

Ductilibility, LLC

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

November 20, 2008

NOT FOR EXTERNAL DISTRIBUTION

e) info@ductilibility.com • t) +1-507-301-3149 • f) +1-480-247-4773 • www.ductilibility.com

Overview

Generally, sentiment has worsened among senior risk professionals over the past month.

In our second monthly update to the original survey of risk executives' sentiment about the status of the credit crisis, there has been an increase in the defensive posture of risk managers. One 'less dark spot' is a very modest improvement in the outlook for bank failures, although more than 60% of respondents still expect another major bank to fail or be taken over as a result of the crisis. In this month's study, we have introduced new questions regarding the availability of credit, both from the providers' perspective as well as the users'. Both questions provide a similar assessment that the availability of credit has not improved in the past few weeks despite some market price indicators to the contrary.

Respondents this month also provided us with a list of market indicators which they are using as signals to improving or deteriorating conditions. They also gave us an assessment of whether the supply chain is now under threat due to the credit crisis. It is.

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 65 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. Respondents represent a broad geographic range.

The survey was conducted between Tuesday November 18th and Thursday November 20th, 2008.

Snapshot

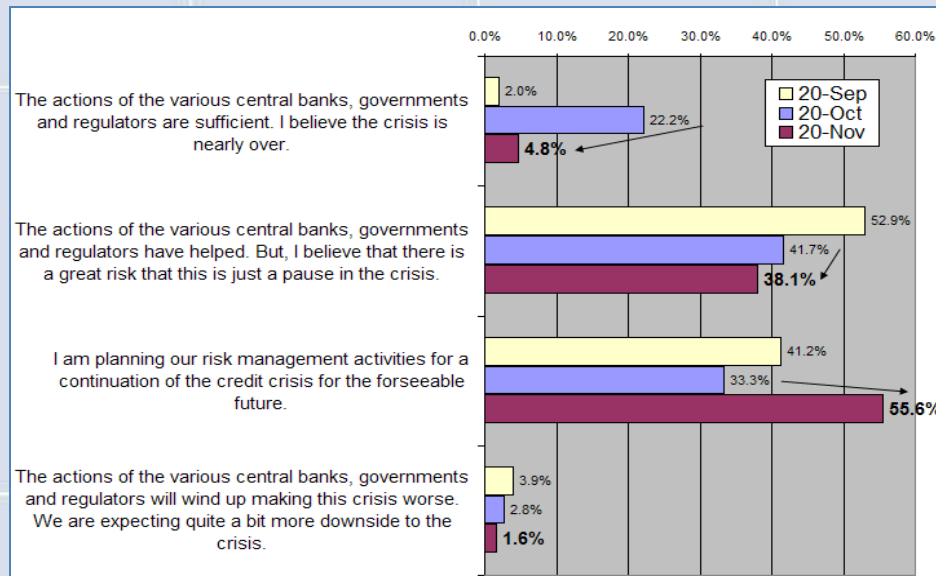
- Only 5% of respondents now think that the actions taken by various governments will be sufficient to end the crisis, down from 22% in the previous survey
- 56% are planning for the crisis to continue for the foreseeable future, up from 33% last month
- 62% expect at least one more major bank to fail or be taken over, down from 81% last month and 92% in September
- 91% expect that a major hedge fund will close as a result of the crisis, down from 97%
- In general, the expectations regarding the possible failure of a major insurance company remains the same with 2/3 of respondents expecting a major failure or take-over
- More than half of credit-providers disagree that credit availability from their institution has been improving over the past few weeks, this figure is 80% of those expressing an opinion
- Likewise, 80% of those expressing an opinion say that credit availability to their institution has not been improving over the past few weeks
- 88% say that fear among the public is growing, up from 80% last month, but there is some moderation of the degree to which this opinion is expressed
- 60% say that fear among market professionals is growing, up from 52% last month

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

David R. Koenig
Founding Partner
+1-507-301-3149
david.koenig@ductilibility.com

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 a decisive movement towards a more defensive posture from last month. In comments left by respondents, many were highly critical of the government intervention, perhaps due to what was perceived as a turnabout in strategy at the US Treasury during the week prior to the collection of responses. Respondents also note the movement of the crisis from the financial sector to the “real economy”. What is most dramatic in the data is the increase in the percentage of respondents who are now incorporating a long-term credit crisis into their daily risk management planning. This may also explain some of the data later in the study which indicates that credit has not become more available in recent weeks despite some market-based evidence that it had.

