UBS Seen Winning as Wealth Management Emulates Pimco

By Elena Logutenkova - Apr 17, 2013 5:01 AM GMT+0600

When UBS AG (UBSN) wealth manager Abdallah Najia came to Switzerland from Dubai in March for a week of training, he was as stunned by the message as by the scenery.

"The first couple of days have been shocking," Najia, who advises clients with more than $50 million to invest, said during a break between lectures on March 20 at UBS-owned Hotel Seepark on the shores of Lake Thun with views of pyramid-shaped Niesen mountain. "They sort of cut our legs off and said you guys are at risk of extinction. We need to evolve."

Juerg Zeltner, who heads UBS wealth management outside the Americas, says his business is going through the biggest changes he has seen in his quarter-of-a-century career. Photographer: Gianluca Colla/Bloomberg

UBS wants its wealth-management units, which lost 27 percent of assets under management during the financial crisis, to contribute half of pretax profit by 2015 compared with 35 percent a decade earlier. Photographer: Gianluca Colla/Bloomberg

The shock therapy was offered to Najia and 34 other client advisers of the world's second-biggest private bank as part of an effort to jolt them into reinventing the wealth-management business. Boosting profit at the unit is paramount for the success of the Zurich-based lender, as UBS Chief Executive Officer Sergio Ermotti is cutting 10,000 jobs and shrinking the investment bank by exiting most debt trading.

"The success of the wealth-management business is fundamental to where the stock goes over the next five years," said Christopher Wheeler, a London-based analyst with Mediobanca SpA, who has a neutral recommendation on UBS shares. "It's the core business, and a number of other businesses feed off it, not the least asset management."

Lost Assets

The challenges are as large as the Swiss peaks visible from the shores of Lake Thun. UBS wants its wealth-management units, which lost 20 percent of assets under management during the financial crisis, to contribute half of pretax profit by 2015 compared with 32 percent a decade earlier. Profit has been squeezed since banking secrecy came under attack after UBS admitted in 2009 to helping Americans evade taxes. Customers pulled funds or have been reluctant to trade amid Europe's sovereign-debt crisis.

Juerg Zeltner, who heads UBS wealth management outside the Americas, says his business is going through the biggest changes he has seen in his quarter-century career. Zeltner, who has led the unit since 2009, said the crisis and the dilution of Swiss secrecy convinced him that UBS had to become more of an investment house than an asset gatherer.

"It wasn't that transparent historically how private banks manage money," Zeltner, 45, said in an interview this month at UBS headquarters on Zurich's Bahnhofstrasse. "I didn't want to be a Swiss private bank only. We always had access to global demand. We always had clients from around the world. What we lacked was content."

Pimco, BlackRock

Zeltner and former UBS CEO Oswald Gruebel stopped the net outflow of customer funds in 2010. They brought in Alexander Friedman the next year to oversee creation of a new investment process to rival the experts at firms such as Pacific Investment Management Co., manager of the world's largest mutual fund, and BlackRock Inc., the biggest asset manager. Since then, UBS has been educating client advisers and making sure the bank's recommendations are fed through to customer portfolios.

"The degree of differentiation among the top 20 wealth managers in the world is relatively small," said Sebastian Dovey, managing partner of London-based Scorpio Partnership Ltd., which provides client-experience research to the wealth- management industry. "It's becoming much clearer to heads of businesses that that differentiation has to become very explicit to demonstrate the value, to demonstrate quality and to demonstrate a reason for people to pay for you."

Harvard Transformation

The transformation at UBS is akin to that of Harvard Management Co., which runs the university's endowment. Since losing 27 percent on investments after Lehman Brothers Holdings Inc.'s 2008 bankruptcy, Harvard, the world's wealthiest college, added staff and expanded the proportion of funds it manages internally to boost returns. The endowment lost 0.05 percent on investments in the 12 months through June 2012, cutting assets to $30.7 billion, after gaining 21 percent in the previous year and 11 percent in fiscal 2010.

Zeltner said the revamp is already paying off, though the lever to profitability won't become evident until clients' risk appetite increases. At the end of 2012, advisory clients still held 29 percent of their assets in cash, according to UBS. Assets under management rose by 71 billion francs ($76 billion) to 821 billion francs last year, thanks to net new money of 26.3 billion francs and returns achieved on existing assets.

In 2011, invested assets fell by 18 billion francs as negative equity-market performance and the decline of the euro against the franc more than offset net new funds and positive returns on bonds.

Discretionary Mandates

Money that UBS manages in 80,000 portfolios at its discretion on behalf of clients, based on pre-selected product types and risk appetite, returned as much as 16.9 percent last year, according to the bank. Most popular discretionary mandates within the conservative and moderate risk brackets returned between 6 percent and 10.2 percent in 2012 after taxes and before fees, depending on the currency of the portfolio, the bank said. UBS didn't provide performance data for previous years, saying figures wouldn't have been comparable.

