The launch of the first covered bond programme in Switzerland set up outside the framework of the Swiss statutory covered bond system

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On October 6, 2009 UBS AG, acting through its London branch, successfully issued a first tranche of €2,000,000,000 Series 2009-1 3% Inaugural Covered Bonds, due in 2014. Further tranches followed within a couple of months. The covered bonds are indirectly backed by part of UBS AG's Swiss residential mortgage loan portfolio. It is the first covered bond transaction established in Switzerland involving Swiss mortgage assets outside the statutory framework of the Swiss mortgage bond system.

Background

In Switzerland, Swiss mortgage assets have been regularly refinanced or sold through capital markets transactions.

Transactions through the statutory Swiss mortgage bond system

Most importantly, Swiss banks may refinance Swiss mortgage assets through the Swiss mortgage bond system governed by the Swiss mortgage bonds act (introduced in 1930), involving the Pfandbriefbank or the Pfandbriefzentrale. These two financial institutions are set up in the framework of the act and are doing business under limited banking licenses of the Swiss Financial Market Supervisory Authority (FINMA) (all strictly in accordance with the Swiss mortgage bonds act). Within the statutory framework of the Swiss mortgage bond system mortgage bonds (Pfandbriefe) are issued by either of the

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Pfandbriefbank or the Pfandbriefzentrale to the market. The funds so raised are then lent to the member banks against a pool of mortgage security (consisting of mortgage loans).

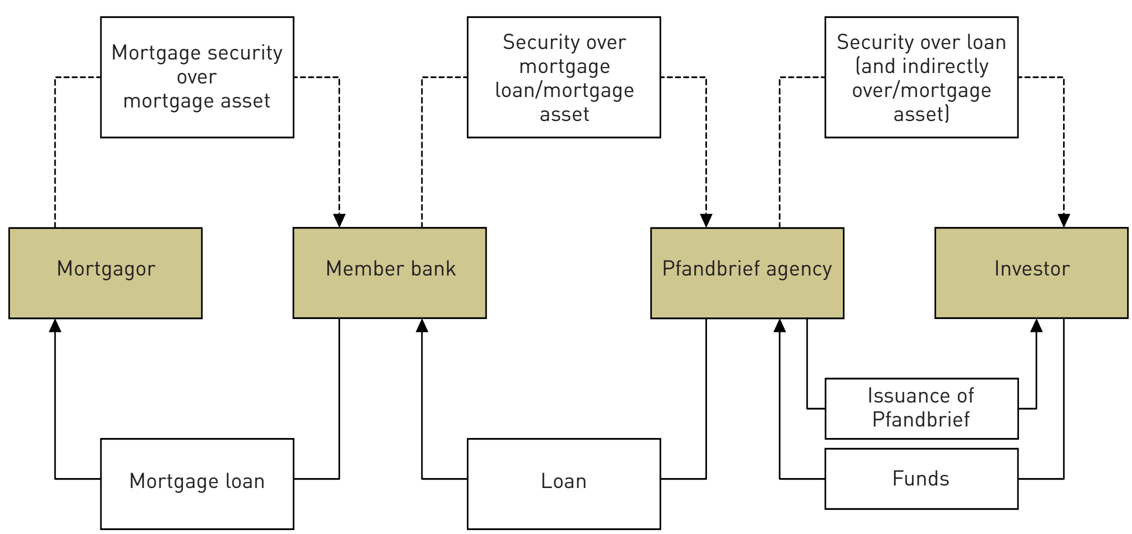
The Pfandbrief is a covered bond-like investment instrument and is (indirectly) fully secured by the mortgage security provided by the members' banks (i.e., real property located in Switzerland). Such security does exist by law and certain requirements for the valid creation of a security interest that would be required in a secured lending transaction may be ignored. Also, the act provides for a conservative statutory framework with low loan to value ratio requirements and a strict monitoring of the underlying mortgage pool. Covered bonds issued under the Swiss covered bond system are typically marketed in Switzerland, due to the limited volumes and withholding tax considerations.

