Confidential

DCM, Regulatory Developments & Market Outlook

What's New, What's Next

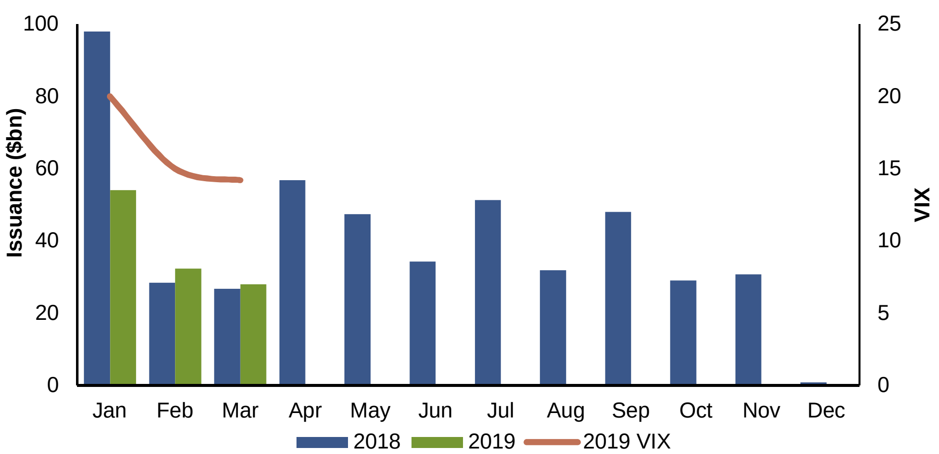
UBS FIG Debt Capital Markets & Solutions

April 2019

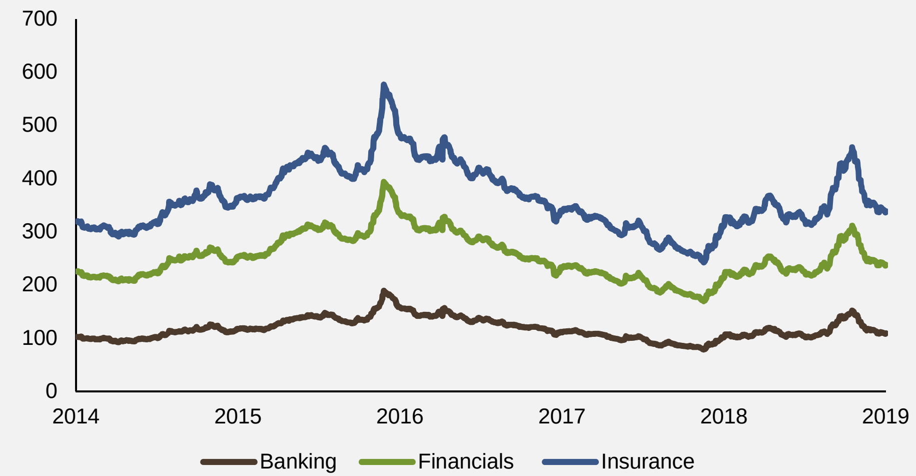
US FIG IG Debt Market Overview

US FIG supply is down 25% year to date, lagging the corporate market

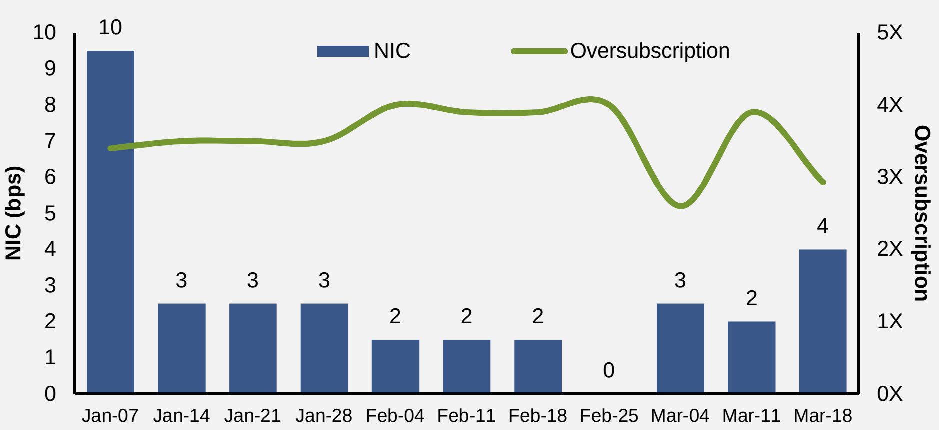
FIG IG paper is down 25% YTD 2019 vs. YTD 2018



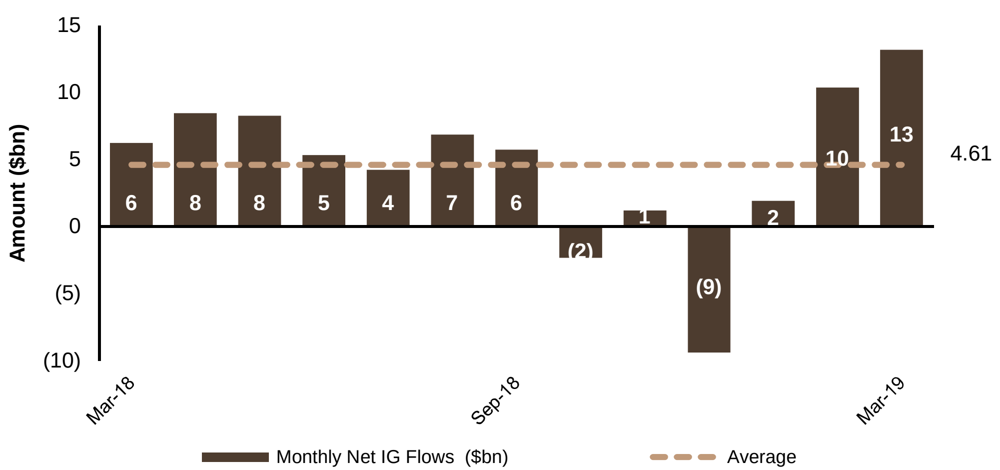
Financial spreads have narrowed to the tightest levels in more than five months



New issue concessions have decreased dramatically from the highs of Q4 2018



IG Fund Flows have rebounded significantly since December, a large driver being increased foreign demand for FIG issuance

