

31st SUERF Colloquium and Baffi Finlawmetrics Conference 2014

*Money, Regulation and Growth:
Financing New Growth in Europe*

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held at the BAFFI Center on International Markets, Money and Regulation, Bocconi University, Milan

Report by Morten Balling, Marc Quintyn, Frank Lierman and Donato Masciandaro



(l-r): Mario Monti (President, Bocconi University), Anat Admati (Stanford University), Olivier Blanchard (IMF)

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On 4-5 June, approximately 110 participants gathered at Bocconi University's BAFFI Center in Milan for a special joint SUERF Colloquium and Baffi Finlawmetrics Conference 2014. Opening the event, SUERF President **Urs Birchler** characterized the current state of the world economy as a situation with lots of money, a lot of regulation but not a lot of growth. The president mentioned that he had told the driver of the taxi from the airport that he was going to meet Mario Monti at a conference. The driver had been so excited that he would hardly accept to be paid for the trip to the city center of Milan. When the former Italian Prime Minister subsequently took the floor, his first remark was that Urs Bircher had been very lucky, when he chose the taxi. The outcome could have been very different! In his opening address, **Mario Monti** referred to the importance of money and regulation for growth, as well as referring to the recent SUERF conference in Paris, where SUERF had celebrated its golden jubilee.

The first keynote speaker was **Anat Admati**, Stanford Business School. She had chosen the headline "*The False Tradeoff Between (Effective) Financial Regulation and Growth.*" The steep decline in real GDP and the rise in unemployment since the 2008 crisis was not caused by regulation. Banks are much more important in Europe than in the US. From 1996 to 2012, total assets of the banking system divided by GDP increased in both regions, but at a much higher level in the EU. The balance sheets of the largest 28 global banks have grown faster than the balance sheets of other banks. The notional amounts of derivatives in which 21 large banks are contract partners grew from USD 409 trillion in 2006 to USD 661 trillion in

2013. It reflects that the banks are still exposed to a lot of risk. Systemic banks receive large subsidies. But there seems to be no evidence of scale economies in banks with total assets above USD 100 billion adjusting for subsidies. Book equity to total assets in American and British banks have with few interruptions declined during more than 100 years. J.P.Morgan Chase is an example of a very big and leveraged financial institution. On the asset side of bank balances, traditional loans represent in many cases less than 30 % of the balance sheet. In the third quarter of 2013, for Euro Area MFIs loans to non-financial companies represented on average only 15 % of total assets and loans to households 18 %.

According to the speaker, analogies to banks' behavior could be either "polluting behavior" or speeding trucks with explosive cargo. Under both analogies, bailouts or government guarantees would imply moral hazard. Guarantees and subsidies enable and feed leverage ratchet and distort incentives. Basel II and Basel III capital requirements and leverage ratios are in the view of the speaker based on flawed analyses of tradeoffs. Non-banks rarely maintain less than 30 % equity in relation to total assets. Why should banks be allowed to operate with much lower solvency ratios? For the society, excessive bank leverage is expensive due to tax subsidies and safety net benefits. More equity reduces systemic risk, reduces deadweight cost of distress, default and crises, reduces excessive risk taking and improves the ability of banks to lend after losses. The speaker characterized the Basel risk weighting system as complex, manipulable and distortive. Hybrid capital like cocos with bail-in functions were called unreliable and complex. It is much more simple to mandate more equity. The Basel regulatory capital ratios do not measure leverage properly. Accounting measures do not show the true crisis situation. The speaker argued in favor of an equity requirement of 30 % of total assets, allowed to decline to 20 % with restrictions on payouts. The authorities should be able to mandate new equity issuance. Inability by a bank to raise equity should be interpreted as a failed "stress test". Tightening capital requirements may – according to the speaker – reduce the growth of subsidized banks, but will have a positive effect for all (except possibly bankers). Better regulation is essential and possible, but the political will is missing.

