

Systemic Credit Risk Transfer

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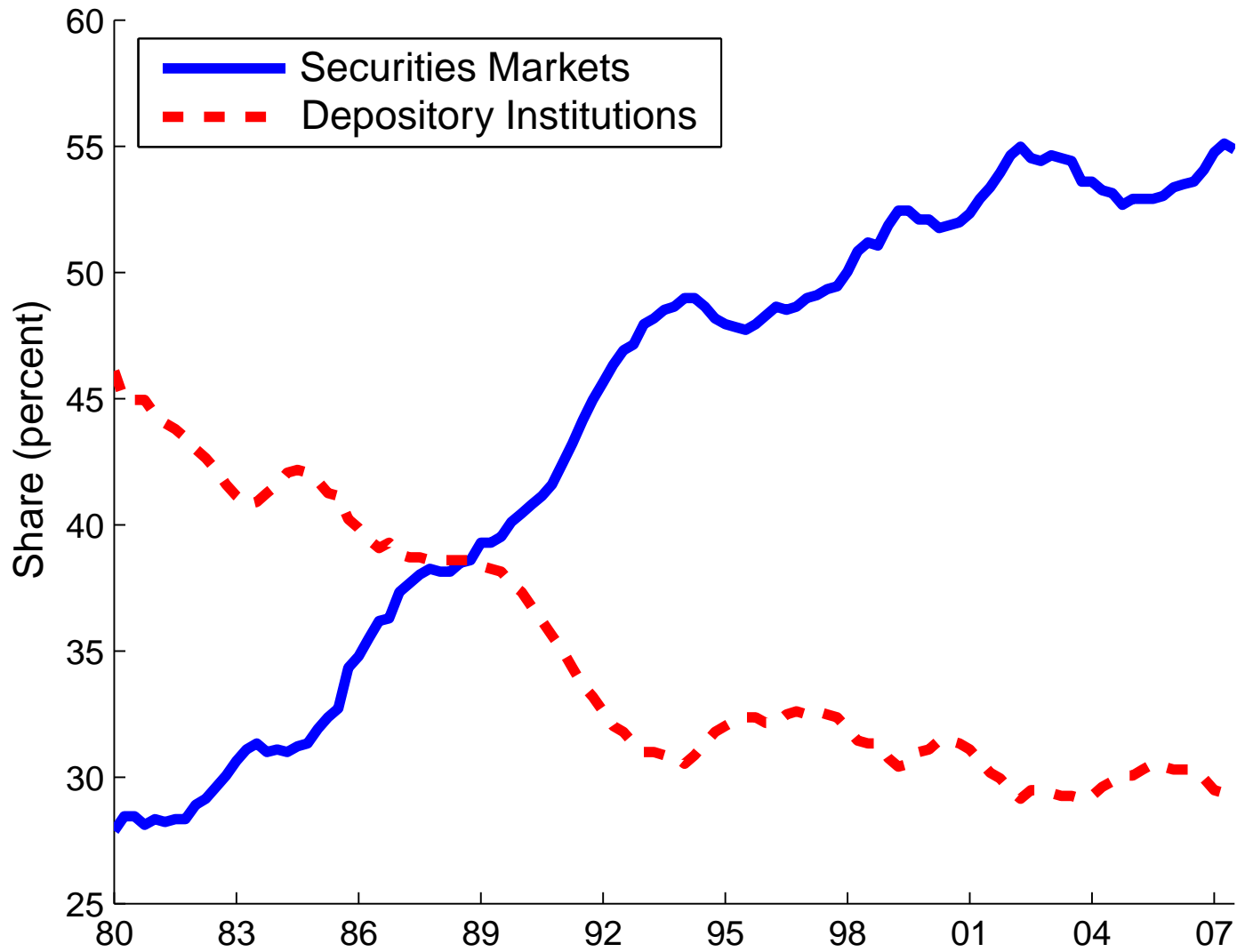
Graduate School of Business, Stanford University

The Future Role of Central Banking Policy:
Urgent and Precedent-Setting Next Steps

