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UBS Group AG (UBS) Q3 2023 Earnings Call Transcript

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UBS Group AG (NYSE:UBS) Q3 2023 Earnings Conference Call November 7, 2023 3:00 AM ET

Company Participants

Sergio Ermotti - Group Chief Executive Officer
Todd Tuckner - Group Chief Financial Officer
Sarah Mackey - Investor Relations

Conference Call Participants

Stefan Stalmann - Autonomous Research
Giulia Miotto - Morgan Stanley
Andrew Coombs - Citi
Adam Terelak - Mediobanca
Flora Bocahut - Jefferies
Jeremy Sigee - BNP
Andrew Lim - Société Générale
Amit Goel - Barclays
Benjamin Goy - Deutsche Bank
Christopher Hallam - Goldman Sachs

Operator

Ladies and gentlemen, good morning. Welcome to the UBS Third Quarter 2023 Results Presentation. The conference must not be recorded for publication or broadcast. [Operator Instructions].

At this time, it's my pleasure to hand over to Sarah Mackey, UBS Investor Relations. Please go ahead, madam.

Sarah Mackey

Good morning, and welcome everyone. Before we start, I would like to draw your attention to our cautionary statement slide at the back of today's results presentation. Please also refer to the risk factors filed with our Group results today, together with additional disclosures in our SEC filings.

On slide two, you can see our agenda for today. It's now my pleasure to hand over to Sergio Ermotti, Group CEO.

Sergio Ermotti

Thank you, Sarah, and good morning everyone. During the third quarter and as we speak, we continue to see an evolution of the macroeconomic outlook with opinions, forecasts, and market changing at very rapid pace. In addition, we've witnessed an even further deterioration of the geopolitical landscape as a result of tragic events in the Middle East. Our thoughts are with those who are suffering and have been impacted by this violence, as well as our affected employees.

While we have been very busy executing on our integration plans, our top priority is always to stay close to clients, helping them protect their assets and position their portfolios and businesses for future opportunities. Our wealth management clients remain cautious and defensively positioned. And while some of our institutional clients are taking advantage of short term opportunities, many still remain on the sidelines.

Our consistent dedication continues to be rewarded by their confidence and trust in UBS. This was demonstrated by another quarter of strong flows across GWM and P&C. In the third quarter, the first full quarter since the acquisition, we made strong progress and delivered underlying profitability.

With respect to the integration of Credit Suisse, we continue to be encouraged by our achievements to-date, in both our planning and execution. In terms of the lessons learned from the events in March, we welcome the recent reports issued by the Basel Committee on Banking Supervision, the Financial Stability Board, and the Swiss Expert Group on Banking Stability.

Their findings confirmed our view that the crisis was not a result of insufficient capital or liquidity requirements. Rather, the reports emphasize sustainable business models, risk adjusted profitability, and importantly, the critical role of robust risk management cultures and effective governance. We take comfort in these conclusions as they have been and remain core principles of UBS.

Today, we are positioning UBS to be an even stronger and safer global financial institution. It is for this reason that we remain confident the acquisition will allow us to deliver significant value for all our stakeholders, notwithstanding potential macroeconomic or geopolitical challenges.

Briefly summarizing our results this quarter, our strong underlying performance was driven by positive operating leverage at the Group level. GWM, P&C, and Asset Management all delivered underlying PBT growth. IB performance was impacted by market conditions that were unfavorable to our business model and investments we expect to be accretive in future quarters.

Our capital position remains strong with a CET1 ratio of 14.4% and total loss absorbing capacity of nearly $200 billion. We achieved these results while incurring $2 billion in integration-related expenses and making good progress running down non-core assets.

Despite our reported loss in the quarter, we incurred over $500 million in tax expense and paid over $200 million in cash taxes in Switzerland.

Our confidence in the ability to successfully integrate Credit Suisse and create substantial long-term value is supported by the strong progress we made in the third quarter. We have now stabilized Credit Suisse and continue to grow our franchise through new client acquisition and share of wallet gains.

In addition, our client retention and win-back strategy is working. Net new money in GWM was $22 billion and our strong deposit momentum continued through the quarter. The $33 billion in net new deposits across GWM and P&C also supported our ability to reduce quarterly funding costs by $450 million through the repayments of the public liquidity backstop and the ELA+ that we announced in August.

We are pleased to see strong demand for UBS debt in the wholesale market, with transactions priced at similar levels to where UBS papers stood before the rescue of Credit Suisse. We have finalized the perimeter of non-current legacy and our efforts to actively unwind positions resulted in a capital release of around $1 billion.

Lastly, we continue to execute our plans to reduce costs in non-core and legacy, restructure Credit Suisse's Investment Bank and remove duplications across our operations. We have already delivered around $3 billion in annualized exit rate gross cost savings. We expect to make further progress in the fourth quarter.

Slide six summarizes well how quickly we have stabilized Credit Suisse and the confidence of clients in UBS. Credit Suisse Wealth Management's quarterly net new money has now turned positive for the first time in a year and a half, with $3 billion in the third quarter. UBS Wealth Management's $18 billion in net new money is the second highest third quarter result in over a decade.

In addition, it was satisfying to see that our efforts to win back client assets resulted in $22 billion in net new deposits from Credit Suisse clients across GWM and P&C. Following our decisions to integrate Credit Suisse Schweiz, we reached out to our clients to reassure them that we remain committed to delivering the best capabilities of both institutions. In addition, we reiterated that their credit limits across both banks will remain in place.

To-date, client retentions have been broadly constructive and – reactions sorry – client reaction have been broadly constructive and net new deposits in P&C were positive in both Personal and Corporate Banking client segments. We are particularly pleased that this was also the case in September, the month following our decision to integrate both franchises.

In non-core and legacy, we also made strong progress this quarter. 80% of the sequential reduction in NCL's credit and market risk risk-weighted assets was driven by actively running down positions executed above marks. Non-operational risk-weighted assets have now been reduced by nearly one-third since Q1, ‘23 and the expected natural runoff profile has improved by $3 billion.

While we have some credit risk exposure in certain local emerging markets and other more complicated bilateral positions that resulted in CLEs this quarter, the key risks across the portfolio are well understood, actively managed, and in most cases, well hedged.

