July 10, 2014

UBS AG:
Examining UBS Holding Company structure

Scope Ratings

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On May 6, UBS AG announced that it would modify its legal structure in the context of the improvement of the resolvability of the group. Scope Ratings has therefore decided to examine what could be a potential and credible legal structure for UBS Group as a whole.

Scope Rating expects that there should not be any difference in rating between the future holding company of UBS (that we have called "UBS Group AG" in this report) and the operating bank of UBS (UBS AG – which we assume will be a direct subsidiary of UBS Group).

In its Bank Rating Methodology, Scope indicates that [it] "may potentially rate the Holding Company (HC) [of a banking group] at the same level as it would rate the main operating bank. This will be the case as long as there are no grounds to estimate that, in a stress scenario, the creditors of the HC would be treated differently from the creditors of the operating bank".

Keeping in mind this methodological context, we can make the following comments on UBS's new legal structure:
Because UBS is a very integrated group with centralized treasury functions, intra-group items play a large part in the funding and the capitalization of the group as a whole. As a result, we believe that the vast majority of UBS Group's capital is located at UBS AG level and will therefore be located at the Holding Company level once the share exchange is complete (later this year, according to company official communication), therefore offering significant protection to investors.

Since the FINMA privileges the single Point of Entry (or SPE) method of resolution, we believe that UBS's Holding Company will play an increasingly important part in the loss absorption capability of the group as a whole. We believe that as the senior debt of the operating bank matures, the holding company will substitute for the operating bank as main issuer for the group as a whole. We expect that by YE 2018 UBS's Holding Company will have raised around CHF 20bn of senior debt. We do not expect UBS to issue material amounts of capital instruments since what the bank has already issued seems to cover the needs of the bank's capital requirements with regards to low-trigger loss-absorbing capital. We believe that UBS would rather build more common equity than hold high-trigger capital instruments.

UBS AG may become less important to the group under the new legal structure. UBS AG was, under the old structure, the main component of UBS Group (representing almost CHF 1tn of total assets as of YE 2013). With the constitution of a Swiss legal entity (which will carry the bulk of the deposits of the group) and our expectation that the assets of UBS AG London Branch will be transferred to UBS Limited, the activities of UBS AG could be limited to asset management and wealth management outside Switzerland. The size of UBS AG could therefore decrease considerably, but so will its risk profile – particularly if the investment banking assets located at the London branch are transferred to UBS Limited.

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More generally, we believe that the combination of the Holding Company, the operating bank and the Swiss legal entity should be considered as a whole in the resolution process. The Holding Company hosts the vast majority of Group capital (and soon a large portion of its bailinable debt), while the Swiss legal entity hosts the deposit base (and also a very large and stable section of group profits). As a result, it is probable that in the unlikely case of resolution, these three Swiss-based entities would end up narrowly linked and considered as one by the regulator. This is in our view all the more probable since FINMA has recently stated that bank parent company capital should not drive group capital requirements – a direct acknowledgement of the highly-integrated nature of the bank's business model.

This report analyses the new post-Basel 3 legal structure of UBS. The group acknowledges the preference of FINMA for SPE, but Scope believes that in practice this will not be easily implemented for UBS as UK and US regulators may want to maintain a large amount of capital at local subsidiary level. Since these subsidiaries host a large investment banking component, the segregation of their capital and bailinable debt at subsidiary level should be another factor of comfort for the bondholders of the Holding Company.

The new legal structure of UBS AG

New legal structure of UBS AG announced on May 6

On May 6 UBS Group announced plans to modify its legal structure so as to improve resolvability. In the press release published that day, UBS said that it *"intends to establish a group holding company through a share for share exchange offer, which will commence later this year, subject to regulatory approvals. UBS anticipates that the measures to improve resolvability will allow the firm to qualify for a capital rebate under the Swiss too-big-to-fail requirements".*

By adopting a holding company structure, UBS follows on Credit Suisse's announcements about its legal structure back in November 2013. Scope believes that both banks should operate in broadly similar structures, all the more that UBS has also announced in its May 6 press release that it *"intends to establish a banking subsidiary in Switzerland in mid-2015. The scope of this future subsidiary's business is expected to include the Retail & Corporate business and the Swiss-booked wealth management business".*

UBS's public statement also articulates the bank's plans for its US and UK operations: "In the UK, and in consultation with the UK and Swiss regulators, UBS expects to commence the implementation of a revised business and operating model for UBS Limited in the second quarter of 2014. This will result in UBS Limited bearing and retaining a greater degree of the risk and reward of its business activities. UBS AG expects to increase the capitalization of UBS Limited accordingly.

"In the US, UBS will comply with new rules for foreign banks under the Dodd-Frank Wall Street Reform and Consumer Protection Act that will require an intermediate holding company to own all of its operations other than US branches of UBS AG by 1 July 2016. As a result, UBS will designate an intermediate holding company to hold all US subsidiaries of UBS."

SPE vs. MPE resolution and holding company ratings according to Scope's Bank Rating Methodology.

In the context of its Bank Rating Methodology, Scope points out that it may potentially rate the HC at the same level as it would rate the main operating bank. This will be the case as long as there are no grounds to estimate that, in a stress scenario, the creditors of the HC would be treated differently from the creditors of the operating bank(s). This rating approach may be different for bank HCs in the US, since US HCs are legacies of the 1927 McFadden Act which was preventing US banks from interstate banking. In Europe, Scope perceives the HC as more of a resolution tool.

