House of Finance
Sustainable Architecture for Finance in Europe

Newsletter

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About SAFE

The Research Center SAFE – "Sustainable Architecture for Finance in Europe" – is a cooperation of the Center for Financial Studies and Goethe University Frankfurt. It is funded by the LOEWE initiative of the State of Hessen (Landes-Offensive zur Entwicklung wissenschaftlich-ökonomischer Exzellenz). SAFE brings together more than 40 professors and just as many junior researchers who are all dedicated to conducting research in support of a sustainable financial architecture. The Center has two main pillars: excellent research on all important topics related to finance; and policy advice, including the dissemination of relevant research findings to European decision makers from the realms of politics, regulation and administration.

In order to promote a fruitful exchange with interested parties from politics, academia, business and the media, SAFE issues a newsletter on a quarterly basis. This aims to provide an overview of the Center's ongoing research and policy activities. The SAFE Newsletter succeeds the House of Finance Newsletter, which was published between 2009 and 2012.

SAFE is based at Goethe University's House of Finance, however extends beyond by drawing on scholars from other parts of Goethe University as well as from fellow research institutions. The Center builds on the reputation of the House of Finance institutions, serving as an interdisciplinary think tank on the issue of finance.

Content

Editorial

Uwe Walz
Director, SAFE

The financial crisis has provided a number of lessons for current and future research in economics and finance, in particular. One of the main lessons is that thinking and working in "silos" may cause one to overlook interrelations with other areas as well as the interconnectivity of the financial system itself and its implications for the real economy as a whole. Looking beyond the boundaries of very narrowly defined disciplines and topics is not only beneficial, but also of key importance to understanding the different facets of the international financial and macroeconomic environment.

In SAFE, we have tried to learn from this lesson. We have aimed at overcoming the dividing lines that generally limit a comprehensive research approach. One way of achieving this has been to specifically seek new colleagues whose academic interests help build bridges between traditional research areas.

A good example of this is Alexander Ludwig, who took over the SAFE Professorship of Public Finance and Debt Management in April. His research focuses on dynamic macroeconomics with heterogeneous agents, public finance and computational economic methods. A key area of interest is the optimal design of social insurance institutions, such as pension systems, and how these systems should be reformed in light of the ongoing demographic transition. Following recent practice in dynamic macroeconomics of basing the analysis of macroeconomic questions on microeconomic data, he uses multi-facetted life-cycle models to investigate the effects of different policy regimes on the financial behavior of private households. He combines these models with macroeconomic components in order to investigate how social insurance systems affect the aggregate economy and to analyze macroeconomic feedback effects on household decisions (see also p. 12).

As this brief overview suggests, the research interests of Alexander, who joins us from the University of Cologne, provide for links between several focal areas in SAFE research: microeconomic theory and fiscal policy, macroeconomics and household finance, and – from a methodological point of view – computational, empirical and theoretical economics.

Another interesting interdepartmental link will be established in July with the coming of Simone Wies, who will be joining us as an Assistant Professor from Duke University. In her work, she investigates how marketing investment, e.g. on product innovations or advertising, influence capital markets and investor behavior and vice versa.

You will definitely learn more about the current research activities of our new SAFE scholars in forthcoming issues of this newsletter.

Yours sincerely,
Uwe Walz

Euro Membership and Fiscal Reaction Functions

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Goethe University & SAFE

Jochen Zimmer
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The debt crisis in Europe has put renewed emphasis on the sustainability and prudence of fiscal policies. The fiscal problems of countries like Portugal and Greece, which entered the crisis with high debt levels, suggest that excessive deficits have contributed to the severity of the debt crisis. Countries that became part of the euro area not only experienced a change of monetary system, but their fiscal frameworks and fiscal incentives have also altered. On the one hand, the Stability and Growth Pact has imposed additional restrictions on deficits, albeit with perhaps half-hearted enforcement. While, on the other hand, joining the euro area may have created implicit bailout expectations that could have led to less fiscal prudence. What is the empirical evidence on the net effect of these developments?

In this paper we have looked for evidence as to whether euro membership has indeed changed fiscal behavior in a systematic way, making it potentially less prudent.

Simple insights from the government budget constraint

There are several ways to gauge the sustainability of public finances. A simple, yet important, insight from the intertemporal budget constraint of a government is that a higher stock of public debt needs to be associated with a higher level of discounted aggregated primary surpluses in the future, where the primary surplus – as compared with the ordinary surplus – is derived by excluding interest payments from government expenditures. Figure 1 presents cross-section data for the years 1991, 1996, and 2007; all before the outbreak of the financial crisis. It suggests that the introduction of the euro from 1999 has indeed been associated with a smaller correlation of Member States' current primary surpluses and the level of accumulated debt.

While it is unclear when exactly an increase in the debt level will induce a reaction of the primary surplus, previous studies have found significant immediate reactions (Bohn, 1998; Mendoza and Ostry, 2008) that indicate governments' efforts towards achieving financial sustainability.

Fiscal reaction functions under different regimes

We follow previous authors by estimating fiscal reaction functions that capture how debt levels have empirically influenced primary surpluses in the short run. But unlike previous studies, in our panel of European countries, we distinguish between three different regimes. We may consider the time before the signing of the Maastricht Treaty as the period during which countries were neither influenced by a common currency, nor by the aspiration to be a member of the single currency area. In the period between the signing of the Maastricht Treaty and the start of the common currency (the aspiration period), countries had to work towards the Maastricht criteria for acceptance into the European Monetary Union (EMU) and may therefore have been subject to increased fiscal responsibility. Finally, we consider the time since full membership as a separate period which is of

special interest. While the Stability and Growth Pact required continued efforts to contain government deficits, the frequent infringements of the three percent deficit rule, the weakening of the rules and the moral hazard effects from implicit bail-out guarantees (i.e. a non-credible "no bail-out" clause) may have reduced government efforts below those of the aspiration period or even below the pre-Maastricht period.

