

# Adair Turner 'Responding to the Demographic Challenge: Deciding the appropriate role of the Government'

## UBS Pensions Research Programme

1 February 2006

Lord Turner, chairman of the Pensions Commission which presented its final report on April 2006, delivered a public lecture under the auspices of the UBS Pensions Programme at the Financial Markets Group. The lecture, which is Lord Turner's third presentation within the UBS

Programme, represented a significant opportunity for academic and practitioner participation, and offered a perspective into the work of the Commission.

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Adair Turner, Chairman, Pensions Commission

# Determinants of Hedge Fund Liquidity

Andrew Patton and Sheng Li \*

Liquidity is an elusive concept to measure and it has a variety of definitions and interpretations. A standard definition of liquidity is 'the cost and ease with which an asset can be converted into cash', see Bodie, Kane and Marcus (1999). Standard measures of liquidity include variables such as

the bid-ask spread, the volume of turnover, and possibly the 'depth' of the best bid and ask quotes. But these measures are not available for all traded assets, and, more importantly, they only capture certain aspects of liquidity.

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\* Andrew Patton is a Senior Research at the FMG Asset Pricing and Portfolio Management Research Programme. Sheng Li is a Research Assistant at the Financial Markets Group.

## FMG Asset Pricing and Portfolio Management Programme

The purpose of this FMG Research Programme is to provide theoretically rigorous and practically useful research on the behaviour of asset markets. Research under the Asset Pricing and Portfolio Management Programme ranges from quantitative research on the cross-sectional and time-series properties of the distributions of asset returns through to portfolio choice theory, as well as equilibrium and no-arbitrage asset pricing theory.

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The Financial Markets Group organised a series of events to contribute to the public debate around the UK Pensions Commission second report, which was published in November 2005.

On 24 January 2006, we hosted an informal roundtable dinner where Professor John Hill, Commission member of the Pensions Review, lead the discussion and outlined some of the salient issues addressed by the Commission in its report.

On 1 February, Lord Turner delivered a public lecture on 'Responding to the demographic challenge: deciding the appropriate role of government'.

The above activities were organised and supported by the UBS Pension Research Programme at LSE. For more information please see the programme website at [www.lse.ac.uk/ubs/](http://www.lse.ac.uk/ubs/)

On 9 February Alicia H Munnell (Peter F Drucker Professor of Management Sciences, Boston College) gave a public lecture on 'Work Past Retirement'. This lecture was sponsored by Watson Wyatt.

# Adair Turner 'Responding to the Demographic Challenge: Deciding the appropriate role of the Government'

## UBS Pensions Research Programme

1 February 2006



Adair Turner, Chairman, Pensions Commission

Lord Turner began his public lecture by familiarizing the audience with the potential implications for markets and individual behaviour when governments increase taxes/social security contributions. Economic constraints on increasing taxes include the effects on capital markets, on a country's global competitiveness, potential disincentives to work and to save and the implications for migration and tax avoidance. However, Lord Turner illustrated how some of these common arguments do not apply to the current situation and that the real issues which relate to internal political choice, such as popular support, real wage resistance and empowering popular will, are more relevant.

Lord Turner pointed out that while debating and deciding on the appropriate role of the state one has to take into account the existing set of arrangements. Currently in the UK the implicit philosophy is to ensure a universal public provision of health benefits and a public provision of pensions which is moving towards universalism. This means that under current arrangements state pension benefits are partially and increasingly means tested, pension expenditure can rise less than proportionally with demographic pressures and it is redistributive through both proportional contributions and means testing. The central question in the debate on the role of the state in pension provision is then whether the public pension provision should be at a flat rate, aiming at

keeping people out of poverty in retirement, or an earnings related pension, which is rising with earnings/contributions.

Common arguments for a purely flat rate system are that the state should concentrate its limited tax/contribution resources on the redistributive role of poverty prevention, doing this using means testing wherever possible. Also, individuals should make their own private decisions on additional provision, via personal savings, in light of diverse preferences on inter-temporal consumption allocation and risk/return trade-off. However, in practice these arguments do not always hold because individuals are not always rational decision makers (as emphasized in the findings of behavioural economics), and there are often moral hazard and cost efficiency issues involved.

Lord Turner then continued his talk by describing the advantages of funded approaches compared to pay as you go (PAYG) systems. First, funded systems enable the 'pre-funding' of pension liabilities therefore increasing the national savings rate and smoothing the tax burden over time. Second, they shift the pre-retirement longevity and falling fertility risks to the individual. Additionally, they can be achieved within a PAYG system by moving to a notional defined contribution (NDC) by linking the rate of return to GDP and/or by 'Automatic Balance Mechanism' as in Sweden. In general if the rate of return on government bonds is equal to the rate of growth of the economy then a compulsory funded system invested in government bonds is equivalent to a PAYG notional DC system. However, this argument does not hold if individuals have different preferences in relation to the risk/return trade-off. In particular, Lord Turner illustrated how the level of risk aversion declines as the relative position in the income distribution increases, and how risk aversion declines as the replacement rate already secured increases. Given this, there is a clear inherent advantage of funded pension schemes because they enable different people to express different preferences for different combinations of risk and return, in particular, higher risk/higher return preference than government bonds. In addition, there is a political advantage because it may be a more politically accepted way to shift the risk from the state to the individual.

Stressing the fact that the analysis of the pension reform should be related to the economy's starting point, Lord Turner presented the Pensions Commission proposals for the UK. In a political economy context which will not support high levels of taxation and in which the introduction of SERPS squeezed out an adequate non-means tested Basic State Pension (BSP) it is proposed to: (i) focus state PAYG expenditure on adequate and less means tested flat rate pension provision, accelerating the evolution of S2P to a flat rate pension; (ii) strongly encourage funded earnings-related pension saving via auto-enrolment; (iii) enable low cost saving for all.

Another highlight of Lord Turner's public lecture was the relation between health care and pension expenditures. Recently public expenditure in health care has increased dramatically and is projected to continue this trend. Pension provision expenditure is projected to decline by limiting the state role. In order to analyse the arguments for state intervention one has to



**Responding to the demographic challenge: deciding the appropriate role of government**

consider the reasons for what are the market failures in the health care and pensions markets. In the health care market there is asymmetry of information and knowledge between producer and consumer and price signals are of limited value to consumers due to their inability to assess quality and high levels of anxiety. These factors imply that there are inefficiencies in the free markets and therefore a role for state intervention. In pension provision there is also asymmetry of information and knowledge between the financial adviser and the consumers. Price signals are also imperfect, eg the unclear relationship between past achieved return and future prospective return. This creates a high level of confusion for consumers and prevarication. This implies the need for regulation and will lead to high costs in personal pension market.

The final topic of Lord Turner's public lecture was how the distinctions between health care and pension provision affect the optimal level of state intervention in each sector. In terms of consumer demand differentiation, health care demand derives from income rather than inherent differing preferences. Moreover, there are ethical arguments for close to equal access. This implies that the social provided minimum should be closer to the average desired level in health than in pensions. This comes from the fact that the demand for pensions derives from differing preferences in terms of retirement age/saving/income and risk/return trade-offs as well as from different income levels. There is no argument for provision to be more equal than income in general. In terms of the degree of means testing there are serious disadvantages of means testing in both markets.