Under resolution and recovery regimes, once they are clarified and implemented, any potential gap between the HC ratings and the operating bank(s) ratings, or between parent and subsidiary banks, may be influenced by the single point of entry (SPE) vs. multiple points of entry (MPE) resolution avenues. For example, a notching gap, potentially widening as the group's credit fundamentals deteriorate, could exist between HC ratings and operating bank(s) ratings in the case of SPE-resolution groups more so than in the case of MPE-resolution groups. This is so because in SPE resolution the group is likely to be held together and bailin likely to occur at the level of the top HC's liabilities, unlike MPE groups which could be subject to more horizontal fragmentation in resolution (thus not solely via the top HC).

UBS Group AG will issue "new style" capital instruments.

When asked to comment about the new legal structure of UBS, Group CEO Sergio Ermotti was quoted saying, on May 6, 2014: *"By establishing a holding company with a single-point-of-entry which will be the vehicle that will issue the bailinable instruments, you create really that kind of going-concern security that allows us to operate in an efficient manner".* This statement confirms that the Holding Company will issue bailinable debt.

So far, UBS has issued seven eligible "new style" capital instruments, all of them at the UBS AG level, all of them Tier 2 and all of them parts of the Progressive Buffer Capital component with trigger target CET1 ratio of 5% (except for the two programs eligible for employees and totaling CHF 950mn, which have a trigger CET1 ratio of 7% under phased-in rules for employees, and 10% for Group Executive Board Members). At the end of May 2014, these issues totaled close to CHF 10.5bn. UBS AG was, in all cases, the issuer with the Stamford branch and the Jersey branch of UBS AG specifically issuing one instrument each.

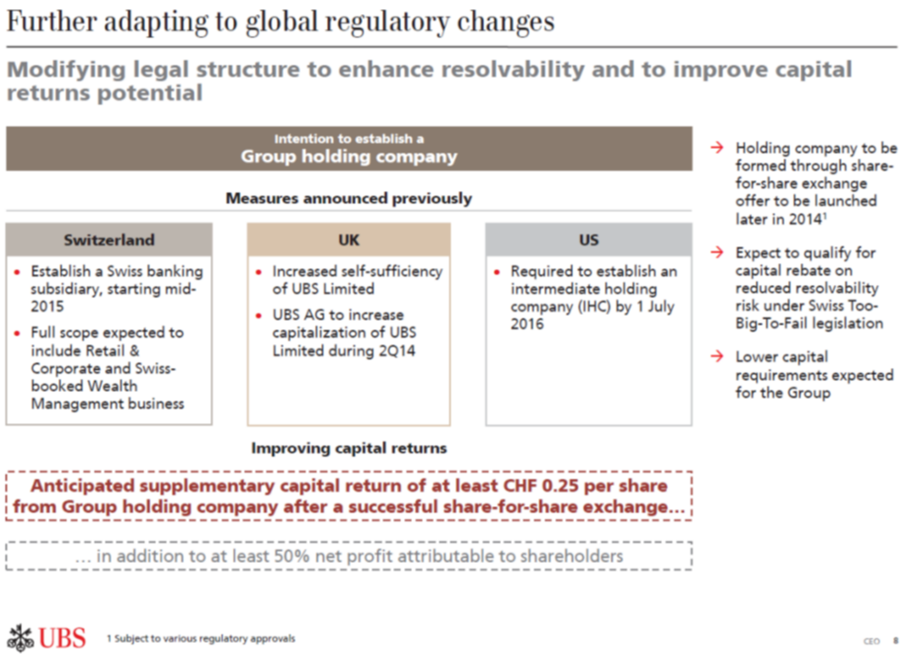
These issues are very consistent with UBS's view on AT1 capital. The bank has always been very cautious about the relevance of contingent capital, and has made the choice of building up its high-trigger LAC buffer as common equity (and not capital instruments). We believe that the vast majority of UBS Group AG's issuing program will be in the form of senior debt – as the bank already has ample low-trigger instruments at the AG bank parent level.

The main features of the seven capital instruments issues can be found in Annex I.

UBS Group's post-resolution corporate structure is still a work in progress

While Credit Suisse Group has always been organized with a Holding Company at the top, this structure is brand new for UBS and we believe that the bank has not fully completed its transformation. UBS has disclosed a fragmentary look at what the new structure would look like (the slide is reproduced in the chart below).

Chart 1: UBS Group Holding Company and subsidiaries



Source: UBS

However, Chart 1 gives an incomplete picture, and UBS's management says that much. The bank's CEO, when questioned about this slide during the Investor Update on May 6, said the following: *"On the slide we are missing UBS AG, which is currently the entity where we book Wealth Management business outside Switzerland and we have the participation in Asset Management and we are booking our Investment Banking business. If you want, you could add a fourth pillar to this chart and you would have a representation".*

One of the most important entities within UBS AG is UBS AG, London Branch, and we do not expect this entity to remain a branch. According to UBS 2013 Annual Report: *"We have significant operations in the UK and currently use UBS AG's London branch as a global booking center for many types of products. We are being required by the UK Prudential Regulatory Authority and by FINMA to increase very substantially the capitalization of our UK Bank Subsidiary, UBS Limited, and expect to be required to change our booking practices to reduce or even eliminate out utilization of UBS AG London branch as a global booking center for the ongoing business of the investment bank."*

In light of this paragraph we have taken the view that UBS AG London Branch would be transferred to UBS Limited. We stress that this transfer is an assumption made by Scope and that UBS has in no way indicated that developments were heading that way in the UK.

