



SALZBURG  
GLOBAL  
SEMINAR

SESSION REPORT

580

# Global Challenges, Regional Responses: How Can We Avoid Fragmentation in the Financial System?

SALZBURG GLOBAL FORUM ON FINANCE IN A CHANGING WORLD





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Salzburg Global Seminar would like to thank our partners: **EY, HSBC, JPMorgan Chase & Co. and Oliver Wyman;** our sponsors: **Cleary Gottlieb, Davis Polk and Deutsche Bank;** and our co-sponsors: **Buckley Sandler, The Cynosure Group, Dynex Capital, Inc. and State Street** for their generous support of the *Salzburg Global Forum on Finance in a Changing World* and all participants for contributing their time and expertise to this session.

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## Session 580

June 26 to 28, 2017  
Salzburg, Austria

# Global Challenges, Regional Responses: How Can We Avoid Fragmentation in the Financial System?

SALZBURG  
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## About the Salzburg Global Forum on Finance in a Changing World

The *Salzburg Global Forum on Finance in a Changing World* is an annual high-level program convened by Salzburg Global Seminar that addresses issues critical to the future of financial markets and global economy in the context of key global trends.

Established in 2011, the Forum offers senior and rising leaders from the financial industry and public sector an opportunity for in-depth, off-the-record conversations on how to build inclusive, open and resilient financial systems and set an agenda for the future.

The Forum's overarching goal is to facilitate critical analysis of the changing financial landscape and regulatory environment, comparison of practical experience around the world, understanding of technology-driven transformations, and open dialogue on issues of trust and ethics. Each summer, it convenes an internationally representative group of leaders from financial services firms, supervisory and regulatory authorities, consultancies, auditors, law firms and other professional service providers who share a belief that inclusive, efficient and stable financial systems are essential for sustainable growth, shared economic opportunities and prosperity. Going forward, the Forum will continue to explore key developments, strategic shifts and tipping points in global finance, and to help participants learn practical lessons and share international insights.

Salzburg Global Seminar is an international non-profit organization founded in 1947 with a mission to challenge present and future leaders to solve issues of global concern.

We work with a global network of partners and institutions to bridge divides and foster collaboration for lasting change.

### PAST SESSIONS

**2011: New Rules for Global Finance: Which kinds of regulation are useful and which are counterproductive?**

[SalzburgGlobal.org/go/478](https://salzburgglobal.org/go/478)

**2012: Financial Regulation: Bridging Global Differences**

[SalzburgGlobal.org/go/492](https://salzburgglobal.org/go/492)

**2013: Out of the Shadows: Regulation for the Non-Banking Financial Sector**

[SalzburgGlobal.org/go/516](https://salzburgglobal.org/go/516)

**2014: The Future of Banking: Is There a Sustainable Business Model for Banks?**

[SalzburgGlobal.org/go/546](https://salzburgglobal.org/go/546)

**2015: The Future of Financial Intermediation: Banking, Securities Markets, or Something New?**

[SalzburgGlobal.org/go/552](https://salzburgglobal.org/go/552)

**2016: Financing the Global Economy: How Can Traditional and Non-Traditional Sources Be Integrated?**

[SalzburgGlobal.org/go/563](https://salzburgglobal.org/go/563)

**2017: Global Challenges, Regional Responses: How Can We Avoid Fragmentation in the Financial System?**

[SalzburgGlobal.org/go/580](https://salzburgglobal.org/go/580)



## ADVISORY COMMITTEE

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**Randal Quarles**, *Managing Director, The Cynosure Group, Salt Lake City, UT*

**David Wright**, *Chair, EUROFI, Paris; partner at Flint-Global, London; former Secretary General, IOSCO, Madrid*



1. Douglas Flint delivers a keynote speech on "Conflicts and Contradictions"
2. Session Co-Chair Ranjit Ajit Singh
3. Session Co-Chair Sylvie Matherat
4. Panelists Lorenzo Bini Smaghi and Joanna Cound

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## Session Report

### *Introduction*

In recent years, the world has been undergoing significant political and socioeconomic changes, threatening to reverse decades of globalization and development towards open and integrated markets and free trade. While in the past globalization has driven efficiency gains and aggregate productivity and hence led to an overall improvement of welfare and living standards for a significant part of the world's population, its individual effects have been unevenly distributed across geographies as well as income levels and skills.<sup>1</sup>

The result appears to be a higher degree of social, economic, political and regulatory fragmentation – partially also driven by a loss of trust in institutions – and leading to a backlash against globalization by those who feel left behind and call for more protection instead of more integration. This in turn leads to significant consequences for the financial system and its ability to finance sustainable global growth. To achieve its full potential for public good, the financial system must remain global. Effective frameworks of international cooperation are particularly important for countries at different stages of development – such as emerging and developing economies that need to ensure solutions are consistent with their markets and policy goals, but still avoid regulatory arbitrage.

