UBS

Annual Report 2007

1 | Strategy, Performance and Responsibility
2 | Risk, Treasury and Capital Management
3 | Corporate Governance and Compensation Report
4 | Financial Statements

Contents

Introduction 3

Risk management 4
Risk management and control 6
Risk concentrations 11
Credit risk 15
Market risk 31
Investment positions 42
Operational risk 44

Treasury and capital management 46
Interest rate and currency management 48
Liquidity and funding management 51
Capital management 56
Shares and capital instruments 62
UBS shares in 2007 68

More about UBS 73
Sources of information 74
Contacts 76

Introduction

This year we have changed the structure of our annual report. Based on feedback from users, our annual report now consists of four themed reports. These combine audited and non-audited information.

Together, the four reports make up UBS's full *Annual Report 2007* and replace the former Financial Report, the Handbook and the Compensation Report. They comply with the US disclosure requirements for foreign private issuers as defined by Form 20-F of the Securities and Exchange Commission (SEC).

The four reports are:

Strategy, Performance and Responsibility 2007
This provides a description of our firm, its strategy, organizational structure and financial performance for the last two years. It also discusses our standards for corporate behavior and responsibility, outlines demographic trends in our workforce and describes the way our people learn and are led.

Risk, Treasury and Capital Management 2007
In addition to outlining the principles by which we manage and control risk, this report provides an account of developments in credit risk, market risk, operational risk and treasury management during 2007. It also provides information on UBS shares.

Corporate Governance and Compensation Report 2007
Comprehensive information on our governance arrangements is included in this report, which also explains how we manage our relationships with regulators and shareholders. Compensation of senior management and the Board of Directors (executive and non-executive members) is discussed here.

Financial Statements 2007
This comprises the audited financial statements of UBS for 2007, 2006 and 2005, prepared according to the International Financial Reporting Standards (IFRS). It also includes the audited financial statements of UBS AG (the parent bank) for 2007 and 2006, prepared according to Swiss banking law. Additional disclosure required by Swiss and US regulations is included where appropriate.

In addition to the four reports, *Review 2007* is distributed broadly to UBS shareholders and contains key information on our strategy and financials. This booklet summarizes the information in the four-part annual report.

If you only ordered specific reports in prior years, please note that the former Compensation Report is now called *Corporate Governance and Compensation Report 2007,* and the former Annual Review is now called *Review 2007*. Our contact details are listed in the final pages of this report – please be in contact with us so that we can arrange delivery of the reports you require.

This report contains information that is current as of the date of this report. We undertake no obligation to update this information or notify you if it should change or if new information should become available.

Our aim is to provide publications that are useful and informative. In order to ensure that UBS remains among the leading providers of corporate disclosure, we would like to hear your opinions on how we can improve the content and presentation of our products (see contact details on the final pages of this report).

UBS

Audited information according to IFRS 7 and IAS 1

Risk disclosures provided in line with the requirements of the International Financial Reporting Standard 7 (IFRS 7), *Financial Instruments: Disclosures,* and disclosures on capital required by the International Accounting Standard 1 (IAS 1), *Financial Statements: Presentation,* form part of the financial statements audited by UBS's independent registered public accounting firm Ernst & Young Ltd., Basel. This information (the audited texts, tables and graphs) is marked by a bar on the left-hand side throughout this report and is incorporated by cross-reference into UBS's *Financial Statements 2007.*

Risk management and control

– Taking, managing and controlling risk is core to UBS's businesses. The aim is to achieve an appropriate balance between risk and return
– UBS's risk management and control frameworks are based on business management accountability and independent risk control for credit, market, liquidity, funding and operational risks
– After its substantial losses in 2007, UBS is taking steps to ensure that the lessons learnt are embedded in its risk management and control framework

Developments in 2007

Many parts of UBS's risk management and control framework were resilient in the face of 2007's stressful market conditions

Credit risk:

– the quality of Global Wealth Management & Business Banking's lending portfolio remains high
– the Investment Bank actively reduced credit risk where possible, in light of its exposure to the US residential mortgage market and in conjunction with its management of balance sheet and risk-weighted assets usage

Market risk:

– neither trading management nor market risk controllers foresaw the extreme developments in the previously deep and liquid US residential mortgage market, which revealed the tail risks in UBS's portfolio
– with the accompanying drying up of liquidity in parts of the market, the size of UBS's positions has proved excessive relative to the market

Recent enhancements to market risk management and control

Risk management:
Repositioning of the Investment Bank's fixed income, currencies and commodities (FICC) business:

– creation of a workout group to ensure robust risk management of segregated legacy portfolios and develop orderly exit strategies
– refocusing remaining real estate-related activities towards intermediation of client flows and alignment to needs of investment banking and wealth management clients
– consolidation of flow credit trading management to improve risk aggregation and communication

Risk management and valuation models for products related to US residential mortgages have been refined and recalibrated to reflect current projections and market prices

Risk control:
– improvement of measurement of basis risk by increasing granularity of risk representation
– protection against extreme market moves through more extensive use of limits by asset class, based on gross values as well as risk sensitivities
– additional controls to highlight positions which are large relative to market depth
– revision of global stress testing approach to deliver a more diverse range of scenarios, which better differentiate between the source of a stress event and its contagion effect. Stress testing to consider liquidity as well as price sensitivity

Disclosed risk concentrations

US sub-prime residential mortgages:
– residential mortgage-backed securities (RMBS)
– super senior RMBS collateralized debt obligations (CDOs)
– warehouse and retained RMBS CDOs

US Alt-A residential mortgages:
– AAA-rated RMBS backed by first lien mortgages
– other

US commercial real estate exposures:
– trading assets
– real estate loans

US reference-linked note program

Monoline insurers

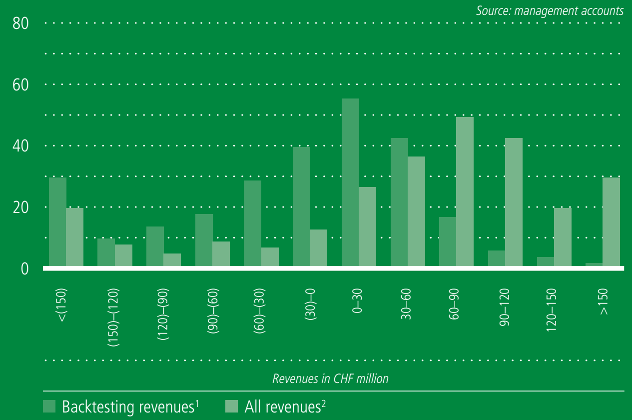
Auction rate certificates

Leveraged finance deals

Disclosure is detailed on pages 11-14 of this report

Investment Bank: revenue distribution

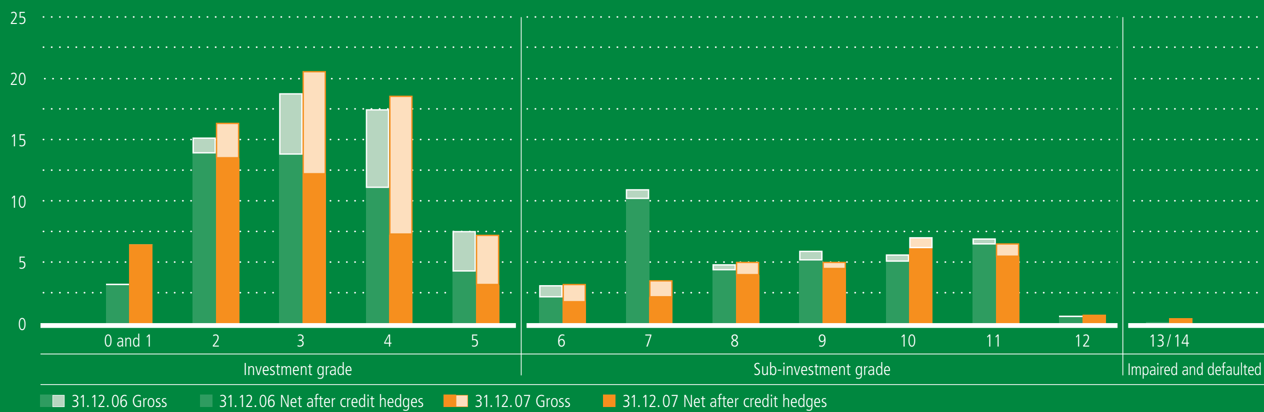
Frequency in number of days *1 January 2007 – 31 December 2007*



1 Excludes non-trading revenues, such as commissions and fees, and revenues from intraday trading. 2 Includes all revenues from business areas which have trading activities.

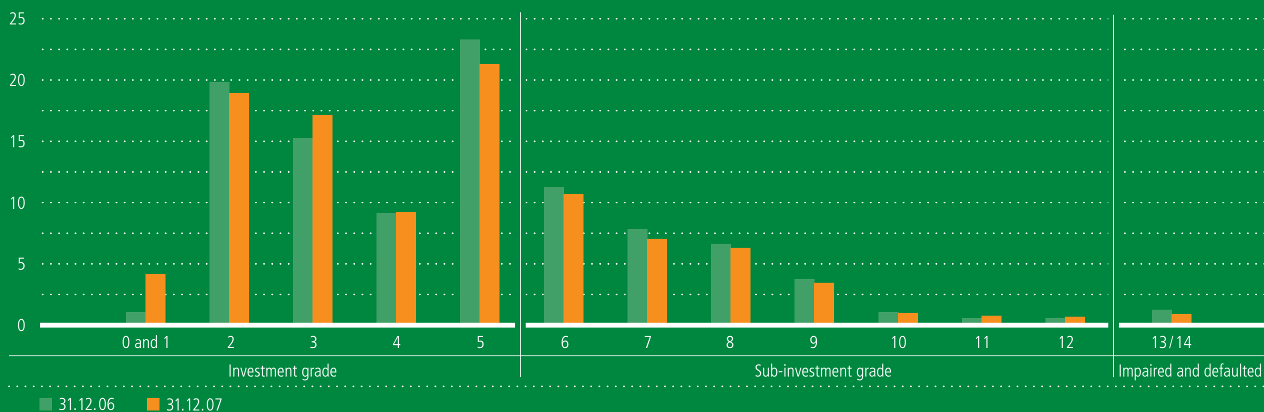
Investment Bank: banking products exposure by UBS internal rating

As a % of Investment Bank banking products exposure



Global Wealth Management & Business Banking: banking products, gross by UBS internal rating

As a % of Global Wealth Management & Business Banking banking products, gross



Risk management and control

In 2007, UBS suffered significant losses as a result of positions in instruments related to US residential mortgage markets. This experience does not invalidate UBS's risk management and risk control principles – the high level precepts remain valid – but it has demonstrated that the policies, measures and processes that implement the principles can be strengthened in some ways. UBS is taking steps to ensure that the lessons learned in 2007 are embedded in its risk management and control frameworks and in the structure and processes of its risk control organization.

The pace of innovation in financial markets makes this challenging, and never more so than when markets undergo major dislocations as they did in 2007. Many parts of UBS's risk management and control frameworks were resilient in the face of these stressful conditions, but, in a limited area of the Investment Bank, some aspects of risk management assessments and the market risk control framework proved inadequate to identify certain risk concentrations and therefore to prevent losses in the extreme market conditions of the second half of 2007.

➔ **The steps UBS is taking to strengthen its risk management and control frameworks are described in the sidebar "Enhancements to market risk management and control" on pages 36–37 of this report**

Risk management and control principles

Audited

Taking, managing and controlling risk is core to UBS's business. The aim is not, therefore, to eliminate all risks but to achieve an appropriate balance between risk and return. UBS's approach to risk management and control is based on five principles:

- *business management throughout the firm is accountable* for all the risks assumed or incurred by their business operations and is responsible for the continuous and active management of risk exposures to ensure that risk and return are balanced;
- an *independent control process* is an integral part of the firm's structure – its goal is to provide an objective check on risk-taking activities and to support senior management in achieving appropriate alignment of the interests of all stakeholders including shareholders, clients and employees;
- comprehensive, transparent and objective *risk disclosure* to senior management, the Board of Directors (BoD), shareholders, regulators, rating agencies and other stakeholders is an essential component of the risk control process;
- *earnings protection* is based on limiting the scope for adverse variations in earnings and exposure to stress events – controls are applied at the level of individual exposures and portfolios in each business and to risk in aggregate, across all businesses and major risk types, relative to the firm's risk capacity (the level of risk UBS is capable of absorbing, based on its anticipated earnings power); and
- *protection of UBS's reputation* ultimately depends on the effective management and control of the risks incurred in the course of business.

The principles are the foundation upon which the more detailed risk management and control frameworks are built. These frameworks comprise both qualitative elements, including policies and authorities, and quantitative components including limits. They are continually adapted and enhanced as UBS's business and the market environment evolve.

Risk management and control responsibilities

Audited

The *BoD* has a strategic and supervisory function. It is responsible for the firm's fundamental approach to risk, for approving the risk principles and for determining risk capacity and risk appetite.

The *Chairman's Office* acts as the Risk Council of the BoD. In this capacity, it oversees the risk profile of the firm on behalf of the BoD and oversees implementation by the Group Executive Board (GEB) of the risk management and control principles.

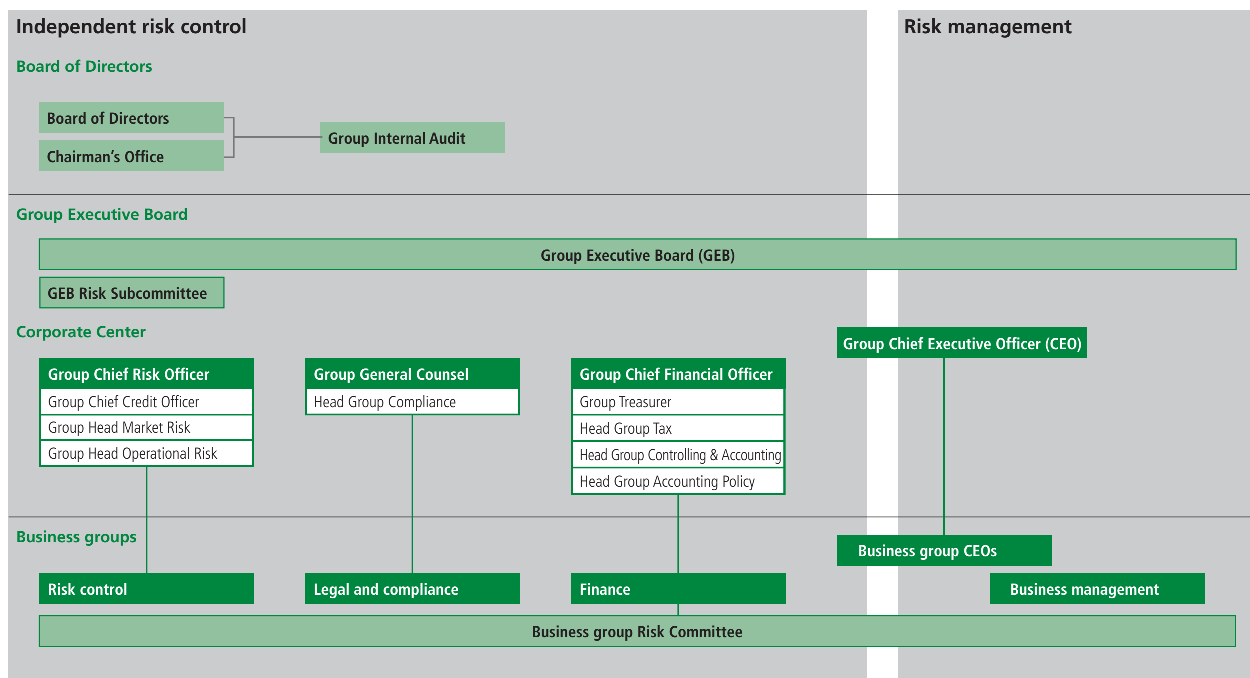
The *GEB, together with its Risk Sub-Committee,* is responsible for implementing the risk principles, including approval of core risk policies, and for managing the risk profile of UBS as a whole.

The *Group Chief Risk Officer (Group CRO)* has overall responsibility for the development, implementation and enforcement of UBS's risk principles. The role is supported by the Group Chief Credit Officer (Group CCO), the Group Head of Market Risk and the Group Head of Operational Risk. Together they establish risk control frameworks, formulate risk policies and determine methodologies for measurement and assessment of risk. They are responsible for monitoring UBS's risks and its risk / return profile, and have the authority to mandate risk reductions in the light of market conditions and UBS's financial resources.

The *Group Chief Financial Officer (Group CFO)* is responsible for transparency in the financial performance of UBS and its business groups, including high-quality and timely reporting and disclosure in line with regulatory requirements, corporate governance standards and global best practice. The Group CFO is responsible for implementation of the risk principles in the areas of capital management, liquidity, funding and tax.

The *Group General Counsel* is responsible for implementing the risk principles in the areas of legal and compliance.

Risk management and control framework



The *Chief Executive Officer (CEO)* of each business group has overall responsibility for the business group and its management, and is accountable for its results and risks.

Within the business groups, *business management* is responsible for ensuring that risks are identified and managed. The *risk control functions* are responsible for the implementation of independent control processes. They are empowered to enforce the risk principles and frameworks and corrective measures mandated by the Group CRO, the risk function heads and senior management.

All employees, but in particular those involved in risk decisions, must make UBS's reputation an overriding concern. Responsibility for UBS's reputation cannot be delegated or syndicated.

The risk control process

There are five key elements in the independent risk control process:

– *risk policies* to implement the risk principles, reflecting UBS's risk capacity and risk appetite, and consistent with evolving business requirements and international best practice. UBS's risk policies are principle-based, specifying minimum requirements, high-level controls and standards, and broad authorities and responsibilities – they are never a substitute for the exercise of sound business judgment but, rather, guide and determine actions and decisions;
– *risk identification* through continuous monitoring of portfolios, assessment of risks in new businesses and complex or unusual transactions, and ongoing review of the risk profile in the light of market developments and external events;
– *risk measurement* using methodologies and models which are independently verified and approved;
– *risk control* by monitoring and enforcing compliance with risk principles, policies and limits, and with regulatory requirements; and
– *transparent risk reporting* to stakeholders, and to management at all levels, on all relevant aspects of the approved risk control framework, including limits.

UBS has control processes around the establishment of new businesses or significant changes to existing businesses, and the execution of complex or unusual transactions. These processes involve the business, and potentially all the control functions – risk control, legal, compliance, treasury, finance, tax and logistics, as necessary. The objective is to ensure that all critical elements are addressed across disciplines. A key aspect is whether transactions can be booked in a way that will permit appropriate ongoing risk management, measurement, control and reporting. These processes are being strengthened to reflect the lessons learned in 2007.

More generally, UBS is seeking ways to further integrate its credit and market risk structure in the Investment Bank to provide a more holistic view within and across asset classes.

➔ For further details, refer to the sidebar "Enhancements to market risk management and control" on pages 36–37 of this report

Risk categories

Business risks are the risks associated with a chosen business strategy – it is business management's responsibility to respond to fundamental changes in the economic environment and the competitive landscape. Business risks are not subject to independent risk control but are factored into the firm's planning and budgeting process and the assessment of UBS's risk capacity and overall risk exposure.

The primary and operational risks inherent in business activities are subject to independent risk control.

Audited

Primary risks are:

- *credit risk* – the risk of loss resulting from the failure of a client or counterparty to meet its contractual obligations. It arises on traditional banking products, such as loans and commitments, and on derivatives and similar transactions. A form of credit risk also arises on securities and other obligations in tradable form. Their fair values are affected by changing expectations about the probability of failure to meet obligations as well as actual failures. Where these instruments are held in connection with a trading activity, UBS controls the risk as market risk;
- *market risk* – the risk of loss resulting from changes in market variables of two broad types: general market risk factors and idiosyncratic components. General market risk factors include interest rates, exchange rates, equity market indices, commodity prices and general credit spreads. Idiosyncratic components are specific to individual names and affect the values of their securities and other obligations in tradable form, and derivatives referenced to those names. *Investment positions* may also be affected by market risk factors but they are often not liquid and are generally intended or required to be held beyond a normal trading horizon. For these reasons they are subject to a different control framework; and
- *liquidity and funding risk* – the risk that UBS might be unable to meet its payment obligations when due, or to borrow funds in the market on an unsecured or secured basis at an acceptable price to fund actual or proposed commitments.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external causes, whether deliberate, accidental or natural. Operational risks must be monitored, and are controlled and mitigated to the extent possible and desirable.

➔ The control frameworks for these risk categories are described in the following sections of this report: "Credit risk", "Market risk", "Investment positions", "Operational risk" and "Treasury and capital management"

Quantitative controls

Audited

In principle, for risks that are quantifiable, UBS measures potential loss at three levels – expected loss, statistical loss and stress loss.

Expected loss is the loss that is expected to arise on average over time in connection with an activity. It is an inherent cost of such activity, and must be factored into business plans. For financial instruments carried at fair value, expected loss is reflected in valuations and deducted directly from revenues.

Statistical loss measures, such as Value at Risk ("VaR"), estimate the amount by which actual loss in a portfolio can exceed expected loss over a specified time horizon, measured to a specified level of confidence (probability).

Stress loss is the loss that could arise from extreme events, typically beyond the confidence level of the statistical loss estimate, and is normally a scenario-based measure.

Concentration controls complement portfolio risk measures. Controls are generally applied where UBS identifies that positions in different financial instruments or different portfolios are affected by changes in the same risk factor or group of correlated factors and there is the potential for significant loss in the event of extreme but plausible adverse developments. UBS's concentration controls include credit limits for individual clients, counterparties and counterparty groups, ceilings on exposure to all but the best-rated countries, limits on potential loss from changes in general market risk factors, and thresholds on single name exposures in the trading portfolio.

➔ These controls are explained in more detail in the "Credit risk" and "Market risk" sections of this report; an analysis of identified risk concentrations is provided in the "Risk concentrations" section of this report

Audited

The primary day-to-day quantitative controls are intended to govern normal periodic adverse results and prevent severe losses as a result of stress events. The identification of stress events and scenarios to which UBS is vulnerable and an assessment of their potential impact – in particular the danger of aggregated losses from a single event through concentrated exposures – is a critical component of the risk control process. Risk measures and controls rely on a combination of past experience, available external data, and judgments about likely future developments. Each new stress event is in some way unique, and thus no risk measure can provide complete protection against every possible scenario. Equally, each stress event offers new insights into ways of enhancing risk measures and controls, whether specific to an individual portfolio or risk type or, as is the case with the experience of 2007, a more generic extension from a particular experience, applying the lessons learned more broadly.

➔ The measures UBS is taking in response to the losses incurred in 2007 are described in the sidebar "Enhancements to market risk management and control" on pages 36–37 of this report

"Earnings-at-risk" and "Capital-at-risk"

To complement the day-to-day operating controls, UBS has developed two concepts – "Earnings-at-risk" and "Capital-at-risk" – to assess aggregate risk exposure across risk types and businesses against its financial resources. These measures

assess UBS's ability to absorb the potential loss inherent in its business in the current economic cycle, across all business lines, and from all major sources, including primary risks, operational risks and business risks.

Earnings-at-risk focuses on UBS's ability to absorb losses from current earnings, while capital-at-risk considers more extreme losses and their potential to lead to a breach of minimum regulatory capital requirements or, ultimately, to insolvency. Capital-at-risk is an input to the capital management process.

Earnings-at-risk has been an integral part of the risk control process since 2004 and is monitored by the GEB and Chairman's Office as part of the regular quarterly risk reporting cycle. The concept reflects UBS's long-held view that the first and primary resource to absorb losses is a firm's earnings stream. Earnings-at-risk has three elements – risk capacity, risk exposure and risk appetite.

Risk capacity is the level of risk UBS considers itself capable of absorbing, based on its earnings power, without damage to its dividend paying ability, its strategic plans and, ultimately, its reputation and ongoing business viability. It is based on a combination of budgeted/forecast and historical revenues and costs, adjusted for performance-related compensation, and dividends and related taxes.

Risk exposure is an estimate of potential loss based on current and prospective risk limits and risk positions across major risk categories – primary risks, operational risk and business risk. It is assessed against a severe but plausible constellation of events over a one-year time horizon to a 95% confidence level – in effect to assess the impact of a "once in 20 years" event. The measure builds on the statistical loss measures used in the day-to-day operating controls as far as possible, extending their time horizons where necessary, with adjustments and supplements determined by management to reflect known coverage gaps, measurement weaknesses and potential events. The results are combined to reflect potential correlations between the various risk categories under the severe scenarios envisaged.

A comparison of risk exposure with risk capacity serves as a basis for determining the appropriateness of current or proposed risk limits, and UBS's ability to pay a cash dividend out of its current year earnings. It is also one of the tools available to management to guide decisions on adjustments to the risk profile.

Risk appetite is established by the BoD, who set an upper bound on aggregate risk exposure in the form of a "risk exposure ceiling". It is appropriate that risk exposure should be less than risk capacity, but in the difficult market conditions that confronted UBS in 2007, this relationship has not held: calculated risk exposure has increased and risk capacity has fallen beyond the levels predicted. For 2007 as a whole, UBS recorded a net loss, showing that the risk inherent in some positions had resulted in total risk exposure greater than UBS's risk capacity.

The pattern of UBS's losses was unexpected – a limited area experiencing extreme writedowns while other areas maintained strong or even record performance. In these circumstances, there was less flexibility to adjust performance-related compensation than had previously been assumed. This, and the actual losses experienced, reduced measured risk capacity.

On the other hand, risk exposure increased. Major market and credit risk limits for parts of the Investment Bank not connected to US residential mortgage markets were adjusted in recognition of the reduced risk capacity but the reduction was more than offset by other factors: the standard market risk measures reported higher exposure as volatility increased, and because it had become apparent that some of these measures did not fully capture certain market risks, a much larger exposure estimate was used for these positions.

Measured risk exposure is neither an expected case nor a worst case and it can be significantly affected by many external factors. Based on UBS's assessment of the various dimensions of its portfolio of risks, and their potential evolution – particularly in light of its US residential mortgage-related exposures – management will continue to reduce the firm's risk exposure to achieve an appropriate level relative to its risk capacity, but liquidity has been and remains quite poor in the markets for positions on which UBS has suffered major losses.

As with any model, Earnings-at-risk is heavily dependent on the many assumptions (including the chosen confidence level) and estimates that are necessarily entailed in determining the inputs and generating the output, not least because risk exposure includes a combination of statistical and more judgmental elements. Measured risk exposure must be understood in this context. Risk capacity and risk exposure are, furthermore, dynamic measures, affected significantly by the external environment which will impact, for example, correlations between risk categories, the liquidity of UBS's positions, the potential to reduce or hedge them at reasonable prices, and UBS's funding costs. In the current difficult market conditions, there is a high degree of uncertainty in the statistical estimation of risk exposure and a material element is now contributed by supplementary measures. Observable data has been supplemented by judgmental elements for residential and commercial real estate, corporate and consumer credit and US municipal and student loan markets, and for potential defaults by monoline insurers. These estimates are subjective, not derived from statistical models but determined through extensive consultation between risk control professionals.

Capital-at-risk builds off the Earnings-at-risk concept but assesses the potential for losses to exceed earnings capacity and erode capital. For Capital-at-risk, the analysis of risk exposure is essentially the same as for Earnings-at-risk but measured at two higher confidence levels – the first in relation

to UBS's minimum regulatory capital requirement, and the second in terms of solvency.

The Capital-at-risk measure of aggregate risk exposure is an important consideration in the assessment of capital adequacy.

➔ Further details are available in the "Capital management" section of this report

Like Earnings-at-risk, Capital-at-risk relies on the day-to-day risk control measures and will potentially underestimate aggregate exposure if these measures do not fully capture the risks. As the underlying systems are enhanced – a process which is already in hand – the measures of aggregate risk exposure will also improve, and in the meantime supplementary estimates will continue to be incorporated. Furthermore, as a result of the events of 2007, UBS has gained a better understanding of the dynamics of the risk capacity and exposure measures and of the interplay between different measures of capacity – in particular the relationship between risk management, treasury management and capital management measures.

Qualitative controls

Although measurement of risk is clearly important, quantification does not always tell the whole story, and not all risks are quantifiable. Due diligence, sound judgment, common sense and an appreciation of a wide range of potential outcomes – including a willingness to challenge assumptions – are key components of a strong risk culture for both risk management and risk control. UBS's risk measures did not adequately identify risks in the US residential mortgage markets in 2007, and qualitative assessments equally did not fully appreciate the range of potential outcomes and the deep tail risk in the portfolio. UBS will learn from this experience and will strive to strengthen its risk culture accordingly.

Risk concentrations

Audited

Risk concentrations

A concentration of risk exists where positions in financial instruments are affected by changes in the same risk factor or group of correlated factors, and the exposure could, in the event of extreme but plausible adverse developments, result in significant losses. The identification of risk concentrations necessarily entails judgment about potential future developments, which cannot be predicted with certainty. In determining whether a concentration of risk exists, risk controllers consider a number of elements, both individually and in combination. They include the shared characteristics of the instruments; the size of the position; the sensitivity of the position to changes in risk factors and the volatility of those factors; the liquidity of the markets in which the instruments are traded and the availability and effectiveness of hedges or other potential risk mitigants; and the risk reward profile of the positions. If a risk concentration is identified, it is assessed to determine whether it should be reduced or the risk should be mitigated, and the available means to do so. Identified concentrations are subject to increased monitoring.

Based on its assessment of the portfolios and asset classes where there is the potential for material loss in a stress scenario relevant to today's environment, UBS believes that the exposures shown below can be considered risk concentrations according to this definition.

There is clearly a possibility that losses could arise on asset classes and positions other than those disclosed, if the correlations that emerge in a stressed environment differ markedly from those envisaged by UBS. The firm has, for example, exposures to other US asset-backed securities (ABS), non-US (both Swiss and non-Swiss) residential and commercial real estate and mortgages, non-US ABS, non-US reference linked note (RLN) programs, corporate collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs) globally, and non-US structured credit programs. It is exposed to credit spread and default risk on its fixed income trading inventory, to idiosyncratic risk on both equities and fixed income inventory, and to emerging markets country risk in many of its trading activities. It has derivatives transactions and a significant prime services business through which it is exposed to the hedge fund industry. If UBS decided to support a Global Asset Management fund or another investment sponsored by UBS it might, depending on the facts and circumstances, present risks that could increase to material levels. UBS does not currently foresee the likelihood of material losses on such positions but the possibility cannot be ruled out.

➔ **The amount and composition of UBS's Swiss real estate exposure, which arises from domestic lending by Global Wealth Management & Business Banking, is discussed in the "Credit risk" section of this report**

Audited

Exposure to US mortgage markets

The area of UBS most severely affected by the progressive market dislocation during 2007 is the fixed income, currencies and commodities (FICC) business of the Investment Bank, which has positions in securities related to the US residential mortgage market in a number of portfolios. The deterioration of this sector was more sudden and severe than any such event in recent market history. As a result, the securitized credit markets became illiquid and UBS's positions, including securities with high credit ratings, lost substantial value. These difficulties persisted throughout third quarter 2007, with further deterioration in fourth quarter 2007 as increasing homeowner delinquencies fuelled market expectations of future writedowns. During fourth quarter, monoline insurers were adversely affected by their exposure to US residential mortgage-linked products.

