



Dear ...,



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image

Jan Krahn  
*SAFE Director*

welcome to the first issue of our refreshed newsletter format. The new digital "SAFE Update" will be published six times a year and offers selected news from our institute along four recurrent sections:

- Focus on a specific topic
- Research Highlight
- #SAFEtheDATE, which works as a combined outlook and review of events, and
- Handpicked, a recommendation worth reading, listening or watching from one of our department directors.

The first digital issue starts with a focus on recent publications by researchers around SAFE on the German financial market supervisory authority BaFin following the Wirecard scandal and research on empirical measures of market sentiment.

We wish you an interesting read and welcome your feedback to the editorial team via [newsletter@safe-frankfurt.de](mailto:newsletter@safe-frankfurt.de).

Jan Pieter Krahn

## Focus: BaFin (in)dependence after the Wirecard scandal



### Granting Germany's securities market supervisor more authority

Following the case of the insolvent payment service provider Wirecard in June 2020, the call for a comprehensive revision of the supervisory regulations for capital markets in Germany and in Europe has been enormous. At SAFE, financial economists and lawyers joined their expertise and presented a viable reform proposal in [SAFE White Paper No. 82](#) that aims at strengthening BaFin's performance and credibility in the future.

According to the proposal, BaFin should be insulated from instructions from Germany's Federal Ministry of Finance and be required to report directly to the German parliament on an annual basis. Additionally, two

international representatives from other securities market supervisors should be appointed to BaFin's administrative council.

These suggestions are closely connected to the wider supervisory implications of the Wirecard case with regard to market integrity, better investor protection, reforms for internal company controls and external auditing as well as the establishment of an independent European Single Market Supervisor (ESMS) that an international team of financial and legal experts around SAFE disclosed in [SAFE White Paper No. 74](#) and [SAFE Policy Letter No. 88](#).

## Research Highlight: Measures of market sentiment

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### **Volatility, Valuation Ratios, and Bubbles: An Empirical Measure of Market Sentiment**

by [Can Gao](#), Advanced Researcher in the SAFE Department Financial Markets, and Ian Martin, London School of Economics.

In *SAFE Working Paper No. 312*, which is forthcoming in the *Journal of Finance*, the authors introduce a market sentiment indicator which may help policy makers to better assess the “bubblieness” of markets. The indicator consists of three components that are based on valuation ratios, option prices, and interest rates. It could be seen as a lower bound on the expected growth rate of the fundamental. It is a leading indicator of detrended volume, of long-term earnings growth expectations, and of various measures of stress in the financial system.

The authors theoretically justify their construction of the sentiment indicator using an axiomatic approach. They first create a forecast of the difference between expected future return and dividend growth using a modified version of the classic Campbell-Shiller decomposition of valuation ratio. Then, starting from no arbitrage condition, they use option prices to construct a volatility index that serves as a lower bound of the expected excess log-return of the market.

In the end, the authors put those former two ingredients together with the interest rate to back out a lower bound of expected dividend growth implied by stock market, bond market and option market jointly. The indicator characterizes the late 1990s as bubbly as the bound was very high during that period time, reflecting dividend growth expectations that may have been unreasonably optimistic.

[Download the SAFE Working Paper No. 312 here](#)

## #SAFEtheDate

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### Outlook

The SAFE Workshop "EMU at a Crossroads? Economic Governance Reforms in the European Union" on 14 and 15 July 2021 is about to bring together contributions from political science, law, and economics on the completion and implementation of the European banking union as well as perspectives on the Capital Markets Union. [Register here for the event.](#)

### Review

In a SAFE-CEPR Web Seminar, SAFE's Department Director of Financial Markets *Loriana Pelizzon*, the Chair of the Supervisory Board of the European Central Bank *Andrea Enria*, and *Thorsten Beck*, Director of the Florence Business School of Banking and Finance, discussed whether measures in the European Commission's "NPL action plan" are effective and sufficient to deal with a potential wave of non-performing loans following the Corona crisis. [Read the follow-up report and rewatch the video here.](#)

## Handpicked

Andreas Hackethal 

**Andreas Hackethal, Director of SAFE's research department "Household Finance", chooses a podcast series by US economist Katy Milkmann:**

"The wonderful books of Kahnemann, Thaler/Sunstein and Ariely made behavioral economics mainstream and helped millions of readers to better understand individual decision making. Katy Milkman, Professor at the Wharton School, who has co-authored an important paper on peer effects in finance, has been showcasing behavioral insights in a Charles Schwab sponsored podcast and in her new book 'How to change' is now advising readers on strategies of how to achieve financial and life goals."

[Find the podcast here](#)

## News & Latest

- **News:** [A SAFE Working Paper \(by Farshid Abdi, Emily Kormanyos, Lorian Pelizzon, Mila Getmansky Sherman, and Zorka Simon\)](#) shows that former U.S. President Donald Trump has preferred to [communicate a lot via Twitter, but has hardly revealed any market-relevant information](#)
- **Video:** [John Fell presented the latest ECB Financial Stability Review at a SAFE Policy Web Seminar](#)
- **SAFE Finance Blog:** [Market liquidity of European sovereign bonds during the Covid-19 crisis \(by Emanuel Moench, Lorian Pelizzon, and Michael Schneider\)](#)
- **All [upcoming events](#) and [SAFE publications](#)**

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