

Ductilibility, LLC

Crisis Sentiment Index:

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

September 30, 2009

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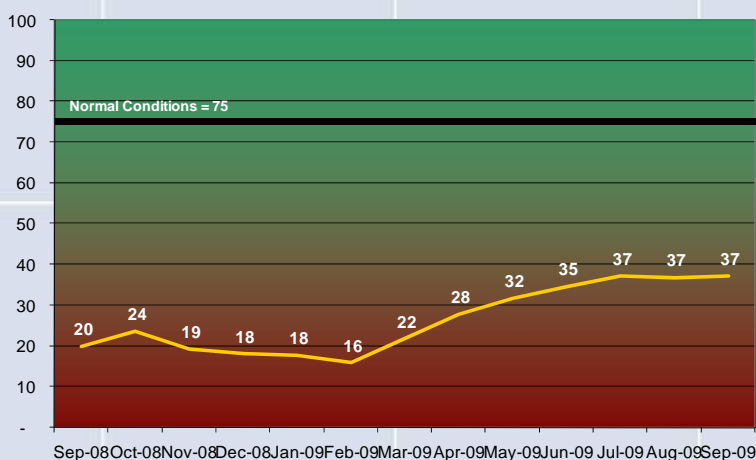
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Executive Summary

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

The Crisis Sentiment Index (CSI) for September 2009 was 37, unchanged for the second month in a row. Despite buoyant comments from central bankers and others that the recession has ended, our respondents are demanding much more time to pass without incident before declaring an end to the crisis. In fact, more than 60% of those who still feel there is a risk to a continuation or worsening of the crisis want to see more than one year pass without major incident before declaring the crisis to have passed.

Crisis Sentiment Index (CSI)



Slight improvements in industry-specific sub-indexes were offset by a second straight decline in the CSI-Fear sub-index. The latter had been on a steady increase since February, but peaked at a reading of 53 in July and registered a reading of 47 in September. We had been expecting that a continued improvement in CSI-Fear would be a forerunner to a general improvement in the CSI. Comments suggest that some respondents feel we have only moved one month closer to a second wave of problems, the overall impact of which they fear.

Given the indication from respondents that attitudes towards the crisis are fixed for some period of time, the CSI will be updated on a quarterly basis going forward, unless there is some major event or a major deterioration in market or economic conditions.

Should you have any questions, please don't hesitate to contact me.

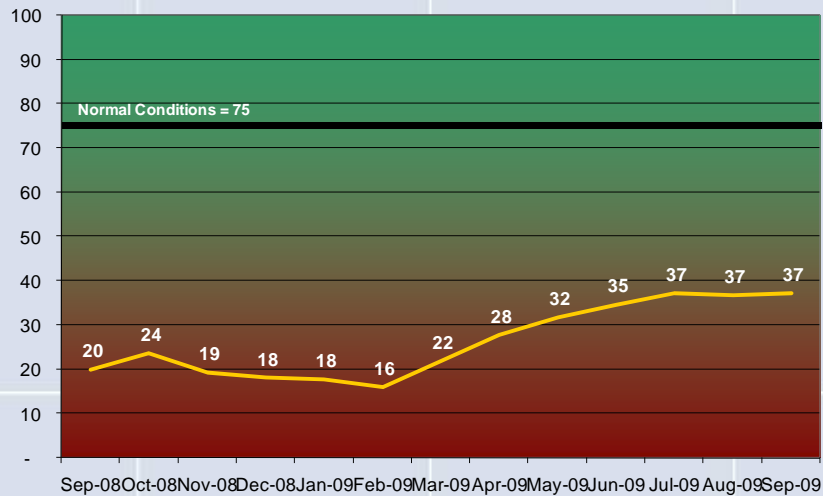

David R. Koeng

The survey was conducted between Thursday, September 24th and Monday, September 28th, 2009. Survey participants typically hold the titles of Chief Risk Officer / Heads of Risk Management, Board Director or other C-Level title. Seventy-nine 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 23 countries, 49% from the Americas, 41% from EMEA and 10% 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)



Having risen 21 points from the lows of February, the CSI has now generally been unchanged for four straight months suggesting a stalling of the modest improvement in sentiment seen since early this year. The Crisis Sentiment Index in September was 37, equal to the reading of the two prior months. Comments left by survey respondents seem to indicate that the rebound in sentiment has reached a plateau and only the passage of a substantial amount of time, without incident, will convince people that the financial crisis has ended.

