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Mishandling of the First Loss Piece and Misalignment of Bank Manager Compensation are Causes of the International Financial Crisis

The Implementation of European Best Execution Obligations in Germany

Housing as an Explanation for low Stock Market Participation – a Simulation Approach

Target2-Securities – Who Will Benefit?

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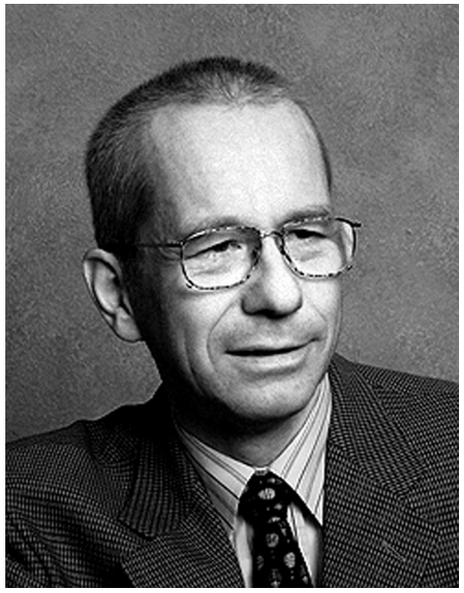
Editorial

Mishandling of the First Loss Piece and Misalignment of Bank Manager Compensation are Causes of the International Financial Crisis



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Our analysis focuses on the relationship between manager incentives and risk management. Irresponsible lending, overly complex financial instruments, and conflicts of interest impaired market transparency and translated into market illiquidity.

One important misalignment relates to the first loss piece in securitizations. In simplified terms, consider a 1,000,000,000 US$ reference portfolio of assets consisting of 100 entities. A special investment vehicle (SIV) with no assets or liabilities at start wants to purchase this portfolio. Rather than borrowing 1,000,000,000 US$ in one go it borrows in tranches which have different risks associated with them. For example, 10% are AAA rated (class 1), 80% are A+ rated (2), 7% are B+ rated (3) and 3% are unrated (4). The latter class is called the first loss piece, because when there is a total loss of 1.2% of the entire portfolio, class 4 noteholders cover this sum completely. When the total loss of the entire portfolio sums-up to 3.5%, class 4 noteholders cover "the first" 3% and in addition class 3 noteholders loose 0.5%.

Information asymmetries enable the originator of a securitization transaction to benefit from adverse selection and moral hazard at the expense of investors. The standard cure for these problems is that the originator retains a substantial fraction of the first loss piece. Over the years it appears that originators sold more and more of this piece, invalidating their incentives to safeguard the quality of the securitized assets. Since originators refuse to tell investors about the retained first loss piece, investors were not aware of this problem for a long time – and opacity in financial asset valuation translates into opacity of institutions trading or holding those assets. Therefore, the risks of these institutions cannot be evaluated by peer institutions, and the interbank market will collapse, too.

Another important incentive misalignment relates to bank manager compensation. A substantial part of the compensation is an annual bonus which can never be negative. By setting up SIVs, and similar structures, and by strongly leveraging their activities, managers can raise their bonus income. Therefore we observe leverage ratios which endanger financial stability.

One way to discourage managers from taking excessive risk is to supplement the bonus system by appropriate malus components.

Therefore, the bursting of the house price bubble may have triggered the financial crisis, but it is not its primal cause. In the paper "The Future of Securitization" which has recently been presented and discussed at the Brookings-Tokyo Club-Wharton conference on "Prudent Lending Restored", we propose several measures to improve transparency in a specific way, and give regulation the role to enforce this transparency:

1. Markets need to know at all times the size and the fraction of first loss position retained by the originator. There should not be mandatory retention, however, because a rule can always be gamed.
2. Compensation schemes of managers needs to balance bonus and malus components. Again, no regulation is required, only transparency on remuneration policy, including an independent assessment of incentive properties of the scheme, e.g. by rating agencies.
3. An extra capital charge should be imposed on banks whose risks are opaque, reflecting the externality imposed on the market as a whole.
4. Rating processes should not be regulated, while rating performance measurement (i.e. the validation of ratings) should – and be made public. Also, ratings should provide information on incentive alignment in complex transactions.
5. Comprehensive data on risk exposure of financial intermediaries (a risk map) should be collected and published quarterly, signaling early warnings.

