

Ductilibility, LLC

Credit Crisis Status:

*An assessment by senior risk
executives*

September 22, 2008

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Overview

Given the aggressive steps taken by central banks, and in particular, the U.S. Government, in response to the rapid deterioration of the equity, credit and funding markets worldwide, a quick survey was taken of senior risk executives around the world, seeking their assessment of the status of the credit crisis. Over fifty firms participated in this study. 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. Companies represented in the sample set 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.

The survey was conducted between the close of business on Friday September 19th and mid-day on Monday September 22nd.

Highlights

- Respondents were generally very skeptical that the crisis is over
- 93% expect that a major hedge fund will close as a result of the crisis
- 92% expect that at least one more major bank will fail or be taken over
- 40% expect that another major money fund will “break the buck”
- 40% felt that the government take-overs of Fannie, Freddie and AIG were the most helpful steps taken
- 36% felt that the government backing of risky assets, such as was done in the Bear Stearns / JP Morgan deal, was the most helpful step taken

While there is significant unease still being expressed, there is some underlying hope that the more aggressive actions taken in terms of asset-backing by the US Government will be effective.

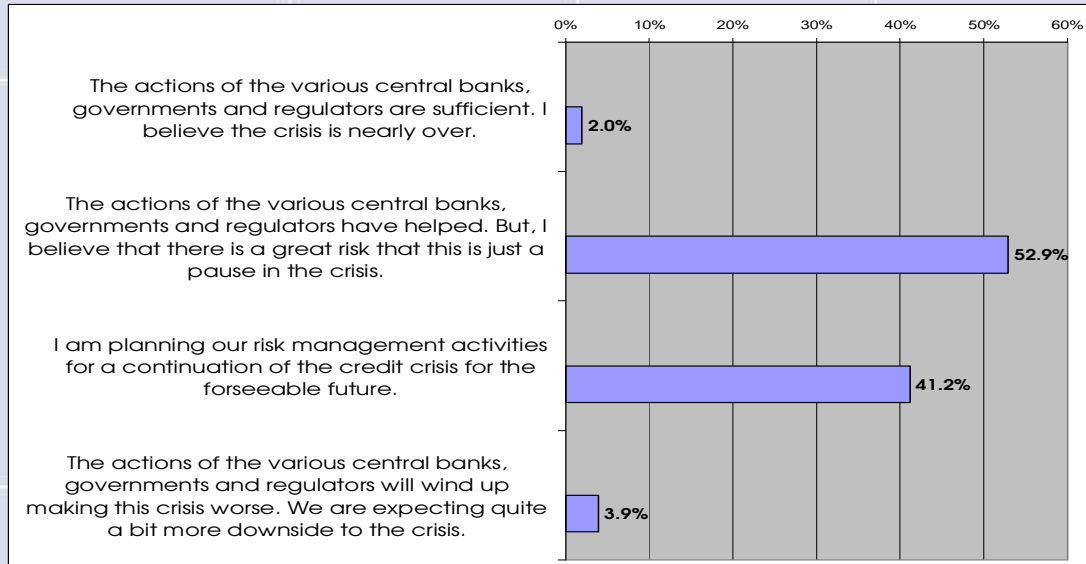
Said one respondent *“Congress' willingness to aggressively get involved in a substantial tax payer financed bailout plan is going to be the key to solving the crisis. I think that Congress is now fully committed to getting this done. Taking bad assets off bank balance sheets IN VOLUME is the only solution”*

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

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Credit Crisis Status

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



Only 2% feel that the crisis is nearly over, while over 44% expect either a continuation of the credit crisis for the foreseeable future, or a worsening of the crisis.

Selected comments:

“Confidence needs restoration at retail/general public level... Still waiting to see alt-a resets in November”

“The deleveraging of the banks is the first step, to be followed by an impact on the real economy. I anticipate that the bank deleveraging will go on till the end of 2008 and then we will see the impact on the real economy, including continued defaults and increasing loan loss provisions until mid-2009”

“We are definitely closer to the crisis being over. If “planned” policy initiatives in Congress can be executed, we’ll have the solution.”

“The reaction of equity markets in particular still shows liquidity is extremely thin. Markets are moving rather than trading”

“...with the yield on the one-month T-bill dropping to 6 bps, the fear was palpable... Optimism is comforting as long as one doesn’t believe hope is a strategy.”

