Financial information on the stabilisation fund

The SNB StabFund Limited Partnership for Collective Investment (stabilisation fund), with its subsidiaries, forms a closed-end capital investment scheme within the meaning of art. 98 of the Federal Act on Collective Investment Schemes (CISA).

The subsidiaries are consolidated according to recognised accounting principles, in order to permit an economic assessment of the stabilisation fund.

The reporting currency of the stabilisation fund is the US dollar. The figures reported here are therefore stated in this currency.

1 Introduction

Structure

The SNB StabFund Limited Partnership for Collective Investment (stabilisation fund) manages the illiquid assets taken over from UBS as at 1 October 2008.

The participation units in the stabilisation fund are held by the limited partner, LiPro (LP) AG, and the general partner, StabFund (GP) AG. The shares of both companies are owned by the Swiss National Bank (SNB). To hold different types of assets, the stabilisation fund also has subsidiaries which take account of the local legal specificities.

The financial information on the stabilisation fund is consolidated at limited partnership level. All financial values are stated in US dollars.

Organisation

The SNB manages the activities of the stabilisation fund by controlling the general partner, StabFund (GP) AG, for which it provides three of the five members of the Board. The general partner is responsible for the management of the stabilisation fund. The fund has no staff of its own. Operational management tasks are performed by the SNB's StabFund unit. Although UBS acts as investment manager, the investment strategy is defined by the general partner. The assets are held in custody at an independent custodian bank.

Activities

The financial instruments taken over mainly comprise loans and securities (securitised loans) in the area of real estate as well as corresponding derivatives positions. In some instances, defaults on positions resulted in the SNB taking ownership of the associated collateral or, in the case of derivatives, the underlying assets. These are in the form of additional securities, loans or real estate.

The National Bank financed the purchase of investments with a loan to the stabilisation fund. Sales as well as current income from repayments and interest made it possible to pay down part of this loan. Since reaching a high in April 2009, the debt to the National Bank had been reduced by half, to USD 12.6 billion, by the cut-off date.

The recovery in the securitisation markets had a positive impact on the result. Owing to a profit of USD 2.5 billion, the stabilisation fund's equity turned positive again (USD 2.1 billion), after it had been depleted shortly after the fund was incorporated and had reported over-indebtedness of USD 418 million as at the end of 2009.

Additional information

Further information on the stabilisation fund can be found in chapter 6.7 (pp. 80–83) of this report.

2 Stabilisation fund balance sheet and income statement

Balance sheet as at 31 December 2010
In USD millions

	Item no. in Notes	31.12.2010	31.12.2009	Change
Assets				
Bank deposits		**514.1**	**660.6**	**–146.5**
Securities (securitised loans)	01	11 661.6	15 769.7	–4 108.1
Non-securitised loans	01	2 479.2	3 322.5	–843.3
Real estate	02	39.7	15.5	+24.2
Subtotal investments		**14 180.5**	**19 107.7**	**–4 927.2**
Interest rate derivatives	03	45.0	26.2	+18.8
Credit derivatives	04	45.4	105.2	–59.8
Subtotal derivatives		**90.4**	**131.4**	**–41.0**
Prepayments and accrued income		54.3	49.3	+5.0
Other assets	04	129.4	31.8	+97.6
Total assets		**14 968.7**	**19 980.9**	**–5 012.2**

Liabilities and equity

	Item no. in Notes	31.12.2010	31.12.2009	Change
Interest rate derivatives	03	176.0	43.5	+132.5
Accrued expenses and deferred income		22.3	43.0	–20.7
Other liabilities		0.7	11.2	–10.5
SNB loan	05	12 618.9	20 281.9	–7 663.0
Deferred management fee	06	40.5	19.3	+21.2
Subtotal liabilities		**12 858.5**	**20 398.9**	**–7 540.4**
Equity				
Paid-in equity	07	3 896.3	3 896.3	–
Result, carried forward		–4 314.5	–1 690.6	–2 623.9
Result, current period		2 528.5	–2 623.8	+5 152.3
Subtotal equity		**2 110.3**	**–418.0**	**+2 528.3**
Total liabilities and equity		**14 968.7**	**19 980.9**	**–5 012.2**

Income statement for 2010

In USD millions

	Item no. in Notes	2010	2009	Change
Net interest income from securities and non-securitised loans		866.6	1 431.5	–564.9
Effective interest (less impairments)	08	1 080.5	–1 595.8	+2 676.3
Net result from derivatives	03, 04	–141.3	110.6	–251.9
Unrealised valuation gains/losses	09	1 123.8	–2 424.4	+3 548.2
Realised valuation gains/losses		110.3	521.2	–410.9
Financing costs		–457.6	–586.4	+128.8
Gross income		**2 582.3**	**–2 543.3**	**+5 125.6**
Foreign tax expenses (–) and tax credits (+)		–0.1	–0.3	+0.2
Operating expenses		–53.8	–80.2	+26.4
Net income		**2 528.5**	**–2 623.8**	**+5 152.3**

3 Notes to the financial information on the stabilisation fund as at 31 December 2010

General

Stabilisation fund accounting principles

The SNB StabFund group's accounting principles conform to the requirements of the CISA. The accounting and valuation principles for financial instruments (securities, loans and derivatives) comply with the International Financial Reporting Standards (IFRS). The figures reported here are an extract from the stabilisation fund's annual report as submitted to the Board of Directors of StabFund (GP) AG.

