Financial Crisis and the Structured Credit Markets

Cambridge

Robert Reoch

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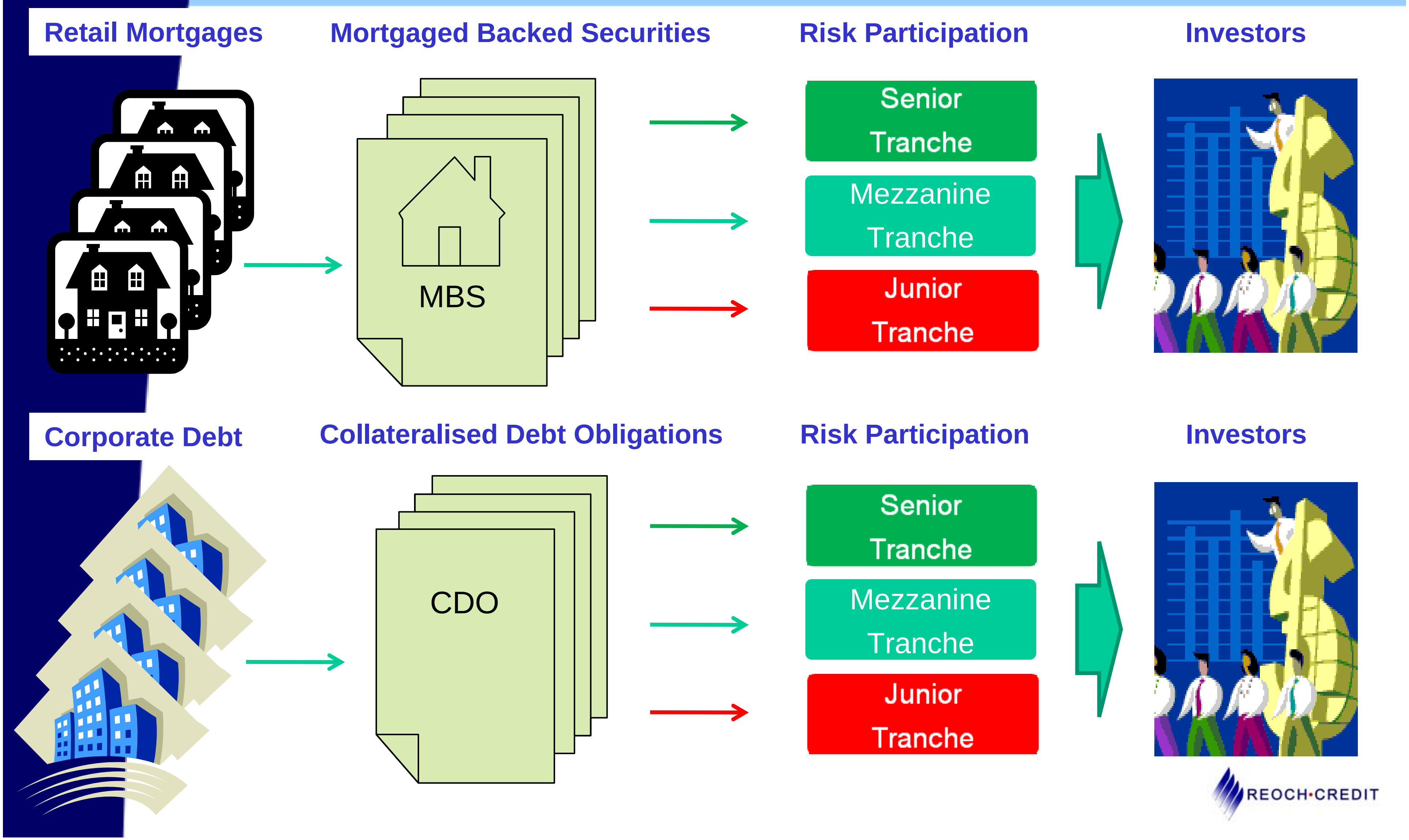
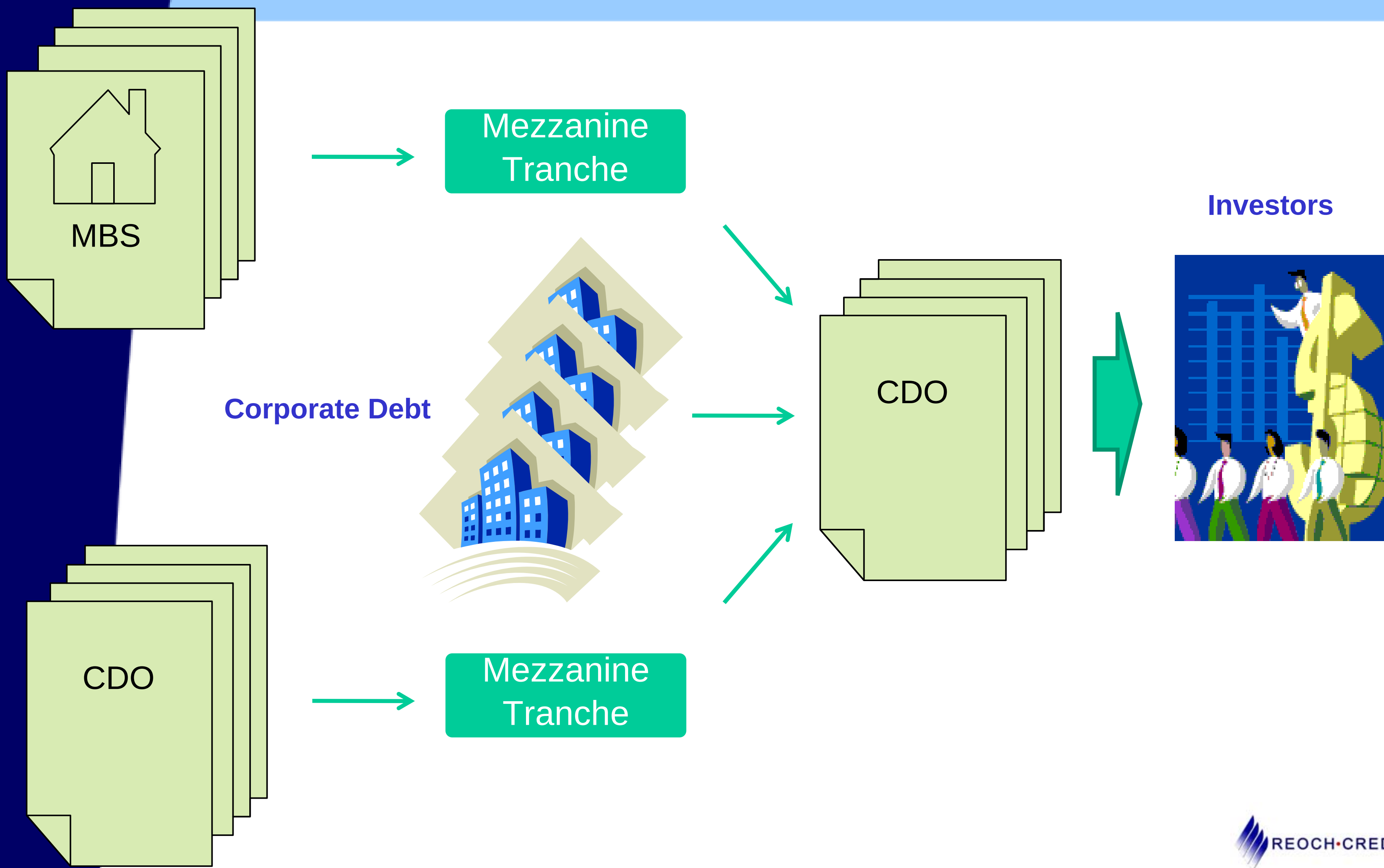
Agenda

