Equity Risk Management
Hedging and Monetization Strategies

UBS is the main partner of Alinghi, America’s Cup winner 2003.
I. Introduction

Concentrated Assets — Maximize the Power, Minimize the Risk

High-profile initial public offerings and stock-for-stock acquisitions have left many individuals with an enviable, yet precarious, position of owning large concentrations of a single stock. Unfortunately, the inability to sell — whether due to insider status, capital gains implications or legal restrictions — can make managing the risks associated with these holdings complicated.

In a time when our U.S. equity markets are characterized by unprecedented growth and volatility, how do you protect the value of your large positions and enhance investment flexibility? That’s where UBS can help.

You and us —
A Powerful Partnership

Your circumstances and goals are unlike anybody else’s. At UBS, we take time to find out about your needs and create an equity risk management strategy that makes sense for you. We remain focused on you and how we can best optimize your concentrated equity positions. We utilize strategies which can:

- Protect against declines in stock value
- Enhance returns by “monetizing” a stock position
- Allow for diversification
- Increase borrowing capacity
- Defer costly capital gains taxes

Why UBS?

- Consistently recognized as a leader in Equity Risk Management
- Strength of credit rating (S&P: AA+, Fitch: AA+, Moody’s: Aa2)
  — Peace of mind for our investors
- Globally integrated presence in all major financial markets
  — Some 70,000 employees around the world, 40% in the U.S.
- High caliber and experience of sales team professionals
- Awarded “Best Global Risk Management House” by Euromoney, 2005

UBS is a world-leading financial powerhouse with the heart and soul of a two-person organization. Our Equity Risk Management Team will work hand-in-hand, employing their financial acumen and analytical insight to tailor the best strategy for you.
The Advantages of Equity Risk Management

Equity Risk Management delivers two significant benefits. It allows you to utilize strategies that protect your holdings and, at the same time, enhances investment flexibility.

**Liquidity Strategies Provide Diversification**

Diversification is the key to enhanced investment flexibility. UBS offers solutions that provide access to cash — to buy stock in other companies or simply enjoy life’s rewards. There is no need to sell shares and incur capital gains taxes or surrender the privileges of holding the stock.

**Hedging Strategies Limit Risk**

To limit downside risk, UBS also offers a variety of hedging tools with expertise in execution. We provide a customized strategy designed to meet your unique needs and objectives.

In addition, UBS can create a program that limits potential losses while simultaneously enhancing liquidity.

All of our risk management strategies are structured as over-the-counter (OTC) transactions and are not listed on any options exchange. The OTC option market has the following advantages over listed option markets:

- **Flexibility:** The OTC market provides the ultimate flexibility with regard to determining price and maturity.
- **Liquidity:** The OTC market is as liquid as the liquidity of the underlying stock.
- **European Style:** Exercisable at maturity, there is no risk of early exercise in the OTC market.

The true power of diversification lies in its ability to target an expected return while reducing the exposure to risk. This chart depicts 10 individual stocks and their expected returns and associated volatility. The blue line represents a diversified portfolio holding various combinations of these 10 assets. An investor holding any one of these individual stocks (we’ve used A in our example) would clearly be better off diversifying to create a portfolio that offers the same potential rewards with less risk (point B).
Serving Diverse Investor Needs

Equity Risk Management solutions can accommodate a variety of high net worth investors holding large, concentrated positions. These include:

- **Executives who were bought out for stock**: A company executive, founder or investor of an acquired company who received shares of the acquirer as consideration in a merger transaction.

- **Current or retired executives or employees**: A current or former company executive or employee who has accumulated a large amount of shares.

- **Individuals with leveraged positions**: An individual with an unprotected concentrated equity position who carries margin debt can restructure and eliminate the possibility of margin calls.

- **Initial investors**: Initial investors who own restricted or low-basis shares of an issuer who recently had an initial public offering or a merger transaction.

- **Inheritance**: A family who has owned shares of a company for many years, perhaps even generations.

Equity Risk Management solutions can accommodate a variety of high net worth investors.
You and us. It’s our primary focus at UBS. Our Equity Risk Management solutions are no exception. Here’s a case in point…

A long time investor in United Parcel Service, Inc. (UPS), John had large holdings in the stock, as well as a significant position in FedEx Corp. (FDX). At the time he met with UBS, his holdings were valued at $350 million, with margin debt of nearly $100 million. John was bullish on the long-term prospects of both companies, but was smart enough to realize that a short-term decline might result in a forced liquidation of his stock at depressed prices.

During his initial conversation with UBS, John was shown how the firm could:

• Reduce his existing margin expense by moving the loan to UBS, and
• Reduce the risk of any margin call by hedging some or all of his position with a Maximum Monetization and Asset Protection (“MMAP”) transaction.

This initial discussion was followed by a review, during which UBS evaluated multiple scenarios to determine which strategy most effectively:

• Minimized shares allocated to hedge (to retain upside)
• Eliminated margin call risk
• Significantly reduced financing cost

John’s original intention, to hedge half his FDX and half his UPS, proved to be the most expensive and least effective strategy. The optimal result was to hedge his entire UPS position, which generated the maximum liquidity. UBS expedited John’s strategy, completing his documentation within days of his pending business trip, and acted upon trading instructions to meet John’s objectives. Despite a volatile market, UBS exceeded John’s expectations on the execution of the deal.

