

Unregulated Financial Products: Potential, Risk and Regulatory Reform

Hung Tran

OECD-ADBI 10th Roundtable
on Capital Market Reform in Asia
Tokyo

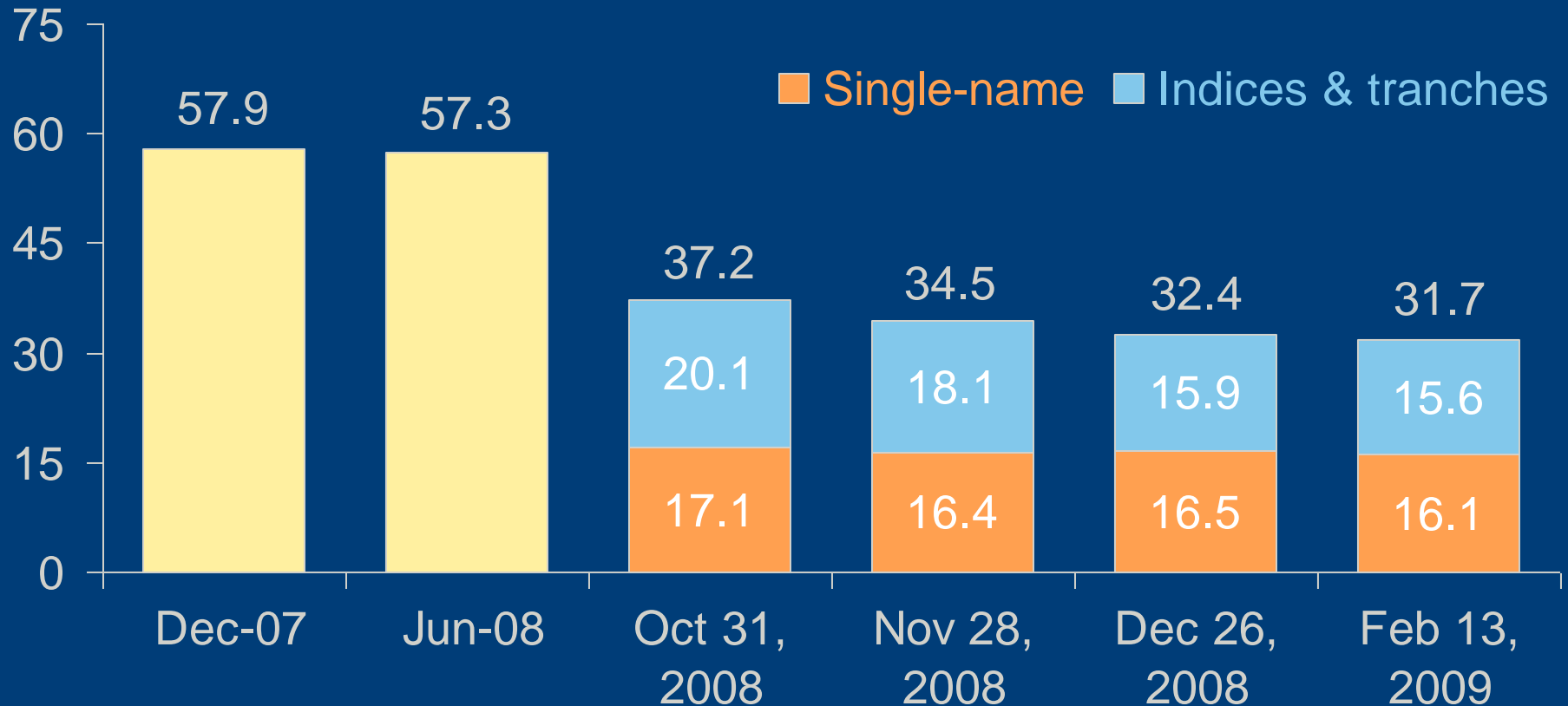
March 2-3, 2009

- 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

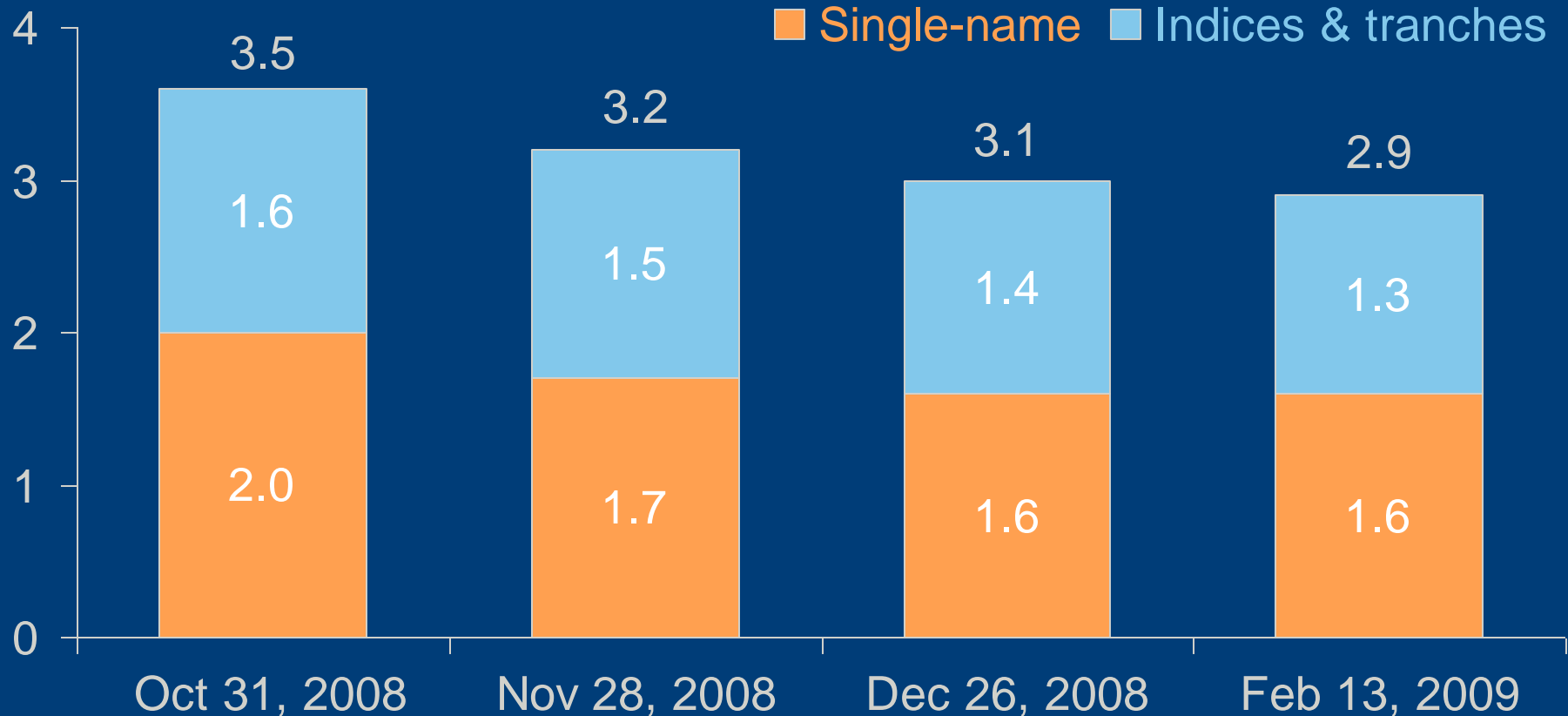


Source: BIS (December 2007 and June 2008); DTCC (all other dates); IIF calculations.

