Financial Institutions Ratings
UBS AG – T2 rating report

Security ratings

Outlook	Positive
7.25% USD 2bn Tier 2 Subordinated Notes due 2022	BBB+
7.625% USD 2bn Tier 2 Subordinated Notes due 2022	BBB+
4.75% USD 1.5bn Tier 2 Subordinated Notes due 2023	BBB+
4.75% EUR 2bn Tier 2 Subordinated Notes due 2026	BBB+
5.125% USD 2.5bn Tier 2 Subordinated Notes due 2024	BBB+

Rating rationale

We have assigned a rating of BBB+ to the above noted low-trigger Tier 2 Subordinated Notes issued by UBS AG. The 7.25% and the 7.625% USD 2bn Tier 2 Subordinated Notes due 2022 were issued by UBS AG acting through its Jersey and Stamford branches, respectively. The other three Tier 2 Subordinated Notes were issued by UBS AG directly. The rating is based on the following considerations:

- Senior unsecured debt rating (eligible for TLAC): A, Positive Outlook
- Minimum notches down from senior unsecured debt rating: 2
- Additional notches: 0

In accordance with our recently updated rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and no longer the issuer credit-strength rating (ICSR). The minimum of two notches reflect the subordinated status of Tier 2 capital instruments in the priority of claims and their loss absorbing features. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2016 for more details.

Issuer credit profile

The ICSR of A+ for UBS is underpinned by the group's very significant focus on capital and balance sheet strength, driven in part by the influence of two proactive policy and supervisory authorities in Switzerland. As well, UBS is ahead of many global peers in reshaping its business model. Consequently, the group has a mix of businesses which is well adapted to a changed operating environment. Earnings have also recovered since the financial crisis although more can be done to improve costs and efficiency. Potential conduct and litigation costs remain a risk.

On 20 June 2016, we changed the outlook on the ICSR to Positive from Stable. The outlook change reflects the successful reshaping of the group's business model and the group's reassuring credit metrics.

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Summary terms

Issuer	**UBS AG, acting through its Jersey branch**
Issue Date	22 February 2012
Amount	USD 2bn
Coupon	• 7.25% fixed until first call date, reset once on that date • payable annually in arrears
Format	Tier 2 Subordinated Notes due 2022, callable on 22 February 2017
ISIN	XS0747231362

Issuer	**UBS AG, acting through its Stamford branch**
Issue Date	17 August 2012
Amount	USD 2bn
Coupon	• 7.625% fixed until maturity • payable semi-annually in arrears
Format	Tier 2 Subordinated Notes due 2022
ISIN	US90261AAB89

Issuer	**UBS AG**
Issue Date	22 May 2013
Amount	USD 1.5bn
Coupon	• 4.75% fixed until first call date, reset once on that date • payable annually in arrears
Format	Tier 2 Subordinated Notes due 2023, callable on 22 May 2018
ISIN	CH0214139930
Issue Date	13 February 2014
Amount	USD 2bn
Coupon	• 4.75% fixed until first call date, reset once on that date • payable annually in arrears
Format	Tier 2 Subordinated Notes due 2026, callable on 12 February 2021
ISIN	CH0236733827

Issue Date	15 May 2014
Amount	USD 2.5bn
Coupon	• 5.125% fixed until maturity • payable annually in arrears
Format	Tier 2 Subordinated Notes due 2024
ISIN	CH0244100266

Capital Treatment	**Tier 2 grandfathered (details below)**
Principal Loss Absorption	• Following the occurrence of a Trigger Event or a Viability Event, the full principal amount of each note shall automatically be written down to zero. • A Trigger Event shall be deemed to have occurred if the Relevant Trigger Capital Ratio (defined as the sum of the CET1 capital ratio and the High-Trigger Capital ratio) is less than the Write-down Threshold of 5%. • A Viability Event refers to (1) FINMA notifying UBS that conversion or write-down of all Basel 3-compliant capital instruments is an essential requirement to prevent UBS AG from becoming insolvent, bankrupt, unable to pay a material part of its debt or ceasing to carry on its business; or (2) UBS AG has received irrevocable commitment of extraordinary support from the public sector without which UBS AG would have become insolvent, bankrupt, unable to pay a material part of its debts as they fall due or unable to carry on its business.
Trigger for Principal Loss Absorption	UBS AG's CET1 capital ratio + Higher Trigger capital ratio <5%, transitional basis