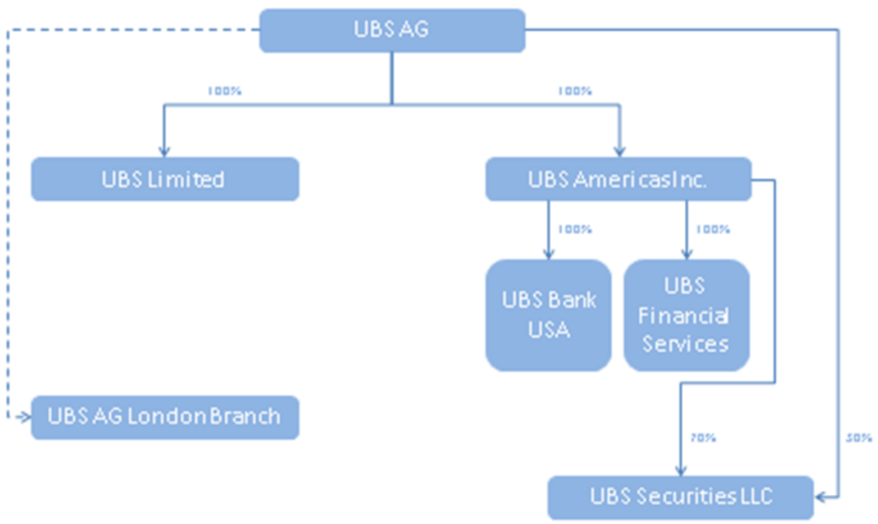
UBS plans still at an early stage

Contrary to Credit Suisse, UBS has never been structured as a Holding Company. As a result, we perceive the group as being a little bit behind Credit Suisse in terms of full finalization of the new, resolvable structure, and as a result of the above the public information that can be used for assessing UBS's potential new corporate structure is limited. This is why we attach a significant health warning to the assumptions below, even if believe that the information in the following sections is credible – essentially because largely inspired from Credit Suisse's structure (see Scope's report "Credit Suisse: the last line of defence is also the better one", published on June 24 2014).

A proposed look at a possible new corporate structure for UBS

Charts 2 and 3 respectively picture the current structure, and then a proposed "new" structure for a "resolvable" UBS.

Chart 2: Current corporate structure of UBS Group

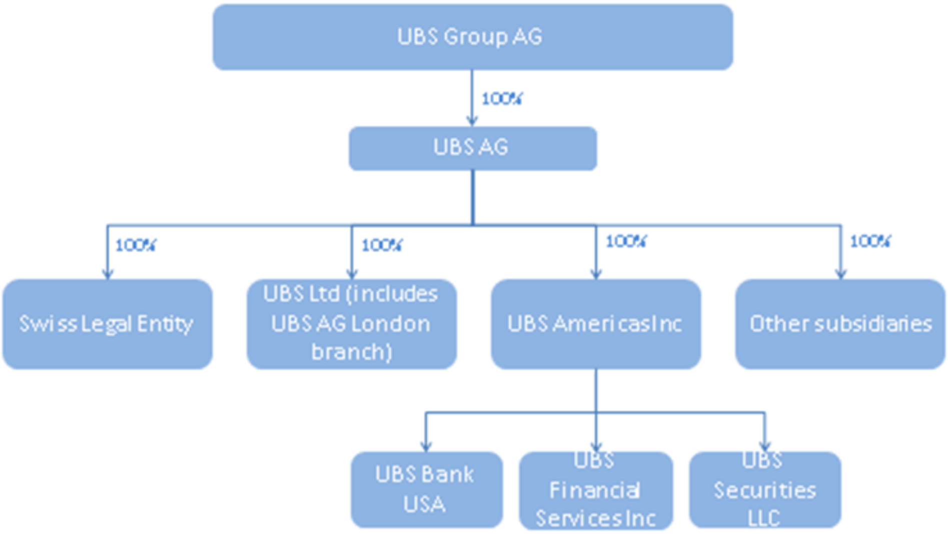


Source: Company data, Scope Ratings

- UBS Group should be headed by a separate holding company, which will sit at the top of the group. The reason we believe that a new company will play that role (and not the current group head UBS AG) lies in the fact the May 6 press release specifies that the holding company will be "established through a share for share exchange offer". The fact that the Holding Company cannot be a bank also favors, in our view, the establishment of this new company. For reasons of simplicity (and comparability with the Credit Suisse proposed new legal structure), we have called this holding company "UBS Group AG".
- We have also added a "Swiss Legal entity" that will include the Swiss retail and corporate business as well as the Wealth Management business booked in Switzerland.
- The other major change we have assumed is that UBS Limited (the UK subsidiary) would take over the vast majority of the assets of UBS AG London Branch. This would, in our view, make sense in light of the business of UBS Limited (as described in the subsidiary's Pillar 3 report): "UBS Limited conducts business in a broad range of investment banking products and services including lending, securities trading, securities financing, executing and clearing exchange traded and OTC derivatives, money market and FX trading. UBS Limited also provides underwriting, advisory and other fee driven services". Since UBS AG London Branch is also a booking center for the investment bank it would intuitively make sense to associate both entities – even if UBS has in no way indicated that developments are heading that way in the UK.
- We have assumed also that UBS Americas Inc. would play the part of Intermediate Holding Company as per the new FBO Rules.

A likely new legal structure appears on Chart 3 – we again stress that this is an estimate by Scope of what a “resolvable” UBS could look like – and by no means an official company view.

Chart 3: Proposed changes to UBS legal entity structure (other view)



Source: Scope Ratings estimates, company data

The next step is to try and allocate capital and assets to the different entities of the suggested structure showed on Chart 3.

