Inside this issue

Brussels Conference Report  2
SUERF/UniCredit & Universities Foundation Workshop  10
London Conference Report  11
Vienna Programme  19
Milan Programme  21
Helsinki Programme  22
Book Reviews  24
News from the Council of Management  28

Upcoming Events

44th OeNB Economics Conference in cooperation with SUERF
The Financial System of the Future
Date: 29-30 May 2017
Location: Vienna, Austria
www.suerf.org/vienna2017

SUERF/BAFFI CAREFIN Centre Conference
New Challenges in Central Banking: Monetary Policy Governance and Macropudential Issues
Date: 8 June 2017
Location: Milan, Italy
www.suerf.org/milan2017

SUERF Member Announcements

We welcome information about activities of our Members to share with the SUERF community. If you would like to enhance your visibility by promoting events or making announcements through our channels, please email us at suerf@oenb.at. www.suerf.org/member-announcements

De Nederlandsche Bank (DNB) Call for Papers Submission deadline is 31 May 2017 20th Annual Research Conference “Fiscal and Monetary Policy in a changing Economic and Political Environment”

Belgian Financial Forum (BFF) Invitation to Colloquium “The low interest rate environment: causes, consequences and risks” 4 May 2017, Brussels

European Central Bank (ECB) Call for Papers Submission deadline is 15 May 2017 “Monetary policy in non-standard times” 11-12 September 2017, Frankfurt am Main

European Investment Bank (EIB) Current Vacancies Current Vacancies - EIB Group

www.suerf.org
Conference Report

By Morten Balling, Carlos Bourgeois, Frank Lierman and Jan Vermaut

The conference was organised to celebrate the 80th anniversary of the journals Revue bancaire et financière/Bank- en Financiewezen and Revue de Droit bancaire et financier/Bank- en Financieel Recht, edited by the Belgian Financial Forum (BFF) with the help of the Larcier Group.

Fintech means financial technology. The words refer to new applications, processes, products and business models, which are transforming the financial services industry in rather disruptive ways. The organisers of the Brussels conference had invited experts from Fintech start-ups, financial regulators, bankers, insurers, consultants and lawyers to present to the audience their very different perspectives on the impact of Fintech in particular on retail banking. The very high attendance at the conference reflected probably the deep concerns in the financial industry about the implications of Fintech for the future of payment systems and other fee based financial services. Managers of traditional financial services providers understand that they need to learn about Fintech and to transform their products and their business models.

After the welcome remarks by Jean Hilgers, President of the BFF and Executive Director of the NBB, and by Frank Lierman, Vice-President of SUERF and Chairman of the Editorial Board of the Revue bancaire et financière/Bank- en Financiewezen, Jan Smets, Governor of the NBB presented the 23rd SUERF Annual Lecture on “Fintech and Central Banks”. His starting point was the distributed ledger technology (DLT) which
offers a decentralised electronic transaction database, distributed and shared by members of the network, thereby providing a tool to process and record asset transactions without any trusted parties, but with complete transparency and immutability and without necessarily revealing identity. The promise of improved efficiency seems the central interest for commercial banks, which seek central banks (CB) support due to their crucial role in the management of interbank settlement. For CB’s the DLT offers the potential of exchanging CB money more efficiently and to launch the central bank digital currency (CBDC). But DLT helps also to further underpin trust in the monetary system, which is crucial in a fiduciary system. Is CBDC a solution for the zero lower bound (ZLB) problem? The likelihood of the ZLB becoming binding has increased due to the structural components of the roots of the ZLB constraint and the higher macro-economic volatility since the financial crisis. How to slacken the ZLB constraint? Abolishing cash? A CBDC implies holding an account at the CB and DLT permits anonymity. A CBDC could provide competition for deposits. It could limit the practice of fractional reserve banking and make for a safer financial system with less scope for impairments in the monetary policy transmission. At first sight a desirable outcome. But is this indeed the case? Are banks ready to step up an alternative funding? If not, we could expect a tightening of the credit market and at least an increase in lending rates. Or should the CB step in, for instance as provider of alternative bank funding? Moreover the adoption of a CBDC could make credit supply more volatile. To conclude there are more questions than answers about a CBDC and how exactly it should be designed. We should always think before we act. If new insights originate from thinking they can only progress by discussion.

Session 1 - The threats and opportunities of Fintech: Is Fintech an enabler or a disruptor?, was chaired by Frank Lierman, SUERF and BFF. Jürgen Ingels, Managing Director of Smartfin Capital developed the theme “Fintech or Fin 4 Tech?”. There are ten differences between the dot.com hype (2000) and the Fintech situation (2016). Between 2000 and 2016 we moved from an expensive server infrastructure towards cheap cloud solutions, from USSR style development towards a trial and error development, from standalone solution towards end-to-end solution, from in house development towards third party development, from product centric approach towards customer centric approach, from perpetual license towards subscription model, from in your own neighbourhood towards anywhere in the world, from improve towards focus on talent, from knowledge is power towards sharing knowledge is power and from proprietary towards open source.

Banks need to lean towards an open platform. However they don’t have enough money, people and time to rebuild the infrastructure and the current infrastructure does not allow for open source, sharing, usage of data, real time interaction. Three ingredients of the solution are:

- The platform has to move from silos and multiplication of data to layered monoliths, which are dynamically reconfigurable. They remove chaos and are easy to govern apps. Open platforms will allow banks to participate in API-ecosystems, to shield back end systems, to become customer centric, to create and change rich services faster, to scale cheaper and to collaborate with each other and with Fintechs.
- The ecosystem in Belgium is in place thanks to the headquarters of Swift, Euroclear and BNY Mellon, the presence of the EU and good education and
cheap housing. Others such as Clear2Pay, Vasco, Capco, Ogone, Finarch paved the way. Up to now it is mainly B2B. It is still small but is fuelled by powerful partners such as the four largest banks, the largest telecom company, and others. A new Fintech Valley in Brussels is built up.

- The money is available thanks to venture companies and finance, such as Smart fin.
- All in all, Fintech improves the original financial system with technology. Tech 4 Fin rebuilds the system using technology.

Marc Niederkorn, Senior Partner, McKinsey Company expressed his views on “The impact of Fintech on the Retail Banking”. The key message is that thanks to Fintech we are moving towards an ecosystem of services covering all sectors provided by a large group of partners offered via a B2C/B2B platform with deep intelligence, accessible, omni-channel, fully personalized, embedded into everyday life 24/7. The global investment in Fintech jumped from 2.4 billion USD in 2011 to 19.1 billion USD in 2015. 52% of the Fintech investments focus on retail banking. The EU 27 represents 9% of the global Fintech investments. There are at least thirty areas emerging as new norm in banking, such as mobile payments, P2P lending and investment, mPos devices, new digital lending, robo-advisory, crowdfunding, trade finance, collateral management, cash management, etc. Most of them are still in the hype phase. Only the B2C payments, P2P lending and robo advisory are already in the bust phase. The majority of B2B ideas are already in the so called enlightenment phase.

It is clear that Fintechs shape customer expectations. Take the payments example. Between 2000 and now we moved from card-entry over one-click check-out towards omni-device and the future could be an auto-purchase. It is not only limited to consumer facing space, but also rapidly creeping up to SME and corporate payments. We identify 690 mobile payments Fintech attackers across the globe. Players with large customer base (e.g. GAFA) are formidable competitors. The battle for new payment solutions will not be fought over technology, but over solutions. Banks should not set on one hype technology as solution space. The offer is fragmented and no winner has yet emerged. At the same time broader innovations in commerce are likely to influence the nature of future payments solutions. Successful solutions follow six winning markers: guaranteed satisfaction of goods to buyers, targeted marketing for merchants, digital offers, payments mechanism for niche markets, established infrastructure, market context (e.g. online remittances via account to account and cash pick-up), adjacent revenues such as prepaid cards for the unbanked by leveraging revenue from store traffic.

The impact on sector economics shows us that customer disintermediation targets the most profitable activity in banking. Origination and sales account for some 60% of global banking profits and give a ROE of 22% in 2014. The traditional balance sheet activities generate a ROE of only 6%. We know that digital attackers enjoy substantial cost advantages: for operating expense only 2% of outstanding loan balance against 5 to 7% for traditional banks. Another example: customer acquisition cost only 5 USD per customer against 300 USD. The fee based businesses are likely to experience the largest margin reductions. For the Eurozone the most vulnerable activities are payments and asset wealth management (minus 10 to 20%), followed by term deposits, mortgages and consumer finance (minus 3 to 10%).

Bank profits in 2020 are at risk due to the low interest rates and the digitalisation. The 2015 profit of Eurozone of 88 billion USD could drop to only 15-33 bn USD. The cost gap is estimated at some 50 bn USD of 13% of OPEX. Banks are drastically cutting costs. The announced cost and headcount reduction between 2015 and 2020 for the Eurozone are resp. 21 bn USD and 45,000 FTEs, which is resp 12% of total costs and 14% of total FTEs.

Partnerships are necessary to survive. Already 52% of the top 100 banks are active in partnerships with Fintechs while the share of Fintechs having a B2B business model has increased from 34% in 2011 to 47% in 2015.

In session 2, chaired by Wim De Waele, CEO Eggsplore, testimonials were given by five Fintech companies.

QOVER, represented by Jean-Charles Velge and Quentin Colmant, Co-founders and Directors, is building the first ever B2B2C Sliced On-Demand Digital insurance infrastructure, aiming to change the way insurance is designed, managed and distributed. Qover’s unique digital library of sliced coverage allows consumer
businesses to increase their revenues by adding complementary insurance solutions to their product offering. Qover’s easy-to-use and robust APIs are designed to seamless integration within any ecosystem, website or app. Qover digitally manages the whole stack of insurance: product design, pricing, risk and claims. Qover is headquartered in Brussels and operates in Europe. Customers are e-commerce firms, banks, motor retailers, insurance brokers willing to open a digital distribution channel.

