The Future of Sovereign Borrowing in Europe

Key findings from a conference jointly organised by SUERF, the Oesterreichische Nationalbank and the Austrian Society for Bank Research (BWG) Friday 8 March, 2013

By Ernest Gnan, Secretary General, SUERF and Johannes Holler, OeNB

In March 2013 around 130 participants from academia, banking and finance, governments and central banking gathered at the premises of the OeNB in Vienna for a conference jointly organized by the European Money and Finance Forum SUERF, the OeNB and the Österreichische Bankwissenschaftliche Gesellschaft to discuss “The Future of Sovereign Borrowing.” The financial, economic and sovereign debt crisis has fundamentally changed the rules of the game in sovereign debt markets, particularly in the euro area, but also beyond its borders. Sovereign bonds are no longer widely perceived as “risk-free” assets. Even the sovereign bonds of safe-haven countries have come under close scrutiny or lost some of their prime ratings. Yet crisis countries have seen dramatic downgrades of their sovereign debt ratings so that they face soaring risk spreads and unsustainably high financing costs (or even a loss of access to bond market financing), pushing them towards shorter financing or forcing them to rely on financial support from other countries and the international community, or massive intervention by central banks. Against this backdrop, the conference focused on three aspects: first, how issuers and lenders have reacted to the changed environment (session 1); second, implications of the current and likely future state of public finances and debt markets for financial stability, monetary policy and central banks (session 2); and third, ways to improve risk management and foster caution in future sovereign borrowing (session 3).

Framing the Discussion on the Future of Sovereign Borrowing

In opening the conference, OeNB Governor Ewald Nowotny emphasized the importance of the topic, given that the ability to borrow centrally affects governments’ ability to conduct countercyclical policies, with direct operational and strategic ramifications for monetary policy, particularly in a monetary union. Dysfunctional sovereign debt markets hamper the monetary policy transmission mechanism and may seriously threaten financial and banking system stability. While the virtually zero sovereign risk premiums among euro area countries in the years up to the crisis did not properly reflect true risks, the very large spreads over the past two years were exaggerated, too – and both conditions are signs of market failure. The Eurosystem’s decisive measures to break the vicious circle between sovereign bond market runs, financial system instability, dysfunctional

www.suerf.org
monetary policy transmission and deep real economic impacts, together with the reform measures taken by EU governments, managed to calm the situation. While central bank independence is crucial for credibility, crisis management at the same time requires close coordination between the various legs of economic policies. Accordingly, the Eurosystem’s readiness to undertake Outright Monetary Transactions (OMT) in secondary sovereign bond markets is firmly linked to economic reform programs agreed by recipient countries and approved by political authorities. At the same time, many open issues are yet to be evaluated, such as lessons from the debt crisis for debt management, the future perception of risk associated with sovereign bonds and, related to that, the optimal treatment of sovereign debt in banking supervision and regulation. Clearly, the fact that some economics textbooks bemoan the loss of a risk-free asset should not prompt us to ever again succumb to such an illusion.

SUERF President Urs Birchler, University of Zurich, thanked the co-organizers for the invitation and smooth joint preparation of the conference as well as for hosting SUERF’s Secretariat and providing its General Secretary.

**Questioning the Conventional Wisdom on Debt Sustainability**

The Keynote Address on “The Future of Sovereign Borrowing,” chaired by Ernest Gnan, SUERF Secretary General, was given by Alessandro Missale, Debt and Development Finance branch (UNCTAD) and University of Milan. He addressed three issues. First, he questioned the conventional wisdom on sovereign debt sustainability, based on the view that sovereign debt is sustainable as long as creditors are prepared to buy and hold it. Creditors are not concerned with debt levels as such but with debtors’ perceived ability to pay. This is confirmed by financial markets’ assessment of Japanese, U.S. or U.K. government debt as opposed to their assessment of Italian or Spanish government debt. Debt sustainability cannot be adequately captured by a single debt ratio as it depends on a mix of expectations about future fiscal surpluses, economic growth, interest rates and their interactions. This introduces an important self-fulfilling element: market panics can lead to self-fulfilling debt runs. Hence, sustainability is ultimately a matter of market sentiment. Using an indicator of “fiscal proximity” (which captures the similarity among countries in terms of deficit and debt ratios), Favero and Missale (2012) show that the impact of fiscal fundamentals on Italian and Spanish bond yields reflects the significant volatility of global market sentiment over time. When global market participants consider risks to be low, fundamentals have no effect on yield spreads; yet in periods of high risk aversion, market overreaction may itself become a source of instability.

Second, Missale argued that, in order to prevent debt runs, debt management should aim to match fiscal surpluses with maturing debt, and that debt with longer maturities reduces default risk and risk premiums. Therefore, debt maturities are important fiscal fundamentals and should be taken into account as such in sustainability analysis. Swap contracts may conceal the “true” maturity and should therefore be subject to greater transparency. The reinforced EU fiscal rules had failed to trigger positive market reactions, indicating low credibility. Fiscal austerity may become self-defeating but is unavoidable in crisis; to reduce its negative growth impact, fiscal consolidation should be pursued softly. Fiscal surpluses benefit sustainability more through expectations than through direct debt reduction effects. Growing out of debt is a very long process.

Third, Missale argued in favor of central banks acting as lender of last resort for governments in order to provide insurance to markets. EMU is special in that the Eurosystem is more clearly separated from national fiscal authorities than the central bank of a single nation state. The ECB’s OMT program reduces the likelihood of a panic equilibrium, but the conditionality attached to it reduces its effectiveness as a deterrent against market runs, and its use comes with a stigma.

**Reacting to the Changed Environment**

Session 1, chaired by Ernest Gnan and entitled “Sovereign Borrowing—Adjusting to the New Environment,” brought together the three perspectives of investors, issuers and policymakers. Christopher Marks, BNP Paribas, provided the market perspective with his presentation entitled “From the Sacred to the Profane.” Markets are well aware that the crisis has initiated a structural change in financial markets. Despite low yields and even negative real interest rates, funds continue to flow into global bond markets. The increase in stock prices over the past couple of months (the “Great Rotation”) does not reflect an outflow of funds from bond markets. In a very long-term perspective spanning three centuries, going back to 1700, nominal long-term bond yields moreover appear to be at normal levels. Currently, the European Union is undergoing a major reform process, which is very fast and far-reaching by historical standards. Given their complexity, the sum of these developments is difficult to price for financial markets, which is also why these developments have not been priced in in full as yet. Marks argued that European politicians had a poor understanding of bond markets, with the exception of ECB President Draghi and Italy’s former Prime Minister Mario Monti, who are very much aware of the fact that small pieces of information can make a big difference. Draghi’s announcement in July 2012 made the rules of the game very clear, namely that it is pointless to bet against the euro because the euro is here to stay. This has paved the way for stabilizing the
markets, and is also the reason why recent political uncertainties in Italy have had very minor effects on Italian bond yields. Government investors clearly group euro area countries by liquidity and credit risk, which currently yields four groups: core, subcore, peripherals, and distressed peripherals. When investing in euro area bonds, they consider commingled European sovereign risk, reflecting rescue mechanisms (ESM, EFSF, SMP, OMT), the limits of these mechanisms (conditionality), individual countries’ political risk and contingent liabilities due to ailing banking systems or large industrial firms, and market liquidity and functioning more generally. Bond market developments have led to strongly diverging developments in the duration of euro area countries’ bond issuance: While the core countries (Netherlands, Belgium, Germany) used their prevailing low yields to also issue long-term debt, Italy and Spain were forced to shorten durations dramatically. The financial transactions tax will sharply increase borrowing costs for European sovereign issuers (one debt management agency estimated that this tax would raise annual borrowing costs by 20 basis points). Some hedge funds consider banning trading euro area government bonds with European counterparties. Tighter provisioning rules may increase the cost of holding sovereign bonds for financial institutions. The broader definition of high quality liquid assets in the new Basel framework reduces the relative advantage of holding government bonds. Multi-asset funds increasingly take the place of old-style pure sovereign bond funds. Current public finance problems will take a whole generation to solve. Central banks will in one way or another (have to) play a role in this and will have to manage their independence very prudently.