# 'Work Past Retirement'

Alicia H Munnell (Peter F Drucker Professor of Management Sciences, Boston College)

Second Watson Wyatt Lecture at LSE

9 February 2006



Alicia H Munnell (Peter F Drucker Professor of Management Sciences, Boston College)

Professor Alicia Munnell started her public lecture by pointing out the fact that despite the increase in life expectancies, there are fewer old people working. Longer retirement and aging populations will increase pressures on public pensions and reduce per capita GDP growth. Moreover, many people will not have enough resources to finance their retirement. In Alicia Munnell's view, the only way forward is to get people to work longer. This is due to several factors: social security replacement rates will decline even under current arrangements; the observed shift to 401(K) plans makes pensions more uncertain; and individuals save virtually nothing outside the pension plans. However, increasing labour market participation of older workers is not easy. There are major impediments on both sides of the labour market. About one-third of those retiring at 65 may not be able to work longer, and those able to work would prefer to work part-time. Additionally, on

the demand side firms seem to be reluctant to employ older workers mainly because they involve higher health and pension costs. For these reasons she argued that changes should be made to increase both demand and supply of older workers. Some changes have already been made to legislation to enhance labour market participation, such as, the abolishment of mandatory retirement, and the increase in delayed retirement credit. However, these changes had little impact on the labour market for older workers. Alicia Munnell then suggested more plausible options such as to increase Social Security's Earliest Eligibility Age and to eliminate payroll taxes on older workers. From the household's perspective the payoff to working longer is significant as it dramatically reduces required assets to finance retirement consumption. At an aggregate level it increases GDP growth per capita.



Watson Wyatt Public Lecture on: 'Work Past Retirement'

# Corporate Governance at LSE

## European Takeover Directive Conference

As part of the Corporate Governance at LSE Programme, a conference was organized on 12 January 2006 to analyse issues raised by the introduction of the European Takeover Directive.

### Session 1

The first session of the conference began with a keynote speech by **Jaap Winter** (De Brauw Blackstone Westbroek and chairman of the High Level Group of Company Law Experts) which highlighted the strengths, weaknesses and controversies of the European takeover directive. The key benefits of the directive were described as Articles 5, 15 and 16, the directives dealing with the mandatory bid clause in protection of minority shareholders. Mr Winter gave a brief overview of these directives and then described the contentious Article 4 of the directive as a necessary but complex and ambitious clause. Article 4 deals with the choice of corporate law governing the takeover transaction (usually that of the target's domicile or registered office). The final part of the presentation described Articles 9 and 11 that involved the takeover defenses measures open to companies. Mr Winter noted that the choice of takeover defences and compliance with Articles 9 and 11 could result in significant diverge in market opinions and valuations of firms.

**Mr Richard Murley** (Managing Director, NM Rothschilds & Sons), the former Director General of the Takeover Panel, described the history, objectives, timetables and key issues faced by this panel. He described the panel's objectives to retain speed, flexibility and certainty of its directives, to retain its independence, minimise tactical litigation and preserve the panel system for non-directive companies. The deadline for implementation of the directive is set for May 2006. Mr Murley concluded by voicing his view of positive prospects for satisfactory implementation of the directive.

### Session 2

During the second session of the conference, which was chaired by **Sir Geoffrey Owen** (Institute of Management, LSE), two views on the 13th European Takeover Directive were given. The opening speaker, **Jonathan Rickford** (UK Representative, High Level Group of Company Law Experts; Visiting Professor, LSE) commenced his exposition with a summary of current takeover practices and gave an overview of how the implementation of the new directive would impact on these. In particular,

he highlighted the transition from the currently non-statutory nature of the Takeover Panel to an authoritative body which may give binding rules and impose sanctions for breach enforceable by court. After a critical assessment of potential institutional and jurisdiction problems that might arise (eg, conflicts of interest between shareholders and stakeholders), he concluded his presentation with a discussion of the new directive's stand on the topics of Optionality and Reciprocity. **John Armour** (Senior Lecturer, Cambridge University) presented joint work with **David Skeel** (Professor, Pennsylvania State University) in which the authors investigated the subtle differences in both substance and mode that exist between the corporate governance models of the US and the UK. He explained the crucial role of hostile takeovers as an important means of corporate control and analysed regulatory differences that might be at the heart of, for example, the significantly higher percentage of successful hostile bids in the UK. He also discussed competing explanations of the differences in the regulatory environment between the US and the UK.

### Session 3

Session three began with panel presentations focusing on the national effects of the takeover directive presented by experts from Cleary Gottlieb Steen and Hamilton LLP. **Jan Meyers** was the first to provide an overview of the history of the directive. The directive was first proposed in 1989 in the first Commission draft. The directive suffered its first setback in 2001-03 over the issue of permissible scope of takeover defenses, especially relating to US/EU company takeovers. The mandate continued its development and made progress by 2005-04 on the areas of mandatory bid and squeeze-out (sell-out) rights. The squeeze-out rights are contained in Articles 15 and 16 of the directive. **Valerie Lemaitre** outlined the current state of French regulation with regards to the takeover directives. The French ministry of Economy and Finance funded the 'Lepetit' report of June 2005 to study the implementation of the directive in France. The report recommended implementation of 'board neutrality' (Article 9) only under the reciprocity condition of Article 12. The report rejected the 'breakthrough' rule of Article 11 as an excessive restriction on contractual freedoms. **Stuart Banks** continued the panel discussion by presenting the case for the effect of the directive in the UK. The speaker outlined the combined effect of Optionality and Reciprocity for UK listed firms. As bidders, UK firms may face different



## Corporate Governance Conference

situations because the UK has not made both Articles 9 and 11 mandatory. The applicable rule of law will depend on whether the company has itself opted in to Article 11, the implementing legislation in the jurisdiction of the target and whether the target has opted-in to optional provisions. In the case of competing bids, this may result in differential treatments between bidding firms and create an overly complex legal environment.

**Klaus Riehmer** made a detailed presentation of the state of German law with respect to the directive. German law is mostly already compliant with the directive, but rejects the mandatory board passivity that is adopted by France, Italy and the United Kingdom. **Roberto Bonsignore** drew a detailed comparison between the directive and Italian law. Early indications suggest that Italy may enact the option of reciprocity (Article 12) with respect to both the passivity and the breakthrough rules.

The company case studies that evidenced the failure of the newly introduced corporate governance regulation were presented on the topics of Banca Antonveneta, Endesa and Gas Natural and Beiersdorf. **Giuseppe Scassellati-Sforzolini** (Cleary Gottlieb Steen & Hamilton) described the takeover of Banca Antonveneta as demonstrating how the existing EU harmonization measures leave plenty of room for de facto discriminatory practices and may themselves lead to discrimination in national interests. In this case, the Bank of Italy authorised BPI to acquire a controlling stake on a future prospective assessment, although the necessary assessment should have been made prior to the bid to acquire. The scandal led to the resignation of the Governor of the Bank of Italy in December 2005, due to investigations that exposed his involvement in the takeover.

**Alejandro Fernandez** (Araoz & Rueda) presented the takeover of Endesa by Gas Natural as one plagued by a politically charged atmosphere and concerns of antitrust litigation. The prospect of lengthy anti-trust litigation was strategically employed to deter takeover bids. **Thomas Kirchmaier** (Financial Markets Group, LSE) outlined the case of Beiersdorf, where the controlling shareholders disadvantaged minority shareholders by failing to extend the offer to them. They successfully circumvented mandatory bid rules that are in effect throughout Europe. The cases clearly outlined the need for standardised concepts and definition in a pan-European financial market to strengthen the corporate governance regulation.

