

Ductilibility, LLC

*Credit Crisis Status:
An updated assessment by
senior risk executives*

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Overview

One month ago, risk executives at various institutions around the world were asked to express their feelings regarding the status of the credit crisis. At that time, there was a general skepticism that the actions taken by central banks and national governments would be sufficient to end the credit crisis. In fact, nearly all respondents felt that what respite had been experienced at that time was only temporary. Nearly half of respondents at that time were operating with the expectation of a continuation or worsening of the crisis. Since that first survey was taken, global equities have generally fallen by more than 25% and governments around the world have taken extraordinary actions to address the crisis. Opinions expressed in this follow-up survey are still highly negative and have improved only modestly in a couple of areas, while deteriorating in others.

The survey was taken of individuals who typically hold the titles of Chief Risk Officer / Heads of Risk Management, Board Director or other C-Level title. Over 35 companies are represented in the sample set and are typically in the largest 25% of firms in their industries. The sample set is primarily financial service firms, but also includes a number of non-financial companies.

The survey was conducted between Friday October 17th and Monday October 20th, 2008.

Highlights

- 22% of respondents now think that the actions taken by various governments will be sufficient to end the crisis, up from 2% in the first survey
- 33% are planning for the crisis to continue on its current path, while 3% expect it to worsen
- 81% expect at least one more major bank to fail or be taken over, down from 92%
- 97% expect that a major hedge fund will close as a result of the crisis, up from 93%
- 68% expect that another major insurance company will fail or be taken over, up from 45%
- 70% expect a recession to follow that is long in duration, but those expecting a long recession are split evenly between whether it will be long and deep or long and shallow
- The Asian economic region is expected to see the least negative impact from the crisis
- The most negative impact is expected to the Russian economy, although there is a wide disparity of opinions about this
- Nearly 50% expect the US economy to contract by more than 3% over the coming two years, while 11% are expecting it to contract by more than 7% over that time frame
- 80% say that fear among the public is growing

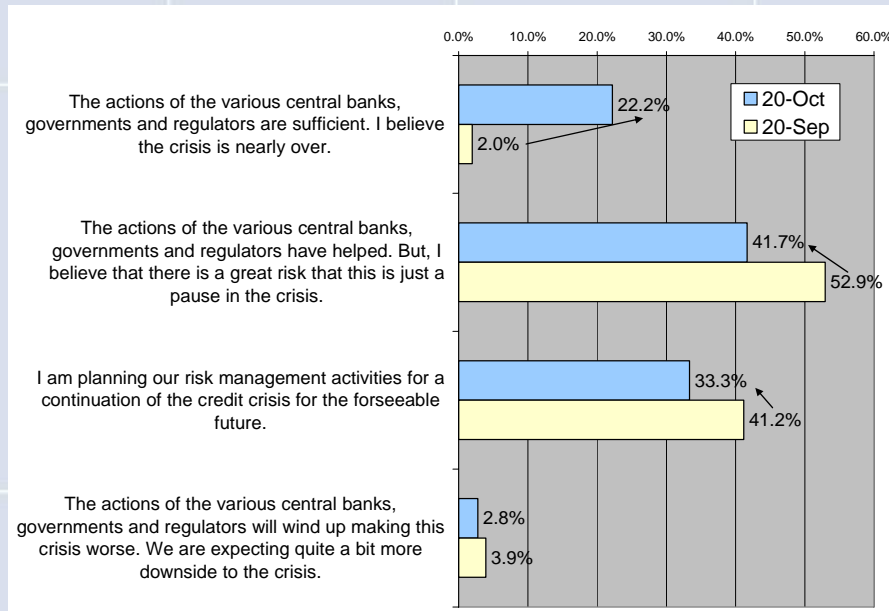
Perhaps reflecting the sentiment of the majority, one respondent opined “*Phase 1 of the crisis may be nearing an end. Phase 2 looms and is still an unknown....*”

Details of the survey responses follow. Should you have any questions, please don't hesitate to contact me.

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Credit Crisis Status

Question 1: As you prepare for your work, which one statement below best characterizes your approach regarding the current credit crisis?



