

# Unregulated Financial Products: Potential, Risk and Regulatory Reform

Hung Tran

OECD-ADBI 10<sup>th</sup> Roundtable  
on Capital Market Reform in Asia  
Tokyo

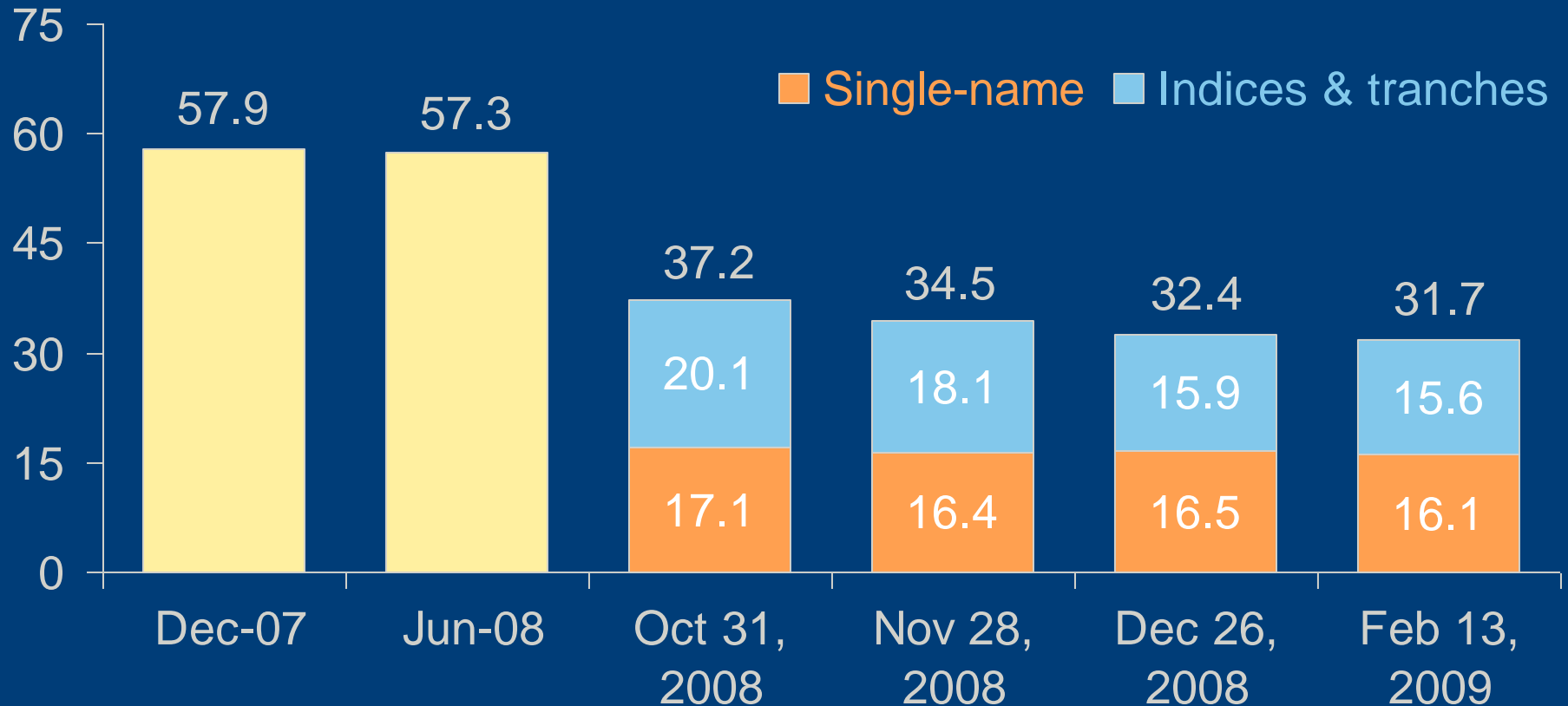
March 2-3, 2009

- CDS, CDO, CLO, etc.
  - > Uncertain size: notional, gross, net, market value, etc.
  - > Uncertain distribution: who is exposed to whom on what, and by how much?
  - > Uncertain market impact:
    - \* Mark-to-market losses: banks, insurance companies, etc.
    - \* Netting, settlement and replacement when a major counterparty fails
    - \* Restructuring proceedings
  - > Reforms: Don't throw baby out with bathwater
    - \* Trade compression/upgrade standard contracts
    - \* Centralized clearing counterparty
    - \* Revive securitization markets
    - \* Others (e.g., "skin in the game")

- Hedge funds
  - > Performance
  - > Change in assets under management
  - > Leverage and market impact: liquidity providers or takers?
  - > Reforms: focus on hedge funds or prime brokers?
- Private equity
  - > Leverage of the target companies
  - > CLOs
- Back to the banks
  - > Exposure to risk
  - > Funding risk

