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Compensation Report

UBS's new compensation model

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1. Foreword

This report details the changes in the compensation for the Board of Directors and the Group Executive Board. The 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 new best practices of compensation and potentially will include amendments to the new compensation system. UBS is fully committed to avoiding shortcomings in the future and – as far as the bank can – correcting previous errors.

As of April 7, UBS had already submitted to the Swiss Federal Banking Commission (SFBC), upon its request, a report concerning the origins of the bank's subprime crisis. The report laid out, among other things, how some disproportionately large risks had been assumed within what was a relatively small and isolated proprietary trading area of the Investment Bank. Earnings – and the bonuses linked to them – had not been sufficiently tied to the amount of assumed risk. In addition, the bonus payments were calculated based on short-term results, without sufficient appraisal of the quality or sustainability of those earnings.

Chairman of the Board Peter Kurer committed himself immediately after being elected on April 23 to establishing a new Human Resources and Compensation Committee within the Board that would “review the incentive systems throughout the Group to ensure alignment with UBS's values, guiding principles and long-term orientation.” After the October 16 transaction with the Swiss Confederation and the Swiss National Bank was defined, UBS accelerated the revision of its compensation system.

As of 2009, UBS's compensation model will continue to include variable compensation as a key component of its compensation; however, variable compensation will be based on clear performance criteria which are linked to risk-adjusted value creation. The measurement period for these performance criteria will be lengthened, aligning variable compensation with sustainable profitability. Long-term results, increased risk awareness and a focus on profitability and value creation for shareholders are the cornerstones on which compensation will be based in the future.

In all service industries, and especially in the financial services industry, success depends almost exclusively on highly qualified employees with strong relationships to their clients. A compensation system must be formulated that is competitive in the international industry environment – even in these challenging times. As such, industry standards, though not the sole reference point, cannot be neglected. The new compensation system must aid in the attraction and retention of key talent.

The new compensation model should also be designed to alter the UBS corporate culture. Monetary incentives will continue to have a clear place in it, but they can not run counter to UBS corporate objectives nor endanger the reputation of the bank. UBS is convinced that its revised compensation model will play a central role in its future success and enable shareholders, clients and the public to once again recognize the bank as a trusted partner in the future.

Peter Kurer
Chairman of the Board of Directors

Joerg Wolle
Chairman of the Human Resources
and Compensation Committee

2. Key facts: UBS changing compensation model

For 2008, the top executives of UBS will not receive a bonus. The Chairman of the Board, the CEO and the other members of the Group Executive Board will only receive their fixed salary. In addition, all members of the senior management as well as all other employees will have their 2008 variable compensation components reduced.

As of 2009, a new compensation model will apply for top executives. It is long-term oriented, rewards realized value creation and takes business risk into account. Performance-based variable compensation components are foreseen in profitable periods. In difficult times, no variable cash compensation will be paid. In addition, a "malus" can be deducted from bonus accounts. The new compensation model consists of three components:

1. A fixed base salary
2. Variable cash compensation
3. Variable equity compensation

The variable cash component is based on a bonus/malus system. A maximum of one-third of the annual variable cash component will be paid out at year's end, subject to positive business development. The larger portion of the variable cash component will be held in escrow in a bonus account. Should UBS's results be poor, a negative award, or malus, can result and the bonus account will decline. The account can also decline if regulations are grossly violated, if unnecessarily high risks are undertaken or if individual performance targets are not met. This ensures that compensation is linked directly with long-term company performance and the risks assumed in achieving it.

A similar concept applies to the equity program. It is also based on UBS achieving positive results over several years. The number of shares and their value are dependent on the long-term value created and on the UBS stock price performance. The shares vest only after three years, and members of top management are obliged to hold these shares for an even longer period.

The compensation model for 2009 has already been revised for the Chairman of the Board and the Group Executive Board. 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.

For the remaining employees, the current system of variable compensation will basically not change. For many lines and functions, the current compensation program ensures sustainable remuneration in line with divisional and overall performance.

3. Variable Compensation for 2008

3.1 Chairman of the Board, Group Executive Board

For 2008, no bonus will be paid to the Chairman of the Board and the 12 members of the Group Executive Board.