Whereas this route of refinancing mortgage asset has been considered as conservative (as restrictive eligibility criteria for the mortgage assets apply), it has proven to be a reliable way to refinance mortgage assets, even in extraordinary situations. However, it is usually difficult to approach a broader circle of international investors, in particular in situations where such investors would not be entitled to reclaim Swiss withholding tax deducted on interest payments.

Securitisation transactions involving Swiss mortgage assets

Swiss mortgage asset portfolios have also been refinanced through securitisation transactions. Both residential mortgage-backed securities (RMBS) as well as commercial mortgage-backed securities (CMBS) have been issued in the framework of such transactions. Most often, such transactions were structured as true sale transaction, but certain transactions were also set up under synthetic structures.

Structure overview of the Swiss statutory covered bond system **Exhibit 1**



Source: Walder Wyss & Partners Ltd.

Until recently, there were no covered bond transactions established in Switzerland (outside the statutory covered bond system)

However, no covered bond transactions involving Swiss mortgage assets have been established in Switzerland so far. The set up of UBS' covered bond programme is the first transaction of its kind in Switzerland and as it has been set up outside the statutory framework of the Swiss mortgage bonds act and, other than under the Swiss mortgage bonds act, all elements of the transaction are set up by agreement between the relevant parties.

The purpose of the structure set up by UBS AG was to use and refinance its Swiss residential mortgage asset portfolio as security cover pool, but to approach a broader circle of investors, to issue under its own name and to have flexibility in determining the terms of each issuance.

Covered bond programme of UBS AG

Structure overview

UBS AG, acting through its London branch, set up a covered bond programme under which it issues covered bonds. The obligations of UBS AG, London branch under the covered bonds are its direct, unsubordinated, unsecured and unconditional obligations, guaranteed by UBS Hypotheken AG, a special purpose entity (**SPE**) incorporated in and under the laws of Switzerland, acting as guarantor (**Guarantor**). The Guarantor issues a guarantee (**Guarantee**) under a so-called guarantee mandate agreement (**Guarantee Mandate**) in favour of the holders of covered bonds, represented by the bond trustee (**Trustee**). All liabilities (as well as costs and expenses) incurred by the Guarantor in performance of its obligations under the Guarantee, will have to be reimbursed (or pre-funded accordingly) by UBS AG, London branch to the Guarantor under the Guarantee Mandate. Such reimbursement and pre-funding obligations towards the Guarantor are secured by UBS AG, Switzerland providing security by an assignment and transfer for security purposes of a pool of mortgage loans (together with the related mortgage security) to the Guarantor.

Thus, in a default scenario, the Guarantee would be drawn by the Trustee and the Guarantor would claim for coverage by UBS AG, London branch under the Guarantee Mandate. As UBS AG, London branch would most likely not be in a position to satisfy such obligation to cover (as there would have already been a default under the covered bonds), the Guarantor would be able to enforce in the asset cover pool for purposes of covering the claims under the Guarantee Mandate that it would have against UBS AG, London branch. As a result, the Guarantor would be in a position to satisfy the amounts drawn by the Trustee (on behalf of the covered bondholders) under the Guarantee.