Loss of prudence: Greece makes the difference

We find evidence for such a loss of prudence as, in our full sample, the Member States' primary surpluses react significantly less to shocks in their debt levels compared to the time period before the euro. This said, the results are not robust to changes in the specification. In particular, the results become insignificant when excluding Greece from the panel. Therefore, according to our analysis of fiscal reaction functions, the reduction of fiscal prudence is not a general feature of the first years of EMU. This may be seen as an indicator that the negative effects of the euro on fiscal incentives have not been as pervasive as the European debt crisis may suggest, which gives hope for the future. Yet, a strong caveat applies. Our results do not imply that a fiscal policy that may be adequate for a country with its own currency is also commensurate with a currency union. Membership in a currency union may even require lower debt levels, as countries lose monetary policy as a means to handle public debt and competitiveness problems.

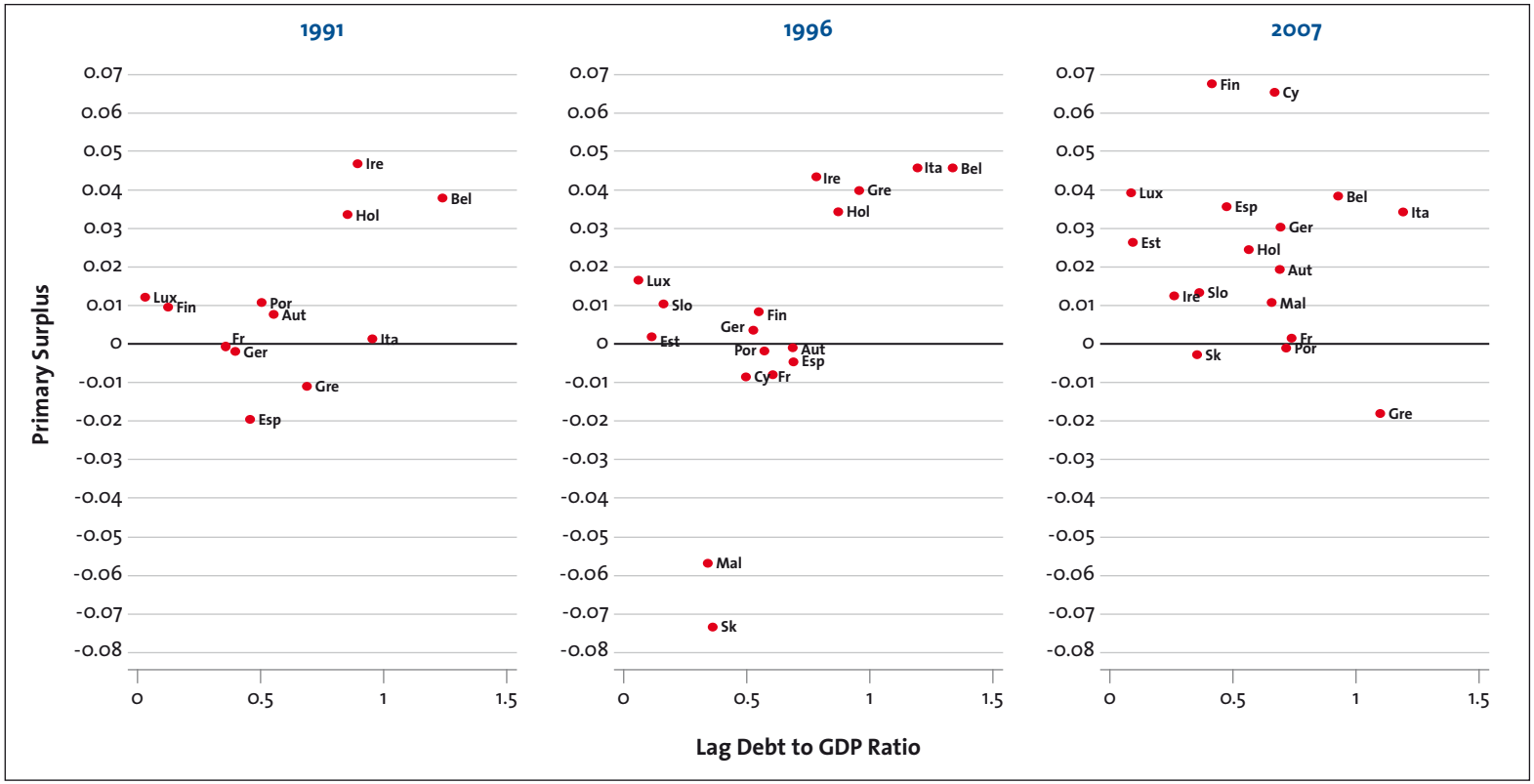

Figure 1: Primary surplus as a share of GDP versus the inherited level of debt to GDP for the years 1991, 1996, and 2007 respectively.

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The full paper will be published in International Tax and Public Finance and is available at: http://link.springer.com/article/10.1007/s10797-013-9299-3

Did Consumers Want Less Debt in the Wake of the 2008/09 Financial Crisis?

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John Krainer
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In the wake of the 2008/09 financial crisis, the United States (U.S.) economy has struggled to emerge from the downturn, largely due to a sluggish recovery of consumption expenditure in parts of the U.S. where house prices appreciated the most before the crisis and where the decline in prices was subsequently steepest (Mian et al., 2013). At the same time, households in these same areas have tended to reduce their debt significantly ("deleveraging"). This is well established (see also Mian et al., 2011), but the question that remains is whether the reduction in household debt was predominantly voluntary or involuntary from the perspective of households. This paper attempts to answer this question.

To set the stage, consider a simple model of household consumption planning (Carroll, 1992). In such a setting, homeowners would optimally choose to reduce their lifetime consumption, and thereby reduce their household debt, on perceiving a negative and permanent shock to their housing wealth such as that which took place in 2009. This would imply that deleveraging and the reduction in consumption was an optimal adjustment to the changing economic conditions of households. Households reduced their debt levels and consumption because they chose to do so. The alternative mechanism for household deleveraging focuses on credit supply. This posits that households, homeowners and non-homeowners alike were forced to reduce debt levels (because banks were unwilling to lend to them), refinance their mortgages, or roll over existing debt.