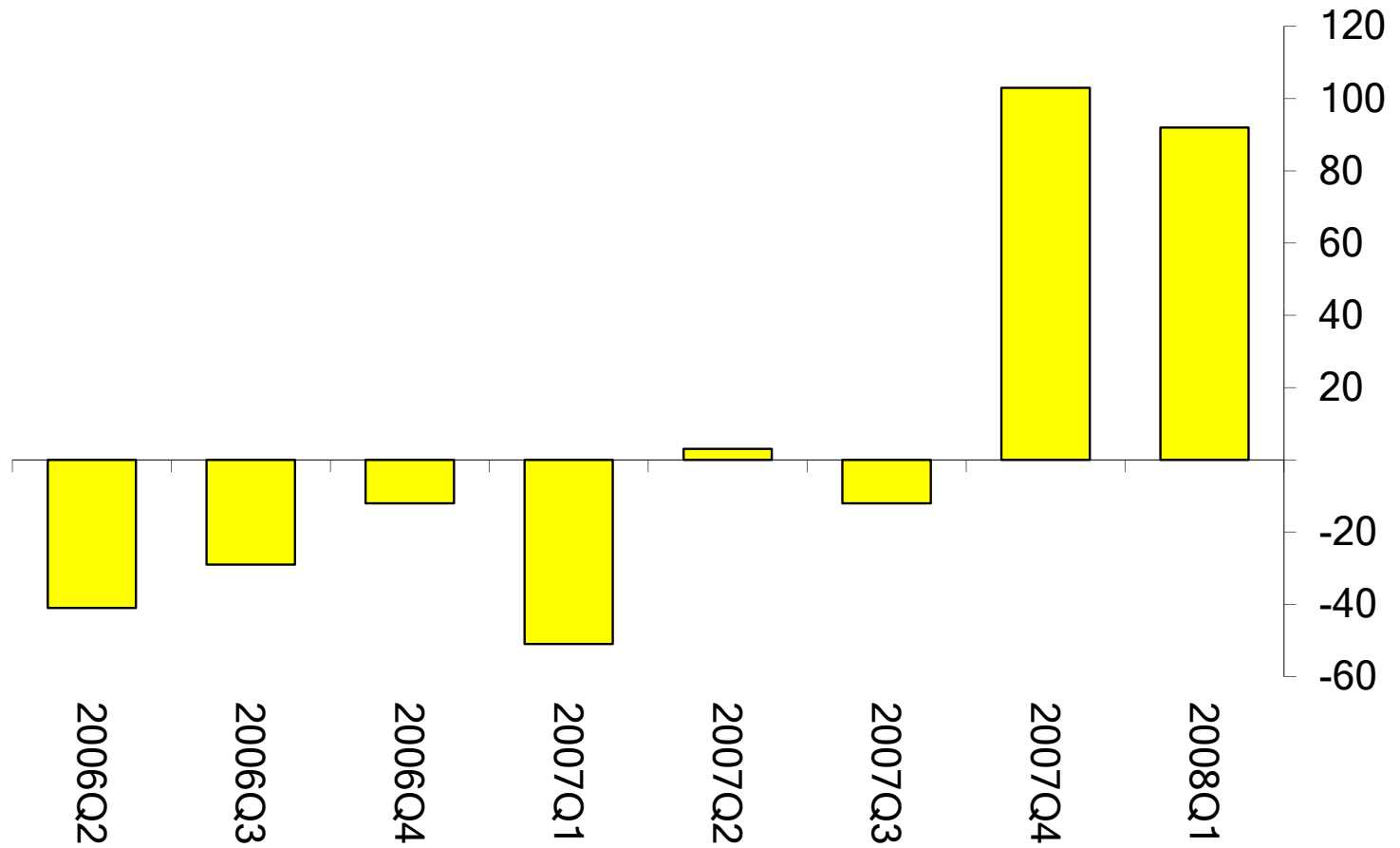
Stanford One-Day Policy Workshop, July, 2008

Acknowledgements: Richard Cantor, Cliff Gray

Figure 1: [Share of Private Nonfinancial Debt Outstanding](#). Source: Morgan Stanley from Federal Reserve Flow of Funds Data.



