

The Impact of Weather on German Retail Investors_4

Jochen M. Schmittmann • Jenny Pirschel • Steffen Meyer • Andreas Hackethal

Contingent Convertible Securities: from Theory to European Regulation_6

Andreas Cahn • Patrick Kenadjian

“Credit Risk of Financial Institutions has Increased through Basel II”_8

Rainer Haselmann

IMPRINT

Publisher:

Prof. Dr. Wolfgang König • Executive Board
Research Center SAFE
House of Finance • Goethe University
Grüneburgplatz 1
60323 Frankfurt am Main • Germany

Editors:

Dr. Muriel Büsser
Bettina Stark-Watzinger
Prof. Dr. Wolfgang König

Contact:

info@safe-frankfurt.de
www.safe-frankfurt.de

Design:

Novensis Communication GmbH
Bad Homburg

4th Edition

Copyright © by the Research Center SAFE,
Frankfurt am Main

Printed in Germany

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

The Impact of Weather on German Retail Investors_4

Jochen M. Schmittmann • Jenny Pirschel • Steffen Meyer • Andreas Hackethal

Contingent Convertible Securities: from Theory to European Regulation_6

Andreas Cahn • Patrick Kenadjian

Interview:

“Credit Risk of Financial Institutions has Increased through Basel II”_8

Rainer Haselmann

What Does U.S. Money Market Mutual Fund Reform Portend for the European Union?_10

Craig M. Lewis • Christian Schlag

2nd SAFE Conference on Financial Market Policy:

Banking Beyond Banks_14

News_12

Selected Publications_13

Events_15

Editorial



Jan Pieter Krahen
Director, SAFE

Sound and comprehensive data sets are a major resource for research. Empirical studies that rely on such data play an increasingly important role in finance and macroeconomics. For this reason, from the very beginning, SAFE has made huge efforts to provide its researchers with all the data they need for their work, e.g. by facilitating access to commercial databases and cooperating with institutions that collect and process valuable data sets.

A great success in this regard was celebrated on 6 November, when a formal inauguration ceremony was held to mark the opening of a new research data center at the House of Finance. This center allows for direct access to the data resources of Germany’s Federal Statistical Office and its state counterparts (see page 12). At two specially created workplaces, guided by employees from the state statistical offices, researchers will be able to access a universe of anonymized micro data, analyze them and take them as a basis for future research. The new research data center is a prime example of how cooperation between academia and statistical offices can help stimulate research while ensuring data protection. We aim to expand the reach of this data network to other relevant institutions in Germany and Europe.

Access to German and European data is also of utmost importance for research to evaluate government policy and provide forward-looking recommendations on this basis. As there are hardly any financial pan-European data sets, finance scholars often use data from the United States, where the integration of different databases is more advanced. However, due to several factors, including legal and institutional differences, there is only a limited extent to which the policy recommendations resulting from these empirical analyses can be transferred to Europe, if at all possible.

The financial and debt crises have demonstrated that there is a strong need for some “catching up” with respect to data resources in Europe. The shadow banking sector, the subject of this year’s SAFE Policy Center Conference held on 17 October, provides a good example of this. Both Vítor Constâncio and Claudia Buch (vice presidents of the European Central Bank and the Deutsche Bundesbank respectively) stressed the importance of improving data availability, statistics and knowledge of non-bank banking (see page 14).

A number of initiatives are currently being undertaken around the world with the objective to improve financial data sets. For Germany and Europe as a whole, it is crucial that our society and institutions need to become more open towards the needs of academia and research. We urgently require more European data for analyses that can provide solid information on the possibilities and risks of our particular institutional setup.

Yours sincerely,
Jan Pieter Krahen

The Impact of Weather on German Retail Investors



Jochen M. Schmittmann
International Monetary Fund



Jenny Pirschel
Goethe University & GSEFM



Steffen Meyer
Leibniz University Hannover
& SAFE



Andreas Hackethal
Goethe University & SAFE

The influence of weather on financial markets is a prime example of non-rational behavior and market inefficiency. Several behavioral finance studies document a relationship between weather conditions and stock market returns, in keeping with psychological theories that see non-news related exogenous environmental variables as having an impact on investors' trading behavior. It is assumed that weather affects a person's mood, and that this has consequences for aggregate trading flows and possibly prices. However, there are few studies investigating the precise channel through which weather conditions may impact individual trading decisions.

In a new study, we test whether there is a relationship between weather and individual trading behavior by using a sample of more than 50,000 customers of a large German brokerage house. Figure 1 shows the trading behavior of these individuals on good and bad weather days. After controlling for the frequency of good and bad weather conditions, we find that retail investors tend to trade less when the weather is pleasant. However, if they are trading on days with good weather, their activity tends to be more on the buying side than on the selling side. We use panel methods to confirm these descrip-

tive results and to investigate weather-induced investor behavior in more detail.

A major difference to earlier empirical studies is that we are able to exclude quasi-automatic trades from our data set that cannot be related to weather, such as savings plan transactions. Another innovation is the use of panel regressions at the individual investor level. This approach accounts for differences in personality among individuals and avoids any information loss resulting from the aggregation of trading behavior at the city or weather station level