THE GLUE, represented by Stefan Dierckx, Co-founder, is a contemporary, new solution which enables financial services providers to quickly develop innovative digital products and services for today’s online consumers. These are delivered by creating a customer centric environment, connected with and communicating to core legacy processing systems. The approach helps to significantly reduce costs and accelerates time to revenue. The Glue is a unique, non-disruptive, enabling solution which helps to protect and prolong the lifespan of existing infrastructure investments. The Glue is established in Diegem and operates in Europe. Customers are retail banks, wealth management firms, private banks, non-life insurance providers and other consumer finance organisations.

EASYVEST, represented by Matthieu Remy, Co-founder and CEO, is a fast growing online financial advisor that offers highly efficient investment solutions. This implies delivering higher return to customers through a sound investment approach designed around the core conviction that “nobody beats the market”. Efficiency means also providing a delightful customer experience. This includes opening of an account within 15 minutes and being able to chat or talk to a human financial advisor at any time. Efficiency means affordable. Easyvest opens accounts as of 5.000 euro and charges a unique fee as low as 0.5% per year. Easyvest is settled in Brussels and operates in Europe. Customers are mainly younger generations, but half of its customers are above 40 and represent two thirds of the assets.

RATEPAY, represented by Miriam Wohlfahrt, Founder and CEO, offers online payment solutions with real-time credit decision and 100 percent payment guarantee. Ratepay provides an easy and frictionless access to the most popular online payment methods in the DACH region such as instalments, check-out lending, invoice payment and SEPA direct debit. Ratepay is based in Berlin and operates in Europe. Customers are companies such as Eurowings, myToys, Aboutyou, Secret Escapes, Casper, 123tv, Heizöl 24.

XPENDITURE, represented by Wim Derkinderen, Co-founder, is a leading expense management solution that helps you save time managing your expenses. Xpenditure has reinvented the entire expense management process by focusing on digitizing receipts and on eliminating the need for expense reports. Xpenditure is settled in Mechelen and works in over 150 countries worldwide. Customers are corporates from 500 to 5000 employees such as consulting (Deloitte, ...), FMCG (Pernod-Ricard, ...), manufacturing (Kone, Miele, ...), automotive (BMW, Jaguar, Scania, ...), but also small and medium businesses and independents.

Peter Kerstens, Head of Financial Technology Task force and Advisor on Cybersecurity, European Commission DG for Financial Stability, Financial Services and Capital Markets Union, developed the theme “Does Technological Innovation require Policy and Regulatory Innovation?”.

His starting point is that the financial sector represents 700 bn USD or 20% of global IT expenditure. A big part is spent on maintaining legacy systems and regulatory issues. Finance has become an anytime, anyplace, any device proposition, and in fact finance has become fun. This technological revolution offers new opportunities for all stakeholders. Business models are adapted. We have a change of era. The whole value chain is on the move. Finance is about money, but also increasingly about data and technology. Regulatory and policy innovation are needed. DG FISMA follows four principles: Fintech is a continuum, need of multi-disciplinary approach, need for a single technology policy and the embracement of innovation. New methods of regulation and supervision are unavoidable: more diversity of financial institutions implies more specialized licensing regimes. Innovation in finance is tested via the sandbox approach. It looks to innovations not via traditional compliance reports and ticking the box, but by having a dialogue with regulators and seeing how one can establish the merits of and issues with
innovative operations, and seeing what requires regulatory control and intervention. A modernisation of outsourcing requirements is also needed.

The second big area the task force is looking at is blockchain technology. The centralised approach must be replaced by decentralisation. Furthermore the existing representational system – your bank account does not hold any money, it just says that you have some money in the bank – could be replaced by distributed ledgers on which you hold the assets themselves in tokenized form. Cyber security must be fine-tuned, even if the financial sector is by far the best aware and prepared for cyber incidents and attacks. Integrity is guaranteed. Operational risk management is primarily quantitative but more capital is not a buffer against cyber-attack. Finally a review of the data policy is required. Not all data hold in the financial sector is private. Standardized data facilitate reporting-ownership of data and location of data.

The future will be a function of which technological innovation is capable of what the economy and economic powers will allow for and the values which we hold for ourselves on the way we want financial markets to be regulated.

The third session, chaired by Ernest Gnan, Secretary General of SUERF, focussed on “The Economic and Legal Vision on Fintech”. Geert Gielens, Chief Economist of Belfius Bank and Insurance, looked at “The impact of Technology on the Economy”. There is a clear link between technology and growth. The higher the GDP/capita the higher the global innovation index. R&D expenses are crucial. Of course productivity benefits of this investment, shown by an increased output which goes hand in hand with a decrease of employment. Nevertheless a lot of forecasts are quite precise on the number of jobs which could be eliminated but the expectation on new jobs is not yet quite clear. Flexibility of labour markets is crucial and of course also a permanent training. Technology leads towards a consumer surplus: greater choice of products and lower prices, also for software, computers and IT applications. Technology contributes to growth and consumer wellbeing. But it needs to be embedded in a fertile system. It is not a Pareto improvement. Mitigation via demand and supply side measures are needed. The benefits outweigh the disadvantages.

Alvaro Martin, Chief Economist on Digital Regulation of BVVA looked at “The Economic Impact of Fintech”. Banks are facing the emergence of Fintech at a moment that interest rates are historical low, growth expectations are mitigated and regulatory pressure on capital requirements and consumer’s privacy increased. At the same time banks are asked to be more innovative and to be resilient in terms of cyber security. Mobile, internet and cloud computing are exponential growth technologies. Most of the venture capital of banks is used for Fintech. Regulators use their sand boxes and innovation hubs to enter the ecosystem. Global investments in Fintech grew sharply, but recently some slowing is observed. Efficiency gains, lower transactional costs, better risk management, new products, new value propositions, customized offering are the expected impact of Fintech on the financial ecosystem. Disruption is in the air, but in fact it is the arrival of new business models which is crucial. There is no conclusive evidence concerning the positive or negative impact of automation of jobs, artificial intelligence, etc, on the economy. Regulators have to find a balance between the new customer value propositions and the protection of the customers. The digital platforms offering great service for free could be the new internet giants. The Spotify model could be the example by excellence.

Tanguy Van Overstraeten, Partner at Linklaters, presented “The impact of the General Data Protection Regulation (GDPR) on Fintech”. The regulation has already been published in the Official Journal and will apply by 25th of May 2018. The actual data protection rules focus on the processing of personal data. The GDPR introduces an increased enforceability and higher administrative fines. The fundamental principles for data controller, data processor, processing conditions remain, but some new elements are added. What will be stricter? Content requirements on data which could also include genetic and biometric data, transparency, data processing agreement. What will be new? Accountability, private by design or by default, data breach notification, new rights for data subjects. Security is crucial. Data transfers are limited to the EU (EEA) but some derogations and safeguards are possible. GDPR will
impact Fintech because Fintech is full of data and Big data technologies are used. The goal is to strengthen trust. Compliance with GDPR could be an opportunity to enhance the branding of Fintech companies.

In the fourth session representatives of well-established financial institutions debated the topic on how they evaluate the challenge of Fintech. Rik Vandenberghe, CEO of INF Belgium and President of Febelfin, chaired the session. The panel was composed of the following persons: Michael Anseeuw (MA), CEO of Hello Bank, subsidiary of BNPParibas Group, Jörg Hessenmüller (JH), Head of Group Strategy & Development of Commerzbank, Frederik Meheus (FM), Global ex-US Head of Retail Technology of Blackrock, Rudi Peeters (RP), CIO of KBC Group, Gunter Uytterhoeven (GU), Chief Customer & Data Officer of AXA. Different themes have been debated. For each of them please find here the most relevant statements of the panel members.

– Customer behaviour
    RP: The share economy will pop-up and the on-demand economy will be huger.
    MA: The bank evolves towards an open-sourced and transparent platform.
    JH: The customer has the power and data will be the game-changer.
    FM: Not all people trust technology so there will be still need for a financial advisor.
    GU: Customers that consume cars in-stead of buying them and self-driving cars change the risk management strongly.

– Customer experience
    MA: Biometrics with nanotechnology enable banks to do things much better than today.
    RP: Regulations and security are not blocking banks from being digital even data privacy is not an issue any more from a customer point of view.
    FM: Aggregation of banks data and a European regulation create a very competitive space.

– Less regulation for Fintechs
    JH: Fintechs target those sweet spots in the value chain of banks, characterized by a maximum of customer interaction and the least amount of regulation. Cloud computing in combination of the huge database of customers could lead to a better business model for the banks.
    GU: The customer looking for a lot of relevant information and an easy use of services is hampered by regulation. The creation of companies receiving the mandate of customers to manage all privacy elements could be a solution.
    MA: We have to find an equilibrium between strict regulation and the wider scope of finance. Regulation has been up to now a major reason why disintermediation of finance is not yet pronounced.

– Flexibility of the actual players in banking and insurance
    GU: The IT legacy is a serious handicap, but IT investments are already huge.
    RP: It is not an IT, but a business issue. We have the best people and good technology in house and this is not a legacy. New developments are there but a better organisation and governance are welcome.
    FM: Most players are not ready due to the legacy of thirty, even forty years of IT systems; others are aware of the challenge and consider that the head of innovation has to be the head of business.
JH: A change of the culture of the firm is necessary. A good understanding of the customer needs and the development of end-to-end goals are for the change of the IT systems to create a modern bank which provides a superior customer experience.