* 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.

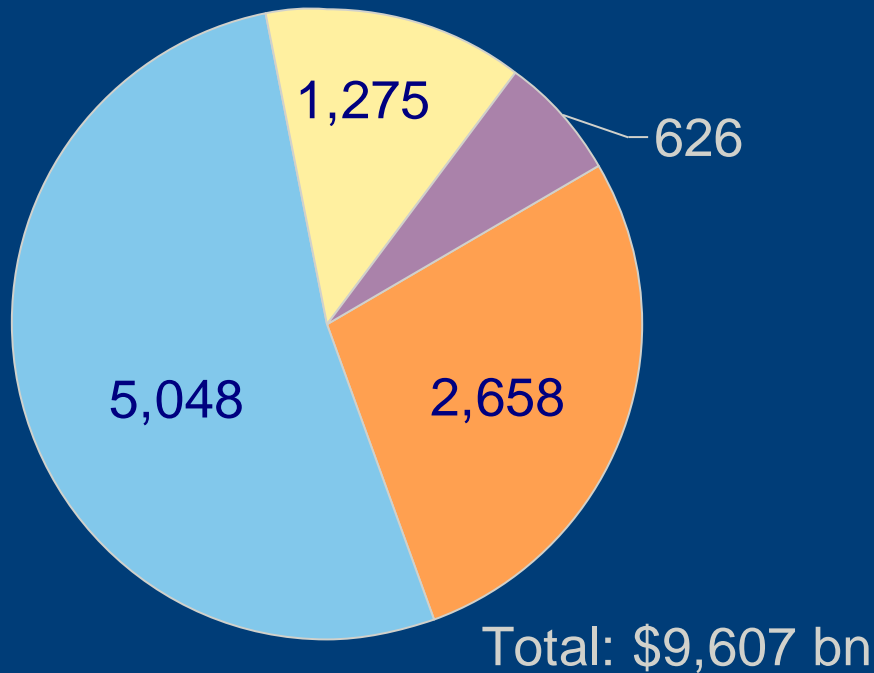
* Includes banks and security firms, insurance and financial guaranty firms, and other financial institutions.

Securitized Assets Outstanding by Region*

U.S. Originated Assets

US\$ billions

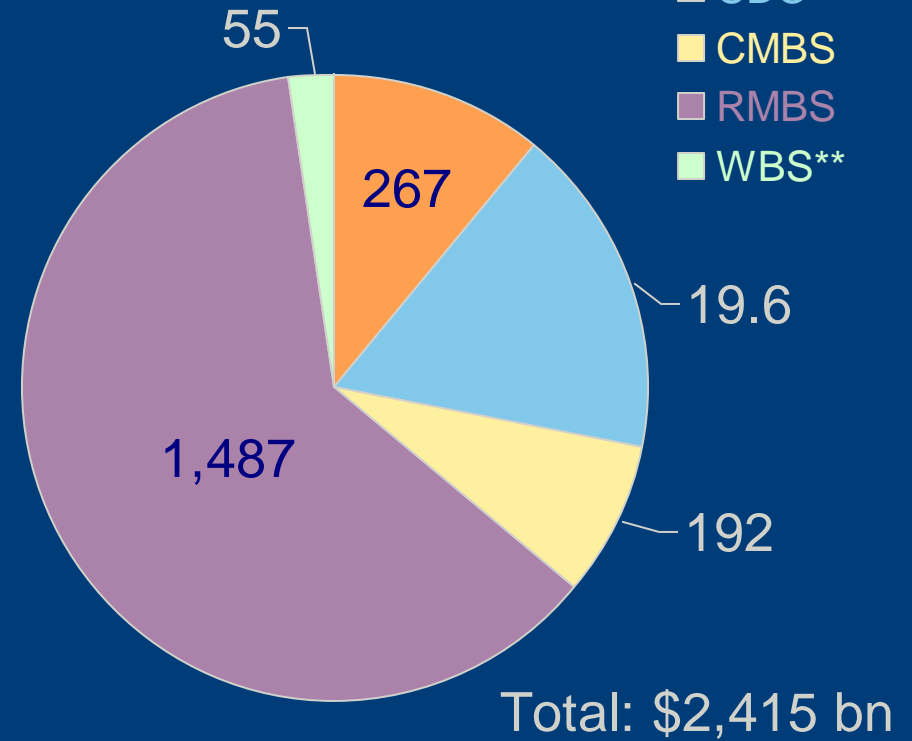
- ABS
- Agency MBS
- Nonagency RMBS
- CMBS



