

Newsletter

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EDITORIAL

SFI: An initiative successfully on track

by Olivier Steimer

First of all, I wish to welcome Prof. Claudio Loderer as the new Managing Director (MD) of SFI.

This ends the interregnum we had at the SFI since our first MD, Prof. Jean-Pierre Danthine, left the SFI at the end of 2009 to join the prestigious Governing Board of the Swiss National Bank. The unique profile we require of the person filling the position of MD at the SFI made the search more challenging than we had expected: The MD must not only be a researcher accepted by the eminent finance researchers of this world as their peer, the MD must also be an experienced manager enthusiastic to spend considerable energy on further developing this public private partnership called Swiss Finance Institute!

So I am all the more delighted that as of February 1, 2011 we have found one of these exceptional persons. Prof. Loderer is a reputed researcher, teaching at outstanding institutes such as the University of Chicago, the University of New York, and the University of Bern. He also brings extensive experience in the management of an Institute as well as in managing executive education.

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INTERVIEW

Swiss Finance Institute welcomes new Managing Director

On February 1, 2011 Professor Claudio Loderer took up his new position as Managing Director of the Swiss Finance Institute. Professor Loderer is Professor of Financial Management at the University of Bern and also Director of its Institute of Financial Management.

Professor Loderer, why did you accept the position of Managing Director of SFI?

I was impressed by the remarkable reputation that SFI has achieved in research, doctoral and executive education, and knowledge transfer. I also like the challenge of developing SFI further, something we can achieve with the support of the many individuals who are part of the SFI family.

Which will be the key objectives/areas which you want to focus on as the new Managing Director?

As in the past, we strive for the number one rank among the finance research institutes in Europe, we aim to offer one of the best PhD programs in the field of finance worldwide, and we want to make SFI the benchmark for high level executive education in banking and wealth management. We will also continue to use our successful knowledge transfer activities to further the debate between academia and practice.

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Prof. Claudio Loderer

>> **Editorial**

But although 2010 was an interregnum year, it was definitely not a year lost. In fact a number of noteworthy milestones were achieved: For the first time since our existence we were able to allocate an SFI Chair to more than half of our 50 finance professors, which is a tremendous tribute to the research quality of our faculty. From our SFI PhD program, 7 graduates assumed positions as finance professors at some of the world's most prestigious universities in the US, Europe, Asia and Australia while 9 joined the finance industry, thereby increasing the talent pool available to the Swiss financial center, which is another target of SFI. No wonder we had a record number of applicants from all over the world for the 24 incoming SFI PhD positions available in 2010.

Executive Education on the other hand successfully adapted to the post-financial crisis world, returning to profitability while building its international reputation: For example after only three years our Senior Management Program in Banking managed to attract a record 50% of participants from overseas, with senior executives coming from as far as South America to benefit from the expertise available at SFI! And finally our public event with Nobel Laureate Prof. Stiglitz set a new milestone as the most successful event ever held by SFI, with 600 participants and extensive media coverage.

Of course we must expect to encounter headwinds along our way, but the fact that the above successes were possible even during an interregnum speaks for the resilience and the potential of our young organization. As the Chairman of the SFI it was heartening to see that the care we put into developing SFI in its first years was rewarded in this way. And with the SFI team now complete again, we now have an outstanding platform from which we will be able to jump even higher!

*Olivier Steimer,
Chairman of the
SFI Foundation
Board*



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As a finance researcher who has observed the SFI from the outside, what has been the main contribution of SFI to the Swiss financial center?

I should first say that I was both surprised and amazed at SFI's success in such a short time. I'm impressed this performance was possible in our academic landscape. The most visible contribution to the Swiss financial place comes from SFI's research and its PhD program. The high quality of those activities has added to the international reputation of the Swiss financial place and has provided a striking certification of the first-rate know-how of our financial center.

What type of research should SFI sponsor?

