

UBS AG, Mumbai Branch
(Scheduled Commercial Bank)
(Incorporated in Switzerland with limited liability)

Basel II Pillar 3 Disclosures for the period ended 30 September 2010

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Basel II regulations do not require the Pillar 3 disclosures to be audited by an external auditor. Accordingly, the information/details presented in this section were not subject to audit by our statutory auditors.

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Background

The disclosures and analysis provided herein below are in respect of the Mumbai branch ('the Bank') of UBS AG which is incorporated in Switzerland with limited liability. Also, the disclosures herein below are solely in the context of local regulatory requirements and guidelines prescribed by the Reserve Bank of India (RBI) under Pillar 3-Market Discipline of the New Capital Adequacy Framework (commonly referred to as Basel II). The Pillar 3 disclosures are designed to complement the minimum capital requirements in Pillar 1 and the Supervisory Review and Evaluation Process in Pillar 2. The aim of Pillar 3 is to promote market discipline by allowing market participants access to information of risk exposures and risk management policies and process adopted by the bank.

UBS AG is the parent bank within the UBS Group ('the Group'). UBS Group is an international financial services group providing a broad range of financial services including advisory services, underwriting, financing, market making, asset management and brokerage on a global level, and retail banking in Switzerland.

As the bank is a branch operation of UBS AG (incorporated in Switzerland with limited liability), it operates in line with UBS Group principles and policies on risk management which are aligned to local regulations wherever required. For comprehensive disclosures and details of the UBS Group's Risk Management and Control Framework, please refer to the section 'Risk and Treasury Management' of the UBS Group's annual report section available in the Investor Relations section on the Group website www.UBS.com.

Scope of application

The Basel II framework applies to the Mumbai branch of UBS AG which is incorporated in Switzerland with limited liability. The Mumbai branch has no subsidiaries, including those directly owned/controlled by its Parent, which are subject to consolidation requirements under the generally accepted accounting principles (GAAP) or under the capital adequacy framework.

Capital structure

The capital structure of the Bank mainly comprises of interest free funds provided by its Head Office in the form of Tier 1 capital.

(Rs. 000s)

Composition of capital	As at 30 September 2010
Tier 1 Capital	
Head Office capital	14,582,404
Statutory Reserve	2,623
	14,588,027
<u>Deductions:</u>	
Debit balance in Profit and Loss Account	(189,513)
Amount receivable from Head Office (Other than Nostro Balances)	-
Deferred Tax Asset	(41,271)
Total Tier 1 Capital	14,354,243
Tier 2 Capital (General Provisions)	2,588
Total eligible capital base (Tier 1 + Tier 2)	14,356,831

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Capital adequacy

Sufficient capital must be in place to support business activities, according to both the bank's own internal assessment and the requirements of its regulators. Ensuring compliance with minimum regulatory capital requirements and targeted capital ratios is central to capital adequacy management.

The Bank aims to maintain sound and optimum capital ratios at all times, and it therefore considers not only the current situation but also projected developments in both its capital base and capital requirements. Currently the main source of the Bank's supply side of its capital is capital infusion by its Head Office.

The capital management process involves:

- (a) monitoring the regulatory capital and ensuring that minimum regulatory requirements and internal targets are met;
- (b) estimating the capital requirements based on forecast and strategic plan; and
- (c) reporting the regulatory capital situation to senior management on a regular basis.

Local Finance function is responsible for co-ordinating the above process. The Bank has developed and documented a suitable Internal Capital Adequacy Assessment Process (ICAAP).

The Bank's minimum capital requirements and capital ratios are follows.

(Rs 000s)

Particulars	As at 30 September 2010
Capital requirements for credit risk	186,246
Portfolios subject to standardized approach	629,117
Securitization exposures	-
Capital requirements for market risk	557,163
Standardized duration approach	
• Interest rate risk	512,163
• Foreign exchange risk (including Gold)	45,000
• Equity risk	-
Capital requirements for operational risk	47,796
Basic indicator approach	47,796
Total Capital ratio	104.70%
Tier 1 Capital ratio	104.68%

As per Basel II requirements, the minimum capital to be maintained by the banks during initial periods has been subject to the prudential floors of 100%, 90% and 80% of the capital requirement under Basel I over the years ended 31 March 2008, 2009 and 2010 respectively. RBI vide circular (DBOD. BP.BC.No.87/21.06.001 / 2009-10) dated April 7, 2010 has advised banks to continue with prudential floor of 80% beyond 31 March 2010 until further instructions.