A demand or a supply story?

The difference is important. If households optimally adjust to what they perceive to be a permanent shock to their wealth, the correct response by policymakers may be to stimulate aggregate demand through expansionary fiscal policy (or, conceivably, do nothing). If, on the other hand, households are constrained because of banks' unwillingness or inability to lend, the optimal policy response is quite different. In this case, policymakers should alleviate the frictions in credit markets that resulted in the reduction in credit supply, for example, through policies that address banks' capital shortfall or liquidity constraints. Hence, the first case calls for action by the treasury or no action at all, while the second unambiguously calls for action by the regulator or the central bank to remove a distortion in the financial sector.

In our paper, we make use of the fact that there were large differences across the U.S. as to how pronounced the real estate boom-bust cycle between 2001 and 2011 was. In the 10 percent of counties that had the lowest house price appreciation, house prices only increased by 3 percent during the period concerned, while in the 10 percent of counties with the highest appreciation, they more than doubled. Correspondingly, the subsequent decline in house prices also differed among counties. We then divide the continental U.S. into counties with a pronounced boom-bust cycle ("boom counties") and those without such a cycle ("non-boom counties"). Next, using the Federal Reserve Board's Senior Loan Officer Opinion Survey on Bank Lending Practices, we show that loan officers tightened credit supply more in boom counties than in non-boom coun-

ties after the financial crisis, suggesting that supply effects may at least be partially at work (see Figure 1). However, note that a tightening of credit standards by itself does not tell us much about the economic importance of tighter standards. It may still be the case that the reduction in household leverage largely came about because households demanded less debt. In that case, the tighter standards would not have been binding and, by themselves, may not have contributed much to the deleveraging.

Hence, in order to obtain a sense of the relative economic importance of supply and demand effects, we rely on the fact that renters did not experience an adverse housing wealth shock in either boom or non-boom counties. Thus, if the difference in deleveraging between renters in boom counties and renters in non-boom counties is greater than the difference between homeowners in boom counties and homeowners in non-boom counties, credit supply effects would appear to dominate demand effects. If, on the other hand, the difference between renters in non-boom counties and renters in boom counties is smaller than the difference between the deleveraging of homeowners in boom counties versus that of homeowners in non-boom counties, we cannot exclude that demand effects dominate. Hence, our identification of credit supply effects relies on a difference-in-differences term. The first difference is between boom and non-boom counties and the second one is between homeowners and renters.

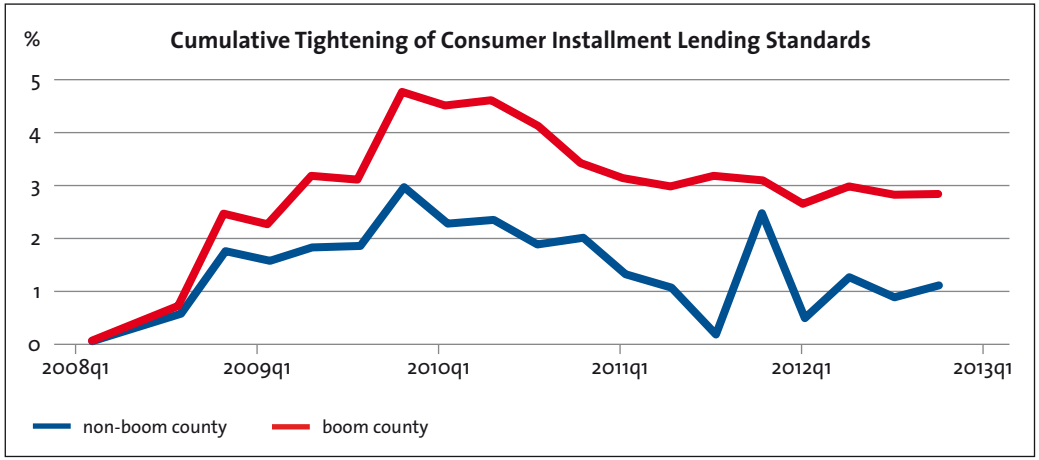

Figure 1: Cumulative differences in loan officers' lending standards in "boom" versus "non-boom" counties in the U.S.

Unresolved solvency and liquidity problems

Our results indicate that credit supply effects are first order and may dominate demand effects. We find that the difference in deleveraging for renters in boom and non-boom counties is larger than the difference between homeowners in boom and non-boom counties. This difference-in-difference is quite large: the decline in borrowing for consumption is 26% steeper for renters than for homeowners when comparing boom with non-boom counties. We argue that, as renters were not hit by an adverse wealth shock, and controlling for the economic environment faced, this difference must be due to differences in the availability of credit in boom versus non-boom counties. In contrast, a demand story based on housing wealth would predict that homeowner borrowers would de-lever more than renter borrowers in boom counties. Consistent with a supply story, we also find that boom county deleveraging is more pronounced for households with risk scores that indicate a lower creditworthiness. Indeed, for credit card and auto debt, there is very little difference in deleveraging between boom and non-boom counties associated with borrowers featuring an average risk score. For borrowers with low risk, deleveraging is actually less in the boom counties than in the non-boom counties.

Overall, the results suggest that the main reasons for the sluggish growth in consumption spending in the U.S. after the 2008/09 financial crisis were the unresolved solvency and liquidity problems of financial institutions, rather than an optimal adjustment of households to over-indebtedness and declining real estate prices.

