

Ductilibility, LLC

Crisis Sentiment Index:

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

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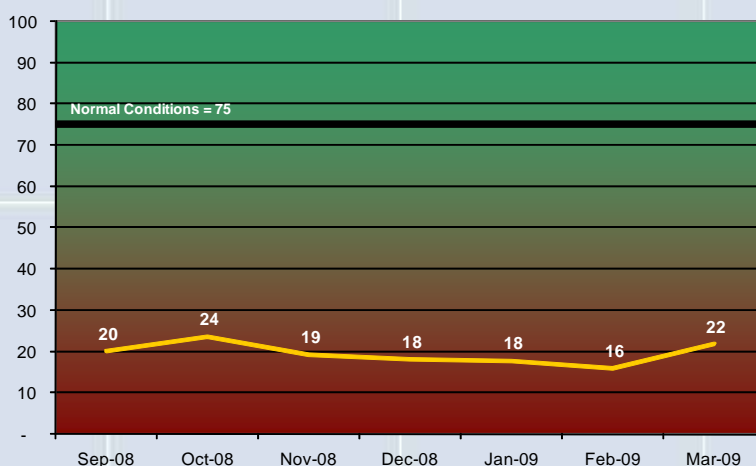
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Executive Summary

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 March 2009 has improved to a reading of 22, up from 16 in February, and ending the deterioration realized in each successive month since October of last year. While still an extremely negative sentiment reading (nearly 2/3 of respondents expect a continuation of the crisis for the foreseeable future, or a worsening), sharp improvements in two leading indicators, fear and the availability of credit, combined with somewhat improving sentiment towards financial institutions to push the index higher this month.

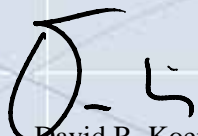
Crisis Sentiment Index (CSI)



The CSI-Banking sub-index jumped to 15 from last month's reading of 9. CSI-Money Markets increased to 33, its highest reading since the surveys began in September of last year. CSI-Fear jumped to 29 from 17 last month and is also at its highest point since the survey began. CSI-Credit, increased to a reading of 33, its highest level since the survey started. While normal conditions are indicated by a reading near 75, we have often cited CSI-Fear and CSI-Credit as the two indices we will watch for the first signals of overall improvement.

This month we asked for our respondents to take a punt on calling whether stock markets have bottomed. Equity prices feed some important corporate credit models. Hence, changing sentiment here could have other implications.

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.

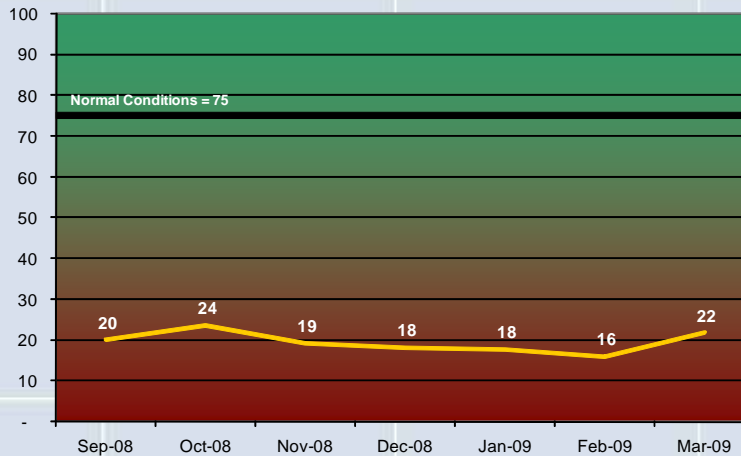

David R. Koenig

The survey was conducted between Wednesday March 18, 2009 and Friday March 20, 2009. Survey participants typically hold the titles of Chief Risk Officer / Heads of Risk Management, Board Director or other C-Level title. 94 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 21 countries, 52% from the Americas, 40% 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 9% expect a worsening of the crisis. More than 1/3 of respondents, though have chosen our two more optimistic assessment choices, with 30% saying that conditions are improving, but risk remains. Five percent believe the crisis is nearly over.