Hans Blommestein, OECD and Tilburg University, offered key insights from the OECD’s “Sovereign Borrowing Outlook 2013” published a few days prior to the conference. Euro area government gross borrowing was not very large over recent years by international comparison. The sovereign debt crisis has emphasized rollover risk and brought a return of home bias. Many sovereign debt management agencies try to reduce rollover risk, but not at all costs. Highly indebted countries in Europe and elsewhere should indeed lengthen the maturity of their sovereign debt. That said, they should not switch opportunis-tically between markets and maturities for short-term motifs. Between 2007 and 2012, many European countries have actually increased the average term to maturity of outstanding debt, and in the case of Italy and Spain, the average term to maturity has dropped only slightly. Moreover, central government marketable debt as a fraction of GDP, while having increased substantially since 2007, is not high in the euro area countries compared to G7 countries. Non-resident holdings of Spanish and Italian sovereign bond holdings have gone down markedly over the past two years. ECB President Draghi’s announcement of the OMT program brought Spanish and Italian yields down considerably across the entire yield curve, particularly at the short end. Finally, the crisis has also highlighted the difficulties associated with measuring sovereign risk – market rates such as bond spreads or CDS spreads have turned out to be very unreliable predictors of fundamental difficulties. Market mispricing is linked to various sources: disagreement and uncertainty on how to define and measure sovereign risk, dysfunctional debt markets, and animal spirits. Therefore, market discipline does not work consistently but spasmodically. As a result, the criteria for estimating the “supply of safe sovereign assets” have been relaxed in the latest edition of the Sovereign Borrowing Outlook: Now assets are considered “safe” if a sovereign is rated AAA or AA by one of the major rating agencies. Despite this conceptual change, the share of safe sovereign assets has declined markedly between 2007 and 2012. The decline was stronger for EU countries than for the OECD as a whole.

Juha Kilponen, Bank of Finland, gave a presentation on the “European Debt Crisis and European Crisis Resolution Policies.” He started out by recalling that the Werner Report of 1970 for the creation of a monetary union had, for good reason, envisaged a parallel creation of fiscal and monetary union, with full centralization at the Community level also of fiscal policy, including decision-making on budget size, fiscal balances, methods of financing and utilization of funds. By contrast, in the Delors Report of 1989 monetary union was designed to discipline other areas of economic decision-making. The outcome was a monetary union without a centralized fiscal policy. The current crisis was the result of several developments, including unified interest rates causing exuberance and credit bubbles, lax fiscal policies in several countries, strong private capital flows from core to peripheral countries (reflecting underpriced risks and the global savings and liquidity glut), a lack of incentives for deep economic reform, and the failure of both market and political disciplinary mechanisms. The crisis triggered a number of policy reforms, extending to fiscal policy, financial regulation and supervision, as well as monetary policy. An empirical estimate shows that the results of these policy measures on bond yields were significant for SMP and OMT programs, mixed for the EFSF and ESM, and negligible for the reforms of EU economic governance. Recent developments are encouraging: Ireland and Portugal are returning to capital markets, and investor sentiment towards Spain has also improved markedly over recent months, the EFSF and ESM have established themselves as supranational issuers able to refinance themselves at low rates, and the ECB’s OMT announcement has successfully removed redenomination risk. In the post-crisis new market environment, increased market sensitivity should be good for fiscal
discipline. By contrast, fiscal rules lack credibility given that they are constantly subject to renegotiation, and fiscal decision-making remains largely decentralized. The increasing home bias implies market fragmentation detrimental for the smooth functioning of the single monetary policy, possible crowding out of private investment and increasing real economic divergence. The environment for sovereign borrowing remains challenging. Monetary policy currently bears too large a share of the burden to cope with the crisis.

**Reviewing the Role of Sovereign Debt for Monetary and Financial Stability**

Session 2, chaired by OeNB chief economist Peter Mooslechner, addressed the interlinkages between “Sovereign Debt, Monetary and Financial Stability.” The session’s first contribution, “The Role of Sovereign Debt in Monetary Policy Implementation – An International Comparative Perspective” by Ulrich Bindseil, European Central Bank, discussed the importance of sovereign debt for central banks’ outright holdings and repo operations. Central banks hold sovereign debt outright for several reasons. In normal times, sovereign debt holdings aim to secure low credit risk for the central bank and a slim aggregate balance sheet for the state sector. In crisis times, sovereign debt is additionally held to influence asset prices, sovereign yields and long-term rates at large. Besides actively selecting the composition and size of outright holdings, central banks can steer the influence of sovereign bonds in monetary policy implementation by choosing the eligible collateral framework for repo operations. A broad collateral framework has the advantage of supporting high liquidity of the financial system while a narrow approach reduces risk-taking by central banks and prevents moral hazard in the sense of an undue reliance of commercial banks on central bank credit. The different treatment and use of sovereign debt in monetary policy implementation by the major central banks may reflect two different doctrines. Considering outright holdings, the Bank of England, the U.S. Fed and the Bank of Japan seem to follow a “consolidated state sector doctrine,” which views the central bank and government balance sheet in tandem; thus they do not see a major problem in buying large amounts of sovereign debt. By contrast, the ECB may be seen to follow a “central bank independence doctrine,” which sees the balances sheets of currently 17 euro area member states and the Eurosystem as distinct, and views central bank purchases of government debt as a potential risk to price stability; thus, the Eurosystem buys relatively small amounts of sovereign debt, even in the event of crisis, with these purchases being strictly limited to secondary market transactions and, in the case of the OMT program, subject to strict conditionality.

Martin Hellwig, Max Planck Institute for Research on Collective Goods, started his contribution “On the Treatment of Sovereign Borrowing in Banking Supervision and Regulation” with a review of the developments and origins of the sovereign debt crisis, where he focused on the lack of credible commitments by EU institutions and EU governments towards sustainable, stability-oriented policies, with a special reference to the violated SGP targets and no-bail out clause. Banking supervision and regulation played a key role in the evolution of the sovereign debt and financial crisis through the zero-risk treatment of sovereign bonds. The risk-free treatment of sovereign debt for central banks’ outright holdings and repo operations. Central banks hold sovereign debt outright for several reasons. In normal times, sovereign debt holdings aim to secure low credit risk for the central bank and a slim aggregate balance sheet for the state sector. In crisis times, sovereign debt is additionally held to influence asset prices, sovereign yields and long-term rates at large. Besides actively selecting the composition and size of outright holdings, central banks can steer the influence of sovereign bonds in monetary policy implementation by choosing the eligible collateral framework for repo operations. A broad collateral framework has the advantage of supporting high liquidity of the financial system while a narrow approach reduces risk-taking by central banks and prevents moral hazard in the sense of an undue reliance of commercial banks on central bank credit. The different treatment and use of sovereign debt in monetary policy implementation by the major central banks may reflect two different doctrines. Considering outright holdings, the Bank of England, the U.S. Fed and the Bank of Japan seem to follow a “consolidated state sector doctrine,” which views the central bank and government balance sheet in tandem; thus they do not see a major problem in buying large amounts of sovereign debt. By contrast, the ECB may be seen to follow a “central bank independence doctrine,” which sees the balances sheets of currently 17 euro area member states and the Eurosystem as distinct, and views central bank purchases of government debt as a potential risk to price stability; thus, the Eurosystem buys relatively small amounts of sovereign debt, even in the event of crisis, with these purchases being strictly limited to secondary market transactions and, in the case of the OMT program, subject to strict conditionality.

