UBS

Annual General Meeting
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Speech by Kaspar Villiger, Chairman of the Board of Directors of UBS AG

Check against delivery.

Dear Shareholders

I.

Introduction

I would like to start our AGM by giving you a general overview of where our bank stands two years after the financial crisis and what our challenges are going forward. In his talk, Oswald Grübel will take a closer look at some of these issues.

Today, I have mostly good news to report about UBS. For the first time we can state confidently that we have managed to turn the bank around. If somebody had told me two years ago that we would be where we are today, I probably would have said that, if that's the case, then practically all our major problems have been solved. The markets, the regulators and politics in general have ensured that this is not so. New challenges await us. But they do not affect UBS alone. All global banks face challenges. But many people in our country do not understand that the Swiss financial center also has to deal with these challenges. I will go into this in more detail in the second part of my talk.

But let's look at the good news first.

II.

The successes

I can report to you today that we have been successful in six major areas.

First: UBS is stable. The bank has reduced its balance sheet and risks by nearly half since the financial crisis. On the basis of current regulations it is well capitalized compared with other banks and it has outstanding liquidity.

Second: The bank is profitable again. The net profit for 2010 of 7.5 billion francs speaks for itself, and the 2011 first-quarter results are also solid in light of the difficult market environment.

Third: For the most part the problems of the past have been settled. The Swiss federal government was able to sell its investment in UBS at a good profit, and the stake the Swiss National Bank has in the SNB StabFund has been generating profits for this institution as well. The astute support package of the federal government and the National Bank was therefore successful. The problem with the United States was solved not least due to the excellent negotiations conducted by the Swiss federal government and the approval given by the Swiss parliament. For this we are grateful.

Fourth: In our transparency report we analyzed the errors of the past openly, honestly and comprehensively, in a way that no other bank in the world has done. We have received many compliments for this.

Fifth: A whole series of important restructuring processes was carried out, starting with substantially improved governance and continuing with an overhaul of risk management, adjustments to the business model, and a total revision of the compensation models, which aimed to do away with misdirected incentives. The management, under the guidance of Oswald Grübel, achieved these important milestones together with our motivated staff. They all deserve our thanks.

Sixth: Our reputation has improved significantly. In Asia, the US and the UK it is excellent, and it has also become considerably better in Switzerland. The clearest sign of this is the first-quarter net new money. It shows that clients are regaining their trust in UBS. Clients are the lifeblood of a business. I would therefore like to take this opportunity to thank all clients for their loyalty.

III.

The challenges

We are currently undertaking a thorough investigation of whether the regulatory changes and the new market trends will require strategic and organizational adjustments, and, if so, what sort of adjustments. This process is extremely difficult due to numerous uncertainties and the complexity of the global environment. I would like to briefly describe three of the most important challenges facing us. We need to: further strengthen our reputation in Switzerland, negotiate the global regulatory jungle, and maintain the competitiveness of the Swiss economy and financial sector.

Reputation in Switzerland

UBS suffered the bitter experience of learning that a reputation can be destroyed overnight and that restoring it takes time and hard work. In spite of the much improved situation, we still have a long way to go in Switzerland.

There are basically four problems weighing on our reputation in Switzerland.

First, there is a lingering impact from the understandable disappointment that many people still have over the mistakes we made.

Second, the criticism is often heard that UBS did not learn anything from the crisis and that the bank is still assuming risks that are too great.

Third, compensation is perceived as too generous.

Fourth, many commentators took our purely objective and well-founded criticism of the Swiss regulatory proposals the wrong way.

Oswald Grübel will comment on the problem of risks. But I would like to say that I recently asked internal auditing to estimate our risks in comparison with other big banks, which is quite a complex task. I realized that compared with other major banks our level of risk is much lower. I can comprehend that many people have no understanding for the amount of compensation that our senior executives receive. In Switzerland the international pressures of our industry, over which we have no influence, collide with our middle-class culture. To simplify the issue somewhat, our remuneration system must meet three criteria, which can, however, lead to conflicting aims.

