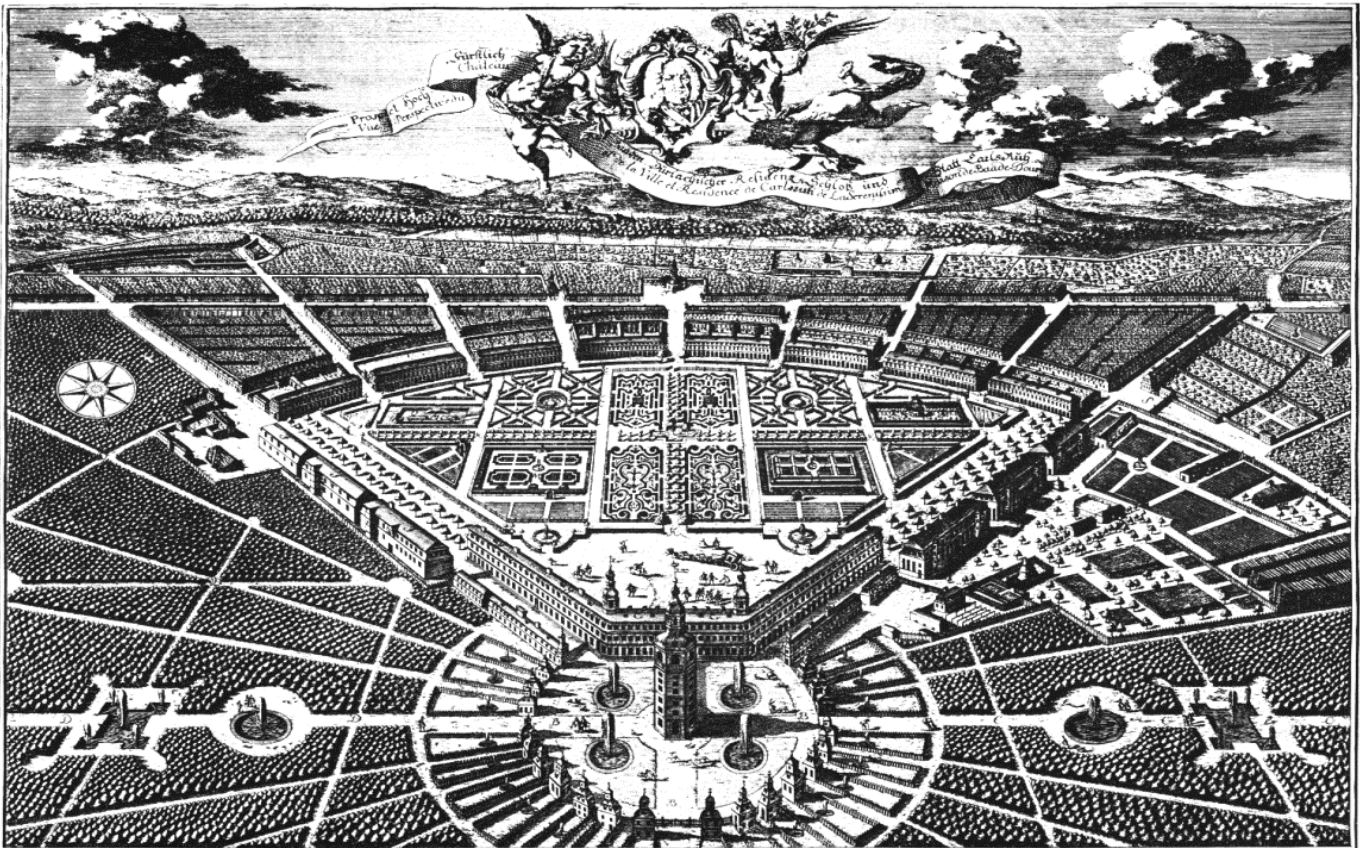


# 12<sup>th</sup> Symposium on Finance, Banking, and Insurance

Karlsruhe Institute of Technology (KIT), Germany

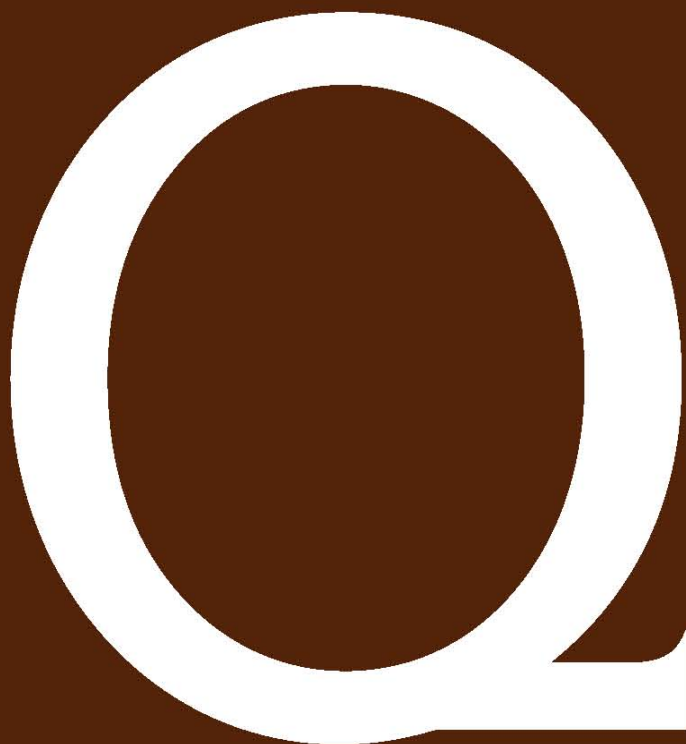
December 15-16, 2011



## Program

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# 12<sup>th</sup> Symposium

## Finance, Banking, and Insurance

Ladies and Gentlemen,

Welcome to the 12<sup>th</sup> Symposium on Finance, Banking, and Insurance at the Karlsruhe Institute of Technology (KIT).

The Symposium provides an overview of the current developments in the fields of finance, banking, and insurance. It aims at offering a basis for the exchange of ideas between academia and practice.

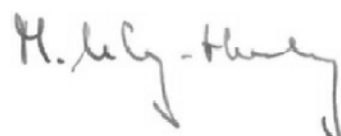
We are particularly proud to welcome our keynote speakers Prof. Milton Harris and Dr. Thomas Mayer. Both have selected topics related to the current situation on financial markets: Prof. Harris will talk about rating agencies in the face of regulation and Dr. Mayer's presentation will shed light on Euroland's hidden balance-of-payment crisis.

We wish you a very interesting and enjoyable time in Karlsruhe!

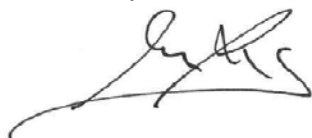
Sincerely



Ryan Riordan



Marliese Uhrig-Homburg



Martin E. Ruckes



Christof Weinhardt

## Contents

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The Symposium is organized by Symposia FBV e.V. and supported by Förderverein Finanzwirtschaft und Banken e.V. at the Karlsruhe Institute of Technology (KIT)

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## Information for Participants

**Cafeteria:** We will provide free snacks and drinks during the coffee breaks in building 20.13.

**Lunch:** On Thursday, Dec. 15, lunch will be served at the Cafeteria. On Friday, lunch is at Building 11.40.

**Conference Office:** Location: Building 20.13  
Opening hours:  
Thu, Dec. 15 8:00 am to 7:00 pm  
Fri, Dec. 16 8:30 am to 4:30 pm

**Conference Location:** Plenary Sessions: Building 11.40, Tulla HS  
Sessions: Building 20.13, 20.14  
See pages 10 to 23

**Contact:** Ryan Riordan (Financial Markets)  
Martin Ruckes (Finance and Banking)  
Marliese Uhrig-Homburg (Derivatives)  
Christof Weinhardt (Information Management)  
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**Parking:** Parkhaus am Schlossplatz  
Opening hours: 6:30 am to 9:00 pm  
Waldparkplatz  
Opening hours: 24 h  
Parking Fee: free

**Internet:** Free Internet access at building 20.13  
Free W-LAN access available

**Conference Dinner:** Concert House Karlsruhe, Festplatz 9  
Tram Line S1, S11, S4, S11 to stop Kongresszentrum





### Academic keynote:

#### **Prof. Milton Harris, Ph.D.: Rating Agencies in the Face of Regulation**

*(Thu, Dec, 15th, 09:00 pm, Bldg. 11.40, R103, Tulla HS)*

Professor Harris is one of the leading experts in corporate finance and the economics of information. His current research interests are rating agencies, bank disclosure regulation, and intellectual property contracts.

Professor Harris is the former president of the Western Finance Association and Fellow of the American Finance Association 2011. Since 1987, he has been the Chicago Board of Trade Professor of Finance and Economics at the University of Chicago Booth School of Business. He has held visiting positions at Stanford University, The University of Haifa, and Tel Aviv University.

The academic keynote is exclusively sponsored by Audi



### Practitioners' keynote:

#### **Dr. Thomas Mayer: Euroland's Hidden Balance-of-Payment Crisis**

*(Fri, Dec, 16th, 11:00 am, Bldg. 11.40, R103, Tulla HS)*

Dr. Thomas Mayer is one of the most distinguished experts on international and European economic issues. He has written numerous articles on these issues and is frequently present in the public media.

Currently, Dr. Thomas Mayer is the Chief Economist of Deutsche Bank AG and Head of Deutsche Bank Research. He has held positions at Goldman Sachs, Salomon Brothers, and the International Monetary Fund in London, Frankfurt, and Washington.

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Springer Verlag



### Wednesday - December 14, 2011

06:30 pm \_\_\_\_\_ Inofficial Get Together

#### Inofficial Get Together and Registration

Location:

Kap, Kapellenstraße 68, 76131 Karlsruhe

### Thursday - December 15, 2011

08:00 am \_\_\_\_\_ Registration

09:00 am \_\_\_\_\_ Welcome & Academic Keynote

**Dr. Karl-Friedrich Ziegahn**

Chief Science Officer, Karlsruhe Institute of Technology (KIT)

**Prof. Dr. Clemens Puppe**

Dean, School of Economics and Business Engineering, KIT

**Chair: Prof. Dr. Martin Ruckes**

**Prof. Milton Harris, Ph.D.**

Chicago Board of Trade Professor of Finance and Economics, The University of Chicago  
Booth School of Business

*"Rating Agencies in the Face of Regulation"*

Location:

Bldg. 11.40, R103, Tulla HS

10:30 am

#### Coffee Break

# Program Overview

11:00 am \_\_\_\_\_ Sessions

<b>Economics of Banking</b>	<b>Asset Pricing I</b>	<b>Math. Issues in Banking and Insurance</b>	<b>Governance</b>	<b>Retail Investments</b>
Location: 20.13, R006	Location: 20.14, R103.2	Location: 20.14, R103.1	Location: 20.13, R111	Location: 20.13, R109

1:00 pm

## Lunch Break at the Cafeteria in Bldg. 20.13

2:30 pm \_\_\_\_\_ Sessions

<b>Systemic Risk &amp; Contagion</b>	<b>Asset Pricing II</b>	<b>Insurance and Information</b>	<b>Focus Session: Minimum Variance Portfolio</b>	<b>News</b>
Location: 20.13, R006	Location: 20.14, R103.2	Location: 20.14, R103.1	Location: 20.13, R111	Location: 20.13, R109

4:00 pm

## Coffee Break

4:30 pm \_\_\_\_\_ Sessions

<b>Banking: Regulation</b>	<b>Portfolio Selection</b>	<b>Annuities</b>	<b>Government and Corporate Finance</b>	<b>Institutional Trading</b>
Location: 20.13, R006	Location: 20.14, R103.2	Location: 20.14, R103.1	Location: 20.13, R111	Location: 20.13, R109

6:00 pm

07:00 pm \_\_\_\_\_ Dinner Reception

### Dinner Reception

Location:  
Concert House Karlsruhe, Festplatz 9  
Tram Line S1, S11, S4, S11 to stop Kongresszentrum

## Program Overview

**Friday - December 16, 2011**

09:00 am \_\_\_\_\_ Sessions

<b>Banking: Empirical</b>	<b>Delegated Portfolio Management &amp; Mutual Funds</b>	<b>Contemporary Issues in Insurance</b>	<b>Debt Financing</b>	<b>Market Microstructure</b>
Location: 20.13, R006	Location: 20.14, R103.2	Location: 20.14, R103.1	Location: 20.13, R111	Location: 20.13, R109

10:30 am

### Coffee Break

11:00 am \_\_\_\_\_ Practitioner Keynote

**Chair: Prof. Dr. Ryan Riordan**

**Dr. Thomas Mayer**

Chief Economist of Deutsche Bank, Head of Deutsche Bank Research

*"Euroland's Hidden Balance-of-Payment Crisis"*

Location:

Bldg. 11.40, R103, Tulla HS

12:00 am

### Lunch Break at Bldg. 11.40

01:15 pm \_\_\_\_\_ Sessions

<b>Credit Risk</b>	<b>Commodity &amp; Energy Finance</b>	<b>Insurance &amp; Risk Management</b>	<b>Empirical Corporate Finance</b>	<b>Empirical Finance</b>
Location: 20.13, R006	Location: 20.14, R103.2	Location: 20.14, R103.1	Location: 20.13, R111	Location: 20.13, R109

02:45 pm

## Sessions

---

### Track 1

Location: Bldg. 20.13, R006

#### Economics of Banking

---

**Chair: Schaeck, Klaus****Schaeck, Klaus**

Cihak, Martin

*Competition, Efficiency, and Soundness in Banking: An Industrial Organization Perspective*

*Discussant: Scalia, Antonio*

**Daske, Holger**

Gebhardt, Günther

Bischof, Jannis

*Fair Value Accounting and the Business Model of Banks*

*Discussant: Ruprecht, Benedikt*

**Scalia, Antonio**

Sahel, Benjamin

*Ranking, Risk-taking and Effort: An Analysis of the ECB's Foreign Reserves Management*

*Discussant: Haselmann, Rainer*

**Ruprecht, Benedikt**

Entrop, Oliver

Memmel, Christoph

Wilkins, Marco

*Determinants of Bank Interest Margins: Impact of Maturity Transformation*

*Discussant: Vorgrimler, Stephan*

Thursday, 11:00 a.m. – 1:00 p.m.