➔ **The major losses incurred in 2007 on the positions disclosed below are detailed in Note 3 in *Financial Statements 2007***

Audited

In the tables below, the size of the positions held is expressed as "net exposure". Net exposures for each instrument class are the sum of the long and short positions where hedge effectiveness is considered to be high. UBS's net exposures will increase

Audited

US sub-prime residential mortgage exposure

USD billion	Net exposures as of 31.12.07
Total[1]	**27.6**
Of which	
residential mortgage-backed securities (RMBS)	14.2
super senior RMBS collateralized debt obligations (CDOs)[2]	13.3
warehouse and retained RMBS CDOs	0.1

1 The equivalent position at 31 December 2006 was approximately USD 42.5 billion. At this date, positions were not analyzed in the form presented for 31 December 2007. The figure for 31 December 2006 has therefore been estimated based on securities position records, in order to supply the disclosure required by accounting standards. 2 Hedges provided by a single monoline insurer rated non-investment grade on 31 December 2007 were considered to be ineffective. Hedge ineffectiveness is treated as an addition to net exposure and no value is ascribed to the hedge.

Audited

US Alt-A residential mortgage exposures

USD billion	Net exposures as of 31.12.07
Total[1]	26.6
Of which	
AAA-rated RMBS backed by first lien mortgages	21.2
other	5.4

1 There is no industry standard definition of Alt-A. For 31 December 2007 the classification is based solely on FICO scores, which are a commonly used basis of categorization. The equivalent position at 31 December 2006 was approximately USD 37.6 billion. At this date, positions were not analyzed in the form presented for 31 December 2007. The figure for 31 December 2006 has therefore been estimated based on securities position records, in order to supply the disclosure required by accounting standards.

Audited

US commercial real estate exposures

USD billion	Net exposures as of 31.12.07
Trading assets[1]	3.6
Real estate loans[2]	4.1

1 Equivalent position at 31 December 2006 USD 6.5 billion. 2 Equivalent position at 31 December 2006 USD 3.7 billion.

Audited

US reference-linked notes program exposure

	31.12.07[1]		
USD billion	Assets held	Credit protection remaining	Net exposures
Market value	13.2	2.0	11.2
Of which			
sub-prime and Alt-A	4.4	0.6	3.8
commercial mortgage-backed securities (CMBS)	3.6	0.6	3.0
other	5.2	0.8	4.4

1 Equivalent positions at 31 December 2006 were: assets held USD 20.8 billion, of which sub-prime and Alt-A USD 9.9 billion, commercial mortgage-backed securities (CMBS) USD 3.7 billion; net exposure USD 17.2 billion, of which sub-prime and Alt-A USD 7.9 billion, CMBS USD 3.1 billion.

Audited

if hedges are considered to have become ineffective. From a risk management perspective, it is necessary to look beyond net exposure and consider important factors such as different vintages, delinquency rates, credit ratings and underlying mortgage pools, as well as differences in attachment points, timing of cash flows, control rights, other basis risks and counterparty risk.

Positions related to US residential sub-prime mortgages

On 31 December 2007, approximately one-quarter of residential mortgage backed securities (RMBS) referred to mortgage loans of 2005 or earlier vintages, while three-quarters referred to mortgage loans with 2006 and 2007 vintages. On 31 December 2007, the overwhelming majority of these securities were rated AAA and had an expected weighted average life of around three years.

At the same date, around one-third of UBS's positions in super senior RMBS CDOs referred to mortgage loans of vintage 2005 or earlier. The other two-thirds referred to mortgage loans with 2006 and 2007 vintages. These securities have a range of subordination levels, maturities and rights in the event of default.

Positions related to US residential Alt-A mortgages

UBS's Alt-A position can be divided into two categories. The first consists of AAA-rated RMBSs, backed by first lien mortgages, which amounted to USD 21.2 billion at 31 December 2007. The second category consists of other RMBSs, either non-AAA or RMBSs backed by second lien mortgages, and a small CDO exposure. These positions amounted to USD 5.4 billion at year-end 2007.

Positions related to US commercial real estate

UBS has exposure to US commercial real estate from two sources. The first is its trading inventory, which includes commercial mortgage-backed securities (CMBS) and loans held for securitization, amounting to USD 3.6 billion net exposure on 31 December 2007. Approximately 90% of the CMBS and loans are rated AA or better. These positions are exposed to credit spread movements and this risk is actively managed.

The second category consists of direct loans and investments totaling USD 4.1 billion on 31 December 2007, of which USD 400 million are classified as equity investments. These assets are diversified by sector and geography.

Positions related to the US reference-linked note program

The structure of UBS's reference-linked note (RLN) program is explained in the sidebar opposite.

UBS has created ten US RLNs to date. The maximum permitted face values of the underlying asset pools total USD 16.9 billion face value, and UBS holds total credit protection of USD 3.8 billion (on average about 23%).

Audited

Exposure[1] to monoline insurers, by rating

USD billion Credit protection bought from monoline insurers rated[2]	31.12.07 Notional amount[3] Column 1	Fair value of underlying CDOs[4] Column 2	Fair value of CDSs[5] prior to credit valuation adjustment Column 3 (=1–2)	Credit valuation adjustment in 2007 Column 4	Fair value of CDSs after credit valuation adjustment Column 5 (=3–4)
A or higher					
on US sub-prime residential mortgage-backed securities (RMBS) CDOs high grade	7.1	4.7	2.4	0.2	2.2
on US sub-prime RMBS CDOs mezzanine	1.1	0.6	0.5	0.0	0.5
on other US RMBS CDO	1.0	0.8	0.2	0.0	0.2
Total	**9.2**	**6.1**	**3.1**	**0.2**	**2.9**
Non-investment grade or unrated					
on US sub-prime RMBS CDOs high grade	0.0	0.0	0.0	0.0	0.0
on US sub-prime RMBS CDOs mezzanine	1.6	1.1[6]	0.5	0.4	0.1
on other US RMBS CDO	0.8	0.6[6]	0.2	0.2	0.0
Total	**2.4**	**1.7[6]**	**0.7**	**0.6**	**0.1**
Credit protection on US RMBS CDO	**11.6[7]**	**7.8**	**3.8**	**0.8**	**3.0[7]**
Credit protection on other than US RMBS CDOs	**12.6[7]**	**11.9**	**0.7**	**0.1**	**0.6[7]**

1 Excludes the benefit of credit protection purchased from unrelated third parties. 2 Categorization based on the lowest insurance financial strength rating assigned by external rating agencies. 3 Represents gross notional amount of credit default swaps (CDSs) purchased as credit protection. 4 Collateralized debt obligations (CDOs). 5 Credit default swaps (CDSs). 6 Remaining credit protection from non-investment grade monoline of USD 1.2 billion on sub-prime residential mortgage-backed securities (RMBS) CDOs and USD 0.6 billion on other RMBS CDOs is considered ineffective. 7 As of 31 December 2006, the notional amount of CDSs on US RMBS CDOs bought from monoline insurers was USD 6.7 billion and on other exposures USD 7.8 billion. The fair values of these CDSs were zero at that date.

Audited

On 31 December 2007, the total fair value of assets held by UBS in connection with the US RLN program was USD 13.2 billion.

The original credit protection of USD 3.8 billion is still intact. Cumulative fair value gains of USD 1.8 billion have been recognized on this credit protection in the income statement up to 31 December 2007 and the fair value of the remaining credit protection at 31 December 2007 was USD 2 billion.

Exposure to monoline insurers

The vast majority of UBS's direct exposure to the monoline sector arises from over-the-counter (OTC) derivative contracts – mainly credit default swaps (CDSs). Across all asset classes, the total fair value of CDS protection purchased from monoline insurers on 31 December 2007 was USD 3.6 billion, after credit valuation adjustments of USD 957 million (CHF 1,091 million) in 2007, all of which were taken in

Audited

Reference-linked note program

Reference-linked notes (RLN) are credit-linked notes issued by UBS referenced to an underlying pool of assets which are consolidated on UBS's balance sheet. The assets consist of a variety of fixed income positions, including corporate bonds, collateralized loan obligations, residential mortgage-backed securities (RMBSs), commercial mortgage-backed securities, collateralized debt obligations (CDOs) and other asset-backed securities. The proceeds of the notes provide UBS with credit protection against defined default events in the underlying asset pool up to a certain percentage. The notes have a maturity that is generally longer than the life of the instruments included in the underlying pool.

Through the lifetime of each RLN, UBS will realize losses if defaults in the underlying asset pool exceed the percentage protection, or if assets which do not ultimately default are sold at a loss.

Up to maturity, UBS is subject to revenue volatility as the RLN program is classified as held for trading under International Financial Reporting Standards (IFRS) and is therefore carried at fair value. Since the inception of the US RLN program, the credit protection has been valued using approaches that UBS considers to be consistent with market standard approaches for tranched credit protection. UBS seeks to actively manage its risk exposures in connection with the US RLN program via derivative and cash market positions. This can also contribute to revenue volatility.

Audited

Leveraged finance commitments

USD billion	As of 31.12.07[1]
Total	11.4
Of which old deals	5.6
funded	3.2
Of which new deals	5.8
funded	4.2

1 The total equivalent position at 31 December 2006 was total USD 12.3 billion, of which the funded component was USD 0.9 billion.

Audited

fourth quarter. Of these totals, USD 2.9 billion represents CDSs bought as protection for portfolios of US RMBS CDO, after credit valuation adjustments of USD 871 million (CHF 993 million) in fourth quarter.

Direct exposure to monoline insurers is calculated as the sum of the fair values of individual CDSs. This, in turn, depends on the valuation of the instruments against which protection has been bought. A positive fair value, or a valuation gain, on the CDS is recognized if the fair value of the instrument it is intended to hedge is reduced.

The table on the previous page shows the CDS protection bought from monoline insurers. It illustrates the notional amounts of the protection originally bought, the fair value of the underlying CDOs and the fair value of the CDSs both prior to and after credit valuation adjustments taken for these contracts in 2007.

In fourth quarter 2007, UBS took credit valuation adjustments of USD 588 million (CHF 670 million) on CDSs on US RMBS CDOs purchased from a monoline insurer whose credit rating was downgraded to "non-investment grade". These valuation adjustments reflect the degree to which UBS considers its claims against this monoline counterparty to be impaired. For risk management purposes, the underlying US RMBS CDOs are treated as unhedged on 31 December 2007 and are included in the super senior RMBS CDO exposure in the table on page 11.

In its trading portfolio, UBS also has indirect exposure to monoline insurers through "monoline wrapped" securities issued by US states and municipalities, student loan programs and other asset-backed securities totaling approximately USD 11 billion on 31 December 2007 (approximately USD 8 billion on 31 December 2006).

Exposure to auction rate certificates

Auction rate certificates (ARCs) are long-term securities structured to allow frequent resetting of their coupon and, at the same time, the possibility for holders to redeem their investment, giving ARCs some of the characteristics of a short-term instrument. They are typically issued by US states, student loan programs, municipalities and related agencies and authorities, and may be wrapped by monoline insurers. An auction takes place at the beginning of each interest reset period to determine the coupon for that period.

UBS sponsors ARCs programs and although it is not obligated to do so, it has, from time to time, provided liquidity to the auction process by buying securities when there were not enough bids from investors. As a result of the continued deterioration of credit markets and concerns about the financial status of monoline insurers, the demand for ARC securities has been falling since fourth quarter 2007. In first quarter 2008 a number of auctions failed and the market has become illiquid, leading to valuation uncertainties.

On 31 December 2007, UBS had ARC positions in its trading inventory totaling USD 5.9 billion, of which USD 4.5 billion related to student loans. USD 1.9 billion of the student loans and USD 1.4 billion of the other ARCs are "monoline wrapped" and are included in the indirect exposures to monolines of USD 11 billion detailed above. There were no material writedowns on ARCs securities up to the end of 2007.

On 31 December 2006, UBS had ARC positions totaling USD 1.0 billion, of which USD 0.3 billion related to student loans. USD 0.1 billion of the student loans and USD 0.7 billion of the other ARCs were monoline wrapped.

Exposure to leveraged finance deals

UBS has leveraged finance commitments entered into both before and after the market dislocation in July 2007. Transactions since this dislocation typically have pricing terms and covenant and credit protection that are more favorable to underwriters and investors than those entered into in the first half of 2007. On 31 December 2007, commitments entered into by UBS before the dislocation ("old deals") amounted to USD 5.6 billion while those entered into subsequent to the dislocation ("new deals") totaled USD 5.8 billion.

Credit risk

Audited

Credit risk is the risk of financial loss resulting from failure by a client or counterparty to meet its contractual obligations to UBS. This can be caused by factors directly related to the counterparty, such as business or management problems, or from failures in the settlement process, for example on foreign exchange transactions, where UBS has honored its obligation but the counterparty fails to deliver the counter-value (settlement risk). Alternatively, it can be triggered by economic or political difficulties in the country in which the counterparty is based or where it has substantial assets (country risk).

Sources of credit risk

Credit risk is inherent in traditional banking products – loans, commitments to lend and contingent liabilities, such as letters of credit – and 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 – 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.

Many of the business activities of Global Wealth Management & Business Banking and the Investment Bank create credit risk. Global Wealth Management & Business Banking offers private and corporate customers in Switzerland and wealth management clients internationally a variety of credit products, although the majority of credit risks are well secured against financial collateral or other assets. The Investment Bank gives corporate, institutional, intermediary and alternative asset management clients access to the full range of credit and capital markets instruments across all product classes, and engages with other professional counterparties in its trading and risk management activities.

Credit risk control organization and governance

Effective credit risk control is critical to UBS's safety and soundness. The credit risk control framework is based on the risk management and control principles, supported by credit policies. It has both qualitative and quantitative elements. UBS has established processes to ensure that risks are identified, assessed, pre-approved where necessary, and continuously monitored and reported. Measures and limits are applied to the credit risk of individual counterparties and counterparty groups, and the quality and diversification of portfolios and sub-portfolios are assessed, a key objective being to control risk concentrations.

The Group Chief Credit Officer (Group CCO), who reports to the Group Chief Risk Officer (Group CRO), is responsible for implementing and maintaining this framework, supported by independent credit risk control units in the business groups who report to the Group CCO functionally and who continuously monitor and control credit risk. Their responsibilities include assessing the creditworthiness of individual counterparties and the adequacy and effectiveness of any security or credit hedges, and evaluating credit risk in portfolios, subportfolios and other aggregations, including country risk.

The Chairman's Office delegates authority to the Group Executive Board (GEB) and approves delegations by the GEB ad personam to the Group CCO and the business group CCOs. Further delegations are made to credit officers in the business groups. The level of credit authority delegated to holders depends on their seniority and experience and varies according to the quality of the counterparty and any associated security. These authorities encompass all aspects of the approval of credit risk, including settlement risk, and the determination of allowances, provisions and credit valuation adjustments for any impaired claims.

Credit risk control

Limits and controls

The primary objective of quantitative controls is to avoid, as far as possible, undue credit risk concentrations. Concentrations of credit risk exist if clients are engaged in similar activities, or are located in the same geographical region or have comparable economic characteristics such that their ability to meet contractual obligations would be similarly affected by changes in economic, political or other conditions. UBS has established limits to constrain exposure to individual counterparties and counterparty groups and at portfolio and sub-portfolio levels, wherever risk concentrations are identified, including exposure to specific industries and countries, where appropriate.

At the level of the individual counterparty and counterparty group, credit officers establish limits for all types of banking and traded products exposure, which cover not only the current outstanding amount and replacement values of contractual obligations but also contingent commitments and the potential future development of exposure on traded products. Credit engagements may not be entered into without the appropriate approvals and limits.

Limits are applied in a variety of forms to portfolios or sectors, where necessary, to restrict risk concentrations or areas of higher risk, or to control the rate of portfolio growth. In particular for higher risk engagements, such as the Investment

Audited

Bank's leveraged lending portfolio, the impact of variations in default rates and asset values is assessed using stress scenarios, taking into account risk concentrations. Stress loss limits are applied to portfolios where considered necessary, including limits on exposures to all but the best-rated countries.

In establishing these controls, including the related authorities and approval processes, a distinction is made between those exposures which are to be held to maturity ("take and hold" exposures) and those which will be held only in the short term, pending distribution or risk transfer ("temporary exposures"). An example of temporary exposure is syndicated lending where the bulk of the original commitment will be distributed to other financial institutions or investors. For all exposures, the credit quality and cash flow generation capacity of the counterparty over the full term of the obligation are at the heart of the credit assessment. For temporary exposures, market liquidity and UBS's distribution capabilities are also key considerations in the approval process.

Risk mitigation

UBS employs risk mitigation techniques for most of its credit portfolios, typically by taking security in the form of financial collateral (cash or marketable securities) or other assets, or through risk transfers or the purchase of credit protection.

Taking security is the most common form of risk mitigation. Valuation standards are applied in assessing the mitigating effect of security. In lending to affluent private clients (lombard lending) the pledge of securities or cash is required. The Investment Bank also takes financial collateral in the form of marketable securities in much of its over-the-counter (OTC) derivatives activity and in its securities financing (securities lending/borrowing and repurchase/reverse repurchase) business. Where financial collateral is taken, discounts ("haircuts") are generally applied to the market value, reflecting the quality, liquidity, volatility – and in some cases complexity – of the individual instruments. Exposures and collateral positions are continuously monitored, and margin calls and close-out procedures are enforced when the market value of collateral falls below predefined levels relative to the exposure. Collateral concentrations within individual client portfolios and across clients are also monitored where relevant and may affect the discount applied to specific collateral. For property financing, a mortgage over the relevant property is taken to secure the claim, considering the ability of the borrower to service the debt from income, and in accordance with UBS's policy on loan to value ratios.

OTC derivatives business is conducted almost without exception under bilateral master agreements, which generally allow for the close out and netting of all transactions in the event of default by the other party. UBS has also entered into two-way collateral agreements with market participants, under which either party can be required to provide collateral in the form of cash or marketable securities when exposure exceeds a pre-defined level. The OTC derivatives business with lower-rated counterparties is generally conducted under one-way collateral agreements where the counterparty provides collateral to UBS. Under these agreements, only cash or very liquid collateral is accepted. UBS has standards for netting and collateral agreements, including assurance that contracts are legally enforceable in insolvency in the relevant jurisdictions.

UBS has also made use of credit hedging, in the form of risk transfers, securitizations and purchase of credit protection, as part of its active management of credit risk to reduce concentrated exposures to individual names or sectors or in specific portfolios. Most of this credit hedging is achieved by transferring underlying credit risk to high-grade market counterparties using single name credit default swaps, executed under bilateral netting agreements and generally also under collateral agreements. Credit-pooling vehicles are also used to transfer risk to outside investors via credit-linked notes. In the internal risk reporting processes, the gross exposure before hedging as well as net exposure is tracked. The benefit of credit hedges is only recognized in credit risk measures if they cover future exposure increases to a high level of confidence, and offer protection against a wide range of credit events, including failure to pay, bankruptcy and insolvency, restructuring and repudiation, and moratorium. Proxy hedges (credit protection on a different but correlated name) and index or macro hedges are not recognized.

The effectiveness of credit protection bought from a counterparty depends on the ability of the counterparty to meet any claim. Exposure to credit protection providers is monitored as part of overall credit exposure. Where there is significant correlation between the counterparty and the hedge provider (so-called "wrong-way risk") UBS's policy is not to recognize any benefit in credit risk measures.

Reporting

An essential element of the credit risk control process is transparent and objective risk reporting.

The credit risk control units in the business groups are responsible for risk reporting to business group management covering both exposure to individual counterparties from all products and activities, and portfolio risks. They also supply information to a central unit under the Group CCO, which provides consolidated reports of counterparty and portfolio risk and country risk to senior management, the GEB, the Chairman's Office, the Board of Directors (BoD) and regulators where applicable.

Credit risk measurement

Credit risk measurement is an essential component of the credit risk control framework. The measurement of credit exposure from a loan which is fully drawn is straightforward. By contrast, the estimation of credit exposure on a traded product, the value of which varies with changes in market variables, interim cash flows and the passage of time, is more complex and requires the use of models. The assessment of

portfolio risk also entails estimations of the likelihood of defaults occurring, of the associated loss ratios if they do, and of default correlations between counterparties.

UBS has developed tools to support the quantification of credit risk of individual counterparties, applying the three generally accepted parameters: probability of default, loss given default and exposure at default. Models are also used to derive portfolio risk measures – expected loss, statistical loss and stress loss.

Models are generally developed by dedicated units within the business groups. In line with UBS's internal governance standards and the requirements of the new regulatory capital framework (Basel II), the development and maintenance of models conforms to global standards, and the models and their components are subject to independent verification by a specialist team in Corporate Center before implementation. The model owners in the business groups are responsible for monitoring performance once the models are deployed. Models must comply with established measurement standards to ensure consistency and allow meaningful aggregation of credit risk across all businesses.

Audited

Credit risk parameters

Three parameters are used to measure and control individual counterparty credit risk:

- the *"probability of default",* which is an estimate of the likelihood of the client or counterparty defaulting on its contractual obligations. This probability is assessed using rating tools tailored to the various categories of counterparties. They are also calibrated to the UBS 15-class Masterscale, in order to ensure consistency in the quantification of default probabilities across all counterparties. Besides their use for credit risk measurement, ratings are an important element in setting credit risk authorities;
- the likely recovery ratio on the defaulted claims, which is a function of the type of counterparty and any credit mitigation or support (such as security or guarantee), from which the *"loss given default"* is determined;
- the current exposure to the counterparty and its possible future development, from which potential *"exposure at default"* is derived. For traded products such as OTC derivatives, the exposure at default is not a definitive number – it must be derived by modeling the range of possible outcomes. In measuring individual counterparty exposure against credit limits, UBS considers the "maximum likely exposure" measured to a high confidence level over the full life of all outstanding obligations, whereas in aggregating exposures to different counterparties for portfolio risk measurement, the expected exposure to each counterparty at a given time horizon (usually one year) generated by the same model is used.

These parameters are the basis for most internal measures of credit risk. They are also key inputs to the regulatory capital calculation under the Advanced Internal Rating Based approach of the new Basel Capital Accord (Basel II), which UBS has adopted from 1 January 2008, when the Accord came into force.

➔ For a more detailed description of the three credit risk parameters discussed above, please refer to "Rating system design and estimation of credit risk parameters" on pages 29–30 of this report

Expected loss

Credit losses must be expected as an inherent cost of doing business. But the occurrence of credit losses is erratic in both timing and amount, and those that arise usually relate to transactions entered into in previous accounting periods. In order to reflect the fact that future credit losses are implicit in today's portfolio, UBS uses the concept of "expected loss".

Expected credit loss is a statistically based concept which is used to estimate the annual costs that are expected to arise, on average, from positions in the current portfolio that become impaired. The expected loss for a given credit facility is a function of the three components described above – probability of default, loss given default and exposure at default. The expected loss figures for individual counterparties are aggregated to derive the expected credit loss for the whole portfolio.

Expected loss is the foundation of credit risk quantification in all portfolios. It is an input to the valuation or pricing of some products, and the determinant of credit risk costs charged to the business in the management accounts, which differs from the credit loss expense reported under International Financial Reporting Standards (IFRS). Expected loss is also the starting point for the measurement of portfolio statistical loss and stress loss.

➔ For more information on credit loss expenses, please refer to pages 28–29 of this report and Note 2a in *Financial Statements 2007*

Statistical loss

UBS uses a statistical model – Credit Value at Risk ("Credit VaR") – to estimate the largest potential loss on the portfolio over one year measured to a specified level of confidence. The shape of the modeled loss distribution is driven by systematic default relationships amongst counterparties within and between segments. The results of this analysis provide an indication of the level of risk in the portfolio, and the way it develops over time. It is also an important input to the overall risk measures Earnings-at-risk and Capital-at-risk.

➔ "Earnings-at-risk" and "Capital-at-risk" are described in the "Risk management and control" section of this report

Stress loss

Stress loss is a scenario-based measure which complements the statistical model. It is used to assess potential loss in various extreme but plausible scenarios in which it is assumed that one or more of the three key credit risk parameters deteriorates substantially according to a pattern that is

typical for the chosen scenario. Stress tests are run regularly, and on an ad hoc basis as necessary, in order to identify adverse portfolio situations, particularly risk concentrations. All scenario results are monitored, and for certain portfolios and segments, stress loss is subject to limits.

Audited

Composition of credit risk (Group)

The measures of credit risk differ, depending on the purpose for which exposures are aggregated – financial accounting under IFRS, determination of regulatory capital, or UBS's own internal management view, i.e. the way credit portfolio risk is managed. The table below starts with the IFRS view ("maximum exposure to credit risk"), and shows the adjustments made to reach the internal view ("gross credit exposure"). The gross credit exposure shown in the table is broadly aligned with the regulatory capital view, but does not include the potential future exposure that can arise on traded products which is an additional component of both the internal and regulatory capital views, as explained below.

In general, none of the exposures in the table reflects the benefit of security held or other risk mitigation employed, such as hedging and risk transfers. The main differences between the internal and IFRS views of gross credit exposure are:

- within banking products, cash collateral posted by UBS against negative replacement values on derivatives and other positions is not considered to be credit exposure but, rather, is reflected in the assessment of counterparty risk on the underlying positions. On the other hand, in its internal risk control view UBS considers certain financing which is conducted, for legal reasons, under repurchase-/reverse repurchase-like agreements, and shown as such under IFRS, to be loans;
- the derivatives exposure shown under IFRS is the sum of all positive replacement values, offset by negative replacement values with the same counterparty only if the cash flows are intended to be settled on a net basis. Internally, UBS nets positive and negative replacement values with the same counterparty where the business is conducted under a bilateral master agreement which allows for close-out and netting of all transactions in the event of default by either party, and such agreements are judged to be legally enforceable in insolvency; and
- under IFRS, securities lending/borrowing and repurchase/reverse repurchase transactions are shown on the balance sheet as UBS's full claim on the counterparty without recognizing the counterclaim which the counterparty has for return of cash or securities on the same transactions. By contrast, for internal risk control purposes, the claims on and counterclaims from each counterparty are considered on each transaction on a net basis, and further netted across transactions where such netting is considered to be legally enforceable in insolvency.

Note that under US Generally Accepted Accounting Principles (GAAP) a greater degree of netting is permitted than under IFRS for OTC derivatives replacement values and for securities lending/borrowing and repurchase/reverse repurchase transactions. UBS's balance sheet figures for these types of transactions are not directly comparable to those of firms which report under US GAAP.

Audited

Exposure to credit risk

	31.12.2007					31.12.2006	
	IFRS[1] reported values[2]	Adjustments: balance sheet to regulatory capital view		Valuation and other adjustments		IFRS[1] reported values[2]	
CHF million	Maximum exposure to credit risk	Consolidation scope adjustment	Capital view adjustments		Gross credit exposure[3]	Maximum exposure to credit risk	Gross credit exposure[3]
Cash and balances with central banks	18,793	(1)	0	(2,358)	16,434	3,495	1,311
Due from banks	60,907	(293)	(1,928)	(32,383)	26,303	50,426	25,810
Loans	335,864	(136)	(3,910)	(50,984)	280,834	297,842	274,830
Financial assets designated at fair value	4,116	0	0	50	4,166	2,252	2,348
Contingent claims	20,824	0	0	(384)	20,440	17,908	17,654
Undrawn irrevocable credit facilities	83,980	51	846	(3,906)	80,971	97,287	83,428
Banking products	**524,484**	**(379)**	**(4,992)**	**(89,965)**	**429,148**	**469,210**	**405,381**
Derivatives[4]	428,217	3,171	(39)	(292,371)	138,978	292,975	110,732
Securities lending/borrowing[5]	207,063	0	0	(184,060)	23,003	351,590	37,851
Repurchase/reverse repurchase agreements	376,928	0	0	(372,937)	3,991	405,834	10,019
Traded products	**1,012,208**	**3,171**	**(39)**	**(849,368)**	**165,972**	**1,050,399**	**158,602**
Total at the end of the year	**1,536,692**	**2,792**	**(5,031)**	**(939,333)**	**595,120**	**1,519,609**	**563,983**
Less: contra assets allowances, provisions and credit valuation adjustments					(1,978)		(1,477)
Net of impairment losses recognized					**593,142**		**562,506**

1 International Financial Reporting Standards (IFRS). 2 These amounts are considered the best representation of "maximum exposure to credit risk" as defined by IFRS, measured gross, without taking into account collateral held or other credit enhancements and only netting in accordance with IFRS. 3 Gross credit exposure is an internal view of credit risk. 4 Positive replacement values, netted in accordance with IFRS or internal view as applicable. 5 Cash collateral on securities borrowed.

As explained in the Credit risk measurement section, UBS also measures, and generally applies limits to, credit exposure to individual counterparties and counterparty groups and measures risk across counterparties at various portfolio and sub-portfolio levels. In these calculations UBS also considers the potential development of replacement values of traded products over time as market risk factors change, interim payments are made and transactions mature, all of which can significantly alter the risk exposure profile over time. These potential developments are not reflected in the tables opposite and below, which reflect only the current exposures.

Audited

The credit risk exposure reported in the table opposite also excludes UBS's participation in the deposit insurance guarantee scheme under Swiss Banking Law, according to which Swiss banks and securities dealers are required to jointly guarantee an amount of up to CHF 4 billion for privileged client deposits in the event that another Swiss bank or securities dealer becomes insolvent. For the period 1 July 2007 to 30 June 2008, the Swiss Federal Banking Commission (SFBC) has established UBS's share in the deposit insurance as CHF 846 million.

Total gross credit exposure amounted to CHF 595.1 billion on 31 December 2007, an increase of CHF 31.1 billion since the end of the previous year. Almost half of this increase was due to higher balances with central banks, reflecting UBS's higher liquidity reserves towards year-end. The growth in loan exposure was entirely due to increased collateralized lending activity in Global Wealth Management & Business Banking. The Investment Bank actively reduced credit risk, where possible, in light of its exposure to US residential mortgage-related products and in conjunction with its management of balance sheet and risk-weighted asset usage.

The quality of the gross unimpaired credit portfolio improved as the investment grade component (internal rating grades 0–5) increased to 79.0% from the previous year's level of 73.5%.

The table below shows the gross credit exposure (i.e. without recognition of credit hedges, collateral or other risk mitigation) by business group.

The largest contributor to gross credit exposure at CHF 311 billion is the lending portfolio (Due from banks CHF 26 billion, Loans CHF 281 billion, and Financial assets designated

Audited

Gross credit exposure by UBS internal ratings

CHF million	Banking products		Traded products		Total exposure	
UBS internal rating	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06
0–1	**30,540**	5,265	**42,852**	34,148	**73,392**	39,413
2–3	**164,476**	135,149	**98,454**	95,449	**262,930**	230,598
4–5	**113,955**	119,926	**15,210**	19,973	**129,165**	139,899
6–8	**76,601**	94,278	**7,566**	8,084	**84,167**	102,362
9–12	**38,875**	44,711	**915**	760	**39,790**	45,471
Total 0–12 (net of past due)	**424,447**	399,329	**164,997**	158,414	**589,444**	557,743
Impaired assets	**2,433**	2,682	**975**	188	**3,408**	2,870
Past due but not impaired	**2,268**	3,370			**2,268**	3,370
Total	**429,148**	405,381	**165,972**	158,602	**595,120**	563,983

Gross credit exposure by business groups

	Global Wealth Management & Business Banking		Investment Bank		Other[1]		UBS[1]	
CHF million	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06
Cash and balances with central banks	**9,992**	900	**6,441**	410	**1**	1	**16,434**	1,311
Due from banks	**8,236**	6,245	**17,532**	18,966	**535**	599	**26,303**	25,810
Loans	**240,643**	222,775	**39,725**	51,951	**466**	104	**280,834**	274,830
Financial assets designated at fair value	**0**	0	**4,166**	2,348	**0**	0	**4,166**	2,348
Contingent claims	**15,929**	13,138	**4,500**	4,516	**11**	0	**20,440**	17,654
Undrawn irrevocable credit facilities	**2,081**	2,064	**78,890**	81,364	**0**	0	**80,971**	83,428
Banking products	**276,881**	245,122	**151,254**	159,555	**1,013**	704	**429,148**	405,381
Derivatives	**2,735**	1,273	**136,149**	109,437	**94**	22	**138,978**	110,732
Securities lending / borrowing	**63**	307	**22,940**	37,544	**0**	0	**23,003**	37,851
Repurchase / reverse repurchase agreements	**162**	234	**3,829**	9,785	**0**	0	**3,991**	10,019
Traded products	**2,960**	1,814	**162,918**	156,766	**94**	22	**165,972**	158,602
Total credit exposure, gross	**279,841**	246,936	**314,172**	316,321	**1,107**	726	**595,120**	563,983
Net of impairment losses recognized	**278,873**	245,705	**313,162**	316,075	**1,107**	726	**593,142**	562,506

1 Includes Global Asset Management, Corporate Center and Industrial Holdings.

at fair value CHF 4 billion) which represents 52% of total gross credit exposure and 73% of total banking products exposure. Within this lending portfolio, CHF 249 billion (80%) is attributable to Global Wealth Management & Business Banking. Traded products exposure is incurred predominantly by the Investment Bank. The sections below provide further details of products, industry and rating distributions in the business group portfolios.

