

Global Financial crisis: the supervisory perspective

Eurobanking 2009

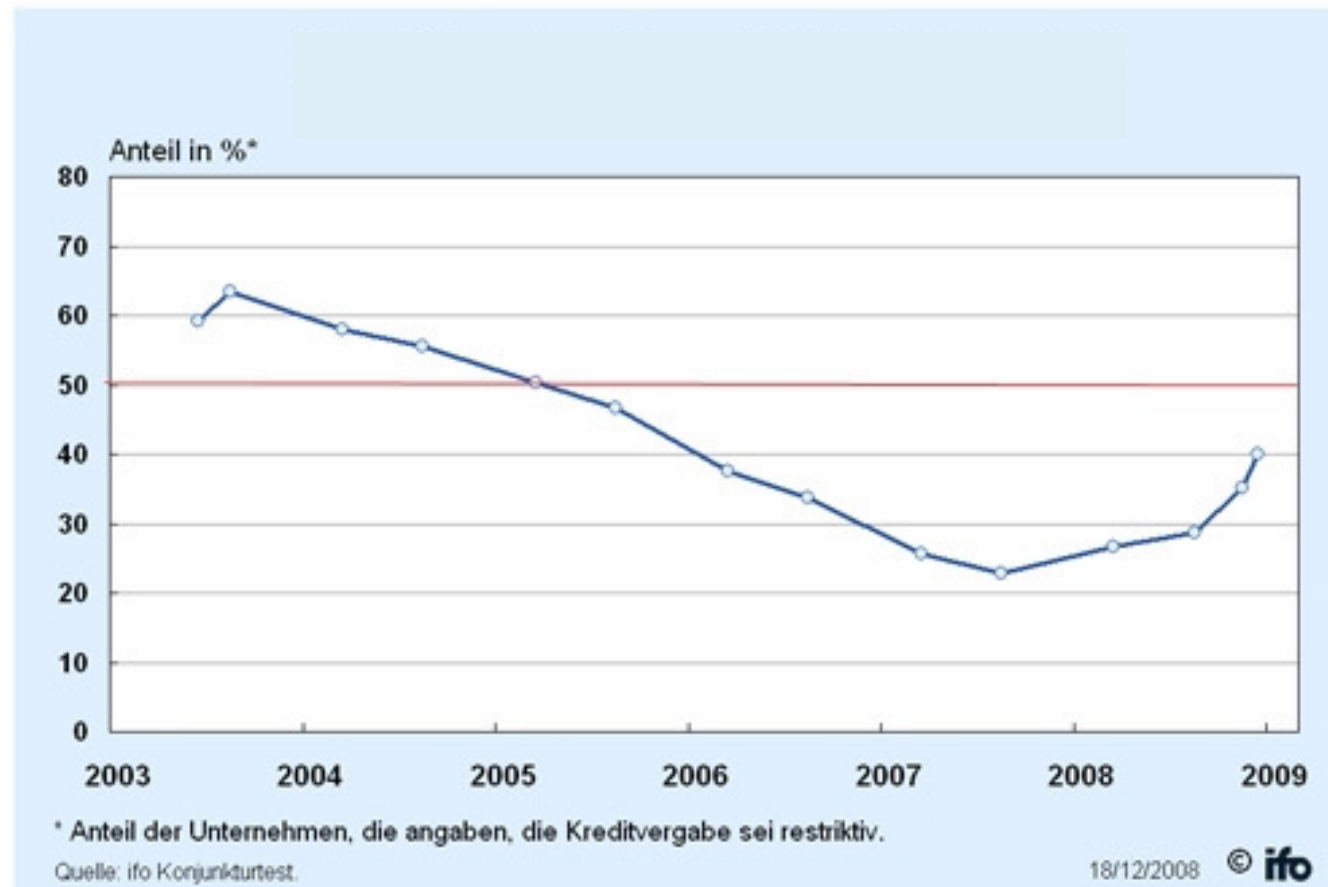
17 – 20 May 2009

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