(The article can be retrieved at:
http://www.ifk-cfs.de/index.php?id=1462)

Research Report

The Implementation of European Best Execution Obligations in Germany

AN EMPIRICAL ANALYSIS OF THE BEST EXECUTION POLICIES OF THE TOP 100 GERMAN FINANCIAL INSTITUTIONS AND THE 15 LARGEST ONLINE BROKERS.

Peter Gomber
Adrian Wranik
Gregor Pujol

Scope

From 01 November 2007 the provisions of the "Markets in Financial Instruments Directive" (MiFID) have to be applied by all firms which provide investment services as well as by all regulated markets throughout Europe. The central innovations of the MiFID are the classification of trading venues (regulated markets, multilateral trading platforms, and systematic internalisers), the definition of "best execution" at European level and the introduction of far-reaching transparency regulations for OTC trading.

Investment firms are obliged to make adequate provisions including processes and IT systems for order routing to achieve the best possible result ("best execution arrangements") in order execution and to disclose sufficient information of the most important measures to their clients ("best execution policies"). Although best execution and the associated duties initially constitute a legal obligation in the relationship between clients and investment firms, at the economic level this topic also decisively affects the interface between investment firms and execution venues. Because of the new regulations for best execution, communication of the execution venues' performance, particularly in terms of price quality and execution costs, has become a major competitive factor.

Data and methodology

Against this background and nine months after the applicability of MiFID, an E-Finance Lab research project examines and compares German "best execution policies". In two studies of the EFL among 200 investment firms in Germany in 2006 and 2007 (Gomber et al. 2007), 32% of the institutions stated that competitive differentiation through the design of the best execution policies has a very high or fairly high competitive potential, and it was thus considered to have the best chances of all services connected with the introduction of MiFID. Therefore the current study also checks how far this assessment is actually reflected in the best execution policies which were evaluated.

The 100 largest German financial institutions in terms of their total assets in 2006 and the 15 largest online brokers in Germany according to the number of security accounts serve as the starting basis for this study. After adjustments (e.g. removing firms which do not provide investment services) the final sample totals 75 best execution policies (60 financial institutions and 15 online brokers).

A comprehensive list of criteria is developed for the analysis which is based on MiFID's legal requirements and also contains other aspects which resulted from the practical implementation by the investment firms (best practice). These include, for example, the explanations of the factors which were used to evaluate the execution venues. A second part of this analysis then focuses on the execution venues listed in the policies, in particular with regard to the assignment of execution venues to categories of financial instruments and with regard to the existence of a ranking of execution venues in the policies.

Key results concerning the general set-up of execution policies

The most important legal requirements concerning best execution are specified in §33a of the German Securities Trading Act (WpHG). Nearly all investment firms fulfill the minimal obligations which cover aspects such as the description of the method used for the definition of a best execution policy, details on the process of selecting an execution venue – including a list of the principal execution venues which consistently provide the best possible result for clients – or information on how orders are dealt with when specific instructions are given by the client.

In addition to the minimum requirements, many investment firms provide their clients with further details in their best execution policies. The results show that a "best practice" has established for many measures, e.g. scope of the policies or weighting of the relevant criteria for achieving the best possible result.

While all 75 best execution policies are applicable for private clients, 17 policies exclude the validity for professional clients leaving a total of 58 policies for that client category.

The relevant criteria (e.g. price, costs, speed of execution) and the corresponding weighting for achieving the best possible result were analyzed: No weighting can be recognized in 11% of the policies. The remaining policies provide such a weighting either by ranking the criteria (e.g. price has priority over speed) or even by specifying percentage values concerning the relative weight of the individual criteria. One policy even states to evaluate the appropriate execution venue based on real-time market data for individual orders (order-by-order approach).
As required by law, most best execution policies base their decision for a particular execution venue on the total consideration, i.e. execution price plus external costs, except for one policy

that ascribes the greatest importance solely to the price and another policy that assigns the highest priority to total costs, i.e. external costs plus inhouse charges, completely neglecting the criterion price.

Key results concerning the selected execution venues

Finally, details regarding the ranking of the execution venues were examined. Obviously, from a competitive point of view this ranking is very important for execution venues. Therefore, it is of high interest how concrete and detailed policies list and rank the different execution venues.

