Financial information on the stabilisation fund

The SNB StabFund Limited Partnership for Collective Investment (stabilisation fund), with its subsidiaries, forms a closed-end collective 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 address the local legal requirements.

The financial information on the stabilisation fund is consolidated at the limited partnership level. All amounts 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 of Directors. 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 financial instruments are held in custody at an independent custodian.

Activities

The financial instruments of the stabilisation fund mainly include loans and securities (securitised loans) in the area of real estate as well as related 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 SNB financed the purchase of assets with a loan to the stabilisation fund. Sales as well as proceeds from principal repayments and interest income make it possible to repay this loan. As at 31 December 2012, the remaining debt to the SNB amounted to USD 4.8 billion (2011: USD 8.1 billion).

In the current year, a positive result of USD 1.9 billion was recorded (2011: USD 69.5 million). For the first time since the fund's establishment, this result is measured at fair value (cf. 'Transition to fair value', p. 181). Equity now amounts to USD 5.5 billion (2011: USD 3.7 billion), which corresponds to 116% of the outstanding loan. As at 31 December 2012, this security cushion, which absorbs any unfavourable portfolio developments, reached the highest level since the establishment of the stabilisation fund.

Additional information

Further information on the stabilisation fund can be found in chapter 6.7 of the accountability report.

2
Stabilisation fund balance sheet and income statement for 2012

BALANCE SHEET AS AT 31 DECEMBER 2012

In USD millions

Assets

	Item no. in Notes	31.12.2012	31.12.2011 Restated	Change
Bank deposits		**486.4**	**396.6**	**+89.8**
Securities (securitised loans)		8 076.7	9 348.0	–1 271.3
Non-securitised loans		1 752.0	2 027.3	–275.3
Real estate	01	81.4	69.7	+11.7
Subtotal investments		**9 910.2**	**11 445.0**	**–1 534.8**
Interest rate derivatives	02	153.1	138.3	+14.8
Credit derivatives	03	11.3	25.5	–14.2
Subtotal derivatives		**164.5**	**163.8**	**+0.7**
Accrued income		40.7	41.3	–0.6
Other assets	03	224.2	232.8	–8.6
Total assets		**10 826.0**	**12 279.5**	**–1 453.5**

Liabilities and equity

	Item no. in Notes	31.12.2012	31.12.2011 Restated	Change
Interest rate derivatives	02	407.1	403.6	+3.5
Accrued interest and expenses		17.4	16.4	+1.0
Other liabilities		0.8	1.4	–0.6
SNB loan	04	4 790.1	8 140.4	–3 350.3
Deferred management fee	05	69.7	56.6	+13.1
Subtotal liabilities		**5 285.2**	**8 618.4**	**–3 333.2**
Paid-in equity	06	3 896.7	3 896.7	–
Foreign currency translation differences		–2.8	–2.4	–0.4
Result, carried forward		–233.3	–302.8	+69.5
Result, current period		1 880.1	69.5	+1 810.6
Subtotal equity		**5 540.8**	**3 661.1**	**+1 879.7**
Total liabilities and equity		**10 826.0**	**12 279.5**	**–1 453.5**

INCOME STATEMENT FOR 2012

In USD millions

	Item no. in Notes	2012	2011 Restated	Change
Net interest income from securities and non-securitised loans		516.5	623.2	–106.7
Net result from derivatives	02, 03	–52.3	–47.6	–4.7
Unrealised valuation gains/losses		1 180.8	–328.0	+1 508.8
Realised valuation gains/losses		459.7	150.1	+309.6
Financing costs		–189.3	–286.9	+97.6
Gross income		**1 915.3**	**110.7**	**+1 804.6**
Foreign tax expenses (–) and tax credits (+)		0.1	0.0	+0.1
Operating expenses		–35.4	–41.1	+5.7
Net income		**1 880.1**	**69.5**	**+1 810.6**

3
Notes to the financial information on the stabilisation fund as at 31 December 2012

GENERAL

Stabilisation fund accounting principles

The stabilisation fund's accounting principles conform to the requirements of the CISA. 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) have been elected as auditors for the stabilisation fund. These disclosures on the stabilisation fund were audited as part of the overall audit of the SNB group.

Transition to fair value

At the time of the stabilisation fund's establishment, no reliable market values were available on a regular basis for its assets. It was therefore decided to apply the amortised cost valuation method.

In the meantime, conditions in the lending and securitisation markets have eased considerably. A number of players strengthened their analytical capacity for assessing the underlying financial claims of securitised financial instruments. Investors and intermediaries have returned to these markets. Both of these factors have contributed to an improvement in the pricing processes. Demand for assets such as the ones the stabilisation fund has in its portfolio has since become quite robust. This is also evidenced by the success of the fund's liquidation strategy. This active sales strategy is better reflected by measuring the fund's assets according to market parameters. Assets are therefore now recorded at fair value in accordance with a decision taken by the Board of Directors of StabFund (GP) AG.

Restatement of prior-year figures

The restatement is presented as though the stabilisation fund's assets had always been recorded at fair value. Therefore, the comparative figures differ from those published in the 2011 financial report.

The value of the assets recorded on the balance sheet was adjusted to reflect their fair value, which was already published in the notes to the previous year's report. Accordingly, total equity for 2011 was corrected by the difference between fair value and amortised cost, i.e. an increase of USD 495.4 million.