MA: The biggest challenge is how to steer your people and how to interact as an organisation. Digitalisation of banks is on the way and they are not missing the train. But how to manage the speed of the observed exponential growth of digital services to the customers?

– The change of the culture
RP: It starts already with the hiring of people, with the engagement of the CEO and the executive committee. IT is part of the business, like payments or asset management of life, etc.

MA: Put the customer in the middle of your three year business plan and be flexible to adapt it as fast as needed

RP: Planning and budgeting are needed to move forward. Taking the risk: if you empower somebody, without feeling uncomfortable, you probably haven’t empowered enough

MA: We need to focus on, even in the non-IT, digital thinking and way of working and interacting, which must be embedded in the DNA of every employee in front- and back-office

JH: React fast is the opposite to how the bank sector developed in the past, due to regulations, control in command, sweet sign offs on every policy.

– Financial sector lagging or frontrunner?
FM: Regulation change is the main driver together with a bit of a culture spirit. North Europe is more flexible than South Europe

RP: Belgium is lagging in e-commerce but is a frontrunner for e-banking. We also need e-governance to be successful

MA: Sweden could be an example because there is a generation of entrepreneurs which is strong in IT and Fintech, trained during the last 25 years already. Digitalisation goes beyond banking and influence the whole society. Looking to the infrastructure, the e-banking and the available technology we can be proud of what has been done and of what is done today.

GU: Belgians are less good in some kind of gadget innovation, but we are better in some fundamentals streams like customer journey designer, like big data.

– Collaboration and exchanging of knowledge as key factors of success
JH: The creation of an ecosystem which eases the lives of entrepreneurs and SMEs is easier and better when we combine the strengths of the traditional banks and those of the Fintech newcomers

FM: Open APIs are standards for the financial institutions to have a smoother dialogue with Fintech companies. Unfortunately not many institutions have an open API

RP: We will be forced to work with Fintech, doing things much better than we are doing. Different ways are open: copy, joint venture, acquisition? You need a clear strategy about which part of your value chain you take them for and how you do integrate them

MA: Bancontact and Isabel are nice examples of collaboration between Belgian banks. Working with Fintech in that domain is recommended

GU: As incumbents we add value to Fintech. We have the customers and volume, and we can deal with regulation

RP: Three big banks and Eggsplore launched recently a new mobile payment system.

– Marketing of the added value for customers
JH: We should be convinced what we really deliver and that much by what we promote via newspaper or whatever

FM: Everybody must understand that we can use technology to our advantage to serve the customer in a proper way

MA: Actions speak louder than words

GU: how to move via digitalisation our value to other levels beyond our balance sheet?
Blockchain: threat or opportunity?

RP: For sure both. The trade finance application in KBC has proven: lower price, easier infrastructure, new business opportunities (e.g. SMEs), bigger market, smaller fee. Experimenting is essential, but technology is still changing and legislation is not adapted. I am a strong believer.

JH: Don’t use blockchain to replicate your existing flows. One of the biggest values of banks is to inject trust into the system. Part of it can be digitalized. Not thinking about it, is not an option.

RP: The combination of blockchain with “know your customer (KYC)” can lead to one of the biggest in-depth changes in the whole market. Linking this with the internet of things is certainly a major step.

JH: KYC can become a service because there are many other players not familiar with that.

MA: It is a business process optimisation for instance in the custody business.

GU: In insurance it gives the possibility to develop peer to peer insurance models at a cheap cost.

RP: The knowledge is the most blocking factor and of course the reluctance to start experiments.

Ultimate key to success concerning digitalisation

GU: Culture and people.

RP: Learn outside, organisational agility which is more than technology, so it means governance, planning, budgeting, hiring, a new way of working and also top level support.

JH: It is a chance, an opportunity. If we see it as a threat, we will lose.

FM: Disrupt your own thinking and the way you organise yourself.

To summarize Fintech presents important threats and opportunities for people and institutions involved in retail banking. The entrepreneurs from the Fintech start-ups focused in their presentations at the conference on the opportunities created by financial innovation in a digital world. From their perspective, the word disruption has a positive ring. Fintech opens new business opportunities, when for instance e payments, asset management and other financial transactions and exchange of investor information can be carried out much smarter and cheaper than before. In particular young customers are becoming more sophisticated and expect their bank to be digitally sophisticated as well. In today’s world and in the years to come, the ability to innovate determines the competitiveness of financial services suppliers. Some of the start-ups act as independent financial services providers in competition with traditional suppliers, while others provide Fintech based advice and software to existing banks, asset management companies and insurance companies. Regulators admitted during the conference that technological innovation requires policy and regulatory innovation. Cybersecurity, operational risk and protection of data are serious regulatory concerns. In the contributions by banks and insurers there was a different balance between the discussions of threats and opportunities. Several of the speakers described the digital revolution as a challenge because it meant stronger competition and pressure on the profitability of traditional financial services. Financial institutions are forced to reduce their costs, to modernize their IT-systems, to develop digital platforms and to improve their products according to new customer needs. Traditional bank functions are being replaced by digital solutions. It is a great challenge for employees, bank managers and bank board members to keep themselves up to date with Fintech trends and their implications for business opportunities. Business plans must be adapted currently. Partnerships between financial institutions and Fintech start-ups may be part of the solution. Employees with digital skills will gradually replace bankers with a traditional education in accounting, management of cash, credit and security investments.
On Thursday, 26 January 2017, a half-day workshop on the topic of “Asset management at crossroads” took place at the Vienna University of Economics and Business. Following a “Call for Papers”, the 4th SUERF/UniCredit & Universities Foundation Research Prize was awarded to two winning papers (EUR 3,000 each) that were presented during the workshop by the authors:

Heiko Jacobs (University of Mannheim) with the paper "Beta and Biased Beliefs"

Mancy Luo (Ph.D. candidate in Finance at Tilburg University) with the paper "Financial Product Design and Catering: Evidence from the Global Mutual Fund Industry"

The following discussions provided the participants valuable insights into various issues addressed by the papers.

SUERF would like to thank Vienna University of Economics and Business, especially Professor Josef Zechner, Professor Christian Laux and their team, for hosting this workshop.

The papers and presentations are available for download on the SUERF website at www.suerf.org/suerf-unicredit-and-universities-foundation.
Brexit and the Implications for Financial Services

Key insights from a SUERF conference hosted by EY
London, 23 February 2017

Conference Report

By Morten Balling, Ernest Gnan and Patricia Jackson

On 23rd February 2017, SUERF and EY organized a conference on “Brexit and the Implications for Financial Services” at EY’s offices, Churchill Place, Canary Wharf, London. While the outcome of the Brexit negotiations remains highly uncertain, the conference discussed the burning questions for financial firms, markets and regulators with a range of different viewpoints expressed on a number of important themes: the systemic risks from Brexit; the possible role of equivalence versus passporting to continue to facilitate cross-European financial transactions; the effects on the deep wholesale markets located in London and the question as to whether the sheer size and interconnectedness of London as a financial center implied that it would still act as a magnet for European business; the effects on Europe if the result created fragmentation of markets and CCPs; and the implications for bank, insurer and asset manager business models, in particular whether Brexit would act as a catalyst for restructuring and retrenchment from activity in the EU27.

The economic backdrop to Brexit and the implications of political uncertainty

Peter Praet, Member of the Executive Board, European Central Bank presented his views on the economic backdrop of Brexit and the effects of political uncertainty. In terms of the current European economic prospects, Praet was positive. The euro area economy has been relatively resilient in the face of a number of risks and uncertainties at the global level. The ECB’s monetary policy measures have contributed to the positive economic developments. Measures of economic confidence have markedly improved.

Nonetheless he highlighted the fact that political uncertainty, epitomized by Brexit, poses increasing concerns and creates downside risks to the economy. The outcome of the UK referendum in June 2016 can be partly attributed to the decades-long development and spread of negative popular narratives about European integration. Anti-establishment and anti-globalization movements have been very active.

This movement tends to overlook the fact that international trade and economic growth are strongly correlated. Multilateralism has been a cornerstone of economic expansion since World War II and the WTO legal framework for international trade has proved to be robust. Brexit could have a significant impact on European trade in goods and services with knock on effects on the economy.

Given the added risks, effective institutional structures are vital, which includes sound supervisory frameworks. The independence of central banks is also essential. For example, during the crisis, the ECB was an anchor of stability. The international institutional architecture has been strengthened and has also played an important role. In the euro area, the establishment of the Single Supervisory Mechanism and the Single Resolution Mechanism has strengthened the financial system. Anti-globalization and anti-establishment sentiments are likely to remain a factor. History has shown that attitudes toward openness to trade come in cycles with periods of protectionism succeeding periods of free trade. Brexit proves that there is a possibility for European integration to go into reverse and this could jeopardize economic prosperity. Monetary policy can do much but structural reforms are also required to ensure the full diffusion of economic gains and economic growth across the Single Market to maximize the benefits to all citizens.

Charles Grant, Director, Centre for European Reform looking at political uncertainty, observed that Theresa
May has set out her plan for Brexit: the UK will leave the single market and the customs union and seek a free trade agreement with the EU27-countries. It is, however, not certain that the country will succeed. The “article 50 divorce talks” may collapse in a row over money. Perhaps, the two sides will not be able to agree on the transitional arrangements that would lead to a free trade agreement. EU officials are pessimistic because they observe the pressure May is under to take a very tough approach to the negotiations, while there seems to be rather limited pressure for a softer Brexit.

