



Risk Management, Ratings and Information Asymmetries:

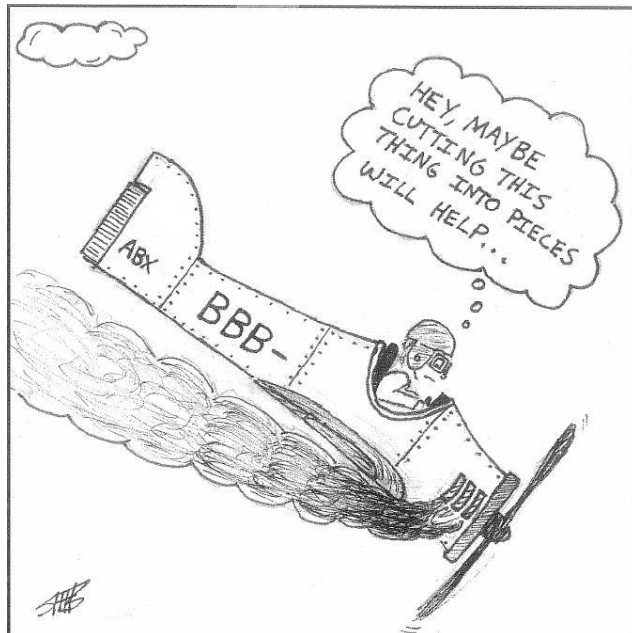
Setting The Right Incentives for Systemic Stability