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The full article has been published as a SAFE Working Paper (No. 42) and is available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2402086

Investor Protection through Model Case Procedures – Public Interest Objectives vs. the Enforcement of Individual Rights

Brigitte Haar
Goethe University & SAFE

Collective redress enabling a larger number of people to benefit from the effects of a favorable court decision is on the rise in Europe. The European Commission as well as the European Parliament are supporting a coherent European approach to collective redress as an implementation tool for regulatory goals of the European Union (EU), as apparent from the Commission's non-binding recommendation of 2013 stating guidelines for the Member States' conception of collective redress mechanisms.

Collective redress in a comparative perspective

With respect to investor protection, in the long run, the enforceability of investor rights may go hand in hand with the public interest in the attractiveness of the capital market. Compensatory collective redress is available in cases of retail investor harm in a growing number of Member States. In the United Kingdom (UK) the Financial Services Act 2010 provides for a financial services dispute resolution scheme, involving extensive case management powers for the courts and the power to intervene for the Financial Conduct Authority. As regards the award of compensation to individual investors, the UK Parliament has been reluctant to facilitate such collective claims.

In France an opt-in group action law was passed in February 2014, but this is only applicable to consumer and competition cases. In Belgium a new law enacted in 2014 enables collective recovery from businesses of harm suffered by a group of consumers on the basis of the same contractual cause after a mandatory negotiation phase. Along similar lines, in the Netherlands the Act on the Collective Settlement of Mass Damage Claims (WCAM) enacted in 2005 introduced an innovative settlement procedure. Its efficiency results in part from its opt-out regime, under which the representative foundation or association brings an action on behalf of all members of a broadly-defined class except for those who have expressly chosen not to participate. Compared to the cases under the WCAM, the number of representative group action cases based on the general principles of the Dutch law of civil procedure is higher and increasing.

Model case procedures may have some advantages from the point of view of the individual plaintiff. Similarly to the above-mentioned examples, in these proceedings a judgment produces effect over and above the parties to the model case itself. As becomes clear from an analysis of the model case procedures provided for in Germany, Austria, Portugal and Switzerland, these procedures differ from the collective redress mechanisms described above with regard to a standing that is only granted to individuals.

The German Capital Markets Model Case Act

Under the German law of civil procedure, the dominant role of individual parties and the principle of party control over proceedings help explain the problems with regard to the bundling of claims. The Capital Markets Model Case Act (KapMuG), an experimental law with a sunset clause until 1 November 2010 that was extended to 2020 after an interim evaluation, was a reaction to the now infamous Deutsche Telekom litigation. The sheer numbers involved (e.g. 15,000 plaintiffs, 2,100 individual lawsuits and 700 lawyers) showed the shortcomings of the

German court system when dealing with mass claims. The scope of the law was enlarged to claims for damages because of inaccurate, misleading or omitted public capital market information in the 2012 amendment of the KapMuG. As a consequence, more individual claimants may now be party to a mass litigation and thus affected by the delays and limitations of procedural rights which could occur when trying to enforce claims that may result from misstatements violating the Prospectus Directive's implementation provisions. This is when a conflict between the implementation of the said Directive – a piece of regulation that pursues a public interest objective – and the efficient enforcement of individual rights may arise.

Procedural implications

In the three-tier procedure, the parties in a dispute may file a petition for a model case decision for common questions of fact or law in the trial court. This will lead to resolution by the higher regional court, which will decide whether it will accept the model case if at least ten parties have filed for a model case decision. It will then choose one of the applicants as the model case plaintiff. The remaining third party petitioners have the right to undertake procedural acts as long as they conform with those of the model case plaintiff. The findings of the model case procedure set the basis for the calculation of damages in the individual proceedings in the trial court. In addition, the 2012 amendment introduced an opt-out settlement, a new procedure that is partly borrowed from the above-mentioned Dutch WCAM, even though, in light of its more limited scope, the procedure under the KapMuG leaves slightly more room for individual investor interests (as opposed to regulatory goals) than settlement pursuant to the Dutch WCAM.

Given questions about the KapMuG, e.g. vis-à-vis the compulsory subjection of individual claimants to mass litigation due to its scope of application, the sometimes time-consuming ping pong match between lower and higher courts and the not yet fully clarified balancing of interests in the newly introduced opt-out settlement, as well as the ongoing debate at the EU level, model case procedures will remain on the legislative agenda in the future.

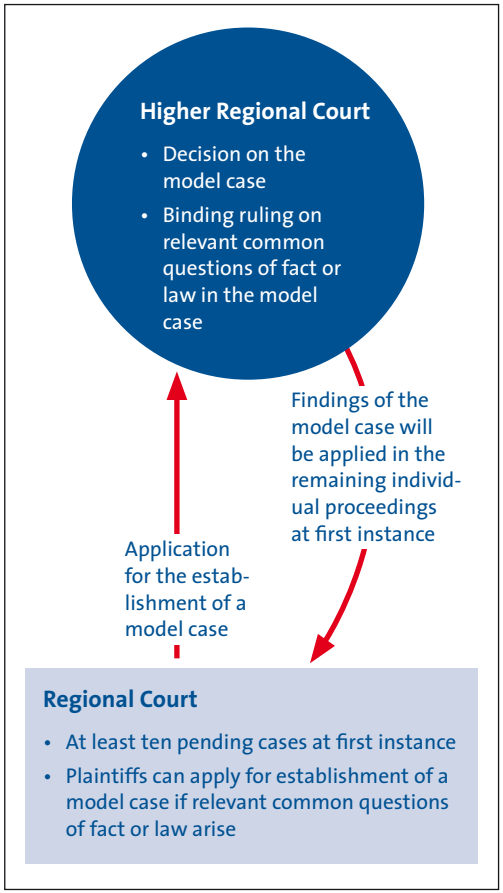

Figure 1: The model case procedure under the KapMuG

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The full paper will be published in the European Business Organization Law Review (Vol. 15) and is available at: http://ssrn.com/abstract=2352248

Should Board Members of Municipal Savings Banks disclose their Remuneration?

