UBS

Security and constancy in uncertain times

Speech by Marcel Ospel, Chairman of the Board of Directors, at the Annual General Meeting of Shareholders of UBS AG in Zurich on 16 April 2003

Ladies and Gentlemen
Valued Shareholders

At our last year's General Meeting, I quoted the proverb "It takes *bad* weather to show the *good* seaman". This aptly sums up the challenge we and many others were confronted with last year, namely weathering the storms while at the same time keeping the ship on course and maintaining headway even in slack winds. A true test of good seamanship. So how did we fare in those more turbulent times? I believe UBS has coped with the rough seas admirably. Certainly, we would have liked to present a better result to you, our shareholders. But given the circumstances, we can be satisfied with what we have achieved. Adjusted for the special write-down of just under CHF 1 billion on the "PaineWebber" brand, which was a well thought-out strategic decision and in no sense a loss, our net profit for the year was just under 13% lower. In a peer comparison, that is an excellent result. The fact that the share markets failed to reward this performance in full and that all of you saw the book value of your shareholdings dwindle last year is regrettable. Sadly, the general mood of the markets and the prevailing climate of uncertainty drag fundamentally sound investments down as well.

All the more reason, then, for me to thank you, our shareholders, for your continuing loyalty to UBS. We are very conscious of your expectations.

My thanks also go to our clients – of whom there are now more than six million spread around the word – for their loyalty. Despite the adverse environment, our

69,000 staff members around the globe did everything in their power last year to ensure their clients received the best possible service and professional advice. The loyalty of our clients is a testimony to the excellence of our staff at all levels of our organization. At the operational level, in the Group Executive Board we have a strong team dedicated unswervingly to the success of our enterprise. For us within the Board of Directors and for you, too, as owners of our company this represents grounds for confidence, going forward. My sincere thanks go to Peter Wuffli and his team.

Finally, let me say a word of appreciation to my colleagues on the Board of Directors. As times have grown more challenging, the demands made upon them have grown more exacting. And I am glad we can count on the counsel of a strong board made up of personalities with wide-ranging backgrounds, experience and the ability to think critically.

Uncertainty as the central challenge

Allow me now to share some thoughts with you on an issue which I suspect is a source of preoccupation for all of us at the present time: I am referring to the uncertainty that currently has so many of us in its grip. We cannot help but find it unsettling when every single institution of the post-war era – from the UN to Nato, from the International Monetary Fund and the World Bank to the EU – is simultaneously caught up in crisis. Ladies and gentlemen, the challenges facing us are sobering indeed.

I do not intend to deal with geopolitics in my remarks to you today. Geopolitics have been our constant companion for the past few weeks, and we all live with the uncertainty spawned by international terrorism. There is no way the global economy can remain immune. For international trade and for the financial markets, these many uncertainties about the future are a poison that paralyses the propensity to invest. The stock markets are in endless decline, and one of the fatal side-effects is the crisis in which so many pension funds now find themselves. Anxiety in the population about the safety of pension systems in turn influences the behaviour of consumers and only serves to compound the existing economic problems. We need to break out of this vicious circle.

Security of pension plans – an issue vital for the banks as well

I want to examine the issue of pensions more closely as we are not as powerless in the face of this challenge as we are in a number of the other instances I mentioned. It is, moreover, an area where we as a bank can contribute expertise and experience and point the way to potential solutions.

One thing is immutable: the demographic trend. We know this for a fact. All of us are growing older, and the size of the working population is constantly diminishing in relation to the number of pensioners. In 1999, the figure stood at 4.3 wage-earners to each pensioner, today it has already dropped below 4, by 2010 it will be 3.5 and 10 years later only 3.

It is a phenomenon with which all the industrialized nations are confronted. It has reached dramatic proportions where pension systems are predominantly funded on a pay-as-you-go basis, in other words where pensions are financed from the current contributions of the working population. In our own case here in Switzerland, this applies to our state pension system - the AHV.