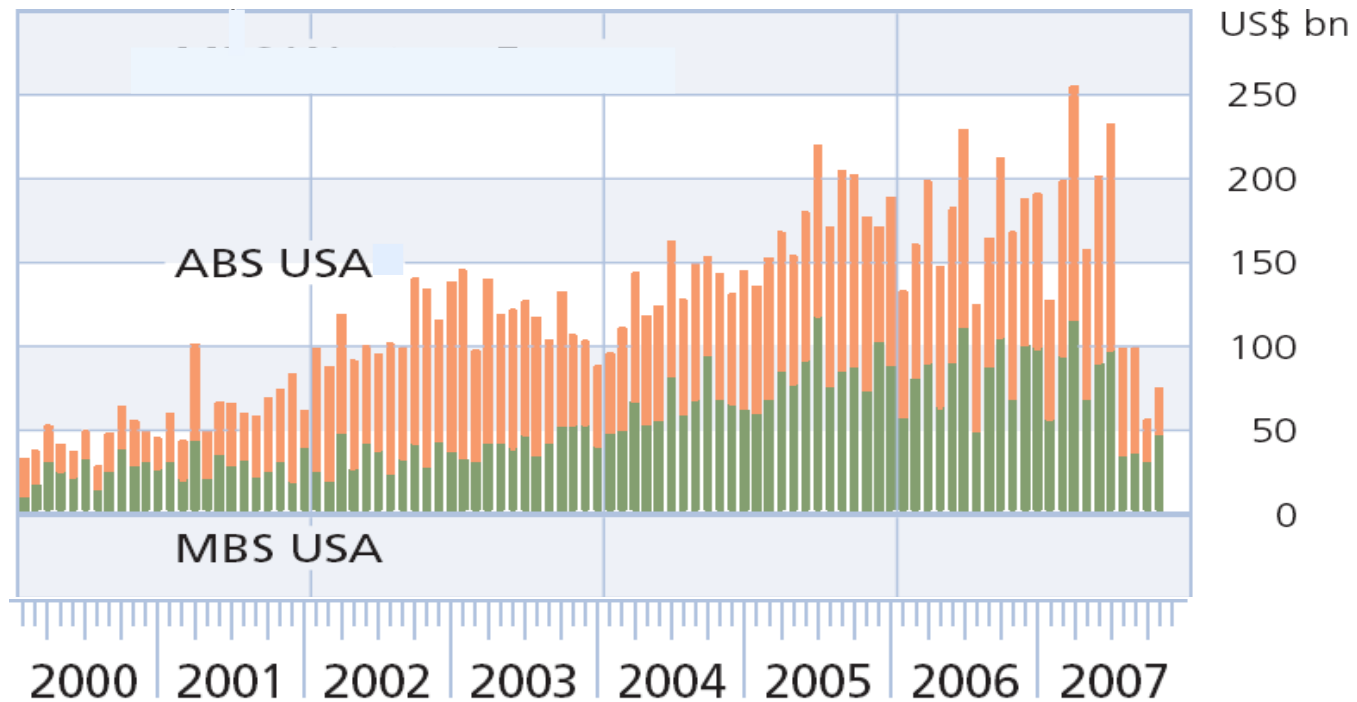
Agenda

- Main riskdrivers towards the crisis
- Turning into crisis
- Reactions
- Outlook

- Weaknesses of credit standards („credit hurdle“ Germany)