J.P. Morgan Chase & Co.'s Dealer Net Notional Protection Purchased (Billions of Dollars)



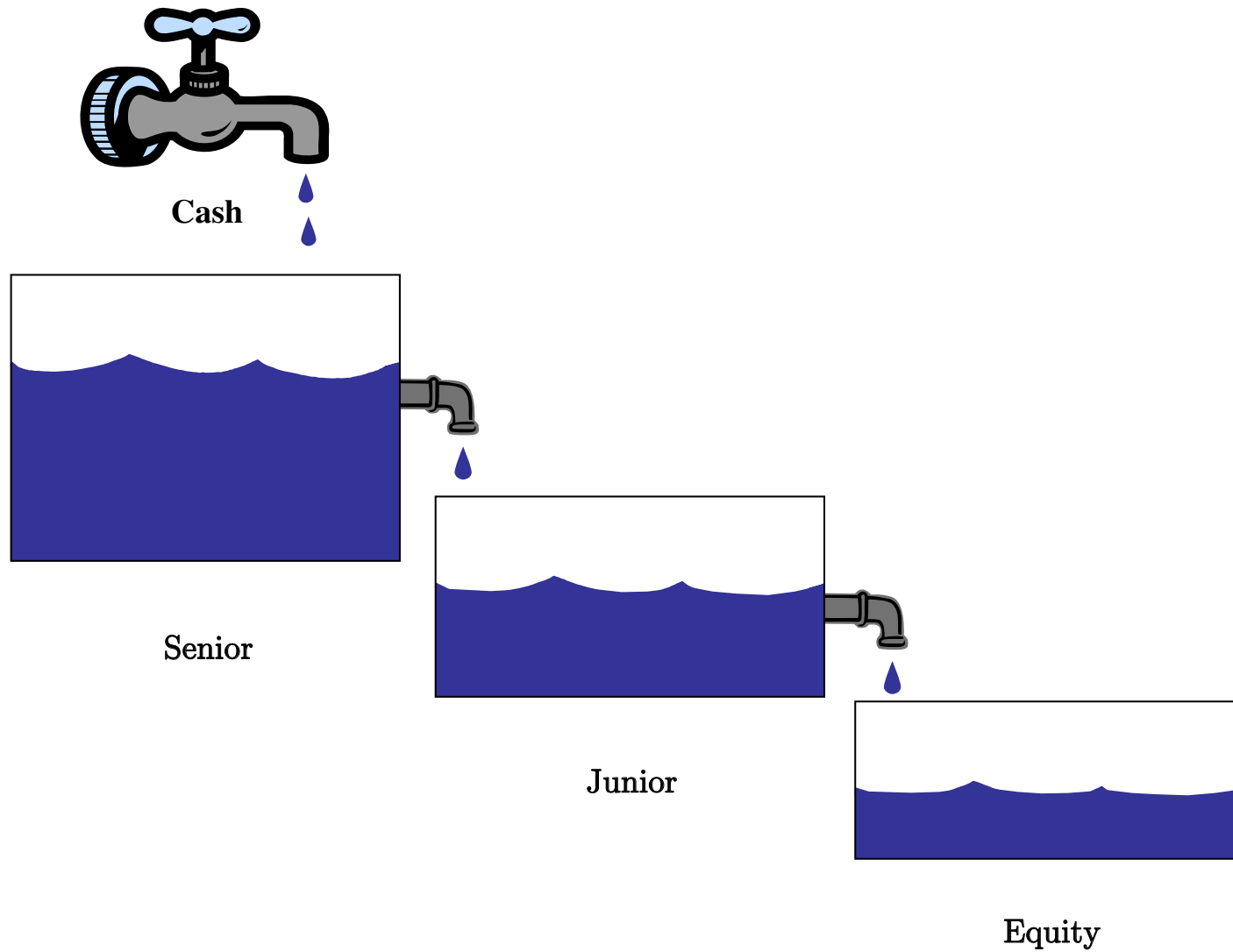


Figure 3: "Waterfall" of a collateralized debt obligation.