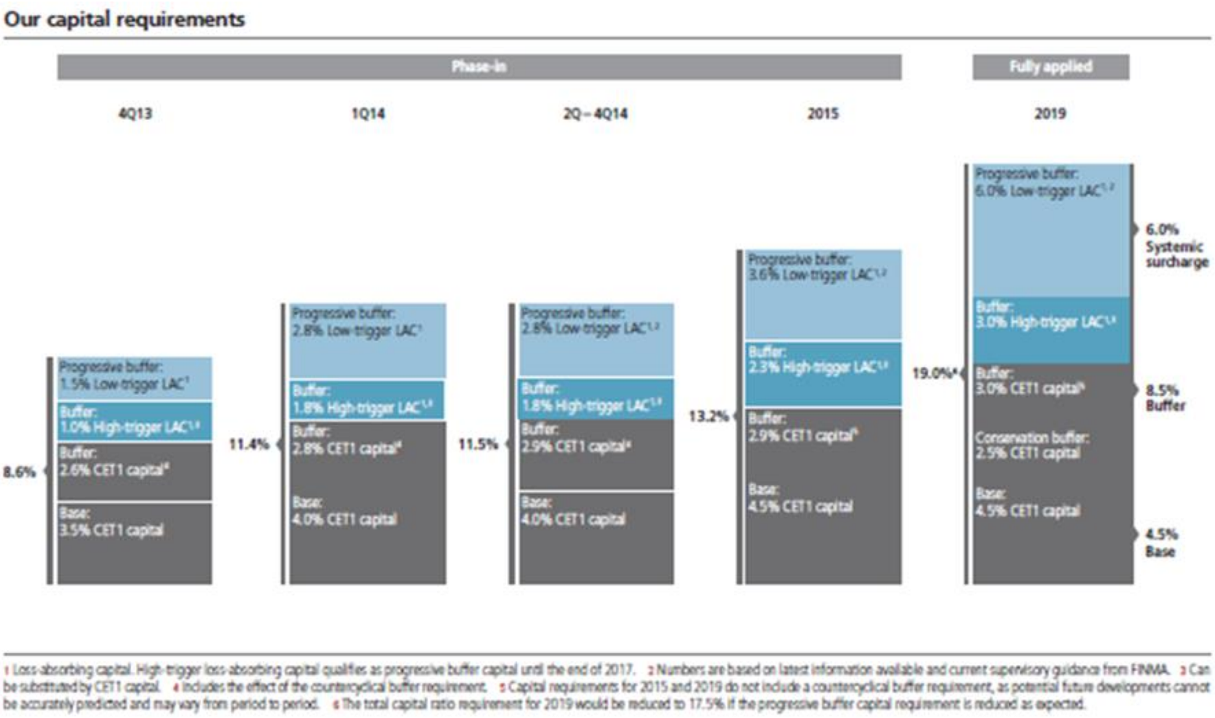
Main Assumptions regarding breakdown of assets, liabilities and capital between different entities.

The following points sum up different references we use thanks to UBS’s public information.

- Among the supplemental guarantor information required under SEC regulation, UBS discloses the balance sheet contributions of UBS AG, UBS Americas Inc., Other subsidiaries and all the intragroup entries.
- We also use the parent company accounts of UBS AG, even if they are made more difficult to interpret by the fact that UBS AG parent company reports under Swiss GAAP while the supplementary guarantor information mentioned above is reported under group consolidated IFRS standards.
- The accounts of UBS Limited are provided in UBS Q1 2014 report.
- UBS discloses the total leverage exposure of each division as well as the RWAs. The only difficulty is how to allocate the assets of a very large corporate center. For practicality purposes, we have allocated the non-core and legacy portfolios to the Investment Banking division. We have allocated the “core” corporate center assets and RWAs proportionally to the exposure and RWAs of the other divisions.
- For the determination of the assets of the Swiss legal entity, we have included the whole Retail & Corporate division as well as 60% of the assets of the wealth management business. This is based on Slide 8 of UBS’s investor update on Wealth Management showing that Switzerland and Europe represents 59% of the operating income of the division (even if this is not a split by booking center). This is consistent with the data on page 33 of the annual report showing the breakdown of invested assets by client domicile (showing 66% of assets in Switzerland and Europe).
- As for Wealth Management Americas, we assume that all the assets and RWAs can safely be allocated to UBS Americas Inc.
- We are left with the difficult task of allocating the assets and RWAs of the investment bank. The accounts and RWAs of UBS Limited are disclosed so they can be extracted from the investment bank. As for the investment bank at UBS Americas it can be inferred from the weight of Wealth Management Americas. Without the assets of Wealth Management America, the balance sheet of UBS Americas Inc. should be all investment banking. By difference, we assume that the assets of the Investment Bank that are not with UBS Limited or with UBS Americas Inc. can only be with UBS AG London Branch (and this would include the legacy and non-core portfolios).

- To build up the new UK structure, we assume that the assets of UBS AG London Branch that we have just estimated will be transferred to UBS Limited.
- The next task consists in allocating CET1 to the different entities. We can estimate the CET1 of UBS Limited, UBS Americas and the other subsidiaries with the disclosed information. The difficult work consists in breaking down the regulatory capital within the “old” UBS AG, between what will benefit the new Swiss Legal Entity, the capital to support the assets of UBS AG London Branch and ultimately what will remain at UBS AG. We use a breakdown of CET1 as a percentage of total assets.
- To fine-tune the debt issue forecasts, we assume that the bonds issued by UBS AG London Branch will also be transferred to UBS Limited.
- We have also made earnings estimates by legal entity to be able to estimate the capital build-up of each entity between now and 2018. These forecasts are consistent with the divisional forecasts we use in our Issuer Report on UBS.
- As far as the structure is concerned, we are then left with the financials of the Holding Company (which we have called UBS Group AG). A look at the parent company accounts of Credit Suisse Group AG demonstrates that the accounts of such companies are based on two items: capital on one side, and financial investments in subsidiaries on the other side. We estimate that the capital of the HoldCo will equal investments in subsidiaries and associates reported in UBS’s reporting by legal entity.
- As far as estimates are concerned, the capital build-up uses the capital requirements of UBS as disclosed by the bank in its quarterly reporting (see Chart 4 below).
- As a function of the capital build-up we can then determine how much “new style” capital instruments UBS needs to issue to fit these requirements.
- We assume that there is a fixed relationship between RWAs and total assets for capital requirement purposes at 24% (the same as Credit Suisse).

