

Ductilibility, LLC

Crisis Sentiment Index:

*An updated assessment of the
current financial crisis by
senior risk executives*

January 21, 2009

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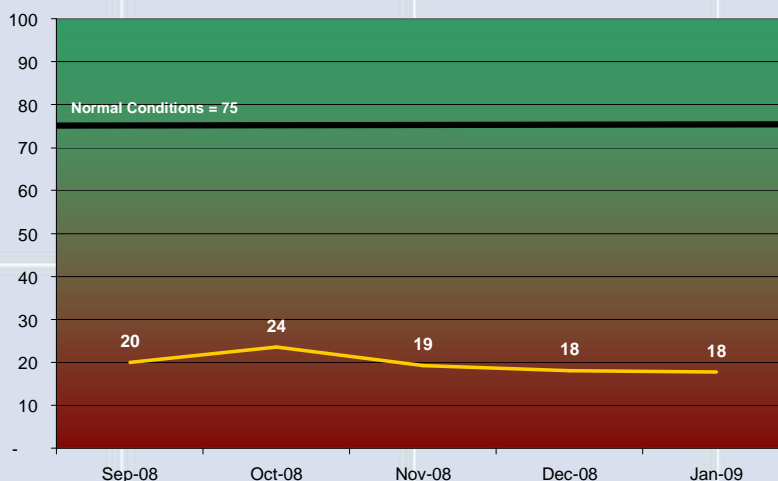
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Executive Summary

The *Crisis Sentiment Index (CSI)* is a monthly assessment of the status of the current financial crisis by senior risk executives around the world. Reported on a scale of 0 to 100, a reading of 75 indicates normal conditions.

The Crisis Sentiment Index (CSI) for January 2009 is 18, unchanged from December of 2008 and at its lowest level since the survey began in September of last year. Sub-indices of the CSI indicate some improvement in credit conditions, while such improvement was offset by a rapid deterioration in expressed sentiment towards the condition of financial institutions.

Crisis Sentiment Index (CSI)



Survey respondents this month continue to have highly negative views regarding the credit crisis, extending concerns to sovereign risk among major economies. The CSI-Banking sub-index fell to a reading of 7, from last month's reading of 17, now below the group's sentiment towards hedge funds. The CSI-Hedge Funds sub-index rose to a reading of 8, up from a level of 6 the month prior. Attitudes towards insurance companies deteriorated rapidly with the CSI-Insurance sub-index falling to a reading of 13.

This month we also asked for an assessment of the probability of a sovereign default by one of the G-10 countries. More than 1/3 of respondents assign a probability of greater than 5% to a default by one or more of the G-10 countries in the next ten years.

Full details are included in the body of the main report, which follows. Should you have any questions, please don't hesitate to contact me.

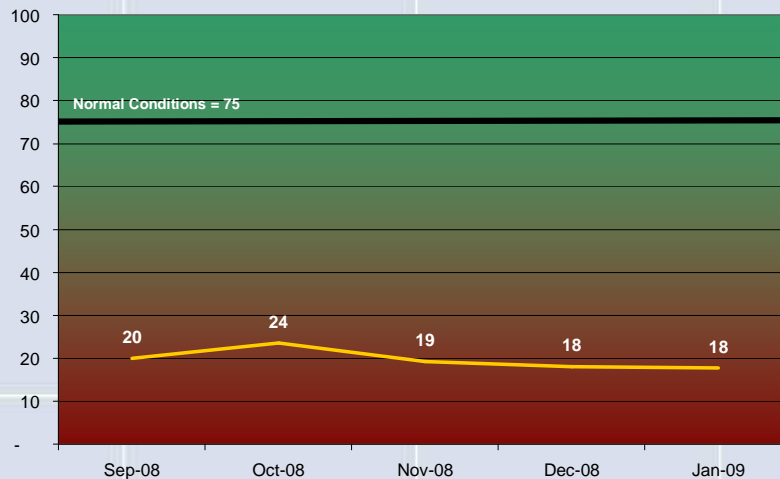
David R. Koenig

The survey was conducted between Monday January 19th and Wednesday January 21st, 2009. Survey participants typically hold the titles of Chief Risk Officer / Heads of Risk Management, Board Director or other C-Level title. Seventy-seven firms are represented in this month's sample set and are typically among 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 come from 19 countries, 51% from the Americas, 41% from EMEA and 8% from the Asia-Pacific region.

