ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Financial Crisis Presentation Warsaw, Poland 17 November 2009

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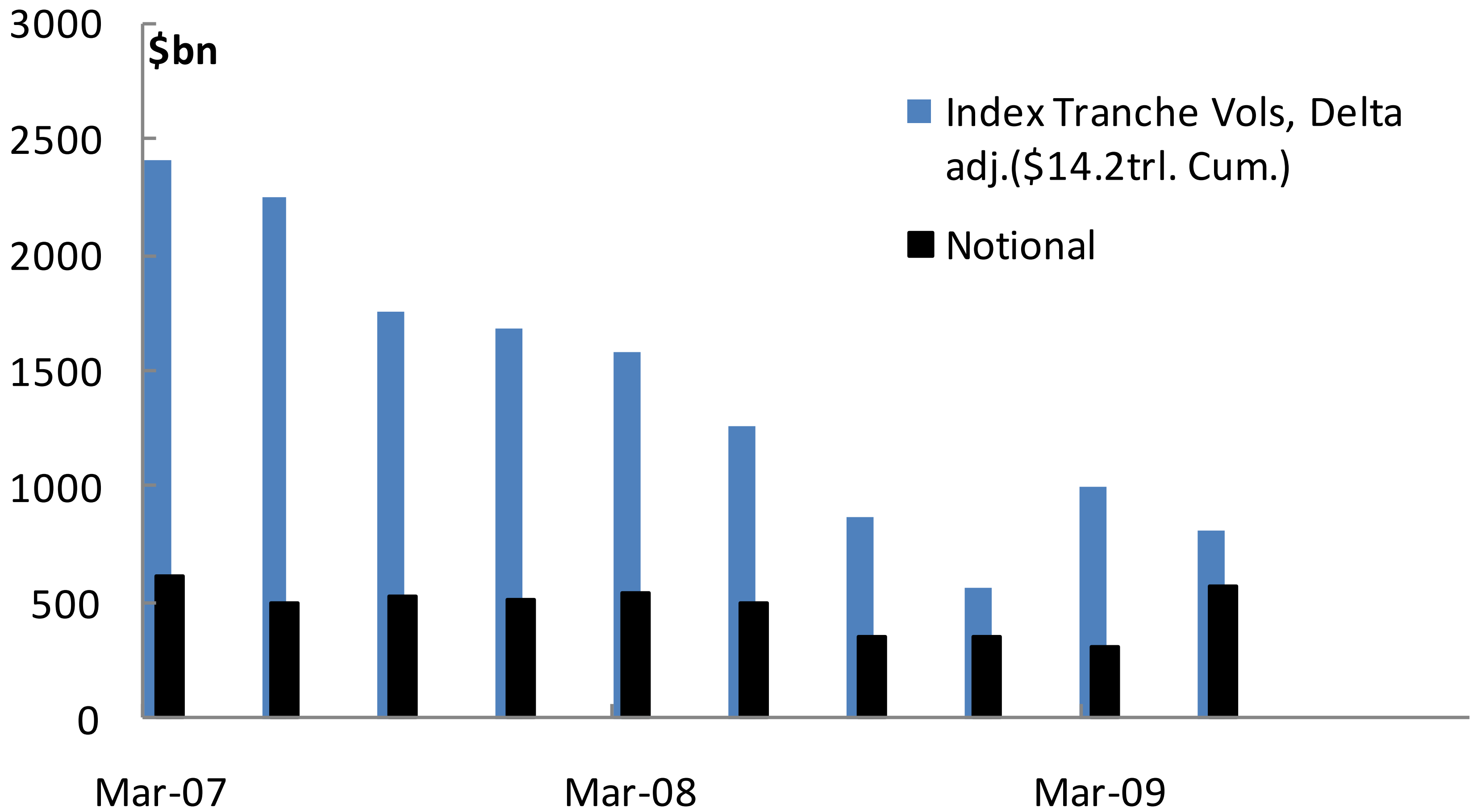
Fig 1: The Crisis

- Too much risk taking & LEVERAGE associated with: excess liquidity conditions; poor regulations; competition & governance frameworks that encouraged the ‘equity culture’ to take over from the ‘credit culture’ in banking. Structured product & derivative growth drivers—often motivated by tax considerations.
- The damage was caused by losses driving down toxic security prices (negative equity) and freezing-up markets for them:

  --CONTAGION risk within banks.

  --COUNTERPARTY RISK between banks.
- Smaller banks not regionally diversified concentrating too much mortgages to fill the demand for product by securities firms also failed.