The majority of our credit risk exposure is with high-quality borrowers. Over 75% of the exposure is rated investment-grade. This provides us with the comfort to continue to pursue our strategy to accelerate the disposal of these assets in a way that optimizes value for our shareholders, while also protecting our clients and counterparties.

The finalized perimeter of non-current legacy contains $30 billion in operational risk-weighted assets. As a function of the natural decay across the portfolio, we expect a reduction of around 50% by the end of 2026. Todd will take you through this in more detail.

Returning to the integration, let me reiterate that the complexity is not just from managing two GC fees banks. Our immediate priorities since the transaction was announced and closed had to be on stabilizing and restructuring Credit Suisse. This will continue to be the case until the early part of 2024.

At the same time, we are executing on our integration plans at pace, and on the left side of slide eight, you can see a selection of our recent achievements. Notably, we have established management responsibilities and operating models across business divisions and legal entities, including in our Swiss franchise.

You can also see some of our key priorities through the end of this year and beyond. This includes the merger of our significant legal entities, client migrations across all of our business divisions, and executing on our technology decommissioning plans. Last but not least, we are also working towards finalizing our three-year strategic plan, which we will present in early February.

As we continue to progress our plan, the main focus has been on delivering synergies for the combined group. We remain confident that the 2026 goals that we presented last quarter are achievable. But, as I say then, it will not be a straight-line journey. We are pleased that the first phase of gross cost savings has already been executed in 2023.

But I am sure we all appreciate the significant costs associated with running and combining two GC fees, one of which is still structurally unprofitable. From an operational standpoint of view, it is clear that 2024 will be a pivotal year. Completing the merger of our significant legal entities before the end of next year is a critical step to enable us to unlock the next phase of our cost, capital and funding synergies, which we expect to realize in 2025 and 2026.

Our enhanced scale, leading client franchises and increased future earnings power will position us for growth. Disciplined execution will continue to be an important driver for our performance, and we are on track to deliver on our plans. We are optimistic about our future as we build an even stronger and safer version of the UBS that was called upon to stabilize the financial system in March, and one that all of our key stakeholders can be proud of.

With that, I hand over to Todd.

Todd Tuckner

Thank you, and good morning everyone. As Sergio highlighted, we are executing on our plans at pace. In our first full quarter since the Credit Suisse acquisition, we have delivered underlying profitability and maintained strong client momentum with impressive net new money inflows in Global Wealth Management and net new deposit growth in our Swiss franchise. We also made substantial progress in de-risking our non-core and legacy portfolio, reinforcing our balance sheet for all seasons.

Before I move on to discussing details of our financial performance, let me describe the reporting changes we implemented this quarter and the ones we expect to introduce soon. Today, for the first time, we are presenting the results of our performance segments on a combined basis, reflecting the way we are managing our businesses and engaging with clients.

In addition to Global Wealth Management, Personal and Corporate Banking, Asset Management, and the Investment Bank, we are now separately reporting non-core and legacy, as well as group items, all of which reflect the combined performance of UBS and Credit Suisse under IFRS and in U.S. dollars.

As I said during the second quarter earnings call, our aim is to be clear and forthcoming in explaining the financial reporting of this complex transaction. Therefore, we've introduced underlying performance metrics that primarily strip out the PPA-related pull-to-par effects from revenues in our core businesses and adjust for integration-related expenses across all performance segments.

Regarding the pull to par effects in NCL, in the quarter we reclassified most of the positions that Credit Suisse's Investment Bank and capital release unit historically accounted for on an accrual basis to fair value through P&L, as those positions in NCL are now held for sale.

As a reminder, those positions gave rise to the $3.1 billion in future NCL pull to par revenues that we flagged last quarter. Given that NCL generates revenues in various ways, whether from early unwinds of positions and other disposals, mark-to-market on its fair value book, or from pull to par effects, we don't distinguish among the various accounting classification types. Accordingly, in the quarter and going forward, all sources of NCL income, gain or loss, will be treated as part of its underlying performance.

As last quarter's disclosed IFRS results reflect only one month of Credit Suisse's operating performance, to improve comparability, we've prepared estimated underlying results that reflect all three months of the second quarter. As I go through my remarks, unless otherwise stated, I will compare our underlying third quarter results sequentially to this estimated performance in the prior quarter. We'll focus on sequential developments until the third quarter of 2024, when we'll resume year-over-year commentary.

Now, onto our plan changes. In the fourth quarter, we will expand our Global Wealth Management asset flows disclosure and enhance comparability with U.S. peers. We will report net new money plus dividends and interest, as well as disclose net new fee-generating assets for the combined franchise. We intend to introduce a growth target for net new money plus dividends and interest when we present our integration KPIs and targets as part of our fourth quarter results early next year.

Additionally, starting from the first quarter of 2024, we expect to push out to our business divisions substantially all balance sheet and P&L items that were previously retained centrally in group items. The only exceptions will be for group items that are not directly attributable to divisional activities, including deferred tax assets, cash flow hedges, own credit, and their associated P&L effects.

Our business division equity attribution framework will also reflect these changes, whereby the average levels of equity across the business divisions will more closely align to our current group capital targets.

Moving on to our financial performance on slide 12. The quarterly profit before tax was $844 million, a $1.4 billion increase from the second quarter, as we delivered strong positive operating leverage with $0.6 billion higher revenues and $0.5 billion lower operating expenses.

Additional CLE declined by $0.4 billion sequentially to $0.3 billion, which mainly related to Credit Suisse loans within P&C and NCL, which I cover later in more detail. By comparison, CLE in the second quarter of $0.7 billion included more than $0.5 billion of charges, primarily related to the take-on recognition of ECL allowances on Credit Suisse's lending portfolios.

On a reported basis, the third quarter net loss was $785 million. As $526 million in tax expense arising in profitable entities could not be offset by tax benefits from losses primarily generated by certain Credit Suisse subsidiaries.

We expect our effective tax rate to remain elevated until we merge and restructure our most significant legal entities. After that time, the effective tax rate should gradually return to a level below 25%, absent the effects of any remeasurement of deferred tax assets.

Moving to slide 13. Revenues increased by 6% this quarter to $10.7 billion, driven by lower funding costs within group items and gains in non-core and legacy, as the team accelerated the unwind of certain positions at attractive prices relative to book values.