# Credit Default Swaps Outstanding – Gross Notional\*

US\$ trillions

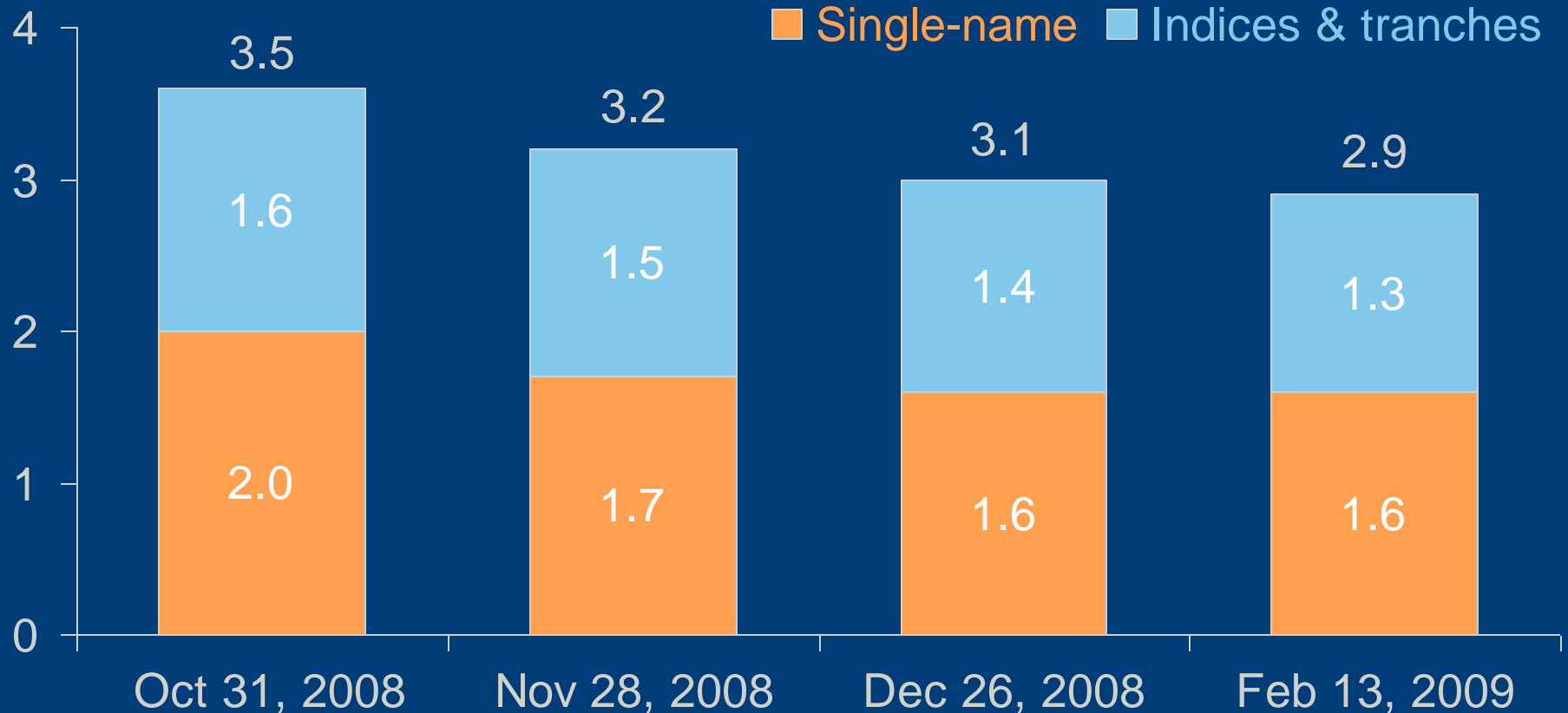


Source: BIS (December 2007 and June 2008); DTCC (all other dates); IIF calculations.

\* Estimate of gross notional value of CDS outstanding; assumes DTCC database covers 90 percent of CDS market.

# Credit Default Swaps Outstanding – Net Notional\*

US\$ trillions



Source: DTCC; IIF calculations.

\* Estimate of net notional value of CDS outstanding; assumes DTCC database covers 90 percent of CDS market.

# Credit Default Swaps Outstanding by Type of Counterparty

US\$ trillions, gross market value



Source: BIS; IIF calculations.

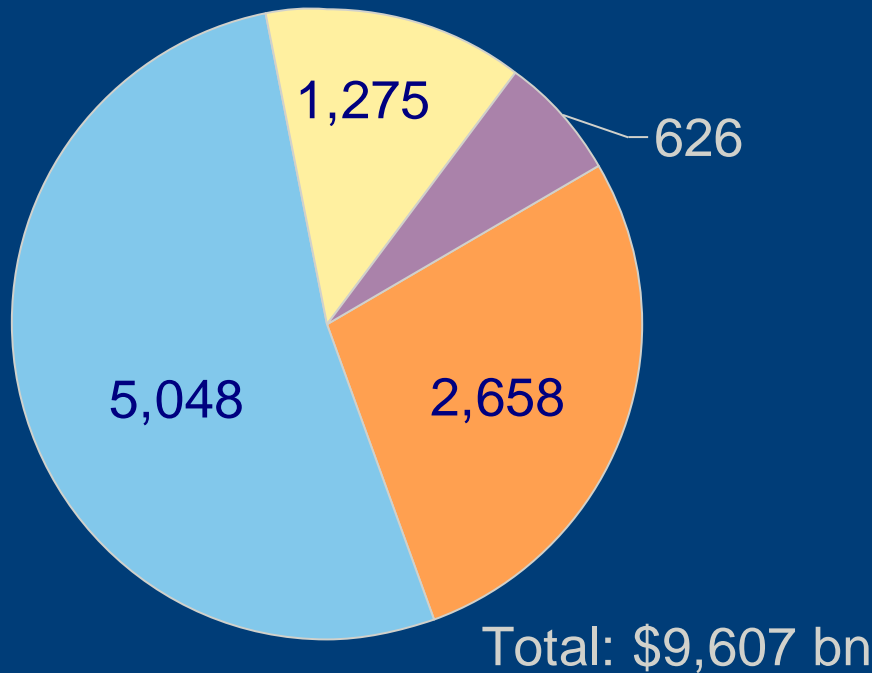
\* Includes banks and security firms, insurance and financial guaranty firms, and other financial institutions.

# Securitized Assets Outstanding by Region\*

## U.S. Originated Assets

US\$ billions

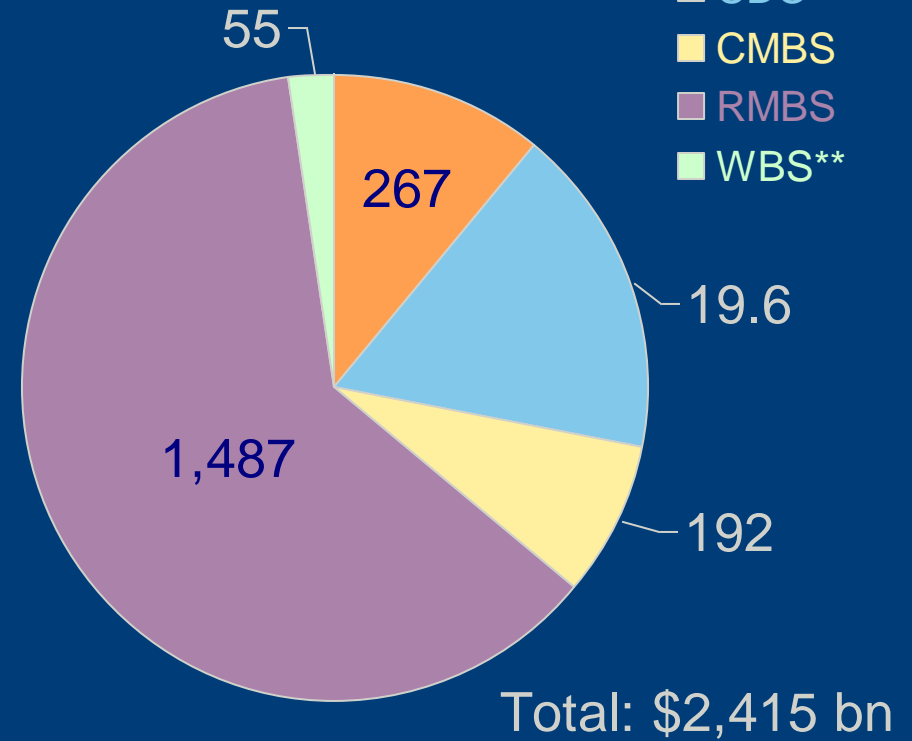
- ABS
- Agency MBS
- Nonagency RMBS
- CMBS