Selected comments:

“The actions of central banks, governments and regulators are neither sufficient nor will they make the crisis worse. I am not banking on "TARP-like" programs to save our ship.

“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)”

“I think that the actions of the central banks may have reduced the depth of the crisis and the concurrent recession. However, I expect that the recovery will take about two years...longer than previous cycles. This prolonged impact will be due largely to the central bank interventions. The resulting uncertainties around valuation and the restructuring of the global financial industry will hold recovery back. “

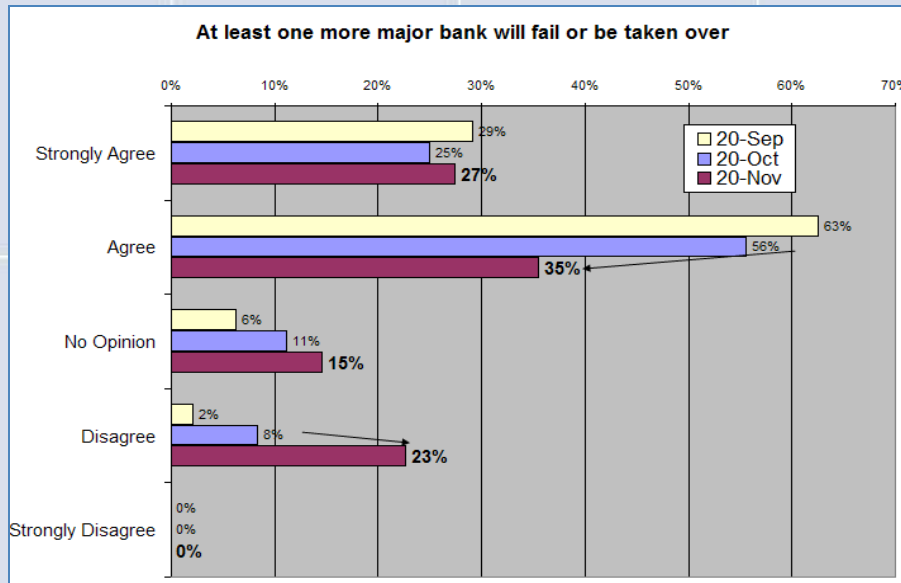
“Central banks thus far have stabilized the financial system to a point. It remains vulnerable though to further shocks from the real economy. The ability of the banking system to withstand further hits to capital remains to be seen.”

“So far we have seen just the part of the crises the whole cycle is yet to be completed. The economic effect i.e. after shock such as recession and contracting of economic activity will have larger impact.”

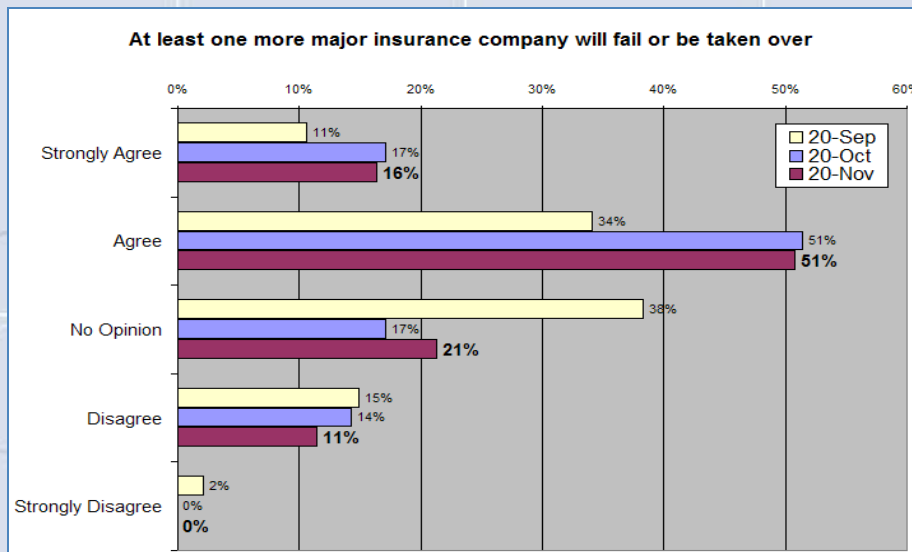
“As politicians - rather than trading pros - have been in the driver's seat in many actions undertaken in this crisis...have resulted in further confusion and panic amongst investors”

What's Next?