There has been an overall improvement in sentiment, with a dramatic increase in the number of respondents who think the crisis is nearly over. Still, the sentiment is highly negative with roughly 4 in 5 respondents saying they do not think the crisis is over and over 36% see the crisis continuing on its current path into the foreseeable future or to be getting worse.

Selected comments:

“I’m not sure any of those statements fully reflect my view. I think the banking crisis for the most part is over although how this intervention of government in the banking systems worldwide is untangled remains to be seen. The fallout from the reduction in credit and the flow on effects to consumer and business behavior are probably yet to be seen and it may take decades to repair the damage to expectations. One thing I think for certain is that we are probably going to see a change in the balance between high deficit western countries and those with excess reserves such as Asia and the oil producing nations.”

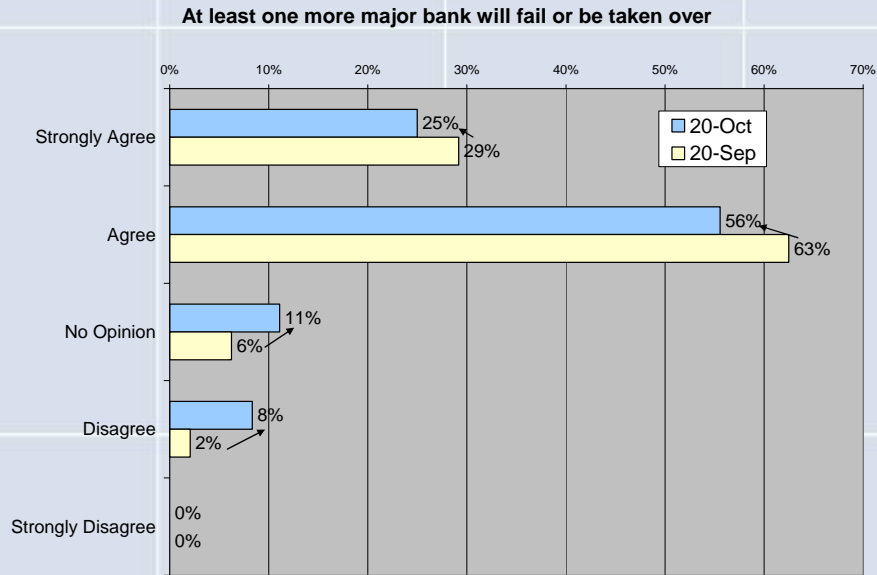
“It is now very clear that this has spread from financial crisis to early signs of a broad global recession - the next wave of bank write offs will be consumer credit (personal loans, credit cards, etc)”

“Our expectation is that continued illiquidity and tighter credit will dramatically increase corporate defaults and further reduce recoveries until the markets calm and volatility declines. “

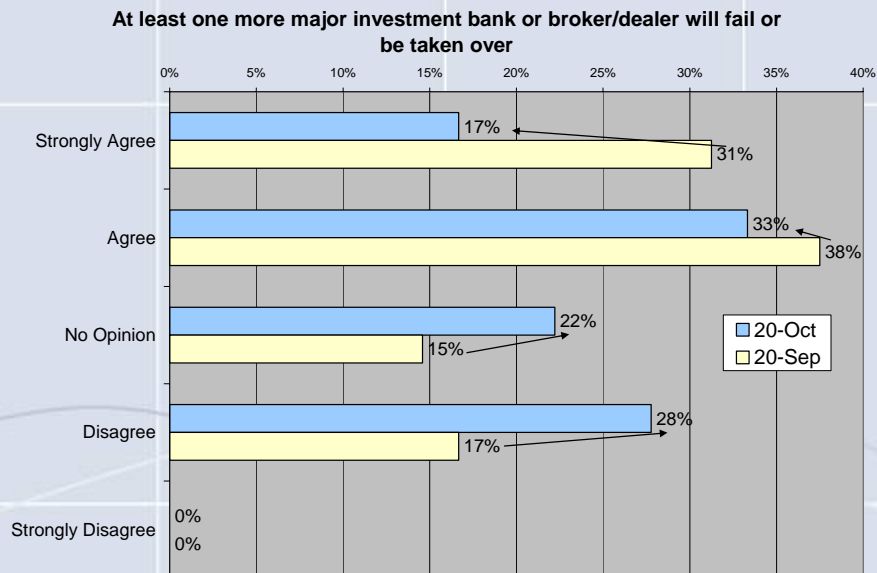
“US Treasury asset pricing is a question that if answered correctly will lead to credit being unlocked - some counterparts appear interested in market-share-land-grabs...collateral haircuts either by central bank or in practice continue to call on incremental margin & add stress...positive notes are that with gov’t action deposit migration risk appears to be stabilizing as equity markets calm down.”