First, compensation must reward performance as accurately as possible.

Second, there must be no incentives that encourage excessive risks.

Third, we must be competitive in the labor market, because the bank can be successful only with highly talented employees.

We are attempting through different measures to bring our systems in line with these criteria.

Last year you expressed your dissatisfaction through the relatively narrow approval of the compensation report. We took this vote very seriously and worked intensively on improvements. We are convinced that our system is in line with the requirements of regulators and economists today.

As for criticism of the amount of the bonuses, I would like to remind you that two years ago we reduced bonuses too much, and because of that we lost entire teams along with the clients and earnings the teams brought in. This bloodletting must not be repeated. Even today we are not at the top of the league in terms of bonuses paid. We reduced the bonus pool by about 11% despite the much improved results. Incidentally, this issue led to some rather difficult discussions within the bank.

There has been some criticism lately that UBS does not have the right to point out any shortcomings in the too big to fail legislation because UBS is the cause of all the problems in the first place. I strongly reject this criticism for two reasons.

First, the team that today manages UBS did not cause the crisis. It took on the job of leading the bank back to success on your behalf. This team has the legitimate right to express its concerns if it believes that Switzerland is running the danger of overshooting in some sectors, to the long-term detriment of the financial center. Ultimately, of course, the decisions of the democratically elected authorities will be accepted.

I was surprised how many politicians and commentators distinguished between a "good" and a "bad" big bank in terms of the two big banks' reactions to the regulatory proposals. If I compare the very detailed comments submitted by each of the two banks on the proposals, I can barely find any differences.

Second, we believe that UBS is adaptable enough to be able to increase the enterprise value for you, whatever the regulatory provisions may be. However, the Swiss financial center, which is so important for our economy and our prosperity, will very likely suffer if wrong measures are put in place. Where I am convinced that not all aspects were sufficiently considered – and I have more than just a little experience with the consequences of regulation – I will not let my right to express my opinion freely be taken away from me. We do this for you, our shareholders, and for Switzerland. If later it turns out that we were right, I would not want to be accused of having been silent out of politeness.

I said that the first reason for the difficulty in restoring our reputation was the disappointment of the Swiss people regarding the crisis at UBS. I understand their disappointment. I felt the same way at the time as an unsuspecting ordinary citizen.

There is only one approach: Hard work for the benefit of our clients. We are determined to do this job.

The regulatory jungle
The errors that were committed in the financial sector are not to be glossed over. We have disclosed the errors that UBS made. This should not hide the fact, however, that the actual reasons of the crisis are to be found – and I want to emphasize this point – outside Switzerland, in particular in the broader political environment. Mark Branson, the new head of the Banking Division at FINMA, made a very important remark at the FINMA press conference in March. He said that history teaches us that bank crises have almost always arisen because too much credit was given too cheaply to the wrong people. It would be difficult to express the political causes of the recent crisis more clearly. Central banks are responsible for making financing "too cheap." When interest rates are too low for too long, they encourage too much debt. Projects that are actually unsustainable are realized because the cost of money is too cheap. That's how bubbles are created. Politics also has to take its share of blame for the fact that credit was granted to

the "wrong people." It was a declared aim of US policy to encourage people to take out mortgages and buy their own home even though many of them were clearly financially incapable of doing so. The end result was the subprime crisis. Some countries were also "the wrong people." These were countries that did not do their financial homework, which in the end led to the euro crisis. This was also very clearly a political failure in some European countries. Very few people would dispute the assertion that government regulation intensified the crisis because it was in part procyclical.

There is no doubt that the central banks and many governments did good work in dealing with the crisis. This applies to Switzerland in particular. But while politics must share with the financial sector some responsibility for the crisis, neither side can claim a monopoly on the competence needed to assess the consequences of the regulatory adjustments being proposed. It is nonetheless undeniable that government regulations do need to be adjusted in light of the crisis.