## European Originated Assets

US\$ billions

- ABS
- CDO
- CMBS
- RMBS
- WBS\*\*



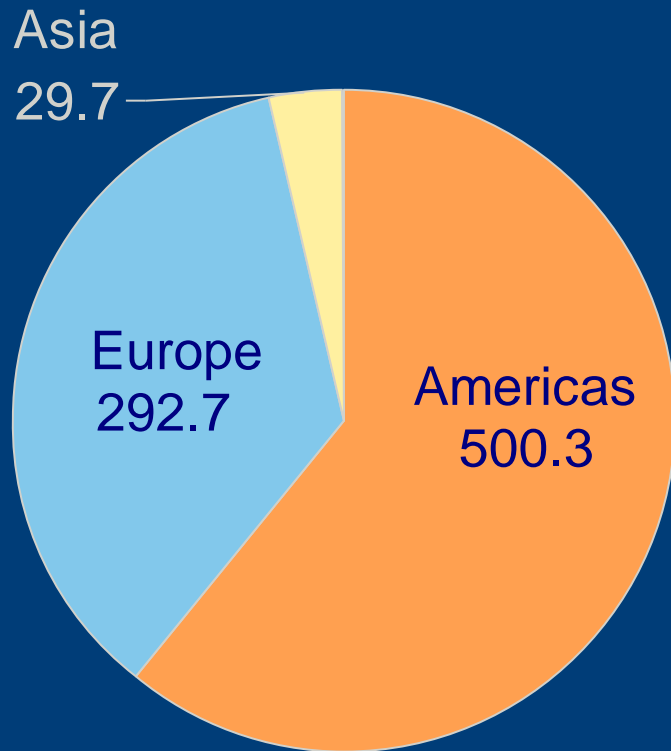
Source: European Securitization Forum.

\* Outstanding volumes at end-2008. \*\* Whole business securitization.