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Risk Management and Control Framework Overview

Risk management and control principles

There are 'five' key principles that underpin the Bank's risk management and control framework.

- Protection of financial strength
- Reputation protection
- Business management is accountable for all risks
- Independent control of risk
- Disclosure of risk

Risk management and control responsibilities

Key roles and responsibilities related to risk management and control are outlined below:

- The Branch Management and Risk Committee (MRC) has a strategic and supervisory function and is responsible for determining the Bank's fundamental approach to risk. The Committee is headed by Country Chief Executive Officer and its composition includes heads of business, logistic and control functions in India.
- The MRC is supported by the following key committees responsible for the implementation of risk management and control principles.
 - The Risk Control Sub-Committee which is responsible for the three major risk types viz. Credit, Market and Operational Risks.
 - The Asset Liability Sub-Committee (ALCO) with a responsibility for balance sheet management, liquidity and capital management, interest rate risk management.
- The head of each business division is accountable for the results and risks of his or her division as well as maintaining an appropriate risk management structure.
- The Branch Risk Officer and the Chief Operating Officer are responsible for the development and implementation of appropriate control frameworks for credit, market and operational risks with support from the business divisions.
- The Head of Finance and the Chief Operating Officer are responsible for ensuring that the Bank and its business divisions disclose their financial performance in a clear and transparent way, and that this reporting and disclosure meets all regulatory requirements and corporate governance standards. They are also responsible for the implementation of UBS Group's risk management and control frameworks in the areas of capital management, liquidity, funding and tax.

Risk management and control framework

The Bank's risk management and control principles are implemented via a detailed risk management and control framework. The framework comprises both qualitative elements such as policies and authorities, and quantitative components including limits. With the risk management and controls principles as its basis, the framework is continually adapted and enhanced as the Bank's businesses and the market environment evolve.

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There are five key components in the independent risk control framework:

- Risk policies and authorities
- Risk identification
- Risk measurement
- Risk control
- Risk reporting

Credit Risk

Credit risk is the risk of loss resulting from the failure of a client or counterparty to meet its contractual obligations to the Bank

Credit risk is inherent in traditional banking products such as loans, commitments to lend and contingent liabilities (for example, letters of credit) as well as in "traded products": derivative contracts such as forwards, swaps and options; repurchase agreements (repos and reverse repos); and securities borrowing and lending transactions. The risk control processes applied to these products are fundamentally the same, although the accounting treatment varies, as they can be carried at amortized cost or fair value, depending on the type of instrument and, in some cases, the nature of the exposure.

Credit risk is controlled and monitored by establishing appropriate limits and operational controls to constrain credit exposure to individual counterparties and counterparty groups. There are specific policies and procedures applicable to different business segments.

The Bank uses its Group developed tools to support the quantification of the credit risk of individual counterparties for internal measurement and management, applying the three generally accepted parameters: probability of default, exposure at default and loss given default. Models are also used to derive the portfolio risk measures expected loss, statistical loss and stress loss.

Credit risk regulatory capital requirements are computed based on the standardized approach prescribed by RBI.

Quantitative disclosures

a) Analysis of credit risk exposures

		<i>(Rs 000s)</i>	
		As at 30 September 2010	
Gross credit risk exposures		21,393,104	
Fund based *		4,579,104	
Non fund based		16,814,000	
Geographic distribution of exposures		<i>Domestic</i>	<i>Overseas</i>
Fund based		4,512,711	66,393
Non fund based		14,612,300	2,201,700
Total		19,125,011	2,268,093

*Excluding investments subject to specific market risk, fixed assets and other assets.