Alexander Ohl

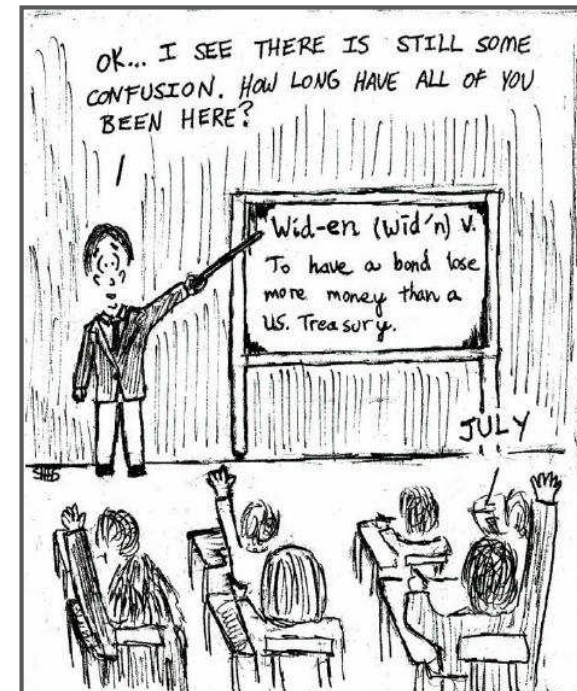
Zürich, September 09

Pre-Crisis: where we come from

- Mispriced risk
- Mispriced liquidity
- Mispriced complexity

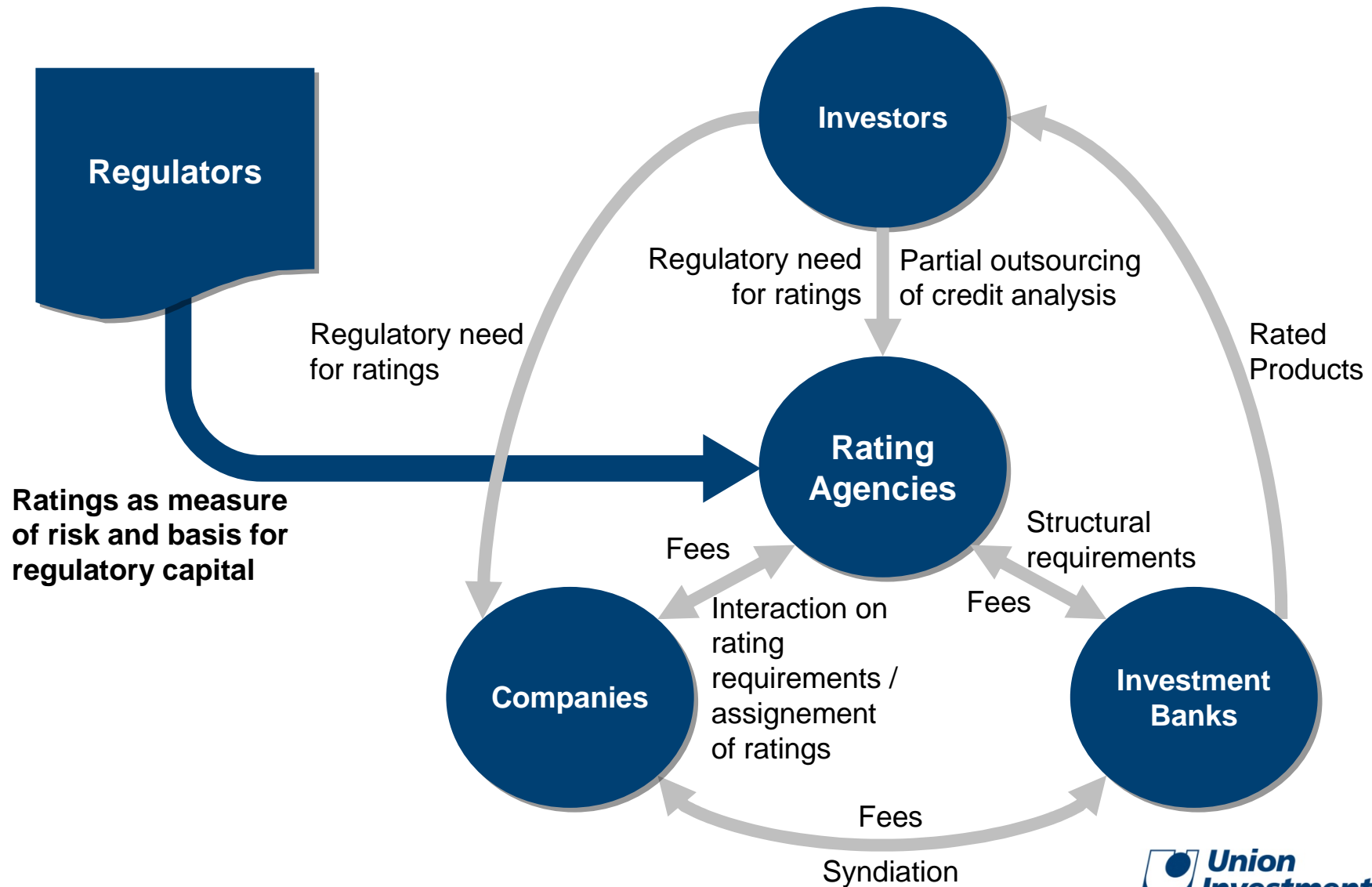


but also



- Outsourcing of regulatory tasks to rating agencies
- Outsourcing of analysis for credit products and complex assets to rating agencies
- Interdependence between investment banks, rating agencies and investors