What's Next?

Question 2: Please tell us your agreement or disagreement with the following statements about the next stages of the current credit crisis:

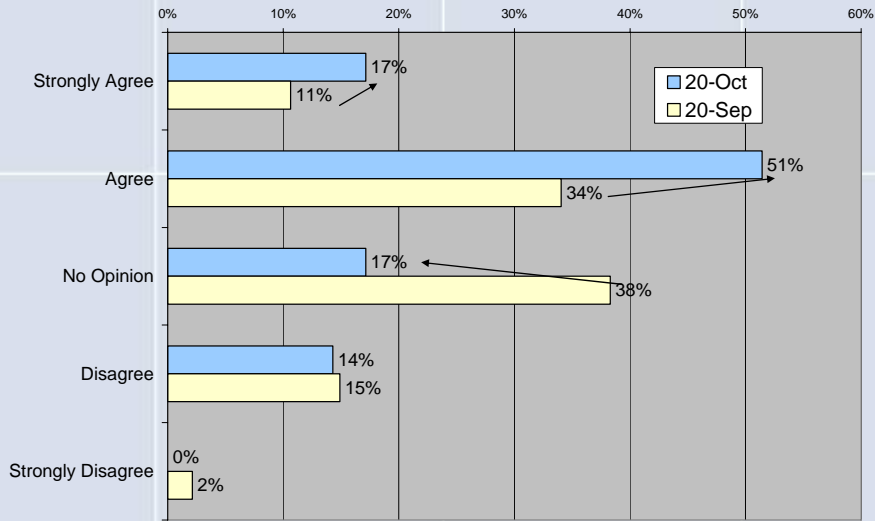


There has been a modest improvement in the attitude about banks, but still more than 80% expect at least one more failure or forced takeover among major banks.



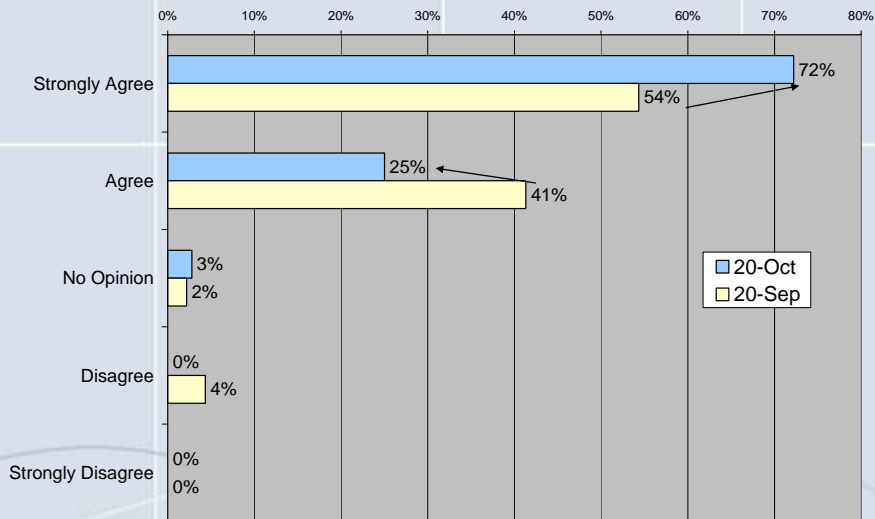
While there is a major improvement in the sentiment about major investment banks, one respondent noted "*there are no major investment banks left*", which could be the single reason for the apparent improvement in sentiment.