Eric Leeper, Indiana University, who was prevented from attending the conference in person due to weather-induced flight cancellations, transmitted a video of his presentation entitled “Thinking about Fiscal Sustainability,” which focused on the definition and implications of fiscal limits, the point at which countries’ surpluses can no longer adjust to stabilize government debt. At the fiscal limit, countries that lack control over the debt-denomination currency – which is also the case for euro area member states – have no other option than to default. Sample calculations for the probability distribution of the fiscal limit for Greece showed that higher productivity, stable growth in transfers and
credibility of consolidation efforts lower the probability of reaching the fiscal limit at a given debt ratio. Regarding the current situation in the United States, this time is different. In the past, society was willing to accept shared sacrifices, e.g. to reduce a very high public debt burden. With political polarization being at all-time highs, the costs connected to the aging of the society imply increases of the future debt burden. Therefore the fiscal limit of the United States, which is ultimately always a political decision, might be lower than in the past. At the fiscal limit, countries controlling the currency of their issued debt have the additional policy option of devaluing real debt by means of inflation. At the fiscal limit monetary policy has to prevent the debt service from exploding by keeping real interest rates low. It therefore loses its ability to prevent “fiscal inflation.” The tradition of assigning inflation control and short-run stabilization to monetary policy rests on the assumption that fiscal policy fulfils the task of ensuring solvency at all times. These assignments are currently questioned by the fact that political outcomes might no longer support fiscal policies that can keep the economy sufficiently far from its fiscal limits. Recent research has already picked up this idea and shown that reversing the assignments can generate welfare nearly equivalent to consensus assignment.

**Improving Risk Management and Prudence of Sovereign Borrowing**

Session 3 chaired by [Martha Oberndorfer](#), Federal Financing Agency of Austria, focused on potential steps “Towards More Prudent Sovereign Borrowing.” By reviewing the strategies of Italian debt management over the last three decades in her presentation “Risk Management of Debt Portfolios,” [Maria Cannata Bonfrate](#), Italian Treasury, identified various forms of risk associated with the extensive reliance on certain debt management instruments and argued for a medium- to long-term perspective which protects against the temptation to make use of short-term market developments. Past experience, such as the excessive reliance on T-bills which contributed to the explosion of Italian sovereign debt in the 1980s or the increased reliance on long dated floaters implying high levels of interest rate risk which materialized after the monetary crisis in 1992, highlight the potential of debt management strategies to cause severe problems. As a reaction to these problems the Italian Treasury constantly increased the average life and the duration of the debt portfolio over time to allow for a temporary shortening of maturities in difficult times (e.g. second half 2011 and 2012). Yet sovereign debt issuance strategies face tradeoffs. A strategy that minimizes rollover risk by smooth redemption profiles is challenged by markets’ preference for concentration in coupon cycles and common expiring dates for nominal debt and inflation linkers. Despite the fact that the debt manager can make use of buy-backs and exchange operations (e.g. EUR 5 billion in 2011) debt redemption pikes cannot always be prevented. For 2013 the Italian Treasury has scheduled a further lengthening of the average life and duration of Italian debt. Moreover, following the successful launch of inflation-linked bonds in 2012, a new 30-year government bond indexed to Italian inflation (“BTP Italia”) will be issued when market conditions appear to be favorable. The usual hedge of currency risk via currency swaps will be continued.

The presentation entitled “GDP-Indexed Bonds: A Tool to Reduce Macro Risk?” by [Guido Sandleris](#), Universidad Torcuato di Tella (Buenos Aires), focused on the benefits and design of GDP-indexed debt contracts. Besides collective action clauses and seniority clauses, debt indexation can be seen as a possibility to reduce the cost of sovereign debt renegotiations. Real-indexed debt contracts further make debt crises less likely, allow for better risk-sharing and counteract procyclical fiscal policy. In the past only a few countries have issued indexed debt, either in the form of GDP indexation (Costa Rica, Bosnia-Herzegovina, Bulgaria, Argentina and Greece), commodity price indexation (United States, France, Mexico, Nigeria and Venezuela) or fiscal revenue indexation (Spain). Index variables that are under the control of the issuer, such as government revenues or expenditures which would provide the best insurance, may give rise to moral hazard problems. Variables that are harder to manipulate but still correlated with revenues or expenditures are therefore preferable (GDP or commodity price indexation). A simulation of debt servicing costs for Argentina showed that, with reliance on GDP-indexed bonds, debt servicing costs would have been much lower than actually observed before the crisis, but substantially higher following the crisis, from 2003 onwards. So if GDP-indexed bonds are conceptually so appealing, why do we not see widespread use of the instrument? Possible answers include large fixed costs of market set-up, incentives to misrepresent data, unattractiveness during good times and alternative hedging options that already exist, such as simple variable interest rate bonds.

Representing UNCTAD, which launched an initiative to promote responsible sovereign lending and borrowing practices in 2009, [Juan Pablo Bohoslavsky](#) presented the current status of the “UNCTAD Principles of Sovereign Lending and Borrowing.” These principles, which
emerged from contributions of a group of experts in law and economics and which are still open for discussion, highlight that both the borrower and the lender have responsibilities and duties. Lenders should be obliged to provide all necessary information to allow for a proper evaluation of the risks and benefits of the financial products they offer. Lenders also have to evaluate the capacity of borrowers to repay a given credit and have to comply with UN sanctions imposed against a governmental regime. In case of debt restructurings all lenders must behave in good faith and with cooperative spirit to reach a consensual rearrangement of obligations. In the context of project financing, sovereign borrowers should also conduct ex ante investigations into the financial, operational, civil, social, cultural and environmental implications of the project and its funding. Borrowers have to act in the interest of their citizens and honor binding obligations. Further principles include transparency, disclosure and publication of debt obligations and liabilities as well as adequate management and monitoring of debt portfolios. Governments further have a responsibility to perform a cost-benefit analysis for their investments financed by liabilities. If restructuring is unavoidable, it should be undertaken promptly, efficiently and fairly.

Conclusions

In sum, the conference on “The Future of Sovereign Borrowing” established that European sovereign debt markets have indeed undergone, and are still undergoing, substantial and lasting changes as a result of the crisis, with important consequences for governments’ fiscal scope and debt management, for monetary policy and for financial stability.

There is no uniform definition of fiscal sustainability, which in turn has implications for adequate crisis management measures. Some economists emphasize the possible self-fulfilling nature of market forces impacting on debt sustainability and consequently call for massive intervention in the event of sovereign debt runs, in particular by central banks. Others emphasize that governments share a substantial part of the blame for the sovereign debt crisis, having neglected principles of good fiscal governance and provoked banking system vulnerability through prudential rules that encouraged large exposures to individual sovereign borrowers. Hence, they call for a stricter enforcement of fiscal rules and for nonpreferential treatment of government debt in bank regulation.

That sovereign debt is not a risk-free asset was in principle already reflected in the Basel II framework; however, the room for discretion left to national supervision and regulation by the EU Capital Requirements Directive prevented an enforced treatment of sovereign debt as a risky asset. The application of risk weights and of a leverage ratio for sovereign assets were identified as necessary conditions for breaking the adverse feedback loop between banks and sovereigns.

Central banks’ interventions in sovereign debt markets may reflect different doctrines (possibly related to the difference between single states with a currency of their own and the euro area, where a “consolidated view” of central bank and government balance sheets is difficult or impossible) or different aims of these interventions (influencing risk-free long rates versus correcting for excessive risk premiums in some bond market segments). In terms of effectiveness to counter the crisis, the SMP and OMT programs were generally seen as most successful, while the reformed EU fiscal rules framework was not found to have gained credibility so far.

Given the problems to secure political majorities for painful but necessary fiscal adjustments, including substantial reductions of debt ratios even over the medium to long term, the consensus division of tasks between fiscal policy and monetary policy is currently challenged. Central banks may come to feel substantial pressures in coming years to facilitate debt reduction in one or the other way.