Nonetheless he thought that several factors could favor a less-than-very-hard Brexit. A majority of Britain’s MPs want to retain close ties with the EU, as do business lobbies. An economic downturn (if it happens) could steer public opinion away from supporters of a clear break. However, other EU governments are mostly united in taking a hard line. They do not want populist leaders in other EU-countries to use Brexit as a blueprint and exiting the EU must be seen to carry a price. The British Government has yet to decide, for instance, what kind of special deal, if any, it should seek for the City of London; and what transitional arrangements it aims for. Britain’s strongest card is her contribution to European security but Britain’s other cards are weaker. The country regards the City of London as a European asset that should be cherished by all – but this is not how most of the EU27 sees it. Once Britain triggers article 50, the country is in a weak position: It must leave within two years, and if it has not signed a separation agreement before doing so, it risks economic chaos. Whatever happens in the negotiations, Brexit will be difficult for the UK. Exiting and relying on WTO rules, or perhaps even falling out of the EU without any separation agreement would lead to very high legal uncertainty for companies and individuals. Britain’s partners did not like the suggestion that Britain’s free trade agreement could take in elements of current single market arrangements for the car industry and financial services, since this would amount to “cherry-picking”. The EU27, by contrast, views the single market as “all-or-nothing”. Even the best possible deal that is feasible will harm the economic well-being of all concerned. The UK will, however, lose more than the rest of the EU. It is doubtful whether the “City” can obtain a good deal. Grant concluded that the UK is in a weak position and that the Government does not fully appreciate this.

Assessing the status of the European financial system as the backdrop for Brexit, Nicolas Veron, Senior Fellow, Bruegel, believes that the European financial system is in better shape than it has been since the crisis 10 years ago. This year is the first without major pockets of fragility in the banking system – with the exceptions of Greece and Cyprus. Difficulties with specific banks in Italy and Portugal are expected to be settled soon. Plans still need to be finalised for addressing problems with these banks and ensuring that all viable banks have full market access, but the European financial system is now beyond country-wide system instability. While systemic risk is now largely reduced, the European banking system still needs to return to soundness. The process for doing so would ideally be as market-driven as possible, and involve a lot more M&A deals, sales of portfolios, restructuring, governance changes, changes in ownership structures, etc. But it is important that, should those changes occur, they will not be done under the threat of systemic risk and the imperative of addressing system-wide fragility. Two further institutional considerations should be taken into account. The first one is the change made in the European parliament in 2014 that has led to the current expectation that Europe-wide lists will have a say in terms of the composition of the European Commission (EC). This is likely to change the dynamics of European parliamentary elections in 2019, and will reinforce the accountability and representativeness of the European Parliament. Second, the development of the European Banking Union and a single supervisory system led by the ECB have largely been successful, and ECB banking supervision is demonstrably more demanding in every member state (save Finland) than the national authorities it replaces. Not everything is rosy as the increasing social and political fragmentation indicates, and Brexit is likely to expose important weaknesses in the EU framework, particularly regarding markets oversight and supervision. Nonetheless, the EU is undoubtedly better prepared to deal with such an event now than it would have been only a few years ago.

Implications of fragmentation of regulation and markets

Piers Haben, Director of Oversight at the European Banking Authority (EBA), set out the benefits of the integration in markets and regulation. A considerable
amount of important work has been done since the financial crisis in terms of furthering international cooperation and agreement on common standards. However, much work remains to be done, for example to repair the still fragile EU banking sector, or to avoid further fragmentation of the EU’s financial systems (as can be seen by higher sovereign and corporate credit spreads, and a drop in cross border lending). Fragmentation makes it harder for business and investors. Financial integration has contributed to the development of EU economies and the development of the single market, has incentivized the development of cross-border banking and supported the availability of finance for households and businesses. Further, having broadly similar rules and regulatory regimes is not enough given how different jurisdictions interpret and apply them – which can cause considerable uncertainty for banks and investors, and could create opportunities for regulatory arbitrage. In this context, and given London’s importance for the EU’s financial system, it is crucial that Britain’s exit from the EU be as smooth as possible. Relying on an equivalence regime in and of itself will likely not be sufficient. For banking, equivalence is not about access but about rules – for example around confidentiality or consolidated supervision. Equivalence is perhaps broader under securities regulation while in banking an alternative to equivalence might be some form of mutual recognition agreement. However, it is unclear what exactly such an agreement would entail and the practicalities of such assessments, not least for resources, should not be underestimated.

In contrast, Jon Danielsson, London School of Economics, looking at the systemic risk effects of Brexit reached a different view on the implications of divergence and fragmentation. Concerns have been raised about the financial stability consequences of Brexit, but in his view Brexit should not increase or decrease systemic risk. One might even argue that differences in regulations enhance financial stability, as they reduce synchronized reactions of financial firms, which are an important cause for systemic instability. The crucial question to ask is what the unknown unknowns from Brexit are. Risks we know, we can manage. Very few mechanisms can cause a systemic crisis. For 30 years, investors have built their decisions on the assumption that the UK is part of the European financial market. The regulatory environment has several times been subject to “legal plumbing”, but that has not caused systemic risks. Since it is uncertain what a “Soft Brexit” would be, such a Brexit might be the most destabilizing outcome of the negotiations. One challenge put to Danielsson was whether fragmentation of markets and consequent loss of market depth post Brexit might lead to greater market volatility and hence greater systemic risk.

The ‘Single Market’ and equivalence for wholesale markets

Baroness Sharon Bowles, former MEP and chair of the European Parliament’s Economic and Monetary Affairs Committee, and currently a member of the UK’s House of Lords, distinguished between the different language used by the UK versus the continental countries in the original discussions on open European markets and the messages from that language of the actual focus of the different countries. The UK used the term “single market” thinking of it across Europe but as a platform to trade competitively outside Europe. Whereas continental countries started by using the term “internal market” with a focus on internal rules. This had led in the negotiations to more emphasis on broader equivalence provisions for third countries by the UK, with resistance from other countries. The provisions are patchy because a general consideration was to protect retail customers – therefore equivalence provisions were not included in all parts of the legislation. But there was grudging agreement that for infrastructure and markets the EU did need to connect up to the rest of the world. Nonetheless even here there was quite a fight in the negotiations. Now though, if you try to imagine what the implications of lack of equivalence for CCPs would be, what it would mean in terms of the extra capital that banks in the EU would have to hold, it shows that the earlier discussions reflected some reluctance to recognize the practicalities. If you look at the Commission’s attitude in the past few years, it has been that equivalence should only be allowed if it is in the interests of the EU, rather than wider connectedness, which cuts across the liberal nature of articles 63 and 64. With regard to financial services there is an approximation to a single market rather than an actual single market. There are still national provisions and the ability to have individual arrangements in a way that you cannot with goods. This is one of the sources of friction between the UK and the rest of the EU. The UK has felt
the EU hasn’t been a service based economy with provisions that enable full open access to services. In terms of the domestic political situation in the UK, the white paper on Brexit has large gaps - it does not mention risk, it does not mention sufficient options. There is a feeling that the government has made choices that do not necessarily carry a majority.

John Armour, Professor of Law and Finance, Oxford University looked at the importance of the UK in particular in wholesale financial markets – with around 85% of EU hedge fund assets under management, almost 80% of EU FX trading, over 70% of EU OTC derivatives trading, and over 60% of private equity assets under management, compared with a share of around 18% of EU GDP. This reflected the fact that the UK financial system was traditionally more market orientated and benefitted from agglomeration effects. This made the UK markets important for the EU27 which internally tended to rely on bank finance.

This makes the issue of equivalence and broader integration of wholesale markets across Europe even post-Brexit, under equivalence rules for third countries, important. Equivalence is, however, not a general framework but a lattice of specifics and a moving target – importantly it was also reversible. There is a patchwork of equivalence decisions covering different aspects of the financial markets and market infrastructure taken by the European Commission covering countries ranging from Abu Dhabi to the US. Third country equivalence is about either supervisory coordination or market access – it is the latter which is important for Brexit. There are no market access equivalence provisions with regard to retail and commercial banking and for insurance it is limited to some aspects of reinsurance. But there are equivalence regimes for asset management and wholesale markets. The MiFIR passport scope covers brokerage, underwriting, market making, structured finance, M&A advisory, proprietary trading and M&A securities. Given the countries already covered by some equivalence provisions including Mexico, Hong Kong, Singapore and South Africa, the speaker could not see how the Commission could with a “straight face” decide that the UK, which has as the starting position the same regulatory framework as the rest of the EU, was not equivalent. The Commission must determine whether the country has equivalent rules, an effective supervisory framework and in some cases reciprocity provisions.

A larger risk is delay in decisions by the EU commission and the ongoing need to ensure continued equivalence. Credibility in the UK’s commitment to ongoing equivalence was key - otherwise firms would not want to invest. He made the point that equivalence was clearly not a solution for access to European cross-border traditional banking. There the use of subsidiaries by UK and inbound banks established in the UK would be important or the negotiation of pass-porting rights by the UK government.

The effect on wholesale markets and market infrastructure

Franklin Allen, Imperial College London, focused on the effects of Brexit on markets. Today, New York and London are the world’s largest financial centers by far. Agglomeration effects are very important for the development of such centers. One important factor is that English is the language of finance. Activities in Hong Kong and Singapore are also based on English. The interconnectedness of different aspects of the City of London is also important, for example, the availability of legal and accounting services as well as banking, insurance and markets. Also a well-educated workforce is key. Taxation of income from shares and bonds for foreign investors and inheritance tax rules can also be relevant. It will be difficult for Frankfurt and Paris to develop agglomeration characteristics at par with those of current global financial centers such as London. It also needs to be borne in mind that electronic finance has loosened the connection between financial activity and geographic location. London is a leading center of Fintech. In the Allen’s view, Anglo-Saxon countries are also ahead with regard to the legal handling of financial crime, with a longer history of a tough stance on issues such as insider trading and market manipulation. As a result, Allen expected that New York and London would continue to dominate global financial markets even after Brexit.