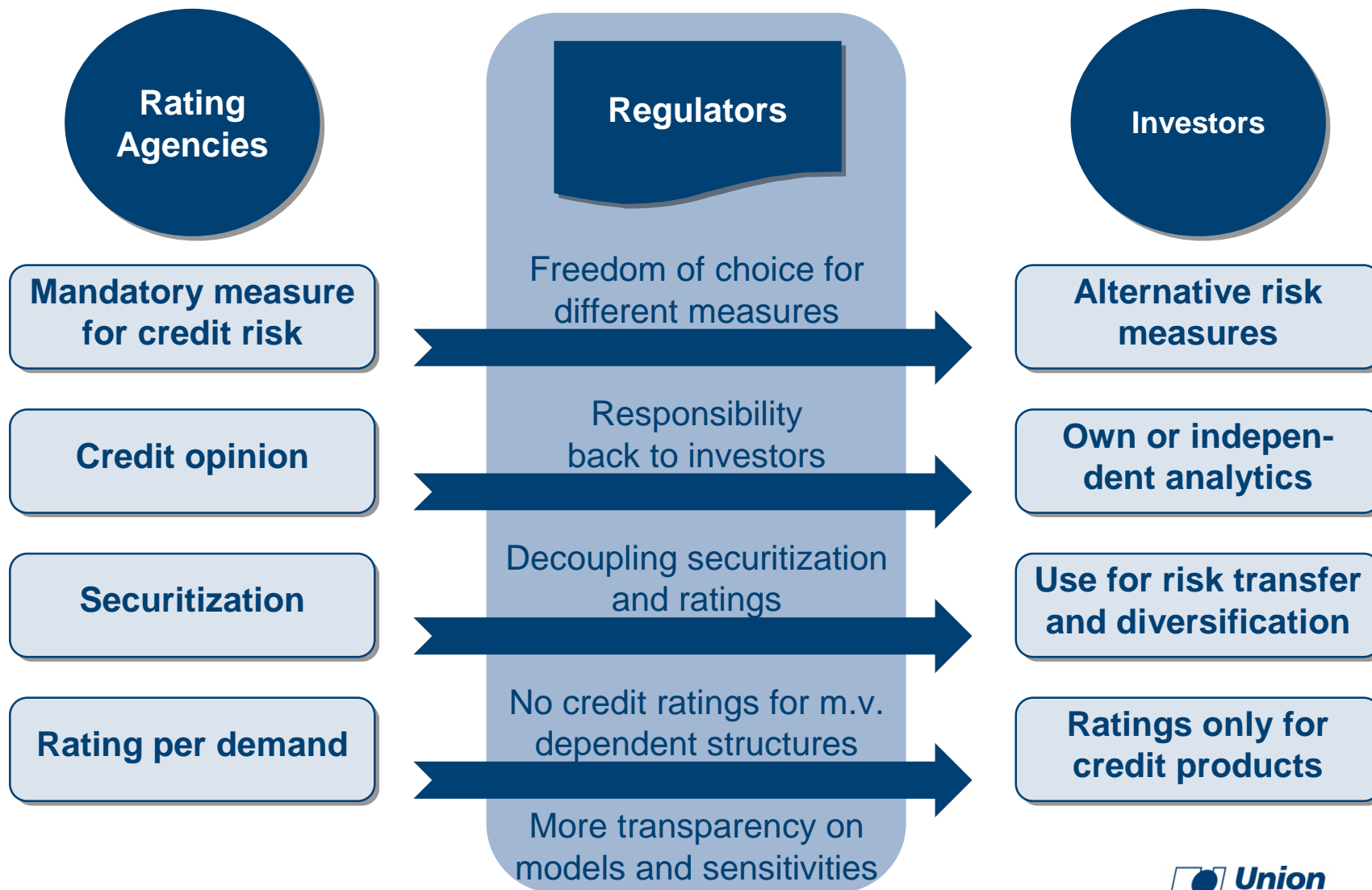
Dependencies: the spirits that we called



Ratings: what they are and what we need them for

A Rating is ...	It's needed by ...	It's needed for ...
<p>a credit opinion.</p> <p>an estimate on the probability of default for a give time horizon.</p>	<p>Investors</p> <p>Companies</p> <p>Banks</p>	<p>regulatory needs and as risk measure for investment guidelines.</p> <p>achieving better financing via capital markets.</p> <p>enhancing sales of fixed income products as investors need ratings.</p>

A possible way out: regulatory actions



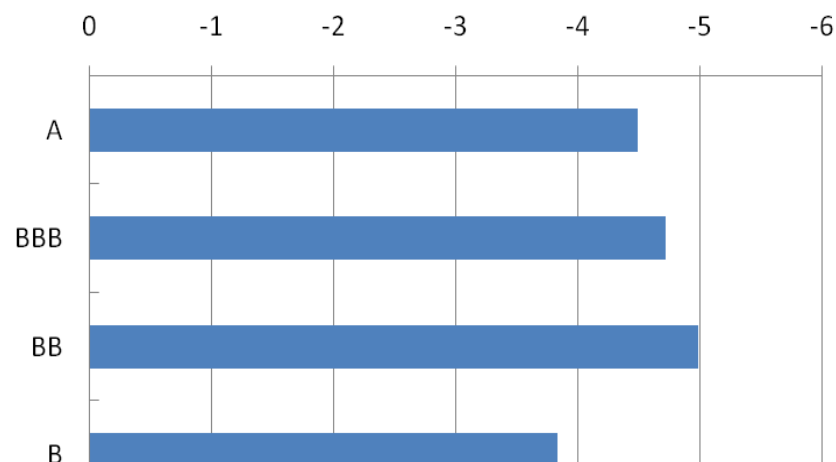
Thank you.

