



## **Joint Scottish-Swiss Financial Services Reception**

**Sponsored by Telekurs Financial**

**Hosted by Scottish Financial Enterprise and the Swiss Embassy**

**Wednesday 20 September 2006**

**The Royal Scots Club, 30 Abercromby Place, Edinburgh**

### **Speech given by Matthew Stemp, Head of UK, Managing Director, UBS Global Asset Management**

Good evening Mr Ambassador, honoured guests, ladies and gentlemen.

It is with great pleasure that I join you here in Edinburgh this evening at the first reception of the Scottish Swiss Financial Services group. I am afraid that, personally, I feel a bit of an impostor, as, despite my best efforts, I am unable to claim any Swiss or Scottish ancestry. The closest that I can come is that one side of my family brewed beer, and the other sold it, and the Swiss produce very fine beer, and the Scots do something even more clever with malted barley.

I suspect, however, that the reason that I am here is because I work for UBS, which, whilst a genuinely global financial services firm, is well-known for its Swiss roots. I am proud to say that UBS is also well represented in Scotland with a growing presence through the Edinburgh office of UBS Wealth Management.

So with both Swiss and Scottish business connections, I hope that you feel that I am suitably qualified to address you this evening.

Scotland and Switzerland have much in common, aside from a UBS presence. A similar topography – with a preponderance of lakes, or lochs, and mountains. A similar population – about 5 million in Scotland, 7 million

in Switzerland. And a similar reputation as a world-class financial centre where the financial services industry makes a strong and growing contribution to national GDP.

It is, of course, my task this evening to focus on the financial and the fund management industry in particular. Scotland and Switzerland, although both relatively small in population terms, are, to use a terrible cliché much beloved of our largely Scottish government, both punching considerably above their weight and are both home to leading players on the global stage. There are too many names to mention and, knowing the strong competitive spirit that exists here in the Scottish financial community I would be fearful of forgetting someone. Suffice it to say that I am pleased to see so many firms represented in this room this evening.

Scotland and Switzerland also share a long history of innovation in the investment industry.

Switzerland is pre-eminent in private banking, although it was Scot Robert Fleming of Dundee that pioneered the investment trust movement in the 1870s. The primary investors were the private banking clients of their day, the rich owners of the Dundee based jute industry. Sadly, as Scottish Financial Enterprise amusingly note on their website profile of the investment management industry, Robert Fleming's fame is somewhat overshadowed these days by his grandson, Ian Fleming, the novelist and creator of James Bond. I suspect that Robert's descendants are not complaining too much, however!

While there are some striking similarities between Scotland and Switzerland in the financial sector, there are also some differences in the way that funds are structured. I'll touch on three – asset mix, distribution and regulatory factors, notably tax.

First, let's consider the mix of assets. And this is where I have to beg your permission to group Scotland with the rest of the United Kingdom to consider the assets managed for institutional and individual clients.

A major part of the institutional money managed both in the UK and Switzerland is in pension funds. The asset mix of pension funds in the UK and Switzerland remain strikingly different. Swiss pension funds typically have just under 30% of their assets invested in equities, whereas UK pension funds are nearer 70% equities. Conversely, Swiss funds have around twice as much invested in bonds compared with UK funds.

I believe these contrasting investment approaches reflect both different regulatory environments and different perceptions of risk. Swiss pension funds have been constrained to some degree by a statutory requirement to produce a minimum return – currently 2.25% per annum – on pension funds. This has led

to the tendency to invest mostly in bonds for their generally less volatile returns. Although the behaviour of global bond markets of late does bring bonds' reliable reputation into question, perhaps not before time in the opinion of some of us.

Meanwhile, UK pension funds have historically been largely unconstrained in their investment choices. Thus, from the 1950s onwards, they embraced the so-called cult of the equity. The equity market fall-out in the early 2000s gave pause for thought and was a salutary reminder that equities are far from the risk-free asset that some had come to think of them as over the preceding decade. The recent arrival of accounting rules that make pension liabilities clear on corporate balance sheets has provided further momentum towards increased bond investment.