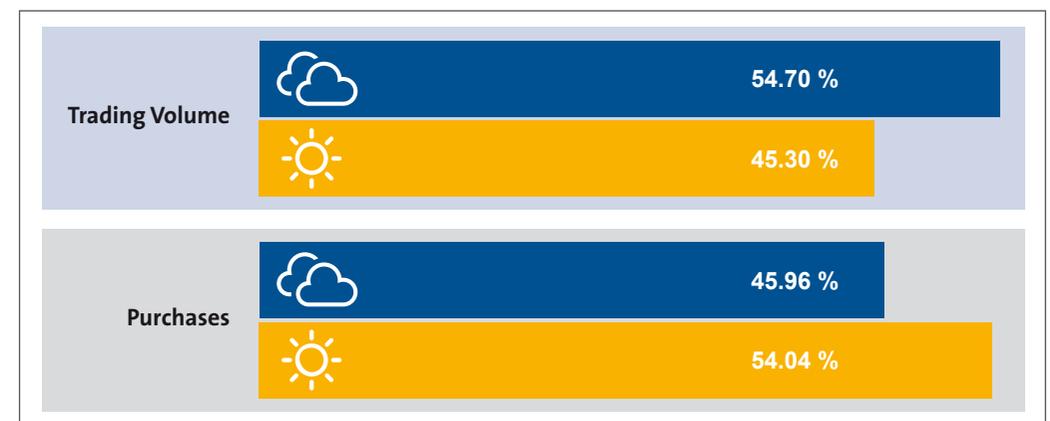


Figure 1: Trading behavior of retail investors in the period 2000-2007

(a method commonly used in previous empirical studies). Furthermore, our sample includes only self-directed online investors whose trading decisions are not influenced by third parties, such as financial advisors. To clearly identify the impact of weather conditions on the trading behavior of individual investors and to avoid any spurious results, seasonally adjusted weather variables are used, as well as control variables for various calendar effects.

The sentiment effect of weather

We find a significant positive relationship between nice weather, i.e. high temperature/high air pressure and investor purchases (relative to sales). For cloud cover, a relevant weather variable widely used in the finance literature, there is no anticipated effect on trading at the aggregate weather station level. However, at the individual investor level, it can be expected that there is a negative relationship between investors' propensity to buy and cloud cover/precipitation. These findings establish the link between weather and individual investor trading which has been missing up until now. In addition, our empirical study suggests a potential

risk tolerance channel through which weather affects securities purchases. On days with favorable weather, retail investors not only tend to buy, rather than sell, but they also tend to purchase more high-risk securities than low-risk securities. A good mood seems to increase investors' risk tolerance. That result is in line with past studies in the field of psychology and with experiments recently conducted by Bassi, Colacito, and Fulghieri (2013).

The opportunity cost effect of weather

Our research presents another novel result concerning the impact of poor weather on overall trading activity. On days with bad weather, retail investors trade significantly more than on other days. One possible explanation is that investors incur an opportunity cost vis-à-vis the amount of time spent trading, particularly on good weather days. A similar effect has been documented by Hong and Yu (2009), who show that trading activity declines during holidays. These findings suggest that investors forego or postpone trading when the weather is nice and the number of pleasurable outside options increases.

The interaction between the two weather effects

Altogether, our results suggest that the impact of weather on the average investor is twofold: on good weather days, investors trade less (the opportunity cost effect) but tend to buy relatively more, in particular risky securities (the sentiment effect). To provide a detailed analysis of these two interacting weather effects, we divided our sample on the basis of the frequency of trading activity. Frequent traders do not adapt their overall trading pattern to weather. Hence, opportunity costs do not seem to play a big role for them. Yet, on good weather days, they purchase more risky securities, suggesting that they are susceptible to sentiment effects. The opposite can be observed for occasional traders: their overall trading frequency responds quite strongly to swings in weather conditions. Given that occasional traders hardly trade on good weather days, they are much less exposed to the sentiment effect. As a result, the inclination to purchase risky securities on good weather days is much more pronounced for frequent traders than for occasional traders.

The weather, it appears, is one of many answers to the question "what makes investors trade" (Grinblatt and Keloharju, 2001).

References

- Bassi, A., Colacito, R., Fulghieri, P.** (2013) "O Sole Mio: An Experimental Analysis of Weather and Risk Attitudes in Financial Decisions", *Review of Financial Studies*, Vol. 26, Issue 7, pp.1824-1852.
- Grinblatt, M., Keloharju, M.** (2001) "What makes investors trade?", *Journal of Finance*, Vol. 56, pp. 589–616.
- Hong, H., Yu, J.** (2009) "Gone fishin': Seasonality in trading activity and asset prices", *Journal of Financial Markets*, Vol. 12, pp. 672–702.
- The full paper was first published online in the Review of Finance (June 4, 2014) and is available at: <http://rof.oxfordjournals.org/content/early/2014/06/04/rof.rfuo20.short>*

Contingent Convertible Securities: from Theory to European Regulation



Andreas Cahn
Goethe University &
Institute for Law and Finance

Two important conclusions drawn from the financial crisis of 2007-09 were that banks had been allowed to operate with too little capital and that too much of what they had been allowed to count as regulatory capital (in addition to common equity) had proved to have little loss absorbing capacity outside of insolvency. Thus, an important strand of financial reform has been to require banks to increase the minimum amount of equity capital they must carry and restrict the kinds of financial instruments (other than common equity) which can count towards bank regulatory capital to those that can absorb losses on a “going concern” basis in order to reduce the probability that a bank will fail.

Why CoCos?

A simple reaction to the crisis could have been to require that only common equity could count as regulatory capital, as suggested by Admati et al. (2010). But it was generally recognized that, notwithstanding their arguments to the

contrary, common equity was the most expensive form of capital. Furthermore, it was argued that, since banks were being required to hold capital not just to meet normal operational requirements but also to cover times of crisis, such additional capital, in the form of the various buffers, might be met by other kinds of financial instruments which would be cheaper to issue than common equity.

This led both academics and policy makers to consider designing a financial instrument which would start out as preferred stock or subordinated debt, but would automatically convert to common equity upon the occurrence of a defined event indicating that the financial health of a bank had deteriorated to a point where it needed more capital. The discussion quickly focused on contingent convertible bonds (CoCos), which would be subordinated obligations that do not share profits in good times (instead they receive a fixed coupon) but automatically share in losses in bad times, being converted into the quintessential first loss instrument – common shares. As debt, they should be cheaper to issue and to service in

normal times than common equity, but in bad times they would become common equity. A variation in which conversion is replaced by writing down principal was developed to allow CoCos to be used by banks which do not issue common equity, and many CoCos have been issued as write-down instruments.