In the portfolio of loans to affluent private clients secured by securities (lombard lending) there are no material risk concentrations, either within the overall collateral pool or with respect to the counterparties themselves.

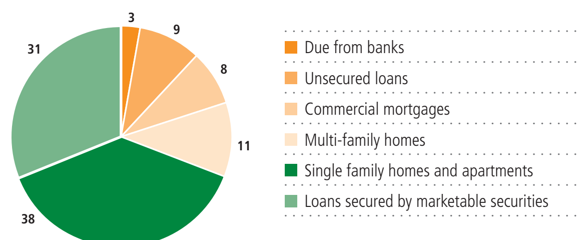
The property financing portfolio is diversified and limits per counterparty ensure that no single property exposure presents an undue concentration.

Exposure to providers of credit protection, usually in the form of credit derivatives, is controlled by the overall credit limit for the counterparty, which is typically a high-grade financial institution, or else the exposure is fully funded, for example through a synthetic securitization.

Global Wealth Management & Business Banking: composition of lending portfolio, gross

in %

As of 31.12.07



Composition of credit risk (business groups)

Global Wealth Management & Business Banking

Total gross banking products exposure of Global Wealth Management & Business Banking, which stood at CHF 277 billion on 31 December 2007, increased by CHF 32 billion or 13% from a year earlier. Both the amount and the proportion of the total portfolio classified as investment grade increased from the previous year. The distribution of the exposure across UBS's internal rating and loss given default (LGD) buckets as displayed in the table below shows that the majority of the exposure is from products attracting the lowest LGDs, demonstrating the continued improvement in the quality of this portfolio.

Global Wealth Management & Business Banking's gross lending portfolio (Due from banks and Loans) on 31 December 2007 amounted to CHF 249 billion, of which CHF 142 billion (57 %) was secured by real estate and CHF 78 billion (31%) by marketable securities. The pie chart above shows that exposure to real estate is well diversified with 38% of the gross lending portfolio being secured on single family homes and apartments which, historically, have exhibited a low risk profile. The 11% of exposure secured by residential multi-family homes consists of rented apartment buildings. Loans and other credit engagements with individual clients, excluding mortgages, amounted to CHF 99 billion and are predominantly extended against the pledge of marketable securities. The volume of collateralized lending to private individuals rose by CHF 15 billion or 24% from the previous year. The increasing demand for this product, as in 2006, reflects the continuing low interest rate environment.

The high quality of Global Wealth Management & Business Banking's lending portfolio is demonstrated by the table below, which shows newly impaired loans and related allowances and provisions in relation to the total gross lending portfolio at year-end for the last four years. Despite an increase in the total gross lending portfolio each year, the totals of new impairments and of new allowances and provisions have declined. Most of the newly impaired loans are secured by mortgages or other collateral so that new allowances are proportionately lower than the newly impaired positions.

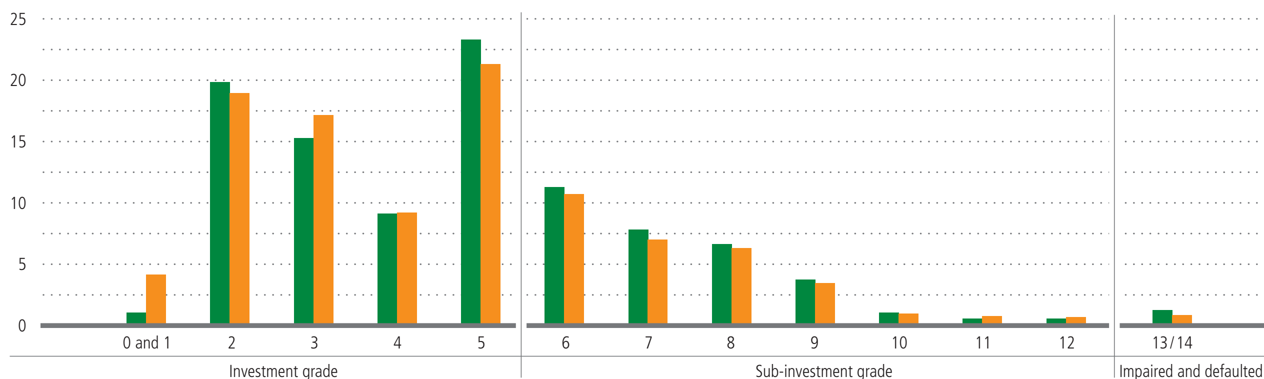
The Swiss lending portfolio (excluding mortgages) within the Business Banking area amounted to CHF 22 billion, representing 8% of Global Wealth Management & Business Banking's total gross banking products exposure. It is widely spread across industries, with the largest exposures being to banks and financial institutions, followed by public authorities.

Global Wealth Management & Business Banking: development of impaired loans portfolio

CHF million, except where indicated	**2007**	2006	2005	2004
Total lending portfolio, gross, at year-end	**248,878**	229,021	217,327	180,718
New impaired loans	**323**	345	532	537
New allowances / provisions	**91**	128	138	239
New impairments as a % of total lending portfolio, gross	**0.13**	0.15	0.24	0.30
New allowances / provisions as a % of total lending portfolio, gross	**0.04**	0.06	0.06	0.13

Global Wealth Management & Business Banking: banking products, gross by UBS internal rating

As a % of Global Wealth Management & Business Banking banking products, gross



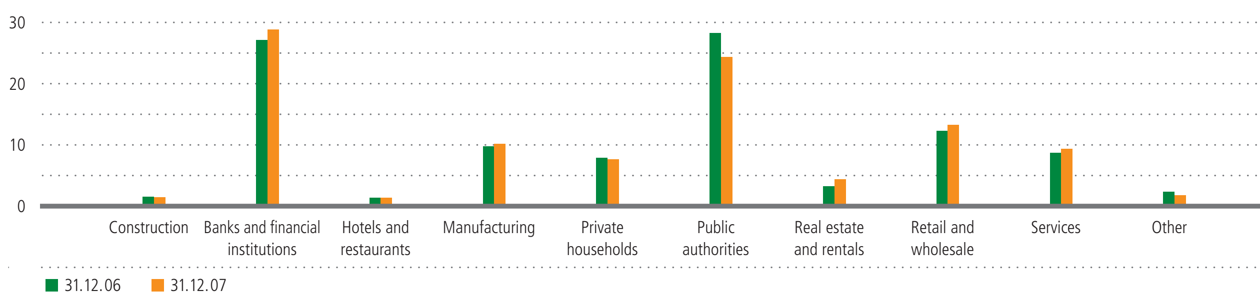
Global Wealth Management & Business Banking: distribution of banking products exposure across UBS internal rating and loss given default buckets

As of 31.12.07		Loss given default (LGD) buckets				Weighted average
CHF million	Gross exposure	0–25%	26–50%	51–75%	76–100%	LGD (%)
0	1,498	104	1,393	1		33
1	9,741	4	9,696	41		40
2	52,237	48,881	3,110	246		20
3	47,473	40,476	5,083	570	1,344	21
4	25,163	21,643	2,986	534		18
5	58,957	53,665	3,650	1,639	3	17
6	29,307	25,222	3,851	222	12	19
7	19,210	16,599	1,977	613	21	20
8	17,192	11,723	4,502	962	5	24
9	9,019	6,883	840	237	1,059	27
10	2,192	1,805	266	119	2	23
11	1,689	1,468	194	27		22
12	1,349	1,305	29	15		20
Total non-impaired	**275,027**	**229,778**	**37,577**	**5,226**	**2,446**	**21**
Investment grade	195,069	164,773	25,918	3,031	1,347	
Sub-investment grade	79,958	65,005	11,659	2,195	1,099	
Impaired and defaulted[1]	1,854					
Total banking products	**276,881**	**229,778**	**37,577**	**5,226**	**2,446**	

1 Includes CHF 34 million of off-balance sheet items.

Business Banking Switzerland: lending portfolio, gross (excluding mortgages) by industry sector

As a % of Business Banking Switzerland lending portfolio, gross (excluding mortgages)



Investment Bank

A substantial majority of the Investment Bank's gross credit exposure falls into the investment grade category (internal counterparty rating classes 0 to 5), both for gross banking products (69%) and for traded products (94%). The counterparties are primarily banks and financial institutions, multinational corporate clients and sovereigns.

Banking products exposure

On 31 December 2007, the Investment Bank's total gross credit exposure from banking products amounted to CHF 151.3 billion or CHF 100.7 billion net, taking credit hedges into account. Of this net amount, CHF 31.3 billion was considered temporary exposure and CHF 69.4 billion take and hold exposure. The table below shows the composition of the Investment Bank's gross banking products exposure, the hedges and other risk mitigation and the net exposure in total and for the take and hold portfolio. Compared with the end of 2006, the net take and hold exposure fell by one-third as a result of active risk reduction and management of balance sheet and risk-weighted asset usage.

As described under "Risk mitigation" on page 16 of this section, the Investment Bank has engaged in a substantial credit risk hedging program and on 31 December 2007 had

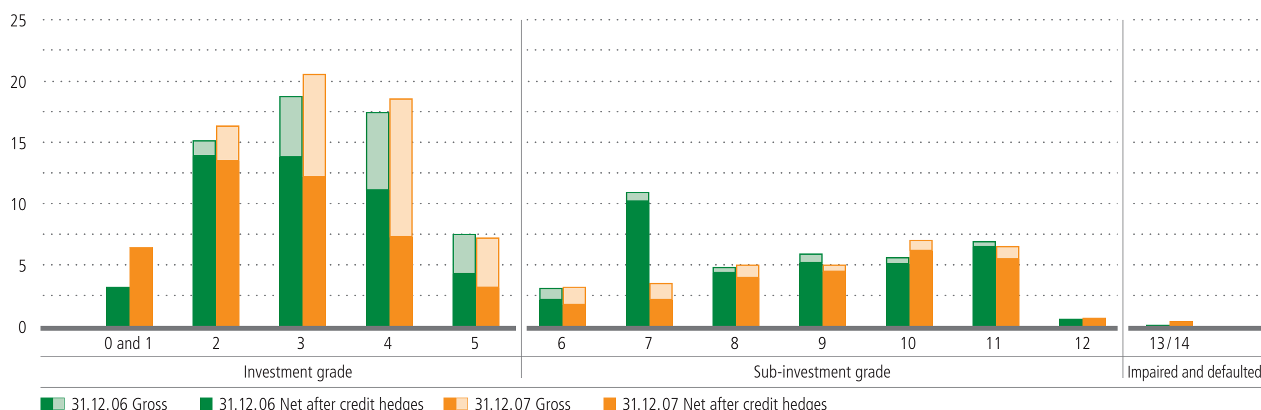
Investment Bank: banking products

CHF million	31.12.07				31.12.06			
	Investment grade	**Sub-investment grade**	**Impaired and defaulted**	**Total**	Investment grade	Sub-investment grade	Impaired and defaulted	Total
Gross banking products exposure	**103,848**	**46,755**	**651**	**151,254**	98,801	60,503	251	159,555
Risk transfers[1]	**2,901**	**(2,864)**	**(37)**		2,576	(2,551)	(25)	
Less: specific allowances for credit losses and loan loss provisions	**0**	**0**	**(126)**	**(126)**	0	0	(101)	(101)
Net banking products exposure	**106,749**	**43,891**	**488**	**151,128**	101,377	57,952	125	159,454
Less: credit protection bought (credit default swaps, credit-linked notes)[2]	**(43,012)**	**(7,391)**	**(29)**	**(50,432)**	(28,245)	(4,410)	(1)	(32,656)
Net banking products exposure, after application of credit hedges	**63,737**	**36,500**	**459**	**100,696**	73,132	53,542	124	126,798
Less: temporary exposure	**(11,091)**	**(20,160)**	**(30)**	**(31,281)**	(6,833)	(21,354)		(28,187)
Net take and hold banking products exposure	**52,646**	**16,340**	**429**	**69,415**	66,299	32,188	124	98,611

1 Risk transfers include unfunded risk participations. Risk participations are shown as a reduction in exposure to the original borrower and corresponding increase in exposure to the participant bank. 2 Notional amount of credit protection bought on net banking products exposure includes credit default swaps and the funded portion of structured credit protection purchased through the issuance of credit-linked notes.

Investment Bank: banking products exposure by UBS internal rating

As a % of Investment Bank banking products exposure



a total of CHF 50 billion in credit hedges in place against banking products exposure.

To illustrate the effects of credit hedging and other risk mitigation, the graph opposite shows the exposures by counterparty rating before and after application of risk mitigation.

Additionally, the matrix below shows the distribution of the Investment Bank's take and hold banking products exposure after application of risk mitigants, across UBS internal rating classes and LGD buckets. There is a concentration in the 26–50% bucket where most senior secured and unsecured claims fall. Sub-investment grade exposure – which in aggregate reduced by CHF 16 billion (–49%) – decreased mainly in the 0–25% LGD bucket as exposure to US mortgage originators was wound down. At the end of the year UBS had no credit risk exposure to any sub-prime mortgage originators. It should be noted that exposure distributions shown elsewhere in this section refer only to gross or net exposure and do not take recovery expectations into account.

Net banking products exposure after application of credit hedges continues to be widely diversified across industry sectors. At 31 December 2007, the largest exposures were to regulated banks (22%) and financial institutions (21%).

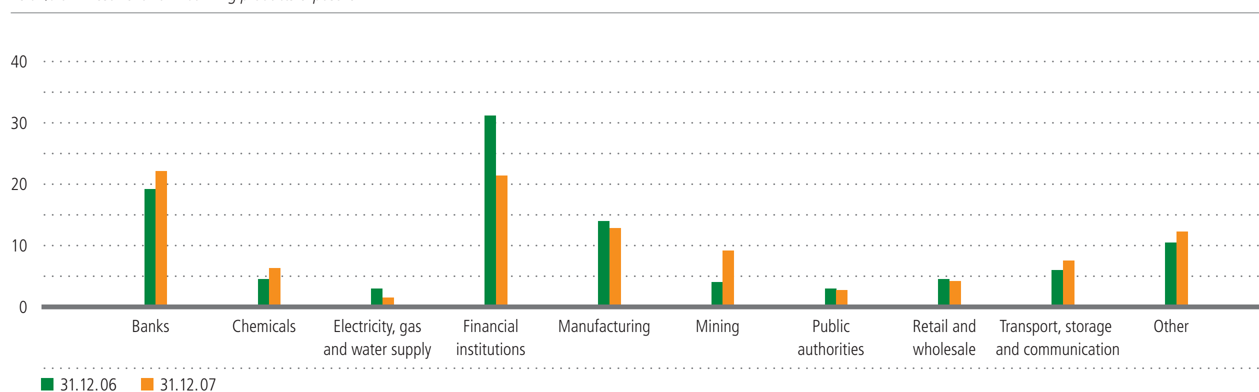
Investment Bank: distribution of net take and hold banking products exposure across UBS internal rating and loss given default buckets

As of 31.12.07		Loss given default (LGD) buckets				
CHF million	Exposure[1]	0–25%	26–50%	51–75%	76–100%	Weighted average LGD (%)
0 and 1	9,388	27	8,632	617	112	50
2	19,309	2,396	15,382	534	997	44
3	11,894	384	9,606	919	985	48
4	8,059	588	6,083	968	420	45
5	3,996	1,004	1,686	1,140	166	44
6	1,995	262	1,223	425	85	45
7	2,184	142	1,630	379	33	46
8	2,383	214	1,128	771	270	51
9	3,659	887	2,254	514	4	36
10	2,865	1,173	1,138	457	97	35
11	2,579	1,256	871	380	72	31
12	675	509	117	29	20	20
Total non-impaired	**68,986**	**8,842**	**49,750**	**7,133**	**3,261**	**43**
Investment grade	52,646	4,399	41,389	4,178	2,680	44
Sub-investment grade	16,340	4,443	8,361	2,955	581	39
Impaired and defaulted	429	360	54	15	0	12
Net take and hold exposure	**69,415**	**9,202**	**49,804**	**7,148**	**3,261**	**43**

1 Net take and hold exposure.

Investment Bank: banking products exposure[1] by industry sector

As a % of Investment Bank banking products exposure[1]



1 Net banking products exposure, after application of credit hedges.

Settlement risk

Settlement risk arises in transactions involving exchange of value when UBS must honor its obligation to deliver without first being able to determine that the counter-value has been received. Market volumes have continued to rise year-on-year but UBS has expanded its own transaction volume without increasing settlement risk by the same proportion, through the use of multilateral and bilateral arrangements. In fourth quarter 2007, settlement risk on 78% of gross settlement volumes was eliminated through risk mitigation.

The most significant source of settlement risk is foreign exchange transactions. UBS is a member of CLS ("Continuous linked settlement"), a foreign exchange clearing house which allows transactions to be settled on a delivery versus payment basis, significantly reducing foreign exchange-related settlement risk relative to the volume of business. In 2007, the transaction volume settled through CLS continued to increase, although the proportion of UBS's overall gross volumes settled through CLS fell to 51% in fourth quarter 2007 from 55% in fourth quarter 2006. 71% of UBS's CLS volume was with other CLS settlement members and the remainder with third party members, who settle their eligible trades via CLS settlement members. While the number of CLS settlement members is relatively stable, in 2007 the number of third party members UBS dealt with again increased considerably year-on-year.

Risk reduction by other means – primarily account-account settlement and payment netting – increased to 27% of gross volumes in fourth quarter 2007 from 23% a year earlier.

The avoidance of settlement risk through CLS and other means does not, of course, eliminate the credit risk on foreign exchange transactions resulting from changes in exchange rates prior to settlement. Pre-settlement risk on forward foreign exchange transactions is measured and controlled as part of the overall credit risk on OTC derivatives.

Country risk

UBS assigns ratings to all countries to which it has exposure. Sovereign ratings express the probability of occurrence of a country risk event that would lead to impairment of UBS's claims. The default probabilities and the mapping to the ratings of the major rating agencies are the same as for counterparty rating classes (as described under "Probability of default"). In the case of country rating, the three lowest classes (12 to 14) are designated "distressed".

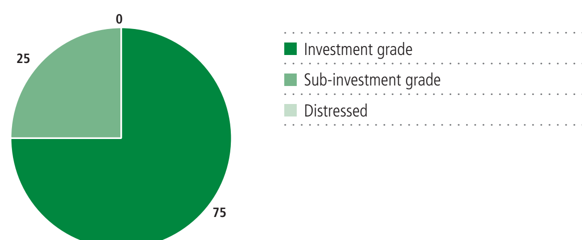
For all countries rated three and below, UBS sets country risk ceilings approved by the Chairman's Office or under delegated authority. The country risk ceiling applies to all UBS's exposures to clients, counterparties or issuers of securities from the country, and to financial investments in that country. Country risk measures cover both cross-border transactions and investments, and local operations by UBS branches and subsidiaries in countries where the risk is material. In determining the size of a country risk ceiling, goodwill resulting from acquisitions is also taken into account. Extension of credit, transactions in traded products and positions in securities may be denied on the basis of a country ceiling, even if exposure to the name is otherwise acceptable. Within the group of countries subject to ceilings, those that have yet to reach a mature stage of economic, financial, institutional, political and social development or have significant potential for economic or political instability are defined as emerging market countries. The country data provided in this section cover only country risk exposures to emerging market countries.

Counterparty defaults resulting from multiple insolvencies ("systemic risk") or general prevention of payments by authorities ("transfer risk") are the most significant effects of a country crisis, but for internal measurement and control of country risk UBS also considers the probable financial impact of market disruptions arising prior to, during and following a country crisis. These might take the form of severe falls in the country's markets and asset prices, longer-term devaluation of the currency, and potential immobilization of currency balances.

Emerging markets exposure by UBS internal country rating category

in %

As of 31.12.07



The potential financial impact of severe emerging markets crises is assessed by stress testing. This entails identifying countries that might be subject to a potential crisis event and determining potential loss, making conservative assumptions about potential recovery rates depending on the types of transaction involved and their economic importance to the affected countries.

UBS's liquidity position could be adversely impacted by restrictions on, or major impediments to, cross-border transfers of funds, which might prevent a liquidity surplus in one country being used to meet a shortfall in another. This risk does not generally result from existing or foreseeable legal restrictions in specific countries but, rather, from unexpected economic stress situations or sovereign defaults, which might induce a government to limit or prohibit the transfer of funds outside the country. UBS assesses the potential impact on its liquidity position of potential transfer risk events in countries with a one-year probability of default of 5% or more as indicated by UBS's internal sovereign rating.

Country risk exposure

Exposure to emerging market countries amounted to CHF 41.3 billion on 31 December 2007, compared with CHF 30.6 billion on 31 December 2006. Of this amount, CHF 30.9 billion or 75% was to investment grade countries. The growth of CHF 10.6 billion in total emerging markets exposure arose to a large extent in Asia.

The pie chart opposite shows UBS's emerging market country exposures (excluding those which are of a temporary nature) on 31 December 2007, based on the main country rating categories. The table below analyzes emerging market country exposures by major geographical area and product type on 31 December 2007 compared with 31 December 2006. Temporary exposures arising from loan underwriting in these markets are separately shown in the table.

On 31 December 2007, UBS had net exposure totaling CHF 911 million to 29 countries with a one-year probability of default of 5% or more, of which CHF 556 million was to those with a probability of default of 8% or more. Only CHF 81 million was to distressed countries, which have a one-year probability of default of 13% or more and where restrictions are highly probable or have already materialized. This represents less than 0.2% of UBS's emerging markets exposure and the associated risk is immaterial.

Impairment and default – distressed claims

Audited

UBS has a number of classifications for distressed claims.

A loan carried at amortized cost is considered to be *"past due"* when a significant payment has been missed. It is classified as *"non-performing"* where payment of interest, principal or fees is overdue by more than 90 days and there is no firm evidence that the claim will be settled by later payments or the liquidation of collateral; or when insolvency proceedings have commenced against the borrower; or when obligations have been restructured on concessionary terms.

Any claim, regardless of accounting treatment, is classified as *"impaired"* if UBS considers it probable that it will suffer a loss on that claim as a result of the obligor's inability to meet its obligations according to the contractual terms, and after realization of any available collateral. "Obligations" in this context include interest payments, principal repayments or other payments due, for example under an OTC derivative contract or a guarantee.

The recognition of impairment in the financial statements depends on the accounting treatment of the claim. For products carried at amortized cost, impairment is recognized through the creation of an allowance or provision, which is charged to the income statement as credit loss expense. For products recorded at fair value, impairment is recognized through a credit valuation adjustment, which is charged to the income statement through the net trading income line.

UBS has policies and processes to ensure that the carrying values of impaired claims are determined in compliance with IFRS on a consistent and fair basis, especially for those im-

Emerging markets exposure by major geographical area and product type

CHF million	Total		Banking products		Traded products		Financial investments		Tradable assets	
As of	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06
Emerging Europe	**5,439**	4,663	**1,590**	1,476	**1,071**	1,110	**151**	104	**2,627**	1,973
Emerging Asia	**22,039**	15,904	**5,653**	4,266	**6,210**	3,401	**2,123**	1,325	**8,053**	6,912
Emerging America	**8,778**	7,282	**1,486**	1,024	**2,288**	2,267	**150**	132	**4,854**	3,859
Middle East / Africa	**5,007**	2,768	**2,414**	1,145	**1,603**	892	**0**	19	**990**	712
Total	**41,263**	30,617	**11,143**	7,911	**11,172**	7,670	**2,424**	1,580	**16,524**	13,456
Temporary exposures [1]	**3,049**	2,160								

1 Temporary exposures are loan underwritings which are held short-term, pending syndication, sale or hedging. They are not included in the regional subtotals or overall total.

Audited

paired claims for which no market estimate or benchmark for the likely recovery value is available. The credit controls applied to valuation and workout are the same for both amortized cost and fair-valued credit products. Each case is assessed on its merits, and the workout strategy and estimation of cash flows considered recoverable are independently approved by the credit risk control organization.

Portfolios of claims carried at amortized cost with similar credit risk characteristics are also assessed for collective impairment. A portfolio is considered impaired on a collective basis if there is objective evidence to suggest that it contains impaired obligations but the individual impaired items cannot yet be identified.

➔ Note: portfolios considered impaired on a collective basis are not included in the totals of impaired loans in the tables on pages 20, 21 and 23 of this report or in Note 9c in *Financial Statements 2007*

Audited

The assessment of collective impairment differs depending on the nature of the underlying obligations. In UBS's retail businesses, where delayed payments are routinely seen, UBS typically reviews individual positions for impairment only after they have been in arrears for a certain time. To cover the time lag between the occurrence of an impairment event and its identification, collective loan loss allowances are established, based on the expected loss measured for the portfolio over the average period between trigger events and their identification for individual impairments. Collective loan loss allowances of this kind are not required for corporate and investment banking businesses because individual counterparties and exposures are continuously monitored and impairment events are identified at an early stage.

Additionally, for all portfolios, UBS assesses each quarter – or on an ad hoc basis if necessary – whether there has been any previously unforeseen development which might result in impairments which cannot be immediately identified individually. Such events could be stress situations such as a natural disaster or a country crisis, or they could result from structural changes in, for example, the legal or regulatory environment. To determine whether an event-driven collective impairment exists, a set of global economic drivers is regularly assessed for the most vulnerable countries and, on a case by case basis, the impact of specific potential impairment events since the last assessment is reviewed. Again, the expected loss parameters of the affected sub-portfolios are the starting point for determining the collective impairment, adjusted as necessary to reflect the severity of the event in question.

Past due but not impaired loans

Audited

The table opposite provides an overview of the aging of past due but not impaired loans. These loans have suffered missed payments but are not considered impaired because UBS expects ultimately to collect all amounts due under the contractual terms of the loans or with equivalent value.

Compared with 31 December 2006, the past due exposure has decreased by CHF 1.1 billion, primarily as a result of improved processes to identify and settle overdue amounts.

Impaired loans, allowances and provisions

The table opposite shows that allowances and provisions for credit losses decreased by 12.6%, to CHF 1,164 million on 31 December 2007 from CHF 1,332 million on 31 December 2006. Note 9b in *Financial Statements 2007* provides further details of the changes in allowances and provisions for credit losses during the year. In accordance with International Accounting Standard (IAS) 39, UBS has assessed its portfolios of claims with similar credit risk characteristics for collective impairment. On 31 December 2007, allowances and provisions for collective impairment amounted to CHF 34 million.

The gross impaired lending portfolio decreased to CHF 2,392 million on 31 December 2007 from CHF 2,628 million on 31 December 2006.

The ratio of the impaired lending portfolio to the total lending portfolio (both measured gross) improved to 0.6% on 31 December 2007 from 0.8% on 31 December 2006.

In general, Swiss practice is to write off loans only on final settlement of bankruptcy proceedings, sale of the underlying assets, or formal debt forgiveness. By contrast, US practice is generally to write off non-performing loans, in whole or in part, much sooner, thereby reducing the amount of such loans and corresponding allowances recorded. A consequence of applying the Swiss approach is that, for UBS, recoveries of amounts written off in prior accounting periods tend to be small, and the level of outstanding impaired loans as a percentage of gross loans tends to be higher than for its US peers.

Audited

Loans or receivables with a carrying amount of CHF 126 million and CHF 48 million were reclassified from impaired to performing during 2007 and 2006 either because they had been renegotiated and the new terms and conditions met normal market criteria for the quality of the obligor and type of loan, or because there had been an improvement in the financial position of the obligor, enabling it to repay any past due amounts such that future principal and interest are deemed to be fully collectible in accordance with the original contractual terms.

Collateral held against the impaired loans portfolio consists in most cases of real estate. It is UBS policy to dispose of foreclosed real estate as soon as practicable. The carrying amount of foreclosed property recorded in the balance sheet under Other assets at the end of 2007 and 2006 amounted to CHF 122 million and CHF 248 million respectively.

UBS seeks to liquidate collateral in the form of financial assets in the most expeditious manner, at prices considered fair. This may require that it purchases assets for its own account, where permitted by law, pending orderly liquidation.

Audited

Past due but not impaired loans

CHF million	31.12.07	31.12.06
1–10 days	**515**	942
11–30 days	**1,381**	410
31–60 days	**74**	544
61–90 days	**36**	463
> 90 days	**262**	1,011
Total	**2,268**	3,370

Allowances and provisions for credit losses

CHF million	Global Wealth Management & Business Banking		Investment Bank[1]		Other[2]		UBS[1]	
As of	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06	**31.12.07**	31.12.06
Due from banks	**8,237**	6,245	**52,164**	43,612	**507**	506	**60,908**	50,363
Loans	**240,641**	222,776	**95,760**	76,188	**466**	104	**336,867**	299,068
Total lending portfolio, gross	**248,878**	229,021	**147,924**	119,800	**973**	610	**397,775[3]**	349,431[3]
Allowances for credit losses	**(908)**	(1,159)	**(123)**	(97)	**0**	0	**(1,031)**	(1,256)
Total lending portfolio, net	**247,970**	227,862	**147,801**	119,703	**973**	610	**396,744[3]**	348,175[3]
Impaired lending portfolio, gross	**1,820**	2,507	**572**	121	**0**	0	**2,392**	2,628
Estimated liquidation proceeds of collateral for impaired loans	**(740)**	(1,034)	**(364)**	(25)	**0**	0	**(1,104)**	(1,059)
Impaired lending portfolio, net of collateral	**1,080**	1,473	**208**	96	**0**	0	**1,288**	1,569
Allocated allowances for impaired lending portfolio	**874**	1,121	**123**	97	**0**	0	**997**	1,218
Other allowances and provisions	**94**	110	**73**	4	**0**	0	**167**	114
Total allowances and provisions for credit losses	**968**	1,231	**196**	101	**0**	0	**1,164**	1,332
Of which collective loan loss provisions and allowances	**34**	38	**0**	0	**0**	0	**34**	38
Ratios								
Allowances and provisions as a % of total lending portfolio, gross	**0.4**	0.5	**0.1**	0.1	**0.0**	0.0	**0.3**	0.4
Impaired lending portfolio as a % of total lending portfolio, gross	**0.7**	1.1	**0.4**	0.1	**0.0**	0.0	**0.6**	0.8
Allocated allowances as a % of impaired lending portfolio, gross	**48.0**	44.7	**21.5**	80.2	**N/A**	N/A	**41.7**	46.3
Allocated allowances as a % of impaired lending portfolio, net of collateral	**80.9**	76.1	**59.1**	101.0	**N/A**	N/A	**77.4**	77.6

1 Figures reflect International Financial Reporting Standards (IFRS) reported values and, for 31 December 2006, the reclassification of prime brokerage as explained Note 1 in *Financial Statements 2007*. 2 Includes Global Asset Management and Corporate Center. 3 Excludes CHF 27 million and CHF 93 million gross loans from Industrial Holdings for the years ended 31 December 2007 and 31 December 2006.

