



**Global Credit Derivatives Survey  
Presentation for the International Monetary Fund  
“Managing Financial Risks – The Insurance Industry”**

**Keith M. Buckley, CFA  
Managing Director**

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# Topics

1. Market and Survey Overview
2. Market Flows
3. Reference Entities
4. Credit Events
5. Counterparties
6. Issues for Consideration

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## Global Credit Derivatives Market

- Rapidly growing and relatively immature
- Potential for risk concentrations as well as risk dispersion
- Information asymmetries exist
- Low transparency and disclosure
- Risk flows difficult to track by region and sector
- Banks cited as beneficiaries
- Potential sellers (risk takers) not as apparent

## Fitch Global Credit Derivatives Survey

- Targeted nearly 200 rated financial institutions
- \$1.8 trillion notional identified
- Better understand global flows and market participants
- Emphasis on 'protection selling'
- Identify key issues for further study
- All information as of 9/30/02
- Updated survey as of 12/31/03 in process

## Global Credit Risk Transfer

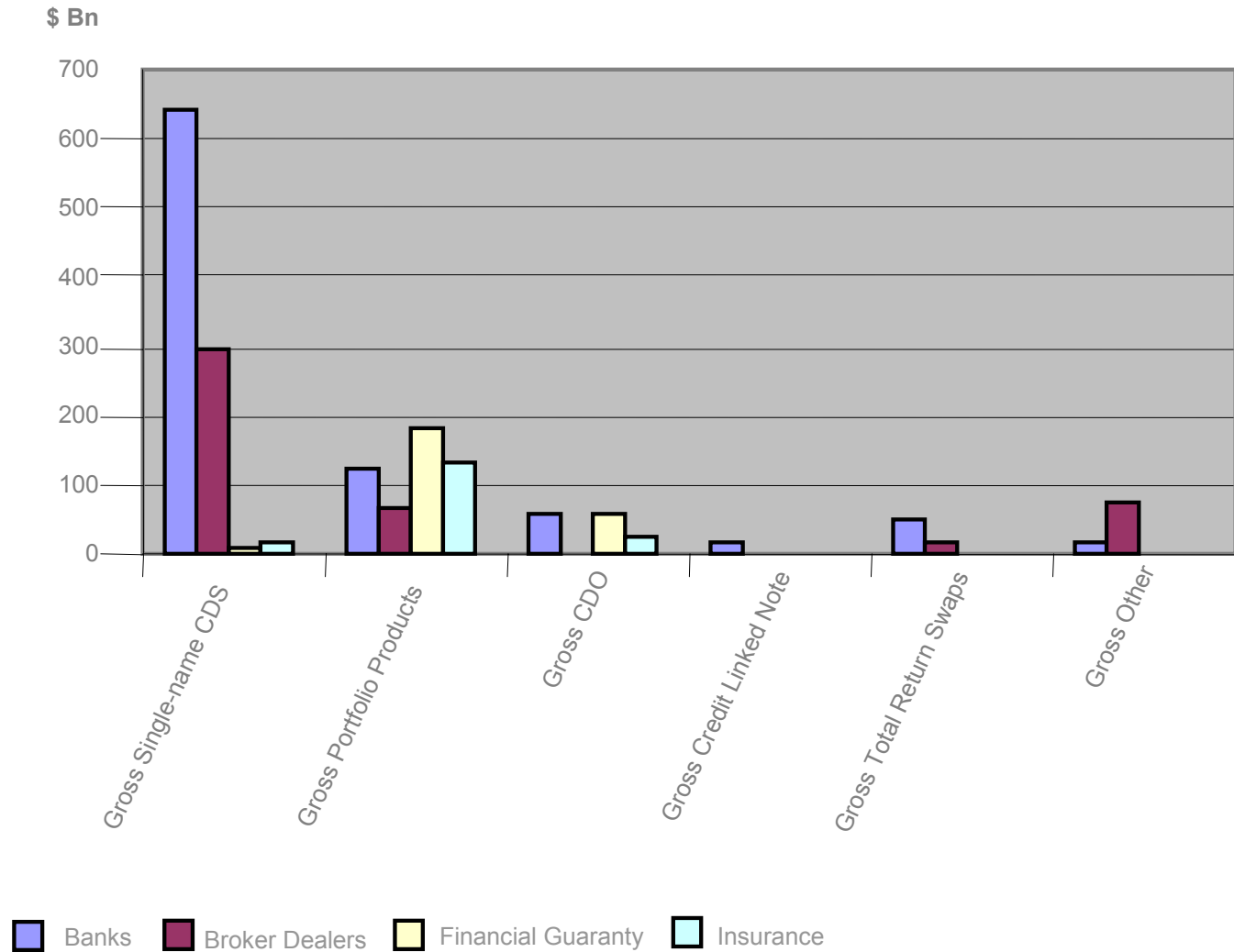
1. Global Banks/  
Broker Dealers

**Credit Risk Flows**

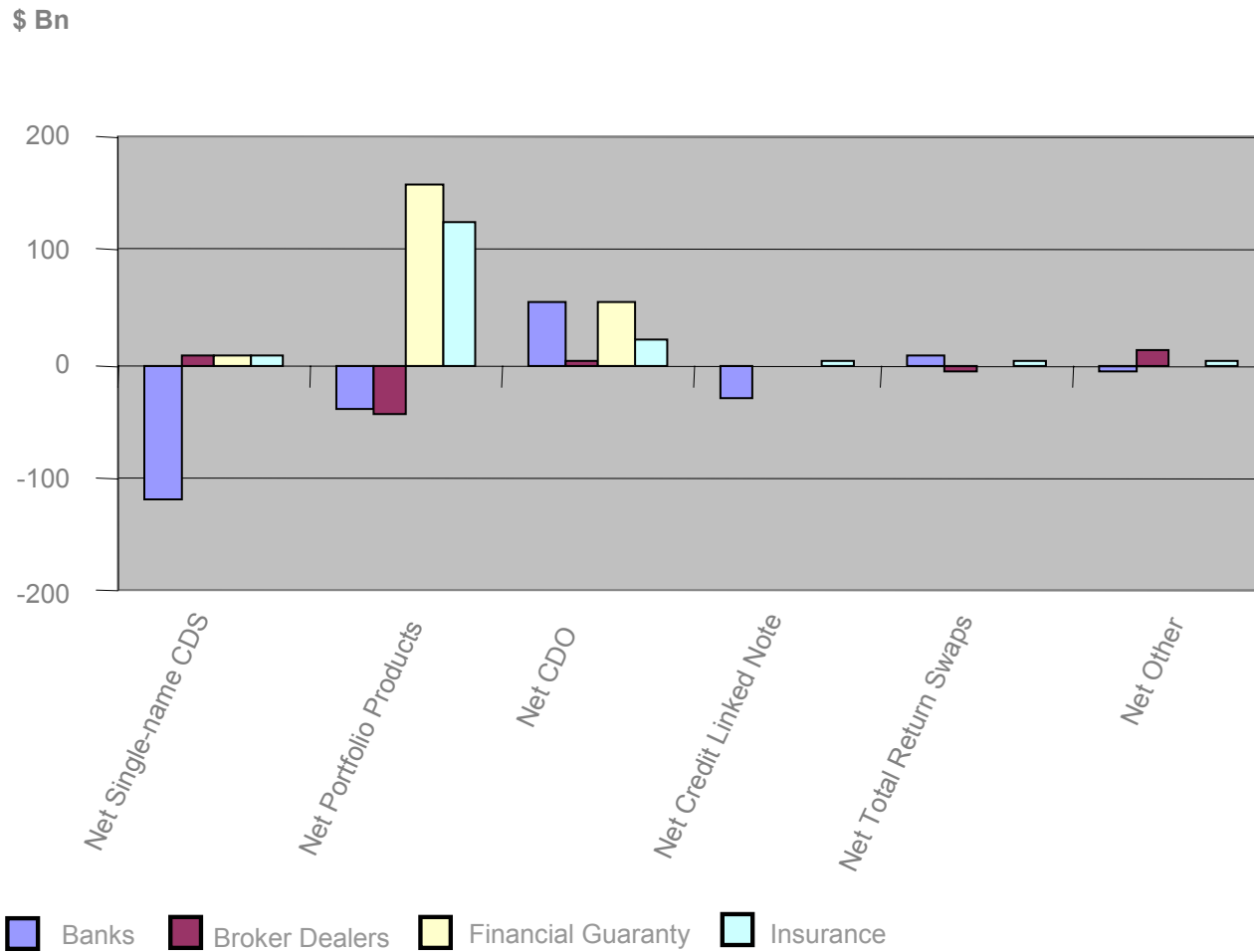
1. Financial Guaranty  
2. Insurance/Reinsurance  
3. Regional Banks  
(Primarily Europe)