Banking regulation as a limiting factor

Current European banking regulation, namely the requirements of the Bank Recovery and Resolution Directive (BRRD) and of Chapter 3, Section 1 of the Capital Requirements Directive (CRR), effectively limits the amount of CoCos that can count towards a bank’s regulatory capital to a level that, according to prior academic literature, would not be sufficient to have an in terrorem effect on existing shareholders. That is, make them avoid risky behavior and raise new capital before risking “death by dilution” through the conversion of a large number of CoCos. However, based on back-testing data for two large German banks, our article suggests that prior research may have underestimated the dilutive effect which stock price declines could have upon conversion of CoCos

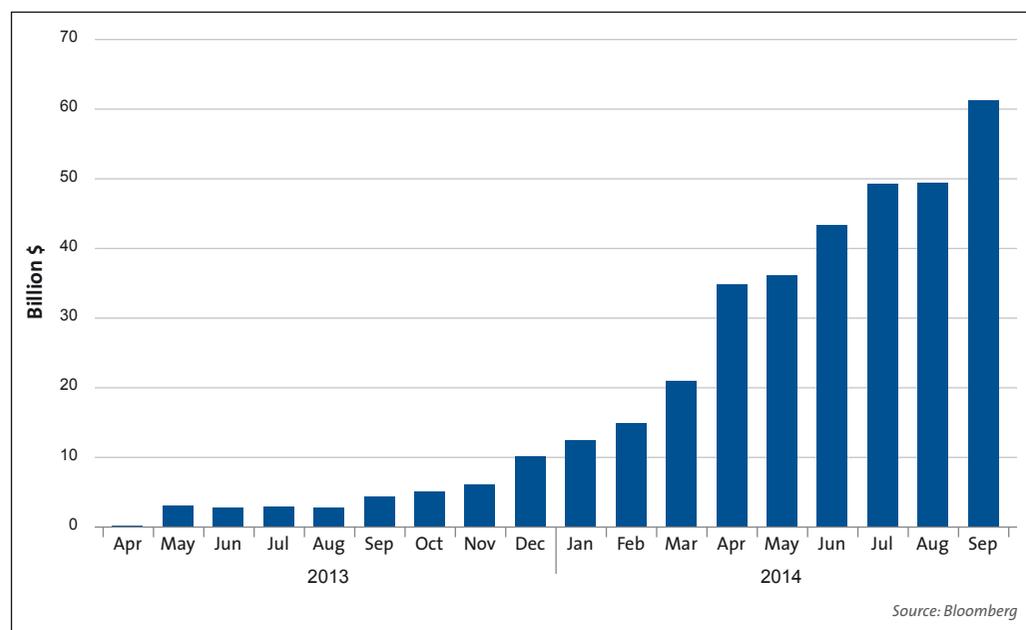


Figure 1: Additional Tier 1 Contingent Convertible deals

and thus overestimated the amount of convertible CoCos needed to achieve their policy ends.

Company law issues

The issuance and conversion of CoCos relies on instruments of company law, namely convertible securities and shares. Therefore, the extent

to which CoCos will be useful as a loss absorption device for bank debt and as a means to incentivize shareholders to avoid risky behavior and to agree to timely increases of capital depends on the applicable company law regime. Critical issues are the limits regarding management authorizations to issue CoCos and shares

upon their conversion, the shareholders' right of pre-emption and the conditions for not applying it, and the requirement of a contribution to the company's capital.

The European framework provided by Directive 2012/30/EU gives rise to a number of questions which merit closer attention than they appear to have received so far, in particular the distinction between contributions in cash and in kind and the scope of the right of pre-emption when preference shares are issued. The transposition of the Directive into the laws of the Member States has produced significant differences between national company laws which, in turn, create obstacles to the use of convertible (as opposed to write-down) CoCos, namely the limits on authorized capital, the specification of a minimum nominal share value, and the additional requirement of a justification for a disapplication of the right of pre-emption by a predominant business purpose under the German Stock Corporation Act (AktG).

While Articles 123 and 54 of the BRRD eliminate such company law-related impediments to the

use of CoCos, the scope of these provisions is limited to CoCos that are issued upon the request of a resolution authority, i.e. it does not cover CoCos that a bank issues under its own discretion. Finally, the idea that CoCos should incentivize shareholders to agree to a timely increase in bank capital so as to avoid greater dilution in the case of conversion – a concept embraced by Article 47 of the BRRD – should be a reason to review the concept of dilution underlying the right of pre-emption. These limitations do not apply to write-down CoCos, but only convertible CoCos can achieve the in terrorem effect described above.

References

- Admati, A., DeMarzo, P.M., Hellwig, M.F., Pfleiderer, P.C.** (2010) "Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Expensive", Rock Center for Corporate Governance at Stanford University, Working Paper No. 86.

The full article is available at: http://www.ilf-frankfurt.de/uploads/media/ILF_WP_143_01.pdf

Interview:

“Credit Risk of Financial Institutions has Increased through Basel II”



Rainer Haselmann
Goethe University & SAFE

Which research questions are you currently focusing on?

My research is about financial intermediaries with a strong focus on the questions of how financial institutions react to regulation and how this reaction affects the real economy, mainly via bank lending. A related field is the examination of how certain regulations come into place, taking a political economy perspective on regulation in the financial sector.

A recent paper of yours focuses on model-based capital regulation that was introduced by the Basel Committee (Basel II). What did this regulation aim for?