At least one more major insurance company will fail or be taken over



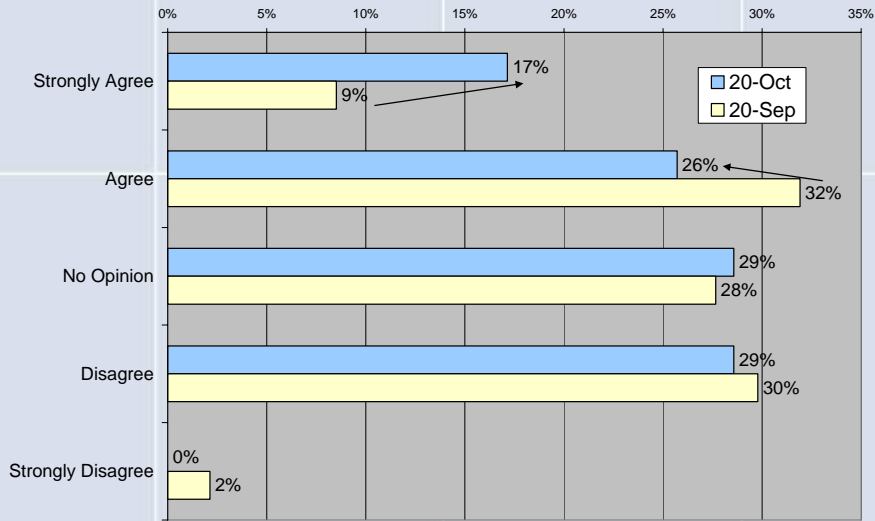
Following the takeover of AIG, some respondents to the previous survey expressed the opinion that AIG was not acting like an insurance company. In this month's follow-up, though, the general attitude towards insurance companies has deteriorated markedly. Now, 68% of respondents expect that a major insurance company will fail or be taken over as a result of the crisis, which is up from only 45% one month ago.

A major hedge fund will close



Sentiment towards hedge funds remains strongly negative, with near unanimity of expectations that a major hedge fund will close as a result of the credit crisis. Fully 72% strongly agree that such will occur.

Another money market fund will "break the buck"