The seventh session of the *Salzburg Global Forum on Finance in a Changing World – Global Challenges, Regional Responses: How Can We Avoid Fragmentation in the Financial System?* – brought together stakeholders from different sectors and regions to discuss emerging risks to the financial system and potential solutions; to review obstacles to global coordination and cooperation in the light of increasing fragmentation; to assess progress in implementing the regulatory reform agenda against the backdrop of ongoing realignment in the global economy; and to outline priority steps to strengthen the global financial system.

Here follows an executive summary of the discussions from the intense two-day program (June 26 to 28, 2017). The annexes also contain a list of all participants in attendance, the opening speech of the Session Co-Chair Ranjit Ajit Singh, Executive Chairman, Securities Commission Malaysia, as well as remarks of Jerome Powell, Member of the Board of Governors, US Federal Reserve System.

This summary reflects the author's view of the overall discussion during the session and should not be attributed to individual participants.

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<sup>1</sup> See for example "87th Annual Report". Bank of International Settlement, June 2017 [www.bis.org/publ/arpdf/ar2017e.pdf](http://www.bis.org/publ/arpdf/ar2017e.pdf)

## *Social, economic, political and regulatory fragmentation pose challenges for the financial system*

Increasing social fragmentation is clearly evident when observing the growing inequality of incomes, ongoing stagnation of real wages for middle class workers in developed economies, displacement of jobs, and significant increase of insecurity regarding employment and general future perspectives. This development is driven by slowing growth especially in developed markets, high levels of debt, and changing demographics, but also very strongly by technological innovations such as robotic process automation (RPA) and artificial intelligence (AI), which will replace a significant proportion of jobs.<sup>2</sup> A consequence of this development is the rise of the “precariat,”<sup>3</sup> characterized as having no occupational identity but significant existential insecurity.

Interlinked with social fragmentation is also political and economic as well as regulatory fragmentation. Social and economic inequalities and divergences leave nations far more inward looking than before, resulting in a rise in populism and nationalism as well as an entrenchment of financial and capital flows and a fragmentation of the financial system. The recovery after the financial crisis in the US and Europe remains sluggish and is also hampered by strict banking regulations, causing American and European banks to focus inward on increasing stability, liquidity and security by reducing their lending activities and by de-risking and cutting off smaller correspondent banks in Africa and Asia. On the other hand, Asian markets, with their growing middle class and banking sectors, display significantly different but also sometimes highly heterogeneous dynamics. Chinese and Indian banks have started to step in regarding infrastructure and trade finance where American and European banks tend to disengage. With emerging markets accounting for 59% of world GDP and more than 80% of the world's population, economic power is clearly shifting and divergent dynamics affect all countries through manifold linkages.<sup>4</sup>

Banks and markets as well as their regulation still remain very fragmented even in developed countries as individual jurisdictions have different legal, regulatory and institutional frameworks. Policymakers and regulators are faced with the trade-off between protecting their national banking systems; investors and customers on one side and increasing cross-border activity to enhance growth and efficiency on the other. Different policy interpretations and regulations, as well as a persistent

<sup>2</sup> See for example “The Future of Jobs”, World Economic Forum, 2016; Frey, C. and Osborne M. *The future of employment: How susceptible are jobs to computerization?*, University of Oxford, 2013; UK Economic

<sup>3</sup> See Standing, G. *The Precariat: The Dangerous New Class*, Bloomsbury Academic. 2011

<sup>4</sup> See IMF World Economic Outlook Datasets, April 2017; ECB



national focus of policymakers, continue to reflect a lack of trust between banking systems, policymakers and regulators from different regions which and increases fragmentation, as the debate about the euro clearing, for example, shows. Inconsistencies also arise in implementation and supervision as different regions sometimes have significantly different local requirements or conduct regulation, such as requirements regarding audit trails of transactions and client information in some regions versus data protection laws in other regions. Markets are also still very fragmented from an asset management perspective, with significant obstacles to cross-border flows such as differences in tax laws and treatments, data harmonization and protection, domestic regulation of private assets, and insolvency arrangements.

As a consequence, banks are less efficient than they could be and capital markets – especially in Europe – are not developing as fast as they could. Fragmentation influences capital allocation and creates arbitrage and different if not inconsistent treatment of customers. Entrenchments, home bias and reduction of capital flows also lead to financial shocks not being efficiently absorbed. Additionally, de-risking potentially creates problems for the poorest parts of the world by cutting them off from much needed capital flows. While generally there exists a large amount of investable capital in the world, blockages such as significant differences in countries' stability, governance, rule of law and insolvency and foreclosure regimes – efficiently preventing capital from flowing to where it would be most needed – strongly reflect economic and political fragmentation as well. As Brexit will further increase fragmentation, banking and market regulators, supervisors and policymakers should focus their efforts on maintaining work on global harmonization.





