

UBS Exchange Traded Funds

Frequently Asked Questions



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UBS ETFs	3
Replication Methodology	4
Securities Lending	5
Performance and Costs	7
Trading and Liquidity	8
Commodities ETFs	9
Other	10
Contacts	11

UBS ETFs

How long have UBS ETFs been in existence?

The first UBS ETF was launched in 2001. UBS ETFs have three platforms: in Ireland, in Luxemburg, and in Switzerland. UBS ETF SICAV was incorporated in the Grand Duchy of Luxembourg as an open-ended investment company (a "Société d'Investissement à Capital Variable") on September 7, 2001 for an unlimited period under the original name of "Fresco". The Company qualifies as a self-managed SICAV and is governed by Luxembourg law. The first ETF on the UBS platform in Switzerland was approved by the Swiss Federal Banking Commission and listed on the SIX Swiss Exchange (SIX) in 2003. In 2010, a fund company was established in Ireland.

Have you always labeled your products with UBS ETFs?

On December 1, 2004, the name "Exchange Traded Funds" replaced the old "Fresco Index Shares", bringing the name of UBS ETFs into line with the branding used for the rest of our fund range.

How are UBS ETFs different from other ETF providers?

UBS offers a comprehensive product line that includes both physical and synthetic replicated ETFs with competitive fees. Our ETFs are often listed on multiple stock exchanges in multiple trading currencies. UBS ETFs offer a multi-share class architecture with listed A and I share classes for most of its ETFs. In addition, UBS ETFs have demonstrated a successful long-term performance track record and all products have a low tracking error due to conservative index tracking (physical replicated) or fixed performance drag approach (synthetic replicated). UBS ETFs are operated by an experienced investment team and dedicated product specialists. Our ETFs have high on-exchange and off-exchange liquidity due to a multi-market maker approach. For cash-based UBS ETFs, we employ a leading securities-lending program in conjunction with State Street Bank and UBS Investment Bank, with fully collateralized loan values. In addition, our swap-based ETFs offer zero tracking error.

Replication Methodology

What is the replication methodology for UBS ETFs?

Generally there are two types: cash-based (physical replicated ETFs) and swap-based (synthetic replicated ETFs).

Within cash-based (or physical replicated) ETFs, there is full replication and stratified sampling. With the fully replicated cash-based approach, the ETF physically holds all securities in the index according to index weightings and index adjustments, and corporate actions require regular transactions.

With the stratified sampling cash-based approach the ETF physically holds a sub-set of index constituents. The performance of the basket is based on the physical holdings in the ETF. Optimization strategies/tools are applied to reduce transaction costs, increase liquidity and minimize tracking error. UBS Portfolio Management in London uses analytical tools to define a sub-set of the index constituents which will provide a return similar to the original stocks in the index. The maximum tracking difference according to the prospective is 5%. Currently, stratified sampling is being used for only three ETFs.

Swap-based or synthetic replicated ETFs means the fund doesn't actually hold the underlying securities of the index, but instead relies on swaps to deliver the performance of the index. There are total return (or unfunded swaps) and fully-funded swaps.

How does a total-return (i.e. unfunded) swap-based replication method work?

The ETF holds a basket of securities agreed between the portfolio manager and swap counterparty; the final decision rests with the portfolio manager. The basket may contain only part of the index constituents, or even include securities not related to the underlying index. The performance of the basket is exchanged against the performance of the underlying index. The swap counterparty guarantees the total return performance, less fees and expenses, of the fund (constant performance drag), which leads to zero tracking error. The swap counterparty generates the index performance by investing in securities or derivatives which track the index performance. Counterparty risk in the fund is limited to 10%, to be in line with UCITS IV.

How does a fully-funded swap-based replication method work?

The ETF pays the cash-inflow from the client to the swap counterparty. Counterparty risk is mitigated through 105% collateralization using only G10 bonds. The fund holds only a fully-funded swap. The fully-funded swap delivers the performance of the underlying index. The swap counterparty guarantees the total return performance less fees and expenses of the fund (constant performance drag) which leads to zero tracking error. The swap counterparty

generates the index performance by investing in securities or derivatives which track the index performance.

Which replication methods do swap-based UBS ETFs employ?

UBS has cash-based and swap-based ETFs. The majority of its cash-based ETFs are fully replicated. Stratified sampling is being used with three of its ETFs. Currently, the majority of UBS synthetic replicated ETFs are following the combined model approach: fully funded/unfunded swap and asset portfolio.

Who are the swap counterparties for UBS?