The next keynote speech "How can the European Banking Union contribute to Growth?" was given by **Franco Bruni**, Bocconi University. The aims of European Banking Union (EBU) are to fight Euro Area fragmentation, to enhance financial stability and to complete the single market. During the sovereign debt crisis, interest rate differentials developed between euro-denominated bonds from different member countries, and this was interpreted as signals of a risk of a break-up of the Euro Area. The EBU has contributed to a convergence between the interest rates and to reduced volatility in financial markets. The EBU implies also a reshaping of banks'



(l-r) Thorsteinn Thorgeirsson, Olivier Blanchard, Donato Masciandaro

business models in Europe. The speaker argued that in the long term only a denationalized banking system can support a denationalized currency. The EBU is essential for the "ins" (i.e. the Euro Area member states), but also desirable for the "outs". If the "outs" (including Denmark, Sweden and the UK) do not participate in the EBU, Europe's financial integration and multinational banking will turn out to be less sound and natural. Bail-ins, SRM and SRF aren't aimed at dealing with systemic shocks. Systemic crises call for ESM actions. The speaker proposed that the ESM should play a role (backstop of last resort) also in dealing with legacy assets to hedge against systemic shocks originating from them.

At the end of the first day of the event, **Olivier Blanchard**, International Monetary Fund delivered the 2014 SUERF Marjolin Lecture on "Sustaining Growth in the Short and Medium Term". The speaker distinguished between advanced economies (AEs) and emerging market economies (EMs). In the AEs, there are still output gaps implying a need for policies to raise output and employment. In the EMs, potential growth has also declined and there is a need for structural reforms. The slow recovery in the AEs is partly explained by legacies from the financial crisis: Large Government debt, private household and company debt and bank debt. Monetary policy in the AEs implies policy interest rates close to zero and large central bank balances. Fiscal policy aim at fiscal consolidation and lower interest spreads especially in the Euro Area periphery. Statistics on household debt to income is misleading. Net worth to income is more relevant. For firms, debt to equity is relevant. Banks' Tier 1 capital as percent of risk-weighted assets has increased everywhere from 2005 to 2013. Deflation is dangerous because it increases the real value of debt, the real interest rate and because it can lead to a deflationary spiral. Currently, the economic policy breaks are loosened but at different rates in different countries. Stronger growth in AEs will stimulate exports from EMs. Economic growth in the future is challenged by long-term trends in demographics (ageing), education (drop-out rates), fiscal pressures and innovation. In a diagram from World Economic Outlook, AEs were plotted according to net Government gross debt at the beginning of 2014, and primary fiscal balance as percent of GDP. The

outliers in the diagram was Norway with positive net Government assets and a fiscal surplus, and Japan with a large Government debt and a fiscal deficit. In the years to come, economic growth in the EMs is expected to slow down but still to be much higher than in the AEs. In his concluding remarks, the Marjolin speaker recommended that the AEs reduced the speed of fiscal consolidation, recapitalized their banking systems, and normalized monetary policy. EMs should adapt to the new global environment and carry out supply-side reforms.

In keeping with the tradition of SUERF Colloquia, the remainder of the event was split into three parallel commissions.

Commission 1 was chaired by **Morten Balling**, Aarhus University and **Sylvester Eijffinger**, Tilburg University. The Commission headline was *“Monetary Policy and Growth”*.

The first presentation in the commission by **Michele Lenza**, ECB, evaluated the effects of the 2012 announcements of ECB’s Outright Monetary Transactions (OMTs), first on bond yields and second on real activity. The speaker explained how these announcements impacted the yields of Italian and Spanish government bonds downwards. The macroeconomic effects were studied in a multi-country model of the financial linkages in France, Germany, Italy and Spain. The general outcome of the analysis was that the OMT announcements were associated with positive and quite sizeable effects on real activity, loans and consumer prices in Italy and Spain. The evidence pointed also to moderately positive spill-overs on real activity in France and even smaller in Germany.

Gancho Ganchev, South West University, Blavoevgrad, Bulgaria, examined the dynamics of the supply of credit and nominal GDP growth in Central and Eastern Europe. He looked at the relationship between lending and economic growth, using data from 10 CEE countries. In the middle term perspective, past changes of the volume of lending influence the dynamics of nominal GDP. The weak interdependence in the long term may, according to the speaker be viewed as confirmation of the long-term neutrality of money.