Helmut Siekmann
Goethe University & SAFE

In contrast to ministers, members of parliaments or judges, board members of public savings banks generally do not disclose their remuneration. In August 2013, the Pirate faction in the North-Rhine Westphalian state parliament demanded the obligatory filing of these board members' remuneration in a machine readable database. In an expert opinion to the budget and finance committee of the parliament, Helmut Siekmann comes to the conclusion that the states indeed have the competence for legislation in this field. Moreover, the proposed legal obligations do not infringe fundamental rights, such as the right to privacy derived from the general personality rights.

This advisory opinion deals with an important aspect of the disclosure of remunerations in the largest banking sector in Germany. Parallel to the discussion on the disclosure of the remuneration of board members of listed companies, attempts were undertaken on the state level to increase the transparency of remuneration in companies controlled by states or municipalities. Specifically, the municipal owners of savings banks in the state of North-Rhine Westphalia have been obliged by sect. 19 (6) of the Savings Banks Act (Sparkassengesetz), inserted 2009, to "work towards" publishing the individual remunerations of each member of the advisory board, the management board and similar bodies. However, this provision has to a large extent remained ineffective, not least because the State Superior Court at Cologne ("Oberlandesgericht") had issued an injunction prohibiting the disclosure, as to its opinion the provision is void, due to the lack of competence for legislation by the state.

It is against this background that the Pirate faction in the state parliament of North-Rhine Westphalia introduced a bill "for the disclosure of the remunerations of board members of Sparkassen (municipal savings banks) in the Internet". Upon closer scrutiny, the legal concerns in view of the state-competence for legislation on the disclosure of remuneration and in view of the fundamental rights or the substantive due process requirements are in fact not justified. It is part of the "formal" savings banks law, which falls under the legislative powers of the states, no matter how they are shaped in detail.

Legislative powers of the state

The Basic Law (German federal constitution) provides as general rule that the states dispose of legislative powers whenever the Basic Law does not provide the federal government explicitly with this power (Article 70 (1)). By this, the states command the residual legislative competence in the Federal Republic of Germany. Such an explicit competence of the federal government could be derived from Article 74 No. 11 Basic Law, which transfers legislative powers in the fields of commerce and banking to the federal level. On the basis of this clause a federal statute on the disclosure of board remuneration had been enacted in 2005. The legislation, however, does not exclude state legislation mainly for two reasons: The organization of the municipal savings banks has always been considered to be part of the administrative powers of the states even if their operations fall under the federal Banking Act (1). The federal statute sets only minimum standards for a small fraction of

enterprises and is by its nature and objective not conclusive (2).

(1) The municipal savings banks in the state of North-Rhine Westphalia – as in almost all other states – are organized as legal persons. They have to discharge a public task and are subject to the basic principles of administrative law. As an indirect part of the executive branch of government, they have to meet the demands for guidance and control by the citizens and their representatives in parliamentary bodies. The remunerations of state or municipal employees need to be more transparent than in the private sector, not least because of the far reaching liability of the public for their activities and the dangers of self-serving in well endowed positions in this sector, which is difficult to control.

Even if the Savings Banks Act (Sparkassengesetz) denominates savings banks as commercial enterprises, the law still acknowledges, for good reason, that they have to deliver a specific service to the general public. This public task is not ancillary, but an essential part of the reason and justification for the existence of these banks. Within the jurisdiction of its municipal owner (Träger) a savings bank has to provide banking services for everyone, no matter what her financial status; an obligation which does not exist for the other credit institutions in the market. They are, by law, obliged to secure these services for the population and the economy as affordable and as safe as possible. These specific tasks and the effect of management decisions on the public budget justify enhanced transparency and control.

(2) The transparency and control of public enterprises have other objectives and originate from other sources than the reporting requirements regulated by federal law. In the first place, the latter are designated to inform capital markets and not parliamentary bodies or the general taxpayer. In addition, these requirements are not only aiming at a different aim, but they also only set minimum standards. They are open for additional requirements set by state legislation.

Violation of basic rights and due process requirements

The proposal also does not violate the right to privacy derived from the general personality rights (Article 2 (1) in conjunction with Article 1 (1) Basic Law). Admittedly, it curtails the legal protection of individual citizens, to decide, when and to what extent they want to disclose circumstances of their personal life. However, this regulation follows an objective approved by the German Basic Law. The transparency of the remuneration in public enterprises is an acceptable legislative objective; even more in respect to the special public tasks the savings banks have to discharge. Weighing the intrusion and the objectives pursued, it has to be considered that the closer privacy sphere is not touched.

The proposed legislation is also consistent with the requirements of due process. Specifically they do not violate the principle of proportionality. Especially in the current situation, after having experienced the behavior of private credit institutes and following the ongoing discussion about a participation of creditors (i.e. depositors) in bank losses ("bail-in"), a reliable and safe credit institute, which primarily accomplishes a public service, is more important than ever. The disclosure of remunerations is appropriate, especially given that the publication of the remunerations of judges, superintendents (of the police), ministers and the German Federal President is also not considered as inappropriate interference.

The full article is available in German at:
http://safe-frankfurt.de/uploads/media/Siekmann_Offenlegung_Sparkassenbezuege.pdf

Selected Policy Center Publications

Aldasoro, I., Faia, E. (2014)
"The Fiscal Compact and Government Debt: One Law, Multiple Statistics ",
Policy Letter 22, SAFE Policy Center

Elliott, D. J., Rauch, C. (2014)
"Lessons from the Implementation of the Volcker Rule for Banking Structural Reform in the European Union",
White Paper 13, SAFE Policy Center

Gomber, P., Jäger, B. (2014)
"MiFID: Eine systematische Analyse der Zielerreichung",
White Paper Series No. 14, SAFE Policy Center

Gropp, R. (2014)
"How Important Are Hedge Funds in a Crisis?",
Policy Letter 23, SAFE Policy Center

Haliassos, M. (2014)
"The Fiscal Crisis as a Crisis in Trust",
Policy Letter No. 25, SAFE Policy Center