Banks have an interest to reduce their equity holdings to a minimum. This is why regulators impose capital charges that reflect the riskiness of loans. The main idea of Basel II was to steer banks' behavior. When a bank invests in a risky asset or provides loans, it should have an adequate equity buffer to bear possible losses. Under Basel I, all bank assets were classified into five broad risk buckets with each of them having a fixed risk weight assigned. The most important novelty of the Basel II regulation was to

allow banks to develop their own internal rating for each client which would then be used to determine how high the capital buffer for this exposure should be. One reason behind allowing banks to assess borrower risk is that they have inside knowledge about their clients and, therefore, should be able to evaluate their risks better than outsiders such as external rating agencies.

However, they have different incentives...

Exactly. Banks have a strong incentive to under-evaluate risks in order to economize on capital charges. For this reason, the banks' risk models have to be certified by the supervisor

on a portfolio basis. This way, so the idea behind this exercise, strategic understatement of risk would be impossible.

What are your findings?

In our paper, we look at the introduction of model-based capital regulation in Germany, which was introduced step-wise because of the time-consuming certification process. The long introduction phase allows us to observe, simultaneously, both regulatory designs within the same bank. We were able to compare portfolios that have been shifted to the new regulation with portfolios that were still under the stan-

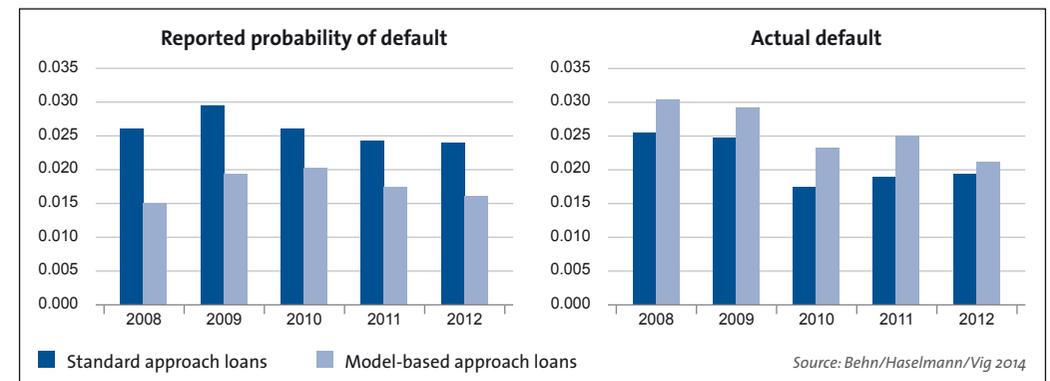


Figure 1: Reported probability of default and actual default rate under the standard and the model-based approach

dard approach but would eventually be shifted. What we find is that the estimated ratings within the standard approach predict the probability of defaults quite well, while the risk models under the new model-based regulation tend to considerably under-predict actual defaults (see Figure 1). This is, of course, quite surprising. The main idea of the new regulation had been to come to a more sophisticated risk assessment. But the outcome was directly opposed.

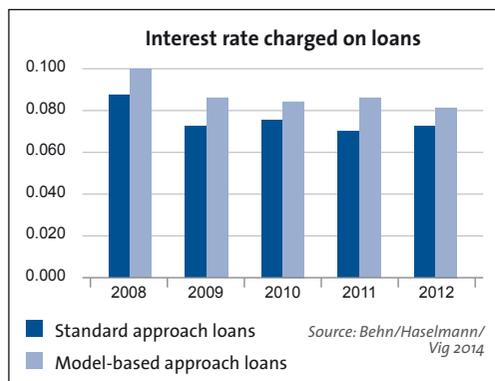


Figure 2: Interest rates charged on loans under the standard and the model-based approach

How do you explain these results? Did the banks manage to manipulate the models despite the certifying process?

This is difficult to say. What can give us an indication are the interest rates that the banks charged their clients on these loans. We find that

the interest rates under the model-based approach are higher than under the standard approach and tend to reflect the actual default patterns and, thus, the real riskiness of the loans (see Figure 2). So, interest rates and reported ratings show opposite patterns. This, in fact, suggests that the banks were quite aware of the riskiness of their loan portfolios.

So, why is the regulated equity buffer not linked to the interest rate charged?

Banks could circumvent such a regulation by charging fees or changing other contractual features instead of adjusting the interest rate. It is nearly impossible to design a regulation which is geared towards getting a regulated entity to act against its own interest.

What lessons need to be drawn from your findings? Should regulation be less complex in order to allow for better supervision?

In theory, a highly complex regime like model-based regulation is clearly better than simple categories for risk assignment. But in practice, especially when enforcement costs are high, this might not be the case. However, I cannot prove that simplicity is always better than complexity. As a reaction to our results, you can also think of even more complex regulation that is supervised by many more regulators.

But I strongly believe that we would benefit from simplicity in the regulation of banks.

What are the implications of your results for financial stability?

When Lehman collapsed in September 2008, a considerable number of the large German banks had already introduced model-based risk regulation while most cooperative and savings banks remained in a standard approach similar to Basel I. The large banks benefitted from the regulation because they were able to reduce capital charges and, thus, to expand their lending – potentially at the expense of smaller banks. We find that banks that opted for the new approach increased their lending by about 9 percent relative to banks that remained under the traditional regime. In other words, this regulation subsidized larger banks, which seems rather paradoxical given the systemic risk associated with larger banks. All in all, our results suggest that the aggregated credit risk of financial institutions has increased through the regulatory framework of Basel II. So, the regulator has failed to meet the objective of better detecting default risks and increasing financial stability.

Behn, M., Haselmann, R., Vig, V. (2014) “The Limits of Model-Based Regulation”, SAFE Working Paper No. 75

Selected Publications by Rainer Haselmann

Hackbarth, D., Haselmann, R., Schoenherr, D. (2014) “Financial Distress, Stock Returns, and the 1978 Bankruptcy Reform Act”, forthcoming in *Review of Financial Studies*.

Althammer, W., Haselmann, R. (2011) “Explaining Foreign Bank Entrance in Emerging Markets”, *Journal of Comparative Economics*, Vol. 39, Issue 4, pp. 486-498.

