Discussion:
Disclosure Practices and Option Implied Probability of Default

Ilknur Zer

Discussant: Magdalena Pisa
University of Luxembourg and Maastricht University

FMA European Meeting 2014
12 June 2014

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.

Comments (1/4)

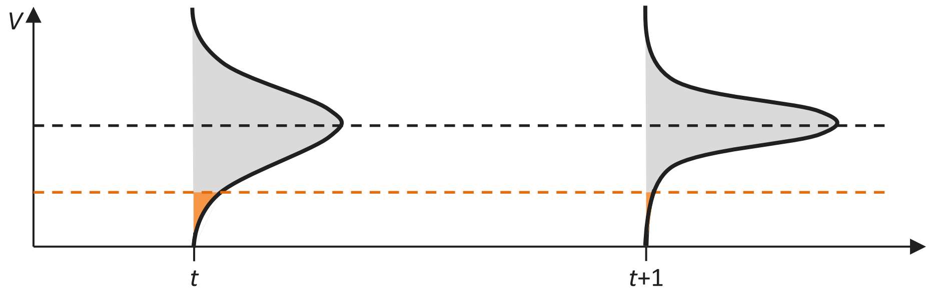
1) Impressive, *novel* data set on 80 BHC that combines:

- 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.
- Federal Reserve Bank of Chicago for FR Y-9C reports (consolidated financial statement).
- Thompson-Reuters I/B/E/S for analyst estimates.

Comments (2/4)

2) Main hypothesis:

- Banks with ↑ disclosure in t benefit from ↓ 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.

→ Is disclosure affecting the market perception of default risk or the default risk itself or the *net effect* of those?

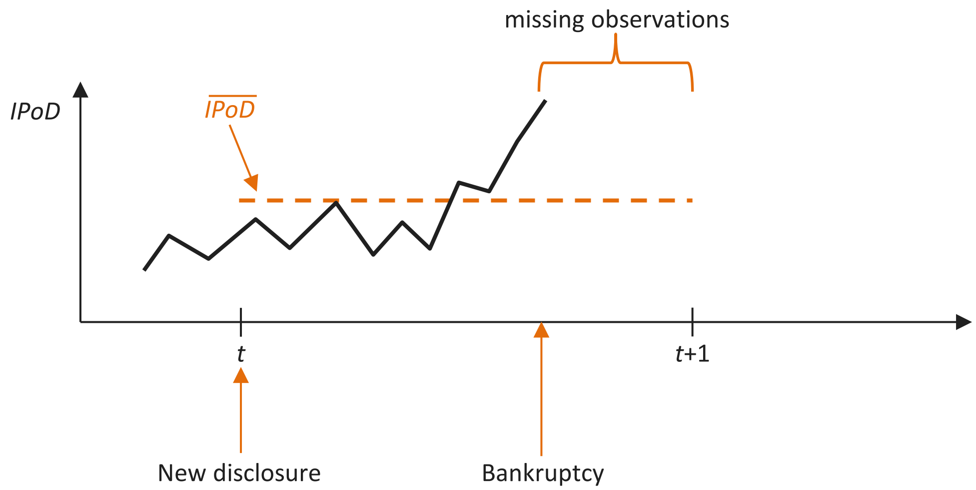
Comments (3/4)

3) Distressed banks

- 2007-2010 you have ↑ 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?

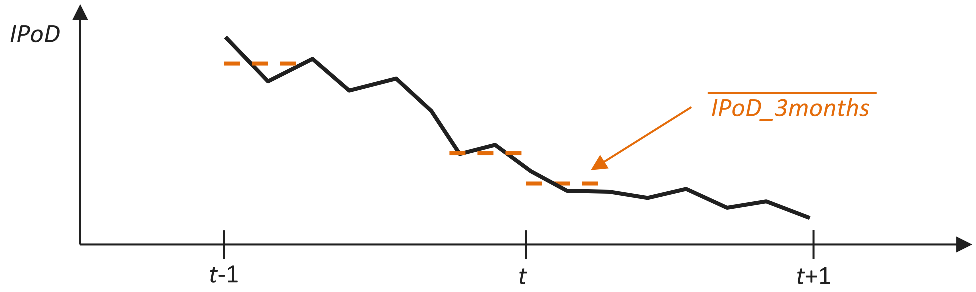


Comments (4/4)

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 (-3monts,+3months).



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.