### Session 4

The fourth session was chaired by **David Webb** (Director, Financial Markets Group, LSE) and comprised of two presentations and a consecutive Investor Activism Panel. The first speaker, **Simon Dingemans** (Managing Director, Investment Banking Division, Goldman Sachs), put the 13th Takeover Directive into perspective with respect to European M&A trends more generally. Whilst he welcomed the new directive as making some 'useful progress' towards establishing common elements in M&A markets, he also

dwelled on its limited overall impact, emphasizing that the commercial rationale for takeover deals would remain the key driving force behind the European takeover activity. Moreover, he identified Articles 9, 11, and 12 as likely to generate legal uncertainty and possibly increase litigation in some jurisdictions. Notwithstanding, he concluded with an optimistic outlook on European M&A activity in 2006, based on a strengthening economic outlook and improving cross-border activity. **Colin Melvin** (Director of Corporate Governance, Hermes Investment Management), the second speaker, centred his presentation around the topics of ownership and conflict, providing a special focus on shareholder activism. He commenced by noting that effective corporate governance ought not to be an abstract problem but a matter of concern for 'each and every single one of us' be it as an active investor or simply as a beneficiary of a pension plan programme. Correspondingly, he emphasized the concept of investor governance and accountability of fund managers whose interests might diverge from what is optimal for society as a whole. Colin Melvin positioned himself as an opponent of most M&A transactions, corroborating his point of view with empirical evidence which shows that most mergers destroy shareholder value. Lastly, he argued that effective corporate governance is not only a question of corporate law but also of ownership structure. The Investor Activism Panel was chaired by **Erik Bomans** (Managing Director, Deminor) and included **Patrick Dewez** (Knight Vinke Asset Management LLC), **Daniel Goldwater** (P Schoenfeld Asset Management), and **Colin Melvin** (Hermes Investment Management). The first topic was Rising Shareholder Activism: Threat or Opportunity? All panel members agreed that shareholder activism represents an opportunity for as long as it based on an open dialogue with management and other investors. At the same time, 'uninformed' activism and 'shooting from the hip' are detrimental, ie, an active shareholder ought to respect industry practices and exercise his or her control rights in an appropriate fashion. The second question to be discussed was: What is Appropriate Activism? A consensus emerged that 'appropriate' activism could be defined as serving shareholders' interests, where a distinction between short and long-term interests has to be made. Litigation should be regarded as a last resort and dialogue with management ought to be sought as long as possible. As a third topic, Recent Trends in Shareholder Activism were discussed. The panel members agreed that most forms of shareholder activism they had been involved with were deal- and case-specific, ie, it seemed that no blueprint could be applied to describe some common features or recent trends. The last topic was: What is Needed to Make Shareholder Activism Succeed? The discussants quickly agreed that the main factors for success are i) possessing an expertise in a variety of areas (covering commercial and legal issues), ii) forming alliances with other shareholders, iii) and having a sound understanding of the respective regulatory environment.



# Corporate Governance at LSE

The Corporate Governance at LSE programme continued its successful work with two further Research Debates. Both meetings generated large interest among distinguished academics and professionals and resulted in stimulating debates.

On 2 February, **Professor Paul Davies** gave a presentation on 'The Company Law Reform Bill: What is New?'. The presentation was discussed by **Vanessa Knapp** (Freshfields Bruckhaus Deringer) and was introduced and chaired by **Sir Geoffrey Owen** (LSE). The purpose of this seminar was to debate the underlying themes of the Company Law Reform Bill, rather than the details of the legislation itself (which are contained in 885 clauses and 15 Schedules). The Bill is largely the result of a reform process set in train by the newly elected Labour Government in 1998 through a Green Paper entitled 'Modern Company Law for a Competitive Economy'. This paper stated that 'the Government is determined that the nation should have an up-to-date framework which promotes the competitiveness of UK companies and so contributes to national competitiveness and increased prosperity.' Three years later, and after issuing a number of substantial consultation documents, the Steering Group of the Company Law Review produced its final, two-volume report; and four years after that the Government has introduced the Reform Bill into Parliament. The seminar addressed the following fundamental questions arising from this legislation. What does modernisation mean in the context of company law and why has modernisation produced such an extensive piece of legislation? In what ways, to use the phraseology of the Steering Group, does the Act aim to 'promote enterprise and competitiveness, represent a modern view of the balance of interests between participants, and be as simple and accessible as possible'?

On 23 March **Sir Geoffrey Owen** and **Dr Thomas Kirchmaier** (LSE) gave a presentation on the 'Changing Role of the Chairman: The Impact of Corporate Governance Reform in the UK'. **Paul Myners**, (Chairman, Marks & Spencer Group) discussed their comments. The presentation was based on a study carried out by the presenters for the Chairmen's Forum. The resulting report, based partly on interviews and partly on a detailed analysis of changes in board composition over the 1995-2005 period, discusses the criteria which companies are now following in selecting a new chairman. These include: a track record of making good appointments; experience as an effective outside director of other quoted companies; a feel for the company's business and an understanding of its culture (though not necessarily direct experience of the industry in which it operates); and, most important of all, complementarity with the chief executive.

The separation of the posts of chairman and chief executive has become almost the norm among UK quoted companies, at least as far as larger

firms are concerned. Some of the questions addressed by Geoffrey Owen and Tom Kirchmaier in this presentation were: how do non-executive chairmen ensure that they add real value to the company's business? how do they handle the potentially awkward relationship with the chief executive – supportive but not in each other's pocket, monitoring performance but not interfering or second-guessing – while at the same time getting the most out of the other non-executive directors? What combination of skills, qualities and experience does the chairman need?

Given that the UK is the only major industrial country to have made the chairman/chief executive split virtually mandatory, it is important to understand how this arrangement affects the operation of the board. The Chairmen's Forum report contributes to that understanding by investigating how non-executive chairmen see their role, and how they interact with other board members and with the executive team. The report concludes that the British-style unitary board, containing a well-qualified independent chairman and a balanced group of strongly motivated outside directors, can improve the quality of the company's decision-making, but it also highlights a number of obstacles – some of them arising from current corporate governance rules – which may prevent boards from realising their full potential.

The aim of our 'Corporate Governance' research debates is to create a platform in which practitioners, policymakers and academics can discuss current issues in corporate governance, underpinned by the latest research evidence. To provide this the programme brings together a series of high profile scholars from around the LSE to study issues surrounding Corporate Governance.

Future Corporate Governance at LSE Research Debates include:

- |                    |   |
|--------------------|---|
| <b>8 May</b>       | <b>Lucian Bebchuk</b> (Harvard) on <i>the Limits of Regulatory Competition in Corporate Law</i> . |
| <b>25 May</b>      | <b>David Yermack</b> (NYU) on <i>Severance Packages</i> .   |
| <b>12 October</b>  | <b>Brian Main</b> (Edinburgh) on <i>Pay in the UK</i> .   |
| <b>13 November</b> | <b>Gerhard Cromme</b> (Chairman ThyssenKrupp) on <i>Corporate Governance in Germany</i> .         |

Attendance to the Research Debates is by invitation only. Further information is available on the FMG website: <http://fmglse.ac.uk>

The 'Corporate Governance at LSE' initiative is led by:

**Professor Paul Davies**, Department of Law, LSE  
**Professor Antoine Faure-Grimaud**, Financial Markets Group, LSE  
**Dr Thomas Kirchmaier**, MBS and Financial Markets Group, LSE  
**Sir Geoffrey Owen**, Interdisciplinary Institute of Management, LSE

# Determinants of Hedge Fund Liquidity

Andrew Patton and Sheng Li

Using various proxies for liquidity, the liquidity risk in stock and bond markets has been intensively studied. However the liquidity risk of hedge funds has only recently begun to attract attention. Hedge funds are a large and fast-growing sector of the economy. According to Hedge Fund Research, the assets under management by hedge funds are estimated to be \$1 trillion worldwide at the end of 2005 and, when combined with leverage-intensive strategies, are large enough to move markets around the world. To pursue high 'absolute returns', many hedge funds invest in illiquid securities that may be mis-priced by markets, such as emerging-market debt, distressed assets, and exotic over-the-counter derivatives. The 1998 Long Term Capital Management crisis highlighted liquidity risk as a particularly important source of risk for hedge funds.