In general, there is a sense that the deterioration in the financial sector, particularly banking, has slowed. This is not to say that the sector is rebounding, but rather that it may be less unstable than in past months. Several respondents made comments regarding real-economy impacts feeding back into the banking sector and having the potential to create renewed problems.

Said one European Head of Risk Management, “With delinquencies on auto loans on the rise, we just have to be careful that there will be no further deterioration in bank’s balance sheets.” Similarly, one European Chief Financial Officer noted “I think the banking side may be stabilizing, but other sectors – retail, anything involving consumers – is going to get worse before it starts to get better.”

One North American Board Member believes “the extent of the bank ‘portfolio problem’ has been over-estimated by many commentators.” He continued, “Incremental capital injections by the government may be less than many have predicted. The big issue going forward will be the rise in the unemployment rate, which will affect bank reserves and economic demand.” Concurring on the last point, a North American Chief Risk Officer warned that “this still has not worked through the entire economy, yet, which will continue to stress bank balance sheets and curb credit.”

Nearly half of the responses were received before the U.S. Fed announced its specific plans for quantitative easing and all were received before the U.S. Treasury detailed its plans for the supported purchase of bad assets. However, there was no significant difference in the responses received after the Fed announcement and those received before. A Chief Investment Officer in the Asia-Pacific region opined “quantitative easing is likely to bring in spreads over the near term, but the market remains vulnerable to any bad news.”

Additional comments:

“At this point in time, there appears too little movement in lending at the consumer level. Therefore consumers will continue to restrict their spending that in turn will lead to the continued stagnation of sales, manufacturing orders, etc. My sense is that what will drive improvement in this cycle is improvement in consumer confidence which is still weak at this time.” – North American Board Member

“I certainly don’t believe that we (the USA) have seen the bottom of this current crisis. In looking at the bigger picture (the rest of the economic world) you can see that numerous paradigm shifts will need to take place before true economic recovery is acknowledged. An example is that the world dependencies are not the same continent to continent and are even more pronounced in the Asian [countries]. Credit tightening, energy and general resource depletions are at stake here but that is not necessarily the case in other parts of the world and yet the crisis exists there too.” – North American Board Member

“[I see] bright spots, but still finding unintended consequences.” – North American Board Member

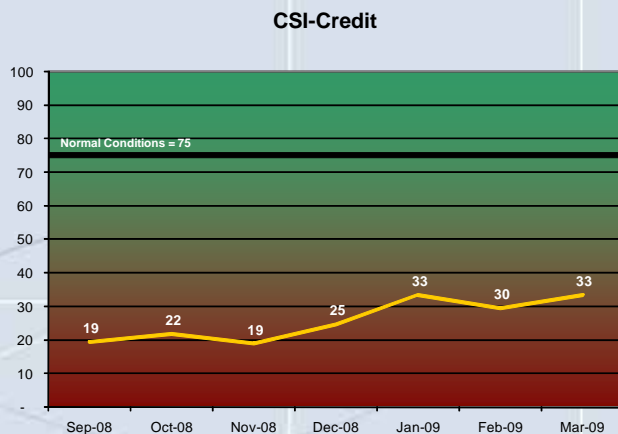
“Continued deleveraging across broad asset classes and client types.” – European Head of Quantitative Risk Management

“I see another 2-3 months of stress, but lightening quickly thereafter.” – North American Head of Risk Management

“Too much optimism exists with respect to emerging economy powerhouses in Asia and Latin America being able to navigate the real economic contraction...I expect the final leg down in asset prices to occur once this optimism has faded.” – European Chief Risk Officer

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. Conditions continue to improve, albeit slowly. While still quite far from a reading of 75, which would indicate normal availability of credit, the CSI-Credit sub-index is up to its highest reading since our study began, at 33.



“Credit and credit-related insurance remains tight,” said one European Chief Financial Officer. “But [credit] is available in ‘pockets’ and banks credit committees seem more supportive where they see long-term and existing relationships.” A North American Chief Risk Officer said “Credit is available. Lending goes on despite all of the claims by regulators and legislators that it isn’t. It is now more prudent. What do they expect, the same level of lending and free credit that got us into this

situation?”