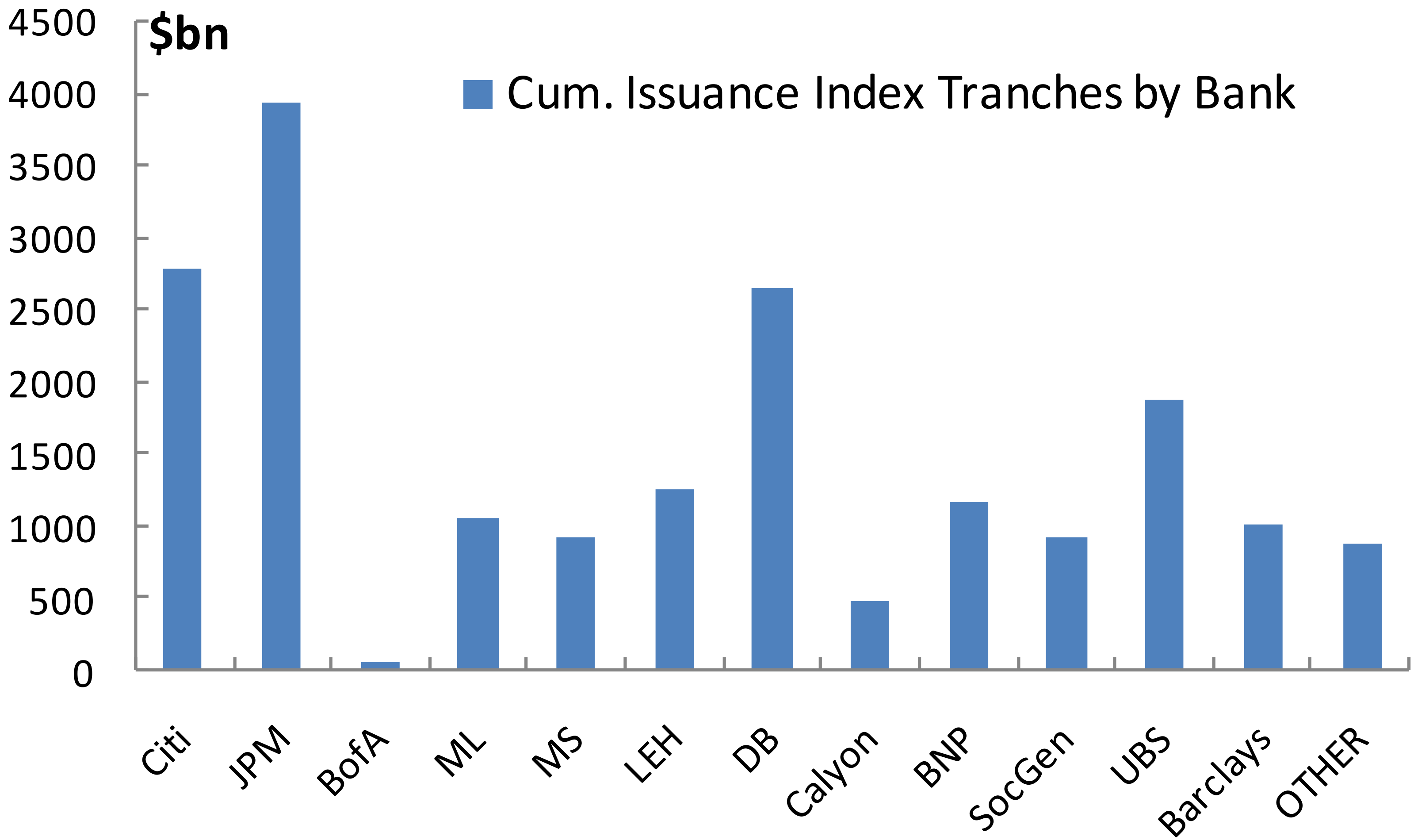
Fig. 2: Notional & Delta Adj. Index Tranche Obligations, Structured Credit Notes



Nov-2009

Source: Datastrean, OECD

Fig. 3: Notional & Delta Adj. Index Tranche Obligations, Structured Credit Notes: Main Issuers since 2007



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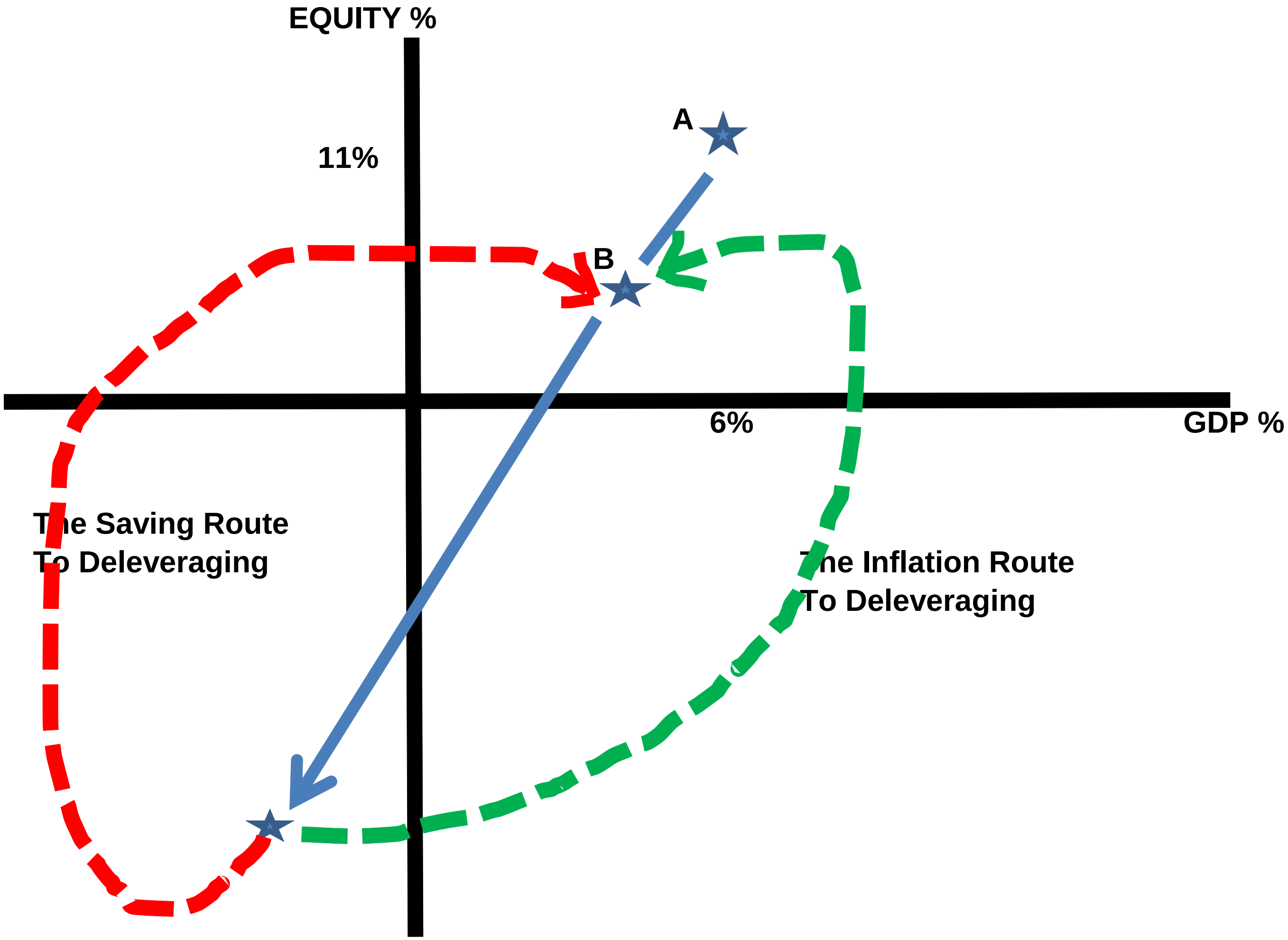
Source: Datastrean, OECD

Fig 4: Forbearance & Time

- Compliance with regulatory standards and accounting rules are eased.
- The economy is supported with fiscal & monetary policy, and special measures.
- The aim is to make the environment as favourable as possible for the underlying earnings of banks & their ability to issue new equity in rising markets.
- Over time retained earnings & issuance restore capital as write-offs continue.
- [*The alternative is the nationalisation, deal with toxic assets & re-capitalise route*]