#### Systemic Risk & Contagion

---

**Chair: Cooper, Ian Anthony****Krause, Andreas**

Giansante, Simone

*Interbank Lending and the Spread of Bank Failures: A Network Model of Systemic Risk*

*Discussant: Lehar, Alfred*

**Cooper, Ian Anthony**

Brealey, Richard A.

Kaplanis, Evi

*International Propagation of the Credit Crisis*

*Discussant: Raupach, Peter*

**Raupach, Peter**

Löffler, Gunter

*Robustness and Informativeness of Systemic Risk Measures*

*Discussant: Packham, Natalie*

Thursday, 2:30 p.m. – 4:00 p.m.



## Banking: Regulation

### Chair: Gamba, Andrea

#### Gamba, Andrea

De Nicolò, Gianni

Lucchetta, Marcella

*Capital Regulation, Liquidity Requirements and Taxation in a Dynamic Model of Banking*

*Discussant: Fecht, Falko*

#### Packham, Natalie

Bannier, Christina E.

Feess, Eberhard

*Competition, Bonuses, and Risk-taking in the Banking Industry*

*Discussant: Gamba, Andrea*

#### Berg, Tobias

Kaserer, Christoph

*Does Contingent Capital Induce Excessive Risk-taking and Prevent an Efficient Recapitalization of Banks?*

*Discussant: Stenbacka, Rune*

Thursday, 4:30 p.m. – 6:00 p.m.

## Banking: Empirical

### Chair: Düllmann, Klaus

#### Düllmann, Klaus

Kick, Thomas K.

*Stress Testing German Banks Against a Global Credit Crunch*

*Discussant: Krause, Andreas*

#### Kick, Thomas K.

Berger, Allen

Christa, Bouwman

Schaeck, Klaus

*Bank Risk Taking and Liquidity Creation Following Regulatory Interventions and Capital Support*

*Discussant: Steffen, Sascha*

#### Steffen, Sascha

Fischer, Markus Jens

Hainz, Christa

Rocholl, Jörg

*Government Guarantees and Bank Risk Taking Incentives*

*Discussant: Schaeck, Klaus*

Friday, 9:00 a.m. – 10:30 a.m.

## Sessions

### Credit Risk

**Chair: Lehrbass, Frank**

**Fuess, Roland**

Gehrig, Thomas  
Rindler, Philipp

*Risk Decomposition of Credit Spreads*

*Discussant: Trapp, Monika*

**Belke, Ansgar**

Gokus, Christian

*Volatility Patterns of CDS, Bond and Stock Markets Before and During the Financial Crisis: Evidence from Major Financial Institutions*

*Discussant: Füss, Roland*

**Speck, Christian**

*Credit Risk and the Macro Economy in an Affine Term Structure Model*

*Discussant: Belke, Ansgar*

Friday, 1:15 p.m. – 2:45 p.m.

### Track 2

Location: Bldg. 20.14, R103.2

**Asset Pricing I** Thursday, 11:00 a.m. – 1:00 p.m.

**Chair: Branger, Nicole**

**Dumitrescu, Ioana**

Branger, Nicole  
Ivanova, Vesela  
Schlag, Christian

*Preference Heterogeneity and Survival in Long-Run Risk Models*

*Discussant: Eraker, Bjorn*

**Branger, Nicole**

Rodrigues, Paulo  
Schlag, Christian

*The Role of Volatility Shocks and Rare Events in Long-Run Risk Models*

*Discussant: Rieger, Marc Oliver*

**Eraker, Bjorn**

Wang, Wenyu

*Dynamic Present Values and the Intertemporal CAPM*

*Discussant: Halling, Michael*

**Halling, Michael**

Cremers, Martijn  
Weinbaum, David

*In Search of Aggregate Jump and Volatility Risk in the Cross-Section of Stock Returns*

*Discussant: Branger, Nicole*

Thursday, 11:00 a.m. – 1:00 p.m.

## Asset Pricing II

### Chair: Schlag, Christian

**Jank, Stephan**

Grammig, Joachim

*Creative Destruction and Asset Prices*

*Discussant: Faias, José*

**Buchner, Axel**

*New Insights on Asset Pricing and Illiquidity*

*Discussant: Schlag, Christian*

**Faias, José**

Ferreira, Miguel

Matos, Pedro

Santa-Clara, Pedro

*Does Institutional Ownership Matter for International Stock Return Comovement?*

*Discussant: Buchner, Axel*

Thursday, 2:30 p.m. – 4:00 p.m.

## Portfolio Selection

### Chair: Franke, Günter

**Rieger, Marc**

Ley, Patrick

Oliver Wagner,

Alexander

*Asset Allocation of Defined-benefit Pension Plans in the Absence of Agency Conflicts*

*Discussant: Korn, Olaf*

**Franke, Günter**

Schlesinger, Harris

Stapleton, Richard

*Risk-Taking-Neutral Background Risk*

*Discussant: Brandtner, Mario*

**Brandtner, Mario**

*On the (Mis)Use of Conditional Value-at-Risk and Spectral Risk Measures for Portfolio Selection – a Comparison with Mean-Variance-Analysis*

*Discussant: Peter, Richard*

Thursday, 4:30 p.m. – 6:00 p.m.

## Sessions

---

### Delegated Portfolio Management & Mutual Funds

---

**Chair: De Bondt, Werner F.M.**

**De Bondt, Werner**  
Xu, Wei

*The Expertise of Mutual Fund Managers*  
*Discussant: Mählmann, Thomas*

**Halling, Michael**  
Cooper, Michael  
Lemmon, Michael

*Fee Dispersion and Persistence in the Mutual Fund Industry*  
*Discussant: Jank, Stephan*

**Mählmann, Thomas**

*Equity Friendly or Noteholder Friendly? The Role of Collateral Asset Managers in the Collapse of the Market for ABS-CDOs*  
*Discussant: Daske, Holger*

Friday, 9:00 a.m. – 10:30 a.m.

### Commodity & Energy Finance

---

**Chair: Davison, Matt**

**Biegler-König, Richard**  
Benth, Fred Espen  
Kiesel, Rüdiger

*An Empirical Study of the Information Premium on Electricity Markets*  
*Discussant: Stoll, Sven-Olaf*

**Davison, Matt**  
Mnif, Walid

*What Can We Learn from the EU ETS Experience?*  
*Recommendations for Effective Trading and Market Design.*  
*Discussant: Kiesel, Rüdiger*

**Borovkova, Svetlana**

*News Analytics for Energy Futures*  
*Discussant: Davison, Matt*

Friday, 1:15 p.m. – 2:45 p.m.



## Track 3

Location: Bldg. 20.14, R103.1

### Math. Issues in Banking & Insurance

#### Chair: Madan, Dilip B.

##### Madan, Dilip B.

*Capital Adequacy of Financial Enterprises*

*Discussant: Franke, Günter*

##### Artzner, Philippe

Eisele, Karl-Theodor

*Multiperiod Top-down Models for Banking Supervision*

*Discussant: Madan, Dilip B.*

##### Schwenkler, Gustavo

Giesecke, Kay

Azizpour, Shahriar

*Exploring the Sources of Default Clustering*

*Discussant: Becker, Christoph*

##### Becker, Christoph

Schmidt, Wolfgang M.

*Stressed Correlations and Volatilities – How to Fulfill*

*Requirements of the Basel Committee*

*Discussant: Schwenkler, Gustavo*

Thursday, 11:00 a.m. – 1:00 p.m.

### Insurance and Information

#### Chair: Stenbacka, Rune

##### Aarbu, Karl Ove

*Asymmetric Information in the Home Insurance Market*

*Discussant: Berg, Tobias*

##### Peter, Richard

Hofmann, Annette

*Safe Today or Sorry Tomorrow? The Impact of Time-Structure on Optimal Loss Prevention*

*Discussant: Aarbu, Karl Ove*

##### Stenbacka, Rune

Jansen, Jos

*Information Exchange in the Insurance Industry: A Procompetitive or Anticompetitive Device?*

*Discussant: Hirth, Stefan*

Thursday, 2:30 p.m. – 4:00 p.m.

## Sessions

---

### Annuities

---

**Chair: Bauer, Daniel****Schneider, Judith**

Mahayni, Antje

*Variable Annuities and the Option to seek Risk: Why Should You Diversify?*

*Discussant: Moenig, Thorsten*

**Moenig, Thorsten**

Bauer, Daniel

*Revisiting the Risk-Neutral Approach to Optimal Policyholder Behavior: A Study of Withdrawal Guarantees in Variable Annuities*

*Discussant: Kraut, Gunther Arno*

**Kraut, Gunther Arno**

Knoller, Christian

Schoenmaekers, Pascal

*On the Propensity to Surrender a Variable Annuity Contract*

*Discussant: Schneider, Judith*

Thursday, 4:30 p.m. – 6:00 p.m.

### Contemporary Issues in Insurance

---

**Chair: Schiller, Jörg****Börger, Matthias**

Aleksic, Marie-Christine

*Coherent Projections of Age, Period, and Cohort Dependent Mortality Improvements*

*Discussant: Wesker, Hannah*

**Graf, Stefan**

Kling, Alexander

Ruß, Jochen

*Financial Planning and Risk-return Profiles*

*Discussant: Schiller, Jörg*

**Schiller, Jörg**

Lammers, Frauke

*Contract Design and Insurance Fraud: an Experimental Investigation*

*Discussant: Gründl, Helmut*

Friday, 9:00 a.m. – 10:30 a.m.

## Insurance & Risk Management

### Chair: Gründl, Helmut

**Körbitz, Paul**  
Löffler, Gunter

*Risk Management of Implicit Options in Life Insurance Contracts under Estimation Uncertainty*  
*Discussant: Gatzert, Nadine*

**Gatzert, Nadine**  
Wesker, Hannah

*Mortality Risk and its Effect on Shortfall and Risk Management in Life Insurance*  
*Discussant: Bauer, Daniel*

**Gründl, Helmut**  
Schade, Christian  
Zimmer, Anja

*Price-Default Risk-Demand-Curves and the Optimal Corporate Risk Strategy of Insurers: A Behavioral Approach*  
*Discussant: Körbitz, Paul*

Friday, 1:15 p.m. – 2:45 p.m.

## Track 4

Location: Bldg. 20.13, R111

## Governance

### Chair: Guedhami, Omrane

**Guedhami, Omrane**  
Attig, Najah  
Cleary, Sean  
El Ghoul, Sadok

*Institutional Investment Horizon, Corporate Governance, and the Cost of Equity Capital*  
*Discussant: Walther, Tobias*

**Raaballe, Johannes**  
Bechmann, Ken L.

*Bad Corporate Governance: When Incentive-Based Compensation Identifies Dangerous CEOs*  
*Discussant: Schneider, Christoph*

**Andres, Christian**  
Fernau, Erik  
Theissen, Erik

*Is it Better to Say Goodbye? When (Former) Executives Set Executive Pay*  
*Discussant: Guedhami, Omrane*

**Tykvova, Tereza**  
Bertoni, Fabio

*Which Form of Venture Capital is Best-suited for Innovation?*  
*Discussant: Strych, Jan-Oliver*

Thursday, 11:00 a.m. – 1:00 p.m.

## Sessions

---

### Focus Session: Minimum Variance Portfolio (together with Quoniam Asset Management GmbH)

---

**Chair: Göppl, Hermann**

**Korn, Olaf**

Kempf, Alexander

Saßning, Sven

*An academic's view*

*A Fully Implied Approach to Find the Global Minimum Variance Portfolio*

**Kieselstein, Thomas**

*Quoniam*

*A practitioner's view*

*Comparing Alternative Beta Equity Strategies*

Thursday, 2:30 p.m. – 4:00 p.m.

### Government and Corporate Finance

---

**Chair: Andres, Christian**

**Saffar, Walid**

Boubakri, Narjess

Cosset, Jean-Claude

*Corporate Risk-Taking in Privatized Firms: International Evidence on the Role of State and Foreign Owners*

*Discussant: Tykvova, Tereza*

**Amore, Mario Daniele**

Bennedsen, Morten

*Political Reforms and the Causal Impact of Blood-Related Politicians on Corporate Performance*

*Discussant: Saffar, Walid*

**Haselmann, Rainer**

Hackbarth, Dirk

Schoenherr, David

*Default Risk, Stock Returns and the Bankruptcy Reform Act of 1978*

*Discussant: Andres, Christian*

Thursday, 4:30 p.m. – 6:00 p.m.



## Debt Financing

### Chair: Norden, Lars

#### Norden, Lars

Silva Buston, Consuelo  
Wagner, Wolf

*Banks' Use of Credit Derivatives and the Pricing of Loans: What Is the Channel and Does It Persist Under Adverse Economic Conditions?*

*Discussant: Düllmann, Klaus*

#### Limbach, Peter

Andres, Christian  
Betzer, André

*Certification and Reputation Milking: Comprehensive Evidence from Corporate Bonds*

*Discussant: Norden, Lars*

#### Hirth, Stefan

*The Credit Ratings Game - revisited*

*Discussant: Thabe, Tim*

Friday, 9:00 a.m. – 10:30 a.m.