European Originated Assets

US\$ billions

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



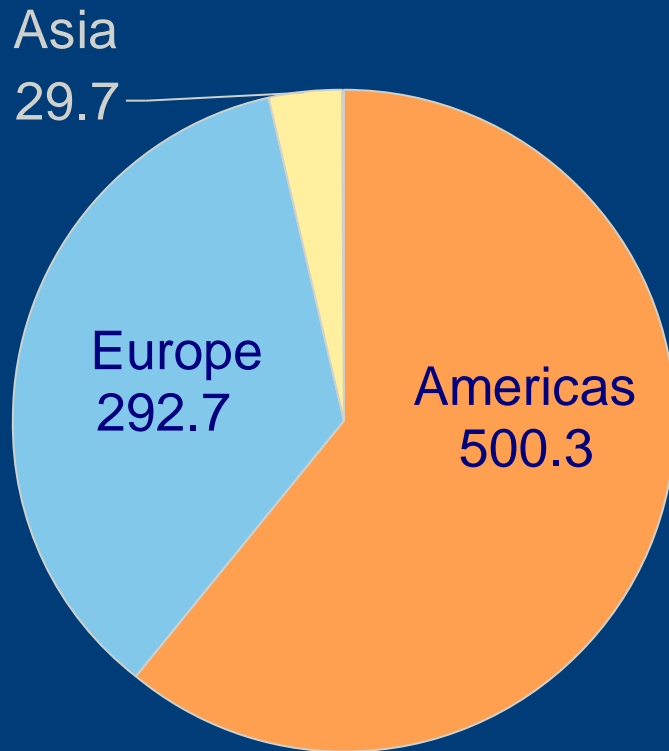
Source: European Securitization Forum.

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

Losses Reported by Financial Institutions*

Banks

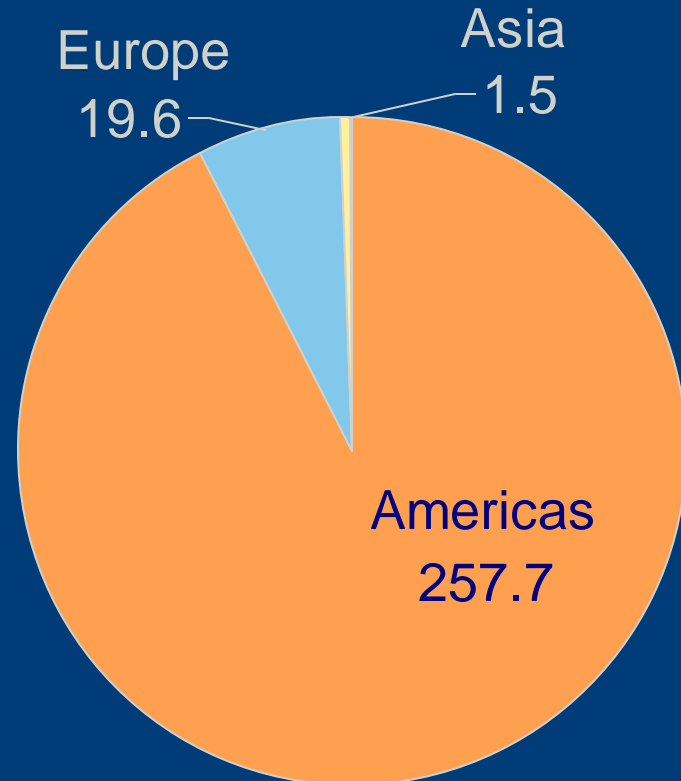
US\$ billions



Total: \$823 bn

Insurance Companies & GSEs

US\$ billions



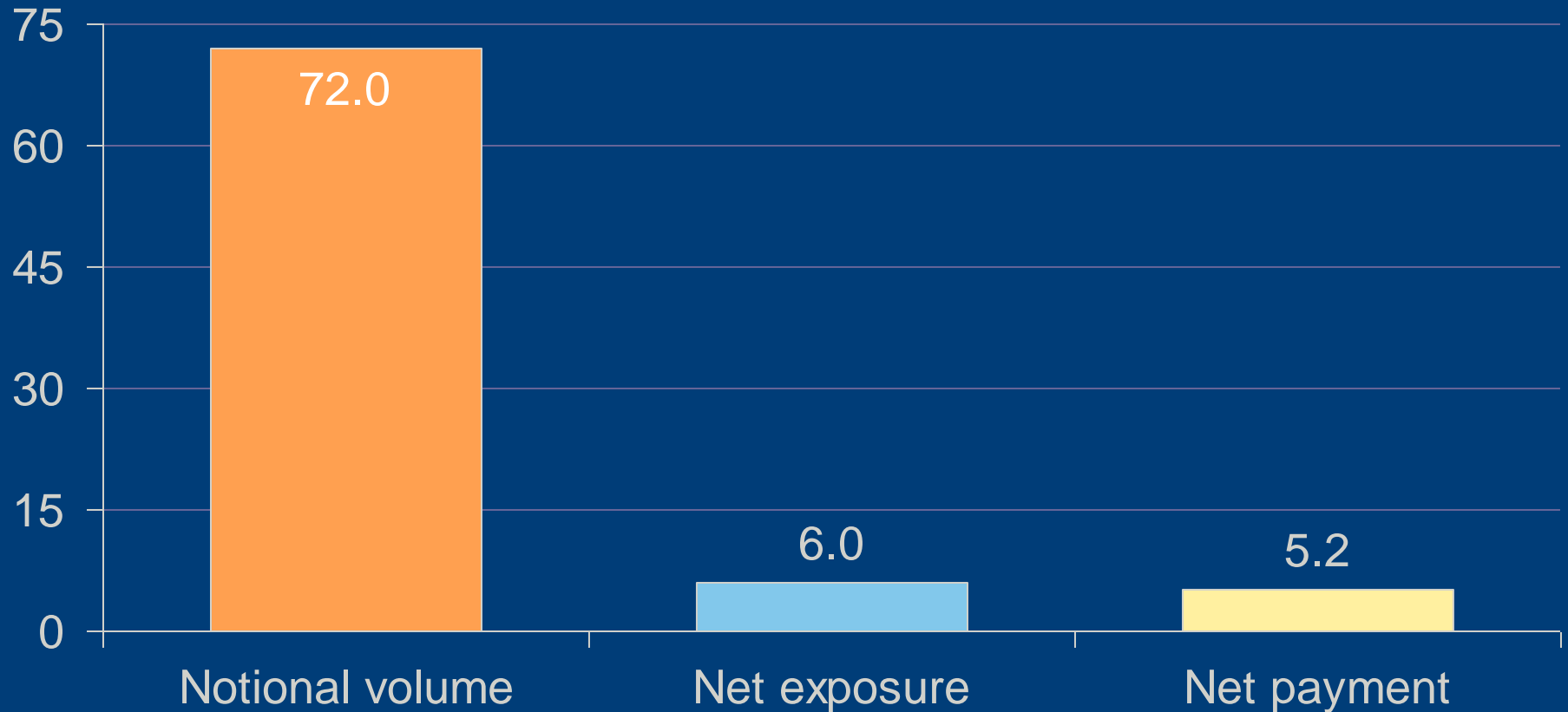
Total: \$279 bn

Source: Bloomberg.