Fig. 5: Two Routes to Deleveraging



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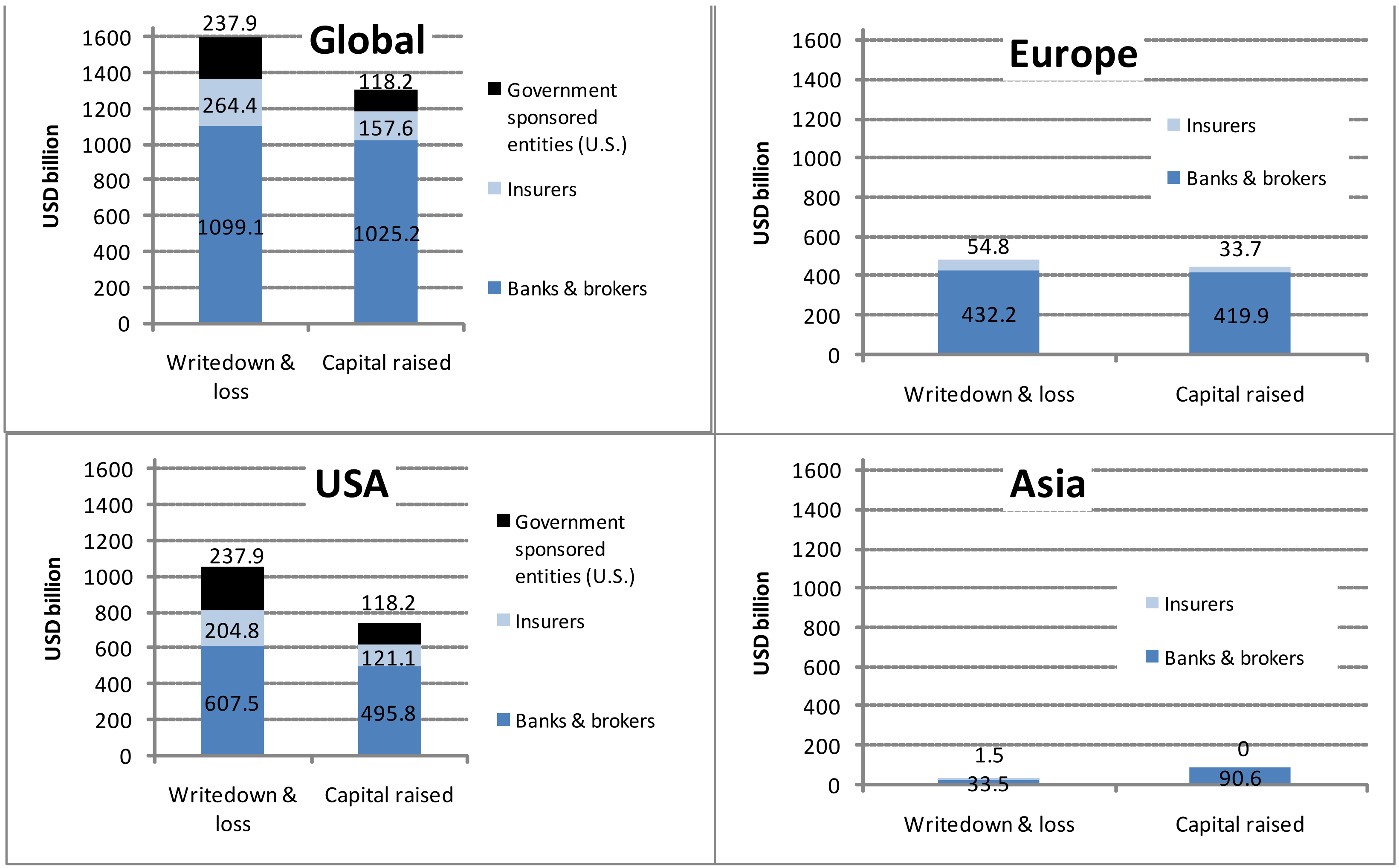
Source: OECD