UBS was able to add value by:

• Delivering expert and objective ideas
• Focusing on what’s right for the client
• Providing personal service with great attention to detail
• Timely execution

Case History: A Study in Personalization
## II. Equity Risk Management Strategies

### Overview Chart of Equity Risk Management Strategies

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Benefits</th>
<th>Considerations</th>
</tr>
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<tr>
<td>Sale of Position</td>
<td>Generates cash flow</td>
<td>Removes downside risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Recognizes capital gain</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Eliminates upside exposure</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Discounted if shares restricted</td>
</tr>
<tr>
<td>Sale of Covered Calls</td>
<td>Generates cash flow</td>
<td>No tax event until maturity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Provides floor for stock price</td>
</tr>
<tr>
<td>Purchase of Puts</td>
<td>No ceiling on upside exposure</td>
<td>Potentially significant up-front cost</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Does not fully hedge downside risk</td>
</tr>
<tr>
<td>Collars</td>
<td>Can be structured with zero up-front cost</td>
<td>Ceiling on upside exposure</td>
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<td></td>
<td></td>
<td>Upside influenced by option pricing, not the client</td>
</tr>
<tr>
<td>MMAPs</td>
<td>Substantial liquidity generated up-front cost</td>
<td>No tax event until maturity</td>
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<tr>
<td></td>
<td></td>
<td>Provides floor for stock price</td>
</tr>
</tbody>
</table>

Protected stock position facilitates collateralized lending arrangement
Self-financing: No separate loan vehicle required
Summary of Equity Risk Strategies

Remain Unhedged

**Investor Profile**
This strategy may be right for a high net worth individual who is *extremely bullish* on the underlying stock, and who is willing to accept the risk of a dramatic stock price decline.

**Action**
- For the investor holding freely tradable, unrestricted shares, simply sell the shares, pay taxes and reinvest the net proceeds.
- For the investor holding illiquid securities, including restricted stock subject to Rule 144, call options or warrants, there may be possible sale opportunities — UBS may be able to privately purchase restricted securities from non-affiliates at a discount to the current market price, thereby creating immediate liquidity.

**Benefits**
- Cash flow is generated
- Downside risk is removed

**Considerations**
- Creation of a recognized capital gain
- Upside exposure is eliminated
- Sale price may be discounted if shares restricted

Sale of Position

**Investor Profile**
This strategy may be right for a high net worth individual who is extremely bearish and who believes the stock price will likely fall over the medium to long-term.

**Action**
- For the investor holding freely tradable, unrestricted shares, simply sell the shares, pay taxes and reinvest the net proceeds.
- For the investor holding illiquid securities, including restricted stock subject to Rule 144, call options or warrants, there may be possible sale opportunities — UBS may be able to privately purchase restricted securities from non-affiliates at a discount to the current market price, thereby creating immediate liquidity.

**Benefits**
- Cash flow is generated
- Downside risk is removed

**Considerations**
- Creation of a recognized capital gain
- Upside exposure is eliminated
- Sale price may be discounted if shares restricted

Sale of OTC Covered Call Options

**Investor Profile**
This strategy may be right for a high net worth individual who is *mildly bullish* on the underlying asset position and wishes to enhance its “yield.”

**Action**
Implement a strategy of selling OTC covered call options.

**Benefits**
- Cash flow is generated
- No tax event until maturity

**Considerations**
- Ceiling on upside exposure
- Downside risk is not fully hedged

In light of the recent equity market performance, many investors recognize the prudence of protecting at least a portion of their concentrated stock position by pursuing an equity risk management strategy.

Note:
1 See Section V, Tax Considerations.
**Investor Profile**
This may be right for a high net worth individual who is *bullish* on the underlying stock and who does not want to be exposed to unforeseen downward price movements.

**Action**
Implement a strategy of purchasing OTC put options.

**Benefits**
- Upside exposure has no ceiling
- No tax event until maturity
- Provides floor for stock price

**Considerations**
- Potentially significant up-front costs
- Protected stock position facilitates collateralized lending arrangement

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**Investor Profile**
This may be right for a high net worth individual who is *moderately bullish* on the underlying stock, and who wishes to protect the value of the position without paying option premium.

**Action**
Implement a strategy of zero-premium collars.

**Benefits**
- Can be structured with zero up-front cost
- No tax event until maturity (assuming no early unwind)
- Provides floor for stock price

**Considerations**
- Ceiling on upside exposure
- Upside determined by option pricing, not the client
- Protected stock position facilitates collateralized lending agreement

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**Investor Profile**
This may be right for a high net worth individual who is optimistic about the prospects of the stock, but who wishes to protect the value of a concentrated equity position and maximize monetization proceeds and diversification possibilities.

**Action**
Implement a strategy of Maximum Monetization and Asset Protection (MMAP).

**Benefits**
- Substantial liquidity generated up-front
- No tax event until maturity (assuming no early unwind)
- Provides floor for stock price

**Considerations**
- Ceiling on upside exposure
- Self-financing: no separate loan vehicle required

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*Note:
1 See Section V, Tax Considerations.
2 See Section V, Tax Considerations, which contemplates documenting the collar as a single-pay contract.*
III. Strategy Details

Remain Unhedged

The investor who is extremely bullish on the underlying stock and is willing to accept the risk of a dramatic stock price decline should simply do nothing on 100% of their position.

In light of the recent equity market performance, many investors recognize the prudence of protecting at least a portion of their concentrated stock position. Therefore, many investors pursue one of the strategies discussed in this section for at least a percentage of their holdings.

Sale of Securities

Freely Tradable

- The investor who owns freely tradable unrestricted shares and believes the stock price will likely fall over the medium to long-term should simply sell the shares, pay taxes and reinvest the net proceeds.

Illiquid Securities

- Many investors hold illiquid securities including restricted stock subject to Rule 144, call options or warrants and are unaware of possible sale opportunities. In certain situations, UBS may be able to facilitate the sale of restricted securities in the open market.
- UBS may be able to privately purchase restricted securities from non-affiliates at a discount to the current market price, thereby creating immediate liquidity for the investor.
- The amount of the discount is determined primarily by liquidity of the underlying security, borrow costs, market interest rates and the remaining length of the restricted period. Trade date will be the effective sale date, triggering a taxable event for the investor.