Nevertheless, compared with many other countries we are still in a comfortable position despite the present difficulties and the problems – in some cases acute – faced by individual pension funds. The Three-Pillar Principle on which our pension system is built is proving able to cope with the strains. Each of the three pillars is based on a different financing structure, providing a measure of natural protection by balancing the risks.

So what needs to be done to solve the problems currently besetting the Second Pillar of occupational pension provision? To my mind, the present debate revolves far too narrowly around the so-called “minimum yield”. The main problem lies somewhere else: In the “fat” years, when equities yielded rich returns, it was frequently forgotten that, under a funded pension system, provision had to be made in the good times for the possibility of “lean” years ahead. Instead, however, of laying down reserves in bumper stock market years, pension plan operators erred on the side of generosity. Premiums were lowered and pensions were increased. And in the process, an elementary rule of good husbandry went unheeded: namely, when times are bad you have nothing to fall back on but what you have set aside earlier. I am well aware how unpopular it is to raise the issue of increasing contributions and reducing pensions. But the fact is that those funds which erred in the past now have no alternative but to resort to unpopular measures. It is just not on for some participants to opt out of the generation contract – whether in good times or in bad.

Essentially, the problem today is one of insufficient transparency, a state of affairs which only serves to cover up professional failings. Past indiscretions only come to light progressively. There is an urgent need for action here, and the only route lies through greater competition. Pension plan participants deserve to have the assurance that their retirement assets are being managed in line with the best possible standards – and with a long-term horizon. Pension funds in their search for investment advice need to have the power of choice from among a pool of competing high-quality providers. They deserve access to the best specialists the financial industry has to offer.

I would go one step further still. It is not only pension funds that should have the opportunity to benefit from greater competition among professional providers of investment products – the same opportunity should also be extended to the individual. In the longer term, our goal must be to enable individuals themselves to decide how they wish their retirement capital to be invested. They should be free to select the level of investment risk appropriate to their own individual circumstances. Then we can forget about a “minimum yield” because other, more important criteria come into play.

One recipe, however, irrevocably spells disaster: a pro-cyclical approach to investing capital. Anyone who, four years ago, had opted to invest virtually all his assets in bonds and money market paper, who then – towards the end of the bull market – switched to equities, and who now decides to sell his shares and buy bonds yielding a minimum rate of interest, will in no time be overtaken by the next crisis. That crisis will come as soon as low-yielding bonds are less sought after than shares and consequently see their value eroded. Pension assets are a long-term investment. As such, they should rather be invested anti-cyclically.

What we must resist at the present time is the political inclination to compound this misguided approach to stock market cycles through regulatory action.

Another mistake we cannot afford to make under the pressure of present events would be to strengthen the First Pillar at the expense of the Second. If we move away from the funded system, on which the Second Pillar is based, in a few short years we could risk the collapse of our entire pension edifice. The working population and the economy would no longer have the capacity to finance pension payments. The State would have to assume the burden. And we all know what that means: more reckless borrowing or higher taxes.

The present state of affairs highlights one further aspect: the Third Pillar, i.e. voluntary, individual provision for old-age, is steadily gaining in importance. The individual who also makes his own personal provision for his later years is less exposed to the current turbulence. At the legislative level, we need to ensure that this sort of self-reliance receives the support it deserves and that it is not undermined by new taxes and contributions.

Finally, we shall be well served by having a "4^{th} Pillar" as well – I am thinking here of an employment market for those who are willing and able to continue working beyond their nominal retirement age. We must find ways and means to provide incentives for people to remain active professionally. With models of this sort, we would not only be helping to alleviate the present strains on the system. We would also be building in safeguards against the foreseeable demographic development of our population. The challenge facing the legislator would be to devise a system of taxes and social security contributions such that it provides a genuine incentive for temporarily forgoing pension benefits while continuing to work.