Issing, O., Krahnen, J. P. (2014)
"Transcript of a hearing before Members of the House of Lords (UK) in Frankfurt on Genuine Economic and Monetary Union and its Implication for the UK",
Policy Letter 21, SAFE Policy Center

SAFE Contributes to CEPS Ideas Lab

On 3 and 4 April, SAFE organized the finance session of the CEPS Ideas Lab on "Does Europe Matter?" in Brussels, a conference that consisted of ten parallel labs on the key dimensions of European integration, such as energy, foreign policy or economics. The finance lab was comprised of three sessions; the first, entitled "Banking Union I: The ECB on the move", had Philippe Lamberts (MEP, Group of the Greens) and Alexander Italianer (European Commission) as panelists, with Karel Lanoo (CEPS) acting as moderator. There was a heated debate among participants about the possible conflict of interest between the traditional and new functions of the European Central Bank and on the need for democratic checks and balances.

The second session on "Banking Union II: Restructuring without the public purse" brought together Eddy Wymeersch (Public Interest Oversight Board), Thomas Huertas (Ernst & Young) and Ludger Schuknecht (German Ministry of Finance); Tobias Tröger (Goethe University & SAFE) acted as moderator. The discussion focused on the importance of clear communication in regulation, of consistent macroprudential oversight and of a good planning of banking resolution.

The last panel on "Less Banking? What financial system for an ageing Europe?" included John Llewellyn (Llewellyn Consulting), Sven Giegold (MEP, Group of the Greens) and Alessio Pacces (Erasmus Universiteit Rotterdam), and was moderated by Andreas Hackethal (Goethe University & SAFE). It dealt with institutional differences between Member States in the area of banking and capital markets and the necessity of European Union legislation taking account of this.

Alexander Ludwig joins SAFE Macro Team

Alexander Ludwig has taken over the SAFE Professorship of Public Finance and Debt Management. His research focuses on dynamic macroeconomics with heterogeneous agents, public finance and computational economics. Before coming to Frankfurt, Alexander Ludwig was a Professor for Macroeconomics at the University of Cologne's Center for Macroeconomic Research. Previously, he had been working at the University of Mannheim where he had also earned his doctoral degree in 2005. He spent research visits at the Universities of Barcelona (Pompeu Fabra) and Berkeley.

Alexander Ludwig is Director of the FiFo Institute for Public Economics at the University of Cologne, Senior Fellow at the Munich Center for the Economics of Aging (MEA), Research Fellow at the University of Tilburg's Network for Studies on Pensions, Aging and Retirement (Netspar) and Research Associate at the Centre for European Economic Research (ZEW) in Mannheim.

Vikrant Vig joins IMFS

Vikrant Vig has taken over the Endowed Chair of Financial Economics at the Institute for Monetary and Financial Stability (IMFS). Curently, he is on leave from his position as Professor of Finance at London Business School. In 2008, he earned a Ph.D. from Columbia University. Vig's fields of interest are Corporate Finance, Law and Finance, Banking, and Organizational Economics. In various publications, he analyzed the subprime crisis in the United States. In collaboration with Deutsche Bundesbank, he investigated aspects of banking regulation and supervision.

Vig is a co-editor of the "Review of Finance" and associate editor of the "Journal of Financial Intermediation" and "Finance Research Letters". Organizations worldwide are making use of his expertise. He gave talks at renowned institutions such as the universities of Harvard, Chicago, Berkeley, Yale, Wharton and Columbia and also was a Visiting Scholar at the Reserve Bank of India in 2005.

Deyan Radev Awarded Best Dissertation Prizes

SAFE researcher Deyan Radev has received two best dissertation awards: the Hochschulpreis of the Deutsches Aktieninstitut (DAI) for the best habilitation or dissertation, which is awarded to young researchers who write their theses on topics related to the stock and capital markets; and the Sonderpreis of the Johannes Gutenberg University Mainz (JGU), awarded in cooperation with the Deutsche Bundesbank, for outstanding scientific achievements. Radev completed his Ph.D. studies in economics at Goethe University's Graduate School of Economics, Finance, and Management and at JGU in July 2013, after having been supervised by Isabel Schnabel and Jan Pieter Krahnen. His dissertation on "Systemic Risk and Contagion in the European Union" adds to research on the question of how systemic risk and the contagious feedback effects between euro area sovereigns and the European Union banking system should be assessed, by introducing a new systemic risk contribution measure.

Merits and Risks of Joint European Debt Instruments

In July 2013, the European Commission established an "Expert group on a debt redemption fund and eurobills" to analyze the merits and risks of these joint European debt instruments. The expert group was chaired by Gertrude Tumpel-Gugerell, who presented its results in a SAFE Policy Center Lecture on 7 May. The group came to the conclusion that both instruments would generally be beneficial for financial integration in Europe, but only if they are introduced in such a way that the problem of moral hazard is avoided. As a further drawback of a debt redemption fund, the former ECB board member mentioned that it would lead the way to a fiscal union and increase funding costs for countries with good credit ratings. Furthermore, introducing eurobills would entail the risk of triggering a political debate on longer-term joint debt instruments.

A Stress Test for Models – The Macroeconomic Model Data Base 2.0

What are the consequences of a cut in interest rates? How effectively can the economy be boosted by applying certain measures? These questions can be answered more precisely on the basis of the latest version of the "Macroeconomic Model Data Base" (MMB 2.0), which is part of a SAFE research project pursued by Volker Wieland and his team. In the MMB 2.0, one can find 61 macroeconomic models, e.g. from the European Commission, the International Monetary Fund, the Federal Reserve, the European Central Bank as well as several other central banks – including those that contain a detailed modeling of the financial sector. There are more than 4,500 registered users worldwide for the platform, which is accessible via www.macromodelbase.com. Users can analyze the consequences of a cut or a rise in interest rates, a tax reform or a stimulus package, using different models at the same time. The tool thus helps to clarify the strengths and weaknesses of various models.