- Globally, banks and broker dealers net protection buyers totaling \$229 bn.
- Insurance/reinsurance financial guaranty net protection sellers of \$381 bn. (including CDOs).
- Close to 70% European banks net protection sellers (\$67 bn.).

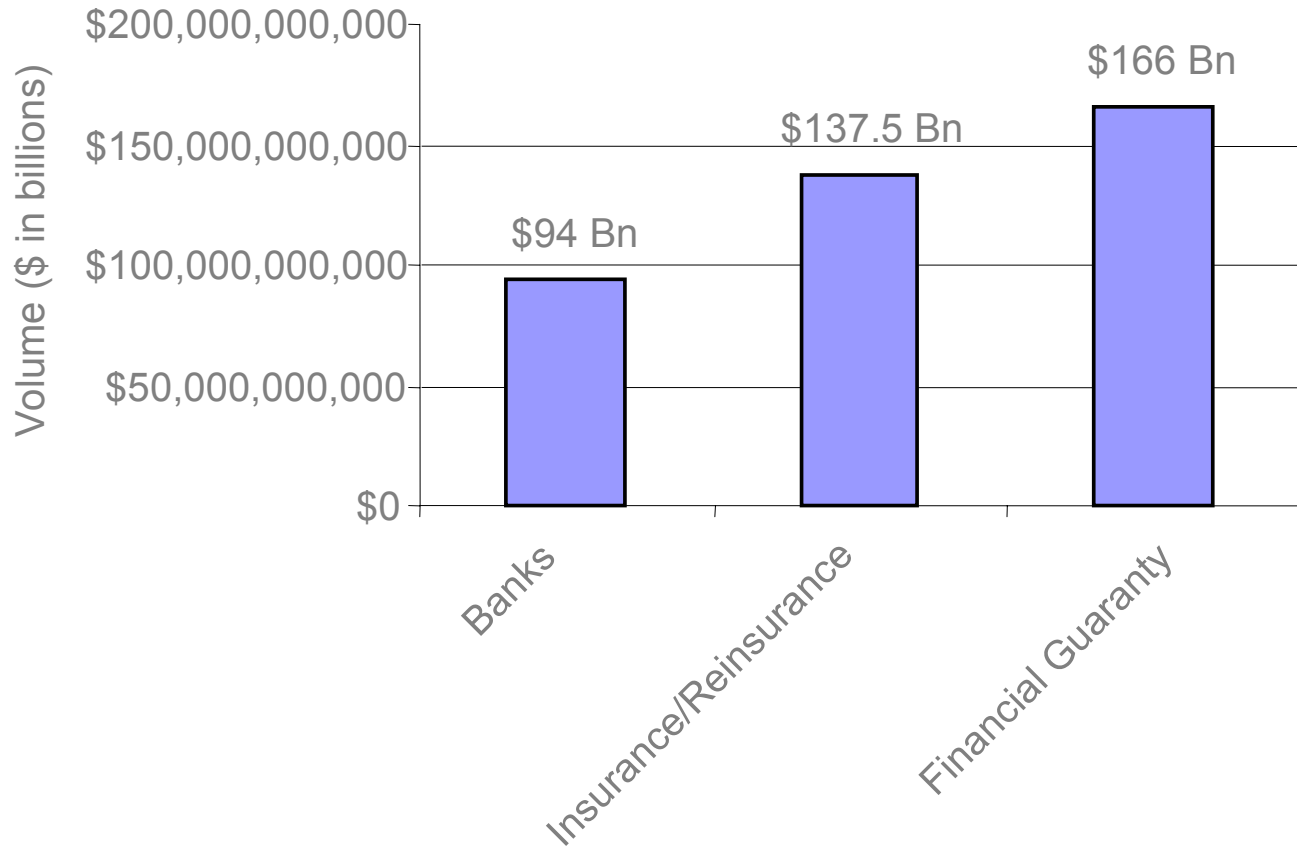
# Gross Positions



# Net Positions

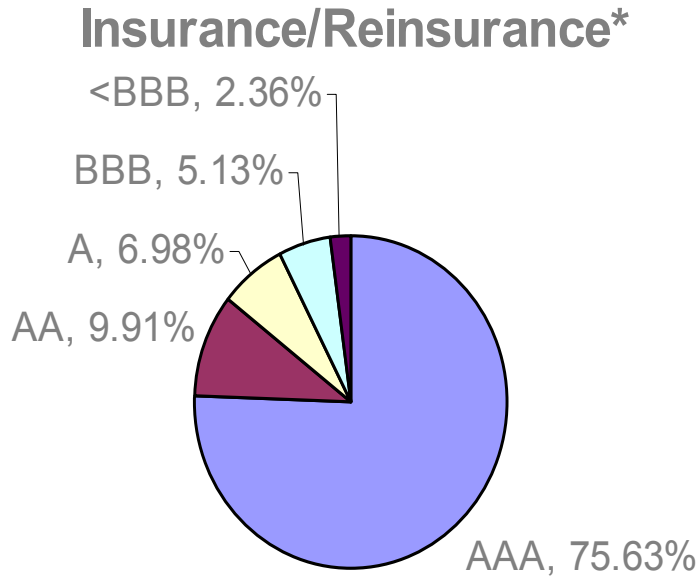


# Net Seller Volume

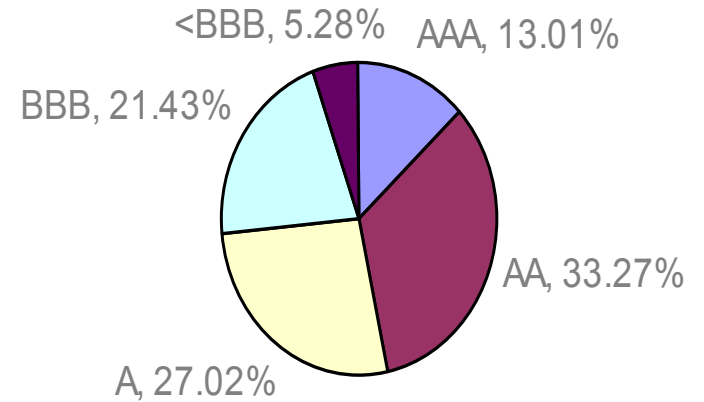




# Risk Appetite – Protection Sellers



### European/Asian Banks (Sellers)

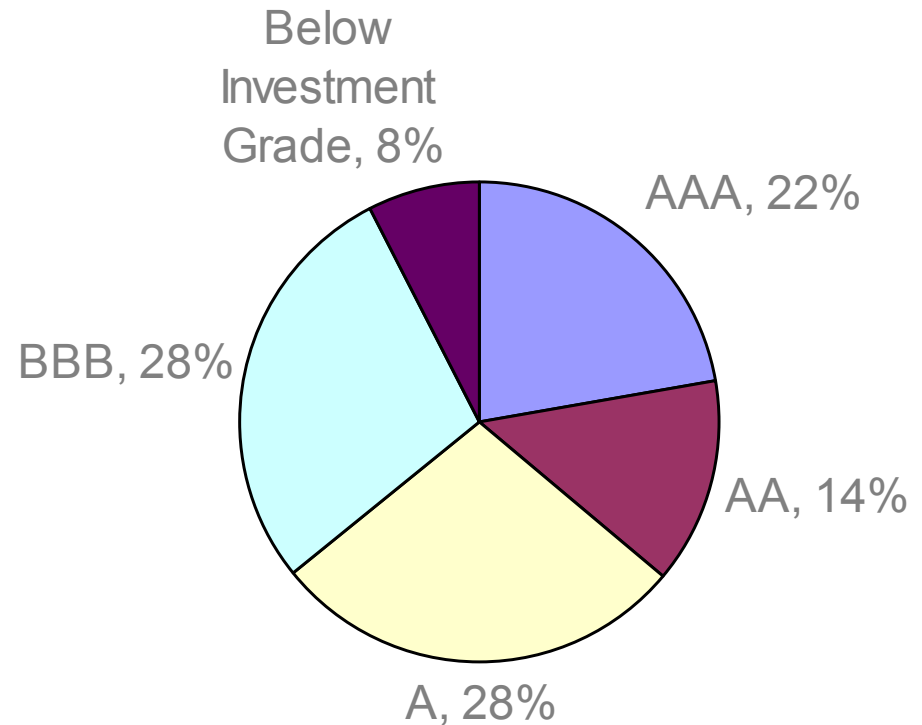