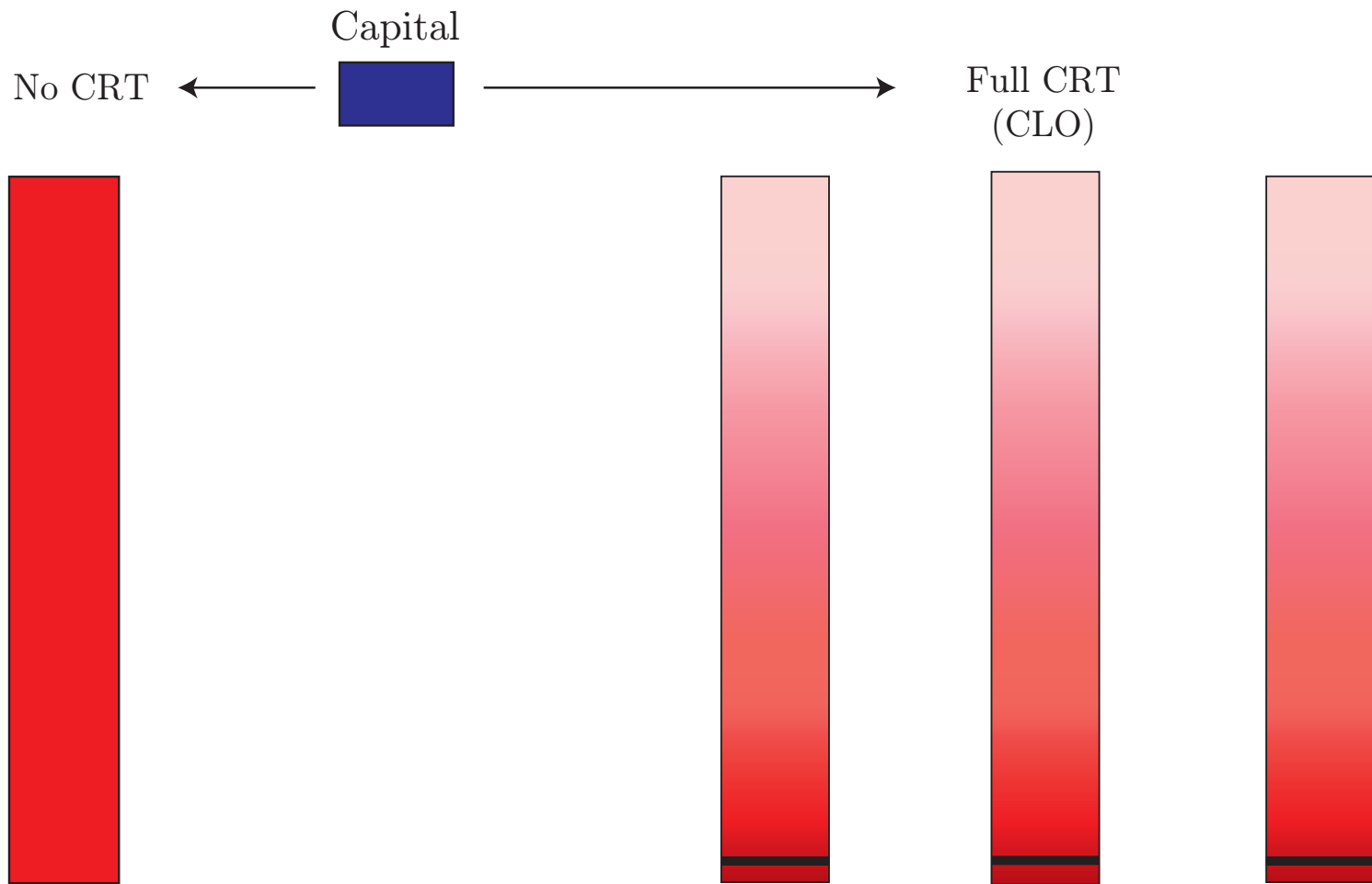