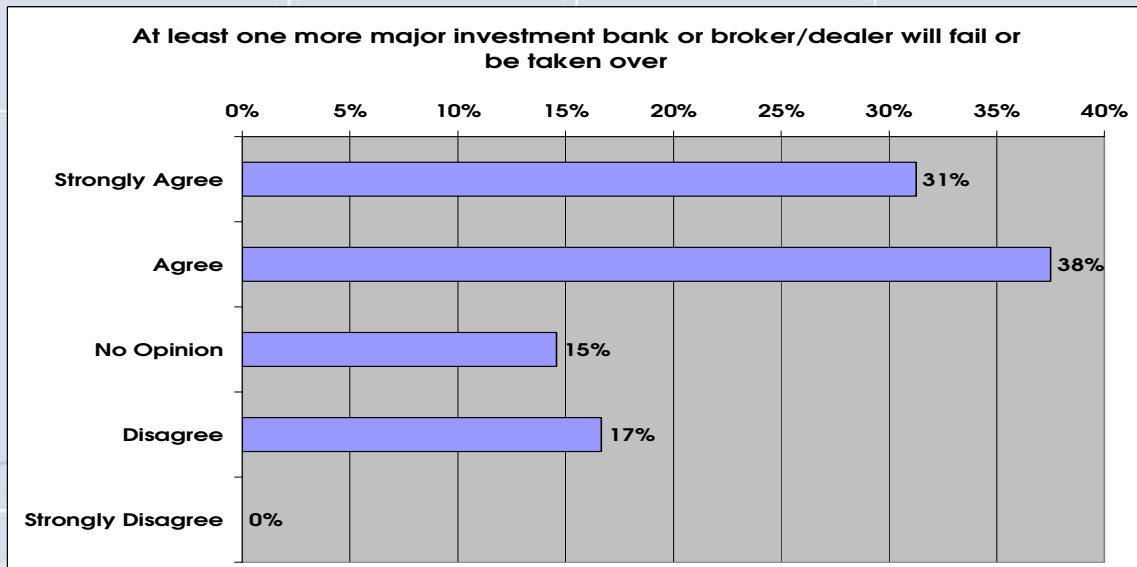
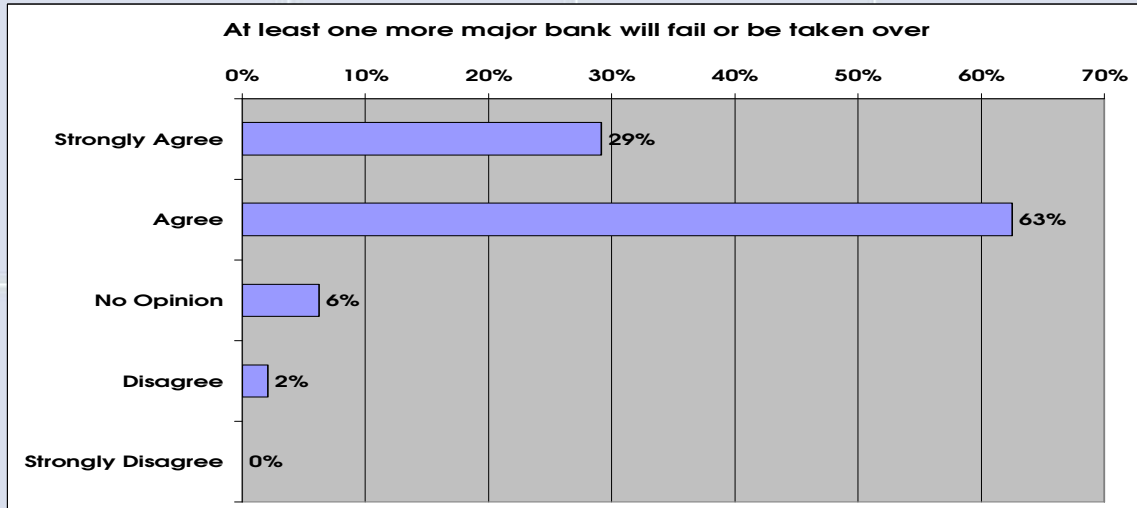
“...by continuing the pattern of delaying the readjustment after a decade of excesses , the increasingly desperate steps adopted by policymakers are actually driving systemic risk up, since aggressive and often inefficient allocation of risk capital is encouraged and the odds of skyrocketing treasury deficits and inflation rise...”

“Policymakers had better remember that they won a battle today [Friday], but that the war to restore consumer confidence and keep long term interest rates down will be a long one indeed.”