For all UBS ETFs, the UBS Investment Bank is the exclusive counterparty for all OTC swap transactions. The long-term counterparty credit ratings are: S&P: A (29.11.11) und Moody's A2 (21.06.12).

Is swap exposure collateralized? What are the minimum collateral quality standards?

Yes. Counterparty risk associated with OTC derivatives is mitigated through collateralization of the exposure under the relevant swap using G10 government bonds. Collateral is held in a segregated account in the name of the fund (transfer of ownership model).

Who is custodian of swap collateral?

State Street is the custodian of swap collateral for all UBS swap-based ETFs except for the UBS-IS CMCI Oil ETF which is in custody by UBS AG.

How often is the level of collateral for each swap monitored and marked-to-market?

Daily.

What is the minimum swap collateralization level and how is it enforced?

The minimum level for fully funded swaps is 105%, and 102% when securities are lent out. Under UCITS regulations, a fund cannot have a counterparty exposure greater than 10%.

What happens if the swap counterparty, UBS Investment Bank London, defaults?

Because the collateral is owned by the fund (vs. pledged) in the fully-funded swap structure, the collateral reverts to the fund. Then a new swap counterparty would be appointed by UBS Global Asset Management.

Why are the UBS swap-based ETFs domiciled in Ireland?

UBS has an existing management company domiciled in Ireland, which has a proven track record in managing swap based structures.

Securities Lending

Do UBS ETFs participate in securities lending?

Yes, some UBS physical-replicated ETFs domiciled in Luxembourg and in Switzerland participate in securities lending. For the Irish ETF business, we do not participate in securities lending. Also, UBS precious metals and fixed income ETFs do not carry out any lending transactions.

Why do UBS ETFs participate in securities lending?

Securities lending by the fund generates additional revenues (typically 1 to 20 bps depending on the index). Securities-lending revenues are reflected in the NAV, therefore directly reducing the net cost to investors. The securities-lending revenues from within the ETF can help investors offset the total expense ratio (TER) incurred while holding their ETF position. In addition to the securities lending that occurs at the fund level, the investor may also be able to participate in securities lending of their actual ETF shares. He/she should contact his/her client advisor.

Who is the securities lending agent for UBS ETFs?

The securities lending agent for the Luxembourg product range is State Street Bank GmbH London Branch and State Street Bank and Trust. For the Swiss UBS ETFs, UBS AG acts as both the lending agent and borrower.

Who are the securities lending borrowing counterparties for UBS Luxembourg-domiciled ETFs?

State Street acts as lending agent. The Borrower list of the lending agent is approved by UBS representatives. In addition, it matches with the UBS counterparty list. The counterparty risk is fully monitored on a daily basis by the lending agent, State Street. State Street also provides borrower default indemnification in the event that a borrower is unable to return securities. Securities lending transactions of UBS ETFs are fully collateralized.

Who are the securities lending borrowing counterparties for UBS Swiss-domiciled ETFs?

UBS AG is the only borrowing counterparty (principal) to the ETF guaranteeing all contractual duties and protecting the ETF from any hypothetical default of UBS AG's borrowers. To protect the ETF against the UBS counterparty risk UBS AG provides collateral according to stringent FINMA regulations (Collective Investment Schemes Ordinance).

What is the general process for Luxembourg UBS ETFs securities lending?

1. The terms of the trade are agreed between the lending agent and the borrower, and collateral is delivered.
2. Once the collateral has been received by the lending agent, the lent securities are transferred to the borrower.
3. The lender (i.e. the ETF) remains the beneficial owner of the security on loan. As such, the lending agent collects all entitlements paid on each security whilst on loan and passes these back to the lender as a manufactured payment. The lender is in the same economic position as if the security had not been lent.
4. The borrower pays the lending agent the pre-agreed lending fee. Payments are agreed and made on a monthly basis.
5. The borrower returns the securities once the demand is fulfilled, or earlier if the lender liquidates a position. All trades are callable on demand on a daily basis and no fixed term trades are entered into.
6. Once the security has been returned to the lender's custody account, the lending agent returns the collateral held to the borrower.

What is the general process for Swiss UBS ETFs securities lending?