Cécile Bastidon, Université Toulon, presented a theoretical model of complex financial intermediation. She stressed the importance of household credit within banks’ balance sheets and in total outstanding credits. In France and Spain, household credit represents approximately 40 % of banking intermediation activity and in the US much more. In Europe, household credit portfolios are a priori less sensitive to default risk compared to the US. The model presented proposes a transmission sequence of a shock on household credit portfolios to the whole financial system via the interbank market. Including household credit in the intermediation chain modifies the interpretation of the Taylor Rule.

Pierre Siklos, Wilfrid Laurier University, talked about central bank credibility. This credibility can be measured by inflation expectations, the mean reversion properties of inflation, the term structure and quality spreads, and indicators of exchange rate risk. He observed that credibility changes over time, that it is difficult to restore, when it has been lost, that credibility can be transmitted across countries and that policy errors make things worse. An interesting observation was that central banks have become far more “talkative” and focus on their ability to communicate with the public.

Enisse Kharroubi, BIS, presented a paper, which investigates the effect of cyclical interest rates and financial sector constraints on growth. Traditionally, economists have discussed stabilization policies and long-term growth separately. But the speaker took a different approach and asked if bank capital adequacy rules – in so far as they affect banks’ lending supply – can dampen or amplify the effects of cyclical interest rate policy on growth. According to the paper, a more countercyclical interest rate policy significantly enhances output growth in more financially or liquidity constrained industries.

Hans Degryse, KU Leuven and CEPR, has together with colleagues studied how banks’ lending techniques affect funding to SMEs over the business cycle. In their paper presented at the Colloquium they observe that the positive impact of relationship lending in a downturn is strongest for smaller and more opaque firms and holds independently of the legal and institutional environment in which the bank operates. He showed also, that distance reduces the positive impact of relationship lending. That observation explains probably the paper’s remarkable headline: *“When arm’s length is too far.”*

Alex Cukierman, Tel-Aviv University and CEPR, focused on the behavior of American Banks after the collapse of Lehman Brothers in September 2008. The huge injection of liquidity by the FED has not resulted in an increase in inflation as the quantity theory of money would predict. The speaker made an interesting comparison with the German inflation in 1923. The US banks increased their liquidity reserves – according to the speaker because they reacted to an increase in bailout uncertainty. At the same time, credit expansion decelerated sharply after September 2008. An important consequence of the cautious bank behavior is that only a minor part of the huge quantitative easing operations of the FED are transmitted to the real economy, which leads to both anemic growth and subdued inflation.

Lola Hernandez, De Nederlandsche Bank, presented a paper concerning determinants of the rate of the Dutch unsecured overnight money market. Transaction data comes from the Dutch segment of Target 2. The pattern of interest rate movements changes considerably before, during and after the crisis. A strong impact is observed in October 2008, when ECB introduced fixed

rate full allotment tender procedures. Modifications in the monetary policy framework in 2004 succeeded in reducing the volatility of the interest rate, but the unconventional measures during the turmoil period after the collapse of Lehman Brothers were not able to reduce the volatility of the rate.

Robert Krainer, University of Wisconsin-Madison, looked at alternative specifications of bank lending in France and Germany. He found that a capital budgeting model based on equity valuations in France provides a better specification of bank lending than the typical demand factors of bank lending rates and an income variable like GDP. For Germany the results were mixed. Conventional monetary policy assumes that there is an interest rate channel in bank lending. If the central bank alternatively believes in a stock market channel, it could (if it had the authority) make open market operations in stocks.

Neeltje Van Horen, De Nederlandsche Bank, analyzed the sovereign debt crisis, which has highlighted the close connection between the fates of sovereigns and banks. European banks own not only domestic government bonds, they own also foreign government bonds, including Greek, Irish, Italian, Portuguese and Spanish government bonds (ie. Bonds from the GIIPS-countries). Concerns about counterparty risk and higher sovereign risk may impact negatively on lending by the banks, who own them. The empirical analysis shows that banks with relatively large holdings of GIIPS government bonds increased their syndicated lending less than banks that were only marginally exposed to these bonds.