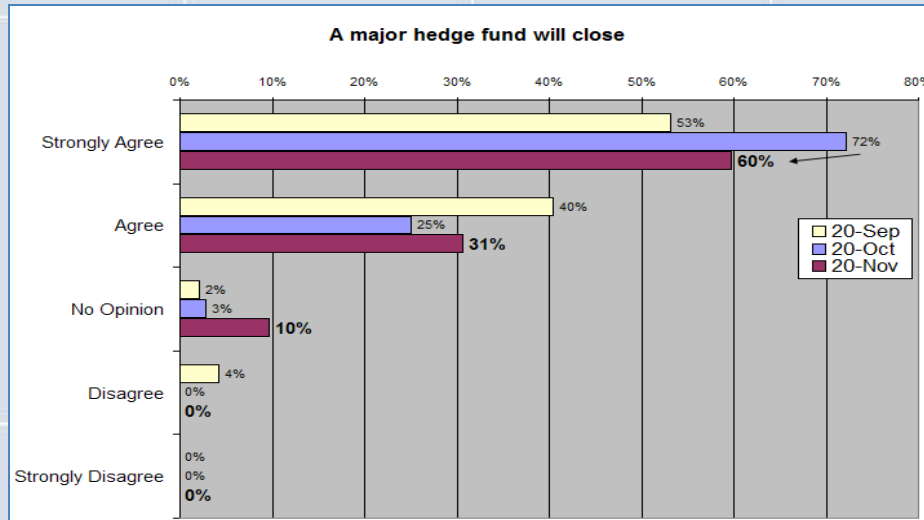
Question 2: Please tell us your agreement or disagreement with the following statements about the next stages of the current credit crisis:



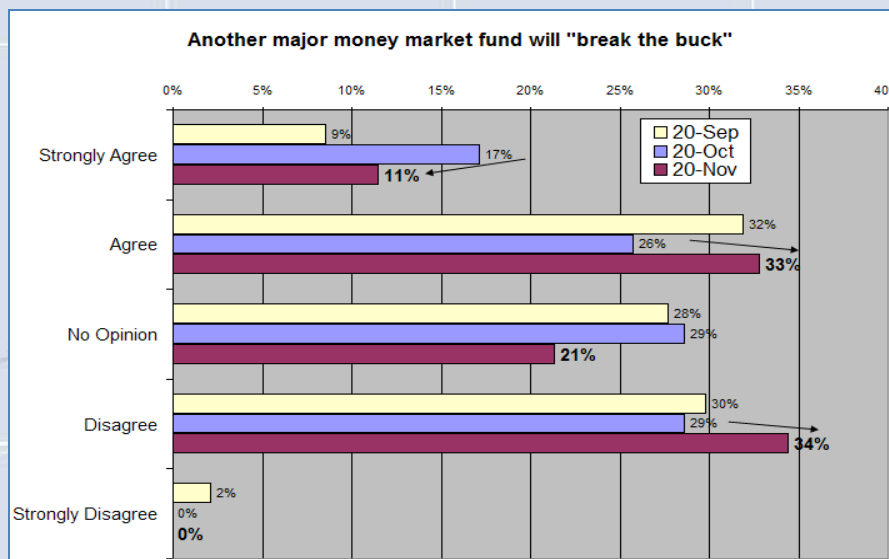
The one “less dark spot” in the study is that it appears that expectations regarding major bank failures or forced take-overs have subsided modestly. Still, though, a majority of respondents expect at least one additional failure.



There is growing concern among some industry observers that insurance companies are about to experience some very difficult times, particularly as it relates to products with embedded interest rate guarantees. There does not appear, though, to have been a material deterioration in expectations about major insurance companies among respondents. However, still more than 2/3 of respondents feel that a major insurance company will fail or face a forced take-over due to the credit crisis, which cannot be described as an optimistic outlook.



Last month, almost ¾ of respondents expected a major hedge fund to fail as a result of the credit crisis. The number of funds closing seems to be growing, as do reports of substantial losses. Several major hedge fund managers appeared before the US Congress and seemed to indicate more openness to regulation along with more willingness to provide transparency to their activities. Sentiment among respondents has improved slightly from last month, but still 91% of senior risk executives in our study expect another major fund to fail as a result of the crisis.