Fig. 6: Losses, Capital Rebuilding 2009



Nov-2009

Source: Bloomberg

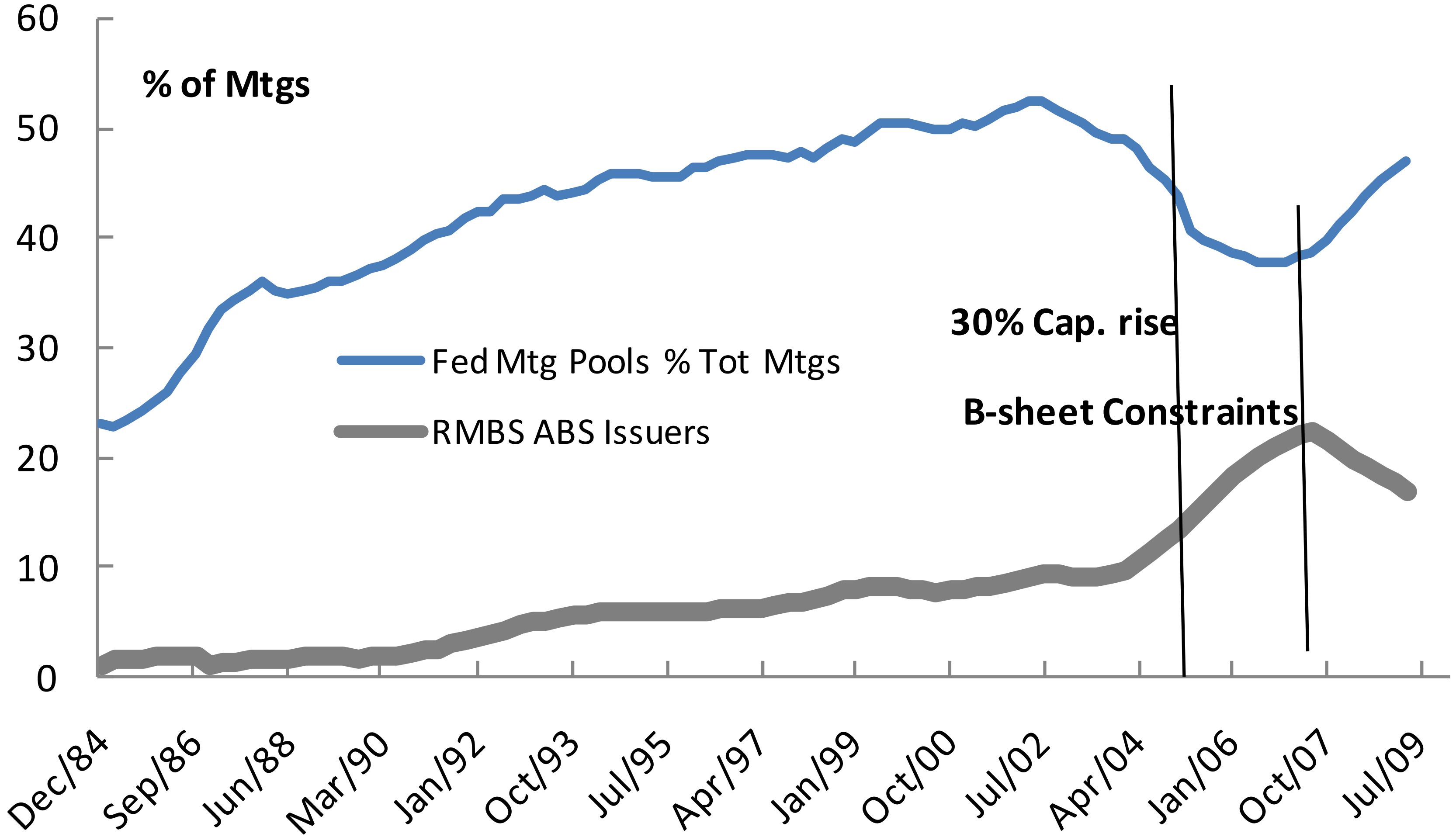
Fig. 7: US vs Europe Losses

COUNTRY	LOSSES $bn	Years of Earnings (from mid 2009)
USA		
Potential New Losses On & Off B/Sheet (OECD)	802	
Plus B/sheet shortfall to date ($97bn)	899	5
Europe		
Potential New Losses On B/Sheet (IMF)	1027	
Plus $1343bn to catch up to US capital	2370	7

Nov-2009

Source: OECD, Company reports and Bloomberg

Fig. 8: Fannie and Fredddie vs Private Label Mortgage Securitisation



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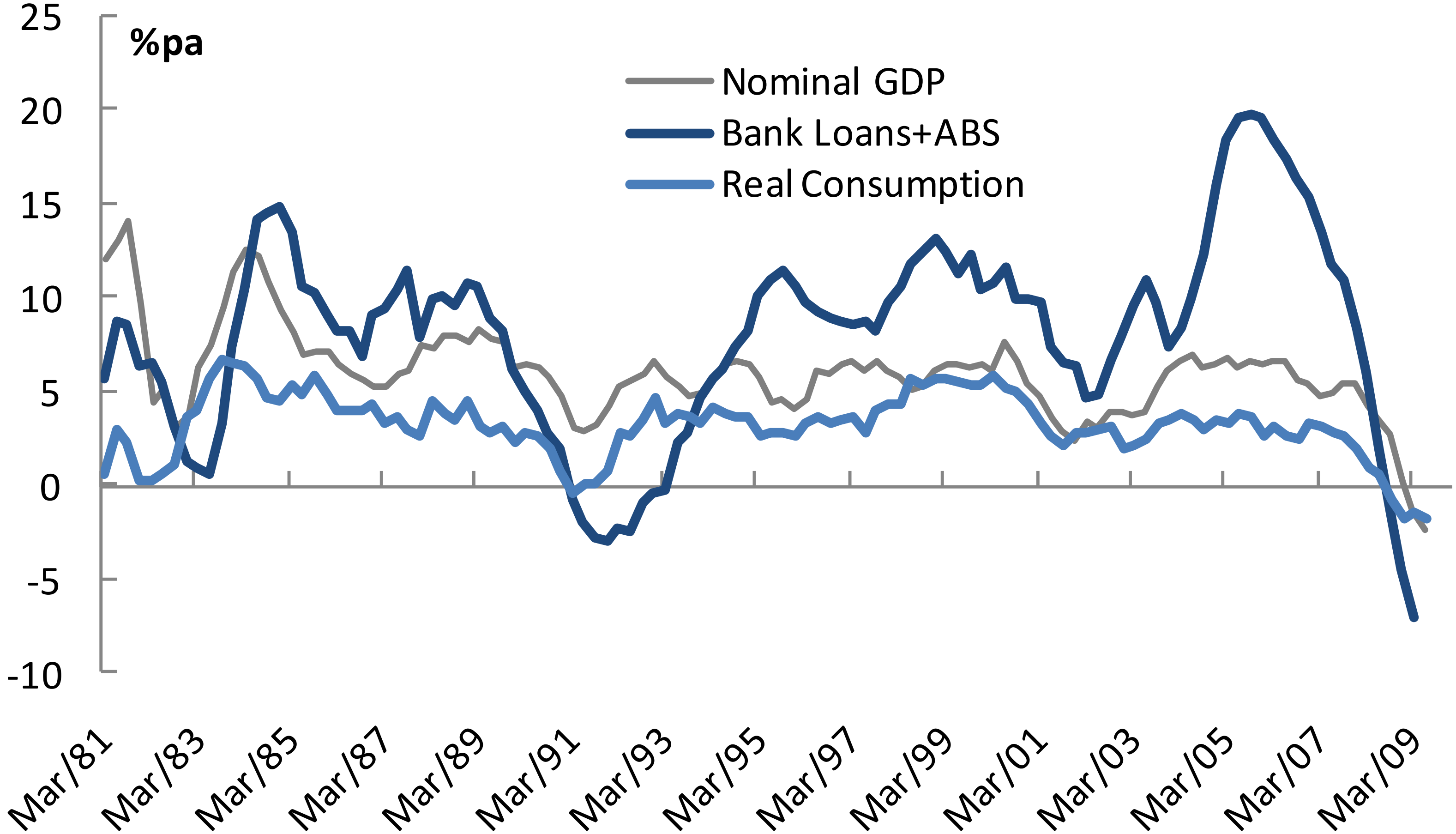
Source: BIS