In making these critical remarks about some central banks, I expressly exclude the Swiss National Bank from them. Because of the exchange rate problems, it is between a rock and a hard place, so to speak. It has handled this issue decently. In my previous position I was an ardent defender of the independence of the National Bank. My view of this has not changed at all. It is in the best interests of the country that we do not undermine the credibility of the central bank and the people who run it.

A year ago we were hoping that banking regulation, at least in the main financial centers, would be more or less comparable in the future. But what has emerged internationally is not so much a global playing field with solid, uniform rules, but poorly coordinated national regulation often drawn up under populist political pressure. Here a few new taxes, there a brake on bonuses, elsewhere nothing at all, and still elsewhere protectionism. All this creates a much more complex situation for banks with international operations. The exploitation of regulatory differences – what is called "regulatory arbitrage" – becomes unavoidable in a competitive environment. Many businesses will migrate to less tightly controlled gray markets. At the same time, the tightening of capital and liquidity requirements will make loans more expensive. This tightening will hamper growth just when central banks finally have to stop flooding the money markets with liquidity and highly indebted governments, under the pressure of demographic change, have no room for fiscal stimulus. Some countries might even quietly take their leave of Basel III. I am not certain whether the new risks being created might not end up being bigger than the ones they are trying to reduce. In this difficult environment, we, as a global bank, 80 percent of whose shareholders are non-Swiss, must seek the optimum structure for our business.

Switzerland as a business location

Switzerland is doing splendidly at the moment. It is easy to forget that good economic framework conditions form an indispensable basis for our prosperity. As a small country with the population of a medium-sized Chinese city, we can create prosperity only by exchanging goods and services with other countries. Because all factors of production are highly mobile in the liberalized global economy and can be shifted at any time to what are regarded as more favorable locations, there is hard-fought competition among business locations. Large companies in particular make the most of this location competition. Together with their domestic suppliers, listed Swiss companies produce about a quarter of national output, pay 40 percent of corporate taxes and carry out more than 50 percent of private-sector research. Without them, our above-average level of prosperity would be inconceivable. The shares of the largest of these companies are mainly in non-Swiss hands. These companies will remain here as long as we are one of the leading locations for doing business. Through astute policies, Switzerland has for many decades ensured it offers excellent location advantages. The banks, too, benefit from them. However, location advantage is a moving target. Other places seek to become more attractive while we risk making mistakes. I am thinking, for instance, of the Minder initiative. It is an illusion to think, for example, that we can decide here in Switzerland what the market value of senior executives at global corporations is. But we certainly can influence whether their income is taxed in Switzerland or elsewhere. I would prefer it to be here.

All of these considerations also apply to the financial industry. This sector makes a huge contribution to our prosperity. Oswald Grübel will have more to say on this later.

I would merely point out that a large part of the foreign funds that are important for our prosperity are here not for reasons of banking secrecy, but because the big banks, with their investment banks, are able to provide wealthy clients in particular with a comprehensive, integrated banking service. This is a service which should not be made unduly difficult to offer. Regulations for the big banks are now under consideration that will have consequences for the financial sector which, in our view, are underestimated. It is precisely because we are committed to Switzerland as a financial center, because UBS Switzerland is an important pillar of our bank, because we want to lead UBS from Switzerland – it is precisely for these reasons that we are trying, despite all the criticism, to avoid unnecessarily weakening Switzerland as a financial center.

Let me be clear: we, too, are of the opinion that what happened to UBS cannot be allowed to happen again. This means, first of all, that the big banks need to do their homework carefully and that this needs to be checked by a qualified supervisory body. We want an effective FINMA. It also means that we are in favor of having effective mechanisms that enable important, system-relevant functions to remain in place in a crisis and allow even a major bank to go bankrupt.