Said one EMEA-based Head of Risk Management “even though [the biggest] impacts on large corporate are almost over...SMEs and retail customers are under pressure now....as we can watch personal bankruptcies will happen more and more often...this can lead to some troubles of large corporates and finance houses again.” A Chief Investment Officer in the EMEA region suggests that there is a dichotomy forming between the financial world and the underlying economy, with a re-inflating of the financial asset bubble happening without much benefit to the underlying economy.

A Board Member in the Americas notes “some borrowers that showed resiliency throughout the last 18 months are suddenly indicating weaknesses in their ability to withstand continuing adverse market conditions.” In the Asia-Pacific region, a respondent who is the Head of Credit wonders if the effects of the crisis will be seen in another 3 or 4 years, noting “many companies have rescheduled their debts with grace periods ranging from 12 months to 24 months.” Further, he suggests “what has now happened is only a short-term [tidy] over and NOT a solution.” Finally, an EMEA-based Chief Risk Officer notes “as we operate mostly in Europe and Asia, we are still seeing strong need to make actions to prevent the crisis impact.”

As is detailed below, a strong majority of respondents felt that they will need to see at least one year pass without major incident before they will come to a conclusion that the crisis is over. This suggests that rapid improvement in the CSI is unlikely in the short-term, especially given a re-emergence of increased fear (see below).

Additional comments:

“A couple of positive signs emerging from the government’s intervention and banks seem to be stabilizing, but it’s just too early to call this as being over the worst yet.” – EMEA Chief Risk Officer

“Much depends on three things:

- how the financial sector refinances debt maturing over the next few months, particularly in the property sector*
- how the economies of the world respond when governments remove life support pump priming*
- whether or not inflation emerges as a threat, especially in the UK where, I suspect, inflation psychology, whilst dormant, is not yet dead..” – EMEA Senior Executive*

“Even though there are some positive signs such as better collection results, improved payment capacity from the clients and improved deposit balance, we are preparing for a possible shock that may hit us in the last quarter.” – EMEA Board Member

“The better feeling that seems to pervade credit and capital markets has resulted far more from the reckless socialization of debt and losses and - more important - from one of the fastest stock market recoveries ever than from truly improved business conditions. Goldman Sachs research has recently attributed all of this year's scant growth to public stimulus, which has been quantified as high as 4% of GDP. If and when an exit strategy is put in place, will the private sector be in decent enough shape to run with the ball and make up for the disappearing stimulus???” – EMEA Chief Investment Officer

“Believe the market will have a major shock due to the world situation - specifically the threat posed by Iran.” – Americas Board Member

“The immediate risk of a market lending freeze is now over, thanks to the actions of Geithner, Paulson and Bernanke. However, Wall Street has not yet fully realized (or admitted to itself) that securitizations will not come back for the foreseeable future, because the crisis there is epistemological: the rating agency methodologies, therefore the ratings they have assigned to CDOs, are worthless. No one can accurately assess or calculate correlation. Therefore, an important source of liquidity will not come back.” – Americas Head of Credit

“This crisis appears to be in a state where some unanticipated second-and third order effects are being experienced by consumers and businesses alike. Hopefully that will not undermine confidence, but it has the potential to do so.” – Americas Board Member

“I believe the worst of the crisis is over. The overall positive sentiment is helping the situation.” – Asia/Pacific Chief Risk Officer

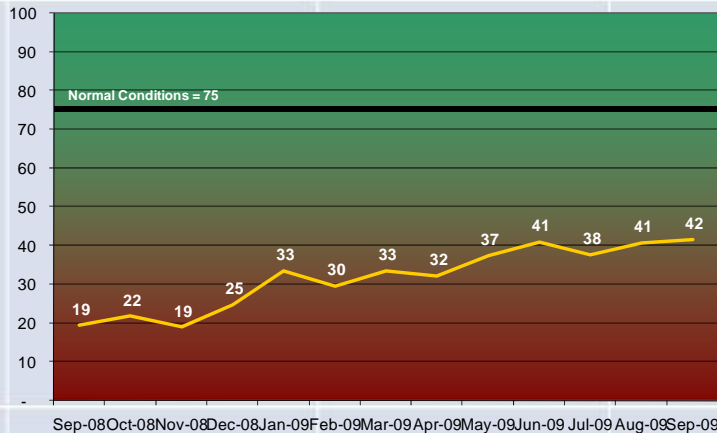
“Conditions are improving; banks need to start lending at sensible rates to more to provide momentum; the BoE's action to charge for reserves should help.” – EMEA Head of Risk Management

