

To Manage Risk, You Have to Know the Waters

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For 12 months, it seems as though every financial headline has focused on risk – and rightly so. In 2008, the failures of large prestigious financial institutions in the U.S. and Europe accelerated the financial turmoil that originally stemmed from declining global real estate values. One key factor was exposure to securities of packaged subprime loans and the credit default swaps issued to insure these loans and their issuers. In addition to bank failures across the U.S. and Europe, we saw the devaluation of certain currencies and sharp reductions in the value of equities and commodities worldwide. In reaction, some countries sought to stabilize markets by temporarily closing them.

The View from Asia-Pacific

At first, the financial crisis had limited consequences for the region, due to a widely held belief that the Asia-Pacific economies were somewhat decoupled from their Western counterparts. It was presumed that, since holdings of subprime/exotic securities were negligible, the potential for damage would be limited.

This myth was soon shattered and Asia-Pacific felt the full heat of the economic crisis. Some stock markets were temporarily closed: upon reopening, they were at a significantly lower levels and drifting lower. The economies also bore the brunt of the steep decrease in consumer demand and the sudden drop of exports. This created a squeeze on liquidity, sharply increasing the cost of funds while dramatically reducing the availability of credit.

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One immediate reaction to this was a ban on 'short-selling' in many Asia Pacific markets, institutions also systematically reduced lending limits to their counterparties while tightening the noncash collateral requirements. Concurrently, the focus shifted from term repos to overnight and short-term products.

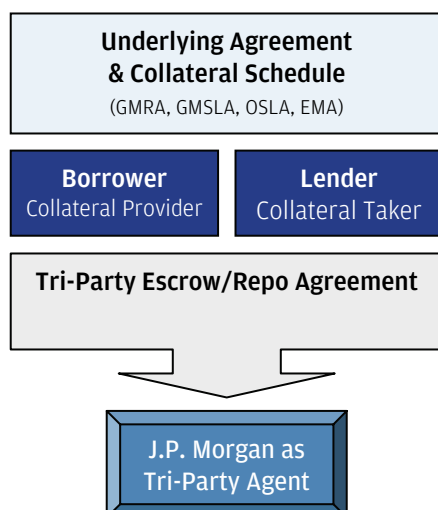
Governments stepped in, pumping funds through different channels to ease liquidity pressure. While credit default spreads have come down, lending activity remains subdued and margins/hairsts are still comparatively high.

The use of collateral, growing exponentially for years in other markets, is increasingly viewed as a vital tool for Asia-Pacific companies navigating unpredictable waters.

The Role of Collateral

We continue to see increasing scrutiny of asset classes and related haircuts, manifested as smaller trades with larger transactions split over several days.

The use of collateral can significantly mitigate credit risk in volatile markets. Specifically, tri-party collateral management can help manage exposure and enable expedited recovery of collateral in the event of default. Additionally, collateral managed in an operationally efficient manner can also be a significant driver of profitability.



J.P. Morgan's locally driven and market-leading solutions provide additional flexibility for clients domiciled within specific countries



Choosing the Right Collateral Agent

One year on, we believe that this market crisis has provided a unique opportunity to analyze risk in action, with an eye toward more effectively mitigating it with structures that are tailored to meet local needs.

Understanding the changing regulatory environment in these diverse markets, and their closer-than-expected ties to the West, is essential for any collateral agent.

J.P. Morgan leverages its extensive history in the region and its expertise as a premier provider of collateral services to create bespoke solutions for its clients. Specifically, understanding our clients' need to distinguish between mobilizing Asian assets as collateral around the world and local-local financing activity, J.P. Morgan introduced solutions that support both local financing activity and the leveraging of assets in the global marketplace. We support the use of global securities within local time zones, as well as the use of Asian securities in other time zones.

J.P. Morgan's long history of innovation is evidenced by its continued investment in its technology and global infrastructure, including a multiyear, multimillion-dollar program currently underway to rearchitect its

systems and operating platforms. This initiative is designed to help us maximize and optimize clients' use of collateral while continuing to mitigate risk and minimize their financing costs in the unpredictable waters of today's financing markets.

J.P. Morgan's Services

J.P. Morgan supports a variety of collateral solutions to mitigate counterparty risk:

- In Tri-Party Repo, buyers can realize attractive returns from their short-term cash investments while allowing sellers to utilize long assets to raise cash. J.P. Morgan receives and values securities before delivering cash, and facilitates transactions through introductions to an ever-expanding network of sellers and buyers.
- Securities Lending Escrow offers multiple benefits to asset managers including: enhancing yields, upgrading collateral and generating additional income from assets through loans to dealers seeking to cover their own positions. To offset credit risk, lenders demand collateral to place against the exposure. As escrow agent, J.P. Morgan manages collateral received from borrowers for the benefit of lenders.
- Margin Management can help the clearinghouse and its clearing members to effectively manage collateral for margin obligations. J.P. Morgan, as Tri-party agent, provides safekeeping, collateral valuation, reporting and related agency services.
- Structured Transaction Solutions leverages tri-party to manage collateral used in simple hedging and investment structures to the most complex and sophisticated structures.