Source: Prospectuses, Scope Ratings

Key risk: principal loss absorption

The Notes are subject to permanent write-down if The Relevant Trigger Capital Ratio (defined as the sum of the CET capital ratio and the High-Trigger Capital ratio) is less than 5% and UBS has not paid any distribution in cash or kind on its common equity capital nor has it bought back shares one month before the notice of a trigger event write-down has been given.

If there is any High-Trigger Contingent Capital outstanding, these shall be written down before the Notes. This specification provides some protection to Tier 2 holders, in our view.

There is also the possibility that a write-down will not occur if FINMA agrees that as a result of actions taken by UBS AG, or due to circumstances or events, the Relevant Capital Ratio has been or will be restored above 5%.

In addition, the Notes are subject to write-down upon the occurrence of a Viability Event. if FINMA determines that a write-down of the Notes as well as other similar capital instruments is essential in order to prevent UBS AG from becoming insolvent, bankrupt, unable to pay a material part of its debts or unable to carry on its business; or UBS AG has received an irrevocable commitment of direct or indirect extraordinary support from the public sector in order to prevent UBS AG from becoming insolvent, bankrupt, unable to pay a material part of its debts or unable to carry on its business. The Terms and Conditions of the Notes also clearly state that a Viability Event may occur irrespective of whether or not a Trigger Event has occurred, highlighting the discretion of the regulator in determining the point of non-viability.

In our opinion, the write-down risk for these Notes is very low outside of a resolution scenario. First, this is because of the way the trigger is determined (sum of CET1 capital ratio and High-Trigger capital ratio) as well as the low level of the threshold at 5%. As of end-March 2016, UBS AG had a phase-in CET1 ratio of 17.8%. In addition, UBS AG had another CHF 2.0bn in high-trigger loss absorbing capital outstanding (equivalent to 0.9% of RWAs).

Secondly, per the latest Swiss TBTF requirements which must be met by end-2019 the group will need to maintain a minimum going concern capital requirement of 14.3% of RWAs, of which 10% must be met with CET1 capital and the remainder with high-trigger AT1 instruments. The provisions provide for the grandfathering of both high and low trigger Tier 2 securities (including the Notes). They will qualify as going concern capital until the earliest of end-2019, maturity or the first call date. Thereafter, they may be used to meet gone concern requirements.

Distance to trigger

Considering the undemanding trigger of the Notes, we expect the sum of UBS AG's CET1 and High-Trigger capital ratios to remain largely above the 5% trigger level. Since the establishment of UBS Group AG as the holding company for the group and the parent company of UBS AG, UBS Group AG is the primary financial reporting entity for the group. There are limited differences in the financial profiles of the two entities. The group targets a CET1 ratio of at least 13% on a fully applied basis.

Table 1: Distance to trigger – UBS AG

	2015	1Q 2016	2017	2018	2019
Trigger level	5%	5%	5%	5%	5%
Sum of CET1 + High-Trigger capital ratio	19.5%	18.7%	> 13% CET1 fully applied target		
Gap (%)	14.5%	13.7%			
Gap (CHF bn)	30.9	29.9			

Source: Company data, Scope Ratings

Regulatory Disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund and Dr. Sven Janssen.

The rating analysis has been prepared by Pauline Lambert, Executive Director

Responsible for approving the rating: Sam Theodore, Managing Director

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

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Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodologies applicable for this rating "Bank Rating Methodology" (May 2016) & "Bank Capital Instruments Rating Methodology" (May 2016) are available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's credit rating, definitions of rating symbols and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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