1. UBS AG borrows securities from UBS ETF.
2. UBS AG provides collateral including safety margins + haircuts (over-collateralization). A daily mark-to-market process ensures that the value of the collateral that UBS AG provides is always adjusted to the correct level.
3. UBS AG will usually lend the securities in the market against a fee. These market transactions are done in the name and risk of UBS AG.
4. Fees received from the market borrower are shared according to a pre-agreed fee split arrangement between the UBS ETF and UBS AG.
5. UBS AG passes on any corporate actions to the ETF. Coupons and dividends will be paid to the ETF via a "manufactured" substitute payment ensuring the ETF is economically at least in the same position as it would be if the securities were not borrowed.
6. UBS AG will return the securities to the ETF upon termination of the loan, or if the ETF wishes to regain the securities, for example in case of a sale. The ETF portfolio manager can sell securities anytime even though they are lent as securities lending does not interfere with the main investment process.
7. Collateral level will be adjusted as per (2) above.

How are the securities lending loans collateralized for the Luxembourg-domiciled UBS ETFs?

Securities lending transactions for UBS ETFs set up in Luxembourg are fully collateralized. The Luxembourg regulator requires a minimum of 90%; however, UBS ETFs over collateralize to 102% on US equities and 105% on international equities. UBS ETFs only accept securities issued by G-10 countries (except Japan and Italy) and Austria, Denmark, Finland, Norway and New Zealand, and world equities. The collateral is held in a custodian account that is ring-fenced from the lending agent's balance sheet. Further risk mitigation measures are careful selection of borrowers and revaluation of loans and collaterals on a daily basis.

How are securities lending loans collateralized for Swiss-domiciled UBS ETFs?

Securities lending transactions for Swiss-domiciled UBS ETFs are fully collateralized. UBS AG has a very

robust collateral setup which is in accordance with FINMAs Collective Investment Schemes Ordinance. UBS ETFs over collateralize to a minimum of 105%. The collateral consists of liquid assets including government securities, liquid equities (with a 15% haircut) and bonds with a minimum rating stipulated by one of the FINMA approved rating agencies. Further concentration limits ensure proper diversification of the collateral portfolio. A daily mark-to-market process ensures that the collateral value is adapted to reflect the loan value. Collateral is transferred in the name of the lender in a segregated collateral account which is remote from the bankruptcy estate of UBS AG.

What is the maximum amount lent from a fund for UBS ETFs?

There is no maximum loan level agreed, a fund can lend 100% of its assets and receive collateral accordingly. This is true for Luxembourg- and Switzerland-domiciled UBS ETFs. In practice, effective lending rates observed usually tend to be much lower.

Performance and Costs

How should I evaluate the performance of an ETF?

The performance of an ETF should be compared to the index and to other ETFs on the same index. It helps to compare the performance over several years as the best-performing ETF on a product can change from one year to another. For ETFs paying annual or semi-annual dividends, these payments should be reinvested in order to adequately compare them to ETFs that do not distribute dividends.

How does securities lending impact performance?

The reason ETFs engage in securities lending is the revenue gained to the fund, which positively impacts performance. For funds with highly desirable assets (from a lending perspective), such as European stocks, the extra revenue can partly or greatly offset the management fee of the fund.

What are the costs that can negatively impact performance?

There are several factors that can negatively impact a fund's performance: management fees, collateral costs, trading costs, rebalancing costs and cash drag (although depending on index performance, cash drag has a potential to have a positive impact on performance). These are the basic costs to manage the fund. Management fees are probably the most visible of these, but are usually not the only consideration. Trading costs, rebalancing costs and cash drag are factors that signify the importance of a skilled provider. Skilled ETF providers, such as UBS, may be characterized by having an experienced portfolio management team, dedicated index research analysts and global trading capabilities. These attributes are major factors in limiting costs that can negatively impact ETF performance.

What causes tracking error in UBS ETFs?

For physical-replicated ETFs, the following may cause tracking error: different withholding taxes applied to the index vs. the fund, different reinvestment dates for the dividends, cash drag, management of index events and securities lending income. Therefore it is important to have an experienced portfolio management team with a long track record in passive management, such as UBS.

For UBS swap-based ETFs, we have applied the concept of zero tracking error so that the fee structure is totally transparent to investors. The result is that the investor knows in advance exactly how much he/she will underperform the index being tracked, with no tracking error.

What's the difference between UBS "A" and "I" share classes?

UBS offers multi-share classes on the majority of its ETFs, with the "A" share classes, for private clients, and the "I" share class, which targets the needs of institutional investors and high net worth private clients. Both classes can be purchased by all investors. "I" share classes have management fees significantly lower than "A" share classes and have higher NAVs, with the majority of orders handled over-the-counter (OTC). Both share classes feed the same pool of assets, resulting in efficient portfolio management, while providing choices to investors. Both classes can be purchased by all investors.

What are the different types of fees assessed for UBS ETFs? What are the differences between flat fee, management fee, TER and drag level?