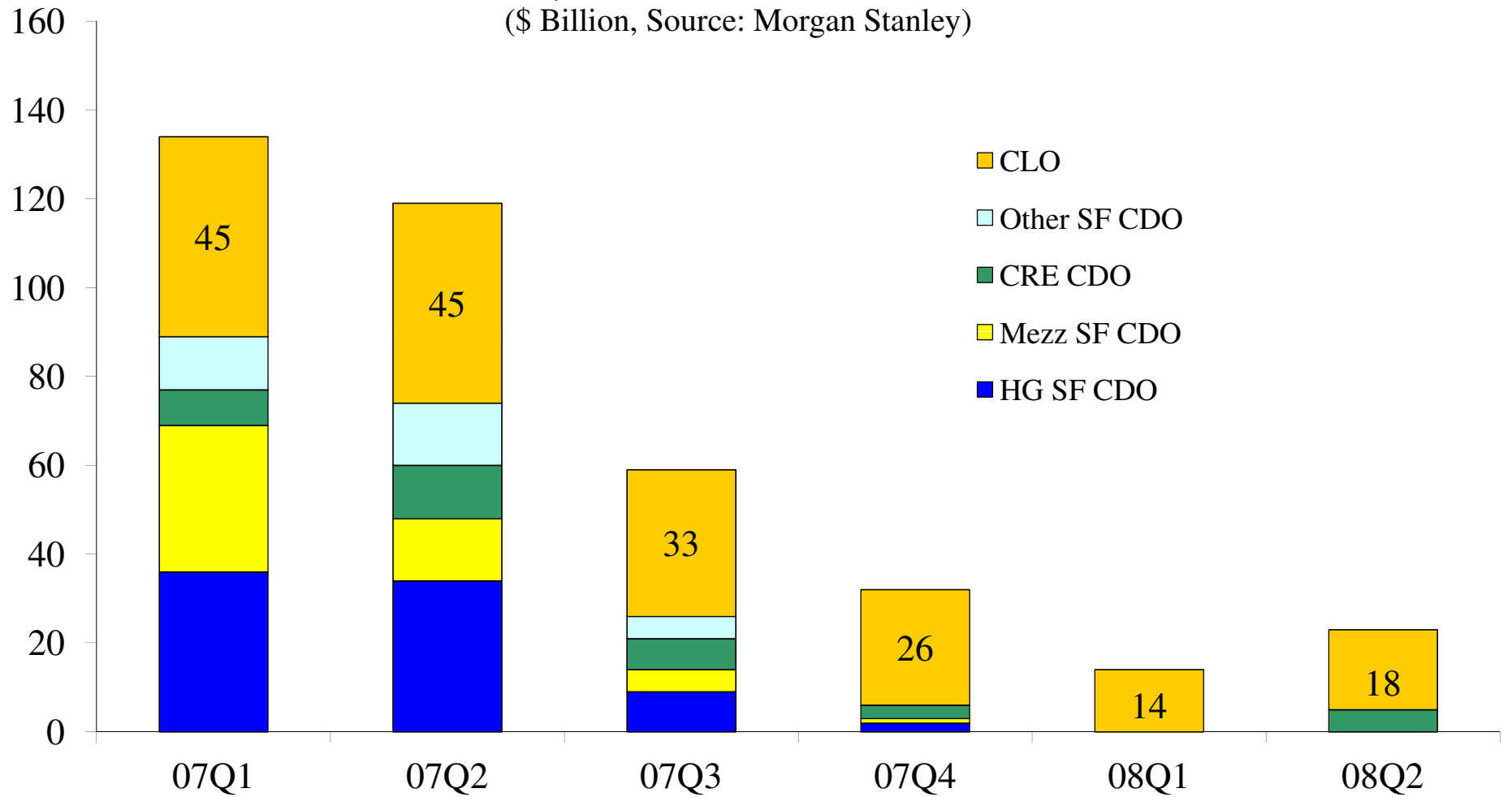