Backup slides

Moody's: changes in methodology lead to severe downgrades for structured products, namely CLOs

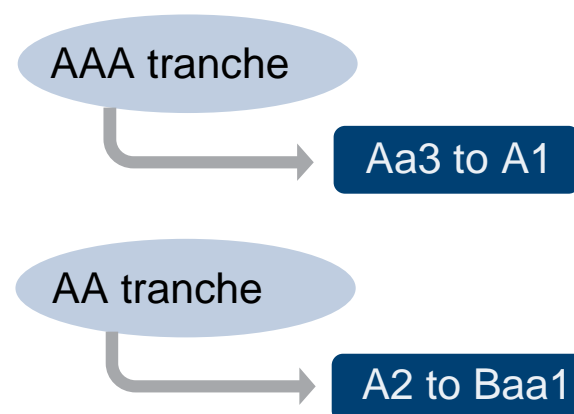
- First round of downgrades in March 2009 seems to be continued by a second, equally severe wave of downgrades lasting until Q4.
- The market does no longer trade on ratings but on individual situation.

Average downgrades on CLOs in notches



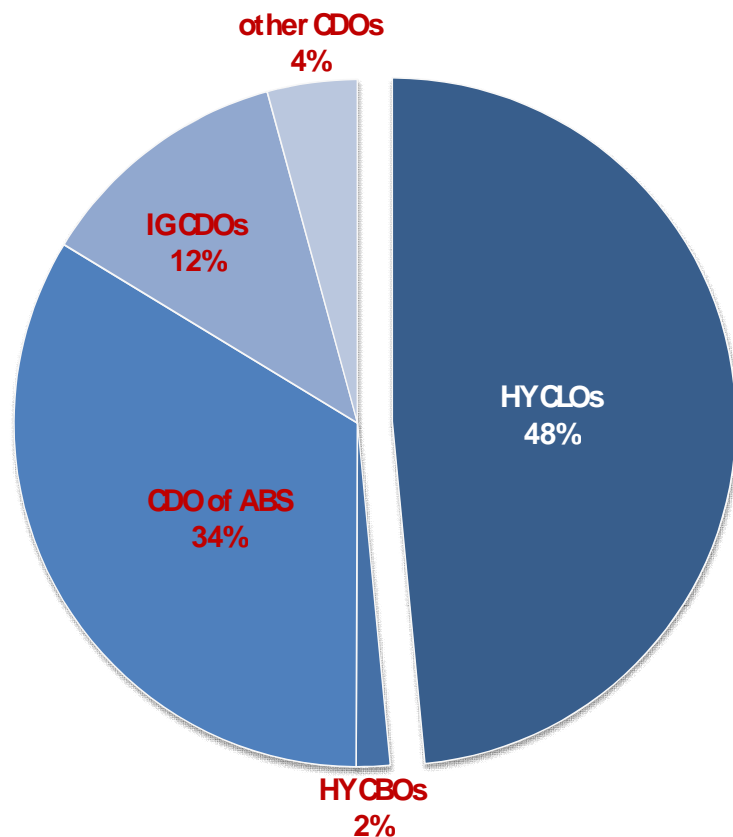
Quelle: Moody's

Expected average effect
on AAA and AA tranches

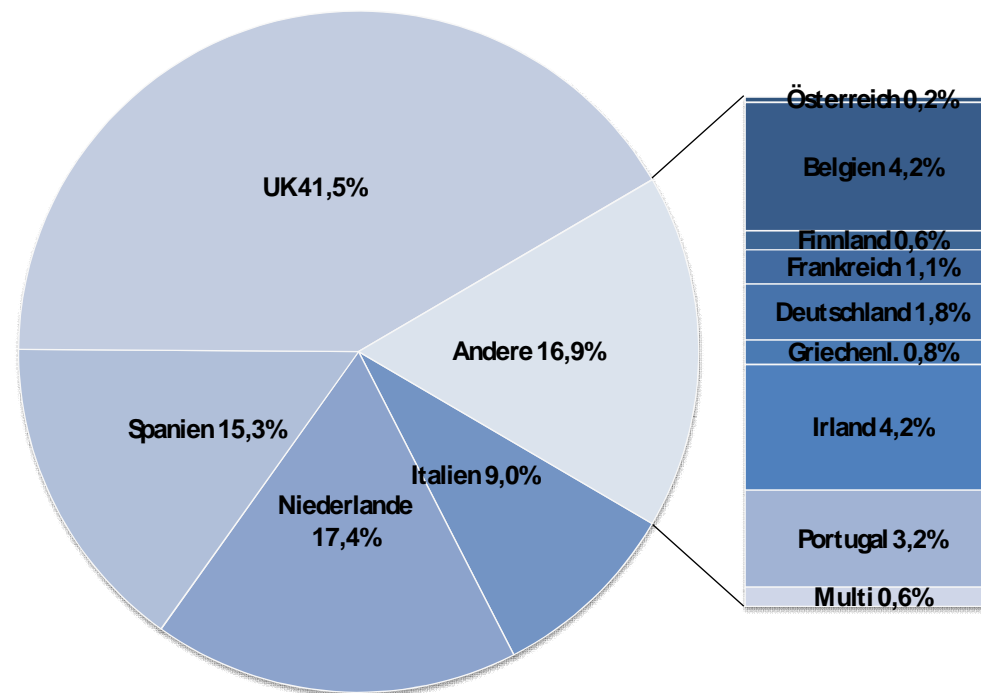


Outstanding notional: global CDOs and EU RMBS

■ Est. \$ 2.3 trn notional of CDOs are outstanding globally.

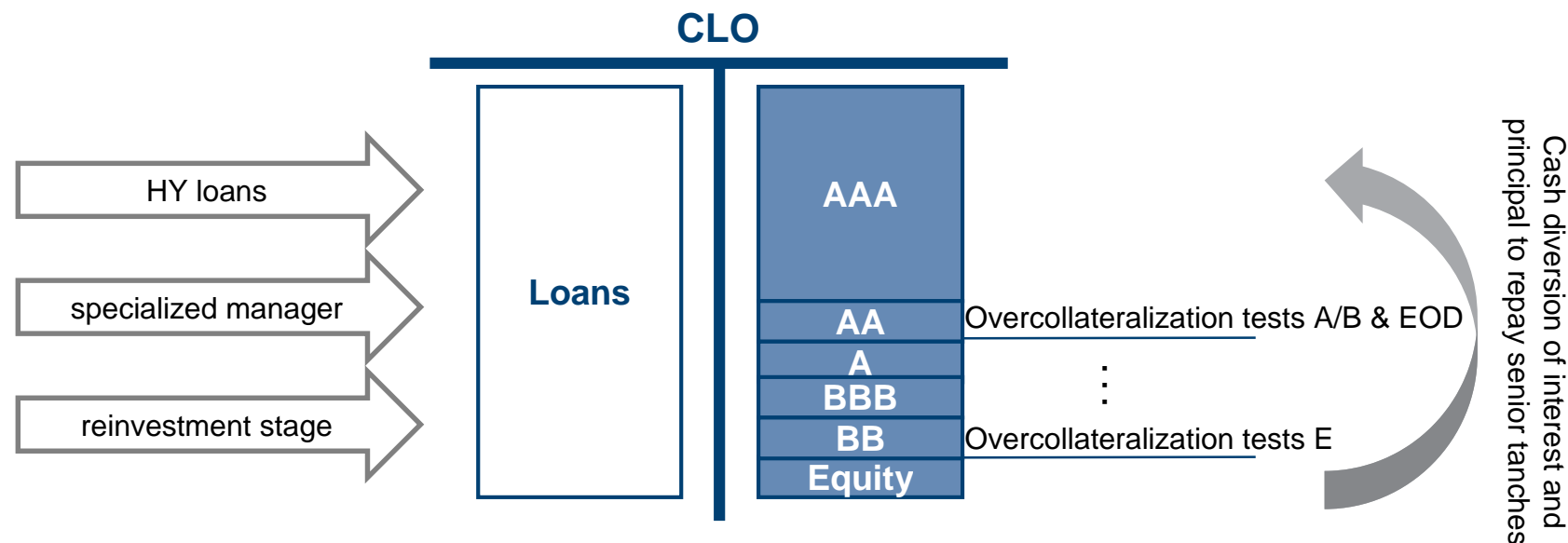


■ European RMBS alone sum up to an est. \$ 1 trn of notional.



