

## **UBS Second Quarter 2016 Earnings Call Remarks**

July 29, 2016

### **Sergio P. Ermotti (Group CEO): Opening remarks**

#### SLIDE 2 – 2Q16 results

Thank you, Martin and good morning everyone.

For those who follow us regularly, Caroline Stewart is currently on maternity leave looking after her new baby girl. I am sure you will all join me in congratulating Caroline and her husband on this great news.

In the second quarter, the slowdown in economic growth, the challenging interest rate environment and geopolitical turmoil – including Brexit – intensified the storm of uncertainty in the industry. On a global basis, this translated into increased cash holdings for our wealth management clients from already high levels and very low transaction volumes.

Despite these conditions, we delivered an adjusted pre-tax profit of 1.7 billion francs, slightly up from the second quarter of 2015, which benefited from a more favorable environment. The Group generated over 1 billion in net profit attributable to shareholders, with an adjusted return on tangible equity of 10.1%, and we maintained our strong capital ratios, which are well above current requirements. These strong results highlight our consistent disciplined execution and demonstrate the ability of our diversified business model to deliver, even in very difficult market conditions. It is this strength and resilience that contributed to recent upgrades in our credit ratings.

The Group achieved 1.4 billion of net cost savings as of the June exit rate, a 200 million franc improvement in the quarter, making progress toward the 2.1 billion 2017 year-end target, while absorbing substantially higher regulatory costs. We continue to take responsible measures to save costs across the firm in light of the current challenging environment. At the same

time, however, the firm is ensuring that its control framework, quality of client service and strategic growth priorities are not compromised by taking overly aggressive steps to show short-term cost reductions.

Having said that, it is clear to me that in the medium to long-term, the banking industry must find ways to structurally lower costs, regardless of market conditions. This will, for example, only be achievable through closer collaboration between financial institutions in order to create economies of scale, without necessarily pursuing M&A.

Turning to the business divisions, our wealth management businesses globally generated nearly 900 million in pre-tax profits. They also attracted close to 10 billion of net new money, which brings us to almost 40 billion for the first half of the year. We achieved these results without the benefits of normal client activity levels or favorable yield curves, and while staying disciplined on asset quality.

Wealth Management delivered a resilient performance. During the quarter, we implemented changes to our structure that will enable us to enhance the client experience and improve the efficiency of our operations. These changes, while inevitably having some impact, strengthen the business, which now can once again focus on executing its strategy and delivering on its objectives.

Wealth Management Americas delivered a strong performance, with profit before tax up more than 20% year-on-year, and our financial advisors maintained their status as the most productive among peers. We also recently announced changes to our organizational model in WMA, including a new compensation model, with emphasis on retaining our best advisors. This will allow us to de-emphasize the aggressive recruiting practices prevalent in the industry, which are not in the best interests of our clients, advisors and shareholders.

Personal & Corporate Banking generated strong results, with its best profit before tax since the fourth quarter of 2008. The business delivered higher income and lower operating expenses against the challenging backdrop of negative interest rates. P&C continues to experience very robust momentum, as demonstrated by its best ever first-half net new client account openings, with many of them attracted by our mobile and e-banking offerings.

Asset Management delivered a profit before tax 10% higher than the previous year. Clearly, we are not immune to the challenges facing the active asset management industry, such as highly risk-averse clients and the continuing shift from active to passive. We will maintain our focus on executing our strategy, as we believe this business will continue to deliver attractive returns.

The Investment Bank delivered a strong return on attributed equity, while maintaining prudent risk, cost and resource management. I am especially pleased with the performance of our highly-efficient FRC business, which increased revenue without using more resources.

Looking ahead, visibility is limited given market conditions, regulatory ambiguity and other factors. In addition, we and the industry remain exposed to elevated expenses associated with litigation and regulatory matters. At least until we see sustainable stabilization across the macroeconomic and geopolitical arenas, we believe it no longer makes sense to provide short-term return guidance. However, we still believe we can achieve our targets in a more normalized environment.