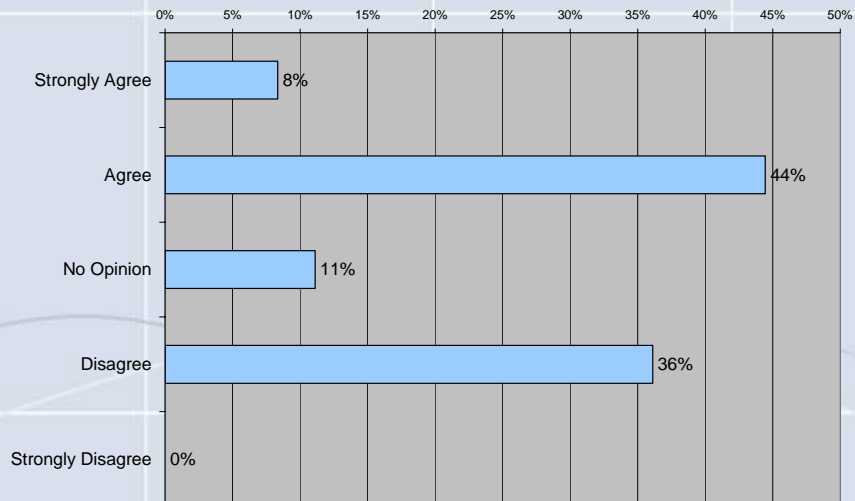


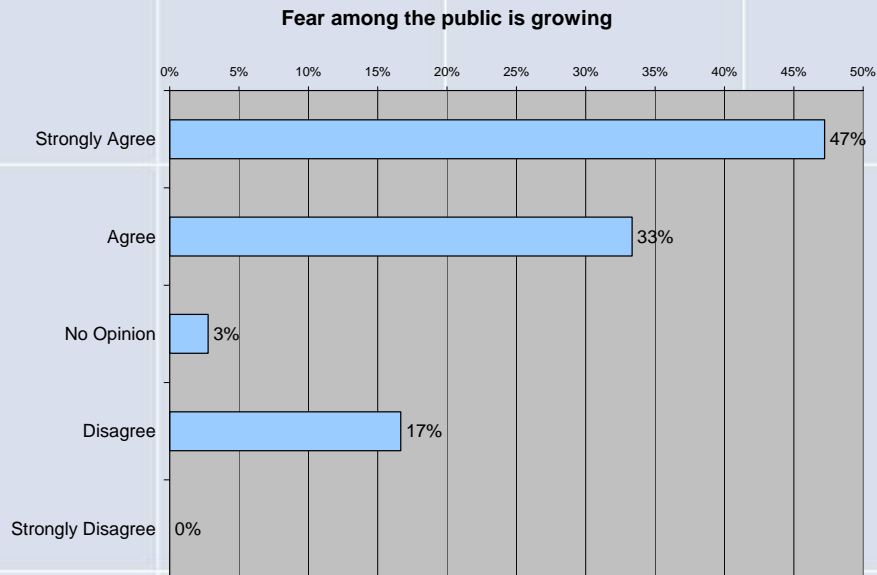
Little comfort can be found in respondents' sentiment towards money market funds, with a near doubling of those who strongly agree that another money market fund will "break the buck". The overall percentage of respondents who expect such a failure, though, is roughly the same as last month.

Fear

In this round of questioning, we asked whether fear and panic were growing problems. Opinions were somewhat split regarding market professionals, which we assume includes liquidity providers. However, there is a strong consensus that fear is growing among the public.

Fear among market professionals is growing





Effect on the Real Economy

While our survey participants are not necessarily economists, we were interested to learn their assessment regarding the extent to which various regions would be vulnerable to an economic downturn as a result of the credit crisis. Not surprisingly, there is unanimity in expectation of a recession in the US and European Union, with more than 10% expecting a contraction in the US that exceeds 7% in GDP.

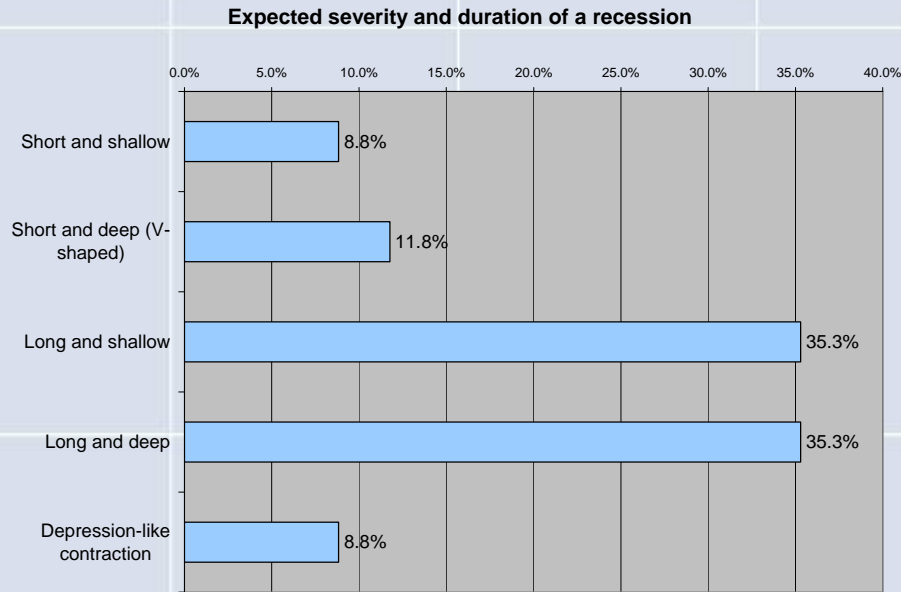
Asian economies are expected to be the least affected, with over 40% of respondents feeling that Chinese GDP will not contract and half feeling that the Indian economy, if it contracts, will do so at a rate of less than 1%.