The theme of ongoing lending, but only to better credits, is one we have had expressed in this study for a few months now. One North American Chief Risk Officer noted “we are trying to diversify and therefore are investing in more high quality credits (wholesale, not consumer).”

In our study, 22% of credit providers report expanding their offerings, while 18% say they are not. This increased availability is not yet seen by those in our study who use credit, with just 13% reporting credit to be more available and 25% disagreeing that credit is more available.

Industry-Specific Assessments

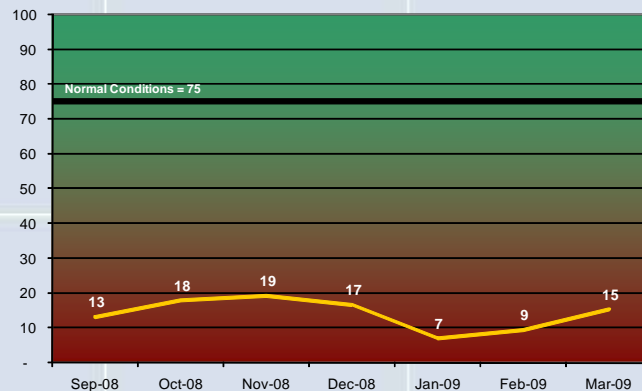
The CSI-Banking sub-index is a weighted index of sentiment as expressed via a specific question about the likelihood that at least one major bank will fail or be taken over as a result of the crisis and the primary question of the survey.

Following a series of “happy talk” comments on bank profits in the first quarter to-date, sentiment seems to have improved among our respondents, although, attitudes can still be classified as dismal. During March, the CSI-Banking sub-index rose to a reading of 15, up from 9 in February and from a low of 7 in January of this year.

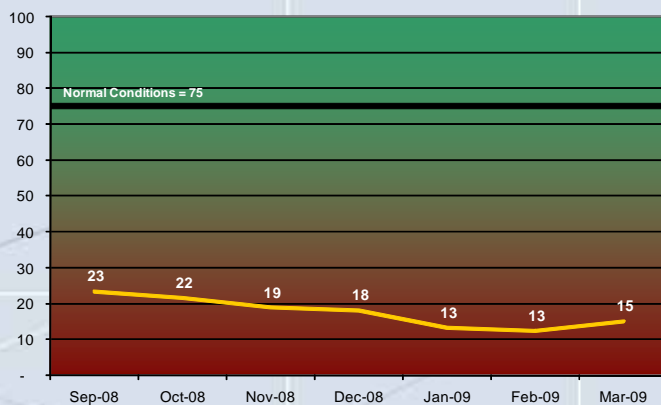
Only 27% “strongly agreed” that “at least one more major bank will fail or be taken over as a result of the crisis”, which is down from 47% in February and 58% in January. Twelve percent “disagreed” or “strongly disagreed” with this statement, which is up from 8% in February and just 4% in January.

The CSI-Insurance sub-index is a weighted index of the study’s primary question and sentiment 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.

CSI-Banks



CSI-Insurance



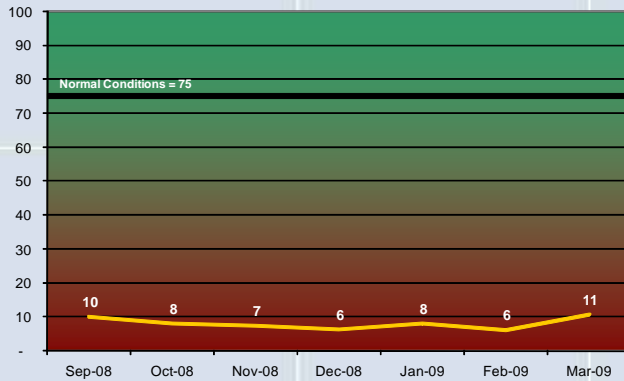
This sub-index has been in decline every month through January, and remains mired at a very low reading of 15 in March, clearly reflecting a high degree of pessimism about insurance company prospects.