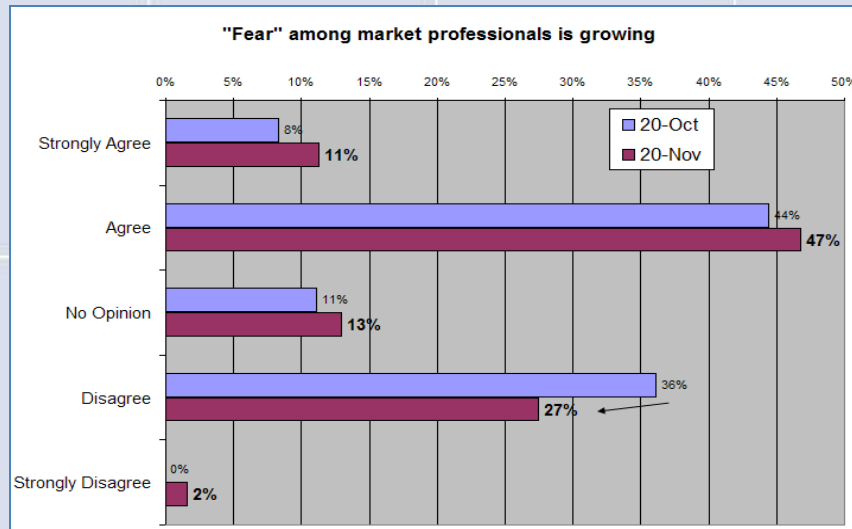


Attitudes have improved somewhat about the likelihood that another major money market fund will fall below a \$1.00 NAV, but still 44% expect that one will, while 34% do not expect such to occur.

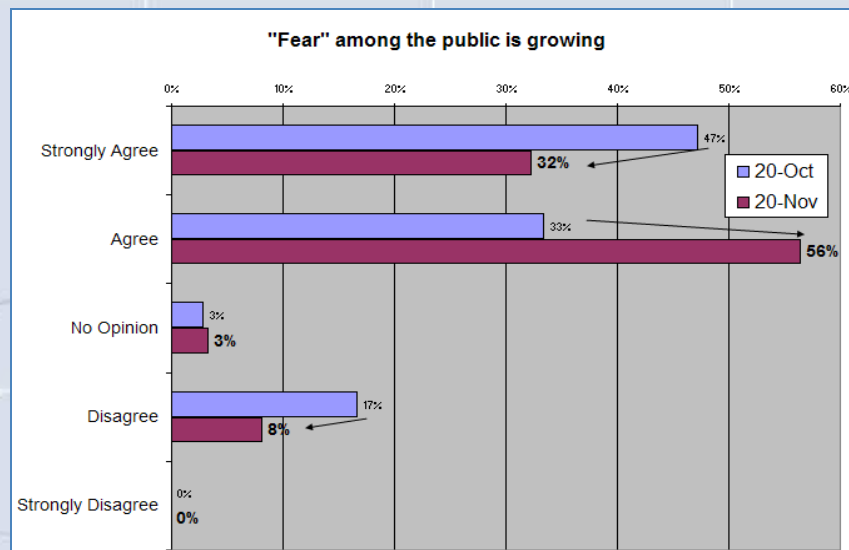
Fear

Growing fear among market professionals was noted in a [story on Bloomberg today](#). "Markets are back in crisis mode," said Agnes Kitzmueller, a Munich-based credit strategist at UniCredit SpA, Italy's biggest bank. "There is fear in the market."

In this round of questioning, we again asked whether fear and panic were growing problems. Opinions were somewhat split last month regarding market professionals, but seem to have moved into more of a sentiment that fear is growing. More than twice as many respondents "agreed" or "strongly agreed" that market professionals are growing more fearful than disagreed.