There was general agreement that markets have generally failed to fulfil their signaling and disciplinary function by ignoring sovereign risk in the run-up to the crisis, while subsequently over-reacting with panic during the crisis. It is not enough, however, to criticize markets’ herd behavior. Instead, on the one hand, issuers should learn to take possible nonlinear behavior of markets as a given and stay safely clear of the limits to fiscal sustainability. Prudent fiscal behavior should go beyond a narrow view of current (headline) fiscal balances and debt levels, but must take due account of contingent liabilities from the financial system and the economy at large. On the other hand, markets in their investment behavior and risk evaluation should take into account nonlinear behavior of electorates in democratic societies as an integral and normal part of democratic decision-making processes, both at the level of single countries and the European Union or euro area.

The crisis induced changes in issuing techniques and funding strategies. Several European sovereign debt managers engaged in short-term debt issuance, for cost advantages or due to problems of access to longer maturities. This stands against the notion that longer-term financing would render public finances more robust against sovereign bond runs. Hedging strategies such as linking interest to real economic variables such as GDP growth have so far rarely been employed, not least because it may be difficult to newly introduce such new instruments to the markets, or because of the higher financing costs in good times.

www.suerf.org/vienna2013
### Conference Programme

**Wednesday, 12 June, 2013**

<table>
<thead>
<tr>
<th>Time</th>
<th>Event</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>19:30</td>
<td>Conference Gala Dinner</td>
<td>Bank of Finland Banqueting Hall</td>
</tr>
</tbody>
</table>

**Thursday, 13 June, 2013**

<table>
<thead>
<tr>
<th>Time</th>
<th>Event</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>08:00</td>
<td>Registration</td>
<td></td>
</tr>
<tr>
<td>08:45</td>
<td>Opening and welcome</td>
<td>Jouko Vilmunen, Bank of Finland</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Urs Birchler, SUERF &amp; University of Zürich</td>
</tr>
<tr>
<td>09:00</td>
<td>Session 1 - Regulation</td>
<td>Chair: Jouko Vilmunen, Bank of Finland</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The current state of reforming bank structures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mario Nava, European Commission</td>
</tr>
<tr>
<td>09:30</td>
<td>Regulatory and resolution measures needed</td>
<td>Jukka Vesala, Finnish Financial Supervisory Authority</td>
</tr>
<tr>
<td></td>
<td>to foster market discipline</td>
<td></td>
</tr>
<tr>
<td>10:00</td>
<td>Coffee break</td>
<td></td>
</tr>
<tr>
<td>10:30</td>
<td>Session 2 - Research on bank business models</td>
<td>Chair: Jouko Vilmunen, Bank of Finland</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Century of Firm-Bank Relationships: did</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Banking Sector Deregulation spur Firms to add Banks and Borrow more?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Steven Ongenae, Tilburg University</td>
</tr>
<tr>
<td>11:15</td>
<td>Keynote Address I</td>
<td>Chair: Seppo Honkapohja, Bank of Finland</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Guarding against systemic risk: the remaining agenda</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Alan Blinder, Princeton University</td>
</tr>
<tr>
<td>12:00</td>
<td>Lunch</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Time</th>
<th>Event</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>13:30</td>
<td>Invited Speech</td>
<td>Chair: Urs Birchler, SUERF</td>
</tr>
<tr>
<td></td>
<td></td>
<td>How much speculation is socially optimal?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Jean-Charles Rochet, University of Zürich</td>
</tr>
<tr>
<td>14:15</td>
<td>Keynote Address II</td>
<td>Chair: Urs Birchler, SUERF</td>
</tr>
<tr>
<td></td>
<td></td>
<td>On the size and structure of the banking sector</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Erkki Liikanen, Governor, Bank of Finland</td>
</tr>
<tr>
<td>15:00</td>
<td>Coffee break</td>
<td></td>
</tr>
<tr>
<td>15:15</td>
<td>Keynote Address III</td>
<td>Chair: Urs Birchler, SUERF</td>
</tr>
<tr>
<td></td>
<td></td>
<td>title to be confirmed</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Paul Tucker, Deputy Governor, Bank of England</td>
</tr>
<tr>
<td>16:00</td>
<td>Panel Discussion - The Future Banking Environment</td>
<td>Chair: David T. Llewellyn, Loughborough University and SUERF</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Panellists:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hugo Bänziger, Member of the HLEG</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Andrea Enria, Chairperson, EBA</td>
</tr>
<tr>
<td></td>
<td></td>
<td>José Manuel Campa, IESE and HLEG</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Philipp Hartmann, ECB and SUERF</td>
</tr>
<tr>
<td>17:30</td>
<td>Closing words</td>
<td></td>
</tr>
<tr>
<td>17:45</td>
<td>End of conference</td>
<td></td>
</tr>
</tbody>
</table>

Registration & Hotel Reservation Forms: [www.suerf.org/helsinki2013](http://www.suerf.org/helsinki2013)
Friday, 4 October, 2013

09:00  Registration
09:30  Opening and welcome
   Urs Birchler, SUERF & University of Zürich
09:40  2013 SUERF Annual Lecture
   Chair: Ernest Gnan, SUERF and Oesterreichische Nationalbank

Lex Hoogduin, University of Amsterdam and LCH.Clearnet

10:30  Session 1 - What impact does bank size have?
   Chair: Frank Lierman, SUERF and Belfius Bank
   Big banks, bio-diversity and systemic risk aspects
   Michael Koetter, University of Groningen
   Size and stability of big banks
   Tigran Poghosyan, IMF
   To be confirmed
   Teunis Brosens, ING
12:15  Lunch

12:45  SUERF General Assembly
   for SUERF members only

13:15  Session 2 - Do different bank models add different value?
   Chair: Wim Boonstra, Rabobank
   Banking system characteristics and crisis performance
   Clemens Kool and Mark Sanders, Utrecht University and Sustainable Finance Lab
   Business model supervision
   Femke de Vries, De Nederlandsche Bank
   Cooperative banks’ performance during the crisis
   Nicole Smolders, Rabobank
15:00  Coffee break
15:30  Session 3 - What have we learnt about banks and their business models?
   Chair: Dirk Schoenmaker, Duisenberg School of Finance
   What have we learnt about banks and their business models?
   Klaas Knot, Governor, De Nederlandsche Bank
   Panellists:
   Harald Benink, Tilburg University and ESFRC
   Alicia Sanchis, Banco Santander
   Andreas Bley, BVR
   Michael Bijlsma, CPB
17:30  End of conference

Further information: www.suerf.org/amsterdam2013
Provisional Programme

Friday, 22 November, 2013

08:30  Registration and Coffee

09:00  Opening and welcome

  Urs Birchler, SUERF & University of Zürich
  Christian Noyer, Governor, Banque de France

09:30  Session 1: Addressing Macroeconomic, Structural and Policy Issues

  Philipp Hartmann, ECB and SUERF
  Ewald Nowotny, Governor, Oesterreichische Nationalbank
  Huw Pill, Goldman Sachs
  Niels Thygesen, Copenhagen University
  Ignazio Visco, Governor, Banca d'Italia

11:00  Coffee

11:30  Session 2: Restructuring the Banking Sector and Ensuring the Single Market for Financial Services

  Charles Goodhart, LSE
  David T. Llewellyn, Loughborough University and SUERF
  Daniele Nouy, Autorité de Contrôle Prudentiel
  Jean Tirole, Toulouse School of Economics

13:00  Buffet lunch

14:10  Keynote Speech

14:40  Session 3: Enhancing European Governance

  Franco Bruni, Bocconi University
  François Villeroy de Galhau, BNP Paribas
  N.N.
  N.N.

16:10  Coffee

16:30  Panel: Which financial Europe for the future?