Haselmann, R., Wachtel, P. (2011) “Foreign Banks in Syndicated Loan Markets”, *Journal of Banking and Finance*, Vol. 35, Issue 10, pp. 2679-2689.

Haselmann, R., Pistor, K., Vig, V. (2010) “How Law Affects Lending”, *Review of Financial Studies*, Vol. 23, Issue 2, pp. 549-580.

Haselmann, R., Wachtel, P. (2010) “Institutions and Bank Behavior”, *Journal of Money, Credit and Banking*, Vol. 42, Issue 5, pp. 965-984.

Haselmann, R., Herwartz, H. (2009) “The Introduction of the Euro and its Effects on Investment Decisions”, *Journal of International Money and Finance*, Vol. 29, Issue 1, pp. 94-110.

What Does U.S. Money Market Mutual Fund Reform Portend for the European Union?



Craig M. Lewis
Vanderbilt University

On 23 July 2014, the U.S. Securities and Exchange Commission (SEC) passed the “Money Market Reform: Amendments to Form PF,” designed to prevent investor runs on money market mutual funds such as those experienced in institutional prime funds following the bankruptcy of Lehman Brothers. The two most important of these amendments are 1) the introduction of Floating Net Asset Value, and 2) providing non-government money market funds with the power of discretionary impositions of liquidity fees and redemption gates. The possibility that systemic liquidity runs occur is mitigated by these reforms.

U.S. money market funds are open-end investment management companies that are registered under the Investment Company Act of 1940 (Rule 2a-7). A money market fund must satisfy constraints on portfolio holdings related to liquidity, maturity, and portfolio composition, as well as satisfy a number of operational requirements. A key feature of money market funds has

been that they price portfolios using amortized cost pricing, which has allowed them to maintain a constant \$1.00 share price. This ability differentiates money market funds from other mutual funds. Many investors find that stable \$1.00 pricing enables them to use money market funds as a cash management vehicle. However, it also confers a first-mover advantage to investors that redeem shares after portfolio losses. They can sell shares for \$1.00 even though the underlying portfolio securities are worth less, forcing remaining shareholders to absorb any capital losses or liquidity discounts.

Investor redemption following the Lehman Brothers bankruptcy

Financial turmoil in 2007 and 2008 put money market funds under considerable pressure, which culminated in September 2008 when Lehman Brothers declared bankruptcy. Investors withdrew approximately \$300 billion from prime money market funds, or 14% of all assets held in those funds. The heaviest redemptions generally came from institutional funds, which placed widespread pressure on fund share prices as credit markets became illiquid.

In response to market events, the SEC in February 2010 tightened the risk-limiting conditions of Rule 2a-7 of the Investment Company Act by requiring funds to maintain a portion of their portfolios in instruments that can be readily converted to cash, reducing the maximum weighted average maturity of portfolio holdings, and improving the quality of portfolio securities. The amendments also included a number of operational requirements, such as reporting portfolio holdings to the SEC on a monthly basis as well as stress testing.

The SEC’s 2014 amendments

The most recent amendments adopted by the SEC on July 23, 2014, specify additional structural and operational reforms designed to ameliorate the residual possibility of investor runs.

The Floating Net Asset Value option requires institutional prime money market funds to value their portfolios at market prices and sell and redeem shares based on those prices. These funds will no longer be allowed to price portfolios using amortized cost pricing at \$1.00. This amendment only applies to institutional prime funds,

because only institutional prime money market funds experienced significant redemption activity during the financial crisis.

The second major amendment makes liquidity fees and redemption gates available to the funds' boards. In the event a fund's weekly liquid assets (WLA) fall below 30%, a board can elect to impose a liquidity fee of no more than 2% or a temporary redemption gate of no more than 10 days during any 90-day period. If WLA drop below 10%, funds will be required to charge a 1% liquidity fee unless the board decides to opt out. By design, liquidity fees are intended to force redeeming shareholders to pay the fair price for the liquidity they are demanding. This becomes especially important during periods when markets are illiquid. Since the 30% minimum reflects significant liquidity, a discretionary fee would only need to be imposed if the board believed that the liquidity discounts reflected in market prices would induce shareholder redemptions.

Implications for Europe

A policy option that was considered in the U.S. and ultimately rejected, but which is still

contained in the proposed EU regulation for money market funds, was to require the funds to hold capital against possible shareholder losses. As residual claimants, capital buffer investors effectively become the "equity holders" and shareholders are converted into "debt holders", i.e. demand depositors.

The European Commission's proposed regulations require a capital buffer of 3%. While a capital buffer of this magnitude could protect shareholders from all but extremely large losses, the opportunity costs of capital need to be considered. The costs of providing this protection must be borne at all times. Those contributing to the buffer deploy valuable scarce resources that could be used elsewhere. Moreover, because the capital buffer absorbs fluctuations in the value of the portfolio, much of the yield of the fund would be diverted to funding the capital buffer, which, in turn, would reduce fund yield. This would change the nature of the product from one offering enhanced yield to one that replicates a government money market fund.

The current EU proposal also disallows the use of amortized cost pricing. We believe that this policy choice is something of a red herring. With appropriate evaluation guidelines, amortized cost does not create material price distortions, it does, however, facilitate intraday liquidity and same day settlement. We therefore believe

that the outright prohibition of amortized cost would impose operational inefficiencies, without providing significant improvements in price transparency.

The full article is available at: <http://safe-frankfurt.de/money-market-mutual-fund-reform>

Selected Policy Center Publications

Franke, G., Krahen, J., von Lüpke, T. (2014)
["Effective Resolution of Banks: Problems and Solutions"](#),
 White Paper 19, SAFE Policy Center.

Goetz, M. (2014)
["Stellungnahme zum Entwurf eines Gesetzes zur Umsetzung der Richtlinie 2014/59/EU \(BRRD-Umsetzungsgesetz\)"](#),
 Policy Letter 31, SAFE Policy Center.