Recommendations to buy U.S. junk bonds and U.S. stocks were among the most successful last year and were viewed as risky when made, according to Friedman. Calls to overweight sovereign bonds in emerging markets until the end of September and bets on Western companies that get at least 20 percent of sales or earnings from emerging markets also boosted performance.

The Pimco Total Return Fund, the world's biggest mutual fund with $289 billion in assets and at least 65 percent allocated to investment-grade fixed-income instruments, returned 10.4 percent in 2012 and the Vanguard Balanced Index fund, which tracks U.S. stocks with 60 percent of its assets and bonds with the rest, gained 11.3 percent. Those returns are after fees.

Gates Foundation

Being better known for its investment decisions globally should help UBS compete with local firms, Zeltner said. He plans to expand business in Europe, his biggest market, where the bank is already profitable in every country except for two including Germany, and invest in hiring and technology in Asia and emerging markets, where he doesn't exclude acquisitions.

"Over a three-year period, I'm pretty confident that we'll see Europe contribute strongly to the profit and grow again," Zeltner said.

UBS gained 21 percent over the past six months as of April 16, making it the sixth-best performer on the Bloomberg Europe Banks and Financial Services Index, which tracks 40 companies and increased 4.4 percent in the same period.

Friedman, 42, an American who served as chief financial officer for the Bill & Melinda Gates Foundation, brought a sense of urgency into the organization, which he compared to an Airbus A380 double-decker plane that had to become more agile.

Nike FuelBand

"I like that he's very impatient, which is very good for a large organization," Zeltner said about Friedman. "We cut our investment process to five days from three weeks because someone says, 'Sorry, I don't have weeks.' This is not a buy-and-hold market anymore, I need to trade tomorrow."

Friedman, who usually works standing up at his desk and wears a Nike FuelBand, which monitors how active he is during the day, says the process he put in place is “fluid” and “thought-through” at the same time, “like the layout of well- designed emergency room in a hospital, organized to minimize costly errors.”

The same day that top client advisers were in Thun, Friedman and Mark Haefele, a former hedge-fund manager now UBS’s head of investment, were preparing for the monthly global investment committee meeting at which decisions affecting the management of $1.7 trillion of assets would be made.

Covered Windows

The two-hour meeting, held in a top-floor room where the windows were fully covered by blinds, marked the culmination of research and discussions involving UBS analysts and investment professionals, quantitative models and billionaire clients. Experts from external asset managers such as Pimco and Fidelity Investments, the second-biggest mutual-fund manager in the U.S., are also consulted as part of the investment process.

“There is always at least one meeting going on somewhere in the world,” Haefele said. “We’re assessing new information, distilling it down, discussing it and then bringing forward the most important elements to the global discussion where we look at overall asset allocation.”

On the agenda that day was the deadlock surrounding efforts to stave off a financial collapse of Cyprus. Friedman doesn’t lead the meetings and talks little to avoid what he describes as groupthink, the behavioral pattern of people agreeing with the decision-maker. Fourteen other people participating in person or by video and conference calls on March 20 from all regions and businesses of UBS, offered their views and anecdotal evidence.

Bernanke Ammunition

“I’m rather puzzled that the markets are still so good,” Andreas Hoefert, chief economist at UBS wealth management, told the group, adding that he got e-mails from two friends over the weekend asking how the situation in Cyprus might affect their bank accounts. “The market still is of a consensus that this thing will be solved by the end of this week. If it’s delayed beyond that, then it starts really to hit on the sentiment.”

Friedman mentioned Federal Reserve Chairman Ben S. Bernanke’s news conference scheduled for later that day.

“It’s going to give him some good ammunition to fight off the hawks if he points to Cyprus,” Friedman said. “Good for the markets in a counterintuitive way.”

The Fed later decided to leave the pace of asset purchases unchanged, as Bernanke said further gains in the U.S. labor market are needed for the central bank to consider reducing its record monetary easing.

‘Front Wheel’

UBS recommends that clients allocate more funds to U.S. stocks than those from other regions, and when Friedman’s monthly letter to client advisers comes out the next evening he compares market dynamics to a tricycle.

“The U.S. is the front wheel, powering the market, and China and the euro zone provide somewhat wobbly traction on the sides,” Friedman wrote.

The Standard & Poor’s 500 index, which tracks U.S. stocks, has gained 1.9 percent since the CIO’s letter came out on March 21, while the Stoxx Europe 600 Index fell 2.1 percent and the MSCI Asia Pacific index added 0.9 percent.

UBS takes a view on every asset class, in all regions, with price or yield targets over a six-month horizon. The reasons for calls and the views of everyone participating in the process are documented and tracked for transparency purposes. Apart from the recommendation on U.S. stocks, UBS currently advises clients to underweight government bonds in favor of emerging-market and investment-grade corporate bonds, as well as high-yield notes. The bank recommends the British pound over the euro.

UBS Advice

Friedman’s views are directly implemented for more than $100 billion in assets the bank manages for clients on a discretionary basis. Those mandates are typically among the most profitable for the bank, with annual fees of about 1 percent and low operating costs because of scale. UBS said it had more months with net positive inflows into discretionary mandates in 2012 than in any of the previous three years amid withdrawals by cross-border European clients.