# Losses Reported by Financial Institutions\*

## Banks

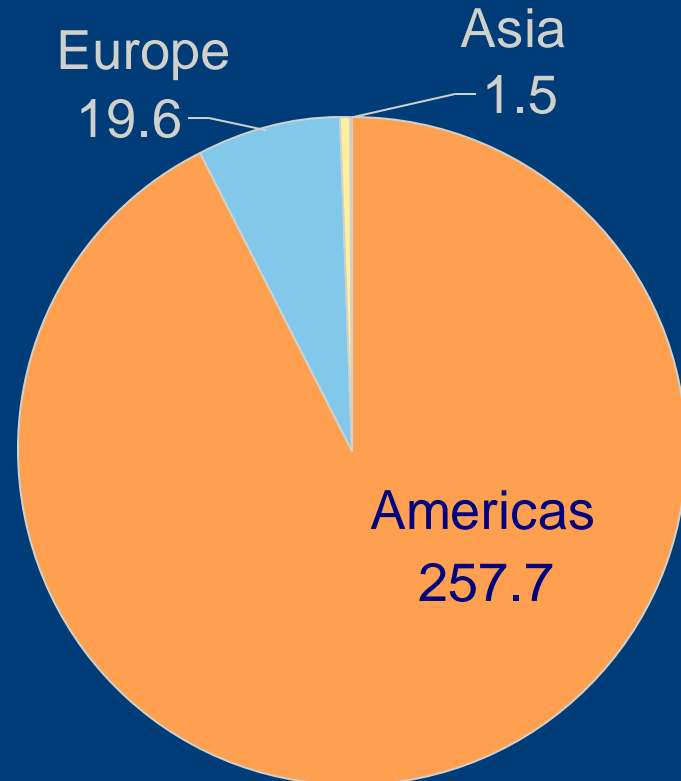
US\$ billions



Total: \$823 bn

## Insurance Companies & GSEs

US\$ billions



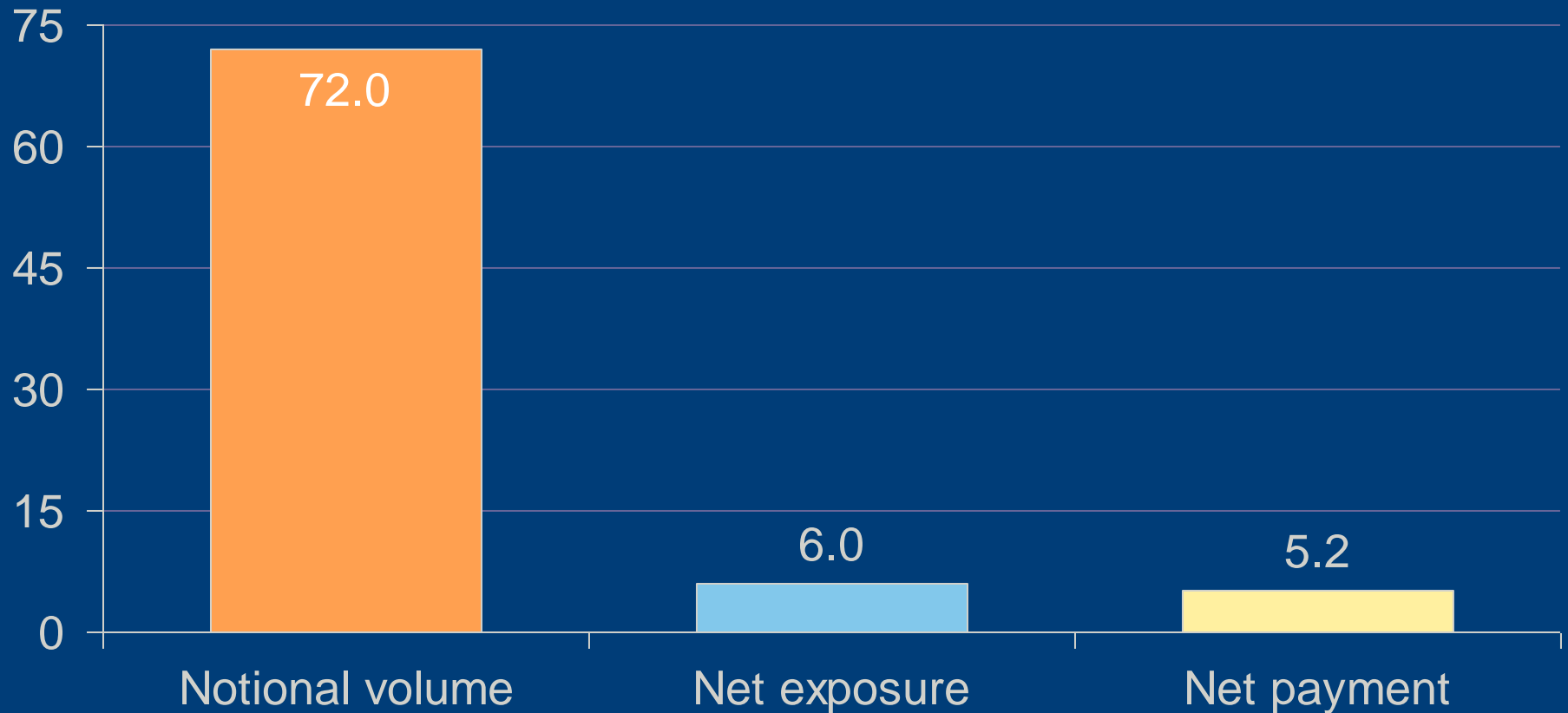
Total: \$279 bn

Source: Bloomberg.

\* Since beginning of 2007; includes writedowns and credit losses.

