UBS

Listening to our shareholders – key compensation changes for 2012

Supplementary information for shareholders related to the advisory vote on the Compensation Report 2012 – Agenda item 1.2.

Changes to our compensation model

Following the advisory vote on UBS's Compensation Report at last year's Annual General Meeting (AGM), we consulted widely with our shareholders to better understand their views with regard to improving our compensation plans and disclosures. We incorporated the findings from these consultations into our review process and have implemented wide-ranging changes for the performance year 2012. The key changes, which apply to awards granted in 2013 for the performance year 2012 and onwards, are outlined as follows:

To balance the interests of our shareholders, bondholders and employees, we have **introduced the Deferred Contingent Capital Plan (DCCP),** which is designed to replicate the main features of UBS's contingent loss-absorbing bonds placed in the market in 2012. Awards under this plan are deferred for five years and paid out at the end of year five (five-year "cliff-vesting") subject to continued employment, performance conditions being met as well as harmful acts provisions. DCCP awards will be forfeited if our capital-ratio trigger is breached or if a viability event occurs in any year prior to vesting. The plan's 7% capital-ratio trigger is higher than the 5% trigger on the loss-absorbing bonds currently held by investors, so employees, including Group Executive Board (GEB) members, would forfeit their awards before the bonds held by investors are written down. Despite the higher loss-trigger, we have based the interest rates on market levels of the existing UBS low-trigger loss-absorbing bonds, setting lower interest rates for employees compared with those for existing loss-absorbing bondholders. We will only pay interest for the years in which the firm generates an adjusted pre-tax profit. If there are years in which the bank reports an adjusted pre-tax loss, no interest will be paid to plan participants. In addition to the capital-ratio trigger of 7%, DCCP awards for GEB members will be subject to an additional performance condition. GEB members will forfeit 20% of their award for any year during the vesting period where UBS does not achieve an adjusted pre-tax profit. As such, 100% of the GEB DCCP awards are at additional risk of forfeiture over the vesting period. FINMA, our regulator, has approved the capital treatment for DCCP, and we anticipate that over the next five years, we could build up to another 100 basis points of high-trigger loss-absorbing capital from this program, which would act as an additional buffer against declines in our capital base.

We have made **significant changes to the Equity Ownership Plan (EOP),** which also applies to GEB members. EOP awards now have longer deferral periods, as described below. In addition, the performance conditions have been revised so that the vesting of awards for GEB members, Group Managing Directors, Key Risk

Takers and Highly Paid Employees (employees whose performance awards exceed CHF/USD 2 million) is dependent on both Group and divisional performance. (Previously, the vesting of EOP awards for senior employees depended on the performance of their business divisions alone, or in the case of Corporate Center employees, on the performance of the Group as a whole.)

Furthermore, the **performance conditions are now more stringent,** with loss-making performance for the Group and/or business divisions resulting in full forfeiture and weak performance resulting in partial forfeiture. We have chosen performance criteria that strengthen our focus on sustainable performance by considering our results over two and three-year periods, with thresholds set such that employees do not have to earn a performance award twice (once when granted and again during the vesting period). Our performance criteria are also aligned with our external strategic goals and take into account the financial effects of the transformation and restructuring the bank will undergo during 2013 and 2014. Our performance conditions for 2012 awards have been published in advance and we will report progress for compensation purposes against these criteria. The Board of Directors (BoD) will review the progress made in relation to these performance thresholds each year and set the threshold for new awards as appropriate. We believe our revised practices in this area will prevent inappropriate pay for poor or loss-making performance, while focusing our employees on sustainable performance over the medium- to longer-term.

Previously established deferred variable compensation plans for the GEB, namely the Cash Balance Plan, the Senior Executive Equity Ownership Plan and the Performance Equity Plan have all been **discontinued and replaced with two universal plans** that apply to all employees – the abovementioned EOP and DCCP. By doing so, we have eliminated all leverage elements from our deferred variable compensation plans going forward.