Salih Fendoglu, Central Bank of the Republic of Turkey, looked at the effectiveness of macroprudential policies in Turkey. This country has in recent years devised new policy tools such as an asymmetric interest rate corridor and a reserve option mechanism. One of the aims of the new monetary policy instruments was to create a buffer against volatile cross-border capital flows. The new policy framework has been successful in achieving a soft landing in the economy and in lessening the financial stability risks.

Diego Valiante, CEPS, studied financial integration in the Euro Area. Governments compete on funding costs by supporting “their own banks” with state aid, which distorts the playing field. The retrenching hampers the transmission of monetary policies and – potentially – economic growth. The speaker argued in strong words in favor of a common financial backstop to a privately funded recapitalization/resolution fund and a blanket prohibition on state aids.

Taken together, the 12 papers presented in Commission 1 answered several of the research questions that were posed in the call for papers for the Colloquium.

Commission 2 was chaired by **David Llewellyn**,

Loughborough University and **Marc Quintyn**, IMF. The headline of the commission was “*Financial Regulation and Growth*”. The twelve papers presented can be divided in two groups: Six papers focused mainly on the interactions between bank behavior and the governmental and regulatory environment, while the other six papers dealt with policy-oriented issues.

A paper with the headline “*The Winner’s Curse: Evidence on the Danger of Aggressive Credit Growth in Banking*” was presented by **Thomas Kick**, Deutsche Bundesbank. The speaker and his co-authors use a data set of loan loss provisioning at the bank portfolio level and show that, if banks go beyond the “organic growth” of their credit portfolios, they tend to under-estimate the general risk level in the credit market and will suffer disproportional write-offs on loans in subsequent years.

Razvan Vlahu, De Nederlandsche Bank, presented a paper “*Risk-taking incentives of modern banks*”. The speaker and his co-authors explain that high franchise value allows a bank to borrow more, so it can take risk on a larger scale. The bank can achieve high leverage and go outside its core business thanks to the institutional environment. The analysis can be applied, when policy makers look at limits on leverage ratios as regulatory instruments.

Edward Kane, Boston College, gave a presentation on “*Shadowy Banking*”. This kind of financial activity is, according to the speaker, engineered to extract implicit subsidies from Government safety nets. The shadows obscure organizational forms and transaction strategies that circumvent regulatory restraints and extract subsidies by regulation-induced innovation. Safety nets are implicit contracts that offer loss-absorbing equity capital from taxpayers. The speaker argued that taxpayers should be given more say as stakeholders in financial institutions.

Bálint Horváth, Tilburg University, presented a paper “*The Impact of Taxation on Bank Leverage and Asset Risk*”. Interest deductibility encourages debt financing, but regulatory and market constraints create dependency between bank leverage and risk. The author used a large international sample of banks to estimate the short- and long-run effects of corporate income taxes (CIT) on bank capital structure and portfolio risk. A higher statutory CIT-rate is according to the sample associated with higher bank leverage and a reduction in the average riskweight of assets. Taxation induces portfolio reallocation toward less lending. The results suggest that elimination of the tax-bias of debt may not improve bank stability.

Peter Andrews, Financial Conduct Authority (FCA), called his presentation “*Shadow banking from the perspective of a securities regulator*”. Shadow banking is not easy to define. A common definition is, however, credit intermediation involving entities and activities outside the regular banking system. It is relevant to

consumer protection, market integrity and competition, which are all according to the UK Financial Services Act (2012) objectives of the FCA. Shadow banking makes credit quality and liquidity harder to assess and complicates documentation, transparency and risk evaluation. Measuring the costs and benefits of regulating shadow banking is extremely difficult.

Alessandro Scopelliti, University of Warwick, presented a paper “*Securitisation and Bank Capital in European Banking: Does Regulation Affect Risk Retention Decisions?*”. The paper was awarded the 2014 Marjolin Prize as the best contribution to the Colloquium by an author below the age of 40. The speaker focused on the issuances of structured products by European banks from 1999 to 2010. He found that regulatory incentives had a strong impact on the decisions regarding the retention of credit risk and the composition of bank assets and liabilities after securitization. Banks changed their risk-weighted capital and leverage ratios after securitization, by considering structured issuances with different collateral, rating and nationality. The paper has policy implications for the impact of the collateral framework on the risk retention behavior of banks and for current reforms of prudential regulation.