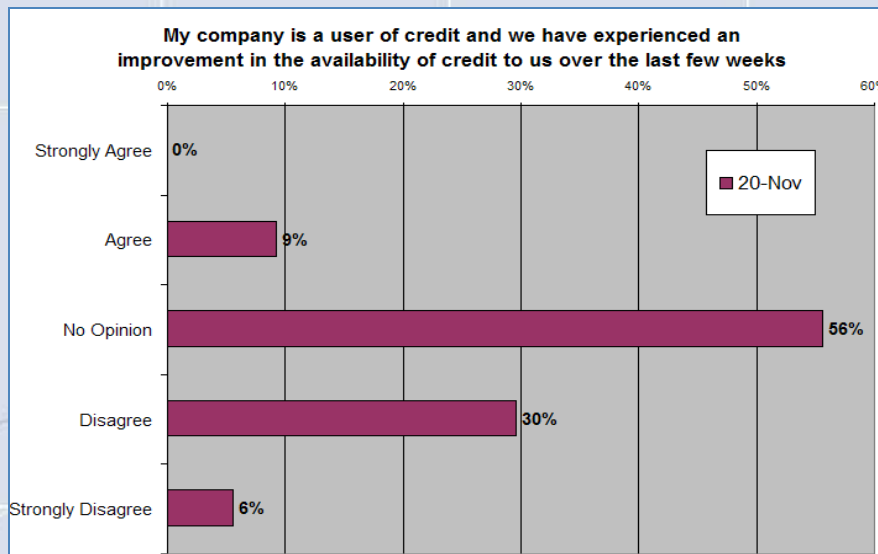
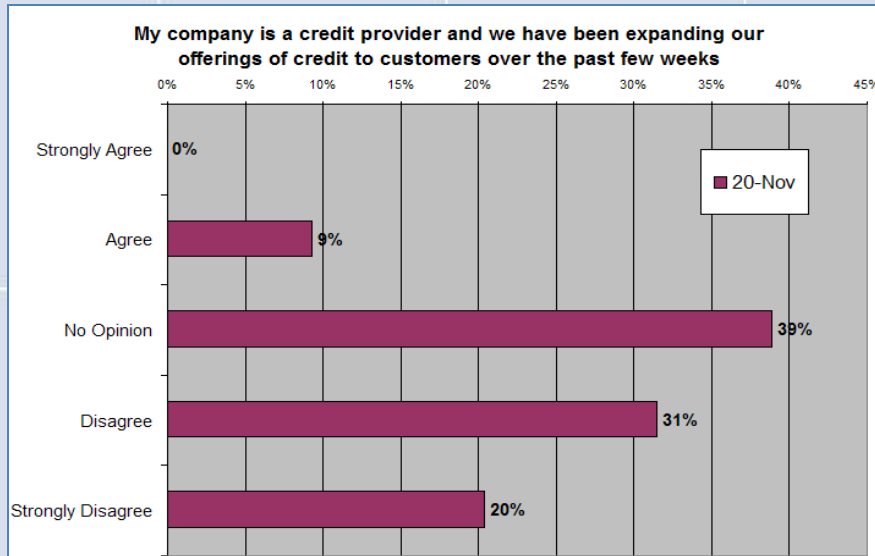
Survey participants indicate a stronger sense that fear among the public is growing now than last month, in which 79% already agreed it was. The current figure stands at 88%.



Experience with Credit Conditions

This month's study asked for data on the actual experience of participants, either in their activities in making credit more available or in their activities seeking credit. There is strong sentiment, which seems to align both from the perspective of credit providers and credit demanders, that the availability of credit has not improved despite some market-based indications that it had.

Fifty-one percent of credit providers disagreed that their offerings of credit had expanded over the past few weeks, while 36% of credit demanders expressed the same disagreement. In both cases, only 9% agreed that the availability of credit had improved.



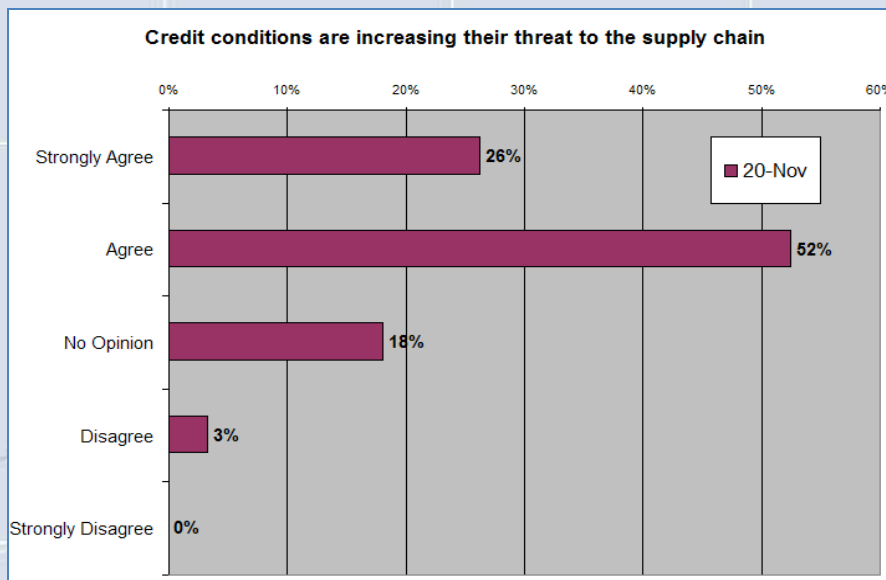
We were interested to know what market indicators the members of our research network are using to help give them advance notice of changing conditions in credit availability and/or the sentiment of market participants. A [story from the Calculated Risk weblog](#) which we featured to the LinkedIn Directors and Chief Risk Officers Group looked at LIBOR, the TED spread and