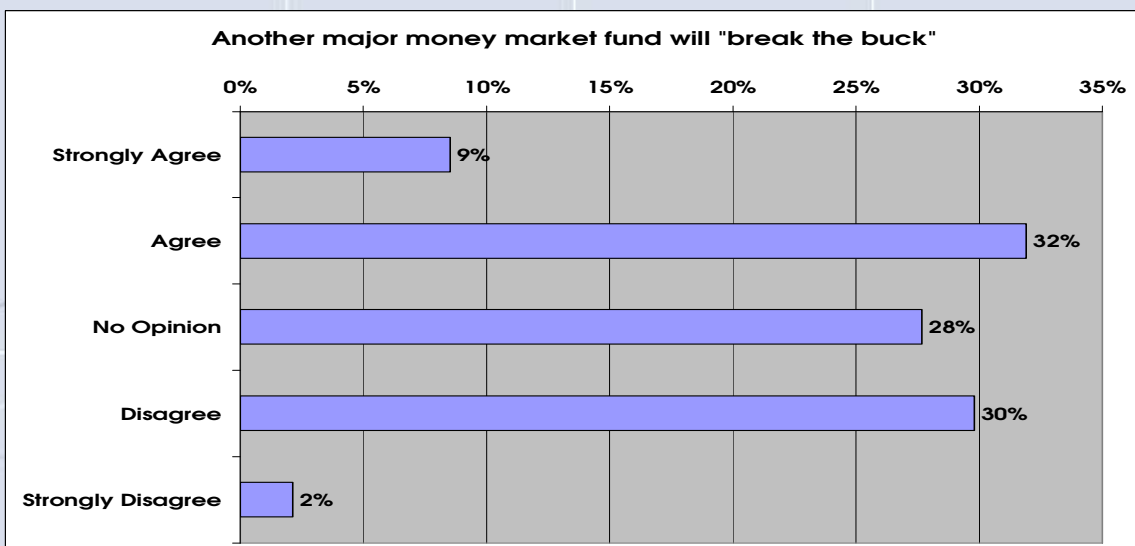
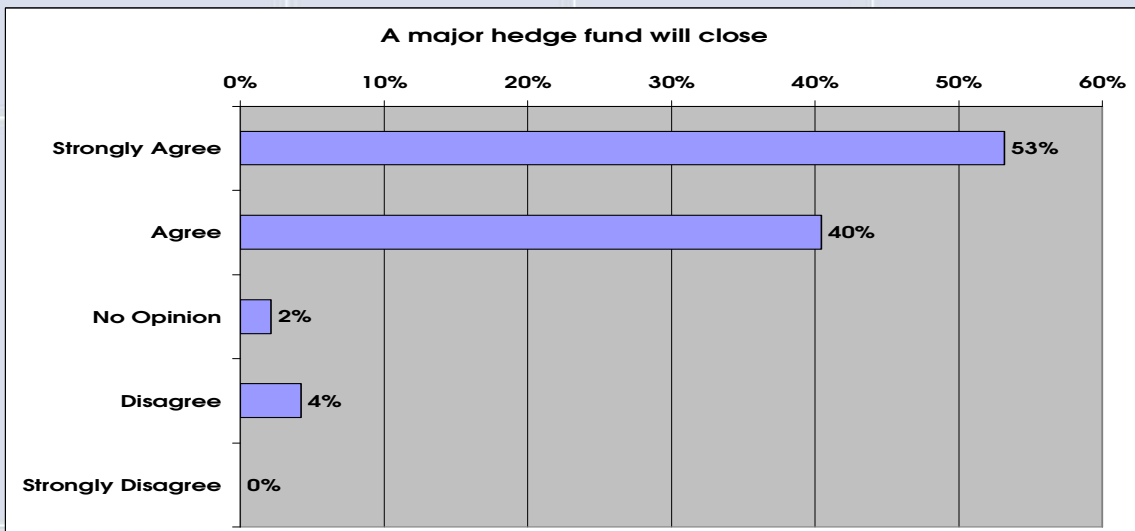
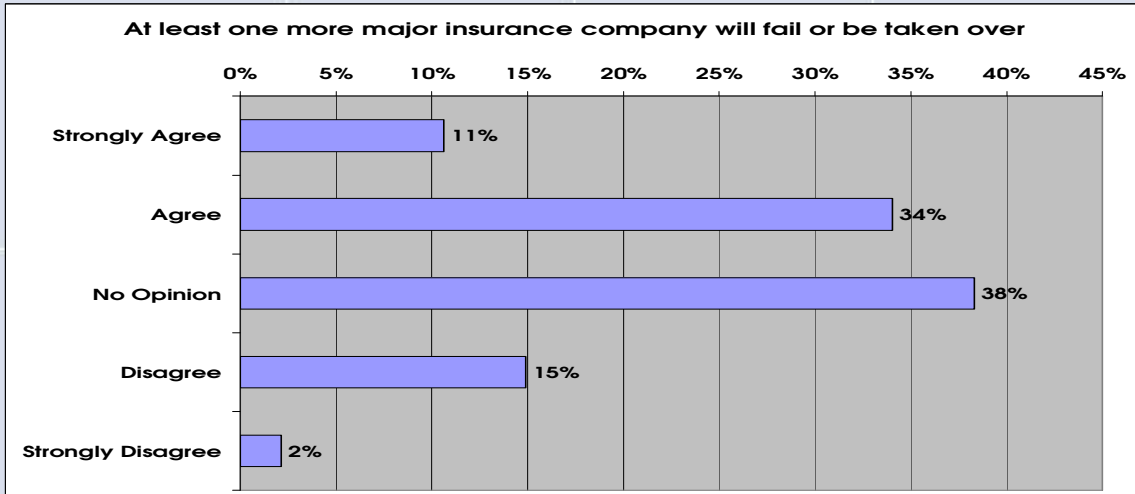
“I do not know if anyone can know fathom the bottom. In the short term, increased liquidity will help; in the long term, it will devalue all paper assets.”