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

Lehman-referencing Credit Default Swaps

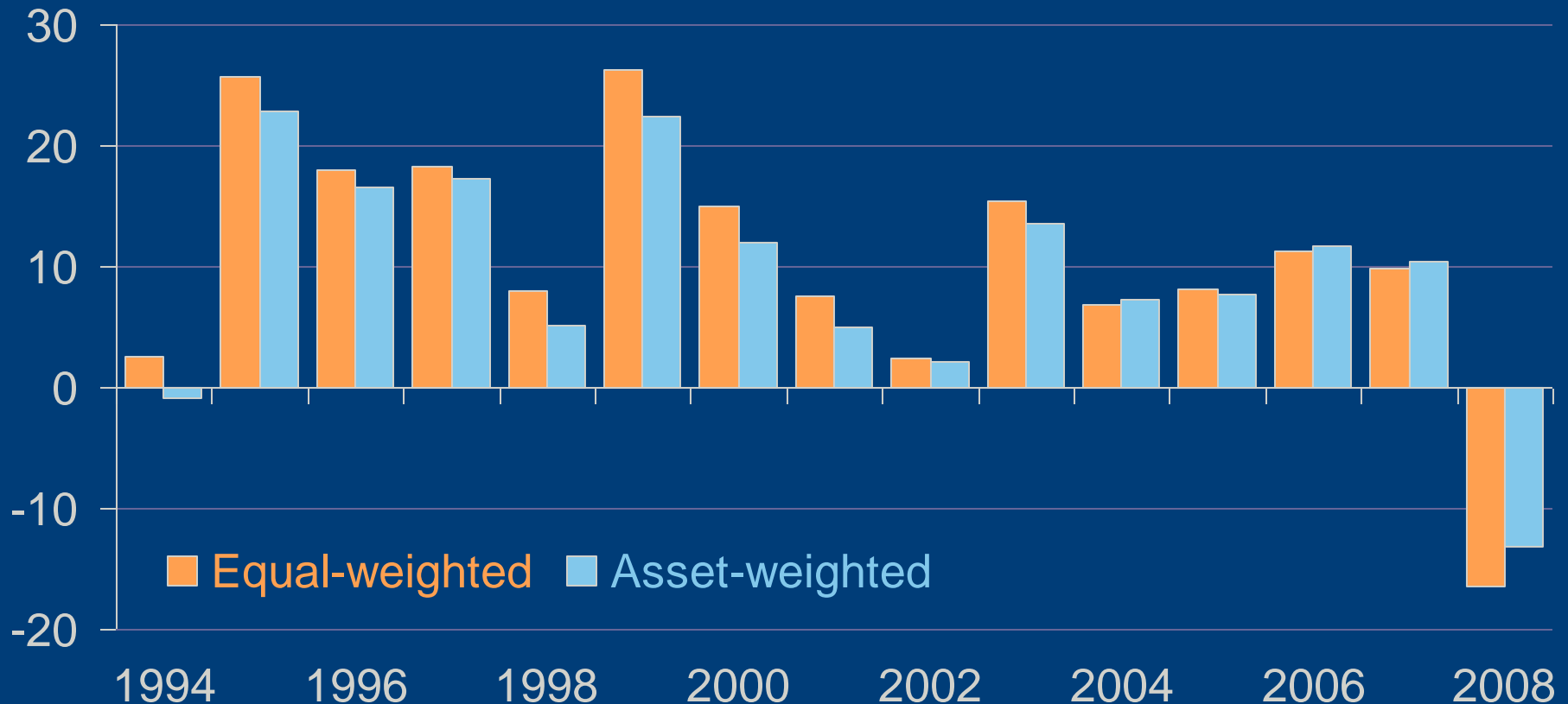
US\$ billions



- Reforms: Don't throw baby out with bathwater
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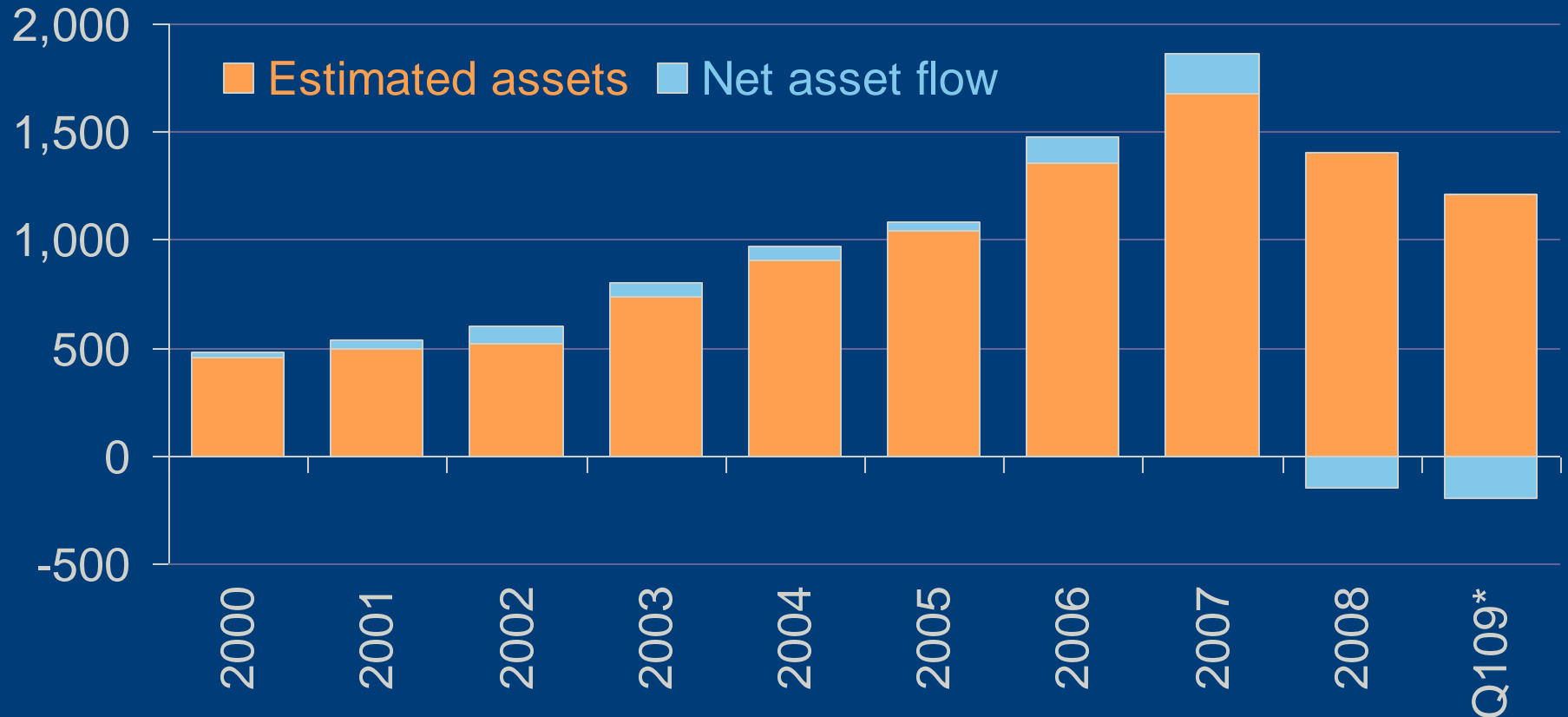
Hedge Fund Annual Returns