Audited

Impaired assets by type of financial instrument

CHF million	Impaired exposure	Estimated liquidation proceeds of collateral	Allocated allowances, provisions and credit valuation adjustments	Net impaired exposure
Impaired loans	2,392	(1,104)	(997)	291
Impaired contingent claims	41	0	(33)	8
Defaulted derivatives contracts	905	0	(814)	91
Defaulted securities financing transactions	70	0	(70)	0
Total 31.12.07	**3,408**	**(1,104)**	**(1,914)**	**390**
Total 31.12.06	2,870	(1,059)	(1,399)	412

Impaired assets by region and time elapsed since impairment[1]

	Time elapsed since impairment					
CHF million	0–90 days	91–180 days	181 days–1 year	1 year–3 years	> 3 years	Total
Switzerland	135	41	89	326	1,306	1,897
Europe	33	11	2	22	80	148
North America / Caribbean	1,221	4	17	1	35	1,278
Latin America	12	22	0	14	3	51
Asia Pacific	0	5	0	1	12	18
Middle East / Africa	0	0	0	0	16	16
Total 31.12.07	1,401	83	108	364	1,452	3,408
Allocated allowances, provisions and credit valuation adjustments	(813)	(26)	(40)	(154)	(881)	(1,914)
Carrying value	588	57	68	210	571	1,494
Estimated liquidation proceeds of collateral	(436)	(26)	(55)	(146)	(441)	(1,104)
Net impaired assets	152	31	13	64	130	390

1 Impaired assets include loans, defaulted derivative contracts, defaulted securities financing transactions and impaired contingent claims.

The table above shows the geographical breakdown and aging of the impaired assets portfolio on 31 December 2007. This portfolio includes not only impaired loans, but also impaired off-balance sheet claims and defaulted derivatives and repurchase / reverse repurchase contracts, which are subject to the same workout and recovery processes.

The CHF 1,221 million of impaired assets shown against North America / Caribbean in the 0 to 90 day time band is a consequence of the recent US mortgage-related market dislocations. Two exposures make up the majority of the total. One is an exposure to a monoline insurer from whom UBS has purchased credit protection in the form of credit default swaps, predominantly on collateralized debt obligations backed by US residential mortgage-backed securities. A 90% credit valuation adjustment on this exposure was taken in fourth quarter 2007. The second is a loan to an Alt-A mortgage originator where the estimated liquidation proceeds of the collateral are only slightly below the outstanding loan amount.

CHF 1.5 billion, or 42% of the gross portfolio of CHF 3.4 billion, relates to positions that defaulted more than three years ago.

After deducting allocated specific allowances, provisions and credit valuation adjustments of CHF 1.9 billion and the estimated liquidation proceeds of collateral (to a large extent real estate) of CHF 1.1 billion, net impaired assets amounted to CHF 0.4 billion.

Credit loss expense

UBS's financial statements are prepared in accordance with IFRS, under which credit loss expense charged to the income statement in any period is the sum of net allowances and direct write-offs minus recoveries arising in that period, i.e. the credit losses actually incurred. By contrast, for internal management reporting, credit loss expense is based on the expected loss concept described under "Credit risk measurement". To hold the business groups accountable for credit losses actually incurred, they are additionally charged or refunded the difference between actual credit loss expense and expected credit loss, amortized over a three-year period. The difference between the amounts charged to the business groups in the management accounts ("adjusted expected credit loss") and the credit loss expense recorded at Group level is reported in Corporate Center.

→ **For further information on adjusted expected credit loss, see Note 2a in *Financial Statements 2007***

From first quarter 2008, as part of the transition to the new Capital Accord (Basel II), UBS will cease using the adjusted expected credit loss concept in management accounts and will no longer report adjusted expected credit losses in its quarterly reports. Expected loss as a risk measure will, however, continue to be a key part of the overall credit risk framework.

The discussion which follows covers only the credit loss expense recorded under IFRS.

In 2007, UBS experienced a net credit loss expense of CHF 238 million, compared with a net credit loss recovery of CHF 156 million in 2006.

The Investment Bank recorded a net credit loss expense of CHF 266 million for 2007, compared with a net credit loss recovery of CHF 47 million in 2006. The main component was valuation adjustments of CHF 131 million taken during fourth quarter 2007, reflecting spread widening (as opposed to credit impairment) on US commercial mortgages that had been carried at amortized cost and were securitized or sold at less than their carrying value.

Global Wealth Management & Business Banking reported a net credit loss recovery of CHF 28 million for 2007, compared with a CHF 109 million net credit loss recovery for 2006. The reduced level of net credit loss recovery was a consequence of the continued reduction in the impaired lending portfolio and related allowances to a level such that recoveries realized from work-outs continue to trend lower and no longer compensate for the ongoing need to establish new allowances. The US

mortgage market dislocation had no impact on Global Wealth Management & Business Banking figures.

Rating system design and estimation of credit risk parameters

Probability of default

UBS assesses the likelihood of default of individual counterparties using rating tools tailored to the various counterparty segments. Probability of default is summarized in a common Masterscale, shown below, which segments clients into 15 rating classes, two being reserved for cases of impairment or default. The UBS Masterscale reflects not only an ordinal ranking of counterparties, but also the range of default probabilities defined for each rating class, and in order to ensure consistency in determining default probabilities, all rating tools must be calibrated to the common Masterscale. This approach means that clients migrate between rating classes as UBS's assessment of their probability of default changes. The performance of rating tools, including their predictive power with regard to default events, is regularly validated and model parameters are adjusted as necessary.

External ratings, where available, are used to benchmark UBS's internal default risk assessment. The ratings of the major rating agencies shown in the table are linked to the internal rating classes based on the long-term average 1-year default rates for each external grade. Observed defaults per agency rating category vary year-on-year, especially over an economic cycle, and therefore UBS does not expect the actual number of defaults in its equivalent rating band in any given period to equal the rating agency average. UBS monitors the long-term average default rates associated with external rating classes. If these long-term averages were observed to have changed in a material and permanent way, their mapping to the Masterscale would be adjusted

At the Investment Bank, rating tools are differentiated by broad segments. Current segments include banks, sovereigns, corporates, funds, hedge funds, commercial real estate and a number of more specialized businesses. The design of these tools follows a common approach. The selection and combination of relevant criteria (financial ratios and qualitative factors) is determined through a structured analysis by credit officers with expert knowledge of each segment, supported by statistical modeling techniques where sufficient data is available

The Swiss banking portfolio includes exposures to a range of enterprises, both large and small- to medium-sized ("SMEs") and the rating tools vary accordingly. For segments where sufficient default data is available, rating tool development is primarily based on statistical models. Typically, these "score cards" consist of eight to twelve criteria combining financial ratios with qualitative and behavioral factors which have proven good indicators of default in the past, are accepted by credit officers and are easy to apply. For smaller risk segments with few observed defaults a more expert-based approach is chosen, similar to that applied at the Investment Bank. For the Swiss commercial real estate segment and for lombard lending, which is part of the retail segment, the probability of default is derived from simulation of potential changes in the value of the collateral and the probability that it will fall below the loan amount.

Default expectations for the Swiss residential mortgage segment are based on the internal default and loss history, where the major differentiating factor is the loan to value ratio – the amount of the outstanding obligation expressed as a percentage of the value of the collateral.

Audited

UBS internal rating scale and mapping of external ratings

UBS rating	*Description*	Moody's Investor Services equivalent	Standard & Poor's equivalent
0 and 1	*Investment grade*	Aaa	AAA
2		Aa1 to Aa3	AA+ to AA–
3		A1 to A3	A+ to A–
4		Baa1 to Baa2	BBB+ to BBB
5		Baa3	BBB–
6	*Sub-investment grade*	Ba1	BB+
7		Ba2	BB
8		Ba3	BB–
9		B1	B+
10		B2	B
11		B3	B–
12		Caa to C	CCC to C
13	*Impaired and defaulted*	D	D
14		D	D

Loss given default

Loss given default or loss severity represents UBS's expectation of the extent of loss on a claim should default occur. It is expressed as percentage loss per unit of exposure and typically varies by type of counterparty, type and seniority of claim, and availability of collateral or other credit mitigation. Loss given default estimates cover loss of principal, interest and other amounts due (including work-out costs), and also consider the costs of carrying the impaired position during the work-out process.

At the Investment Bank, where defaults are rare events, loss given default estimates are based on expert assessment of the risk drivers (country, industry, legal structure, collateral and seniority), supported by empirical evidence from internal loss data and external benchmark information where available. In the Swiss portfolio, loss given default differs by counterparty and collateral type and is statistically estimated using internal loss data. For the residential mortgage portfolio, a further differentiation is derived by statistical simulation based on loan to value ratios.

Exposure at default

Exposure at default represents the amounts UBS expects to be owed at the time of default.

For outstanding loans, the exposure at default is the drawn amount or face value. For loan commitments and for contingent liabilities, it includes any amount already drawn plus the further amount which is expected to be drawn at the time of default, should it occur. This calculation is based on a "credit conversion factor", a fixed percentage per product type derived from historical experience of drawings under commitments by counterparties within the year prior to their default.

For traded products, the estimation of exposure at default is more complex, since the current value of a contract or portfolio of contracts can change significantly over time and may, at the time of a future default, be considerably higher or lower than the current value. For repurchase and reverse repurchase agreements and for securities borrowing and lending transactions, the net amount which could be owed to or by UBS is assessed, taking into account the impact of market moves over the time it would take to close out all transactions ("close-out exposure"). Exposure at default on OTC derivative transactions is determined by modeling the potential evolution of the replacement value of the portfolio of trades with each counterparty over the lifetime of all transactions – "potential credit exposure" – taking into account legally enforceable close-out netting agreements where applicable.

For all traded products, the exposure at default is derived from the same Monte Carlo simulation of potential market moves in all relevant risk factors, such as interest rates and exchange rates, based on estimated correlations between the risk factors. This ensures a scenario-consistent estimation of exposure at default across all traded products at counterparty and portfolio level. The randomly simulated sets of risk factors are then used as inputs to product specific valuation models to generate valuation paths, taking into account the impact of maturing contracts and changing collateral values, including the ability to call additional collateral.

The resultant distribution of future valuation paths supports various exposure measures. All portfolio risk measures are based on the expected exposure profile. By contrast, in controlling individual counterparty exposures UBS limits the potential "worst case" exposure over the full tenor of all transactions, and therefore applies the limits to the "maximum likely exposure" generated by the same simulations, measured to a specified high confidence level.

Cases where there is material correlation between factors driving a counterparty's credit quality and the factors driving the future path of traded products exposure – "wrong-way risk" – require special treatment. In such cases, the potential credit exposure generated by the standard model is overridden by a calculation from a customized exposure model that explicitly takes this correlation into account. For portfolios where this risk is inherently present, for instance for the hedge funds portfolio, UBS has established special controls to capture these wrong-way risks.

Market risk

Market risk is the risk of loss from changes in market variables. There are two broad categories of variables – general market risk factors and idiosyncratic components. General market risk factors are variables which are driven by macroeconomic, geopolitical and other market-wide considerations, independent of any instrument or single name. They include the level, slope or shape of yield curves (interest rates), the levels of equity market indices and exchange rates, prices of energy, metals and commodities, and the general level of credit spreads – the yield paid by borrowers above that on risk-free securities. Associated volatilities and correlations between risks factors – which may be unobservable or only indirectly observable – are also considered to be general market risk factors. Idiosyncratic components are those that cannot be explained by general market moves – broadly, elements of the prices of debt and equity instruments and derivatives (including derivative securities and basket products) linked to them, that result from factors and events specific to individual names.

UBS discloses its market risk in terms of statistical loss using its proprietary Value at Risk ("VaR") model, but internally also applies stress measures and a variety of concentration and other quantitative and qualitative controls.

In 2007, the market for US residential mortgage-related products – a previously large and highly liquid market – suffered extreme moves and severe dislocation. Although, conceptually, the market risk framework includes appropriate types of controls, their detailed implementation did not cover all the dimensions of risk measurement and aggregation which, in the extreme events of 2007, proved to be necessary. The Investment Bank had accumulated positions, predominantly in highly rated instruments, which were not identified as concentrations. Enhancements have been made and will continue to be made to reflect the lessons learnt.

➔ Further detail is provided in the sidebar "Enhancements to market risk management and control" on pages 36–37 of this report

Sources of market risk

UBS takes both general and idiosyncratic market risks in its trading activities, and some non-trading businesses create general market risks.

Trading

Most of UBS's trading activity is in the Investment Bank. It includes market-making, facilitation of client business and proprietary position taking in the cash and derivative markets for equities, fixed income, interest rates, foreign exchange, energy, metals and commodities.

The fixed income trading area of fixed income, currencies and commodities (FICC) carries inventory, including exposures to residential and commercial real estate, corporate and consumer credit, and US municipal and student loan markets. Credit spread exposure from FICC positions is generally the largest contributor to VaR.

Exposure to movements in the level and shape of yield curves arises in all the Investment Bank's trading activities but predominantly in parts of FICC. Exposure to directional interest rate movements varies depending on client flows and traders' views of the markets. It is often these variations that drive changes in the level of Investment Bank VaR, although the impact of any position or change in position depends on the composition of the whole portfolio at the time.

UBS is active in all major equity markets and an increasing number of newer markets. Equity risk is the other major contributor to Investment Bank market risk, partly from index-based transactions but also from individual stocks, giving rise to idiosyncratic as well as general market risk. A significant component of equity VaR is event risk from proprietary positions, which are taken, for example, to capture arbitrage opportunities or price movements resulting from mergers and acquisitions.

UBS trades in large volumes in currencies, and to a lesser extent in energy, metals and commodities, but the contribution from these activities to overall market risk has generally been relatively small.

The asset management and wealth management businesses carry small trading positions, principally to support client activity. The market risk from these positions is not material to UBS as a whole.

Trading businesses are subject to a variety of market risk limits within which traders manage their risks according to their view of the market, employing a variety of hedging and risk mitigation strategies. Senior management and risk controllers may, however, 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. Hedging and mitigation strategies are then discussed and agreed with trading management.

Non-trading

In the Investment Bank, significant non-trading interest rate risk and all non-trading foreign exchange risks are captured, controlled and reported under the same risk management and control framework as trading risk.

Audited

In the other business groups, exposures to general market risk factors – primarily interest rates and exchange rates – also arise from non-trading activities. Market risks are generally transferred to the Investment Bank or Treasury, who manage the positions as part of their overall portfolios within their allocated limits. The largest items are the interest rate risks in Global Wealth Management & Business Banking. All risk transfers take place according to approved transfer pricing mechanisms. Market risks that are retained by the other business groups are not significant relative to UBS's overall risk, and all exposures are subject to market risk measures and controls. With the exception of structural currency exposures, all non-trading currency and commodity positions are subject to market risk regulatory capital and are therefore generally captured in VaR, although such positions do not contribute significantly to overall VaR.

Treasury also assumes market risk from its balance sheet and capital management responsibilities. Treasury finances non-monetary balance sheet items such as bank property and equity investments in associated companies; it also manages interest rate and foreign exchange risks resulting from the deployment of UBS's consolidated equity, from structural foreign exchange positions and from non-Swiss franc revenues and costs. The market risk limits allocated to Treasury cover both the risks resulting from these responsibilities, and those transferred from other business groups. The limits allow them flexibility to pre-hedge or delay hedging if desired, both to manage large flows and to take advantage of market movements.

➔ **Treasury's risk management activities are explained in more detail in the "Treasury and capital management" section of this report**

Exposure to single names arising from debt instruments, such as loans, which are not originated or acquired as part of a trading activity is controlled under the credit risk framework. Neither idiosyncratic nor credit spread risk on these instruments is captured under the market risk framework. Credit spread risk is, however, a material component of the risk on the Investment Bank's syndicated financing business and the credit spread exposures from this activity are reported to senior management alongside those on the trading inventory.

The Investment Bank hedges an increasing proportion of its credit exposure. Specific hedges, such as credit default swaps on the same name, are reflected in credit risk measures, but other types of hedge may also be used for exposure management – for example, credit indices or proxy hedges on other names. Hedges of this type are treated as open positions for risk control purposes and are captured under the market risk framework.

Risk on equity investment positions, including private equity, is not controlled under the market risk framework.

➔ **For details on risk control please see the "Investment positions" section of this report**

Audited

Risk control organization, governance and structure

The Group Head of Market Risk, reporting to the Group Chief Risk Officer (Group CRO), is responsible for development of the market risk control framework. There is a CRO in each business group and a designated CRO for Treasury. The Group Head of Market Risk, the business group CROs and their teams are responsible for the independent control of market risk.

It is the primary responsibility of traders to identify the risks inherent in their activities, including those arising from new businesses and products, and from structured transactions. The independent controllers are responsible for ensuring that identified risks are completely and accurately captured in risk measurement systems and appropriately constrained by portfolio and concentration controls. They are also responsible for assessing the reasonableness of reported risk, particularly in relation to the revenues generated on the risk positions – an important step in identifying risks that are not adequately reflected in risk measures.

The Investment Bank CRO organization provides market risk measurement and reporting support to all business groups and, in close cooperation with the Group Head of Market Risk, is responsible for the development and ongoing enhancement of market risk measures, including the models used to measure VaR, stress loss and risk on tradable single name exposures.

The Chairman's Office delegates market risk authority to the GEB and approves delegations by the GEB ad personam to the Group CRO, the Group Head of Market Risk and the business group CROs. Further delegations are also made to market risk officers in the business groups. For many trading businesses, standard transactions within approved business lines and limits do not require prior risk control approval. Rather, risk management and risk control authority holders approve the retention of positions or give instructions for risk to be reduced based on subsequent review. Large transactions such as security underwritings and transactions creating less liquid risks – particularly structured and complex transactions – do, however, require pre-approval, as do temporary increases in limits to accommodate new transactions or positions.

Standard forms of market risk measures, limits and controls are applied to portfolios and risk concentrations. Other forms of measurement and control are developed, where necessary, for individual risk types, particular books and specific exposures. The quantitative controls are complemented by qualitative controls geared to the prompt identification, assessment, measurement and monitoring of market risks. Risks that are not well reflected by standard measures are subject to additional controls, potentially including transaction level pre-approval and specific limits.

UBS's policy requires that models used for valuation or which feed risk positions to risk control systems are subject

to independent verification by specialist quantitative units in the CRO organization.

UBS's approach to valuation of instruments for which no directly observable market price is available is described in Note 26 in *Financial Statements 2007.* Valuation adjustments for model uncertainty are applied where appropriate, consistent with accounting requirements.

Reporting is an important component of the qualitative framework and UBS therefore has processes requiring regular reporting to senior managment in the business groups, the Group Head of Market Risk and Group CRO, and the GEB, Chairman's Office and Board of Directors (BoD).

Utilizations of most limits, including all major portfolio and concentration limits, are reported daily and all excesses are investigated. Daily reports, including commentary, on material risk positions are provided to senior management in the business groups and to the Group Head of Market Risk and Group CRO. Monthly and quarterly reports, including both quantitative and qualitative information, are prepared in the business groups, and these provide the basis for consolidated reports to the GEB, the Chairman's Office and the BoD.

Risk measures

UBS has two major portfolio measures of market risk – VaR and stress loss – which are common to all business groups. They are complemented by concentration risk measures and supplementary controls.

Concentration limits are tailored to the nature of the activities and the risks they create. They therefore differ between, for example, the Investment Bank, where the risks are most varied and complex, and Treasury, which carries market risk in a limited range of risk types and not generally in complex instruments.

Supplementary limits are established on portfolios, subportfolios, asset classes or products for specific purposes where standard limits are not considered to provide comprehensive control. These "operational limits" are intended to address concerns about, for example, market liquidity or operational capacity. They may also be applied to complex products for which not all model input parameters are observable, and which thus create difficulties in valuation and risk measurement. Operational limits can take a variety of forms including values (market, nominal or notional) or risk sensitivities. The ways in which operational limits are applied have been expanded following the experience of 2007.

➔ For further information, please see the sidebar "Enhancements to market risk management and control" on pages 36–37 of this report

Value at Risk (VaR)

VaR is a statistically based estimate of the potential loss on the current portfolio from adverse movements in both general and idiosyncratic market risk factors. The same VaR model is used for internal risk control (including limits) and as the basis for determining market risk regulatory capital requirements.

➔ For futher information, please refer to the "Capital management" section of this report

UBS measures VaR using a 10-day time horizon for internal risk measurement and control, and as the basis for market risk regulatory capital, and based on a 1-day horizon for information and for backtesting. VaR is derived from a distribution of potential losses. It expresses the amount that might be lost over the specified time horizon as a result of changes in market variables, but only to a certain level of confidence (99%) and there is therefore a specified statistical probability (1%) that actual loss over the period could be greater than the VaR estimate.

VaR is calculated at the end of each trading day, based on positions recorded at that time. Retrospective adjustments to valuations, affecting risk positions, may be booked some days later, particularly at period ends. VaR is not subsequently restated to reflect these later adjustments to positions.

VaR models are based on historical data and thus implicitly assume that market moves over the next 10 days or one day will follow a similar pattern to those that have occurred over 10-day and 1-day periods in the past. For general market risk, UBS uses a look-back period of five years – a period which generally captures the cyclical nature of financial markets and is likely to include periods of both high and low volatility. UBS applies these historical changes directly to current positions, a method known as historical simulation.

Idiosyncratic risk is measured on all forms of single name risk. For debt instruments the measure includes rating migration risk and prepayment risk – these measures were enhanced during 2007. For equity instruments, the measure is based on the Capital Asset Pricing Model ("CAPM") supplemented by a "deal break" methodology for equity arbitrage positions, where UBS is typically long in the stock of one company and short in that of another. The deal break measure assesses the probability of collapse of a merger or takeover, and its impact on the two stock prices – a one-off jump move generating the same potential loss for both 10-day and 1-day VaR.

The Chairman's Office annually approves a 10-day VaR limit for UBS as a whole and allocations to the business groups, the largest being to the Investment Bank. In the business groups, VaR limits are set for lower organizational levels as necessary.

In the start-up phase of a business, some market risks may be controlled outside VaR but the level of such risk is deliberately kept small, typically by application of operational limits.

Backtesting
The predictive power of the VaR model is monitored by "backtesting". Backtesting compares the 1-day VaR calculated on trading portfolios at close of each business day with the actual revenues arising on those positions on the next business day. These revenues ("backtesting revenues") exclude non-trading components such as commissions and fees, and estimated revenues from intraday trading. If backtesting revenues are negative and exceed the 1-day VaR, a "backtesting exception" is considered to have occurred. If the number of backtesting exceptions in a rolling 12-month period exceeds levels specified by regulators, the "multiplier" by which the market risk regulatory capital requirement is derived from 10-day VaR is increased.

Although UBS uses VaR to measure general market risks arising in non-trading books, the results are not formally backtested because these books are not generally marked to market.

Audited

VaR based on a 1-day horizon provides an estimate of the likely range of daily mark to market revenues on trading positions under normal market conditions. When 1-day VaR is measured at a 99% confidence level, such an exception can be expected, on average, one in a hundred business days. More frequent backtesting exceptions are likely to occur if market moves are greater than those seen in the look-back period, if the frequency of large moves increases, or if historical correlations and relationships between markets or variables break down (for example, in a period of market disruption or a stress event). Backtesting exceptions are also likely to arise if the way positions are represented in VaR does not adequately capture all their differentiating characteristics and the relationships between them. Such granularity can become particularly important as business grows and as markets evolve or when they experience the sort of dislocation seen in 2007.

UBS experienced many backtesting exceptions as a result of these developments and is responding to them.

➔ **For further details, please refer to the sidebar "Enhancements to market risk management and control" on pages 36–37 of this report**

All backtesting exceptions and any exceptional revenues on the profit side of the VaR distribution are investigated, and all backtesting results are reported to senior business management, the Group CRO and business group CROs.

As required by regulations, backtesting exceptions are also notified to internal and external auditors and relevant regulators.

Stress loss

The purpose of stress testing is to quantify exposure to extreme and unusual market movements. It is an essential complement to VaR.

The VaR measure is based on observed historical movements and correlations, whereas stress loss measures are informed but not constrained by past events. UBS's objectives in stress testing are to explore a wide range of possible outcomes, to understand vulnerabilities, and to provide a control framework that is comprehensive, transparent and responsive to changing market conditions.

UBS's stress scenarios include an industrial country market crash with a range of yield curve and credit spread behavior, and emerging market crises, with and without currency pegs breaking. A general recovery scenario is also assessed. The standard scenarios are run daily, and it is against these that the development of stress loss exposure is tracked and comparisons are made from one period to the next. Stress loss limits, approved by the Chairman's Office, are applied to the outcome of these scenarios for all business groups. Emerging markets stress loss in aggregate and stress loss for individual emerging market countries, measured under the standard stress scenarios, are also separately limited. The scenarios and their components are reviewed at least annually.

UBS has been developing and will soon implement a new approach to the specification of stress loss scenarios that better differentiates between the source of a stress event and its contagion effect.

Specific scenarios targeting current concerns and vulnerabilities are also used. They must, by definition, be constantly adapted to changing circumstances and portfolios. The choice of scenarios is judgmental, depending on management's view of potential economic and market developments and their relevance to the positions UBS carries. The market moves envisaged in a targeted stress test might prove to be less than the moves actually seen in a stress event, and actual events may differ significantly from those modeled in the stress scenarios. UBS's targeted stress tests did not predict the severe dislocation in US residential mortgage-related markets in 2007 – in particular the breakdown in correlation within and between asset classes and the complete drying up of liquidity. UBS is endeavoring to reflect these experiences in its stress testing framework.

The VaR results beyond the 99% confidence level are analyzed to better understand the potential risks of the portfolio and to help identify risk concentrations. The results of this analysis are valuable in their own right and can also be used to formulate position-centric stress tests. Although the standard scenarios incorporate generic elements of past market crises, more granular detail of specific historical events is provided by the VaR tail. During 2007, the "worst historical loss" from the VaR distribution was introduced as an additional formal stress scenario. UBS is also considering use of a longer historical time series, where available, to generate this stress exposure.

Additionally, UBS measures and limits the impact of increased default rates on the value of its portfolio of single name exposures.

UBS applies country ceilings to limit exposure to all but the best-rated countries and these measures cover market as well as credit risks.

➔ **For details of country risk control please refer to pages 24–25 in the "Credit risk" section of this report**

Most major financial institutions employ stress tests, but their approaches differ widely and there is no benchmark or industry standard in terms of scenarios or the way they are applied to an institution's positions. Furthermore, the impact of a given stress scenario, even if measured in the same way across institutions, depends entirely on the make-up of each institution's portfolio, and a scenario highly applicable to one institution may have no relevance to another. Comparisons of stress results between institutions can therefore be highly misleading, and for this reason UBS, like most of its peers, does not publish quantitative stress results.

Concentration limits and other controls

Audited

UBS applies concentration limits to exposures to general market risk factors and to single name exposures. The limits take account of variations in price volatility and market depth and liquidity.

In the Investment Bank, limits are placed on exposure to individual risk factors. They are applied to general market risk factors or groups of highly correlated factors based on market moves broadly consistent with the basis of VaR, i.e. 10-day, 99% confidence moves. Each limit applies to exposures arising from all instrument types in all trading businesses of the Investment Bank. The market moves are updated in line with the VaR historical time series and the limits are reviewed annually or as necessary to reflect market conditions. The effectiveness of risk factor limits in controlling concentrations of risk depends critically upon the way risk positions are represented. If long and short positions are considered to be sensitive to the same risk factor, potential gains and losses from changes in that factor are netted. The steps UBS is taking to enhance granularity of risk representation in its VaR measure are equally relevant to its risk concentration controls.

The Investment Bank carries exposure to single names, and therefore to event – including default – risk. This risk is measured across all relevant instruments (debt and equity, in physical form and from forwards, options, default swaps and other derivatives including basket securities) as the aggregate change in value resulting from an event affecting a single name or group. The maximum amount that could be lost if all underlying debt and equity of each name became worthless is also tracked. Positions are controlled in the context of the liquidity of the market in which they are traded, and all material positions are monitored in light of changing market conditions and specific, publicly available information on individual names – market risk officers do not have access to non-public information and must therefore rely to a significant extent on external ratings.

This form of single name exposure measure is most appropriate to corporate clients, financial institutions and other entities, the value of whose equity and debt instruments is dependent on their own assets, liabilities and capital resources. Asset-backed securities are usually issued through special purpose, bankruptcy remote vehicles and it is more important to aggregate risk in other dimensions than the issuer name, in particular the factors affecting the value of the underlying asset pools. UBS monitored underlying exposures by broad asset category but not to the level of granularity that proved neccessary in the case of mortgage-backed securities. It is now enhancing its measures accordingly.

➔ **For further details, please refer to the sidebar "Enhancements to market risk management and control" on the next two pages of this report**

Audited

Exposures arising from security underwriting commitments are subject to the same measures and controls as secondary market positions. There are also governance processes for the commitments themselves, generally including review by a commitment committee with representation from both the business and the control functions. All firm underwriting commitments are approved under specific delegated risk management and risk control authorities.

Other applications of market risk measures

Market risk measurement tools may be selectively applied to portfolios for which the primary controls are in other forms. VaR can, for example, provide additional insight into the sensitivity of investment positions to market risk factors, even though some of the assumptions of VaR – in particular the relatively short time horizon – may not be representative of their full risk. The results can be used by business management and risk controllers for information or to trigger action or review.

Enhancements to market risk management and control

In 2007, UBS's market risk measures underestimated the potential losses resulting from exposures to the previously deep and liquid US residential mortgage market – neither trading management nor market risk controllers foresaw the extreme rates of delinquency and default and low recovery levels now projected, or the breakdown in correlation within and between asset classes that emerged in the second half of 2007 and revealed the tail risk in UBS's positions. With the accompanying drying up of liquidity in parts of the market, the size of UBS's positions has proved excessive relative to the market. The size, frequency and pattern of market moves were exceptional and UBS suffered losses in excess of those predicted by statistical or even stress loss risk measures based on historical market movements. Other market risk management and control processes were, however, intended to identify risk concentrations and sources of potential loss in more extreme circumstances. UBS is therefore taking steps to address the gaps which these events have revealed.

Risk management

Following the major losses, senior management changes were made. The fixed income, currencies and commodities (FICC) business unit is being restructured to build upon and strengthen its core business strategy of client servicing and risk distribution, and introduce stronger risk discipline:

- a workout group has been established to ensure robust risk management of the segregated, legacy portfolios and to develop orderly exit strategies;
- the remaining real estate-related activities are being refocused towards intermediation of client flows and alignment to the needs of investment banking and wealth management clients; and
- management of flow credit trading is being consolidated. This will improve risk aggregation and communication and, over time, will allow consolidation of risk management systems.

The introduction of a new funding framework for the Investment Bank will encourage more disciplined use of the balance sheet.