We remain committed to our policy of returning at least 50% of net profits to shareholders and we aspire to grow our ordinary dividend, while building the capital needed to address regulatory requirements and to support growth. Given prevailing market conditions, our priority for 2016 will be to deliver at least the same baseline dividend as in 2015 of 60 Rappen per share.

In order to achieve our goals, it is critical that we stay close to clients to help them navigate these difficult conditions while continuing to execute our strategy.

With that, I will turn it over to Kirt.

## **Kirt Gardner (Group CFO): Walk-through of the quarter**

Thank you, Sergio. Good morning everyone.

### Slide 3 - UBS Group AG results (consolidated)

As usual, my commentary will reference adjusted results, unless otherwise stated.

This quarter, our results have been adjusted for 377 million francs in net restructuring expenses, 120 million in gains on sales of real estate, 100 million in net gains on sales of subsidiaries, businesses and investments, as well as 26 million net foreign currency translation losses.

Consistent with the change in our earnings materials published today, comparisons will be with the second quarter of 2015 unless otherwise stated.

### Slide 4 - Wealth Management

In Wealth Management, we delivered resilient results in very challenging market conditions that have now persisted for 4 quarters, with 606 million in profit before tax, down 21% versus a very strong second quarter 2015.

As already mentioned by Sergio, clients continued to express concerns and fears over escalating geopolitical and macroeconomic risks. Transaction revenue was 347 million, the lowest quarter we have seen. As a reminder, Asia Pacific is the largest contributor to our transaction revenues, and we saw a significant drop from the prior year.

Apart from low activity, clients' concerns and fears continued to drive de-risking with cash levels at 28% of non-contracted advisory assets, the highest we've seen since 1Q14. We've also seen movement into lower margin products, including out of active and into passive funds.

These trends, combined with lower average invested assets, contributed to a reduction in recurring net fee income, which was down 10%.

To offset these recurring revenue headwinds that are not expected to abate soon, we're redoubling our focus on pricing discipline and discount management, accelerating the roll-out of our new Alternatives solutions where we are underweight, enhancing our CIO aligned asset allocation offerings, and continuing to improve mandate penetration.

Net interest income increased due to higher deposit revenues, partially offset by lower allocations from Group ALM.

In response to prolonged challenging conditions, we've initiated a number of cost actions, both tactical and structural, which have already provided some relief this quarter. Ultimately, we expect our actions to result in net savings of around 200 million per year from the first quarter of 2017 versus full-year 2015, which will contribute to our net cost reduction program of 2.1 billion.

Overall, our expenses were down 4% to 1.2 billion, on lower personnel expenses. The increase in G&A expenses was driven by higher professional fees related to building out our digital platform.

#### Slide 5 - Wealth Management

The value and confidence clients place in UBS is evidenced by the 6 billion in net new money inflows seen in the quarter, after absorbing 3.1 billion in outflows related to cross-border, mainly related to emerging markets, and net reductions in Lombard lending.

We also saw 6.9 billion in net new mandates. Mandate penetration increased 50 basis points to 27.1% excluding the impact of business disposals.

Invested assets increased to 935 billion from the prior quarter on net new money inflows, positive market performance and FX movements, partly offset by a 7 billion net reduction related to the sale and acquisition of subsidiaries and businesses.

## Slide 6 - Wealth Management

We saw continued strong net new inflows in Asia Pacific and Switzerland. Over a quarter of the net new inflows in Asia Pacific came from our high-net worth clients, reflecting our increased focus on this segment.

We also saw net inflows in Europe domestic, although these were offset by cross-border outflows. Flows in Emerging markets continued to reflect net outflows from cross-border effects, mostly in Latin America, and reduced Lombard lending.

We continue to expect to absorb these outflows within our annual net new money growth target of 3-5%.

## Slide 7 – WM CIO: Providing innovative solutions

In response to clients' evolving needs and changing market conditions, we have improved our leading mandate offering to make full use of the unique capabilities of our CIO and IPS platform.

Since the fourth quarter last year, we have launched four new offerings, about which we are particularly excited. Let me comment briefly on two of these:

The systemic allocation portfolio adjusts its equity allocation based on quantitative signals about the likelihood of a market downturn, appealing to clients with an interest in a dynamic equity exposure.