Chart 4: Capital requirements of UBS – 2013-2019 as of Q1 2014



Source: Company data

Table 1: Estimated location of capital and bailinable debt by legal entity, UBS Group

Post-transitional Basel 3

UBS Group AG	2013E	2014E	2015E	2016E	2017E	2018E
Common Equity Tier 1	-	67,175	67,175	67,175	67,175	67,175
High Trigger Capital Notes	-	-	-	-	-	-
Low Trigger Capital Notes	-	-	-	-	-	-
Other bailinable debt	-	-	5,600	10,200	14,800	19,800
Total IFRS assets/Exposure	-	67,175	72,775	77,375	81,975	86,975
RWAs (proxied against RWAs % Assets at group level)	-	16,122	17,466	18,570	19,674	20,874
Leverage Ratio (%)	-	100.0%	92.3%	86.8%	81.9%	77.2%
CET1 ratio (%)	-	416.7%	384.6%	361.7%	341.4%	321.8%

UBS AG	2013E	2014E	2015E	2016E	2017E	2018E
Common Equity Tier 1	3,712	3,712	3,712	3,712	3,712	3,712
High Trigger Capital Notes	951	951	951	951	951	951
Low Trigger Capital Notes	4,686	9,367	9,367	9,367	9,367	9,367
Other bailinable debt	52,012	48,512	47,193	42,593	37,993	32,993
Total IFRS assets/Exposure	81,416	75,473	74,154	69,554	64,954	59,954
RWAs (proxied against RWAs % Assets at group level)	13,281	18,114	17,797	16,693	15,589	14,389
Leverage Ratio (%)	11.5%	18.6%	18.9%	20.2%	21.6%	23.4%
CET1 ratio (%)	27.9%	20.5%	20.9%	22.2%	23.8%	25.8%

UBS Americas Inc (appointed IHC in the US)						
Common Equity Tier 1	2,530	3,130	3,730	4,350	4,950	5,550
High Trigger Capital Notes	-	-	-	-	-	-
Low Trigger Capital Notes	-	-	-	-	-	-
Other bailinable debt	781	758	735	713	734	756
Total IFRS assets/Exposure	159,627	154,838	150,193	145,687	150,058	154,560
RWAs (proxied against RWAs % Assets at group level)	35,565	37,161	36,046	34,965	36,014	37,094
Leverage Ratio (%)	1.6%	2.0%	2.5%	3.0%	3.3%	3.6%
CET1 ratio (%)	7.1%	8.4%	10.3%	12.4%	13.7%	15.0%

UBS Ltd (UK business plus UBS London Branch)						
Common Equity Tier 1	14,733	14,733	14,733	14,733	14,733	14,733
High Trigger Capital Notes	-	-	-	-	-	-
Low Trigger Capital Notes	-	-	-	-	-	-
Other bailinable debt	37,793	30,235	25,699	22,102	19,228	17,305
Total IFRS assets/Exposure	478,456	382,765	325,350	279,801	243,427	219,084
RWAs (proxied against RWAs % Assets at group level)	129,736	91,864	78,084	67,152	58,423	52,580
Leverage Ratio (%)	3.1%	3.8%	4.5%	5.3%	6.1%	6.7%
CET1 ratio (%)	11.4%	16.0%	18.9%	21.9%	25.2%	28.0%

Swiss legal entity						
Common Equity Tier 1	7,935	8,299	8,663	9,038	9,402	9,766
High Trigger Capital Notes	-	-	-	-	-	-
Low Trigger Capital Notes	-	-	-	-	-	-
Other bailinable debt	-	-	-	-	-	-
Total IFRS assets/Exposure	308,301	317,550	327,077	336,889	346,996	357,406
RWAs (proxied against RWAs % Assets at group level)	46,518	76,212	78,498	80,853	83,279	85,777
Leverage Ratio (%)	2.6%	2.6%	2.6%	2.7%	2.7%	2.7%
CET1 ratio (%)	17.1%	10.9%	11.0%	11.2%	11.3%	11.4%

Intra-group/Other						
Common Equity Tier 1	-	- 67,175	- 67,175	- 67,175	- 67,175	- 67,175
High Trigger Capital Notes	-	-	-	-	-	-
Low Trigger Capital Notes	-	-	-	-	-	-
Other bailinable debt	-	-	-	-	-	-
Total IFRS assets/Exposure	-	- 45,405	- 49,855	- 51,351	- 52,891	- 54,478
RWAs (proxied against RWAs % Assets at group level)	-	- 10,897	- 11,965	- 12,324	- 12,694	- 13,075
Leverage Ratio (%)	-	147.9%	134.7%	130.8%	127.0%	123.3%
CET1 ratio (%)	-	616.4%	561.4%	545.1%	529.2%	513.8%