➔ **For further information, please refer to the sidebar "New funding framework" on page 51 of this report**

The models used in the risk management and valuation of US residential real estate-related products have been refined and recalibrated to reflect projections for lifetime cumulative losses consistent with market prices, where observable, and will continue to be updated as these projections and market parameters change. Even though some of these developments were undertaken under time pressure in a period of rapidly evolving markets and expectations, all models were approved for use by the independent model verification team. In first quarter 2008, the models were put into full production mode in the Investment Bank.

Risk control

As explained under "Risk measures", which starts on page 33 of this section, where values of different instruments are assessed to be driven by the same risk factor, sensitivities in standard risk control measures have typically been expressed net across instruments and positions. If the drivers are not, in fact, the same risk factor but, rather, risk factors which have historically been very closely correlated, this netting will disguise "basis" risk – the risk of divergent movements between risk factors that are not perfectly correlated. A feature of the market dislocation in 2007 was the breakdown of historical correlations within markets, for example delinquency rates on sub-prime mortgages of different vintages. An important enhancement to the market risk control framework is therefore to increase the granularity of risk representation – not just for US residential mortgage related products but more generally – so that basis risks can be appropriately measured and

controlled.
The specific characteristics of individual instruments which are critical in a stress event cannot always be predicted and it is therefore important to have a multi-faceted framework with complementary controls. UBS is applying more extensive limits, by asset class, based on gross values as well as risk sensitivities, in order to protect against extreme losses in the event of future dislocations and breakdowns – even if the probability of their occurring currently appears to be remote.
Additionally, controls have been introduced to highlight positions which are large relative to market depth.
In 2007, UBS also suffered significant markdowns as a result of leveraged positions – positions on which the rate of loss accelerated as market moves became more extreme – and on positions which were protected against market moves up to a certain point but fully exposed beyond that level. Such risks often only materialize when markets move beyond the range covered by statistical and stress loss parameters, and thus they do not show up in the regular risk measures. Controls over these deep tail risks already exist for some portfolios and are now being more widely applied.
UBS is revising its approach to global stress testing to deliver a more diverse range of scenarios, which better differentiate between the source of a stress event and its contagion effect. Additionally, more extensive use of targeted stress tests is planned, using forward looking scenarios based on analysis of the positions and vulnerabilities of each portfolio. An important additional aspect of stress testing will be to consider liquidity as well as price sensitivity. New stress loss limits have been introduced at business area level, and on the stress loss contribution to standard scenarios from emerging markets, individually and in aggregate.
Since second quarter 2007, a series of in-depth reviews, which will cover all Investment Bank trading portfolios, has been under way. The findings of these reviews are being incorporated into development plans and will be factored into the quantitative enhancements described above. They also provide important insights into necessary qualitative changes to market risk management and control. It is intended that reviews of this type will become a regular feature, contributing to the ongoing enhancement of the market risk framework.
UBS has, for many years, had a policy covering the pre-approval of structured and complex transactions. This has operated well at the transactional level but needs to be more systematically complemented by an assessment of the cumulative impact of "one-off" transactions with similar characteristics on market risk in the portfolio. Processes have been adjusted so that repeat transactions now trigger a review as a new business initiative, the objective being to identify, at an early stage, any potential build-up of risks that are not appropriately captured by the control framework.
Investment Bank market risk policies are also being revised to emphasize the key characteristics of trading activities, and the criteria for assessing the liquidity of positions.
Market and credit risk control operate on opposite sides of information barriers – market risk officers do not generally have access to non-public information about clients and counterparties unless formally brought "over the wall". There are, however, areas where the two teams can and do work closely together to provide a comprehensive and consistent view of risks. Areas for further cooperation and integration in organization and processes are being explored to better exploit the complementary skills of the two units.
The planned quantitative improvements and enhancements to processes will be reinforced through education to ensure that the lessons from 2007 are understood by risk managers and risk controllers alike. UBS has a dedicated risk education unit, reporting to the Group CRO, which is developing programs to help strengthen risk culture and risk awareness.

Market risk in 2007

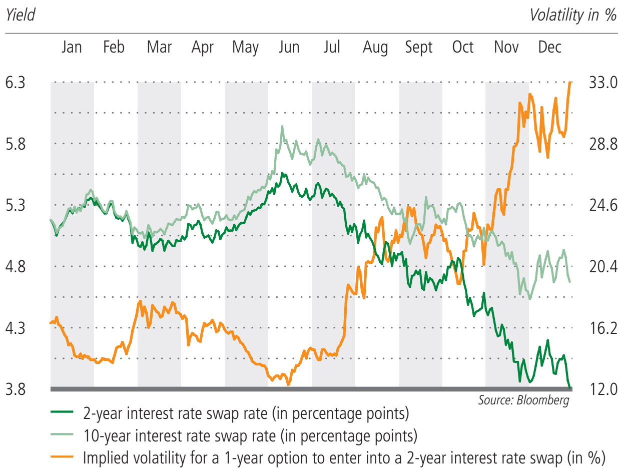
The graphs below illustrate the relative calm of the first half of 2007, and the severe dislocation of markets and extreme volatility of the second half. Markets retreated in response to the first fall in the US sub-prime market, but by the end of first quarter the impact appeared to have been contained. Equities markets resumed their upward trend from late March through to May, but by June inflation fears and renewed concerns about wider contagion from the sub-prime market led to increased volatility. A flight to quality and rapid deleveraging by some market participants followed in third quarter, resulting in intra-market dislocations as participants exited "crowded trades". Spreads between government yields and bank borrowing rates ("TED spread") widened dramatically and central banks intervened to counter the general drying up of liquidity. In the US residential mortgage-related markets, credit spreads on the highest rated securities reached unprecedented levels, with associated increases in volatilities. A temporary recovery in September was short-lived – markets fell again in November on further deterioration in US residential mortgage markets, fears of a US recession and uncertainties about the health of the banking sector. Despite a slight recovery in some markets in December many experienced professionals regard trading conditions in fourth quarter as amongst the most difficult for many years.

Value at Risk

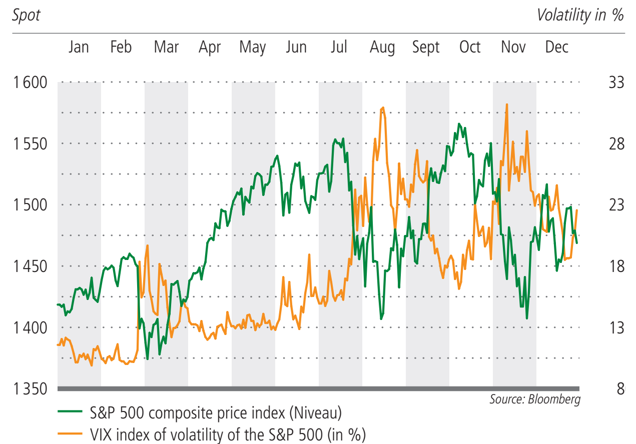
Audited

In 2007, Investment Bank VaR was higher on average and at year-end than in 2006, with a much greater range between minimum and maximum.

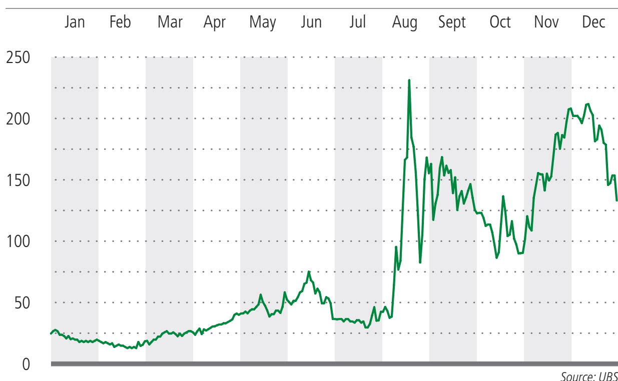
USD interest rates



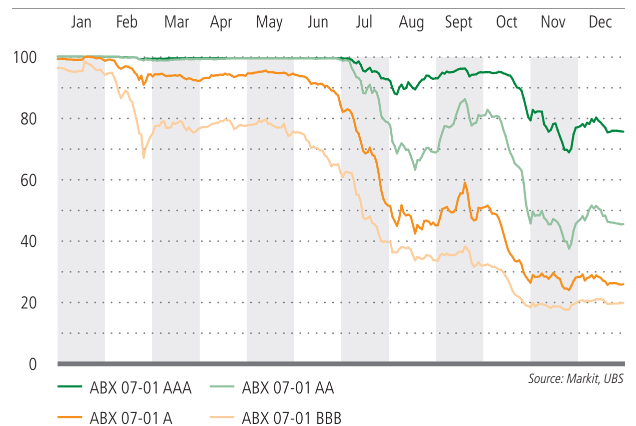
US stock price development



TED spread



US sub-prime mortgage-backed securities



The graph of US sub-prime mortgage-backed securities illustrates the scale of market value decline which eroded partial hedges on positions, and increased risk exposure. The extreme volatility of spreads has progressively increased reported VaR on existing positions with each update of the 5-year historical time series. While the illiquidity of large parts of this market has prevented significant reductions in positions, amortizations and writedowns, together with active risk reduction in other areas, resulted in a lower VaR at year end than the peak for the year which occurred in fourth quarter.

There were other notable contributors to the fluctuations in Investment Bank VaR during the course of the year. The acquisition of Banco Pactual, completed in December 2006, resulted in more volatile interest rate VaR. In the first half of the year, directional exposure to equity markets not only increased equity VaR but also reduced the offset against interest rate VaR. Credit spread exposure and idiosyncratic risk were major contributors to the risk profile throughout the year.

Market risk limits were adjusted in third quarter to constrain the level of risk in areas other than US residential mortgage market related exposure, but the impact on these positions of updates to the historical time series in third and fourth quarters has more than offset risk reductions elsewhere.

Corporate Center VaR was generally lower than in 2006, until fourth quarter when the major writedowns announced in December led to temporary positions associated with Treasury's management of the foreign exchange component of parent bank profits and losses, and its management of the parent bank equity.

VaR for UBS as a whole was dominated by the Investment Bank, with Treasury providing some offset at times.

Investment Bank: Value at Risk (10-day, 99% confidence, 5 years of historical data)

	Year ended 31.12.07				Year ended 31.12.06			
CHF million	**Min.**	**Max.**	**Average**	**31.12.07**	Min.	Max.	Average	31.12.06
Risk type								
Equities	**147**	**415**	**210**	**242**	144	360	203	232
Interest rates (including credit spreads)	**269**	**877**	**475**	**576**	237	607	417	405
Foreign exchange	**9**	**73**	**28**	**21**	16	65	31	40
Energy, metals and commodities[1]	**24**	**90**	**51**	**41**	26	102	49	44
Diversification effect	[2]	[2]	**(227)**	**(266)**	[2]	[2]	(280)	(248)
Total	**291**	**836**	**537**	**614**	331	559	420	473

1 Includes base metals and soft commodities risk from 15 March 2006. 2 As the minimum and maximum occur on different days for different risk types, it is not meaningful to calculate a portfolio diversification effect.

Audited

UBS: Value at Risk (10-day, 99% confidence, 5 years of historical data)

	Year ended 31.12.07				Year ended 31.12.06			
CHF million	**Min.**	**Max.**	**Average**	**31.12.07**	Min.	Max.	Average	31.12.06
Business groups								
Investment Bank[1,2]	**291**	**836**	**537**	**614**	331	559	420	473
Global Asset Management[3]	**2**	**10**	**4**	**3**	4	16	9	10
Global Wealth Management & Business Banking	**2**	**5**	**3**	**3**	4	14	10	5
Corporate Center	**10**	**92**	**25**	**61**	25	69	43	27
Diversification effect	[4]	[4]	**(34)**	**(93)**	[4]	[4]	(54)	(52)
Total	**288**	**833**	**535**	**588**	336	565	429	464

1 Includes UBS risk managed by Dillon Read Capital Management from June 2006 to 2 May 2007 and risk transferred from Dillon Read Outside Investor Fund from 3 May 2007. 2 Includes UBS Pactual from 1 December 2006. 3 Only covers UBS positions in alternative and quantitative investments. During first quarter 2007, seed money and coinvestments in these funds were reclassified as financial investments and they are not included in reported Value at Risk from that point. 4 As the minimum and maximum occur on different days for different business groups, it is not meaningful to calculate a portfolio diversification effect.

UBS: Value at Risk (1-day, 99% confidence, 5 years of historical data)[1]

	Year ended 31.12.07				Year ended 31.12.06			
CHF million	**Min.**	**Max.**	**Average**	**31.12.07**	Min.	Max.	Average	31.12.06
Investment Bank[2]	**124**	**253**	**164**	**149**	129	230	172	160
UBS	**126**	**254**	**165**	**152**	131	233	173	162

1 10-day and 1-day Value at Risk (VaR) results are separately calculated from underlying positions and historical market moves. They cannot be inferred from each other. 2 Positions in Investment Bank subject to market risk regulatory capital contributed average VaR of CHF 160 million in 2007 and CHF 169 million in 2006.

Backtesting

As a result of the severe market volatility and dislocation which prevailed from the end of July, UBS experienced 29 backtesting exceptions in 2007, its first since 1998. The multiplier by which the market risk regulatory capital requirement is derived from 10-day VaR has been increased accordingly.

The first histogram shows daily backtesting revenues alongside all daily revenues for 2007. In the second histogram, the daily backtesting revenues are compared with the corresponding VaR over the same 12-month period for days when backtesting revenues were negative.

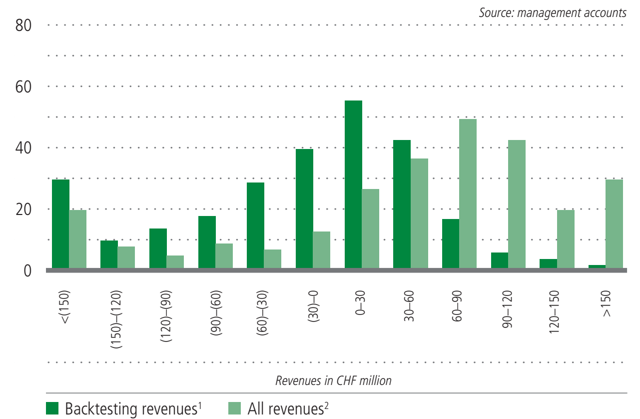
Given market conditions, the occurrence of backtesting exceptions is not surprising. Moves in some key risk factors were, on occasions, well beyond the level expected statistically with 99% confidence based on the historical time series in use at the time. Despite regular updates to the time series, backtesting exceptions have continued, partly caused by "jump events". Some of these reflect a step change in market conditions, such as the mass downgrade by a rating agency of highly rated US residential mortgage market-linked securities. Others result from periodic new information or show the cumulative impact over several days or weeks of changing conditions in markets with diminished liquidity – the monthly remittance data published by mortgage servicers typically results in discontinuities of this type. UBS also made changes to its valuation approach to certain positions, leading to step changes. For example, as liquidity dried up, certain positions moved from a mark-to-market to a market-to-model basis. The enhancements UBS is making to market risk measures will not, of course, eliminate backtesting exceptions from these sources.

Stress loss

Stress loss for Investment Bank is defined as the worst case outcome from the official stress scenarios, which now include the worst historical loss from each day's VaR simulation. Stress loss, like VaR, is dominated by US residential mortgage-related positions, with a significant contribution from corporate credit spread exposure. Changing directional exposures to interest rates and equity markets have led to fluctuations in reported stress loss over the course of the year.

Investment Bank: revenue distribution

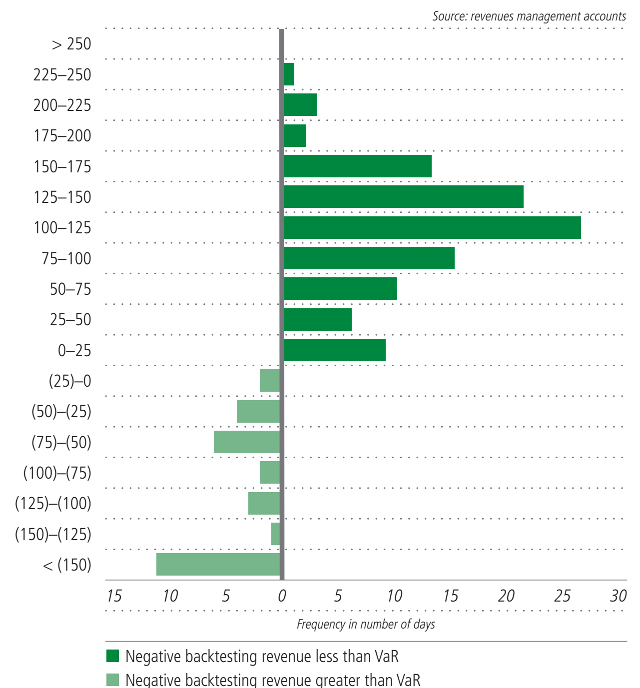
Frequency in number of days *1 January 2007 – 31 December 2007*



1 Excludes non-trading revenues, such as commissions and fees, and revenues from intraday trading. 2 Includes all revenues from business areas which have trading activities.

Investment Bank: analysis of negative backtesting revenues[1]

1-day 99% confidence Value at Risk (VaR) less backtesting revenue (CHF million) *1 January 2007 – 31 December 2007*



1 Backtesting revenues exclude non-trading revenues, such as commissions and fees, and revenues from intraday trading. Analysis for loss days only.

Value at Risk outlook

In its fourth quarter 2007 report, UBS indicated that it was considering changing the internal risk control and/or regulatory capital treatment of some US residential mortgage market-related positions. Decisions have now been taken to reclassify some of the legacy portfolios managed by the FICC workout group. The markets for these positions are not liquid and 10-day VaR is not an adequate measure of their risks or an appropriate risk control tool. They will no longer be subject to internal VaR limits, they will be subject to banking book, rather than trading book, regulatory capital, and they will be excluded from UBS's disclosed VaR from first quarter 2008.

Audited

The marginal contribution of the legacy positions to Investment Bank VaR at 31 December 2007 is approximately CHF 260 million.

Since year-end 2007, the VaR historical time series has been further updated to capture the continued increase in market volatility in November and December. As a result, VaR on existing Investment Bank positions – excluding the legacy positions – increased by approximately 4%. Had the legacy positions remained in VaR their marginal contribution to Investment Bank VaR would have more than trebled.

Investment positions

Audited

UBS makes investments for a variety of purposes. The majority of investment positions are equity holdings, some of which are made for revenue generation or as part of strategic initiatives, while others, such as exchange and clearing house memberships are held in support of UBS's business activities. Investments are also made in funds managed by UBS to seed them at inception or to demonstrate alignment of UBS's interests with those of investors. UBS also holds debt investments.

Equity investments

Many equity investments are unlisted and therefore illiquid. Investments in listed stocks are limited in number both by individual market and in total. The fair values of equity investments are generally dominated by factors specific to the individual stocks and the correlation of individual holdings to equity indices varies. Furthermore, equity investments are generally intended to be held medium- or long-term and may be subject to lock-up agreements. For these reasons, they are not directly controlled using the market risk measures applied to trading activities. They are, however, subject to controls, including pre-approval of new investments by business management and risk control, and regular monitoring and reporting.

Where investments are made as part of an ongoing business they are also subject to standard controls, including portfolio and concentration limits. Seed money and co-investments in UBS-managed funds made by Global Asset Management are, for example, subject to a portfolio limit. All investments must be explained and justified, approved according to delegated authorities, and monitored and reported to senior management throughout their life.

Private equity positions were, in the past, the major component of equity investments but the portfolio is being managed down.

While equity investments are not subject to UBS's Group and business group VaR limits, market risk measurement tools may be selectively applied to them, where appropriate, for internal management information. VaR can, for example, provide additional insight into the sensitivity of investments in UBS-managed funds where the assets and other exposures of the funds are in the form of tradable financial instruments. Although some of the assumptions of VaR – in particular the relatively short time horizon – may not be representative of the full risk on equity investments, the results can be used by business management and risk controllers for information or to trigger action or review.

Under International Financial Reporting Standards (IFRS), equity investments may be classified as Financial investments available-for-sale, Financial assets designated at fair value through profit and loss, or Investments in associates.

Composition of equity investments

At 31 December 2007, UBS held equity investments totaling CHF 7,690 million of which CHF 3,583 million were classified as Financial investments available-for-sale, CHF 2,128 million as Financial assets designated at fair value and CHF 1,979 million as Investments in associates. Within Financial investments available-for-sale, CHF 1,865 million are listed equities. None of UBS's equity investments is in structured equity products.

At 31 December 2006, equity investments totalled CHF 10,014 million of which CHF 8,062 million were classified as Financial investments available-for-sale, CHF 429 million as Financial assets designated at fair value and CHF 1,523 million as Investments in associates. Within Financial investments available-for-sale, CHF 5,880 million were listed equities.

UBS's largest single equity investment is its 1% stake in Bank of China, which was taken in 2005, as part of a major strategy initiative. The fair value of this investment on 31 December 2007 was CHF 1,644 million, of which CHF 1,084 million is an unrealized gain reported in equity. The fair value at 31 December 2006 was CHF 2,055 million of which CHF 1,450 million was an unrealized gain recorded in equity. Bank of China is a domestic Chinese bank which has a listing on the H-share register in Hong Kong. The fair value at which UBS carries this investment is determined by a valuation technique (level 2) to reflect the lock-up agreement between UBS and Bank of China. The market value of the shares is affected primarily by the performance of the bank itself, which will, in turn, be somewhat influenced by the Chinese economy, but it is not expected that day to day movements in either Chinese or Hong Kong stock market indices will have a long term impact on the value of this investment. Changes in the exchange rate between the Swiss franc and the Chinese renmimbi, in which the assets and liabilities of Bank of China are primarily denominated, will affect the fair value at which the investment is recorded in UBS's financial statements.

At 31 December 2006, UBS held a stake in Bank Julius Baer with a fair value of CHF 3,029 million. This stake was acquired when Private Banks & GAM was sold in 2005. It was sold in June 2007.

Within the total of CHF 2,128 million Financial assets designated at fair value, an amount of CHF 1,788 million

Audited

represents the assets of trust entities associated with employee compensation schemes. They are broadly offset by liabilities to plan participants included in Other liabilities. The equivalent positions at 31 December 2006 amounted to CHF 1,726 million.

➔ **Details of significant associates are provided in Note 33 in *Financial Statements 2007***

Debt investments

Debt investments classified for IFRS as Financial investments available-for-sale can be broadly categorized as money market papers and debt securities, which are mainly held for statutory, regulatory or liquidity reasons, and non-performing loans, which are purchased in the secondary market by the Investment Bank as part of an approved business line.

The risk control framework applied to debt instruments classified as Financial investments available-for-sale varies depending on the nature of the instruments and the purpose for which they are held.

UBS Bank USA holds debt investments in instruments for which there are liquid markets and of a type which the Investment Bank also carries in its trading inventory (US government sponsored agency securities). They are controlled under the market risk framework and for internal risk control purposes are not considered to be investment positions.

Non-performing loans are subject to specific limits and controls, including risk management and risk control pre-approval. The fair value of non-performing loans is not highly sensitive to interest rate movements but, rather, depends on the expected recovery rate for each individual loan.

Other debt investments are predominantly securities issued by sovereigns of the Organization for Economic Co-operation and Development (OECD) and highly rated financial institutions.

Where applicable, debt investments are reflected in reports to senior management of consolidated credit exposures and in large exposure reports to the Swiss Federal Banking Commission (SFBC).

Composition of debt investments

On 31 December 2007, debt financial investments classified as Financial investments available-for-sale consisted of money market papers of CHF 349 million and other debt investments of CHF 1,034 million.

At 31 December 2006, the equivalent positions were CHF 354 million money market paper and CHF 521 million other debt investments.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external causes, whether deliberate, accidental or natural. It is inherent in all UBS's activities, not only in the business the firm conducts but due to the fact it is a business – because UBS is an employer, it owns and occupies property and holds assets, including information, belonging to both the firm and its clients. The approach to operational risk is not designed to eliminate risk per se but, rather, to contain it within acceptable levels, as determined by senior management, and to ensure that the firm has sufficient information to make informed decisions about additional controls, adjustments to controls, or other risk responses. The Group Chief Risk Officer (Group CRO) and the Group Head of Operational Risk (who reports to the Group CRO) are responsible for the independence, objectivity and effectiveness of the operational risk framework.

Operational risk framework

Every function, whether a front-end business or a control or logistics unit, must manage the operational risks that arise from its own activities. Because these risks are all pervasive, with a failure in one area potentially impacting many others, UBS's framework is based on mutual oversight across all functions. Each business group has therefore established cross-functional bodies as an integral part of its governance structure, to actively manage operational risk.

To ensure the integrity of risk management decisions, each business group also has an Operational Risk Control unit, the head of which reports functionally to the Group Head of Operational Risk. The primary remit of these units is to confirm the effective implementation of the operational risk framework in the business group, to ensure transparent assessment and reporting of risks to senior management, and to coordinate with their counterparts in other business groups and with the Group Head of Operational Risk on cross-business group matters.

The foundation of the operational risk framework is the definition by all functions of their roles and responsibilities so that, collectively, they can ensure that there is adequate segregation of duties, complete coverage of risks and clear accountability. From this analysis, they develop control objectives and standards to protect UBS's tangible and intangible assets and interests, based on the types of operational risk events that might arise, ranging from daily reconciliation problems to potentially severe events such as fraud. UBS recognizes that it cannot eliminate all risks, because errors and accidents will always happen, and that even where it is possible it is not always cost effective to do so. UBS's internal control framework differentiates potential events depending on their likely frequency and impact. Its mitigation and avoidance efforts are focused on areas where UBS believes it is most exposed to severe events – including both those that are reasonably foreseeable and those that, while not predictable, are thought to be reasonably possible. For lower impact risks UBS concentrates on management and monitoring.

The functions monitor compliance with their controls and assess their operating effectiveness in several ways, including self-certification by staff, and evaluation of responses by management. Additionally, they track a wide range of metrics to provide potential early warning of increased risk associated with non-attainment of control objectives. These include numbers and characteristics (severity, size, age, etc.) of, for example, client complaints and claims, deal cancellations and corrections, unreconciled items on cash and customer accounts, and systems failures. The implications of internal and external audit findings and other relevant sources of information are also assessed.

As major operational risk events occur, UBS assesses their causes and the implications for its control framework, whether or not they lead to direct financial loss. This includes events affecting third parties that are relevant to the firm's business if sufficient information is made public. It is important to use all available information to test the control framework because, even if an internal event does not lead to a direct or indirect financial loss, it may indicate that UBS's standards are not being complied with.

The totality of this information is reviewed by functional managers to assess their operational risk exposure and the actions needed to address specific issues. These issues are formally captured on a risk inventory, which forms the basis of reporting to senior management. Regular reports are made both within the business groups and to the Group CRO to allow senior management to assess the overall operational risk profile.

Operational risk measurement

UBS has developed a model for quantification of operational risk, which meets the regulatory capital standard under the Basel II Advanced Measurement Approach (AMA). It has two main components. The historical component is based on UBS's own internal losses and is used primarily to determine the expected loss portion of the capital requirement. The firm has been collecting operational risk event data (both profits and losses) since 2002.

The scenario component of the AMA model is used primarily to determine the unexpected loss portion of the capital requirement. It is based on a set of generic scenarios that represent categories of operational risks to which UBS is exposed. The scenarios themselves are generated from an analysis of internal and external event information, the current business environment, and UBS's own internal control environment through comparison to the risk inventory. For each scenario, UBS estimates a base case mainly derived from its own experience, a stressed case mainly derived from integrating experiences of select peers and a worst case based on events experienced by an expanded set of peers in the financial industry. The scenarios are reviewed at least annually by experts in the relevant subject matter and their risk control counterparts to ensure their validity and may be updated based on material new information or events that occur.

Currently, UBS does not reflect mitigation through insurance in its AMA model.

UBS does not set limits on operational risk but reports the measured risk through the standard reporting processes, and includes it in the overall quantification of risk under the Earnings-at-risk and Capital-at-risk frameworks.

With the implementation of Basel II from 1 January 2008, UBS calculates its operational risk regulatory capital requirement using the AMA model for the consolidated group and the parent bank, in accordance with the requirements of the Swiss Federal Banking Commission, UBS's primary regulator. For regulated subsidiaries, the simpler basic indicator or standardized approaches are adopted, as agreed with local regulators.

The operational risk framework is primarily qualitative rather than quantitative – financial losses and capital considerations are only one, and not the most important, element. UBS uses the operational risk framework as the basis for specialist internal control assessments in areas such as legal, compliance, tax and human resources and to meet internal control-related regulatory requirements, such as Section 404 of the US Sarbanes-Oxley Act of 2002, as well as Basel II.

Treasury and capital management

- UBS's treasury department is responsible for the management of the firm's financial resources. This includes management of: liquidity and funding; capital and balance sheet; and interest rate and currency risks arising from balance sheet and capital management responsibilities
- UBS aims to maintain sound capital ratios at all times - to ensure strong external credit ratings and to remain one of the best capitalized firms in the international financial sector

Liquidity management

- *Liquidity risk* is the risk of being unable to raise funds to meet payment obligations when they fall due. Liquidity must be continuously managed to ensure that the firm can survive a crisis
- *Liquidity management* became a challenge during 2007, following the dislocation of the US residential mortgage market
- *Liquidity position:* in anticipation of an extended period of market turbulence, UBS took several measures to strengthen its liquidity position, including adjustment of short-term funding targets and increased focus on balance sheet management

Funding management

- *Funding risk* is the risk of being unable, on an ongoing basis, to borrow funds in the market at an acceptable price to fund actual or proposed commitments and thereby support UBS's current business and desired strategy
- *Access to funding:* despite challenging market conditions in the second half of 2007, UBS was able to maintain access to funding, primarily as a result of its broadly diversified funding base

Capital management

Despite significant writedowns on US mortgage-related exposures, UBS remains one of the best capitalized financial institutions in the world

Risk-weighted assets in 2007
In 2007, capital requirements increased for the Investment Bank, in particular for market risk exposures and derivatives

Eligible capital in 2007
In 2007, UBS's BIS Tier 1 capital decreased, reflecting the losses sustained, accruals for share-based compensation plans and foreign exchange translation differences

Capital improvement program
Effective by year-end 2007:
- rededication of 36.4 million shares that had previously been bought back for cancellation
- replacement of cash dividend for 2007 with stock dividend

Effective in first quarter 2008:
- issuance of CHF 13 billion of mandatory convertible notes to two long-term financial investors

Introduction of Basel II in 2008
UBS expects the overall impact on its BIS Tier 1 ratio to be negative, depending on the further development of the business mix

Capital adequacy

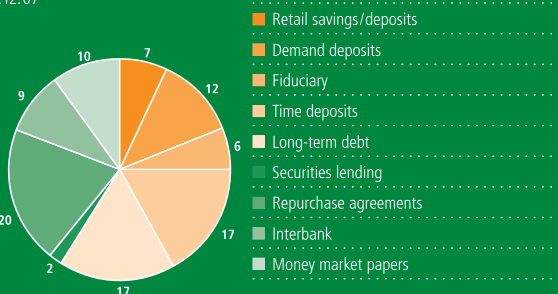
CHF million, except where indicated	As of 31.12.07	31.12.06	31.12.05
BIS Tier 1 capital	32,811	40,528	39,834
of which hybrid Tier 1 capital	6,387	5,633	4,975
BIS total capital	44,507	50,364	43,808
BIS Tier 1 capital ratio (%)	8.8	11.9	12.8
BIS total capital ratio (%)	12.0	14.7	14.1
Balance sheet assets	292,988	273,588	252,364
Off-balance sheet and other positions	37,200	48,444	37,010
Market risk positions[1]	42,110	19,860	21,035
Total BIS risk-weighted assets	372,298	341,892	310,409

1 BIS risk-weighted asset equivalent of market risk capital requirement.

UBS: funding by product type

in %

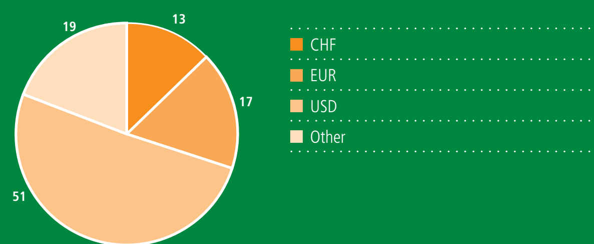
As of 31.12.07



UBS: funding by currency

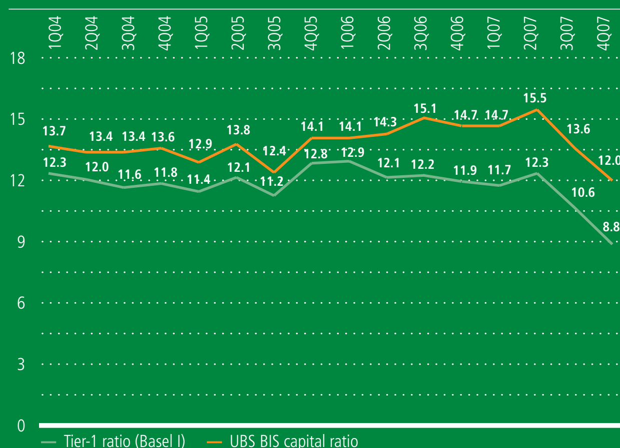
in %

As of 31.12.07



UBS: BIS capital ratios

in %



Interest rate and currency management

Management of non-trading interest rate risk

Audited

UBS's largest non-trading interest rate exposures arise in its wealth management and Swiss-based banking business. These risks are transferred from the originating businesses into one of UBS's two centralized interest rate risk management units – Treasury or the Investment Bank's foreign exchange and money market unit (FX&MM). These units manage the risks on an integrated basis, exploiting the full netting potential across risks from different sources.