## Empirical Corporate Finance

### Chair: Betzer, André

#### Rapp, Marc Steffen

Hüttenbrink, Alexander  
Wolff, Michael

*Does Institutional Environment matter in Executive Compensation? A Multinational Analysis*

*Discussant: Raaballe, Johannes*

#### Haller, Rebekka

Bessler, Wolfgang  
Drobetz, Wolfgang  
Meier, Iwan

*Financial Constraints and the International Zero-Leverage Phenomenon*

*Discussant: Hofbaur, Ulrich*

#### Schneider, Christoph

Spalt, Oliver

*Acquisitions as Lotteries: Do Managerial Gambling Attitudes Influence Takeover Decisions?*

*Discussant: Drobetz, Wolfgang*

Friday, 1:15 p.m. – 2:45 p.m.

## Sessions

---

### Track 5

Location: Bldg. 20.13, R109

#### Retail Investments

---

**Chair: Höchstötter, Markus****Post, Thomas**

Hoffmann, Arvid O. I.

Pennings, Joost M. E

*How Severe Was the Impact of the Financial Crisis on Individual Investor Perceptions and Behavior?*

*Discussant: Schmid, Markus*

**Schmid, Markus**

Hoechle, Daniel

Zimmermann, Heinz

*A Generalization of the Calendar Time Portfolio Approach and the Performance of Private Investors*

*Discussant: Höchstötter, Markus*

**Fecht, Falko**

Karabulut, Yigitcan

Hackethal, Andreas

*Is Proprietary Trading Detrimental to Retail Investors?*

*Discussant: Post, Thomas*

Thursday, 11:00 a.m. – 12:30 p.m.

#### News

---

**Chair: Dzielinski, Michal****Dzielinski, Michal**

*When Does Company Specific News Matter? Determinants of News-related Stock Returns.*

*Discussant: Graf, Ferdinand*

**Frey, Roman**

Manuel Ammann

Verhofen, Michael

*Do Newspaper Articles Predict Aggregate Stock Returns?*

*Discussant: Dzielinski, Michal*

**Graf, Ferdinand**

*Mechanically Extracted Company Signals and their Impact on Stock and Credit Markets*

*Discussant: Frey, Roman*

Thursday, 2:30 p.m. – 4:00 p.m.

## Institutional Trading

### Chair: Scholz, Hendrik

**Scholz, Hendrik**  
Krimm, Sebastian  
Wilkins, Marco

*Selection, Timing and Total Performance of Equity Funds:  
Wasting Time Measuring Timing  
Discussant: Porras Prado, Melissa*

**Vasios, Michalis**  
Nolte, Ingmar  
Payne, Richard

*The Economic Value of Market Transparency and the  
Determinants of the Information Content of Order Flow: An Asset  
Allocation Perspective  
Discussant: Scholz, Hendrik*

**Porras Prado, Melissa**

*The Price of Prospective Lending: Evidence from Short Sale  
Constraints  
Discussant: Vasios, Michalis*

Thursday, 4:30 p.m. – 6:00 p.m.

## Market Microstructure

### Chair: Lüdecke, Torsten

**Wagener, Martin**  
Storckenmaier, Andreas

*Do we Need a European "National Market System"? Competition,  
Arbitrage, and Suboptimal Executions  
Discussant: Colliard, Jean-Edouard*

**Colliard, Jean-Edouard**  
Foucault, Thierry

*Trading Fees and Efficiency in Limit Order Markets  
Discussant: Sojli, Elvira*

**Sojli, Elvira**  
Skjeltorp, Johannes A.  
Tham, Wing Wah

*Sunshine Trading: Flashes of Trading Intent at the NASDAQ  
Discussant: Wagener, Martin*

Friday, 9:00 a.m. – 10:30 a.m.

# Sessions

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## Empirical Finance

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### Chair: Bestelmeyer, Georg

**Fricke, Christoph**

*Expected and Unexpected Bond Excess Returns: Macroeconomic and Market Microstructure Effects*

*Discussant: Bestelmeyer, Georg*

**Bestelmeyer, Georg**

Dicke, Kristian

Hess, Dieter

*Implied Risk Premium and the Business Cycle: You Can't Always Get What You Want*

*Discussant: Kinateder, Harald*

**Kinateder, Harald**

Wagner, Niklas

*Market Risk Prediction Under Long Memory: When VaR is Higher than Expected*

*Discussant: Fricke, Christoph*

Friday, 1:15 p.m. – 2:45 p.m.

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**Thursday, December 15, 2011**

**10:30 am - 01:00 pm**

**Economics of Banking**

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**Competition, Efficiency, and Soundness in Banking: An industrial Organization Perspective**

**Schaeck, Klaus (1); Cihak, Martin (2)**

*1: University of Wales Bangor, United Kingdom; 2: The World Bank*

Discussant: Antonio Scalia

*Time & Location: Thursday, 11:00 a.m. - Bldg. 20.13, R006*

The recent financial crisis has drawn renewed attention to the effect of competition on bank soundness. Using two complementary samples for European banking systems and for rural markets in the U.S., and exploiting a new measure of competition that captures the reallocation of profits from inefficient banks to efficient ones [Boone, J., A new way to measure competition, *EconJnl*, Vol. 118, pp. 1245-1261], we ask how competition can enhance soundness. We first illustrate that the new competition indicator captures a variety of other characteristics of competition. Second, we present novel evidence that efficiency is the conduit through which competition contributes to soundness. Third, examining heterogeneous responses to competition, we show that smaller banks' soundness measures respond more strongly to competition than larger banks, and the soundness-enhancing effect of competition is greater in magnitude for sound banks than for fragile ones. We highlight implications for regulatory responses to the financial crisis.

### **Fair Value Accounting and the Business Model of Banks**

**Daske, Holger (1);** Gebhardt, Günther (2); Bischof, Jannis (1)

*1: University of Mannheim, Germany; 2: Goethe-University Frankfurt, Germany*

Discussant: Benedikt Ruprecht

*Time & Location: Thursday, 11:30 a.m. - Bldg. 20.13, R006*

Bank lobbyists and regulators frequently argue that fair value measurement inadequately mirrors a ‘banking book’ business model aimed at originating and holding financial instruments. As an outcome of this political position, existing and currently proposed accounting rules for financial instruments can be characterized as an option-based mixed measurement model. Using a comprehensive global sample of IFRS reporting banks, we study the reporting practice and consequences for capturing banks’ risk-taking under this accounting regime. First, we find that operating characteristics (e.g. trading vs. banking book business) and the risk exposures of banks are only weakly related. Second, we show that the current application of fair value measurement is primarily determined by a bank’s operating business model and reporting incentives, but not by its risk-taking. Third, we document the risk-relevance of individual components of mixed measurement income. While comprehensive fair value income from trading book activities is significantly associated with stock returns, an equivalent association can only be observed for those portions of banking book income which are (voluntarily) measured at fair value. Overall, our findings suggest that risk exposure of banks operating under a ‘banking book’ business model can be severe and that such risk-taking is more adequately reflected by fair value accounting than by amortized cost accounting.



**Ranking, Risk-taking and Effort: An Analysis of the ECB's Foreign Reserves Management****Scalia, Antonio (1); Sahel, Benjamin (2)***1: Banca d'Italia, Italy; 2: European Central Bank, Germany*

Discussant: Rainer Haselmann

*Time & Location: Thursday, 12:00 a.m. - Bldg. 20.13, R006*

The investment of the ECB reserves in US dollars and yen, delegated to a network of portfolio managers in the Eurosystem's national central banks, involves a periodic assessment of performance against a common benchmark, controlled by the ECB and subject to revision on a monthly basis. Monetary reward for the best performers is almost entirely absent, and compensation comes mainly as reputational credit following the transmission of the annual report to the Governing Council. Employing a new data set on individual portfolio variables during 2002-2009, we study this peculiar tournament and show the existence of risk-shifting behaviour by reserve managers related to their year-to-date ranking: interim losers increase relative risk in the second half of the year, in the same way as mutual fund managers. In the dollar case, risk-shifting is asymmetric: the adjustment to ranking is generally reduced or entirely offset if reserve managers have achieved a positive interim performance against the benchmark. Yen reserve managers that rank low show a tendency to increase effort, as proxied by portfolio turnover. We also find that reserve managers who ranked low in the previous year tend to reduce risk significantly. Our evidence is consistent with a reserve managers' anecdote, according to which they obtain a concave reputational reward within their national central banks, which induces risk aversion and explains the observed low usage of the risk budget. Since reserve managers should have a comparative advantage over the tactical benchmark within a monthly horizon, possible enhancements to the design of the tournament are discussed. These might involve an increased reward for effort and performance by means of a convex scoring system linked to monthly, rather than annual, performance.

### **Determinants of Bank Interest Margins: Impact of Maturity Transformation**

**Ruprecht, Benedikt (1);** Entrop, Oliver (2); Memmel, Christoph (3); Wilkens, Marco (1)

*1: University of Augsburg, Germany; 2: University of Passau, Germany; 3: Deutsche Bundesbank, Germany*

Discussant: Stephan Vorgrimler

*Time & Location: Thursday, 12:30 p.m. - Bldg. 20.13, R006*

This paper explores the extent to which interest and credit risk premia are priced in bank margins. Our contribution to the literature is twofold: First, we present an extended model of Ho and Saunders (1981) that explicitly captures interest rate risk from maturity transformation. Banks price interest risk premia according to their individual exposure separately in loan and deposit rates. Second, using a comprehensive dataset covering the German universal banks between 2000 and 2009, we test the model-implied hypotheses not only for the commonly investigated net interest income, but additionally for interest income and expenses, separately. Controlling income and expenses for characteristics of the bank portfolios and their maturities, we find macroeconomic interest risk drivers, in general, to significantly impact margins of all banks. Microeconomic on-balance interest risk exposure, however, only affects the smaller savings and cooperative banks, but not private commercial banks.

## Asset Pricing I

**Preference Heterogeneity and Survival in Long-Run Risk Models****Dumitrescu, Ioana (1);** Branger, Nicole (2); Ivanova, Vesela (1); Schlag, Christian (1)

1: Goethe University Frankfurt, Germany; 2: University of Muenster, Germany

Discussant: Bjorn Eraker

*Time & Location: Thursday, 11:00 a.m. - Bldg. 20.14, R103.2*

We analyze an economy with two heterogeneous EZ investors, where consumption growth contains a stochastic long-run risk component. We focus on how the investors share risk and under what conditions both investors can survive in the long run. Risk sharing in consumption is driven by differences in risk aversion, while positions in long-run growth risk depend on the differences in the preferences for the early resolution of uncertainty. A small investor can survive by either saving or speculating his way out of extinction, i.e. by saving more or by investing into a riskier portfolio with a higher expected rate of return. The first strategy is followed by an investor with a high EIS, while the second is favorable for an investor with a low risk aversion combined with a low preference for early resolution of uncertainty. Our main result here is that the area of preference parameter combinations for which both investors survive is much larger in the case with a state variable than without.

### **The Role of Volatility Shocks and Rare Events in Long-Run Risk Models**

**Branger, Nicole (1);** Rodrigues, Paulo (2); Schlag, Christian (3)

*1: University of Muenster, Germany; 2: Maastricht University, Netherlands; 3: Goethe University Frankfurt, Germany*

Discussant: Marc Oliver Rieger

*Time & Location: Thursday, 11:30 a.m. - Bldg. 20.14, R103.2*

We generalize and extend the long-run risk model by Drechsler and Yaron (2010) by separating the processes for the jump intensity and the stochastic conditional variance. Furthermore we replace their Ornstein-Uhlenbeck specification for the long-run mean of the conditional variance by a square-root process. Although these two modifications seem mainly technical at first sight they have major economic implications and change fundamental characteristics of the model. First they substantially improve the performance of the model in predictive regressions of future excess returns on the current price-dividend ratio and lead to an equity risk premium which is increasing not only with short-run but also with long-run uncertainty. Second, the decoupling of jump intensity and conditional variance permits a detailed analysis which of the effects first shown by Drechsler and Yaron (2010) are due to the role of the conditional variance as a diffusive factor and which are caused by its second job, namely to control the likelihood of jumps. We find that for most effects generated by the model time-variation in the jump intensity is much more important than diffusive volatility risk.

**Dynamic Present Values and the Intertemporal CAPM****Eraker, Bjorn; Wang, Wenyu***University of Wisconsin, United States of America*

Discussant: Michael Halling

*Time & Location: Thursday, 12:00 a.m. - Bldg. 20.14, R103.2*

We show that the intertemporal CAPM can be consistent with dynamic present value computations only if future cash flows are exogenously assumed to be proportional to systematic risk. We argue that most empirical studies of the ICAPM, in continuous and discrete time, inadvertently makes this strong assumption. We study a general model in which we relax the implicit correlation assumption. In this model both aggregate cash flow shocks and systematic risk shocks are priced. Our model is a traditional wealth based dynamic CAPM without intermediate consumption and dividends. An essential feature of the model is that prices respond endogenously to shocks in systematic risks such as market volatility shocks. Unlike other present value models, prices in our general equilibrium framework obtain without numerical approximations.

### **In Search of Aggregate Jump and Volatility Risk in the Cross-Section of Stock Returns**

**Halling, Michael (1);** Cremers, Martijn (2); Weinbaum, David (3)

*1: University of Utah, United States of America; 2: Yale University, United States of America;*

*3: Syracuse University, United States of America*

Discussant: Nicole Branger

*Time & Location: Thursday, 12:30 p.m. - Bldg. 20.14, R103.2*

We introduce measures of volatility and jump risk constructed from S&P index options to examine the pricing of aggregate jump and volatility risk in the cross-section of stock returns. Using straddle returns to proxy for volatility risk, we find strong evidence that aggregate stock market volatility is a priced risk factor. The results are much weaker when volatility risk is measured using the VIX index. We also find evidence that aggregate jump risk is a priced risk factor. However, jump risk appears to be economically less important and statistically less significant than volatility risk. Therefore, the relatively small cross-sectional effect of jump risk stands in contrast to the large effect of aggregate jump risk on aggregate market returns that has been established in the literature. These results are robust to other cross-sectional determinants of returns.