Source: Bloomberg, May, 2006
Sale of OTC Covered Call Options

The sale of covered call options is best suited for the investor who is mildly bullish and wishes to enhance the “yield” on the underlying asset position. While the sale of covered calls generates up-front premium income, it should not be considered a hedge of downside risk.

The owner of a European-style call option has the right to buy the stock on a certain date for a pre-determined price (the call strike). The seller of a call option will forego any appreciation above the call strike. When an investor sells calls on shares he/she already owns outright, the calls are “covered.”

For example, the sale of a six-month call option which limits the seller to the first 10% of appreciation might generate a premium of 3%–6%, payable up-front in cash (assuming a zero dividend, moderately volatile stock).

The sale of an out-of-the-money covered call option will not immediately trigger a taxable event. Unlike listed call options, European-style call options may be settled either in cash or physical form, at maturity. Exercise occurs if the final market price is higher than the call strike. With cash settlement, the investor pays to UBS the difference between the call strike and the final market price. For physical settlement, the investor delivers the stock to UBS and receives cash equal to the call strike. Physical settlement is an actual sale of the underlying shares while cash settlement is not.

The graph below assumes an initial price of $100 and the investor received a call premium.

Note:

1 See Section V, Tax Considerations.
The investor who is bullish on the underlying stock but does not wish to be exposed to unforeseen downward price movements should consider the purchase of put options. Purchasing a put option will effectively guarantee a minimum value for the asset. The owner of a European-style put option has the right to sell the stock on a certain date for a pre-determined price (the put strike).

For example, a two-year put option that provides 90% protection may cost 15% to 25% or more, payable up-front in cash (assuming a zero dividend, moderately volatile stock).

The purchase of an out-of-the-money put option will not trigger a taxable event. Unlike listed put options, European-style put options may be settled either in cash or physical form, if exercised at maturity. Exercise occurs if the final market price is below the put strike. With cash settlement, the investor receives from UBS the difference between the put strike and the final market price. For physical settlement, the investor delivers the stock to UBS and receives cash equal to the put strike. Physical settlement is considered a sale of the underlying shares at the put strike while cash settlement is not.

The graph below assumes an initial price of $100 and the investor paid a put premium.

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**Purchase of OTC Put Options***

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**Monetization for Put Options**

The combination of long stock and a put option creates a creditworthy asset. During the life of the put option, UBS will generally lend up to a maximum of 90% of the protected value (the put strike) for non-purpose credit on unrestricted shares. If the loan is to be used for purpose credit (the purchase of margin securities) the maximum loan amount is restricted to 50% of the market value of the underlying stock at the time of borrowing.

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Note:

1 See Section V, Tax Considerations.
Zero-Premium Collars

The investor who is moderately bullish but wishes to protect the value of a particular equity position without paying option premium should consider an equity collar. Many investors like the protection afforded by the purchase of a put option but do not wish to pay the up-front premium required. If willing to forego appreciation above a certain level, the investor can sell a call option to generate premium income.

When the cost of purchasing a put option is fully funded by selling a call option, the transaction is referred to as a “zero-premium collar.”

During the life of the collar, the investor retains ownership, voting rights, and dividends (however, often capped at the current level on trade date) on the underlying shares.

For example, an investor owns stock with a market price of $100 and wants to limit his downside risk to 10%.

The investor purchases a two-year European-style put option with a strike price of $90 and simultaneously sells a two-year European-style call option with a call strike of $120 (the calculated level necessary to generate call premium income which fully offsets the put premium cost). For $0.00 out-of-pocket cost, the investor’s exposure is protected at $90 and below, capped at $120 and above, and fully exposed in between.

Capped
If stock finishes above call strike, investor pays UBS (final price less $120) at maturity

Investor retains first $20 of appreciation...

and is exposed to first $10 of depreciation.

Protected
If stock finishes below put strike, UBS pays investor ($90 less final price) at maturity

At maturity, if the final price is at or between $90 and $120, both the call and put options expire without value and there are no payments.

Note:
1 See Section V, Tax Considerations, which contemplates documenting the collar as a single-pay contract.
Zero-Premium Collars
Continued from previous page.

Many tax advisors have the opinion that entering into a zero-premium collar which has at least a 15% to 20% spread between the call strike and put strike will not create a taxable event. As with separate put and call options, the zero-premium collar may be cash or physically settled.

Monetization of Zero-Premium Collars
Since the collar protects the underlying stock, it becomes a very credit-worthy asset, thus, combining a loan with a collar will provide monetization and an opportunity for diversification.

During the term of the zero-premium collar, UBS will generally lend up to a maximum of 90% of the protected value (the put strike) for non-purpose credit (i.e., for the purchase of investments other than margin securities). If the loan is to be used for purpose credit (i.e., the purchase of margin securities) the maximum loan amount will be limited to 50% of the market value of the underlying stock at the time of borrowing. Investors seeking more than 50% should consider the MMAP transaction described on the following page.

Based on the prior example, the $90 put strike would allow for a maximum loan amount of $81 for non-purpose credit (assuming unrestricted shares are hedged) and $50 for purpose credit.

There is no risk of a margin call when a non-purpose loan is secured by a zero-premium collar.
Maximum Monetization and Asset Protection (MMAP)\textsuperscript{1}

The MMAP transaction, generically known as a variable pre-paid forward sale, is the most common method of hedging and monetizing used today. The MMAP is best suited for the investor who is optimistic about the prospects for their stock, but wishes to protect the value of a concentrated equity position and maximize their monetization proceeds and diversification possibilities.