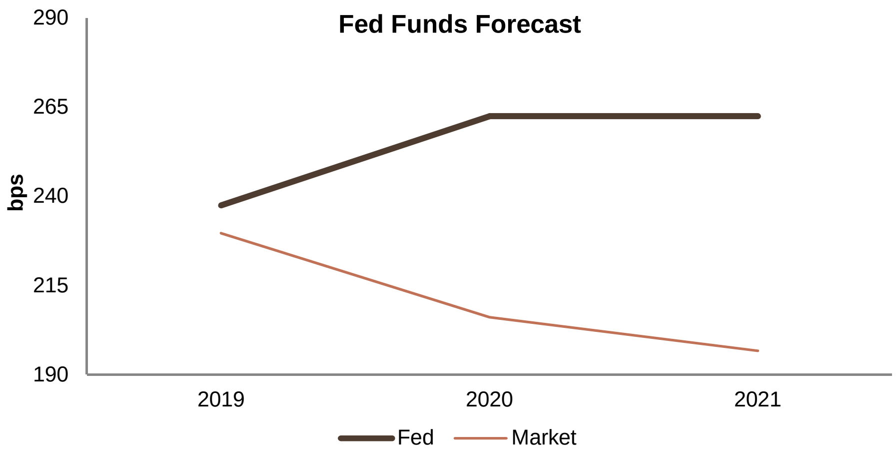


Source: UBS CCS Analysis, Bloomberg

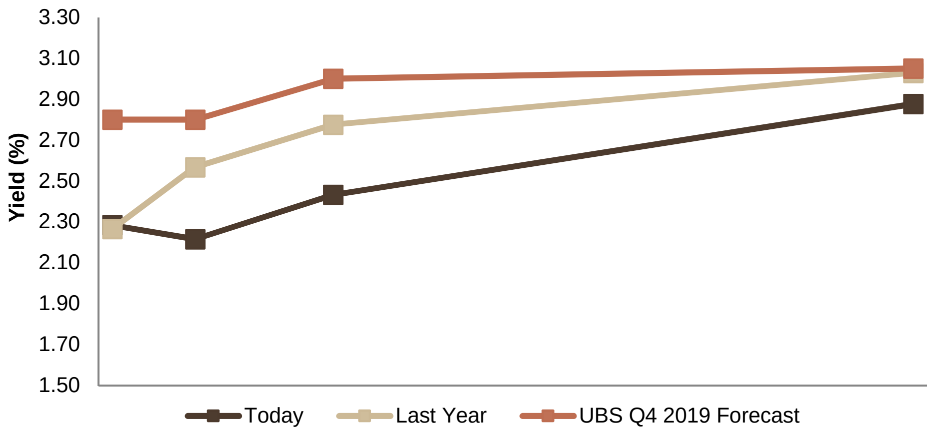
March FOMC: No 2019 Hikes, End Unwind in September

After nine hikes since 2015, the Federal Reserve has signaled no rate hikes for 2019, and one increase in 2020

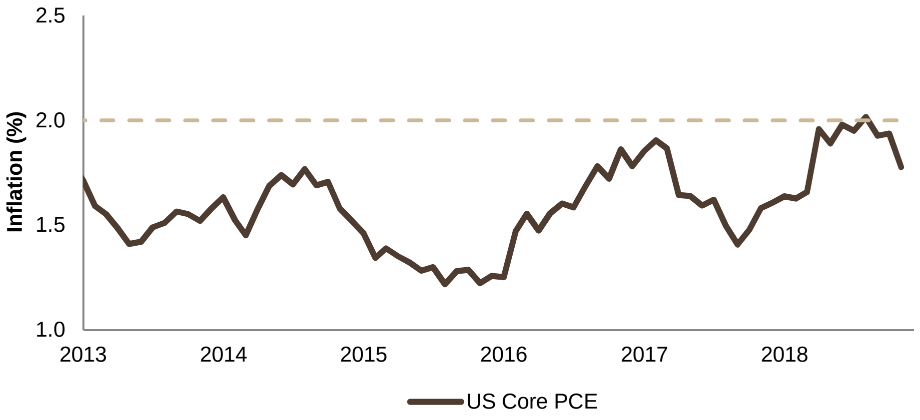
The market continues to expect a rate cut



UBS Economists expect the yield curve to flatten on shrinking labor market slack and negative inflation risk premium



Inflation has fallen below the Fed's 2% target



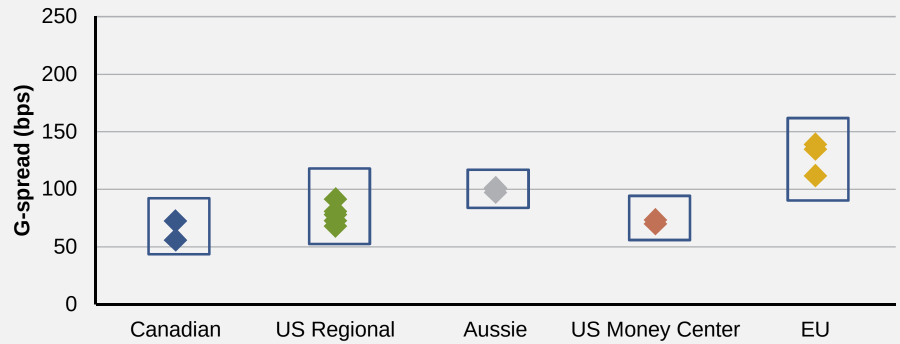
Observations

- The FOMC repeated its January language that it will be "patient" amid "global economic and financial developments and muted inflation pressures"
    - In the statement, there's a downgrade in the economic assessment: "activity has slowed from its solid rate in the fourth quarter"
- The committee announced that it would start slowing the shrinking of its balance sheet in May, and halt the drawdown altogether at the end of September
    - Beginning in October, the Fed will roll its maturing holdings of MBS into Treasuries, using a cap of $20bn per month
- Rates rallied following the FOMC's announcement, with rates rallying 10 to 12 bps across the curve

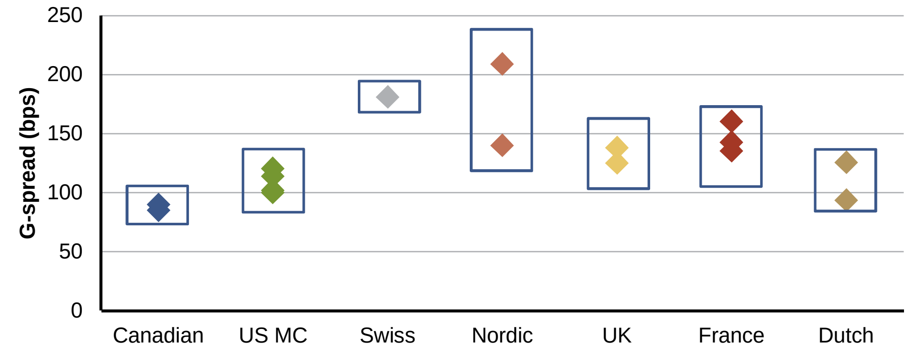
UBS Source: UBS CCS Analysis, Bloomberg

Global Bank USD Bail-in Senior Overview

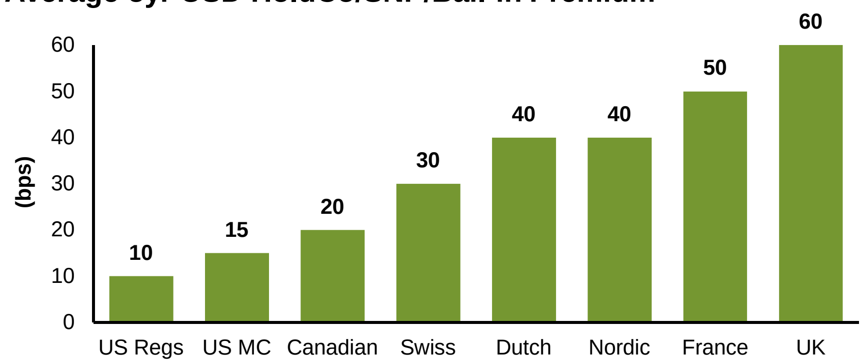
USD 5yr Relative Value – OpCo / Senior Preferred Legacy