3.2 Independent members of the Board of Directors

The independent members of the Board of Directors will continue to receive only a fixed fee for 2008, half of which will be in cash and half in shares that are blocked for four years.

3.3 Variable compensation in general

In general, variable compensation will be reduced for 2008, in line with the poor performance of the bank and the banking industry. By the end of January 2009, the Board of Directors, after full-year financial results are available, will determine the size, composition and allocation of variable compensation for 2008 in consultation with the SFBC. In doing so, UBS's competitiveness and operative effectiveness, as well as the financial results achieved within its divisions and regions, will be taken into account. UBS estimates that personnel costs will be reduced in line with the market, but only to the extent that competitiveness is not harmed.

3.4 Former members of the Board and top executives of the bank

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. Separately, a task force has been set up to pursue voluntary pay-backs by former board members and top executives.

4. Compensation 2009 and beyond

4.1 Guiding principles

UBS is changing to a long-term compensation model that makes a major portion of the variable pay dependent on sustained performance with an adequate return on equity risk capital to foster its appropriate use. A relative performance measure will be used to better measure senior management's contribution to value creation. In addition, the new compensation system will be a tool to attract and retain key talents.

A substantial portion of variable compensation will no longer be paid out immediately, but held at risk subject to future performance. This change applies to variable cash compensation as well as to share-based compensation through the newly established Performance Equity Plan.

UBS is affirming the accountability of the business divisions for their performance. The new compensation programs will reinforce the achievement of targets within the divisions. In doing so, the variable compensation component will be awarded primarily based on the results of the corresponding divisions. Applying the bonus/malus system to both the Cash Balance Plan and the Performance Equity Plan ensures that variable compensation is in line with long-term performance.

The changes delineated here apply to the Group Executive Board, divisional top management and specific employees, e.g. the so-called "risk takers," and address the areas where the limitations of the previous system became apparent. For the majority of employees, the current system of variable compensation will basically not change. For many lines and functions the current system ensures sustainable remuneration in line with divisional and overall performance.

4.2 Chairman of the Board, Board of Directors and Group Executive Board

UBS has simplified its compensation programs into three components. In addition, the shareholder retention program has been redesigned for the Chairman as well as the Group Executive Board.

	Chairman	Independent members Board of Directors	GEB
Fixed pay	Base salary in cash and a fixed number of blocked shares	Fixed fee (min. 50%; max 100% in blocked shares)	Fixed compensation
Variable cash compensation	No	No	Cash Balance Plan
Variable equity compensation	No	No	Performance Equity Plan
Shareholder retention policy	Yes (see 4.2.4)	Yes (blocked for 4 years)	Yes (see 4.2.4)

These changes to the compensation program for the UBS Chairman of the Board and the Group Executive Board signal a clear commitment to a long-term orientation and a regard for taking business risk into account. These principles will also be applied at the level of the business divisions and further down the organizational hierarchy.

4.2.1 Fixed pay

The independent members of the Board of Directors will receive only fixed compensation and no variable compensation. Fees are paid 50% in cash and 50% in blocked UBS shares. However, members can elect to have 100% of their remuneration paid in UBS shares restricted from sale for four years.

Special requirements regarding checks and balances exist for the compensation of the Chairman of the Board. In accordance with corporate governance standards, the Chairman will no longer participate in the variable compensation program defined for the Group Executive Board. The Chairman shall not receive any performance-related compensation through it. Rather, he will receive a fixed base salary that will be paid out in cash and in a fixed number of shares determined in advance. These shares are restricted from sale for four years and are subject to the new shareholding retention rules. This compensation package is clearly different from the performance-dependent model of management. At the same time, it underscores the focus of the Chairman on long-term value creation – in accordance with the interests of shareholders.

The members of the Group Executive Board will receive a fixed base salary based on their skills, experience and the knowledge they bring to their role in the relevant market segment. Base salaries, as an individual component within total compensation, are set taking into account market criteria.

4.2.2 Cash Balance Plan

The Cash Balance Plan for the Group Executive Board rewards long-term success and links variable compensation to ups and downs in business performance. It holds top executives accountable for delivering sustained long-term performance.