percent



Hedge Fund Assets Under Management

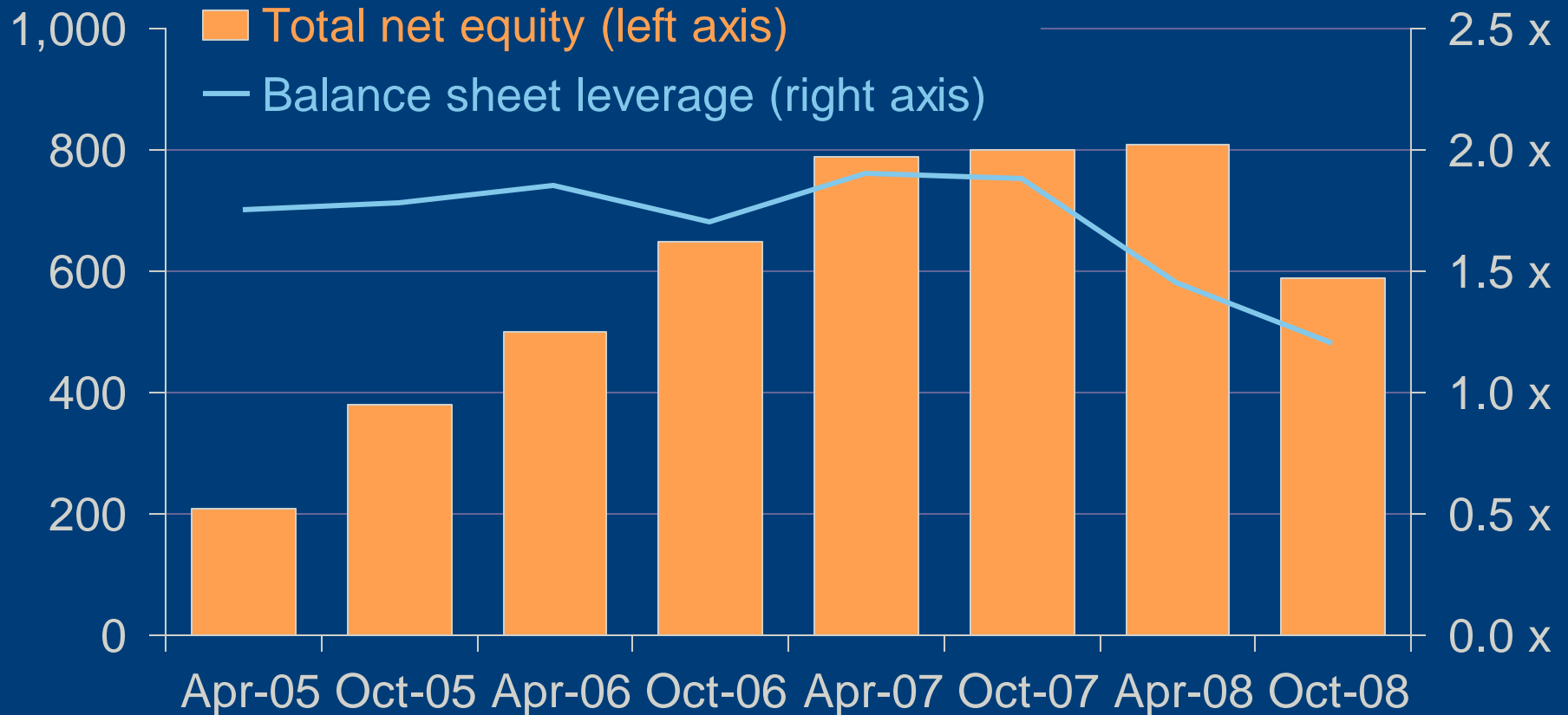
US\$ billions



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

