Discussion:
Disclosure Practices and Option Implied Probability of Default

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Contributions

- **Big question:**
  What is the relationship between bank’s disclosure decisions and the market value of its expected default probability?

- Why is it **interesting:**
  
  i. *1st study* to formally analyze relationship between level of disclosure and market assessment of credit risk.
  
  ii. Provides a *template* to measure the level of disclosure using only public information:

  ➔ *Hand-collected* data on 80 U.S. BHC from 10-K statements:
  
  - liquidity risk,
  - group structure,
  - intra-annual information,
  - spillover risk.
Impressive, *novel* data set on 80 BHC that combines:

- SEC-Edgar for 10-K statements, proxy statements, annual reports, dates the 10-K statement was released.
- OptionMetrics Standardized Options for information on call options.
- CRSP for bid and ask prices of the equity.
- Kenneth French's online data library for market returns and the risk free rates.
- Thompson-Reuters I/B/E/S for analyst estimates.
2) Main hypothesis:

- Banks with \( \uparrow \) disclosure in \( t \) benefit from \( \downarrow \) market implied default probabilities in \( t+1 \).
  
  i. The bank *becomes* less risky due to, i.e. lower capital cost, greater market discipline, change in management that decides new strategy, no big reorganization (M&A).
  
  ii. The bank *is perceived* as less risky as there is less uncertainty (learning about the parameters in a sense of Pastor and Veronesi (2009)).

- Alternative: Level of disclosure does not have any real impact on investors' assessment on the default probabilities of banks.

\( \Rightarrow \) Is disclosure affecting the market perception of default risk or the default risk itself or the *net effect* of those?
3) Distressed banks

- 2007-2010 you have $\uparrow$ in the level of disclosure. It is also period when some banks went into distress.

- How many BHC in your sample went into *distress*?

- Did any of the new disclosures occurred in distressed banks? How do you deal with those observations?
4) Time intervals

- This may strengthen your results as some firms may show a trend, i.e. due to changes in management or strategy and become more transparent/less risky.

→ Did you try to take the time interval around the disclosure (-3 months, +3 months).
Conclusions

- Interesting paper with robust analysis of changes in disclosure and the response in IPoD among 80 U.S. BHC.

- **Message**: increase in level of disclosure reduces the average level of IPoD in the next period.

- Also, disclosure has a beneficial effect on other enterprise risk (return volatility, downside risk, market risk, idiosyncratic risk).

- Contributions to:
  - *regulatory* framework.
  - literature on disclosure indices (voluntary disclosure).
  - Literature on consequences of corporate disclosure on capital markets.