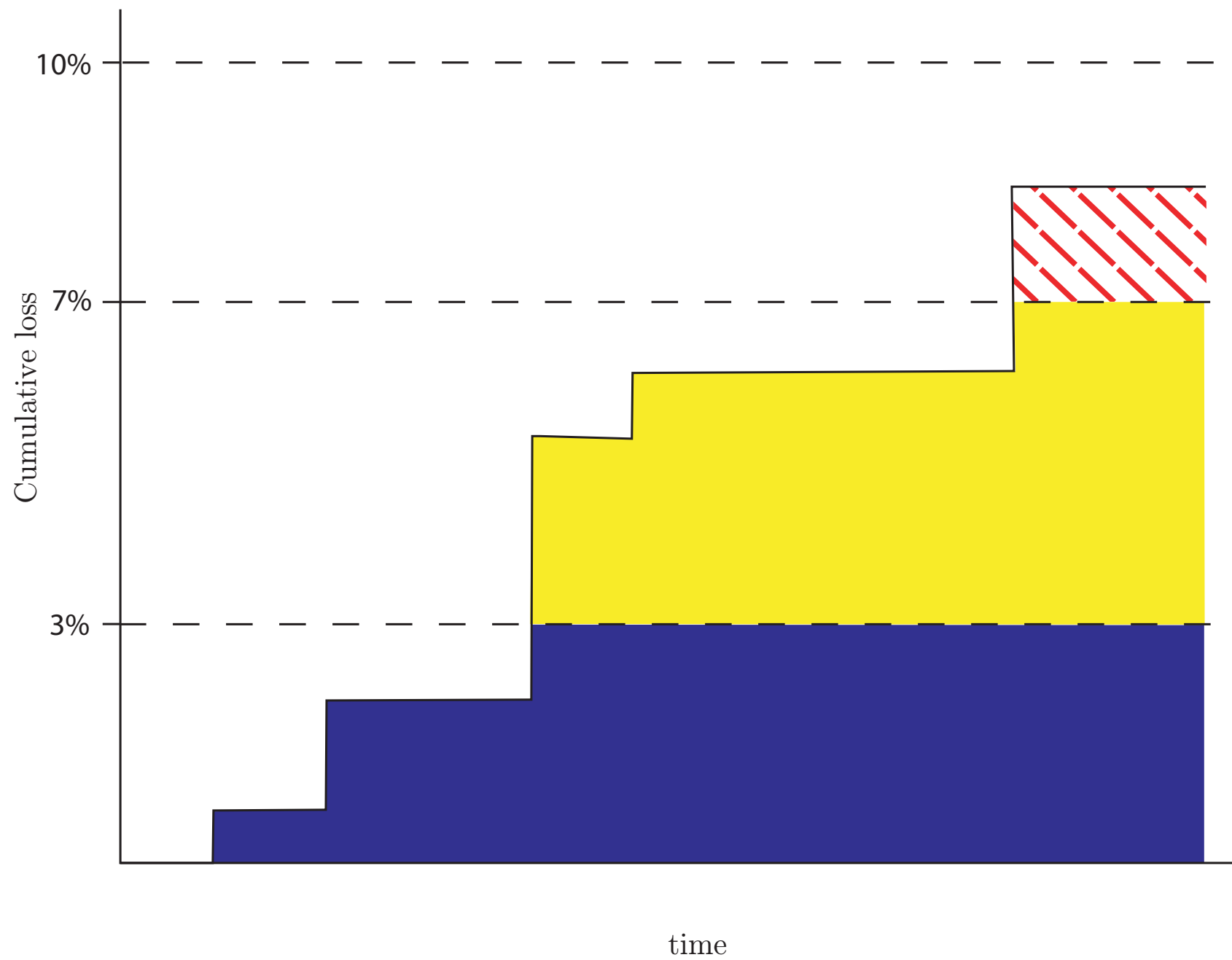
Figure 4: Retention of toxic waste at low leverage.