We want the type of research that helps us achieve our goals. This includes research that keeps us on the map internationally and is relevant for the private and public sector. However, we don't have to do and sponsor everything ourselves. We can also locate the relevant research internationally and make it available to our stakeholders. ♦

: SFI Honorary Membership awarded to Jean-Pierre Danthine and Urs Ph. Roth

In December 2010, the Swiss Finance Institute Foundation Board awarded the title of SFI Honorary Member to Prof. Jean-Pierre Danthine, former Managing Director of the Swiss Finance Institute and now Member of the Governing Board of the Swiss National Bank, and Dr. Urs Ph. Roth, former representative on the SFI Foundation Board of the Swiss Bankers Association. The title of SFI Honorary Member is awarded to select members of the financial community in view of recognizing their outstanding contributions and dedication to the SFI initiative. ♦

Mark your calendars...

Outstanding Paper Award, March 29, 2011
Société de Lecture, Geneva

**Breakfast Seminar with Philippe Moutot from the European
Central Bank, April 29, 2011**
Zurich Cantonal Bank, Zurich

6th Annual Meeting, November 30, 2011
ConventionPoint, Zurich

: Finance will become less innovative but more robust

At this year's 5th Annual Meeting, distinguished finance experts from academia and industry discussed systemic risk, liquidity risk and risk management, outlining solutions in research and applied sessions.



Prof. Ingo Walter, NYU Stern School of Business, lecturing in applied session

A systematic overview of the financial crisis, systemic risk, competitive performance and lessons learned was given by Ingo Walter, Dean of Faculty of the NYU Stern School of Business. Walter's recent book «Regulating Wall Street», on the impact of new regulation of the financial system, follows his 1985 book «Deregulating Wall Street». According to Walter, the new financial architecture is likely to bring more stability and strength to the financial system, despite also bringing a loss in innovation and efficiency. There still was much to do to «detoxify finance and make it more transparent as well as limit systemic risks», he said.

«Myopic risk analysis gives no consideration to systemic risk»

«Warnings, guilt and lessons hopefully learned» was the topic of Paul Embrechts, Professor of Mathematics at the ETH Zurich and Swiss Finance Institute as well as Director of RiskLab. He said that one should be careful about «new paradigms», as there was no such thing as a «free lunch». One should always question excessive gains, and consider what it would take to break a financial product, Embrechts advised. Michel Crouhy, Head of Research and Development at NATIXIS Foundation for Quantitative Research, described the basics of securitization and the making of triple-A securities, which were the underlying problem in the sub-prime crisis.

Questioning what went wrong in risk management and risk modeling, he opined that ratings from rating agencies were false, and the applied risk models «unrealistically simple» and not designed to deal with the complexity of structural credit products.

Moreover, the data used for modeling was inaccurate, short-term financing bore little consideration of liquidity risk, and myopic risk analysis took no consideration of systemic risk. Consequently, risks were massively underestimated, Crouhy said.

The collapse of the structural credit products market eventually led to the downfall of the financial markets. The inter-bank market for liquidity had dried up. «Tightness in the inter-bank market for liquidity leads banks to engage in what we term liquidity pull-back, which involves selling financial assets either by banks directly or by levered investors», said Kjell G. Nyborg, Chair of Corporate Finance at the University of Zurich and Swiss Finance Institute Professor. This was done to convert low powered money, namely financial assets, into higher powered money. «Although this does not increase the stock of money in aggregate, it can increase the money balances of an individual bank», he added.

«Liquidity risk is more than just one number»

To rule out liquidity risk, liquidity has to be managed. This was illustrated by Tobias Guldemann, Group CRO and a member of the Executive Board of Credit Suisse. «Our funding policy is based on a strategy to maintain long-term funding and equity at a level sufficient to continue business as usual for a defined time period in a specific market stress environment», he said; key elements thereby being liquidity buffers, strong funding and continued risk assessment. However, not all market participants display such prudence. Therefore, regulatory initiatives for better liquidity are underway. ♦



Prof. Michel Crouhy, Vice President, Natixis

: Meeting highlights

A highlight of the 5th Annual Meeting was a speech by SNB Vice Chairman Thomas J. Jordan, who spoke about systemic risk and regulation, and the key criteria or “roadmap” that should be applied when designing regulatory measures.