Variable incentive payments are based on operating results with risk- and capital-adjusted financial performance (group/division) and non-financial goals (namely leadership and adherence to values) taken into account. With the Cash Balance Plan, any previously announced variable compensation will be booked to a participant's account before a distribution is made. If the balance is positive, up to a maximum of 33% of the account is paid out. The remaining balance is carried forward to the next performance year and is exposed to future performance delivered.

A negative award, i.e. a malus, will be recognized in the cash balance in the case of:

- a) A financial loss at the Group or business division level
- b) A large adjustment to the group's balance sheet

As such, the plan provides a multi-year reflection of performance and compensation. This is designed to ensure that the financial impact of decisions and actions taken in one period impact the variable compensation over a longer period of time.

A malus to an individual participant will also be recognized in the case of:

- a) Misconduct with regard to compliance issues
- b) A breach of risk parameters
- c) Non-adherence to other quantitative and qualitative core objectives as expressed within individual target agreements and performance measurements

The Cash Balance Plan establishes a buffer between the determination and payment of variable compensation. It promotes sustainable performance by ensuring future results are considered. Even if an executive leaves the company, the balance will be kept at risk for a period of three years in order to

capture any tail risk events. The malus system could also lead to no variable compensation in times of continued poor performance for several years.

Cash Balance	Year 1	Year 2	Year 3	Year 4	Year 5	etc.
Previous year balance		100	40	120	60	80
+ Awarded bonus	150		140		60	
- Awarded malus		-40		-30		
= Interim balance	150	60	180	90	120	
x Payout	33 %	33 %	33 %	33 %	33 %	
= Amount paid out	50	20	60	30	40	
Balance after payout		100	40	120	60	80

Note: The final definition of the malus regulations is still in development. They will be aligned according to best practice and the SFBC standards. Details will be communicated at the 2009 annual general meeting (AGM).

Advantages of the Cash Balance Plan

Lengthens decision horizon for executives and further aligns executives' with investors' interests.

Smooths variable compensation payments through fluctuating business performance, and, hence, helps to retain productive employees throughout a business cycle.

Holds executives accountable for delivering sustained improvements in value contribution ("insurance" for investors).

Establishes a buffer between the determination and payment of variable compensation.

The potential malus encourages effective, successful thinking and actions.

4.2.3 Performance Equity Plan

The Performance Equity Plan replaces all former equity incentives and increases transparency with regard to compensation components.

Under the plan, participants receive a certain number of restricted performance shares at market price. When the shares are granted, they are not yet owned by the participant. This is the forward-looking variable pay component. The final number of shares only vest – in contrast to today – after three years. The final number of shares depends on two performance criteria:

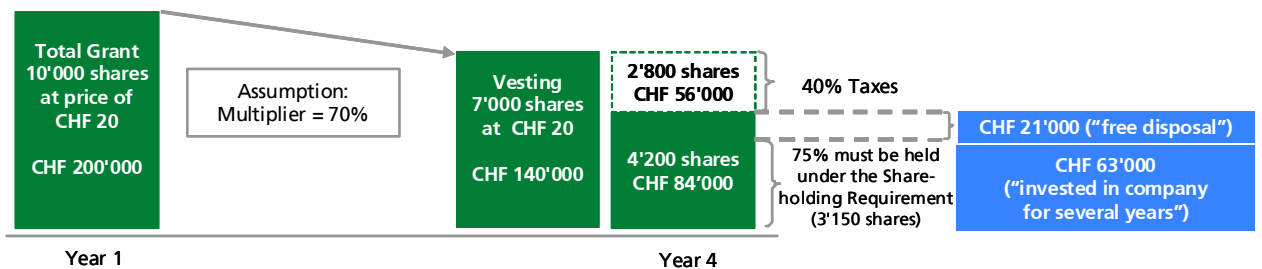
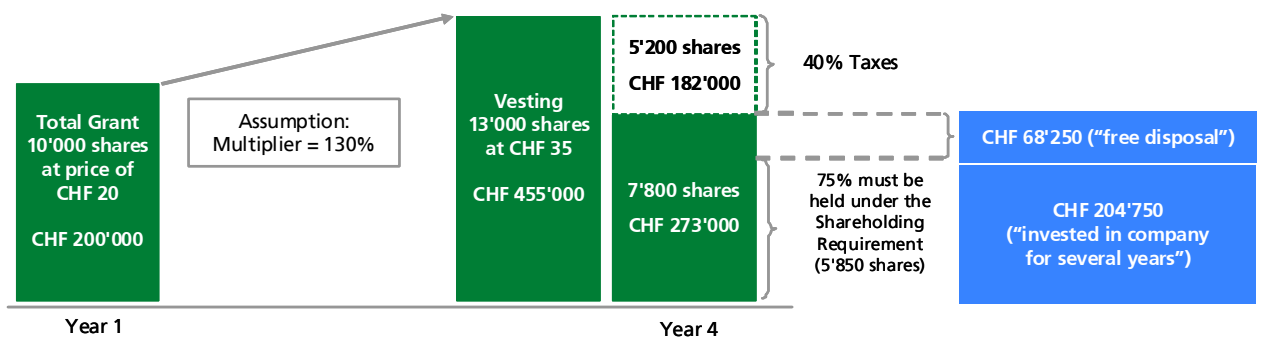
1. Achieving pre-defined economic profit (EP) targets
2. Achieving relative total shareholder return (TSR)