# Lehman-referencing Credit Default Swaps

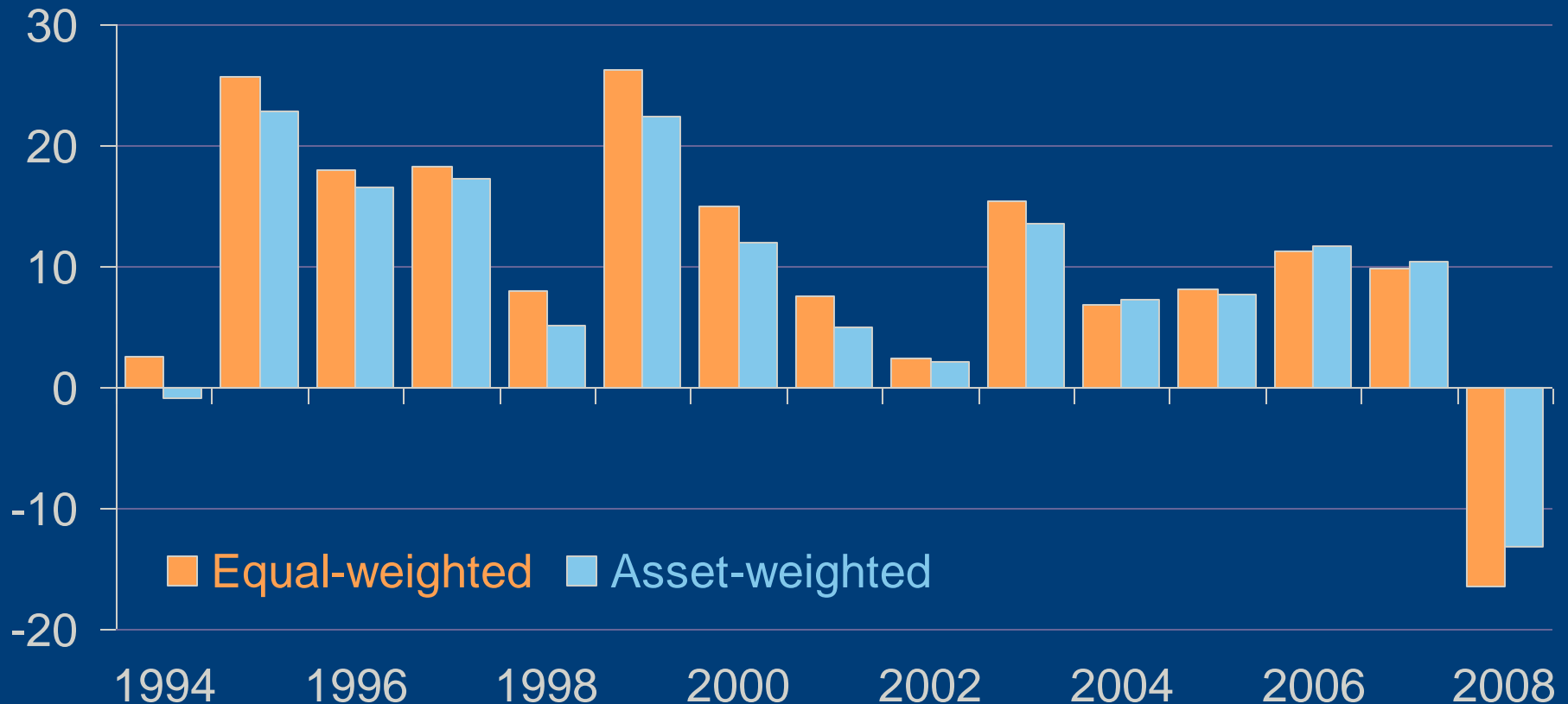
US\$ billions



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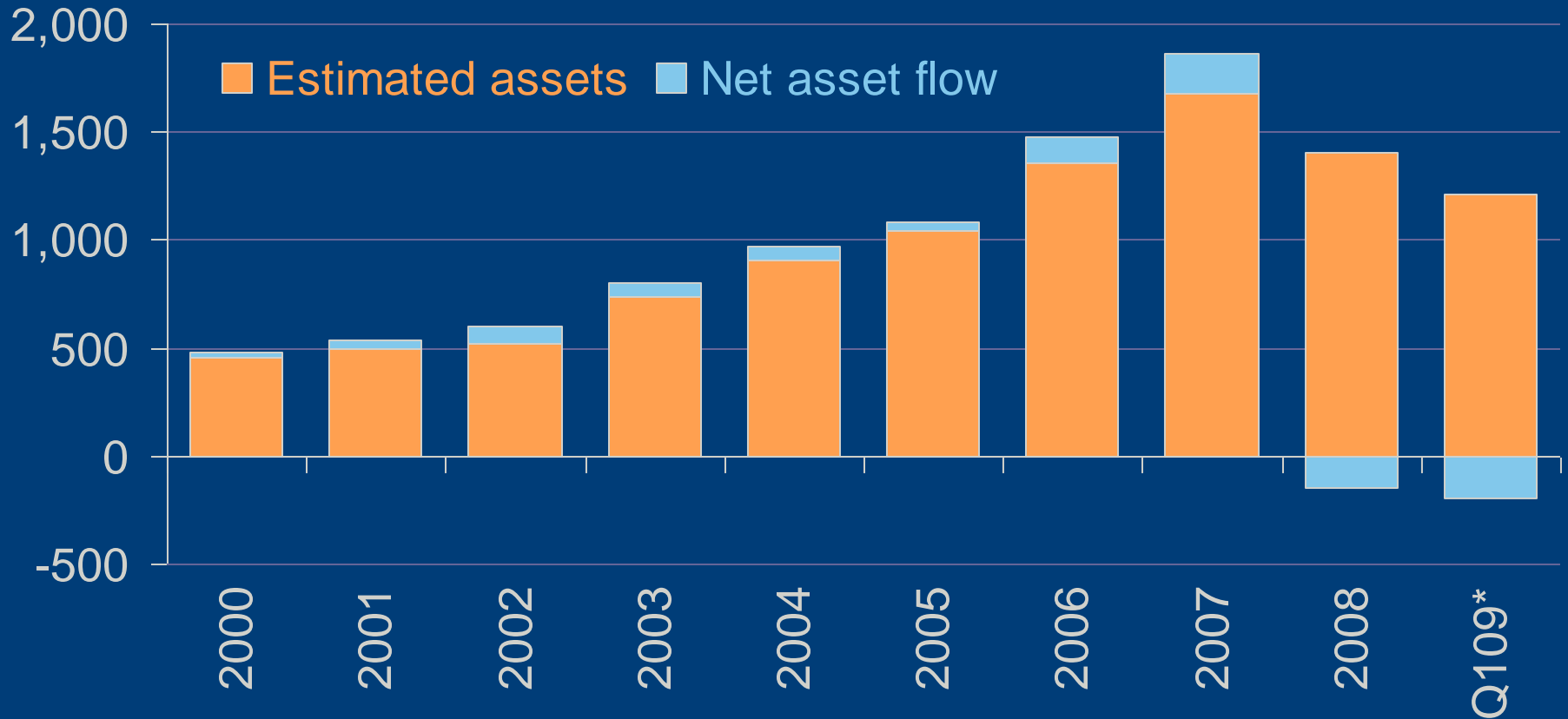
# Hedge Fund Annual Returns

percent



# Hedge Fund Assets Under Management

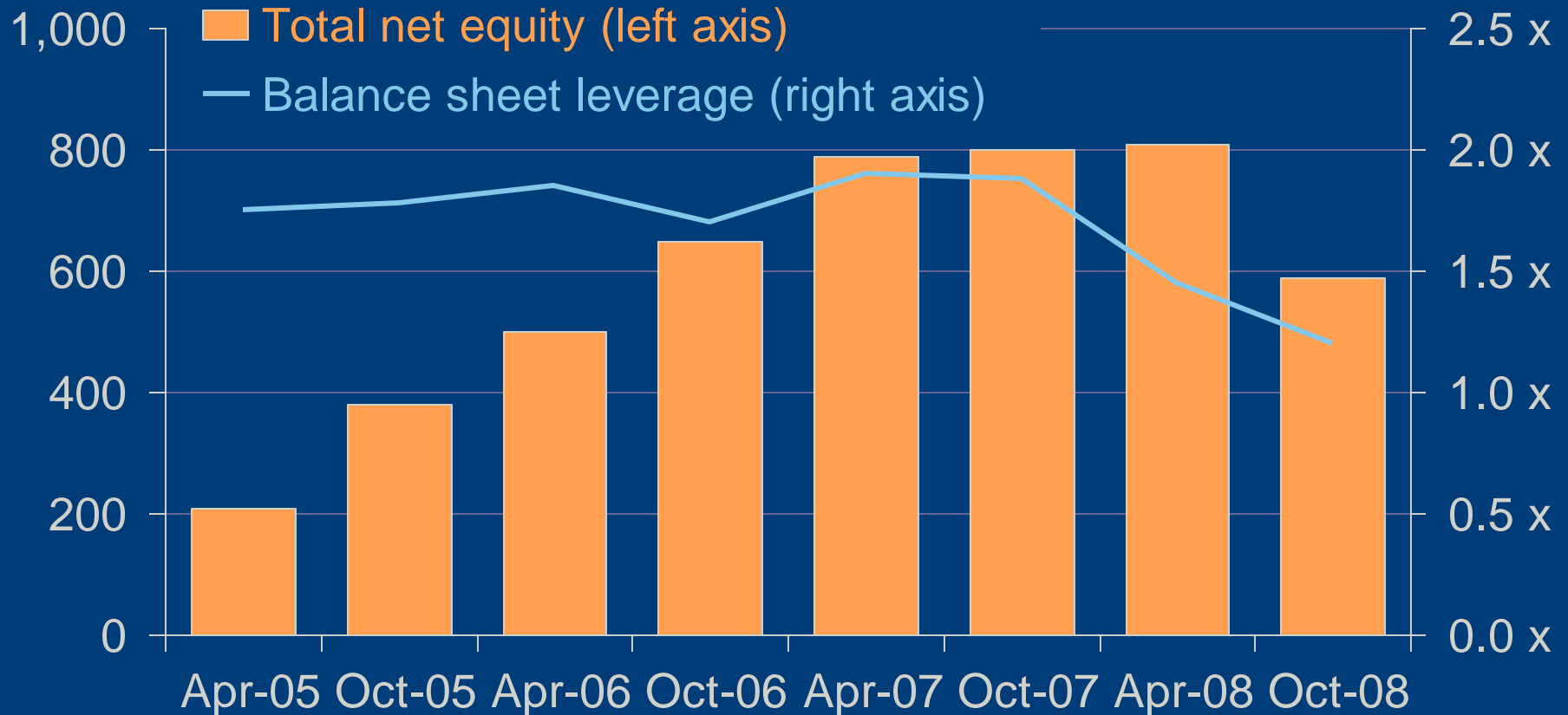
US\$ billions



Source: Financial Times; Bloomberg. \* UBS estimate for 2009 Q1.