A panel on stock exchanges and Euro clearing, derivatives, FX and bonds was chaired by Tim Skeet, Director, International Capital Market Association. He initially noted that the public suffers from misconceptions regarding the activities of the financial industry and its importance to the economy. Brexit and recent election results across the Atlantic reflect the fact that the benefits of international cooperation have not been properly explained to electorates.
Stephen Burton, Managing Director, The Association for Financial Markets in Europe (AFME), focused on the practical difficulties with clearing post-Brexit. CCPs would face a “cliff-edge” if they lost their equivalence post-Brexit as EU27 clients of UK CCPs would have to mark their risk exposure to a CCP at 100% for derivative transactions, rather than 2% or 4% under current requirements. This could pose a real systemic risk, and create opportunities for regulatory arbitrage. This is therefore an issue that must be carefully addressed, and which will require the UK government to think about how it will recognize CCPs in the EU. There is an urgency to the task, as AFME estimates that migrating CCP activities from the UK into the EU27 would take about 2 or 3 years of preparation time.

From a practical point of view, restricting Euro clearing to the EU would have deleterious effects – particularly on the position of the Euro as a global reserve currency. It would cut across global practice because, for example, dollar contract are cleared outside of the United States. Many CCPs outside the EU27 have multiple portfolios with offsetting balances between euros and dollars. Taking out Euros out of the equation would require calling for a lot more high-quality liquid assets as collateral, which are already in limited supply. CCPs would also have to be able to manage their risk, and have historical pricing on contracts they take on. Likewise, proposals to impose thresholds above which participants would no longer be able to clear as a CCP could backfire, as firms might then decide to take the clearing back to the US, rather than migrating to Europe.

Anthony Belchambers, Member of the Financial Services Negotiating Forum, discussed the issues of equivalence and euro clearing in the context of Brexit. Taking it as a given that the UK will not have full access to the single market, he emphasized the need to recognize that equivalence is “the only game in town”. Therefore, the focus should be on strengthening and streamlining the current equivalence regime rather than thinking of time-consuming alternative solutions for structuring cross-border market activities. The experience of market infrastructures, which do not have a passport and rely instead on equivalence and recognition, show that despite its problems, an equivalence regime works relatively well.

Given that post-Brexit 75% of Euro clearing would take place outside of the EU, the ECB’s focus on systemic risk of the EU27 is appropriate. However, not only does relocating euro clearing in the EU27 carry potential risks for market economies and the international standing of the euro, it may also not be effective in mitigating systemic risk. A better approach would be through enhanced regulatory cooperation and supervision of CCPs – if only because it would avoid significant market and legal disruption. A recent IOSCO industry analysis showed that the main challenge to such cooperation is that regulators do not trust each other enough in order to outsource their public duty responsibilities among themselves, recognising that some functions could be carried out by other regulators and cooperating on who does what. One issue raised in the questions was whether, if grit was thrown into the wholesale market machinery by Brexit, would the markets just transform and flow round it. The speaker thought it was quite possible that synthetic instruments could be created to avoid the need for euro clearing.

Kathleen Tyson, Director, Granularity Ltd., examined the impact of Brexit on various market infrastructures. Post-Brexit, the UK will need to improve control of assets in CCPs in order to improve the UK’s position in resolution. Mandatory margining of OTC derivatives has made CCP asset holdings huge, and CCPs based in the UK may be forced to hold clearing assets/initial margins in overseas depositories – in both the EU and the US. Therefore, agreements with foreign jurisdictions should ensure that CCPs in the UK retain residual control of surplus assets in foreign depositories to recover value for UK claimants in case of resolution.

Mandatory OTC margining now globally creates the risk of negative feedback as margin calls force selling in illiquid and volatile markets. For instance, shocks such as the Brexit referendum and the US presidential elections dislocated markets because intra-day margin calls forced immediate selling in markets that are less liquid than they were in 2008. More generally, the series of unexpected and poorly understood flash crashes since 2010 showed how vulnerable markets are. Developments such as quantitative easing, dealer disintermediation and hoarding by investors in anticipation of margin calls, have contributed to high quality liquid asset shortages. Markets are becoming “seriously dysfunctional” given their lack of depth and limited use for price discovery. This is because harmonized transparency, order-driven
markets and punitive capital requirements on trading books have discouraged market makers from providing liquidity or carrying inventory. In this context, Basel III, liquidity coverage ratios and leverage ratios are self-defeating, particularly if the consequence is that the value and marketability of assets is purely theoretical, and price discovery is becoming increasingly more questionable.

The world needs one deep, liquid financial capital, which London could become again, if it rejects “misguided” harmonization, goes back to having serious market makers carrying bigger transactions, and puts in place immediate trade reporting while delaying post-trade transparency to allow “jobbers” to make large deals. All this would give asset managers incentives to do business in London where they could get better, deeper, lower-cost liquidity than anywhere else.

Implications for bank business models

In the afternoon, Laurie Mayers, Associate Managing Director, Moody’s analyzed pressures on bank business models. Global investment banks are already today faced with a number of challenges, in particular regulatory costs and declining returns on equity. Brexit will present a new challenge to pan-European business models. A likely effect will be increasing costs of doing business and more macroeconomic uncertainty. As a response to Basel III, banks have reassessed capital targets and client relationships. As a result, solvency metrics have materially improved and liquidity is now a strength. Cost cutting is important but expense cuts cannot keep pace with revenue declines. Declining ROEs increase shareholder pressure for further business model re-engineering. Loss of access to the single market due to Brexit and loss of EU pass-porting represent new challenges with implications for business models. It is positive, however, that Moody’s view is that banks likely to be more impacted by Brexit are well capitalized.

John Liver, an EY Partner, chaired a panel on the implications of Brexit for investment banks and commercial banks. James Chew, Global Head, Regulatory Policy, HSBC, remarked that the outcome depended on the nature of Brexit, the nature of a bank’s business operations and its client base, how the bank is set up with branches or subsidiaries on the continent, interaction with other regulations and specific issues such as FTT and ring-fencing. The nature of Brexit was becoming clearer and it seemed unlikely that banks’ ability to branch freely across the EU from London, using passporting, would remain. But there could be an asymmetric outcome with banks in the EU27 still able to branch into London. The timetable for Brexit was crucial to give financial institutions time to adjust. Without transition arrangements, changes in business models across Europe and structures could well be short-termist and inefficient. But the picture varied considerably across different activities. In retail banking there was little cross border activity, in practice even now subsidiaries were needed in the different countries in which a bank wished to operate. On the other hand, corporate activity in London funds international operations extending beyond the EU. The operation of markets is a much bigger question. If EU banks are allowed to continue to branch into London, this will support the continuity of markets such as FX. Other areas such as cross border capital raising which involve access to the EU could be more affected. Furthermore, if banks (UK and 3rd country incorporated in the UK) do have to locally incorporate in the EU, an issue will be critical mass – namely, can the costs of infrastructure, capital and liquidity be remunerated? Some banks will decide to no longer provide services to the clients in the EU, with a reduction in supply. These issues should not affect the supply of services in the UK and outside Europe.

Diederik Zandstra, British Bankers’ Association, thought the world would change because of Brexit. EU customers procure a variety of services in London and, going forward, banks will have to think about which customers they are dealing with in Europe and customers will have to think about which banks they use. Banks will have to change their operating models and there will be a period of uncertainty. Without passporting, to service an EU27 client base, banks would have to rely on national licensing, equivalence rules for some markets and subsidiarisation to get entry to the EU27, then branching. However, not all client bases will be equally affected. Larger EU27 customers could set up treasury operations in London to access London markets and services. Smaller customers would be more affected. Transition arrangements will be important to avoid a patchwork of developments. Bank models will change, contracts will change and some services provided to the
EU27 will stop. It is important that the world changes in a way that does not hamper trade in financial services. Transaction costs will rise with market fragmentation. Although smaller corporates will be more affected by certain services possibly being no longer provided, larger corporates in the EU27 would also be affected by changes in transaction costs.

Kinner Lakhani, Deutsche Bank, observed that investment bank profitability is lower in Europe than in the US. This was due to the fact that most US banks operate first and foremost in their domestic market, which is deep and sophisticated and this center of gravity gives them a cost advantage, overall giving better cost income ratios. Asia is fragmented across different geographies and regulatory structures. Europe sits somewhere between. The advantage Europe had was that London is a center of excellence and enabled centralization of markets and services for Europe as a whole giving efficiency gains. The risk was that Brexit could lead to more balkanization, already in train globally since Dodd Frank required intermediate holding companies in the US trapping liquidity and capital. This had had a substantial negative effect on European investment banks. Subsidiarisation in Europe combined with ring fencing will pile yet more pressure on European banks.

Brexit challenges for the asset management and insurance industries

Hugh Savill, Association of British Insurers, chaired the last panel on insurers and asset managers. William McDonnell, RSA Insurance Group, looked at the implications of the overall environment for insurance. Brexit was part of a wider range of populist moves in the US, Italy, France and Scotland for example. What lies behind it is a long period of low growth and rising inequality. What it heralds is the potential for damage to economic growth. For insurers this could be compounded by a fall in yields or yields staying low for longer. With this backdrop, insurers have to focus on underwriting profit and underwriting excellence. They also need to be best in class at the way they operate - digitization, pricing sophistication etc..