These different market environments present different challenges for fund managers. In the UK defined benefit market, for example, the focus is very much on looking for new ways to address pension deficits with a careful combination of risk-mitigating and performance-seeking strategies. A new take on the age old search for higher returns with less volatility, or risk.

UBS, you will not be surprised to hear from me, is innovating in this area and bringing new products to the market such as targeted return funds using portable alpha techniques, enabling the skill of managers to pick stocks within a market to be separated from the beta, or overall market return.

The contrasting asset mix seen in the institutional pension market also seems to be present across the funds market. Data from FERI, the mutual fund market analysis company, is instructive. Some 75% of UK fund assets are in equity funds (and of that 75% by far the lion's share in UK equity income funds), in contrast to 34% for Swiss funds and the Pan European average of 38%. Once again, the British cult of the equity is in evidence. And, as in the institutional pension market there is growing interest in innovative products that balance risk while seeking more consistent returns. At UBS, for example, we have seen strong demand for our absolute return bond fund, and are working at making available targeted return funds that benchmark against cash rather than an index.

The second area of difference between the UK and Swiss fund industries lies in distribution channels for retail funds. Swiss fund distribution is dominated by the private banks and discretionary managers. This is in contrast to other European markets, where retail banks tend to dominate, and to the UK where IFAs (Independent Financial Advisors) account for the largest single segment, with the next largest segment being the life insurance industry in which Scottish companies dominate.

These market traits are reflected in asset manager's distribution structures and UBS is no exception. In the Swiss market, where UBS is long-established, relationships with private banks, including UBS's own Wealth Management business group are absolutely key. In the UK, where UBS Global Asset Management has recently entered the retail fund market, an IFA-focused distribution model is most appropriate. Having said that, UBS is making its own impact on these market trends through the tremendous growth of its UK Wealth Management business. In Edinburgh, for example, Colin and his team have just this week moved to larger offices following five years of strong business growth.

And so, somewhat inevitably to the knotty issues of regulation and tax. There are, after all, only three certainties in life – birth, taxation, and death, although today that should perhaps be modified to 4 – birth, taxation, death, taxation. Through UCITS and MIFID, there is some harmonisation of regulation. Meanwhile, local regulation remains significant in many other countries.

Tax regimes also continue to be heterogeneous in nature – a point that I probably don't need to make here in Scotland to a mixed Scots / Swiss audience. Tax planning is a key driver of the UK savings market, and perhaps because of that the UK savings market is one of the most complex, with a whole host of past and present tax wrappers in the form of PEPs, TESSAs and ISAs. Not forgetting, of course, several forms of pension which the recent round of so-called pensions simplification seems to have done little to simplify.

So that's a rather rapid survey of the UK and Swiss, and indeed European, fund markets as we find them today. What, perhaps does the future hold? I'll pick just three key points on which to conclude.

First, I believe there is a very positive outlook for the fund industry as a whole across Europe. Private savings in particular look set to increase as individuals are increasingly encouraged to take responsibility for their own financial wellbeing, and it becomes clear that State funded pension schemes are simply unable to provide the level of security that previous generations expected. The State pension promise is in many cases unaffordable.

Second, we will see continued consolidation in both the life insurance and asset management industries across Europe. A process of polarisation is already underway as firms seek to be either smaller, specialist and boutique-like or large, international concerns. The middle ground is becoming increasingly difficult to occupy.

Third, when it comes to investment products, innovation is the key in both institutional and retail markets. The onus is on us in the industry to understand our clients' needs and respond to them with innovative product offerings. The move away from long only products benchmarked to a benchmark that itself can be very volatile is the first sign of this. Whilst I as an asset manager may do a very good job and outperform the UK equity index by 5% in a year, if that implies a return of -15% rather than -20% few clients, especially in the retail world where that may be their only exposure, are likely to crack open the champagne.

Talking of cracking open the champagne, I begin to sense your need for refreshment so I shall endeavour to bring that moment a little closer. May I finish by thanking you for your attention and thanking Scottish Financial Enterprise, the Swiss Embassy and the Swiss Bankers Association for this opportunity to address you.