Ranjit Ajit Singh, chairman of Securities Commission Malaysia, and Greg Medcraft, chairman of the Australian Securities and Investments Commission (ASIC), signed the Innovation Co-operation Agreement during the 2017 session of the Salzburg Global Forum on *Finance in a Changing World*

### *The potential for global policy coordination to mitigate fragmentation*

Due to the manifold linkages of international trade and finance, financial markets and their activities are often cross-border by nature. To mitigate the above-mentioned challenges to the financial system and to unlock capital flows, global harmonization of regulation and policymaking, as well as a higher focus on fostering growth, is fundamentally necessary. Important elements of harmonization include more cross-border coordination regarding regulation, implementation and supervision, as well as global standards and a greater level of trust and mutual recognition – which goes hand in hand with a certain degree of delegation of authority. To achieve this while at the same time maintaining financial stability and also fostering global growth, a higher engagement of industry players together with an appreciation of the appropriate level of risk appetite on a regulatory level will be required. This also means, however, that policymakers have to share more of their sovereignty to make the banking and financial system more efficient – especially in Europe – and that proprietary national regulation has to be adapted to a certain extent to obtain mutual recognition.



Generally, the direction that regulation needs to take to allow more global harmonization is one of outcome- and principle-based orientation instead of prescriptive, detailed and comprehensive rulebooks, which can cause bankers to become very risk averse and compliance-focused and lead to a legalistic management approach. While past regulatory reforms increased the capital held by financial institutions, as well as the liquidity and transparency of the financial system, they also presented a regulatory burden with a high degree of complexity, which becomes difficult for smaller countries and institutions to fully comply with. Due to different points of departure as well as systems and market dynamics, a “one size fits all” approach has its limits in financial regulation. Proportionality therefore is an important issue to obtain global adherence to minimum standards especially for smaller banks.

Global standards are a key element to promote consistent regulatory outcomes, support cooperation across regions and jurisdictions, enhance financial stability and avoid regulatory arbitrage. A very important role for international standard setters is helping to identify the gaps in regulation or understanding and occurrences of ambiguity (sometimes stemming from fundamental economic conflicts of interest of the involved players) that need global solutions and coordination, and then stepping in to fill these gaps by setting the right standards and incentives. A prominent example is the work the International Organization of Securities Commissions (IOSCO) has been doing by developing the MMoU (Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information) and the EMMoU (Enhanced Multilateral Memorandum of Understanding), which foster greater cross-border enforcement cooperation and assistance among securities regulators. By trying to bring different countries up to similar standards, organizations like IOSCO are building the necessary basis for harmonization instruments such as mutual recognition. While the advantage is that standards are adaptable to local circumstances, the challenge, however, is that these international organizations are not treaty based. Hence standard setters can only hope for voluntary compliance, which does not necessarily always help to mitigate fragmentation.

To increase trust and reliance on other jurisdictions’ regulators as well as market participants, coordination in implementation, supervision and enforcement is also necessary. It narrows down the differences between jurisdictions, limits the sometimes tremendously broad interpretation of market practices, and retains the overall relevance of international standards. A thoughtful attitude in supervision and emphasis on encouraging positive culture is important given that market misconduct is often also a result of internal and external pressures as well as the management culture of organizations. Human behavior is mainly driven by deterrence, incentives and culture – thus the assessment of cultural indicators needs to be included in supervision as well.



Given the size of global capital markets, their different regional systems and dynamics, as well as the increasing reliance on markets for financing global growth, the unintended effects due to the dominance of prudential regulation and its expansion to capital markets and non-financial institutions need to be addressed. Global harmonization and consistency of standards in markets require an increased presence of market regulators and market players, and a higher level of their integration into prudential regulatory discussion, due to the high level of linkages and spill-over effects between banks and markets.

Additionally, some phenomena and developments influencing the financial systems have significant global aspects by nature, such as the protection against cyber-crime and the development of fintech as well as technology-based solutions such as blockchain. While fintech in most areas currently still seems to have manageable dimensions, its rapid rise could render it systemic in the not too far future and significantly transform the financial system. These challenges undoubtedly need to be addressed through international coordination as a proprietary jurisdictional perspective will inevitably fall short of addressing potential critical issues – especially as there are no national borders in cyberspace. Regarding the long-term technological advancement, key issues will also include how to provide a level playing field while ensuring liability in the face of the rise of fintech, how to control the development of artificial intelligence, and how to ensure the continuity of the infrastructure of the financial system in the long run.

### *Consequences for 21st century banks and financing long-term growth*

In this world of fragmentation, banks, particularly those in developed countries, are faced with a number of challenges and contradictions, especially regarding the expectations of the public, their customers, investors, policymakers and regulators. These areas of conflict include the absolute focus on stability and safety – among other measures by increasing capital reserves and setting incentives to fund government bonds and low risk assets – while at the same time having to satisfy the expectation to finance sustainable growth by also financing SMEs and long-term infrastructure projects. Additionally, banks are expected to raise private capital, while at the same time stricter regulation and increased fragmentation limit their activities as well as their profitability and attractiveness for this external private capital.

Stakeholders and the general environment of the 21st century bank will change as well: While wholesale customers will most likely not exhibit fundamental changes, retail customers will. They will value and choose banks by their ability to enable and improve their lifestyle, expecting 24/7 omni-channel access and seamless integration of their financial service interactions with other activities.