Rationale of the MMAP
Enables investors to:
• Hedge the position
• Maintain upside exposure (as defined by the client)
• Extract up to 90% of the stock value in cash \textit{without selling the underlying shares}. The cash advanced to the client is tax deferred and can be used for any purpose. Typical objectives include diversification or elimination of margin debt.

Components of the MMAP Discount
The up-front discount of the MMAP is made up of three components:

1. \textit{Cost of Funds}: present-value discount of the Lower Strike over the term
2. \textit{Cost of Hedge}: credit or debit attributed to an equivalent collar priced with Lower and Upper Strikes of the MMAP
3. \textit{Dividend Yield}: present-value of any dividend cash flows are debited

Cash Flows of the MMAP
The cash flows of the MMAP are as follows:

• \textit{Trade Date}: Client receives discount to the current stock price by agreeing to deliver a variable amount of the underlying stock (or equivalent cash amount) at the maturity date.

• \textit{Maturity}: Client delivers variable amount of underlying shares (or equivalent cash amount) per the settlement scenarios illustrated in the following page.

Note: \textsuperscript{1} See Section V, Tax Considerations.

\textit{Continued on following page.}
### Maximum Monetization and Asset Protection (MMAP)

The example shown here illustrates the settlement for an investor who has hedged 100,000 shares of a $100 stock and received $85 up-front in a MMAP transaction. The investor chose a Lower Strike of $100 and an Upper Strike of $140 to retain up to $40 per share in value at maturity.

- If the investor chooses **cash settlement**, the investor will pay the amount in Column C.
- If the investor chooses **physical settlement**, the investor will deliver the number of shares in Column B, while retaining the number of shares in Column D.

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stock price at maturity ($)</strong></td>
<td><strong>Number of shares investor delivers</strong></td>
<td><strong>Value of shares delivered/cash settlement amount ($)</strong></td>
<td><strong>Number of shares investor retains</strong></td>
<td><strong>Value of retained shares ($)</strong></td>
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Unlike the collar, the MMAP transaction requires no separate loan facility to generate liquidity. Monetization for the MMAP comes via the up-front advance.

In the example on the previous page, the investor receives an advance amount of $85. Thus, in this example, the MMAP provides 70% more liquidity than the collar for investment in publicly traded equities ($85 for the MMAP vs. $50 for the collar).

### Comparative Analysis: MMAP vs. Collar with Loan

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<tr>
<th>Concentrated Equity Position</th>
<th>MMAP</th>
<th>Collar with Loan</th>
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</thead>
<tbody>
<tr>
<td>Asset Protection</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>Available Proceeds</td>
<td>Up to 90% — dependent on upside retained</td>
<td>50% of market value (purpose credit) 90% of put strike value for unrestricted shares (non-purpose credit)</td>
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<tr>
<td>Maintain Current Dividend (capped)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Collateral Required</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Tax Deferral</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Retain Appreciation</td>
<td>Yes — determined by client (capped)</td>
<td>Yes — determined by option pricing (capped)</td>
</tr>
<tr>
<td>Maintain Ownership</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Ongoing Interest Payments</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Margin Calls</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Separate Loan-Paperwork</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

*Continued on following page.*
The MMAP vs. Sale after-tax analysis is based on a hypothetical assumption of a three-year 100/140% MMAP which raises 85% up-front on a stock with a $0.00 tax basis. This transaction is compared against a sale of the same stock. The after-tax analysis is summarized as follows:

- **Breakeven**: This is the annual stock growth required for the MMAP transaction to be the same as a sale on an after-tax basis. For this example, the stock would have to grow by approximately 4.2% for the MMAP and sale after-tax performance to be identical.

- **MMAP Outperformance**: The dark green shaded area represents the after-tax MMAP outperformance over a sale if the annual stock growth exceeds 4.2%. The maximum absolute outperformance for this example is $2mm.

- **Sale Outperformance**: The area shaded light green represents the after-tax sale outperformance over the MMAP if the annual stock growth is less than 4.2%. This illustration shows the maximum underperformance for the MMAP is under $1mm regardless of how low the underlying stock falls.
What is “equity risk management?”
Equity risk management, or stock hedging, is a way for investors to reduce and manage price risk in concentrated stock positions. Although holding a stock position without interruption may have resulted in significant net worth, it is prudent to explore strategies to reduce risk in the biggest component of an investors’ net worth, and review methods to create liquidity in a tax-efficient manner.

Can I “roll” into a new MMAP at maturity?
Generally, yes. Many investors who elect to deliver cash and retain their stock will raise the cash by entering into a new transaction at maturity. As the stock price rises, the lower and upper limit prices will be reset at the newer, higher levels, and the investor will receive a new up-front payment. This payment will be credited against his obligation from the original transaction (usually with a slight debit or credit) and allow him to maintain ownership of the stock.

Is there a minimum dollar contract value?
The target minimum transaction value is $2 million in a single stock position. UBS can, however, entertain transactions as low as $1 million in certain instances (i.e., unrestricted stock held individually by a non-affiliate of the issuer).

How does UBS set up their hedge?
We will first establish our hedge by selling short shares into the market. In order to sell stock short UBS will borrow shares from the market to deliver to a buyer.

Buying a put, selling a call — can’t I do this on my own?
Yes, to some extent. Investors can purchase and sell listed put and call options, but both the collar and MMAP are customized transactions that involve private, over-the-counter (OTC) European-style options. These options are not exercisable until maturity, which eliminates the risk that the investor’s stock would be called away during the transaction. OTC options will also provide the flexibility of cash or physical settlement, customized maturity and strike prices. Finally, investors would also be unable to replicate the MMAP transaction since no similar financing vehicle exists for listed options.