Credit Crisis Status

The Crisis Sentiment Index (CSI) is a weighted average of the results from standard questions being asked each month. The core assessment asks respondents to choose whether they feel the crisis is nearly over, that there are signs of improvement, that they are planning for a continuation of the crisis for the foreseeable future or that they expect the crisis to get worse.

Crisis Sentiment Index (CSI)



Fifty-seven percent of respondents are planning for a continuation of the crisis for the foreseeable future, while 13% expect a worsening of the crisis. Last month, only 4% chose this most pessimistic assessment. Only one respondent felt that the crisis was nearly over, while nearly 30% say that there are signs of improvement, but risks that the crisis will worsen again.

Respondents do note that credit conditions are improving somewhat, but credit remains quite constrained. There is a continuation of emphasis on the notion that this crisis is now hitting the real economy and is no longer just a financial crisis. There are expected additional negative consequences from this crossover.

Selected comments:

“Recent market evolutions are suggesting that the credit crisis is not over and in particular that we should take into account a possible feed back from the worsening of the macroeconomic scenario into the financial sector” - Chief Risk Officer, Europe

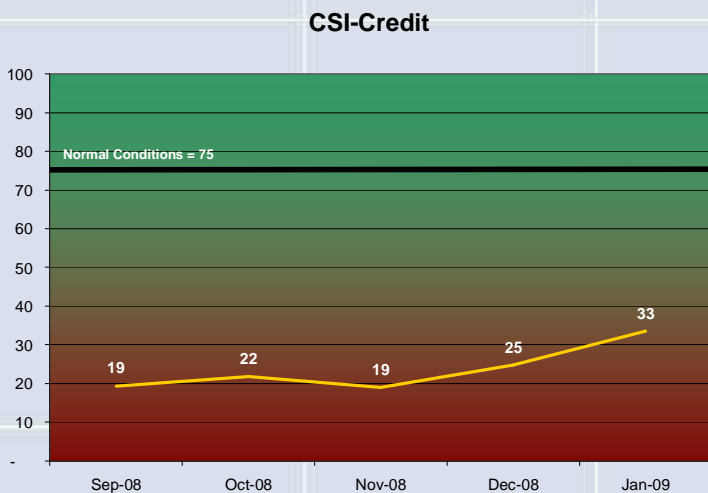
“There are signs of an improvement - falling inflation and interest rates, renewed interest in the housing market. As such we see 2009 as a year of stabilization. But bank lending still needs to improve.” – Head of Operational Risk, Europe

“This is not going to be a quick fix. There is a question of realigning priorities and ethical values to suit society's needs. It must be done before the interveners will relinquish their grip on the intervened.” – Board Member, Asia-Pacific

“This is more or less country specific. I believe that actions taken by financial institutions as well as concerted government actions will start to take their bite in mid 2009 and increase the liquidity situation of the banks. But I expect that the situation will only start to get better towards the end of the year in western markets and ripple out to other locations such as Eastern Europe.” – Chief Risk Officer, Europe

Availability of Credit

Our survey asks both credit providers and demanders of credit to tell us the extent to which they agree that credit has been made more available in the most recent weeks leading up to our survey. For the second month in a row, there is a reported improvement in credit conditions. While still quite far from a reading of 75, which would indicate normal availability of credit, the CSI-Credit sub-index reached a level of 33 in January, up from the low reading of 19 in November.



A North American Head of Risk Management said “the credit markets are thawing and both new issuance, new loans and secondary trading have increased.” He continued with an important modifier, though, noting that underwriting standards are tighter and origination is no longer being delegated to third parties that were negligent in terms of documentation. Such could give the appearance of tighter credit.

An Asia-Pacific Board Member noted the effects of the crisis on the process of planning, saying “We have had a roller coaster - our bank reneged on finance then came back and said we could have the loan after all then offered us a lower interest rate then told us we could only have half the loan. Some long term clarity and direction provided to the providers of loans by their senior managers would be a big help.”

In our study, 10% of users of credit report that conditions have improved, while 38% say that they have not. Of those providing credit, 15% report expanding the credit which they make available, while slightly more than one-quarter say that they are not making credit more available.

According to a North American Board Member, “while there is more liquidity in the system and interbank lending has improved, the condition of borrowers has deteriorated to such an extent that the expansion of credit will be impaired until the recession bottoms.”

He continued “the banks will continue to be under significant pressure until the recession bottoms,” noting that “as a result, additional ‘shocks’ like the recent Bank of America need for government support will continue to be a risk [and] will continue to affect the credit sector.”