Looking forward, the effects of Brexit, in particular for FX and inflation, have to be considered. London is the leading global insurance market and this does mean that overseas earnings will be boosted by a fall in the pound. But this would be offset partially for general insurers as the cost of car parts etc. rises with the lower pound. Inflation is also a concern- the data and therefore the modelled results are based on low or falling inflation but an increase has to be stress tested. In terms of structure for general insurers there is diverse mix - single EU legal entities with branches, Lloyds of London relying on freedom of services, and groups with a range of subsidiaries across the EU. Insurers doing business in the EU will need a subsidiary in the EU. This raises the specter of trapped capital. Harmonization across regulators will be important and insurers will be reliant on their home supervisor getting an effective college arrangement. The Industry wants Solvency II to be kept as the framework and this was the PRA goal as well.

Menno Middeldorp, APG Asset Management, feared that Brexit might be the beginning of a much larger de-globalization. For institutions with large portfolios, access to different financial markets is essential. As a very large Dutch asset manager, covering pension funds, his issue was not access from London to clients but access from the Netherlands to London markets. APG invest in the UK, use financial services and financial markets in the UK. They need to be able to make very large transactions which they do through London. The concern was therefore what it would mean if the Brexit negotiations resulted in the fragmentation of markets given they were very dependent on access to deep and liquid markets. The outlook for risk and return from UK investments had been impacted negatively by Brexit but this was not the only consideration and they were continuing to invest in the UK. He summed up that fragmentation harms the asset management business across Europe.

A wider concern when he looked at developments in different countries and regions was whether there was a de-globalization trend (this was not about Brexit which was more about wider access). Protectionist moves would increase risk with the possibility of introduction of capital controls or expropriation of investment. This is important for Dutch asset managers because they tend to invest in long term illiquid projects. In a de-globalization world returns would be lower and risks higher at least in transition.

Responding Jon Danielson’s argument that fragmentation
meant lower systemic risk because of diversification, in fact for APG harmonization of interest rate regimes gave them a better scope to hedge the effect of interest rate change on their liabilities.

**Jorge Morley-Smith**, Investment Association, looked at the issues relevant for the UK fund management industry which is by far the largest in Europe - larger than the next three put together. 40% of assets under management were for overseas clients, of which half were for other EU citizens. The industry is truly global and operated in many markets without the passporting rights and protections of the harmonized EU market. It is important to recognize the diversity of the industry from small firms to huge international institutions and the issues to be solved are different. For those carrying out activities in the rest of the EU it depends if they are doing business with clients, European funds or distributing funds across Europe. Restrictions on access to London managers by EU27 funds and institutions would cut across the global principle in the industry that a fund manager could delegate management of a portion of a fund to wherever globally could best manage it. This would be to the detriment of the EU as well as the UK. In terms of supply of services into the EU27, the impact of Brexit depended on the final arrangements but also which market and which customers. Even today some EU countries were more open to the provision of services into their countries from outside than others.

* * *

**Brexit as a trigger for “creative destruction” in the financial industry?**

**Ernest Gnan**, SUERF Secretary General and Oesterreichische Nationalbank, closed the conference. He remarked, first, that currently a whole industry focusing on offering advice with regard to Brexit is mushrooming. At least, there are some winners from Brexit. Second, big institutional changes, such as international trade integration or the formation of a currency union, are usually associated with substantial costs. But these costs are accepted to reap the benefits of integration which are expected to more than outweigh these initial costs later on. By contrast, trade disintegration in general and Brexit more in particular involves huge transitional costs, while not carrying the prospect of future economic gains; on the contrary, mainstream economic theory predicts economic losses from such disintegration. So, the outcome can be expected to be costly in a double sense. Finally, it is often argued that populism is on the rise, and that the UK people voted for Brexit, because the losers from globalization had been neglected by policy makers. It seems, however, doubtful that these globalization losers will be the ones to benefit from Brexit. Furthermore, there will be many losers from Brexit, both in the UK and in the other EU countries. There is no discussion so far who will compensate these new losers. As a result, it is very conceivable that after Brexit there will be even larger shares of the population who are dissatisfied with politics and are thus ready to embrace populist calls. An advantage of Brexit for the financial industry may be that it may trigger overdue structural reforms that would otherwise have been delayed, thus fostering “creative destruction”.
Modern economies need a functioning financial system. The financial system has in principle four main functions: Providing a system for making payments, matching borrowers and lenders, enable people to manage their personal finances across their lifetimes and between generations and the sharing and management of risk. Despite a long list of reforms implemented in 2010 including enhanced capital requirements for banks, new bank resolution legislation and centralizing derivatives markets there is an ongoing debate about the question whether the financial system today is fit for the future. Critics claim that it looks today still very similar to before the financial crises has started in 2007. Is the financial system fit for the future? Will its current structure allow it to fulfil its main functions? Do we need further structural change? If so, what kind of change? Is tighter bank regulation, an increasing role for shadow banking and the EU’s project of capital market union the way forward, what opportunities and potential risks does this involve? How will technological developments like Fintech and digital money shape the future financial system?

### Preliminary Programme

**Monday, 29 May 2017**

<table>
<thead>
<tr>
<th>Time</th>
<th>Event</th>
<th>Speaker/Title</th>
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<tbody>
<tr>
<td>08:45</td>
<td>Registration and Welcome coffee</td>
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<tr>
<td>09:00</td>
<td>Opening address</td>
<td>Chair: <strong>Ewald Nowotny</strong>, Governor, Oesterreichische Nationalbank</td>
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<td><strong>Christian Kern</strong>, Austrian Federal Chancellor</td>
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<td>09:15</td>
<td>Opening remarks</td>
<td><strong>Ewald Nowotny</strong>, Governor, Oesterreichische Nationalbank</td>
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<td><strong>Urs W. Birchler</strong>, SUERF President and Professor of Banking, University of Zurich</td>
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<tr>
<td>10:00</td>
<td>Session 1: Monetary policy in the digital future</td>
<td><strong>Doris Ritzberger-Grünewald</strong>, Director, Economic Analysis and Research Department, Oesterreichische Nationalbank</td>
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<tr>
<td>11:15</td>
<td>Coffee break</td>
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<tr>
<td>11:45</td>
<td>Session 2 - Keynote address: Is the post-crisis financial system fit for the future?</td>
<td><strong>Andreas Ittner</strong>, Vice Governor, Oesterreichische Nationalbank</td>
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<td><strong>Sir Paul Tucker</strong>, Chair Systemic Risk Council, Senior Fellow, John F. Kennedy School of Public Management</td>
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<td>12:30</td>
<td>Lunch</td>
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<td>14:30</td>
<td>Session 3: Technological change and the future of financial intermediation</td>
<td><strong>Martin Summer</strong>, Head of Division, Oesterreichische Nationalbank</td>
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<td><strong>Thomas Puschmann</strong>, Head of Swiss FinTech Innovation Lab, University of Zürich, <em>Banking without banks? How will technology transform financial Intermediation?</em></td>
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John Kay, Economist, Will Fintech disrupt financial services?

Patricia Jackson, Non Executive Director, Atom Bank, Adviser, EY and SUERF, Title to be confirmed

15:15 Coffee break

15:45 Session 4: The capital markets of the future

Chair: Ernest Gnan, Secretary General, SUERF, and Head of Division, OeNB
David Yermack, Professor, NYU, Smart contracts and corporate governance
Nikolaus Hautsch, Professor, University of Vienna, High Frequency Trading: Costs and Benefits

16:45 Klaus Liebscher Award Ceremony and Presentation of the Award-Winning Papers

Claus J. Raidl, President, Oesterreichische Nationalbank
Ewald Nowotny, Governor, Oesterreichische Nationalbank

17:15 End of session

19:00 Aperitif

19:30 Dinner 'Kamingespräch'

with Hans-Jörg Schelling (tbc)
Austrian Federal Minister of Finance

12:15 Session 7: SUERF Annual Lecture
Erkki Liikanen, Governor, Bank of Finland, Is the post-crisis financial system more resilient? What remains to be done? (tbc)

13:00 Lunch
**SUERF/BAFFI CAREFIN Centre Conference**

**New Challenges in Central Banking: Monetary Policy Governance and Macroprudential Issues**

Sponsored by Intesa Sanpaolo

8 June 2017
Baffi Carefin Centre, Bocconi University
Milan, Italy

Which are the new frontiers in central banking? The aim of the workshop is to discuss two fields - monetary policy committees and new prudential responsibilities - and how they influence banking decisions.