Revenues in group items increased sequentially, primarily due to the reduction of around $450 million in centrally held funding costs from the Credit Suisse-related liquidity measures that were repaid and returned in the middle of the third quarter. For the fourth quarter, we expect an additional $100 million benefit from these actions. It is worth noting that the cost of replacement funding is being absorbed by the core businesses and is reflected in their sequential NII performance and guidance this quarter.

Total revenues reached $11.7 billion, including $958 million that we've stripped out of underlying revenues. This amount consisted of $764 million in pull to par effects, as well as $194 million of NII in our core businesses, benefiting from the merger date elimination of the unrealized loss balance associated with Credit Suisse's cash flow hedge program.

On slide 14 we showed the details of pull to par and similar effects that we expect to recognize in future quarters. The pull to par starting balance as the transaction closed was $9.3 billion, excluding the $3.1 billion reclassification in NCL that I described earlier.

Considering the pull to par accretion of $1.1 billion recognized since the merger date, including $0.8 billion this quarter, the remaining balance that will accrete into income over future quarters is expected to be around $8.2 billion. We expect the majority of this balance to accrete into income by the end of 2026, barring the impact of any early unwinds, with $500 million expected next quarter.

We also expect to recognize around $900 million of additional NII in GWM and P&C, relating to the eliminated cash flow hedge item I mentioned a few moments ago, with $150 million expected in 4Q. As a reminder, these effects are stripped out of our underlying revenues, with about half being CET1 capital accretive.

I would also point out that we continue to expect total pull to par revenues, including the reclassified NCL and post-2026 recognized portions, to broadly offset the cost to achieve the greater than $10 billion in gross savings we described last quarter.

Having said this, like in the third quarter, we expect there will be timing mismatches in the recognition of these reported revenues and expenses, resulting in headwinds to our reported results, particularly in the fourth quarter and throughout 2024.

Moving to slide 15. Operating expenses for the group decreased to $9.6 billion, down 5% as our cost savings initiatives take effect, partially offset by reinvestments to help grow our core businesses. Progress on our restructuring actions led to $2 billion in integration-related expenses.

Roughly half of these expenses was related to personnel costs, including severance payments, salaries of employees fully dedicated to integration matters, and the cost of retaining key personnel. The other half was related to non-personnel matters, including real estate impairments and depreciation, onerous contract charges and consulting and legal fees.

For the fourth quarter, we expect integration-related expenses in excess of $1 billion, although certain additional costs to achieve may arise if we see opportunities to accelerate savings.

While we manage our integration to achieve overall cost reductions without specific headcount targets, I would note that our combined workforce fell by over 4,000 in the quarter, bringing year-to-date reductions to 13,000 or down 9% versus the workforce of both banks as of the end of 2022. Across our cost savings initiatives, we've achieved around $3 billion to-date in gross run rate cost saves, with further progress expected in the fourth quarter.

Turning to slide 16, in the quarter we maintained a strong capital position with around 200 billion of TLAC and a CET1 capital ratio of 14.4%, mainly as we reduced RWA from the active rundown in our NCL portfolio, which offset reductions in our CET1 capital in the quarter. Our CET1 leverage ratio increased to 4.9% at the end of the quarter.

As we previously guided, we expect to maintain a CET1 capital ratio of around 14% throughout the integration timeline, even if our reported performance over the coming quarters remains affected by the costs of winding down the NCL unit and the work needed to achieve cost synergies in our core businesses.

During the quarter we issued $4.5 billion of U.S. dollar TLAC, attracting very strong demand and pricing at pre-acquisition spreads in a clear sign of fixed income investor confidence in our name. To further diversify our sources of funding, we successfully placed $3 billion in SEC registered OpCo and just after the quarter, CHF820 million in UBS's inaugural Swiss covered bond issue, both attractively priced.

Regarding liquidity, we maintain a prudent profile in the quarter with an LCR of nearly 200%, supported by $33 billion in total deposit inflows. I would note that these strong deposit inflows across global wealth management and personal and corporate banking increased our overall deposit coverage ratio.

Going forward, we expect to continue to operate with a prudent LCR to comply with the revisions to the Swiss liquidity ordinance that will come into effect on January 1, 2024. Regarding the Swiss national bank's recently announced changes to its minimum reserve requirements and site deposit remuneration policies that take effect next month, we expect an annualized reduction of around CHF80 million to our NII, of which two-thirds will impact P&C and one-third GWM.

Turning to the performance in our businesses, beginning on slide 17, in Global Wealth Management, we continued strong momentum with $22 billion in net new money inflows across all regions. We saw particularly strong inflows in both APAC and EMEA with $13 billion and $8 billion in net new money respectively.

Importantly, our Credit Swiss Wealth Management Business attracted quarterly net inflows for the first time since the beginning of 2022. In the quarter, we also attracted $25 billion of net new deposits, including $17 billion from the Credit Swiss wealth side.

These impressive flows are a true testament to the trust our clients continue to place in us. They also reflect the success of our clear and decisive win-back, retention, and client acquisition actions, as well as intensified client engagement levels since the deal's completion.

We expect to further build on this momentum as the value proposition of the combined firm becomes more tangible to our clients. For instance, all of our clients now have access to the UBS House view from our CIO, and our wealth management product and solution offerings are being unified and aligned across the platforms.

As mentioned, from next quarter, we will report net new money plus dividends and interest, as well as net new fee-generating assets for the combined franchise. In the third quarter, inflows based on this new definition were $39 billion, and net new fee-generating assets in solely the UBS portion of our wealth business were $21 billion, with positive flows across all regions.

Moving on to GWM's P&L, profit before tax was $1.1 billion, over 40% higher sequentially, driven by a reduction in costs and credit loss expenses with roughly flat revenues. Excluding the impact of CLE, which included a significant acquisition-related ECL charge last quarter, underlying profit before tax increased by around 20%, supported by lower underlying operating expenses.

This quarter, GWM revenues of $5.5 billion were broadly flat, as increases in recurring fees were offset by a decline in NII. Combined net interest income was down 3% on an underlying basis and excluding FX, reflecting continued deposit mix effects due to rotation into higher-yielding deposits and ongoing deleveraging. This was partially offset by sequentially higher deposit balances that served to close the funding gap in the business and strengthen the structural profile of our balance sheet. For the fourth quarter, we expect a mid-single digit percentage decline in NII, mainly from continuing deposit mix shifts.