Who receives dividends and retains voting rights?
If the underlying stock pays a dividend at the time the hedge is executed, the investor will determine whether he or UBS will receive it. Most investors elect to receive stock dividends and cap them at their current levels. If the investor elects to cap the dividends at their current levels, the investor will be obligated to pay to UBS any dividends it receives above that cap. Any dividends received in a hedging contract are not considered to be “qualified income” and therefore not eligible to receive the favorable 15% tax rate.

In the MMAP, I receive cash and my stock is posted as collateral — how is this different from a margin loan?
The MMAP strategy differs from a margin loan in many ways. First, margin provides no downside price protection. In fact, if the stock price falls, there is a substantial risk of a margin call and the stock being sold. If an investor is seeking liquidity for diversification, margin will also limit “purpose” borrowing to 50%, and may force an investor to accept a higher, floating interest rate that requires regular debt service. In contrast, the MMAP protects the investor’s stock position, provides a low, fixed cost of funds, and allows investors to receive up to 90% of value for reinvestment.

Can employee stock options be hedged?
Both incentive stock options (ISO) and non-qualified stock options (NQSO) present collateral issues. Since options are merely a contractual right between a company and an employee, UBS is unable to perfect its security interest. An alternative collateral arrangement would be necessary.

Can stock held in a 401(k) or IRA be hedged?
No. Prevailing interpretations of ERISA hold that such stock may not be pledged.
V. Tax Considerations

Applicable Tax Legislation and Straddle Rules

Jobs and Growth Tax Relief Reconciliation Act of 2003
On May 28, 2003 President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the “Tax Bill”). The most widely publicized aspects of the Tax Bill are the reduction in the maximum long-term capital gains tax rate (from 20% to 15%), the reduction of the ordinary and short-term capital gains rates (from 38.6% to 35%) and the reduction of the maximum tax on cash dividends paid to individuals (from 38.6% to 15%). These changes affect stock hedging strategies minimally.

If a client hedges a stock that pays a dividend with any hedging transaction other than a “qualified covered call,” the prevailing tax opinion is investors would not receive the new beneficial tax treatment on dividends.

Taxpayer Relief Act of 1997
The Taxpayer Relief Act of 1997 (the “Act”) was signed into law on August 5, 1997 and included a number of points relating to equity risk management transactions. The Act specifically defines a Constructive Sale as a taxable event. Four types of transactions where both upside potential and downside risk are eliminated were clearly outlined as Constructive Sale transactions, including: “Short-Against-the-Box,” offsetting notional principal contracts, forward contracts to deliver a “substantially fixed” amount of property for a “substantially fixed” price, and a long purchase by an investor who has an appreciated “short” position.

Prevailing industry opinion has taken the view that puts, calls, collars and MMAPs are not constructive sales as long as the investor is subject to some element of risk or reward on the equity position. Factors that may be relevant in determining whether a constructive sale has occurred include the amount of retained economic exposure, use of client borrowing and allocation of dividends.

Straddle Rules
A tax straddle is defined as holding offsetting positions with respect to personal property which is actively traded. The IRS regulations of May 1, 1995, expanded the definitions of “personal property” to include stock positions, as well. The following points summarize the consequences of straddle characterization:

• **Holding period more than one year:** If one position is long-term when the straddle (hedge) is entered into, any loss in either position is taxed as a long-term capital loss. Any gain on closing out the offsetting position is taxed as a short-term capital gain.

• **Holding period less than one year:** If the shares are short-term when the straddle (hedge) is entered into, the holding period of the shares is eliminated and does not begin again until the offsetting position of the straddle is closed. Capital gain or loss from either straddle position is taxed as short-term.

• Any loss realized on closing out one leg of a straddle position is deferred until the offsetting leg of the straddle is also closed and the gain/loss is recognized.

• If the client borrows money against the straddle position, interest paid on the loan is capitalized (if otherwise deductible). The amount of interest subject to capitalization is limited to the excess of interest paid over dividends received on the position securing the loan.

Clients should seek their own counsel for tax, accounting and legal advice in light of their own particular circumstances.
Tax Consequence Scenario Analysis

Collar

Collar Assumptions:
- Client has 100,000 shares of ABC; held greater than one year (i.e., long term)
- Client’s cost basis in stock is $0
- ABC currently trading at $100 per share

Note:
1 Assumes collar treated as a “single-pay” collar. Bifurcated put and call options to construct the collar is also available, but not illustrated in this example.

For tax purposes, LT = Long Term and ST = Short Term

<table>
<thead>
<tr>
<th>Physical Settlement</th>
<th>Tax Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock finishes below the Lower Threshold (i.e., $70)</td>
<td>• Client delivers all shares to UBS and receives $90 per share</td>
</tr>
<tr>
<td>Stock finishes between the Lower and Upper Threshold (i.e., $110)</td>
<td>• No sale of stock occurs</td>
</tr>
<tr>
<td>Stock finishes above the Upper Threshold (i.e., $140)</td>
<td>• Client delivers all shares to UBS and receives $120 per share</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash Settlement</th>
<th>Tax Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock finishes below the Lower Threshold (i.e., $70)</td>
<td>• Client retains all shares and receives $20 from UBS</td>
</tr>
<tr>
<td>Stock finishes between the Lower and Upper Threshold (i.e., $110)</td>
<td>• No sale of stock occurs</td>
</tr>
<tr>
<td>Stock finishes above the Call Strike (i.e., $140)</td>
<td>• Client retains all shares and pays $20 to UBS</td>
</tr>
</tbody>
</table>