The first paper that belongs to the set of policy-oriented papers was a presentation on banking supervision and growth by **Mario Quagliariello**, European Banking Authority (EBA). Historically, GDP and credit growth tend to be correlated. It is, however, difficult to establish whether financial development is cause or effect of economic growth. The importance of the supervisory capital levels in relation to the expected default frequencies has changed in the last few years. Bankers and economists do not agree on the question whether the request for more equity in banks reduce growth or not. Regulation in the EU goes beyond the provisions agreed at the global level. Capital conservation buffers and countercyclical buffers combine micro- and macro-prudential regulation. Increasing banks’ resilience in difficult times as well as leaning against the wind are used to explain macro-prudential policies. According to the speaker, financial regulation can deliver a sounder banking sector by imposing stricter capital and liquidity standards, but it is not a tool for managing the real economy. Automatic stabilizers, however, improve the chances of early intervention.

Mark Mink, De Nederlandsche Bank, presented a paper “*Spillovers from Systemic Bank Defaults*”. The speaker and his co-author examine to what extent banks’ stock market values during the 2007 to 2012 financial crisis were driven by increases in the default risk of banks designated as globally systemically important (GSIFIs) by the Financial Stability Board. Stock market values of the individual GSIFIs seem hardly to respond to changes in their own default risk. There seems, however, to be an

impact of these risks on changes in other banks’ market values.

Iftekhar Hasan, Fordham University, gave a presentation “*Regulations, Foreign Banks and Income Inequality*”. The speaker and his co-authors examine empirically the impact of bank regulatory policies on the income distribution in different countries. Data from the period 1973 to 2005 came from 87 countries. Dependent variables are the Gini Coefficient and the income share of the lower 10 % or 20 % of the income distribution. It turns out that more liberalized banking systems are associated with lower Gini values. Failing to liberalize banking sectors hurts the poor. Abolishing credit and interest rate control decrease inequality. High foreign bank ownership is expected gradually to benefit equality.

Stefano Zedda, University of Cagliari, asked: “*Will the bail-in break the vicious circle between banks and their sovereign?*”. Banking crises impact on public finances and sovereign debt crises impact on bank balance sheets. The speaker proposed a computational approach to quantify the effects of this circular relationship. The method is tested on four countries. The results show that, while limited crises tend to be absorbed by the system, serious crises tend to exacerbate at each turn, so that it becomes impossible to stop them without external intervention. Results show that a bail-in of 8 % of the total balance sheet can be really effective in breaking the vicious circle and preventing contagion between banks and public finances.

Javier Villar Burke, European Commission, presented a paper “*The Resolution Fund and Incentives*”. The goal of some resolution fund initiatives is to make the financial sector repay the costs of the last crisis. Other funds aim to make private funding available for financing future resolutions of banks as an alternative to bailing out financial institutions with public funds. The speaker argued that a resolution fund, if not designed properly, can have unintended consequences by exacerbating the cycle and promoting perverse incentives. A well designed resolution fund should promote financial stability as a preventive tool. This can be achieved through contributions based on a dynamic factor, which would depend on asset growth and income.

Jordi Gual, La Caixa, gave a presentation “*Prudential regulation and the cost of bank funding*”. The new Basel requirements have two goals: To deal with potential losses and to ensure less risk is taken. The question is if higher prudential requirements will imply less actual risk-taking. The capital requirements directive (CRD IV) include Tier 1-, Tier 2- capital and a capital conservation buffer, a countercyclical buffer and for SIFIs additional buffers. The new EU bail-in requirements have also potential impact on capital. Since 2008, there has been a sharp increase in regulatory capital ratios. Risk weighted assets (RWAs) are, however, a poor proxy for the actual

risk of an institution. On theoretical grounds, we cannot take for granted that higher capital requirements will imply less actual risk taking.

Commission 3 “*Economic Growth and Financial Institutions and Markets*” was chaired by **Frank Lierman**, Belfius Bank and **Pierre Siklos**, Wilfrid Laurier University.