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**Math. Issues in Banking & Insurance**

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**Capital Adequacy of Financial Enterprises****Madan, Dilip B.***University of Maryland, United States of America*

Discussant: Günter Franke

*Time & Location: Thursday, 11:00 a.m. - Bldg. 20.14, R103.1*

Financial entities commonly go bankrupt with disastrous consequences for individuals and society. These consequences arise since a bankrupt limited liability company is not responsible for losses exceeding its financial resources. Such losses are carried by unsecured creditors or, in the case of insurance companies, policy holders. Hence each limited liability entity holds an option to put losses in excess of its financial resources to other parts of the economy. Governments may cover losses, in which case the option is often called the "taxpayer put." Business with random assets and liabilities, such as banks, insurance companies and hedge funds, are typically required to hold capital to decrease the probability of bankruptcy and make businesses acceptable to the external economy. In this paper these businesses are viewed as operating in markets with the law of two prices with sales occurring at bid prices and purchases at ask prices. The structure of bid and ask prices defines the market environment. Given the business and its regulatory and market environment, expressions are developed for the rest of the balance sheet. This includes the value of equity, the value of the implicit put option, exact expressions for the capital adequacy ratios that correct both the numerator employed in the Basel accords along with a theoretically precise formulation of the denominator or the equivalent of risk weighted assets. Computations are illustrated for two balance sheets. One with lognormally distributed and correlated assets and liabilities and the second for a business of risky loans financed by writing options on a related underlier.

### **Multiperiod Top-down Models for Banking Supervision**

**Artzner, Philippe;** Eisele, Karl-Theodor

*University of Strasbourg, France*

Discussant: Dilip B. Madan

*Time & Location: Thursday, 11:30 a.m. - Bldg. 20.14, R103.1*

The present paper gives a quantitative approach to the supervision of commercial banks. It is based firstly on the three processes of the banks liquid asset value, the deposit amount and the market consistent evaluation of the loan repayments. Secondly, the approach uses a multiperiod risk assessment supposed not to allow supervisory arbitrage.

By these tools, the supervisory deposit line, i.e. the maximum allowed value of deposits, the process of optimal replicating trading risk exposures as well as the notions of the risk margin and of the equity capital requirement are quantified by their natural definitions.



**Exploring the Sources of Default Clustering****Schwenkler, Gustavo (1);** Giesecke, Kay (1); Azizpour, Shahriar (2)*1: Stanford University, United States of America; 2: Credit Suisse, United States of America*

Discussant: Christoph Becker

*Time & Location: Thursday, 12:00 a.m. - Bldg. 20.14, R103.1*

We develop filtered maximum likelihood estimators and goodness-of-fit tests for event timing models in which the arrival intensity is influenced by past events and time-varying explanatory covariates, some of which cannot be measured. Applying these tools to default events of US firms between 1970 and 2010, we find that the response of the intensity to defaults is economically and statistically significant, after controlling for the influence of the macro-economic covariates that prior studies have identified as predictors of US defaults, and for the role of an unobservable frailty risk factor whose importance for US default timing was recently established. Both frailty and contagion, by which the default by one firm has a direct impact on the health of other firms, are significant sources of default clustering, over and above any correlation caused by firms' joint exposure to observable risk factors.

### **Stressed Correlations and Volatilities – How to Fulfill Requirements of the Basel Committee**

**Becker, Christoph;** Schmidt, Wolfgang M.

*Frankfurt School of Finance & Management, Germany*

Discussant: Gustavo Schwenkler

*Time & Location: Thursday, 12:30 p.m. - Bldg. 20.14, R103.1*

We propose a new approach to the definition of stress scenarios for volatilities and correlations which fulfills the requirements of the Basel Committee on Banking Supervision for the quantification of market risk. Correlations and volatilities are functions of one and the same market factor, which is the key to stressing them in a consistent and intuitive way. Our approach is based on a new asset price model where correlations and volatilities depend on the current state of the market. The state of the market captures marketwide movements in equity-prices and thereby fulfills minimum requirements for risk factors stated by the Basel Committee. For sample portfolios we compare correlations and volatilities in a normal market and under stress and explore consequences for value-at-risk. Stressed value-at-risk exceeds the standard value-at-risk by a factor of 3 to 4, confirming estimates from the Basel Committee. We finally compare our modeling approach with multivariate GARCH models. For all data analyzed our model proved to be superior in capturing the dynamics of volatilities and correlations.

## Governance

**Institutional Investment Horizon, Corporate Governance, and the Cost of Equity Capital****Guedhami, Omrane (1);** Attig, Najah (2); Cleary, Sean (3); El Ghouli, Sadok (4)*1: University of South Carolina, United States of America; 2: Saint Mary's University, United Kingdom; 3: Queen's University, Canada; 4: University of Alberta, Canada*

Discussant: Tobias Walther

*Time & Location: Thursday, 11:00 a.m. - Bldg. 20.13, R111*

This paper studies the impact of firms' investment horizon on the governance role of institutional investors evident in firms' equity financing costs. We hypothesize that the predilection of institutions with a long-term investment horizon toward exerting monitoring effort is different from that of institutions with a short-term investment horizon. Our results show that long-term institutional investors are associated with a lower cost of equity than short-term institutional investors, supporting a more valuable governance role of the former. These findings are robust to alternative model specifications and alternative proxies for the variables of interest. Overall, our evidence suggests that when we think about monitoring by institutional investors, it is critical to account for institutional heterogeneity, which gives rise to new directions for future research.

### **Bad Corporate Governance: When Incentive-Based Compensation Identifies Dangerous CEOs**

**Raaballe, Johannes (1);** Bechmann, Ken L. (2);

*1: University of Aarhus, Denmark; 2: CBS, Denmark*

Discussant: Christoph Schneider

*Time & Location: Thursday, 11:30 a.m. - Bldg. 20.13, R111*

Inherited corporate governance characteristics largely determine the ownership structure in Danish banks. Bad characteristics, including severe restrictions on shareholder rights, are associated with dispersed ownership. Banks with dispersed ownership take more risk and perform much worse than banks with a large individual shareholder. CEOs in banks with dispersed ownership are powerful, but only half of the CEOs in the sample studied decided to extract rents using incentive-based compensation – and only these banks took more risks and performed much worse than other banks. Given that these banks took more risk already before the introduction of incentive-based compensation, the use thereof is found to be an indicator of unfortunate traits of the CEO, which cannot be identified by other observable characteristics of the CEO.

**Is it Better to Say Goodbye? When (Former) Executives Set Executive Pay****Andres, Christian (1);** Fernau, Erik (2); Theissen, Erik (2)*1: WHU - Otto Beisheim School of Management, Germany; 2: University of Mannheim, Germany*

Discussant: Omrane Guedhami

*Time & Location: Thursday, 12:00 a.m. - Bldg. 20.13, R111*

In the German two-tier system of corporate governance, it is a common practice for CEOs to become the chair of the supervisory board of the same company upon retirement. As members of the supervisory board they are involved in setting the pay for their successors as well as for their former colleagues. We analyze a panel covering 150 listed firms and the period 1998- 2007. We show that firms in which a former CEO serves as the chairman of the board of directors pay their executives significantly more. We find no difference in the compensation for the members of the supervisory board. Thus, former CEOs apparently exert their influence to increase the pay of their former colleagues and their successor, but not to increase their own pay.

### **Which Form of Venture Capital is Best-suited for Innovation?**

**Tykvova, Tereza (1);** Bertoni, Fabio (2)

1: ZEW Mannheim, Germany; 2: Politecnico di Milano, Italy

Discussant: Jan-Oliver Strych

*Time & Location: Thursday, 12:30 p.m. - Bldg. 20.13, R111*

While there seems to be consensus in the literature that venture capital investors increase the innovation output of their portfolio companies, there is little evidence about how investor type (governmental vs. private) and transaction structure (syndicated vs. nonsyndicated) moderate this impact. Using a sample of 865 young biotech and pharmaceutical companies from seven European countries, we investigate which form of venture capital is best-suited for innovation. Our results suggest that in companies financed by syndicates and by private venture capital investors the innovation output increases significantly faster than in non-venture backed companies. The best-suited form for innovation is an heterogeneous syndicate (i.e., consisting of both types of venture capital investors) led by a private investor.

## Retail Investments

### How Severe Was the Impact of the Financial Crisis on Individual Investor Perceptions and Behavior?

**Post, Thomas (1,2);** Hoffmann, Arvid O. I. (1,2); Pennings, Joost M. E (1,3)

*1: Maastricht University, The Netherlands; 2: Netspar; 3: University of Illinois at Urbana–Champaign, United States of America*

Discussant: Markus Schmid

*Time & Location: Thursday, 11:00 a.m. - Bldg. 20.13, R109*

Based on a unique combination of monthly survey data and matching trading records, we examine how individual investor perceptions change and drive trading and risk-taking behavior during the 2007–2009 financial crisis. Investor perceptions fluctuate significantly, with risk tolerance and risk perceptions being less volatile than return expectations. At the onset of the crisis, return expectations and risk tolerance sharply decline, while risk perceptions strongly increase. Towards the end of the crisis, these survey variables recover. We find substantial swings in trading and risk-taking behavior that are driven by changes in perceptions. As perceptions recover, trading and risk-taking behavior also return to pre-crisis levels. Although the crisis temporarily depresses individual investor perceptions and substantially changes their behavior, the impact of the crisis is not particularly long-lasting.

### **A Generalization of the Calendar Time Portfolio Approach and the Performance of Private Investors**

**Schmid, Markus (1);** Hoechle, Daniel (2); Zimmermann, Heinz (3)

*1: University of Mannheim, Germany; 2: University of Basel and Man Investments, Switzerland; 3: University of Basel, Switzerland*

Discussant: Markus Höchstötter

*Time & Location: Thursday, 11:30 a.m. - Bldg. 20.13, R109*

We present a new, regression-based methodology for decomposing the risk-adjusted performance of private investors, firms, and mutual funds. Our technique allows for the inclusion of multivariate and continuous subject characteristics in the analysis and it ensures that the statistical results are robust to cross-sectional and temporal dependence. Considering a unique dataset on 40,000 European private investors, we apply our methodology to reassess some of the most popular hypotheses on the performance of private investors. By testing the various hypotheses on a stand-alone basis, we are able to confirm the results of previous studies. However, when we apply our methodological framework to perform a joint test of the hypotheses, our results question several findings from previous research on private investor performance. More generally, our results indicate that (1) testing for a specific hypothesis separately and (2) erroneously ignoring cross-sectional dependence in microeconomic data can both lead to severely biased statistical results.



**Is Proprietary Trading Detrimental to Retail Investors?****Fecht, Falko (2);** Karabulut, Yigitcan (1); Hackethal, Andreas (1)*1: Goethe University Frankfurt, Germany; 2: European Business School, Germany*

Discussant: Thomas Post

*Time & Location: Thursday, 12:00 a.m. - Bldg. 20.13, R109*

We study the conflict of interests that might arise at universal banks between their proprietary trading and their retail banking. Using a unique data set that covers the stock investments of each German bank and of its respective retail customers on a security-by-security basis we study the return characteristics of those stocks that flow from a bank's proprietary portfolio into its respective customers' portfolio. Our results show that those stocks that are removed from banks' proprietary portfolio into the portfolio of their respective customers are lower performing than the average stock held in both banks and customers portfolios. This suggests that banks abuse their role in advising retail investors in order to dump low performing stocks.

## Abstracts

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**Thursday, December 15, 2011**

**02:30 pm - 04:00 pm**

### **Systemic Risk & Contagion**

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#### **Interbank Lending and the Spread of Bank Failures: A Network Model of Systemic Risk**

**Krause, Andreas;** Giansante, Simone

*University of Bath, United Kingdom*

Discussant: Alfred Lehar

*Time & Location: Thursday, 02:30 p.m. - Bldg. 20.13, R006*

We model a stylized banking system where banks are characterized by the amount of capital, cash reserves and their exposure to the interbank loan market as borrowers as well as lenders. A network of interbank lending is established that is used as a transmission mechanism for the failure of banks through the system. We trigger a potential banking crisis by exogenously failing a bank and investigating the spread of this failure within the banking system. We find the obvious result that the size of the bank initially failing is the dominant factor whether contagion occurs, but for the extent of its spread the characteristics of the network of interbank loans are most important. These results have implications for the regulation of banking systems that are briefly discussed, most notably that a reliance on balance sheet regulations is not sufficient but must be supplemented by considerations for the structure of financial linkages between banks.

### International Propagation of the Credit Crisis

**Cooper, Ian Anthony;** Brealey, Richard A.; Kaplanis, Evi

*London Business School, United Kingdom*

Discussant: Peter Raupach

*Time & Location: Thursday, 03:00 p.m. - Bldg. 20.13, R006*

In this study we examine the propagation of the recent crisis to banks outside the US. We develop a framework combining stock market and structural variables that can be used with both individual bank and country aggregate data. We find that the differential incidence of the crisis measured by share price impact is explained by prior correlation with the US banking sector, bank leverage and liability structure, the foreign assets of banks, and the importance of banking in the economy. We find that a simple measure of bank capital was a better predictor of crisis impact than the risk-weighted measure of Basel II, but do not find that banks were penalized for making aggressive use of Basel II rules. These results are robust to various specifications and whether we use country data or individual banks. Using this framework we test a number of hypotheses which have been put forward in other studies. We find that some results are sensitive to sample selection and test specification. We do not find evidence that the incidence of the crisis was associated with mortgage holdings, stock market returns prior to the crisis, or standards of governance. We do find that countries with higher prior GDP growth suffered less in the crisis. We discuss the implications of our results for bank regulation.