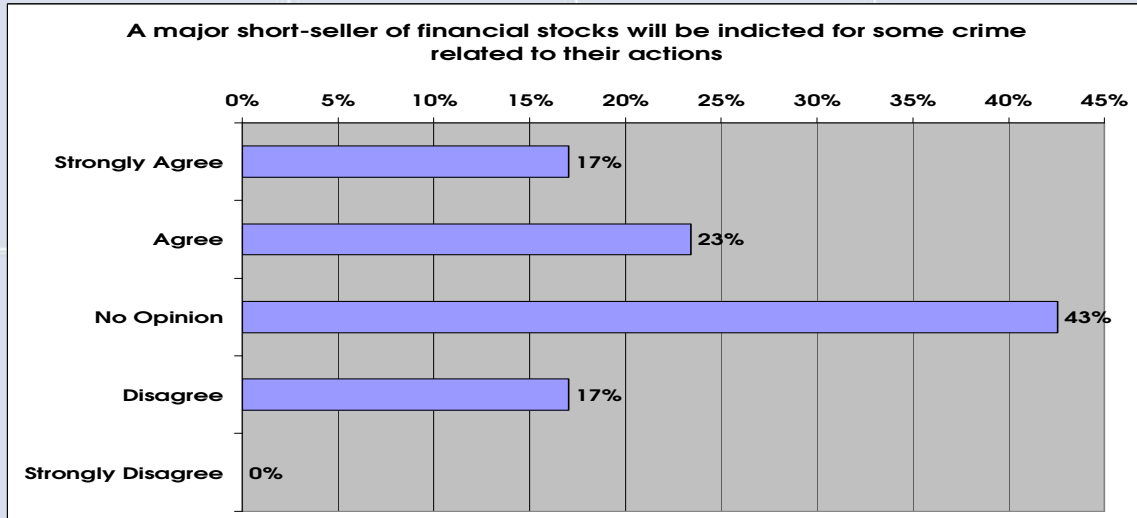
What’s Next?

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



It should be noted that approximately 60% of responses were received before the announcement about Goldman and Morgan Stanley on Sunday evening.