Credit loss expenses in the quarter across GWM were $2 million. Operating expenses declined $0.2 billion to $4.4 billion, mainly driven by lower personnel expenses as reduced headcount levels, which we expect to continue sequentially, began to benefit our underlying earnings.

Although it's early days in terms of synergy realization in GWM, we are already seeing progress from our integration efforts. The division's underlying cost-to-income ratio in the third quarter dropped by around 3 percentage points to 80%.

Turning to Personal and Corporate Banking on slide 18, profit before tax increased by $0.1 billion to CHF773 million, mainly driven by a decrease in credit loss expenses. Excluding CLE, P&C's PBT was up slightly quarter-on-quarter.

Revenues increased to $2.2 billion. With the announcement of the Swiss integration at the end of August, the business is highly focused on client engagement and deposit win-back. Early indications are encouraging, as evidenced by the stability of the revenue line, the resilience of business volume, and the commencement of deposit returns.

Net interest income decreased by 4% despite the narrowing funding gap from net new deposit inflows, which mainly came from our corporate clients. A primary driver of the sequential decline this quarter was the additional cost of restoring the structural funding profile of the combined business to UBS's NSFR standards. For the fourth quarter, we expect a low single-digit percentage decline in NII, mainly due to rotation to higher-yielding deposits.

Credit loss expense in the quarter was CHF154 million, almost exclusively from two factors related to Credit Suisse's Swiss Bank. First, we recognized CLE on loans, mainly to corporate counterparties that were already impaired on the merger date and deteriorated further this quarter, as well as newly defaulted positions.

Second, we moved to Stage 2 and provisioned in line with UBS's coverage ratio standards, all loans, including those as of the merger date, on Credit Suisse's watch list, as well as those lending exposures that experienced a significant increase in credit risk during the third quarter. Underlying operating expenses were roughly unchanged at $1.2 billion on lower personnel and litigation expenses, with the underlying cost-income ratio down quarter-on-quarter to 57%.

Moving to slide 19. In Asset Management, the underlying profit before tax increased to $156 million on higher revenues and lower costs. Revenues were slightly higher at $755 million, with increases in net management fees driven by market performance and FX, and higher performance fees from our hedge fund businesses. Operating expenses decreased to $599 million, mainly due to lower personnel expenses.

Net new money in the quarter was negative $1 billion, driven by Credit Suisse outflows, which continue to taper since the acquisition, with inflows expected to gradually return from proactive client engagement.

It's worth noting that the UBS side of the business attracted net new money inflows this quarter in a challenging environment for asset managers. We saw strong demand for our money market, SMA, and real estate and private markets solutions, partly offset by client asset allocation shifts away from China, equities, and hedge funds in the current market dynamic. Net new money, excluding money markets and associates was negative $8.3 billion.

Turning to the investment bank performance on slide 20. Since the UBS IB has taken on only select parts of Credit Suisse's investment bank, and the latter saw little activity in the second quarter, we compare the results of the combined IB with standalone performance in the prior year's third quarter. We will continue to offer year-over-year comparisons to standalone UBS IB performance in the quarters ahead, while also providing commentary on sequential developments until the third quarter of 2024, as with the other business divisions.

The operating loss of $116 million was a result of additional costs related to the retained portion of Credit Suisse's investment bank, which was only partially offset by standalone profit before tax in UBS IB, as market conditions remain challenging for our business model. Underlying revenues, which exclude $251 million of pull to par accretion and other effects, declined 6% year-over-year to $1.9 billion amid muted client activity due to ongoing concerns around terminal interest rates and geopolitical events.

Volatility across asset classes declined significantly from a year ago, and global fee pools remain depressed. Against this backdrop, global banking revenues increased 36%, with particular strength in leveraged capital markets and strong performance in EMEA. Advisory outperformed the global fee pool and was further supported by revenues from the Heritage Credit Suisse franchise.

Global markets revenues declined 15% from a very strong third quarter, reflecting lower revenues across macro products and equity derivatives. This was partly offset by growth in financing, supported by increased client balances. Overall, revenues generated from the retained portion of Credit Suisse's investment bank were $113 million this quarter, primarily in advisory, as well as derivatives and solutions.

Operating expenses rose 27%, predominantly from additional personnel costs related to the retained portions of Credit Suisse's investment bank, as well as higher technology costs and FX. As we manage the investment bank integration, we remain disciplined in our resource management. RWAs at 23% of the group's resources, excluding NCL, were roughly unchanged sequentially.

Looking ahead, as the majority of the onboarding of our colleagues and positions to UBS IB systems is planned for completion by the end of the year, we expect revenues to ramp up over the course of 2024. Given this timing, in addition to current market conditions and seasonality, we expect continued pressure on our underlying profitability in the fourth quarter.

Moving to non-core legacy on slide 21. Excluding integration related expenses, NCL generated an underlying operating loss of $1 billion. Quarterly revenues of $350 million consisted mainly of gains from the early unwind of loan commitments, while the portion of the NCL portfolio that remains on the accrual method of accounting was left broadly unchanged this quarter, given recovery expectations on the underlying lending positions.

Credit loss expense was $125 million. Additional provisions of $71 million reflect application of the same extended credit watch list approach I described earlier in the context of P&C. We also saw $54 million of charges from Stage 3 and purchased credit-impaired loans that deteriorated further in the quarter.

Underlying operating expenses reached $1.2 billion, split roughly equally between personnel and non-personnel costs. Integration related expenses of $918 million consisted of onerous contract charges, real estate related expenses, and personnel costs linked to headcount reductions and retention. For the fourth quarter, we expect the underlying cost base in non-core and legacy to decrease further from additional staff reductions, whose costs are directly housed within or allocated to NCL.

As Sergio mentioned, in the quarter we took decisive actions to reduce RWAs. Five of the total $6 billion reduction resulted from active de-risking of exposures across the array of NCL portfolios. LRD was reduced by $52 billion, including $15 billion resulting from lower HQLA requirements and $12 billion from the accounting reclassification of loan commitments from accrual to fair value.

During the quarter, we completed the initial impact assessment on our operational risk RWA from the final Basel III standard, which comes into effect on January 1, 2025. Based on this initial study, we expect Group Op Risk RWA to remain broadly unchanged at the current level of $145 billion.