Similarly, employees of the 21st century will be more conscious of the social value their employers create, while shareholders will still expect a significant return on their investment. Generally, the sentiment of the public will become ever more important, especially against the backdrop of the social contract that banks have. Fintech, technology companies such as Google, and large retailers also have the potential to change and shape banks' environments: Fintechs already ease access to financial services particularly in developing economies, and tech and internet companies as well as large internet retailers possess scale, vast customer bases, and detailed customer data while enjoying the trust of millennials.

Despite these challenges and changes, banks will continue to play a relevant role due to their fundamental value to provide liquidity as well as risk and liquidity transformation. Banks also enjoy a unique position as the only player able to create and tailor credit, while also retaining the ability to fund the economy to a large extent in a downturn. Nevertheless, banks' business models are changing significantly and will continue to do so, although the trajectory may differ for different regions of the world. Regaining and retaining trust and the client interface will be key in the face of these changes. Banks currently still enjoy a high level of customers' trust regarding the safekeeping of funds and private data, which opens up new possibilities in the light of increasing digital identity and the growing importance of gateways to the digital lives in the future.







Fellows and staff of the session  
*Global Challenges, Regional  
Responses: How Can We Avoid  
Fragmentation in the Financial  
System?*

Supply chains will exhibit a growing fragmentation and disintermediation as already visible in payments and other retail banking services. Banks' mindsets need to shift from owning the end-to-end process to managing the end-to-end process to provide superior customer journeys – also by sharing platforms and using fintechs and other third parties as suppliers or partners. It is important, however, that banks still be able to maintain and finance their core infrastructure that most other players also use and rely on; regulators therefore will have ensure they do not allow too-extreme disintermediation and do not stifle banks' scope for profitability, which is already limited by the increased economic and regulatory fragmentation. One avenue to pursue would also be closer collaboration on non-competitive issues such as KYC (know your customer) and AML (anti-money laundering) as well as cyber-risk – which would require the support of policymakers and regulators to lower or remove data barriers.

The mandates, incentives and risk appetites of regulators are all important elements in fostering sustainable growth while at the same maintaining financial stability. As long as the sole legal obligation is to ensure safety and soundness of the banking system there will be a natural bias towards more capital, liquidity and regulatory oversight at the expense of growth, particularly given that the finance



of small- and medium-sized enterprises (SMEs) and long-term infrastructure projects naturally require a higher risk appetite – also at the regulatory level. Going forward, a better balance between safety and stability on one side and fostering long-term growth on the other would help to mitigate fragmentation in the long run. After strengthening the resilience of the banking system and its individual institutions with measures for global systemically important banks (G-SIBs), such as higher risk-based surcharges, liquidity requirements, stress testing and resolution, it is now also necessary to revise to which degree these measures are essential and relevant for all institutions and where they might lead to duplications, unintended outcomes or a very high operational burden for small not-systemically important banks. Fostering growth in emerging markets will be difficult otherwise, especially in light of the ongoing de-risking of US and EU banks and the existing domestic bias due to economic and regulatory fragmentation.

Additionally, the growing importance of market-based finance needs to be reflected in the regulatory debate. Market enhancing and harmonizing initiatives such as the capital markets union (CMU) and the creation of a new capital markets ecosystem throughout Europe has to be strengthened. Market-based finance will be essential for financing long-term infrastructure in emerging countries, while more diversity in funding may be able to decrease the vulnerabilities of the financial system and increase overall global growth. Non-banks and fintechs will also fill certain financing gaps that banks are prohibited or dis-incentivized to fill. They additionally can assist in channeling funds into the market as they offer attractive value propositions, especially to millennials as in their view, non-banks and fintechs potentially offer more objective advice.

## *Conclusion*

To conclude, social, economic, political and regulatory fragmentation poses significant challenges for the financial system and its ability to foster long-term growth. Collaboration on global standards and efforts to harmonize regulation, its implementation as well as supervision and enforcement, could help to mitigate fragmentation but it requires a certain degree of mutual trust and a close dialogue between regulators, supervisors, standard-setting bodies, policymakers and market players. Against this backdrop, it is important not to let nationalism and populism deter the relevant players from a generally observable course of harmonization, which is evident for example in the European Commission adopting equivalence decision for central counterparties (CCPs) in the USA and other non-EU jurisdictions.

## APPENDIX I

## Session Participants

## Co-Chairs

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## APPENDIX II

# Session Agenda

## Day 1: Challenges

### Opening Remarks

**Stephen Salyer**, *President & Chief Executive Officer, Salzburg Global Seminar*

**Ranjit Ajit Singh**, *Executive Chairman, Securities Commission Malaysia*

**Sylvie Matherat**, *Chief Regulatory Officer and Member of the Management Board, Deutsche Bank*

**Sylvie Matherat**, *Chief Regulatory Officer and Member of the Management Board, Deutsche Bank*

**Jerome Powell**, *Member, Board of Governors, Federal Reserve System*

### Opening Keynote Speech: Conflicts And Contradictions

**Douglas Flint**, *Group Chairman, HSBC Holdings plc*

### Emerging Risks: The Big Picture

What are the major risks of the future and are we coordinated for a structured response? What are the underlying causes of growing discontent over capitalism and corresponding political risks? What are the challenges to financial stability in the current macroeconomic environment? What remains to be done to address risks arising from non-banking institutions? Which frameworks for cybersecurity resilience are needed? What is the compound impact of the many policy changes initiated in the past decade? Can banks remain viable and healthy?