It is noticeable that the investment firms primarily prefer abstract and summarizing descriptions to document their choice of an execution venue (e.g. domestic execution venue, foreign exchange) instead of naming specific execution venues. A concrete execution venue is named only in every fourth policy (24%).

Segment	DAX 30, other DAX (MDAX, TECDAX, SDAX)			EUROSTOXX 50, DJ STOXX 40, NASDAQ 100			Other domestic shares		
Execution venue	**Frequency**	**Rank 1**	**Rank 2**	**Frequency**	**Rank 1**	**Rank 2**	**Frequency**	**Rank 1**	**Rank 2**
Xetra-Best	1	4	0	3	3	0	1	1	0
Xetra	14	8	5	10	5	4	11	6	4
Berlin	2	0	1	2	1	0	2	0	1
Düsseldorf	2	0	1	2	1	0	2	0	1
Frankfurt	4	0	3	4	1	2	4	2	2
Hamburg	2	1	0	2	2	0	2	2	0
Hannover	1	0	0	1	1	0	1	1	0
München	2	0	2	2	0	2	2	0	2
Stuttgart	2	0	1	2	1	0	2	0	1
Tradegate	1	1	0	1	1	0	1	1	0
OTC	1	1	0	1	1	0	1	1	0
Domestic floor Trading system	3	0	3	4	1	3	4	2	2
Domestic home exchage	2	0	2	2	0	2	1	0	2
Fixed-price business	3	3	0	3	3	0	3	3	0
No details	3	0	3	6	1	5	6	0	6
Total		18	21*		22*	18		19*	21*

** Multiple count of execution venues at the same rank*

Figure 1: Segmenting of the securities group shares

Figure 1 exemplarily lists the 18 best execution policies which named at least one specific execution venue and documented a recognizable ranking for the securities category shares. The figure shows the results for the segments DAX 30, other DAX (MDAX, TECDAX, SDAX), EUROSTOXX 50, DJ STOXX 40, NASDAQ 100 and other domestic shares by showing how often a venue is mentioned and how often it is ranked first or second (although existing, individual rankings beyond rank 2 are not shown here).

The execution venue mentioned most frequently in all segments is Xetra. In some policies precisely one specific execution venue is prioritized and occupies rank 1; in these cases no specific nomination for rank 2 exists – a "domestic floor trading system" or "domestic home exchange" was ranked second. As execution venues of equal rank are also named multiple times in the policies, this indifference with regard to selecting a venue results in a value greater than 18 in the bottom line. It is noticeable that the regional stock exchanges are rarely placed in rank 1 or 2 and that new trading platforms like Chi-X were not mentioned at all in the policies examined in this study.

Conclusion

Nearly all of the investigated best execution policies have recognizably implemented the minimum legal requirements. However, significant heterogeneity can be recognized between the policies of various investment firms: some policies are extremely comprehensive and describe the procedure selected in great detail, while others are limited to minimum details and are not very meaningful for clients.

In 24 %, i.e. in approximately every fourth policy, specific execution venues are named or a ranking is provided. The short timeframe between the implementation into national law and the final applicability of the new rules may be an important reason for the fact that the use of these policies as a competitive instrument cannot be recognized at present. Future analysis of the policies or even an analysis on a European level will reveal how far MiFID finally achieved to foster competition for investment services in Europe.

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Research Report

Housing as an Explanation for low Stock Market Participation – a Simulation Approach

Valentin Braun

Introduction

Owner-occupied housing is the most important asset in many investors' portfolios. This article investigates optimal portfolios including real estate ownership and examines the resulting optimal intensity of stock market participation. Therefore, this paper explores whether low or no stock market participation can be rational.

The first sophisticated papers treating the issue of portfolio optimization appeared in the 1960's [Sharpe (1964), Mossin (1968), Merton (1969), Samuelson (1969)]. They all assume complete markets and therefore hardly address the issue of background risk, because in this framework background risk can be priced and capitalized into wealth. Under those conditions the statistical properties of background risk do not influence the optimal portfolio allocation to risky and risk-free assets.