We also determined on the basis of our impact assessment, initial levels of RWA to a portion to each of our business divisions, including NCL. The $30 billion of operational risk RWA assigned to NCL this quarter is expected to diminish over time as a function of two considerations, the rundown of the NCL portfolio and the removal of certain legacy litigation matters given the lapse of time. On the basis of natural roll-off in both contexts, we expect operational risk RWA and NCL to decrease to around $14 billion by the end of 2026.

As a reminder, we continue to expect a roughly 5% increase from day one effects in 2025 from other final Basel III considerations, mainly FRTB. As we look ahead to the fourth quarter, we expect many of the drivers of underlying profitability to continue to progress. In particular, we expect underlying operating expenses to decline sequentially as our core businesses realize incremental synergies and NCL remains focused on actively running down its portfolio to release capital and accelerate cost saves.

In addition to the NII expectations that I described earlier, transactional activity may be affected by seasonal factors, as well as client sentiment in response to the geopolitical landscape. Despite these elements, we are executing on our integration plans at pace and remain on track to achieve our goals of around a 15% return on CET1 capital and a cost-income ratio of less than 70% by the end of 2026.

With that, let's open for questions.

Question-and-Answer Session

Operator

[Operator Instructions]. The first question is from Stefan Stalmann from Autonomous Research. Please go ahead.

Stefan Stalmann

Good morning gentlemen. Thank you very much for the presentation. I have two questions and they may be linked. The first regarding outstanding SNB funding. I don't think there's any update in the disclosure material on where the number has moved to. I think the last disclosed number was CHF38 billion at the end of August. Could you provide an update here?

And possibly related to this, it looks to me, looking at SNB data, that there has not been a lot further reduction of SNB funding after August in September. Is that a good interpretation of the data? And is there any connection here between your management of the SNB funding and the new liquidity ordinance that will come into place in January?

And is it possible for you to give us the guidance on how your liquidity ratios will look like on the 1st of January under this new liquidity ordinance in Switzerland, please? Thank you.

Todd Tuckner

Hi, Stefan. Thanks for your questions. So, in terms of the outstanding SNB funding, no, we still have the – that funding levels are still unchanged at this stage. We are working through our business plans and as well as our funding plans, and we'll consider the ability to repay some or all of that over the course of the coming months, but your read was correct.

In connection with that funding and the liq ordinance, no, I'd say there's no specific connection with that, and we're not maintaining that funding, particularly in respect of satisfying the liquidity ordinance per se. That said, the LCR guidance that you're looking for, as we say, will remain prudent, so you can expect it to remain at levels not terribly far away from where we finished 3Q at.

Stefan Stalmann

Great. That was very helpful. Thank you.

Operator

The next question is from Giulia Miotto from Morgan Stanley. Please go ahead.

Giulia Miotto

Yes, hi. Good morning. Two questions for me. The first one on capital distribution. I know it's very early. I guess you will comment on Q4, but what are the stepping stones that we should look out for before you can resume a buyback? That's my first question.

And then the second question is with respect to costs. In the quarter, there was an excellent delivery on costs, and the $3 billion target by year end has already been achieved. So basically, where do we go from here? Can we assume that this steady path of cost saves can continue or will there kind of be a pause until there is the legal merger, because you have already basically extracted as much as you could of the low-hanging fruit? Thank you.

Sergio Ermotti

Okay. Thank you. So in respect of the capital distribution plan or capital return plans, as you pointed out, you're going to have to be patient. For the time being, I just can't reiterate that we are still looking to have a progressive cash dividend policy that will be implemented. And for the rest, what you need to see is the visibility with the plan. So we are finalizing the three-year plan, and that will allow us to really calibrate capital returns.

I just want to reiterate that I still believe at this stage, although the plan is not finished, that capital returns and share buybacks is not a matter of years. In my point of view, it could be a matter of quarters, but without having the final plan, it's difficult to really make a final statement. But that will be addressed in February.

And somehow, it's linked to your second question, because of course, I'm not so sure. I would define the progress we've made so far as low-hanging fruits. But I think that it takes effort and time to go through this. I do believe that we still have costs that can be taken out during 2024, regardless of what you are pointing out being the critical issue, is the legal entity merger.

The legal entity merger is the triggering point that allow us to go to the next level of cost reduction and synergy realizations from an operational standpoint of view, but also from an IT standpoint of view. So 2024, as Todd mentioned, and I also remarked, is a pivotal year. It's probably the one time in which we're going to incur the most cost in order to achieve the synergies that we'll achieve in 2025 and 2026.

So, you see how the two questions are somehow linked.

Giulia Miotto

Thank you.

Operator

The next question is from Andrew Coombs from Citi. Please go ahead.

Andrew Coombs

Good morning. Two questions from me, please. Firstly, on the GWM net interest income trajectory, thank you for the commentary in your pre-prepared remarks. I think you said, after a 3% decline in Q3, you expected mid-single digit percentage decline in Q4, and that was an ongoing deposit mix shift. So that seems to be accelerating rather than decelerating. So can you give us any indication of how much longer you think that trend could continue for?

Do you think now that we're at peak rates. If anything that should slow as we go into 2024? And also, if there's any implications from your broader deposit pricing that's also influencing that sequential NII decline? That's the first question.

Second question, there's been quite a lot of media commentary over the past week ahead of the “Too Big to Fail” review coming out in spring next year. I think there's been some explicit discussion around potentially introducing more exit fees or more notice periods around deposits. Is there anything you could say with regards to that? And also, what that means for your competitive positioning versus international peers? Thank you.

Todd Tuckner

Yeah, thanks. Thanks, Andrew. On the first, in terms of GWM NII trajectory, I think you captured it right in terms of guidance around the mid-single digit decline owing to deposit mix shifts and whether that seems like an acceleration. I'd comment that I think what we're seeing is a bit of a broadening of that dynamic more across the globe. We saw in most of 2023 that dynamic being very significantly driven by moves from sweep deposits into higher-yielding deposits in the U.S., and we saw less of that in Europe in APAC, as well as in Switzerland.