swap spreads which seemed to show indications of improving conditions. Many of our respondents report also looking at these, as well as other indicators:

	% of Responses
CDS Spreads	57%
TED Spread	43%
LIBOR	30%
Equity Prices	27%
VIX	10%
EUR/JPY	3%
10 yr Note to Average S&P Dividend Yield	3%
New Issues	3%
LIBOR to 3-month USTAA 5yr Industrial Spread	3%
LoC Costs	3%
Bond Spreads	3%

Downstream Effects

As several respondents indicated that the financial crisis had expanded to the real economy, and as an additional point of data regarding credit availability, we asked whether survey respondents now felt that the “supply chain” had come under threat due to the credit crisis. Insurers of “Big 3” auto payments to suppliers in Europe were reported to have pulled their coverage and automakers were in Washington this week seeking funding for ongoing operations. As might be expected from just this auto-industry news, 78% of our respondents did indeed feel that the supply chain is being threatened by the credit crisis, while just 3% did not.



Additional Actions

As we have asked in each month's survey, we wondered what additional actions, if any, should be taken to address the crisis. We received more comments this month than in any of the past months. Many seem to call for more intervention, while others argue that the markets should just be allowed to do what they are doing. There is no clear consensus, but it does appear that the confusion created by the politicians is not helping. All comments appear at the end of this study.

Conclusion

Risk executives who participated in this survey continue to express highly negative sentiment about the status of the credit crisis and have become more defensive. This data was collected before the sell-off in equity prices over the past two days. Hence, we would expect that sentiment may have worsened still.

Elements of the real economy are now under threat and we would argue this has as much to do with the uncertainty and sentiment about exposures in the market. Our chapter on [The Human Reaction to Risk and Opportunity](#) from this year's "New Frontiers in Enterprise Risk Management" talks about how such amplification factors can come to fruition, as does our [streamlined blog posting](#) from January. We highlight these not to claim prescience, but to highlight the issues that still need to be addressed to reduce fear and continued amplification of the crisis.

Risk executives seem to be seeking safer haven and the steps taken to-date by governments are clearly not enough to have changed their sentiment.

You can discuss this report online in the LinkedIn Directors and Chief Risk Officers Group.

Comments Left by Respondents

"Encourage the banks to lend at a reasonable level. "

"Let the market do its work, let banks and/or GM fail, then the Feds can put together a consortium of vultures who can com in and buy what is left for pennies on the dollar. Maybe later sell at a small profit. i.e. let the free market do the work it's supposed to."

"Guarantees of the governments should be granted for long periods, should be increased banking control by the local banking supervisors, strict rules should be prepared to what level risk is tolerated, gathering funds by deposits should be recommended as the core source of funds for the most of the banks"

"Consistency from government"

"Need to deleverage banks and initiate lending to consumers possibly through an insurance program similar to the 1980 episode"

"Fiscal stimulus in major economies may help soften the recession but otherwise just time"

"I do not believe that further government action is required (at least in the UK). The priority now is for the surviving Firms to regain confidence and start lending to each other again."

"Government stimulus"

"Get policymakers into a room and throw away the key! The market is performing the downward value readjustment of companies with impaired economics that politicians are desperately trying to avoid. The public is being sold the official spiel that these market problems are about the repricing of risk while in reality the repricing of growth prospects is also a significant contributor. While politicians are wasting no time in advocating Keynesian-style policies of state intervention, nobody mentions that even such policies failed to revive the economy during the New Deal (the economy was still mired in recession as late as 1937)"

"Restoring consumer/market confidence in our financial institutions and demonstrating appropriate responsibility/accountability at the senior-most levels is an absolute key."

