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Letter of Comment No: 234
File Reference: 1102-001
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January 31, 2003

RE: Comparison of Statement 123 and the Proposed IFRS (File Reference no. 1102-001)

Dear Ms. Bielstein:

UBS AG is pleased to have the opportunity to comment on the comparison of FASB Statement 123, *Accounting for Stock-Based Compensation*, and the IASB Proposed IFRS, *Share-based Payment*. UBS AG listed its global registered shares on the New York Stock Exchange in May 2000. UBS AG utilizes International Accounting Standards ("IAS") as its primary reporting framework, and provides a reconciliation to US GAAP. We are thus keenly interested in the work of the IASB and the FASB and cognizant of the need for high quality accounting standards, which facilitate the international comparability of financial statements. As UBS reports under both IAS and US GAAP we maintain a heightened awareness of the similarities and difference between the two standards and therefore, strongly support the joint efforts of the IASB and the FASB to work towards convergence.

We agree with both the IASB and the FASB that recognizing the fair value of equity compensation awards is appropriate. While we agree that Statement 123 and the Proposed IFRS are based on the same fundamental concept, fair value measurement recognized in the income statement, we acknowledge that the two standards vary significantly in the methods used to achieve this result. We agree with the FASB's conclusion that the amounts and timing of expense recognition could differ substantially between the two when applied to the same transaction. In the current global economy such varied results will hinder rather than improve financial reporting, as investors will be unable to compare the financial statements of similar companies. As such, we believe that convergence on this issue is of significant importance.

Overall, we support the Statement 123 approach to accounting for share-based payments. We strongly support the concept of "issuance" as defined by the FASB and agree that an award should only be considered "issued" when all of the requirements for receipt have been completed. We fully support the FASB's treatment of cancellations and forfeitures and believe that the expense recognized should reflect the economic outflows of the entity.

January 31, 2003

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We strongly disagree with the IASB's service based approach. The proposed units of service method creates an anomaly in the reported compensation expense as the amount booked will vary widely based on an entity's estimated forfeitures. We disagree with the IASB requirement to continue to record expense for cancelled awards and not to adjust compensation expense for forfeited awards. This approach does not accurately reflect economic reality, and will be difficult for investors to interpret and understand.

We agree with both the IASB and the FASB that share-based awards issued to employees should be measured at the grant date. However, we believe that grant date measurement should be extended to all share-based awards. We believe that grant date measurement should be used for both employee and non-employee transactions irrespective of whether the fair value of the award is measured by reference to the goods/service received or the equity instruments granted. We believe that it is reasonable to presume that the full value of the economic benefits to be received in exchange for equity instruments granted are contemplated by the entity and the counterparty at the time the arrangement was entered into. As such at the grant date the monetary value of the economic benefits to be received is substantially equal to the fair value of the equity instruments granted.

We have included our responses to the specific questions raised in the Invitation to Comment on the *Primary Similarities and Differences Between SFAS 123 and the Proposed IFRS* in Appendix A.

We very much appreciate the opportunity to comment. If you would like to discuss any comments that we have made, please contact us at your convenience. Your contacts on the subject are Robert Mills, Managing Director (203-719-7789) and John Gallagher, Executive Director (203-719-4212).

Yours sincerely,

UBS AG

Robert Mills
Managing Director
CFO Americas
Regional Operating Officer

William Widdowson
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Appendix A

Issue 1: Statement 123 provides a scope exclusion for ESOPs and certain ESPPs, and the Proposed IFRS does not. Which view do you support and why?

Answer: We support the FASB's view to exclude ESOPs and ESPPs from the scope of Statement 123. The purpose of ESOPs and ESPPs are to promote employee stock ownership and are not viewed by the entity or its employees as compensatory. The discount received by employees typically offsets the costs, such as underwriting or brokerage fees, and replicates the capital structuring discount that would be required by an issuance of similar size if an entity were to publicly issue the shares. As such, we recommend that the IASB revise the Proposed IFRS to exclude ESOPs and ESPPs from its scope.