And so while we're seeing the U.S. taper now, both in the current quarter and as we look ahead, we're seeing a bit of an expansion of that dynamic in other parts of the globe, and that's what's sort of driving that. As I look out into 2024, we're doing that work now. We'll come back with a view during February with a view on full year 2024.

I would just conclude on the point saying, no, I don't see pricing having an impact. I mean, this is just a response to the current rate environment as clients are undergoing cash sorting across our client base.

Sergio Ermotti

So in respect of what you mentioned, changes in the law and/or regulations around liquidity, I think I can only say that it's pretty difficult to track all the rumors, speculations, and ideas that are coming up almost daily on the Swiss media. I think that I can only tell you that at this stage what stands is that even the finance minister took an official stance on the matter.

I mean, those are speculations. I don't believe this is going to be part of the package. I think that I'm convinced that Switzerland will keep its standards in terms of allowing the – responding to the crisis in March, not only the one in Switzerland, but broadly speaking with a following recommendation that will be set by the FSB and other bodies. And in that sense, I don't see us being particularly disadvantaged compared to any other jurisdictions in terms of liquidity ordinance.

So I guess we will follow-up, and I think it's going to still take months and months before the full analysis of what happened will translate into concrete actions.

Operator

The next question is from Adam Terelak from Mediobanca. Please go ahead.

Adam Terelak

Good morning. Thank you for the questions. I had one big picture question on revenues and then a follow-up on the operational risk RWA.

Big picture, your revenues at the minute are annualizing to low $40 billion or so. Clearly your target has a number which is probably $50 billion plus. So, I just want to understand how you see the revenue bridge from here through to 2027 and what the key moving parts should be, particularly in the context of some of your GWM trends, which at the minute seem to be down before we go back up.

And then secondly, on operational risk, I just want to understand some of the assumptions that are going into your Basel IV guidance there. Clearly, there's some uncertainty around ILM. There's a bit of uncertainty about what losses to use in that standardized calculation. So what losses from the Credit Suisse business are you having to carry forward and how does that impact your operational risk RWA?

And then finally, can I just clarify on the Basel III AT 1 finalization guidance, that 5% ex any moves in operational risk? Thank you.

Sergio Ermotti

Thank you, Adam. So in terms of revenues, I'm not so sure we ever indicated that we have a $50 billion plus revenue. I don't know where this figure is coming from. What I remember saying back in August is that our targets, our ambitions for 2026 are not based on blue sky scenarios on revenues. So if anything, I guided to the contrary of that.

So we are definitely focused on costs and we are definitely also focusing on the denominator. So we need to basically focus on managing and utilizing in a better way the resources and the risk weighted assets that we have right now.

I have to go back to the critical point. The mission number one we have had in the last six months and in the foreseeable future is to restructure Credit Suisse, okay. And then we're going to talk about synergies and then we're going to talk about growth. But before we talk about growth of the top line, we need to restructure and reset the basis. And in that sense, believe me, we are not counting on blue sky scenarios and that figure is not really our figures.

Adam Terelak

Can I ask for a better landing point then?

Sergio Ermotti

Well, the landing point you will see in February.

Adam Terelak

Thank you.

Todd Tuckner

Adam, on your second question in terms of op-risk RWA and modeling, as I mentioned, we did an initial impact assessment. It was quite dynamic. We've had only initial discussions with our regulator at this point in time, naturally ahead of the formal introduction of Basel III final for op-risk RWA. There will be much more extensive interactions with the regulator to agree on the particulars around the ILM.

As you say, we made certain modeled assumptions for now, as well as the loss history. We made certain assumptions about the loss history and the roll off of certain legacy matters. So, it was a thoughtful analysis, a good initial view, but it's going to be one that requires more work and more engagement with our regulator over the coming months.

On the 5%, actually no, it's not ex-op-risk, it's inclusive. But given that op-risk, we're saying, as I said in my remarks, we see that as broadly unchanged for now. The maths are the same either way.

Adam Terelak

Thank you very much.

Operator

Next question is from Flora Bocahut from Jefferies. Please go ahead.

Flora Bocahut

Yes, good morning. I'd like to talk about the net new money, especially at CS this quarter, because if I look at extrapolating the quarterly changes in net new money at CS that we've seen over the past two quarters, it seems to point to a run rate where you gain $20 billion $30 billion of net new money per quarter. But then if I try and reconcile just the month of September from what you had disclosed with Q2, it looks like there's been a slowdown actually in net new money at CS with just $2 billion in wealth this month.

So what should I consider as a more normalized level from here? Is it going to be still the pace we saw over a quarterly basis or there is a slowdown because the environment is tougher? You probably have visibility there with what happened on October.

And the second question is actually following up on this. I know you are going to provide us with the strategic update at the full year, but any hints as to what kind of assumptions you've made in your RoCET1 target towards 26 regarding the AUM level, especially considering the fact that the market effect is turning further more negative now? Thank you.

Todd Tuckner

Hey, Flora. Thanks for the question. So on the net new money for Credit Suisse Wealth, I appreciate you're doing a fair bit of the extrapolation math, but a long time in this business tells me that extrapolating net new money trends is probably not necessarily the way to go, certainly not from a month or so.

The point we've made is that we've stabilized the business. We're seeing inflows after massive outflows. And that for us, as Sergio highlighted, was really objective. Number one was to stabilize the business and that we've achieved.

Look, going forward in any case, we're going to be reporting these metrics on a combined basis. We're just giving an indication, because we talked about that in the second quarter. We gave an indication even up to the late publication date towards the end of August. So Sergio and I wanted to follow through on that and offer that perspective. But the expectation going forward in any case is that wealth management, which is how we manage the business, will be providing a combined net new money plus dividend and interest figure going forward.

And in terms of the ROCT1 assumptions, in terms of AUM levels, we're doing that work now. Naturally, when we develop the landing zone targets that we articulated in the second quarter, we had a view on growth. But now we're validating that in our business planning process. And we'll come back and offer specificity around that in February.

Flora Bocahut

Thank you.

Operator

The next question is from Jeremy Sigee from BNP. Please go ahead.

Jeremy Sigee

Good morning. Thank you. I'd like to ask two questions about non-core, if I could. The first one on the RWA outlook, you had a great start already reducing that balance down quite effectively. The runoff you show in the slide is effectively the natural runoff with no action, but clearly you are taking action. So is it reasonable for us to expect that rather than being down 50%, it could be down 75% or 100% within that sort of three-year time frame? It seems that you're on a more aggressive trajectory than that passive runoff that you are showing in the slide.