USD 5yr Relative Value – HoldCo / Senior Non-Preferred/Bail-in

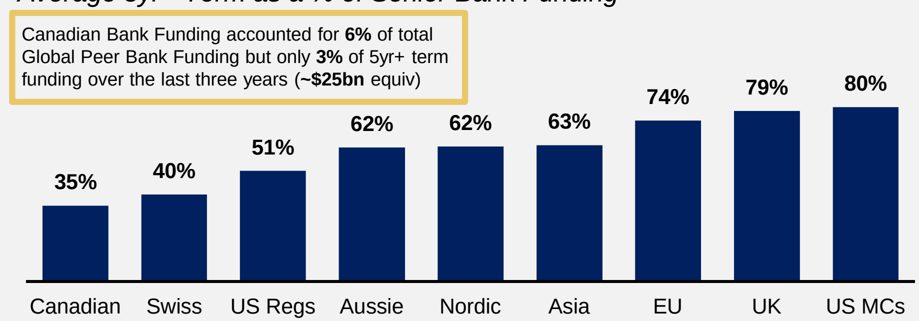


Average 5yr USD HoldCo/SNP/Bail-in Premium



Capacity Analysis – Relative Term Scarcity

Average 5yr+ Term as a % of Senior Bank Funding



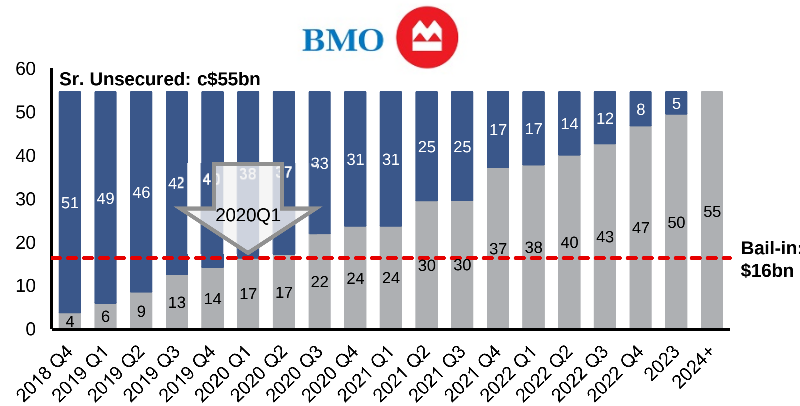
Issue Date	Ticker	Rating (M/S)	Ranking	Coupon (%)	Size ($mm)	Tenor	Maturity	Reoffer (bps)	Current T-Sprd (%)	Current G-Sprd (%)
Mar 2019	CM	A2/BBB+	Bail-in Senior	3.100	1,000	5-year	04/02/24	92	**93**	**93**
Mar 2019	BAC	A2/A-	Senior HC	3.458	2,250	6NC5	03/15/25	105	**102**	**102**
Mar 2019	LLOYDS	A3/BBB+	Senior NP	3.900	1,000	5-year	03/12/24	140	**138**	**138**
Mar 2019	TD	Aa3/A	Bail-in Senior	3.250	1,250	5-year	03/11/24	75	**75**	**75**
Mar 2019	HSBC	A2/A	Senior NP	3.803	2,500	6NC5	03/11/25	128	**125**	**125**
Feb 2019	GS	A3/BBB+	Senior HC	3.625	1,500	5-year	02/20/24	112.5	**114**	**114**
Feb 2019	BNS	A2/A-	Bail-in Senior	3.400	1,250	5-year	02/11/24	92	**85**	**85**
Jan 2019	BMO	A2/A-	Bail-in Senior	3.300	1,750	5-year	02/05/24	92	**88**	**88**
Jan 2019	WFC	A2/A-	Senior HC	3.750	3,000	5-year	01/24/24	125	**86**	**87**
Jan 2019	C	A1 / A+	Senior BK	3.650	2,250	5-year	01/23/24	117	**72**	**72**
Jan 2019	BNP	Baa1 / A-	Senior NP	4.705	1,700	6NC5	01/10/25	235	**159**	**160**
Oct 2018	RY	A2 / A	Bail-in Senior	3.700	1,500	5-year	10/05/23	78	**72**	**73**

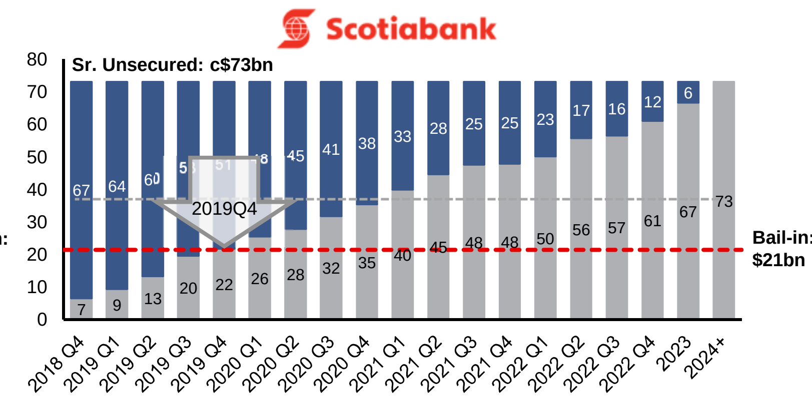
Note: 6NC5 structure used for Money Center TLAC relative value
Banks for 5-yr relative value analysis: (1) Canada (CIBC, TD); US Regionals (HBAN, USB, PNC, KEY, STI),Aussie (NAB, WSTP, CBA, ANZ), Money Centers (WFC); EU (Credit Mutual, BPCE, Rabo); (2) Money Centers (BAC, Citi, JPM, MS, GS); Swiss(CS); Nordic (Nordea, Danske); UK(Lloyds, HSBC); France(BNP, Credit Ag, BPCE); Dutch (Rabo, ING)
Source: Bloomberg, UBS CCS Analysis

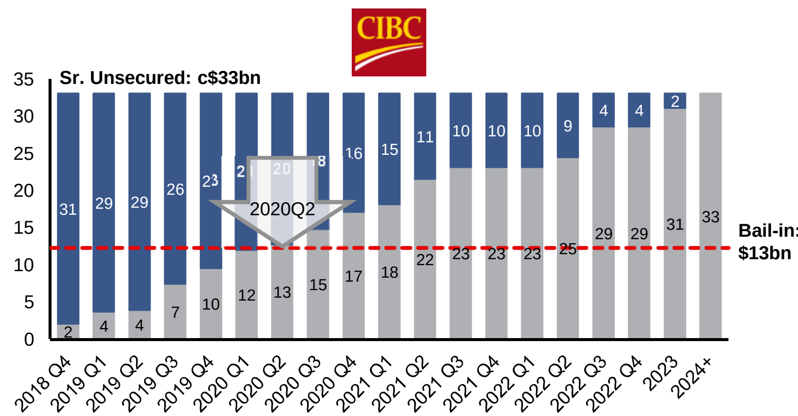
Comfortable Horizon for Building Bail-in Buffer

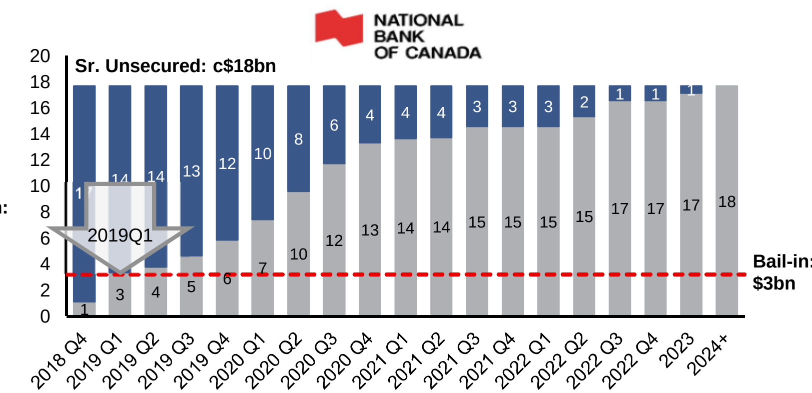
The nature of the banks existing senior maturity profile enhances flexibility, allowing gradual, organic refinancing of senior debt with issuance of Bail-in senior