Continued on following page.
### Tax Consequence Scenario Analysis

*Continued from previous page.*

**MMAP**

**MMAP Assumptions:**
- Client has 100,000 shares of ABC; held greater than one year (i.e., long-term)
- Client's cost basis in stock is $0
- ABC currently trading at $100 per share
- Client executes a 36-month MMAP transaction on $10mm notional
  - Lower Strike is $100
  - Upper Strike is $140
  - Client receives up-front proceeds of 85% of notional or $8.5mm
- Gain on stock is measured by up-front proceeds less cost basis in stock delivered at settlement

<table>
<thead>
<tr>
<th>Physical Settlement</th>
<th>Tax Implications</th>
</tr>
</thead>
</table>
| Stock finishes below the Lower Strike (i.e., $70) | • Client delivers 100% of Stock = 100,000 shares
  • Gain on Shares = Up-front proceeds – Cost Basis
    = $8.5mm – $0 = $8.5mm LT Capital Gain on 100,000 shares |
| Stock finishes between the Lower and Upper Strikes (i.e., $110) | • Client delivers stock worth original notional value
  = $10.0mm / $110 per share = 90,909 shares
  • Gain on Shares = Up-front proceeds – Cost Basis
    = $8.5mm – $0 = $8.5mm LT Capital Gain on 90,909 shares |
| Stock finishes above the Upper Strike (i.e., $150) | • Client delivers stock worth original notional value plus amount above upper strike
  = ($10mm + $1mm) / $150 per share = 73,333 shares
  • Gain on Shares = Up-front proceeds – Cost Basis
    = $8.5mm – $0 = $8.5mm LT Capital Gain on 73,333 shares |

<table>
<thead>
<tr>
<th>Cash Settlement</th>
<th>Tax Implications</th>
</tr>
</thead>
</table>
| Stock finishes below the Lower Strike (i.e., $70) | • Client delivers cash value of 100% of Stock
  = 100,000 shares x $70 per share = $7.0mm
  • Gain on MMAP = Up-front proceeds – payment at settlement
    = $8.5mm – $7.0mm = $1.5mm ST Capital Gain |
| Stock finishes between the Lower and Upper Strikes (i.e., $110) | • Client delivers original notional value = $10.0mm
  • Loss on MMAP = Up-front proceeds – payment at settlement
    = $8.5mm – $10.0mm = $1.5mm LT Capital Loss (Deferred) |
| Stock finishes above the Upper Strike (i.e., $150) | • Client delivers original notional value plus amount above upper strike
  = $10mm + $1mm = $11.0mm
  • Loss on MMAP = Up-front proceeds – payment at settlement
    = $8.5mm – $11.0mm = $2.5mm LT Capital Loss (Deferred) |

For tax purposes,
LT = Long Term and ST = Short Term
VI. Legal and Regulatory Issues

Rules 144 and 144(k)

The Securities Act Of 1933
The Securities Act of 1933 requires that every offer to buy or sell securities that is made in or through the United States be registered unless an exemption is available. Private transactions and regular secondary market transactions are exempt from registration. The primary objective of the 1933 Act is to promote accurate and complete disclosure about the Issuer to investors. Disclosure is required to be included in the registration statement filed with the Securities Exchange Commission (SEC) and in the prospectus. The 1933 Act also enhances scrutiny of this disclosure by Issuers, underwriters and certain selling shareholders by imposing liability should the disclosure be materially defective.

While secondary market transactions are generally exempt from registration, the 1933 Act and the rules and regulations of the SEC do impose restrictions on certain transactions including: (i) affiliate transactions, (ii) sales of securities acquired in public stock-for-stock mergers/acquisitions by persons that were affiliates of the acquired or target company and (iii) sales of securities acquired in private transactions that are subject to certain resale limitations.

Rule 144
Rule 144 under the Securities Act of 1933 permits holders of “restricted” (unregistered) securities and “control” securities (securities purchased in the open market by an officer or control person of the underlying company) to sell those shares in the open market without filing a registration statement prior to the sale, provided certain SEC conditions are met:

- **Holding Period:** Restricted securities must have been fully paid for and held for at least one year before they can be sold to the public. (Holders may “tack” the holding period of prior holders if they are unaffiliated with the issuer. If, however, the holder is an affiliate, then a new holding period commences for the purchaser.) Control Securities are not subject to the Holding Period requirement.
- **Volume:** The number of shares sold in any three-month period may not exceed the greater of (i) 1% of the shares outstanding or (ii) the average weekly volume as calculated over the four full weeks prior to the filing of the notice of sale. (This is also known as the “dribble-out provision.”)
- **Manner of Sale:** All sales under Rule 144 must be in unsolicited broker’s transactions or transactions directly with a market maker.
- **Public Information:** Adequate current public information is available regarding the Issuer.
- **Notice:** Notice of sale is filed on Form 144 with the SEC and the principal exchange on which the Issuer’s stock is listed. Forms are valid for 90 days from their filing date. The notice of sale should be filed for the full share amount when the sell order is placed.

Rule 144(k) – Restricted Securities
Rule 144(k) provides an exemption for the sale of securities that have not been registered and have been held for at least two years by shareholders who are not an affiliate or control person of the Issuing company. These securities can be sold without the volume or manner of sale limitations required under Rule 144.

Clients should seek their own counsel for tax, accounting and legal advice in light of their own particular circumstances.
Rule 145

Rule 145 applies to merger transactions involving a shareholder vote or consent and payment in securities issued pursuant to a registration statement under Rule 145, persons who are “affiliates” with the target or the acquirer are deemed underwriters of securities received and may resell those securities only pursuant to a registration statement or the resale provisions in Rule 145(d).