In the first presentation, **Massimiliano Affinito**, Banca d’Italia, focused on the convergence in banking and the real economy within clubs of countries. He posed the question: “*Is the Euro Area a blunder?*” The main indicators used were deposits to GDP, loans to GDP and per capita income. 65 countries were grouped within 17 potential clubs such as for instance the Euro Area, EU 27, OECD, G 20, OPEC and NAFTA. The analysis via 4 econometric methods covered the period from 1964 until the outbreak of the financial crisis in 2008. It seems that the Euro Area is the only area with clear signs of banking convergence. The Euro founders show high convergence. Banking convergence has a positive impact in fostering real convergence. Euro Area enlargements must be implemented very carefully, because in the past they reduced the degree of convergence.

Michael Koetter, Frankfurt School of Finance and Management, presented the link between banking competition and opaque firms. His dataset was composed of more than 700.000 year observations of German SMEs for the period 1996-2006. Do banks act as referees concerning the information they receive from SMEs? Banks need sufficient margins to generate the necessary private information in order to allocate financial funds efficiently. Banks can improve the economy because they can make firms more productive or help productive firms to grow. Regional markups in banking are beneficial because they permit the generation of important private information needed for an efficient selection and monitoring of risks and, ultimately, growth. Even small banks may extract rents from lock-in firms that depend heavily on external finance, which may entail negative growth. Hence, regional market conditions should matter for antitrust policies rather than considerations of bank size alone.

Debora Revoltella, European Investment Bank, presented the role of EIB in the launching of the European recovery. Her starting point was the weak performance of the economy: EU potential growth declined by more than 1 % between 2007 and 2013, investments fell by 14.9 %, unemployment jumped to 12 %, competitiveness deteriorated. Financial market fragmentation and continuing deleveraging are major handicaps for SMEs to obtain bank financing. Differences among countries are huge. Other economic challenges are the weak intra EU convergence, energy security and also the external policies. Each year the EIB issues AAA bonds for some EUR 76 billion. In fact, they can be considered as

forerunners for the so-called Eurobonds. The group of customers of the EIB is quite broad: banks, non-financial companies and social organizations. The projects to finance are mainly linked to SMEs, innovation, strategic infrastructure and climate change. New areas of financing are explored via innovative and higher risk products, even equity capital in order to foster innovation.

Alessandra dal Colle, Banco Prossima, analyzed the influence of financial liberalization on growth. No empirical evidence was given. As long as financial liberalization leads to lower fixed costs of financial intermediation, the competition within the financial sector increases. In order to stimulate economic growth via financial liberalization it is not useful to lower the barriers to entry in the form of fixed income, but proper account has to be taken of their relationship to macro-economic fundamentals of the liberalized economy.

Stavros Vourloumis, London School of Economics, tried to answer the questions: can the financial system supply the economic recovery and the growth process with capital? And has the state a role in this process? The financial sector limits its intermediation due to regulation, structural reform, insufficient size and level of development. The role of the state has to increase beyond a Keynesian public expenditure policy and the traditional industrial policies. The state has to become a strategic investor via seed capital to help SMEs, which occupy a strategic role for productivity, innovation, employment and growth.

Yuan Xie, Fordham University, focused on the influence private information concerning pending approval of patents can have on bank loan spreads. Banks incorporate borrowers’ pending approval patent info in debt contracting. More than 2650 firm year observations on patents for the period 1987-2006 were used. Banks charge lower loan spreads for borrowers with such info, and borrowers with high patents pending approval have higher expected economic values.

Harald W. Stieber, European Commission, looked at the determinants of capital structure in non-financial companies. Via a series of panel analyses, the leverage drivers were determined. The dataset is composed of nearly 1.2 million firms with more than 6.3 million firm year observations. There is huge heterogeneity across countries, industries and regions. Respectively, size, industry leverage and growth, and tax shield are increasing the leverage ratio, while profitability and liquidity are reducing it. Tangibility has a positive impact on the firms that use long-term debt financing. International capital allocation has also a strong impact. Corporate taxation needs to be part of macro prudential policy frameworks in view of the important effects of national tax codes on leverage ratios.