And then the second question is also about non-core, about the P&L. So you're annualizing in this quarter around $1 billion positive revenues and $5 billion of costs. I just wonder, is that a representative starting point for us to sort of model non-core going forward? And linked to that, how much could that change in 2024? Could we see – will we still see positive revenues in 2024 in non-core? And how much could we expect the costs to reduce in 2024 in non-core?

Sergio Ermotti

I think that – Todd, let me start with taking the one on – we are giving as I mentioned last time, we just give you a flavor for the natural decay in order for you to understand that what would be the leftover in case we do nothing. And as you pointed out, we have been pretty active.

Having said that, I don't think it's reasonable to assume that we're going to take down 100% or 75% to 100% per se, because it all depends on at what terms we will do it. The very critical topic here is that we have to do it in a that creates value and not just headlines. So, we can get rid of probably many of those positions, but destroying a lot of value. And this will be in conflict with capital accretion and the ability for us to return capital to shareholders.

So, I think that it's very clear what is the framework we are using. And I think objecting number one around non-core is not necessarily just to accelerate the wind down of assets, but it's to take down cost. That's the much more critical element of freeing up capacity and resources.

Todd Tuckner

And Jeremy, on the P&L question, for sure, on the revenue side I would not annualize the current quarter's revenues. The revenues are a function of the market through which we would exit these positions. It depends on the nature of the positions we're talking about. It depends on market conditions will be opportunistic, and everything Sergio just said that actually informs the dynamic about the speed, the timing, the intensity of when we get out of positions is of course what governs in that respect. So, I would put no sort of target or certain extrapolation, certainly no extrapolation to the current quarter's revenues in NCL as saying, well, that's a run rate.

On the cost side, I would argue that's different because there you're looking at on the underlying OpEx. You're looking at this point, the run rate costs to support the rundown of the business. So, as that business runs down, you would expect that the costs associated, the underlying OpEx supporting the portfolio will also run down.

Now, that may not be linear and I wouldn't expect it to be linear, but it ought to be in some way, shape or form correlated with the size of the balance sheet as it starts to diminish over time.

Jeremy Sigee

Okay. Thank you.

Operator

The next question is from Andrew Lim from Société Générale. Please go ahead.

Andrew Lim

Hi, morning. Thanks for taking my questions. So, just turning to tax, obviously we saw some nice RWA reduction, but it was negated by the high tax charge. But at the same time, you're talking about mergers of the divisional structure to enable you to reduce the effective tax rate. I was wondering if you could give us more specificity on when we can expect that to happen and would that be a gradual process for the reduction in the tax, effective tax rate, or would that be actually a step down, change there?

And then my second question is, you've done a good job on costs. Well done there. The exit run rates for the end of the year, I was wondering if you could update us on that.

Todd Tuckner

Thanks, Andrew. So, on the tax question, in terms of timing, as I mentioned in my remarks, certainly the elevated tax rate is a function of the fact that the expenses that are weighing on our pre-tax at the moment, in particular, the integration-related expenses are being incurred in jurisdictions where we're not able to offset, even within the jurisdictions, necessarily offset profits and losses in different entities, just given where they fall out.

So, there could be expenses or losses in one entity that's not tax group with an entity that is generating taxable profits, and that's indeed what's happening really across the globe, because the Credit Suisse entities, in particular, as you'll appreciate, under Credit Suisse AG, which is not yet merged with UBS AG, those are separate chains of entities. So, therefore, anything happening on the CS AG side that you would otherwise ideally shelter with profits of the UBS side isn't happening until we start the mergers.

Now, once we do that, your question was, is it a step or it's gradual? We'll see both. I mean, certainly, we'll see some immediate benefits by bringing together certain entities. Others are going to be harder work and harder planning to unlock some additional tax value and get the rate to a lower level. So, you'll see, once the mergers take place over the course of ‘24, you'll see some step down, but you'll also as I said, gradually see the rate come back in.

In terms of the update for year-end, we did say that as of the third quarter, we see the run rate saves in excess of $3 billion and expect to make further progress. We're undertaking actions at present. We haven't quantified that, but you can expect that there will be further progress in the fourth quarter before we exit 2023.

Andrew Lim

That's great. Thank you.

Operator

The next question is from Amit Goel from Barclays. Please go ahead.

Amit Goel

Hi, thank you. Two questions for me. So, the first is, I mean, so clearly the legal entity mergers are pretty important in terms of the kind of the cost and the tax and so forth. So do you mind just reminding us exactly the main pieces in terms of the timing? So, would you be expecting some of that to happen within the first half of the year or is that kind of second half? And just things that we can monitor to check the progress there.

And then secondly, just in terms of the revenue picture, just into Q4, obviously there's the commentary on the transactional income and NII. Just thinking, are you thinking the underlying revenues Q4, X NCL are likely to be in line with what we've seen in Q3 or slightly better or due to seasonality slightly worse? Thank you.

Todd Tuckner

Thanks for the questions, Amit. So, on the legal entities in terms of the main pieces and the timing, obviously the big groups to address are the parent banks that will take place, the two Swiss banks and then the U.S. IHCs and the subsidiaries below. I mean I'd say those are, and in the UK as well. And those are going to be the biggest chunks of course across the globe.

There's also a lot of undertaking in Europe and in Asia, but the big, I highlighted the big pieces because that's what you were looking for. We are working hard on developing plans for all of those. I think it's fair to say over the course of 2024, I won't at this stage speculate on exact timing, but we'll provide more updates as we go and as we enter the year and as we go through the year, we'll give you more specificity around timelines.

In terms of the revenue picture in the fourth quarter, I mean as you mentioned, repeating back that I offered some NII guidance for our core businesses in terms of underlying NII. We do see the potential for transactional activities. I mean, the market for transactional activities is a bit clouded at the moment.

We are seeing some risk off, even though earlier this month, certainly some of the less hawkish sentiment, coupled with further rate hike pauses and seeing bonds and equities rally more recently, that would suggest perhaps more risk on, but I think that's all counterbalanced as well in our clients' minds also about what's happening in the Middle East.