In recent years the assumption of complete markets was exposed to increasing criticism and new theoretical as well as practical interest in the portfolio optimization problem arose. In contrast to early portfolio theory, current research assigns transaction costs and information asymmetry to significantly impact economic decisions, and therefore affects asset allocation [Leland (1985), Odean (1998), Barber and Odean (2001), Statman et al. (2006)].

Besides, a switch in the assumptions from complete to incomplete markets also entails the existence of background risks, which affect the asset allocation rules for an optimal portfolio. As a result, investors modify their portfolios' consistency to avoid non-market risk exposures [Mayers (1974), Duffie et al. (1997)]. The most frequently named sources of background risks are proprietary income and fluctuations in labor income and housing [Guiso et al. (1996), Fratantoni (1998), Heaton and Lucas (2000), Shum and Faig (2006)].

I use a model, based on Markowitz's (1952) theory of portfolio optimization, to integrate the ownership of real estate into households' portfolios as an additional restriction and derive the mean-variance optimal portfolio. First I calculate the optimal portfolio shares invested into Stocks and Bonds and T-Bills with respect to mortgage and house value. Those results are then compared to asset shares in simulated and optimized portfolios. The simulations show that low or no stock market participation can be rational with regard to house ownership as one source of background risk. In addition, the simulations reveal differences in the optimal portfolios according to investors' house-to-net worth ratios and their personal risk attitude. Finally, I calculate the optimal portfolio structure for several West German federal states and unfold that they match the simulation results.

Model

I focus on the issue how owner-occupied houses (instead of real estate investment trusts) impact German households' optimal shares in risky assets. One major country specific difference lies in the volatility of residential house prices. For example, US house prices are almost as volatile as risky assets, whereas West German house prices are nearly stable over time. From those facts I conclude that the shares of Stocks and Bonds and T-Bills vary significantly for German household portfolios compared to the US, all other things being equal.

The objective is to find optimal portfolios for all households that own a home as well as households that rent and to answer the question why German households hardly participate in stock markets. In allusion to Flavin and Yamashita (2002) I abstract from labor income or human capital and assume that wealth is held in any of n risky investments and owner-occupied houses. Further, the household can borrow up to the value of the house. All other financial investments have to be of positive value. I stick to Grossman and Laroque (1990), who assume that the house size cannot be adjusted after being purchased.

I calculate the optimal shares of risky and housing assets under the restriction that the house was purchased before the optimization process and its value is exogenously determined. Consequently, only the shares of the risky assets (x_t) can be adjusted to determine the efficient frontier, whereas the Housing-to Net-Worth ratio (h_t) is fix. The calculations include an investor who is unrestrained in dividing up his wealth among any risky asset class, but does not purchase a house (h_t=0.0).

Data

The mean returns and standard deviation and covariance matrix (Ω) are presented in Table 1. As expected, Stocks have the highest returns out of the five assets, whereas Houses show a much smaller return. Those results are significantly different from US data, which show a much stronger return for houses at a much higher volatility. I accent the House index's Sharpe-Ratio (SR=0.65) to be the highest in this data set, followed by Stocks (SR=0.62). It is important to acknowledge that I do not include taxes in my calculations and therefore probably overstate asset returns.

Results

Optimal portfolio allocation for real data in case of West Germany

	Stocks	Bonds	T-Bills	House	Mortgage
Mean (arith.)	0,088	0,020	-0,007	0,021	0,000
Std.	0,153	0,069	0,037	0,038	0,031
Correlation Matrix					
Stocks	1,000				
Bonds	0,011	1,000			
T-Bills	0,015	-0,759	1,000		
House	-0,004	-0,074	0,093	1,000	
Mortgage	0,177	-0,645	0,929	0,214	1,000
Covariance Matrix					
Stocks	0,02330				
Bonds	0,00012	0,00476			
T-Bills	0,00009	-0,00196	0,00140		
House	-0,00002	-0,00020	0,00013	0,00146	
Mortgage	0,00085	-0,00140	0,00109	0,00026	0,00099

Table 1: Return Matrix and Covariance Matrix for West Germany; Data from Bloomberg and Bureau of Statistics and IFS (1990-2007)