- 1. Overview on what is happening today
- 2. Where are the losses?
- 3. Short-term prognosis
- 4. Debt pricing changes
- 5. Flexibility of debt markets ahead
- 6. Outlook

Established securitisation market



..is more complex today



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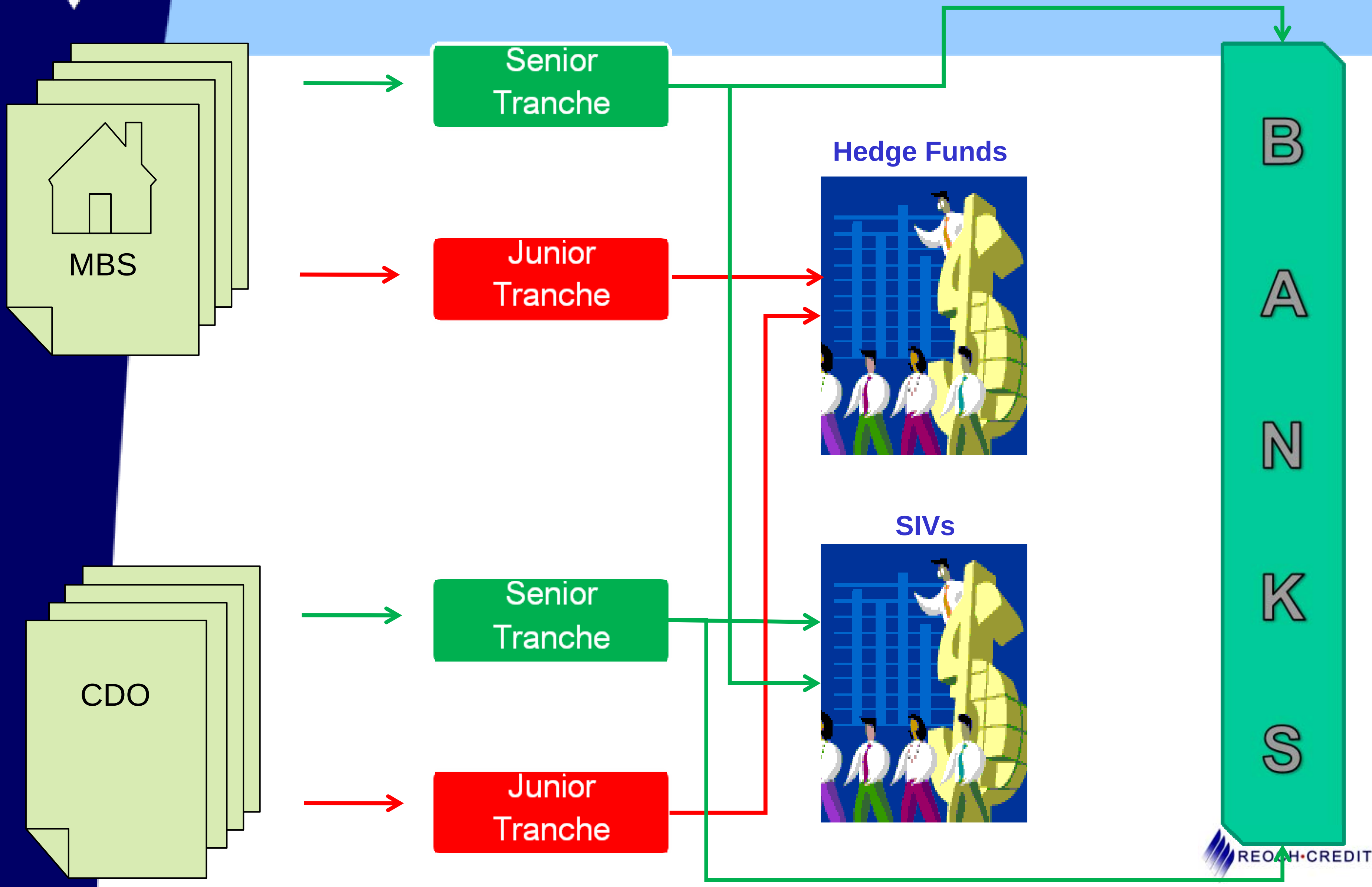
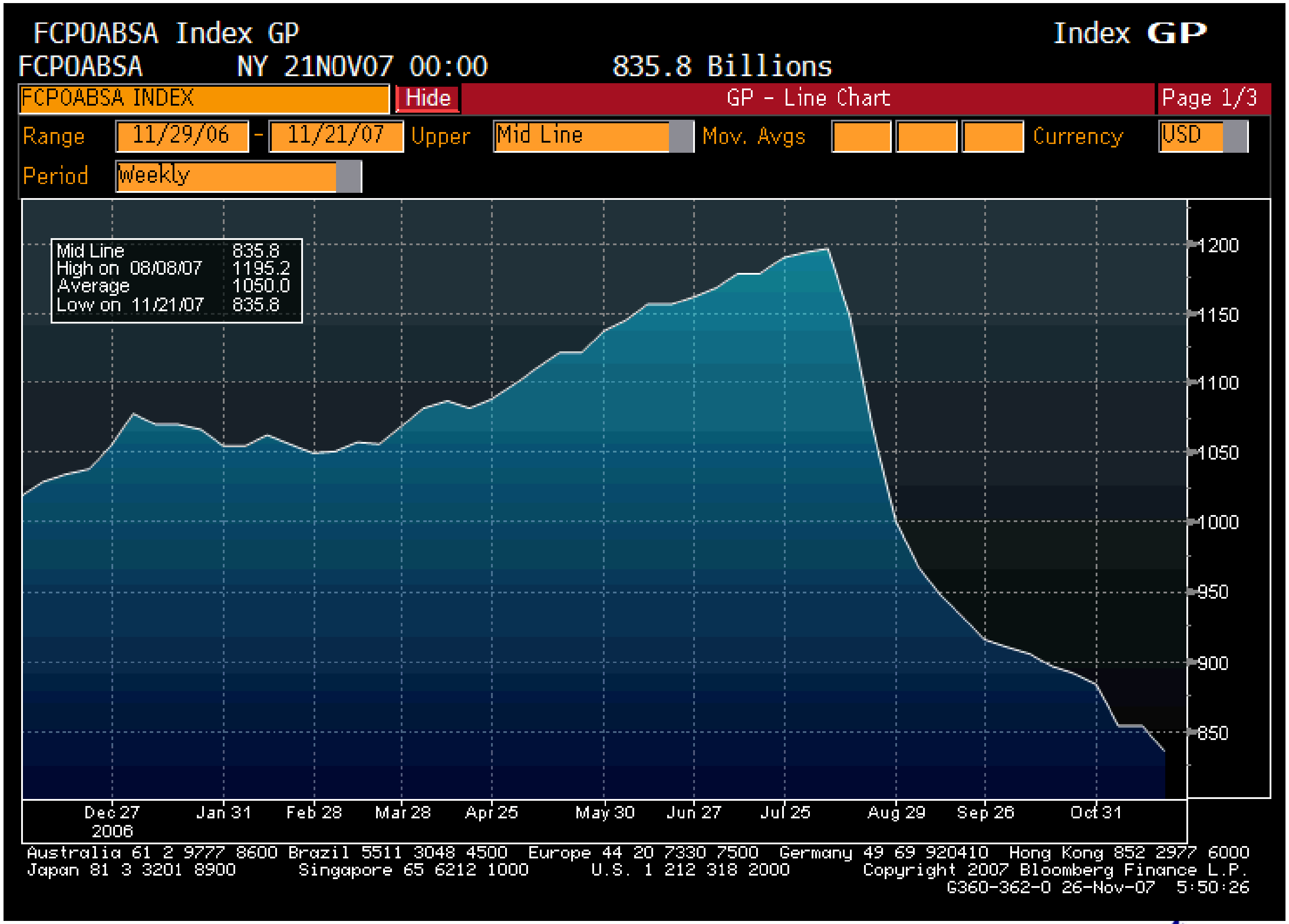
… so are the investors