And so we do see the potential for TRX in our asset gathering businesses as well as transactional activity in our IB to potentially be affected by that. And as you mentioned, seasonality will for sure in any event be a factor.

So I'd say the revenue picture is a bit clouded, but I at this point wouldn't necessarily expect it to increase quarter-on-quarter significantly at this stage.

Amit Goel

Got it. Thanks. And just on the legal entity piece, so just, sorry from my understanding, it's like getting the legal work done and getting the regulators to kind of sign off and just in terms of the main things that obviously have to get done to do the mergers. Is that right?

Todd Tuckner

Yeah, that's correct. There is a lot of planning to be done. The planning manuals are incredibly extensive. And of course, it needs to be approved by the regulators. And when you think about the parent bank and how many jurisdictions they operate in, you're talking about regulators across the world. So these are not simple transactions by any stretch of the imagination.

Amit Goel

Okay. Thank you.

Operator

The next question is from Benjamin Goy from Deutsche Bank. Please go ahead.

Benjamin Goy

Hi, good morning. Two questions, please. The first, if you could maybe speak about the profitability of the recovery of funds and assets of Credit Suisse and how it's going, the discussion with clients there. And the second is, it looks like in particular non-core significantly outperformed your expectations, you said in Q2 in the third quarter. So just wondering what does it mean for the budget? So to say you have to accelerate a rundown in Q4 and beyond. Thank you.

Sergio Ermotti

Yeah. I mean, in terms of the non-core, I don't think that extrapolating a quarter is meaningful. I do, as Todd mentioned before, we need to look at. In some cases, we were able to dispose that assets above marks in order that we will need to make an assessment about what we think is the value of those positions. But I would pay attention to – not to use the third quarter numbers and extrapolate and call it is better than what we expected, because we didn't really give any guidance on that.

So I mean, I think that we are confident that the quality, broadly speaking, of the assets is there. They are non-core assets per se. The vast majority is not problematic and therefore I'm not overly concerned about the revenue or the cost to exit. As I mentioned before, it's more of a matter of addressing the cost to sustain those assets than it is about managing out the asset themselves.

In terms of recovery of the funds, we see the win-back strategy still in place. We have been – it's very focused. Probably what I can offer as a comment is, as time goes by, we saw it already in the second quarter of the year after the announcement of the transaction and definitely has been confirmed in the third quarter.

Basically, the third quarter is a year after you started to see departure of assets and client advisor from Credit Suisse. Despite the massive outflows that you saw, the amount of assets that were able to be moved by the people that were serving those assets has been within what we expected.

On average, no more than 20%. So the first big issue is to say that we have been able to keep the vast majority of the assets. So it's very difficult for people that move out to be able to bring the assets with them.

So if you look at the numbers, it’s quiet – I can give you maybe a bit of anecdotal evidence. Credit Suisse in the last 12 months lost around 500 client advisors. They moved so far $20 billion of assets. Let's say that we're going to lose further assets, because some of those people just left more recently and we're going to see some outflows later on. But we are totally convinced that it's not going to be a multiple of that $20 billion, the future outflows, so. And we are working hard to recapture some of it.

I think that our strategy now is more focused on regaining the clients that left because of fears of the instability of the system. In that sense, we maintain our ambitions. As we say, most likely we're going to formulate these ambitions as Todd mentioned as a combined wealth management business going forward. Because it's not really an issue any longer Credit Suisse versus UBS. It's one team. We are working on maximizing the outcome. And so we're going to just outline our many money growth ambitions in our three-year plan in a way that reflects win-backs and organic growth.

Benjamin Goy

Good color. Thank you.

Operator

The next question is from Christopher Hallam from Goldman Sachs. Please go ahead.

Christopher Hallam

Yeah. Good morning, everyone. Just two for me. So on profitability, clearly better than expected in the quarter. Previously, you'd guided for positive underlying PBT and H2 and breakeven in the third quarter. So given the third quarter is already quite positive, does that change how we should think about Q4? I guess the old guidance implied a sequential improvement in the fourth quarter in terms of PBT. So just wondering whether that's still the right way to think about that.

And then second, and I appreciate it's a bit of a follow-up to some of the earlier questions on CS net new money. You've given the regional disclosure on a combined basis, but I just wanted to check whether the combined regional picture, sort of Asia strong, EMEA strong, Switzerland more balanced, is that consistent across both the CS and UBS wealth franchises?

Todd Tuckner

Thanks Christopher. Yeah, on the second question, it is consistent. Obviously, ex the U.S., given CS doesn't have a wealth presence there, but across it is. I would say the APAC and EMEA proportionality holds, obviously, on the smaller base that we were talking about in terms of the net inflows this quarter compared to the UBS side. But yes, that dynamic does hold.

In terms of profitability in the fourth quarter, I would say that we certainly accelerated a bit of what we were forecasting back in August in terms of 3Q, 4Q, where we said roughly breakeven in 3Q and further progress in 4Q. I think we've seen the progress that we've been able to accelerate, so really undertaking and executing integration and pace, and you see the results of that.

I'd say 4Q, in a way, standing alone relative to how we saw it back in August is still around the same. So I would look, meaning I would say we expect 4Q to come in better than break even, which is what we said was the case back in August. And I would say balancing the execution on the cost side, but also considering some of how we're guiding on the revenue side, I think that number, you have an idea of where we at this stage expect that number to come in.

Christopher Hallam

Thanks, Todd. Very helpful.

Sergio Ermotti

Okay, I think this was the last question. Let me thank you for dialing in and by just quickly reiterating, as you can see, we are in full execution mode, but also at the same time we are planning for the future and the next milestones other than the operational one I just – we just described is to prepare the three-year plan that we will present in February.

In the meantime, we are very focused really on, as I said, on execution, and I'm totally convinced that we are in a good place. And of course, in our missions to really create something that will not only be a huge restructuring story, but also something that set the base for future growth and ambitions that we have.

We look forward to present you the three-year plan in February, and I'm sure in the meantime, we're going to be in touch either directly or through my colleagues for the follow-ups of this goal.

Thank you for calling in and enjoy the rest of the day. Thank you.

Operator

Ladies and gentlemen, the webcast and Q&A session for analysts and investors is over. You may disconnect your lines. We will now take a short break and continue with a media Q&A session at 10:45 CET.

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