

# Third quarter 2016 results

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Speeches by **Sergio P. Ermotti**, Group Chief Executive Officer and **Kirt Gardner**, Group Chief Financial Officer

**Check against delivery.**

**Numbers for slides refer to the third quarter 2016 results presentation.**

**Sergio P. Ermotti**

Slide 2 – 3Q16 results

Thank you Martin, and good morning everyone.

In addition to normal seasonality, the third quarter was marked by a continuation of the macroeconomic uncertainty and geopolitical tensions that we have seen over the past several quarters.

Despite these challenges, and substantial provisions for litigation, we delivered a strong performance, with an adjusted pre-tax profit of 1.3 billion francs. The Group generated 827 million in net profit attributable to shareholders, with an adjusted return on tangible equity of 10.1%. We also maintained strong capital ratios, which are well above current requirements.

Our wealth management businesses combined, generated a billion francs in adjusted pre-tax profits, with an improvement in net margin for both businesses, as the advantages of being the world's only truly global wealth manager, with a strong presence in both mature and growth markets, helped mitigate the headwinds of a challenging quarter.

Wealth Management delivered a solid profit, seeing the first benefits of its cost reduction efforts and making progress on its strategic initiatives, while Wealth Management Americas delivered a record performance, with adjusted profits up 28% year-on-year.

Net new money was positive in all regions except Emerging Markets, where it was almost flat, and we remained disciplined with respect to attracting assets that are expected to drive long-term profitability. Year to date, we have attracted nearly 50 billion francs of net new money, despite ongoing cross-border outflows and client deleveraging in Wealth Management.

Personal & Corporate Banking delivered another very strong result, with an adjusted profit before tax of 473 million francs, its best performance since 2008. While revenues will come under pressure as negative interest rates are likely to persist, we are very pleased with our momentum in client acquisition and the success of our digital initiatives.

Asset Management generated an adjusted pre-tax profit of 138 million, with strong performance fees. Net new money excluding money markets rebounded to 2 billion francs.

Profits in the Investment Bank declined year-over-year, mainly as a result of lower client activity and our business and geographic mix, which is more skewed towards Europe and APAC than the US. Consistent with our strategy, we did not increase the level of risk or resource deployment to offset the difficult environment. In fact, we reduced the leverage ratio denominator by 21 billion francs. For the quarter, the IB delivered a solid adjusted return on attributed equity of 18%.

Also in the quarter, we recorded provisions of around 400 million related to various RMBS matters in Non-core and Legacy Portfolio.

Given headwinds such as subdued market conditions, negative interest rates, elevated litigation expenses, and that we are all still awaiting finalization of Basel 3, also known as Basel 4, visibility is still limited and our outlook remains prudently cautious.

With respect to capital returns, while our policy remains unchanged, our priority for 2016 is to deliver a baseline dividend of 60 Rappen per share, the same as in 2015.

In summary, our results once again demonstrate the ability of our diversified, yet focused business model to deliver strong performance in a variety of environments. We will continue to leverage our strengths, while staying close to our clients, executing our strategy with discipline, and focusing on creating value for shareholders.

With that, I will turn it over to Kirt.

## Kirt Gardner

Thank you, Sergio. Good morning everyone.

### Slide 3 – UBS Group AG results (consolidated)

My commentary will reference adjusted results and comparisons will be with the third quarter of 2015, unless otherwise stated.

This quarter, our results have been adjusted for 444 million francs in net restructuring expenses and 21 million of gains related to investments in associates.

### Slide 4 – Wealth Management

In Wealth Management, we delivered solid overall results with expense discipline, resilient revenues, and strong net new money. PBT was 643 million.

Transaction revenues decreased to the lowest level we've seen since 2008, reflecting clients' reaction to the continued uncertain environment and seasonality factors. Fees paid to P&C for client referrals and upshifts were higher, which also impacted transaction revenues.

Recurring net fee income decreased due to the impact of lower investment fund and custody revenues, as a result of client asset allocation shifts, as well as cross-border asset outflows. These declines were partly offset by higher average invested assets, pricing actions, and net new mandates.

Net interest income decreased, due to low interest rates.

Expenses were down 6% to 1.2 billion, with a reduction in all expense lines, reflecting the initial results from Wealth Management's previously announced restructuring. The cost income ratio was 64%, flat year-on-year and down 2 percentage points sequentially, despite lower income.

