

Ductilibility, LLC

Crisis Sentiment Index:

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

April 23, 2009

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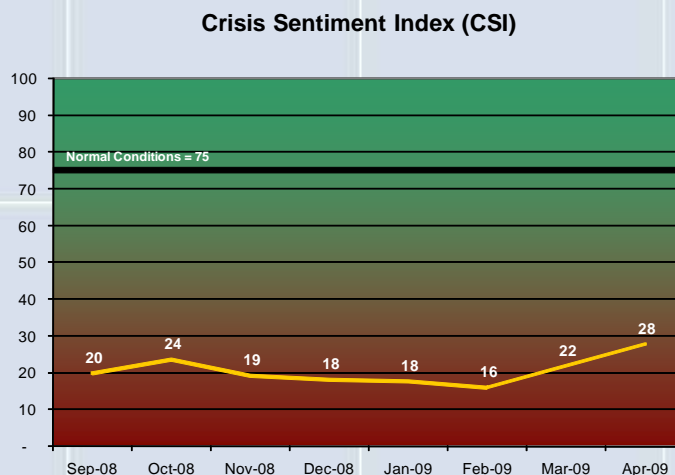
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Executive Summary

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.

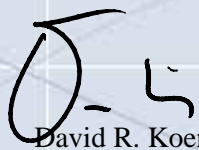
The Crisis Sentiment Index (CSI) for April 2009 has improved to a reading of 28, up from 22 in March, the second straight month of improvement in sentiment. While the CSI is at its highest level since we began our surveys, it must be emphasized that sentiment is still substantially negative. Only 5% of respondents believe the crisis is nearly over, while twice that many expect a worsening of conditions. The extent to which fear among market professionals is affecting the crisis improved again this month, but our other leading indicator, regarding the availability of credit, deteriorated slightly, with providers of credit reporting less willingness to lend than in recent months.



The CSI-Fear sub-index improved to 39 from 29 last month and is at its highest point since the survey began. CSI-Credit dropped slightly to 32 from last month's reading of 33 and has been mired around this level for four months. The CSI-Banking sub-index improved again, rising to 25 from 15 last month and other industry sentiment readings also improved. CSI-Money Markets increased to 41, its highest reading since the surveys began. Like the overall CSI, all sub-indices remain well below the 75 level which is considered indicative of "normal" conditions.

This month we asked for our respondents to assess the likely impact of the crisis and government responses on inflation over the coming two years. Respondents have some strong opinions and differing expectations. We examine expectations for different countries and regions.

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.