The percentage of respondents who agree or strongly agree with the statement that “at least one major insurance company will fail or be taken over as a result of the crisis” is over 80%. Just 10% of respondents disagree.

Since the start of our survey, sentiment towards the hedge fund industry has been the most negative of all that we have examined. While, in March, the CSI-Hedge Fund sub-index reached its highest

level since our survey started, the sub-index reads just 11, continuing its place as the financial industry receiving the most dismal sentiment score in our study.

CSI-Hedge Funds



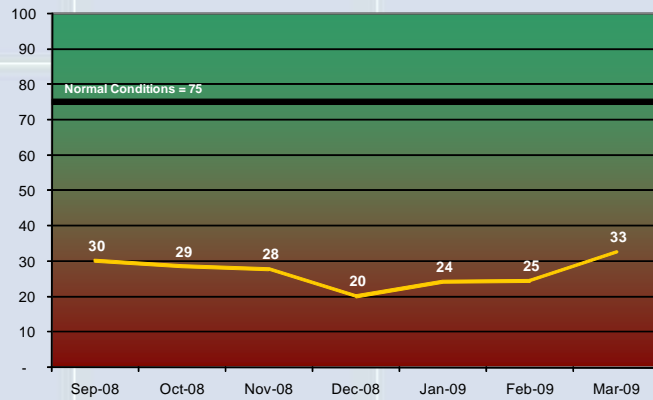
Sentiment regarding the likelihood that another money market fund will “break the buck” has improved for the third month in a row. The CSI-Money Markets sub-index rose to a reading of 33 in March, also at the highest level since we began our survey.

A general note of caution was left by one North American Board Member, saying “Corporations and government entities are early into an execution

mode – haste and politics have spawned inevitable errors of discovery and solution. People are grappling with now-apparent recessionary consequences and implications.”

One European Chief Risk Officer said “There is a growing sense that, in the U.S., at least, we may be in the end phase. Whatever that means, I suggest that the recovery will be far weaker than is commonly supposed.”

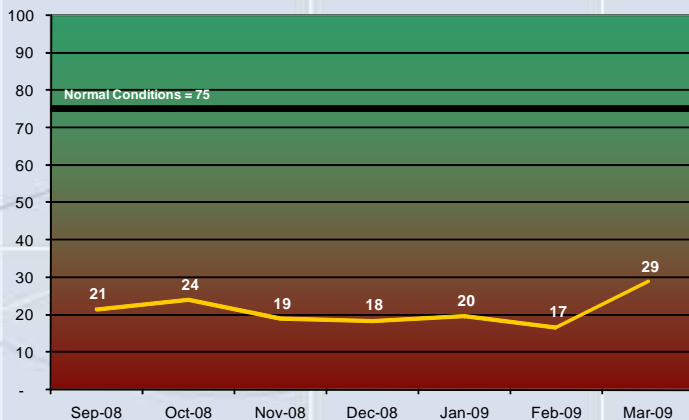
CSI-Money Market Funds



Fear

Each month we ask whether fear is growing among market professionals and the public. We believe this to be one of the key leading indicators of the direction the crisis will take, especially as it relates to credit availability. During March, the CSI-Fear sub-index jumped to a new high for our survey history of 29.

CSI-Fear



Again, with a reading of 75 being an indication of normal times, there is still a great deal of growing fear.

In this month’s study, the growth in fear is identified to be more prevalent among the public than financial professionals. This month, more respondents “disagreed” or “strongly disagreed” that fear among financial professionals is growing than “agreed” or “strongly agreed” with the statement. In fact, fully 50% of respondents were in the camp that could not agree with

the statement that fear among market professionals was growing. Just 31% “agreed” or “strongly agreed”.

The story for the public, though, is not so positive, perhaps reflective of the many comments about how this crisis has become one of the real economy. Almost 2/3 of respondents feel that fear among the public is growing, while just 20% disagreed.