2007-08 Quarterly CLO and Structured Finance CDO Issuance
(\$ Billion, Source: Morgan Stanley)

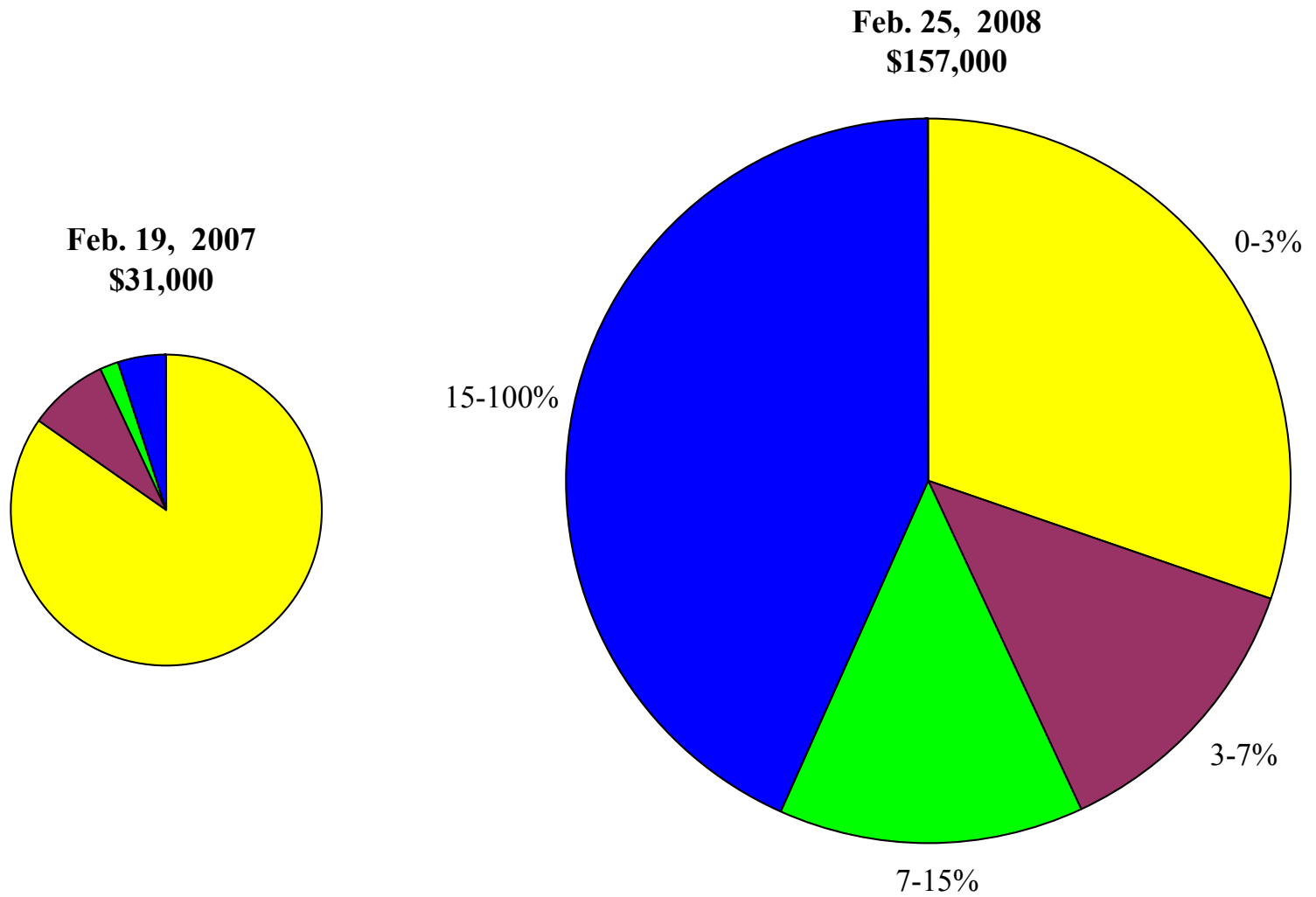


Systemic Risks of Poor Credit Risk Transfer

1. Credit squeeze: Hoarding of credit.
2. Interference with central-bank monetary policy.
3. Bank runs (Northern Rock, Florida Pool, Bear Stearns).
4. Too-big-to-fail adverse incentives.
5. Spillover to other credit markets (e.g. muni bonds).
6. Lost credibility of CRT products.