\*Includes Monoline Financial Guarantors and U.S./European Insurance/Reinsurance.

Without Financial Guaranty AAA 58.71%, AA 6.20%, A 15.47%, BBB 15.43% and <BBB 4.20%.

## Reference Entities by Rating — Global Snapshot, Including Portfolio Products (by \$)

- Primarily an investment-grade market
- Average rating of BBB+
- Below-investment grade primarily reflects sovereigns and fallen angels
- High yield component expected to increase over time



## Credit Events Experienced\*

- Top 5 credit events represent 47% of total
- Historically, credit events concentrated (fallen angels)

1	Worldcom	14	TXU Europe
2	Enron	15	Armstrong
3	Marconi	16	Comdisco
4	Railtrack	17	Conseco
5	Xerox	18	Global Crossing
6	Argentina	19	NRG Energy
7	Teleglobe	20	Solutia
8	Pacific Gas & Electric	21	Telecom Argentina
9	Swissair	22	Adelphia Comm.
10	AT&T Canada	23	Owens Corning
11	Finova	24	Southern California Edison
12	K-Mart	25	Warnaco Group
13	TXU		

\*Commonly quoted credit events, based on frequency of occurrence.

# Top Counterparties\*

- Top ten counterparties 70% of total market.
- Critical role in global credit risk transfer.
- Is the market too concentrated?