We acknowledge the IASB's difficulty in specifying a scope exclusion due to problems in defining what constitutes a "small" discount in a principles based approach. However, from a practical standpoint, we believe that a specific scope exclusion for ESPPs would be beneficial as it would promote consistency in the application of this standard and reduce the operational difficulties of having to support on a continuous basis the fact that the amounts in question are immaterial. We believe that the conditions that the FASB requires for ESOPs and ESPPs to be excluded from the scope of Statement 123 are reasonable and should be included in a final IAS standard. We urge the FASB and IASB to converge on this issue.

Issue 2: In measuring the fair value of stock options granted to employees, both Statement 123 and the Proposed IFRS require use of an option-pricing model that takes into account six specific assumptions. The standards provide supplemental guidance for use in selecting those assumptions

Issue 2(a): Do you believe that an accounting standard should mandate the use of an option-pricing model for measurement purposes? If not, what other approaches do you believe would provide more consistent and reliable estimates of the fair value of employee stock options granted and why?

Issue 2(b): If you agree that an accounting standard should mandate the use of an option-pricing model, do you believe that a particular model should be mandated? If so, which model should be required to be used and why?

Issue 2(c): If you agree that an accounting standard should not mandate the use of a particular option-pricing model, do you believe that additional disclosures should be made to improve the user's ability to compare the reported financial results of different enterprises? If so, what types of additional information should be required to be disclosed?

Issue 2(d): Statement 123 and the Proposed IFRS require that certain modifications be made to the outcome of an option-pricing model to address certain features of employee stock options. If you believe that other modifications should be made to improve the consistency and reliability of those outcomes, please describe those modifications and why they should be required.

Issue 2(e): Do you believe that additional guidance for selecting the factors used in option-pricing models is necessary to provide added consistency and comparability of reported results? If so, what types of guidance should be provided and in which areas?

Answer:

Issue 2a: We agree with both the FASB and the IASB that the share-based compensation standards should mandate the use of option pricing models for measurement purposes. Option pricing models are widely used and accepted by the investment community, and have been proven in practice to develop reasonable and reliable valuations. These models are also accepted globally by regulators as a tool to measure risk. We agree with the conclusion of the FASB that any imprecision associated with these models are no greater than the imprecision inherent in complex accrual models.

Issue 2b: Because new option pricing models may be developed in the future, we do not believe that the standard should mandate the use of only one option model. Furthermore, the use of one particular model because of the different types of options used and the complexity of the plan terms. For example a standard Black Scholes model may be suitable for pricing a European style option but it does not work well with American style options. We recommend that the standards allow flexibility in the choice of model used to allow options to be valued according to market conventions.

Issue 2c: Yes, we believe that if the standards do not mandate the use of a particular option-pricing model additional information should be disclosed to improve the users ability to understand and compare financial statements. We propose that entities should be required to disclose the model applied, and if a proprietary model was used, a description of the model and how it deviates from either the Black Scholes or binomial based models.

Issue 2d: Due to the variety and complexity of plans, we propose that the standards permit entities flexibility to apply modifications to the outcomes of option pricing models in order to reflect specific plan conditions (e.g. performance criteria) as long as they can be reasonably supported and explained.

Issue 2e: We do not advocate specific rules for selecting the factors used in option pricing models as option and share award grants can vary widely in their structure and complexity. We believe that the factors used in an option pricing model are widely understood in practice. An entity should also be allowed the flexibility to make adjustments to input factors (e.g. volatility) to reflect how a dealer would adjust the price.

Issue 3: Do you believe that employee and nonemployee transactions are distinct and, therefore, warrant different measurement dates for determining the fair value of equity instruments granted? If so, why? If not, why not?

Answer: No, we believe that employee and non-employee transactions should be measured at the same date as the basic transactions are the same, namely the receipt of goods or services as consideration for the issuance of equity instruments. We observe that there is no conceptual difference between an employee and non-employee transaction and therefore, recommend that grant date measurement be used for both types of transactions irrespective of whether the fair value of the award is measured by reference to the goods/services received or the equity instruments granted. We believe that it is reasonable to presume that the full value of the economic benefits to be received in exchange for equity instruments granted was contemplated by the entity and the counterparty at the time the arrangement was entered into. As such, at the grant date the monetary value of the economic benefits to be received is substantially equal to the fair value of the equity instruments granted.

Issue 4: Do you believe that the fair value of equity awards granted to nonemployees that include performance conditions can be measured with sufficient reliability to justify a grant-date measurement method? If so, why? If not, why not?

