[April 24 und 25. 2009 in Bendorf (Rhine)]

On April 24 and 25, 2009, the following presentations were held and discussed in Bendorf (Rhine):

1. The future of securitization - analysis of false incentives

Prof. Dr. Dr. hc Günther Franke, University of Konstanz

Günter Franke gave a lecture on "The future of securitization - analysis of false incentives". First, he outlined various theses on the causes of the financial crisis. Since it is a combination of different causes, it is very difficult to give a clear answer here. The lecture then focused on false incentives in the financial system. The first loss piece in a securitization transaction serves to limit the originator's adverse selection and moral hazard. The prerequisite for this is that he retains a substantial portion of the first loss piece. This has often not been the case. Then the incentives of the originator's first profit position were explained. They give him a largely risk-free profit position, even if the quality of the underlying portfolio is rather poor. Then the diverse agency problems in the value chains, which play a major role in the securitization of mortgage loans, were addressed. Off agency problems cannot simply be controlled by contracts. The discussion about incentive systems for bank managers took up more space. If a bank manager's income is made up of fixed salary, bonus and shares / options, there is a risk that this creates a high incentive to take risks. Whether this is the case depends on various parameters. However, it can easily happen that the bank manager with higher leverage can increase his income in terms of First Order Stochastic Dominance. This then leads to excessive levels of debt, such as were observed with ABCP conduits and structured investment vehicles. Finally, possible wrong incentives in rating agencies were discussed, triggered by the enormous earning opportunities of the rating agencies in the securitization business.
Finally, various approaches to improve the institutional framework for securitization transactions were discussed.
This includes more transparency about the whereabouts of the first loss position, controls on the reward systems by the banking supervisory authority to mitigate the negative external effects of such systems, and in particular the development of a risk map that allows systemic risks to be identified earlier and in the risk management of banks consider. Even in the general discussion, proposals for further refinement of banking regulation met with skepticism.

2. Contracts as Rent Seeking Devices: Theory and Evidence from German Soccer

Prof. Dr. Eberhard Fees, Frankfurt School of Finance and Management

Recent theoretical research has identified mandy ways how contracts can be used as rent seeking devices vis-à-vis third parties, but there is no empirical evidence on this issue so far. To test some basic qualitative properties of this literature, we develop a theoretical and

empirical framework in the context of European professional soccer where (incumbent) clubs and players sign binding contracts which are, however, frequently renegotiated when other clubs (entrants) want to hire the player. Because they weaken entrants in renegotiations, long term contracs are useful rent seeking devices for the contracting parties. From a social point of view, however, they lead to allocative distortions in the form of deterring efficient transfers.
Using data from the German "Bundesliga", our model predictions are broadly confirmed. In particular, our analysis supports the concerns expressed in the theoretical literature about detrimental effects of strategic contracting on allocative efficiency.

3. Tournament incentives and heterogeneity

Prof. Dr. Kerstin Pull, University of Tübingen

The theoretical literature on organizational reward systems repeatedly points to the importance of tournament models from an efficiency perspective, very few is known about the application and effectiveness of tournament compensation in organizations, especially when contestant heterogeneity is taken into account. While the distorting effects of contestant heterogeneity on tournament incentives have been theoretically analyzed for the two-contestant-case, tournament incentives in a typical organizational context with more than two contestants and with more than one prize, have not been studied so far. In our paper, we analyze these effects theoretically as well as empirically by studying incentive travel sales contests as a quantitatively important component of compensation,

4. Time-Varying Credit Risk and Liquidity Premia in Bond and CDS markets

Prof. Dr. Dr. hc Wolfgang Bühler, University of Mannheim

The current financial crisis underlines once again that there is a close relationship between credit and liquidity risks. The reassessment of credit risks by investors led to drying up of individual markets and a drop in prices. Which part of the price decline is due to higher credit risks and which is due to the reduced liquidity can only be answered against a model-theoretical background. A well-founded answer to this question is important for the internal risk management of credit institutions and for their supervision. It is also important for optimizing a company's borrowing costs by controlling the risk of default and the liquidity of the fixed-income securities issued.
The lecture examines theoretically and empirically the decomposition of yield spreads and CDS premiums. In the theoretical part, we develop an approach for mapping credit and liquidity risks of bonds and CDS contracts in a reduced-form model. For the first time, liquidity aspects of CDS markets and the effect that an illiquid bond is delivered to the CDS contract in the event of a default are recorded in this.
In the empirical part of our analysis, we break down CDS premiums and bond yield spreads into a pure credit risk - a pure liquidity and a correlation component. Here we achieve three main results. (1) The consideration of liquidity effects in CDS markets always leads to positive liquidity premiums in bond yields and thus to an explanation of a confusing result by Longstaff, Mithal and Neis (2005). (2) We show that an increasing credit risk leads to a decrease in bond liquidity. This empirical finding confirms the theoretical prediction of

Ericsson and Renault (2006). (3) We document on both the factor and premium level that a decrease in liquidity in the bond market has an analogous consequence for the CDS market.