Which criteria should be considered when designing regulation?

Thomas Jordan emphasized that the handling of risk in financial systems was a huge challenge. «It is not always possible to pinpoint the precise source of systemic risk due to complex interdependencies in global financial markets», he said, explaining that before the outbreak of a crisis, it was almost impossible to identify the domino that would fall first and so cause the financial system to falter and even collapse. Because systemic crises are extremely costly – with the social costs being higher than the private ones – intelligent regulation was needed to reduce the magnitude of risk and the probability of crises.

According to Jordan, the question was where to start and how to set priorities in designing such regulation. As a first criterion, measures had to ensure market discipline instead of formulating individual solutions by focusing on specific causes. One example was the too-big-to-fail issue, illustrating that the market’s power to impose sanctions was not fully functioning, since systemically important banks currently could not fail.

Another criterion was the aim to tackle the structural causes of crises wherever possible. «We have to recognize general patterns and include them in regulatory considerations in order to improve our crisis prevention», Jordan said.



Antonio Foglia, SFI Foundation Board Member, in discussion with guests

Besides, each individual measure had to strengthen the regulatory setup – also on an international level. «Only by applying the same definitions worldwide can the soundness of individual banks be compared internationally», he continued.

At the same time, measures should take national circumstances into account. «By observing these criteria, we can make a significant contribution to better managing the challenges that arise in connection with systemic risk in the financial system», Jordan added. Ultimately, however, it was politicians, who had to bear responsibility for the regulatory measures. «Supervisory authorities and central banks play an advisory role but cannot make decisions on the introduction of the necessary laws and ordinances», he said.



Prof. Thomas Jordan, Swiss National Bank, delivering his speech

Following this presentation, Olivier Steimer thanked all the financial opinion leaders for their valuable contributions throughout the day-long research and knowledge transfer program, focusing on financial architecture, liquidity and risk management. He also thanked the PhD students, who were introduced earlier by Rajna Gibson, Swiss Finance Institute Director of Research, in a prize-giving ceremony preceding Jordan’s speech.

As in past years, the 2010 Annual Meeting of the Swiss Finance Institute was jointly organized with research partner FINRISK (National Centre of Competence in Research Financial Valuation and Risk Management). ♦



Audience in applied session

: Recognition in Research

A number of prizes and awards were given at the 5th Annual Meeting in November:

- This year's best doctoral paper award presented at the Annual PhD Workshop organized by FINRISK and SFI has been given to Julien Cujean, University of Lausanne and Swiss Finance Institute, for his paper «Equilibrium Asset Prices with Bid-Ask Spreads». Each year on the same occasion the SFI also awards a prize to PhD students holding an outstanding discussion of a paper presented at the Workshop. The awards for this year have been given to Julien Cujean and Jan-Peter Kulak of the University of Lausanne and Nilüfer Caliskan of the University of Zurich.

- The private banking prize, sponsored by Banque Privée Espírito Santo, has been awarded to SFI Professor Rüdiger Fahlenbrach and his co-author René M. Stulz for their paper entitled «Bank CEO Incentives and the Credit Crisis».



Audience at the research session of the 5th Annual Meeting including Prof. Fabio Trojani

- Finally, the 2010 Outstanding Paper Award, selected by a jury of SFI faculty members for an unpublished research paper making an outstanding contribution to the field of finance, was awarded to Jules H. van Binsbergen (Stanford University), Michael W. Brandt (Duke University) and Ralph S.J. Koijen (University of Chicago) for their paper «On the Timing and Pricing of Cash Flows». The findings of this paper will be presented in a public lecture in Geneva in the first half of 2011. ♦

Olivier Steimer congratulates Ms. Nilüfer Caliskan as the recipient of the Best Discussion Doctoral Award

: Welcome on board!