Source: JP Morgan; June 2009

CLOs: pros & cons



■ Pros:

- Senior secured loans
- High industry diversification
- Specialized manager for collateral management
- Active management of underlying risks

■ Cons:

- Pressure on collateral ratings through waves of downgrades : increasing CCCs
- Pool dependent on credit cycle

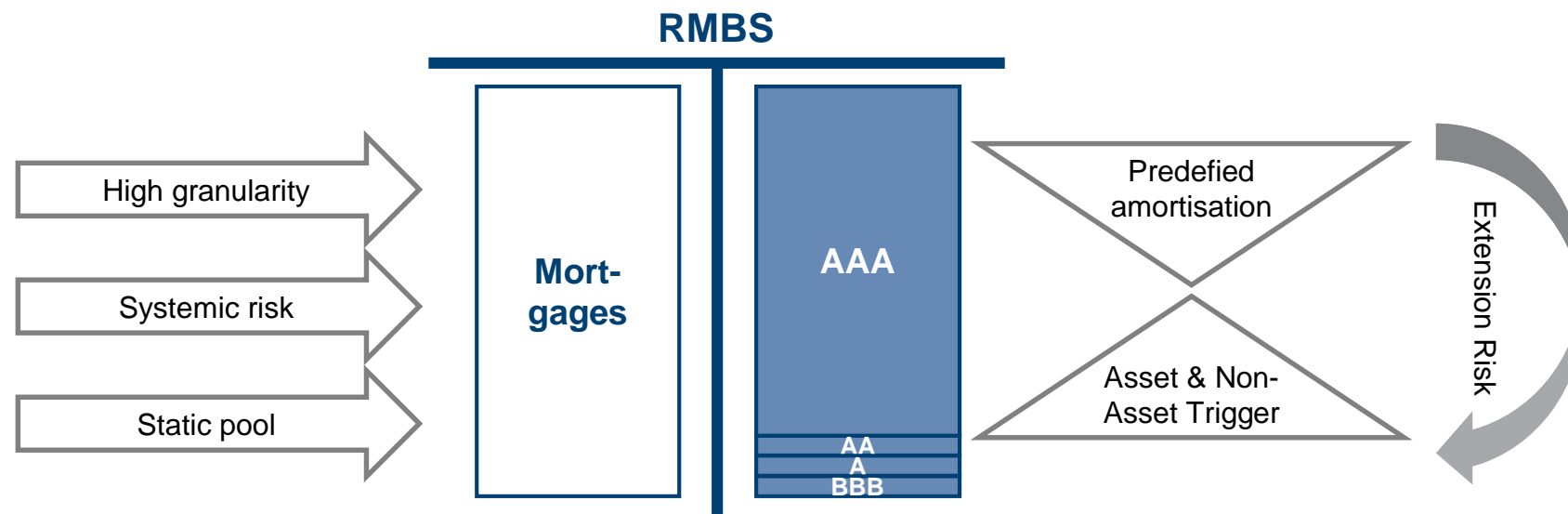
■ Pros:

- Cushion through subordinated tranches
- Overcollateralization tests as a shield against portfolio deterioration
- Ongoing measurement of overcollateralization

■ Cons:

- Interest deferrable (PIK) for lower tranches
- Technical default in case of massive credit deterioration of the underlying collateral.

RMBS: pros & cons



■ Pros:

- Real estate mortgages, LTV 60-95%
- Very high granularity, thousands of loans

■ Cons:

- Static pool strongly dependent on national housing market, high systemic risk
- Deterioration of pool quality over time

■ Pros:

- Short expected maturities for upper tranches
- Predefined amortisation schedule

■ Cons:

- Meeting the amortisation schedule depends on prepayment speed of the mortgage pool: extension risk for bond maturities
- No credit enhancement through cash diversion
- High leverage: est. 90-95% AAA