We have **extended the deferral periods** for our performance award plans. The introduction of the DCCP with five-year "cliff-vesting" and changes to vesting conditions for the EOP have resulted in the average deferral period for the GEB increasing to 4.5 years (from 2.7 years for 2011) and to 3.8 years for other employees (from 2.0 years for 2011). The vesting period for the EOP has been increased so that awards for the GEB now vest in three equal installments in years three to five, whereas they previously vested in five equal annual installments over five years. For other employees, EOP awards generally vest in two equal installments in years two and three, whereas they previously vested in three equal annual installments over three years. This helps to ensure that all of our employees remain fully focused on the longer-term profitability of the firm. We believe that our length of deferral and, in particular, the scope of employees subject to the DCCP five-year "cliff-vesting" (over 6,000 employees), is more than at any firm within our peer group.

Furthermore, for employees with a total compensation of CHF/USD 250,000 or more, at least 60% of any performance award they receive above that level (at least 80% for GEB members) is subject to deferral. As a result of these changes, we believe that the combination of high deferral rate, long vesting periods and broad population covered result in the **largest proportion of deferred compensation at risk in our peer group.** Thus our compensation plans provide greater protection to our stakeholders in the event of poor performance or harmful acts.

We have **introduced a cap on the GEB performance award pool,** which is set at up to 2.5% of the Group's adjusted pre-tax profit. While this cap is an important mechanism to prevent excessive pay, it also incentivizes the management team to strive for improved financial performance for the Group as a whole. Moreover, the maximum portion of a performance award that can be granted in immediate cash to a GEB member is 20%, and the Group CEO has discretion to recommend that this portion be partly or fully reduced with any affected balance being then granted under the EOP, subject to approval by the BoD. In addition, we have halved the cap on immediate cash awards for all employees, including the GEB, with the maximum cash amount reduced from CHF/USD 2 million to CHF/USD 1 million (with any excess above this cap paid being granted under the EOP). All of these measures provide further safeguards against excessive pay.

We have substantially **increased the UBS share retention requirement** by 67% for the Group CEO, and 75% for other GEB members, with the Group CEO required to hold 500,000 shares (up from 300,000) and other GEB members required to hold 350,000 (up from 200,000). Each executive is required to build up and retain these investments for the full duration of their tenure on the GEB. We believe these changes create better alignment with shareholders without increasing compensation expense to the bank. GEB members may not sell shares until these retention thresholds are met.

We have **enhanced our harmful acts provisions** to better ensure that performance awards can also be forfeited in the event that an employee fails to discharge his or her supervisory or managerial responsibilities.

While we firmly believe that the changes we have implemented this year represent significant improvements to our compensation structure and go further than many of our competitors to directly address stakeholders' concerns, compensation remains subject to far-reaching regulatory change and best practices continue to evolve across the industry. For these reasons, we have reserved judgment on other possible changes, such as the introduction of fixed caps on the proportion of fixed to variable pay, as important regulatory debates in this area have not been concluded. While a consistent compensation model is an important factor in shaping the behavior of the organization, the BoD remains committed to adapting our pay structure as industry practice evolves.

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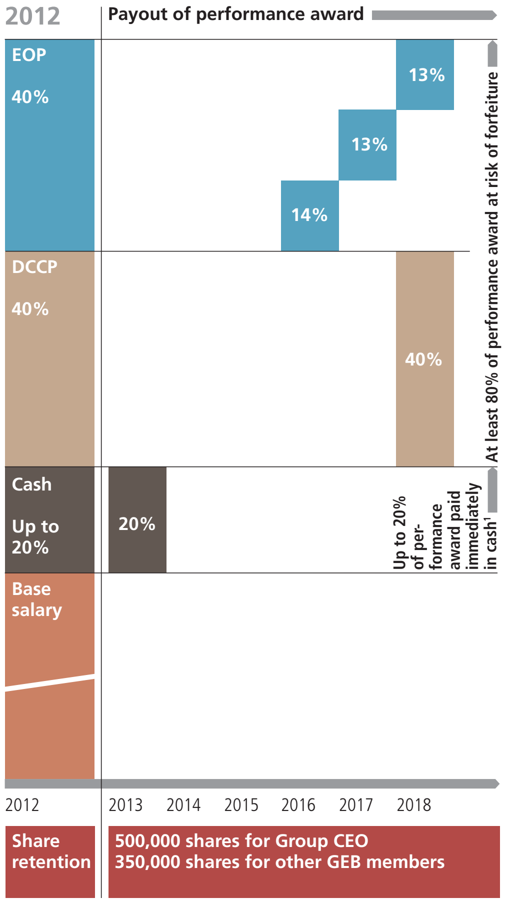
2012 compensation framework for GEB members