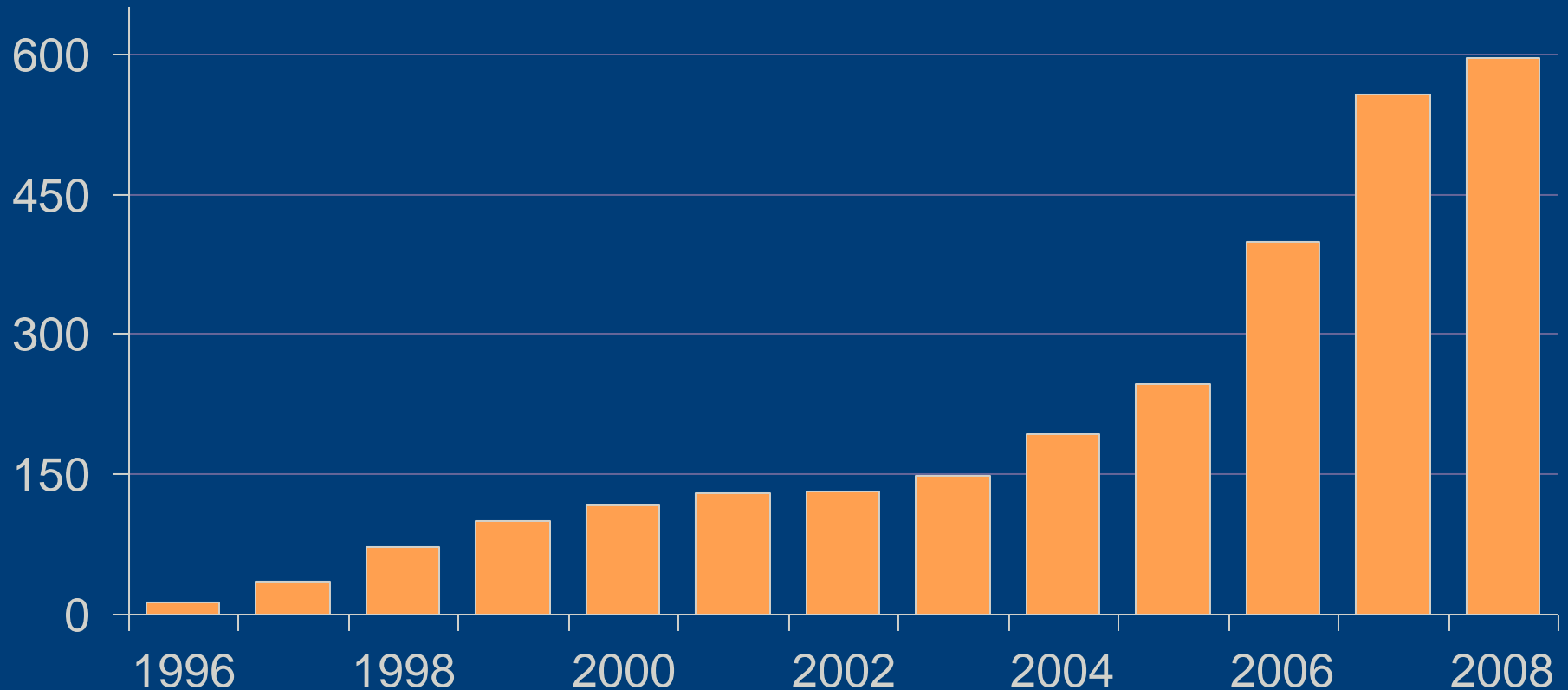
# Hedge Fund Leverage

US\$ billions



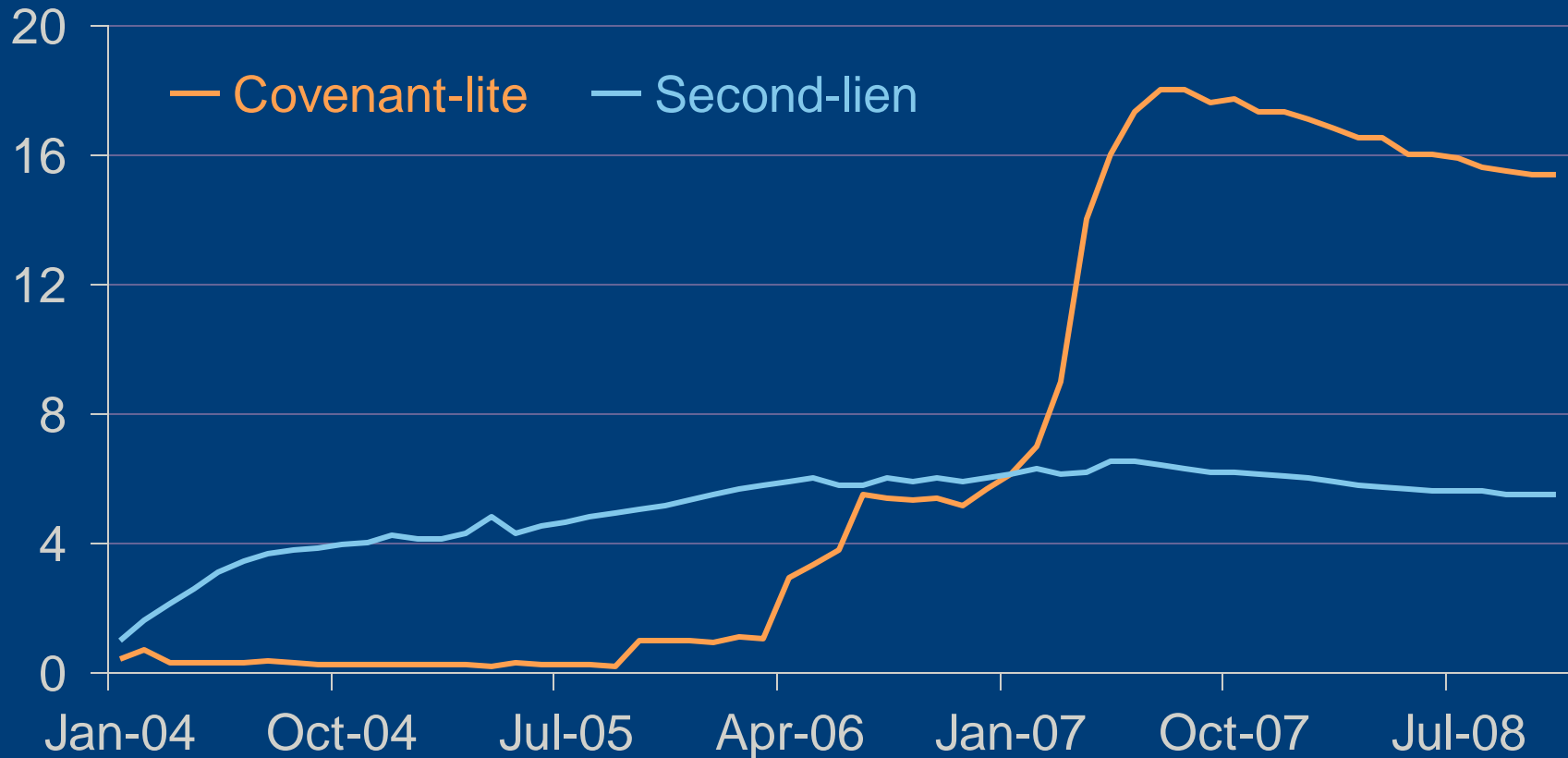