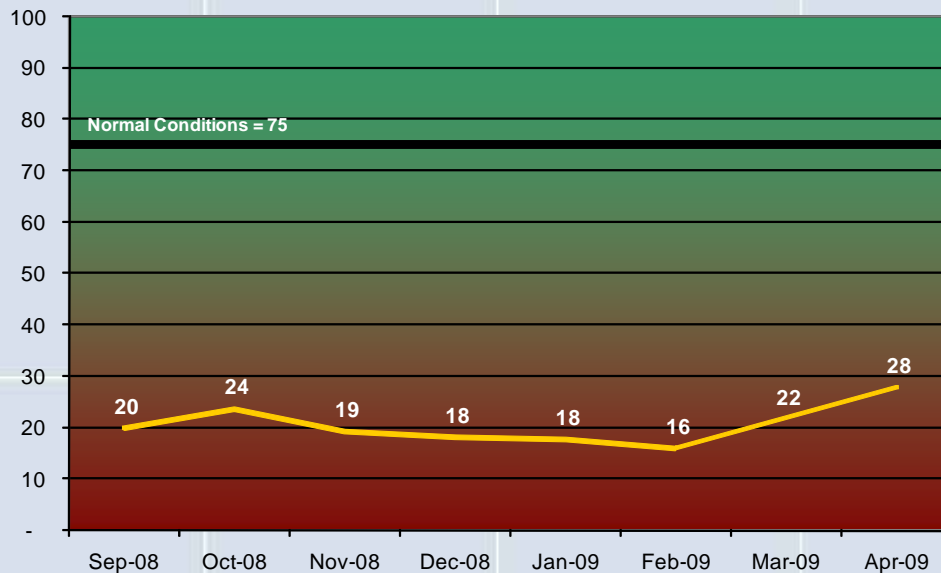

David R. Koenig

The survey was conducted between Monday April 20th, 2009 and Wednesday April 22nd, 2009. Survey participants typically hold the titles of Chief Risk Officer / Heads of Risk Management, Board Director or other C-Level title. 102 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 significant number of non-financial companies. Respondents come from 18 countries, 50% from the Americas, 42% 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)



Those expecting that the crisis is nearly over (5%) or that it will worsen (9%) comprise roughly the same percentage of respondents as in the past month. However, there has been a reversal of the ratio of respondents choosing the less extreme views among our standard statements of assessment. More than half of all respondents indicated that conditions are improving, with a chance that the crisis will worsen again. But, just 1/3 of respondents are now planning for a continuation of the crisis for the foreseeable future, down from nearly 60% last month.

Several respondents seem to be looking for a “W” shaped recovery, suggesting that we have only gone through the first phase, with risks of a second phase of credit losses being realized in the not too distant future. Said a Head of Investments from the Asia-Pacific region, “the systemic risk to the banking system is probably past...what remains to be seen is whether the banks and other financial groups begin to take larger than expected losses on their consumer, commercial property and corporate loan books.” A Chief Risk Officer from the Americas indicated concern over the same risk, saying “[we] still have to see the deterioration (continued) of credit card, auto, CRE and other asset types.” Finally, a Chief Executive Officer and Board Member from the Americas similarly noted “the commercial real estate and credit card markets have yet to feel the full pain of the situation...that is still to come.”

Challenges to dealing with the crisis from a practical standpoint were also noted by two respondents. A Chief Risk Officer from the Americas said “[my] colleagues are overly optimistic, in my opinion, and are not working to prepare for the worst, even though it can be done with little risk of lost opportunity.” Such lack of focus on preparation for hypothetical outcomes could be the case because companies are too busy dealing with the present. Said one EMEA Senior Executive “[we’re] still reducing some difficult risk concentrations.”

Commenting on the politics of the crisis, an EMEA Chief Investment Officer said “we have been witnessing a series of PR-intensive efforts (including the irresponsible congress-pressured changes in [mark-to-market] treatment under FASB 157). I expect a major media offensive by governments and central banks to underscore the ‘crisis nearly over’ message.” An EMEA Chief Operating Officer said “The UK still lags behind and does not implement visible changes. It will require a political change before this will be possible.”

Additional comments:

“The warnings of the President of the FDIC are still burning my earlobes.” – EMEA Board Member

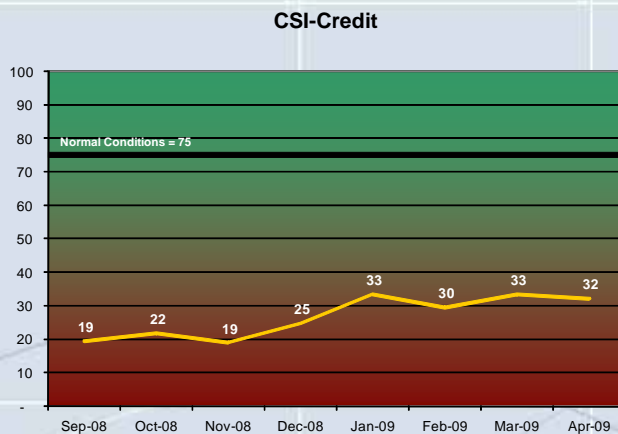
“The government stress tests are useless and clearly favor investment banks over commercial banks as they punish bad loans but not the structured products built on those loans.” – EMEA Chief Risk Officer

“Some of the CEE/Far East countries are only now starting to feel the brunt of the downturn, lagging some 9-12 months behind the US and UK.” – EMEA Head of Risk Management

“Banks’ failure to get ahead of this and loan money to small (5 person) businesses in order to allow a continuation of operations vastly increases the severity of this crisis. Bankers...action to vastly increase consumer credit rates was deplorable...how can the economy improve when the benefactors of government actions don’t share the benefit?” – Americas 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. For four months now, credit conditions have been mired in a poor state, albeit a slightly improved state from the fourth quarter of last year.



