growth is mostly coming from the standard Lombard or security-based loans here in the US or elsewhere around the globe.

I do think some of the things that we've actually seen, it goes back to something I mentioned before, which is giving our clients advice about better ways to borrow. One of the things that we've seen over the course of the last year or so has been a shift in a business that used to be 95% variable and 5% fixed into a business that's more like two thirds fixed and a third variable. So we see clients extending now, I'd say on average, out to 18 to 24 months in terms of fixed financing in US dollars, but some clients are also even extending out past the five-year tenor as well.

So, I think we're in a position that we could also think about - to your risk question. - let's think about the real time stress test that we had in the first quarter of 2020. We did have the opportunity to see that on our entire loan book, our loss expenses ran around three basis points. Some of which has been recovered since that time period. If we look at impaired loans in the GWM portfolio, it's currently at 0.3%. That 0.3% is the same position we were in pre pandemic. So I think that we showed that the advice we give our clients, which is good credit work is also good for them because none of us wants to see them in a position of liquidation or collateral.

Amit Goel

Thank you. And so moving on. So the SMA initiative in the US has seen some success, and I think management have indicated that it goes beyond initial expectations. What do you attribute this to?

Tom Naratil

So this is one of these things where it sounds so simple after the fact, it makes you wonder what took us so long to get there, but it really was focusing in on what did we see where clients were willing to pay, where were they seeing value? And clients were telling us that they didn't want to pay for shadow beta. They were willing to pay for active management. So that's the first thing that we are seeing. The second thing, and this was a little bit more of an assessment of our position was how do we take advantage of our scale position, you know, certainly given our position in wealth management. But it wasn't about how do we get better economics for ourselves. It was, could we redesign the product to be able to give better economics to our client?

And so we effectively set up a freemium model and the freemium model works in technology. I would say it also works in finance. So we were able to effectively take the additional third-party manager fee that the client would pay down to zero. We contract with the third-party manager, whether it's our affiliate or an existing third party manager at an institutional rate that we set. And then our clients also can now see something that's more transparent because there are services that are premium services, things like personalized tax management, things like sustainable finance, certainly personalized sustainability as well.

And so clients have been able to, rather than seeing that bundle price, they've got a dis-aggregated price. They're paying for the part of the relationship that they think adds value, which is the financial advisor and those premium services that we've added. So since inception, I think we've got around $78 billion in net new money for our own asset manager under that program. We've also signed up from third-party managers, 38 different strategies from which our clients can choose. So, it's certainly outpaced. We thought it was going to take us two years to get to an accretive point in the P&L for the group, and we were there in year one. So it's been a big win for our clients and also a good win for us.

Amit Goel

Okay. Thank you. And I guess sticking with the US Wealth Management business, you've seen improvement in Wealth Management US pre-tax margins, but they remain below peer levels. How much of this is structural and reflective potentially of a lack of scale? And do you need a deal to achieve your growth ambitions as we've seen others in the US asset gathering space? With a significant capital buffer at group level, you're like, it looks like you have the capacity to be active in M&A. Could this be in the US?

Tom Naratil

So Amit, let's talk a little bit about the journey that we've been on. If you go back five years ago to 2016, our pre-tax margins were running roughly around 12%. If you annualize the first half of the year, we're running closer to 19%. So we've seen a 700 basis point improvement during that time period. Now, why have we seen that? It's really the key levers that we've been focusing on. It's growing the lending business as you know well. Our compensation ratio on net interest income is a fraction of our compensation ratio on asset management. So that certainly helps to improve our margins overall. Second driving more net new fee-generating assets going forward is certainly something that helps to improve our margin. And then finally, the third piece, and probably one of the best indicators of both our profits and our pre-tax profit margins is the productivity of our advisers. Not only in the US, every place around the world our strategy is to focus on driving that productivity. And we would expect as we continue to drive those three key levers, lending, net new fee-generating assets, as well as productivity, we'll continue to expand our margins in the US and around the world.