Moreover, it means that we accept the desire for the big Swiss banks to be even better capitalized than the significantly tightened rules of Basel III call for, i.e., better capitalized than banks in other countries are. We are even prepared to impose several years of no dividends on you, our shareholders, in order to strengthen our capital quickly. But we feel an obligation to point out the consequences for our competitiveness if Switzerland goes too far by itself and others do not come with us to a certain extent. It is therefore not clear why Switzerland needs to rush ahead with legislation before we have a better idea of what is really happening internationally. Even in just one year's time we would have a much better idea.

I hear it said that our reservations are not taken very seriously and that the too big to fail legislation will strengthen Switzerland as a financial center irrespective of what rival financial locations do. Perhaps we should look at what the major investors or analysts that our large shareholders abroad use for guidance have to say. I would like to select just three examples from many.

In March of this year, Barclays Capital published a study in which it recommended selling UBS shares, with a target price of 14 francs. One of the reasons for this was that the stringent capital requirement of 19 percent of risk-weighted assets would undeniably lead to low return on equity and competitive disadvantages. This would be reflected in a lower share valuation.

One major investor, also in the financial sector, signaled that he would no longer be investing in financial institutions with a capital requirement of more than 13 percent. The prospects for returns were simply not high enough.

Autonomous Research, an independent financial advisory firm, has calculated that within four years, 30 billion francs in capital could be distributed to shareholders if UBS sold its Swiss retail and corporate client business, used the proceeds to boost the capital of the Investment Bank in the United States, shifted its head office across the Atlantic and kept Swiss Wealth Management as a branch.

Obviously, these are just some people's opinions. But it would be wrong to ignore such considerations entirely. We also attach importance to the opinions of those who, because of their large investments in financial institutions, are forced to think about such questions seriously.

Because we have raised a red flag about overhasty regulation, we are increasingly suspected of dishonest motives. We will probably have to live with that. Nonetheless, I would expressly like to reiterate that our main concern is with regard to Switzerland's position as a financial center, which is so important for our prosperity.

Nor are we threatening to relocate abroad. We are simply being honest in highlighting that we cannot make loans more expensive and make many transactions unprofitable without it being felt somewhere. And believe me, our Swiss location is the one we like best! We are aware of its advantages.

The fact that we are grappling seriously with suitable solutions to the problem for Switzerland is demonstrated by our response to the too big to fail proposal. Our response was in agreement with the basic direction of the proposal, while also trying to make constructive suggestions, some of which were then accepted by the Federal Council. We recognize and are grateful for these improvements. However, the main problem remains unresolved. We still believe that the risks for Switzerland can be sufficiently limited without unduly disadvantaging the country as a financial center.

IV.

The Future

Irrespective of future regulation and how markets develop, we attach importance to a number of guiding principles in shaping the future. I would like to close with five of these principles:

Number one: Creating lasting shareholder value is always our first objective. You have invested your hard-earned money in our bank. We would like to thank you for this. In return, you are entitled to expect sustained earnings, an appropriate return, security and long-term growth in value. We are working hard to provide this.

Number two: The customer is king. As long as we solve our clients' problems better than others do, we will create shareholder value. That is why we focus everything on client needs and client benefits, including in the Investment Bank.

Number three: We want our services to be present in the world's key growth markets. Nevertheless, Switzerland is and will remain our main base, provided conditions permit.

Number four: We invest in our employees, as it is their abilities which determine how well the bank performs. They are some of the most important capital that UBS has.

Number five: We want to create value not only for our shareholders but also for the other key stakeholders. I have mentioned our clients and employees. We have perhaps had a different opinion from our regulators from time to time in shaping the rules. But in terms of practical collaboration with them and compliance with regulations, we do all we can to ensure that we are a constructive and transparent partner. We also feel an obligation to the other countries in which we operate, as well as to Switzerland. That is why we want to be good corporate citizens, obey the laws, pay taxes, support the wider society, etc. All this requires that we adhere to values which we have not only formulated in our ethics code but which, step by step, we systematically implement, teach, monitor and live.

It is by these principles, dear shareholders, that the Board of Directors and management of UBS intend to be guided following the turnaround. We believe that in this way we can best serve your interests as well as those of Switzerland and its economy.