Trying to provide an explanation for this result, a Chief Executive Officer and Board Member from the Americas stated “I believe that until the ‘bad’ banks are weeded out, and consumer confidence has a chance to recover, there will continue to be a credit crisis.”

As an EMEA Board Member noted “credit remains tight [and] highly sophisticated techniques are necessary to obtain credit at a good rate.”

One EMEA Chief Risk Officer said “banks are trying to be supportive of existing relationships, but are not at all keen to expand unless a transaction is fee-income driven and with a short duration risk horizon.” Seeing opportunity in the withdrawal of some larger institutions, one Board Member from the Americas noted that “smaller regional and community banks continue to seize opportunities being abandoned by large banks.”

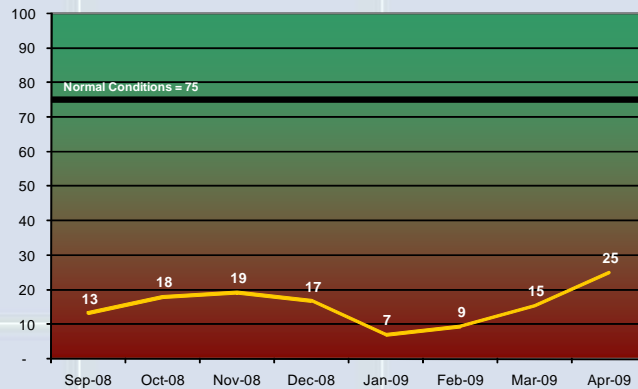
In our study, 26% of credit providers report reducing their availability of credit, up from 18% last month, while roughly the same percentage as last month, around 20%, say they are expanding credit offerings.

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 number of respondents who “strongly agreed” that “at least one more major bank will fail or be taken over as a result of the crisis” continues to improve with just 17% choosing this option in April, down from 27% in March, 47% in February and 58% in January. Twenty-six percent “disagreed” or “strongly disagreed” with this statement, which is up from 12% in

CSI-Banks

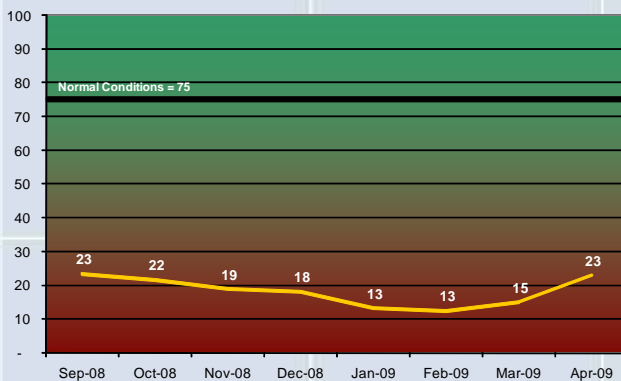


March, 8% in February and just 4% in January.

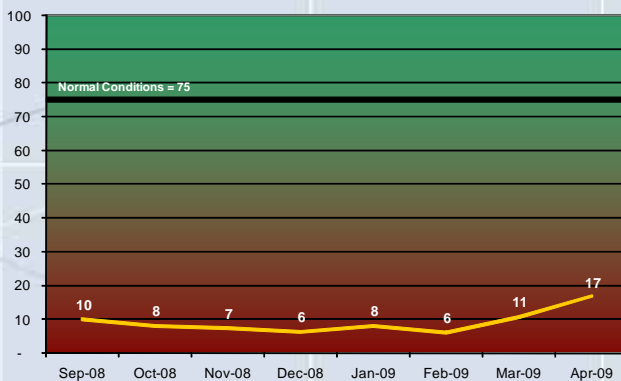
The CSI-Insurance sub-index is a weighted index of the study’s primary question and sentiment as expressed via a specific question about the likelihood that at least one major insurance company will fail or be taken over as a result of the crisis.