The work in Commission 3 was concluded by a panel on experiences from financial institutions and markets. The

panelists were **Javier Castrillo Pénades**, Head of SME Banking in Banco Santander Group, **Gregorio De Felice**, Chief Economist in Intesa Sanpaolo, **Davide Grignani**, Head Financial Institutions Group Italy Société Générale, and **Carl-Christoph Hedrich**, Senior Research Manager Public Affairs Commerzbank. All four banks are strongly engaged in retail banking including private customers and SMEs. The relative importance of retail banking varies between 50 % and 70 % of the turnover. All banks have a huge number of branches and millions of retail customers, not only in their home countries but also in foreign markets. They apply a traditional financing model for SMEs but add new services to meet the changing expectations of SMEs such as international trade finance, talent management, training, cash management, issuance of short- and long-term bonds etc.

Bank financing of SMEs suffers in all considered countries, but for different reasons. In Spain and Portugal the financial structure of many companies is weak, and banks are still in their deleveraging and de-risking process. A bottom seems to have been reached, but the upward movement is very slow. In Latin America, the US and the UK, the revival is much more pronounced and a return of the financing activity to pre-crisis levels is on the way. In Italy, the credit quality is deteriorating, which implies increasing loan loss provisions. Italian banks are too much leveraged but up to now no tax money was necessary to bail out some banks. Credit demand is increasing but it is a more risky demand. The financial fragility of the companies must be decreased and bank dependency must be lowered. The development of public guarantee schemes for credits to SMEs could be an appropriate measure to stimulate the financing of the Italian economy. At the same time, business models of banks must be changed via a decrease of the huge volume of government bonds on the balance sheet in favor of more performing credits to the SMEs. A consolidation of the banking sector, mainly within the group of small and regional banks, is urgently needed. The revitalization of the Italian economy is only possible via an increased injection of equity capital in companies and more discipline in public spending in order to stop the progressive impoverishment. Healthy shadow banking via organic financial innovation is a necessary and useful urgent step to deploy on the largest possible scale. This implies more securitization, ABS, commercial paper, IPOs etc.

In Germany, the capital structure of most companies improved substantially thanks to the severe attitude of the banks, referring to the Basel II capital requirements. The equity capital increased from some 16 % in 1997 up to 27.5 % of their balance sheets in 2012, while long-term debt represents some 40 %, down from 47.2 %. The German economy faces a decline of investments, which is a danger for the maintenance of its actual strength. The net savers status of private persons and companies

since 2009 is a danger for the growth potential, which declined from 3 % to only 1.5 %. A real credit crunch is not observed. Credit conditions are quite normal and interest rates have never been so low. The interest charges represent only 1.2 % of the total costs of the companies. Bank margins are extremely low. Many companies intend to expand their investments but are not looking for bank financing according to a Commerzbank survey in April 2014. Alternative financing channels are offered by insurance companies, institutional investors, hedge funds, crowd funding, etc. Banks could stimulate the “Schuldscheinen” (corporate bonds), as an alternative to traditional bank credits. These papers are unlisted privately placed senior debt instruments. They have earlier been used with success.

All panelists considered an ECB interest rate cut to be insufficient to stimulate the European economy. The huge dispersion of rates on loans to companies between core and peripheral countries proves that the transmission of monetary policy to credit rates remains ineffective. More unconventional measures are welcome such as ABS, LTRO with conditionality of use of the obtainable funds, purchase of government bonds, etc. The ECB must work together with the European Commission, the EIB, the EBA and other regulators, but also with national governments to create as soon as possible a real European level playing field in favor of SME-financing. Europe needs a new ambitious project to revitalize its economy and to increase the confidence of the population and the companies, if not a long disappointing growth period will be ahead of us.

The closing plenary session was chaired by **Ernest Gnan**, Oesterreiche Nationalbank. The panel members were **Elena Carletti**, Bocconi University, **Michala Marcussen**, Société Générale Corporate & Investment Banking, and **David Llewellyn**, Loughborough University.