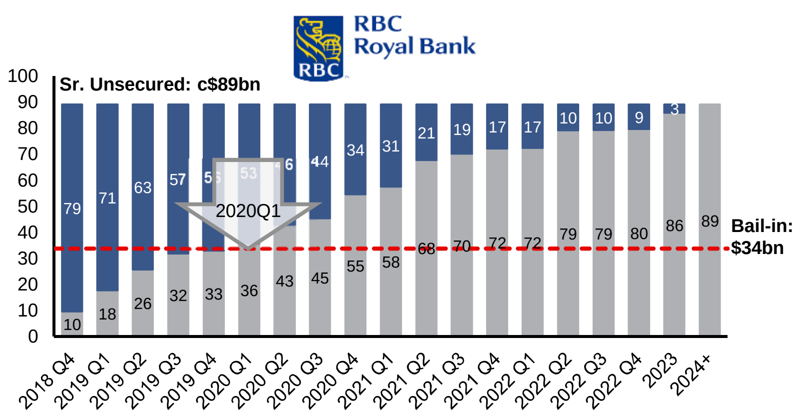
Implementation of Bail-in requirements are not expected to create incremental issuance needs, as maturing legacy senior debt can be comfortably refinanced with Bail-in senior before OSFI's deadline (Nov 2021)

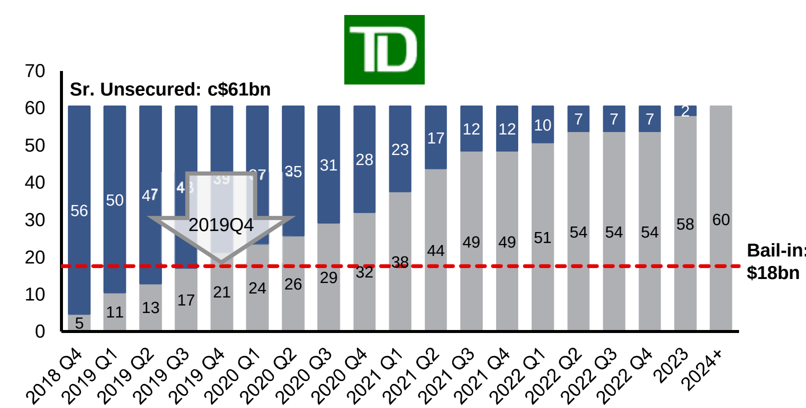












Grandfathered Senior Unsecured

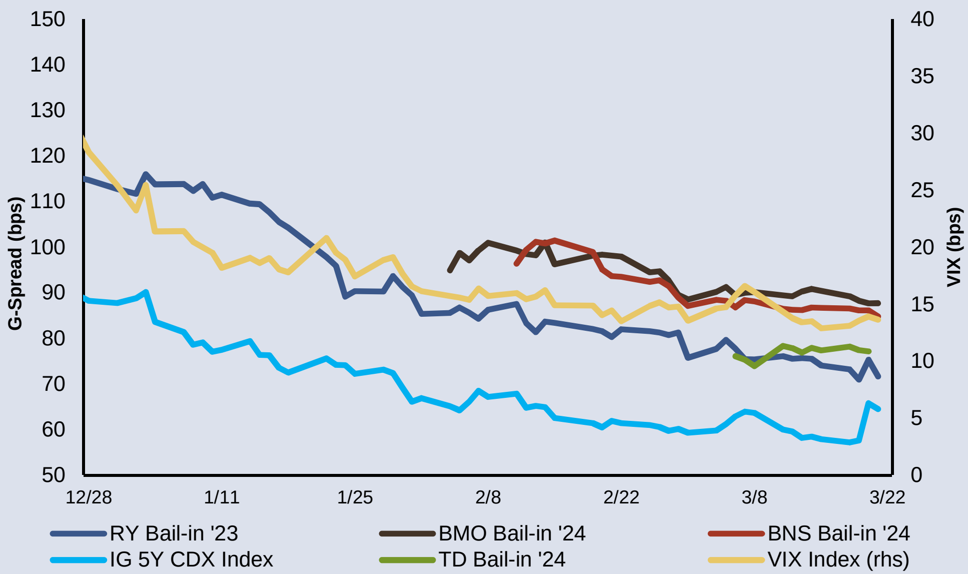
Refinanced TLAC Senior Unsecured

UBS

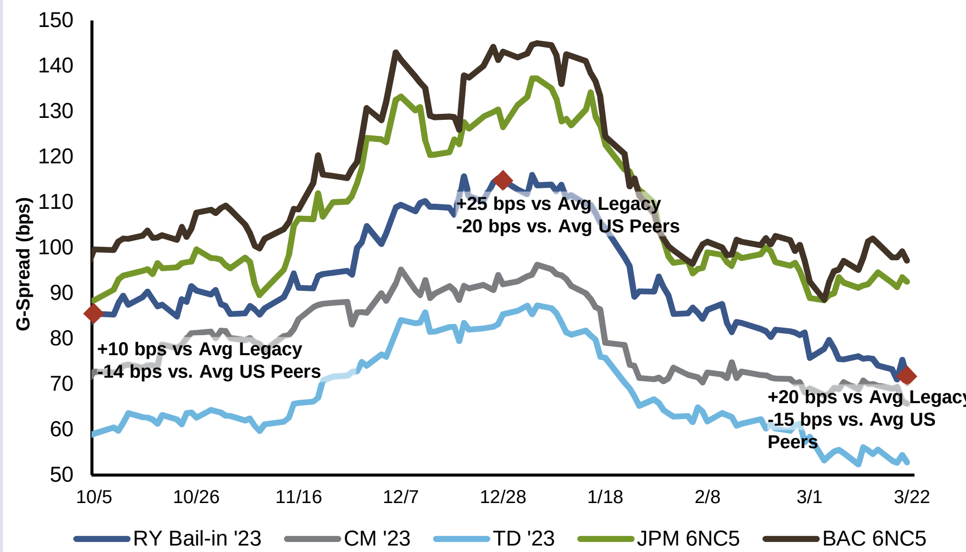
Source: UBS CCS Analysis, Bloomberg

Canadian Bail-in Secondary Performance and Considerations

Performance of Bail-in Senior 5-year versus Benchmarks



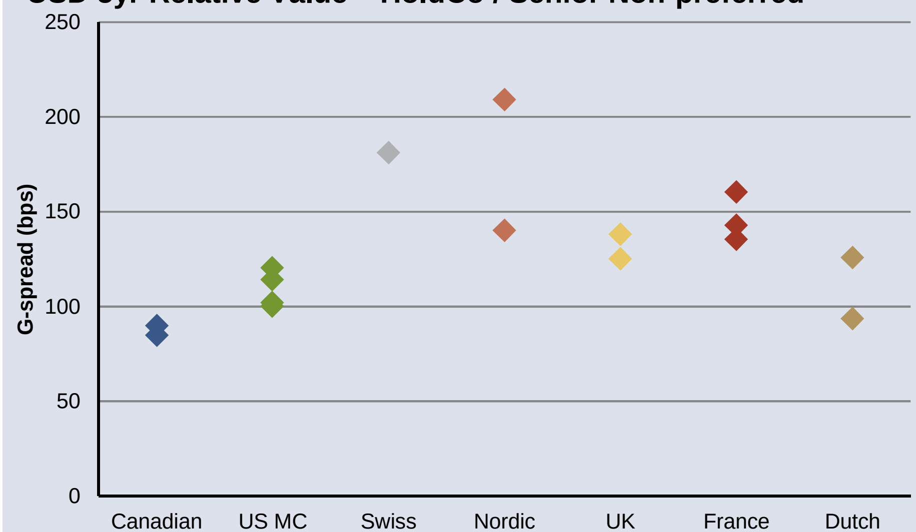
Bail-in versus Legacy Senior Differential