Fig. 9: US Bank Intermediation (Bank Loans + ABS), GDP & Real Consumption



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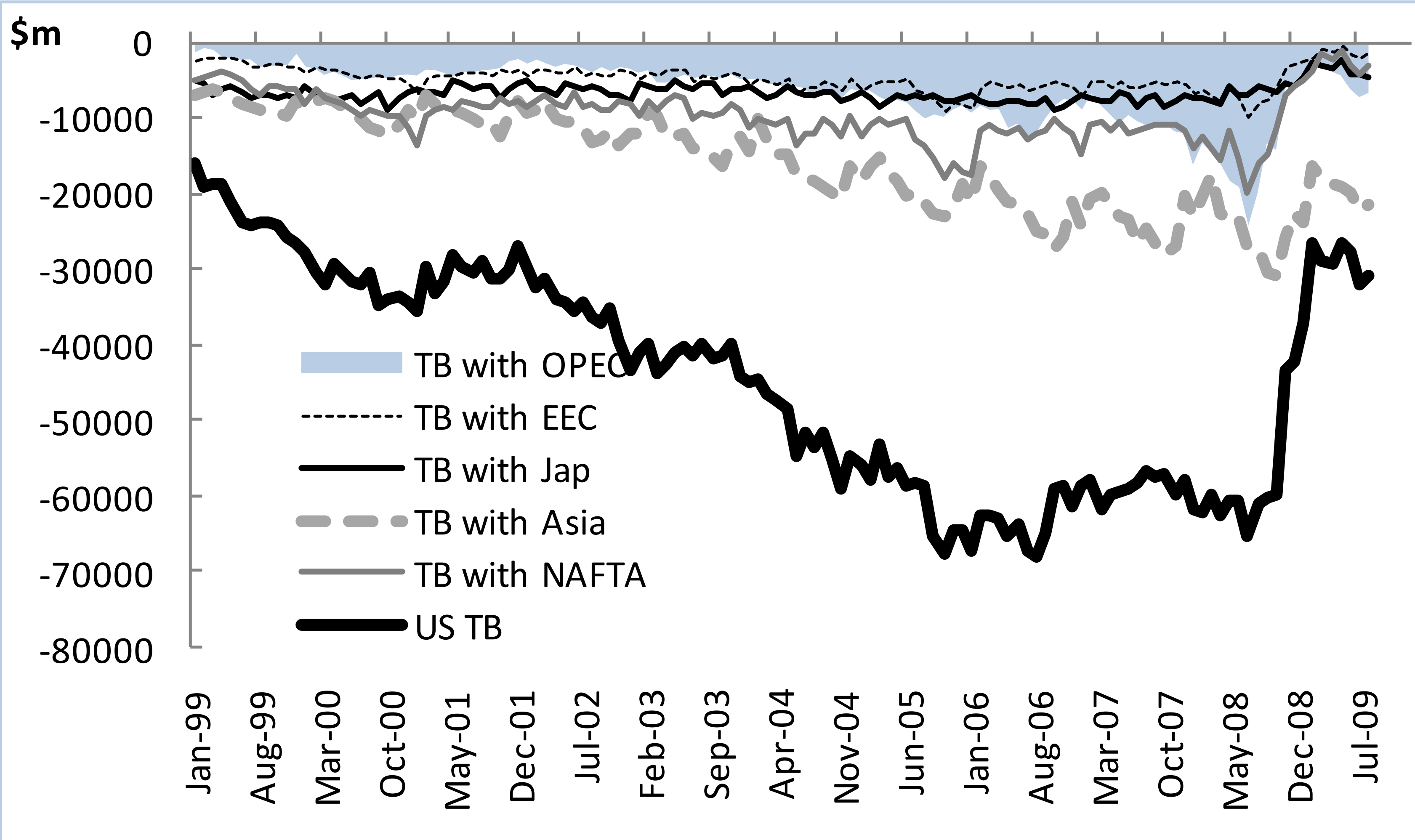
Source: Datastream, OECD

Exit Strategy Issues

New Fault-lines Already Emerging

- Asia versus the crisis countries.
- The 'broken dam' refilling anew with liquidity.
- Asset prices bouncing strongly.

Fig. 10: US Monthly Trade Balance, Bilateral Comparisons



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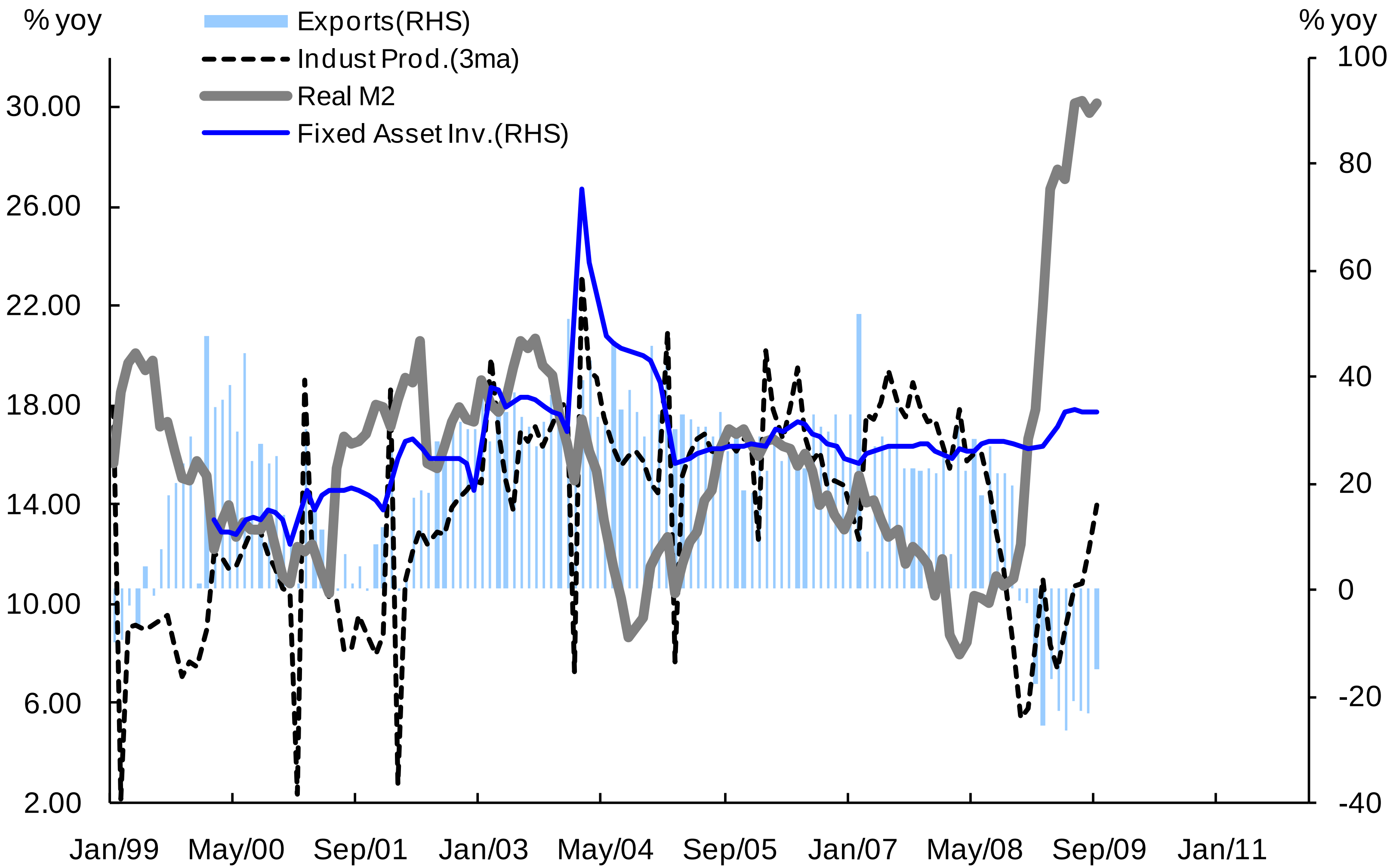
Source: Datastream, OECD