The liquidity of hedge fund returns has various aspects. From the perspective of investors in hedge funds, the 'lock-up' and redemption notice periods are the two sources of illiquidity of most concern. The lock-up period is the period that investors must wait before withdrawing their initial investment in the fund. The redemption notice period is the notification period required before investors can redeem their shares. The main source of illiquidity from the perspective of the hedge fund manager is the liquidity of the fund's investments. The liquidity of the fund's investments and that of the fund's investors, in the form of lock-up and redemption periods, are closely linked to each other: hedge funds with longer lock-up and redemption periods may invest in more illiquid assets, which may provide greater profit opportunities.

## 2. Measuring Hedge Fund Liquidity

The various aspects of hedge fund liquidity have very different properties. The illiquidity imposed on hedge fund investors by the fund itself, through the lock-up and redemption notice periods, have two important properties: they are constant (through time) and they are directly observable, both to the investor (of course) and to the researcher. The illiquidity in hedge fund returns caused by the fund's investments in illiquid assets may possess neither of these properties: the degree of illiquidity may not be constant, and the degree of illiquidity is not directly observable.

Using the first type of illiquidity as a liquidity risk measure, Aragon (2006) finds that liquidity risk is a source of hedge fund returns. He shows that there is a positive, concave relationship between a hedge fund's excess returns and its redemption notice period. He also documents that the difference in excess returns on lockup versus non-lockup funds is about four per cent per annum in aggregate.

In a current research project, Li and Patton (2006), we examine the harder-to-measure second type of illiquidity, caused by exposures to illiquid assets.

We build on the work of Getmansky, Lo and Makarov (2004), who suggested that exposure to illiquid assets is the most likely cause of the strong observed autocorrelation in hedge fund returns, see Table 1 for example. Holdings of illiquid assets can lead to autocorrelation in reported returns if, for example, assets are 'marked-to-model' rather than 'marked-to-market'. Marking-to-model will usually lead to smoothed returns, even for sophisticated pricing models. Further, by influencing how illiquid assets are marked-to-model hedge fund managers also have the ability to 'manage' their reported monthly returns. Part of the gains/losses earned in a given month may not be reported so as to off-set future losses/gains. This directly results in lower volatility of reported returns and higher Sharpe ratios.

Extending the work of Getmansky, et al (2006), we use the link between autocorrelation and illiquid asset exposures to gain an insight into the time-varying liquidity of hedge fund returns, by analysing the time-varying nature of autocorrelation in hedge fund returns. In Li and Patton (2006) we propose and estimate a formal statistical model of time-varying autocorrelation, but some general conclusions can be drawn with simple figures, as illustrated below.

## 3. Determinants of Hedge Fund Liquidity

Unlike traditional fund managers, the strategies of hedge funds are known to be dynamic, with fast turnover, involving long and short positions, thus hedge funds usually have time-varying exposures to sources of risk. It is thus quite possible that the degree of illiquidity of hedge returns is also time-varying. By testing whether the degree of autocorrelation (or illiquidity) varies with certain variables we are able to draw some inferences as to the sources of this illiquidity. For example, how does the degree of illiquidity change with market volatility or market-wide liquidity measures? Does the degree of illiquidity change with the number of months remaining until the next fund audit, controlling for market-wide liquidity?

We focus on the 'event driven' style of hedge funds. Given the data-intensive nature of the research question, we consider only those funds with at least 48 months of data, leaving us with 67 hedge funds. Our sample period is January 1993 to September 2003. The average level of first-order autocorrelation across these 67 funds is 23.8 per cent. In Figures 1 to 4, we present some simple plots of first-order autocorrelation conditional on a state variable:

$$\text{Corr}[r_t, r_{t-1} | X_t = x]$$

In practise, we compute the autocorrelation using data from just those periods when  $X_t$  is in some interval. eg: when  $X_t$  is below its mean. The four figures also present approximate 95 per cent confidence intervals (CIs); for a more formal econometric treatment of this problem see Li and Patton (2006).

In Figure 1 we plot the average autocorrelation for event driven funds conditioning on the average return on the S&P 500 over the preceding six months. This figure reveals that autocorrelation is highest when market returns are low (in their first quintile), suggesting that hedge fund liquidity is low when market returns are low. However when market returns are around their historical average (in the second to fourth quintiles) average liquidity is high (autocorrelation is low).

Average autocorrelation for event driven funds, conditional on market return

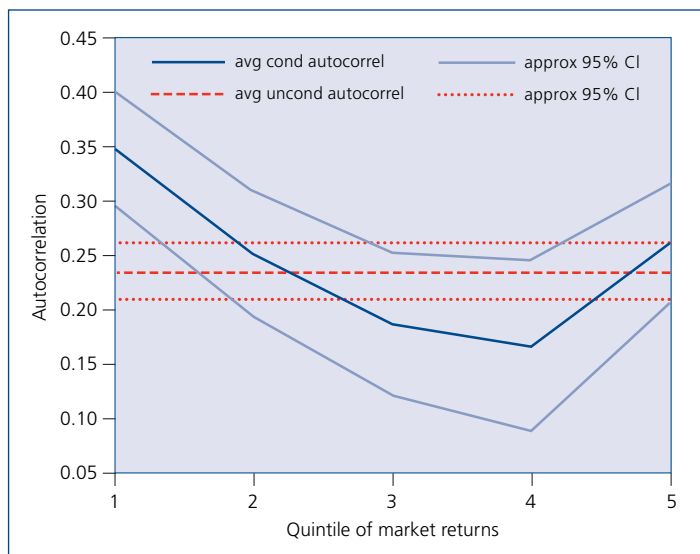


Figure 1: Hedge fund autocorrelation and returns on the S&P 500 index

In Figure 2 we plot average autocorrelation conditioning on the level of market volatility. This is measured using the 'realised volatility' on the S&P 500 index during the previous month. This plot clearly shows a positive relationship between average hedge fund autocorrelation and market volatility. Using the inverse relationship between autocorrelation and liquidity, this then implies that periods of high market volatility correspond to periods of low hedge fund liquidity.

We next employed the Pastor and Stambaugh (2003) liquidity index for the US equity market. Our reasoning here is that if aggregate market liquidity, somehow measured, is low, then hedge fund liquidity is likely also to be low. This reasoning is borne out in the data: autocorrelation in hedge fund returns is negatively related to aggregate market liquidity, as shown in Figure 3, implying a positive relationship between aggregate market liquidity and hedge fund liquidity.

Finally, we determine whether a seasonal pattern is discernable in hedge fund returns. This pattern could come from at least two sources. The first is a seasonal pattern in aggregate market liquidity, which is then passed through to hedge fund liquidity via their investments. Such a pattern in US equities is documented in Hong and Yu (2005), who find that aggregate

Average autocorrelation for event driven funds, conditional on market volatility

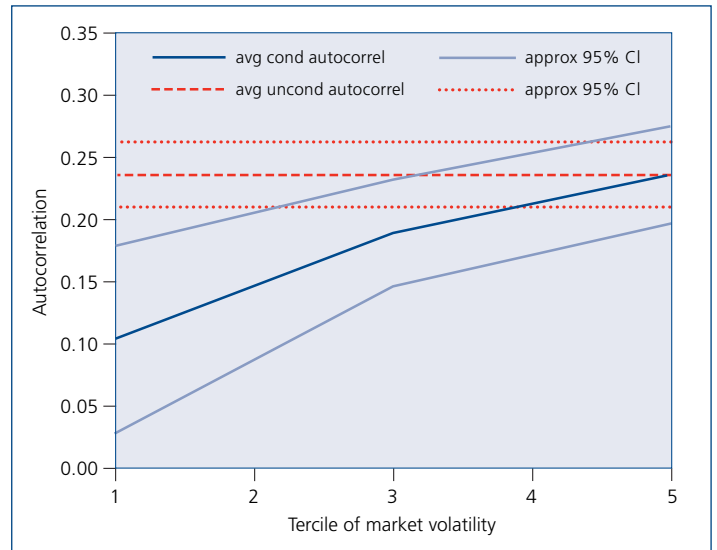


Figure 2: Hedge fund autocorrelation and volatility of the S&P 500 index

market liquidity is much lower during traditional holiday periods (such as June to August in the Northern Hemisphere). The second possible source of a seasonal pattern is less benign: if hedge funds are audited (though not all of them are) then the audits most commonly take place at the end of the calendar year. If hedge fund managers were intentionally 'smoothing' their reported returns, then it would be easiest to do so in the months furthest from an audit date, ie, in the middle of the calendar year. Figure 4