Ignatowski, M., Korte, J. (2014)
["Resolution threats and bank discipline – What Europe can learn for the Single Resolution Mechanism from U.S. experience"](#),
 Policy Letter 33, SAFE Policy Center.

Krahen, J. (2014)
["Implementing bail-in properly"](#),
 Policy Letter 35, SAFE Policy Center.

Krahen, J. (2014)
["Keine Institutionenkonkurrenz auf nationaler Ebene schaffen: das „doppelte AIDA“-Modell"](#),
 Policy Letter 30, SAFE Policy Center.

Steffen, S. (2014)
["Robustness, Validity, and Significance of the ECB's Asset Quality Review and Stress Test Exercise"](#),
 White Paper 23, SAFE Policy Center.

Weichenrieder, A., Hebous, S. (2014)
["What Do We Know about the Tax Planning of German-Based Multinational Firms?"](#),
 White Paper 22, SAFE Policy Center.

Research Data Center Opens at the House of Finance



On 6 November 2014, Axel Wintermeyer, Hessian Minister and Head of the State Chancellery of Hessen, opened a new research data center at the House of Finance in a formal ceremony with welcome addresses by Christel Figgenger, President of the Hessian Statistical Office, and SAFE Director Jan Pieter Krahn. The center, operated in cooperation with SAFE, will provide researchers with direct access to data resources from Germany's Federal Statistical Office as well as its counterparts at the state level. Scientists from universities and independent research institutions will be able to analyze anonymized micro data at two workplaces, guided by employees from state statistical offices.

SAFE Research Area “Financial Institutions” has New Head

The “Financial Institutions” research area, one of five under SAFE's research program, has a new program director. Rainer Haselmann has taken over from Reint Gropp, who is now President of the Halle Institute for Economic Research. Haselmann, SAFE Professor of Finance, Accounting and Taxation since October 2014, was previously a Professor of Finance at the University of Bonn. His research focuses on banking regulation, lending and portfolio allocation (see interview on page 8). Rainer Haselmann is one of six SAFE professors whose position is funded by the state of Hessen's LOEWE research initiative.

New Professor for Finance and Accounting



Jannis Bischof was appointed House of Finance Endowed Professor of Finance & Accounting, funded by Helaba Landesbank Hessen-Thüringen, in summer 2014. Bischof conducts research at the intersection between

financial accounting and banking. In particular, he examines the role of public information in the supervision of banks, the incentives for banks' disclosure behavior, and the relation between disclosure and risk-taking behavior. Before joining Goethe University, he was a Visiting Assistant Professor of Accounting (2013-14) and a Postdoc Researcher (2012-13) at the University of Chicago Booth School of Business. He earned both a Ph.D. and a master's degree from the University of Mannheim, where he also worked as an Assistant Professor (2009-12). During his Ph.D. studies, he visited Harvard University (GSAS Program in Business Economics, 2007-08) and ESSEC Business School in Paris (2006-07).

Policy Lecture on the Euro Area Sovereign Debt Crisis



On 26 September, William R. Cline, Senior Fellow at the Peterson Institute for International Economics, held a SAFE Policy Lecture on “Managing the Euro Area Debt Crisis”. He argued that sovereign debt in the euro area has now reached a point where it is manageable without having to make recourse to formal debt restructuring mechanisms. Sovereign risk spreads have come down substantially, allowing fiscally troubled countries to plan their return to sustainable debt levels through fiscal adjustments and privatizations. Large write-offs in the banking industry are no longer to be expected, which further reduces the level of risk for sovereign debt. Cline cautioned that a formal debt restructuring mechanism for the euro area would entail moral hazard problems. The credibility of public finances hinges on the belief that modern industrialized countries do not default on their debt.

Awards and Honors for SAFE Researchers

- Nicola Fuchs-Schündeln, Professor of Macroeconomics and Development at Goethe University Frankfurt and a principal investigator at the Research Center SAFE, has been elected to the Council of the European Economic Association (EEA) for a term of five years, starting in January 2015. The EEA is the most important European organization for the economics profession, with membership being open to all persons involved or interested in this field. Furthermore, Fuchs-Schündeln has been elected to the Board of Directors of the Review of Economic Studies for the period 2014-17. The Review of Economic Studies is a leading economics journal, consistently ranked among the top five titles.
- Ester Faia, Professor of Monetary and Fiscal Policy at Goethe University and Program Director of SAFE's “Macro Finance” research area, was awarded a Research Fellowship by the Directorate General for Economic and Financial Affairs (ECFIN) of the European Commission for its 2014-15 initiative “Forward to a New Normal: Growth, integration and structural convergence revisited”. The fellows will advise ECFIN staff on mapping out a new economic policy framework, focusing on medium-term growth perspectives, the architecture of the financial system and the European convergence and integration mechanisms.
- Loriana Pelizzon, SAFE Professor of Law and Finance and Program Director of the SAFE Research Lab on Systemic Risk, has been named a joint winner (one of three) in a call for academic research projects using high frequency financial data that was issued by EUROFIDAI. Funded by the French National Center for Scientific Research (CNRS), EUROFIDAI aims to develop financial databases useful to academic researchers in finance. Pelizzon shares this honor with her co-authors Marti G. Subrahmanyam (NYU Stern School of Business) and Jun Uno (Waseda University, Japan).

Selected Publications

Benthaus, J. (2014)

“Making the right Impression for Corporate Reputation: Analyzing Impression Management of Financial Institutions in Social Media”,
Proceedings of the 22nd European Conference on Information Systems (ECIS 2014), Tel Aviv, Israel.

Cahn, A. (2014)

“Gesellschaftsinterne Informationspflichten bei Zusammenschluss- und Akquisitionsvorhaben”,
Die Aktiengesellschaft 2014, pp. 525-534.