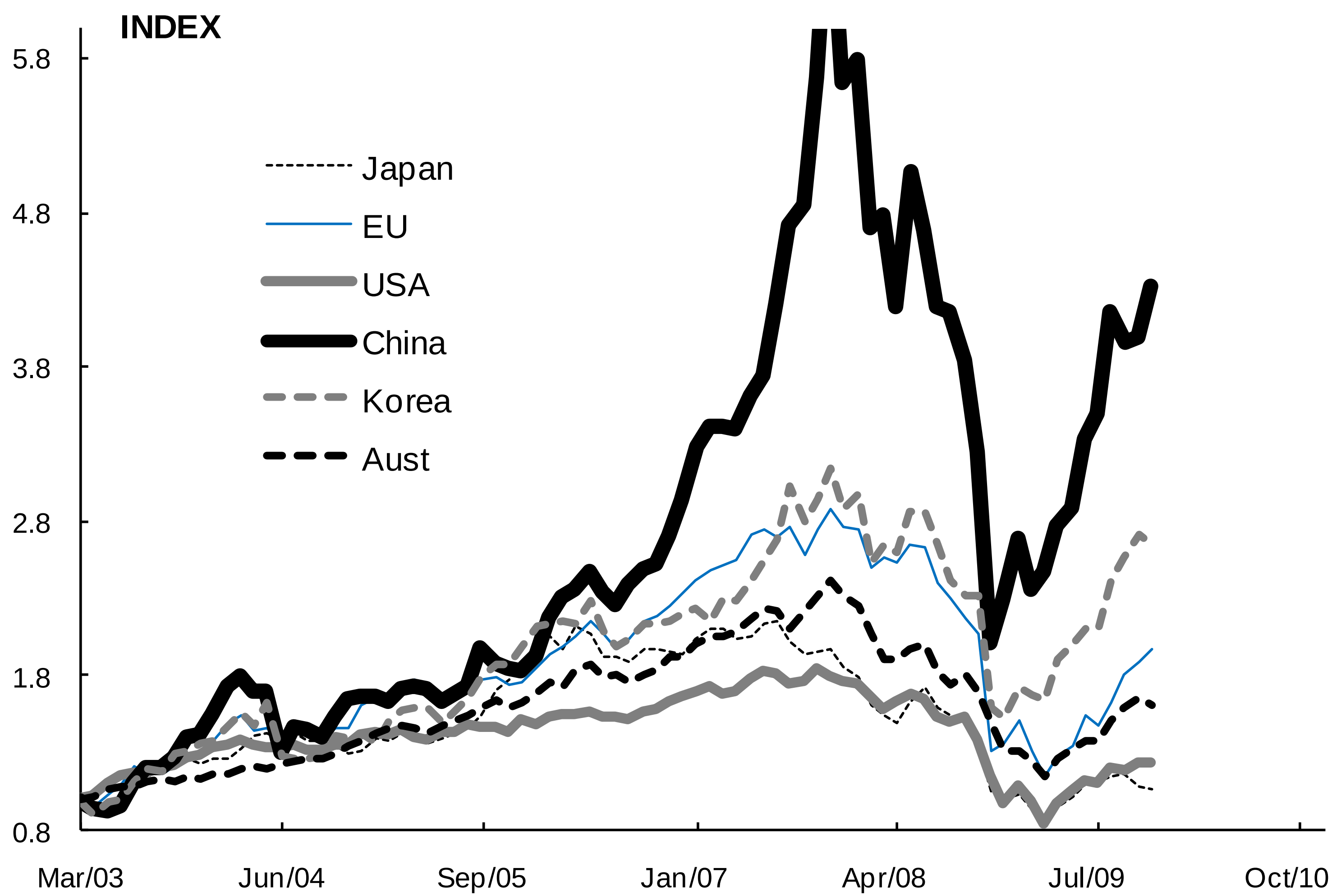
Fig. 11: China: IP, FAI, Real M2 Exports



Nov-2009

Source: Datastream, OECD

Fig. 12: Stock Markets: Better EM Fundamentals?



Nov-2009

Source: Datastream, OECD

Fig 13: G20 Coordination Issues

- As asset inflation pressures build in non-crisis countries, the ability to raise rates is constrained by large countries with low crisis rates—as exchange rate pressure rises. A coordination issue for the G20.
- Capital levels are different in the US, Europe & elsewhere. Can all countries agree on new rules by end-2010 and implement them by end-2012?
- Removal of guarantees & deposit insurance—will this lead to fund shifts between weak & strong institutions & between countries?
- Are we able to agree on the future shape of the financial system?