### **Robustness and Informativeness of Systemic Risk Measures**

**Raupach, Peter (1);** Löffler, Gunter (2)

1: Deutsche Bundesbank, Germany; 2: University of Ulm, Germany

Discussant: Natalie Packham

*Time & Location: Thursday, 03:30 p.m. - Bldg. 20.13, R006*

Recent literature has proposed new methods for measuring the systemic risk of financial institutions based on observed stock returns. In this paper we examine the reliability and robustness of such risk measures. Adding option positions to a portfolio that is linear in the market portfolio can easily create situations in which systemic risk is consistently misestimated. Protective put strategies that are immune against extreme shocks are judged to have high systemic risk because estimation methods rely on less extreme return realizations in which option premia depress returns relative to unprotected institutions. On the other hand, extreme tail risk can be masked by buying protection against less extreme events. The estimation problems are illustrated for portfolios with standard equity options but they carry over to credit risk. This raises doubts about the informativeness of the proposed measures. In particular, a direct application to regulatory capital surcharges for systemic risk could create wrong incentives for banks.

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Asset Pricing II

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**Creative Destruction and Asset Prices****Jank, Stephan;** Grammig, Joachim*University of Tübingen, Germany*

Discussant: José Faias

*Time & Location: Thursday, 02:30 p.m. - Bldg. 20.14, R103.2*

This paper introduces Schumpeter's idea of creative destruction into asset pricing. The key point of our model is that small-value firms are more likely to be destroyed during technological revolutions, while large-growth firms provide a hedge against creative destruction risk. The expected return difference between assets with the highest and lowest exposure to creative destruction risk amounts to 8.6 percent annually. A model including market return and invention growth as priced factors accounts for a large portion of the cross-sectional variation of size and book-to-market sorted portfolios and successfully prices HML and SMB.

### **New Insights on Asset Pricing and Illiquidity**

**Buchner, Axel**

*Passau University, Germany*

Discussant: Christian Schlag

*Time & Location: Thursday, 03:00 p.m. - Bldg. 20.14, R103.2*

Many important asset classes are illiquid in the sense that they cannot be traded. When including such illiquid investments into a portfolio, portfolio decisions take on an important dimension of permanence or irreversibility. Using a continuous-time model, this paper shows that this irreversibility leads to portfolio proportions being stochastic variables over time as they can no longer be controlled by the investor. Stochastic portfolio proportions have major implications since they can change portfolio dynamics in a fundamental way. First, it is shown that stochastic proportions implied by illiquidity increase overall portfolio risk. Interestingly, this effect gets more pronounced when the return correlation between the illiquid and liquid asset is low, i.e., illiquidity costs of a portfolio, as measured by the increase in portfolio risk, are inversely related to the return correlation of the illiquid and liquid assets. Second, the paper illustrates that illiquidity also affects the choice of an optimal portfolio. Particularly, it is shown that a traditional mean-variance approach that assumes that portfolio proportions can be kept constant over time leads to biased results when applied to portfolios that consist of liquid and illiquid assets. Third, the paper extends the model to an equilibrium setting and derives a novel liquidity-adjusted CAPM. This valuation framework shows that stochastic portfolio proportions give rise to a new form of systematic risk. The additional premium investors require for this systematic risk could be regarded as a compensation for a form of liquidity risk.

**Does Institutional Ownership Matter for International Stock Return Comovement?****Faias, José (1);** Ferreira, Miguel (2); Matos, Pedro (3); Santa-Clara, Pedro (2)*1: Universidade Católica Portuguesa, Portugal; 2: NOVA - School of Business and Economics, Portugal; 3: University of Southern California, United States of America*

Discussant: Axel Buchner

*Time & Location: Thursday, 03:30 p.m. - Bldg. 20.14, R103.2*

There has been a long dispute about the relative importance of country versus industry diversification. We test the hypothesis that institutional ownership affects the relative importance of country and industry effects in explaining stock returns worldwide. We find that industry effects become relatively more important than country effects as more institutions hold a larger share of a firms shares. Additionally, industry effects dominate country effects among stocks in the top quartile of ownership by institutions, especially by foreign-based ones. Our findings show that cross-border portfolio affect return variation across national stock markets and international diversification.

# Abstracts

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## Insurance and Information

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### **Asymmetric Information in the Home Insurance Market**

**Aarbu, Karl Ove**

*Tryg Insurance / Norwegian School of Economics, Norway*

Discussant: Tobias Berg

*Time & Location: Thursday, 02:30 p.m. - Bldg. 20.14, R103.1*

In this paper I test for the presence of asymmetric information in the home insurance market. To this end I apply the so-called positive correlation test to a dataset containing about half million home insurance contracts gathered from a Norwegian insurer. I find evidence of asymmetric information, a result which is robust across different model specifications. Unlike earlier studies that address this issue I am in a position to control for unobserved heterogeneity in risk aversion and wealth/income effects through detailed administrative register information. It turns out, however, that this information almost has no impact on the results. The observed impact of asymmetric information may be due to adverse selection, moral hazard or a combination. I utilize an exogenous law reform that had an effect on the insurance price in this market. The test allows me to remove the adverse selection component for each policyholder by using a 2SLS fixed effect regression. The test indicates that the information asymmetry is a compound of these two explanations.



**Safe Today or Sorry Tomorrow? The Impact of Time-Structure on Optimal Loss Prevention****Peter, Richard (1); Hofmann, Annette (2)***1: Munich Risk and Insurance Center, Germany; 2: Institute for Risk and Insurance, Hamburg, Germany*

Discussant: Karl Ove Aarbu

*Time & Location: Thursday, 03:00 p.m. - Bldg. 20.14, R103.1*

Although loss prevention decisions have long been studied by economists, the overall focus is on static models. This is surprising given the fact that many prevention decisions are often undertaken as investments in future states. We study optimal prevention decisions in a two-period expected utility model. We show that given an intuitive assumption on the nature of intertemporal prevention, (1) weaker discounting in time implies more prevention both today and in the future, (2) a higher loss severity is associated with more prevention both today and in the future, (3) a higher period-1 wealth implies more prevention both today and in the future, and (4) prevention today and in the future are complements. Introducing insurance, we extend the prominent result by Ehrlich and Becker (1972) by showing that under intuitive assumptions on the nature of intertemporal prevention and the level of risk aversion, insurance and loss prevention tend to be substitutes.

### **Information Exchange in the Insurance Industry: A Procompetitive or Anticompetitive Device?**

**Stenbacka, Rune (1); Jansen, Jos (2)**

*1: Hanken School of Economics, Finland; 2: Max Planck Institute for Research on Collective Goods, Bonn, Germany*

Discussant: Stefan Hirth

*Time & Location: Thursday, 03:30 p.m. - Bldg. 20.14, R103.1*

We analyze the effects of information sharing between insurance companies regarding population risks on industry profits and consumer surplus. With endogenous investments in information acquisition the insurance companies have incentives to share information. Quid pro quo information sharing agreements are profitable regardless of whether information is exogenous or endogenous. However, information exchange introduces a distributional conflict between insurance companies and consumers, because information sharing hurts consumer welfare. Consequently, our model specifies plausible circumstances under which information sharing regarding population risk would have anti-competitive effects contrary to the purpose of the current European block exemption regulation applied to the insurance industry.

### Focus Session: Minimum Variance Portfolio (together with Quoniam Asset Management GmbH)

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#### **A Fully Implied Approach to Find the Global Minimum Variance Portfolio**

**Korn, Olaf (1);** Kempf, Alexander (2); Saßning, Sven (1)

*1: Georg-August-Universität Göttingen, Germany; 2: University of Cologne, Germany*

*Time & Location: Thursday, 02:30 p.m. - Bldg. 20.13, R111*

In this paper we develop and test a new approach to find the global minimum variance portfolio from a set of risky assets. Different fully implied estimators of the return covariance matrix are derived that use exclusively forward looking information from a cross-section of option prices. An out-of-sample study for US blue-chip stocks highlights different properties of minimum variance strategies based on these implied estimators. The implied approach consistently outperforms several historical and passive benchmarks. This outperformance is very strong in "crises periods", whereas in "normal periods" all strategies lead to similar results. A superior performance can only be reached by a fully implied approach that uses both implied variances and implied correlations and not by a partially implied approach that combines implied moments with historical ones.

### **When Does Company Specific News Matter? Determinants of News-related Stock Returns.**

**Dzielinski, Michal**

*University of Zurich, Switzerland*

Discussant: Ferdinand Graf

*Time & Location: Thursday, 02:30 p.m. - Bldg. 20.13, R109*

Using a large database of company-specific newswire announcements I study the impact of various news characteristics on abnormal returns around news days. To capture the overall content of the news, the output of a sophisticated text-processing algorithm based on natural language processing is used. The first finding is that positive linguistic content ("news sentiment") predicts higher returns over a period of up to 10 days. Additionally, the impact of news sentiment increases when the news is split into several individual items, consistent with the greater informativeness and attention-grabbing capacity of such segmented stories. On the other hand, the impact of news sentiment is smaller for longer and less novel news, as well as news more specific to a single company. These results suggest that investors dislike the effort associated with processing longer text, recognize staleness in the news but still react to it and also prefer news with a broader scope. In the cross-section, news is more important for small stocks, growth stocks, stocks with low overall news volume and stocks with high analyst dispersion. News also seems to contribute to the momentum effect, with positive/negative news having stronger impact on stock with high/low past returns. However, the rapidly increasing overall news volume has caused the average piece of news to be less informative. Instead of drifting in the direction of the initial reaction, stock prices appear to reverse unless the news contains a strong quantitative component. This pattern can be best explained within the Barberis et al. (1998) framework, where investors overreact to news, which is more salient than it is informative and underreact to news where the balance is opposite.

### **Do Newspaper Articles Predict Aggregate Stock Returns?**

**Frey, Roman;** Ammann, Manuel; Verhofen, Michael

*University of St. Gallen, Switzerland*

Discussant: Michal Dzielinski

*Time & Location: Thursday, 03:00 p.m. - Bldg. 20.13, R109*

We analyze whether newspaper content can predict aggregate future stock returns. Our study is based on newspaper articles from July 1989 to March 2011 of the Handelsblatt, a leading German financial newspaper. We summarize newspaper content in a systematic way by constructing wordcount indices for a large number of words. Wordcount indices are instantly available and therefore potentially valuable financial indicators. Our main finding is that the predictive power has increased over time, in particular after 2000. We find that a cluster analysis approach increases the predictive power of newspaper articles substantially. Our analysis shows that newspaper content is a valuable predictor for future DAX returns in- and out-of-sample.

### **Mechanically Extracted Company Signals and their Impact on Stock and Credit Markets**

**Graf, Ferdinand**

*Universität Konstanz, Germany*

Discussant: Roman Frey

*Time & Location: Thursday, 03:30 p.m. - Bldg. 20.13, R109*

I analyze company news from Reuters with the 'General Inquirer' and relate measures of positive sentiment, negative sentiment and disagreement to abnormal stock returns, stock and option trading volume, the volatility spread and the CDS spread. I test hypotheses derived from market microstructure models. Consistent with these models, sentiment and disagreement are strongly related to trading volume. Moreover, sentiment and disagreement might be used to predict stock returns, trading volume and volatility. Trading strategies based on positive and negative sentiment are profitable if the transaction costs are moderate, indicating that stock markets are not fully efficient.

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Thursday, December 15, 2011

04:30 pm – 06:00 pm

Banking: Regulation

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**Capital Regulation, Liquidity Requirements and Taxation in a Dynamic Model of Banking**

**Gamba, Andrea (1);** De Nicolò, Gianni (2); Lucchetta, Marcella (3)

1: Warwick Business School, United Kingdom; 2: IMF, Research Department, Portugal; 3: European University Institute, Italy

Discussant: Falko Fecht

*Time & Location: Thursday, 04:30 p.m. - Bldg. 20.13, R006*

This paper formulates a dynamic model of a bank exposed to both credit and liquidity risk, which can resolve financial distress in three costly forms: fire sales, bond issuance and equity issuance. We use the model to analyze the impact of capital regulation, liquidity requirements and taxation on banks' optimal policies and metrics of efficiency of intermediation and social value. We obtain three main results. First, mild capital requirements increase bank lending, bank efficiency and social value relative to an unregulated bank, but these benefits turn into costs if capital requirements are too stringent. Second, liquidity requirements reduce bank lending, efficiency and social value significantly, they nullify the benefits of mild capital requirements, and their private and social costs increase monotonically with their stringency. Third, increases in corporate income and bank liabilities taxes reduce bank lending, bank efficiency and social value, with tax receipts increasing with the former but decreasing with the latter. Moreover, the effects of an increase in both forms of taxation are dampened if they are jointly implemented with increases in capital and liquidity requirements.

### **Competition, Bonuses, and Risk-taking in the Banking Industry**

**Packham, Natalie;** Bannier, Christina E.; Feess, Eberhard

*Frankfurt School of Finance & Management, Germany*

Discussant: Andrea Gamba

*Time & Location: Thursday, 05:00 p.m. - Bldg. 20.13, R006*

Remuneration systems in the banking industry, particularly bonus payments, have frequently been blamed for contributing to the build-up of risks leading to the recent financial crisis. In our model banks compete for managerial talent that is private information. Competition for talent sets incentives to offer bonuses inducing risk-taking that is excessive not only from society's perspective, but also from the viewpoint of the banks themselves. In fact, bonus payments and excessive risk-taking are increasing with competition. Thus, our model offers a rationale why bonuses are paid even when reducing the expected profits of banks. This confirms the impact of competitive pressures on the remuneration schemes as claimed by many industry representatives and assigns a positive role to legal restrictions on bonus payments.