CHAIR: **Sandra O'Connor**, *Chief Regulatory Affairs Officer, J.P. Morgan Chase & Co*

**Guy Standing**, *Economist; Professorial Research Associate, School of Oriental and African Studies, University of London; author, "The Precariat: The New Dangerous Class"*

**Andreas Dombret**, *Member of the Executive Board, Deutsche Bundesbank*

### Challenges of Rising Fragmentation and Protectionism

How does fragmentation and protectionism affect the flow of capital and economic growth? What are the specific indications and impact of fragmentation in the financial industry and its markets? What is the possible impact of the increased risk aversion? What are the implications of the fragmentation of the financial ecosystem in Europe due to Brexit? How will Capital Markets Union work in a post-Brexit world? What are the implications for global coordination?

CHAIR: **Douglas Flint**

**Paul Andrews**, *Secretary General, IOSCO*

**Lorenzo Bini Smaghi**, *Chairman of the Board, Société Générale*

**Saeb Eigner**, *Chairman, Dubai Financial Services Authority*

**Joanna Cound**, *Managing Director, BlackRock*

### Breakout Groups I

Drawing on insights from the panel discussions, the breakout groups will provide an opportunity for more sustained work on major challenges listed below, with the agenda and direction of discussion guided by the group chairs

### US, European and Asian Capital Markets Integration: A Lost Cause?

CHAIR: **Amelie Champsaur**, *Cleary Gottlieb*

### Economic Viability Challenges of the Banking System

CHAIRS: **Colin Brereton**, *PricewaterhouseCoopers (PwC)*

**Miles Kennedy**, *PricewaterhouseCoopers (PwC)*

### Policy Challenges of Disruptive Innovation in Finance

CHAIR: **Greg Medcraft**, *Australian Securities and Investments Commission*

### Issues and Challenges of Non-Bank Financial Institutions in the New Landscape

CHAIR: **Joanna Cound**, *BlackRock*

### Evening Debate: Resolved, Globalization Benefits Only the Elites

MODERATOR: **Stefan Gavell**, *Executive Vice-President and Global Head of Regulatory, Industry and Government Affairs, State Street*

## Day 2: Solutions

### Breakout Group Reports

MODERATOR: **Ranjit Ajit Singh**

#### Global Policy Coordination: The Way Forward

In the current political and economic environment, where does policy coordination survive and where does it not? What can be done to foster coordination where it is most needed? Is there a better system to coordinate global financial regulation than the one we have now? Should we still aspire to a global rulebook as a long-term goal? What has to be done to progress done by the FSB and IOSCO in working toward more harmonization and coordination across regulatory regimes? What should be done to advance financial crime coordination?

CHAIR: **Annette Nazareth**, *Partner, Davis Polk*

**Greg Medcraft**, *Chairman, Australian Securities and Investments Commission*

**Mark Yallop**, *Chairman, FICC Markets Standards Board*

**Sharon Bowen**, *Commissioner, U.S. Commodity Futures Trading Commission*

#### Breakout Groups II

Drawing on insights from the panel discussions, the breakout groups will provide an opportunity for more sustained work on solutions to the issues listed below, with the agenda and direction of discussion guided by the group chairs

#### How Can We Ensure Long-Term Financing?

CHAIR: **Paul Muthaura**, *Capital Markets Authority of Kenya*

#### Strategic Agenda for Financial Stability

CHAIR: **Patrick Kenadjian**, *Davis Polk*

#### How Can Technology and Fintech Help to Deal with Fragmentation?

CHAIR: **Heather Russell**, *BuckleySandler*

#### How to Make The CMU Work in a Post-Brexit World?

CHAIR: **Cyrus Ardalan**, *OakNorth Bank*

### Breakout Group Reports

MODERATOR: **Sylvie Matherat**

#### The 21 Century Bank

How should banking in the 21st century respond to a whole new set of political, economic, regulatory and technological challenges? What is the impact of new market entrants? Which reforms are needed to improve banks' competitive edge and economically viable? How should banks better adapt to the ongoing technological innovation? Which growth opportunities does the big data offer to the banking sector?

CHAIR: **Thomas Huertas**, *Partner, EY*

**Douglas Flint**, *Chairman, HSBC Holdings plc*

**Sandra O'Connor**, *Chief Regulatory Affairs Officer, J.P. Morgan Chase & Co*

**Michael Krimminger**, *Partner, Cleary Gottlieb*

#### Financing Economic Growth Within a Safe Financial System

What are the prospects for sustained growth in the future? How can central banks, policy-makers and the financial industry work together? How should policy-makers balance the tasks of reducing vulnerabilities and promoting growth? Are these tasks mutually exclusive? How can emerging market countries harness innovative technologies while also build robust regulatory frameworks? Are there lessons learned that could be applied globally about "leapfrogging"?