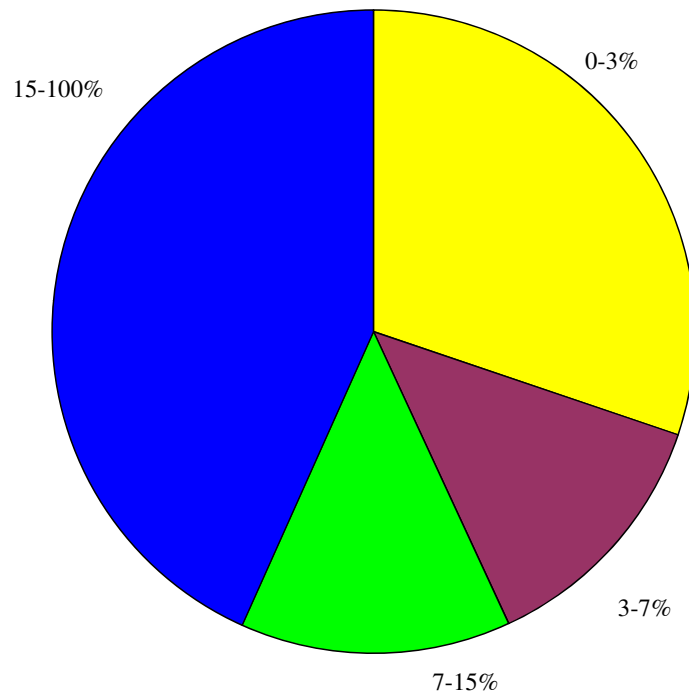
Default Insurance on \$10 Million Investment Grade Corporate Debt Portfolio Annual Premiums on 5-Year Coverage



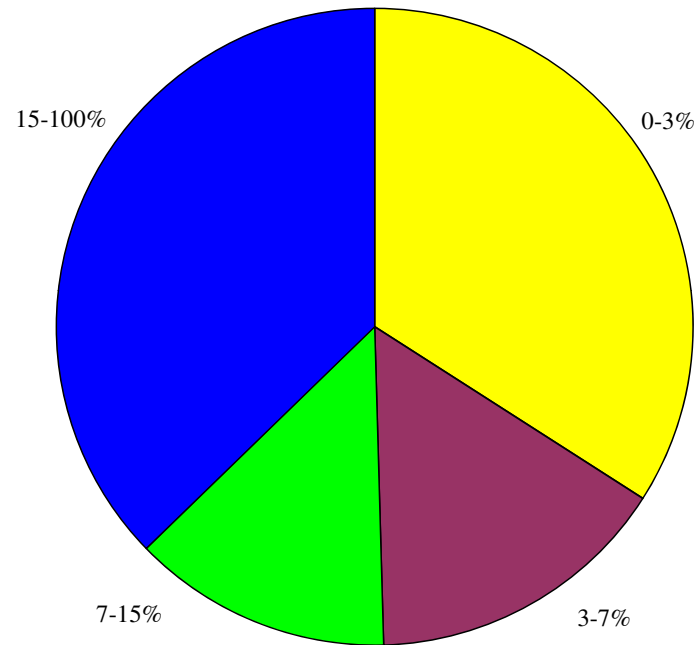
Source: CDX.NA.IG.5yr Tranche Pricing, Morgan Stanley

Default Insurance on \$10 Million Investment Grade Corporate Debt Portfolio Annual Premium on 5-Year Coverage

Feb. 25, 2008
\$157,000



July 14, 2008
\$145,000



Source: CDX.NA.IG.5yr Tranche Pricing, Morgan Stanley