EP is a risk-adjusted profit that explicitly takes into account the cost of risk capital. See annex for further information.

TSR combines share price appreciation with dividends to show the total return to shareholders. It is used as a relative measurement of the banking industry. See annex for more information.

Illustrative example of the Performance Equity Plan:

The measurement period for the Performance Equity Plan consists of years one, two and three. An award or disbursement of a share portion follows beginning in year four. Assume that an executive is granted in year one 10,000 performance shares at the current market price of CHF 20 per share. The executive does not own these shares at this point. After reaching the EP performance targets as well as the relative TSR performance targets in years one, two and three, the executive receives – in this example – a total of 130% or 13,000 shares at the beginning of year four. Assuming a share price of CHF 35 at the time of the transfer of ownership, these shares are worth CHF 455,000. From this vesting value, the executive pays approximately CHF 182,000 in taxes and social security. Given the new share retention requirements, the executive has to hold on to 75% of the available shares for an even longer period. Also see the details regarding the share retention requirements.



Note: illustrative example¹

With the two performance criteria EP and TSR, UBS links equity ownership to an internal measure of EP as well as an external measure of TSR. The performance conditions ("vesting matrix") will be pre-defined for every three-year performance cycle. The range of the vesting multiple is between 0% and 200%, i.e. a shortfall in value creation in the measured period can result in fewer or even zero shares, i.e. a malus, when compared to the initial shares granted. However, in the case of outperformance in terms of EP as well as relative TSR, the vesting can result in a maximum of double the number of initial shares.

Vesting of 100% means that the strategic and operative goals were achieved. With a range between 0% and 200%, UBS establishes symmetric performance conditions: a shortfall will be sanctioned with a malus and could even result in a payout of zero. On the other hand, the plan offers a higher payout, but only if the strategic and operative goals are exceeded.

¹ Share grants and share prices are hypothetical and are presented only for purposes of illustration.

The exit clauses during the three-year period are very restrictive. Generally, if someone leaves the company during the performance cycle, the performance shares are forfeited. Details on the vesting matrix and technical aspects of the Performance Equity Plan are included in the annex.

Advantages of the Performance Equity Plan

- Share ownership is linked to long-term and pre-defined performance conditions.
- Executives only benefit if long-term performance goals are met or exceeded; a shortfall results in zero shares (a malus).
- Executives are obliged to hold on to 75% of the vested shares (after tax) for an even longer period.
- Focus on internal and external value creation, considering both share price performance and execution of company strategy.
- Focus on management performance rather than on industry performance through a relative TSR.

4.2.4 Share retention

There are no regulatory requirements for a share retention obligation. Companies can choose a policy at their own discretion or have no policy at all.

Under the revised share retention policy, all executives who receive share-based compensation, excluding independent members of the Board of Directors, will be required to retain UBS shares as of January 1, 2009 as follows:

1. New shares: 75% of the total vested value of shares after taxes (see also the example of performance shares). This rule applies for any type of mandatory share-based program.
2. Existing shares: Restrictions will be put in place in order to achieve the recommended 75% of net share retention.