- We have the pleasure of announcing Prof. Markus Leippold of the University of Zurich as an SFI Faculty Member as of fall 2010.
- SFI welcomes Prof. Javier Suarez as an SFI Visiting Professor at the University of Zurich from February to April 2011. Prof. Suarez is Professor of Finance at the Center for Monetary and Financial Studies (CEMFI) Madrid and is an international expert on banking regulation. ♦

: Two Smith-Breedon Prizes linked to SFI!

The Smith-Breedon Prize, selected by the Associate Editors of the Journal of Finance, is considered one of the most prestigious prizes in the field of finance. It is awarded annually for the top papers in any area - other than corporate finance - published in the Journal of Finance in the first five issues of the given year and the December issue of the previous year.

The 2010 winners were announced at the American Finance Association's Annual Meeting in January this year. The First Prize for the Best Paper was awarded to

Prof. Lukas Schmid, a 2007 SFI PhD graduate from the University of Lausanne and currently Assistant Professor of Finance at the Fuqua School of Business, Duke University, for his paper entitled «Levered Returns», co-authored with João F. Gomes. A "Distinguished Paper" Prize was awarded to Prof. Norman Schürhoff, SFI Professor at the University of Lausanne, for his paper entitled «Price Discovery in Illiquid Markets: Do Financial Asset Prices Rise Faster Than They Fall?», co-authored with Richard C. Green and Dan Li. ♦

: Joseph E. Stiglitz on rethinking economic theory and economic policies

On September 20th, the Swiss Finance Institute invited Nobel prize-winning economist Joseph E. Stiglitz to Zurich where he presented his view on the lessons learned from the recent global financial crisis to the Swiss banking community.

Despite the early morning hours, Joseph Stiglitz's extraordinary experience attracted more than 600 participants to listen to his lecture "The Global Financial Crisis: Lessons for Economic and Financial Theory and Policy" (video podcast on our website available until March 20, 2011). In front of a full audience, he stated his view on recent events, especially the role of central banks. Stiglitz said that the central banks had failed in terms of fighting the consequences of the crisis and handling the flaws in policy frameworks. Nevertheless, the good news is that central banks have realized that focusing on inflation targeting only is insufficient. They must also pay equal attention to sustaining sound financial stability.

In the course of incorporating more aspects of banks' microeconomics and their behavior to macroeconomic models, it is vital to get a better understanding of the significant role of incentives and constraints in the financial sector both on an organizational and an individual level. This leads to a protection of sufficient funding to small and medium enterprises, which are in turn the primary source of new jobs and economic prosperity.

However, Stiglitz addressed not only the need of revising central banks' macroeconomic models, but also economic theory itself. From his point of view, the main cause is the insufficient attention which has been paid to risk and information architecture. Prior to the crisis, the transfer of risks to the market – as done in the course of



Prof. Joseph E. Stiglitz delivering his speech in Zurich

securitization – was seen as an advantage of globalization. Following the crisis awareness of intransparency and contagion has arisen. In conclusion, Stiglitz sees «a very fruitful period for rethinking both economic theory and the economic policies that must inevitably rest on those theories» coming.

Joseph Eugene Stiglitz studied at Amherst College, University of Chicago and has a PhD from Massachusetts Institute of Technology (MIT). He also held an assistant professorship at the latter institute. Subsequently, Stiglitz held various positions at almost all major international universities of economics, such as Yale, Stanford, Oxford and Princeton. He is currently professor at Columbia University. In 2001 he was honored with the Nobel Prize in Economic Sciences for his analyses of markets using asymmetric information. Furthermore, Stiglitz has held various political roles such as the chair of the US President's Council of Economic Advisors, the position as Senior Vice President and Chief Economist of the World Bank. ♦



The successful graduates of the Executive Program 2009-2010 have received their diplomas at the Diploma Ceremony on December 1, 2010.

IMPRESSUM

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