# Leveraged Loans Outstanding

US\$ billions



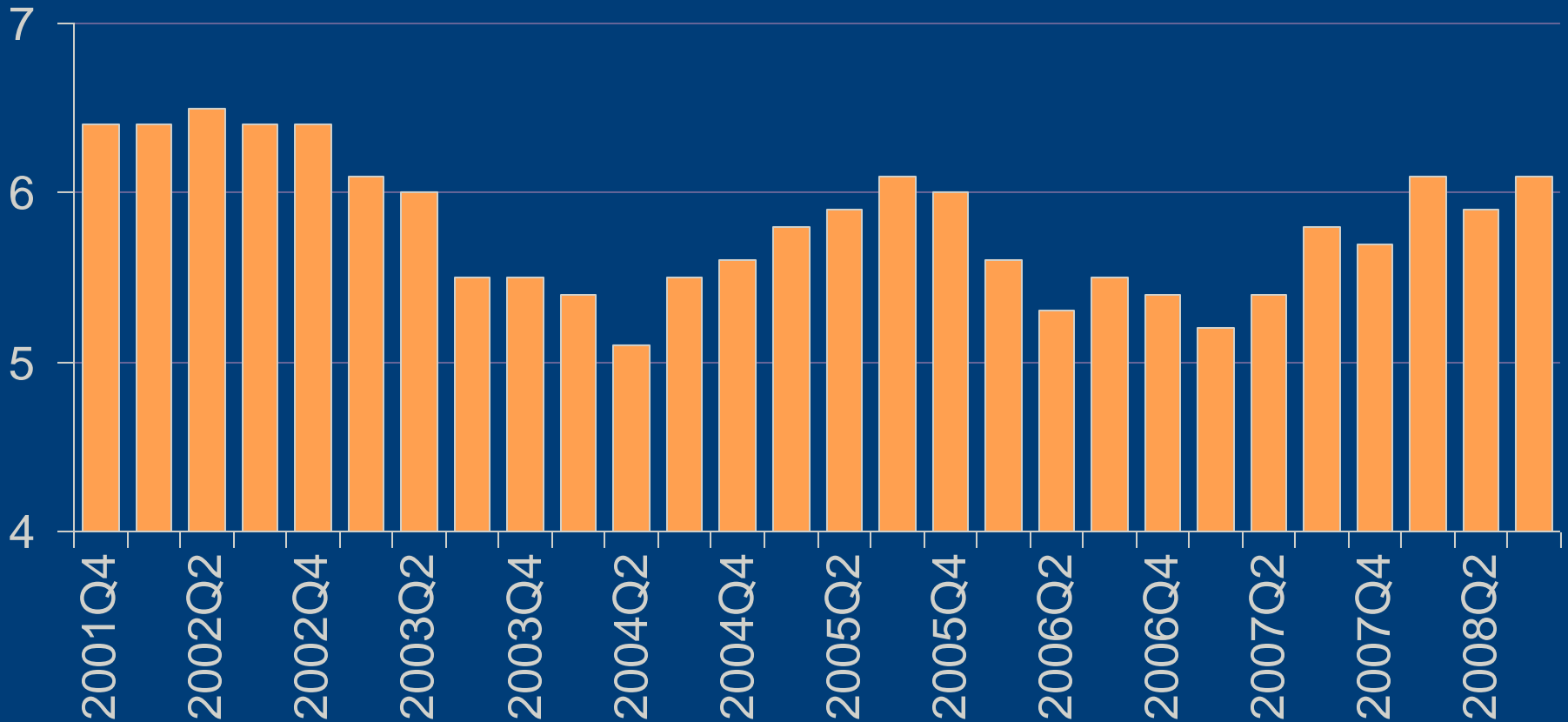
# Underwriting Standards for Leveraged Loans