The graph below provides an illustrative overview of the 2012 compensation for GEB members, comparing it with the framework in 2011. Of the annual performance award, up to 20% is paid immediately in cash, a minimum of 40% is deferred under the EOP and another 40% under the DCCP.



Shares awarded.

Award vests in equal installments in years 3, 4 and 5, subject to both Group and divisional performance over the three financial years before vesting. The amount forfeited may be up to 100% of the installment due to vest.

Subject to forfeiture in the event of financial loss, harmful acts or termination of employment.

Replicates many of the features of loss-absorbing bonds.

Award cliff vests in year 5, subject to forfeiture if a capital ratio trigger or a viability event occurs. Awards are subject to 20% forfeiture if UBS does not achieve an adjusted pre-tax profit.

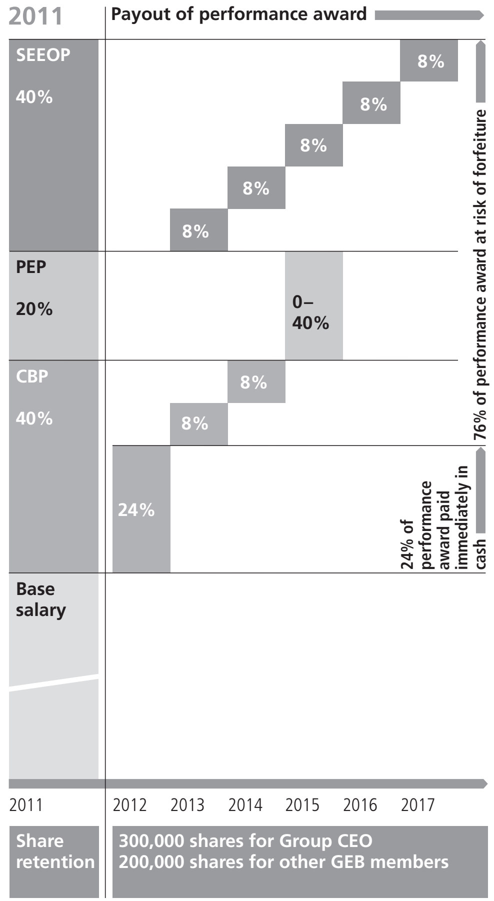
Notional interest will be awarded annually in years where the firm achieves an adjusted pre-tax profit.

Awards are also subject to continued employment and harmful acts provisions.

Up to 20% paid out immediately, subject to a cash cap of CHF / USD 1 million (down from CHF / USD 2 million for 2011). To the extent that less than 20% is paid in immediate cash, that amount will be delivered in EOP.

GEB members are required to hold a certain number of UBS shares as long as they are in office.

This holding has to be built up within a maximum period of five years from the date of their appointment to the GEB.



1 Code Staff receive 50% in the form of blocked UBS shares.

Compensation for 2012

For 2012, UBS reported a pre-tax loss of CHF 1,774 million. The result included a number of items relating to the acceleration of our strategy, which we announced in October 2012. We recorded CHF 3.1 billion of goodwill impairments and CHF 0.4 billion of restructuring costs. Own credit charges were CHF 2.2 billion resulting from the tightening of our credit spreads as the perceived creditworthiness of our debt improved, partly in reaction to the accelerated implementation of our strategy. We also had positive effects of CHF 846 million related to changes to our Swiss pension plan and to our retiree medical and life insurance plan in the US.