"None - let the free market work. "

"Weaker companies in all industries need to reorganize."

"Make sure that credit is available for good companies at a reasonable cost"

"Policy choices are limited -- housing prices will need to fall further until all bad underwriting, fraud and excessive speculation are shaken out of the system. Housing prices need to fall back in line with personal incomes and rental prices."

"Americans need to save/invest more over the longer term (despite paradox of thrift at this point in the business cycle). Auto industry needs to compete with Japanese, Koreans etc. or shut down."

"I think that BIS should rally the regulators and central bankers to discuss the changes that they will make and exchange "best practices", and use this as an opportunity to harmonize regulatory standards."

"Individual regulators would ideally reduce uncertainty by putting forth their ideas for changes ASAP and starting the public consultation process."

"Until US house prices stabilize any actions (tax and interest cuts) will serve to only soften the impact."

"The problem has moved beyond credit to that of the economy. Fiscal stimulus and coordinated action by central banks and governments are needed to restore confidence. Unfortunately given the G20 recently this looks to be highly unlikely."

“Regulation of Credit Default Swaps and other mortgage derivatives.”

“Help the consumer. Money to the banks must have been conditional on their spending it so that it not only helps them but also helps the consumer and the economy as a whole.”

“Lenders need to put liquidity back into the system to restore confidence. Hoarding of liquidity made available by the central banks will not be helpful therefore the regulators should ensure that there is a balance between lenders having sufficient capital to protect the undoubted increase in non performing assets and passing liquidity through to the system. “

"1) All kind of Disclosures of Financial Institutions Business practice with high degree of ethics and honesty

2) Global crises require Global solutions not just quick fixing ...

3) ""No more speculative Derivative"" product or control of the same. There are very few who understands the exotic maths and as such 'BS' model of option pricing has its own fallacy

4) Practitioner and the Educational institutions like Harvard, Wharton, MIT,LBS, INSEAD and of course CFA Institute requires a serious debate on the Financial theory and require to have collaborative work. What the model says once in century is happening every week ... It's a failure ever one should accept and look for serious modeling of fat tail event, the distributions, the volatility and beyond ..."

"Coordinated global fiscal policies increasing government spending”

“Common message from politicians to create ‘trust’”

"1. Introduce measures to make it harder for individuals to get credit.

2. Ensure that interest rate increases/decreases are linked to increase/decrease in inflation/credit usage.

3. Introduce measures to take the "greed" factor out of the banking and investment environment."

“More calm, less shrill politicking; allow the situation to settle and confidence will gradually return.”

“Coordinated stimulation of the economic growth is urgently needed. Seem to be agreed, but no strong credible action yet (US election slows down the process, EU coordination remains to be proven). Imposes that budget deficits increase beyond usual levels. There is no reason to believe that other countries than US can take the lead or that other countries growth will compensates what is happening to the US and the EU economies. Help (conditional) on weakest industries needed (GM). Otherwise, deflation and deep recession are to be expected”

“For all those non-financial firms, let 30% go bankrupt and let 70% merge before giving them any kind of "conditional" assistance.”

"Force banks to lend to each other"

"Force banks to take government guarantees wherever the central banks believe necessary"

"Force banks to de-lever - or introduce emergency regulation."

"Think we are passed the run on banks stage (state intervention has softened any further credit downside), but are now into the wider recession/depression as deleveraging continues. Deflation concerns need to be put to bed through monetary and tax policy."

"-more aggressive writedowns of weak on balance sheet assets

-GM needs to go through a bankruptcy reorganization

-AIG needs to be placed in conservatorship--Treasury support is delaying the inevitable"

"Put more focus on the credit markets. The equity markets are just a side show."

"- more unified actions from regulators

- review of the Basel II accord

- stricter supervision

- enforcement of penal codes in several cases (e.g. Lehman)"

"US citizenship to anyone who buys a house over \$500K and stays in it for 5 years."

Ductibility, 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

Contact:

David R. Koenig
Founding Partner

email) david.koenig@ductibility.com
telephone) +1-507-301-3149
fax) +1-480-247-4773
videoconference) <http://199.199.129.246>
web) <http://www.ductibility.com>

NOT FOR EXTERNAL DISTRIBUTION