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UBS's new compensation model

10 key questions and answers

- **No variable compensation for the top executives of UBS.** Chairman of the Board Peter Kurer, CEO Marcel Rohner and the other members of the Group Executive Board (GEB) will receive only their fixed salary for 2008. In addition, all members of management as well as all other employees will have their variable compensation for 2008 reduced.

- **As of 2009, UBS will introduce a new compensation model.** Top management may receive variable cash compensation and variable equity compensation in addition to their fixed pay. A large portion of this variable compensation will be held in reserve and paid out only if the results of UBS warrant it. Otherwise, there will be neither variable cash nor equity compensation. This should bring about a cultural shift in the company. Those who are rewarded will be those who deliver good results over several years without assuming unnecessarily high risk.

1. Why adopt a new compensation model?

UBS takes the shortfalls of its current incentive system seriously and is revising its variable compensation model for the 2009 fiscal year. The guiding principles of these changes rest on a series of insights gained over the course of the past few months – either through internal analysis or through the work of regulatory agencies, shareholders, clients and politicians. UBS continues, however, in its pursuit of compensation best practices and potentially will include amendments to the new compensation system. In particular, the following shortcomings were eliminated:
- Variable compensation was strongly aligned with short-term results, without consideration for the quality or sustainability of the bank's performance.
- The system for determining variable compensation did not sufficiently take into account the risks assumed.

UBS is fully committed to taking its responsibilities seriously and correcting previous errors.

2. When does the new system take effect?

The compensation model for 2009 has already been revised for the Chairman of the Board and the GEB. Revision of compensation will occur in a similar manner for the next executive level (potentially lower) and specific employees, the so-called "risk takers." These revisions will be introduced in 2009 and designed to address the areas where the limitations of the previous systems became apparent.

3. How will variable compensation for 2008 be handled?

For 2008, **top management will receive no variable compensation**: The Chairman of the Board, the CEO and the other members of the GEB will receive only their fixed salary without any additional variable compensation for 2008. All other managers and all other employees will have their variable compensation for 2008 reduced. The size, composition and allocation of the **variable compensation for 2008** will be set in **close discussions with the Swiss Federal Banking Commission** after year-end results are available.

4. What does the new system look like? What has changed and for whom?

The **Chairman of the Board** receives henceforth only a fixed base salary in cash and a fixed number of shares restricted from sale for four years. He has the same obligations in regard to holding his shares as do the GEB members. The variable component – in both cash and equity – is eliminated.

Members of the GEB receive a fixed salary and variable compensation in cash and equity. A **large portion** of this variable component **will be held back** and fully paid out only if UBS achieves good business results in future years. If the firm does not, there will be neither variable cash nor variable equity compensation. This should result in a cultural shift in the firm. Those who are rewarded will be those who deliver good results over several years. The new model ensures that the cost of deployed capital and the risks assumed are both taken sufficiently into account. It consists of three components:

1. A fixed base salary
2. Variable cash compensation (Cash Balance Plan)
3. Variable equity compensation (Performance Equity Plan)

The underlying philosophy and the elements of the new model for the GEB will also be employed for the senior executives and key people of the business divisions. Furthermore, the Cash Balance Plan will be implemented for personnel in executive positions and key functions, for example, employees responsible for using risk capital and assuming significant financial risks. The group of people affected will be defined presently.

5. How is the variable compensation system designed?

The variable **cash compensation** is based on a **bonus/malus system**. A **maximum of one-third** of the annual variable cash compensation will be paid out. The larger part of it will be held in an **escrow account** and kept at risk for future performance. For example, should UBS achieve a loss in a subsequent year, no bonus will be awarded, and the cash balance will be reduced by a malus.

A similar concept applies to the variable **equity compensation**. It is also based on UBS achieving positive results over several years. Variable equity compensation in the form of shares is provisionally awarded. The shares only vest **after three years**, provided pre-defined performance criteria are met. Furthermore, executives are obliged to hold **75% of their vested shares** (after paying taxes) **for several more years**. If UBS' performance in the three-year measurement period does not meet the set criteria, the number of provisionally awarded shares is reduced in part or in whole. This strengthens the link of compensation to shareholder's interests.

6. What performance criteria serve as the basis for the measurement of the Performance Equity Plan?

The plan is based on two forward-looking performance criteria:
1. Achieving pre-defined economic profit (EP) targets
2. Achieving relative total shareholder return (TSR) performance

EP is a risk-adjusted profit that explicitly takes into account the cost of risk capital. EP is only realized when the achieved entire **return on capital is larger than the bank's cost of capital**.

TSR measures the **total return of a stock** to an investor (**capital gain** plus **dividends**). The TSR captures both: the dividend yield that only measures the cash yield on the current share price, as well as any capital appreciations via share price. Hence, the TSR is a comprehensive metric to express the success of a stock investment over a certain period of time. UBS is measuring the TSR relative to the industry performance; either to a specific peer group or a broader banking index (to be determined).

The Performance Equity Plan has a forward-looking incentive component and is, therefore, not directly linked to the variable compensation of the previous year. The initial measurement of the plan begins in 2009. The first possible payout, respective to the transfer of share ownership, would follow in 2012 based on the performance for the three-year period 2009-2011.

7. How will shareholders be involved?

For the annual general meeting, UBS is implementing from 2009 an advisory vote on the principles and fundamentals of the new compensation model.

8. How will independent members of the Board of Directors be compensated?

The independent members of the Board of Directors will continue to receive **only fixed compensation**. Fees are paid 50% in cash and 50% in restricted UBS shares. However, members can elect to have 100% of their compensation paid in UBS shares restricted from sale for four years.

9. Will variable compensation that has already been paid be reclaimed?

Whereas UBS honors employment contracts on all levels, a potential claw-back of paid bonuses for the former members of the Board as well as former top executives is being assessed on legal grounds. For this purpose, the Board of Directors established a committee of independent members that assigned an outside expert to conduct the legal review. Apart from that, a task force has been set up to pursue voluntary paybacks by former board members and top executives.

10. Are there "golden parachutes" at UBS?

No. At UBS, so-called "golden parachutes" do not exist. Due to existing contracts, payments occurred to former executives for the year 2007 because base salary and variable pay components for the entire period of notice had to be paid. These contracts will now be revised. From 2009, notice periods will be reduced to six months (for certain executives, it was previously 12 months). For GEB members leaving the company, the variable compensation component will be calculated on a pro rata basis and will only be based on the cash portion. Furthermore, payments will take place under the Cash Balance Plan regime. This should prevent any payments that prove to be inappropriate in the near future.