For the second straight month, this sub-index has improved, moving to 23 in April, equal to the best assessment of the industry since our first survey in September of 2008.

CSI-Insurance



CSI-Hedge Funds



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” has fallen to just below 65%, whereas it was over 80% in the prior month’s assessment.

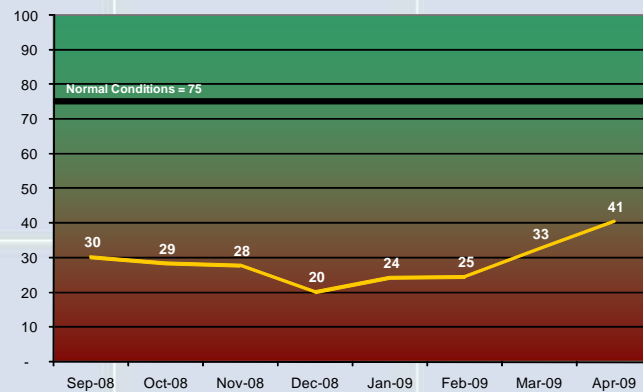
The sentiment towards hedge funds has improved for the second straight month, but continues to be the most negative assessment towards any of the sectors on which we have asked for opinions. Rising to a level of 17,

from a low of just 6 two months ago might seem like a significant improvement. However, “normal” conditions are nearly 60 points away from present conditions. Given the regulatory outlook for hedge funds and the challenges faced by pensions and endowments, it would be reasonable to expect this sub-index to struggle even to reach modestly negative levels in the next few months.

Sentiment regarding the likelihood that another money market fund will “break the buck” has improved for the fourth month in a row. The CSI-Money Markets sub-index rose to a reading of 41 in April, the best assessment of any of the sub-indices in the study. Clearly risks remain and we will only begin to take more significant comfort from this sub-index when we see readings in the 60s.

An EMEA Head of Risk Management expressed his company’s economic assessment as being a cross-roads over the next 3-6 months, deciding how deep the recession will be. He indicated that broadly, “another broken bank will cause further issues.” Another EMEA Chief Risk Officer suggested that “the banking sector appears to be stabilizing, although there is considerable risk that the worst may still be to come in the non-banking sector.” Many cite the feedback loop of corporate problems to the bank’s balance sheets as the issue which could trigger the second leg down in a “W” shaped recession and recovery.

CSI-Money Market Funds

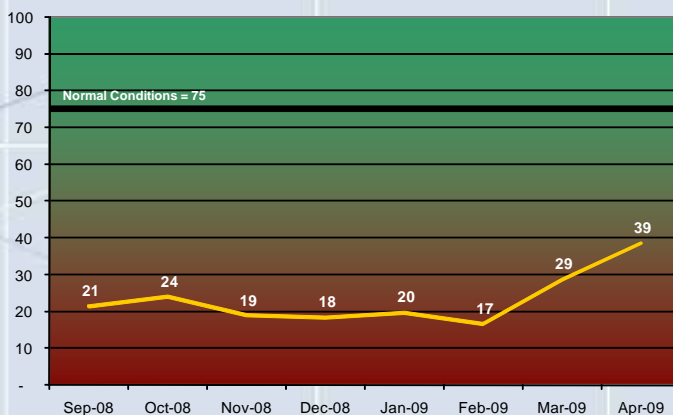


With a very specific regional assessment, one Board Member from the Asia-Pacific region said “Australian first-tier banks are sound.”

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 April, the CSI-Fear sub-index jumped to a new high for our survey, reaching a level of 39. Again, with a reading of 75 being an indication of normal times, fear continues to grow, just more slowly.

CSI-Fear



Sixty percent of respondents said that they disagreed or strongly disagreed that fear was growing among market professionals, but still 40% felt it is growing among the public.