Recent Peer Secondary Spread Performance

	G-Spread (bps)			1-Month Change		2-Month Change	
	Jan	Feb	March	bps	%	bps	%
RY Bail-in '23	98	80	73	-7	-10%	-25	-27%
BMO Bail-in '24	--	98	88	-10	-10%	--	--
BNS Bail-in '24	--	94	85	-9	-10%	--	--
TD Bail-in '24	--	--	75	--	--	--	--
CIBC '23	74	71	65	-6	-8%	-9	-12%
TD '23	69	60	51	-9	-15%	-18	-26%
JPM 6NC5	117	99	93	-6	-6%	-24	-21%
BAC 6NC5	--	--	102	--	--	--	--

USD 5yr Relative Value – HoldCo / Senior Non-preferred



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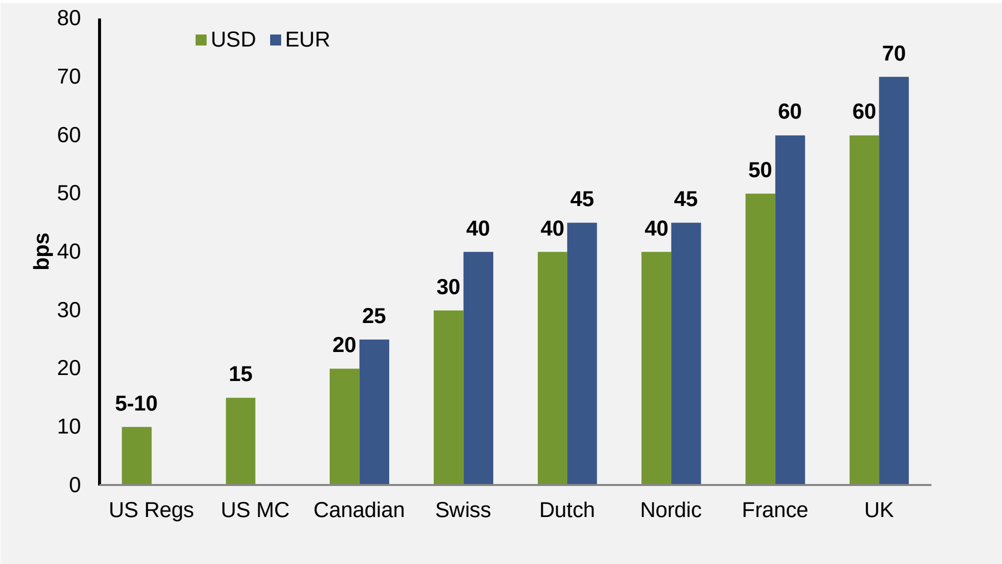
Source: Bloomberg, CCS Analysis

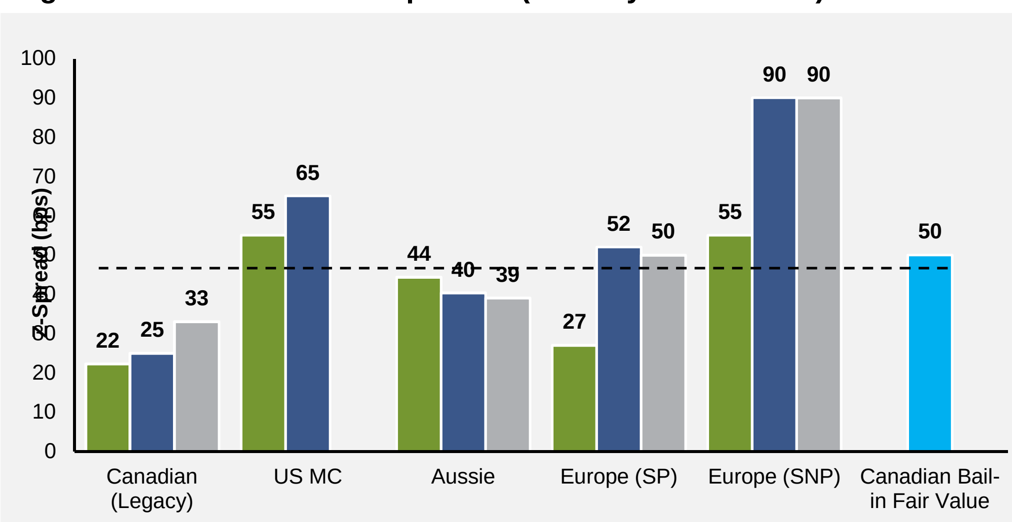
Banks for 5-yr relative value : (1) Canada (BNS, BMO, RY, TD); US Money Centers (BAC, JPM, MS, GS, WFC);Swiss (CS); Nordic (NDASS, DANBNK); UK(Lloyds, NWIDE); France(BNP, ACAFP, BPCE); Dutch (RABOBK, INTNED)

Global Bank EUR Bail-in Senior Overview

Average USD /EUR HoldCo-OpCO / SNP-SP Differentials



Regional Relative Value Comparison (EUR 5-year Duration)



Canadian 5-year EUR Bail-in Senior Fair Value Analysis

Method 1: Triangulating vs USD – using Canadian Bail-in Senior

	Holdco/SNP USD (G+)	Diff. to Avg CanadianBail-in	HoldCo/SNP EUR (MS+)	Implied Canadian FV
RY	75	-	-	**-**
BMO	85	-	-	**-**
BNS	85	-	-	**-**
JPM	80	-0	55	**55**
WFC	90	-10	65	**55**
NDASS	120	-40	85	**45**
RABOBK	100	-20	55	**35**
INTNED	120	-40	90	**50**
HSBC	120	-40	85	**45**
UBS	115	-35	90	**55**
				MS+45-55

Method 2: Building up from OpCo Differentials

A. Canadian Legacy EUR 5-year Senior Trading Levels

	Coupon (%)	Maturity	Reoffer (MS+)	Current (MS+)
BNS	0.375	Apr-2022	22	**24**
CM	0.750	Mar-2023	35	**33**
TD	0.625	Jul-2023	38	**25**
			5-year Legacy MS+25-35	

B. European Peer Bank EUR 5-year Senior New Issue Indications

	OpCo / SP (MS+)	HoldCo /SNP (MS+)	Differential	Implied Canadian FV
NDASS	30	85	+55	**85**
RABOBK	27	55	+28	**58**
INTNED	52	90	+38	**68**
BNP	35	90	+55	**85**
UBS	50	90	+40	**70**
HSBC	40	85	+45	**75**
				MS+60-70