“A cautious approach is still prevalent in the Arabian (Persian) Gulf. Banks have taken some provision against the Al Gosaibi / Saad exposures but more provisioning is expected as the situation evolves...Deal sourcing in investment banking continues to be tough not due to lack of opportunity but due to private investor sentiment (almost a reluctance). Investment deals continue to be focused on cash yielding assets.” – EMEA Head of Internal Audit

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. Credit availability, perhaps reflecting steady sentiment overall, is basically unchanged since June.

CSI-Credit



CSI-Credit at a reading of 42 is the highest level seen since we began this survey, but just 1/3 of credit providers say that they have made credit more available in the past month and only 1 in 5 users of credit have found such to be more available.

One EMEA Chief Risk Officer noted seeing “very slight easing of consumer credit, with margins coming back from their widest spreads.” Meanwhile an Americas-based Chief Risk Officer said “only structured credit facilities

that allow banks to minimize their capital requirements are being offered. We are being aggressive in pursuing those banks willing to structure credit facilities to specific market conditions.”

Exuding some caution, a Chief Investment Officer from the Asia-Pacific region explained “This is a good news - bad news story. On the one hand it is encouraging to see banks able to lend again. On the other it is disturbing to see them offering leverage again quite so soon. It suggests they have not learnt any of the lessons of the recent past and are hell bent on growing their way out of trouble. Given the anemic growth outlook this may not be possible.”

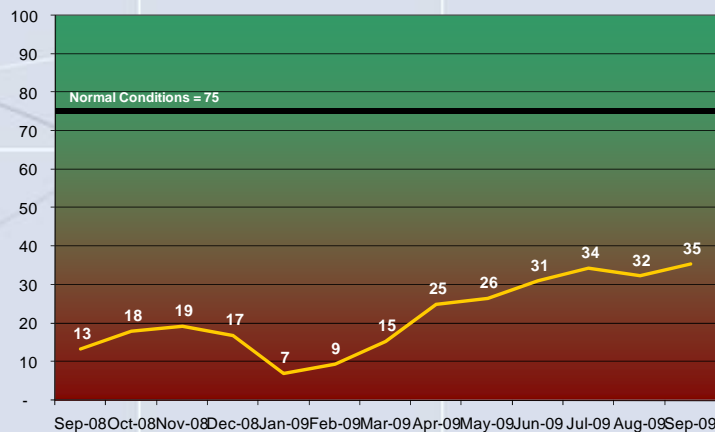
A user of credit in the Asia-Pacific region seemed to suggest a defensive move on the part of his company, saying “we have been reducing our portfolio in order that we are in a position to fund ourselves and less reliant on external borrowing.” Meanwhile, a Chief Risk Officer in the EMEA region indicated “we started to increase volumes in some markets.”

Industry-Specific Assessments

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

While only reaching a level of 35, which is still very low, the CSI-Banking sub-index improved in September to its highest reading since the survey began. With the

CSI-Banks



Sep-08 Oct-08 Nov-08 Dec-08 Jan-09 Feb-09 Mar-09 Apr-09 May-09 Jun-09 Jul-09 Aug-09 Sep-09

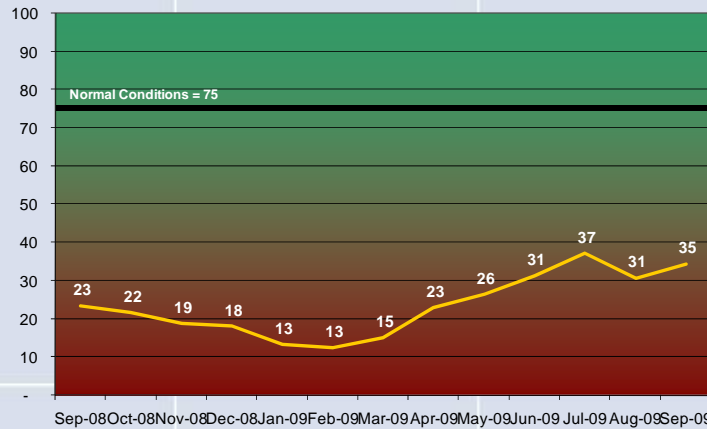
exception of a modest drop in August, sentiment towards the banking sector has improved every month since hitting near rock-bottom levels in January.