Last quarter, we mentioned that we expect to realize net savings of around 200 million per year in Wealth Management from the first quarter of 2017 versus full-year 2015, which will contribute to the Group's net cost reduction program of 2.1 billion. While we have seen some benefits accrue already, we expect any further improvement in the fourth quarter to be more than offset by an increase in other costs, including Corporate Center allocations, due to seasonal factors.

### Slide 5 – Wealth Management

The strong momentum in net new money from the first half of the year continued, as we recorded 9.4 billion in 3Q, while absorbing 2 billion in cross-border outflows, mainly related to emerging markets. Year-to-date net inflows were 31 billion, despite 6 billion in cross-border outflows.

Net new mandates were 4.1 billion, and penetration remained stable from the prior quarter at 27.1% of invested assets.

Invested assets increased to 967 billion from the prior quarter on positive market performance and net new money inflows, partly offset by FX translation effects.

During the quarter, we saw a further 2 basis point drop in our gross margin, as the impact of cross-border outflows, low client activity, continued increased penetration of the ultra high net worth segment, and clients shifting out of higher-margin investments offset the positive impact of net mandate sales and pricing actions. Despite gross margin erosion, net margin rose 1 basis point sequentially to 27, driven by operating margin improvement, reflecting the positive leverage inherent in our WM operating model and as we cut costs further. Net margin and cost-to-income are much more critical to our business than gross margin, and both metrics improved quarter-over-quarter.

#### Slide 6 – Wealth Management

Net new money was driven by strong net inflows in Asia Pacific and Europe.

Asia Pacific contributed 5.1 billion, including a single large inflow from Greater China. We continue to selectively hire client advisors in Asia, and CA headcount in the region was up 5% year-on-year, adjusting for the exit of our Australian domestic business effective in 2Q16.

Flows in Emerging Markets were marginally negative, driven by cross-border outflows.

Year-to-date, our annualized growth rate is 4.4%. But as a reminder, we typically see higher levels of cross-border outflows in the fourth quarter.

#### Slide 7 – Wealth Management Americas

Wealth Management Americas was up 28% year-on-year generating a record PBT of 367 million dollars, with all-time highs in a number of metrics, including operating income, net margin, and managed account penetration.

Operating income increased to nearly 2 billion dollars, as higher net interest income and recurring net fee income more than offset lower transaction revenues, reflecting the lowest third-quarter transaction volumes seen since 2009. Net interest income was up 19% on higher short-term interest rates and continued growth in loan and deposit balances. Recurring net fee income increased due to higher managed account fees on increased invested assets and higher advisory revenues, partly offset by lower mutual fund fees.

Operating expenses decreased slightly to 1.6 billion dollars, mainly due to lower net expenses for provisions for litigation. This was partly offset by higher legal fees and personnel expenses.

#### Slide 8 – Wealth Management Americas

Net new money was around 800 million dollars, driven by financial advisors who have been with the firm for over a year.

Invested assets increased by 3% from the prior quarter to over 1.1 trillion dollars, mainly due to positive market performance. Managed account penetration rose 30 basis points to 34.8% of invested assets.

#### Slide 9 – Wealth Management Americas

Our financial advisors remained the most productive among their peers, with both invested assets and revenues per FA increasing quarter-over-quarter.

Lending balances were up 2% in the quarter, driven by increases in mortgages. Credit losses remained de-minimis.

#### Slide 10 – Personal & Corporate Banking

Personal and Corporate Banking delivered its best quarterly and year-to-date performance since 2008, despite the current negative interest rate environment, with profit before tax increasing 11% to 473 million francs.

Operating income increased by 1%, as higher transaction-based income and recurring net fees more than offset a decrease in net interest income. The latter was driven by low interest rates. Transaction-based income increased due to higher net client shift and referral fees from Wealth Management and also hedging losses in the prior-year quarter.

Operating expenses decreased by 7% to the lowest level on record, mostly driven by lower Corporate Center allocations.

Annualized net new business volume growth for our personal banking business was 3.5%. Our P&C business continues to consolidate its leadership position in the Swiss market, with record year-to-date net new clients.

#### Slide 11 – Asset Management

Asset Management delivered a profit before tax of 138 million, flat on the prior year.

Net management fees were down 9% to 437 million, driven by lower fund services revenues following the sale of the Alternative Fund Services business in the fourth quarter of 2015, as well as lower average invested asset levels. Performance fees nearly doubled to 44 million, mainly driven by O'Connor. Excluding the AFS sale, operating income would have been roughly flat.

Expenses were down year-over-year, mostly driven by lower allocations from Corporate Center.

Net new money excluding money markets was 2 billion, mostly from third parties.