The endowment-style mandate allows clients with a long-term horizon to include illiquid private markets and alternative investments into a portfolio solution that they would not be able to replicate on their own.

In aggregate across all solutions launched so far, these have generated significant client interest, with over 2 billion in inflows since their respective launch dates. Once we complete the development of our integrated Wealth Management and Wealth Management Americas platform, these products will also be available to WMA clients.

## Slide 8 - Wealth Management

While treacherous market and geopolitical conditions have weighed heavily on clients' attitudes towards their investments, they continue to look towards UBS as their key global wealth manager.

The strong mandate inflows further confirm our clients' confidence in our ability to help them to navigate periods of short-term market volatility and achieve their long-term wealth objectives.

It is from this position that we're taking a number of actions to further strengthen our global leading wealth management franchise:

We're optimizing our operating model by implementing one global platform, consolidating our EU onshore entities, simplifying our processes and streamlining non-client facing units.

Leveraging this platform, we are enhancing our coverage and offering by establishing a global distribution management function. This will further improve clients' access to global investment opportunities and solutions, tailored to meet their unique needs within a consistent service and risk management framework.

We also continue to invest in our digital capabilities, and are enhancing our Alternatives offering, allowing our clients to access industry-leading managers across a wide range of strategies and to benefit from our global buying power.

## Slide 9 - Wealth Management Americas

Wealth Management Americas delivered a strong quarter, with profit before tax up 22% year-on-year, with records for net interest income, invested assets and managed account penetration.

Operating income decreased slightly to 1.9 billion dollars, on lower client activity and lower mutual fund fees as clients changed their asset allocation in response to the environment. Net interest income was up 19% from the previous year on interest rate moves and continued growth in loan and deposit balances.

Operating expenses decreased 4% to 1.6 billion dollars, mainly due to 73 million lower net expenses for provisions for litigation, regulatory and other matters.

#### Slide 10 - Wealth Management Americas

Net new money of 2.4 billion dollars was driven by net recruiting and includes seasonal withdrawals associated with income tax payments of around 3 billion dollars.

Invested assets increased by 3% from the prior quarter to 1.1 trillion dollars. Managed account penetration rose to 34.5% of invested assets.

#### Slide 11 - Wealth Management Americas

FA productivity remained industry-leading, as both revenue and invested assets per FA increased.

Lending balances were up 6% year-on-year, with an increase across all banking product lines, our twenty-second consecutive quarter of loan growth.

#### Slide 12 - Wealth Management Americas

In June, we enhanced our operating model in WMA to move decision-making closer to clients, retain our most talented advisors, and free up resources to drive growth.

The changes made are focused on four key levers:

First, empowerment; we streamlined management and reduced the complexity of our organization. Given the critical role Branch Managers play in the satisfaction and productivity of our advisors, we made a variety of changes and investments to empower them to more efficiently run their branches with an emphasis on economic profitability.



The second is global leverage; we're building on our partnership between Wealth Management and Wealth Management Americas, which we expect to allow WMA to achieve the economies of scale of our larger local peers, while maintaining its agility. In addition, we will make available our global solutions offering to WMA, as previously referenced. This emphasizes our unique "feel small, play big" positioning in the US, which is a key differentiator for WMA.

The third lever is technology, which we'll continue to focus on so that clients and FAs have the most cutting edge tools. For example, our strategic alliance with SigFig announced in May allows us to partner with a Fintech leader, and implement online and mobile technologies to improve our clients' digital experience, as well as enhance the ability of our FAs to provide advice efficiently and effectively. This platform will also become available to WM in due course.

The fourth and final lever is organic growth. Simply stated, we prefer to invest to retain our current advisors rather than continuously recruiting new ones, as a retained advisor generates significantly higher economic profits compared with a recruited one over time, due in part to greater client retention and lower capital consumption.

### Slide 13 – Personal & Corporate Banking

Personal and Corporate Banking delivered an exceptionally strong performance despite persistent negative interest rates, with profit before tax increasing 12% to 463 million francs, our best result since the fourth quarter of 2008.

