UBS

Keeping you informed
Key compensation changes 2013

The cover picture shows Swiss 400 m hurdles champion Kariem Hussein (foreground) analyzing his performance during a recent training session. Kariem, a member of the Swiss Starters program, will be part of the Swiss team at the 2014 European Athletics Championships in Zurich. UBS is proud to be accompanying the team on the road to the championships. Through its support of Swiss Starters, UBS intends to make a significant contribution to homegrown athletes enjoying the greatest possible success at the European Athletics Championships. UBS's engagement in national athletics underscores its strong relationship to its domestic market and its aim to inspire the enthusiasm of the general public and promote the sport on a lasting basis.

Dear shareholder,

I am pleased to report that in 2013 we further anchored our strategy and a culture of accountability into our compensation framework. Our aim is simple. We want to foster a true culture of accountability at all levels and embed this core value into our daily actions, including enhanced safeguards on pay alongside appropriate governance oversight.

In this publication, we have summarized the main changes to our compensation framework for 2013. We have also taken the opportunity to say a few words regarding our performance last year and the proposed distribution to our shareholders. Furthermore, we have highlighted the amendments on compensation we made to our Articles of Association as to how UBS suggests to implement the new Swiss Ordinance Against Excessive Compensation in Listed Stock Corporations in response to the Minder Initiative. Notably, we propose that our shareholders vote on the fixed compensation for the Group Executive Board (GEB) for the following year and the compensation for the Board of Directors up to the next Annual General Meeting. When it comes to the variable compensation for the Group Executive Board, however, we agreed to put forward that shareholders should make decisions on the proposed actual variable compensation for the past year based on the firm's performance. Although this provides more uncertainty for our GEB members, it allows our shareholders to make an informed decision and to consider pay in the light of actual performance achieved.

As a last point, we mention the implementation of the EU Capital Requirements Directive 2013 (CRD IV) regarding the ratio of variable to fixed compensation for some employees within UBS AG for which we will seek approval in an advisory vote at the AGM.

Kind regards,

Axel A. Weber
Chairman of the Board of Directors

Performance achievements and *performance award pool*

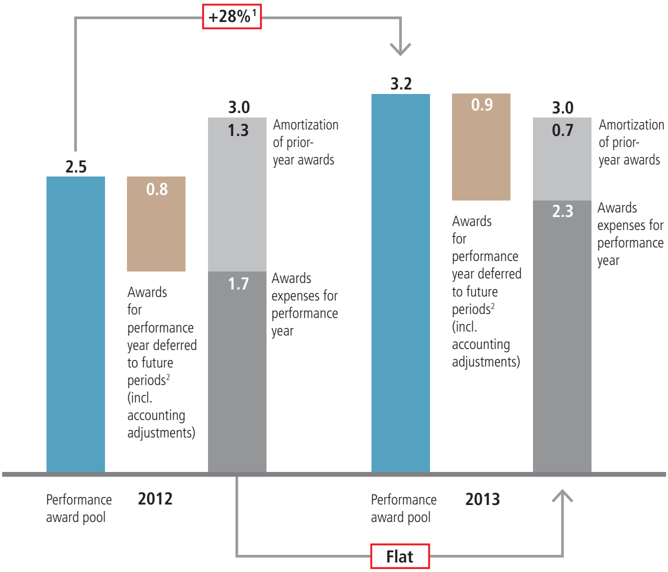
Looking at our performance in 2013, we achieved increased profits and shareholder returns. Our business divisions posted strong results and were profitable in every quarter. Our employees met the continued challenges affecting our industry with energy, determination and commitment, enabling us to deliver for both our clients and shareholders. While the performance of our businesses improved significantly during 2013 and we finished the year ahead of many of our targets, we remain fully committed to moderation in performance-related pay.

In 2013, adjusted Group profit before tax increased by 44%. Reflecting the firm's strong performance, the Board of Directors is recommending a 67% increase in the dividend for shareholders. By way of comparison, we took the decision to increase the overall performance award pool by 28% to CHF 3.2 billion. The increase on 2012 also reflects the fact that a year ago we addressed issues of the past that weighed on our performance. This resulted in pay that was understandably at the lower end of the scale compared with the industry. While the performance award pool increased 28%, the actual recognized performance award expense remained flat compared with 2012, reflecting the lower awards in recent years and the strong deferral component in our compensation plans.