**Does Contingent Capital Induce Excessive Risk-taking and Prevent an Efficient Recapitalization of Banks?****Berg, Tobias;** Kaserer, Christoph*Humboldt University of Berlin, Germany*

Discussant: Rune Stenbacka

*Time & Location: Thursday, 05:30 p.m. - Bldg. 20.13, R006*

Contingent capital instruments (CoCo-Bonds) currently receive much attention by regulators and academics as a mechanism to make the banking sector more resilient. In this paper we argue that CoCo-Bonds can have the opposite effect. The type of CoCo-Bonds that has been issued so far by Lloyds, Rabobank and Credit Suisse can potentially exacerbate future financial crises because these CoCo-Bonds magnify both the asset substitution as well as the debt overhang problem. This is driven by the fact that equity holders bear all of the losses up to a prespecified amount, while they can impose part of these losses on CoCo-Bond holders once losses exceed this amount. Losses which slightly exceed this amount are therefore more desirable for equity holders than losses which are slightly less than this amount.

This payoff profile induces two destabilizing effects: First, bank owners have an increased incentive for excessive risk-taking if the level of risk is non-contractible. Second, CoCo-Bonds might prevent private recapitalization for viable banks in the onset of future financial crises. Banks are therefore recapitalized too late thereby inducing or exacerbating a credit crunch. Finally, we show how a simple change in the conversion mechanism of these instruments will eliminate the debt overhang as well as the asset substitution problem.

### **Asset Allocation of Defined-benefit Pension Plans in the Absence of Agency Conflicts**

**Rieger, Marc (1);** Ley, Patrick (3); Oliver Wagner, Alexander (2)

*1: University of Trier, Germany; 2: University of Zurich, Switzerland; 3: University of St. Gallen, Switzerland*

Discussant: Olaf Korn

*Time & Location: Thursday, 04:30 p.m. - Bldg. 20.14, R103.2*

Choosing the asset allocation for a pension plan so that welfare of the sponsoring company is maximized poses a challenging intertemporal optimization problem that is also influenced by the regulatory framework a pension plan operates in. We analyze this optimization problem in the U.S. and in Switzerland, pointing to common features (in particular, the asymmetric implications of pension plan overfunding and underfunding for sponsor welfare) as well as to differences between the two countries. Even abstracting away from risk-shifting incentives, the optimal allocation to risky assets is generally predicted to be mostly negatively related to the funding ratio. In the U.S., however, at higher funding ratios, a positive relation becomes optimal. In both countries, the empirically observed relationships deviate significantly from the benchmark theoretical predictions. Thus, factors other than optimal allocation criteria may frequently influence the investment decisions.

**Risk-Taking-Neutral Background Risk****Franke, Günter (1);** Schlesinger, Harris (2); Stapleton, Richard (3)*1: University of Konstanz, Germany; 2: University of Alabama, United States of America; 3: University of Manchester, United Kingdom*

Discussant: Mario Brandtner

*Time & Location: Thursday, 05:00 p.m. - Bldg. 20.14, R103.2*

This paper examines how decision making under uncertainty is affected by the presence of a background risk. By background risk, we refer to a risk for which there is no market for trading or hedging. In particular, we construct a class of background risks that we label as risk-taking-neutral (RTN). These background risks have the property that they will not alter the choice decisions made with respect to another risk. As such, these RTN background risks can provide a benchmark. In many situations, a background risk that is faced by an investor can be compared to one from the RTN class in order to predict qualitative changes in the investor's choice decision. In particular, we illustrate our benchmarking with three examples with regards to portfolio choice: (1) effects of an independent zero-mean background risk, (2) effects of a flat-rate income tax and (3) effects of parameter uncertainty.

### **On the (Mis)Use Of Conditional Value-at-Risk And Spectral Risk Measures For Portfolio Selection – A Comparison With Mean-Variance-Analysis**

**Brandtner, Mario**

*Friedrich Schiller University of Jena, Germany*

Discussant: Richard Peter

*Time & Location: Thursday, 05:30 p.m. - Bldg. 20.14, R103.2*

We study portfolio selection using Conditional Value-at-Risk and, as its natural extension, spectral risk measures instead of the variance. We do not focus only on the derivation of efficient frontiers, but also consider the choice of optimal portfolios within an integrated framework. We find that spectral risk measures tend towards corner solutions. If a risk free asset exists, diversification is never optimal. Similarly, for risky assets we obtain only limited diversification. The reason is that spectral risk measures are based on a regulatory concept of diversification that differs fundamentally from the reward-risk tradeoff underlying the traditional mean-variance framework.

## Annuities

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### **Variable Annuities and the Option to seek Risk: Why Should You Diversify?**

**Schneider, Judith Christiane (1); Mahayni, Antje (2)**

*1: Universität Münster, Germany; 2: Universität Duisburg-Essen, Germany*

Discussant: Thorsten Moenig

*Time & Location: Thursday, 04:30 p.m. - Bldg. 20.14, R103.1*

We analyze the impacts of an additional rider which is incorporated in recent retirement planning products. The payoff of these products is linked to the performance of a multi asset investment strategy and includes a minimum interest rate guarantee on the contributions. In addition, the buyer receives the option to decide on the investments dynamically. Prominent examples are so called Variable Annuities, in particular guaranteed minimum accumulation benefits (GMABs). Due to the embedded guarantee, these products are interesting for risk averse investors who, in general, benefit from diversification. However, to stay on the safe side the price setting of the provider must take into account the most risky strategy. We show that this implies an incentive to invest more riskily than without the additional rider. Taking into account background risk, we quantify the trade-off between the utility of diversification and the utility of a more valuable guarantee. It turns out that a product design including the additional flexibility on the investment decisions causes significant utility losses.

### **Revisiting the Risk-Neutral Approach to Optimal Policyholder Behavior: A Study of Withdrawal Guarantees in Variable Annuities**

**Moenig, Thorsten;** Bauer, Daniel

*Georgia State University, United States of America*

Discussant: Gunther Arno Kraut

*Time & Location: Thursday, 05:00 p.m. - Bldg. 20.14, R103.1*

Policyholder exercise behavior presents an important risk factor for life insurance companies. Yet, most approaches presented in the academic literature – building on value maximizing strategies akin to the valuation of American options – do not square well with observed prices and exercise patterns. Following a recent strand of literature, in order to gain insights on what drives policyholder behavior, this paper develops a life-cycle model for variable annuities (VA) with withdrawal guarantees. However, in contrast to these earlier contributions, we explicitly allow for outside savings and investments, which considerably affects the results. Specifically, we find that withdrawal patterns after all are primarily motivated by value maximization – but with the important asterisk that the value maximization should be taken out from the policyholders’ perspective accounting for individual tax benefits. To this effect, we develop and apply a risk-neutral valuation methodology that takes these different tax structures into consideration. The results are in line with corresponding findings from the life cycle model as well as prevalent market rates for the considered withdrawal guarantee. Also, our findings endorse the application of simple reduced-form exercise rules based on the “moneyness” of the guarantee that are slowly being adopted in the insurance industry.

**On the Propensity to Surrender a Variable Annuity Contract****Kraut, Gunther Arno (1);** Knoller, Christian (1); Schoenmaekers, Pascal (2)*1: Ludwig-Maximilians-Universität München, Germany; 2: Munich Re, München, Germany*

Discussant: Judith Christiane Schneider

*Time & Location: Thursday, 05:30 p.m. - Bldg. 20.14, R103.1*

Policyholder exercise behavior presents an important risk factor for life insurance companies. Yet, most approaches presented in the academic literature – building on value maximizing strategies akin to the valuation of American options – do not square well with observed prices and exercise patterns. Following a recent strand of literature, in order to gain insights on what drives policyholder behavior, this paper develops a life-cycle model for variable annuities (VA) with withdrawal guarantees. However, in contrast to these earlier contributions, we explicitly allow for outside savings and investments, which considerably affects the results. Specifically, we find that withdrawal patterns after all are primarily motivated by value maximization – but with the important asterisk that the value maximization should be taken out from the policyholders’ perspective accounting for individual tax benefits. To this effect, we develop and apply a risk-neutral valuation methodology that takes these different tax structures into consideration. The results are in line with corresponding findings from the life cycle model as well as prevalent market rates for the considered withdrawal guarantee. Also, our findings endorse the application of simple reduced-form exercise rules based on the “moneyness” of the guarantee that are slowly being adopted in the insurance industry.

### **Corporate Risk-Taking in Privatized Firms: International Evidence on the Role of State and Foreign Owners**

**Saffar, Walid (1);** Boubakri, Narjess (2); Cosset, Jean-Claude (3)

*1: American University of Beirut, Lebanon; 2: American University of Sharjah, UAE; 3: HEC Montreal, Canada*

Discussant: Tereza Tykvova

*Time & Location: Thursday, 04:30 p.m. - Bldg. 20.13, R111*

Using a unique database of 190 newly privatized firms from 36 countries, we investigate the impact of shareholders' identity on corporate risk-taking behavior. We find strong and robust evidence that state (foreign) ownership is negatively (positively) related to corporate risk-taking. Moreover, we find that these relations depend on the level of government extraction. Our results suggest that relinquishment of government control, openness to foreign investment, and improvement of country-level governance institutions are key factors in the success of privatization reform.



### **Political Reforms and the Causal Impact of Blood-Related Politicians on Corporate Performance**

**Amore, Mario Daniele (1);** Bennedsen, Morten (2)

*1: Copenhagen Business School, Denmark; 2: INSEAD, France*

Discussant: Walid Saffar

*Time & Location: Thursday, 05:00 p.m. - Bldg. 20.13, R111*

Estimating the causal effect of political connections on corporate performance is challenging due to lack of appropriate counterfactuals. Applying difference in differences, matching and regression discontinuity techniques we use a reform that increased the size of a majority of municipalities in Denmark as exogenous variation to identify a positive causal impact of blood related politicians. Connections increase market share, are more valuable in service sectors and in outsourcing municipalities. Focusing on local connections in the world's least corrupt country, we conclude that political networking is a valuable business strategy even in settings where connections are expected to be least relevant.

### **Default Risk, Stock Returns and the Bankruptcy Reform Act of 1978**

**Haselmann, Rainer (1);** Hackbarth, Dirk (2); Schoenherr, David(1)

1: University of Bonn, Germany; 2: University of Illinois, United States of America

Discussant: Christian Andres

*Time & Location: Thursday, 05:30 p.m. - Bldg. 20.13, R111*

We use an important legal event as a natural experiment to examine the relation between default risk and stock returns. The 1978 Bankruptcy Reform Act materially changed the way in which financial distress affects stock returns given the introduction of Chapter 11 implied a substantial increase of shareholders' bargaining position in the restructuring process leading, e.g., to large and widely documented violations of the absolute priority rule. Based on the testable implications of a structural asset pricing model that links stock returns to default risk, we find evidence that investors valued these legal changes and rationally adjusted the pricing of default risk; that is, the reform (i) induces a significant reduction in portfolio-level and firm-level stock returns of distressed firms, (ii) weakens the influence of firm-level proxies of shareholder advantage on stock returns of distressed firms, and (iii) increases momentum profits for distressed firms.

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Institutional Trading

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**Selection, Timing and Total Performance of Equity Funds: Wasting Time  
Measuring Timing****Scholz, Hendrik (1);** Krimm, Sebastian (2); Wilkens, Marco (2)*1: University of Erlangen-Nuremberg, Germany; 2: University of Augsburg, Germany*

Discussant: Melissa Porras Prado

*Time & Location: Thursday, 04:30 p.m. - Bldg. 20.13, R109*

It is well known that timing activities can bias the Jensen alpha. However, whether this bias is economically or statistically significant has not yet been studied sufficiently. This is the first paper to theoretically and empirically analyze whether and how the capturing of timing activities influences mutual fund performance as measured by the Jensen, the Treynor-Mazuy and the Henriksson-Merton model. Our main findings are: i) The three models display factually identical total performance. ii) The timing performance measured by the Treynor-Mazuy model is linearly related to the timing performance measured by the Henriksson-Merton model. The same applies to selection performance. iii) Concerning timing activities, the Treynor-Mazuy and the Henriksson-Merton models most likely yield artificial results. Overall, the measurement of timing activities using ex-post fund returns does not reveal new information about fund managers' abilities.

### **The Economic Value of Market Transparency and the Determinants of the Information Content of Order Flow: An Asset Allocation Perspective**

**Vasios, Michalis (1); Nolte, Ingmar (1); Payne, Richard (2)**

*1: Warwick Business School, University of Warwick, United Kingdom; 2: Cass Business School, United Kingdom*

Discussant: Hendrik Scholz

*Time & Location: Thursday, 05:00 p.m. - Bldg. 20.13, R109*

A current debate in finance is about the transparency in financial markets and the disclosure of counterparty identity information. We use an asset allocation framework and economic criteria to assess the economic value of market transparency in Helsinki Stock Exchange. We show that a mean-variance investor can benefit remarkably from observing the disaggregated order flow information of an non-anonymous market, which suggests that market transparency yields positive economic value. Additionally, this finding shows that financial reforms can have asset allocation implications, thus, introducing a regulatory risk on investors' investment strategies. A second result is the substantial variation in the informational content of order flow at the broker firm level. We find that the order flow of large brokers is less informative than the order flow of small brokers, which is driven by the high dispersion of beliefs of large brokers' clients. Moreover, the order flow of brokers associated with momentum investment style is more informative, which can be explained by the evidence of higher stock-picking ability of momentum brokers.