A European Head of Operational Risk said “It is still difficult to access long term funds on the money markets. We are planning to reduce our retail lending in 2009.” Similarly, a European Board Member said “while western banks might be loosening up with their credit, Eastern European and Asian banks are still holding very tight and refuse to budget on tightened restrictions.”

Industry-Specific Assessments

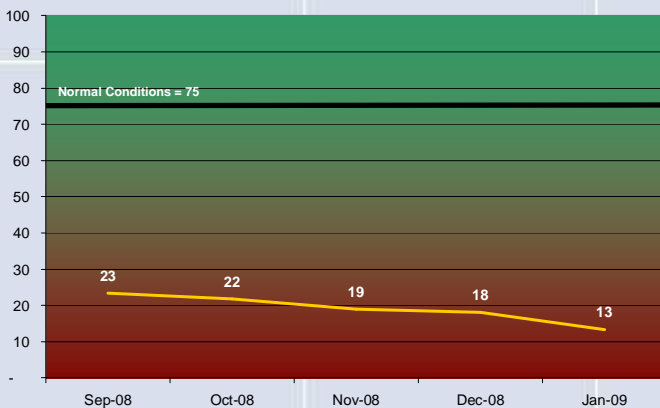
The CSI-Banking sub-index is a weighted index of sentiment as expressed via a specific question about the likelihood that at least one major bank will fail or be taken over as a result of the crisis and the primary question of the survey.

The survey results were surely impacted by the news stories in the days before the study regarding RBS, Bank of America / Merrill Lynch and others driving a rapid deterioration in sentiment towards the health of banks. The CSI-Banking sub-index fell to 7 in January.

Nearly 90% of respondents expect that “at least one more major bank will fail or be taken over as a result of the crisis”. Only three respondents disagreed with this sentiment.

Similarly, the CSI-Insurance sub-index is a weighted index of sentiment

CSI-Insurance

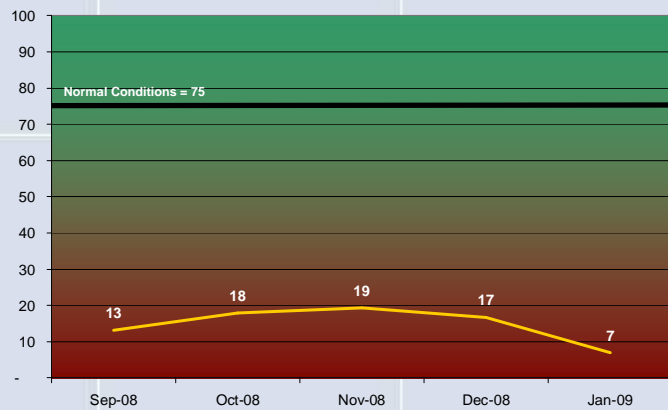


taken over as a result of the crisis” is roughly the same as last month. However, the percentage of respondents who disagree, nearly halved from last month to just 9%.

In January, the CSI-Hedge Fund sub-index showed very modest improvement, returning to the levels of October. Still, at a reading of 8, the assessment remains extraordinarily negative as the hedge fund graveyard fills.

Sentiment regarding the likelihood that another money market fund will “break the buck” has improved somewhat with the CSI-Money Markets sub-index rising to a reading of 24. This is still below all other months besides December, however.

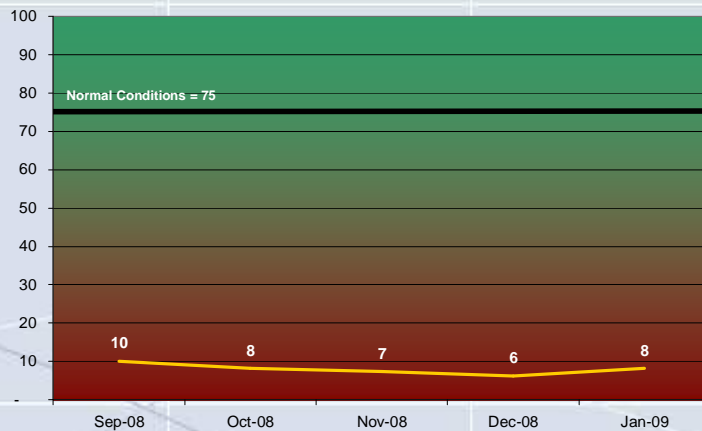
CSI-Banks



as expressed via a specific question about the likelihood that at least one major insurance company will fail or be taken over as a result of the crisis and the study’s primary question. This sub-index has been in decline every month and reached a new low of 13 in January.