Average autocorrelation for event driven funds, conditional on market liquidity

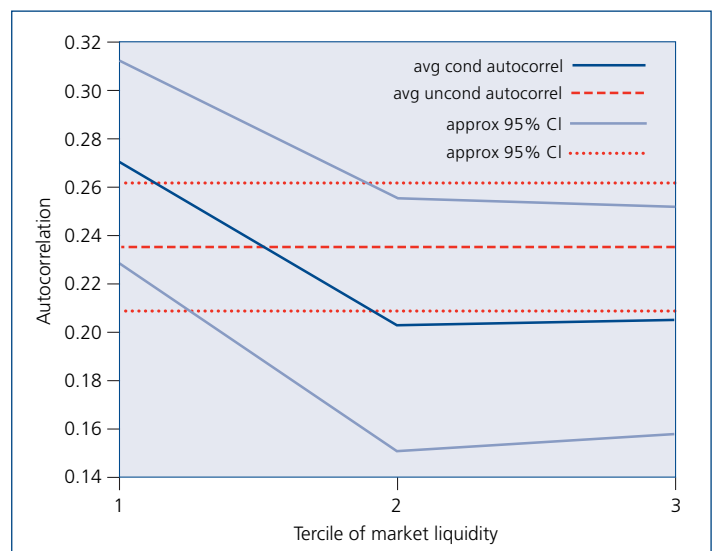


Figure 3: Hedge fund autocorrelation and aggregate market liquidity

suggests that a seasonal pattern in hedge fund liquidity is indeed present, but it, of course, cannot distinguish between the two possible causes of this seasonality. More formal econometric analysis is required to disentangle these competing effects.

Average autocorrelation for event driven funds, conditional on month of Year

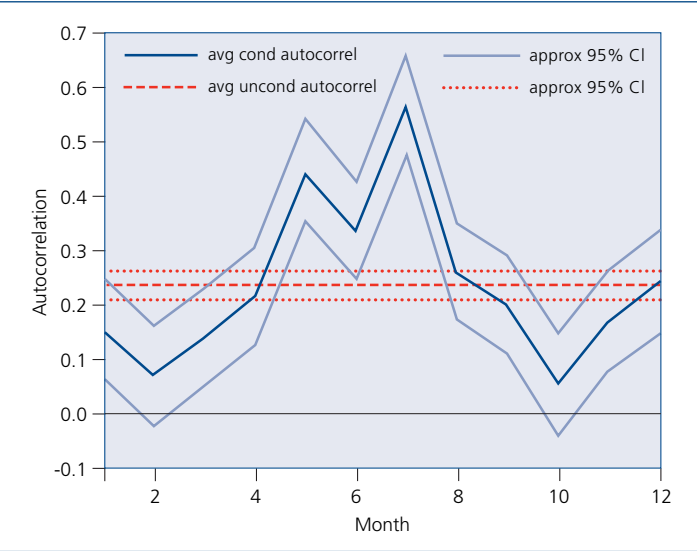


Figure 4: Calendar effects in hedge fund autocorrelation

4. Conclusions

Hedge funds are a large and growing part of the financial sector, but relatively little is known about their investment strategies. In this note we used the negative relation between autocorrelation in hedge fund returns and the liquidity of hedge fund investments to investigate whether the liquidity of hedge fund investments varies significantly through time. Our informal graphical results suggest that hedge fund liquidity is indeed time-varying. In particular, we found that hedge fund returns are less liquid when: (1) market returns are low, (2) market volatility is high, (3) aggregate market liquidity is low, and (4) during the middle of the calendar year. The simple methods used in this note are not able to distinguish the possible causes of these patterns from each other. A more technical treatment of this problem, Li and Patton (2006), sheds more light on these and related issues.

References

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Table 1: Autocorrelation in hedge fund returns

Style	Corr[ $r_t, r_{t-1}$ ]
Event driven	23.8
Convertible arbitrage	22.5
Equity market neutral	18.2
Fixed income directional	21.6
Global macro	7.2
US equity hedge	7.8
S&P 500	1.6
FTSE 100	1.7

Note: This table presents the average first-order autocorrelation in observed hedge fund returns (monthly) from six different style categories. For comparison, we also present the first-order autocorrelation for monthly returns on the S&P 500 and the FTSE 100 indices.



# Asset Pricing and Portfolio Management Research Programme

The focus is the pricing of financial assets and understanding the portfolio behaviour of individuals and financial institutions. Increased emphasis is being placed on general equilibrium modelling and the role of different behavioural assumptions and market frictions in price determination and the explanatory power of these characteristics.

The ongoing research in this programme can be summarised under the four main headings: risk measurement and management, limits to arbitrage and asset prices, financial market anomalies and liquidity and systemic risk.

**Risk Measurement and Management:** This research, carried out by Andrew Patton focuses on two sub-areas. The first is the application of 'copulas' in financial econometrics; copulas are needed to capture non-linear dependence between two risky assets. Given the dynamic and non-linear nature of the pay-offs to many hedge fund investment strategies, such models are especially relevant for hedge funds. The second sub-area is the evaluation and comparison of risk forecasts. Due to the well known drawbacks of variance as a risk measure, this research aims to generalize the existing methods developed for variance to alternative risk measures, such as Value-at-Risk and Expected Shortfall.

**Limits to Arbitrage and Asset Prices:** Asset pricing theory is based on the assumption of no-arbitrage. In practice, however, arbitrage is imperfect due to capital limitations and other micro-frictions agents may face. The objective of this research, carried out by Professor Dimitri Vayanos, is first to better understand these micro-frictions that limit arbitrage, and second to explore the implications of those frictions for asset prices. Of particular interest are the implications for the pricing of options and defaultable bonds, which relies heavily on the absence of arbitrage.

**Financial Market Anomalies:** This project carried out by Dr Michela Verardo, consists of empirical tests of market efficiency and investment anomalies, in order to determine profitable trading strategies. Three sub-areas are investigated.

The first sub-area concerns how dispersion in analysts' earnings forecasts affects the profitability of momentum strategies, after taking into account conventional proxies for the speed of information diffusion. The second sub-area focuses on how to undo the bias in analysts' forecasts, to recover a more accurate measure of earnings expectations. The third sub-area relates to the question of how institutional trading affects momentum and herding behaviour.

**Liquidity and Systemic Risk:** In the context of this research Jean-Pierre Zigrand examines the effects of hedge funds on liquidity and market stability. One project is to define a rigorous welfare-based metric for liquidity within a model where hedge funds contribute towards the liquidity of global financial markets, and hence identify the fraction of global liquidity provided by hedge funds. A second project is to look into the networks of financial obligations of Hedge funds. The project entails studying which networks are more likely to form, and what their effects are on liquidity and systemic integration. A third project is to examine how hedge funds can contribute to market performance by creating new assets through financial innovations.