A few of our respondents attempted to classify the mindset of consumers in the classic Kubler-Roth model of dealing with grief and loss. They did not agree with each other, though, with one European Head of Risk Management suggesting they were in denial about the recession, a Chief Risk Officer from the Asia-Pacific region suggesting a movement from fear to uncertainty, or perhaps bargaining and a North American Actuarial Executive suggesting we have moved from “fear” to “anger”.

Again, while much of our survey data was collected before U.S. Fed announced its quantitative easing plans, and all was gathered before the U.S. Treasury announced its plans for toxic assets, a look for better clarity and leadership from Washington is still being called for. One North American Chief Risk Officer said “...the growing fear is not being negated or addressed by so-called leadership in Washington, business leaders or elsewhere.”

I have made the case for the need to isolate the bad assets and to address the fear and lack of understanding by the public before. You can read a brief overview on some of the psychology behind how risk events become exacerbated when such is not done in my article “[Watching the Social Amplification of Risk Live](#)” from January of 2008, which is primarily excerpted from a chapter which I wrote for the book *New Frontiers in Enterprise Risk Management* called “[The Human Reaction to Risk and Opportunity](#)”.

Picking a Bottom in Stocks?

Often, equity prices are considered to be leading indicators of future economic conditions. When asked to assess the likelihood that “a bottom” had been put in for equity prices in some important economic regions, our respondents were not very positive, perhaps in line with the overall CSI reading.

Do you think the bottom has been put in on the major stock market indices in the countries below?

	Yes	Not Sure	No
In the UK	7.8% (7)	27.8% (25)	64.4% (58)
In Western Europe	6.6% (6)	25.3% (23)	68.1% (62)
In Japan	10.0% (9)	44.4% (40)	45.6% (41)
In China	11.2% (10)	39.3% (35)	49.4% (44)
In India	6.7% (6)	55.6% (50)	37.8% (34)
In the US	20.9% (19)	24.2% (22)	54.9% (50)
In Brazil	5.6% (5)	53.3% (48)	41.1% (37)

Sentiment is least negative towards U.S. equity prices, with 21% of respondents feeling that a bottom has been reached, but nearly 3 times as many respondents disagreed with them. The most negative assessments were saved for Brazil where just 6% felt a bottom was in, Western Europe and India where just below 7% felt a bottom was in and the UK, where 8% felt that a low may have been reached.

One Asia-Pacific Chief Investment Officer said “labor market flexibility and the fact that the crisis originated in the U.S. suggests that it might bottom out there soonest as well. However, transaction volumes and consumer confidence are likely to remain depressed for at least the next 12 months. “

The notion of labor flexibility in the U.S. has been mentioned by others before as a potential moderating influence. One interesting paradox from the cause of this crisis is that more Americans are locked into their homes and are less flexible than before. An excellent article in the Atlantic Monthly in March, “[How the Crash Will Reshape America](#)”, suggests that if we want labor flexibility the picture may need to flip in coming generations towards a population dominated by renters, not owners. The Economist magazine also raises questions about whether U.S. workers are as mobile as they used to be in “[The Road Not Taken](#)”.

One North American Chief Risk Officer reminds us that “regardless of the duration [of the crisis] (which I do believe will be prolonged), a sound, integrated risk management program must be implemented – one which anticipates future shocks rather than reacts to past crises.” We wish us all such foresight and the willingness of our companies to engage in such reviews.

Conclusion

For the first time since we began our surveys of sentiment among Chief Risk Officers, board members and other senior executives around the world, we have seen some improvements in sentiment, especially in the areas which we expect to be leading indicators (CSI-Fear and CSI-Credit). However, we are a very long way from normalcy and the road ahead seems filled with continued risks that, if realized, would lead to another round of deterioration.

We will update our assessment again in one month’s time to see if the improvement in our leading indicators continues. If it does, we would expect the overall CSI to begin more rapid improvement as well.

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. Do you think the bottom has been put in on the major stock market indices in the countries below (the UK, Western Europe, Japan, China, India, the U.S., Brazil)?

Ductibility, LLC

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

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