Ladies and Gentlemen: four pillars as a rule represent a firm foundation, enabling solidly built structures to withstand intermittent tremors. Naturally, a rebound on the stock markets will help. But we need to address the fundamental issues *now.* Now is the time to take a critical look at the professionalism of certain pension funds and take remedial action where they fail to meet the legitimate expectations of their plan participants. The business, academic and political communities need to work hand in hand to seek ways out of the current crisis. As a bank, we have a vital interest in having pension institutions which are sound and which manage the vested assets of future retirees professionally.

Politics and business need each other

In the past years of economic boom and prosperity, the dialogue between the business and the political communities has lost its way. Where contacts have taken place, they have tended to be stigmatized as "cronyism". I believe we must overcome these inhibitions and acknowledge the fact that the economy cannot flourish without a conducive political environment and that a political system without a flourishing economy will rapidly become unsustainable. We have to fight against the negative label attached to representatives of the business community in politics. How can it be a bad thing for politicians to actively promote the well-being of our economy? Only a healthy economy generates the revenues needed to pay the necessary taxes – both at the corporate and individual level. We as business leaders should not be shy of voicing political opinions or supporting political endeavours.

How crucial political engagement of this sort can be was demonstrated by the heated debate surrounding the Bilateral Accords II with the EU and the closely related issue of the obligation of the banks to disclose information to foreign authorities. I am very pleased for the sake of Switzerland's financial centre that there were some politicians who were prepared to hear our voice, and that we succeeded in lastingly repelling the latest onslaught on bank/client confidentiality. Protecting the financial privacy of our clients is a central concern for us, and will remain so.

UBS strategy on track

Ladies and Gentlemen: so much for my review of some topical economic and political challenges. Fortunately, in unsettled times like these, the keynote of my report on our company is one of constancy. We have the satisfaction of knowing that our strategy has proved to be the right one. There is no need for any fundamental adjustments. At a time when it was fashionable to extol the merits of bancassurance, we decided against a strategic alliance with an insurance company. We were equally sceptical about the technology euphoria, laying ourselves open at times to the charge that we had missed out on major opportunities. Instead, for the past ten years, we have continued to build steadily to make UBS what it is today. Through judicious acquisitions, we have added specialized skills and fresh ideas and brought top-flight professionals into our organization. We have successfully merged the four powerful client platforms of Union Bank of Switzerland, Swiss Bank Corporation, Warburg and PaineWebber, enabling us to continue to now grow organically from our own resources. We concentrated our energies at an early stage on the two areas of the industry with the biggest growth potential – wealth management and investment banking. And we have opted for a policy of controlled risk, avoiding risk concentrations, while at the same time recognizing that risks are inherent to our business and that without them we cannot operate successfully and profitably.

Finally, I am pleased to report that our integrated business model, under which all our businesses work together to deliver the whole firm to our clients, is bearing fruit. From 9 June this year, when we introduce the single UBS brand across the world and no longer market our services under the Warburg and PaineWebber names, we shall be underlining this unified and integrated approach more clearly still. We expect the move to a single flagship brand to further strengthen our position as one of the world's leading financial services firms. Peter Wuffli will provide you with more information on aspects of our growth strategy shortly.

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Fellow Shareholders.

A positive note in uncertain times when negative headlines abound. That is the message we wish to transmit to you today – at least as far as it lies within our power. You can rest assured that we are doing our utmost to keep UBS successfully on track. We have grounds for optimism. Our strategy has stood the test despite a more difficult environment. The structures we have in place are sound and, more crucially still, we have a robust financial basis to work from. At all levels, across all our businesses and at all our locations around the world we have skilled and motivated employees, dedicated to ensuring the success of the firm and pursuing the same interests as yours, ladies and gentlemen: the sustained, long-term growth in the value of our company. I hope we can fulfil your expectations. You may rest assured of our commitment and dedication.