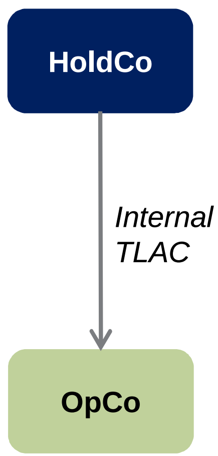
UBS

Source: Bloomberg, UBS CCS Analysis

Banks included in secondary market graph: Canada: BNS, TD, CM; US Money Centers: JPM,WFC; Aussie: WSTP, ANZ, NAB; Europe (SP): Rabobank, Nordea, ING, UBS

Comparison of Resolution Ranking Proposals

US / UK/ Swiss



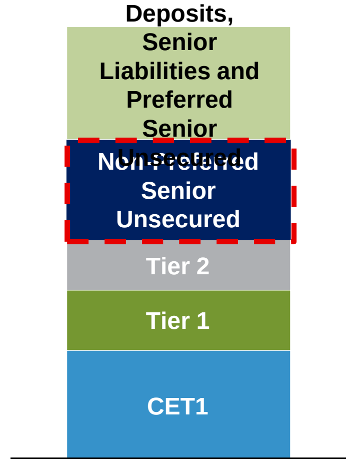
Key points:

- Structural subordination achieved by issuing senior unsecured from a non operating parent HoldCo entity
- In Switzerland an institution loses 50% credit in the penultimate year to maturity and fully in the last year

Considerations:

- ✓ Superior Resolvability model
- ✓ Established market for HoldCo product
- × Premium for issuing senior paper from their HoldCo
- × Operationally difficult to establish a HoldCo

French/ Spanish



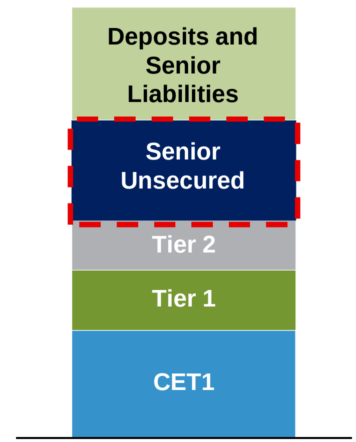
Key points:

- Law passed in December 2016
- A new class of liabilities has been created – non-preferred senior unsecured ranking
- The law is not retroactive

Considerations

- ✓ NCWO constraint addressed
- ✓ Flexibility for banks in choosing their liability structure
- ✓ Lower increase in cost of funding than German approach
- ✓ Clear bail-in structure
- × New contractual clauses need to be written

German



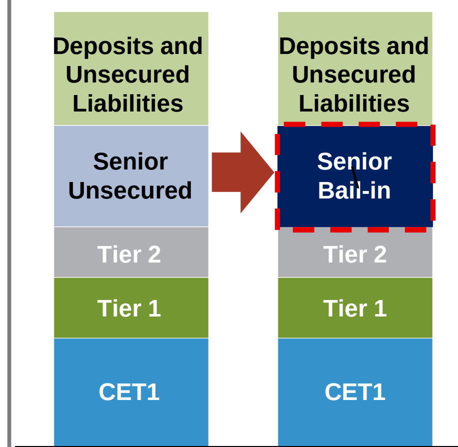
Key points:

- As of 1 January 2017, senior unsecured debt instruments will rank junior to senior liabilities and deposits
- The law is retroactive

Advantages:

- ✓ NCWO constraint addressed
- ✓ Clear bail-in structure:
- × Banks will have less flexibility when choosing their liability structure
- × Expected increase in cost of funding
- × Risk that investor mandates may no longer be allowed to invest in the instrument
- × Risk of substitution with lower risk instruments

Canadian



Key points:

- All senior unsecured debt (term >400 days) issued post the implementation date (September23, 2018) will be subject to bail-in
- Supplements the existing Non-Viable Contingent Capital (NVCC) regime for AT1 and Tier 2

Considerations:

- ✓ Single-class bail-in debt
- ✓ Statutory conversion feature (NVCC
- ✓ multiplier)
- ✓ Clear bail-in structure
- ✓ No incremental funding required
- ✓ Issued at parent bank operating company level
- ✓ Issued under existing programs

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UBS

Canadian Banks Operating in the US—New IRS Guidance

Tax Cuts and Jobs Act of 2017

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Agenda

- New US Base Erosion Anti-Abuse Tax
- New US Anti-Hybrid Rules

BEAT

Base Erosion Anti-Abuse Tax (“BEAT”)

- New IRC §59A – base erosion minimum tax
- This is a 10% tax on a US taxpayer’s taxable income computed without regard to certain related party interest and other expenses (“base erosion payments”).
- Taxpayers with base erosion payments that are less than 3% (2% for financial institutions) of all deductible expenses are not subject to the tax
- Certain derivatives expenses and losses excluded

BEAT, cont'd.

- Example:
- $100 of gross income, $90 of related party interest expense deduction = $10 taxable income
  - 21% tax rate, so $2.1 of tax without BEAT (($100-$90)*21%)
- BEAT: add back the $90 interest expense deduction so "modified taxable income" is $100 and section 59A tax is $7.9 ($100*10% = $10 - $2.1).
  - Total tax is $10
- Increase in tax is 475%

Proposed BEAT Regulations

- Proposed Regulations Issued December, 2018

Who Does BEAT Apply To? Applicable Taxpayer: Prop. Reg. section 1.59A-2

- A corporation other than a RIC, REIT or S corporation
- Satisfies $500 mm gross receipts test (1.59A-2(d))
- Satisfies base erosion percentage test (1.59A-2(e))
- Gross receipts test and base erosion percentage done on basis of aggregate group

Aggregate Group

- Group of corporations
- Controlled group (more than 50% vote or value)
- Exclude foreign corporations
  - Except with regard to U.S. effectively connected income (or net taxable income if treaty-based)

Base erosion payments: Prop. Reg. section 1.59A-3

- Any amount paid or accrued to a related foreign party where a deduction allowed under US Internal Revenue Code
- Any amount paid or accrued by taxpayer to related foreign party in connection with acquisition of depreciable property
- Premiums for reinsurance
- Other items

Exclusions from Base Erosion Payments: Prop. Reg. section 1.59A-2(b)(3)

- Services cost method amounts
- Qualified derivative payments
- Effectively connected income
- Exchange loss on section 988 transaction
- TLAC payments
- Amounts paid or accrued in TY beginning before January 1, 2018
- Business interest carry forward from TY beginning before January 1, 2018

Qualified Derivative Payment: Prop. Reg. section 1.59A-6

- Any payment made by a taxpayer to a foreign related party pursuant to a derivative if
  - Taxpayer marks to market annually
  - Mark to market gain or loss treated as ordinary
  - Taxpayer treats all items with respect to the derivative as ordinary
- Derivative
  - Any contract (including option, forward, futures, short position, swap or similar contract) the value of which (or any payment) determined by reference to stock, debt, actively traded commodity, currency or rate, price, amount, index, formula or algorithm (but not a direct interest in foregoing)

Internal TLAC: Prop. Reg. section 1.59A-3(b)(3))(v)

- Total Loss Absorbing Capital
- US Federal Reserve May Require TLAC for US Subsidiary of Foreign Financial Institution
- Proposed Regulations: exclude interest payments on Federal Reserve required “internal TLAC” from base erosion payment calculation
- Exclusion limited to amount required

Payments to a US Branch: Prop. Reg. section 1.59A-3(b)(3)(iii)