## Asset Pricing and Portfolio Management Research Staff:

Professor Gregory Connor (programme director); Dr Christian Julliard; Professor Oliver Linton; Dr Antonio Mele; Dr Alex Michaelides; Professor Bob Nobay; Dr Andrew Patton; Dr Rohit Rahi; Professor Dimitri Vayanos; Dr Michela Verardo; Dr Jean-Pierre Zigrand

**Research students:** Mr Mohammed Fawaz; Ms Anisha Ghosh; Mr Marcel Heinrichs; Mr Cristian Huse; Mr Sheng Li; Mr Christian Reusch

**Research associates:** Professor Lucien Foldes (LSE); Professor Robert Kosowski (INSEAD); Dr Francois Ortalo-Magne (LSE); Dr Francisco Penaranda (University of Alicante); Mr John Phelan (MSD Capital); Dr Amlan Roy (Credit First Suisse Boston); Professor Enrique Sentana (CEMFI); Professor Ian Tonks (University of Exeter)



# Adam Smith Asset Pricing Conference

On 17 March 2006, the FMG hosted the Adam Smith Asset Pricing conference which was jointly organized by **Tarun Ramadorai** (Oxford), **Raman Uppal** (LBS), and **Dimitri Vayanos** (LSE). The conference was open to papers in all areas of Asset Pricing. The objective of the conference is to stimulate interest in asset pricing research, and foster interaction between European researchers and especially those in the Greater London area (LSE, LBS, Oxford, Imperial, etc). There were six paper presentations, followed by discussants, and a general discussion. The first paper was presented by **Jacob Sagi** (UC Berkeley) and developed a theory of the term structure of interest rates based on regime switching. The discussant was **Andrea Buraschi** (Imperial). **Anna Pavlova** (LBS) presented the second paper which developed a theory of international contagion based on financial constraints and was discussed by **Harald Hau** (Insead). The third paper,

by **Nicolae Garleanu** (Wharton) and discussed by **Rohit Rahi** (LSE), moved onto the topic of the impact of illiquidity on asset prices and portfolio choice. **Robin Greenwood** (Harvard) then presented a paper examining the impact of asset float on prices using data on stock splits in the Japanese stock market with **Chris Malloy** (LBS) acting as the discussant. The penultimate paper, by **Ludovic Phalippou** (Amsterdam), was a criticism of rational explanations of the book-to-market effect and was discussed by **Francesco Franzoni** (HEC). Finally, the sixth paper was presented by **Laurent Calvet** (HEC), and examined the way in which investment decisions of Swedish households deviated from the theoretical optimum. The discussant was **Joao Cocco** (LBS). The conference was well-attended, with an audience of about 45 people, both faculty and students.

## Public Lecture

### 'Survey of Recent Hedge Fund Articles'

**Hilary Till, Principal Premia Risk Consultancy, Inc**

**14 February 2006**

Over the past four years, there has been an explosion of articles on hedge funds by both academics and practitioners. On 14 February, the Financial Markets Group hosted a special seminar on Hedge Fund Research by Hilary Till, co-founder of Premia Capital Management, LLC ([www.premiacap.com](http://www.premiacap.com)). Chicago-based Premia Capital is a proprietary trading firm, which specializes in detecting pockets of predictability in derivatives markets using statistical techniques. The firm's focus is in the natural resources markets. The article presented, 'Survey of

Recent Hedge Fund Articles', (Till, Hilary and Jodie Gunzberg in the Journal of Wealth Management, Vol 8, No 3: 81-98) aims to help the busy practitioner by providing a survey of the critical hedge fund articles that have been published over this period. The article touches upon such topics as the economic drivers of hedge fund returns, the unique risk management requirements for these investments, and how investors should consider incorporating hedge funds in their portfolio.



# Forthcoming Asset Pricing and Portfolio Management events

## The Portfolio Risk Forecasting Workshops

A series of lectures by **Gregory Connor** with practitioner discussions

- 27 April** Chair: **Rupert Goodwin** (Northfield)  
 6pm *The Portfolio Management Setting*  
 Discussion, **Jason MacQueen** (R-Squared)
- 7pm *The Structure of Portfolio Risk Forecasting Models*  
 Discussion, **Jason MacQueen** (R-Squared)
- 4 May** Chair: **Alan Scowcroft** (UBS)  
 6pm *Industry and Country Risk*  
 Discussion, **James Sefton** (UBS)  
 7pm *Statistical Factor Models*  
 Discussion, **Tim Wilding** (EMA)
- 11 May** Chair: *TBA*  
 6pm *The Macroeconomy and Security Market Returns*  
 Discussion, **Ed Fishwick** (Merrill Lynch)  
 7pm *Corporate Characteristics and Security Market Returns*
- 18 May** Chair: **Alan Scowcroft** (UBS)  
 6pm *Measuring and Hedging Foreign Exchange Risk*  
 Discussion, **David Buckle** (Merrill Lynch)  
 7pm *Integrated Global Risk Models*  
 Discussion, **Ed Fishwick** (Merrill Lynch)
- 25 May** Chair: **Alan Scowcroft** (UBS)  
 6pm *Dynamic Volatilities and Correlations*  
 Discussion, **Dan diBartolomeo** (Northfield)  
 7pm *Long-Horizon Risk Forecasting*  
 Discussion, **David Miles** (Morgan Stanley)

The Lecture series is sponsored by Northfield Information Services and UBS Securities.

Please visit <http://fmg.lse.ac.uk/~connor/> or <http://fmg.lse.ac.uk/events/> for more information.

## New Directions in Asset Pricing and Risk Management Conference

**15-16 June 2006**

Room R405, Lionel Robbins Building, LSE

This conference is the final dissemination event organised as part of the EPSRC funded project on 'Asset Price Dynamics under Aggregated Decision Making in Financial Markets with Uncertainty and External Constraints'. The conference will highlight both statistical and theoretical aspects of financial risk and risk management with a special focus on asset price dynamics in the face of liquidity risk and agency conflicts.

### Contributors include:

**Pete Kyle** (Duke/Maryland)  
**Hyun Shin** (Princeton),  
**S Vishwanathan** (Duke),  
**Helyette Geman** (Birkbeck)  
**Arvind Krishnamurthy** (Northwestern).

**Conference Organisers:** **Jon Danielsson** and **Amil Dasgupta**

The full programme and more details will be available on the FMG website at <http://fmg.lse.ac.uk> If you require further information, please contact the FMG administration at 020 7955 6301/020 7955 7891 or email: [fmg@lse.ac.uk](mailto:fmg@lse.ac.uk)

This Conference is sponsored by the Engineering and Physical Sciences Research Council (EPSRC).





# Regional Comparative Advantage and Knowledge-Based Entrepreneurship

## RICAFE2

The Regional Comparative Advantage and Knowledge-Based Entrepreneurship (RICAFE2) research programme was launched on 1 March 2006 with the first meeting of the project's node leaders, which took place in the FMG at LSE. The new programme builds on the successful RICAFE project, completed in April 2005. Under the RICAFE2, the original network of RICAFE is expanded to include new European partners (Amsterdam, Tilburg, Latvia and Lugano) as well as research institutions from India and Israel. RICAFE2 is funded by the European Commission, DG-Research, under Priority 7 – Citizens and Governance in a Knowledge-based society – of the 6th Framework Programme.

### RICAFE2 Research Programme

The project's key objective is to address the questions of how the European models of societal, legal, and economic institutions affect the patterns of regional economic growth and how Knowledge Based Entrepreneurship (KBE) contributes to shifting patterns of regional comparative advantage and shape policy options and priorities. Our research will contribute to this goal by providing two sets of results:

- We will provide an in-depth conceptual and empirical assessment of the societal, legal, and economic forces affecting KBE in Europe in order to develop and advance understanding of the nature of KBE as a complex, multi-faceted process; and
- We will provide new evidence on how KBE contributes to shifts in regional comparative advantage, and build a coherent conceptual framework for understanding observed patterns of regional growth.