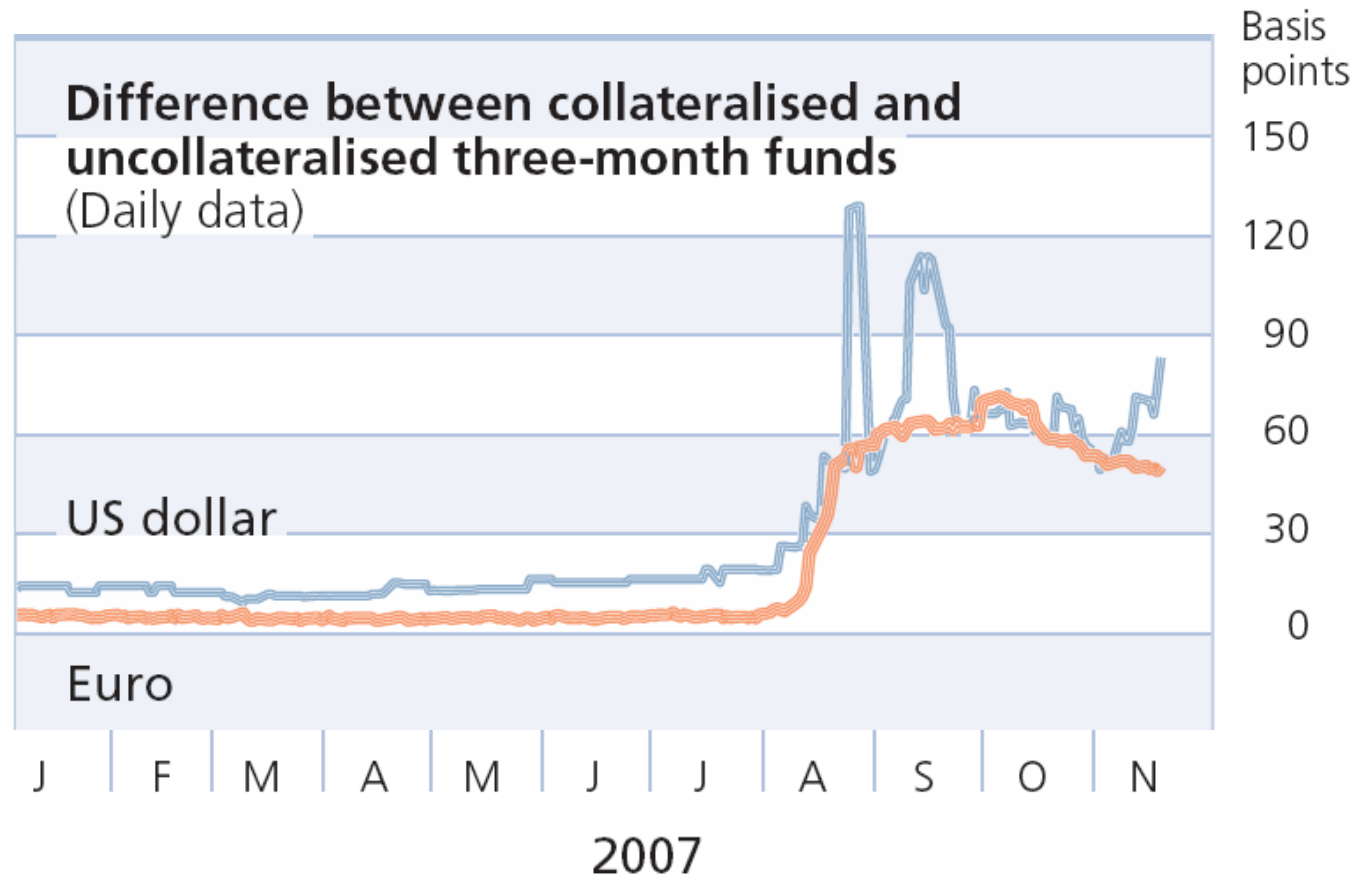


- **Transfer of credit risks**



Source: Deutsche Bundesbank
Finanzstabilitätsbericht 2007