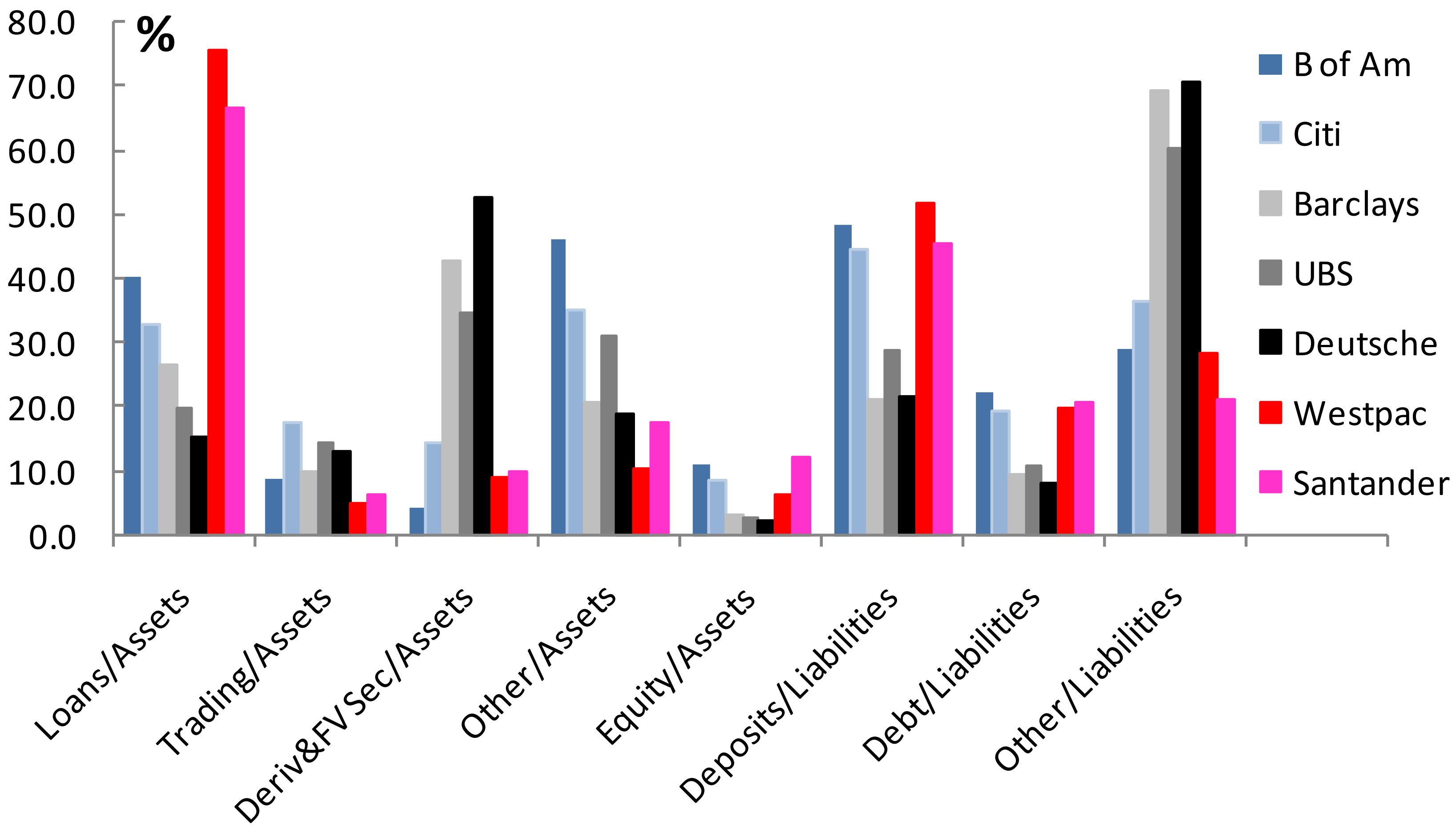
Exit Strategy Issues

Defining What the Future Global Financial System Should Look Like.

Fig 14: G20 What IS & IS Not Being Addressed

- Is addressed:
  - ●capital rules—the FSB & G20 are on the right track.
  - ●compensation—but it is a symptom only .
  - ●accounting, clearing, back office.
- Is NOT yet addressed:
  - ●"Too big to fail" & the implicit 'puts' & the 'equity culture'.
  - ●Contagion risk & corporate structure—what banks should do.
  - ●Corporate governance reform to align shareholder & management interest more generally than compensation.
  - ●The structure of competition in banking conducive to a geographic & product regulation.
  - ●The structure & governance of regulatory agencies to avoid overlap & conflicts.
  - ●Tax reform to remove incentives to structuring.

Fig. 15: Comparative Bank Structures



Nov-2009

Source: Datastream, OECD

Fig. 16: $70.6bn Payments to AIG Counterparties ($45.7bn to EU!): Sept. 16 to 31 December 2008

(billions of US dollars)

Institution	Collateral postings for credit default swaps*	Payments to securities lending counterpaties**	Total	As a share of capital*** at end-2008
Goldman Sachs	8.1	4.8	12.9	29.1%
Societe Generale	11.0	0.9	11.9	28.9%
Deutsche Bank	5.4	6.4	11.9	37.4%
Barclays	1.5	7.0	8.5	20.0%
Merrill Lynch	4.9	1.9	6.8	77.4%
Bank of America	0.7	4.5	5.2	9.1%
UBS	3.3	1.7	5.0	25.2%
BNP Paribas	…	4.9	4.9	8.3%
HSBC	0.2	3.3	3.5	5.3%
[memo: Bank of America after its merger with Merrill Lynch]			12.0	*[18.1%]*

*Direct payments from AIG through end-2008 plus payments by Maiden Lane III, a financing entity established by AIG and the New York Federal Reserve Bank to purchase underlying securities.

**September 18-December 12, 2008.

***Common equity net of goodwill; net of all intangible assets for Merrill Lynch and HSBC.

Source: Fed, US Treasury

Fig 17: Credit Culture

- Prime focus on commercial banking—taking deposits or borrowing long-term to lend to households & firms that produce real things. There is a more transparent revenue stream, transparent balance sheets more easily understood by markets & regulators.
- Less exposure to securities that are difficult to price & subject to sharp volatility & liquidity shifts, that cause losses & contaminate other bank activities.
- Absence of large derivative portfolios that generate huge counterparty risks.