**The Price of Prospective Lending: Evidence from Short Sale Constraints****Porras Prado, Melissa***RSM Erasmus University, The Netherlands*

Discussant: Michalis Vasios

*Time & Location: Thursday, 05:30 p.m. - Bldg. 20.13, R109*

Institutional investors can generate revenue by lending shares to short sellers. In this paper, I show that security prices incorporate expected future security lending profit. To determine whether institutional investors anticipate lending profits, I look at price behavior following a failure-to-deliver in the equity lending market. Failure-to-deliver represents situations in which it is difficult to locate securities available for borrowing, leading to high bargaining power for the lender and prospective increases in lending profits. I use closed-end funds to measure how failures influence deviations from intrinsic value. The results show that the prospect of future lending profits pushes the price of closed-end funds above its NAV. Closed-end funds with reported failures trade at a 2.63% premium with respect to their NAV. The results of this study imply that overpricing caused by the presence of short sale constraints is not solely due to the restriction of negative information but also partly a result of rational capitalized lending revenue.

## Abstracts

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**Friday, December 16, 2011**

**09:00 pm – 10:30 am**

### **Banking: Empirical**

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#### **Stress Testing German Banks Against a Global Credit Crunch**

**Düllmann, Klaus;** Kick, Thomas K.

*Deutsche Bundesbank, Germany*

Discussant: Andreas Krause

*Time & Location: Friday, 09:00 a.m. - Bldg. 20.13, R006*

This paper investigates the impact of a global credit crunch on the corporate credit portfolios of 24 large German banks by a two-stage approach: A macro-econometric model is used in the first step to forecast the impact of a global credit crunch on three particularly export-oriented industry sectors in Germany. By a model-based stress scenario we ensure a consistent quantification of the stress impact in these sectors. The impact of this economic multi-sector stress on banks' credit portfolios is then captured in the second step by a state-of-the-art CreditMetrics-type portfolio model with sector-dependant unobservable risk factors as drivers of the systematic risk. The German credit register provides us with access to highly granular risk information on loan volumes and banks' internal estimates of default probabilities which is key for an accurate assessment of the impact of the stress scenario. We find that the increase of the capital charge for the unexpected loss needs to be considered together with the increase in banks' expected losses in order to assess the change of banks' capital ratios. Furthermore, we confirm that granular information on the level of borrower-specific probabilities of default has a significant impact on the stress results.

**Bank Risk Taking and Liquidity Creation Following Regulatory Interventions and Capital Support****Kick, Thomas K. (1);** Berger, Allen (2); Bouwman, Christa (3); Schaeck, Klaus (4)*1: Deutsche Bundesbank, Germany; 2: University of South Carolina, United States of America; 3: Case Western Reserve, United States of America; 4: University of Wales Bangor, United Kingdom*

Discussant: Sascha Steffen

*Time & Location: Friday, 09:30 a.m. - Bldg. 20.13, R006*

When banks are troubled, authorities often engage in regulatory interventions and/or provide capital support to resuscitate the bank and reduce bank risk taking. An unintended effect of such actions may be a reduction in bank liquidity creation, with possible adverse consequences for the economy as a whole. This paper tests hypotheses regarding the effects of regulatory interventions and capital support on bank risk taking and liquidity creation using a unique dataset over the period 1999-2009. Our short-run analyses suggest that both types of actions are associated with statistically and economically significant reductions in risk taking and liquidity creation. These results are highly robust, and stand up to using an instrumental variable approach to deal with potential endogeneity. Our long-run analyses suggest that 1) there are no significant changes in risk taking and liquidity creation in the years preceding regulatory interventions and capital support, consistent with a causal interpretation of our results; 2) most of the effects occur shortly after these actions are taken; and 3) the effects remain in place in the long run. Thus, both types of actions may have important intended consequences (risk reduction) and unintended consequences (diminished liquidity creation), with implications for policymakers.

### **Government Guarantees and Bank Risk Taking Incentives**

**Steffen, Sascha (1);** Fischer, Markus Jens (2); Hainz, Christa (3); Rocholl, Jörg (4)

*1: University of Mannheim, Germany; 2: Goethe University Frankfurt, Germany; 3: ifo Institute for Economic Research, Germany; 4: ESMT European School of Management and Technology, Germany*

Discussant: Klaus Schaeck

*Time & Location: Friday, 10:00 a.m. - Bldg. 20.13, R006*

This paper analyzes the effect of government guarantees on bank risk taking incentives. We exploit a natural experiment in which regulators remove the state guarantee of German Landesbanken which results in a deterioration in their credit rating, a loss in their franchise value and subsequently higher funding costs. This removal was announced in July 2001 and became effective in 2005 so that Landesbanken are still allowed to issue state-guaranteed bonds during the four-year transition period. We analyze the lending behavior of Landesbanken around the announcement of the removal of the guarantees relative to non-protected private banks using a difference-in-difference framework. While Landesbanken do not differ from other banks in Germany in their lending practices before the removal of state guarantees, they significantly increase their bond issuances after 2001 to give loans to significantly riskier customers and at significantly lower rates afterwards. Furthermore, this trend is most pronounced for those Landesbanken with the largest decrease in expected ratings and franchise value. These results are consistent with banks starting to gamble in expectation of future loss of funding liquidity.



**Delegated Portfolio Management & Mutual Funds****The Expertise of Mutual Fund Managers****De Bondt, Werner F.M.; Xu, Wei***Driehaus Center for Behavioral Finance, DePaul University, United States of America*

Discussant: Thomas Mählmann

*Time & Location: Friday, 09:00 a.m. - Bldg. 20.14, R103.2*

U.S. mutual funds must present themselves as either “diversified” or “non-diversified.” Most funds are diversified funds. The managers of these funds are not allowed to allot more than five percent of fund assets to one stock. This ceiling bars concentrated bets. Managers of non-diversified funds do not face the same restriction, however. They see it as a natural part of their mandate to make aggressive bets. Hence, the distinction between the two types of funds is an opportunity to investigate the stock selection expertise of mutual fund managers. We study the period 1984-2009. A value-weighted return index of non-diversified funds produces an alpha of approximately 2 percent per year net of fees. The managers of non-diversified funds place large bets on stocks that do well over the next twelve months. The large bets are often associated with positive earnings news. Our study sheds light on the puzzle that many fund managers appear to possess valuable information, yet most actively managed mutual funds underperform their benchmarks. The study is also of interest to investors. Choosing an undiversified mutual fund may be a good way to profit from fund managers’ expertise at stock selection.

### **Fee Dispersion and Persistence in the Mutual Fund Industry**

**Halling, Michael;** Cooper, Michael; Lemmon, Michael

*University of Utah, United States of America*

Discussant: Stephan Jank

*Time & Location: Friday, 09:30 a.m. - Bldg. 20.14, R103.2*

In this paper, we present striking new evidence of systematic differences in prices across all US equity funds. We examine the residuals from regressions of fees (annual expenses and 12b-1 fees) on important fund characteristics, essentially allowing us to compare the fees of “identical” funds. We find that the average spread in residual fees across all funds over the sample is approximately 2.3%. The dispersion in fees has not decreased over time, despite the fact that significant numbers of new funds have entered and the aggregate amount of assets under management has increased substantially. An investor purchasing identical lower fee funds would have outperformed an investor purchasing higher fee funds by approximately 32% over our sample. We test a number of hypotheses to explain our results including a random fee, competition, strategic fee setting, and a service hypothesis, and are unable to explain the spreads in residual fees. Surprisingly, a main determinant of fees is the initial fee set by a fund, which varies little over time. Overall, our evidence is largely inconsistent with a competitive market for mutual funds.

### **Equity Friendly or Noteholder Friendly? The Role of Collateral Asset Managers in the Collapse of the Market for ABS-CDOs**

**Mählmann, Thomas**

Catholic University of Eichstaett-Ingolstadt, Germany

Discussant: Holger Daske

*Time & Location: Friday, 10:00 a.m. - Bldg. 20.14, R103.2*

This paper shows that ABS-CDOs (i.e., collateralized debt obligations backed by asset-backed securities) managed by large market share managers have higher ex post collateral default rates. The paper also finds that (1) large manager deals, while having higher realized default rates, do not carry more default risk ex ante (at origination), as measured by the deal fraction rated AAA or the size of the equity tranche, (2) ex post, these deals have higher percentages of home-equity loans, subprime RMBS and synthetic assets in their collateral pools, and larger asset-specific default rates and issuer concentration levels, (3) compared to smaller managers, Top10 market share manager deals pay out higher cash flows to equity tranche investors prior to the start of the subprime crisis (July 2007), but significantly lower cash flows afterwards, and (4) investors demand a (price) discount on non-equity tranches sold by large manager deals. In sum, this evidence is consistent with a conflict of interest/risk shifting argument: some managers boost their market share by catering to the interests of the deals' equity sponsors.

### **Coherent Projections of Age, Period, and Cohort Dependent Mortality Improvements**

**Börger, Matthias (1);** Aleksic, Marie-Christine (2)

1: ifa Ulm, Germany; 2: Ulm University, Germany

Discussant: Hannah Wesker

*Time & Location: Friday, 09:00 a.m. - Bldg. 20.14, R103.1*

The projection of future mortality experience constitutes a challenge for both actuaries and demographers. Some of the currently used projections have several shortcomings which may pose a serious threat to insurers or social security systems.

In this paper, we propose a new projection methodology which overcomes these shortcomings. Our model allows mortality improvements to depend on age, period, and cohort and provides highly plausible forecasts. Moreover, it is very flexible with respect to the level of future mortality improvements. This allows us to derive coherent projections for several populations simultaneously, e.g. males and females of the same country or populations from closely related countries. We observe that the incorporation of information on the mortality experience of other populations can have a significant impact on the projection for a single population. In order to illustrate our methodology, we derive a fully specified projection for German males and females as members of a large reference set of European populations.

**Financial Planning and Risk-return Profiles****Graf, Stefan (1);** Kling, Alexander (2); Ruß, Jochen*1: University of Ulm , ifa Ulm, Germany; 2: ifa Ulm, Germany*

Discussant: Jörg Schiller

*Time & Location: Friday, 09:30 a.m. - Bldg. 20.14, R103.1*

The importance of funded private or occupational old age provision will increase due to demographic changes and the resulting problems for government-run pay-as-you-go systems. Clients and advisors therefore need reliable methodologies to match offered products and clients' needs and risk appetite. In this paper, we analyze existing approaches such as sample illustrations and historical backtesting that are often used for comparing and explaining products. We find that the information provided is often insufficient or even misleading. We introduce an alternative methodology based on risk-return profiles, i.e. the (forward-looking) probability distribution of benefits. In a model with stochastic interest rates and equity returns including stochastic equity volatility, we derive risk-return profiles for various types of existing unit-linked/equity-linked products with and without embedded guarantees. We highlight the differences between actual product characteristics and the impression generated by existing approaches and explain the resulting misleading incentives for product developers and financial advisors.

### **Contract Design and Insurance Fraud: An Experimental Investigation**

**Schiller, Jörg (1);** Lammers, Frauke (2)

*1: Universität Hohenheim, Germany; 2: Universität Bern, Switzerland*

Discussant: Helmut Gründl

*Time & Location: Friday, 10:00 a.m. - Bldg. 20.14, R103.1*

Deductibles are commonly used in insurance relationships to help save transaction costs or limit problems of adverse selection and/or moral hazard. In this paper we use an experimental setup to investigate the impact of deductibles on the filing of fraudulent claims. We test how fraud behavior varies for insurance contracts with full coverage, a straight deductible or claim-dependent premiums (bonus-malus contracts). In our experiment, monetary gains from claim build-up are identical for all contracts. We find that deductible contracts lead to claim build-up to a greater extent than full coverage contracts. This finding indicates that deductible contracts are seemingly perceived as unfair. In contrast, bonus-malus contracts that are payoff equivalent to deductible contracts do not increase claim build-up. Our results indicate that bonus-malus contracts may be superior because they lead to the same monetary payoffs as deductible contracts but are seemingly perceived as more fair.

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Debt Financing

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**Banks' Use of Credit Derivatives and the Pricing of Loans: What Is the Channel and Does It Persist Under Adverse Economic Conditions?**
**Norden, Lars (1);** Silva Buston, Consuelo (2); Wagner, Wolf (2)

*1: Rotterdam School of Management, Erasmus University, The Netherlands; 2: Tilburg University, The Netherlands*

Discussant: Klaus Düllmann

*Time & Location: Friday, 09:00 a.m. - Bldg. 20.13, R111*

This paper studies whether active use of credit derivatives by banks has an impact on the loan spreads they charge to their corporate borrowers, and if so, through which channel(s) this occurs. We find that a bank's gross position in credit derivatives is associated with significantly lower loan spreads, while the bank's net position is not related to loan spreads. We argue that this is consistent with banks passing on risk management benefits to their corporate borrowers, but not with other channels through which credit derivatives may affect loan pricing. We also find that the risk management benefits extend to borrowers unlikely to be traded in the credit derivative markets (although to a smaller extent). The evidence further suggests that risk management remains effective throughout the crisis of 2007-2009 since i) the benefit of borrowing at lower spreads from credit-derivative active banks does not fall during the crisis, ii) active banks have persistently lower loan charge-offs, iii) active banks cut lending by less than other banks during the crisis. Taken together the evidence indicates significant risk management benefits from financial innovations that persist under adverse conditions — that is, when they matter most.