Risks from fixed-maturity, short-term Swiss franc and all non-Swiss franc transactions are generally transferred to FX&MM. These fixed-rate lending products do not contain embedded options such as early prepayment that would allow customers to prepay at par – all prepayments are subject to market-based unwinding costs.

Risks from Swiss franc transactions with fixed maturities greater than one year are transferred to Treasury by individual back-to-back transactions. Current and saving accounts and many other retail products of Global Wealth Management & Business Banking have no contractual maturity date or direct market-linked rate, and therefore their interest rate risk cannot be transferred by simple back-to-back transactions. Instead, they are transferred on a pooled basis via "replicating" portfolios. A replicating portfolio is a series of loans or deposits at market rates and fixed terms between the originating business unit and Treasury, structured to approximate – on average – the interest-rate cash flow and repricing behavior of the pooled client transactions. The portfolios are rebalanced monthly. Their structure and parameters are based on long-term market observations and client behavior, and are regularly reviewed and adjusted as necessary. The originating business units are thus immunized as far as possible against market interest rate movements, but retain and manage their product margin.

A significant amount of interest rate risk also arises from the financing of non-monetary related balance sheet items, such as the financing of bank property and equity investments in associated companies. These risks are generally transferred to Treasury through replicating portfolios which, in this case, are designed to approximate the funding profile mandated by senior management.

Treasury manages its residual open interest rate exposures – taking advantage of any offsets that arise between positions from different sources – within its approved market risk limits (Value at Risk (VaR) and stress loss). The preferred risk management instrument is interest rate swaps, for which there is a liquid and flexible market. All transactions are executed via the Investment Bank – Treasury does not directly access the external market.

➔ For further details on UBS's market risk measures and controls, please refer to the "Market risk" section of this report

Market risk arising from management of consolidated capital

Audited

UBS is required, by international banking regulation (BIS regulations), to hold a minimum level of capital against assets and other exposures (risk-weighted assets). The relationship between UBS's capital and its risk-weighted assets – the BIS Tier 1 ratio – is monitored by regulators and analysts and is a key indicator of its financial strength.

The majority of UBS's capital and many of its assets are denominated in Swiss francs, but the Group also holds risk-weighted assets and eligible capital in other currencies, primarily US dollar, euro and UK sterling. Following the integration of Banco Pactual in December 2006, UBS now also has material risk-weighted assets in Brazilian real. Any significant depreciation of the Swiss franc against these currencies would adversely impact the Group's BIS Tier 1 ratio. Treasury's mandate is therefore to protect this ratio against adverse currency movements and to generate an income flow from the capital. This mandate determines a currency, tenor and product mix – a target profile – against which Treasury manages the Group's capital.

On an overall Group basis, Treasury's target profile is based on a currency mix which broadly reflects the currency distribution of the consolidated risk-weighted assets, using products and tenors which generate the desired income stream. As the Swiss franc depreciates (or appreciates) against these currencies, the consolidated risk-weighted assets increase (or decrease) relative to UBS's capital. These currency fluctuations also lead to translation gains (or losses) on consolidation, which are recorded through equity. Thus, UBS's consolidated equity rises or falls in line with the fluctuations in the risk-weighted assets, protecting the Tier 1 ratio. The capital of the parent bank itself is held predominantly in Swiss francs in order to avoid any significant effects of currency fluctuations on its standalone financial results.

The capital of the parent bank and its subsidiaries is placed in the form of interest bearing cash deposits internally within the Group – primarily with the Investment Bank's FX&MM

Treasury: Value at Risk (10-day, 99% confidence, 5 years of historical data)

	Year ended 31.12.07				Year ended 31.12.06			
CHF million	**Min.**	**Max.**	**Average**	**31.12.07**	Min.	Max.	Average	31.12.06
Interest rates	**9**	**55**	**17**	**54**	19	72	36	19
Foreign exchange	**1**	**87**	**18**	**21**	4	51	30	20
Diversification effect	[1]	[1]	**(10)**	**(14)**	[1]	[1]	(23)	(12)
Total	**10**	**92**	**25**	**61**	25	69	43	27

1 As the minimum and maximum occur on different days for different risk types, it is not meaningful to calculate a portfolio diversification effect.

Audited

unit. Where necessary, Treasury also executes derivatives (mainly interest rate swaps) with the Investment Bank's trading desks to achieve the target profile. FX&MM and the derivative trading units manage the resultant cash and market risk positions as part of their normal business activities and, in the case of FX&MM, within the approved liquidity framework.

➔ **For details on UBS's liquidity framework please refer to the "Liquidity and funding management" section of this report**

Audited

For the purposes of measuring and managing Treasury's market risk position, the Group's consolidated equity is represented in the Treasury book by replicating portfolios (liabilities) with the target currency and interest rate profile. The interest rate positions created by Treasury's deposits with FX&MM or other units, and the associated derivatives, generally offset the interest rate risk of the replicating portfolios. Any mismatches between the two are managed, together with other non-trading interest rate risk positions within Treasury's market risk limits (VaR and stress).

The structural foreign currency exposures are controlled by senior management but are not subject to internal market risk limits and are not included in Treasury's reported VaR.

Treasury interest rate risk development

In measuring Treasury's interest rate risk – expressed as VaR – both the representation of the consolidated equity (replicating portfolios) and the deployment of the equity described above are included in the calculations. Towards the end of December 2007, and as a consequence of the reported writedowns, Treasury had to reduce the amount of shareholders' equity invested in Swiss francs.

On 31 December 2007, UBS's consolidated equity was deployed as follows: in Swiss francs (including most of the capital of the parent bank) with an average duration of approximately three years and an interest rate sensitivity of CHF 5.1 million per basis point; in US dollar with an average duration of approximately four years and sensitivity of CHF 8.6 million per basis point; in euro with an average duration of approximately three years and a sensitivity of CHF 0.7 million per basis point; and in UK sterling with a duration of approximately three years and a sensitivity of CHF 0.5 million per basis point. The interest rate sensitivity of these positions is directly related to the chosen duration – targeting significantly shorter maturities would reduce the apparent interest rate sensitivity but would lead to greater fluctuations in interest income.

Corporate currency management

UBS's corporate currency management activities are designed to reduce the impact of adverse currency fluctuations on its reported financial results, given regulatory constraints. UBS specifically focuses on three principal areas of currency risk management: match funding/investment of non-Swiss franc assets/liabilities; sell-down of non-Swiss franc profit and loss; and selective hedging of anticipated non-Swiss franc profit and loss.

Match funding and investment of non-Swiss franc assets and liabilities

As far as it is practical and efficient to do so, UBS follows the principle of matching the currency of its assets with the currency of the liabilities which fund them – thus a US dollar asset is typically funded in US dollars, a euro liability is offset by an asset in euros, etc. This avoids profits and losses arising from retranslation at the prevailing exchange rates to the Swiss franc at each quarter-end.

Sell-down of reported profits and losses

For accounting purposes, reported profits and losses are translated each month from the original transaction currencies into Swiss francs at the exchange rate prevailing at the end of the month. Treasury centralizes profits or losses in foreign currencies that arise in the parent bank, and sells or buys them for Swiss francs in order to eliminate earnings volatility which would arise from retranslation at different exchange rates of previously reported non-Swiss franc profits and losses. Other UBS operating entities follow a similar monthly sell-down process into their own reporting currencies. Profits retained in operating entities with a reporting currency other than Swiss franc are managed as part of UBS's consolidated equity, as described earlier.

Audited

Hedging of anticipated future reported profits

The monthly sell-down process cannot protect UBS's earnings from swings caused by a sustained depreciation against the Swiss franc of one of the main currencies in which UBS earns net revenues or by an appreciation of one in which it incurs significant net costs.

The firm's corporate currency management seeks to mitigate the potential adverse impact of any such development by executing a dynamic and cost-efficient rollover hedge strategy on a portion of the profits that UBS anticipates for the next three months, on a rolling one-month basis.

Although intended to hedge future earnings, these transactions are considered open currency positions. They are therefore subject to internal market risk VaR and stress loss limits.

In public segmental reporting, the profits and losses arising from the hedge strategy are shown as Corporate Center items, while the business group results are fully exposed to exchange rate fluctuations.

Liquidity and funding management

Audited

Liquidity risk is the risk of being unable to raise funds to meet payment obligations when they fall due. Funding risk is the risk of being unable, on an ongoing basis, to borrow funds in the market at an acceptable price to fund actual or proposed commitments and thereby support UBS's current business and desired strategy. Liquidity and funding are not the same, but they are closely related and both are critical to a financial institution.

Liquidity must be continuously managed to ensure that the firm can survive a crisis, whether it is a general market event, a localized difficulty affecting a smaller number of institutions, or a problem unique to an individual firm. An institution that is unable to meet its liabilities when they fall due may collapse, even though it is not insolvent, because it is unable to borrow on an unsecured basis, or does not have sufficient good quality assets to borrow against or liquid assets to sell to raise immediate cash.

During 2007, liquidity management became a challenge following the dislocation of the US residential mortgage market, which led to a sharp reduction in trading volumes in some previously highly liquid markets. In the repo market, certain assets were subject to higher haircuts, and were sometimes not accepted. Despite these challenging conditions, UBS was able to maintain access to funding, primarily as a result of its broadly diversified funding base. In addition, in anticipation of an extended period of market turbulence, several measures were taken to further strengthen UBS's liquidity position during this period. Short-term funding targets were adjusted accordingly, and increased focus was placed on balance sheet management.

Liquidity approach

Audited

UBS's approach to liquidity management, which covers all branches and subsidiaries, is to ensure that it will always have sufficient liquidity to meet liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking sustained damage to its various business franchises.

Central to the integrated framework is an assessment of all material, known and expected cash flows and the level of high-grade collateral that could be used to raise additional funding. It entails both careful monitoring and control of the daily liquidity position, and regular liquidity stress testing. Risk limits are set by the Group Executive Board (GEB) and monitored by Treasury, and contingency plans for a liquidity crisis are incorporated into UBS's wider crisis management process.

The liquidity position is assessed and managed under a variety of potential scenarios encompassing both normal and stressed market conditions. UBS considers the possibility that its access to markets could be impacted by a stress event affecting some part of its business or, in the extreme case, if it was to suffer a severe rating downgrade combined with a period of general market uncertainty.

UBS's major sources of liquidity are channeled through entities that are fully consolidated.

New funding framework

In 2007, UBS introduced a new funding model for the Investment Bank. The model incorporates two principal changes: the first is the adjustment of the internal pricing curve to reflect UBS's true cost of funding, with an additional component to align the price more closely to the prices of defined peer institutions. The second is the requirement for UBS businesses to be term-funded, based on Treasury's assessment of the quality and liquidity of their assets.

These changes will encourage more disciplined use of UBS's balance sheet by the Investment Bank.

Audited

Liquidity management

UBS manages its liquidity position in order to be able to ride out a crisis without damaging the ongoing viability of its business. This is complemented by the firm's funding risk management which aims to achieve the optimal liability structure to finance its businesses cost-efficiently and reliably. The long term stability and security of UBS's funding in turn helps protect its liquidity position in the event of a UBS-specific crisis.

UBS's business activities generate liability portfolios which are intrinsically highly diversified with respect to market, product and currency. This provides a broad range of investment opportunities for UBS's clients and thus reduces the firm's exposure to individual funding sources, which in turn reduces liquidity risk.

UBS adopts a centralized approach to liquidity and funding management to exploit these advantages to the full. The liquidity and funding process is undertaken jointly by Treasury and the foreign exchange and money market (FX&MM) unit within Investment Bank fixed income, currencies and commodities (FICC). Treasury establishes a comprehensive control framework, while FX&MM undertakes operational cash and collateral management within the established parameters.

This centralization permits close control of both UBS's global cash position and its stock of highly liquid securities. The central treasury process also ensures that the firm's general access to wholesale cash markets is concentrated in FX&MM. Funds raised externally are largely channeled into FX&MM including the proceeds of debt securities issued by UBS, an activity for which Treasury is responsible. FX&MM in turn meets all internal demands for funding by channeling funds from units generating surplus cash to those requiring finance. In this way, UBS minimizes its external borrowing and use of available credit lines, and presents a consistent and coordinated face to the market.

Audited

Liquidity modeling and contingency planning

The daily liquidity position – the net cumulative funding requirement for a specific day – is projected under cautious assumptions for each business day from the current day out to one month to produce a cumulative "cash ladder". The short-term cash ladder is the tool used by FX&MM to manage net daily funding requirements efficiently, while Treasury monitors liquidity exposure against limits set by the GEB.

UBS also regularly assesses the impact of a liquidity crisis scenario, combining a firm-specific crisis with market disruption and focusing on a time horizon starting with overnight and extending up to one year. This UBS-specific scenario envisages large draw-downs on otherwise stable client deposits, an inability to renew or replace maturing unsecured wholesale funding and limited capacity to generate liquidity from trading assets. Liquidity crisis scenario analysis supports the liquidity management process so that immediate corrective measures, such as the build-up of a liquidity buffer to absorb potential sudden liquidity gaps, can be put into effect.

The starting point for stress testing analyses is a breakdown of the contractual maturity of UBS's assets and liabilities. One such breakdown is shown in the table at the end of this section. This maturity analysis is an accounting view. It does not fully represent a liquidity risk management perspective which would also include stress analyses and a more detailed breakdown of asset and liability types.

Audited

Since a liquidity crisis could have a myriad of causes, UBS focuses on a scenario that encompasses all potential stress effects across all markets, currencies and products.

The assessment includes the likelihood of maturing assets and liabilities being rolled over in a UBS-specific crisis, and gauges the extent to which the potential crisis-induced shortfall could be covered by available funding. This would be raised on a secured basis against available collateral, which includes securities eligible for pledging at the major central banks, or by selling liquid inventory. In both cases UBS applies crisis-level discounts to the value of the assets. It assumes that it would be generally unable to renew any of the Group's wholesale unsecured debt, including all its maturing money market papers (outstanding volume CHF 152.3 billion on 31 December 2007) and that no contingency funding could be raised on an unsecured basis. It also factors in potential liquidity outflows from contingent liabilities, in particular those resulting from the drawdown of committed credit lines. Exposures to other contingent commitments, such as guarantees and letters of credit, are included in this analysis, although they are not as vulnerable since they are generally not unconditional but, rather, are linked to other, independent conditions being fulfilled.

Liquidity needs may also result from commitments and contingencies, including credit lines extended to secure the liquidity needs of customers. UBS regularly monitors undrawn committed credit facilities and other latent liquidity risks.

If UBS's credit rating were to be downgraded, "rating trigger" clauses, especially in derivative contracts, could result in an immediate cash outflow due to the unwinding of derivative positions, or the need to deliver additional collateral. UBS's contingent exposure arising directly from these rating triggers is judged not to be material compared to its liquidity-generation capacity, even in a crisis situation. UBS also analyzes the potential impact on its net liquidity position of adverse movements in the replacement values of its over-the-counter (OTC) derivative transactions which are subject to collateral arrangements and includes the potential outflows in its crisis scenarios. Given the diversity of UBS's derivatives business and that of its counterparties, there is not necessarily a direct correlation between the factors influencing net replacement values with each counterparty and a firm-specific crisis scenario.

Liquidity limits and controls

Audited

While its estimated capacity to generate liquidity when required will naturally vary, UBS generally applies a constant limit structure, which imposes a ceiling on the projected net funding requirement along the cash ladder. Limits are based on the amount of cash UBS believes it could raise in a firm-specific crisis.

The limits vary by time zone since access to liquidity will depend on the time of day – at the beginning of the global trading day, during Asia Pacific trading hours, the limits are less severe since more time is available to mobilize funding sources or, if necessary, initiate asset sales to generate additional liquidity. As the day proceeds and currency zones begin to close, the limits become tighter, with the strictest limits applied later in the day when only the US markets are available. FX&MM's day-to-day liquidity management is based on global books that are handed over from time zone to time zone, ensuring 24-hour coverage. Compliance with the risk limits and actual credit liquidity exposures are regularly reported to the GEB.

To complement and support the limit framework, regional teams monitor the markets in which UBS operates for potential threats and regularly report any significant findings to Treasury.

Audited

UBS has also developed detailed contingency plans for liquidity crisis management, the cornerstone of which is the Group's access to secured funding either from the market or from the major central banks, coupled with the ability to turn sufficient liquid assets into cash within a short time frame.

The liquidity contingency plan is an integral part of the global crisis management concept, which covers all types of crisis events. It would be implemented under a core crisis team with representatives from Treasury, from FX&MM and from related areas including the functions responsible for payments and settlements, market and credit risk control, collateral and margin management, and information technology and infrastructure. FX&MM's centralized global management model lends itself naturally to efficient liquidity crisis management.

UBS is continuing to strengthen its relationships with the major central banks, consistent with its general policy, which is to base contingency plans on secured funding against pledges of high-quality collateral, rather than relying on third-party credit lines.

Audited

Liquidity ratios

In addition to the limits and controls described above, UBS also measures three ratios to monitor liquidity risk – the ratio of trading assets (trading portfolio assets and positive replacement values on derivatives) to total assets, the ratio of "level 1" trading assets to total assets, and the ratio of customer savings and deposits to mortgages. Level 1 trading assets are those for which fair values can be obtained from observable market prices and which are therefore considered to be the most liquid. These ratios are largely driven by UBS's two largest business groups, the Investment Bank and Global Wealth Management & Business Banking. The first two ratios show the proportion of UBS's total assets that are of a trading nature and are dominated by the Investment Bank's activities. The third ratio is mainly driven by Global Wealth Management & Business Banking and shows the extent to which UBS is effectively funding its largest Swiss asset portfolio with customer deposits (savings and deposit accounts only), which are a stable funding source – the higher this percentage, the less the bank is reliant on wholesale funding for these potentially longer-term assets.

Audited

Liquidity ratios

in %	**31.12.07**	31.12.06
Ratio of trading assets to total assets	**52.92**	49.93
Ratio of level 1 trading assets to total assets	**15.02**	20.88
Ratio of customer savings and deposits to mortgages	**76.10**	79.10

Funding

UBS's domestic retail and global wealth management businesses have proven in the past to be valuable, cost-efficient and reliable sources of funding. Furthermore, through the establishment of short-, medium- and long-term funding programs in Europe, the US and Asia, UBS can provide specialized investments to its customers through which it can efficiently raise funds globally from both institutional and private investors, minimizing its dependence on any particular source.

Through broad diversification of its funding sources (by market, product and currency), UBS maintains a well-balanced portfolio of liabilities, which generates a stable flow of financing and provides protection in the event of market disruptions. This, together with its centralized funding management, enables UBS to pursue a strategy of efficient funding of business activities.

Funding approach

Medium- and long-term funding activities are planned by assessing the overall funding profile of the balance sheet, taking due account of the effective maturity of the asset base and the amount of maturing debt that will have to be replaced. The ability to continue to fund ongoing business activities through periods of difficult market conditions is also factored in. At the beginning of 2007, UBS decided to further strengthen its funding profile through public issuance of senior, straight, long-term debt and thereby enhance the overall diversification of its funding sources.

To ensure that a well-balanced and diversified liability structure is preserved, Treasury routinely monitors UBS's funding status and reports its findings on a quarterly basis to the GEB. Two main analysis tools are employed – "cash capital" and "secured funding capacity". UBS complements these analyses with regular assessments of any concentration risks in its main funding portfolios.

Cash capital is the excess of UBS's long-term funding over the total of illiquid assets. "Long-term" and "illiquid" both refer to a time horizon of one year. The secured funding capacity concept ensures that short-term, unsecured (wholesale) funding is effectively only invested in freely marketable assets. UBS seeks to maintain a minimum stock of unencumbered assets and cash that exceeds its outstanding short-term unsecured wholesale borrowings.

Audited

Funding position

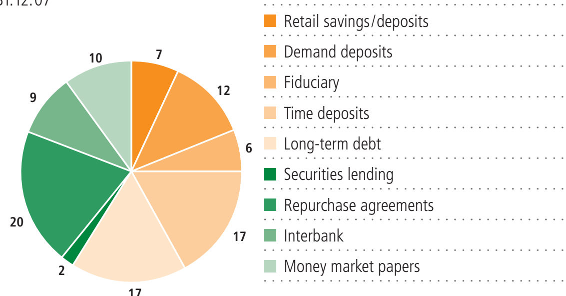
UBS's secured funding base reduces its exposure to periods of stressed market conditions when the ability to raise unsecured funding could be temporarily restricted.

The charts below show a breakdown by product type and by currency of UBS's secured and unsecured funding as of 31 December 2007. Of the total, 22% was raised on a secured basis and 78% unsecured. The unsecured funding base is well diversified, with 19% of total funding stemming from savings and demand deposits, 17% from long-term debt, 17% from time deposits, 9% from short-term interbank borrowing, 10% from money market papers and 6% from fiduciary deposits. Around half of UBS's funding is originated in US dollars, with substantial portions in Swiss francs and euros, roughly mirroring the currency breakdown of its assets. Around 19% of funding was denominated in other currencies (primarily UK sterling and Japanese yen). UBS does not rely on buying committed credit facilities from third-party banks, but instead bases its contingent funding sources on its ability to raise secured funding through the use of high-quality collateral.

UBS: funding by product type

in %

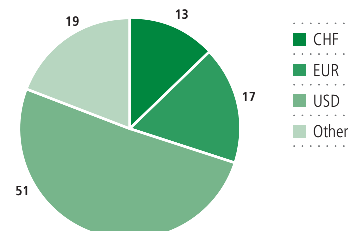
As of 31.12.07



UBS: funding by currency

in %

As of 31.12.07



Audited

Maturity analysis of assets and liabilities

CHF billion	On demand and trading instruments: Instruments at cost and at fair value / level 1	Instruments at fair value / level 2	Instruments at fair value / level 3	Subject to notice[1]	Due within 1 month	Due between 1 and 3 months	Due between 3 and 12 months	Due between 1 and 5 years	Due after 5 years	Total
Assets										
Cash and balances with central banks	18.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	18.8
Due from banks	46.4	0.0	0.0	0.0	6.7	2.1	4.1	1.4	0.2	60.9
Cash collateral on securities borrowed	0.0	0.0	0.0	149.5	46.5	2.4	3.8	1.5	3.4	207.1
Reverse repurchase agreements	0.0	0.0	0.0	34.8	277.3	40.0	22.8	1.9	0.1	376.9
Trading portfolio assets [2]	249.3	323.4	37.3	0.0	0.0	0.0	0.0	0.0	0.0	610.0
Trading portfolio assets pledged as collateral[2]	85.3	55.8	23.2	0.0	0.0	0.0	0.0	0.0	0.0	164.3
Positive replacement values[2]	6.8	407.4	14.0	0.0	0.0	0.0	0.0	0.0	0.0	428.2
Financial assets designated at fair value [3]	1.8	0.3	0.0	0.0	1.9	1.7	0.8	2.2	3.1	11.8
Loans	72.5	0.0	0.0	42.0	61.5	20.0	38.6	72.7	28.6	335.9
Financial investments available-for-sale	0.4	0.5	1.0	0.0	0.3	0.0	1.8	0.3	0.7	5.0
Accrued income and prepaid expenses	0.0	0.0	0.0	0.0	12.0	0.0	0.0	0.0	0.0	12.0
Investments in associates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.0	2.0
Property and equipment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7.2	7.2
Goodwill and other intangible assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	14.5	14.5
Other assets	0.0	0.0	0.0	0.0	18.0	0.0	0.0	0.0	0.0	18.0
Total 31.12.07	**481.3**	**787.4**	**75.5**	**226.3**	**424.2**	**66.2**	**71.9**	**80.0**	**59.8**	**2,272.6**
Total 31.12.06	549.9	673.9	13.1	351.4	404.6	114.3	92.3	98.9	48.0	2,346.4
Liabilities										
Due to banks	39.1	0.0	0.0	1.0	77.8	15.1	11.8	0.4	0.5	145.7
Cash collateral on securities lent	0.0	0.0	0.0	30.5	1.1	0.0	0.0	0.0	0.0	31.6
Repurchase agreements	0.0	0.0	0.0	17.4	186.7	46.8	54.4	0.6	0.0	305.9
Trading portfolio liabilities [2]	119.9	44.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	164.8
Negative replacement values[2]	6.6	420.1	16.8	0.0	0.0	0.0	0.0	0.0	0.0	443.5
Financial liabilities designated at fair value [3]	0.0	0.0	0.0	0.0	4.5	35.3	28.8	68.0	55.3	191.9
Due to customers	179.6	0.0	0.0	124.1	252.3	49.8	23.5	0.7	11.9	641.9
Accrued expenses and deferred income	0.0	0.0	0.0	0.0	21.8	0.0	0.0	0.0	0.0	21.8
Debt issued	0.0	0.0	0.0	0.0	52.2	63.6	49.0	22.6	34.7	222.1
Other liabilities	0.0	0.0	0.0	27.5	33.3	0.0	0.0	0.0	0.0	60.8
Total 31.12.07	**345.2**	**465.0**	**16.8**	**200.5**	**629.7**	**210.6**	**167.5**	**92.3**	**102.4**	**2,230.0**
Total 31.12.06	386.3	290.1	9.2	254.6	843.4	169.8	150.6	97.5	89.1	2,290.6

1 Deposits without a fixed term, on which notice of withdrawal or termination has not been given (such funds may be withdrawn by the borrower subject to an agreed period of notice). 2 Trading and derivative positions are presented in the first three columns of this table: "Instruments at cost and fair value / level 1", "Instruments at fair value / level 2" and "Instruments at fair value / level 3". Management believes that such presentation most accurately reflects the short-term nature of trading activities. The contractual maturity of the instruments may, however, extend over significantly longer periods. The breakdown of these positions into the fair value measurement categories of levels 1, 2 and 3 indicates the liquidity of the markets in which the financial instruments are traded and the availability of market observable inputs to measure these instruments (refer to Note 26 in *Financial Statements 2007*). 3 The contractual redemption amount at maturity of financial assets and liabilities designated at fair value approximates the carrying value as of 31 December 2007 and 31 December 2006.

Audited

Contingent claims and commitments

CHF million	**31.12.07**	31.12.06
Contingent claims	**20,824**	17,908
Undrawn irrevocable facilities	**83,980**	97,287

The Group enters into commitments to extend credit lines to secure the liquidity needs of customers. From the outstanding undrawn irrevocable credit facilities, approximately one-fifth mature within 12 months while four-fifths mature beyond 12 months.

Capital management

Audited

In managing its capital, UBS considers a variety of requirements and expectations. Sufficient capital must be in place to support current and projected business activities, according to both UBS's own internal assessment and the requirements of its regulators, in particular its lead regulator the Swiss Federal Banking Commission (SFBC).

Capital is also managed in order to achieve sound capital ratios, to ensure strong external credit ratings and to ensure that UBS remains one of the best capitalized firms in the international banking sector. This is crucial in retaining clients' confidence in UBS's financial strength and also supports UBS's funding position and favorable borrowing costs in the international financial markets.

UBS aims to maintain sound 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. The main tools by which UBS manages the supply side of its capital ratios are active management of capital instruments and dividend payments.

Audited

Capital adequacy management

Ensuring compliance with minimum regulatory capital requirements and targeted capital ratios is central to capital adequacy management. In this ongoing process, UBS manages towards Tier 1 and Total capital target ratios. In the target setting process UBS takes into account the regulatory minimum capital requirements and regulators' expectations that UBS holds additional capital above the minimum, UBS's internal assessment of aggregate risk exposure in terms of Capital-at-risk, the views of rating agencies, and comparison to peer institutions, considering UBS's business mix and market presence.

Audited

Capital requirements

At year end 2007, UBS was subject to regulatory guidelines based on the original – Basel I – framework established by the Basel Committee on Banking Supervision ("BIS guidelines/ratios"). The capital it is required to hold is determined by its risk-weighted assets – its balance sheet, off-balance sheet and market risk positions, measured and risk-weighted according to criteria defined by its lead regulator, the SFBC. Under BIS guidelines, a financial institution's eligible capital must be at least 8% of its total risk-weighted assets.

UBS's published capital ratios and risk-weighted assets are determined according to BIS guidelines, which differ in certain respects from the regulations of the SFBC. The most important differences are:
– where BIS guidelines apply a maximum risk weight of 100%, the SFBC applies risk weights above 100% to certain asset classes (for example real estate, fixed assets, intangibles, and non-trading equity positions); and
– where the BIS guidelines apply a 20% risk weight to obligations of Organization for Economic Co-operation and Development (OECD) banks, the SFBC applies risk weights of 25% to 75%, depending on maturity.

Capital improvement program

In fourth quarter 2007, the markets for US residential sub-prime mortgages and related securities, and the US residential housing market in general continued to deteriorate. In December, it became increasingly evident that substantial writedowns would be required.

The reduction in the Tier 1 ratio resulting from the expected substantial overall loss in fourth quarter could, among other consequences, have led to rating agency downgrades of UBS's top-tier financial ratings. This, in turn, could have damaged client confidence in UBS's financial strength and increased the Group's borrowing costs in the international financial markets. UBS therefore decided to take immediate actions to strengthen its capital position.

The most important element of the capital improvement program was the proposal to issue CHF 13 billion of mandatory convertible notes (MCN), which was approved at the extraordinary general meeting on 27 February 2008.