  Anne le Lorier, Deputy Governor, Banque de France
  Frank Lierman, Belfius & SUERF
  Catherine Lubochinsky, Global Risk Institute
  Peter Praet, ECB
  William White, OECD

18:00  End of conference

Further information: www.suerf.org/paris2013

SUERF/UniCredit & Universities Foundation Workshop
Banking and Financial Markets between Integration and Segmentation after the Crisis

Thursday 12 December 2013
Vienna, Austria

Further information: www.suerf.org/vienna-uuf2013
2012 was once again a busy year for SUERF with a full programme of events and publications including the 30th SUERF Colloquium on “States, Banks, and the Financing of the Economy” held in Zürich on 5-6 September 2012. In total some 470 participants registered for SUERF’s programme of events in 2012. In a year of continuing uncertainty for the Eurozone, the year’s events started in London in early March with a one day conference on “Future Risks and Fragilities for Financial Stability”. In June a half day workshop on “The Interaction of Political, Fiscal and Financial Stability: Lessons from the Crisis” was held in Vienna, including the 2012 SUERF Annual Lecture, delivered by Governor András Simor of the Magyar Nemzeti Bank. During the 30th SUERF Colloquium, Lorenzo Bini Smaghi (Harvard University) delivered the 2012 SUERF Marjolin Lecture on “Money and Banking in Times of Crisis”. At the final event of the year, held in Copenhagen in November 2012, SUERF and Nykredit held a joint conference on “Property prices and real estate financing in a turbulent world”.

1. Publications

Five SUERF Studies were published in 2012, in part reflecting the Association’s events programme – in the form of two Studies that formed the proceedings of the 29th SUERF Colloquium held in May 2011, the proceedings of the joint SUERF/ICFR Conference in London and the proceedings of the SUERF/IMFS/Deutsche Bundesbank conference on “The ESRB at 1”. The final Study of the year featured an extended paper by Clas Wihlborg on “Developing Distress Resolution Procedures for Financial Institutions”. Detailed information about SUERF Studies can be found on the SUERF website at www.suerf.org/suerfstudies.

The SUERF Studies continue to be printed by Larcier, with members receiving copies of the Studies and all SUERF Studies are available for electronic downloading from the SUERF website. The outlook for the flow of publications in 2013 has been finalised, with the proceedings of the Workshop and Annual Lecture held in Vienna, the 30th SUERF Colloquium and the SUERF/Nykredit conference from 2012 as well as the 2013 conference in Vienna on The Future of Sovereign Borrowing in Europe. Members are of course invited to make submissions of unpublished research for potential publication in the SUERF Studies series, with guidelines for submissions being available on the SUERF website.

In addition, to commemorate SUERF’s 50th Anniversary in 2013, a special 50th Anniversary Volume will be published at the end of the year, featuring a dozen invited contributions that address various issues relating to “50 Years of Money and Finance”. Authors have been busy preparing their contributions and the volume will be launched at the SUERF/Banque de France conference in Paris in November 2013.

The SUERF Website has continued to become an increasingly frequently visited “hub” of SUERF’s activities, with a substantial increase in web traffic in 2012 over the previous year. The Announcement Service, for Calls for Papers and Events has allowed SUERF to publicise members’ events and events of kindred associations reciprocally, and is an increasingly popular resource for members to publish announcements. Towards the end of 2012, SUERF also started more actively using social media – and uses Facebook, Twitter, Google+ and LinkedIn as channels for social media activity.

2. SUERF Events in 2012

The 30th Colloquium, two conferences and a workshop with SUERF Annual Lecture were held in 2012.

• A SUERF/ICFR Conference on Future Risks and Fragilities for Financial Stability jointly organized with the International Centre for Financial Regulation (ICFR) in London on 8 March (the conference proceedings have appeared as SUERF Study 2012/3);

• A half day SUERF/OeNB Workshop on The Interaction of Political, Fiscal and Financial Stability: Lessons from the Crisis was held in Vienna on 18 June including the SUERF Annual Lecture, delivered by Governor András Simor of the Magyar Nemzeti Bank. (The proceedings of the conference appeared in SUERF Study 2013/1);

• The 30th SUERF Colloquium on States, Banks, and the Financing of the Economy in Zürich on 5-6 September, sponsored by UBS, Bank Julius Baer, the Department of Banking and Finance, University of
Zürich, NCCR FinRisk, the Swiss Finance Institute and KOF ETHZ (the Colloquium proceedings will appear as SUERF Studies 2013/2 and 2013/3);

• A one day SUERF/Nykredit Conference in association with Danmarks Nationalbank on Property prices and real estate financing in a turbulent world was held in Copenhagen on 15 November (The proceedings of the conference will appear in SUERF Study 2013/4).

The SUERF Council of Management would like to take this opportunity to thank all co-organizers, sponsors, speakers and scientific committee members for their contributions. We are convinced that our events have made a significant contribution to public debate on important issues.

3. Outlook to 2013/14

The following SUERF events have taken place or are planned to take place in 2013.

• A SUERF/OeNB/BWG Conference on The Future of Sovereign Borrowing in Europe jointly organized by the Oesterreichische Nationalbank and the Austrian Society for Bank Research in Vienna on 8 March 2013 (a report is also included in this newsletter);

• A SUERF/Bank of Finland Conference on Banking after regulatory reforms - business as usual? to be held in Helsinki on 13 June 2013 (the programme is included in this Newsletter);

• A SUERF/DNB/Rabobank Conference on The value of banks and their business models to society to be held at Duisenberg School of Finance in Amsterdam on 4 October 2013, sponsored by De Nederlandsche Bank and Rabobank, including the 2013 SUERF Annual Lecture;

• A SUERF/Banque de France Conference on The Financial Reconstruction of Europe to be held in Paris on 22 November 2013.

• SUERF/UniCredit & Universities Foundation Workshop to be held in Vienna on 12 December 2013.

The SUERF Council of Management is currently planning SUERF’s 2014 events, including the 31st SUERF Colloquium to be held in Milan in June 2014. The Council of Management is always keen to receive views and suggestions from members about possible future events and publications for coming years.

4. Membership

Corporate Membership levels remained stable, with new Corporate Members joining the association at a similar frequency to those leaving. At the end of the year, Corporate Membership stood at 85 (including 29 Central Banks). There was a slight decrease in the number of Academic Institution Membership (AIM) members, with membership drawn from 16 countries. Personal membership remained similar to the previous year. Library Subscription Service (LSS) uptake remained unchanged. SUERF members are located in the following 43 countries.

Albania Malta
Australia Mexico
Austria New Zealand
Azerbaijan Norway
Belgium Poland
Brazil Portugal
Bulgaria Republic of Ireland
Canada Republic of Kosovo
Cyprus Republic of Singapore
Czech Republic Romania
Denmark Russia
Estonia Slovakia
Finland Slovenia
France South Africa
Germany Spain
Greece Sweden
Hungary Switzerland
Iceland The Netherlands
Italy Turkey
Liechtenstein United Kingdom
Luxembourg USA
Macedonia

5. Financial Situation

SUERF’s financial situation remains steady. The association’s financing relies primarily on membership contributions and sponsoring of events. Amid the continued environment of low interest on savings, on the income side SUERF crucially depends on revenues from membership subscriptions to finance its activities. In 2012 cash-flow receipts from membership stood at approx. € 139,600¹ an increase from 2011, but this is mainly due to the increased membership fees from 2012, with membership fees having previously remained

¹This figure includes some payments for 2013 received in 2012.
unchanged for over ten years. Corporate Members and Central Banks contributed approx. € 120,000. Personal members contributed just over € 11,000 whilst Academic Institution Membership (AIM) and the Library Subscription Service (LSS) contributed approx. € 8,600.

We would like to extend our special gratitude to all members – Corporate, Personal, Academic – and to our co-operation partners and sponsors for their continued support and interest in our products. Your support and interest allows SUERF to continue to provide high-quality events, publications and networking opportunities to you.

6. Miscellaneous

Council of Management

At the General Assembly held on 5th September 2012, in Zürich, Allard Bruinshoofd (Rabobank), Jakob de Haan (De Nederlandsche Bank), Patricia Jackson (Ernst & Young) and Christian Pfister (Banque de France) were elected to the SUERF Council of Management for a three year period from 1 January 2012 to 1 January 2015.