- **Underestimation of credit risks**



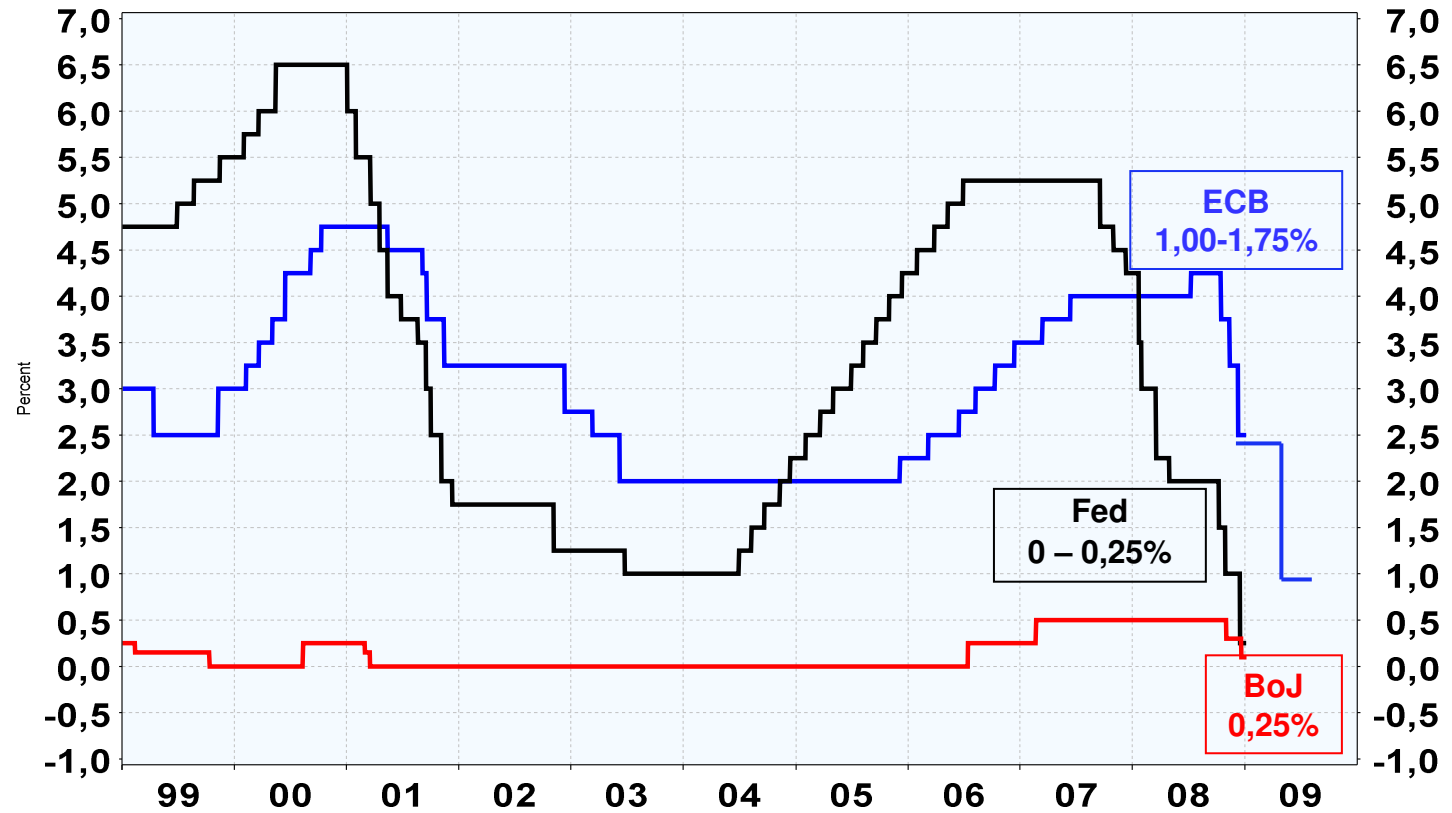
Sources: Bloomberg and the Federal Reserve Board.