TOTAL GROUP	2013E	2014E	2015E	2016E	2017E	2018E
Common Equity Tier 1	28,910	29,874	30,838	31,833	32,797	33,761
High Trigger Capital Notes	951	951	951	951	951	951
Low Trigger Capital Notes	4,686	9,367	9,367	9,367	9,367	9,367
Other bailinable debt	90,586	83,785	79,227	75,607	72,755	70,854
Total IFRS assets/Exposure	1,027,800	956,677	899,694	857,956	834,519	823,501
RWAs (proxied against RWAs % Assets at group level)	225,100	229,603	215,927	205,909	200,284	197,640
Leverage Ratio (%)	3.4%	4.2%	4.6%	4.9%	5.2%	5.4%
o/w CET1 (%)	2.8%	3.1%	3.4%	3.7%	3.9%	4.1%
o/w High Trigger	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
o/w Low Trigger	0.5%	1.0%	1.0%	1.1%	1.1%	1.1%
Total Capital Ratio (%)	15.3%	17.5%	19.1%	20.5%	21.5%	22.3%
o/w CET1 (%)	12.8%	13.0%	14.3%	15.5%	16.4%	17.1%
o/w High Trigger (%)	0.4%	0.4%	0.4%	0.5%	0.5%	0.5%
o/w Low Trigger (%)	2.1%	4.1%	4.3%	4.5%	4.7%	4.7%
Total debt	96,223	94,103	89,545	85,925	83,073	81,172

Source: Scope Ratings estimates, company data

Main Conclusion on Holding Company and on Group structure

Table 1 above summarizes our finding on the legal structure of UBS and the potential issuance of bailinable debt at Holding Company level from now on 2018. There are two methodological points to mention on Table 1:

First, we have not chosen the traditional CRD4/CRR way of disclosing the capital instruments. We have used the Swiss regulatory way of disclosing first common equity, then high-trigger capital instruments and then low-trigger capital instruments. This follows the most logical way of looking at the sequence in which losses would be absorbed: starting with common equity, then capital instruments with a 7% or viability event trigger, and then capital instruments with a 5% or viability event trigger.

The second aspect to point out is that we have created an intragroup adjustment variable enabling us to reconcile the sum of the balance sheet items of all group component and the published consolidated group numbers. This intragroup variable in Table 1 appears much smaller than what we identified at Credit Suisse – simply because we have started our work on UBS with data excluding intragroup adjustments (while our initial work on Credit Suisse started with intra-group adjustments). We draw six conclusions from our numerical work, the first four of them similar to the conclusions we drew after our work on Credit Suisse.

It is also important to point out that the earnings forecasts exercise for each defined legal entity is consistent with our divisional forecasts. We are introducing new, theoretical forecasts for 2016E-2018E. The only objective of these forecasts is to determine the retained earnings contribution per entity and therefore the capital build-up per entity, which can either be kept at subsidiary level or distributed to the parent. Obviously we need to attach a big health warning to our legal entity forecasts and stress that they play no part in our credit and analytical assessment of UBS's financial fundamentals (contrary to our business lines forecasts).

Conclusion 1: the weight of intragroup assets within UBS is very important.

A quick look at the balance sheet by legal entity presented in UBS annual report is enough to demonstrate that intragroup assets play a very important part in UBS's businesses. Once we add up the different assets and capital components of each legal entity, we come up with total IFRS assets of leverage exposure of CHF 1.4tn and common equity of CHF 116bn, while the group level totals are CHF 1.0tn and CHF 50bn respectively (YE 2013). This level of intragroup assets of CHF 0.4tn is not dissimilar to what we estimated for Credit Suisse on a restated IFRS basis (CHF 0.5trn as of 31.12.2013).
The weight of intragroup transactions, both on the assets and liabilities side, is very significant, which is typical of a thoroughly integrated bank with centralized treasury functions.

Conclusion 2: restated from intragroup items, the suggested Holding Company of UBS should be the ultimate holder of group common equity

Restated from intragroup adjustments, Table 1 shows that the holding company (which we have named UBS Group AG in our estimates) is the ultimate owner of the "real" physical capital of UBS. The level of capital at the Holding Company together with the fact that the Holding Company is not a bank should lead the Holding Company to gather a considerable amount of financial resources – all the more that we believe that UBS Group AG will in time be the sole issuer of bailinable debt (capital instruments and senior instruments).

Conclusion 3: UBS Group AG is to become the major issuer of bailinable debt at group level.