- Issue: a payment from a Canadian bank's US subsidiary to the Canadian bank's US branch is technically a payment to a "related foreign person" that would be added back for BEAT purposes
- Proposed Regulations: payment is not treated as a base erosion payment to extent subject to US federal income tax as effectively connected with a US trade or business
- Rationale: US branch is subject to US tax on its net income that is "effectively connected"

Amount of Tax: Prop. Reg. section 1.59A-5

- BEAT Tax Rate
  - 2018: five percent
  - 2019-2025: 10 percent
  - After 2025: 12.5 percent
  - Rate increased by one percentage point for a taxpayer that is member of an affiliated group that includes a bank or securities dealer

Anti-hybrid rules

Section 267A—outbound (from US) interest and royalties

Anti-Hybrid Rules

- In 2015 the OECD/G20 released Action 2 under the Base Erosion and Profit Shifting Project
- Action 2 is aimed at "hybrid" financial instruments
- It recommends that countries adopt tax rules that deny interest deductions on cross border instruments or transactions that give rise to an interest or royalty deduction in the payor's jurisdiction but no inclusion in the recipient's home jurisdiction (hereinafter "Home Jurisdiction")
- For example, debt in the payor jurisdiction treated as equity in Home Jurisdiction

Section 267A(a) (TCJA-2017)

- No deduction for "disqualified related party amount" paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity
- Disqualified related party amount
  - Interest or royalty
  - Paid to related party
  - Amount not included in related party's income in Home Jurisdiction or
  - Related party allowed a deduction in Home Jurisdiction

Proposed regulations—December 2018

Key Defined Terms—Specified Party (Prop. Reg. section 1.267A-5(a)(17))

- A “specified party” is a “tax resident of the United States, a CFC (other than CFC with respect to which there is not a United States shareholder that owns (within the meaning of section 958(a)) at least 10% (by vote or value) of the stock of the CFC), and a U.S. taxable branch.”

Specified Payment (Prop. Reg. section 1.267A-5(a)(18)/1.267A-1(b))

- "…any interest or royalty paid or accrued with respect to the specified party…"
- "Interest" is broadly defined in Prop. Reg. section 1.267A-5(a)(12):
  - Compensation for use or forbearance of money
  - Embedded interest in non-cleared swaps with significant non-periodic payments
  - Amounts affecting the effective cost of borrowing
- "Royalty" is defined in Prop. Reg. section 1.267A-5(a)(16)

Specified Recipient (Prop. Reg. section 1.267A-5(a)(19)

- **Specified recipient** means "with respect to a specified payment, any tax resident that derives the payment under its tax law or any taxable branch to which the payment is attributable under its tax law"
- Prop. Reg. section 1.267A-2(f) requires relationship to specified party
  - Prop. Reg. 1.267A-5(a)(14)[Section 954(d)(3) with qualifiers]
  - Includes a "party to a structured arrangement" under Prop. Reg. section 1.267A-5(a)(20)

Deduction/No Inclusion ("D/NI")

- The situation where, as part of one transaction, a taxpayer is allowed a deduction in one country while the recipient is not subject to tax on the receipt of the income under the laws of the recipient's country

Rule (Prop. Reg. section 1.267A-1(b)): A Specified Party's Deduction for a Specified Payment is Only Disallowed if:

- The payment is a "**disqualified hybrid amount**;"
- The payment is a '**disqualified imported mismatch amount**;" or
- The payment is a specified payment producing a D/NI outcome that the regulations classify as having **a purpose of avoiding the section 267A regulations**.

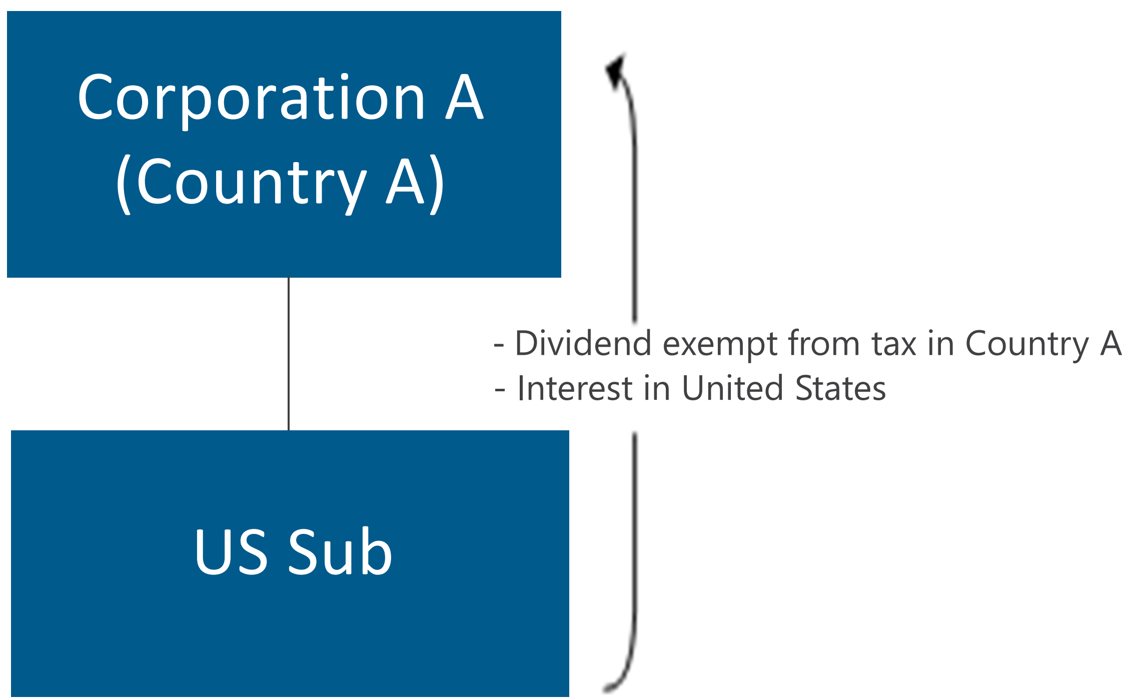
Prop. Reg. section 1.267A-2--Disqualified Hybrid Amount

- Rule: If a **specified payment** is made pursuant to a **hybrid transaction** then, subject to -3, the payment is a “**disqualified hybrid amount**” to the extent that:
  – A specified recipient does not include the payment in income (i.e., a “**no inclusion**”) and
  – The **specified recipient’s no inclusion** is a result of the payment being made pursuant to the hybrid transaction

Is the D/NI Result Caused by Hybridity?

- Under the Proposed Regulations, a D/NI outcome gives rise to a disqualified hybrid amount only to the extent that the D/NI outcome is a result of "hybridity."
- This is not always the case – for example, a hybrid transaction could have a D/NI outcome as a result of the specified recipient's tax law containing a pure territorial system (thus exempting all foreign source income from taxation);
- Or the specified recipient's tax law may not have a corporate income tax.