The Housing-to-Net-Worth (NW) ratio (h_t) plays a major role in my model due to its constraining effect on the mortgage ratio and consequently the mean-variance optimal portfolio. As mentioned in the introduction, households' wealth, saving rates and asset compilation, as well as their risk preferences (λ) vary dramatically over the life cycle. Therefore, I investigate the optimal asset allocation for different h_t, starting at 4.0 for young households with high leverage decreasing to a ratio of 0.5 for older households. Note that those ratios do not violate the restrictions on lending ($0 \geq X_{n,t} \geq -h_t$). In order to descry the mean-variance efficient portfolios under the housing constraint with respect to the various risk preferences I employ quadratic programming to calculate the optimal vector of financial assets, X. In Table 2, the results from the optimization are stated. Note that Stocks and Bonds and T-bills represent the percentage-shares of those three assets among the risky assets, excluding House and Mortgage. Consequently, those three assets must sum up to one in Table 2. Mortgage represents the leverage in accordance to the House value. A Mortgage of -0.8 indicates an 80%-debt financing of the House.

Optimal asset allocation in several German states

At last, I examine optimized portfolios for the states of NRW, Hessen, Rheinland-Pfalz, Bavaria, and Saarland to validate the simulation results. In essence each of those examples reveals special characteristic. NRW is the most populated German state, Hessen contributes the most to the national GDP, Rheinland-Pfalz is a very rural area, Bavaria exhibits the fastest growing economy and lowest unemployment rate, Saarland is suffering from the loss of its coal mining industry, Bremen is a city state with one of Germany's largest harbors and a very low rate of education, on average. Nevertheless, any state is part of Germany and therefore the only variable varying in the model is the House price development and its correlation with other assets. According to standard theory, the optimal portfolios should look quite similar, but I demonstrate that the change of one variable (in this case House) has a major impact on the optimal portfolio allocation. Basically, those results illustrate a scenario analysis for changes in the correlation matrix for the housing variable while all other variables are stable.

The outcome clearly identifies areas where very low stock market participation is fully rational. In case of Bremen and NRW picking λ=10 and h_t=3.5, respectively h_t=4.0 the optimal equity share in the portfolios are as low as 0.00 and 0.11. On the other hand, Rheinland-Pfalz and Saarland disclose an optimal equity share of 0.47 and 0.57 and simultaneously exhibit very low correlations between the house variable and other assets, reducing σ^2, for λ=10 and h_t=4.0. Although most papers on this topic assume an increase in the Stocks share with rising x_t, I find evidence that this is not necessarily true but strongly depends on the interaction between the single variables represented by Ω In addition, the optimal portfolios for each of the states are in accordance with the findings from the simulations. For example, a strong positive Stocks/House-covariance factor insinuates a strong decrease in the equity share for λ=10 and h_t=4.0. This finding is affirmed in the scenario analysis. Therefore, I conclude a general assumption for the optimal portfolio allocation according to λ and h_t is inaccurate if the interactions between all other influencing variables are neglected. One of the few findings to be valid in general is to optimally invest 100% of the portfolio's assets into Stocks in case of very low risk-aversion (λ=2). In addition, the scenario analysis unfolds a tendency towards reducing the Mortgage ratio for decreasing h_t and increasing λ.

Conclusion

The paper's goal is to find a rational explanation for low stock market participation. Therefore I incorporate housing as a background risk into a portfolio and derive the mean-variance optimal portfolios for various levels of h_t and λ. The results from those analyses clearly identify the interactions between the different assets, represented in Ω, as the main driver for stock market participation. In addition I substantiate that low or even no stock market can be rational, depending on Ω. In the end I control for the validity of the simulation results by optimizing

portfolios for different states of Germany.

Nevertheless, housing is only one of the most frequently named sources of background risk, whereas I do not include proprietary income and fluctuations in labor income in my analyses. The model is flexible enough to be extended to incorporate those issues and to examine how the optimal portfolio would deviate if Heaton and Lucas's (1999) findings concerning the amount of wealth is integrated. Another interesting fact would be to examine the optimal portfolios for entrepreneurs based on Gentry and Hubbard's (1989) findings which unfold a higher savings ratio for those investors. Incorporating all three sources of background risk into this model should display the optimal portfolios according to the very different input factors and allow for a comparison of the rationality of different investor groups according to their individual characteristics.