While executives are in office, they must retain their shares for several years, according to the above-mentioned regulations. This is not only a guideline but a directive. Shares covered by the policy will be physically blocked on the UBS IT platforms to prevent any sale or transfer.

4.2.5 Comparison of the old vs. the new model

The following table compares the old and new incentive compensation model for the GEB:

Criteria	Current shortcomings	Remedies
Performance measures	Annual profitability; partially fading out of risk capital costs	Focus on EP, taking risk elements into account
Alignment with shareholder interests	Share-based, but not performance-dependent; asymmetrical bonus payments	Share-based and performance-dependent with relative TSR and EP; symmetrical with bonus/malus components
Orientation	Short-term (yearly basis)	Long-term: 3-year goals and holding periods; aligned with shareholder value
Transparency	Diverse performance factors in different compensation instruments	Only two instruments: Cash Balance Plan and Performance Equity Plan
Variable pay components	Top-down approach based on diverse performance indicators	Top-down approach primarily based on value creation; furthermore, stronger focus on divisional performance
Compensation of the Chairman of the Board	Analogous with the variable compensation components of the GEB	No variable compensation components; base salary and a fixed number of shares

4.3 Divisions

As announced on August 12, UBS will reposition the bank on the basis of independent business units with the goal of increasing the strategic flexibility of the bank's future development. This decision was reached after a detailed review of the strategy by the Board of Directors and the Group CEO.

- The new structure will result in more transparency of the drivers of value creation within UBS and impose strict standards on the allocation and usage of capital and reward management for sustainable value creation. At the same time, the Group achieves maximum strategic flexibility and can benefit from opportunities to maximize shareholder value in the future.
- Variable compensation components for management and staff will, from now on, be directly derived from the financial results of the divisions. This will align the incentive to generate profits with disciplined risk management, taking into account relative risk/reward profiles.

Starting in 2009, the philosophy of the new compensation framework for the Group Executive Board will be introduced on a step-by-step basis to the compensation model for other management levels and the divisions: the Cash Balance Plan and the Performance Equity Plan for the second management level, the Cash Balance Plan for employee categories (for example, risk takers) that significantly use risk capital or take risk positions.

Senior management of the divisions will be rewarded for value creation in their division. This underscores the accountability of the divisions for the financial results, risks taken and the use of capital and resources. This should advocate a mindset that is consistent with partnership, where the performance of the divisions will be measured according to a set of performance targets over the span of several years. Other key factors are:

- risk-adjusted measures aligned with EP
- non-financial measures that allow for a balanced performance assessment
- yearly incentive-based payments for the broad employee base, evaluated against operating targets established by the Group and divisional management

5. Corporate governance and compensation policy

5.1 Role of the general meeting

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

5.2 Role of the Human Resources and Compensation Committee

The independent Human Resources and Compensation Committee of the Board of Directors has clear responsibilities:

- Development of the compensation principles
- Authority to approve the compensation of members of the Board of Directors and the Group Executive Board
- Oversight of the Performance Equity Plan, particularly regarding the allocation and vesting of shares
- Oversight and control over the principles of the share retention policy

5.3 No "golden parachutes"

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 Group Executive Board 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.

5.4 Additional details regarding share-based compensation

For top management, the ongoing allocation of shares will exclusively be carried out on the basis of the Performance Equity Plan. Under certain conditions (e.g. recruiting, buyout), depending on the amount of the total compensation and with the approval of the Board of Directors, UBS can, however, allocate separate portions of the Performance Equity Plan or other instruments in order to meet specific requirements regarding recruiting and retention of people in key positions.