The performance award pool for 2013 was CHF 3.2 billion, an increase of 28%, compared with 2012. Performance award expenses remained flat at CHF 3.0 billion and included expenses related to 2013 compensation awards and amortized expenses related to awards made in prior years.

Performance award expenses

CHF billion



1 Excluding add-ons such as social security.

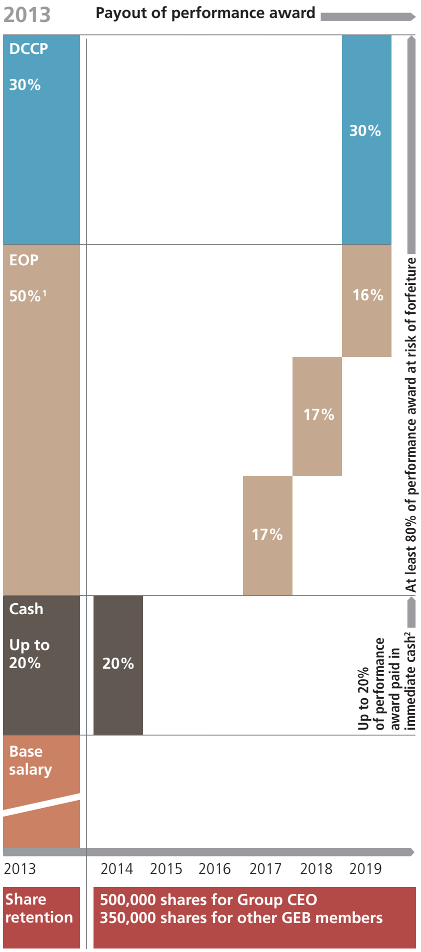
2 Estimate. The actual amount to be expensed in future periods may vary, for example due to forfeitures.

Refinements to the *compensation framework*

The graph below provides an example as to how the annual performance awards of the GEB are paid out over the years: Of the annual performance award, up to 20% is paid in the form of immediate cash, and 80% is paid as a longer-term performance award. For 2013, we increased the weighting of the equity portion of the annual performance awards to a minimum of 50% of the overall performance award being awarded under the Equity Ownership Plan (EOP).

2013 compensation framework for Group Executive Board (GEB) members

Illustrative example



Replicates many of the features of loss-absorbing bonds.

Award cliff vests in year 5, subject to forfeiture if a capital ratio trigger or viability event occurs. The awards are subject to 20% forfeiture for each financial year if UBS does not achieve an adjusted Group profit before tax.

Notional interest payments will be made annually in years where the firm achieves an adjusted Group profit before tax.

Awards are subject to continued employment and harmful acts provisions.

Notional shares awarded.

Award vests in equal installments in year 3, 4 and 5, subject to both Group and divisional performance over the three financial years before vesting. The amount forfeited may be up to 100% of the installment due to vest.

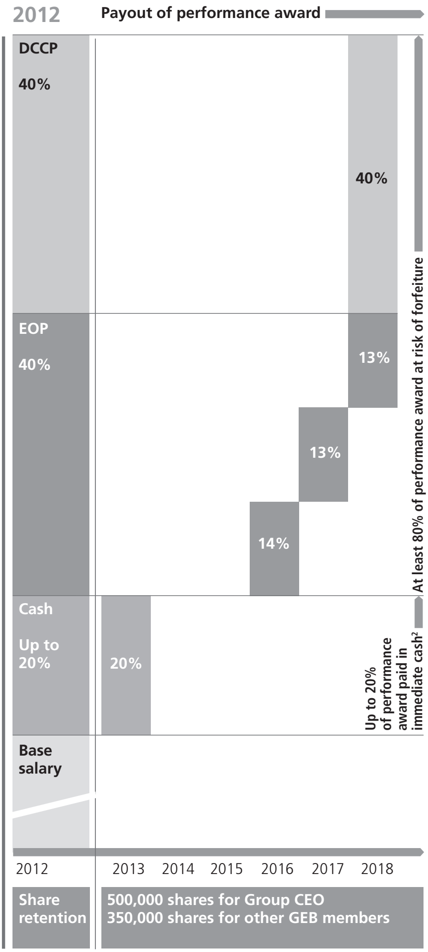
Awards are subject to continued employment and harmful acts provisions.