What do you expect the impact of the credit crisis to be on economic activity over the next two years? Please answer for the specific regions below where you have an opinion.

Answer Options	No recession	0-1% contraction in GDP	1-3% contraction in GDP	3-7% contraction in GDP	7-10% contraction in GDP	Over 10% contraction in GDP
in the United States	0%	6%	46%	37%	6%	6%
in the European Union	0%	15%	44%	32%	3%	6%
in Asia broadly	22%	22%	13%	25%	13%	6%
in China	42%	10%	10%	19%	10%	10%
in India	34%	16%	13%	25%	6%	6%
in Canada	3%	20%	37%	27%	10%	3%
in Latin America	6%	26%	16%	39%	10%	3%
in Russia	13%	13%	19%	25%	16%	16%

Survey participants were asked to discuss their expectations for the length and depth of a recession, if they expect one, in the region in which they live.

If you expect a recession in your region, how would you describe the expected severity and duration?



More than 70% expect that the recession in their region will be long in duration, with that group evenly split as to whether it will be a deep recession or a shallow one. Survey respondents offered equal doses of hope for a short and shallow recession and fear of a depression-like contraction.

Additional Actions

Lastly, we asked if there were any additional actions needed to be taken to end the credit crisis. Opinions ranged widely and are presented below:

“Further reductions in interest rates and more fiscal stimulus”

“Revise regulations. [Provide] strong economic incentives to avoid deep recession”

“Bank mergers, deleveraging of the US consumer”

“Key banks should reestablish credit lines for Money Market operations”

“In the US, GSE coordinated efforts with investors, major banks and local community banks to refinance/restructure loans need to show results in order to slow the drop of real estate. Immediate foreclosure moratorium.”

“The ECB and ESPECIALLY the Bank of England were [unwise] in not slashing interest rates 6 months ago; it was clear that there was no wage price inflation, the problem was commodity

inflation it could now be a Japan style deflation scenario: set interest rates at zero and get the printing press out."

"Enforce more personal responsibility on all those that had a hand in creating this crisis. Blind greed without consequences will perpetuate this cycle unless some pain is felt by those that had a hand in creating this crisis (consumers, wall street, elected officials)."

"The deleveraging process will take a long time, regardless of any government actions."

*"1)Clarity of thought and agreement as to how regulation should be conducted in the future.
2)Separation of money transmission and deposit taking functions (ie the financial fabric of the economy) from esoteric and higher activities - let risk takers bet their own money, not the nation's. This will look like a return to Glass-Steagall and, in a sense, it will be."*

"Stronger regulation and more decisive actions taken earlier."

*"1) resolve housing issues (improve consumer confidence)
2) resolve CDS issues (remove unknowns from the equation)
3) better coordinate rescue efforts across all regions"*

"Leadership on both the national and international levels."

"Central banks to manage key banks activities to ensure interbank and commercial and residential lending restarts."

"More of the same. but further encouragement for banks to lend for productive capacity – especially manufacturing, SMEs and to unfreeze mortgage markets. Full scale recession likely if this does not happen"

"Clarification on the government policy/assistance toward homeowners who are unable to cover their mortgage payments."

"Secured clearing."

"Less government intervention."

Conclusion

Overall, the risk executives who participated in this survey continue to express highly negative sentiment about the status of the credit crisis. While there are some indications of a modest improvement in sentiment, most are preparing for a continuation of the crisis in their day to day activities and most expect a long economic contraction to follow.

The affect on the real economy is the looming uncertainty as fear grows regarding credit card balances, Alt-A mortgages, corporate credits, increased defaults and any pro-cyclicality that could result from credit model updates if the realization of losses at default exceeds those that existing credit models have projected.

Risk executives seem to be calling for greater clarity, a lack of which can only add to growing fear.

Ductilibility, LLC

A private research and advisory network serving the governance needs of Boards of Directors and senior executives through Benchmarking Research, Incentives and Compensation Design, Risk Communication and Education

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