In addition, the mandates of Ernest Gnan (Oesterreichische Nationalbank), Ryszard Kokoszczynski (National Bank of Poland), David Llewellyn (Loughborough University) and Robert McCauley (Bank for International Settlements) were extended for a further term of 3 years from 1 January 2013 until 1 January 2016.

During 2012, the Council of Management met on 4 occasions, coinciding with SUERF events, to plan the activities and monitor the association’s finances and work of the Secretariat. Information about SUERF Council of Management members can be found on the SUERF website at www.suerf.org/councilmembers.

SUERF Presidency

Urs Birchler, Professor of Banking, University of Zürich, was elected by the Council of Management as President of SUERF for a period of three years (1.5.2012 – 30.4.2015) in succession to Catherine Lubochinsky, who had served in the position for two terms since 2006.

Executive Secretariat

The SUERF Secretariat continues to be staffed by Michael Bailey, Executive Secretary (part-time), and Veronika Brookes, Secretary (full-time). SUERF’s Council of Management would like to cordially thank Mr. Bailey and Ms Brookes for their ongoing work.

Interview with Fernando Restoy

In the second in a series of interviews to mark SUERF’s 50th Anniversary, Fernando Restoy, Deputy Governor of the Banco de España (and a past member of the SUERF Council of Management), reflected on a number of questions relating to SUERF’s activities and Money and Finance in Europe, the hot topics at the time of his time on the Council of Management and the current situation.

Fernando Restoy has been the Deputy Governor of the Banco de España since June 2012 and is Chairman of the Governing Committee of the Fund for the Orderly Restructuring of the Banking Sector (FROB) and Chairman of the Deposit Guarantee Fund for Banking Establishments. Prior to this appointment, he was the Vice Chairman of the Comisión Nacional de Mercado de Valores (CNMV) between 2008 and 2012. Between 2001 and 2007 he was the Director of the Monetary and Financial Studies Department of the Banco de España. He holds degrees from Harvard University, the London School of Economics and the Universidad Complutense de Madrid.

1. Which monetary and financial issues were at the top of the European political agenda, when you were member of the SUERF council of management?

I had the honor of being a member of the SUERF council from the early 2000s until 2007. That is, the final part of the long period marked by low macroeconomic volatility that is generally known as the “Great Moderation” and also the time when the euro started to circulate. At that time, the general mood prevailing among academics, policymakers and practitioners was one of optimism. Most believed to have mastered business cycle fluctuations through rule-based monetary policy, delegated to an independent central bank with an implicit or explicit inflation target and with very little role for discretionary fiscal policy. Conducting monetary policy was also considered to be relatively straightforward: the central bank controlled the short-term interest rate with effects on the real economy mainly through three channels: long-term interest rates, inflation expectations...
and asset prices. Linked to the interest rate channel, the credit channel was deemed weak and the banking sector ignored by most models, particularly New Keynesian models. Banks were believed to work well and most market failures were attributed to product and factor markets. Financial markets were assumed to be efficient at distributing and pricing risk, and financial innovation was seen as welfare-enhancing. At the same time, it was thought that systemic financial crises belonged to the past and were unlikely to happen in advanced economies with well-developed and (mostly self-) regulated financial markets.

Finally, it was a period of euro-optimism as well. Its monetary policy strategy and the strong institutional set-up of the Eurosystem seemed to have provided the right foundations for a successful monetary policy in the euro area. Inflation had remained remarkably close to 2%, despite sizeable adverse price shocks, and long-term inflation expectations had been stable and well anchored at levels broadly consistent with the definition of price stability. Those were considerable achievements.

2. Which are the most striking changes, when you observe the monetary and financial issues that dominate the top of the European political agenda today?

It is fair to say that many of the beliefs mentioned above have been questioned profoundly since the global financial crisis erupted in the summer of 2007 and especially after the collapse of Lehman Brothers in September 2008. To be sure, it is probably still premature to fully identify the new paradigm that will emerge from the crisis. I guess that some of the old beliefs will remain more or less intact. For instance, that fiscal policy continues to be limited as a stabilization tool. Despite the heated discussion about the current size of fiscal multipliers, the bad shape of public finances in most countries allows at best very limited leeway. By contrast, I see more scope for innovation in the areas of the efficiency of financial markets and the banking sector and/or their interaction with macroeconomic stability. Although financial innovation has helped to increase resilience to “traditional” macro shocks, it has increased the likelihood of financial shocks, which may create systemic risks that are difficult to insure against. Thus, macroprudential policy together with conventional monetary policy, are bound to become the main element of the policy toolkit in the foreseeable future. In terms of modelling, we have learnt that the assumption of perfect financial markets typical of New Keynesian models, is not merely a simplifying assumption, but instead it conditions fundamentally the model’s predictions. Finally, with respect to European policies, the crisis in the euro area has been a stark reminder of something we should have kept in mind all along: that EMU is work in progress. The crisis has brought to the fore the need for policy makers to complete with urgency the EMU design with the aim of restoring confidence in the single currency project and, hence, bringing back financial stability.

3. The structure of the European financial industry has changed fundamentally in the last five decades. Which are seen from your perspective the most important causes and implications?

The changes in the European financial industry during the last decades have been part of a global trend driven by a process of innovation, deregulation and growing financial integration. In the case of the euro area, the transition and creation of the single currency has also been a fundamental driving factor. The credit boom in many advanced countries and the mispricing of risk helped to expand the financial sector, which experienced fundamental changes in its structure.

But, as the crisis revealed later, these changes had serious weaknesses from the point of view of financial stability. The expansion of the financial sector ended up with highly interconnected entities and with a large concentration of activity in very big entities of systemic importance. Secondly, the development of highly complex financial instruments and business models – like the so-called originate-to-distribute model – allowed an uncontrolled dissemination of risk through the system.

The outbreak of the crisis in 2007 and it subsequent developments were a dramatic manifestation of the risks and weaknesses accumulated. The financial industry is now immersed in a profound restructuring with a need for resizing, for redefining business models and for adapting to the new regulatory and supervisory frameworks. The redefinition of models could be described as a “back to basics” driven by a larger demand for transparency,
simplicity and more robust regulation. The industry also has to be resized to adapt to the new environment of less activity. As a result, consolidation trends may lead to too big to fail entities with even larger market shares than before. Too-big-to-fail related issues will deserve more attention.

4. How do you evaluate the interplay between academic research and practice in financial markets and institutions today compared with the interplay, when you were SUERF council member?

At the time I was a council member one important field of the interplay between research and market practitioners was the application of risk assessment models in day-to-day risk management practice. The trend back then was, in the wake of the Basel II agreements, to implement Value-at-Risk models in the banking sector on a large scale.

With the benefit of hindsight, it is clear that the violent onset of the financial crisis and the speed and intensity of its systemic transmission at a global level proved that these models had not been able to capture the importance of non-Gaussian tail risks that overwhelmed the statistical assumptions in the models. Neither the vulnerabilities stemming from very elaborate financial derivative structures, nor the very deep, intricate and complex interconnectedness of the international financial system which I have mentioned before, had been adequately captured by the prevailing risk-management models. The subsequent spillovers of the crisis proved to be far stronger than expected.

Currently, a lot of work seems to be developing in this area, studying these interconnections and spillovers, and both financial regulation and practice have become more conservative, with the aim of achieving a more robust financial system. One of the main policy lessons we have learned from the global financial crisis is the importance of monitoring correctly the build-up of macro-financial imbalances and of acting in time – in an internationally coordinated way – to prevent the materialization of macroprudential risks. Another important policy lesson is that, if risks of this kind materialize, sufficiently strong risk-sharing mechanisms and institutions must be put in place in order to mitigate spillovers and counteract perverse interactions that tend to amplify their effects.