CHAIR: **Dominik Treeck**, *Partner, Oliver Wyman*

**Ranjit Ajit Singh**, *Executive Chairman, Securities Commission Malaysia*

**Paul Muthaura**, *Chief Executive, Capital Markets Authority of Kenya*

**Lorenzo Bini Smaghi**, *Chairman, Société Générale*

**Laura Ahto**, *Chief Executive Officer, BNY Mellon's European Bank, The Bank of New York Mellon SA/NV*

#### Wrap Up and Closure

**Sylvie Matherat**

**Ranjit Ajit Singh**

**Clare Shine**, *Vice President and Chief Program Officer, Salzburg Global Seminar*

#### Closing Keynote Speech: The Way Forward for the Financial Industry

**Saeb Eigner**, *Chairman, Dubai Financial Services Authority*

## APPENDIX III

*Session Co-chair's opening remarks***Executive chairman of the Securities Commission Malaysia, Ranjit Ajit Singh calls for greater efforts to make the economy and financial system more inclusive and sustainable for all**

These remarks were delivered by Ranjit Ajit Singh during his opening address at the 2017 session of the *Salzburg Global Forum on Finance in a Changing World – Global Challenges, Regional Responses: How Can We Avoid Fragmentation in the Financial System?*

Mr. Stephen Salyer, President and Chief Executive Officer, Salzburg Global Seminar, Sylvie Matherat, my fellow co-chair of the seminar, distinguished participants, ladies and gentlemen, good morning. I am delighted to be here in the lovely location of Salzburg.

And as I stand here, I am reminded that the best test of any human construct or invention lies in its ability to adapt and remain relevant in the face of the only constant of this world – change. The *Salzburg Global Seminar on Finance in a Changing World* aims to do just that – to stimulate important conversations on major trends unfolding across today's financial landscape, as well as the implications they bring, and the responses they necessitate, in this small but highly influential gathering of leading policymakers, regulators, market practitioners and experts in the global financial services sector.

I would like to take this opportunity to thank Stephen Salyer and Tatsiana Lintouskaya for their gracious invitation to be here today and convincing me to co-chair this very important event.

*Fragmentation in today's world*

Ladies and gentlemen,

I would like to take some time this morning to offer a few of my observations on global

developments and the impact of fragmentation on the financial system. While I do not profess to have solutions for the challenges that confront us, I hope that this will provide some perspectives in our conversations over the next two days.

The theme of this year's Seminar is timely, as policymakers and regulators around the world respond to the impact of ongoing political and socioeconomic developments. In my view, there are several permutations to fragmentation that transcend economic, social and geographical boundaries.

Open and integrated financial markets are under threat from political and economic challenges stemming in part from growing backlash against globalization and calls for protectionism policies among many countries. The backlash stems partly from concerns of growing social fragmentation with growth not being evenly spread across the income spectrum, reflecting an increasingly widening inequality gap.

Today, we live in a world where the richest 1% is said to own more wealth than the rest of the world population.<sup>1</sup> Globalization has also resulted in increased inequality within countries, which is particularly pronounced in some advanced economies of the world.

<sup>1</sup> Oxfam (January 2017), "An economy for the 99%", Briefing paper



In contrast, one-third of all food produced for human consumption in the world (around 1.3 billion tons) is lost or wasted, with most wastage occurring in developed markets.<sup>2</sup> In terms of climate change, the share of national GDP at risk from climate change is expected to exceed USD1.5 trillion in 301 major cities (expected to account for two-thirds of the world's GDP) around the world by 2025.<sup>3</sup>

There are also structural implications arising from technological progress and innovation on employment and job displacement, which are very real. While automation has the potential to increase productivity and economic growth, it also raises concerns on implications to jobs, skills, and wages.

Such developments, if taken to extreme, may even fragment the existing social order. Despite recent geopolitical outcomes, the pivot away from globalization that we see is very much a symptom of deeper rooted socioeconomic imbalances, rather than a root cause of its own. It has also been aggravated by the challenging external environment of heightened uncertainty, low growth and high debt and growing inequality.

The second aspect of fragmentation relates to economic fragmentation. We have been observing a realignment of global markets, in terms of the presence and significance of emerging markets within the global financial landscape. Emerging economies contribute nearly 60% of global GDP, as compared to 10 years

ago when they accounted for only about 30% of global GDP.<sup>4</sup>

Global population, in turn, is expected to reach over nine billion by 2050 with the majority of this growth driven by emerging markets.<sup>5</sup> The significance of emerging markets was reinforced by the IMF Managing Director Christine Lagarde in a speech where she said: “Emerging and developing economies are home to 85% of the world’s population, and these 85% matter to the global economy more than ever, and they matter to you more than ever – because of strong linkages through trade, finance, economics, geopolitics, and personal connections that you experience every day.”<sup>6</sup>

In shaping the global agenda, it is critical therefore to consider the heterogeneity of markets with varying economic and social dimensions, and are motivated by different needs. The agenda cannot be one that is premised on a one-size-fits-all model that is driven, and sometimes dictated, by advanced markets. Given the number and growing economic significance of emerging markets, there needs to be a more balanced debate on international regulatory reforms and better inclusion of these considerations in international policy formulation. Otherwise, we risk perpetuating this divide and fragmentation even further.