Adjusting for the above items (all of which are outside the control of divisional management or result from strategic decisions), provides a clearer picture of UBS's underlying performance. On this basis, the Group would have recorded an adjusted pre-tax profit of CHF 3.0 billion, which is after fines and disgorgements of CHF 1.4 billion in relation to LIBOR.

With regard to the actual awards for 2012, the Human Resources and Compensation Committee (HRCC) and the BoD have tried to balance the many positive developments during the year, including
- the firm's strong share price performance, which was up 28% over the year;
- significant progress in building our industry-leading capital ratios;
- the target for reducing risk-weighted assets being exceeded;
- substantial net new money inflows; and
- sufficient progress in executing the firm's strategy set out in 2011 to enable UBS to announce an acceleration of its implementation in October 2012.

In determining the overall performance award pools, the HRCC considered all these factors. Consequently, UBS's performance award pool was reduced to CHF 2.5 billion, a 7% decrease compared with 2011, and a 42% decrease compared with 2010, and the lowest level since the financial crisis. Taken in conjunction with wide-ranging changes we have made to the compensation framework, the firm's achievements in building its industry-leading capital ratios and the proposed 50% increase in dividend payments to shareholders for 2012, it demonstrates the continuing shift in the relationship between compensation, capital and dividends.

As the Group's adjusted pre-tax profit for 2012 was CHF 3.0 billion, and applying the newly introduced 2.5% cap, the GEB performance award pool was capped at CHF 75 million for the 2012 performance year. The actual GEB award pool for 2012 was CHF 52 million, representing 1.7% of the adjusted pre-tax profit. For GEB members who were in office for both the full year 2011 and 2012, performance awards were down 10% and total compensation was down 7% year on year. While the firm's compensation framework provides for up to 20% of the performance award to be paid immediately in cash to GEB members, in light of the firm's overall results for the year, and based on a recommendation from the Group CEO, it was deemed appropriate that performance awards for the firm's most senior leaders be fully deferred for 2012. Consequently, the cash component of the award was delivered in the form of deferred equity under the EOP, and makes up 60% of GEB performance awards for 2012 (the other 40% being the new DCCP). Therefore 100% of every GEB member's performance award for 2012 is deferred and subject to forfeiture if performance conditions are not achieved.

Group CEO Sergio P. Ermotti was granted a performance award of CHF 6.1 million reflecting his achievements in his first full year as Group CEO. As such, his total compensation was CHF 8.9 million. The full amount of the performance award is deferred, with 60% in deferred equity under the EOP vesting in years three to five, and 40% deferred under the DCCP vesting in year five. The highest paid GEB member in 2012, apart from the Group CEO, was Robert J. McCann, with total compensation of CHF 8.6 million. The full amount of the performance award is deferred, with 60% in deferred equity under the EOP vesting in years three to five, and 40% deferred under the DCCP vesting in year five.

During 2012, Andrea Orcel joined UBS after a 20-year career with Bank of America/Merrill (BAC), and was appointed to the GEB on 1 July 2012 as co-head of the Investment Bank. On 1 November, he became sole CEO of the division. In line with market practice, he received awards as a replacement for deferred compensation and benefits forfeited by his previous employer as a result of his joining UBS. As a general principle, in making such replacement awards, we aim to match the terms and conditions of the awards granted by an employee's previous employer which are forfeited upon the employee joining UBS.

Our compensation framework provides for the Chairman of the BoD, Axel A. Weber, who was elected at the AGM in May 2012, to receive annually a base salary of CHF 2 million and 200,000 UBS shares, blocked for four years, as well as benefits in kind. Such shares are not designed or intended as variable compensation. The number of shares that Mr. Weber received for 2012 was pro-rated to take into account that he assumed the role of Chairman in May. At grant, the pro-rated number of shares he received (133,333) was valued at CHF 2,003,995. Accordingly, his total compensation, including benefits in kind and pension fund contribution for his services as Chairman from May to December 2012, amounted to CHF 3,568,341. As previously announced, the BoD approved a one-time payment to Mr. Weber upon his election to the BoD at the 2012 AGM.

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