The restatement of the income statement, by contrast, does not reflect the entire difference between fair value and amortised cost, but only its annual fluctuation. At the end of 2010, the fair value of the assets was USD 1,483.2 million higher than the value at amortised cost. The difference narrowed by USD 987.8 million to USD 495.4 million as at the end of 2011. The 2011 income statement has therefore been adjusted to reflect this narrowing. The restatement thus results in a drop in the 2011 net income from USD 1,057.3 million to USD 69.5 million.

Valuation difference between amortised cost and fair value

IMPACT OF RESTATEMENT ON BALANCE SHEET AND INCOME STATEMENT AS AT 31 DECEMBER 2011

In USD millions

	31.12.2011 Before restatement	Restatement, cumulative effect on prior-year figures	Effect of 2011 restatement	31.12.2011 After restatement
Assets				
Securities (securitised loans)	8 824.7	+1 312.6	–789.3	9 348.0
Non-securitised loans	2 055.1	+170.7	–198.5	2 027.3
Subtotal investments	10 949.5	+1 483.2	–987.8	11 445.0
Liabilities and equity				
Result, carried forward	–1 786.0	+1 483.2	–	–302.8
Result, current period	1 057.3	–	–987.8	69.5
Equity	3 165.6	+1 483.2	–987.8	3 661.1
Income statement				
Effective interest (less impairments)	644.0	–	–644.0	–
Unrealised valuation gains/losses	15.8	–	–343.8	–328.0
Net income	1 057.3	–	–987.8	69.5

Recording of transactions

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

The transferred assets were recorded at fair value at the date of the actual transfer.

Initial valuation

The assets are valued at fair value. In the case of most assets, these values are available market prices. For part of the portfolio, the fair value is determined based on cash flow projections and comparisons with similar assets. The values supplied by the investment manager are compared once a year with those delivered by an independent valuation agent.

Subsequent valuations

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

Reporting currency

FOREIGN EXCHANGE RATES

Foreign exchange rates

	31.12.2012 In USD	31.12.2011 In USD	Change In percent
1 euro (EUR)	1.3226	1.2979	+ 1.9%
1 pound sterling (GBP)	1.6255	1.5548	+ 4.5%
100 yen (JPY)	1.1585	1.2955	– 10.6%

NOTES TO THE BALANCE SHEET AND INCOME STATEMENT

Item no. 01

The stabilisation fund owns real estate taken over in the course of foreclosure processes. Such properties are initially recognised 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. On the balance sheet date, there were outstanding interest rate swaps in US dollars and pounds sterling.

At the end of 2012, the positive replacement value was USD 153.1 million (2011: USD 138.3 million), and the negative replacement value was USD 407.1 million (2011: USD 403.6 million). These positions are not offset against each other. The contract volume was USD 5.2 billion (2011: USD 5.1 billion).

Item no. 03

The stabilisation fund entered into credit derivative contracts both as protection seller and protection buyer. The credit derivatives mainly comprise credit default swaps (CDS). Holders of CDS use them to protect themselves against default by a borrower. The net result from derivatives includes the income from premiums (or expenses) for these transactions.

The amount to be paid in the event of default (using cash held ready in bank deposits) is regularly recalculated, based on the 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 under 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 1.1 billion (2011: USD 2.0 billion), and the deposited collateral to USD 1.3 billion (2011: USD 2.2 billion). As the collateral is held by the counterparty entitled to exercise claims based on the respective derivatives transaction (and amounts will be settled on a net basis), these amounts were offset against each other. The difference between the negative replacement value of credit derivatives and the cash collateral for all derivatives transactions is stated under other assets.

The positive replacement values are stated under credit derivatives on the assets side of the balance sheet.

In USD millions

	31.12.2012	31.12.2011	Change
Net contract volume	1 929.6	2 823.9	–894.3
Positive replacement value	11.3	25.5	–14.2
Negative replacement value	1 138.9	2 021.3	–882.4
Cash collateral posted	1 327.4	2 209.9	–882.5

LOAN COMMITMENT TO STABILISATION FUND[1]

Item no. 04

In USD millions

	31.12.2012	31.12.2011	Change
USD	3 118.2	6 129.1	–3 010.9
EUR	149.7	360.9	–211.2
GBP	1 334.2	1 418.8	–84.6
JPY	188.0	231.6	–43.6
Total	**4 790.1**	**8 140.4**	**–3 350.3**

1 Without accrued interest.

Item no. 05

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 compensated 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. 06

Paid-in equity represents 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).

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 responsibilities relating to the fund's management and reporting.

Risks

The stabilisation fund's assets mainly include securitised assets in the form of mortgage-backed and other asset-backed securities (MBS and ABS). These are backed by various types of claims (mortgages and other loans). Risks therefore arise 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 the UK.

Interest rate risk plays a minor role. Variable rate instruments 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 strategies.

Since the stabilisation fund is congruently financed in the currencies of the investment portfolio, currency risk is modest. The actual or forecast shifts in the composition of the balance sheet are assessed on a regular basis so as to be able to take action in the event of an increase in currency risk.

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. 03, p. 184) and outstanding irrevocable loan commitments.

In USD millions

	31.12.2012	31.12.2011	Change
Exposure from credit derivatives	806.8	843.0	–36.2
Irrevocable loan commitments	14.7	21.3	–6.6
Total	**821.5**	**864.4**	**–42.9**