The third aspect of fragmentation relates to an area close to what I do and that is regulatory fragmentation. The world’s capital markets currently make up more than half of global

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2 Food and Agriculture Organization of the United Nations (FAO)

3 Harvard Business Review, (2017), “If You Think Fighting Climate Change Will Be Expensive, Calculate the Cost of Letting It Happen”

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4 Christine Lagarde, (4 February 2016), “The Role of Emerging Markets in a New Global Partnership for Growth”

5 United Nations Department of Economic and Social Affairs (2015), “World Population Prospects: The 2015 Revision”

6 op. cit. Lagarde

## APPENDIX III

financial assets. Further, a corollary of the narrowing of traditional financing channels as banks adopt a more conservative lending appetite (in line with more stringent prudential requirements) is the greater reliance on capital market-based financing. Prudential regulation and financial stability issues, however, continue to dominate global policy regulation and often is not reflective of the significant role of capital markets in the overall financial system.

For example, there are instances where prudential regulations are being expanded to reach capital market and non-bank entities which by their nature are different from banks. There is also greater focus on issues relating to market regulation, which have traditionally been within the realm of securities regulators further creating duplication and potential fragmentation in regulation.

To reflect the multiple dimensions of global financial regulation and to minimize these unintended consequences on capital markets, there needs to be concerted efforts to increase the representation of capital market regulators in international financial policymaking. Today capital market regulators (both from developed and emerging markets) are severely under-represented in the configuration of some international organizations at a time when market-based financing is increasingly growing.

### *New paradigms of globalization*

The important question for policy makers, regulators, and market practitioners is not whether we should accept or reject globalization, but rather, how do we ensure that that global policy making and regulation leverage on each other and do not perpetuate fragmentation even further and impose undue costs and disruption

to the market. As global finance interconnects us, there needs to be, as the Salzburg Global Forum in their efforts of bridging divides seeks to do, much greater emphasis placed on bridging the divides and creating greater links to financial development to minimize the risk of further polarization.

There is also a need to redefine the paradigms of globalization and re-orientate our development philosophy towards more inclusive access to opportunities that transcend geographical and socio-economic boundaries. Growth must be sustainable across generations and be able to support optimal quality of life for those living within the ecosystem. This includes strengthening the safety nets to ensure sustainability of our retirement systems against the backdrop of an aging population. Are the needs of the aging population being catered to and do they have opportunities for wealth creation through effective savings and pensions structures?

To ensure a meaningful response to many of these issues I described earlier, it is clear that long-termism and sustainability must form the lynchpins of our economic philosophy. This is a central theme as we contend with not only finite but depleting resources, as the forces of globalization impact inclusivity and social inequalities.

### *Sustainable capitalism*

A healthy financial system is vital for the well-functioning of the global economy. It is however observed that finance has also gained a momentum of its own and has become somewhat detached from the real world of industry, manufacturing, services, agriculture, thereby outpacing growth in the real economy and

distorting public's trust and confidence in the financial system along the way.

In order to make finance work for the real world, rapid financial proliferation should be balanced with a more democratized financial system to meet the needs of diversified stakeholders across different segments of society. It cannot be solely anchored on small but influential segments of the economy, whether they be the more advanced markets, the larger companies and institutions or the wealthy and elite individuals.

One clear example is the disconnect between the traditional financial system and the younger generation, where structural inadequacies within the system have helped catalyze new forms of alternative financing and investments enabled by technology (crowdfunding, mobile payments, and investments etc.).

With its ability to provide long-term financing to encourage and sustain business activity, innovation, and infrastructure development, it is critical to have deep and interconnected capital markets that can safely and efficiently allocate investments needed to achieve these outcomes. Global challenges, such as climate change, require significant investments, with the World Economic Forum estimating that an additional investment of US\$700 billion per annum is needed to provide for clean energy infrastructure, sustainable transport, energy efficiency and forestry<sup>7</sup>. Due to the sheer scale and duration of financing required, it is argued that capital markets have the appropriate mobilization and risk diversification capacity to fulfill this demand. Further, Islamic finance, based on principles of equitable and participatory growth with emphasis on risk sharing, can also play an

increasingly pivotal role in promoting sustainable finance. As Islamic finance transactions need to be supported by genuine economic activities, it is also therefore firmly linked to the real economy.

### *Conclusion*

Globalization in its current form is not a viable option, nor is fragmentation or permutations of it, the solution to the challenges we face. What is required is a common set of minds to shift the global ecosystem to make the economy and financial system more inclusive and sustainable for all. A world which incentivizes short-term maximization at the individual level over long-term optimization at the aggregate level is not a world that produces sustainable outcomes for the present as well as the future generation.