Rule 145(d) permits resales if the following conditions are met:

- **Public Information:** Adequate current public information is available regarding the Issuer for the first two years from the date of the merger.
- **Volume:** For the first year following the merger, the number of shares sold in any three-month period may not exceed the greater of (i) 1% of the shares outstanding or (ii) the average weekly volume as calculated over the four full weeks prior to the filing of the notice of sale.
- **Manner of Sale:** For the first year following the merger, all sales under Rule 145 must be in unsolicited broker’s transactions or transactions directly with a market maker.

For non-affiliates of the issuer, after year one all restrictions lapse except the public information requirement. After year two, all restrictions lapse.

Holders who are affiliates of the issuer continue to be subject to the requirements of Rule 144 as they apply to control securities for as long as they remain affiliates.

### Summary Table of Rules 144, 144(k) and 145

<table>
<thead>
<tr>
<th>Rule</th>
<th>Hold Period</th>
<th>Public Information</th>
<th>Volume Limitations</th>
<th>Manner of Sale</th>
<th>Notice of Sale</th>
</tr>
</thead>
<tbody>
<tr>
<td>144 – Restricted Stock</td>
<td>1 year</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>144 – Control Stock</td>
<td>None</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>144(k)</td>
<td>2 years</td>
<td>Not required</td>
<td>No limits</td>
<td>Not required</td>
<td>Not required</td>
</tr>
<tr>
<td>145</td>
<td>None</td>
<td>Yes (for two years from date of merger)</td>
<td>Yes (for one year from date of purchase)</td>
<td>Yes (for one year from date of purchase)</td>
<td>Not required (unless an affiliate)</td>
</tr>
</tbody>
</table>

Note:

1 Control securities are purchased in the open market by an officer or control person of the underlying company. Control securities are identified by the individual who owns them, usually, a control person or affiliate of the issuer. Although they do not bear a restrictive legend, they are considered “control stock” and are subject to Rule 144 requirements.
Considerations for Insiders

Section 16(a) Reporting Requirements
Under Section 16(a) of the Securities Exchange Act of 1934, every officer or director of an Issuer and every beneficial owner of more than 10% of a class of equity security ("Insiders") must file reports (Forms 3, 4 and 5) electronically with the SEC. All acquisitions, dispositions, non-exempt exercise of options and other derivative securities as well as acquisitions and dispositions of the underlying security are changes in beneficial ownership for Section 16 purposes. Change of ownership must be reported by the person conducting the transaction by the second day following the change in ownership. Effective June, 2003, Issuers must provide an electronic link to all Section 16 reports.

Section 16(b) Short Swing Profit Disgorgement
Section 16(b) of the 1934 Act refers to any "profit" by an Insider from any purchase and sale, or sale and purchase, of any equity security of the Issuer (including non-exempt options and other derivative securities) within any six-month period. This "profit" could be the net positive difference between the prices of any such buy and sell transactions, or the earning of premium from the sale of any option that expires worthless within a six-month period. In such cases, the Insider must "disgorge" to the Issuer such net positive difference or such premium.

Buying a put, selling a call and other derivative securities that benefit the Insider as the underlying stock declines in value are considered "put equivalent positions" or sell transactions for pairing purposes. Certain derivative hedges may create unexpected "buy" transactions for purposes of Section 16(b) (i.e., cash settlement of long put/short call positions). Such "buy" transactions may be paired with "sell" transactions in the underlying securities as well as with derivative "sell" transactions requiring disgorgement to the Issuer. Physical settlement of these derivative hedges will mitigate this issue.

Section 16(c) Short Positions
Section 16(c) prohibits Insiders from holding open short positions. However, certain equity derivative transactions are permitted as hedges to long positions. Section 16(c) restricts insiders from holding net short positions (i.e., Insiders cannot hedge more common shares than they own outright).

Note:
1Form 3: This form must be filed upon becoming an Insider.
Form 4: This form must be filed for any changes in ownership or equity interest.
Form 5: An annual notification which must be filed declaring what interests an Insider has in the company during the year and any changes that took place.
Rule 10b5-1

Most corporations limit the frequency and timing of insider sales — often impeding the ability of employees to adequately hedge concentrated equity positions. The SEC adoption of Rule 10b5-1 potentially provides company insiders greater freedom in implementing hedging and diversification strategies.

- Purchase or sale of securities is illegal "on the basis" of insider information
- Rule 10b5-1 precisely defines "on the basis of" and provides an affirmative defense to selling during periods of material nonpublic information
- An insider's transaction is not "on the basis" of insider information if prior to becoming aware of the information the person had established a selling plan

Benefits of Rule 10b5-1

- Corporations may permit insider selling outside of traditional window periods, even when employee later becomes aware of inside information
- Insiders gain increased flexibility to implement hedging and diversification strategies
- Clearer defenses to insider trading lawsuits are established

Benefits of Implementing a Rule 10b5-1 Transaction Plan

- Provides an alternative defense against Federal insider trading lawsuits
- Offers an opportunity to execute more frequent transactions through the year
- Minimizes exposure to price fluctuations during window periods
- Minimizes market impact associated with insiders selling only in window periods
- Minimizes signaling impact often associated with insider transactions

Previous Insider Selling Timeline

Insider/employee stock sales are generally restricted during blackout periods, with one important caveat: awareness of material non-public information prevented the ability to sell during that time period.

Current Insider Selling Timeline

Companies may now permit insider sales both during blackout periods and during times of material insider knowledge, provided a selling plan is established during an open trading window and without prior knowledge of inside information.