- **Weaknesses of the new business model**
Originate to distribute

- Distribution of risks → lose of control
- Roll over-funding → Funding risk/Illiquid markets
- Off balance → Full support for conduits/reputation
- Leverage of return → Leverage of risks

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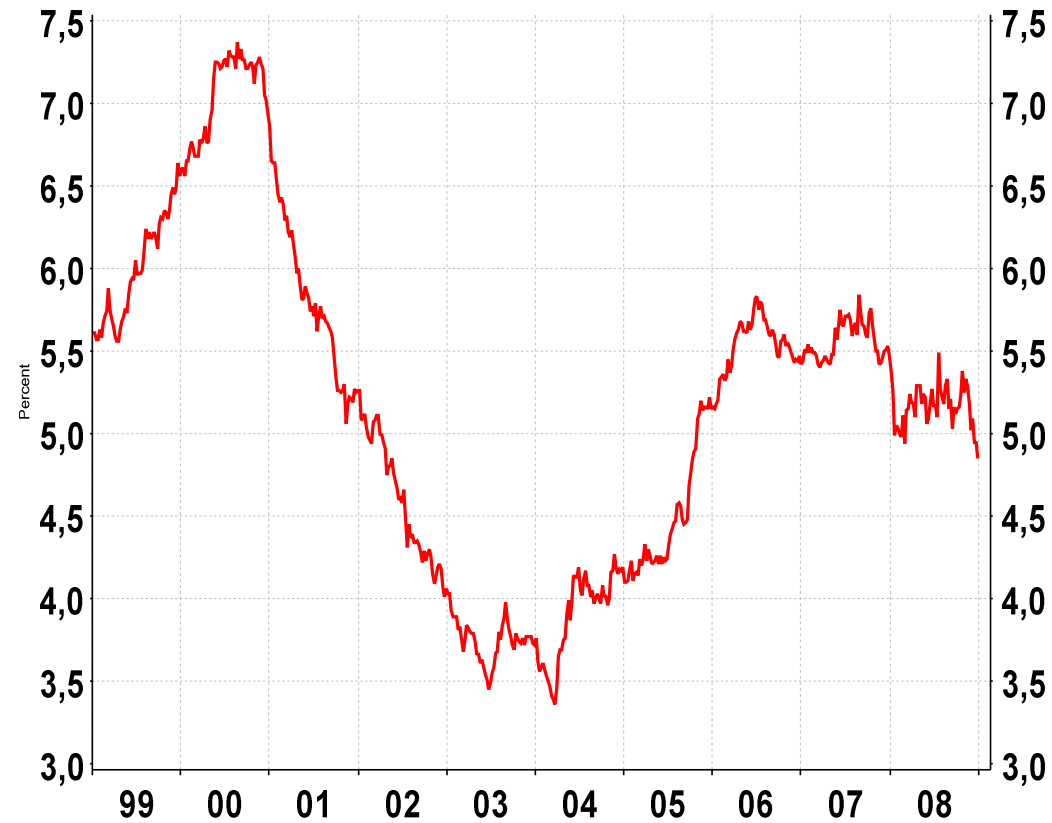
- Rising Central Bank rates