Answer: As more fully discussed in our response to Issue 3, we believe that all share-based awards including performance awards can be measured with sufficient reliability at grant date. Grant date is the date when both parties contemplate the value of the benefits to be given and received. As such we believe that the fair value of the equity instruments at grant date represent a fair indicator of the services expected to be received. If forfeiture occurs due to failure to achieve the performance target, the services have not been received and any recorded expense should be reversed.

Issue 5: Do you believe the notion of issuance is conceptually of importance in the design of a standard on stock-based compensation? If so, why? If not, why not?

Answer: We strongly believe that the notion of issuance is conceptually of importance to the design of any standard on stock-based compensation. We agree with the conclusions under Statement 123 that the cost of the services received should be measured and recognized based on the fair value of equity instruments distributed. The employee does not become unconditionally entitled to a stock based award until all vesting and/or performance conditions have been met. Likewise the entity that grants the award does not receive an enforceable right to the employee service at the grant date. As such, we would agree that the instrument is not issued until the vesting conditions are met. We believe that ultimate delivery is the most important concept when determining total compensation expense. As such, we endorse the modified-grant date measurement method that combines attributes of both grant date and vesting date measurement.

Issue 6: Do you believe an equity instrument subject to vesting or other performance conditions is issued, as defined by Statement 123, at the grant date? If so, why? If not, why not?

Answer: We firmly agree with the FASB's concept of issuance. Equity instruments subject to vesting or performance conditions are granted but not issued because they represent a conditional obligation. We therefore do not believe that an equity instrument subject to vesting or other performance conditions is issued, as defined by Statement 123 at the grant date. At the grant date the counterparty has not fulfilled all of the necessary requirements to receive the award. We do not agree that an instrument is issued in situations where they are conditionally granted subject to the satisfaction of vesting and/or performance conditions. We believe it is the outcome of these conditions that determine whether or not an instrument is issued. As stated above we firmly support the FASB's notion of issuance and recommend that the IASB adopt a similar approach.

Issue 7: Do you believe that the effect of forfeiture should be incorporated into the estimate of fair value per equity instrument (IASB approach)? If so, why? If not, why not?

Answer: We believe that it is appropriate to consider forfeitures when determining the amount of total compensation expense that should be recognized. We support the FASB's approach whereby the effects of forfeitures are addressed through the notion of issuance. We agree that forfeitures do not affect the value of an equity instrument at issuance and believe that total compensation cost should be based on the number of equity instruments actually distributed. As such, we support an approach of estimating the amount of equity instruments expected to be forfeited and truing up that estimate based on actual forfeitures.

We disagree with the IASB's approach to incorporate forfeitures into the estimate of per equity instrument fair value and attribute that amount using the units of service method. As further discussed in our response to Question 10, this method has the ability to distort comparability between entities and create misleading financial results. For example, if an entity grants 10 options to each of its 10 employees and estimates a fair value of \$10 per option and a forfeiture rate of 20%, the revised per option fair value would equal \$8. If in reality, no employees forfeited their options, total expense booked would only equal \$800, where the "economic" fair value of the actual award distributed is equal to \$1,000.

Issue 8: Should failure of an award holder to satisfy the conditions that entitle the holder to retain or receive the promised benefits affect the amount of compensation expense that should be recognized related to that award? If so, why? If not, why not?

Answer: Yes, we believe that total compensation expense should be measured based on the total number of instruments actually issued. No expense should be recognized for failure of an award holder to satisfy the conditions that entitle the holder to retain or receive the award. Until all of the vesting/performance conditions are satisfied the counterparty does not have an unconditional right to receive the award and the entity has no obligation to furnish it.

Issue 9: Do you agree that the result of the IASB's approach to calculate the fair value of equity instruments of nonpublic entities would be closer to fair value than minimum value? If so, why? If not, why not?