Since the capital impact of the MCN issue would only become effective in first quarter 2008, it was also decided in December 2007 to take additional measures that would have an immediate effect on the Tier 1 capital ratio. Firstly, the Board of Directors approved the rededication of 36.4 million shares that had previously been bought back and earmarked for cancellation. Secondly, it proposed to replace the cash dividend for 2007 with a stock dividend.

➔ **Further details on the mandatory convertible notes can be found in the "Shares and capital instruments" section of this report**

Audited

As a result of the differences in regulatory rules, UBS's risk-weighted assets are higher and capital ratios (total and Tier 1) are lower when calculated under SFBC regulations than under BIS guidelines. UBS has always had total capital and Tier 1 capital in excess of the minimum requirements of both the BIS and the SFBC.

UBS measures on- and off-balance sheet claims according to regulatory formulas. Claims are weighted according to type of counterparty and collateral. The least risky claims, such as claims on OECD governments and claims collateralized by cash, are weighted at 0%, meaning that no regulatory capital support is required, while the claims deemed most risky, including unsecured claims on both corporate and private customers, are weighted at 100%, meaning that 8% capital support is required.

Securities not held for trading are treated as claims, based on the net position in the securities of each issuer, including both actual holdings and exposures from derivative instruments. UBS's investments in entities which are consolidated under International Financial Reporting Standards (IFRS) and which are not active in the field of banking and finance (including consolidated industrial holdings) are treated for regulatory capital purposes as positions in securities not held for trading.

Claims arising from derivatives transactions have two components – the current replacement values, and "add-ons" to reflect the potential future exposure. Where UBS has entered into a master netting agreement that is considered legally enforceable in insolvency, positive and negative replacement values with individual counterparties can be netted. Off-balance sheet claims arising from contingent commitments and irrevocable facilities are converted into credit equivalent amounts based on percentages of nominal value specified by the regulators.

Regulatory capital is required to support market risk arising on all foreign exchange, energy, metal and other commodity positions, and on all positions held for trading purposes, including equities and traded debt obligations held in the trading book. For most market risk positions, UBS derives its regulatory capital requirement from its internal Value at Risk (VaR) model which is approved by the SFBC. It is based on 10-day VaR, which is subject to a multiplier reflecting the regulator's view of the robustness of the VaR model. This multiplier is increased in response to backtesting exceptions. For some small positions, market risk regulatory capital is computed using the standardized method defined by the regulators. Unlike the calculations for credit risk, the market risk measure produces the capital requirement itself rather than the amount of risk-weighted assets. In order to compute a total capital ratio, the total market risk capital requirement is converted to a "risk-weighted asset equivalent" such that the capital requirement is 8% of this risk-weighted asset equivalent, i.e. the total market risk capital requirement is multiplied by 12.5.

Other assets, most notably property and equipment, and intangibles are not subject to credit or market risk, but they represent a risk to the Group in respect of their potential for writedown and impairment and therefore require capital underpinning in accordance with regulatory formulas.

Risk-weighted assets (BIS)

	Exposure	Risk-weighted amount	Exposure	Risk-weighted amount
CHF million	**31.12.07**	**31.12.07**	31.12.06	31.12.06
Balance sheet exposures				
Due from banks and other collateralized lendings[1]	**463,796**	**7,450**	452,821	10,438
Net positions in securities[2]	**12,721**	**9,510**	10,262	8,447
Positive replacement values[3]	**138,978**	**34,800**	110,732	24,161
Loans, net of allowances for credit losses and other collateralized lendings[1]	**710,564**	**210,493**	887,694	206,359
Accrued income and prepaid expenses	**10,383**	**5,255**	9,302	4,920
Property and equipment	**8,370**	**8,370**	8,436	8,436
Other assets	**27,234**	**17,110**	15,976	10,827
Off-balance sheet exposures				
Contingent liabilities	**20,824**	**7,512**	17,908	7,842
Irrevocable commitments	**84,978**	**13,028**	98,439	23,592
Forward and swap contracts[4]	**732,930**	**15,565**	459,170	16,599
Purchased options[4]	**9,954**	**1,095**	8,220	411
Market risk positions[5]		**42,110**		19,860
Total risk-weighted assets		**372,298**		341,892

1 Includes gross securities borrowing and reverse repurchase agreement exposures, and those traded loans in trading portfolio assets originated by the Group for syndication or distribution. These financial instruments are excluded from the Market risk positions. 2 Includes industrial holdings, which are not consolidated for capital adequacy. Excludes positions in the trading book, which are included in Market risk positions. 3 Represents the mark-to-market values of Forward and swap contracts and Purchased options, where positive but after netting, where applicable. 4 Represents the add-ons for these contracts. 5 Regulatory capital adequacy requirements for market risk, calculated using the approved Value at Risk model, or the standardized method, multiplied by 12.5. This results in the risk-weighted asset equivalent.

UBS's capital requirements are generally based on its consolidated financial statements in accordance with IFRS. Under these standards, subsidiaries and special purpose entities that are directly or indirectly controlled by UBS must be consolidated, whereas for regulatory capital purposes, subsidiaries that are not active in the banking and finance business are excluded.

On 31 December 2007 risk-weighted assets were CHF 372.3 billion, up 9% from CHF 341.9 billion at year-end 2006. Roughly 55% of the increase was driven by exposures from the Investment Bank, in particular increased capital requirements for market risk resulting from higher market volatility and an increase in the regulatory multiplier, higher positive replacement values of derivatives, and an increase in the syndicated loan portfolio, partially offset by a decrease in risk-weighted assets for undrawn commitments and securities lending and borrowing activities. Global Wealth Management & Business Banking contributed the remainder of the risk-weighted asset increase, mainly related to increased collateralized lending.

Audited

Eligible capital

The capital available to support risk-weighted assets – eligible capital – consists of Tier 1 and Tier 2 capital. Tier 1 capital is required to be at least 4% of risk-weighted assets and total capital (Tier 1 plus Tier 2) at least 8%. To determine eligible Tier 1 and total capital, adjustments have to be made to shareholders' equity as defined under IFRS, most notably by deducting goodwill and investments in unconsolidated entities engaged in banking and finance activities.

Eligible capital is the same under BIS guidelines and SFBC regulations.

Audited

Tier 1 capital / UBS shares

The majority of Tier 1 capital comprises retained earnings attributable to UBS shareholders. As of 31 December 2007, total IFRS equity attributable to UBS shareholders amounted to CHF 35,585 million, which serves as the basis for determining the regulatory eligible Tier 1 capital. The mandatory convertible notes (MCNs), which were announced on 10 December 2007 did not contribute to eligible capital as of 31 December 2007, but became eligible capital after the approval of the issue of MCNs at the EGM, which took place on 27 February 2008.

Hybrid Tier 1 capital

Hybrid Tier 1 instruments are perpetual instruments that can only be redeemed if they are called by the issuer. The payment of interest is subject to compliance with minimum capital ratios and any payment missed is non-cumulative. UBS's hybrid Tier 1 instruments are accounted for under equity attributable to minority interests and amounted to CHF 6,387 million as of 31 December 2007, representing approximately 19.5% of eligible Tier 1 capital.

Tier 2 capital

Tier 2 capital consists mainly of subordinated long-term debt that ranks senior to both UBS shares and hybrid Tier 1 instruments but is subordinated with respect to all senior obligations of UBS. Tier 2 instruments accounted for CHF 14,071 million in total capital as of year-end 2007.

➔ **Further information on UBS's capital instruments is provided on pages 64–65 of this report**

Audited

Capital components

			% change from
CHF million	**31.12.07**	31.12.06	31.12.06
Gross Tier 1 capital	**50,147**	57,713	(13)
of which paid-in share capital	***207***	*211*	*(2)*
of which share premium, retained earnings, currency translation differences	***43,552***	*51,869*	*(16)*
of which innovative capital instruments	***6,047***	*5,267*	*15*
of which non-innovative capital instruments	***340***	*366*	*(7)*
Less: goodwill[1]	**(13,203)**	(13,852)	5
Less: other Tier 1 deductions[2]	**(4,133)**	(3,333)	(24)
Total eligible Tier 1 capital	**32,811**	40,528	(19)
Upper Tier 2 capital	**301**	0	
Lower Tier 2 capital	**13,770**	13,093	5
Tier 3 capital	**0**	0	
Less: deductions[3]	**(2,375)**	(3,257)	27
Total eligible capital	**44,507**	50,364	(12)

1 Includes intangible assets exceeding 4% of Tier 1 capital. 2 Consists of: i) net-long position in own shares held for trading purposes; ii) own shares bought for cancellation (second trading line) or for upcoming share awards; iii) other treasury share positions net of delta-weighted obligations out of employee stock options granted prior to August 2006. 3 Consists of the net-long position of non-consolidated participations in the finance sector and first loss protections out of securitizations.

UBS's eligible capital is based on its consolidated financial statements prepared under IFRS. As illustrated in the table on the opposite page, shareholders' equity is subject to a number of adjustments to arrive at regulatory eligible capital.

On 31 December 2007, BIS Tier 1 capital was CHF 32.8 billion, down from CHF 40.5 billion at year end 2006, reflecting primarily the negative effects of the loss in 2007, accruals for share based compensation plans and foreign exchange translation differences. In 2007, UBS issued EUR 600 million of innovative Tier 1 capital instruments (Trust Preferred Securities).

IFRS Equity to BIS Tier 1 capital

Audited

The key adjustments made to IFRS Equity attributable to shareholders to determine Tier 1 eligible capital result from:
– the ability to net treasury shares held as hedges against obligations from employee stock options granted prior to August 2006 (reducing deductions for treasury shares by CHF 6,230 million);
– the inability to recognize fair value changes recorded directly in equity under IFRS from financial investments available-for-sale and cash flow hedges (reduction of CHF 1,509 million);
– a reduction in retained earnings relating to the application of the fair value option under International Accounting Standard (IAS) 39 for capital adequacy purposes, which was partially offset by adjustments for differences in the scope of consolidation (reducing retained earnings by net CHF 564 million); and
– removing minority interests other than trust preferred securities, causing a further reduction of CHF 564 million.

Capital ratios

The BIS ratios compare the amount of eligible capital (in total and Tier 1) with the total of risk-weighted assets.

The combination of the 9% risk-weighted assets increase and the 19% reduction in BIS Tier 1 capital resulted in a decrease of BIS Tier 1 ratio by 3.1 percentage points to 8.8% at the end of December 2007, down from 11.9% at year-end 2006. In the same period, the total capital ratio decreased from 14.7% to 12.0%.

➔ **For details of UBS's issuance of capital securities during 2007, including hybrid Tier 1 instruments and subordinated debt, please see the section "Capital structure" in *Corporate Governance and Compensation Report 2007***

Audited

Reconciliation of IFRS[1] Equity to BIS Tier 1 capital

	31.12.07		
CHF million	**IFRS view**	**Reconciliation items**	**BIS view**
Share capital	207	0	207
Share premium	8,884	(189)	8,695
Net income recognized directly in equity, net of tax	(1,188)	(1,509)	(2,697)
Revaluation reserve from step acquisitions, net of tax	38	0	38
Retained earnings	38,081	(564)	37,517
Equity classified as obligation to purchase own shares	(74)	74	0
Treasury shares / deduction for own shares	(10,363)	6,230[2]	(4,133)
Equity attributable to UBS shareholders / gross Tier 1 net of own shares	35,585	4,042	39,627
Equity attributable to minority interests	6,951	(564)	6,387
Total equity / gross Tier 1 including hybrid Tier 1 instruments	**42,536**	**3,478**	**46,014**
Less: goodwill			(13,203)[3]
Less: accrual for expected future dividend payment			0
Eligible Tier 1 capital			32,811

	31.12.06		
CHF million	**IFRS view**	**Reconciliation items**	**BIS view**
Total equity / gross Tier 1 including hybrid Tier 1 instruments	55,775	3,187	58,962
Less: goodwill			(13,852)[3]
Less: accrual for expected future dividend payment			(4,582)
Eligible Tier 1 capital			40,528

1 International Financial Reporting Standards (IFRS). 2 Generally, treasury shares are fully deducted from Equity under IFRS, whereas for capital purposes only the following positions in own shares are deducted: i) net-long position in own shares held for trading purposes; ii) own shares bought for cancellation (second trading line) or for upcoming share awards and; iii) other treasury share positions net of delta-weighted obligations out of employee stock options granted prior to August 2006. 3 Includes intangible assets exceeding 4% of Tier 1 capital.

Introduction of Basel II

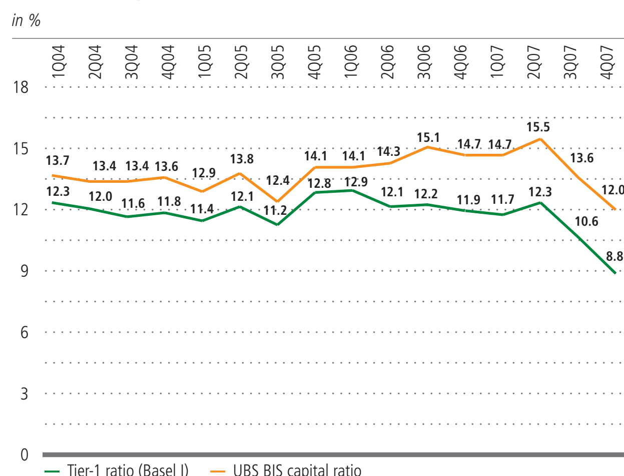
Upon implementation of Basel II on 1 January 2008, UBS expects the overall impact on its BIS Tier 1 ratio to be negative, depending on the further development of the business mix, in particular the profile of the loan book. This expectation is based on a direct comparison between capital ratios under regulations effective at year-end 2007 and the corresponding ratios at the same date under Basel II rules.

Overall, the implementation of Basel II will introduce capital requirements that are more accurate and sensitive to underlying risk positions: not only is the type of counterparty considered when determining the risk-weighted assets; both the counterparty rating and the type of transaction, including collateralization, are taken into account. A new capital requirement for operational risks will also be introduced as part of Basel II.

In addition, with the advent of Basel II, the calculation of the eligible capital will be tightened through the introduction of new deductions from Tier 1 capital and total capital. This will lower the capital ratios, but at the same time clearly improve the quality of capital available to support risks.

Future capital ratios will depend on, among other factors, developments in financial markets and their impact on profit and loss, valuations and capital requirements for market risk; the development of the credit quality of UBS's obligors and counterparties; future issuances of capital instruments and the management of treasury shares; capital requirements for operational risk; and future changes in the regulatory frameworks.

UBS: BIS capital ratios



Credit ratings

Despite significant writedowns in US sub-prime-related securities, UBS remains one of the best-capitalized financial institutions in the world. It believes that this is a key part of its value proposition for both clients and investors.

In November 2007, Moody's Investors Service downgraded from "A-" to "B+" the Bank Financial Strength Rating (BFSR) of UBS AG and affirmed the "Aaa" senior debt and deposit ratings. "The downgrade of the BFSR reflects Moody's view that UBS' sub-prime related exposures have a large loss content which negatively impacts the bank's earnings stability and our understanding of the quality of their risk management," Moody's said in a related media release.

At the end of January 2008, Moody's Investors Service changed the outlook to negative from stable on the B+ BFSR and Aaa senior debt and deposit ratings of UBS AG. "The change in outlook follows the announcement that UBS will take additional writedowns of approximately USD 4 billion on not only its positions related to the US sub-prime mortgage market, but also on positions related to US residential mortgage securities, contributing to a net loss of approximately CHF 4.4 billion in 2007".

In February 2008, following the fourth quarter 2007 earnings release, Moody's affirmed the ratings of UBS AG, commenting: "UBS continues to enjoy a very strong and diversified franchise with solid earnings capability in a number of areas outside the affected fixed-income franchise, and the bank maintains excellent liquidity and good asset quality. Its capitalization levels should be restored to past high levels over a reasonable time frame, benefiting from the planned capital increase of CHF 13 billion".

In October 2007, Standard & Poor's Ratings Services lowered its long-term counterparty credit rating on UBS AG to "AA" from "AA+", commenting that: "the downgrade primarily reflects concerns over the effectiveness of the bank's risk management practices in allowing such a large sub-prime exposure to build".

In late January 2008, Standard & Poor's revised UBS's outlook to negative, commenting: "the outlook was revised to negative in recognition of the challenges to UBS's future revenue generation from the current economic

Capital adequacy

	As of		
CHF million, except where indicated	**31.12.07**	31.12.06	31.12.05
BIS Tier 1 capital	**32,811**	40,528	39,834
of which hybrid Tier 1 capital	**6,387**	5,633	4,975
BIS total capital	**44,507**	50,364	43,808
BIS Tier 1 capital ratio (%)	**8.8**	11.9	12.8
BIS total capital ratio (%)	**12.0**	14.7	14.1
Balance sheet assets	**292,988**	273,588	252,364
Off-balance sheet and other positions	**37,200**	48,444	37,010
Market risk positions[1]	**42,110**	19,860	21,035
Total BIS risk-weighted assets	**372,298**	341,892	310,409

1 BIS risk-weighted asset equivalent of market risk capital requirement.

and market conditions, its large residual sub-prime-related exposure, and the strategic repositioning of the investment bank".
The ratings reflect "UBS's continued strengths, including its diverse business position, strong liquidity, and robust capitalization once its capital strengthening measures are completed".
In December 2007, Fitch Ratings downgraded UBS AG's long-term issuer default ratings (IDR) from "AA+" to "AA" and UBS's Individual rating from "A/B" to "B", commenting: "the additional writedowns announced by UBS on 10 December are significantly higher than previous guidance from the group and reflect ongoing valuation challenges in a still difficult market environment. UBS AG's ratings reflect its excellent private banking/wealth management franchise, diversified revenues, historically consistent profitability, strong liquidity and sound capitalization. The outlook on the long-term IDRs remains negative, reflecting continued uncertainty over future earnings, together with the challenges faced by a new management team in reshaping the group's investment bank."
At the end of January 2008, Fitch Ratings affirmed UBS's long-term issuer default rating at "AA" with negative outlook, and the individual rating at "B".
UBS's long-term credit ratings are shown in the table. Each of these ratings reflects only the view of the applicable rating agency at the time the rating was issued, and any explanation of the significance of a rating may be obtained only from the rating agency. A security rating is not a recommendation to buy, sell or hold securities and each rating should be evaluated independently of any other rating. There is no assurance that any credit rating will remain in effect for any given period of time or that a rating will not be lowered, suspended or withdrawn entirely by the rating agency if, in the rating agency's judgment, circumstances so warrant.

Long-term ratings

	As of		
	31.12.07	31.12.06	31.12.05
Fitch, London	**AA**	AA+	AA+
Moody's, New York	**Aaa**	Aa2	Aa2
Standard & Poor's, New York	**AA**	AA+	AA+

Shares and capital instruments

Shares

UBS shares and Tier 1 capital

The majority of Tier 1 capital comprises retained earnings attributed to UBS shareholders. As per 31 December 2007, total International Financial Reporting Standard (IFRS) equity attributable to UBS amounted to CHF 35,585 million and was represented by a total of 2,073,547,344 issued UBS shares, of which 158,105,524 shares (7.6 %) were held by UBS. Each outstanding share has a par value of CHF 0.10 and entitles the holder to one vote at the shareholders' meeting and to receive a proportionate share of the dividend that is distributed. There are no preferential rights for individual shareholders and no other classes of shares are issued by the parent bank (UBS AG) directly.

In 2007, the outstanding shares were reduced by a net total of 31,725,942 million shares, reflecting the cancellation of shares bought back under the 2006/2007 share buyback program.

Additional future issuance of shares for mandatory convertible notes and stock dividend

As part of the measures to strengthen its capital base following the substantial writedowns related to the US residential sub-prime mortgage market, on 10 December 2007 UBS announced the issuance of mandatory convertible notes (MCNs) and the distribution of a stock dividend for 2007 instead of a cash dividend – see the "Capital management" section and pages 64, 65 and 67 of this report.

To allow for the delivery of shares upon conversion of the MCNs, the extraordinary general meeting of shareholders on 27 February 2008 approved the creation of the conditional capital in a maximum amount of CHF 27,775,000. The conditional capital is to be used exclusively for sourcing the shares for the conversion of the MCNs, which is to occur in March 2010 at the latest. Based on the conditional capital, the share capital of UBS AG upon conversion of the MCNs will be increased through the issuance of a maximum of 277,750,000 fully paid registered shares of UBS AG with a par value of CHF 0.10.

For the stock dividend, shareholders approved the creation of authorized capital at the extraordinary general meeting of shareholders on 27 February 2008. The stock dividend will not exceed 5% of the share capital at year-end 2007 or a ratio of one free new share for a minimum of every 20 shares already owned. This corresponds to a maximum amount of authorized capital of CHF 10,370,000 or 103,700,000 shares. The final exchange ratio will be determined by the Board of Directors (BoD) and the shareholders will be informed on the day of the annual general meeting (AGM) on 23 April 2008.

Furthermore, conditional capital is available to issue an additional 150,138,634 shares against the exercise of employee options.

Capital dilution

Whether earnings per share will be higher or lower as a result of these measures depends on the effect they have in maintaining the strength, and therefore profits, of UBS in general and the wealth management business in particular. When there is excess capital available, UBS expects to also return to its normal policy, subject to regulatory requirements, of returning excess capital – that is, capital that

Shares

	For the year ended
Number of shares	**31.12.07**
Balance at the beginning of the year	**2,105,273,286**
Issue of share capital (exercise of employee options)	**1,294,058**
Cancellation of second trading line treasury shares	**(33,020,000)**
Balance at the end of the year	**2,073,547,344**

Shareholder approved issuance of shares

	Maximum number of shares to be issued	Year approved by shareholders' general meeting	% of shares issued 31.12.07
Authorized capital			
Stock dividend 2007	103,700,000	2008	5.00
Conditional capital			
Mandatory convertible note	277,750,000	2008	13.39
Employee equity participation plans of UBS AG	149,994,296	2006	7.23
Employee stock ownership plan of the former PaineWebber	144,338	2000	

exceeds the level that UBS believes to be reasonably appropriate in the context of its portfolio and business growth – to shareholders, through buyback and cash dividends.

Holding of UBS shares

UBS holds its own shares for three main purposes. Treasury repurchases shares on a second trading line, where they are earmarked for cancellation purposes. Shares are bought back by Treasury to cover employee share and option programs; and the Investment Bank holds shares, to a limited extent, for trading purposes where it engages in market-making activities in UBS shares and its related derivative products.

Share buyback programs

Under Swiss regulations, a company wishing to cancel shares must purchase them on the stock exchange under a special security code that clearly identifies to the market the time and quantity of shares repurchased for that specific purpose (the so-called second trading line). For each buyback program to date, UBS has announced a maximum Swiss franc amount to be used for share purchases. The level of actual repurchases is determined by the capital management plan, which is adjusted throughout the year to reflect changes in business plans or acquisition opportunities. UBS publishes the number of shares repurchased and the average price paid on a weekly basis on the internet at www.ubs.com/investors.

Treasury shares earmarked for cancellation (share buyback program 2006/2007)

As part of the 2006/2007 share buyback program ending on 7 March 2007, 33,020,000 shares representing a total value of CHF 2.4 billion were cancelled on 29 June 2007.

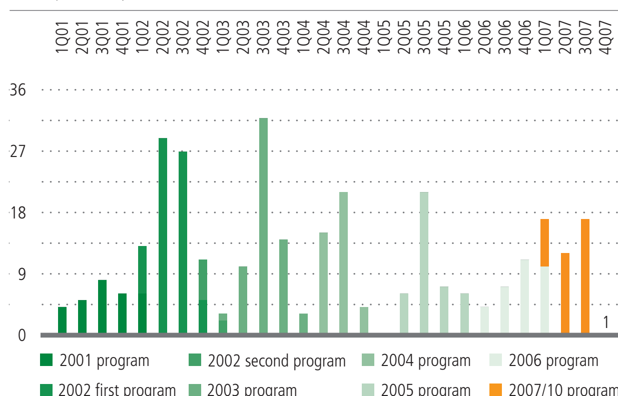
At the AGM on 18 April 2007, shareholders gave the BoD a mandate to set up a repurchase program (2007/2010) for a maximum amount of 10 % of shares totaling 210,527,328 shares. Between 14 March 2007 and 25 September 2007, 36.4 million shares in the total amount of CHF 2.6 billion were purchased for cancellation. As part of the capital measures announced on 10 December 2007, the BoD has used its discretion to rededicate for further use the 36.4 million treasury shares previously intended for cancellation. At year-end, no shares were held under the buyback program earmarked for cancellation.

The holding of treasury shares decreased to 158,105,524 or 7.6% of shares issued on 31 December 2007, from 164,475,699 or 7.8% on the same date a year ago. Shares held cover employee share and option programs and, to a limited extent, market-making activities at the Investment Bank.

In 2007, a total of 32.2 million employee options were exercised and an additional 45.5 million new options were granted. As of 31 December 2007, UBS was holding approximately 141 million shares in Treasury and an additional 150 million unissued shares in conditional share capital that can be used to cover future employee option exercises, of which a total of CHF 186 million were outstanding on 31 December 2007. The shares available cover all exercisable employee options.

Share buyback

Shares (in millions)



1 During fourth quarter 2007, shares under 2007/10 program previously intended for cancellation were rededicated, and the program was suspended.

Effect of second trading line program on basic earnings per share

	For the year ended		
	31.12.07	31.12.06	31.12.05
Weighted average shares for basic earnings per share (EPS) after treasury shares	**1,926,328,078**	1,976,405,800	2,013,987,754
Weighted average second trading line treasury shares[1]	**625,684,926**	598,982,426	544,339,510
Basic EPS (CHF)	**(2.28)**	6.20	6.97
Cumulative impact of treasury shares on basic EPS (CHF)[1]	**(0.56)**	1.44	1.49
Cumulative impact of treasury shares on basic EPS (%)[1]	**24.6**	23.2	21.4

1 From first share buyback program in 2000.

Treasury shares held by the Investment Bank

The Investment Bank, acting as liquidity provider to the equity index futures market and as a market maker in UBS shares and derivatives, has issued derivatives linked to UBS stock. Most of these instruments are classified as cash-settled derivatives and are held for trading purposes only. To hedge the economic exposure, a limited number of UBS shares are held by the Investment Bank.

The presentation in the table below shows the purchase of UBS shares by Treasury at the stock exchange and does not include activities of the Investment Bank in UBS shares.

Capital Instruments

Mandatory convertible notes

On the 27 February 2008 the extraordinary general meeting (EGM) of shareholders approved the issuance of a maximum of 277,750,000 shares (corresponding approximately to 13.4% of the current share capital) to two long-term financial investors, Government of Singapore Investment Corporation Pte Ltd (GIC) and an investor from the Middle East without future dilutive effects. UBS expects to use a maximum of 252,525,253 shares of the available conditional capital. The share capital will be increased upon voluntary or

Treasury share activities

	Share buyback program				Treasury shares purchased for employee share and option participation plans and acquisitions[1]		Total number of shares	
Month of purchase	Number of shares	Average price in CHF	Remaining volume of 2006/2007 share buyback program in CHF million	Remaining volume of 2007/2010 share buyback program in millions of shares	Number of shares	Average price in CHF	Number of shares	Average price in CHF
January 2007	9,900,000	76.72	2626		24,438	74.92	9,924,438	76.72
February 2007	520,000	78.06	2585		1,803,391	78.18	2,323,391	78.15
March 2007	7,210,000	69.35		203[2]	19,465,000	71.64	26,675,000	71.02
April 2007	3,380,000	74.04		200	2,400,000	72.02	5,780,000	73.20
May 2007	2,590,000	77.24		197	6,600,000	76.48	9,190,000	76.69
June 2007	5,850,000	75.96		191	2,750,000	77.89	8,600,000	76.58
July 2007	11,970,000	72.24		180	0	0.00	11,970,000	72.24
August 2007	950,000	64.06		179	0	0.00	950,000	64.06
September 2007	4,450,000	62.73		174	0	0.00	4,450,000	62.73
October 2007	0	0.00		174	0	0.00	0	0.00
November 2007	0	0.00		174	500,000	58.77	500,000	58.77
December 2007	0	0.00		174[3]	4,500,000	55.30	4,500,000	55.30

1 This table excludes market-making and related hedging purchases by UBS. The table also excludes UBS shares purchased by investment funds managed by UBS for clients in accordance with specified investment strategies that are established by each fund manager acting independently of UBS; and also excludes UBS shares purchased by pension and retirement benefit plans for UBS employees, which are managed by a board of UBS management and employee representatives in accordance with Swiss law guidelines. UBS's pension and retirement benefit plans purchased 424,803 UBS shares during the year and held 2,436,257 UBS shares as of 31 December 2007. 2 The 2007/2010 program was approved for a maximum of 210,527,328 shares, equal to 10% of the outstanding shares as of 31 December 2006. 3 In 2007, of the 210,527,328 shares approved to be purchased in the 2007/2010 buyback program, 36,400,000 shares were repurchased for CHF 2.6 billion (at an average price of CHF 71.41 per share). On 10 December 2007, the UBS Board of Directors communicated its decision that these shares will not be cancelled but will be rededicated as a measure to strengthen UBS's capital. However, the number of shares which may be repurchased in the future under the program is reduced by these 36,400,000 shares.

Program	Announcement	Beginning	Expiration	Cancellation	Maximum volume (in CHF billion)	Maximum volume (in millions of shares)	Amount (CHF billion)	Total shares purchased	Average price (in CHF)	Unutilized volume (CHF billion)	Unutilized volume (in millions of shares)
2000/2001	14/12/1999	17/01/2000	02/03/2001	13/07/2001	4.0		4.0	110,530,698[1,2]	36.18[1,2]	0	
2001/2002	22/02/2001	05/03/2001	05/03/2002	05/07/2002	5.0		2.3	57,637,380[2]	39.73[2]	2.7	
2002/2003	14/02/2001	06/03/2002	08/10/2002	10/07/2003	5.0		5.0	135,400,000[2]	36.92[2]	0	
2002/2003	09/10/2002	11/10/2002	05/03/2003	10/07/2003	3.0		0.5	16,540,160[2]	32.04[2]	2.5	
2003/2004	18/02/2003	06/03/2003	05/03/2004	30/06/2004	5.0		4.5	118,964,000[2]	37.97[2]	0.5	
2004/2005	10/02/2004	08/03/2004	07/03/2005	08/07/2005	6.0		3.5	79,870,188[2]	44.36[2]	2.5	
2005/2006	08/02/2005	08/03/2005	07/03/2006	13/07/2006	5.0		4.0	74,200,000[2]	54.26[2]	1	
2006/2007	14/02/2006	08/03/2006	07/03/2007	29/06/2007	5.0		2.4	33,020,000[2]	73.14[2]	2.6	
2007/2010	13/02/2007	08/03/2007	08/03/2010			210.5[3]	2.6[4]	36,400,000[4]	71.41[4]		174.1[3]

1 Restated to reflect 3:1 stock split on 16 July 2001. 2 Restated to reflect 2:1 stock split on 10 July 2006. 3 The 2007/2010 program was approved for a maximum of 210,527,328 shares, equal to 10% of the outstanding shares as of 31 December 2006. On 31 December 2007, the unutilized number of shares (174.1 million) multiplied by the prevailing market price of UBS shares of CHF 52.40 per share equaled an unutilized volume of approximately CHF 9.1 billion. 4 In 2007, 36,400,000 shares were repurchased under the 2007/2010 program for CHF 2.6 billion (at an average price of CHF 71.41 per share). On 10 December 2007, the UBS Board of Directors communicated its decision that these shares will not be cancelled but will be rededicated as a measure to strengthen UBS's capital.

mandatory conversion of the MCNs due 2010. The future mandatory capital increase allows the full proceeds of CHF 13 billion to be counted as Tier 1 capital for regulatory capital purposes for the first time in first quarter 2008.