Certain elements of the structure

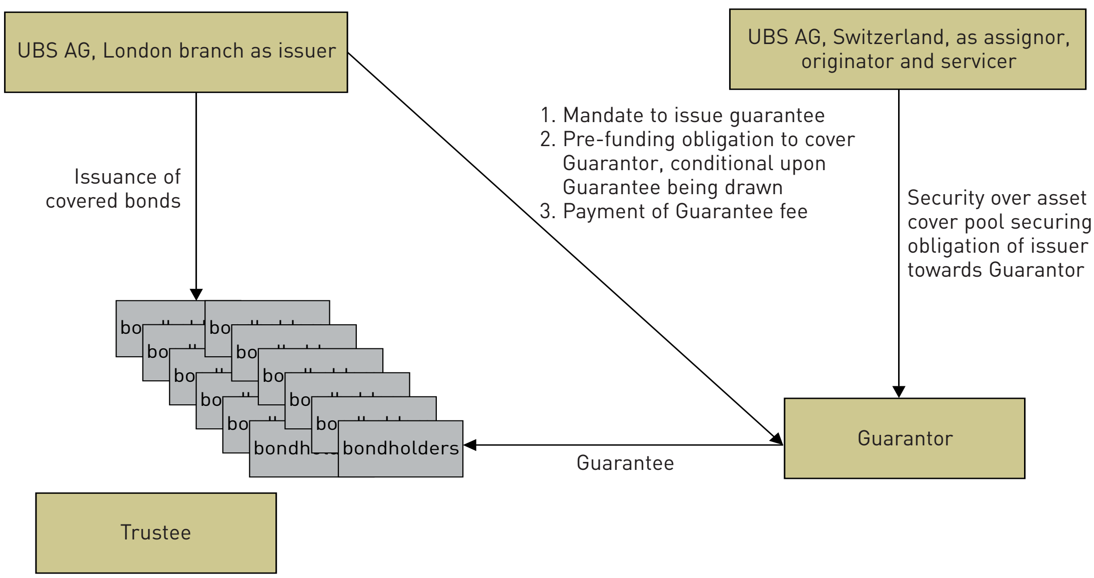
Guarantor

The Guarantor is a SPE, incorporated as a limited liability stock corporation (*Aktiengesellschaft*) under the laws of and in Switzerland. The Guarantor is held by three shareholders (UBS AG [98%] and two independent shareholders [1% each]). The two independent shareholders have a joint veto right (i.e., most of the resolutions of the general shareholders meeting require a 99% majority). The Guarantor has four board members, two of which are independent board members (including the chairman). As a bankruptcy remote SPE, the Guarantor has a limited purpose and it may only enter into certain transactions that are related to the covered bond programme. The Guarantor does not hold any substantial assets, other than the security interest in the asset cover pool.

The Guarantor benefits from non-petition and limited recourse provisions to which essentially all parties to the programme transaction agreements signed up. It is rather unlikely that there will be additional, substantial external creditors not having signed up to such limitations (other than the tax authorities, which confirmed the taxation of the payment streams in tax rulings). This enhances the bankruptcy remoteness of the Guarantor.

Also, an insolvency event or a moratorium of payment obligations at the level of UBS AG would not automatically trigger an insolvency of the Guarantor.

Structure overview of the covered bond programme of UBS AG **Exhibit 2**



Source: Walder Wyss & Partners Ltd.

The Guarantee

The Guarantor issued a Guarantee in favour of the covered bondholders. Such Guarantee covers all obligations of UBS AG, London branch as issuer towards the covered bondholders under any and all covered bonds and may, subject to the occurrence of certain guarantee activation events having occurred, be drawn upon first demand. Claims of the holders of the covered bonds against the Guarantor under the Guarantee are unsecured claims.

The Guarantee is issued by the Guarantor to the issuer on the basis of the Guarantee Mandate. Thereunder, the issuer will pay to the Guarantor a guarantee fee which amounts to the difference between the spreads on the relevant tranche of covered bonds and the spreads obtainable for UBS AG on an unsecured bond issued.

Any amount that becomes payable by the Guarantor under the Guarantee and any expenses and costs whatsoever will have to be covered and borne by UBS AG, London branch and the Guarantor will be fully reimbursed (**Recourse Claims**). These reimbursement obligations have been structured as a pre-funding obligation of the issuer for liquidity reasons at the level of the Guarantor (**Pre-Funding Obligations**).

The security interest

Other than the obligations of the Guarantor towards the covered bondholders and the Trustee under the Guarantee, the Recourse Claims and the Pre-Funding Obligations of UBS AG, London branch against the Guarantor are secured by UBS AG providing security over an asset cover pool in favour of the Guarantor.