5. It is SUERF’s mission to bring academics and financial practitioners, central bankers and supervisors together and to further their mutual understanding of the financial system: Has SUERF in your view been successful in this respect?

In my view, SUERF has been highly successful in its mission. There is more than abundant proof of this on the SUERF website. A very sizeable number of events covering key issues in the field of money and finance have taken place under the auspices of the organization: annual lectures, colloquia, conferences and workshops. SUERF has also contributed to the funding of research, and has published a very long list of studies.

6. If you were asked to list 3 persons who have contributed the most to monetary and financial integration in Europe in the last 50 years, who would you choose? And why?

Firstly, I believe we must credit Jacques Delors as a key driving force of European integration over the last 30 years. During his mandate as President of the European Commission, he laid the groundwork for the European Single Market, an indispensable step for the establishment of the Economic and Monetary Union. But I would also like to mention two persons with whom I have had the honor to work, who have contributed decisively to the creation of EMU, Alexandre Lamfalussy and the late Tomasso Padoa-Schioppa.

Alexandre Lamfalussy was appointed president of the European Monetary Institute from 1994 until 1997. During that period, the bulk of the painstaking and comprehensive preparatory work for the establishment of EMU was undertaken, which justifies the importance of his contribution to European integration. In addition, in 2000, he was appointed chairman of the Committee of Wise Men on the Regulation of European Securities Markets. One of the most visible results of this period is the MiFID Directive, providing harmonised regulation for investment services not only in the Euro Area, or even the EU, but across the 30 member states of the European Economic Area.

Lastly, Tommaso Padoa-Schioppa, member of the first Executive Board of the ECB is rightly considered a founding father of the Single Currency. As far back as 1982, he pointed out the impossibility for EU countries to simultaneously achieve the objectives of free trade,
capital mobility, independent domestic monetary policies and fixed exchange rates, i.e. “the inconsistent quartet”. A few years later, he became Rapporteur of the Delors Committee, of which Lamfalussy was also a member. The Committee recommended the move towards economic and monetary union in three stages, which was endorsed by the Madrid European Council in June 1989. Over the years, Padoa-Schioppa also made important intellectual contributions to the integration of securities markets and payments systems.

7. What is in your view the proper balance between National and European financial regulation and supervision? Should the on-going trend towards European solutions continue?

Financial integration in Europe has suffered a serious setback with the crisis, which has highlighted the need of completing the European Union to ensure stability and prosperity. It is impossible to conceive a stronger European Union without additional transfers of national sovereignty, and we are now immersed in a process of reviewing the balance between National and European responsibilities in different fields, including the financial regulation and supervision. In this particular field the cooperation and convergence of national policies has clearly fallen short to ensure a safe financial sector. Beyond the distortions to the common market competition, the euro area needs a crisis prevention framework capable of breaking the destabilising feedback loop between sovereigns and banks. In a monetary union, the concerns regarding the solvency of banking systems or sovereigns are mutually reinforced when only domestic mechanisms are available to restructure or resolve banks and to protect depositors.

An integrated financial framework requires both a common European supervisory mechanism and a common deposit insurance and resolution framework. The balance of responsibilities between national and European authorities should be tailored according to the nature and size of the entities. In any case, the common supervisory model should be flexible enough to take into account the different nature of the supervised financial institutions. While the ultimate responsibility of some entities will lie with a European body, it will be clearly appropriate to involve national supervisors which will continue to play a key role in day-to-day supervision and participating in the decision making of the single supervisor.

8. Since SUERF was established in 1963 we have seen a breakdown of the Bretton Woods System and a global transition to a mixture of floating exchange rates and regional monetary arrangements and unions including the EMU: Have your views on the role of monetary cooperation and integration in Europe changed since you were SUERF council member?

Absolutely not, in the sense that, if anything, the current financial crisis has highlighted the need and the importance of reinforcing cooperation in order to rise up to the challenges we are faced with. In this sense, as I have mentioned before, I am convinced that the only way to overcome the current problems of the European sovereign debt crisis and the fragmentation of financial markets is to strive towards deeper and more comprehensive economic and, ultimately, political integration.

9. Would you like to give the current SUERF council some general advice or advice concerning the topic for future SUERF Colloquia, other events or publications?

I would advise focussing on the challenges for economic modelling derived from the recent economic experience. In particular, the intrinsic monetary character of our economics and the role of financial fluctuations in shaping the business cycle need to be paid more attention. Another topic I consider very relevant is the analysis of the most adequate monetary and macroprudential policies to achieve financial and monetary stability and promote economic growth. And, of course, we have to discuss about the optimum design of a European (political and financial) framework that is robust both to systemic financial shocks and asymmetric real shocks, possibly, in a context of highly leveraged governments.
I have always thought authoritative lists such as “100 books you should read”, “500 films you must see” or “1,000 albums you should hear at least once in your life” are fascinating. So it is great to also have such a list available in one’s professional field. Professor Diebold’s book does just that; it compiles his list of academic research articles one should know in risk measurement and management. Through his central position in financial econometrics, based on his own extensive research, Professor Diebold is one of the few who can make such a list.

The book divides the history of research in risk measurement in six parts. Each part contains reprints of four to ten articles; totalling thirty-seven (see Table on next page). The oldest article is Bachelier’s classic but long forgotten piece from 1900 on the theory of speculation. However, the “modern” era of risk measurement research, covered by the book, really started in the 1950’s. The list ends with Diebold’s and his co-authors’ own forward-looking review article from 2011, emphasizing the limits of statistical analysis and reminding us of the importance of heeding the unknowable.

In the introductory chapter, which is the key to the book, Diebold explains his choice of articles and reviews the central developments in risk measurement research. As can be seen from the average year of article publication (see Table), the six parts reflect the chronology of the main research themes in the field, although the themes do overlap in time.

An important example of this chronological overlap is the Froot and Stein (1998) article, listed in the first part which deals with the role of financial risk measurement and management. As Diebold points out, it took academic research some forty years, i.e., until that article, to explain why firms actually need risk management. The basis of modern risk measurement methods, constituted by the Arrow-Debreu securities which are a central concept in economics, dating from the 1950’s, assumes markets to be perfect and complete, and hence implies no role for enterprise risk management. Investors could do the optimal risk-sharing among themselves. Only Froot and Stein (1998) carefully considered the market frictions which rationalize risk management within firms.

The next two sets of articles deal with modeling speculative price movements (Part II) and time-varying volatility (Part III). The immediate connection between these parts is the following. The key message from Part II is that unconditional price movements have fat tails. They are not normally distributed, a fact still often not heeded in many practical applications. However, the conditional distribution may still be normal, once time-variation in periodic variance is taken into account (Part III). This is what especially the famous ARCH (autoregressive conditional heteroscedasticity) models formalize.

Part IV then moves to considering the market for default-free bonds; an area of active theoretical and empirical research particularly in the 1980’s and the 1990’s. I was first surprised not to see the well-known Cox-Ingersoll-Ross (1985) and Heath-Jarrow-Morton (1992) models listed, but then realized that the listed article by Duffie and Kan (1996) provides a synthesis and an extension of them.

The crisis that started in 2007 and finally extended to the euro crisis, has reminded us of the possibility that even bonds considered default-free might actually default. Default risk and other rare events are dealt with by the set of articles in Part V. Research in this part also emphasizes that correlations shoot up during market distresses; a lesson painfully learnt during the recent crisis.

Diebold notes we need more understanding of the fundamentals that cause risks, particularly those that become a systemic threat. These risks are typically intertwined with the business cycle. This is the broad theme of the last set of articles in Part VI. As regards systemic risks, “(m)ost related research is unpublished, and much is ongoing”. Hence they do not yet appear in this book. However, I believe an important, and related, concept of endogenous risk (see e.g. Danielsson et al., 11 March 2009, at www.voxeu.org) might have deserved some comment in the book.
Diebold is fully aware of the limits of our knowledge and the possible implications of this for policy. He notes that “a cynic might assert that, by focusing on (known) risks, the existing literature has made us experts on the least-important aspects of financial risks management” (i.e., risks prevailing in normal times), although he believes that such a view is not balanced; the existing literature has certainly served important needs.