Fig. 18: Concentration & Ratings

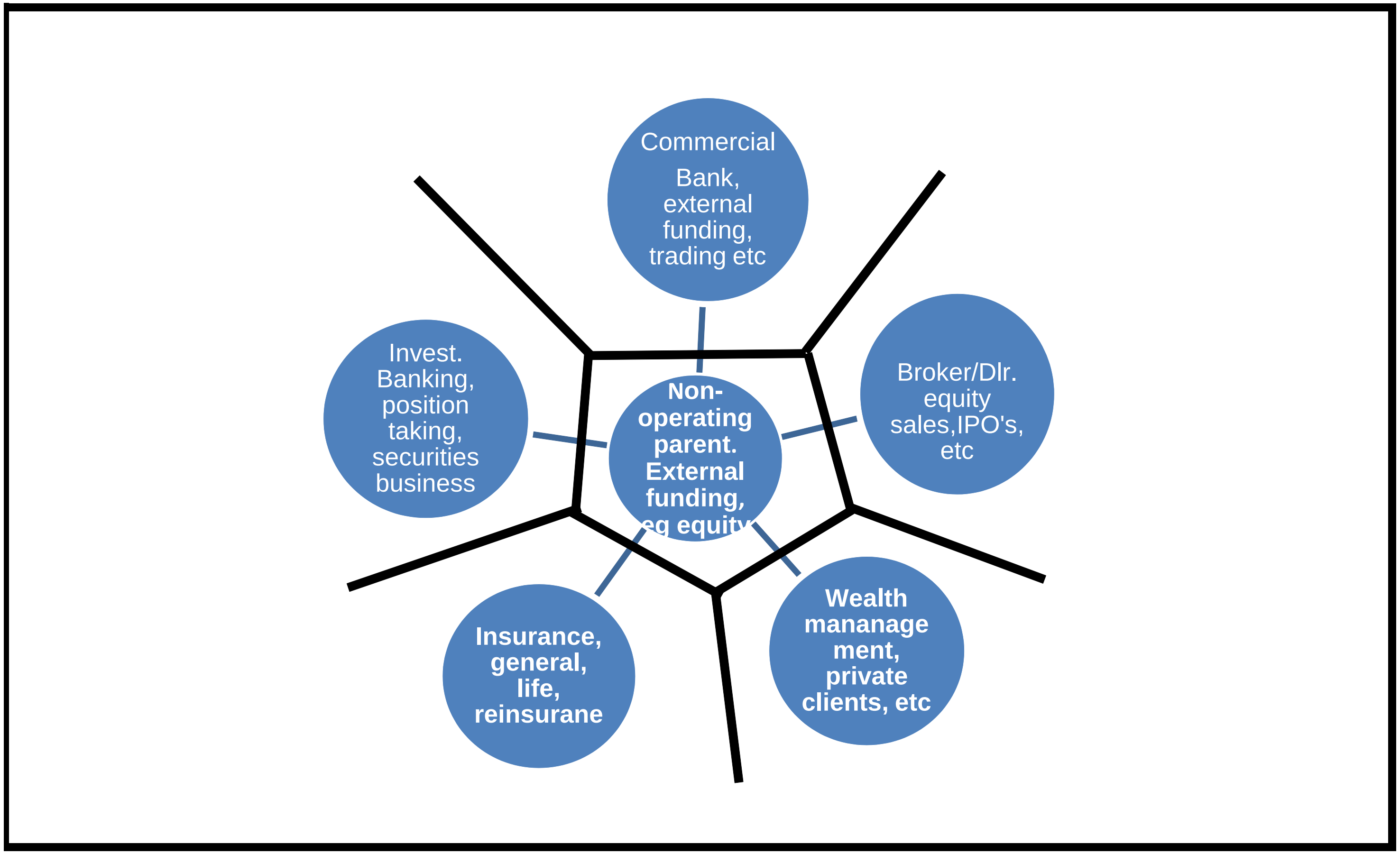
Country Top 4 Banks (by Assets)	Assets	Asset Mkt Share	Top 50 rank Credit Rating
Australia	A$bn	%	
National Australia Bank	657	24.6%	AA
Commonwealth Bank of Australia	488	18.2%	AA
Australia and New Zealand Banking	471	17.6%	AA
Westpac Banking Corporation	440	16.4%	AA
Total Top 4	2055	76.8%	
USA (bank only)	$bn		
JP Morgan Chase	1,664	15%	A+
Bank of America	1,451	13%	no
Citi	1,165	11%	no
Wells Fargo (incl. Wachovia)	1,100	10%	AA
Total Top 4	5,380	49%	
UK	GBP bn.		
Royal Bank of Scotland Plc (The)	2402	18%	no
Barclays Bank Plc	2053	15%	no
HSBC Bank plc	1734	13%	AA-
Goldman Sachs International	896	7%	no
Total Top 4	7084	52%	
Germany	Euro bn.		
Deutsche Bank AG	2202	28%	A+
Commerzbank AG	625	8%	no
Bayerische Hypo-und Vereinsbank AG	459	6%	no
Landesbank Baden-Wuerttemberg	448	6%	AA+
Total Top 4		47%	
France	Euro bn.		
BNP Paribas	2076	29%	AA
Crédit Agricole Group-Crédit Agricole	1784	25%	AA-
BPCE	1144	16%	no
Société Générale	1130	12%	AA-
Total Top 4	6133	81%	

Source: Datastream, OECD

Fig 19: Competition & Concentration Issues

- Capital and reserve ratio rules not correlated with crises.
- Bank concentration is negatively correlated with crises, even after macro & competition factors are controlled for.
- Low barriers to entry & less restrictions also make for efficiency & hence stability. So the role of large banks in stable oligopolies in promoting stability may be related to:
  - Better geographic & product diversification.
  - Easier to supervise—fewer banks with simpler business models in commercial banking.

Fig. 20: Non-operating Holding Company NOHC



Source: OECD

Fig 21: The Tax Issue

- The tax system encourages securitisation.
- Tax haven opaqueness allows capital gains and income to be shifted in CDO creation
- Inequality of tax treatment of income and capital gains/losses causes CDS boom in synthetic CDO's.
- Debt versus equity bias pushes up leverage—double dipping deductions.

Fig 22: Corporate Governance

- Independent directors: strengthen fit and proper person test to cover competence, technical expertise. Risk management skills; formal separation of CEO and Chair; term limit on board membership.
- Risk officer role with access to the board (with special employment terms--CEO doesn't fire or set salary).
- Fiduciary responsibility of directors: clarified tying duties to single affiliate in the case of complex firms.
- Remuneration: board reform helps, and tax incentives provide teeth.