Audit

PricewaterhouseCoopers Ltd (PwC) act as auditors for the stabilisation fund. These disclosures on the stabilisation fund were audited as part of the overall audit of the SNB group.

Recording of transactions

The reporting of the stabilisation fund's transactions follows the principle of trade date accounting.

Initial valuation

The transferred assets were recorded at fair value at the date of the actual transfer. For assets classified as loans and receivables, this was the starting value for amortised cost accounting in conformity with IFRS provisions.

Subsequent valuations …

The market values of the transferred securities and non-securitised loans are of limited use, as these instruments continue to be thinly traded in the market. For this reason, in compliance with IFRS provisions for the loans and receivables category, these assets are valued at amortised cost.

… using the effective interest method

The difference between the purchase value of a financial instrument and its expected repayment value is amortised by applying the effective interest method, which is used to calculate amortised cost. The effective interest rate discounts all future expected cash flows for a financial instrument over its lifetime to equal the instrument's purchase value.

… based on economic models

Since the stabilisation fund's portfolio consists of complex securitisation structures and claims, assumptions must be made as to the expected repayments. These projections are based on macroeconomic scenarios and the specific features of the assets concerned.

Assets recorded at fair value

Assets which, under the IFRS provisions, cannot be assigned to loans and receivables are recorded at fair value. These assets mainly comprise derivatives and securities (securitised loans) containing embedded derivatives.

Value adjustments

Assets carried at amortised cost are subject to periodic impairment tests. The value of these financial instruments is reviewed using cash flow projections. If the evaluation reveals a material difference compared to current book values, values are adjusted accordingly.

Reporting currency

The reporting currency of the stabilisation fund is the US dollar. All values presented here are in this currency.

Valuation rates

Foreign exchange valuation rates

	31.12.2010 In USD	31.12.2009 In USD	Change In percent
1 euro (EUR)	1.3396	1.4370	–6.8
1 pound sterling (GBP)	1.5577	1.6179	–3.7
100 Japanese yen (JPY)	1.2307	1.0780	+14.2

Item no. 01

Notes to the balance sheet and income statement

The table below shows book values (carrying values) and fair values for securities and loans. These assets are generally carried at amortised cost in accordance with the IFRS. However, if the financial instrument contains derivatives components, the entire instrument is valued and recorded at fair value.

	31.12.2010		31.12.2009	
In USD millions	Balance sheet (carrying) value	Fair value	Balance sheet (carrying) value	Fair value
Securities (securitised loans)	11 661.6	12 974.2	15 769.7	15 647.4
At amortised cost	11 143.5	12 456.0	15 279.6	15 157.3
At fair value	518.1	518.1	490.1	490.1
Non-securitised loans	2 479.2	2 649.9	3 322.5	3 615.0
At amortised cost	2 479.2	2 649.9	3 322.5	3 615.0
At fair value	–	–	–	–

The stabilisation fund owns real estate taken over in the course of foreclosure proceedings. Such properties are recorded at market value. For subsequent valuations, either the current book value or the current market value is used, whichever is lower. **Item no. 02**

Swaps are used to hedge interest rate risk. Depending on the term and currency (US dollar and pound sterling), the value of these instruments can vary. **Item no. 03**

At the end of 2010, the positive replacement value was USD 45 million, and the negative replacement value was USD 176 million. These positions are not offset against each other. The contract volume was USD 4.7 billion.

The stabilisation fund has acquired credit derivatives both as protection buyer and protection seller. The credit derivatives mainly comprise credit default swaps (CDS). Holders of CDS use them to protect themselves against default by a borrower. The stabilisation fund took over the risks of the protection seller from UBS. The *net result from derivatives* includes the income from premiums (or expenses) for providing this protection. **Item no. 04**

The amount to be paid in the event of default (using cash held ready in bank deposits) is regularly recalculated, based on the continuous valuation of outstanding CDS contracts. If the value deteriorates, the stabilisation fund pays into this collateral pool, whereas it receives a repayment in the event of a value gain. A credit event triggers an outpayment to the holder (from the pool), as well as a reduction in the liability. The difference between the payment and any underlying asset received in return is stated as *realised valuation gains/losses*. Should the stabilisation fund not have sufficient liquid funds to service the outstanding payments, it could apply for an additional loan drawdown from the SNB.