MCNs are a special type of equity-linked security that will never be redeemed in cash but rather, upon maturity or early conversion, will automatically convert into shares of the note issuer or an affiliated company. The number of shares to be delivered depends on the conversion price, and will vary according to the precise terms (see below).

The MCNs issued by UBS mature in two years (March 2010) and contain market-standard provisions allowing early conversion at the option either of the holders or of UBS.

Through the lifetime of the MCNs, the holders will receive an annual coupon of 9% of the nominal value of the MCNs. This annual coupon reflects not only the cost of capital but also compensates the noteholders for bearing the risk of share price deterioration before conversion, if the share price falls below the reference price described below, for the fact that MCN holders only participate in the benefit of an increasing share price once the share price exceeds 117% of the reference price, and for the fact that until conversion MCN holders will not receive any dividends on the underlying UBS shares. The MCNs can be converted at the earliest after a period of six months has elapsed after their issuance and they must be converted at the latest by maturity of the notes in March 2010.

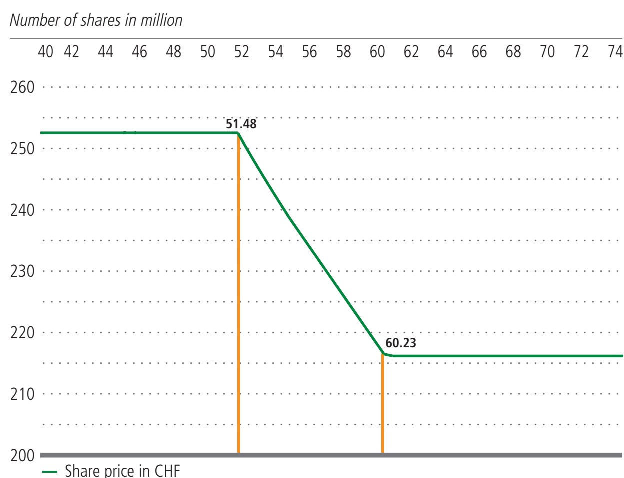
If the MCNs are converted at maturity, they will be converted for UBS shares at a price – the "conversion price" – that is linked to the prevailing market price of UBS shares at specific dates. The conversion price is set within a range that is dependent on the UBS share price in relation to the "reference price" of CHF 51.48. (This, in turn, was determined by the average of (i) CHF 57.2 and (ii) the average of the three daily volume-weighted average price on virt-x for the three days prior to the EGM, subject to a minimum of CHF 51.48 and a maximum of CHF 62.92). The total amount of shares that the MCN holders receive is then calculated by dividing CHF 13 billion by the conversion price. There are basically three different scenarios for conversion at maturity. The conversion price will be set at:

- CHF 60.23, corresponding to 117% of the reference price, if at maturity the UBS share price is at or above CHF 60.23. In this case, the MCN holders will receive approximately 215,839,283 shares (CHF 13 billion/CHF 60.23), which is the *minimum amount* of shares;
- the prevailing UBS share price if it is between CHF 51.48 and CHF 60.23 (corresponding respectively to 100% and 117% of the reference price) at maturity; and
- CHF 51.48, corresponding to 100% of the reference price, if the prevailing UBS share price is at or below CHF 51.48 at maturity. In this case, the MCN holders will receive approximately 252,525,253 shares (CHF 13 billion/CHF 51.48), which is the *maximum amount* of shares;
- If either UBS or the MCN holders choose to convert the MCNs prior to maturity, the maximum conversion price (and hence minimum amount of shares) is applied in case the early conversion occurs at the request of the MCN holders, while the minimum conversion price (and hence maximum amount of shares) is applied if converted at the request of UBS.

The two graphs below illustrate the payout profile of the MCNs at maturity as a function of the underlying UBS share price.

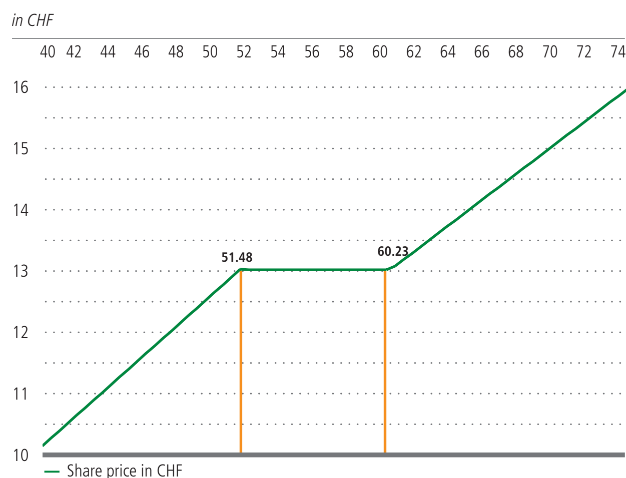
Number of shares delivered

Number of shares in million



Value of shares

in CHF



Hybrid Tier 1 capital

Hybrid Tier 1 instruments represent innovative and non-innovative perpetual instruments and accounted for approximately 19.5 % of eligible Tier 1 capital on 31 December 2007. They are accounted for under minority interest in the bank's equity. In 2007 UBS raised EUR 600 million in the form of preferred securities issued by UBS Capital Securities (Jersey) Ltd. The instrument bears a 7.152 % coupon and is callable in 2017. As per December 31, 2007 UBS had issued in various currencies a total of CHF 6,387 million of such instruments. Hybrid Tier 1 instruments are perpetual instruments which can only be redeemed if they are called by the issuer. If such a call is not exercised at the respective call date, the terms might include a change from fixed to floating coupon payments and, in the case of innovative instruments only, a limited step-up of the interest rate. Non-innovative instruments do not have a step-up of the interest rate and are therefore viewed as having a higher equity characteristic for regulatory capital purposes. The instruments are issued either through trusts or subsidiaries of UBS and rank senior to UBS shares in dissolution. Payments under the instruments are subject to the adherence to minimal capital ratios by UBS. Any payment missed is non-cumulative.

Tier 2 capital

The major element in Tier 2 capital consists of subordinated long-term debt. Tier 2 instruments have been issued in various currencies and with a range of maturities across capital markets globally. They account for CHF 13,770 million in total capital as per year-end 2007, representing 3.7 percentage points of the total capital ratio of 12.0 %. Tier 2 instruments rank senior to both UBS shares and to hybrid Tier 1 instruments but are subordinated with respect to all senior obligations of UBS. In 2007 UBS raised GBP 250 million with a coupon of 6.375% maturing in 2024 callable by the issuer in 2019 and CHF 350 million with a 4.125% coupon maturing in 2017.

Distributions to shareholders

UBS normally pays an annual dividend to shareholders registered as of the date of the AGM (the record date). Payment is usually scheduled three business days thereafter.

The level of the dividend is dependent on UBS's targeted capital ratios and the cash flow generation of the company. The dividend policy takes into account the fact that shareholders have different preferences for receiving shareholder returns: some prefer cash dividends, some prefer share buybacks. By pursuing both avenues, UBS aims to attract and retain the widest, most diverse global shareholder base.

The decision on dividend payments falls under the AGM's authority and is subject to shareholder approval.

Total distributions in 2007

From the results of ordinary business, UBS transferred a total of CHF 5.1 billion in equity to its shareholders in 2007. This included CHF 0.8 billion in shares the bank repurchased during 2007 for purposes of cancellation and a total payout to shareholders for the 2006 financial year of CHF 4.3 billion or CHF 2.20 per share with payment on 23 April 2007.

Shareholders in the US received a net dividend payment of USD 1.19 (rounded) per share on 23 April 2007. This excludes the 35% Swiss withholding tax that can partly be reclaimed by US investors.

Distributions to shareholders in 2008

Stock dividend

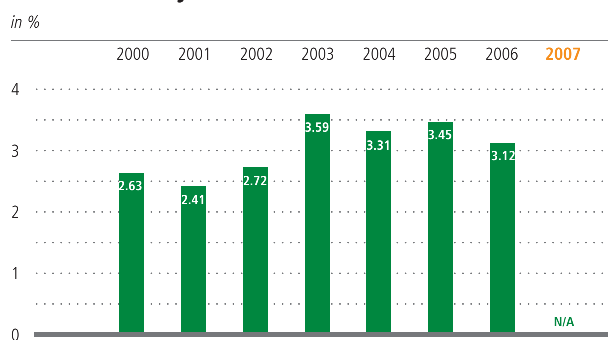
At the extraordinary shareholders' meeting held on 27 February 2008, the shareholders approved distribution of a stock dividend to shareholders. The stock dividend is designed to provide shareholders with the opportunity to obtain proceeds comparable to the cash dividend paid in previous years. There will be one entitlement allocated to each share outstanding on the record date on 25 April 2008 after close of business. A certain number of entitlements will give the holder the right to receive one additional UBS share for free. The entitlements are expected to be tradable for nine business days and will then be exchanged into UBS shares. For the stock dividend shareholders approved the creation of authorized capital at the EGM on 27 February 2008. The stock dividend will not exceed 5% of the share capital at year-end 2007 or a ratio of one free new share for a minimum of every 20 shares already owned. This corresponds to a maximum amount of authorized capital of CHF 10,370,000 or 103,700,000 shares. The final exchange ratio will be determined by the BoD and the shareholders will be informed on or by the day of the AGM on 23 April 2008. After expiration of the entitlement trading period on 9 May 2008, all entitlements will automatically be exchanged into new shares, which will settle on 19 May 2008. Fractions that have not been sold or aggregated during the entitlement trading period will not be compensated by UBS in its capacity as issuer.

This stock dividend is tax-efficient for many shareholders resident in Switzerland and those in many other countries. Unlike a cash dividend, where the Swiss withholding tax of 35% is deducted from the gross amount payable, the stock dividend will be allocated to shareholders without deduction of Swiss withholding tax. For Swiss income tax purposes, the taxable value of the stock dividend will approximately be equal to the par value of CHF 0.10 per share of the shares distributed as a stock dividend proportionately allocated to the entitlement distributed. For Swiss shareholders, this is a very small fraction of the taxable value of an equivalent cash dividend. The taxation of shareholders not resident in Switzerland depends on the laws in their tax jurisdiction. In many cases, the distribution of entitlements and the exercise thereof should be tax-free. Shareholders should consult with their own tax advisors to determine the tax treatment applicable to them.

Compared with the cash dividend, a stock dividend is beneficial for UBS's (Tier 1) capital base. Cash dividend payments are deducted from the bank's net profits and retained earnings, which are some of the major components of the bank's core (Tier 1) capital. In contrast, by issuing new shares in lieu of a dividend cash payment, the level of UBS's (Tier 1) capital base is maintained.

Cash dividend yield[1]

in %

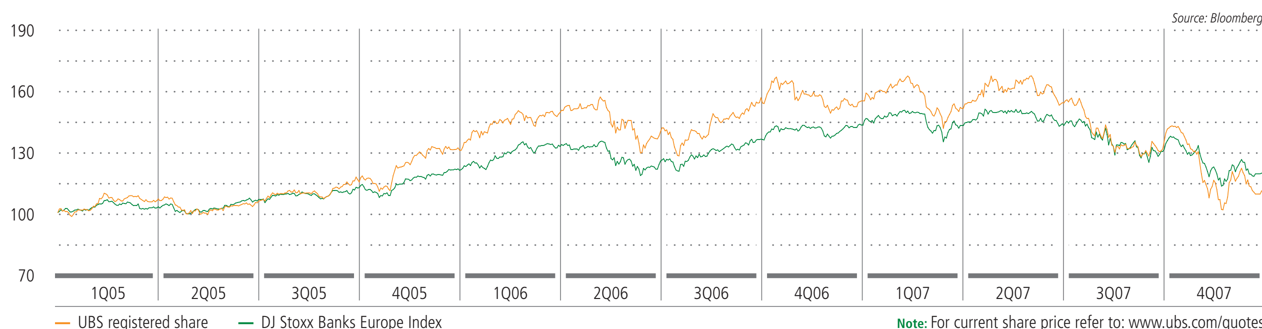


1 Dividend and par value reduction paid / average share price of the year for which dividend or par value reduction was paid. In 2007 UBS will distribute a stock dividend.

UBS shares in 2007

UBS share price chart vs DJ Stoxx banks

in % *1 January 2005 – 31 December 2007*



Note: For current share price refer to: www.ubs.com/quotes

UBS shares are listed on the Swiss stock exchange (SWX), where they are traded on virt-x (SWX Europe), and on the New York and Tokyo stock exchanges.

➔ **For a detailed definition of UBS shares (including par value, type and rights of security), please refer to the section "Capital structure" in *Corporate Governance and Compensation Report 2007***

In 2007, despite continued deterioration in the US housing market, dollar weakness and oil price inflation, global equity markets posted modest gains for the first half of the year buoyed by the continued high corporate earnings and high levels of mergers and acquisitions activity, particularly in the leveraged finance space. Emerging markets outperformed on high commodity prices and strong economic activity. The S&P 500 and MSCI World indices were up 6% and 8% respectively.

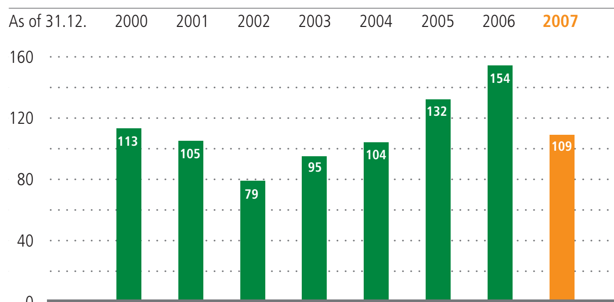
The summer of 2007 brought the strong positive performance of world markets to an abrupt end. Evidence of a significant dislocation in the US sub-prime market led to concerns of contagion and a worldwide credit crunch. In response, many banks and financial institutions began to hoard liquidity, leading to an almost complete cessation of activity in the world's credit markets.

Despite an improvement in liquidity in the final quarter of the year, world markets continued to fall sharply with the financial and insurance sectors bearing the brunt of the declines. Increasing losses from US sub-prime investments, other real estate assets and leveraged lending placed a growing strain on the balance sheets of banks and subsequently financial guarantors.

Outside these sectors growing concerns over a US recession and possible worldwide slowdown tempered an otherwise positive performance in all major indices. The MSCI world index closed up 7% for the year, the Dow Jones Industrials Average closed the year up 6% and the S&P 500 closed up 4% for the year.

Market capitalization

CHF billion



Ticker symbols

Trading exchange	Bloomberg	Reuters
virt-x	UBSN VX	UBSN.VX
New York Stock Exchange	UBS US	UBS.N
Tokyo Stock Exchange	8657 JP	8657.T

Security identification codes

ISIN	**CH0024899483**
Valoren	**2.489.948**
Cusip	**CINS H89231 33 8**

UBS share data

	As of		
Registered shares	**31.12.07**	31.12.06	31.12.05
Total shares outstanding	**1,915,441,820**	1,940,797,587	1,968,745,296
Total shares ranking for dividend	**2,073,547,344**	2,082,673,286	2,109,495,044
Treasury shares	**158,105,524**	164,475,699	208,519,748
Weighted average shares (for basic earnings per share (EPS) calculations)	**1,926,328,078**	1,976,405,800	2,013,987,754
Weighted average shares (for diluted EPS calculations)	**1,927,698,732**	2,058,834,812	2,097,191,540

	For the year ended		
CHF	**31.12.07**	31.12.06	31.12.05
Earnings per share			
Basic EPS	**(2.28)**	6.20	6.97
Basic EPS from continuing operations	**(2.49)**	5.80	4.84
Diluted EPS	**(2.28)**	5.95	6.68
Diluted EPS from continuing operations	**(2.49)**	5.57	4.65

UBS shares and market capitalization

	As of			% change from
Number of shares, except where indicated	**31.12.07**	31.12.06	31.12.05	31.12.06
Total ordinary shares issued	**2,073,547,344**	2,105,273,286	2,177,265,044	(2)
Second trading line treasury shares				
2005 program			(67,770,000)	
2006 program		(22,600,000)		
Shares outstanding for market capitalization	**2,073,547,344**	2,082,673,286	2,109,495,044	0
Share price (CHF)	**52.40**	74.05	62.55	(29)
Market capitalization (CHF million)	**108,654**	154,222	131,949	(30)
Total treasury shares	***158,105,524***	*164,475,699*	*208,519,748*	*(4)*

Trading volumes

	For the year ended		
1000 shares	**31.12.07**	31.12.06	31.12.05
SWX total (virt-x)	**4,079,863**	2,731,841	2,568,531
SWX daily average (virt-x)	**16,451**	10,884	10,073
NYSE total	**304,446**	214,912	167,231
NYSE daily average	**1,213**	853	664

Source: Reuters

First quarter 2007

Equity markets got off to a positive start in 2007, but corrected downwards in later February and early March. After the US Federal Bank's decision to leave its interest rates unchanged, investor confidence stabilized and markets closed the quarter slightly higher than they began.

2007 started on a positive note for UBS with a strong deal pipeline, high levels of market activity. UBS reported a strong full-year performance reporting record revenues, profits and net new money figures across a number of business lines, leading the board to increase the total payout in 2006 by 16%, declaring a dividend CHF 2.20 per share. UBS shares declined by 2% compared with a flat performance in the DJ Stoxx Banks as the market favored businesses with greater fixed income and leveraged finance exposure.

Second quarter 2007

During the quarter stock markets recovered from the lows reached in mid-March. However, credit conditions deteriorated sharply from the middle of June onwards. UBS reported its first quarter results which were strong and consistent with record profits in each business group and for the business as a whole. During the period UBS disposed of stake in Julius Baer, recording a post tax gain of CHF 1,926 million. UBS shares recovered by 2% in the quarter compared with a flat performance in the DJ Stoxx Banks Index.

Third quarter 2007

Credit conditions deteriorated sharply from the middle of June onwards leading to extreme volatility in equity and credit markets over the course of the summer. Concerns over counterparty credit risk led banks to hoard liquidity leading to an almost complete cessation of credit market activity in late August.

UBS reported strong second quarter results in many of its business, but was dissatisfied with fixed income results in some areas due to continued difficulties US mortgage securities markets. Marcel Rohner, delivered the results for the first time in his role as CEO and noted the possibility of weaker results in the second half of 2007 if difficult markets conditions prevailed. UBS shares fell by 15% in the quarter compared with the broader banking sector (DJ Stoxx Banks Europe) which lost 10%.

Fourth quarter 2007

Credit markets remained closed for large part of the quarter and only reopened after significant persistent injections of liquidity by many of the world's central banks. Losses in the US sub-prime sector mounted for the banks, financial institutions and financial guarantors, putting capital ratios under strain and prompting capital raising.

UBS reported a loss for the group for the third quarter mainly reflecting writedowns in US sub-prime residential mortgages and noted an expectation that market conditions would not be resolved in the short term. UBS shares declined by 16% in the quarter compared with DJ Stoxx Banks Europe down 8% in the quarter.

Emerging markets' economies and markets, which performed well throughout 2007, began to reverse some of the year's gain on growing concerns of a US recession and global slowdown. The MSCI World lost 9% in the fourth quarter.

Share liquidity

During 2007, daily average volume in UBS shares on virt-x was 13.1 million shares. On the New York Stock Exchange (NYSE), it was 2.4 million shares.

Because of the greater volume on virt-x, trading of UBS shares there is expected to remain the main factor determining the movement in UBS's share price.

During the hours in which both virt-x and NYSE are simultaneously open for trading (currently 3:30 pm to 5.30 pm Central European Time), price differences are likely to be arbitraged away by professional market makers. The NYSE price will therefore typically be expected to depend on both the virt-x price and the prevailing US dollar/Swiss franc exchange rate. When virt-x is closed for trading, traded volumes will typically be lower. However, the specialist firm making a market in UBS shares on the NYSE, Van der Moolen, is required to facilitate sufficient liquidity and an orderly market in UBS shares.

Stock exchange prices

	SWX Swiss Exchange			New York Stock Exchange		
	High (CHF)	Low (CHF)	Period end (CHF)	High (USD)	Low (USD)	Period end (USD)
2007	**80.90**	**48.00**	**52.40**	**66.26**	**43.50**	**46.00**
Fourth quarter 2007	**68.65**	**48.00**	**52.40**	**58.01**	**43.50**	**46.00**
December	59.10	51.85	52.40	51.89	44.73	46.00
November	61.70	48.00	57.20	51.26	43.50	50.48
October	68.65	59.90	61.95	58.01	52.19	53.69
Third quarter 2007	**75.20**	**60.35**	**62.60**	**62.34**	**49.84**	**53.25**
September	65.85	60.35	62.60	55.18	50.85	53.25
August	68.85	61.25	63.00	57.72	49.84	52.24
July	75.20	64.55	67.55	62.34	53.34	55.07
Second quarter 2007	**80.45**	**71.65**	**73.60**	**66.26**	**58.73**	**60.01**
June	80.45	71.95	73.60	65.18	58.73	60.01
May	80.45	74.60	79.90	65.75	61.75	65.24
April	79.95	71.65	79.15	66.26	59.01	64.90
First quarter 2007	**80.90**	**67.20**	**72.20**	**64.30**	**55.40**	**59.43**
March	73.80	67.20	72.20	60.74	55.40	59.43
February	80.90	70.30	72.25	64.30	57.65	59.04
January	78.95	73.85	77.80	63.33	59.35	63.01
2006	**79.90**	**59.85**	**74.05**	**63.39**	**48.34**	**60.33**
Fourth quarter	79.90	70.70	74.05	63.39	58.50	60.33
Third quarter	74.80	59.85	74.80	59.77	48.34	59.31
Second quarter	75.65	61.35	67.00	61.70	49.36	54.85
First quarter	72.35	62.80	71.60	55.55	48.66	54.99
2005	**63.50**	**46.75**	**62.55**	**49.02**	**38.60**	**47.58**
Fourth quarter	63.50	52.75	62.55	49.02	41.22	47.58
Third quarter	56.15	50.40	55.00	43.40	38.92	42.75
Second quarter	51.40	47.23	50.00	42.93	38.60	38.93
First quarter	52.30	46.75	50.50	44.71	39.70	42.20
2004	**49.18**	**40.80**	**47.68**	**42.19**	**32.47**	**41.92**
Fourth quarter	48.18	42.00	47.68	42.19	35.05	41.92
Third quarter	45.50	40.80	43.95	36.19	32.47	35.17
Second quarter	49.18	44.13	44.13	38.03	34.45	35.53
First quarter	48.53	42.85	47.05	39.63	33.96	37.25
2003	**42.70**	**24.90**	**42.35**	**34.08**	**19.00**	**34.00**
Fourth quarter	42.70	37.43	42.35	34.08	28.77	34.00
Third quarter	40.25	36.75	37.05	29.63	27.19	28.12
Second quarter	37.88	29.45	37.68	29.18	21.79	27.70
First quarter	36.05	24.90	28.75	25.93	19.00	21.35

More about UBS

Sources of information

Annual report 2007

Four reports make up UBS's full *Annual Report 2007.* They comply with the US disclosure requirements for foreign private issuers as defined by Form 20-F of the Securities and Exchange Commission (SEC) and combine audited and non-audited information. All four reports are available in English and German (SAP no.80531). The four reports are:

Strategy, Performance and Responsibility 2007
This provides a description of our firm, its strategy, organizational structure and financial performance for the last two years. It also discusses our standards for corporate behavior and responsibility, outlines demographic trends in our workforce and describes the way our people learn and are led.

Risk, Treasury and Capital Management 2007
In addition to outlining the principles by which we manage and control risk, this report provides an account of developments in credit risk, market risk, operational risk and treasury management during 2007. It also provides information on UBS shares.

Corporate Governance and Compensation Report 2007
Comprehensive information on our governance arrangements is included in this report, which also explains how we manage our relationships with regulators and shareholders. Compensation of senior management and the Board of Directors (executive and non-executive members) is discussed here. This report can be ordered separately (SAP no. 82307).

Financial Statements 2007
This comprises the audited financial statements of UBS for 2007, 2006 and 2005, prepared according to the International Financial Reporting Standards (IFRS). It also includes the audited financial statements of UBS AG (the parent bank) for 2007 and 2006, prepared according to Swiss banking law. Additional disclosure required by Swiss and US regulations is included where appropriate.

In addition to the four reports, *Review 2007* is distributed broadly to UBS shareholders and contains key information on our strategy and financials. This booklet summarizes the information in the four-part annual report.

Quarterly reports

We provide detailed quarterly financial reporting and analysis, including comment on the progress of our businesses and key strategic initiatives. These quarterly reports are available in English.

How to order reports

These reports are available in PDF format on the internet at *www.ubs.com/investors/topics* in the reporting section. Printed copies can be ordered from the same website by accessing the order / subscribe panel on the right-hand side of the screen. Alternatively, they can be ordered by quoting the SAP number and the language preference where applicable, from UBS AG, Information Center, P.O. Box, CH-8098 Zurich, Switzerland.

Information tools for investors

Website

Our Analysts & Investors website at *www.ubs.com/investors* offers a wide range of information about UBS, financial information (including SEC filings), corporate information, share price graphs and data, an event calendar, dividend information and recent presentations given by senior management to investors at external conferences. Information on the internet is available in English and German, with some sections in French and Italian.

Messaging service

On the Analysts & Investors website, you can register to receive news alerts about UBS via Short Messaging System (SMS) or e-mail. Messages are sent in either English or German and users are able to state their preferences for the topics of the alerts received.

Results presentations

Senior management presents UBS's results every quarter. These presentations are broadcast live over the internet, and can be downloaded on demand. The most recent result webcasts can be found in the financials section of our Analysts & Investors website.

Form 20-F and other submissions to the US Securities and Exchange Commission

We file periodic reports and submit other information about UBS to the US Securities and Exchange Commission (SEC). Principal among these filings is our annual report on Form 20-F, filed pursuant to the US Securities Exchange Act of 1934.

Our Form 20-F filing is structured as a "wrap-around" document. Most sections of the filing can be satisfied by referring to parts of the four reports (*Strategy, Performance and Responsibility 2007*, *Risk, Treasury and Capital Management 2007*, *Corporate Governance and Compensation Report 2007* and *Financial Statements 2007*). However, there is a small amount of additional information in Form 20-F which is not presented elsewhere, and is particularly targeted at readers in the US. You are encouraged to refer to this additional disclosure.

You may read and copy any document that we file with the SEC on the SEC's website, **www.sec.gov,** or at the SEC's public reference room at 100 F Street, N.E., Room 1580, Washington, DC, 20549. Please call the SEC by dialing 1-800-SEC-0330 (in the US) or +1 202 942 8088 (outside the US) for further information on the operation of its public reference room. You may also inspect our SEC reports and other information at the New York Stock Exchange, Inc., 20 Broad Street, New York, NY 10005. Much of this additional information may also be found on the UBS website at **www.ubs.com/investors,** and copies of documents filed with the SEC may be obtained from UBS's Investor Relations team at the address shown on the next page.

Corporate information

The legal and commercial name of the company is UBS AG. The company was formed on 29 June 1998, when Union Bank of Switzerland (founded 1862) and Swiss Bank Corporation (founded 1872) merged to form UBS.

UBS AG is incorporated and domiciled in Switzerland and operates under Swiss Company Law and Swiss Federal Banking Law as an Aktiengesellschaft, a corporation that has issued shares of common stock to investors.

The addresses and telephone numbers of our two registered offices are:
Bahnhofstrasse 45, CH-8001 Zurich, Switzerland, phone +41-44-234 11 11; and Aeschenvorstadt 1, CH-4051 Basel, Switzerland, phone +41-61-288 20 20.

UBS AG shares are listed on the SWX Swiss Exchange (traded through its trading platform virt-x), on the New York Stock Exchange (NYSE) and on the Tokyo Stock Exchange (TSE).

Contacts

Switchboards

For all general queries.

Zurich	+41-44-234 1111
London	+44-20-7568 0000
New York	+1-212-821 3000
Hong Kong	+852-2971 8888

Investor Relations

Our Investor Relations team supports institutional, professional and retail investors from our offices in Zurich and New York.

www.ubs.com/investors

Hotline	**+41-44-234 4100**	UBS AG
New York	+1-212-882 5734	Investor Relations
Fax (Zurich)	+41-44-234 3415	P.O. Box
		CH-8098 Zurich, Switzerland
		sh-investorrelations@ubs.com

Media Relations

Our Media Relations team supports global media and journalists from offices in Zurich, London, New York and Hong Kong.

www.ubs.com/media

Zurich	+41-44-234 8500	mediarelations@ubs.com
London	+44-20-7567 4714	ubs-media-relations@ubs.com
New York	+1-212-882 5857	mediarelations-ny@ubs.com
Hong Kong	+852-2971 8200	sh-mediarelations-ap@ubs.com

Shareholder Services

UBS Shareholder Services, a unit of the Company Secretary, is responsible for the registration of the global registered shares.

Hotline	**+41-44-235 6202**	UBS AG
Fax	+41-44-235 3154	Shareholder Services
		P.O. Box
		CH-8098 Zurich, Switzerland
		sh-shareholder-services@ubs.com

US Transfer Agent

For all global registered share-related queries in the US.

www.melloninvestor.com

Calls from the US	+866-541 9689	BNY Mellon Shareowner Services
Calls outside the US	+1-201-680 6578	480 Washington Boulevard
Fax	+1-201-680 4675	Jersey City, NJ 07310, USA
		sh-relations@melloninvestor.com

Cautionary statement regarding forward-looking statements | This report contains statements that constitute "forward-looking statements", including but not limited to statements relating to the risks arising from the current market crisis, other risks specific to our business and the implementation of strategic initiatives, as well as other statements relating to our future business development and economic performance and our intentions with respect to future returns of capital. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations. These factors include, but are not limited to (1) the extent and nature of future developments in the US sub-prime market and in other market segments that have been affected by the current market crisis; (2) other market and macro-economic developments, including movements in local and international securities markets, credit spreads, currency exchange rates and interest rates, whether or not arising directly or indirectly from the current market crisis; (3) the impact of these developments on other markets and asset classes; (4) changes in internal risk control and in the regulatory capital treatment of UBS's positions, in particular those affected by the current market crisis; (5) limitations in the effectiveness of our internal risk management processes, of our risk measurement, control and modeling systems, and of financial models generally; (6) developments relating to UBS's access to capital and funding, including any changes in our credit ratings; (7) changes in the financial position or creditworthiness of our customers, obligors and counterparties, and developments in the markets in which they operate; (8) management changes and changes to the structure of our Business Groups; (9) the occurrence of operational failures, such as fraud, unauthorized trading, systems failures; (10) legislative, governmental and regulatory developments; (11) competitive pressures; (12) technological developments; and (13) the impact of all such future developments on positions held by UBS, on our short-term and longer-term earnings, on the cost and availability of funding and on our BIS capital ratios. In addition, these results could depend on other factors that we have previously indicated could adversely affect our business and financial performance which are contained in other parts of this document and in our past and future filings and reports, including those filed with the SEC. More detailed information about those factors is set forth elsewhere in this document and in documents furnished by UBS and filings made by UBS with the SEC, including UBS's Annual Report on Form 20-F for the year ended 31 December 2007. UBS is not under any obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise.

Imprint | Publisher / Copyright: UBS AG, Switzerland | Languages: English, German
Order number *Annual Report 2007:* SAP-No. 80531E-0801

UBS AG
P.O. Box, CH-8098 Zurich
P.O. Box, CH-4002 Basel

www.ubs.com