To your question on scale. We estimate the impact of scale at this point only be about 300 basis points. Historically, it might've been as much as 500 basis points, but the improvements that we've driven have shrunk the advantage associated with that. So, do we look at things that are inorganic? Certainly, and we should. At the same time, we think the opportunities from an organic basis are quite attractive.

Amit Goel

Okay, thank you. And now changing the [inaudible] little bit, so how have business priorities changed since Ralph joined? He's indicated that UBS will focus investments for growth in both the US and APAC. For the US, how much of this is a continued investment and execution of existing initiatives versus new initiatives and trying to capture untapped growth channels?

Tom Naratil

So without a pre-revealing any details that the group CEO might be giving out, what I would say to you certainly is Ralph has certainly, after having done a full review of our businesses, really pressed the bet in terms of saying, you know, for us in wealth management, the US and Asia, those investments in US and Asia are going to be very meaningful to the growth that we want to drive going forward, in those regions, in Global Wealth Management and for the group as a whole. I think the additional part of that is the emphasis that's being placed on technology. We've always invested in technology, but really focusing in on that technology that can make a difference. So, a lot of focus on the things with which clients will engage. So the digital tools and apps that they will use using digitalization and technology investment to increase the productivity of our advisors as I mentioned before. And really placing our decisions around technology in the context of our client promise. So, what can we do to make the experience with us more personalized, more relevant, more on time and more seamless?

And maybe the last piece, and I think this one will be extremely impactful to the way that we work, the speed at which we work and the way that our clients feel change, which will be a positive. Ralph is really asking the organization to examine itself and focus on operating, not just our technology division, but the entire group in new ways of working that are focused on being agile.

And you know certainly I think very large global financial institutions, when you say agile, probably most people don't think of those institutions in that way, but I do think that Ralph's focus on that and the challenge to our teams on that is what we're going to need to do to be even more effective at delivering for our clients and ultimately for our shareholders. So more to come in terms of details, but Iqbal and I are both optimistic about what it means for wealth management.

Amit Goel

Thank you. Looking forward to obviously hearing more in due course. And so on the next question again for the industry, margin pressure has been an industry-wide trend and clearly UBS has not been immune to that. How are you balancing volume growth with pricing and activation?

Tom Naratil

So I think a lot of the commentary around things like gross margin, I think can lead people sometimes astray, because there's been a lot of chatter about, you know your margin's down year over year, and yet you see the strong profit growth that we've had over that same time period. So the question is, is that some consequence of the strategy that you're pursuing or is it something that's related to either client pressure on pricing or a trade-off of volume versus margin that you're actively making? In our case, it's a little bit more of the latter, but it's not within the existing stock. If we look at our growth in the percentage of assets that we have with clients in a hundred million plus net worth segment, as well as the percentage of those clients who have mandates with us, what we see is we have larger clients consuming our mandate products than ever before.

So as a result of that, certainly a $500 million client is going to pay less than a client who has a million dollars for us in terms of basis points on assets. But it's clearly profit accretive, it's clearly in line with the strategy that we're pursuing, which is focused more on the upper segments in the high net worth and the ultra-high net worth market. So I would say that to us, we don't have extreme concerns about what we're seeing in the margin trends because it is explainable. So I would also add, Amit, that we do have our teams very focused on thinking about pricing, thinking about being very disciplined in terms of price management around discounting. So I think there's a lot more ink on this topic than the real concern really should have.

Amit Goel

Okay. Thank you. And I think we mentioned, well, we touched on technology a little bit earlier as well, but technology has also been flagged as one of the firm's kind of strategic imperatives with UBS looking to shift from being an enabler to a differentiator for the firm. What does this mean for GWM and the Americas and how is it different to the peers?