Operating income increased by 3%, mostly on higher transaction-based and recurring net fee income. Net interest income was stable, as higher loan-related income offset lower deposit revenues and allocations from Group ALM. Net interest margins remained robust at 165 basis points. We recorded a small net credit recovery of 2 million.

Operating expenses decreased by 3%, with all cost lines contributing. The cost/income ratio declined to 53%.

Annualized net new business volume growth for our personal banking business was 3.0%, with contributions from client assets, and to a lesser extent, loans. We continued to attract new clients, with the highest net new client acquisition we've seen for a first half, mainly among younger clients, driven by our strong e- and mobile banking offering.

#### Slide 14 – Personal & Corporate Banking

Personal & Corporate has delivered consistent strong performance over the past two years, with top-line growth, prudent expense management, and minimal credit loss expenses. This resulted in a 12% compound annual growth rate for profit before tax, and a 7 percentage point reduction in the cost/income ratio.

We're particularly pleased with the performance in our home market over the past two years, although we recognize that there are clear headwinds going forward, including negative interest rates, and potential adverse changes in the credit environment related to the strength of the Swiss franc.

#### Slide 15 - Asset Management

Asset Management delivered a profit before tax of 148 million, up 10% year-on-year and 35% quarter-on-quarter.

Performance fees increased to 24 million, mainly in Global Real Estate. Net management fees were largely unchanged at 458 million, despite the sale of Alternative Fund Services in the fourth quarter of 2015.

Expenses were down year-over-year, mostly driven by lower allocations from Group Technology, partly offset by increases in personnel expenses.

Invested assets increased quarter-on-quarter to 633 billion due to positive market performance and currency effects, more than offsetting net new money outflows.

Net new money excluding money markets was negative 8.8 billion, and was mainly driven by asset allocation shifts, including from active to passive investments, and clients' liquidity needs.

### Slide 16 - Investment Bank

The Investment Bank generated 447 million of profit before tax, with strong performance in FX, Rates and Credit, and regionally in the Americas. The IB demonstrated continued disciplined resource utilization and took prompt action on costs.

While Corporate Client Solutions revenues were up 41% from a weak first quarter, they were down 19% year-over-year. DCM saw both high yield and investment grade revenues increase. In Advisory, M&A revenues increased slightly versus a declining market fee pool. The increase in DCM was more than offset by lower ECM revenues on lower market volumes, and losses in Risk Management, mostly due to higher hedging costs.

In Investor Client Services, Equities revenues were 22% lower against a strong 2Q15, reflecting our footprint in APAC and EMEA, with volumes significantly lower, particularly in Structured Derivatives. We've continued to make progress in our Americas business, with revenue growth in Financing Services and Cash.

FX, Rates and Credit has posted strong revenues for 6 consecutive quarters, showing once again that our client-centric, low inventory model works well in all market conditions. Year-over-year, revenues were up 15%, and we would have achieved an increase even without the additional flows following the UK referendum. This is a strong result amidst market turmoil, given our continued discipline in risk and resource usage.

Net credit losses remained low at 6 million, with both provisions and recoveries, in small amounts, within the energy sector.

Operating expenses excluding allocations were managed down 11% year-over-year. Within that, personnel expenses were down 16%, in line with revenues, on lower bonus accruals and as we took decisive action to right-size our business to reflect market conditions.

Looking ahead, there is limited flexibility in the cost base; for example, due to structural compensation considerations, such as the amortization of prior-year awards. In addition, there will be a seasonal impact from the UK bank levy in the fourth quarter.

#### Slide 17 - Investment Bank

Our model focuses on our clients, and is designed to capture client flows, with limited mark-to-market risk and low inventory levels, in order to deliver strong risk-adjusted returns. This quarter, on an annualized basis, the IB delivered a return on attributed equity of 23%.

Our resource utilization adjusts to reflect market conditions. Our current levels are well below our short to medium-term expectations, with RWA at 64 billion and LRD at 267 billion, reflecting muted client transaction levels, and weak primary markets.

#### Slide 18 - Corporate Center

Corporate Center – Services costs before allocations were down, mostly due our cost reduction programs.