Cash-based UBS ETFs disclose management fees, while swap-based UBS ETFs disclose flat fees. Fully replicating ETFs disclose total expense ratio (TER) in semi- and annual-reports. The drag level and flat fee are typically set at the same level; however, there are exceptions when the flat fee is less than the drag level. The drag level is the sum of all costs applied to the fund, including all costs applied to the swap. As a result the fund tracks the index, less the drag level, with no tracking error.

Do you pay out dividends?

All cash-based ETFs pay out dividends according to their pay-out schedules. Pay outs can be made on a monthly, quarterly or yearly basis. All swap-based ETFs usually accumulate and therefore there is no pay out of dividends to investors.

Trading and Liquidity

How is the liquidity level of an ETF identified?

There are two layers of liquidity when it comes to ETFs. The first layer of liquidity for an ETF is the on-exchange liquidity for the secondary market. Designated market makers have contractual agreements with the exchanges and are obliged to provide continuous quotes during trading hours, ensuring low spreads and consequently a high level of liquidity. Therefore, the number of quoted shares in connection with low spreads measures the liquidity of ETFs.

The second layer is measured through the liquidity of the underlying assets themselves. If underlying assets in the fund are illiquid, it can lead to difficulty in the creation of new shares. Since the market maker must hedge open positions with the underlying, the liquidity of the underlying is reflected in the liquidity of the ETF on the secondary market. The easiest measures for judging liquidity is bid/ask spread. For an investment decision consider ETFs with small spreads and sufficient bid/ask volume.

What are bid/ask spreads?

The bid/ask spread for ETFs is the difference between the prices quoted by market makers for an immediate sale (ask) and an immediate purchase (bid). The size of the bid-offer spread in a security is one measure of the liquidity of the market and of the size of the transaction cost. The investor initiating the transaction is said to demand liquidity, and the other party of the transaction, the market maker, supplies liquidity. Investors place market orders and the market maker places limit orders. For a round trip (a purchase and sale together) the investor pays the spread and the market maker earns the spread. The bid/ask spread is an accepted measure of liquidity costs in ETFs. On any standardized exchange, two elements comprise almost all of the transaction cost – brokerage fees and bid-ask spreads (liquidity costs).

How is liquidity ensured for large redemptions (for cash-based ETFs)?

For redemptions in kind, the underlying shares are delivered from the fund to the authorized participants (APs). If the fund receives the redemption versus cash, the fund has to sell the underlying shares. To avoid liquidity-driven issues, the following restrictions are defined in the prospectus for Luxembourg ETFs: *“Procedures for redemptions in cash represent 10% or more of any sub-fund. If for a subfund any applications for redemption for cash is received in respect of any one cash redemption day (the “first cash redemption day”) which either singly or when aggregated with other applications for redemptions for cash so received is more than 10% of the NAV of that sub-fund (or such other percentage as the directors may in their discretion apply to ensure the interests of remaining shareholders are protected), the company reserves*

the right in its sole and absolute discretion to scale down pro rata each application with respect to such first cash redemption day so that a minimum of 10% of the NAV of the relevant sub-fund will be redeemed on that first cash redemption day.”

What is OTC trading?

Over-the-counter (OTC) or off-exchange trading is to trade ETFs directly between the investor and the authorized participant. It is contrasted with exchange trading, which occurs via facilities constructed for the purpose of trading (i.e., exchanges), such as futures exchanges or stock exchanges.

Who is allowed to subscribe in an UBS ETF?

Only authorized participants who have an authorized participant contract with the ETF may subscribe.

What is an authorized participant?

An authorized participant has an authorized participant contract with the ETF. The authorized participant actually buys or sells shares of an ETF directly from or to the fund, which are usually exchanged in-kind with baskets of the underlying securities or in cash. Authorized participants may wish to invest in the ETF shares for the long-term, but usually act as trader on the open market, using their ability to exchange creation units with their underlying securities to provide liquidity of the ETF shares and help ensure that their intraday market price approximates to the net asset value of the underlying assets.

Are there special conditions when buying ETF's through UBS E-Banking?

A discount of 25% is offered on UBS eBanking for transactions up to a volume of CHF 200'000.

Is it possible to buy UBS ETFs at the stock exchange in Frankfurt even if the fund is not registered for distribution in Germany?

A fund without distribution registration in Germany cannot be listed at the stock exchange in Frankfurt. The same would apply in Switzerland (i.e., an ETF not registered in Switzerland may not be listed at the SIX Swiss Stock Exchange).