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(Rs 000s)

Industry wise distribution of exposures	As at 30 September 2010	
	Funded	Non - Funded
Manufacturing - Heavy Engineering	-	71,500
Trading	-	-
NBFC and Fls.	3,000,000	550,800
Information Technology	-	2,234,400
Telecommunications	-	-
Oil and Gas	-	563,200
Chemicals	-	453,100
Rubber	1,000,000	-
Others	-	150,800
Interbank & Central Clearing Counterparties	579,104	12,790,200
Total	4,579,104	16,814,000

b) Residual maturity breakdown of assets

As at 30 September 2010

(Rs 000s)

Particulars	Investments	Advances	Inter-Bank Assets
Day 1	-	-	127,345
2-7 Days	-	-	-
8-14 Days	-	-	-
15-28 Days	-	-	-
29 Days and upto 3 Months	498,714	-	-
Over 3 Months upto 6 Months	-	-	-
Over 6 Months upto 1 Year	1,580,345	4,000,000	-
Over 1 Year upto 3 Years	3,232,113	-	-
Over 3 Years upto 5 Years	6,600,535	-	-
Over 5 Years	10,733,155	-	-
Total	22,644,862	4,000,000	127,345

c) Details of Non-performing assets (NPA)

(Rs 000s)

	Half Year ended 30 September 2010
(i) Amounts of NPAs (Gross)	
- Substandard	-
- Doubtful 1	-
- Doubtful 2	-
- Doubtful 3	-
- Loss	-
(ii) Net NPAs	-

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(iii)	NPA Ratios	
	- Gross NPAs to Net Advances (%)	-
	- Net NPAs to Net Advances (%)	-
(iv)	Movement of NPAs (Gross)	
	- Opening balance	-
	- Additions during the year	-
	- Reductions during the year	-
	- Closing balance	-
(iv)	Movement of provisions for NPAs (excluding provisions on standard assets)	
(a)	Opening balance	-
(b)	Provisions made during the year	-
(c)	Write-off/ write-back of excess provisions	-
(d)	Closing balance	-
(v)	Amount of non-performing investments	-
(vi)	Amount of provisions held for non-performing investments	-
(vii)	Movement of provisions for depreciation on investments	
(a)	Opening balance	24,426
(b)	Provisions made during the year	-
(c)	Write-off/ write-back of excess provisions	-
(d)	Closing balance	24,426

Credit risk : Disclosures for portfolios subject to standardised approach

The Bank uses credit ratings of the external rating agencies prescribed by RBI in the new capital adequacy framework. Eligible rating agencies and the relevant type of exposures where those ratings can be used are as follows:

<i>Exposure/obligor category</i>	<i>Rating agency type</i>	<i>Rating agency names</i>
Foreign sovereigns, Foreign Banks (excluding their Indian branches) and Non resident corporates	International	<ul style="list-style-type: none"> • Standard & Poors • Moody's • Fitch International
Resident corporates, securitization	Domestic	<ul style="list-style-type: none"> • CRISIL Limited • CARE • Fitch (India) • ICRA Limited

The Bank adopts the RBI guidelines in transferring public issue ratings to comparable assets in the banking book. The key norms prescribed in this regard require one notch higher risk weight than the rated exposures for short term claims; unrated claims should be senior or at least pari passu with rated claims; matching of currency of the unrated claims with the rated claims.

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(Rs 000s)

Risk bucketwise analysis of bank's outstanding exposures (fund based and non fund based)*	As at 30 September 2010
Below 100% risk weight	18,618,104
100% risk weight	2,775,000
More than 100% risk weight	-
Total	21,393,104

*Excluding investments subject to specific market risk, fixed assets and other assets.

Credit risk mitigation

Taking collateral is the most common way to mitigate credit risk. The Bank generally takes collaterals in the form of pledges of sufficient eligible marketable securities or cash, mortgages over the property etc. All of the collaterals taken does not necessarily qualify for availing capital relief under the regulatory capital adequacy framework. To ensure with a high degree of certainty that the collateral value will cover the exposure, discounts ("haircuts") are generally applied to the current market value. These reflect the quality, liquidity, volatility and, in some cases, the complexity of the individual instruments. Exposures and collateral values are continuously monitored, and margin calls or close-out procedures are enforced, when the market value of collateral falls below a predefined trigger level. Concentrations within individual collateral portfolios and across clients are also monitored where relevant and may affect the discount applied to a specific collateral pool.

The OTC derivatives business is generally conducted under bilateral master agreements, which typically allow for the close-out and netting of all transactions in the event of default.

Securitisation

The bank has not undertaken any securitization deals during the reporting period.