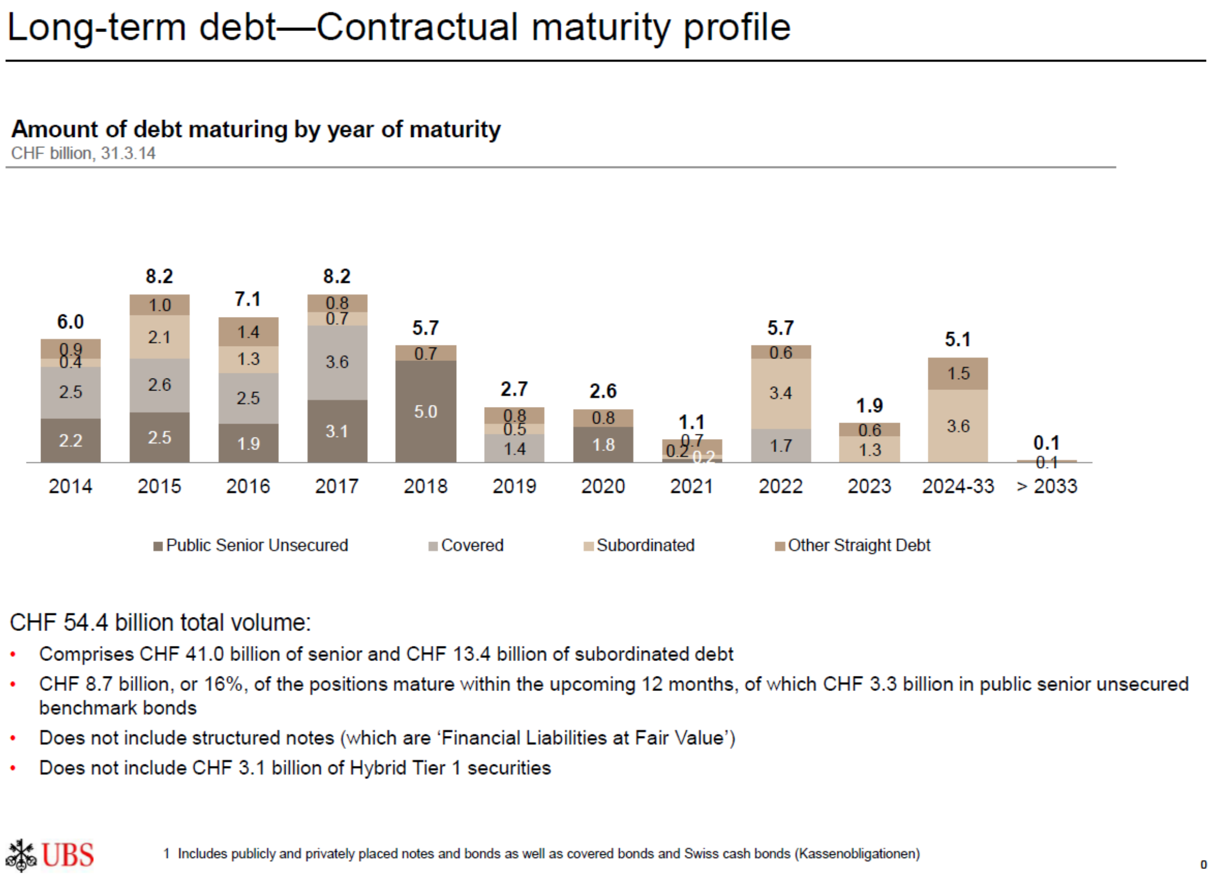
On our estimates, we believe that the capital of UBS Group AG should match the investments in subsidiaries and affiliates, and therefore represent around CHF 67bn. We also believe that, as the senior debt of UBS AG matures, it will be replaced by senior debt at Holding Company level.

As far as capital instruments are concerned, we believe that in theory UBS does not need to issue more than what it has already issued. The bank was never a strong proponent of contingent capital to start with, and, faced with the choice of boosting its capital with high-trigger loss-absorbing capital or common equity, UBS chose the latter. Even if UBS has issued high-trigger capital instruments, these were just deferred payment obligations for employees and only represent about CHF 950m, so about 41bps of total capital ratio, not a significant amount.

The bulk of capital instruments issuance by UBS has been low-trigger capital instruments, which we expect to represent more than 4% of total capital at YE 2014. Since UBS is committed to 4.5% of progressive buffer low-trigger loss-absorbing capital by 2019, the bank actually does not need to issue more. We think that the planned deleveraging corresponding to the reduction of the legacy and non-core portfolios will be enough for UBS to post a progressive buffer capital ratio higher than 4.5% by YE 2018, as demonstrated by Table 1.

Also, we believe that because of its status as SPE, UBS Group AG will fully substitute UBS AG as issuer of bailinable senior debt (the maturity of UBS's debt is illustrated in Chart 5).

Chart 5: Long-term debt of UBS, contractual maturity profile (Q1 2014)



Source: Company data

As a result, we believe that by YE 2018, UBS Group AG could raise around CHF 20bn of senior unsecured debt. This implies that by then the financial resources of the Holding Company could be close to CHF 90bn, offering a very strong financial security to investors.

At this stage, we believe that by 2018E, UBS Group AG will have more capital and more bailinable debt than UBS AG. The only thing UBS Group AG does not have versus UBS AG is a bank status that would, for example, benefit deposit holders. But we believe that the vast majority of deposits of the group will be held at the Swiss legal entity level, and not the level of UBS Group AG, making this provision totally ineffective for UBS AG. Also considering the business mix of the Swiss legal entity (Swiss retail and Private banking), we believe that the risk of recovery and resolution at that level of the company should be pretty low.

Conclusion 4: The UK and the US subsidiaries are likely to remain ring-fenced

The principle of SPE (or Single Point of Entry) in the resolution of banks is a very strong concept in theory but does it even exist in practice?

For global banks with subsidiaries in the USA and in the UK, there is a possibility that in case of resolution these specific jurisdictions will want to maintain the cash and the capital at local level and therefore resolve the subsidiary first and foremost – therefore privileging local creditors. This means that in effect, in the case of a Swiss bank, a credit event in the US could lead to recovery and resolution both in the United States and in Switzerland, creating “multiple single points of entry” – or more adequately an MPE.

Conclusion 5: We expect change in capital allocation between subsidiaries because of the reduction of the non-core and legacy portfolios

As Table 1 demonstrates, we expect the level of capital of UBS Limited to increase significantly in absolute and relative terms, due to the likely deleveraging of the UK investment bank (which we have assumed hosts the vast majority of the non-core and legacy asset portfolios). As these assets go down, it is likely that the capital requirement of the UK business will progressively decrease, which means that UBS could be in a position to reallocate (or distribute) the excess capital of this subsidiary

Conclusion 6: the size of UBS AG is likely to shrink after the build-up of the new legal structure.

UBS AG was, under the old structure, the main component of UBS Group (representing almost CHF 1trn of total assets as of YE 2013). With the constitution of a Swiss legal entity (which will carry the bulk of the deposits of the group) and the possible transfer of UBS AG London Branch to UBS Limited, we believe that the activities of UBS AG will be limited to asset management and wealth management outside Switzerland. The size of the legal entity should decrease considerably, but so will its risk profile – in particular if UBS AG London Branch transfers its investment banking assets to UBS Limited.