percent of outstanding loans



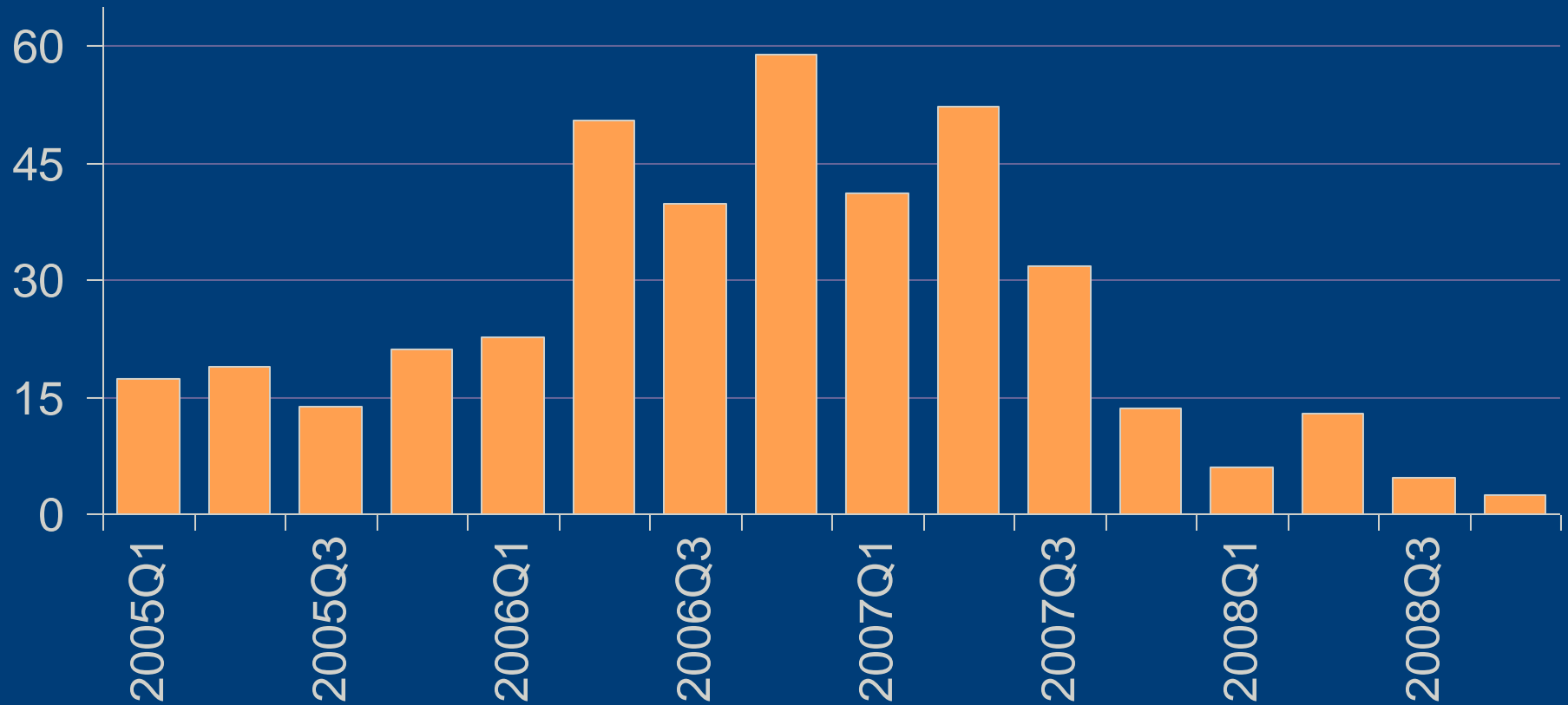
# Leverage Multipliers of Outstanding Leveraged Loans

weighted average current debt/EBITA ratio



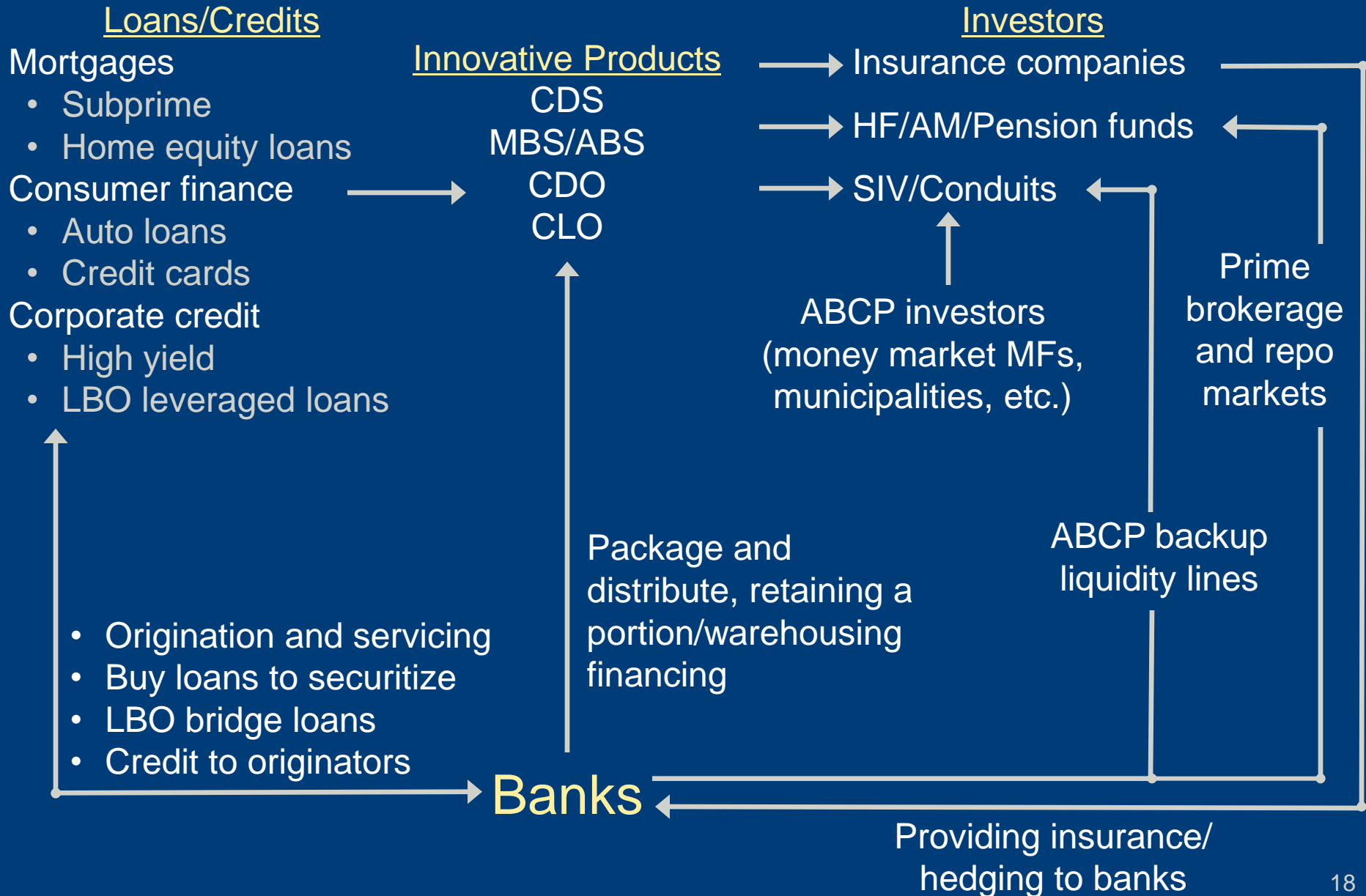
# Collateralized Loan Obligation (CLO) Issuance\*

US\$ billions



Source: SIFMA.

\* Global issuance of CDOs backed by investment grade or high yield loans.



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