Source: Reuters EcoWin

- Rising mortgage rates

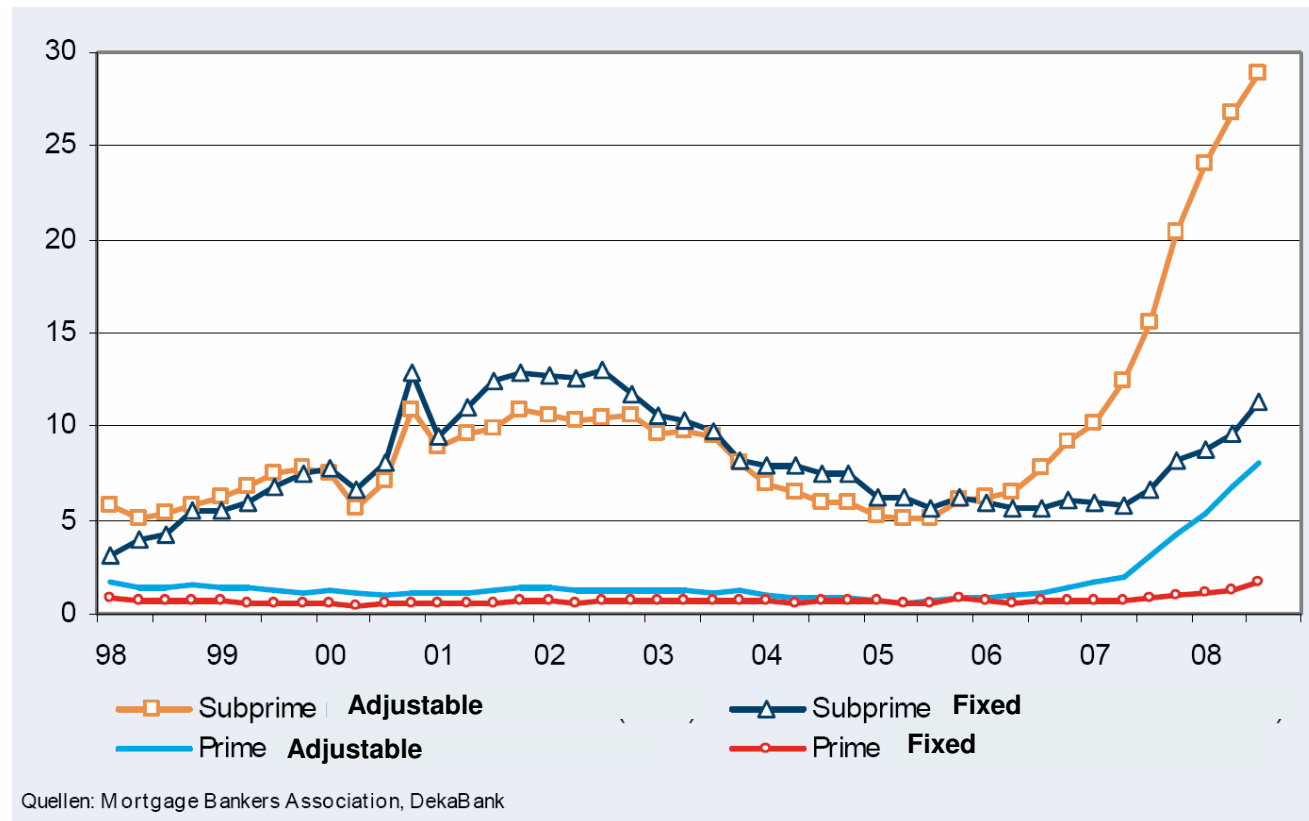
US mortgage rates 1 y ARM



Source: Reuters EcoWin

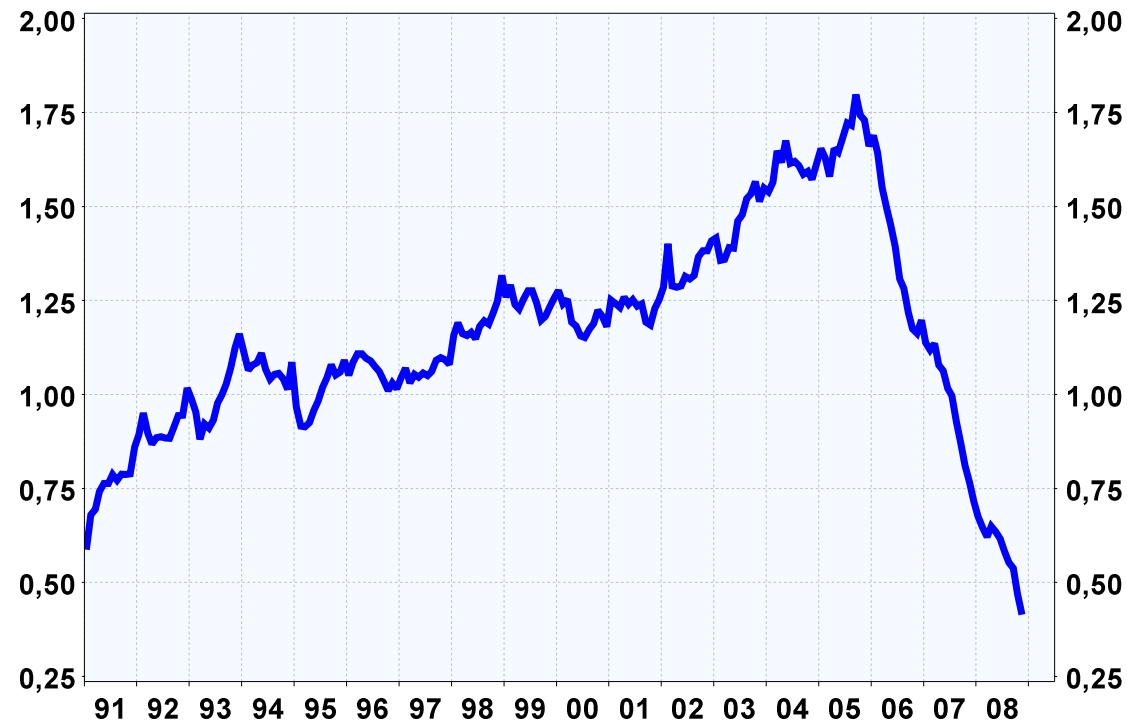
- **Increasing defaults**

Overdue of US mortgages in %



- Drop of US real estate demand

US Building permissions for family homes (mill. units)



Quelle: U.S. Department of Commerce, Reuters EcoWin

- **Turning into collapse**
 - continuous downgrades of assets
 - Spreading distrust
 - collapse of banks (IKB July 27, 2007)
 - disruption of markets