Up to 20% paid out immediately, subject to a cash cap of CHF/USD 1 million. To the extent that less than 20% is paid in immediate cash, the excess amount will be delivered in EOP.

GEB members are required to hold a certain number of UBS shares as long as they are in office.

This holding has to be built up within a maximum period of five years from the date of their appointment to the GEB.

1 At least 50% of the performance award is granted under EOP. 2 UK Code Staff receive 50% in the form of blocked shares.



We recognize that stability and predictability in our compensation framework are important for our employees. Equally as important are the views of our shareholders and our position in a highly competitive environment. Taking these factors into account we made some refinements to our compensation framework for 2013.

Specifically, for the Group Executive Board (GEB) we amended the framework as follows:

We introduced individual caps on performance awards of a maximum of five times the base salary for the Group Chief Executive Officer (Group CEO) and a maximum of seven times the base salary for other GEB members. These caps are in addition to the overall GEB performance pool cap of 2.5% of adjusted Group profit before tax that we introduced last year.

We changed the performance award deferral mix by increasing the weighting of the equity portion under the Equity Ownership Plan (EOP) to at least 62.5% from 50% of the deferred amount, and by decreasing the Deferred Contingent Capital Plan (DCCP) portion to 37.5% from the previous 50% level.

We increased the DCCP's phase-in CET1 capital ratio trigger to 10% from 7% for all GEB members including the Group CEO. This means that if this capital ratio falls below 10%, the affected deferred performance awards would be written down to zero.

We enhanced our performance assessment approach for the Group CEO and other GEB members based on a balanced scorecard. An individual GEB member's performance is assessed based on financial and qualitative measures that are clearly defined and quantified in terms of relative weightings.

At the same time, we also refined the compensation framework for employees below GEB level:

We changed the performance award deferral mix by increasing the weighting of the EOP portion to 60% of the deferred amount from 50% and reducing the DCCP portion to 40% from 50%.

Reflecting market dynamics, **we raised the threshold of compensation levels** subject to deferrals. We introduced deferral rates ranging from 40% to 75% compared with the previously flat rate of 60%, and better aligned performance award conditions to the firm's targets. In general, this means employees at the lower end of the compensation scale had lower levels of deferral than in previous years, while those at the higher end of the scale were subject to higher levels of deferral. We also increased the threshold above which performance awards are deferred to CHF/USD 300,000, up from CHF/USD 250,000. This increase, together with the introduction of graduated deferral rates, aligns our deferral levels closer to the market.

It is important to note that all our variable compensation plans require a significant part of a performance award to be deferred for up to five years and include forfeiture provisions. All plans feature performance conditions for certain employees. Any amount exceeding the cash cap of CHF/USD 1 million is deferred in notional shares under the Equity Ownership Plan.

Key regulatory developments *and implementation*

Ordinance against excessive pay in stock exchange listed companies

In 2013, the Minder Initiative was approved by the Swiss electorate. The Swiss Federal Council has enacted an Ordinance implementing the initiative leading to changes to the governance of public companies. The Ordinance came into effect on 1 January 2014, subject to certain transitional provisions.

Among other things the Ordinance requires companies to hold an annual binding shareholder vote on the compensation of the members of the Board of Directors (BoD) and the GEB. Furthermore, the Ordinance requires public companies to have provisions in their Articles of Association in particular regarding:

- the principal duties and powers of the compensation committee,
- the principles of performance and equity-based compensation for BoD and GEB members,
- limitations to external mandates held by BoD and GEB members,
- employment and mandate agreements with BoD and GEB members, and limitations on loans granted to BoD and GEB members.