Selected Publications

Angeloni, I., Faia, E., Winkler, R. (2014)
"Exit Strategies",
forthcoming in European Economic Review.

Bluhm, M., Krahnen, J. P. (2014)
"Systemic Risk in an Interconnected Banking System with Endogenous Asset Markets",
forthcoming in Journal of Financial Stability.

Camera, G., Gioffré, A. (2014)
"Game-Theoretic Foundations of Monetary Equilibrium",
Journal of Monetary Economics, Vol. 63, pp. 51-63.

Fellner, G., Theissen, E. (2014)
"Short Sale Constraints, Divergence of Opinion and Asset Prices: Evidence from the Laboratory",
Journal of Economic Behavior & Organization, Vol. 101, pp. 113-127.

Gal, J. (2014)
"The German Insurance Ombudsman System",
in Ünan, S. (ed.), Alternative Dispute Resolution Systems Regarding Private Insurance, Istanbul, pp. 9-44.

Groth, S., Siering, M., Gomber, P. (2014)
"How to Enable Automated Trading Engines to Cope with News-Related Liquidity Shocks? Extracting Signals from Unstructured Data",
Decision Support Systems, Vol. 62, pp. 32-42.

Haar, B. (2014)
"Normanerkennung, Normbefolgung und Economic Behavior: eine Studie zu Verbindlichkeitsstrukturen im Wirtschaftsrecht am Beispiel der Corporate Governance",
Archiv für Rechts- und Sozialphilosophie (ARSP), Vol. 100, pp. 219-242.

Hebous, S., Lipatov, V. (2014)
"A Journey from a Corruption Port to a Tax Haven",
forthcoming in Journal of Comparative Economics.

Horneff, V., Kaschützke, B., Maurer, R., Rogalla, R. (2014)
"Welfare Implications of Product Choice Regulation during the Payout Phase of Funded Pensions",
forthcoming in Journal of Pension Economics and Finance.

Langenbucher, K., Kaprinis, K. (2014)
"Private Enforcement of Investor Protection – is Private Law up for the Challenge? A Glance at the United Kingdom",
forthcoming in Festschrift zum 100-jährigen Jubiläum der Goethe-Universität Frankfurt, Fachbereich Rechtswissenschaft.

Paciello, L., Wiederholt, M. (2014)
"Exogenous Information, Endogenous Information and Optimal Monetary Policy",
forthcoming in Review of Economic Studies.

Schulze, C., Schöler, L., Skiera, B. (2014)
"Not All Fun and Games: Viral Marketing for Utilitarian Products",
Journal of Marketing, Vol. 78, Issue 1, pp. 1-19.

Zulehner, C., Hackl, F., Kummer, M., Winter-Ebmer, R. (2014)
"Market Structure and Market Performance in e-commerce",
forthcoming in European Economic Review.

Recent SAFE Working Papers

No. 51 **Aït-Sahalia, Y., Laeven, R. J. A., Pelizzon, L.**
"Mutual Excitation in Eurozone Sovereign CDS"

No. 50 **Angeloni, I., Faia, E., Winkler, R.**
"Exit Strategies"

No. 49 **Gabriele, C., Casari, M., Bortolotti, S.**
"An Experiment on Retail Payments Systems"

No. 48 **Bluhm, M., Krahnen, J. P.**
"Systemic Risk in an Interconnected Banking System with Endogenous Asset Markets"

No. 47 **Kosfeld, M., Schüwer, U.**
"Add-On Pricing in Retail Financial Markets and the Fallacies of Consumer Education"

No. 46 **Bluhm, M., Faia, E., Krahnen, J. P.**
"Monetary Policy Implementation in an Interbank Network: Effects on Systemic Risk"

No. 45 **Castiglionesi, F., Feriozzi, F., Loranth, G., Pelizzon, L.**
"Liquidity Coinsurance and Bank Capital"

No. 44 **Schendel, L.**
"Critical Illness Insurance in Life Cycle Portfolio Problems"

No. 43 **Schendel, L.**
"Consumption-Investment Problems with Stochastic Mortality Risk"

No. 42 **Gropp, R., Krainer, J., Laderman, E.**
"Did Consumers Want Less Debt? Consumer Credit Demand versus Supply in the Wake of the 2008-2009 Financial Crisis"

The Suitability of the Future European Banking Regulation must Prove in Practice

Tarek Al-Wazir
Minister of Economics, Energy, Transport and Regional Development, State of Hessen

The financial crisis has bluntly revealed the deficits in the regulation and supervision of the financial sector. Insolvency and aid provisions have proven inappropriate to orderly resolve a systemically important bank in distress. After the essential components of a European Banking Union were adopted in early 2014, the cornerstones of a new regulatory structure for Europe are now in place. These are, in particular, stricter regulatory standards (Capital Requirement Directive IV, Capital Requirement Regulation), the Single Supervisory Mechanism (SSM), which is being supplemented by common rules for the reorganization and resolution of banks (Single Resolution Mechanism (SRM), Bank Recovery and Resolution Directive (BRRD)), as well as a European deposit guarantee scheme (DGSD). In January 2014, the European Commission has added a further element by presenting a directive proposal on structural reforms in the European banking sector.

This new regulatory setting provides the fundamental prerequisites for a more stable financial system and a more effective banking supervision. It gives the involved institutions – especially the European Central Bank (ECB) as banking supervisor – a flexible amount of power that they should resolutely use to guarantee the reliable framework that the legislator has aimed for. There is, for example, flexibility concerning the question of when, in the future, public funds can exceptionally be used for the resolution of a bank.

The new regulatory framework aims at resolving systemically relevant banks in the case of default without threatening financial stability. This will be possible by strictly bailing in the banks' owners and creditors without drawing on the tax payer. In exceptional circumstances and in the interest of financial stability, public funds (e.g. via the European Stability Mechanism) can, also in future, be used to finance a bank's resolution. In extreme cases, such funds can even replace the resolution fund – a difficult weighing up that needs to consider above all the tax payers' interests.