To make sure other clients benefit equally from the CIO’s recommendations, UBS is educating advisers and developing a new offering called UBS Advice. Customers would be charged a fixed flat fee for advisory services and automated daily checks of their portfolios against their risk profiles and the bank’s market views. Making advice on investments more consistent may make UBS more attractive, Scorpio’s Dovey said.

“The problem most wealth managers have is that their model is typically hostage to the private banker, and the individual flair of each and every private banker,” Dovey said. “We’ve interviewed nearly 20,000 customers, and they buy consistency more than anything else. It is clear clients don’t just go to private banks because they want them to make them 15 percent a year. They’re aware this is an unrealistic expectation.”

Diploma Course

Zeltner, who comes from a small town near Thun and originally wanted to study veterinary medicine before landing an apprenticeship at Swiss Bank Corp., which merged with Union Bank of Switzerland 11 years later to form UBS, said training client advisers is “absolutely key” to making sure CIO recommendations get understood and put to good use.

“People always underestimate what it takes to be a good banker,” Zeltner said.

Last year UBS started requiring all client advisers to take a diploma course about markets and portfolio management approved by Switzerland’s State Secretariat for Economic Affairs, after having only an internal certification in the past. Markus Tanner, who’s responsible for training, said UBS is the first and only bank to get SECO certification for such a course.

“Previously, training was not mandatory,” Tanner said in an interview at the Seepark hotel in Thun. “Based on skill gaps, you were going to certain classes. Now everybody has to reach the benchmark we set.”

Becoming Extinct

This year UBS started offering a masters course to select advisers like Najia, 45, who joined UBS a year-and-a-half ago from JPMorgan Chase & Co. The course, running from 8 a.m. to 10 p.m. with breaks for food, started with a message: Wealth managers who don’t adapt to the historic changes in the industry may become extinct.

“Market leaders are at risk, since based on their superior performance see no urgency for change,” PricewaterhouseCoopers LLP says in mandatory reading for the course. “High performers historically are biggest losers.”

The group that started the course in Thun included client advisers from Switzerland, Germany, Panama and the Middle East, with most catering to customers who have more than $5 million to invest, Tanner said. About 100 people will be starting the two- year program in 2013, with a course taking place in Asia and another one in Switzerland later this year. UBS plans to offer the program to about 500 to 600 advisers, of 4,128 working at the wealth-management unit, Tanner said.

Intrapreneurial Leadership

Lecturers include Daniel L. Shapiro, founder and director of the Harvard International Negotiation Program, who will teach about relationship management; and Rita Gunther McGrath, a professor at Columbia Business School, and Alexander B. van Putten from the Wharton School at the University of Pennsylvania, who focus on intrapreneurial leadership, or behaving like an entrepreneur within a large organization.

“It’s about changing the mindset,” Tanner said. “Currently the organization is very much compliance-driven, and rightly so because we’ve done a lot of mistakes in the past and we have to make sure that from a compliance perspective we fulfill all the standards. But within that framework I still must act as an entrepreneur.”

The program, which costs UBS about 25,000 francs per participant, also brings advisers closer to wealth-management executives, such as Zeltner, or William Kennedy, who runs the investment products and services unit. The unit, with about 2,000 people, is responsible for stocking the shelves with 4,000 to 5,000 products to match CIO views and provide support to client advisers on topics such as wealth planning.

Automated Tool

Last year Kennedy, 42, who comes from a small dairy and horse farm in Ireland that he goes back to about once a month, helped create an automated tool that checks all clients' portfolios overnight for deviations from saved risk profiles and UBS views. The functionality, which delivers an e-mail to advisers every morning with proposed corrections, is being rolled out in Switzerland and will be offered to customers in Europe and emerging markets later this year and in the Asia- Pacific region at the beginning of 2014, Kennedy said.

The tool is at the heart of UBS Advice. Figuring out how to make it work became clear in a discussion with a colleague about tools already being used for select clients, Kennedy said.

"We were clear that clients in this market environment wanted to have their hands on the steering wheel and were willing to pay for good advice," he said.

Red-Flagged

Customers who switch to the flat-fee contract, which will oblige client advisers to alert them to any portfolio issues within a week of being red-flagged, will have to pay a minimum of 2,000 francs to 3,125 francs a year, depending on their risk appetite. The fees range from 0.8 percent to 1.25 percent for clients with assets of less than 500,000 francs and get smaller for those with higher assets.

The offering may be of interest to about half of UBS advisory clients, Kennedy said. It also would fulfill regulatory efforts to improve transparency about how advisers are compensated and reduce incentives for selling inappropriate investment products.

"My guess is, in three to five years, most customers with the bank will be under a contractual framework of one form or another, and that means they'll be paying for advice on assets or for management of those assets," Kennedy said.

The tool stirred interest when Kennedy described it in Thun. The class ran almost half an hour longer than planned.

"We need to change the way we think about our industry," said Najia, the client adviser. "When I go home to Dubai, the first week I'll do nothing else but talk about this."