As a result, UBS has amended its Articles of Association. The *Report of the Board of Directors on the proposed amendments to the Articles of Association,* which can be found in the Annual General Meeting (AGM) invitation, outlines the main amendments which UBS shareholders will have the opportunity to vote on at this year's AGM.

In addition, the Ordinance requires the firm to hold an annual binding shareholder vote on the aggregate amount of total compensation for both the BoD and the GEB.

With regard to GEB compensation, the BoD proposes to amend the Articles of Association as follows:

The maximum aggregate amount of **fixed compensation to be approved prospectively for the following financial year.** This means, for example, that shareholders at the AGM in 2015 will vote on the maximum fixed compensation for the financial year 2016. Shareholders at the AGM in 2015 will approve the maximum fixed compensation (which covers predominantly base salaries for the GEB) for the financial year 2016. This proposal provides planning certainty for both UBS and its GEB members.

On aggregate variable compensation, the BoD proposes that shareholders shall retroactively approve GEB members' aggregate annual performance awards in relation to the preceding financial year. For instance, the variable compensation for the financial year 2014 will be submitted for shareholder approval at the Annual General Meeting in 2015. This means shareholders are able to vote on the aggregate amount of variable compensation for the past performance of all GEB members in office, and can base their decisions on the firm's actual performance for the year under review.

It is also necessary to provide for situations where a person joins the GEB, or is promoted within the GEB (e.g., promotion to Group CEO) after the fixed compensation has already been approved. The Ordinance allows the Articles of Association to provide for a "reserve" pool out of which fixed compensation may be funded in such situations. The BoD proposes a "reserve" pool that in the aggregate does not exceed 40% of the average total annual compensation paid to the GEB during the previous three years.

We believe that this combined approach strikes the right balance between certainty for the firm and its GEB members and accountability to our shareholders on compensation matters.

For BoD compensation, it is proposed to amend the Articles of Association as follows:

The maximum aggregate amount of compensation, including the Chairman's compensation, to be approved prospectively, i.e., the period from the AGM vote to the following year's AGM. This means that the term of office and the compensation period are aligned.

The first binding vote on the BoD's and the GEB's compensation will be held at the Annual General Meeting 2015. As it has done since 2009, and in addition to the new binding votes on aggregate compensation, UBS intends to continue to submit the remuneration report to an annual non-binding shareholder vote.

European Union's Capital Requirements Directive IV

The EU Capital Requirements Directive 2013 (CRD IV) generally limits the ratio of variable to fixed components of remuneration of certain staff of financial institutions to 1:1. However, the Directive does provide that companies may change that maximum ratio to 2:1, for this population, with the approval of shareholders obtained in accordance with a specified procedure, in order to guarantee that the votes of staff who have an interest in the proposed higher ratio will not be counted.

In accordance with CRD IV, the BoD proposes an advisory vote to set the maximum ratio of variable remuneration to fixed remuneration to 2:1 for all employees identified as Code Staff of UBS AG, or who are otherwise subject to the maximum ratio under the CRD IV requirements.

Pursuant to the UK regulator rules and/or regulatory technical standards from the European Banking Authority the definition of the Code Staff of UBS AG includes senior management, and other key staff who take or control material risks on behalf of the firm. The Code Staff of UBS AG also includes certain other staff to whom the cap applies due to their remuneration levels and/or job function.

The CRD IV explanatory report of the UK Prudential Regulation Authority states that branches of non-EU firms would require a vote by the shareholders of the non-EU firm branching in. As a result of the structuring of UBS AG's UK business through a London branch, an advisory vote by the shareholders of UBS AG is required.

We appreciate this is a complex area and you can find a more detailed explanation of the BoD's motion and recommendation regarding the CRD IV at *www.ubs.com/agm.*

As we look ahead to the rest of 2014, we will continue our work to assess and refine our compensation framework to promote sustainable performance, risk alignment and competitive pay positioning against the backdrop of increasing regulation and a changing business environment. To ensure our continued success, we need to attract and retain the best people to deliver sustainable performance for our shareholders. We intend to strike and maintain a balance whereby we reward employees effectively and responsibly. As part of our endeavors, we will continue to be responsive to our shareholders and seek out opportunities to engage with them on compensation matters.

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