Answer: Yes, we agree that the result of the IASB's approach to calculate the fair value of equity instruments of nonpublic entities would be closer to fair value than minimum value. Ignoring the effects of volatility on an option as required by the minimum value approach, could significantly understate the value of the equity instrument. Although the estimation of volatility on nonpublic companies is subjective, we agree with the IASB that there are several methods available to estimate expected volatility. Using an estimate of volatility would still produce a value closer to fair value than the minimum value approach, which does not take into account volatility at all. We firmly believe that the financial markets have advanced to a stage where fair value can be reasonably and adequately determined regardless of whether or not an entity is listed or unlisted. While we agree that quoted market prices represent the best evidence of fair value for instruments that are listed in an active market or exchange traded, we believe that fair value can be reasonably determined for virtually any financial instrument, including options on non-traded companies.

Issue 10: Which of the two attribution methods described by the standards do you believe is more representational faithful of the economics of stock-based compensation arrangements and why?

Answer: We believe that the Statement 123 approach is more representational faithful of the economics of stock-based compensation arrangements in that it takes into consideration forfeitures of awards and recognizes that service periods do not always equal vesting periods.

Units-of-Service Method

We disagree with the units-of-service method. This method has the ability to distort comparability between entities as the total expense booked varies significantly based on the forfeiture assumptions used to obtain the price per unit of service. As such, two entities with identical plans and identical actual forfeiture rates may report completely different expense amounts if, upon initial determination of the cost per unit of service, they estimate different forfeiture results.

Furthermore, there are many plans whereby employees can leave the entity and retain their benefits. If the units-of-service method were applied to grants that permit employees to retain their awards if they leave the entity before vesting, the entity would not be required to record any expense over the remaining vesting period as no services would be received. However, the employees would still receive the awards.

Additionally, we believe that this method is too burdensome and costly for entities to implement. Most entities do not have the systems in place to track forfeitures in such a detailed manner as would be required by the exposure draft. Implementing systems capable of obtaining the necessary information to apply the units-of-service method would be extremely costly.

Concept of Issuance

For the reasons provided in our response to Issue 5, we strongly support the concept of issuance under Statement 123.

Issue 11: Statement 123 does not ascribe value to services received in exchange for equity instruments that are later forfeited (that is, recognized compensation expense is reversed upon forfeiture), whereas the Proposed IFRS ascribes value to such services through its units-of-service attribution method (that is, recognized compensation expense is not reversed upon forfeiture). If you support the Proposed IFRS's view, do you believe the units-of-service method ascribes an appropriate value to services received prior to forfeiture? If so, why? If not, why not?

Answer: As noted in our answer to Issue 10, we do not support the units-of-service method.

Issue 12: Do you believe that the actual outcome of performance awards should affect the total compensation expense incurred by an enterprise? If so, why? If not, why not?

Answer: Yes, we believe that the actual outcome of performance awards should affect the total compensation expense incurred by the enterprise. We agree with the FASB approach that the initial accrual of compensation cost for an award with a performance condition should be based on the best estimate of the outcome of the award, and should be adjusted for changes in the expected or actual outcome until the vesting date.

We firmly disagree with the IASB's conclusions on the accounting for performance based awards, and believe that even under a service based approach, as proposed by the IASB, compensation expense should be adjusted for the outcome of performance awards. We believe that the services necessary to receive performance-based awards are only obtained if the entity meets the performance-related criteria. As such we believe that if forfeitures occur due to failure to achieve the performance target, the services have not been received and no expense should be recorded on the entity's books. We believe that the IASB's approach to performance based awards is completely contradictory to the service based method of recording expense. We would view performance-based awards to be contingent compensation plans and that the accounting for contingencies should be followed. These contingent compensation plans should be assessed continually to determine whether a provision should be made based on the best estimate of the total equity instruments ultimately delivered.

Issue 13: Do you believe that this issue is important in considering an attribution model's validity? If so, why? If not, why not?

Answer: We agree that option pricing models should be used to measure the fair value of stock options at grant date and that the options expected life should be used as an input to the model. We do not believe that it is reasonable to attribute expense over the expected option life. Further, we agree with the concept that expense should be attributed to the period in which services are performed and note that there are many plans for which the service period equals the vesting period. An example of this would be when an award is provided as a sign-on bonus to a new employee to ensure the employee stays within the organization for a certain period of time. However, there are plans where the grant relates to past services performed, although there is a vesting period. We believe that the requirement to equate service period with vesting period is contradictory to the principles based approach adopted by the IASB. We believe that compensation expense should be recognized over the service period, which should be determined based on the substance, facts and circumstances of each equity based compensation plan.