This data was gathered before the [IMF released its report](#) suggesting that banks had accounted for less than half of their losses from the crisis. If the IMF estimates are correct, banks worldwide still have over \$1.5 trillion in losses to recognize. Said one America’s Board Member “There is a growing concern on commercial real estate loan portfolios being the next wave of problems.”

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.

This sub-index also improved in September, but is just below the

CSI-Insurance

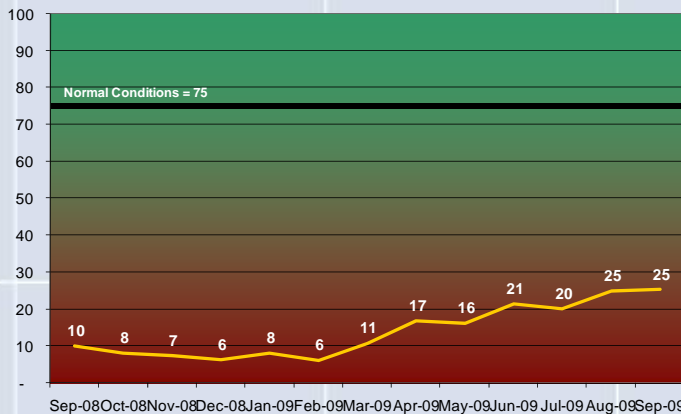


highs of July, coming in at 35, fully 40 points below what would be considered a “normal conditions” reading.

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 again fallen below 40% .

Like other measures this month, the CSI-Hedge Funds sub-index was

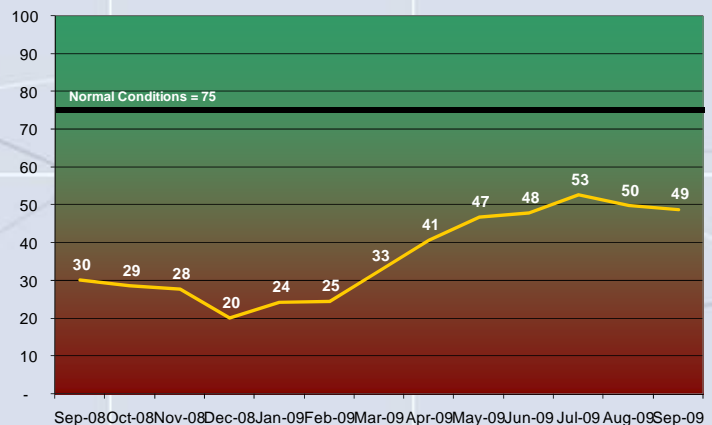
CSI-Hedge Funds



unchanged at 25 in September. There have been growing reports of cash returning to this sector, and an article suggesting that the number of new funds opening during the third quarter may exceed the number of funds closing. Still, more than half of survey respondents agree or strongly agree that another major hedge fund will close as a result of the crisis.

Sentiment regarding the likelihood that another money market fund will “break the buck” has declined for the second month in a row. The CSI-Money Markets sub-index fell back to