To conclude, Professor Diebold’s fascinating compilation summarizes the history of risk measurement research, focusing on research prior to the global financial crisis. After the crisis there has been much debate on the need of a paradigm shift of some degree in economics and finance. Adapting Andy Haldane, perhaps the path more followed in the future will be to study optimal choice under uncertainty – the inability to form priors on the distribution of future outcomes – rather than risk. I can’t wait to see the next authoritative list of the “must readings” of the ongoing new research agenda in risk measurement, to be provided either by Professor Diebold or one of his peers.

Table: Contents of Financial Risk Measurement and Management (Francis X. Diebold) by numbers

<table>
<thead>
<tr>
<th>Part I</th>
<th>Part II</th>
<th>Part III</th>
<th>Part IV</th>
<th>Part V</th>
<th>Part VI</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of articles</td>
<td>6</td>
<td>7</td>
<td>10</td>
<td>6</td>
<td>4</td>
</tr>
</tbody>
</table>

3 Excluding Bachelier (1900).

---

News from the SUERF Council of Management

It was with particular sadness that Council learnt of Catherine Lubochinsky’s decision to stand down from the SUERF Council of Management at the start of 2013. Catherine had served on Council since 2005, including being President of SUERF between 2006 and 2012. In succeeding David Llewellyn, she became SUERF’s first Mme Présidente.

Catherine’s career to date has seen her active across all three of SUERF’s three constituencies. In academia she was until recently Professor of Economics and Finance at the University of Paris 2, teaching courses on financial markets, fixed income, derivatives and interest rates. Her research has focussed on derivative strategies, credit spreads, credit rating agencies, financial regulation and fund management. She has been a consultant to various financial institutions in the private sector and also a consultant to the Banque de France’s Financial Markets and Stability Department. She has also been a member of the “Cercle des Economistes” and the European Shadow Financial Regulation Committee (ESFRC), and has been a very familiar speaker at conferences throughout Europe and in business media in France.

The SUERF Council of Management wishes her every success in her exciting and challenging new position as Managing Director, Research, of the Global Risk Institute in Toronto – and hopes that her relocation to North America will not prevent her from attending future SUERF events. Catherine’s unique blend of Gallic flair and enthusiasm, as well as her ability to mix light-heartedness with seriousness as required will be greatly missed within Council.

Urs Birchler
The SUERF Council of Management was very sorry to learn earlier in the year that it would be losing the services of Christian Pfister, whose departure from the Council of Management coincides with a change in responsibilities at the Banque de France, where he was appointed the Deputy Director General for Statistics at the start of 2013 having previously been the Deputy Director General for Economics and International Relations.

Christian had served on the SUERF Council of Management since 2011, including being involved with preparations for SUERF’s joint conference with the Banque de France, at which event we will also celebrate SUERF’s 50th Anniversary. We of course wish him every success in his new position within the Banque de France and hope to see him at future SUERF events.

We are delighted to welcome Alain Duchâteau as an Observer to the SUERF Council of Management, succeeding Christian Pfister, whom he has also succeeded as the Banque de France’s Deputy Director General Economics and International in January 2013. Prior to this appointment he was the Banque de France’s Deputy Director General of Statistics and Director for International Relations. He has served on numerous committees including the CMFB (Advisory Body for Eurostat), the Committee for Global Financial Stability of the BIS and BEAC (Banque des États de l'Afrique Centrale).

Between 1997 and 2006, he was first Deputy Director and more latterly Director for Research and Policy at the General Secretariat of the French Banking Commission, and a member of the Banking supervision Committee of the Eurosystem and member of several working groups of the Basle Committee having previously been Head of Foreign Exchange Reserves Management at Banque de France. He holds an MA in Economics from the University of Chicago, a Master in International Economics from the University of Paris-Dauphine and degrees from the Institut d'Études Politiques de Paris and Hautes Études Commerciales Paris.

We are delighted to welcome Natacha Valla to the SUERF Council of Management as an Observer. Natacha is Executive Director at Goldman Sachs in Paris, and is in charge of Macroeconomic Research for France, Italy and the Euro Area, focussing on macroeconomic and policy analysis, structural issues, conjunctural assessment and forecasts.

She joined Goldman Sachs from the European Central Bank during which time she was also seconded to the Research Directorate at the Banque de France. She has also lectured in International Economics at the HEC Business School and the Institut d'Etudes Politiques de Paris, and has also been a Consultant at the OECD and the IMF. She holds a PhD in Economics from the European University Institute in Florence and a Masters in Economics from the University of Lyon. She regularly participates in roundtables and interviews in the media both in France and overseas. She is of course no stranger to SUERF events, having previously spoken at past SUERF Conferences and Colloquia in recent years.

SUERF Council of Management member and former SUERF President (2000-2006), David T. Llewellyn, Loughborough University, has been appointed Chair of the European Banking Authority’s Banking Stakeholder Group, having previously been the Group’s Vice Chair. The Group is composed of 30 members, drawn from EU member states and representing credit and investment institutions operating in the Union, their employees’ representatives, consumers, users of financial services and representatives of SMEs. The Group’s role is to help facilitate consultation with stakeholders in areas relevant to the tasks of the EBA.

The Group is consulted on actions concerning regulatory technical standards and implementing technical standards and, guidelines and recommendations, to the extent that these do not concern individual financial institutions. Furthermore it also submits opinions and advice to the Authority on any issue related to the tasks of the Authority, focussing in particular on common supervisory culture, peer reviews of competent authorities and assessment of market developments. The Group also has the power to submit a request to the Authority, as appropriate, to investigate alleged breaches or non-application of Union law.

Further information about the EBA can be found on its website at www.eba.europa.eu
SUERF Council of Management

Urs W. Birchler
President

Frank Lierman
Vice-President

Ernest Gnan
Secretary General

Donato Masciandaro
Hon. Treasurer

Juan Ayuso

Morten Balling
Managing Editor
Editorial Board

Allard
Bruinshooffd

Jakob De Haan

Alain Duchâteau

Philipp Hartmann

Patricia Jackson

Esa Jokivuolle

Ryszard Kokoszczynski

David T. Llewellyn

Robert N. McCauley

Jürgen Pfister

Jens Ulbrich

Natacha Valla

Contact details and curricula vitae of Council Members can be found on the SUERF website at www.suerf.org
New SUERF Studies


Further SUERF Studies planned for 2013 will include the proceedings from the SUERF/Nykredit Conference in Copenhagen (SUERF Study 2013/4) and the SUERF/OeNB/BWG Conference in Vienna (2013/5)

50th Anniversary Volume

Work is at an advanced stage on the 50th Anniversary Volume - entitled "50 years of Money and Finance: Lessons and Challenges" to be published later this year to commemorate SUERF's 50th Anniversary. A group of distinguished researchers have been asked to look at the monetary and financial history of the last 50 years, to summarise the most important trends and experiences and to draw conclusions for the future. Authors have been asked to identify the main trends in international financial markets, in global and European macroeconomic (im)balances, in European financial integration, in central banking, in banking and securities markets, in financial innovation and in the origins and handling of financial crises. Path-breaking events, political decisions and relevant outstanding research contributions in the field since the early 1960s are all mentioned.

Forthcoming SUERF Events

The Council of Management has approved the following forthcoming events in 2013. Further information about each event can be found, in the first instance, by consulting the microsite of the event.


12 December 2013 Vienna, Austria SHERF/UniCredit & Universities Foundation Workshop Banking and Financial Markets between Integration and Segmentation after the Crisis Conference Microsite: www.suerf.org/vienna-uuf2013

Further information about all forthcoming events is available from the SUERF website at www.suerf.org