In an enforcement scenario, the Guarantee would be drawn by the Trustee. On the basis of the Guarantee Mandate, such amounts would have to be (pre) funded by UBS AG, London branch to the Guarantor. In such a scenario, it would be unlikely that UBS AG, London branch would be able to do so and accordingly, the Guarantor would be allowed to enforce in the asset cover pool in order to cover its claims under the Guarantee Mandate and ultimately use such proceeds to satisfy the claims of the covered bondholders and the Trustee under the Guarantee.

In consideration for receiving a security interest over the asset cover pool, the Guarantor pays a fee to UBS AG. Setting off the guarantee fee payable by UBS AG, London branch to the Guarantor, the Guarantor will be paid a margin of approximately 0.5 basis points on the amount of covered bonds issued.

Asset cover pool

The asset cover pool securing the obligations of UBS AG, London branch towards the Guarantor consists of residential mortgage loans made available by UBS AG to retail clients. Each such residential mortgage loan is secured by mortgage notes (*Schuldbriefe*). The mortgage note/s securing a relevant mortgage loan is/are transferred for security purposes by UBS AG's clients to UBS AG under a standard security transfer agreement and UBS AG acquires legal (fiduciary) ownership in the mortgage note/s.

Certain substitute assets may become part of the asset cover pool as well, such as cash, government guaranteed or issued securities or other assets satisfying certain requirements.

The asset cover pool and the mortgage loans being part thereof will have to meet certain criteria. These are (amongst others): (i) a maximum LTV of 80% per property; (ii) only private persons as mortgagors; (iii) no property shall secure mortgage loans for more than CHF5,000,000; and (iv) no construction loans, etc. Furthermore, the asset cover pool has to meet an asset cover test and an interest cover test. Most importantly, the asset cover pool will have to exceed the aggregate amount of all covered bonds issued at the relevant point in time by a certain percentage calculated on the basis of a certain formula. Compliance with these criteria and tests will be monitored by an independent asset monitor on a predefined random basis.

The asset cover pool will remain dynamic. Assets will have to be added, should the asset cover pool otherwise not meet the asset cover test or the interest cover test. Prior to an event of default under the covered bond, non-performing mortgage loans will be taken out of the pool, retransferred to UBS AG and substituted (should any relevant test otherwise not be met).

Security over the asset cover pool and the role of the collateral holding agent

Assignment and transfer for security purposes (Sicherungszession und Sicherungsübereignung)

In order to secure the obligations of the issuer towards the Guarantor under the Guarantee Mandate (which ultimately serves to cover the Guarantee), the mortgage loans will be assigned for security purposes by UBS AG to the Guarantor with the ownership in the mortgage notes (which secure the respective mortgage loans) being transferred simultaneously. In order to effect such assignment and transfer, UBS AG will issue a deed of assignment and transfer listing all mortgage loans to be assigned and mortgage notes to be transferred, whenever assets have to be transferred and assigned to the asset cover pool (exchange of assets in the pool, increase of the pool, etc.). Obviously, this will be of particular relevance in case of the issuance of a new series or tranche of covered bonds. It is a condition precedent to each issue of a series or tranche of covered bonds that the security interest is validly constituted with regard to such amount of mortgage loans, so that the asset cover pool will meet all relevant tests.

Through such assignment and transfer, the Guarantor becomes the (fiduciary) legal holder of the mortgage loans as well as the (fiduciary) legal owner of the mortgage notes.

Physical transfer of mortgage notes required and collateral holding agent structure

As a matter of Swiss law, it is a requirement in order to constitute a valid security interest that the security provider will no longer be able to physically dispose over the mortgage notes by its sole acts. Thus, the mortgage notes will be physically delivered to the beneficiary or to a collateral holding agent or be held in a system with joint access systems for the beneficiary (or its collateral holding agent) and the security provider.

This requirement is addressed by SIX SIS AG (a Swiss company active – amongst others – in the business of securities depositories and transaction settlement) acting as a collateral holding agent of the Guarantor under a collateral holding agreement.