Castiglionesi F., Feriozzi, F., Loranth, G.,

Pelizzon, L. (2014)

“Liquidity Coinsurance and Bank Capital”,
Journal of Money, Credit and Banking, Vol. 46,
Issue 2-3, pp. 409-443.

Haar, B. (2014)

“‘Comply or Explain’ im Spannungsfeld von Law and Finance”,
“100 Jahre Rechtswissenschaft in Frankfurt”,
pp. 471-481.

Hackbarth, D., Haselmann, R., Schoenherr, D. (2014)

“Financial Distress, Stock Returns, and the 1978 Bankruptcy Reform Act”,
forthcoming in Review of Financial Studies.

Kraft, H., Schwartz, E. (2014)

“Cash Flow Multipliers and Optimal Investment Decisions”,
forthcoming in European Financial Management.

Langenbucher, K. (2014)

“Aktien- und Kapitalmarktrecht”,
C.H. Beck, 3rd edition.

Recent SAFE Working Papers

No. 75 Behn, M., Haselmann, R., Vig, V.

“The Limits of Model-Based Regulation”

No. 74 Branger, N., Konermann, P.,

Meinerding, C., Schlag, C.

“Equilibrium Asset Pricing in Networks with Mutually Exciting Jumps”

No. 73 Groneck, M., Ludwig, A., Zimper, A.

“A Life-Cycle Model with Ambiguous Survival Beliefs”

No. 72 Ludwig, A., Schön, M.

“Endogenous Grids in Higher Dimensions: Delaunay Interpolation and Hybrid Methods”

No. 71 Harenberg, D., Ludwig, A.

“Social Security in an Analytically Tractable Overlapping Generations Model with Aggregate and Idiosyncratic Risk”

No. 70 Radev, D.

“Assessing Systemic Fragility – a Probabilistic Perspective”

No. 69 Biljanovska, N., Palligkinis, S.

“Control Thyself: Self-Control Failure and Household Wealth”

No. 68 Tröger, T.

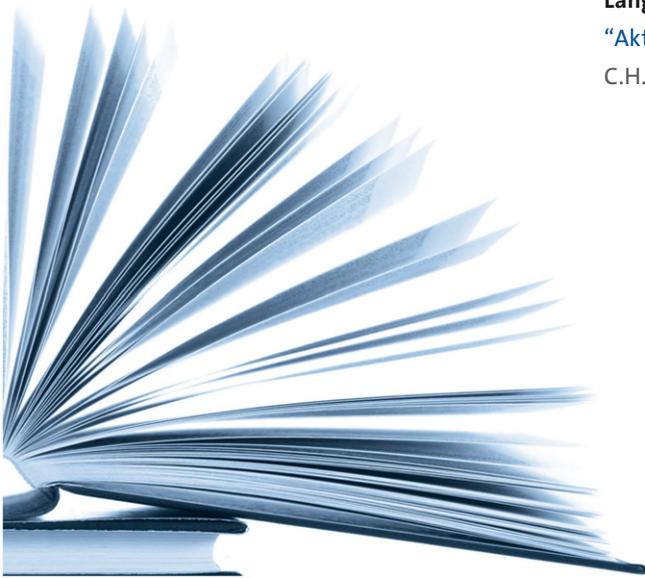
“How Special Are They? – Targeting Systemic Risk by Regulating Shadow Banking”

No. 67 Baghestanian, S., Gortner, P. J., van der Weele, J.

“Peer Effects and Risk Sharing in Experimental Asset Markets”

No. 66 Tröger, T.

“Corporate Groups”



Banking Beyond Banks

On 17 October 2014, the second Frankfurt Conference on Financial Market Policy, organized by the SAFE Policy Center, brought together high-level regulators, academics and industry representatives to discuss the functions and functioning of the non-bank banking sector and the challenges lying ahead for regulators, consumers and practitioners alike. Over 170 participants from more than 15 countries, among them high-level researchers and decision-makers from central banks, supervisory institutions and the financial industry, attended the event held at Goethe University Frankfurt.

The keynote address was given by Vítor Constâncio, Vice President of the European Central Bank (ECB). He argued that the term “shadow banks”, though it seemingly has a strong negative connotation, is fitting none the less, as banking activities outside the regular banking sector are still not visible in monetary statistics and flow of funds accounts, leading to a persistent lack of



Vítor Constâncio, European Central Bank

transparency. He underlined that it should be of highest priority to improve data availability for activities of non-bank banks.

In the first panel session entitled “*What is special/normal about non-bank banking?*”, Claudia Buch, Vice President of Deutsche Bundesbank, noted that the transmission of monetary policy is challenged by the fact that banking-similar ac-



Claudia Buch, Deutsche Bundesbank

tivities are increasingly being conducted beyond the regular banking sector. John Berrigan, Director for Financial Stability, Economic and Financial Affairs in DG ECFIN of the European Commission, emphasized that his institution is interested in promoting securitization, a particular part of the shadow-banking sector. As a complement to the Banking Union, a “Capital Market Union”, a single rulebook for buyers and sellers of securities and related infrastructures, would facilitate market integration in market-based financing. Adrian Blundell-Wignall from the OECD identi-

fied the excessive use of derivatives as one primary cause of the financial crisis. He argued that derivatives continue to be a large source of risk and interconnectedness in non-bank banking.

The second panel on “*Asset Managers: deep pocket specialization, long horizon?*” brought up controversial arguments regarding the role of hedge funds in the context of financial stability. Andreas Billmeier from Stone Milliner Asset Management, argued that hedge funds, while being risky, contribute to market efficiency through arbitrage trading. Anton Brender from Candriam Investors Group praised the fact that securitization provides flexibility to the financial system, both for banks, that want to share the risks of their loan portfolio, and for firms in search of funds. Normalizing securities products and increasing transparency in the markets will make loss behavior predictable and thereby decrease the risks in securitization.