Tom Naratil

Yeah, so this is a really exciting topic and certainly one that's worthy of a deeper dive than the quick answer that I'm going to give you. But when you really think about what we're doing with technology, let's first talk about what we're not doing. It's not an attempt to replace an advisor with a chip or an app. The point is how can we help to enable a better relationship between our advisors and our clients with technology? Clients are willing to self-serve on a number of different things, if it's more convenient for them. And we've seen that with tool introduction over the years, and we'll continue to see that going forward. I also think that technology will be used in different ways to do things like enhancing our product distribution, because we're obviously a very significant manufacturer of wealth management products. If you look at the recent announcement that we made in the US on a partnership with Envestnet and iCapital to distribute UBS curated alternative investments, that's a great example of us taking advantage of our scale and also looking to create additional scale so we'll have better economics in our business, and I'd expect to see more of that going forward.

Maybe last, again using iCapital as an example, the alternative investment, the private investment arena in the US used to be a 50 page contract, multiple signatures, very paper-based, very painful, I would say, for a client. Now we've gone to complete e-signature. It's as easy to get your paperwork done after your advisor has explained an alternative investment as it is to order something on an app. We're very excited that we're going to be rolling out that same technology, or begin to roll that out in the rest of the world, starting at the end of this year. So, partnering in technology with the very best firms for the benefit of our clients and advisors is also going to be a key part of the way we execute.

Amit Goel

Okay. Thank you. And just changing tack slightly, but to one of the kind of key topics at the moment. So what is GWM doing to build its positioning in sustainable finance? And how is client demand here developing? And also, do recent industry developments around your greenwashing cause any concern?

Tom Naratil

Yeah. So great degree of interest around the world from our clients for sustainable advice and products. If you go back to September of last year, Iqbal and I stated that our preferred solution for our clients would be a sustainable solution because we think over the longer run, it'll deliver better investment returns for our clients. But I think the key thing here is different countries and different regions of the world are moving at different paces. The US has a high intent to be engaged with sustainable and a very low current presence in terms of those investments with our wealth management clients. But the key is going to be personalized sustainability. We can go through and sit down with our clients and talk through all of the UN sustainable development goals and try to find the one, what's the one that really matches with them? What's the one when they think about that last question in the UBS Wealth Way? What can we do to benefit other people? They're going to pick that solution. And it's our job to help them find the solution that matches their personalized interest in sustainability.

So we can see things like our oncology impact funds, which have been significant. We've raised over a billion in those vehicles. We've got in the area of a focus on the social side, something like Rethink Impact. And then when we think about affordability and things related to income inequality or wealth inequality, we've done things like bridge workforce and affordable housing here in the US, so there's a lot to do there.

Now on your question on greenwashing, we are very aware of that issue and have been for quite some time, but we're also in a position where we're helping our clients to select. And part of that is making sure that we are doing that due diligence, making sure that we're finding who are those that are really committed to the topics and are running their portfolios in a way that is aligned directly and meaningfully with the objectives. So we're very focused on anything that is a better marketing pitch than it actually is a compliance pitch.

Amit Goel

Got it. Thank you. I'll just remind the audience. If they'd like to ask a question, there is an option on the, I think on the top right of your screen to send questions through. At the moment, we don't have any individual kind of audience questions in the system. I'm just going to double check. So I guess then with that, unless a question comes through shortly, we've hit on client trends, growth and technology across multiple dimensions. So before we wrap up, are there any final remarks you'd like to make?

Tom Naratil

Well, I hope I've communicated to you and to all the people attending your conference how excited Iqbal and I are about the future for Global Wealth Management at UBS both the industry has some very good years ahead and we certainly hope to take more than our fair share of the opportunity that exists. But I'm sort of reminded going back to 2015, the last time I spoke to a large analyst group and said my farewells as group CFO. And at that time, Global Wealth Management was making about $3.6 billion a year and the US was making around $800 [million]. And if we take the first half of 21 and annualize it, we get to $5.4 billion for Global Wealth Management and roughly $1.9 billion for the America's business. So I think it's been a great past five years, but I can tell you that I'm equally optimistic for the next five years.

Amit Goel

Thank you. Thanks, Tom. And enjoy the rest of your day.

Tom Naratil

You as well, Amit. Great to see you. Thank you.

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