		Degree of risk-aversion, λ				
Housing-to-NW ratio	Assets in Portfolio	2	4	6	8	10
h=0.0	Stocks	1,000	0,778	0,574	0,466	0,374
	Bonds	0,000	0,222	0,426	0,507	0,472
	T-Bills	0,000	0,000	0,000	0,027	0,154
	Mortgage	0,000	0,000	0,000	0,000	0,000
h=0.5	Stocks	1,000	0,815	0,612	0,562	0,535
	Bonds	0,000	0,185	0,388	0,438	0,465
	T-Bills	0,000	0,000	0,000	0,000	0,000
	Mortgage	-1,000	-1,000	-1,000	-0,668	-0,400
h=1.0	Stocks	1,000	0,853	0,669	0,658	0,648
	Bonds	0,000	0,147	0,331	0,342	0,352
	T-Bills	0,000	0,000	0,000	0,000	0,000
	Mortgage	-1,000	-1,000	-0,953	-0,730	-0,596
h=1.5	Stocks	1,000	0,890	0,764	0,786	0,808
	Bonds	0,000	0,110	0,236	0,214	0,192
	T-Bills	0,000	0,000	0,000	0,000	0,000
	Mortgage	-1,000	-1,000	-0,899	-0,750	-0,661
h=2.0	Stocks	1,000	0,927	0,886	0,965	0,764
	Bonds	0,000	0,073	0,114	0,035	0,000
	T-Bills	0,000	0,000	0,000	0,000	0,236
	Mortgage	-1,000	-1,000	-0,872	-0,761	-0,770
h=2.5	Stocks	1,000	0,965	1,000	0,629	0,430
	Bonds	0,000	0,035	0,000	0,000	0,000
	T-Bills	0,000	0,000	0,000	0,371	0,570
	Mortgage	-1,000	-1,000	-0,868	-0,930	-1,000
h=3.0	Stocks	1,000	1,000	0,826	0,525	0,429
	Bonds	0,000	0,000	0,000	0,000	0,000
	T-Bills	0,000	0,000	0,174	0,475	0,571
	Mortgage	-1,000	0,999	-0,940	-1,000	-1,000
h=3.5	Stocks	1,000	1,000	0,684	0,523	0,427
	Bonds	0,000	0,000	0,000	0,000	0,000
	T-Bills	0,000	0,000	0,316	0,477	0,573
	Mortgage	-1,000	-1,000	-1,000	-1,000	-1,000
h=4.0	Stocks	1,000	1,000	0,682	0,521	0,425
	Bonds	0,000	0,000	0,000	0,000	0,000
	T-Bills	0,000	0,000	0,318	0,479	0,575
	Mortgage	-1,000	-1,000	-1,000	-1,000	-1,000

Table 2: Optimal Asset Allocation for West German Households with respect to Owner-Occupied Housing

Insideview

Target2-Securities – Who Will Benefit?

Interview with Ole Petersen and Frank Striegel, IBM Deutschland

Ole Petersen,
Partner Financial Services,
IBM Deutschland

Frank Striegel,
Associate Partner, Head of Capital Markets,
IBM Deutschland

Target2-Securities (T2S) is a project of the Eurosystem (central banking system of the Euro area) aiming to create a common platform to settle securities transactions in central bank money. This platform is another step of the European Union towards harmonization of capital markets and enhancement of competitive conditions in the Euro area. T2S is planned to go live in 2013 and to operate on a full cost-recovery and non-profit base.

First, please give us an overview of the current landscape for post trading in Europe.
The current landscape of Europe's post trade industry is characterized by 27 segregated national markets which are linked via complex structures. Each country is mainly focused on its own settlement system which leads to inefficient and expensive crossborder trading. For an international trade, a European investor has to pay up to 10 times as much as for a trade within the national borders.

The Giovannini reports[1] have identified the non-harmonized IT-landscape as well as the country-specific legal regulations as the key barriers in Europe's post trade market. To remove these barriers will be a difficult process, but necessary to overcome the current fragmentation.

How will Target2-Securities (T2S) bring about market integration in this landscape?
T2S will enable a uniform securities settlement landscape which enables participants to perform fast cross-border transactions at low costs. T2S will be a technical platform providing borderless and neutral settlement services in central bank money to the participating Central Securities Depositories (CSDs). Cross border settlement will become as efficient as domestic settlement, hence harmonization of the European post trading is fostered.