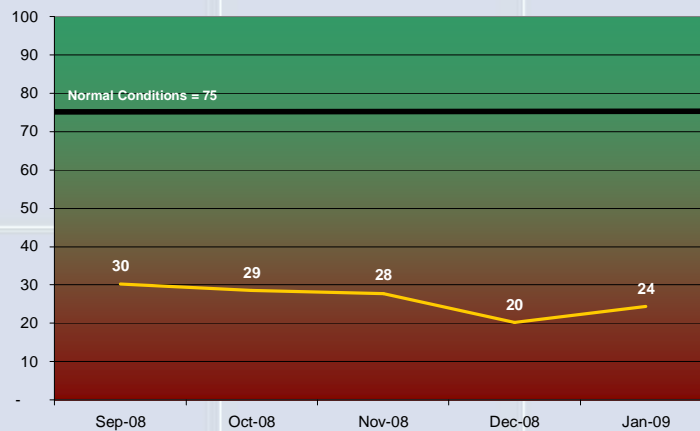
The percentage of respondents who agree or strongly agree with the statement that “at least one major insurance company will fail or be

CSI-Hedge Funds



An improvement in this reading is somewhat surprising given the many concerns expressed in last months study regarding the impact of zero and near-zero interest rates on such funds. Still, a reading of 24 is a highly negative assessment. It only appears better in comparison to readings like those on CSI-Banks, CSI-Insurance and CSI-Hedge Funds.

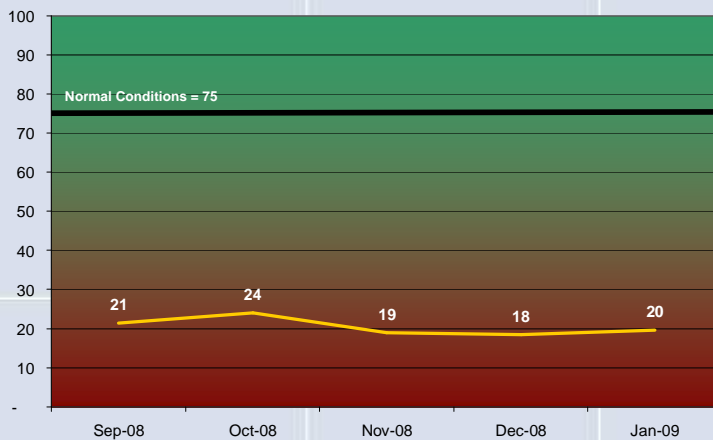
CSI-Money Market Funds



Fear

Each month we ask whether fear among market professionals and the public is growing. The assessments indicate a continued belief that such is the case with both groups. However, there has been a slight moderation in the percentage of respondents who strongly agree that fear is growing. This applies to both groups.

CSI-Fear



As a result, the CSI-Fear sub-index has improved in January to a reading of 20, roughly in the middle of the range of the past five months.

Fifty-five percent of respondents feel that fear is growing among market professionals. Meanwhile 26% disagree with such an assessment. Fear among the public is believed by a large majority to still be growing, 76% of respondents agreed or strongly agreed with this sentiment, with

just 16% in disagreement. Said one European Chief Risk Officer, “corporate and consumer confidence is shattered, momentum for political intervention is rising.”

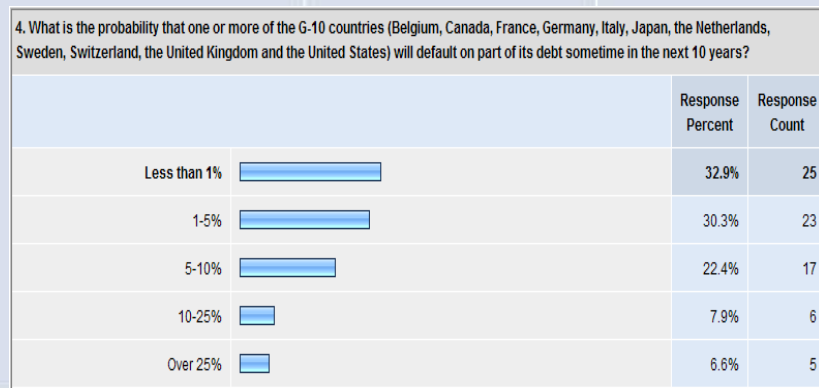
As with the industry-specific sub-indices, a reading of approximately 75 on the CSI-Fear sub-index would indicate normal conditions in the market. We would expect both CSI-Fear and CSI-Credit to be two indices which need to improve first before there will be a general improvement in sentiment towards the crisis. It would seem that is the motivation for political intervention as well. A European Chief Investment Officer suggests “an eerie resemblance to the 1998 days of LTCM’s (Long-Term Capital Management) debacle, [where] the market knows how to take advantage of a terrified counterpart (in this case, politicians and central banks who see no effect from their gargantuan bailouts)”.