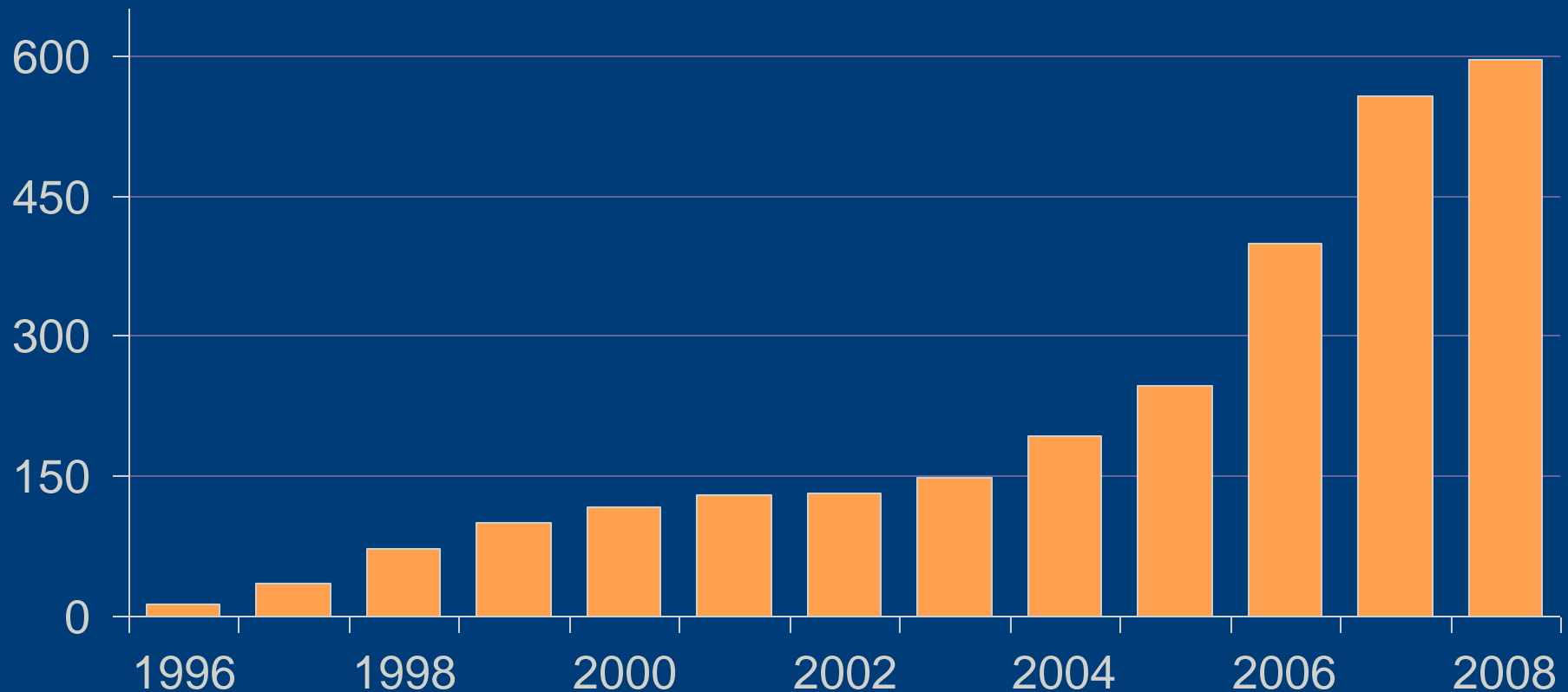
Hedge Fund Leverage

US\$ billions



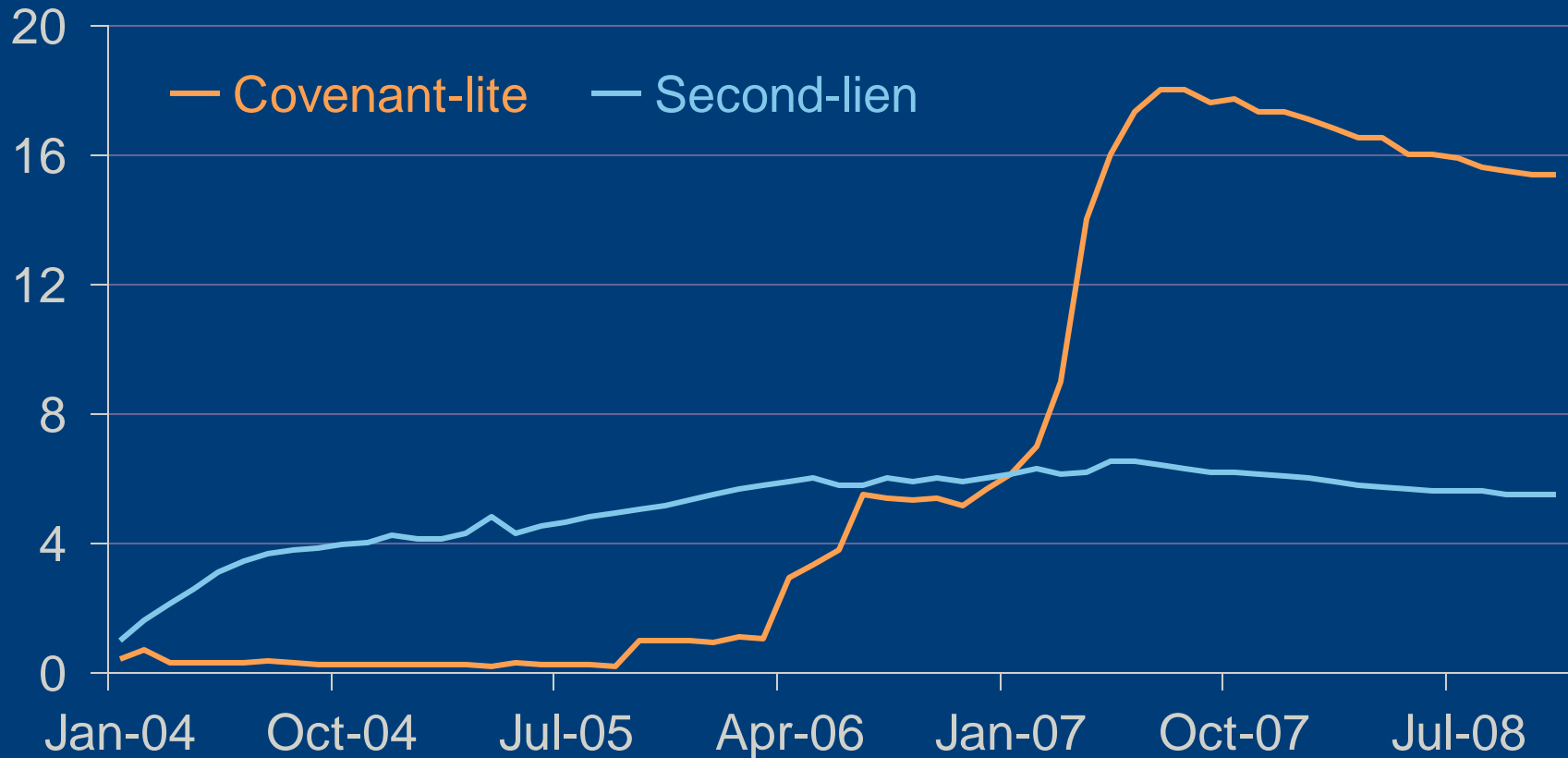