Group ALM profit before tax increased to 70 million, as the effects of accounting asymmetries related to economic hedges moved from negative to positive. Risk management net income after allocations was negative 53 million, in line with our previous guidance of around negative 50 million per quarter.

Non-core and Legacy Portfolio posted a loss of 124 million, slightly improved compared with the prior year, due to lower expenses.

Non-core and Legacy Portfolio LRD decreased 20% from the prior quarter to 33 billion, mainly due to incremental OTC derivative netting and collateral mitigation benefits.

### Slide 19 - Cost reduction

For the quarter, we achieved an additional annualized net cost reduction of around 200 million, increasing our net cost reduction run rate to 1.4 billion.

In the quarter, we delivered cost reductions through streamlining of non-client-facing units in Wealth Management and through efficiency and simplification measures and in the Investment Bank. These actions will also allow us to further streamline Corporate Center functions.

We will continue to deliver front-to-back savings across the Corporate Center and the business divisions by focusing on the levers of workforce and footprint; organization and process optimization; as well as technology and robotics and workflow automation, where we see increasingly substantial opportunities.

Although we continue to face upward pressure on expenses mainly related to regulatory demands, we're fully committed to achieving our targeted Group net cost reduction of 2.1 billion by the end of 2017, while investing in strategic growth priorities and maintaining our focus on risk management.

### Slide 20 – Capital and leverage ratios

Our capital position remained strong and our ratios improved. Our fully applied Basel III CET1 capital ratio increased to 14.2% and our fully applied BIS Basel III CET1 leverage ratio increased to 3.4%.

Fully applied CET1 capital increased due to net profit, partly offset by dividend accruals, as well as pension and current tax effects.

LRD decreased by 8 billion in the quarter, while RWA was stable. As referenced in the second quarter report, the revised credit conversion factors will lead to an increase in credit risk RWA of approximately 3 billion in the third quarter. In addition, we continue to expect regulatory inflation across Swiss income-producing real estate and IB Corporate exposures, with roughly 2 billion anticipated in the second half of 2016, and another 5-6 billion in both 2017 and 2018.

Our short to medium-term expectations for the Group and IB RWA and LRD are unchanged, but these do assume normalized market conditions. That said, if the Basel Committee Banking Supervision's proposed changes to the capital framework were to be adopted in Switzerland in their current form, this would likely lead to a significant increase in RWA, not considering any tactical and strategic mitigating actions that we could implement.

As we complete our business plan over the coming months, we will remeasure our DTAs and reflect any changes in value in our tax expenses during the second half of the year. Proposed UK tax law changes, if enacted in the second half of 2016, would affect our DTAs and moderately increase our effective tax rate.

In conclusion, our businesses delivered an overall strong result, with adjusted profit before tax of 1.7 billion and return on tangible equity of 10.1%, both up year-on-year despite more challenging conditions. In addition to progressing with our cost reduction initiatives, we are executing strategic actions to enhance the global leadership of our wealth management businesses, as well as investing in key opportunities.

Thank you, and with that, Sergio and I will now open it up for questions.