Stock awards are fungible with various other forms of employee compensation such as cash, alternative investment vehicles, allowances for autos and club memberships, etc. Employees expect a

total compensation figure for service performed during the year and stock-based compensation is used as a means to achieve this total. Awards granted may be based simply on the performance of the employee and company for the current year and not based on the expectations of services to be received in the future. Companies and their employees generally view awards as compensation for past performance. Employees are often selected to participate in certain plans as a result of their past performance. As such we believe that a significant portion of equity compensation plans should be expensed in the year of grant. While we would agree that there may be an employee retention benefit (for which value may be measured by a liquidity factor) obtained during a vesting period we believe that this amount is often immaterial in relation to the services performed by the employee during the grant year.

Issue 14: Do you believe that the measurement-date criteria in Issue 96-18 accurately reflect the economics of transactions with nonemployees? If not, why not?

Answer: No. As stated in our response to Issue 3, we believe that grant date measurement should be used to determine the value of all share-based payment transactions as this method most accurately reflects the economics of transaction. We do not support the measurement date criteria described in Issue 96-18. This method has the ability to assign substantially different fair values to the same goods or services, thereby distorting the economic reality of the transaction. We believe that it is reasonable to presume that the full value of the economic benefits to be received in exchange for equity instruments granted was contemplated by the entity and the counterparty at the time the arrangement was entered into. As such the monetary value of the economic benefits to be received is substantially equal to the fair value of the equity instruments granted at grant date. As such, we recommend that the FASB adopt a grant date measurement approach for transactions with nonemployees.

Issue 15: Do you believe that all of the tax benefits derived from stock-based compensation arrangements should be recognized in the income statement? If so, why? If not, why not?

Answer: No. We believe that when realized tax benefits from equity awards exceed the recorded tax benefits based on the cumulative amount of stock-based compensation expense recognized, it should be credited to stockholder's equity. Likewise, if the realized tax benefits are less than the recorded tax benefits, this difference should also be recorded in stockholder's equity. We believe that the accounting for all tax benefits derived from stock-based compensation should be symmetrical. We do not support the IASB view that these tax benefits are a result of an income statement item (i.e. compensation expense), and therefore should be reflected in the income statement. We take the view that these tax benefits are a result of the issuance of equity based instruments, and therefore should be reflected in equity. As pointed out in this *Invitation to Comment*, a consequence of the IASB approach is that an entity may recognize income in excess of the cumulative compensation expense. We believe that recognizing income as a result of the appreciation in the value of the equity instruments granted in a share-based award is not appropriate.

Issue 16: As discussed in paragraph 83 of this Invitation to Comment, the Proposed IFRS expands on the disclosure requirements in Statement 123. Do you believe that those expanded disclosures would be more informative to users of financial statements? If so, why? If not, why not? (Which of the disclosure requirements should be eliminated or modified in that case?)

Answer: Overall we believe that the broad principles outlined in paragraphs 45, 47, and 51 of the Proposed IFRS are appropriate, however the detailed disclosure requirements are excessive. We are skeptical whether the detailed disclosure requirements will provide additional benefits to users of financial statements. Specifically, we do not believe that it is necessary to disclose the number and class of employees participating in all types of share-based payment arrangements. Entities may have numerous types of plans, many of which are immaterial in relation to the other plans. We believe that disclosure about certain plans may hinder an entities competitive advantage and will provide no useful information to users of financial statements. Furthermore, we do not believe that the level of detail described in paragraph 48 of the Proposed IFRS is necessary for users of the financial statements to understand how the fair value of goods and services received, or the fair value of the equity instruments granted was determined. We believe that this level of detail is overly burdensome to prepares and will not necessarily provide users of financial statements with information that is useful.

We believe that preparers of financial statements should be in the position to determine what information is needed to be disclosed in order for a reader of the financial statements to understand the broad principles outlined in the Proposed IFRS.

Issue 17: Please describe any additional disclosures that you believe should be required in order to inform a user of financial statements about the economics of stock-based compensation arrangements?

Answer: We believe that the broad principles outlined under paragraph 45, 47, and 51 of the Proposed IFRS are adequate in order to provide users of financial statements the necessary information to enable them to understand the economics of stock-based compensation arrangements.