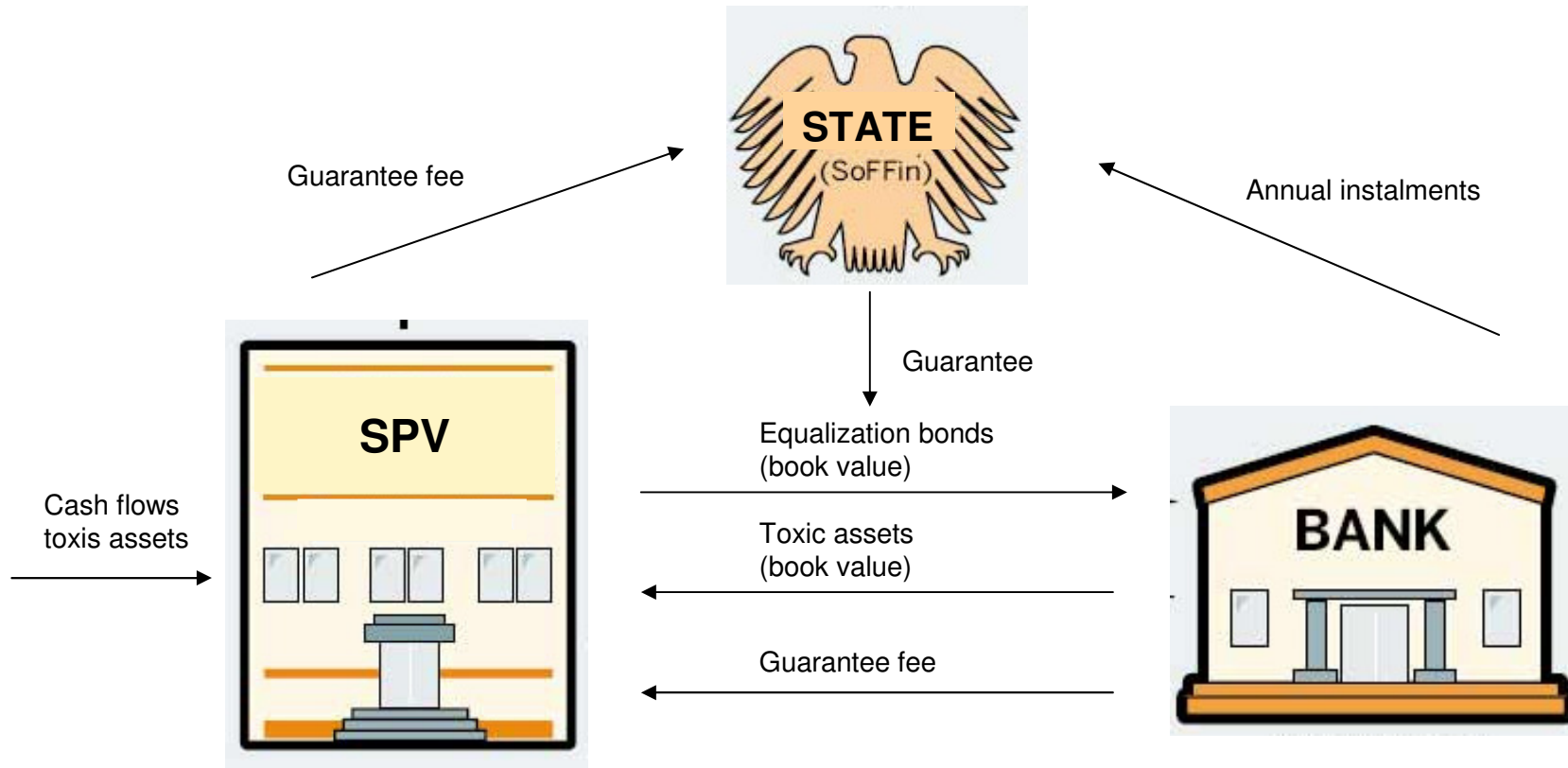
- **Reaction of Central Banks**
 - flooded markets with liquidity
 - accepted more securities
 - reduced Central Bank rates

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- **Modification of accounting standards**
 - mtm causes problems
 - markets are illiquid
 - prices on illiquid markets are not fair
 - mark to model is possible solution
 - market standard DCF
 - calculation of cash flows
 - discounted on basis of individual PD (Swap-curve plus spread)

- **Modification of accounting standards**
 - DCF has negative side effects
 - undisclosed (hidden) liabilities increasing
 - risk bearing capacity affected (risk control, limits)
 - market reaction uncertain (distrust)
 - relief very limited

- Political rescue operation: bad bank



- **Political rescue operation: bad bank**

- State: funding guarantee
rating support
limited risk for tax payers
- SPV: funding
hold to maturity
no minimum equity
no mtm
- Bank: true sale
100% relief
final loss stretched over 20 y
(fundamental value to book value)

- **Regulatory consequences: EU level**

Core objectives for revision:

- Stronger restriction of large exposure
- Tightening of ABS regulations
- Higher capital provisions for liquidity commitments
- Restrictions for hybrid capital
- Liquidity risk management
- Central clearing for credit derivatives
- Regulation of hedge funds and rating agencies
- cross-border cooperation

- **Regulatory consequences: Basel committee**

Mainstreams of work:

- Increase of capital requirements for complex credit instruments
- Improvement of liquidity management
- Implementation of stresstests
- Solution for cyclical effects
- Corporate Governance (compensation schemes)

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5. Outlook

- Many regulatory and political bodies are active:
over-regulation must be avoided
- Deep recession:
loan losses ahead
- Excess liquidity:
danger of inflation
- Distortion of competition:
public support has to be refunded
- Nationalized banks:
how can banks be reprivatized?
- Explosion of public debt:
how can that be settled?