<u>Project Update</u>

We have revised the paper in the last year and in light of feedback are now in the process of exploring the possibility of including an empirical element. A surprising prediction of our model is that, particularly when in distressed states, banks prefer to form connections with other banks that have similar balance sheet exposures and who would fail in the same states of the world. This can transfer value from debtholders to shareholders, but at the cost of exacerbating system risk. As all else equal, as we'd expect risk sharing to be more efficient among those with less correlated risks, we view this prediction as surprising. Using detailed balance sheet and data on bank positions with each other from the Bundesbank, we hope to provide some suggestive evidence in support of our model and to help motivate it further. If this exercise is successful a new coauthor, Co-Pierre Georg from the Bundesbank, will be added to the project.

Externally this project has been presented this year at the Paris School of Economics, Roy Seminar, March 6, 2017. A discussion of the paper is included in a survey article for the INFORMS Tutorials in Operations Research (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2805773).