At the balance sheet date, potential liabilities from credit derivatives amounted to USD 3.3 billion, and the deposited collateral to USD 3.4 billion. As the collateral is held by the counterparty entitled to exercise claims based on the respective derivatives transaction, these amounts were offset against each other. Collateral in excess of the liabilities as protection seller (USD 81.7 million) is stated under *other assets*.

Claims as protection buyer (positive replacement values) are stated under *credit derivatives* on the assets side of the balance sheet.

In USD millions	31.12.2010	31.12.2009	Change
Net contract volume	5 308.6	10 655.2	–5 346.6
Positive replacement value	45.4	105.2	–59.8
Negative replacement value	–3 299.3	–7 034.5	+3 735.2
Cash collateral posted	3 381.0	7 041.2	–3 660.2

Item no. 05

Loan commitment to stabilisation fund[1]

In USD millions	31.12.2010	31.12.2009	Change
USD	9 618.8	15 951.5	–6 332.7
EUR	756.3	1 345.3	–589.0
GBP	2 023.7	2 662.1	–638.4
JPY	220.1	322.9	–102.8
Total	12 618.9	20 281.9	–7 663.0

1 Without accrued interest.

In connection with the loan, a subordination agreement has been concluded by the SNB with the stabilisation fund and StabFund (GP) AG in the amount of USD 1.9 billion. Further information on the SNB loan to the stabilisation fund can be found in chapter 6.7 (pp. 80–83) of this report.

Item no. 06

The agreement on the UBS transaction stipulates that the remuneration payable to UBS for asset management activities is subordinate to the servicing of the SNB loan. UBS will only be recompensed for such activities once the loan from the SNB has been repaid in full, and once all other obligations of the stabilisation fund have been met.

Item no. 07

Paid-in equity corresponds to UBS's contribution of 10% of the transfer price of the assets. This contribution was also paid in respect of derivatives positions, based on the associated potential losses (exposure).

Assets entered in the balance sheet at amortised cost report income from effective interest. The latter results in an increase in value of positions classified as loans and receivables that were initially valued low. The impairment tests conducted regularly for such positions can lead to an increase or decrease of the book values, which are adjusted accordingly. These value adjustments are recorded as a correction or accretion under *effective interest (less impairments)*.

Item no. 08

In the 2009 *Annual Report* these impairments were stated under *unrealised valuation gains/losses*. To achieve consistent reporting, the figures for the compared year were reallocated to *effective interest (less impairments)* in the income statement.

Valuation gains/losses consist of profit and loss not yet realised (book profits or book losses). They arise from the revaluation of assets at fair value.

Item no. 09

Risk management

Strategy

The stabilisation fund's liquidation strategy sets out the principles for reducing the portfolio. As a rule, an asset should be sold if its sale price exceeds the discounted expected cash flow, or if such a sale will mitigate reputational, legal or other risks.

The strategy and the requirements for the investment manager are set out in detail in the investment guidelines. The Board of Directors reviews the asset management strategy on a quarterly basis. It also defines limits for the activities of the various decision-makers reporting to it, i.e. the investment manager and the general manager. The limits define the sales volume, but also the potential losses from sales. In addition, the investment guidelines contain requirements on the disclosure of conflicts of interest for UBS in its roles as bank and investment manager, as well as reporting requirements.

Compliance with the strategy and the investment guidelines is monitored on a continuous basis by the Risk Control section of the SNB's StabFund unit.

The system of internal controls of the stabilisation fund covers all the main responsibilities, working procedures and competences relating to the fund's management and reporting.

The stabilisation fund's assets mainly comprise securitised assets in the form of mortgage-backed and other asset-backed securities (MBS and ABS). These are backed by various kinds of claims (mortgages and other loans).

Risks

Risks therefore derive primarily from changes in the value of this collateral. The main risk factors are the future development of the economy and movements in real estate prices in the US and some EU countries.

Interest rate risk plays a minor role. Around two-thirds of the stabilisation fund's securities are variable rate instruments. Most of these assets are congruently financed through the Libor-based loan from the SNB. The remaining interest rate risk is managed by the stabilisation fund using various hedging operations.

Since the stabilisation fund is congruently financed, currency risk is modest. The National Bank's loan was granted in the stabilisation fund's main investment currencies.

Contingent liabilities

Contingent liabilities are liabilities which may be incurred as a result of past events, and whose existence has yet to be confirmed by the occurrence of one or more uncertain future events. Such liabilities mainly stem from CDS credit events (cf. item no. 04) and outstanding irrevocable loan commitments.

In USD millions	31.12.2010	31.12.2009	Change
Exposure from credit derivatives	2 073.8	3 732.4	–1 658.6
Irrevocable loan commitments	36.9	74.3	–37.4
Total	2 110.7	3 806.7	–1 696.0