

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

**Basel II Pillar 3 Disclosures for the half year ended 30 September 2011**

**Contents**

1. Background
2. Scope of Application
3. Capital Structure
4. Capital Adequacy- Capital requirement for credit, market and operational risks
5. Risk Management and Control Framework Overview
6. Credit risk
7. Securitization
8. Market risk in Trading Book
9. Interest rate risk in the Banking Book
10. Operational risk

***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.***

UBS AG, Mumbai Branch  
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## Basel II Pillar 3 Disclosures for the half year ended 30 September 2011

### ***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 Pillar1 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](http://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)*

<b>Composition of capital</b>	<b>As at 30 September 2011</b>
<b>Tier 1 Capital</b>	
Head Office capital	19,102,404
Statutory Reserve	147,422
Balance in P&L	=
	<b>19,249,826</b>
<u>Deductions:</u>	
Debit balance in Profit and Loss Account	-
Amount receivable from Head Office (Other than Nostro Balances)	-
Deferred Tax Asset	(172,293)
<b>Total Tier 1 Capital</b>	<b>19,077,533</b>
<b>Tier 2 Capital</b>	
General Provisions	56,448
Investment Reserve	<u>10,432</u>
	<b>66,880</b>
<b>Total eligible capital base (Tier 1 + Tier 2)</b>	<b>19,444,413</b>

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## Basel II Pillar 3 Disclosures for the half year ended 30 September 2011

### ***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 2011
<b>Capital requirements for credit risk</b>	<b>1,807,276</b>
Portfolios subject to standardized approach	1,807,276
Securitization exposures	-
<b>Capital requirements for market risk</b>	<b>1,219,243</b>
Standardized duration approach	
• Interest rate risk	1,039,243
• Foreign exchange risk (including Gold)	180,000
• Equity risk	-
<b>Capital requirements for operational risk</b>	<b>124,353</b>
Basic indicator approach	124,353
<b>Total Capital ratio</b>	<b>54.68%</b>
<b>Tier 1 Capital ratio</b>	<b>54.49%</b>

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.71/21.06.001 / 2010-11) dated December 31, 2010 has advised banks to continue with prudential floor of 80% until 31 March 2013.

## **Basel II Pillar 3 Disclosures for the half year ended 30 September 2011**

### ***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.

UBS AG, Mumbai Branch  
(Scheduled Commercial Bank)  
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## **Basel II Pillar 3 Disclosures for the half year ended 30 September 2011**

### ***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.

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.

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

UBS AG, Mumbai Branch  
(Scheduled Commercial Bank)  
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**Basel II Pillar 3 Disclosures for the half year ended 30 September 2011**

Quantitative disclosures

**a) Analysis of credit risk exposures**

(Rs. 000s)

		<b>As at 30 September 2011</b>	
<b>Gross credit risk exposures</b>		<b>69,425,833</b>	
Fund based *		12,091,376	
Non fund based		57,334,457	
<b>Geographic distribution of exposures</b>		<i><b>Domestic</b></i>	<i><b>Overseas</b></i>
Fund based		120,84,434	6,942
Non fund based		56,500,257	834,200
Total		<b>68,584,691</b>	<b>841,142</b>

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

(Rs. 000s)

		<b>As at 30 September 2011</b>	
Industry wise distribution of exposures	Funded	Non - Funded	
Oil & Gas	-	1,104,027	
Information Technology	-	4,466,704	
NBFC & FI	2,000,000	692,111	
Rubber & Rubber Products	1,000,000	-	
Drugs and Pharmaceuticals	350,000	-	
Trading	884,000	4,844	
Infrastructure -Power	1,230,000	-	
Infrastructure -Telecommunication	-	172,059	
Engineering	560,000	232,277	
Iron and Steel	2,154,900	-	
Cements	500,000	-	
Jewellery	-	61,440	
Automobiles	220,000	-	
Others	1,028,475	75,972	
CCIL	144,975	-	
Banks	2,019,026	50,525,023	
	<b>12,091,376</b>	<b>57,334,457</b>	