Market risk in Trading Book

Market risk is the risk of loss from changes in market variables. There are two broad categories of changes: general market risk factors and idiosyncratic components. General market risk factors are driven by macroeconomic, geopolitical and other market-wide considerations, independent of any instrument or single issuer or counterparty. They include such things as interest rates, the levels of equity market indices, exchange rates, commodity prices (including the price of energy and metals), as well as general credit spreads. The associated volatility of these risk factors and the correlations between them are also considered to be general market risk factors. Idiosyncratic components, on the other hand, are those that cannot be explained by general market moves. Broadly they are the elements of the prices of debt and equity instruments, as well as derivatives linked to them, which result from factors and events specific to individual companies or entities.

Trading businesses are subject to multiple market risk limits. Traders are required to manage their risks within these limits which in turn may involve employing hedging and risk mitigation strategies. These strategies can expose the Bank to risk as the hedge instrument and the position being hedged may not always move in parallel (often referred to as "basis risk"). Senior management and risk controllers may also give instructions for risk to be reduced, even when limits are not exceeded, if particular positions or the general levels of exposure are considered inappropriate.

The Bank has two major portfolio measures of market risk – Value-at-Risk (VaR) and stress loss for internal management purposes. They are complemented by concentration and other supplementary

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limits on portfolios, sub-portfolios, asset classes or products for specific purposes where standard limits are not considered to provide comprehensive control.

Market risk regulatory capital requirements are computed based on the standardized approach prescribed by RBI.

Value at Risk (VaR)

VaR is a statistical measure of market risk, representing the market risk losses that potentially could be realized over set time horizon at an established level of confidence. The Bank's Group VaR model is used for internal management purposes only.

The key features of the bank's Group-wide VaR model framework used for internal management purposes are :

- ❖ VaR model makes use of five years of historical data and is calibrated to a 1-day 95% measure. Until September 2009, it was computed using a 10-day 99% measure.
- ❖ VaR is calculated daily, based on end-of-day positions, and by applying the historical changes in market risk factors directly to current positions- a method known as historical simulation.

Realized market losses can differ from those implied by the VaR measure for many reasons. All VaR measures are subject to limitations and must be interpreted accordingly.

Value-at-Risk (Based on 1-day, 95% confidence level)

	Year ended 30 September 2010 (Rs.000s)		
	Min	Max	Average
Interest rate & Fx risk	28,059	100,461	54,168

Stress loss

As a complement to VaR, macro stress scenarios combining various market moves to reflect the most common types of potential stress events, and more targeted stress tests for concentrated exposures and vulnerable portfolios. During the year, stress testing framework was enhanced which included updating stress scenarios to more accurately capture the liquidity characteristics of different markets and implementing stress scenarios to reflect market conditions that were experienced at the height of the financial crisis in fourth quarter of 2008.

Quantitative disclosures

	(Rs 000s)
	As at 30 September 2010
Capital requirements for market risk	557,163
Standardized duration approach	
• Interest rate risk	512,163
• Foreign exchange risk (including Gold)	45,000
• Equity risk	-

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Interest rate risk in the banking book (IRRBB)

The interest rate risk in banking book (IRRBB), as of now is not material and currently monitored based on monthly interest rate sensitivity analysis report by bucketing the exposures into re-pricing buckets.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems (for example failed IT systems, or fraud perpetrated by a UBS employee), or from external causes, whether deliberate, accidental or natural. Operational risks are monitored and, to the extent possible, controlled and mitigated to levels considered acceptable by senior management.

All functions, whether business, control or logistics functions, must manage the operational risks that arise from their activities. Operational risks are pervasive, as a failure in one area may have a potential impact on several other areas. The Bank has therefore established a cross-functional body to actively manage operational risk as part of its governance structure.

The foundation of the operational risk framework is that all functions have adequately defined their roles and responsibilities. The functions can then collectively ensure that there is adequate segregation of duties, complete coverage of risks and clear accountability.

The functions use their controls to monitor compliance and assess their operating effectiveness in several ways, including self-certification by staff, tracking of a wide range of metrics (for example, the number and characteristics of client complaints, deal cancellations and corrections, unreconciled items on cash and customer accounts, and systems failures), and the analysis of internal and external audit findings.

For local regulatory capital measurement purposes, the Bank follows the Basic Indicator Approach.