Leveraged Loans Outstanding

US\$ billions



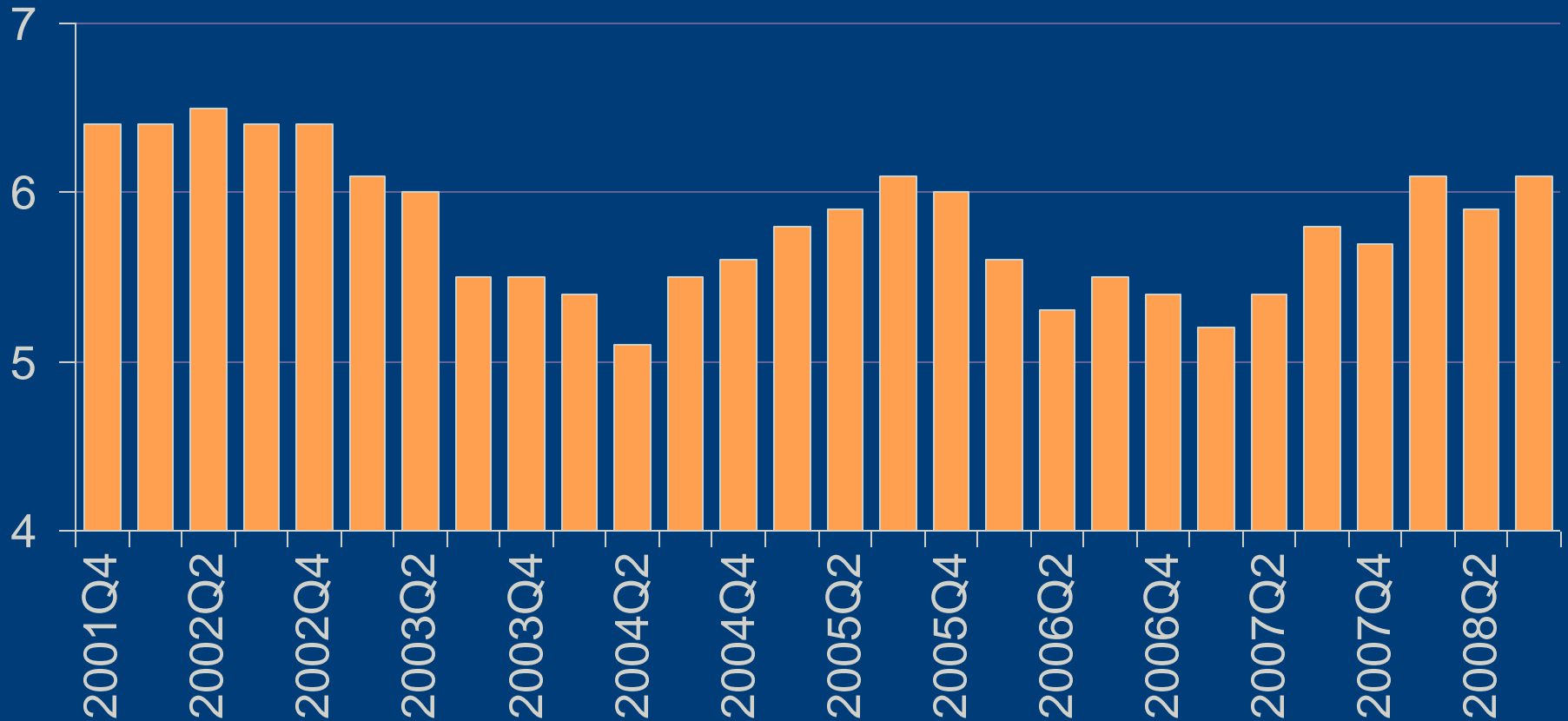
Underwriting Standards for Leveraged Loans