Steps to Pursuing a Rule 10b5-1 Transaction Plan

- Insider and UBS Securities create customized selling/hedging instructions in compliance with both the corporation's trading policies and Rule 10b5-1 (when the corporate insider is not aware of material nonpublic information and inside a trading window)
- The 10b5-1 selling/hedging plan may involve multiple trades at pre-determined intervals
- UBS Securities executes trades of insider's securities pursuant to the customized trading plan
- Any transaction proceeds are delivered from UBS Securities to the insider's account as trades are executed

Further Considerations

- Legal counsel and corporate policies should be consulted in creating a 10b5-1 transaction strategy
- Rule 10b5-1 provides an affirmative defense (but not a safe harbor) against Federal insider trading lawsuits. State laws must be considered on a case-by-case basis
- Modification or early termination of a Rule 10b5-1 transaction plan may weaken the affirmative defense
- Public disclosure of the transaction plan may be required for certain insiders
Additional Issues and Eligibility

Section 13  Disclosure for 5% Holders
All individuals, corporations, partnerships or other entities who are beneficial owners of 5% or more of the common stock of a publicly traded corporation in the U.S. must disclose that ownership stake by filing a Schedule 13D or 13G with the SEC within 10 days after such acquisition. They must also describe their intention (investment purposes or desire to influence or control management.) Furthermore, beneficial ownership of warrants, convertible securities and other rights to acquire stock that are currently exercisable (or that will become exercisable within six months, or were acquired for control purposes) are also treated as beneficial ownership of the underlying securities. Once an investor is a Form 13 filer, all changes in ownership (including hedging activities) must be reported promptly in an amended filing.

Rule 701 Stock
If a client acquired stock through a compensatory benefit plan such as purchase, savings, option, bonus, stock appreciation, profit sharing, thrift, incentive, pension or similar plan, those shares might be sold under Rule 701.

The following requirements apply to the sale of restricted shares under Rule 701 for:

Non-Affiliates
• The stock can be sold 90 days after the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Exchange Act of 1934

Affiliates
• The company must meet the same current public information requirements of Rule 144
• The volume limitations of Rule 144

Eligibility Requirements
Any investor seeking to execute over-the-counter derivative transactions with UBS must be an “accredited investor.” An accredited investor (either alone or jointly with his or her spouse) must have net worth in excess of U.S. $1 million or have income over $200,000 ($300,000 if joint) per year for the past two years. Over-the-counter option transactions are carried out as private placements and are not registered under the Securities Act of 1933.

Certain products may be offered only to investors who are “eligible contract participants” under the Commodities Exchange Act. An individual is an eligible contract participant if he or she has total assets in excess of (i) $10,000,000 or (ii) $5,000,000 if the transaction is entered into to manage the risk associated with an asset or liability of the individual.

Note:
1 Schedule 13D is for any person or group of persons who acquire a beneficial ownership of more than 5% of a class of registered equity securities. Schedule 13G is a much more abbreviated version of Schedule 13D. It is only available for use by a limited category of “persons” (such as banks, brokers/dealers, and insurance companies) and even then only when the securities were acquired in the ordinary course of business and not with the purpose or effect of changing or influencing the control of the issuer.
A Global, Integrated Financial Services Firm

Investment Bank
UBS’s Investment Bank is one of the world’s leading firms in the investment banking and securities business, providing a full spectrum of services to institutional and corporate clients, governments and financial intermediaries. Its salespeople, research analysts and investment bankers provide products and services to the world’s key institutional investors, intermediaries, banks, insurance companies, corporations, sovereign governments, supranational organizations and private investors. For both its own corporate and institutional clients and the individual clients of other parts of UBS, the Investment Bank provides product innovation, research and advice, and comprehensive access to the world’s capital markets.

Wealth Management
With more than 140 years of experience, an extensive global network that includes one of the largest private client businesses in the US, and more than CHF 1,700 billion in invested assets, UBS is the world’s leading wealth management businesses, providing a comprehensive range of services customized for wealthy individuals, ranging from asset management to estate planning and from corporate finance to art banking.

Global Asset Management
The Global Asset Management business is one of the world’s leading asset managers, providing traditional and alternative investment solutions to financial intermediaries and institutional investors. The breadth, depth and scope of its varied investment capabilities enable it to offer innovative solutions in nearly every asset class. Invested assets totaled CHF 801 billion on March 31, 2006, making it one of the largest global institutional asset managers, the second largest mutual fund manager in Europe, and the largest mutual fund manager in Switzerland.

Awards

Best Global
Risk Management House
Euromoney, 2005

No. 1 Distributor of
Global Equities
(Secondary Cash)
Leading Private Industry Survey
2005–2002

No. 1 Trader on the
New York Stock Exchange
NYSE broker volumes

No. 1 Share Trader in
NASDAQ stocks
Autex 2005

No. 1 Global Equity Derivatives
for Corporates
Risk 2006–2005

No. 5 All-America Research Team
Institutional Investor 2005
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This publication provides a general overview of each of the topics addressed, and includes a general description of certain of the U.S. legal, tax and accounting considerations that may affect the transactions described herein. The descriptions of such matters are necessarily general, do not address the situation of a particular client and do not purport to be complete. UBS Securities does not provide legal, tax or accounting advice. Clients should seek their own counsel for tax, accounting and legal advice in light of their own particular circumstances.

The investment strategies outlined in this report involve inherent risks and are not appropriate for every investor. Some or all of the strategies may involve transactions in derivatives, including futures and options. You should refrain from entering into such transactions unless you fully understand the terms and risks of the transactions, including the extent of your potential loss, which can be equal to, or in certain instances greater than, the full amount of your initial investment. Over the counter (“OTC”) transactions are not traded on an exchange or cleared by a clearinghouse. Your counterparty in an OTC transaction would be the Firm or an affiliate of the Firm.

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