With a principle for simplicity, European countries can easily adopt and integrate T2S in its specific landscapes.

Which advantages will the financial market players have once T2S is in place?
T2S can be seen as a catalyst of harmonization of market rules and practices in the post trade area in Europe, the result being reduced complexity, operational costs, and risks.

Commoditized, low cost settlement services will be delivered to the CSDs. The CSDs should be able over time to reduce their internal costs by restructuring and downsizing their own settlement processes and focusing on value added services to their customers.

Issuers will profit from a wider reach of investors and higher liquidity of securities and cash. Investors will be able to reduce the cost of a diversified cross border portfolio and benefit from an increased choice of intermediaries.

Custodians will be able to use a single CSD to access multiple markets, thereby saving costs. Reduced risks and lower costs because of increased efficiency of collateral management will be possible.

The global credit crisis puts even more focus on Europeanwide initiatives such as Target2-Securities and for example the harmonization of regulation of financial markets in Europe. Based on our studies and projects within the T2S environment IBM believes that the financial market in Europe will change substantially in the next years. Gainers will be those financial institutions, which adapt their processes and business models to the new conditions.

Thank you for this interesting conversation.

1) In 2001 and 2003, initiated by the European Council the two Giovannini reports – under the lead of Alberto Giovannini - analyzed the clearing and settlement processes and identified 15 barriers which need to be removed in order to achieve integration.

Infopool

News

The E-Finance Lab moved to the new House of Finance at the end of August. The House of Finance is located at the "Campus Westend" of the Frankfurt University. Detailed directions can be found on our website: **www.houseoffinance.eu** ➔ follow the link "contact". Please also take note of the new phone and fax numbers which can be found at **www.efinancelab.com**. The email addresses of the E-Finance Lab staff have not changed.

Retail Banking Conference at Euro Finance Week

Prof. Dr. Andreas Hackethal (cluster 4) and Prof. Dr. Bernd Skiera (cluster 3) will moderate the Retail Banking Conference at the 11th Euro Finance Week in Frankfurt am Main. The conference will take place at the Congress Center Messe Frankfurt on November 18, 2008.

Awards

Julian Eckert, Nicolas Repp, and Stefan Schulte (cluster 2) have been awarded Best Presentation Awards at the IEEE International Conference on Digital Ecosystems and Technologies 2008. Their respective papers, "Towards Automated Monitoring and Alignment of Service-based Workflows" and "Queuing-based Capacity Planning Approach for Web Service Workflows Using Optimization Algorithms" were presented in Phitsanulok, Thailand. Congratulations!

Michael Niemann, Julian Eckert, Nicolas Repp, and Ralf Steinmetz (cluster 2) have been awarded a Best Track Paper Award in the Track "General Topics" at the 14th Americas Conference on Information Systems (AMCIS) in Toronto, ON, Canada. Congratulations!

Björn Imbierowicz (cluster 4) and Balázs Cserna (Ruprecht-Karls-University Heidelberg) were honored at the Financial Services Symposium 2008 in New York for their paper "How Efficient are Credit Default Swap Markets? An Empirical Study of Capital Structure Arbitrage based on Structural Pricing Models". Their contribution was among the top three conference papers, with more than 30 accepted papers.

Selected E-Finance Lab publications

Beimborn, D.; Hirschheim, R.; Schlosser, F.; Schwarz, A.; Weitzel, T.:
How to Achieve IT Business Alignment? Investigating the Role of Business Process Documentation in US and German Banks.
In: 14th Americas Conference on Information Systems (AMCIS). Toronto, ON, Canada, 2008.

Berger, S.:
How personality and relationship affect customers' adoption of advanced self service technology in branch banking.
In: 14th Americas Conference on Information Systems (AMCIS). Toronto, ON, Canada, 2008.

Berger, S.; Frischmann, T.:
Privatkundengeschäft: Steigerung der Wertschöpfung durch Cross-Selling.
In: BankPraktiker 6 (2008), pp. 274-279.

Berger, S.; Gleisner, F.:
Electronic Marketplaces and Intermediation – An Empirical Investigation of an Online P2P Lending Marketplace.
In: Verein für Socialpolitik Jahrestagung 2008. Graz, Austria.