#### Slide 12 – Investment Bank

The Investment Bank posted 342 million in profit before tax, delivering an annualized return on attributed equity of 18%, reflecting challenging market conditions that did not favor our business mix and strategy, balanced by strong FRC results and continued disciplined cost, risk, and capital management.

Resource utilization remained well below our short to medium-term expectations, as we stayed disciplined and consistent with our strategy and business model. RWA were broadly unchanged at 65 billion, despite the progressive introduction of regulatory multipliers and a 2 billion increase in operational risk allocation. Compared with the prior year, market risk RWA halved to 7 billion, and average VaR reached a new low. Sequentially, LRD decreased 21 billion to 246, mostly in Equities, driven by efforts to optimize balance sheet utilization. Year-over-year, LRD was down 43 billion.

Corporate Client Solutions revenues were down 25% year-over-year, largely reflecting a revenue decrease in ECM, mainly from lower revenues in private transactions, and in DCM, where leveraged finance declined compared with a strong 3Q15. Advisory revenues increased on higher fees from private transactions, which

more than offset the decrease in M&A activity. We also saw a negative revenue impact from hedges booked in Risk Management, as credit spreads tightened.

In ICS, Equities revenues were down 16% against a strong third quarter in 2015, driven by Cash and Derivatives, reflecting low volatility and reduced transaction volumes. Financing Services revenues increased, as a result of improved client activity.

FX, Rates and Credit revenues were up 5% versus a strong 3Q15. Revenues in Rates and Credit increased, driven by higher client activity, partly offset by lower FX revenues. FRC has delivered strong and relatively stable revenues for the last seven quarters, demonstrating the success of our client-centric and resource-efficient business model.

The IB maintained disciplined cost management with decisive actions taken early and throughout the year. Costs excluding variable compensation accruals were down 6% from the second quarter and 8% year-on-year, with some benefit from currency movements. As you look at the year-on-year comparison, this year's accruals for variable compensation are more evenly spread across the quarters, and the corresponding increase in the third quarter this year more than offsets lower salary expenses related to our cost actions.

#### Slide 13 – Corporate Center

Corporate Center profit before tax was negative 654 million.

Corporate Center – Services costs before allocations were down, due to the impact of our cost program. This also contributed to lower allocations to business divisions.

Group ALM profit before tax increased to 30 million, as the effects of accounting asymmetries related to economic hedges moved from negative to positive, and total risk management net income after allocations, at negative 39 million, improved from the prior year.

Non-core and Legacy Portfolio posted a loss of 470 million, largely driven by expenses for provisions for litigation. As you can see in note 15 of our report, expenses for provisions related to legacy matters, including RMBS litigation, are booked in Non-core and Legacy Portfolio. Our provisions for various RMBS-related matters were 1.4 billion as of the end of the third quarter.

Operating income for NCL was positive, but included two non-recurring items.

During the third quarter, we made a change to our operational risk RWA allocation methodology, following the amendment to the AMA model earlier this year. For Non-core and Legacy Portfolio, this translated into a reduction of 11 billion, which has been reallocated to the business divisions. To be clear, this reallocation was made independently of the provisions taken this quarter. More detail is available on page 65 of the third quarter report.

#### Slide 14 – Interest rate sensitivities

In recent quarters, we have referenced the impact from negative interest rates on our financials. The overall impact of implied forwards indicates a cumulative drag of around 400 million on net interest income over the next 3 years. Our banking book currency exposure is balanced between Swiss francs and US dollars, with smaller concentrations in euro and other currencies. Given this, the drag from continued expected negative

franc and euro rates, which is concentrated in P&C, is partially offset by the implied small increase in US dollar rates, which benefits WM and WMA in particular.

#### Slide 15 – Cost reduction

For the quarter, we increased our annualized net cost reductions to 1.5 billion, based on the September 2016 exit rate. The additional saves were mainly driven by front-to-back cost reductions in all business divisions, particularly in Wealth Management and the Investment Bank, and to a lesser extent in Corporate Center Services.

As you compare cost reduction programs across the industry, please note that we will see almost no cost reduction from business disposals compared to some of our competitors, as the implementation of our strategy was materially complete by the end of 2014. Also, non-structural reductions in front-office pay due to lower revenues are not included in our net cost savings.

#### Slide 16 – Cost reduction

Taking a different view on costs, we have reduced Corporate Center Services costs before allocations to the business divisions by 800 million since 2013, if you annualize the first nine-months of this year. Over the same period, there was a 600 million franc reduction in Non-core and Legacy Portfolio costs.