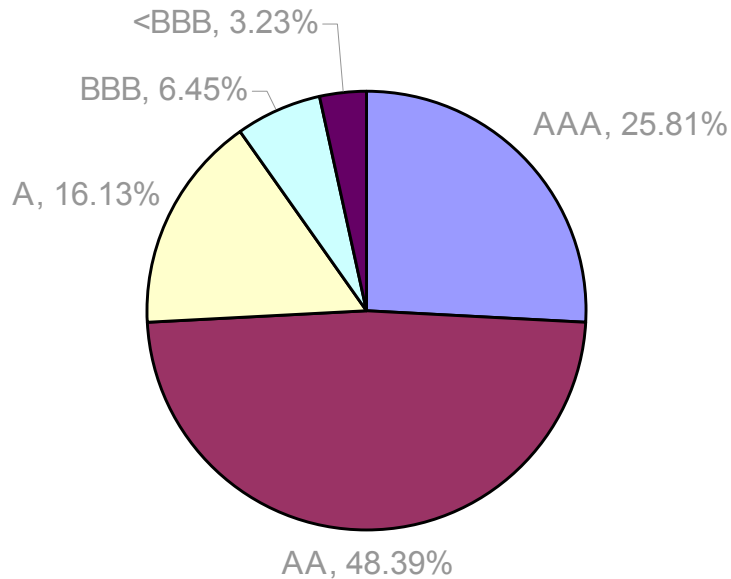
## Top 25 Counterparties\*

	Counterparty	Fitch Rating	Outlook
1	JP Morgan Chase	A+	Positive
2	Merrill Lynch	AA-	Stable
3	Deutsche Bank	AA-	Stable
4	Morgan Stanley	AA-	Stable
5	Credit Suisse First Boston	AA-	Negative
6	Goldman Sachs	AA-	Stable
7	UBS	AA+	Stable
8	Lehman Brothers	A+	Stable
9	Citigroup	AA+	Stable
10	Commerzbank	A-	Positive
11	Toronto Dominion	AA-	Negative
12	BNP Paribas	AA	Stable
13	Bank of America	AA-	Stable
14	Bear Stearns	A+	Stable
15	Societe Generale	AA-	Stable
16	Royal Bank of Canada	AA	Stable
17	Barclays	AA+	Stable
18	Dresdner	A-	Stable
19	Royal Bank of Scotland	AA	Stable
20	ABN AMRO	AA-	Stable
21	CIBC	AA-	Stable
22	Rabobank	AA+	Stable
23	WestLB	AAA	Stable
24	HVB	A	Stable
25	AIG	AAA	Negative

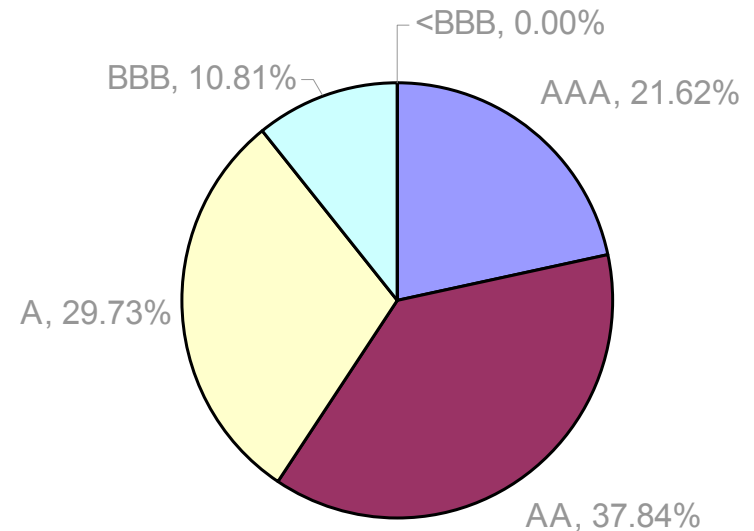
\*Commonly quoted counterparties, based on frequency of occurrence.

# Seller Financial Strength

## Net Seller Rating Mix— Financial Guaranty/Insurers/Reinsurers



## Net Seller Rating Mix— European Banks



▪ Implications of Ratings Migration?

## Issues for Consideration

- Management Information Systems/Enterprise-wide Risk Management
- Financial Disclosure
- Hedge Funds

## MIS and Enterprise-Wide Risk Management

- Many institutions do not or cannot track across business lines/legal entities
- Enterprise-wide responses were manual and time-intensive
- Degree of integration of cash and credit derivative books varied
- Good MIS is the foundation for pro-active risk management
- Credit derivatives are unique instruments, requiring tailored MIS solutions

# Financial Disclosure

- Disconnect between assets (historical) and hedge (mark to market)
- Hedging vs. trading – relative positions and P&L unclear
- Improved disclosure allows:
  - Enhanced financial comparisons across institutions
  - Identification of risk concentrations
  - Promotes market discipline
- Credit derivatives impair traditional financial ratios



## Hedge Funds

- Increasingly active and influential as buyers and sellers
- Most are not rated
- By definition, provide no disclosure
- Fitch requested voluntary disclosure from top 50 hedge funds
- 100% declined to respond
- Raises issues related to:
  - Counterparty/performance risk
  - Market liquidity
  - Transparency

## In Closing

- Fitch will update survey annually beginning December 31, 2003
- Analytical best practices
- On-going dialogue with market participants and regulators
- Additional survey data available upon request
- Launched [fitchcdx.com](http://fitchcdx.com), which houses all Fitch credit derivative research
- Further credit derivative research forthcoming

**“Derivatives are about shifting risk to the dumbest guy in the room”**

**– Martin Mayer**

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***[www.fitchratings.com](http://www.fitchratings.com)***