**Thursday, 8 June 2017**

<table>
<thead>
<tr>
<th>Time</th>
<th>Session</th>
<th>Speaker/Institution</th>
<th>Title</th>
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<tbody>
<tr>
<td>9:00</td>
<td>Welcome</td>
<td>Donato Masciandaro, Bocconi University</td>
<td>Welcome Address</td>
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<td>Keynote Speech</td>
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<td>New Challenges in Central Banking</td>
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<td>Athanasios Orphanides, MIT Sloan School of Management</td>
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<td>9:30</td>
<td>Session I - MONETARY POLICY: GOVERNANCE</td>
<td>Sylvester Eijfinger, Tilburg University, CESifo and CEPR</td>
<td>Estimating the Preferences of Central Bankers: an Analysis of four Voting Records</td>
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<td>Louis Raes, Tilburg University</td>
<td>Deliberation in Monetary Policy Committees</td>
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<td></td>
<td>Alessandro Riboni, Ecole Polytechnique, Paris</td>
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<td>Francisco Ruge-Murcia, McGill University</td>
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<td>Central Bankers as Supervisors: Do Crises Matter?</td>
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<td>Donato Masciandaro, Bocconi University</td>
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<td>Davide Romelli, Trinity College Dublin</td>
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<td>11:30</td>
<td>Coffee break</td>
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<td>12:00</td>
<td>Session II - MACROPRUDENTIAL POLICY: THEORY, INSTITUTIONS AND EMPIRICS</td>
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<th>Time</th>
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<td>13:30</td>
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<td>Ernest Gnan, Oesterreichische Nationalbank and SUERF</td>
<td>Macroprudential Policies and Banking</td>
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<td>Dimitrios Tsomocos, University of Oxford</td>
<td>Use and Effectiveness of Macroprudential Policies: New Evidence</td>
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<td>Eugenio Cerutti, IMF</td>
<td>Bank Capital Regulation with Unregulated Competitors</td>
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<td>David Martinez-Milla, Carlos III University</td>
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<td>Tommaso Monacelli, Bocconi University</td>
<td>Macroprudential and Monetary Rules in a DSGE Setting</td>
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<td>Margarita Rubio, University of Nottingham</td>
<td>Monetary and Prudential Policies in a DSGE Setting</td>
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<td>Jorge Ponce, Banco Central de Uruguay</td>
<td>Optimal Macroprudential and Monetary Policy in a Currency Union</td>
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<td>Sergeyev Dmitriy, Bocconi University</td>
<td>The Eurozone Debt Crisis: A DSGE Model with Default Risk</td>
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<td>Mathilde Viennot, Paris School of Economics</td>
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[www.suerf.org/milan2017](http://www.suerf.org/milan2017)
33rd SUERF Colloquium and Bank of Finland Conference

Shadow Banking: Financial Intermediation beyond Banks

14-15 September 2017
House of the Estates, Snellmaninnaukio 9-11, Helsinki

Motivation - Shadow banking is a broad concept. A possible definition is that it comprises non-bank institutions which do bank-like activities. Another characteristic, to which the word “shadow” refers to, is that the sector is less regulated. Shadow banks can increase competition and spur new innovation in the financial sector. The benefits could come in the form of i) improving efficiency and quality of financial services, and ii) offering better returns and risk diversification opportunities, especially for institutional investors and wealthy individuals. Markets may also become more liquid. On the downside, opacity and risks may increase. The lack of regulation implies that it is difficult to monitor and prevent the build-up of leverage and concentrated risks in the shadow banking sector. Hence, the sector can be a source of systemic risks. Further, traditional banks may utilize the shadow banking sector for regulatory arbitrage. Hence, a big question is whether regulation should be extended to the shadow banking sector, to make it come “out of the shadows”? Will new regulatory loopholes between banks and non-banks develop? Will risks simply pile up in the shadow banking sector now that banks are more heavily regulated? Or will market discipline suffice to do the job of regulation in this sector? Is the growth of shadow banking this time more about FinTech; the provision of financial services making use of technological innovations? What are the fundamental problems of financial frictions they might have solved differently? Are new digital technologies key to finding solutions to the traditional financing frictions? Or are we experiencing just another boom in novel-looking financial services which ultimately share the same problems and risks as more traditional banks?

Preliminary Programme

Thursday, 14 September 2017

13:00  Registration and Coffee
13:30  Opening and Welcome
      Urs W. Birchler, SUERF President
      tbc, Bank of Finland
14:00  Keynote Speech I
      Shapes in the shadows: What do the data (not) tell us?
      Tobias Adrian, Financial Counsellor and Director of the Monetary and Capital Markets Department, International Monetary Fund (IMF)
14:45  Poster Session
15:45  Coffee break

16:00  Panel I - The current landscape:
      Markets and players, competitors and complementarities
      Moderator: Christian Upper, Head of Emerging Markets Monetary and Economic Department, Bank for International Settlements (BIS) and SUERF
      Yasushi Shiina, The Financial Stability Board (FSB)
      Zoltan Pozsar, Credit Suisse
      Antti Suhonen, Aalto University
17:30  Keynote Speech II
      To be announced
18:20  Presentation of the Marjolin Prize 2017
18:30  End of first day’s proceedings
19:30  Conference dinner
Friday, 15 September 2017

09:00  SUERF 2017 Marjolin Lecture  12:15  Lunch
Chair: Urs W. Birchler, SUERF President
Danièle Nouy, Chair of the Supervisory
Board of the Single Supervisory
Mechanism

10:00  Coffee break

10:30  Panel II - Out of the shadows? The role
       of regulation and supervision
Moderator: Jakob de Haan, Head of
Research, Economics and Research
Division, De Nederlandsche Bank and
SUERF
Bengt Holmström, Nobel laureate 2016, MIT
Dong He, Deputy Director of the
Monetary and Capital Markets
Department, International Monetary
Fund (IMF)
Gabriel Bernardino, Chairman, EIOPA
Stan Maes, Deputy Head of Unit
Macroprudential Policy, European
Commission

12:15-12:45  SUERF General Assembly (SUERF
Members only)

13:45  Keynote Speech III
Shadow banking and systemic risks
Nicola Gennaioli, Professor, Bocconi
University

12:15  Lunch

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Shadow banking and systemic risks
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REGISTRATION FEES*:

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*SUERF as a non-profit-making association registered under the French 1901 Law (Loi du 1er juillet 1901) is exempted from paying commercial taxes, VAT, income tax and single business tax (taxe professionelle).
The “European Currency” became reality with the Treaty of Maastricht of 1992, and was introduced practically in 1999. But the idea to create a European Monetary Union as a building block of European Integration is much older. Already in the 1950’s, Triffin proposed to create a European Reserve Fund, which would support European Countries in financial distress. He also advocated the introduction of a European unit of account as a European currency, existing in parallel with the national European currencies. In the 1970’s, the collapse of the worldwide fixed exchange rate system of Bretton Woods, was leading to monetary chaos and increased the need to find a solution to stabilize the currencies within the European Economic Community. The Werner report of 1971 proposed a concrete road map to create a European Monetary Union. By 1979, the intervention of Roy Jenkins was decisive to set up the European Monetary System, based on a new European basket currency, the ECU. At the end of the 1980’s it became increasingly clear that the EMS framework would not be able to guarantee monetary stability in Europe, and the ultimate decision was taken to create a full monetary union, with a new currency, the EURO, replacing all currencies of participating Member States. The authors of this book, and their advisory committee identified 10 personalities who had a major impact on the process to get to a full monetary union during the 50 years between 1950 and 2000. Each of the 10 major chapters of the book is a biography of one of these personalities, focused on his specific contribution to the monetary union idea and process: Robert Triffin, Robert Marjolin, Raymond Barre, Pierre Werner, Roy Jenkins, Hans Tietmeyer, Karl-Otto Pöhl, Tomasso Padoa-Schioppa, Jacques Delors and Alexandre Lamfalussy. The two remaining chapters give a historical and more critical overview of the process towards the EMU, including the experiences since the financial crisis.

The authors make a clear distinction between the “10 architects”, who have provided the intellectual process and the proposals, and the “politicians” who have ultimately taken the decisions, not always respecting the original proposals. This may look like an elegant way to reduce the responsibility of the architects for everything that went wrong with the Euro afterwards. But looking at the list of the selected architects, this distinction seems somewhat theoretical as at least half of the architects were also in the middle of the political process.

Looking at the history of the Monetary Union, from the point of view of these individual approaches of the architects, highlights the confrontation between two economic schools (or ideologies): the “economist” school, led by Germany, and the “monetarist” approach, with France as a major player. The “economists” believe that a monetary union should only be realized once economic convergence is a fact, were the participating countries are stable and have developed sustainable fiscal policies and economic flexibility based on market mechanisms. The “monetarists” on the other hand are...
convinced that a monetary union is a strong instrument to bring economic convergence and integration. As the architects were not able to find a consensus, it is no surprise that the political result of the EMU is a hybrid compromise in which long term stability was sacrificed to achieve a short term political success.

When looking at the proposals of the architects, it is striking that they are often characterized by a strange mix of far-reaching genuine ideas to create a visionary and better supra-national world, combined with sometimes narrow nationalistic or ideologic reflexes and interests. Very few of the architects proposed a balanced project, able to build a broad political consensus. Pierre Werner was probably influenced by the interests of Luxemburg as a potential financial center in the monetary union. Hans Tietmayer and Karl-Otto Pöhl seem by definition convinced that the German way of organizing the monetary system was the best solution, built on the responsibility of the Member states to be competitive and to have “their house in order”. And Tomasso Padoa-Schiopa seems to be more influenced by the Italian-French approach of macroeconomics, were political decisions will change economic realities. That remains until today one of the major challenges of the European construction: every proposal, including those about the monetary architecture is colored by the background – most of the time the “nationality” - of the author.

This book is welcome for those who want to understand the complex process of getting to the single currency, while taking into account the driving forces of the individual personalities who were at the origin of the major ideas. The “human aspect” is never far away. In that respect, the biographic sketches are interesting reading which brings ideas in a historic and human perspective. For example, the way Otto Pöhl defended his vision in the “Delors Committee” and in Germany, including the concept of the “independence” of the Central bank, reads almost like a thriller.