One respondent, a European Head of Risk Management would like for us to “start talking up the market so that ‘confidence’ (green shoots) can start to come back.”

Sovereign Risk

With greater attention being paid to sovereign credit default spreads and the recent downgrades of the governments of [Greece](#) and [Spain](#), our curiosity was piqued as to whether fear had extended to include the fear of default among the most prosperous taxing authorities.

More than 1/3 of survey respondents assign a greater than 5% probability that one or more of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the



United Kingdom or the United States will default on their debt in the next ten years.

Two respondents cited widening sovereign CDS as a signal of growing risk. One European Head of Risk Management pointed to Spain, Ireland, the UK and US as heavily indebted countries, implying that the

greater risk among the G-10 is with the UK and US. However, other respondents cited Italy, Belgium and Switzerland being of concern, with the latter's banking system perceived as being "most at risk" by a European insurance executive. A Head of Investments from the Asia-Pacific region suggested that members of the Euro-currency group would be most at risk given limits on their ability to print money independently.

A [posting in the Financial Times Alphaville](#) from mid-December seems to cast doubt upon the value of sovereign CDS, though, suggesting that it is not clear what a credit event would be for a sovereign and whether anyone would be around to pay the claim should a credit event arise.

One European Treasurer in our study noted the "alternative for this scenario is intensive inflation of liabilities." Continuing, he said "actually this is only a 'technical difference' since this will erode the value of currency of the defaulting country." This respondent also seemed to suggest that differentials in the debt levels among EU countries could strain the Euro area.

The European Treasurer also believes "on a global basis we will observe increasing lack of capital – on the level of government funding." He continued, "this will create the environment for the next stage of market turbulence. Central banks will have to intervene and increase money supply through outright purchases of T-bonds. This will increase inflationary fears and US Dollar weakening, especially against the Yen, the speculative rise of gold and crude oil."

Conclusion

Risk executives who participated in this survey continue to express highly negative sentiment about the status of the credit crisis, and in many ways that sentiment has worsened. The term "downward spiral" has more frequently been in use and perhaps that is a reflection of a general sense that few, if any, know what the exact steps are that need to be taken. Fear has a way of immobilizing, until the flight or fight emotions kick-in. One European Chief Risk Officer believes that liquidity will continue to be the dominant issue in 2009, suggesting the dominance of the 'flight' response.

Overall, some improvements in the availability of credit offset the dramatic declines in sentiment towards banking and insurance sectors, leaving the CSI for January 2009 unchanged at a very low level. We continue to look for improvements in CSI-Credit and CSI-Fear as our leading indicators.

We will update our assessment again in one month's time to see if such have materialized.

In the meantime, you can discuss this report online in the [LinkedIn Directors and Chief Risk Officers Group](#).

Appendix

Questions in the Survey include the following:

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

- I believe the crisis is nearly over
- Conditions are improving, but, there is a chance that the crisis will worsen again.
- I am planning our risk management activities for a continuation of the credit crisis for the foreseeable future.
- I am expecting a worsening of the crisis.

2. Please tell us your agreement or disagreement with the following statements about the next stages of the current credit crisis (Strongly Agree, Agree, No Opinion, Disagree, Strongly Disagree):

- At least one more major bank will fail or be taken over
- At least one more major insurance company will fail or be taken over
- A major hedge fund will close
- Another major money market fund will "break the buck"
- Fear among market professionals is growing
- Fear among the public is growing

3. My company is a credit provider and we have been expanding our offering of credit to customers over the last few weeks (Strongly Agree, Agree, Neutral, Disagree, Strongly Disagree)

4. My company is a user of credit and we have experienced an improvement in the availability of credit to us over the last few weeks (Strongly Agree, Agree, Neutral, Disagree, Strongly Disagree)

5. What is the probability that one or more of the G-10 countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) will default on part of its debt sometime in the next 10 years?

Ductibility, LLC

A private research and advisory network serving the governance needs of Boards of Directors and senior executives.

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