Our research will assess the links between societal, legal, and economic mechanisms and KBE at the micro level, while studying the resulting regional dynamics and growth patterns at the macro level. We will employ a cross disciplinary approach to study the multi-dimensional nature of KBE.

While theoretically grounded, our proposed analysis is also empirical and will provide a detailed blueprint for the implementation of the Green paper on Entrepreneurship. The project has three main objectives:

- Analyse the societal, legal, and economic factors that determine the forms and intensity of KBE. We will identify factors that affect risk-

taking and entrepreneurship and create a conducive environment for the circulation of ideas within and across firms, fostering creative destruction. We will document how societal values, social capital, legal factors (eg, intellectual property rights and corporate governance codes) and the provision of finance (especially through venture capital) affect KBE across European regions.

- Analyse how KBE contributes to shifting patterns of regional comparative advantage. We will assess the experiences of regions with different policies for the creation of human and social capital, for the elimination of barriers to entrepreneurship, for influencing the location decision of knowledge-based firms, and for technology transfers from established companies and universities to start-ups. We will look at the experiences of one accession country and of India, Israel, and Brazil.
- Discuss the policy implications of our analysis. We will deliver detailed policy suggestions.

The Executive Directors of RICAFE2 are Professor D C Webb (FMG, LSE) and Dr Marco Da Rin (Tilburg and Torino).

The partners of the RICAFE2 research network are:

**The London School of Economics and Political Science (FMG)**  
**Turin University**

**Center for Financial Studies (Frankfurt)**

**HEC School of Management (Paris)**

**University of Amsterdam**

**University of Tilburg**

**Baltic International Centre for Economic Policy Studies (Latvia)**

**University of Lugano**

**Indian School of Business**

**Technion (Israel)**

The RICAFE2 Programme will hold its first conference on 5-6 October 2006, at the London School of Economics and Political Science. More details about the network and the conference can be found in the RICAFE2 website at [www.lse.ac.uk/ricafe](http://www.lse.ac.uk/ricafe)

# Regional Comparative Advantage and Knowledge-Based Entrepreneurship

## RICAPE2 First Conference

5 and 6 October 2006

Financial Markets Group, The London School of Economics and Political Science

## Call for Papers

The Regional Comparative Advantage and Knowledge-Based Entrepreneurship (RICAPE2) First Conference will be held on 5 and 6 October at the London School of Economics. The organizers invite submissions for empirical and theoretical papers on the ability of financial systems to channel venture capital to knowledge-based entrepreneurial firms, on the influence of venture capital on firms' ability to translate technological advances into successful products, and on the contribution of knowledge-based entrepreneurship to regional dynamics. Some of the topics to be discussed are (but are not limited to):

- The choice between alternative sources of financing for innovative firms and their impact on strategic decision in entrepreneurial firms;
- The determinants of knowledge-based entrepreneurship;
- Venture capital, its contribution to the knowledge-based economy;
- Economics of intellectual property rights and its implications for knowledge-based entrepreneurship;
- The role and design of financial contracts and of the choice of organizational form in fostering knowledge-based entrepreneurship;
- Effects of regulation on venture capital investment;
- Impact of corporate governance mechanisms on the performance of entrepreneurial firm;
- The contribution of knowledge-based entrepreneurship to regional comparative advantage.

The conference proceedings will not be published, as we aim to attract papers on their way to publication in high quality journals.

**Expenses:** Travel (economy class round-trip) and accommodation expenses will be covered for presenters and discussants.

**Programme Committee:** Catherine Casamatta (University of Toulouse), Vyacheslav Dombrovsky (BICEPS, Latvia), Antoine Faure-Grimaud (London School of Economics and Political Science), Ulrich Hege (HEC), Antoinette Schoar (MIT), Armin Schwienbacher (University of Amsterdam), Per Stromberg (SIFR, Stockholm and GSB, Chicago), Javier Suarez (CEMFI) and Lucy White (Harvard Business School)

**Deadline for submission of papers:** 11 June 2006.

Submissions are accepted online only via the RICAPE2 website: [www.lse.ac.uk/ricape](http://www.lse.ac.uk/ricape)

The authors of selected papers will be informed by the end of July.



# Financial Stability: Theory and Applications

18-19 May 2006

LSE, Room R405, 4th Floor, Lionel Robbins Building  
10 Portugal Street, WC2A 2AE

Formal and rigorous analysis of financial stability issues has been relatively underdeveloped, at least until recently. But work in this field is now starting to catch up. The purpose of this Conference is to bring together those involved in modeling financial stability issues, with an emphasis on those models and approaches which can be applied for the improvement of public policy concerns in this area.

## Thursday 18 May

10am **Financial Distress, Bankruptcy Law and the Business Cycle**

**Javier Suarez** (CEMFI and CEPR)

**Oren Sussman** (Saïd Business School, University of Oxford)

**Bank Risk Taking and Competition Revisited: New Theory and New Evidence**

**John Boyd** (Carlson School, University of Minnesota)

**Gianni De Nicolò** (Research Department, International Monetary Fund)

**Abu Al Jalal** (Carlson School, University of Minnesota)

Discussant: **Charles Goodhart** (LSE)

1.30pm **Devaluation with Debt and Concession Contract Redenomination as a Macroeconomic Policy in Argentina**

**Charles Calomiris** (Graduate School of Business, Columbia)

**Equilibrium Approach to Banking and Financial Stability – the Colombian Case**

**Dairo Estrada** (Director, Financial Stability Department, Banco de la República de Colombia)

**Agustin Saade** (Banco de la República de Colombia)

Discussant: **Mario Blejer** (CCBS, Bank of England)

4.30pm **Unbiased Capital Allocation in an Asymptotic Single Risk Factor (ASRF) Model of Credit Risk**

**Paul Kupiec** (FDIC, USA)

**Commitment to Overinvest and Price Informativeness**

**James Dow** (London Business School)

**Itay Goldstein** (Wharton School, University of Pennsylvania)

**Alexander Guembel** (Saïd Business School/ Lincoln College, University of Oxford)

Discussant: **Sudipto Bhattacharya** (LSE)

## Friday 19 May

9.30am **A Market Risk Approach to Liquidity Risk and Financial Contagion**

**Dairo Estrada** (Director, Financial Stability Department, Banco de la República de Colombia)

**Daniel Osorio R** (Analyst, Financial Stability Department, Banco de la República de Colombia)

**The Double Head Central Bank: Financial and Monetary Stability**

**Gunnar Bårdsen** (NTNU, Department of Economics, Trondheim, Norway)

**Kjersti-Gro Lindquist** (Norges Bank, Norway)

Discussant: **Roman Inderst** (LSE)

1.30pm **Public Policy in an Era of Super-Systemic Risk**

**Prasanna Gai** (Bank of England)

**Andy Haldane** (Bank of England)

**Towards a Measure of Financial Fragility**

**Oriol Aspachs** (FMG/LSE)

**Charles A E Goodhart** (FMG/LSE)

**Dimitrios Tsomocos** (St Edmund Hall and Saïd Business School, University of Oxford, and Bank of England)

**Lea Zicchino** (Bank of England)

Discussant: **Oren Sussman** (Saïd Business School, University of Oxford)

Organisers: **C A E Goodhart** and **D P Tsomocos**

This conference is supported by the Bank of England and the Economic and Social Research Council (ESRC).