Blumenberg, S.:
IT Outsourcing Relationship Quality Dimensions and Drivers: Empirical Evidence from the Financial Industry.
In: 14th Americas Conference on Information Systems (AMCIS). Toronto, ON, Canada, 2008

Fischer, R.; Hackethal, A.; Meyer, S.:
An Empirical Study on the Cost of Institutional Boundaries and Lacking Financial Sophistication in the Mutual Fund Selection Process.
In: German Finance Association 15th Annual Meeting, 2008.

Gerstmeier, E.; Skiera, B.; Stepanchuk, T.:
An Analysis of the Profitability of Different Bidding Heuristics in Search Engine Marketing.
In: 30th INFORMS Marketing Science Conference. Vancouver, Canada, 2008.

Gomber, P.; Gsell, M.:
Evolution der Anforderungen an die IT im Börsenhandel.
In: Technik / IT für Finanzdienstleister, Zeitschrift für das gesamte Kreditwesen 2 (2008), pp. 13-16.

Groth, S.; Muntermann, J.:
A Text Mining Approach to Support Intraday Financial Decision-Making.
In: 14th Americas Conference on Information Systems (AMCIS). Toronto, ON, Canada, 2008.

Niemann, M.; Eckert, J.; Repp, N.; Steinmetz, R.:
Towards a Generic Governance Model for Service-oriented Architectures.
In: 14th Americas Conference on Information Systems (AMCIS). Toronto, ON, Canada, 2008.

For a comprehensive list of all E-Finance Lab publications see:
http://www.efinancelab.com/publications

Infopool

Research outside the E-Finance Lab

RESEARCH PAPER: FACTORS THAT AFFECT CONSUMERS' CROSS BUYING INTENTION: A MODEL FOR FINANCIAL SERVICES

Cross-buying behavior in retail banking and financial services is receiving increasing research attention. This paper analyzes factors that affect customers' intention of cross-buying retail financial services. Results show that the bank's image and consumer's trust in the bank are crucial for customers' cross-buying intention, besides customer satisfaction and perceived value, which are all a prerequisite for cross-buying. Hence, banks need to build a good reputation and to develop trust between customers and the bank, for example by constant provision of information, transparency in the bank's processes and charges, reliability in service delivery, and service recovery systems. This is especially important for the main bank, where the impact of customers' satisfaction and perceived value itself on cross-buying intention is not significant.

Soureli, Magdalini; Lewis, Barbara R.; Karantinou, Kalipso M.
In: Journal of Financial Services Marketing 13 (2008) 1, pp. 5-16.

RESEARCH PAPER: INTERNATIONAL PRICE DISCOVERY IN THE PRESENCE OF MICROSTRUCTURE NOISE

Against the background of a growing share of US markets in the number of trades of Canadian cross-listed stocks Grammig and Peter examine the relative importance of home and US market in the price discovery process of a sample of those stocks. Former studies applying the Hasbrouck approach from 1995, e.g. Grammig, Melvin and Schlag, have shown the home market to be the dominant trading venue. As outlined, return data of time series sampled at high frequencies are subject to market microstructure noise arising from different sources such as market frictions, trading mechanism etc.

The authors modify the Hasbrouck approach to make it robust against distortions from market microstructure noise by means of distributional assumptions and modified information shares. They find that the importance of the US market in a stock's price discovery was underestimated in the past and that a market's contribution to price discovery is mainly based on market- rather than stock-specific factors.

Grammig, Joachim G.; Peter, Franziska J.
In: EFL, CFS & DBAG Research Conference "The Industrial Organisation of Securities Markets: Competition, Liquidity and Network Externalities".

Electronic newsletter

The E-Finance Lab conducts two kinds of newsletters which both appear quarterly so that each six weeks the audience is supplied by new research results and information about research in progress. The focus of the printed newsletter is the description of two research results on a managerial level – complemented by an editorial, an interview, and some short news. For subscription, please send an e-mail to eflquarterly@efinancelab.com or mail your business card with the note "please printed newsletter" to

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The Internet-type newsletter uses short teaser texts complemented by hyperlinks to further information resources in the Internet. To subscribe, please send an e-mail to

newsletter@efinancelab.com.

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