A second case is the planned separation of deposit banking and investment banking – doubtlessly an appropriate measure as it secures saving deposits and forces banks to back their own investments with more equity. However, both the corresponding German law and the EU directive proposal leave it to the supervisor to determine how much business to separate. In my view, there should be a strict separation between a bank's proprietary trading and its financing and deposit services for the real economy.

A further issue will be the differentiation between systemically relevant institutions that are correctly in the focus of the EU Supervisory and Resolution Mechanisms (SSM, SRM, BRRD) as compared to smaller institutions such as regional savings banks and mutual savings banks that remain under national supervision. In this respect, the practice will show whether the ECB's supervisory priorities are correct.

I welcome the considerable progress in financial market regulation that has been made during the last two years. Nevertheless, important regulatory projects are still due. For example, we urgently need a common set of rules that enables a better supervision of the shadow banking sector. European and, in the long run, international rules need to shed light on these shadow markets. Also, high frequency trading raises questions. Progressing financial market regulation will continue to be a key issue on the political agenda.

Events

June

Tuesday, 3rd
12.15 – 1.45 pm
Frankfurt Seminar in Macroeconomics – joint with SAFE
Speaker: Sule Alan, University of Essex

Wednesday, 4th
12.30 – 2.00 pm
CFS Lecture on the Order of Money
Macroprudential policies in the euro area: issues for the next ten years
Speaker: Valerie Herzberg, Member of the Cabinet, President of the European Council

Wednesday, 4th – Thursday, 5th
SAFE Conference
First International Conference on Sovereign Bond Markets

Friday, 6th – Saturday, 7th
SAFE Policy Center Workshop
Financial Regulation: A Transatlantic Perspective

Tuesday, 10th
4.15 – 5.30 pm
Finance Seminar – joint with SAFE
Speaker: Claire Celerier, University of Zurich

Thursday, 12th
12.15 – 1.45 pm
Frankfurt Seminar in Macroeconomics – joint with SAFE
Speaker: Per Krusell, IIES Stockholm University

Saturday, 14th
SAFE Conference
Austerity and Growth: Concepts for Europe

Tuesday, 17th
2.15 – 3.45 pm
Frankfurt Seminar in Macroeconomics – joint with SAFE
Speaker: Ufuk Akcigit, University of Pennsylvania

Tuesday, 24th
4.15 – 5.30 pm
Finance Seminar – joint with SAFE
Speaker: Vasso Ioannidou, Tilburg University

Friday, 27th
12.00 pm
ILF Guest Lecture
Private Enforcement of Securities Law in China: A ten-year Retrospective and Empirical Assessment
Speaker: Robin Hui Huang, University of Hong Kong

July

Tuesday, 1st
4.15 – 5.30 pm
Finance Seminar – joint with SAFE
Speaker: Lukas Schmid, UCLA Anderson School of Management

Tuesday, 1st
2.15 – 3.45 pm
Frankfurt Seminar in Macroeconomics – joint with SAFE
Speaker: Mariacristina De Nardi, Federal Reserve Bank of Chicago

Wednesday, 2nd
5.30 pm
CFS Lecture
Betting the House: Bank Credit, Real Estate Prices, and Financial Crises
Speaker: Moritz Schularick, University of Bonn

Monday, 7th
5.00 pm
EFL Jour Fixe
On the Relevance of Security Risks for Cloud Adoption in the Financial Industry
Speaker: Olga Wenge, E-Finance Lab

Tuesday, 8th
2.15 – 3.45 pm
Frankfurt Seminar in Macroeconomics – joint with SAFE
Speaker: Leo Kaas, University of Konstanz

Tuesday, 8th
5.30 pm
CFS Colloquium
Speaker: Christian Leuz, Chicago Booth

Monday, 14th – Thursday, 31st
GBS Executive Program
Strategic Management of Financial Groups

Wednesday, 16th
SAFE Policy Center Lecture
Speaker: Ewald Nowotny, Gouvernor of the Oesterreichische Nationalbank

Thursday, 17th
SAFE Policy Center Lecture
Speaker: Craig M. Lewis, U.S. Securities and Exchange Commission

September

Tuesday, 2nd
4.15 – 5.30 pm
Finance Seminar – joint with SAFE
Speaker: Michael Hasler, Rotmann School of Management

Tuesday, 2nd – Wednesday, 3rd
SAFE Summer Academy

Monday, 8th – Friday, 19th
ILF Summer School I
Banking and Capital Markets Law

Tuesday, 9th
4.15 – 5.30 pm
Finance Seminar – joint with SAFE
Speaker: Anjan Thakor, Washington University in St. Louis

Tuesday, 9th – Wednesday, 10th
3rd ICIR Conference on Global Insurance Supervision
Fit for Global Thinking?

Wednesday, 10th
5.30 – 7.00 pm
CFS Presidential Lecture
Zukunftsperspektiven des Europäischen Bankensystems: Herausforderungen und Chancen
Speaker: Axel A. Weber, Chairman of the Board of Directors, UBS

Friday, 12th – Saturday, 13th
SAFE Conference
European Conference on Household Finance

Thursday, 18th – Friday, 19th
8.00 am
ILF Seminar
What role will ECB, Commission, Board and national authorities play?

Monday, 22nd – Thursday, 2nd
ILF Summer School II
Corporate Law and Governance

Thursday, 25th – Friday, 26th
SAFE Conference
13th International Conference: CREDIT 2014

Monday, 29th – Thursday, 2nd
ILF Summer School III
M&A Transactions and Law of Transformations

Tuesday, 30th
SAFE Asset Pricing Workshop

Please note that for some events registration is compulsory.

CFS Center for Financial Studies | EFL E-Finance Lab | GBS Goethe Business School | ICIR International Center for Insurance Regulation | ILF Institute for Law and Finance | IMFS Institute for Monetary and Financial Stability

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