Example of Hybrid Transaction



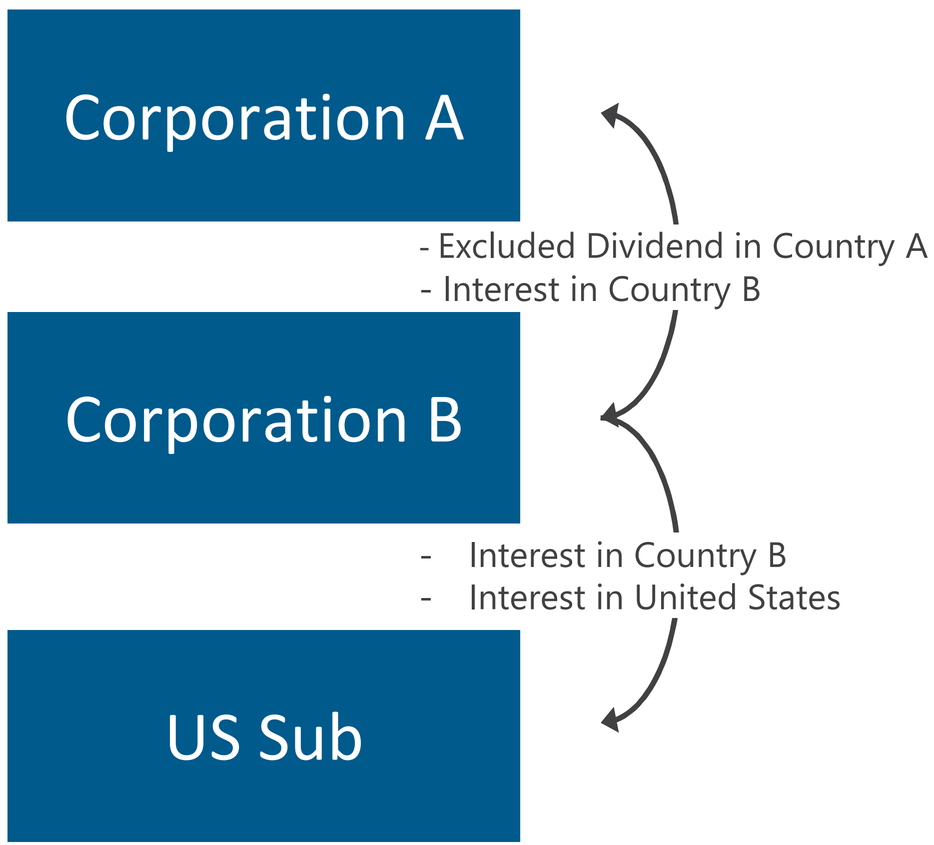
Prop. Reg. section 1.267A-4: Disqualified Imported Mismatch Amount

- This rule addresses the situation where, between the US and a foreign country there is no hybrid, but the D/NI result occurs in the foreign country through a hybrid
- Thus, a payment is generally a disqualified imported mismatch amount where (a) the specified payment is non-hybrid in nature, such as interest paid on an instrument treated as debt for both US and foreign tax purposes, and (b) the income attributable to the specified payment is directly or indirectly offset by a hybrid deduction of a foreign tax resident or taxable branch.

Prop. Reg. section 1.267A-4: Disqualified Imported Mismatch Amount (cont.)

- A hybrid deduction for purposes of the imported mismatch rule is generally an amount for which a foreign tax resident or taxable branch is allowed an interest or royalty deduction under its tax law to the extent the deduction would be disallowed if such tax law were to contain rules substantially similar to the Proposed Regulations.
- So ask: what if foreign country adopted section the Proposed Regulations.
- Connection required: imported mismatch payment must “fund” the hybrid deduction directly or indirectly

Example of Disqualified Imported Mismatch



From a US Taxpayer's Perspective

- Identify all interest and royalties
- Determine whether paid, directly or indirectly, to a related foreign party
- Determine tax treatment of payment in Home Jurisdiction
- A first of a kind exercise from a US federal income tax standpoint

Effective Date

- The Proposed Regulations are generally effective for hybrid dividends and specified payments made in taxable years beginning after December 31, 2017 if they are finalized by June 22, 2019.
- However, if the Proposed Regulations are not finalized by June 22, 2019, they would be effective December 20, 2018.
- Treasury has requested comments on the Proposed Regulations, which were due by February 26, 2019.

Update on Current Developments Affecting Financial Institutions

Agenda

- Update on LIBOR
- Index inclusion
- TLAC/MREL eligibility
- Financial services update

LIBOR

LIBOR: Current Status for Floating Rate Notes

Cessation triggers, fallback rate and a spread adjustment have been put forth for comment; ARRC hasn't published any final versions yet.

- ISDA published two cessation triggers for LIBOR derivative instruments, based on permanent LIBOR discontinuance.
- The most recent ARRC FRN working group consultation added three more, which allows for a transition from LIBOR to a replacement rate without a permanent discontinuance of LIBOR.
  - An unannounced stop to LIBOR, or a permanent discontinuance not meeting the ISDA triggers;
  - A material change to LIBOR (too few panel submissions); and
  - Useless LIBOR – an announcement by a regulator that LIBOR is no longer representative
- Final fallbacks expected to be published shortly
- Fallback rate waterfall:
- Six proposals, including term SOFR, which will not be ready until at least 2021
- Compounded SOFR in arrears
  - This was the choice of market participants responding to the July 2018 ISDA consultation for non-USD IBORs
  - FRN market participants most likely to agree on the same choice in the absence of term SOFR
  - Spread adjustment:
- For cash products, ARRC may publish its choice by the end of 2019

Adjusting Your New Deals Now

- Include updated fallback/LIBOR replacement provisions;
- Make clear that the issuer, the calculation agent or another party may have to exercise discretion; and
- Risk factors:
  - Potential conflicts of interest
  - Potential that the calculation agent's choice of a replacement rate, spread adjustment or other adjustment may result in a rate that will be less favorable then the rate that would have resulted from the "old" LIBOR fallbacks
  - Potential that, in a "zombie LIBOR" situation, the quoted zombie LIBOR rate may be more favorable to investors than the replacement rate chosen as per the note's terms

Existing LIBOR notes with the old fallbacks – what to do?

- Depends on where the last fixing ends – if favorable for investors, issuers may let things rest
- Unfavorable for investors:
  - 100% consent needed to change in interest rate under a TIA – qualified indenture
  - Legislative solution – ARRC discussing potential legislation that would state that existing LIBOR FRNs would be deemed to be amended to replace LIBOR references with the replacement rate and spread adjustment chosen by ARRC
  - But nobody's discussed yet with the NYS legislature

Index Inclusion

Index inclusion

- Many institutional investors are focused on whether a new tranche or new issue will be included in bond indices:
  - Section 3(a)(2) securities are “public” and are included in bond indices from issuance date
  - By contrast, Rule 144A securities generally will not be included in bond indices until an A/B exchange offer has been completed or the one-year holding period has passed and the entire position has moved to an unrestricted CUSIP
  - Bond index inclusion may affect liquidity

MREL/TLAC

European Banking Authority

- Recently, the EBA published Q&As relating to MREL eligibility
- To qualify as an MREL eligible liability, liabilities shall only be included if they satisfy all the conditions set out in Articles 45(4) of the BRRD
- Pursuant to the BRRD, an eligible liability "cannot be owed to, secured by, or guaranteed by the institution itself"
- Because Section 3(a)(2) notes of foreign (non-US) banks are guaranteed by a US branch, which is (according to the EBA) the same legal entity, Section 3(a)(2) notes are not eligible liabilities for MREL purposes

Financial Services Update

Financial services update

- FDIC has proposed changes to leverage limits for the custody banks
- Banking agencies, SEC, and CFTC appear to be headed toward reproposing Volcker Rule changes
- Banking agencies also appear to be reconsidering the proposal to integrate capital requirements and stress testing with the stress capital buffer
- Other changes on the horizon . . .