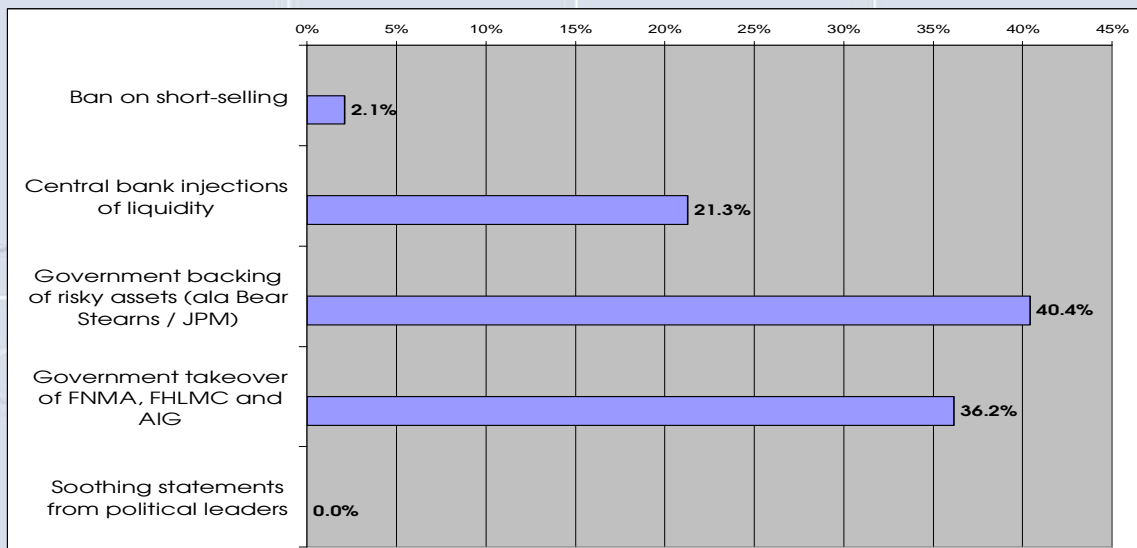
Selected comments:

“A previous moratorium on shorting financials led to an increase in stock price on announcement, but a subsequent decline. I view this move as truly an attempt at market manipulation. To take such an action in the middle of the night before a quadruple witching day in these markets, removing tools that option traders and market makers use, either indicates that the situation as it appears to the government is much worse than what is believed by those without complete knowledge of the situation, or it is an (disingenuous) attempt to shape market psychology.”

“Hard to say with insurance companies. AIG was acting more like a mono-line/inv bank rather than a traditional insurance company.”

Efficacy of Government Actions

Question 3: Which one of the following actions taken has been most beneficial to halting the current credit crisis?



Selected comments:

“All have had an impact ... but it is not clear at this juncture whether the effects will in any way be lasting or form the basis of a newfound confidence in financial markets. And this, in my opinion, is the missing ingredient for truly halting the credit crisis.”

“The RTC plan announced on 19th Sept will help.”

“Banking liquidity is far more important than equity markets perception of what is important. Creating an environment where banks can fund their operations and prevent the spiral of asset price declines from forced sales and continue to lend to each other is paramount although the other measures would also have helped.”

“The events also betray the progressive recognition of the magnitude of problems. (Given the political season, I now understand the statement from a year ago that the sub prime problem was contained, meant that it was contained to this planet.)”

“There is a subtlety in the question. If beneficial is construed as effective, then the last, most aggressive action should be the most effective. If however, one is really asking for the greatest benefit, then liquidity is the answer, since the others create moral hazard going forward and send a contrary message to international investors that the US markets are the most competitive, efficient and free of regulation and intervention.”

“Ban on short selling is bogus. Just makes markets less efficient”

“Government backing of more mortgage securities is most influential, as is opening the Fed window to non-traditional short term borrowers.”

“Wait a minute before considering the current credit crisis over, we may save some banks but the cost to taxpayers and the economy (both in monetary terms and the possible compression in standards of living if inflation jumps) may be enormous. Socializing these huge losses may actually result in spreading the credit crisis to millions of individuals. Is that such a desirable outcome?”

And some general comments left by one individual:

“I believe the accelerating formation of panic as money markets broke the buck forced the government intervention, probably without any viable alternative, given the risk implications. The proposed US action to stabilize the financial system and prevent it from collapse (which is what was at risk) will be costly. A trillion dollars by several estimates, sounds plausible. That will have to be financed. Initially it will be through the Treasury issuing more securities (It already has and made them available to the Fed so that it might be able to continue its open market activities.) on a huge scale to foreign investors. The bond market today is saying that that will be costly, so interest rates and inflation may rise significantly. Subsequently, taxes, or severe fiscal retreat, may be the only alternative. The economy that we went to bed with a week ago, e.g. dollar, trade deficits, GDP, unemployment, has not improved this week. The ominous outlook needs a shot of penicillin, but I think we are yet in the age of Pasteur. Treatment is difficult; soap would have been easier. Debt comes home to roost, and it will. At some point, our creditors will believe some of the economic analyses by intelligent people from the Fed to academia, that the US is not as solvent, long term, as has been held as foundational truth. Then the bill will start to come due, and it will not be pretty.”

Ductibility, LLC

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