When does the Swiss federal stamp duty apply?

The Swiss federal stamp duty of 0.075% applies to ETFs transactions on SIX Swiss Exchange for Swiss-domiciled ETFs. For funds listed in Switzerland, but domiciled outside of Switzerland (such as Luxembourg and Ireland domiciled UBS ETFs), the Swiss federal stamp duty is 0.15%.

Why can I not include any ETF's in the fund savings account (Fondskonto)?

This is due to the fact that ETF shares cannot be traded in fractions.

Commodities ETFs

How are the UBS precious metal ETFs physically replicated?

UBS ETFs that track physical metals invest predominantly in the respective physical metal in the form of standard bars. An exception is the UBS-IS Gold ETF which is invested entirely in physical metal. This ETF does not contain a precious metal account.

How high is the counterparty risk? Can I still withdraw my metals physical if UBS has to file for bankruptcy?

There is no counterparty risk from metal derivatives, as the funds invest mainly and the UBS-IS Gold ETF entirely in physical metals. Lending and borrowing is not permitted. The metal bars are physically segregated and stored in a high-security vault in Switzerland. Investors have the right to redeem in kind (i.e. in physical bars) for the standard bars. Delivery at any UBS branch in Switzerland (no physical delivery outside of Switzerland by UBS) and delivery to third-party banks is offered. Because the funds are legal entities in themselves, bankruptcy of the provider (UBS) would have no impact on investors' ability to redeem in kind or via an exchange.

What is the effect of contango and backwardation on the UBS commodities ETFs?

A commodities market is in contango when the price of a futures contract exceeds the expected spot price

is less than the expected spot price at contract expiration. In traditional commodity indices, roll losses are common during times of contango because as contracts mature, they leave the index when they are at a lower price and are replaced with new contracts at a higher price. Specifically, CMCI is the first commodity index that allows diversification across maturities, not only giving a more continuous exposure to the asset class but also avoiding the speculative activity that can surround monthly rolls of traditional indices. The CMCI Composite Index is designed to perform in both contango and backwardated markets.

How does the currency hedge work for commodity ETFs?

The swap-based commodity funds deliver the index with zero tracking error and a fixed drag level. Therefore, it is the calculation of the hedged index that the investor should consider when looking at the currency risk. The currency impact of the hedged index to the base currency index is minimal as the hedged index is calculated daily by applying the correct FX rate to the base currency index.

In general, what is the issuer risk for ETFs? What happens if UBS goes bankrupt?

In contrast to ETCs and ETNs, ETFs hold underlying securities in a ring-fenced separate account exposing the investor to no issuer risk.

Where can I find index components?

On a daily basis, UBS ETFs disclose the entire basket composition file to authorized participants (APs). To the public, UBS ETFs would like to publish the fund holdings on a daily basis – however, some index providers prohibited us from doing so. On the UBS Internet website the following data with a delay of 10 days are disclosed:

- Top 10 holdings and their weightings
- Sector diversification, country, geographic allocation, number of stocks in the fund, volatility measures and performance returns
- Median market cap, P/E ratio, P/B ratio, 30-day yield, ROE, earnings growth rate, turnover rate for the most recent year, expense ratio and cash investment
- Tracking error, Sharpe ratio and correlation

Are dividends paid out on UBS ETFs?

UBS ETFs are distributing and pay out dividends if the underlying securities in the fund distribute dividends. Since precious metals generate no income, no dividends are distributed. The equity and real estate UBS ETFs established in Switzerland normally distribute dividends twice a year. Interim dividends are also possible. The physically replicated UBS ETFs established in Luxembourg and Ireland distribute the accrued dividends (on equity ETFs) and coupons (on bond ETFs) twice a year. Interim dividends are possible here as well. By contrast, the synthetically replicated UBS ETFs established in Ireland reinvest (accumulate) the dividends. Precious metal ETFs are set up as distributing funds.

When are dividend payments made?

As a rule, for physically replicated ETFs established in Luxembourg and Ireland, interim dividends are distributed in July and final dividends are paid in January. For ETFs established in Switzerland, interim dividend payments may be spread out over the year.

Are dividends distributed gross or net?

UBS ETFs domiciled in Switzerland normally distribute net dividends. UBS ETFs with tax domicile in Luxembourg and Ireland pay gross dividends as a rule.

Where can I find information on dividend payments?

UBS publishes ex-dates and payment dates on its website: www.ubs.com/etf.

For more information, please check our publications on our website:

➤ www.ubs.com/etf

Contacts

Your contacts can be found on our website:

www.ubs.com/etf

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