UBS Profit Misses Estimates on Litigation Provision

By Elena Logutenkova and Jeffrey Vogeli - Oct 28, 2014

UBS AG (UBSN), Switzerland’s biggest bank, rose in Zurich trading after the bank set aside 1.84 billion Swiss francs ($1.94 billion) for litigation provisions, easing investor concern about the future cost of legal challenges.

A net tax gain of 1.32 billion francs helped UBS report net income of 762 million francs in the quarter, compared with 577 million francs a year earlier. That missed the 804 million-franc average estimate of seven analysts surveyed by Bloomberg.

Chief Executive Officer Sergio Ermotti said the bank now has “a better estimate of how to address” litigation issues. “Three years since introducing our strategy, the business is far stronger, its earnings power is much greater and our absolute and relative capital position speaks for itself,” Ermotti said in a statement. “That gives us every confidence in our ability to deliver on our capital return policy.”

Most of the legal provisions were for the securities unit, the bank said, without pointing to specific cases. UBS expects the financial industry to continue facing “elevated” costs for legal and regulatory matters “for the foreseeable future.”

UBS rose 3.1 percent to 15.90 francs at 9:26 a.m. in Zurich. The shares have fallen 6 percent so far this year, exceeding the STOXX 600 Banks Index’s 1.1 percent drop.

“UBS was lucky that it could offset provisions with tax gains and the individual businesses performed quite well,” said Peter Stenz, a Zurich-based fund manager at Swisscanto Asset Management AG. “I think we have seen the peak in litigation costs. At some point we’ll see light at the end of the tunnel.”

‘Positively Surprised’

Wealth management pretax profit rose 27 percent to 707 million francs, beating analysts’ estimate of 641 million francs. Earnings at wealth management Americas rose 17 percent to 236 million francs. The units added 9.8 billion francs and 4.6 billion francs in net new money, respectively.

The investment bank posted a pretax loss of 1.28 billion francs compared with a profit of 251 million francs a year earlier after booking 1.69 billion francs in litigation provisions.
Revenue in the corporate client solutions unit, which includes advisory, underwriting and financing businesses, jumped 46 percent to 738 million francs in the quarter. Equities trading posted a 2.3 percent increase in revenue to 884 million francs, while the foreign-exchange, rates and credit unit saw a 6.8 percent revenue decline to 315 million francs.

“I’m positively surprised about operating results of the businesses,” said Dirk Becker, a Frankfurt-based analyst at Kepler Cheuvreux with a hold recommendation on UBS.

**Outlook Concerns**

Still, the outlook for revenue remains uncertain, the bank said.

“At the start of the fourth quarter of 2014, many of the underlying challenges and geopolitical issues that we have previously highlighted remain and in some cases have intensified,” Ermotti and Chairman Axel Weber said in a letter to shareholders in the quarterly report. “A number of new concerns have arisen including the fear of risks related to the Ebola virus.”

Analysts had estimated legal provisions at 358 million francs in the quarter, according to the average of four forecasts. It has paid about $3.6 billion in fines and settlements since 2012, including $1.5 billion to regulators in the U.S., the U.K. and Switzerland for rigging global interest rates.

“I am pleased with the fact that we are making progress toward a resolution of these matters,” Ermotti said about litigation in an interview with Bloomberg Television. “We are today in a position to have a better estimate of how to address those issues. In some cases we may be able to reach conclusions in the foreseeable future, in others it’s extremely difficult to predict the outcome.”

**Libor Agreement**

 Authorities investigating alleged manipulation of foreign-exchange markets have started settlement talks with UBS that may involve “material monetary penalties,” the bank said last month. UBS said today it’s in discussion with the antitrust and criminal divisions of the U.S. Department of Justice on currencies.

The bank also said that it agreed in principle with the DoJ to extend the term of its non-prosecution agreement on the Libor probe by one year to Dec. 18, 2015. The original agreement said UBS will not commit any U.S. crime in the period and failure to comply with obligations could result in termination of the agreement and potential criminal prosecution.

The U.K.’s Financial Conduct Authority is in talks with banks including UBS, JPMorgan Chase & Co., Citigroup Inc. (C) and Barclays Plc to settle investigations into currency-rigging allegations as soon as next month, people familiar with the probes have said. UBS may be the first bank to reach a settlement with the U.S. DoJ in its investigation of the matter, the Financial Times reported this
Dividend Policy

UBS is under investigation in France and Belgium for allegedly helping wealthy clients avoid taxes. In the French probe it paid a security deposit of 1.1 billion euros ($1.4 billion) at the end of September. The fine in the case could be as high as 4.9 billion euros, a person familiar with the matter has said.

UBS has said it plans to pay out more than 50 percent of earnings as dividends to shareholders, provided its common equity ratio under the Basel III rules is at more than 13 percent and stays at more than 10 percent under internal stress tests. The common equity ratio was 13.7 percent at the end of September, while the post-stress ratio stayed above 10 percent.

Credit Suisse Group AG (CSGN), Switzerland’s second-biggest bank, last week posted earnings that beat estimates on higher revenue from debt trading at the investment bank. The five biggest U.S. securities firms saw their combined revenue from trading fixed income, currencies and commodities rise 14 percent in the third quarter from a year earlier, data compiled by Bloomberg Intelligence show. UBS decided to scale down the debt trading business in 2012.

Earnings in asset management rose 31 percent to 154 million francs, while the retail and corporate unit posted a 6 percent increase in income to 426 million francs.

UBS also said it expects restructuring charges to amount to about 1.5 billion francs in 2015, about 1 billion francs in 2016 and about 500 million francs in 2017 as it continues to target 2.1 billion francs in net annual cost savings. The bank said investments in information technology infrastructure and simplification will account for about half of the costs from next year through 2017.

“This means the reorganization is much more extensive than we had thought,” Becker said.

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