The last Chapter is a critical overview of the experience of the financial crisis, the observed weaknesses of the architecture, the lessons learnt and the future of the monetary union. But readers should not expect a very exhaustive analysis or a consensus view. Providing complete answers on all these issues remains outside the scope of this book and would even be impossible, given that the analysis and political processes are still evolving in a surprising way. The simple question “will there still be a euro in 10 years” is not answered and is even not asked. And given the actual tendency towards more nationalism and Member States trying to get back their sovereignty, it is probably better not to try to answer but to focus on what is a clear priority: restoring confidence in the European Union and convince populations that the EURO remains a valuable project that we should protect, whatever it takes…
BOOK REVIEWS – BOOK REVIEWS – BOOK REVIEWS

Competition and Stability in Banking: The Role of Regulation and Competition Policy

By Xavier Vives

Hardcover, 344 Pages
ISBN: 9780691171791
eBook ISBN: 9781400880904

Reviewed by Urs W. Birchler, SUERF President and University of Zurich

The key question(s)
In the late nineteen-eighties a Swiss bank supervisor observed: “The stability of our banks rests on the weakness of competition.” Soon after, bank cartels fell, profit margins eroded, and a severe banking crisis followed. Is then competition the enemy of stability? Or is stability, achieved through heavy regulation, the enemy of competition? With these general questions in mind I opened Xavier Vives' recent volume. Immodestly, I also hoped for light on a number of other issues: Do economies of scale and scope explain the emergence of big global banks? Can competition policy mitigate the problem of implicit government guarantees? Is capital really expensive for banks (and why)? And: What exactly is a bank? Xavier Vives tackles these questions, and many more, with scrutiny and circumspection. His findings are based on some 600, mostly academic, articles (the references falling thirty pages). While even these represent a selection (given the huge amount of papers on banking written over the last few decades), Competition and Stability in Banking can be said to represent the best of available knowledge.

The structure
The book invites the reader with a transparent and intuitive structure. After an introduction (Ch. 1) and a review of banking trends (Ch. 2) a bifurcation follows. On one track, the author explains banks' fragility and regulation (including shadow banking) (Ch. 3), on the other, he deals with bank competition (Ch. 4). The two tracks meet again for a (theoretical and empirical) analysis of the interaction of both, fragility (or its counterpart, stability) and competition (Ch. 5). After a descriptive insert on bank-related competition policy in different countries (Ch. 6), the author describes the interaction of stability architecture, competition policy, and public intervention during the crisis (Ch. 7). The theoretical and empirical analysis (in Ch. 5) and the international crisis experience (in Ch. 7) constitute the core of the book. The main results of these chapters flow into a summary and the author's policy conclusions (Ch. 8).

What is a bank?
Banks are not quite the same animals from a competition and a stability point of view. From a competition point of view, banks are multi-product firms offering a vast range of services. From a stability point of view, there are two main functions that make a bank a bank: financing (selection and monitoring of) borrowers (Diamond 1984) and the creation of liquidity for depositors (Diamond-Dybvig 1983) which makes banks fragile by definition. This is a very standard starting point; even a leading figure like Xavier Vives does not see any alternative seriously competing with the standard banking paradigm. He also sympathizes with the “global games” approach to avoid multiple equilibria and the related problems of bank liability pricing.

The problem with competitive analysis in banking
For competition theory the banking industry is a snake pit. As Vives points out, market power comes in combination with a number of complications: (i) market failures due to information asymmetries and externalities, (ii) the two-sided nature of many financial markets (like deposits-credits), (iii) network effects (e.g.,
in payment services), plus (iv) the multi-product nature of banking in practice, (v) the presence of deposit insurance or of explicit or implicit government guarantees. Further, entry and exit costs preclude resorting to a contestable markets hypothesis. Finally, bank customers are known to suffer from a number of behavioral biases. For these reasons the relation between competition and stability in banking is intricate. The rich theoretical and empirical evidence can only be presented as a huge - yet incomplete - mosaic of individual small contributions.

**Competition, regulation, stability: The evidence**

The author's task is further complicated by the fact that he writes for both, readers with a main interest in competition and/or stability policy and for students or academic researchers. The first groups, policy practitioners, are likely to look at the mosaic from a distance, keen to see the big picture and to draw the main conclusions. Indeed, they will find - cautiously distilled - answers to the manifold questions (mentioned above) regarding competition and stability. To give a few (excessively simplified) examples:

- **Q:** Do restrictions to competition support banking stability (as the supervisor mentioned above suggested)? **A:** No, but: An intermediate level of competition seems optimal for banking stability (and even overall efficient).
- **Q:** Are there economies of scale and scope explaining the emergence of very big global banks? **A:** There are, but hardly up to the top.
- **Q:** Can competition policy mitigate the TBTF problem? **A:** Not alone.
- **Q:** How should policy responsibilities in the fields of competition and stability be organized? **A:** Separately, but coordinated.
- **Q:** Is bank capital expensive? **A:** Who knows: “We still do not have a satisfactory theory of capital for banks” (p. 49).
- **Q:** Can activity restrictions (like “narrow banking”) increase welfare? **A:** Yes; if pricing risk is not possible, restrictions on bank activities may be a second best (and the two may be complementary).

At the same time Vives tempts the reader to walk closer and to look at those small and sometimes still odd parts of the mosaic. Here, the message is not only that policy makers should never feel too confident with generalizations. The positive message is that academic readers will discover a wealth of issues deserving further study. Future PhD students will hardly fail to find exciting topics if they only put their nose close enough to those tiles. Yet, Vives also presents descriptive material to the benefit of both camps, policy and academia. These are the parts on trends in banking, competition policy around the world, and public intervention in the recent crisis.

**Who should read the book?**

*Competition and Stability in Banking* is an impressive work of one of the leading economists in the field. It is first of all a (rather: the) new textbook on a Master or PhD level. Yet, it should also be mandatory reading to all economists (and lawyers) working in official or government agencies related to either banking regulation and supervision or competition. Despite the demanding subject matter the book is not difficult to read. There are no formulas either. A basic training in microeconomics is of course helpful, but the lack of it is no reason to leave the book aside. Vives is not afraid to disappoint potential readers looking for anecdotes, value judgements, or even finger-pointing. Where others might use stronger language he prefers the understatement. The fact, for example, that in EU countries banks' holdings of government bonds are subject to neither a capital charge nor concentration limits “is worth noting” and “has been put into question” (p. 135).

**Final remark**

With *Oligopoly Pricing: Old Ideas and New Tools* (1999), *Information and Learning in Markets: the Impact of Market Microstructure* (2008) and *Competition and Stability in Banking* (2016) Xavier Vives has come up with a great book roughly every eight years. This is a promising pace, but it also leaves us enough time to read the current volume as carefully as it deserves before arrival of the next one.
News from the Council of Management

The SUERF Council of Management is pleased to announce that Michala Marcussen (Global Head of Economics, Société Générale Corporate & Investment Banking) has been elected as the Association’s new Vice-President, in succession to Frank Lierman, for a period of three years 01.05.2017-01.05.2020. Since her election to the Council of Management in 2014, Michala has been an active Council member in particular with her input on topics and potential speakers for SUERF events. Most recently, she initiated and co-organised the first SUERF event in New York.

The Council of Management would like to extend a warm thank you to Frank Lierman, who served two terms as Vice-President from 2011 to 2017. We are happy that Frank will continue to be a member of the SUERF Council of Management, where his valuable contributions to the Editorial Board and conference activities are much appreciated, as well as his support in maintaining close relationship with SUERF Corporate Members in Belgium.

New observers in the SUERF Council of Management

We are delighted to welcome Pierre Jaillet as an observer to the Council of Management. Mr Jaillet serves as special advisor to the Governor of the Banque de France. Prior to this, he was Chief Representative of the Banque de France for the Americas (2013-2016), Director General for Economics and International Relations (2008-2012), and held various positions relating to monetary policy, European integration and international affairs. Previously, he had been seconded to the International Monetary Fund (IMF), to the European Commission in Brussels and to the French Institute for Statistics and Economic Studies (INSEE). He has represented the Banque de France on various European and international groups of the Eurosystem, the G7&G20 and the BIS. Pierre Jaillet holds a post-graduate degree in Economics, a Masters degree in Political Science and a Bachelor's degree in Sociology. He is member of the French Association of Economic Sciences (AFSE), of the French Political Economy Society (SEP). He sits on the editorial committee of the Financial Economy Review (REF) and on the board of trustees of the Fondation France-Japon-EHESS. He has taught monetary policy and international economics at ENA (Ecole Nationale d'Administration), ENSAE (French School of Statistics and Economic Administration). He has authored and edited numerous publications on economics and international issues.

It is also a great pleasure to welcome Jean-Pierre Vidal as an observer to the Council of Management. Mr Vidal is Counsellor to the Executive Board of the European Central Bank and heads Peter Praet’s office since September 2016. He was previously Chief Economic Advisor to the President of the European Council, Donald Tusk, and a member of the cabinet of the former President of the European Council, Herman Van Rompuy. He held several positions at the European Central Bank: Head of the ECB Representative Office in Brussels (2011-2012), Deputy Head of the Monetary Policy Strategy Division (2007-2011), and Head of the Fiscal Analysis Section (2004-2007). Before joining the ECB as economist in 2000, he worked as senior researcher at the ‘Centre National de la Recherche Scientifique’ (CNRS). Jean-Pierre holds an MBA from ESSEC business school (‘Ecole Supérieure des Sciences Economiques et Commerciales’) and a Ph.D. from the University of Cambridge.
The SUERF Council of Management would like to express its thanks to Allard Bruinshoofd, who decided to leave the Council of Management at the beginning of this year, due to a change in his professional career. Allard joined the Council in 2010 as a representative of Rabobank and always actively supported SUERF’s activities with his valuable advice and knowledge. In June 2016, Allard took up the position as Senior Policy Advisor, Supervision Policy Pensions at the Nederlandsche Bank. We wish him good luck, and do hope that SUERF will have the pleasure of continuing to welcome him at its events!