Different types of investors

- Mark-To-Market ("MTM") investors
  - Report daily or weekly valuations, constrained by thresholds
- Nervous investors
- Hold to Maturity investors
- Leveraged institutions
  - Buy on margin and post daily collateral for value changes
- Structured Investment Vehicles ("SIVs")
  - Long dated CDO tranches funded with commercial paper

Reaction of U.S. ABCP investors



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Where are the losses?

- Real losses in the US mortgage market
  - Cause real losses in MBSs and therefore CDOs
- Panic selling leads to panic valuations
  - AAA tranches regardless of underlying pool are marked down
- Hedge funds post margin, de-lever, or liquidate
  - Equity investors and margin providers lose
- SIVs secure funding, de-lever, or liquidate
  - Equity investors and funding back-stop providers lose
- Banks provide margin to Hedge Funds, back-stop SIVs, own CDOs and lend to each other

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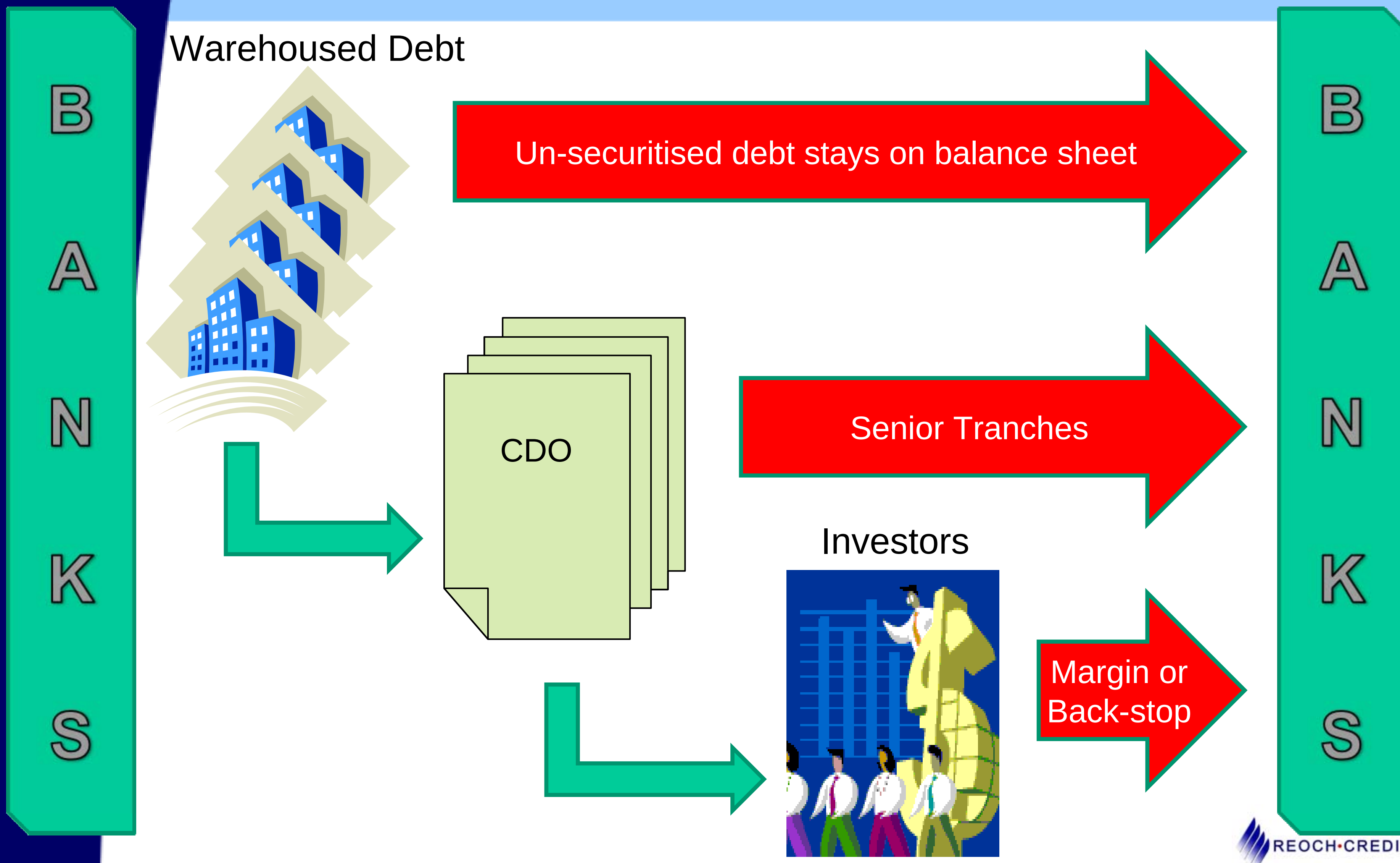
Bank involvement is complex



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Short term prognosis

- Bank trading infrastructure strained (again)
- Balance sheet issues
- Role of Rating Agencies is questioned
- Structured Credit market grinds to a halt
- Credit markets slow down

Debt pricing issues

- Fixed income investors expect a higher risk premium
  - Cost of senior tranches has increased dramatically
- Bank balance sheets more expensive
- Credit spreads remain wide to accommodate changes
- Credit squeeze to move from retail to corporate via SME
  - Many large corporate locked in attractive funding

Flexibility of debt markets ahead

- Collaterised Debt Obligations here to stay
  - No interest in Structured Finance underlying risk
- SIV market on hold indefinitely?
- Banks reluctant to warehouse risk
  - Availability of bank disintermediation tools reduced
- Possibility of regulatory intervention
  - Higher capital charges

Outlook

- Plenty of bad news still to come
  - Mono-line insurers
- Focus on bank capital
- Litigation
- “Death of the acronym”
- Change in the disintermediation of banks
- Nail in the coffin of prudent credit risk management
- Fixed income asset prices to stay low
  - Unlikely to return to pre-crisis levels
- GDP growth linked to cost of credit at all levels
- Consumer spending has been affected by crunch
  - Limited appetite from banks and Structured Finance
  - Economic implications