Generally, SIX SIS AG is holding all mortgage notes on behalf of UBS AG that UBS AG owns as security in connection with its Swiss mortgage loan business. Whenever mortgage loans shall be assigned and ownership in the related mortgage notes transferred to the Guarantor (as such assets shall become subject to the asset cover pool), SIX SIS AG will confirm to UBS AG and the Guarantor to hold the relevant mortgage notes no longer for UBS AG, but for the Guarantor. As a result legal ownership in the mortgage notes will be transferred and such mortgage notes will have become part of the cover pool. SIX SIS AG will ensure segregation of the mortgage notes forming part of the asset cover pool from all other mortgage notes.

Extent of security over mortgage notes

As seen, mortgage loans and related mortgage notes are not transferred separately, but only together as a package. Each mortgage note so transferred will keep on securing the relevant mortgage loan and: (i) such mortgage note shall only be enforced in case UBS AG would be allowed to do so (i.e., in case the relevant mortgage loan is in default); and (ii) the proceeds of a mortgage note shall only cover the relevant mortgage loan and any surplus shall be retransferred to the client. Accordingly, there will be no kind of crossing or netting and in case of a shortfall on one mortgage loan that is not covered by the related mortgage note such shortfall may not be covered by the mortgage note securing another mortgage loan (unless there would be a crossing in the documentation with the client).

Enforcement of security interest

The security over the asset cover pool will become enforceable in case: (i) there is a payment default under the covered bonds; (ii) an insolvency event occurs with regard to UBS AG; (iii) there is a breach of certain obligations under the transaction documents; (iv) there is a breach of the interest and/or the asset cover test (without such breach being remedied within a certain period of time); or (v) there is a payment default of UBS AG towards the Guarantor.

Upon the occurrences of such enforcement events, the Guarantor may enforce in the asset cover pool by either: (i) collecting the mortgage loans (as they fall due) contained in the cover pool and enforce in the related mortgage note(s) (if necessary and allowed); or (ii) selling the asset cover pool to a qualifying investor, subject to very restrictive requirements.

Swaps

The Guarantor entered into swap transactions in order to hedge certain interest rate and currency risk between the income stream generated under the asset cover pool and the obligations under the covered bonds, which may become obligations of the Guarantor through the Guarantee.

Further structure elements

In addition to the elements already mentioned above (in particular the Guarantee and the security backing the Guarantee), the Guarantor entered into various other agreements.

Corporate services, cash management and account services

As the Guarantor does not have any employees, UBS AG provides certain corporate services to the Guarantor under a corporate services agreement. Furthermore, UBS AG as account bank and cash manager provides under a master bank account agreement and a cash management agreement certain services related to the cash streams and the allocation of funds.

Monitoring of asset cover pool and further administrative services

As mentioned, an independent asset monitor conducts certain monitoring services to the Trustee with regard to certain figures and criteria of the asset cover pool. Such services are rendered under a separate asset monitor agreement. Certain administrative services and agency services are provided to the Guarantor by an independent service provider and various agents.

Marketing of the covered bonds

Finally, in connection with the marketing of the covered bonds, dealer agreements and subscription agreements are entered into in order to place the covered bonds in the market.

Outlook

The issuance of the first series of the €2bn inaugural covered bond was massively over subscribed and the terms and conditions under which the inaugural covered bond was issued were attractive to the issuer. UBS AG, London Branch issued further tranches (€1bn, Series 2, 3.875% covered bonds, due 2019; €1.5bn, Series 3, 2.375% covered bonds, due 2013; €1.25bn, Series 4, 4% covered bonds, due 2022). This is a great success for the UBS AG covered bond programme and a clear indication that the market has confidence in the Swiss residential mortgage loan market and accordingly in the Swiss residential property market. Also, it is a clear statement of the market in favour of the structure of the covered bond. Given this success, other banks might follow in setting up such a covered bond programme.

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