# The Changing Risk Landscape in Financial Services; Challenges and Opportunities

24 May 2006

The Insurance Hall, London

The landscape of risks facing the financial services sector is evolving rapidly with the increased globalisation of financial markets and the increasing size and scope of financial institutions. This poses perplexing new challenges for the management and regulation of risk. This one-day workshop brings together industry specialists, regulators and academics to examine a number of the key issues and challenges.

The programme is divided into four sessions that will provide a forum for an interactive discussion of the following crucial issues:

- What are the internal and external views of the key risks facing the financial services industry and the opportunities and challenges they bring?

- What are the known new risks and how are they being addressed. How are the major financial institutions placed to manage these risks?
- How far has risk transfer gone and how far can it go? What are the consequences for the risk management and regulation of financial institutions?
- Is size the answer? What are the drivers and limits of M&A in the financial services sector? What challenges does this pose for risk management and regulation?

## Programme

9am **Keynote address**

*The Changing Risk Landscape in Financial Services*

**Tom de Swaan**, ABN Amro

9.30am **Session 1** *The External Perspective of Risk in Financial Services*

Introduction: Risk and the Valuation of Financial Services  
Systemic Risks and Financial Services Regulation  
Risk Transparency – the key to successful external communication  
Linking Internal and External Views on Risk: Risk Appetite/Budgets and Risk perception

**Pierre Sorel**, Fidelity

**Dr Thomas Garside**, Mercer Oliver Wyman

**Professor Charles Goodhart**, LSE

11.10am **Coffee Break**

11.30am **Session 2** *The 'New' Risks in the Industry*

Introduction: Risk Exposures and New Challenges  
Non-financial risks: Managing the 'Top 20'  
Growing Role of Alternative Asset Managers in Financial Services  
Lessons from Financial Crises

**Chris Chaloner**, Man Group

**Dr Christian Pedersen**, Mercer Oliver Wyman

**Professor Hyun Song Shin**, Princeton

**Kari Hale**, Financial Services Authority

1pm

**Lunch**

2.15pm **Session 3** *Latest Trends in Risk Transfer Markets*

Introduction

Credit as an Asset Class – Growing Liquidity and Consequences  
Appetite for Risk Products amongst Pension Funds, Insurers and other Institutions

Future of Risk Transfer Products: Contingent Capital, Operational Risk Transfer, Liquidity/Capital Mixes, Blurring of Boundaries between Insurance and Capital Markets

**Dr Tom Wilson**, ING

**Stuart Lewis**, Deutsche Bank

**Raj Singh**, Allianz

3.45pm **Coffee Break**

4pm **Session 4** *Size – Good or Bad?*

Introduction and the Growing M&A in Financial Services  
Systemic Risk Implications of Large Groups: Risk Concentrations, Competition and Too Big to Fail  
Diversification and Value  
Growth-Driven Implications for Risk Profiles and Challenges for Risk Management and Risk Organisations

**Jon Hocking**, Morgan Stanley

**Anthony Stevens**, Mercer Oliver Wyman

**Professor Charlie Himmelberg**, Goldman Sachs, New York

**Professor Ingo Walter**, Stern School of Business, NYU

# FMG Publications



## Discussion Papers

### DP 541 (UBS Pensions Series 037)

#### Optimal Intergenerational Risk Sharing

Otto van Hemert

### DP 542

#### Long-term Debt and Hidden Borrowing

Heski Bar-Isaac, Vincente Cuñat

### DP 543 (UBS Pensions Series 038)

#### Reforming Public Pensions in the US and the UK

Peter Diamond

### DP 544

#### Minority Blocks And Takeover Premia

Fausto Panunzi, Denis Gromb, Mike Burkart

### DP 545

#### ART versus reinsurance: the Disciplining Effect of Information Insensitivity

Christian Laux, Silke Brandts

### DP 546

#### An Essay on the Interactions between the Bank of England's Forecasts, the MPC's Policy Adjustments, and the Eventual Outcome

Charles Goodhart

## Special Papers

### SP 162

#### The Future of Central Banking

Charles Goodhart

## Forthcoming Publications

### Discussion Papers

#### DP 547

##### The Interest Rate Conditioning Assumption

Charles Goodhart

#### DP 548

##### On Modelling Endogenous Default

Dimitrios Tsomocos, Lea Zicchino

#### DP 549

##### Subadditivity Re – Examined: the Case for Value-at-Risk

Casper G de Vries, Gennady Samorodnitsky, Bjørn N Jorgensen, Sarma Mandira, Jon Danielsson

#### DP 550

##### Exchange Rate Volatility and Central Bank Interventions

Freyan Panthaki

#### DP 551

##### Comparing Downside Risk Measures for Heavy Tailed Distributions

Casper G de Vries, Bjørn N Jorgensen, Sarma Mandira, Jon Danielsson

### DP 552

#### The Dynamics of Venture Capital Contracts

Julia Hirsch, Carsten Bienz

### DP 553 (UBS Pensions Series 039)

#### Rare Events and Annuity Market Participation

Alex Michaelides, Paula Lopes

### DP 554

#### Towards a Measure of Financial Fragility

Lea Zicchino, Dimitrios Tsomocos, Charles Goodhart, Oriol Aspachs

## Special Papers

### SP 163

#### China's Banking Reform: Problems and Potential Solutions

Xiaosong Zeng, Charles Goodhart

### SP 164

#### Burden Sharing in a Banking Crisis in Europe

Dirk Schoenmaker, Charles Goodhart

# Visitors to the FMG

## February – April 2006

**Frederico Belo** (University of Chicago)

**Tom Chemanur** (BC)

**Joe Chen** (USC)

**Mike Chernov** (Columbia)

**Joost Driessen** (University of Amsterdam)

**Andrew Ellul** (Indiana)

**Mara Faccio** (Vanderbilt University)

**Judith Freedman** (Oxford University)

**Pedro M Herrera Molina** (Universidad Complutense de Madrid and Spanish Institute of Fiscal Studies)

**Vito Gala** (University of Chicago)

**Luciano Greco** (Universita degli Studi di Padova)

**Luigi Guiso** (Bank of Italy)

**Lars Hansen** (University of Chicago)

**Stephane Guibaud** (Princeton)

**Dalida Kadyrzhanova** (Columbia)

**Robert Kosowski** (INSEAD)

**Ossi Lindström** (Helsinki School of Economics)

**David Llewellyn** (Loughborough University)

**Marc Martos-Vila** (Princeton)

**Igor Makarov** (MIT)

**Nour Meddahi** (Universite de Montreal)

**Maria Nieto** (Banca de España)

**Yves Nosbusch** (Harvard)

**Lubos Pastor** (University of Chicago)

**Guillaume Plantin** (Carnegie Mellon University)

**Christopher Polk** (Northwestern)

**Adam Posen** (IIE and Houblon – Norman Fellow at Bank of England)

**Adriano Rampini** (Northwestern)

**Colin Rowat** (Birmingham University)

**Jacob Sagi** (Haas, Berkeley)

**Leandro Saita** (University of Chicago)

**Antoinette Schoar** (MIT)

**Gustav Sigurdsson** (Princeton)

**Arjuna Sittampalam** (Sages and Hermes)

**Jacub Steiner** (CERGE-EI)

**Hilary Till** (Principal Premia Risk Consultancy, Inc)

**Martin Weitzman** (Harvard)



<http://fmg.lse.ac.uk/>

## FMG Review

**Edited by:** Professor Bob Nobay,  
 assisted by Olivia Hague

**Prepared by:** Sridhar Arcot, Carsten Bienz,  
 Mohammed Fawaz, Manuel Klein, Michael Kollo,  
 Maria Komninou, Sheng Li, Andrew Patton, Ashley Taylor

**Designed by:** LSE Design Unit  
[www.lse.ac.uk/designunit](http://www.lse.ac.uk/designunit)