However, as a reminder, our costs year-to-date exclude certain items that will come through by year-end. For example, the UK bank levy is a fourth-quarter expense, for which we cannot accrue. Last year, the charge was 166 million francs for the Group.

Also, at the end of the year, we typically see a seasonal spike in general and administrative expenses, as is evident in our fourth-quarter trend in prior years.

As previously communicated, the gross cost savings required to meet our net cost reduction target have increased, due to substantially higher regulatory expenses than originally anticipated. Therefore, achieving our 2.1 billion net cost reduction target will require that we incur more restructuring costs than the 3 billion initially estimated, of which 2.3 billion has been realized since the beginning of 2015. We expect restructuring charges to remain around current run-rate levels until we complete our cost reduction program at the end of 2017, when we expect our restructuring costs related to this program to taper.

#### Slide 17 – Net tax expense and deferred tax assets

In the third quarter, we recorded a net tax expense of 49 million francs, reflecting the taxes accrued in the quarter and the benefits from a net increase in recognized deferred tax assets of 424 million. This included 681 million related to a net upward revaluation of US DTAs, driven by an increase in our profit forecast for Wealth Management Americas. This was partly offset by smaller net write-downs in the UK, which we previously flagged, and in Switzerland, relating to the effective tax rate applicable to profit forecasts. We also incurred 204 million in current tax expenses, and 269 million in deferred tax expenses in respect of 2016 taxable profits.

Consistent with prior practice, in the third quarter, we recognized around 75% of the expected full-year DTA write-up in relation to profit forecasts beyond 2016, and we expect to book the remaining approximately 25% in the fourth quarter.

As a reminder, last year, we extended the profit recognition period from six to seven years in the US, which contributed to the significant recognition of US DTAs in the third and fourth quarters of 2015. The profit recognition period in the US is unchanged at seven years.

We are not providing guidance on next year's DTA re-measurement.

#### Slide 18 – Capital and leverage ratios

Our capital position remained strong, with a fully applied Basel III CET1 capital ratio of 14.0% and a fully-applied Basel III CET1 leverage ratio of 3.45%.

Fully applied CET1 capital was virtually unchanged, as the effect of lower UK interest rates due to Brexit on defined benefit plans in the UK, dividend accruals, and other factors all offset the positive impact from net profit.

RWA on a fully applied basis increased by 3 billion to 217 billion, mostly in credit risk, largely due to new credit conversion factors in P&C and regulatory add-ons.

The fully applied leverage ratio denominator declined by 21 billion in the quarter, primarily due to lower securities financing transactions and derivatives exposures in the Investment Bank.

The Too Big To Fail rules require us to issue instruments with higher loss absorption, capital content and longer duration than legacy instruments, and this naturally implies increased funding costs. As an example, this year, we have incurred an approximately 50 basis point HoldCo / OpCo premium on senior debt and 200 basis points for high-trigger AT1 over our existing low-trigger tier 2 instruments. Finally, general market conditions have resulted in widening spreads for banks since 2014. In combination, all of these factors will increase the annual run-rate of our funding costs by several hundred million.

In conclusion, we are pleased with our overall operating results, the progress on our cost initiatives, and our continued solid and disciplined execution.

With that, Sergio and I will now open it up for questions.

**Cautionary statement regarding forward-looking statements:** This presentation contains statements that constitute "forward-looking statements," including but not limited to management's outlook for UBS's financial performance and statements relating to the anticipated effect of transactions and strategic initiatives on UBS's business and future development. While these forward-looking statements represent UBS's judgments and expectations concerning the matters described, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from UBS's expectations. These factors include, but are not limited to: (i) the degree to which UBS is successful in executing its announced strategic plans, including its cost reduction and efficiency initiatives and its targets for risk-weighted assets (RWA) and leverage ratio denominator (LRD), and the degree to which UBS is successful in implementing changes to its wealth management businesses to meet changing market, regulatory and other conditions; (ii) continuing low or negative interest rate environment, developments in the macroeconomic climate and in the markets in which UBS operates or to which it is exposed, including movements in securities prices or liquidity, credit spreads, and currency exchange rates, and the effects of economic conditions, market developments, and geopolitical tensions on the financial position or creditworthiness of UBS's clients and counterparties as well as on client sentiment and levels of activity; (iii) changes in the availability of capital and funding, including any changes in UBS's credit spreads and ratings, as well as availability and cost of funding to meet requirements for debt eligible for total loss-absorbing capacity (TLAC); (iv) changes in or the implementation of financial legislation and regulation in Switzerland, the US, the UK and other financial centers that may impose, or result in, more stringent capital, TLAC, leverage ratio, liquidity and funding requirements, incremental tax requirements, additional levies, limitations on permitted activities, constraints on remuneration, constraints on transfers of capital and liquidity and sharing of operational costs across the Group