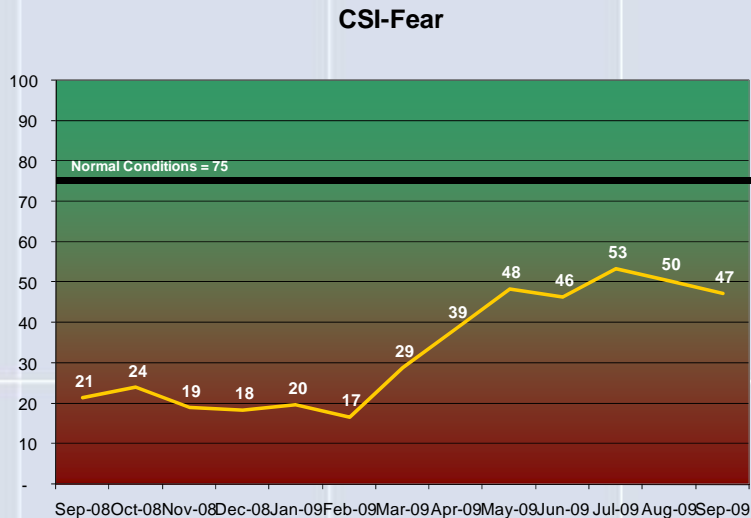
CSI-Money Market Funds



49. One in six respondents think it likely that another money market fund will “break the buck” as a result of the crisis.

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.



One would assume that the continued rally in equity prices would have stimulated a continued rally in this sub-index. As a leading indicator of sentiment, its rapid ascent from the lows of February was a hopeful signal, moving almost in lock-step with equity prices. Yet, for two months in a row, now, survey participants sense that fear may be returning. At a reading of 47 in September, the CSI-Fear sub-index has fallen back to its levels of May-June.

A Board Member in the Americas noted “seeing more senior level people beginning to fear job loss going forward,” while a Head of Credit in the Americas notes “Among market professionals, fear regarding the markets is receding; but fear about their own jobs is growing, as financial institutions change their fundamental strategies, with possible resulting layoffs.”

Meanwhile, a Chief Risk Officer from the EMEA region share concerns with us that “there is a danger of a false dawn arising in the public minds.” Perhaps the equity rally is the source of this potentially false dawn.

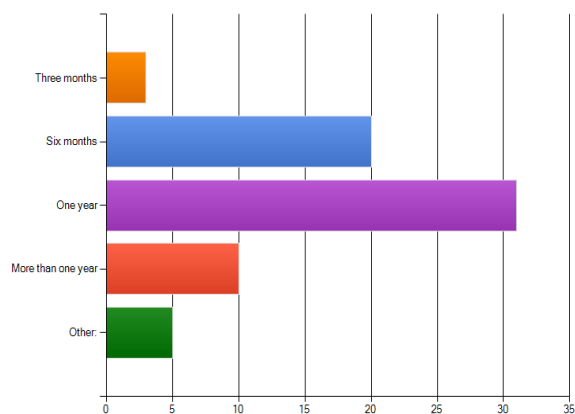
Aligning with the general sentiment that there still might be another wave of problems, a Board Member from the Americas said “while it seems that many are optimistic, and increasingly so, there is still a nagging fear that another wave coming that may be as disruptive, severe, and systemic as the first two waves were.”

What will it take?

Survey respondents who felt that the crisis was not yet over were asked how much time would need to pass, without the realization of another major financial or economic disruption, for them to feel that the crisis had passed.

We had been operating under the assumption that the waiting period was likely only through this year-end. This expectation, it turns out, was wildly optimistic.

Many people seem to be waiting to see if there is a second wave of negative events in this economic and financial crisis. If you still believe that the crisis is continuing and share this “wait and see attitude”, how much time without a major financial or economic disruption will need to pass before you feel that the crisis has passed?



Over 60% of respondents who felt that the crisis had not yet ended are looking for one year of more of time to pass without incident before they will feel comfortable that the crisis has passed. Caution, it seems, is entrenched.

Conclusion

Taken as an absolute reading, the CSI remains in highly negative territory and appears to have reached an interim upward boundary. Fear is no longer abating and there is growing sentiment that banks may face a second wave of major write downs.

Based on the lengthy time our respondents need to see pass before they will change their overall assessments, we have decided to change the frequency of CSI updates to once each quarter. In the event of a major disruption, we will resume the monthly readings. We encourage you to discuss this report and your localized experiences 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. Many people seem to be waiting to see if there is a second wave of negative events in this economic and financial crisis. If you still believe that the crisis is continuing and share this "wait and see attitude", how much time without a major financial or economic disruption will need to pass before you feel that the crisis has passed? (Three months, Six months, One year, More than one year, Other)

3. 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

4. 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)

5. 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)

Ductibility, LLC

A private initiative to advance the practices of corporate governance and risk management at complex organizations.

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