percent of outstanding loans



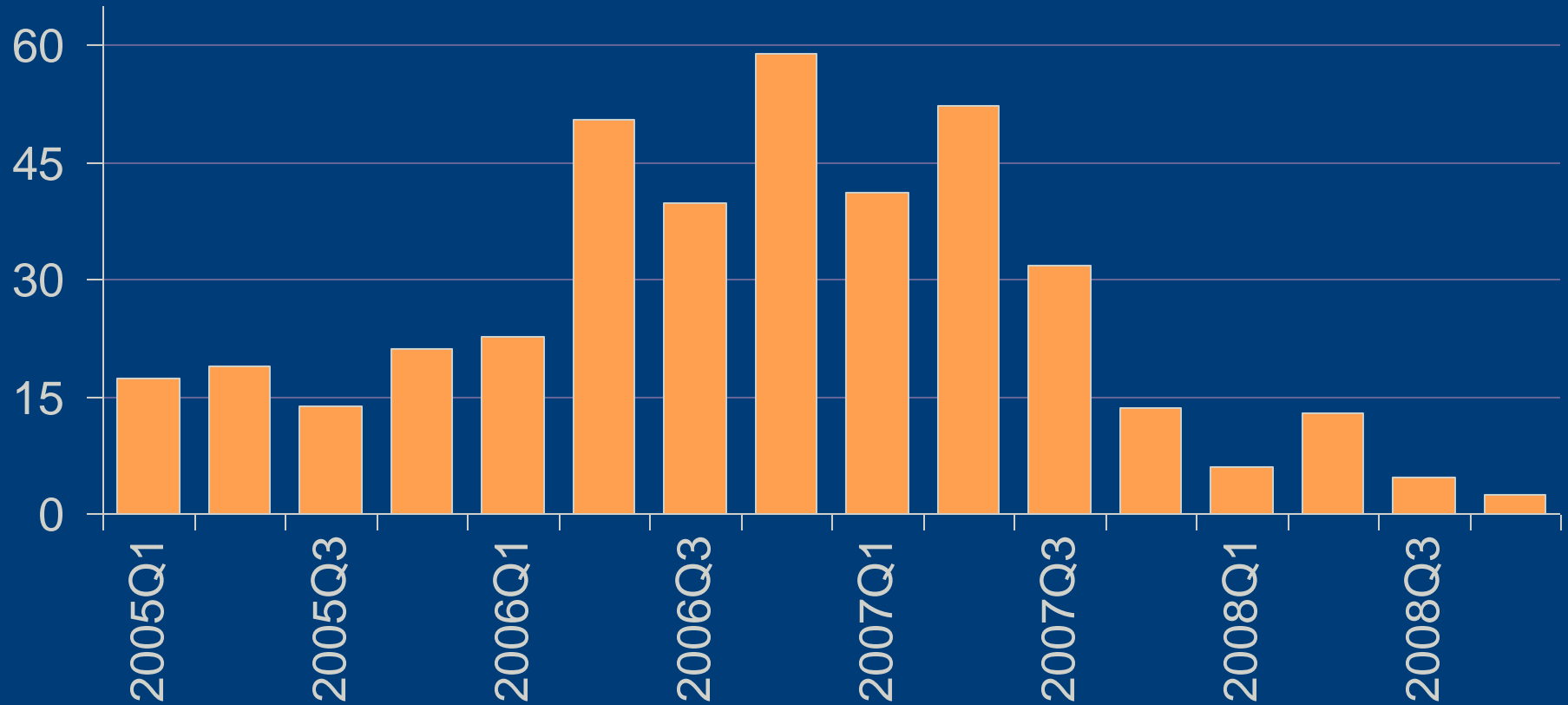
Leverage Multipliers of Outstanding Leveraged Loans

weighted average current debt/EBITA ratio



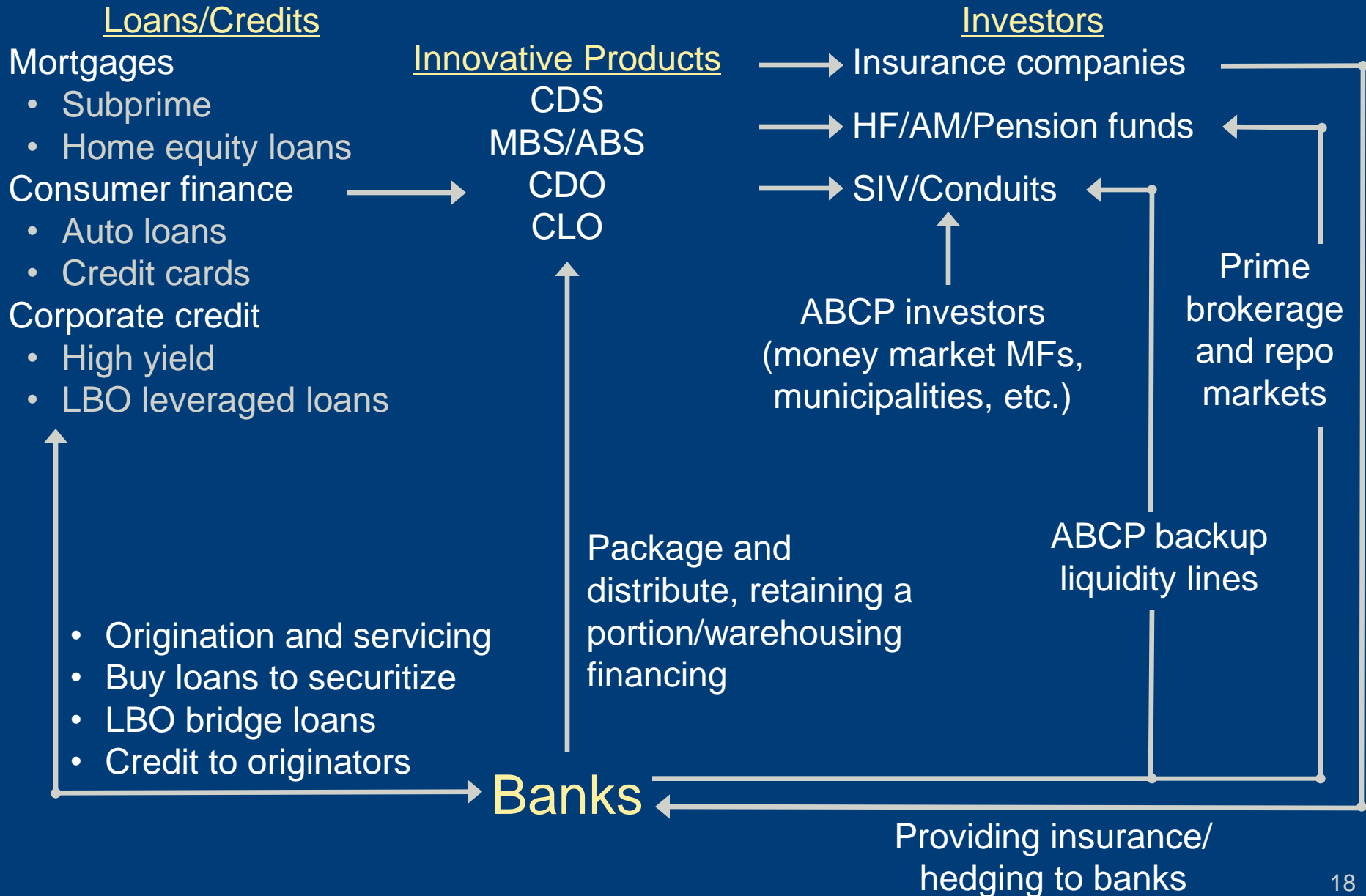
Collateralized Loan Obligation (CLO) Issuance*

US\$ billions



Source: SIFMA.

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



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