On the third panel on “*Infrastructures: delivering safety and liquidity?*”, Thomas Book, CEO of Eurex Clearing AG, Jean-Michel Godeffroy, ECB and Chairman of the Target 2 Securities Board, and Joachim Nagel, Member of the Executive Board of Deutsche Bundesbank, discussed the vital role of financial market infrastructures, such as central counter parties, central banks

and standard-setting institutions. The question whether central counter parties can themselves become systemically important and whether there should be a requirement also for recovery and resolution plans for financial infrastructures was discussed lively.

In his remarks on *Perspectives*, Nouriel Roubini, Chairman of Roubini Global Economics and Professor of Economics at New York University, criticized current economic policy in Europe as being too little, too late and too slow. In particular, the German government continues to be unwilling to show a stronger fiscal response to the dismal growth outlook for Europe. This would force the ECB into more quantitative easing. On the issue



Nouriel Roubini, Roubini Global Economics & NYU

of shadow banking, Roubini expressed the optimistic opinion that a rise in non-bank banking could go hand-in-hand with the banking sector concentrating on more narrow banking activities, with positive consequences for financial stability.

Events

December

Tuesday, 9th
2.15 pm – 3.45 pm

Frankfurt Seminar in Macroeconomics – joint with SAFE

Speaker: Scott R. Baker, Kellogg School of Management

Tuesday, 9th
4.15 pm – 5.30 pm

Finance Seminar – joint with SAFE

Speaker: Günter Strobl, Frankfurt School of Finance and Management

Friday, 12th
5.15 pm

Applied Microeconomics and Organization Seminar – joint with SAFE

Speaker: Martin Holzacker, University of Rotterdam

Tuesday, 16th
2.15 pm – 3.45 pm

Frankfurt Seminar in Macroeconomics – joint with SAFE

The Geography of Consumer Prices

Speaker: Attila Ratfai, Central European University

Wednesday, 17th
5.15 pm

Applied Microeconomics and Organization Seminar – joint with SAFE

Speaker: Sascha Füllbrunn, University of Nijmegen

January

Tuesday, 13th
2.15 pm – 3.45 pm

Frankfurt Seminar in Macroeconomics – joint with SAFE

Speaker: Nicola Pavoni, Bocconi University

Wednesday, 14th
5.15 pm

Applied Microeconomics and Organization Seminar – joint with SAFE

Speaker: Thomas Gehrig, University of Wien

Tuesday, 20th
2.15 pm – 3.45 pm

Frankfurt Seminar in Macroeconomics – joint with SAFE

Speaker: Andreas Mueller, University of Oslo

Tuesday, 20th
4.15 pm – 5.30 pm

Finance Seminar – joint with SAFE

Speaker: Filippo Ippolito, Universitat Pompeu Fabra, Barcelona

Wednesday, 21st
5.15 pm

Joint SAFE – MM Seminar on Applied Microeconomics and Organization

Speaker: Arno Riedl, Maastricht University

Monday, 26th
5.30 pm – 7.30 pm

CFS / Deutsche Bank Prize in Financial Economics

Workshop on Financial Crises

Speaker: Guillermo Calvo, Columbia University, Nobuhiro Kiyotaki, Princeton University

Tuesday, 27th
2.15 pm – 3.45 pm

Frankfurt Seminar in Macroeconomics – joint with SAFE

Speaker: Charles Noussair, Tilburg University

Tuesday, 27th
4.15 pm – 5.30 pm

Finance Seminar – joint with SAFE

Speaker: Bo Becker, Stockholm School of Economics

Thursday, 29th –
Friday, 30th

SAFE International Workshop P2P Financial Systems 2015: Opportunities, Risks, Market Dynamics, Regulation

Friday, 30th
5.00 pm

ICIR Seminar on Insurance and Regulation

Speaker: Sven Giegold, Die Grünen

February

Tuesday, 3rd
2.15 pm – 3.45 pm

Frankfurt Seminar in Macroeconomics – joint with SAFE

Speaker: Tao Zha, Emory University and Federal Reserve Bank of Atlanta

Tuesday, 10th
4.15 pm – 5.30 pm

Finance Seminar – joint with SAFE

Speaker: Nicolas Serrano-Velarde, Bocconi University

Tuesday, 10th
2.00 pm

EFL Spring Conference Liquidity, Transparency and Electronic Trading in Europe

Tuesday, 10th
2.15 pm – 3.45 pm

Frankfurt Seminar in Macroeconomics – joint with SAFE

Speaker: Thorsten Drautzburg, Federal Reserve Bank of Philadelphia

Thursday, 19th
5.30 pm – 7.00 pm

CFS Presidential Lecture Münzen – Banknoten – Cybergeld: Folgen für die Geldpolitik

Speaker: Jens Weidmann, Deutsche Bundesbank

Thursday, 26th
5.30 pm

CFS Colloquium Risk: The Global Perspective

Speaker: Adair Turner, Institute for New Economic Thinking

March

Wednesday, 4th

CFS Lecture

Speaker: Matthias Danne, DekaBank

Wednesday, 4th –
Thursday, 5th

SAFE Workshop Financial Market Imperfections and Macroeconomic Performance

Tuesday, 10th –
Wednesday, 11th

SAFE Conference on Sovereign Bond Markets

Determinants of sovereign bonds yields and the effectiveness of central bank intervention

Tuesday, 17th
4.15 pm – 5.30 pm

Finance Seminar – joint with SAFE

Speaker: David Solomon, USC Marshall School of Business

Thursday, 19th

CFS Conference on Operational Risk

Speaker: Thomas Kaiser, KPMG and Goethe University

Monday, 23rd
5.30 pm

CFS Colloquium

Speaker: Hyun Song Shin, Bank for International Settlements



LOEWE

Exzellente Forschung für
Hessens Zukunft

SAFE | Sustainable Architecture for Finance in Europe
A Cooperation of the Center for Financial Studies and Goethe University Frankfurt