The latter is an improvement from last month where almost 65% of respondents felt that fear was growing among the public. Over 1/3 of respondents this month disagreed or strongly disagreed that fear among

the public is growing. One Chief Executive Officer and Board Member from the Americas suggested “the public is in ‘disaster denial’” incorrectly feeling that the worst is over.

An EMEA Chief Investment Officer believes any improvement in the level of fear among market professionals is misguided, saying “pros continue confusing their hopes with forecasts. I wish them well...” An EMEA Head Actuary states clearly “if share prices (of financials) rise so strongly, sentiment must be improving.” Meanwhile, an EMEA Board Member has less faith that fear is a good leading indicator noting that a year before the crisis, no one was afraid of [a crisis] occurring.

Inflation or Deflation?

Input from respondents seems to match the analysis carried in the financial press about the future of consumer price trends. There seem to be three camps dominating, one arguing that we have entered a period of prolonged deflation, another is looking for the impact of delayed/mistimed government spending and loose monetary policy to spur rapid inflation and those who expect not much change from the present.

On the surface, this month’s focus question might not seem to offer much insight. However, the notion that nearly 1/4 of respondents expect substantially elevated inflation in the US and UK seems worthy of note.

Regarding trends in consumer prices, which is the most likely to be realized over the coming two years?					
	Deflation	Steady and low inflation	Slightly elevated inflation from that of the past three years	Substantially elevated inflation from that of the past three years	No opinion
In the UK	23.0% (23)	18.0% (18)	26.0% (26)	22.0% (22)	11.0% (11)
In Western Europe	18.4% (18)	26.5% (26)	25.5% (25)	16.3% (16)	13.3% (13)
In Japan	27.3% (27)	25.3% (25)	15.2% (15)	4.0% (4)	28.3% (28)
In China	3.0% (3)	32.0% (32)	22.0% (22)	11.0% (11)	32.0% (32)
In India	4.1% (4)	23.7% (23)	23.7% (23)	5.2% (5)	43.3% (42)
In the US	19.0% (19)	26.0% (26)	26.0% (26)	22.0% (22)	7.0% (7)
In Brazil	5.1% (5)	21.4% (21)	18.4% (18)	12.2% (12)	42.9% (42)

On the other end of the spectrum, the risk of deflation taking hold appears to be of most concern in Japan, where nearly 40% of respondents with an opinion expect deflation to dominate the next two years in that country.

Deflation in India, China or Brazil does not seem to be of concern to respondents. Across those countries, fewer than 10% of respondents who had an opinion expressed such an expectation.

Regarding the timing of any changes in inflation trends an EMEA Chief Compliance Officer said “the horizon of two years gives a somewhat tainted picture...most countries will initially experience deflation, however followed by a rather swift “explosion” of inflation.” An EMEA Chief Risk Officer agreed, saying “...inflation will eventually rise, but not until several months [from now] as the crisis is not over.” Another EMEA Chief Risk Officer cited mixed signals, saying “...western countries [are] more exposed to deflation in the short term, but inflation concerns are growing for Q4”.

A Chief Risk Officer from the Americas feels “inflation cannot occur until jobs rebound...there is no sign that jobs are stabilizing or rebounding in any real sense.” An EMEA Chief Risk Officer expressed expectations that Quantitative Easing should be expected to lead to inflationary

pressures, but the stage of the cycle in which we find ourselves makes the inflationary outlook unclear. These two comments seem to tie into the “W” shaped cycle mentioned earlier, suggesting that once we are through with the cycle, inflation risk will quickly grow.

Conclusion

Sentiment has improved, but remains highly negative. We have some concern that the CSI-Credit sub-index has not improved in four months. This would suggest a stalling in improvement of credit conditions. If a stagnation in improvement of credit availability were to continue, this may put the improvement in the CSI-Fear sub-index at risk as well, particularly if a major corporate failure materializes in the coming months.

We will update our assessment again in one month. 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. Regarding trends in consumer prices, which is the most likely to be realized over the coming two years, Deflation, Steady and low inflation, Slightly elevated inflation from that of the past three years or Substantially elevated inflation from that of the past three years? (in 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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