We are at a critical juncture. As stewards of global finance, our actions - or even inaction - in the coming years will be a crucial determinant of the state of resilience and integrity of our economies.

I wish you a productive discussion in the days ahead. Thank you.

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<sup>7</sup> World Economic Forum (2013), "The Green Investment Report: The ways and means to unlock private finance for green growth"



## APPENDIX IV

*Remarks – Governor Jerome H. Powell***US Federal Reserve Governor calls for reforms and vigilance at Salzburg Global Forum on Finance in a Changing World**

These remarks were delivered by Jerome Powell, Member of the Board of Governors of the US Federal Reserve System, during the opening panel at the 2017 session of the *Salzburg Global Forum on Finance in a Changing World – Global Challenges, Regional Responses: How Can We Avoid Fragmentation in the Financial System?*

I appreciate the opportunity to speak at Salzburg Global Seminar. Today I will discuss our current regulatory regime, and areas where we may be able to make adjustments. As always, the views I express here are my own.

We need a resilient, well-capitalized, well-regulated financial system that is strong enough to withstand even severe shocks and support economic growth by lending through the economic cycle. The Federal Reserve has approached the post-crisis regulatory and supervisory reforms with that outcome in mind.

There is little doubt that the U.S. financial system is stronger today than it was a decade ago. Loss-absorbing capacity among banks is substantially higher as a result of both regulatory requirements and stress testing exercises. The banking industry, and the largest banking firms in particular, face far less liquidity risk than before the crisis. And progress in resolution planning by the largest firms has reduced the threat that their failure would pose. These efforts have made U.S. banking firms both more robust and more resolvable.

Evidence overwhelmingly shows that financial crises can cause severe and lasting damage to the economy's productive capacity and growth potential. Post-crisis reforms to financial sector regulation and supervision have been designed to significantly reduce the likelihood and severity of future financial crises. We have sought to accomplish this goal in significant part by

reducing both the probability of failure of a large banking firm and the consequences of such a failure were it to occur.

As I mentioned, we have substantially increased the capital, liquidity, and other prudential requirements for large banking firms. These measures are not free. Higher capital requirements increase bank costs, and at least some of those costs will be passed along to bank customers and shareholders. But in the longer term, stronger prudential requirements for large banking firms will produce more sustainable credit availability and economic growth.

Our objective should be to set capital and other prudential requirements for large banking firms at a level that protects financial stability and maximizes long-term, through-the-cycle credit availability and economic growth. To accomplish that goal, it is essential that we protect the core elements of these reforms for our most systemic firms in capital and liquidity, stress testing and resolution.

With that in mind, I will highlight five key areas of focus for regulatory reform. The first is simplification and recalibration of regulation of small and medium-sized banks. We are working to build on the relief we have provided in the areas of call reports and exam cycles, by developing a proposal to simplify the generally applicable capital framework that applies to community banking organizations.

The second area is resolution plans. The Fed and the Federal Deposit Insurance Corporation believe that it is worthwhile to consider extending the cycle for living will submissions from annual to once every two years, and focusing every other of these filings on key topics of interest and material changes from the prior full plan submission. We are also considering other changes, as I discussed last week when testifying to Congress.

Third, the Federal Reserve is reassessing whether the Volcker rule implementing regulation most efficiently achieves its policy objectives, and we look forward to working with the other four Volcker rule agencies to find ways to improve that regulation. In our view, there is room for eliminating or relaxing aspects of the implementing regulation in ways that do not undermine the Volcker rule's main policy goals.

Fourth, we will continue to enhance the transparency of stress testing and the Comprehensive Capital Analysis and Review (CCAR). We will soon seek public feedback concerning possible forms of enhanced disclosure, including a range of indicative loss rates predicted by the Federal Reserve's models for various loan and securities portfolios, and information about risk characteristics that contribute to the loss-estimate ranges. We will also provide more detail on the qualitative aspects of stress testing in next week's CCAR disclosure.

Finally, the Federal Reserve is taking a fresh look at the enhanced supplementary leverage ratio. We believe that the leverage ratio is an important backstop to the risk-based capital framework, but that it is important to get the relative calibrations of the leverage ratio and the risk-based capital requirements right.

U.S. banks today are as strong as any in the world. As we consider the progress that has been achieved in improving the resiliency and resolvability of our banking industry, it is important for us to look for ways to reduce unnecessary burden. We must also be vigilant against new risks that may develop. In all of our efforts, our goal is to establish a regulatory framework that helps ensure the resiliency of our financial system, the availability of credit, economic growth, and financial market efficiency. We look forward to working with our fellow regulatory agencies and with Congress to achieve these important goals.

And finally, I would also like to note that work continues to address the risks identified with existing reference rates. Just last week, the Alternative Reference Rates Committee (ARRC) selected a new rate suitable for use with new derivative contracts. I am confident the broad Treasuries repo rate, which the Federal Reserve Bank of New York has proposed publishing in cooperation with the Office of Financial Research, is based on a deep and actively traded market and will be highly robust. With this choice, the ARRC has taken another step in addressing the risks involved with the LIBOR.

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