Elena Carletti gave a presentation “*The impact of the regulatory framework on investment in the European Union*”. The speaker gave an overview of recent regulatory reforms in the EU, and referred to the Vickers and Liikanen reports. She expected no major changes in the structure of the financial system. Regulatory reforms are expected to have only a modest impact on cost of funding, and thus on level of investment and aggregate output. Bank lending rates to companies remain divergent. The resolution of the Eurozone crisis and the creation of the banking union seems to be the most important regulatory reform going forward. It will help to restore flow of funds to the real economy.

Michala Marcussen discussed the new macro-prudential dimension of central bank policy. Price stability is different from financial stability. In the OECD area, total debt divided by GDP has increased almost every year since 1980. In addition to the traditional task of maintaining

price stability, major central banks have in recent years assumed responsibilities to maintain financial stability. They have developed new macro-prudential toolkits. Financial policy committees are likely to become more common.

David Llewellyn called his presentation “*The Post-crisis Regulatory Regime: Help or Hindrance?*” The objectives of regulation are to lower the probability of bank failures and to lower the social costs of bank failures. Because there were no resolution arrangements in place, the tax-payers became the insurers of last resort in the recent crisis. The current approach to bank regulation is excessively complex. Bank business models are endogenous to regulatory regimes, but regulatory regimes are also endogenous to business models. Consequently, regulators and supervisors are always shooting at a moving target. There are limits to what regulation can achieve. There is a danger of incremental over-regulation. In the future, resolution arrangements should aim at protecting depositors and tax-payers. Shareholders should not be protected and non-insured creditors should share the costs.



At the end of the Colloquium, the president of SUERF **Urs Birchler** awarded the 2014 Marjolin Prize to **Alessandro Scopelliti**. University of Warwick. The president closed the Colloquium by thanking the authors, speakers, chair persons, organizers and the representatives of the host institution Bocconi University for their hospitality and contributions to a memorable event.

Report from the 2014 SUERF General Assembly

This year's SUERF General Assembly was held during the 31st SUERF Colloquium and Baffi Finlawmetrics Conference in Milan on 4 June 2014. **Urs Birchler** opened the meeting and welcomed those attending the General Assembly. He gave thanks to **Philipp Hartmann**, who had recently stood down from the Council of Management after serving for nine years, including two terms as the association's Vice-President, and welcomed **Gabriel Fagan** (ECB) on board as an observer. **Frank Lierman** was reconfirmed as Vice President of the Association, serving a second term from 1.5.2014 until 30.4.2017. **Roberto Blanco** (Banco de España), **Carl-Christoph Hedrich** (Commerzbank), **Michala Marcussen** (Société Générale CIB) and **Debora Revoltella** (EIB) were all elected to the Council of Management, having been observers to the Council of Management since the last General Assembly.

In addition, the mandates of **Morten Balling** (Aarhus University), **Allard Bruinshoofd** (Rabobank), **Jakob De Haan** (DNB), **Patricia Jackson** (EY), **Esa Jokivuolle** (Bank of Finland), **Frank Lierman** (Belfius Bank), **Donato Masciandaro** (Bocconi University) and **Jens Ulbrich** (Deutsche Bundesbank) were renewed for a further three years (from 1.1.2015-31.12.2017). Since the last General Assembly held in Amsterdam, there have been conferences in Paris, London and now Milan, with a Research Prize Workshop in Vienna, and event planning for 2014-15 is currently underway for conferences in Reykjavik, Madrid, Vienna (as well as another workshop in Vienna), Helsinki and London, with the 32nd SUERF Colloquium to be held in Frankfurt on the topic of “*The SSM at 1*” in the third quarter of 2015.

Publication activities have continued to consist of *SUERF Studies*, although a far-reaching review of the association's publication policy is currently ongoing – SUERF Members are to receive a questionnaire about how the association's publication strategy should be developed.

Michael Bailey reported on behalf of SUERF's Honorary Treasurer, **Donato Masciandaro**, that SUERF's financial position remains sound, thanks to the support of the Association's membership, in particular Corporate Members and Central Bank Members. Finally thanks were given to the organizations with which SUERF has organized events in 2013-2014 as well as to the partner who have already committed to organize joint events with SUERF in 2014-15.

Michael Bailey, Executive Secretary