**b) Residual maturity breakdown of assets**

**As at 30 September 2011**

(Rs. 000s)

Particulars	Investments	Advances	Inter-Bank Assets
Day 1	-	-	10,000
2-7 Days	-	-	780,000
8-14 Days	-	389,000	-
15-28 Days	-	1,370,000	-
29 Days and upto 3 Months	13,014,209	4,054,900	-
Over 3 Months upto 6 Months	-	2,085,000	-
Over 6 Months upto 1 Year	-	2,028,475	-

UBS AG, Mumbai Branch  
(Scheduled Commercial Bank)  
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**Basel II Pillar 3 Disclosures for the half year ended 30 September 2011**

Over 1 Year upto 3 Years	-	-	-
Over 3 Years upto 5 Years	4,127,251	-	-
Over 5 Years	9,287,439	-	-
<b>Total</b>	<b>26,428,899</b>	<b>9,927,375</b>	<b>790,000</b>

**c) Details of Non-performing assets (NPA)**

(Rs. 000s)

		<b>Half Year ended 30 September 2011</b>
(i)	Amounts of NPAs (Gross)	
	- Substandard	-
	- Doubtful 1	-
	- Doubtful 2	-
	- Doubtful 3	-
	- Loss	-
(ii)	Net NPAs	-
(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	-
	(b) Provisions made during the year	-
	(c) Write-off/ write-back of excess provisions	-
	(d) Closing balance	-

***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:

UBS AG, Mumbai Branch  
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**Basel II Pillar 3 Disclosures for the half year ended 30 September 2011**

<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"> <li>• Standard &amp; Poors</li> <li>• Moody's</li> <li>• Fitch International</li> </ul>
Resident corporates, securitization	Domestic	<ul style="list-style-type: none"> <li>• CRISIL Limited</li> <li>• CARE</li> <li>• Fitch (India)</li> <li>• ICRA Limited</li> </ul>

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.

*(Rs. 000s)*

<b>Risk bucketwise analysis of bank's outstanding exposures (fund based and non fund based)*</b>	<b>As at 30 September 2011</b>
Below 100% risk weight	61,428,619
100% risk weight	7,997,214
More than 100% risk weight	-
Deducted from capital	-
<b>Total</b>	<b>69,425,833</b>

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

***Credit risk mitigation***

A key aspect of credit risk mitigation is proper identification of key risks and imposing appropriate credit conditions. While assessing credit facility for a counterparty, the Bank carries out a detailed appraisal exercise which covers areas such as Company's business, industry characteristics, peer analysis, financial analysis, identifying of key risks and risk mitigants. Financial analysis covers analysis of various financial ratios (e.g. leverage, interest cover, etc.) and these in turn are used to arrive at the risk rating of the counterparty and the credit appetite.

Key credit controls include approving credit facilities in line with Company's credit profile, taking appropriate collateral, etc. Further the Bank tracks the credit profile of the Company on an ongoing basis and tracks early warning signal to assess any deterioration in credit profile/ assessment of exposure. Credit facilities to a counterparty are subject to annual review with limited review of financial performance/ industry update on a half yearly basis.

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.



## Basel II Pillar 3 Disclosures for the half year ended 30 September 2011

### ***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 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.

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### Basel II Pillar 3 Disclosures for the half year ended 30 September 2011

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

(Rs.000s)

	Year ended 30 September 2011		
	Min	Max	Average
<b>Interest rate &amp; Fx risk</b>	28,576	145,266	82,019

***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)

	<b>As at 30 September 2011</b>
<b>Capital requirements for market risk</b>	<b>1,219,243</b>
Standardized duration approach	
• Interest rate risk	1,039,243
• Foreign exchange risk (including Gold)	180,000
• Equity risk	-

***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. The increase/decrease in earnings due to a downward/upward shock of 200 basis points in the rupee banking book is Rs. 2,499 (000s)(for F.Y. 31.3.2011).

***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.

UBS AG, Mumbai Branch  
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**Basel II Pillar 3 Disclosures for the half year ended 30 September 2011**

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.