or other measures, and the effect these would have on UBS's business activities; (v) uncertainty as to when and to what degree the Swiss Financial Market Supervisory Authority (FINMA) will approve, or confirm, limited reductions of gone concern requirements due to measures to reduce resolvability risk; (vi) the degree to which UBS is successful in implementing further changes to its legal structure to improve its resolvability and meet related regulatory requirements, including changes in legal structure and reporting required to implement US enhanced prudential standards, implementing a service company model, completing the transfer of the Asset Management business to a holding company, and the potential need to make further changes to the legal structure or booking model of UBS Group in response to legal and regulatory requirements relating to capital requirements, resolvability requirements and proposals in Switzerland and other countries for mandatory structural reform of banks and the extent to which such changes have the intended effects; (vii) the uncertainty arising from the timing and nature of the UK exit from the EU and the potential need to make changes in UBS's legal structure and operations as a result of it; (viii) changes in UBS's competitive position, including whether differences in regulatory capital and other requirements among the major financial centers will adversely affect UBS's ability to compete in certain lines of business; (ix) changes in the standards of conduct applicable to our businesses that may result from new regulation or new enforcement of existing standards, including recently enacted and proposed measures to impose new and enhanced duties when interacting with customers and in the execution and handling of customer transactions; (x) the liability to which UBS may be exposed, or possible constraints or sanctions that regulatory authorities might impose on UBS, due to litigation, contractual claims and regulatory investigations, including the potential for disqualification from certain businesses or loss of licenses or privileges as a result of regulatory or other governmental sanctions, as well as the effect that litigation, regulatory and similar matters have on the operational component of our RWA; (xi) the effects on UBS's cross-border banking business of tax or regulatory developments and of possible changes in UBS's policies and practices relating to this business; (xii) UBS's ability to retain and attract the employees necessary to generate revenues and to manage, support and control its businesses, which may be affected by competitive factors including differences in compensation practices; (xiii) changes in accounting or tax standards or policies, and determinations or interpretations affecting the recognition of gain or loss, the valuation of goodwill, the recognition of deferred tax assets and other matters; (xiv) limitations on the effectiveness of UBS's internal processes for risk management, risk control, measurement and modeling, and of financial models generally; (xv) whether UBS will be successful in keeping pace with competitors in updating its technology, particularly in trading businesses; (xvi) the occurrence of operational failures, such as fraud, misconduct, unauthorized trading, financial crime, cyber-attacks, and systems failures; (xvii) restrictions on the ability of UBS Group AG to make payments or distributions, including due to restrictions on the ability of its subsidiaries to make loans or distributions, directly or indirectly, or, in the case of financial difficulties, due to the exercise by FINMA or the regulators of UBS's operations in other countries of their broad statutory powers in relation to protective measures, restructuring and liquidation proceedings; (xviii) the degree to which changes in regulation, capital or legal structure, financial results or other factors, including methodology, assumptions and stress scenarios, may affect UBS's ability to maintain its stated capital return objective; and (xix) the effect that these or other factors or unanticipated events may have on our reputation and the additional consequences that this may have on our business and performance. The sequence in which the factors above are presented is not indicative of their likelihood of occurrence or the potential magnitude of their consequences. Our business and financial performance could be affected by other factors identified in our past and future filings and reports, including those filed with the SEC. More detailed information about those factors is set forth in documents furnished by UBS and filings made by UBS with the SEC, including UBS's Annual Report on Form 20-F for the year ended 31 December 2015. UBS is not under any obligation to (and expressly disclaims any obligation to) update or alter its forward-looking statements, whether as a result of new information, future events, or otherwise.

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#### **Use of adjusted numbers**

Unless otherwise indicated, "adjusted" figures exclude the adjustment items listed on the previous slide, to the extent applicable, on a Group and business division level. Adjusted results are a non-GAAP financial measure as defined by SEC regulations. Refer to page 10 of the 3Q16 report which is available in the section "Quarterly reporting" at [www.ubs.com/investors](http://www.ubs.com/investors) for an overview of adjusted numbers.

If applicable for a given adjusted KPI (i.e., adjusted return on tangible equity), adjustment items are calculated on an after-tax basis by applying an indicative tax rate. Refer to page 15 of the 3Q16 report for more information.

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