6. Annex: Details Performance Equity Plan

6.1 Basic principles of the structure

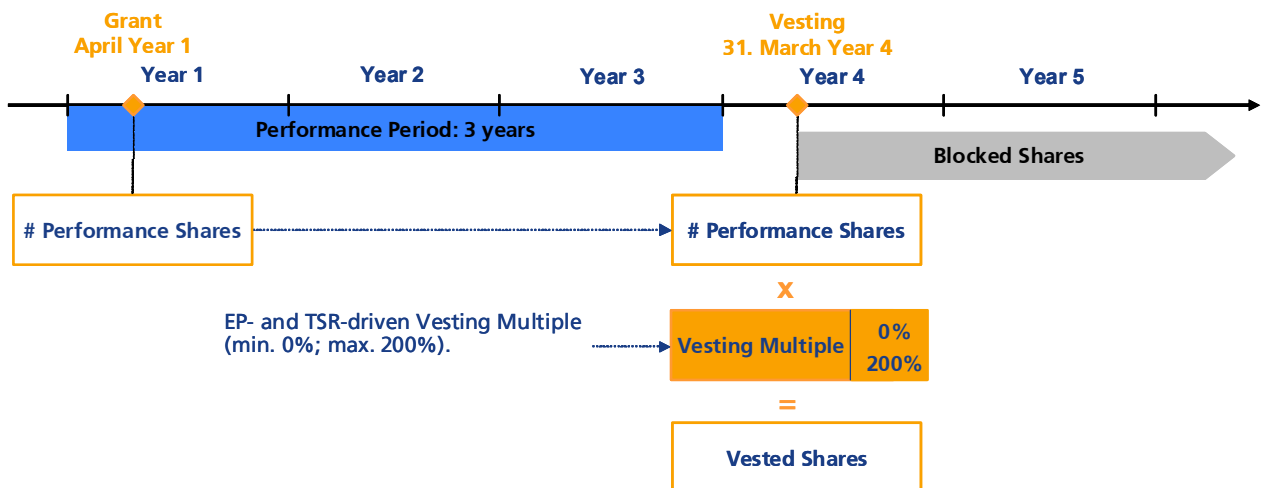
Performance equity plans have been introduced in many companies. The idea is that shares have to be "earned" over a long-term period. Accordingly, these programs contain future-oriented incentives, where management knows in advance what kind of share ownership can be expected if certain performance criteria are met.

At UBS, performance shares are based on the risk-adjusted operating profits as well as the development of the share price.

At the time of the grant of performance shares, ownership of the shares is not yet given to the executive. After a defined performance period – in UBS's case, three years – performance shares vest and are transformed to real shares, depending on the extent to which the pre-defined performance criteria are achieved. At the time of the vesting, the shares are transferred to the ownership of the executive and are considered income and subject to taxation.

After the transfer, a portion of the shares is still blocked. Executives are obliged to keep 75% of the shares remaining after taxes for an even longer period.

The following graph shows the structure of the Performance Equity Plan:

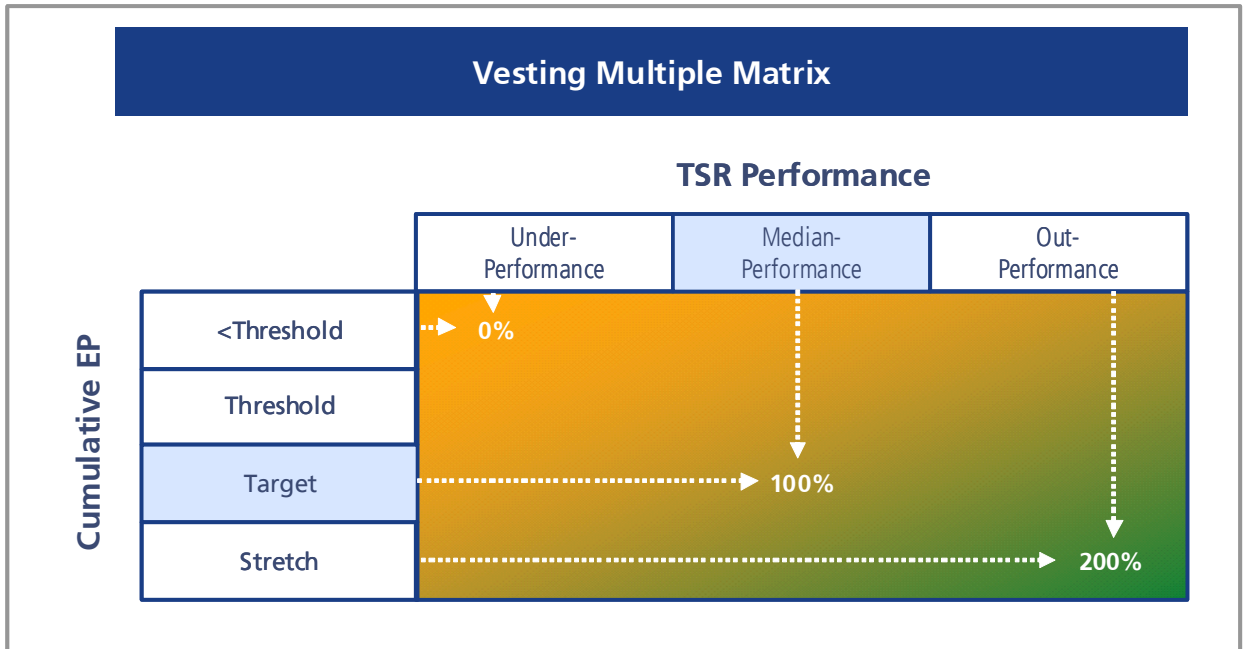


6.2 Grant policy

The Performance Equity Plan has a forward-looking incentive component and is, therefore, not directly linked with variable compensation of the previous year. For example, performance measurement of the first performance equity plan will begin 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.

6.3 Vesting matrix

The vesting matrix will be pre-defined for each three-year performance cycle. The vesting factor by which performance shares are converted to UBS shares will depend on the development of EP and TSR.



The vesting of the so-called "performance shares" into UBS shares occurs at the time of the transfer of ownership according to the following formula:

$$\text{Vested shares} = \text{granted performance shares} \times \text{vesting factor (\%)}$$

The vesting factor depends on:

- Cumulative EP over three years (e.g. 2009, 2010 and 2011)
- Relative TSR performance during the same three years (that means from 1.1.2009 to 31.12.2011)

Performance conditions based on EP and TSR are in line with best practices. These performance conditions stipulate that the incentive-based compensation depends on long-term actual results achieved and is aligned with shareholder interests. Performance is defined as the long-term profitability of the firm, taking into consideration risk and cost of capital.

Economic Profit

EP is an internal measure for value creation and is calculated according to the annual net profit attributed to UBS shareholders minus the cost of capital for equity.

	Economic Profit	=	Adjusted After Tax Profit	-	{ Shareholder Equity	x	{ Cost of Equity Capital }
Description	Profits eliminating accounting distortions and charging for the cost of equity capital deployed		Accounting income adjusted for items where accounting treatment differs from an economic perspective		Total amount of Shareholders' Equity required by the business		Shareholders' required rate of return for the amount of risk assumed by the company
Source	Calculated from the components shown in this table		Audited Financial Statements		Audited Financial Statements		Analysts' Estimate
Measurement method	Calculated from the components shown in this table		"Net Profit attributable to UBS shareholders" as reported in audited Financial statements plus specifically identified adjustments		"Equity attributable to UBS shareholders" as reported in audited Financial statements plus specifically identified adjustments		Analysts' Estimate

In order to balance non-operational influencing factors on the profit and loss statement, the EP calculation will be adjusted with shifts in the market value of UBS's debt and the influences on the mandatory convertible notes. Furthermore, the Human Resources and Compensation Committee of the Board of Directors evaluates if any extraordinary effects are relevant to the calculation of the EP.

The three-year goals in the Performance Equity Plan are based on the strategic business plan and analyst expectations. A threshold and a stretch performance will be defined based on a probability calculation of the future EP performance. The EP performance condition will be interpolated linearly between the minimum, target and stretch level.

Total Shareholder Return

TSR is an external measurement for value creation. In order to neutralize any valuation movements due to industry factors, UBS is measuring the TSR relative to the industry performance. Currently, UBS is evaluating two alternatives: relative performance in comparison to a specific peer group or a broader banking index.

The measurement period for TSR performance is over an entire performance cycle, i.e. for the grant 2009 the three consecutive years (1.1.2009 to 31.12.2011). The comparative basis is an average over a period before the beginning and the end of the performance cycle.

6.4 Other regulations

The shares of the Performance Equity Plan are not eligible for dividends during the three-year measurement period. There is also no adjustment in the case of a rights issue unless the Human Resources and Compensation Committee makes an adaptation.