**Cautionary statement regarding forward-looking statements:** This presentation contains statements that constitute “forward-looking statements,” including but not limited to management’s outlook for UBS’s financial performance and statements relating to the anticipated effect of transactions and strategic initiatives on UBS’s business and future development. While these forward-looking statements represent UBS’s judgments and expectations concerning the matters described, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from UBS’s expectations. These factors include, but are not limited to: (i) the degree to which UBS is successful in executing its announced strategic plans, including its cost reduction and efficiency initiatives and its targets for risk-weighted assets (RWA) and leverage ratio denominator (LRD), and the degree to which UBS is successful in implementing changes to its wealth management businesses to meet changing market, regulatory and other conditions; (ii) the continuing low or negative interest rate environment, developments in the macroeconomic climate and in the markets in which UBS operates or to which it is exposed, including movements in securities prices or liquidity, credit spreads, and currency exchange rates, and the effects of economic conditions, market developments, and geopolitical tensions on the financial position or creditworthiness of UBS’s clients and counterparties as well as on client sentiment and levels of activity; (iii) changes in the availability of capital and funding, including any changes in UBS’s credit spreads and ratings, as well as availability and cost of funding to meet requirements for debt eligible for total loss-absorbing capacity (TLAC) requirements, or loss-absorbing capital; (iv) changes in or the implementation of financial legislation and regulation in Switzerland, the US, the UK and other financial centers that may impose, or result in, more stringent capital, TLAC, leverage ratio, liquidity and funding requirements, incremental tax requirements, additional levies, limitations on permitted activities, constraints on remuneration or other measures, and the effect this would have on UBS’s business activities; (v) uncertainty as to when and to what degree the Swiss Financial Market Supervisory Authority (FINMA) will approve a limited reduction of gone concern requirements due to measures to reduce resolvability risk; (vi) the degree to which UBS is successful in implementing further changes to its legal structure to improve its resolvability and meet related regulatory requirements, including changes in legal structure and reporting required to implement US enhanced prudential standards, implementing a service company model, completing the transfer of the Asset Management business to a holding company, and the potential need to make further changes to the legal structure or booking model of UBS Group in response to legal and regulatory requirements relating to capital requirements, resolvability requirements and proposals in Switzerland and other countries for mandatory structural reform of banks and the extent to which such changes have the intended effects; (vii) the uncertainty arising from the UK referendum vote to withdraw from the EU and the potential need to make changes in UBS’s legal structure and operations as a result of a UK exit from the EU; (viii) changes in UBS’s competitive position, including whether differences in regulatory capital and other requirements among the major financial centers will adversely affect UBS’s ability to compete in certain lines of business; (ix) changes in the standards of conduct applicable to our businesses that may result from new regulation or new enforcement of existing standards, including proposed measures to impose new and enhanced duties when interacting with customers and in the execution and handling of customer transactions; (x) the liability to which UBS may be exposed, or possible constraints or sanctions that regulatory authorities might impose on UBS, due to litigation, contractual claims and regulatory investigations, including the potential for disqualification from certain businesses or loss of licenses or privileges as a result of regulatory or other governmental sanctions, as well as the effect that litigation, regulatory and similar matters have on the operational component of our RWA; (xi) the effects on UBS’s cross-border banking business of tax or regulatory developments and of possible changes in UBS’s policies and practices relating to this business; (xii) UBS’s ability to retain and attract the employees necessary to generate revenues and to manage, support and control its businesses, which may be affected by competitive factors including differences in compensation practices; (xiii) changes in accounting or tax standards or policies, and determinations or interpretations affecting the recognition of gain or loss, the valuation of goodwill, the recognition of deferred tax assets and other matters; (xiv) limitations on the effectiveness of UBS’s internal processes for risk management, risk control, measurement and modeling, and of financial models generally; (xv) whether UBS will be successful in keeping pace with competitors in updating its technology, particularly in trading businesses; (xvi) the occurrence of operational failures, such as fraud, misconduct, unauthorized trading, financial crime, cyber-attacks, and systems failures; (xvii) restrictions on the ability of UBS Group AG to make payments or distributions, including due to restrictions on the ability of its subsidiaries to make loans or distributions, directly or indirectly, or, in the case of financial difficulties, due to the exercise by FINMA of its broad statutory powers in relation to protective measures, restructuring and liquidation proceedings; (xviii) the degree to which changes in regulation, capital or legal structure, financial results or other factors, including methodology, assumptions and stress scenarios, may affect UBS’s ability to maintain its stated capital return objective; and (xix) the effect that these or other factors or unanticipated events may have on our reputation and the additional consequences that this may have on our business and performance. 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**Use of adjusted numbers**

Unless otherwise indicated, "adjusted" figures exclude the adjustment items listed on the previous slide, to the extent applicable, on a Group and business division level. Adjusted results are a non-GAAP financial measure as defined by SEC regulations. Refer to pages 7-10 of the second quarter 2016 report which is available in the section "Quarterly reporting" at [www.ubs.com/investors](http://www.ubs.com/investors) for an overview of adjusted numbers.

If applicable for a given adjusted KPI (i.e., adjusted return on tangible equity), adjustment items are calculated on an after-tax basis by applying an indicative tax rate.

Refer to page 15 of the second quarter 2016 report for more information

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