Appendix A

Eligible post-transitional Basel 3 capital instruments of UBS

Eligible post-transitional Basel 3 capital instruments							
Issuer	UBS AG (Jersey Branch)	UBS AG (Stamford Branch)	UBS AG	UBS AG	UBS AG	UBS AG	UBS AG
Post-transitional Basel 3 rules	Tier 2 (progressive Buffer Capital)	Tier 2 (progressive Buffer Capital)	Tier 2	Tier 2	Tier 2 (progressive Buffer Capital)	Tier 2 (progressive Buffer Capital)	Tier 2 (progressive Buffer Capital)
Instrument type	Subordinated notes	Subordinated notes	Cash payment obligation towards employees (DCCP)	Cash payment obligation towards employees (DCCP)	Subordinated notes	Subordinated notes	Subordinated notes
Par value at issuance (in currency millions)	2,000 USD	2,000 USD	450.6 CHF	500.3 CHF	1,500 USD	2,000 EUR	2,500 USD
Original date of issuance	22.02.2012	17.08.2012	31.12.2012	31.12.2013	22.05.2013	13.02.2014	15.05.2014
Original maturity date	22.02.2022	17.08.2022	01.03.2018	11.03.2019	22.05.2023	12.02.2026	15.05.2024
Issuer call subject to issuer prior to regulatory approval?	Yes	Yes	-	-	Yes	Yes	Yes
First optional call date	22.02.2017				22.05.2018	12.02.2021	
Redemption amount	10% of aggregate principal amount, together with accrued and unpaid interest	10% of aggregate principal amount, together with accrued and unpaid interest			10% of aggregate principal amount, together with accrued and unpaid interest	10% of aggregate principal amount, together with accrued and unpaid interest	10% of aggregate principal amount, together with accrued and unpaid interest
Contingent call dates	Early redemption possible upon a Change in Progressive Capital Component Requirement or an Alignment Event	Early redemption possible upon a Change in Progressive Capital Component Requirement or an Alignment Event			Early redemption possible upon a Change in Progressive Capital Component Requirement or an Alignment Event	Early redemption possible upon a Change in Progressive Capital Component Requirement or an Alignment Event	Early redemption possible upon a Change in Progressive Capital Component Requirement or an Alignment Event
Fixed or floating dividend/coupon	Fixed	Fixed	Fixed	Fixed	Fixed	Fixed	Fixed
Coupon rate and any related index	7.25% till 21.02.2017; 6.061% + MMS afterwards	7.625% semi-annually	5.40% (issues in CHF); 6.25% (issues in USD) annually	3.5% (issues in CHF); 5.25% (issues in USD) annually	4.75% till 21.05.2018; 3.765% + MMS afterwards	4.75% till 11.02.2021; 3.40% + MMS afterwards	5.125% annually
Fully discretionary, partially discretionary or mandatory	Mandatory	Mandatory	Partially discretionary	Partially discretionary	Mandatory	Mandatory	Mandatory
Noncumulative or cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative
Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
If convertible, conversion trigger							
If convertible, fully or partially							
If convertible, mandatory or optional conversion							
If convertible, specify instrument type convertible into							
Write-down feature	Yes	Yes	Yes	Yes	Yes	Yes	Yes
If write-down, write-down trigger(s)	Trigger CET1 ratio is less than 5%; or FINMA determines a write-down necessary to ensure UBS AG's viability; of UBS AG receives a commitment of governmental support that FINMA determines necessary to ensure UBS AG's viability	Trigger CET1 ratio is less than 5%; or FINMA determines a write-down necessary to ensure UBS AG's viability; of UBS AG receives a commitment of governmental support that FINMA determines necessary to ensure UBS AG's viability	Reported phase-in Basel 3 CET1 ratio of the group is less than 7%; or FINMA determines a write-down is required to prevent UBS AG's insolvency, bankruptcy or failure; or UBS AG receives a commitment of governmental support that FINMA determines necessary to prevent UBS AG's insolvency, bankruptcy or failure.	Reported phase-in Basel 3 CET1 ratio of the group is less than 7%/10%; or FINMA determines a write-down is required to prevent UBS AG's insolvency, bankruptcy or failure; or UBS AG receives a commitment of governmental support that FINMA determines necessary to prevent UBS AG's insolvency, bankruptcy or failure.	Trigger CET1 ratio is less than 5%; or FINMA determines a write-down necessary to ensure UBS AG's viability; of UBS AG receives a commitment of governmental support that FINMA determines necessary to ensure UBS AG's viability	Trigger CET1 ratio is less than 5%; or FINMA determines a write-down necessary to ensure UBS AG's viability; of UBS AG receives a commitment of governmental support that FINMA determines necessary to ensure UBS AG's viability	Trigger CET1 ratio is less than 5%; or FINMA determines a write-down necessary to ensure UBS AG's viability; of UBS AG receives a commitment of governmental support that FINMA determines necessary to ensure UBS AG's viability
if write-down, full or partial	Full	Full	Full	Full	Full	Full	Full
If write-down, permanent or temporary	Permanent	Permanent	Permanent	Permanent	Permanent	Permanent	Permanent
Position in subordination hierarchy in liquididation (specify instrument type immediately senior to instrument)	Senior	Senior	Employees' payment rights subordinate to rights of any depositors and general creditors of the group and any subordinated debt obligations which are contractually determined to rank junior	Employees' payment rights subordinate to rights of any depositors and general creditors of the group and any subordinated debt obligations which are contractually determined to rank junior	Senior	Senior	Senior

Disclaimer

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