### **Certification and Reputation Milking: Comprehensive Evidence from Corporate Bonds**

**Limbach, Peter** (1); Andres, Christian (2); Betzer, André (3)

1: Karlsruhe Institute of Technology, Germany; 2: WHU - Otto Beisheim School of Management, Germany; 3: University of Wuppertal, Germany;

Discussant: Lars Norden

*Time & Location: Friday, 09:30 a.m. - Bldg. 20.13, R111*

This paper investigates how certifier reputation affects business standards, initial pricing, and short- and long-term performance in the corporate bond market. We examine auditors, credit ratings, listing standards, and underwriters, and thereby provide the first comprehensive picture of certification. Using a sample of U.S. high-yield bonds issued between 2000 and 2008, we incorporate the profound changes in regulation that have affected competition in auditing and particularly debt underwriting markets. Controlling for self-selection, we report that reputable underwriters significantly lower initial yield spreads by about 50 basis points, while Big 4 auditors do not directly affect borrowing costs. We further find that bonds underwritten by reputable banks perform significantly worse in the long run as measured by rating deterioration and default probability. Results corroborate recent findings on certifier reputation and indicate that capture and reputation milking are problems in the competitive debt underwriting market.



### **The Credit Ratings Game - revisited**

**Hirth, Stefan**

*Aarhus University, Denmark*

Discussant: Tim Thabe

*Time & Location: Friday, 10:00 a.m. - Bldg. 20.13, R111*

I analyze credit rating agencies and competition. A shortcoming of existing models is that they only consider competition in duopoly, although the U.S. market consists of three major players, and even ten organizations that are designated as Nationally Recognized Statistical Rating Organizations. I develop a framework using Evolutionary Game Theory to analyze the interaction of credit rating agencies in a competitive market with more than two agencies. I show that significant changes in market structures and outcomes can happen for any arbitrary current market size, for example when one new agency enters a market currently consisting of two, three, or ten agencies. Furthermore, honest rating behavior can indeed be achieved as a result of high competition. Alternatively, it can be implemented by regulatory measures like abolishing the “issuer pays” model or by a centralized monitoring of ratings quality.

# Abstracts

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## Market Microstructure

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### **Do we Need a European "National Market System"? Competition, Arbitrage, and Suboptimal Executions**

**Wagener, Martin;** Storkenmaier, Andreas

*Karlsruhe Institute of Technology, Germany*

Discussant: Jean-Edouard Colliard

*Time & Location: Friday, 09:00 a.m. - Bldg. 20.13, R109*

The introduction of the European Markets in Financial Instruments Directive (MiFID) ended the quasi-monopoly of national exchanges in equity trading across Europe and many new trading platforms emerged. European trading venues are neither formally linked by technology nor does regulation enforce price-priority across platforms. This raises the question of market integration of fragmented markets. We find that quotes for UK blue-chip stocks are closely linked across trading venues and that a high fraction of trades is executed at best available prices. Our results suggest that competition forces competing but disconnected platforms to quote prices as if they were formally linked.

**Trading Fees and Efficiency in Limit Order Markets****Colliard, Jean-Edouard (1); Foucault, Thierry (2)***1: Paris School of Economics, France; 2: HEC, Paris, France*

Discussant: Elvira Sojli

*Time & Location: Friday, 09:30 a.m. - Bldg. 20.13, R109*

We study competition between a dealer (OTC) market and a limit order market. In the limit order market, investors can choose to be "makers" (post limit orders) or "takers" (hit limit orders) whereas in the dealer market they must trade at dealers' quotes. Moreover, in the limit order market, investors pay a trading fee to the operator of this market ("the matchmaker"). We show that an increase in the matchmaker's trading fee can raise investors' ex-ante expected welfare. Actually, it induces makers to post more aggressive offers and thereby it raises the likelihood of a direct trade between investors. For this reason as well, a reduction in the matchmaker's trading fee can counter-intuitively raise the OTC market share. However, entry of a new matchmaker results in an improvement in investors' welfare, despite its negative effect on trading fees. The model has testable implications for the effects of a change in trading fees and their breakdown between makers and takers on various measures of market liquidity.

### **Sunshine Trading: Flashes of Trading Intent at the NASDAQ**

**Sojli, Elvira (1);** Skjeltorp, Johannes A. (2); Tham, Wing Wah (1)

1: Erasmus University, The Netherlands, The; 2: Norges Bank, Norway

Discussant: Martin Wagener

*Time & Location: Friday, 10:00 a.m. - Bldg. 20.13, R109*

We use the introduction and subsequent removal of an actionable indication of interest (IOI), the flash order facility, from Nasdaq as a natural experiment to investigate the impact of voluntary preannouncement of trade interest, sunshine trading, on different groups of market participants and on market quality. We find that preannounced orders are predominantly placed by agency algorithms, i.e. buy-side investors, which are likely to be uninformed. Actionable IOIs fulfil their role as an advertisement for liquidity and attract responses from liquidity providers immediately after the announcement is placed. They contribute to an increase in liquidity in Nasdaq. In an event study and difference in difference analysis, we show that overall market quality improves substantially when the flash functionality is introduced and deteriorates when it is removed. Our study is important in understanding the impact of voluntary pre-trade disclosure, in guiding future market design choices, and in the debate on dark pools and IOIs.

**Friday, December 16, 2011**  
**01:15 pm - 02:45 pm**

**Credit Risk**

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**Risk Decomposition of Credit Spreads**

**Fuess, Roland;** Gehrig, Thomas; Rindler, Philipp

*EBS University, Germany*

Discussant: Monika Trapp

*Time & Location: Friday, 01:15 p.m. - Bldg. 20.13, R006*

This paper investigates the rise in credit spreads due to market changes and increases in risk aversion over the period 2005-2010. We find that increases in spreads over the past years can be entirely explained by increases in risk aversion. We also show that this increase is mostly due to default risk especially for high-yield bonds. For low-yield bonds the increase is mostly due to liquidity related factors.

### **Volatility Patterns of CDS, Bond and Stock Markets Before and During the financial Crisis: Evidence from Major Financial Institutions**

**Belke, Ansgar (1);** Gokus, Christian (2)

*1: University of Duisburg-Essen, Germany; 2: University of Duisburg-Essen, DIW Berlin and IZA Bonn, Germany*

Discussant: Roland Füss

*Time & Location: Friday, 01:45 p.m. - Bldg. 20.13, R006*

This study is motivated by the development of credit-related instruments and signals of stock price movements of large banks during the recent financial crisis. What is common to most of the empirical studies in this field is that they concentrate on modeling the conditional mean. However, financial time series exhibit certain stylized features such as volatility clustering. But very few studies dealing with credit default swaps account for the characteristics of the variances. Our aim is to address this issue and to gain insights on the volatility patterns of CDS spreads, bond yield spreads and stock prices. A generalized autoregressive conditional heteroscedasticity (GARCH) model is applied to the data of four large US banks over the period ranging from January 01, 2006, to December 31, 2009. More specifically, a multivariate GARCH approach fits the data very well and also accounts for the dependency structure of the variables under consideration. With the commonly known shortcomings of credit ratings, the demand for market-based indicators has risen as they can help to assess the creditworthiness of debtors more reliably. The obtained findings suggest that volatility takes a significant higher level in times of crisis. This is particularly evident in the variances of stock returns and CDS spread changes. Furthermore, correlations and covariances are time-varying and also increased in absolute values after the outbreak of the crisis, indicating stronger dependency among the examined variables. Specific events which have a huge impact on the financial markets as a whole (e.g. the collapse of Lehman Brothers) are also visible in the (co)variances and correlations as strong movements in the respective series.

### **Credit Risk and the Macro Economy in an Affine Term Structure Model**

**Speck, Christian**

*University of Mannheim, Germany*

Discussant: Ansgar Belke

*Time & Location: Friday, 02:15 p.m. - Bldg. 20.13, R006*

The interrelations between corporate lending conditions and the macro economy are getting increasingly important, in particular in the context of bank regulation and monetary policy. In this paper, I develop a joint affine macro-finance model of the term structures of US Treasury yields and US corporate bond yields. A model with inflation, industrial production growth and three latent factors is able to explain the dynamics of a wide range of rating classes and maturities. An economy-wide latent credit risk factor is identified to study the role of credit conditions in the business cycle. In-sample and out-of sample model dynamics provide evidence that credit conditions contain unique information about the business cycle and, therefore, form an integral part of the transmission process of monetary policy. These findings provide a rationale to integrate financial frictions into theoretical business cycle models.

### **An Empirical Study of the Information Premium on Electricity Markets**

**Biegler-König, Richard (1);** Benth, Fred Espen (2); Kiesel, Rüdiger (1)

1: Universität Duisburg-Essen, Germany; 2: University of Oslo, Norway

Discussant: Sven-Olaf Stoll

*Time & Location: Friday, 01:15 p.m. - Bldg. 20.14, R103.2*

The relation between spot and forward prices has been the subject of intensive interest in the academic literature. Typically, a spot-forward relationship is being established involving some sort of risk premium specific to a given market. For electricity markets the relationship is pure in the sense that the non-storability of electricity does not allow to follow any of the traditional arbitrage-type arguments (cash-and-carry, convenience yield). Thus, the structure of the risk premium relates to different information sets for spot and forward pricing. Benth and Meyer-Brandis quantify the influence of information by defining the information premium and conduct a theoretical analysis using the technique of enlargement of filtrations. In this paper we will empirically analyse the existence and size of the information premium applying a specially designed new method. We find significant premia for two market situations on the German EEX: the first being the introduction of CO2 certificates in 2008, the second being the impact of the Tohoku earthquake on German nuclear policy in March 2011. In addition, we outline how our method is also applicable to standard underlyings, such as other commodity and financial markets.



**What Can We Learn from the EU ETS Experience? Recommendations for Effective Trading and Market Design****Davison, Matt;** Mnif, Walid*University of Western Ontario, Canada*

Discussant: Rüdiger Kiesel

*Time & Location: Friday, 01:45 p.m. - Bldg. 20.14, R103.2*

Cap-and-trade markets provide a policy instrument to encourage the decrease of harmful emissions such as global greenhouse gases over both short and long time periods. The European Union Emission Trading Scheme (EU ETS) is the largest carbon emission market yet implemented. Its design, which allows banking and borrowing, makes it different from all other commodity markets since the expectation of market participants has a dramatic impact on the trading volume. This paper introduces an emissions market model and fits it to the EU ETS data. An analysis of this model motivates recommendations for effective trading and market design. We describe futures allowance dynamics by a binomial tree with returns partially driven by the implied expected market position at subsequent compliance dates. By construction, the market is incomplete. We propose a pricing procedure and quadratic risk minimization hedging strategies. We show that the best hedging strategy must include positions in futures maturing at subsequent compliance dates. Consequently the trading compliance periods are correlated. To reduce this inter-period dependency, we recommend that the regulator introduce a new additional tradable primary asset. Such a solution allows non-emitters, who fear long term regulatory ambiguity, to participate in the market hence increasing its liquidity. We present a possible pricing framework based on the indifference pricing technique.

## News Analytics for Energy Futures

**Borovkova, Svetlana**

*Vrije Universiteit Amsterdam, The Netherlands*

Discussant: Matt Davison

*Time & Location: Friday, 02:15 p.m. - Bldg. 20.14, R103.2*

We investigate how crude oil futures markets respond to positive and negative sentiment in news, as measured by the Thomson Reuters News Analytics. We measure the impact of the news sentiment on daily futures returns and on the fundamental factors of the forward curve evolution, such as the forward curve's level and the slope.

We define positive and negative news events as those days when the aggregated daily sentiment is in the top 10% quantiles of the corresponding sentiment distribution. We then relate these events to abnormal futures returns and to significant changes in the forward curve's level and slope.

We find that, for all maturities, positive resp. negative news events are accompanied by long periods of higher resp. lower than normal returns. These abnormal returns are observed already prior to the significant news events, suggesting that news are correlated with price momentum. Furthermore, after a negative news event occurs, returns continue decreasing at least for the subsequent 20 days. This is especially pronounced for nearby maturities, whose returns decrease by more than 3% on average. After a positive news event, returns increase on average by 2-3%. These effects are both statistically and economically significant. We also show a great asymmetry in the market's behavior: although positive and negative events are both 10% of days, the negative events are accompanied by much greater losses than the gains surrounding positive events.

We analyze the complex effect of news on the slope of the forward curve, and show that negative news increase the slope both in backwardation and contango markets. This means that contango deepens and backwardation flattens following a negative news event. Positive news have the opposite, albeit smaller, effect on the forward curve's slope. Generally, the reaction to news is significantly more pronounced in contango than in backwardation market. The results of the analysis lay foundation for profitable trading strategies, based on taking a long/short position in oil futures of a fixed maturity immediately after a significant positive/negative news event. However, we expect such strategies to be quite risky. The analysis of news effects on the entire forward curve can be used to construct profitable (but much less risky) calendar spread trading strategies.

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Insurance & Risk Management

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**Risk Management of Implicit Options in Life Insurance Contracts under Estimation Uncertainty****Körbitz, Paul;** Löffler, Gunter*Ulm University, Germany*

Discussant: Nadine Gatzert

*Time & Location: Friday, 01:15 p.m. - Bldg. 20.14, R103.1*

This paper examines how estimation uncertainty affects risk measures of implicit options in life insurance contracts in a model with stochastic interest rates. The contract we consider features a cliquet-style guarantee and has been analyzed by Tanskanen and Lukkarinen (2003) and Zaglauer and Bauer (2008). Parameter and model uncertainty distributions are derived with a Markov chain Monte Carlo (MCMC) algorithm. The resulting posterior distributions are used to show the impact of uncertainty on two risk management approaches. The first approach does not actively hedge the options while the second approach uses infrequent hedges. Both approaches are impacted by estimation uncertainty which can lead to significant increases in the estimated risk measures. Furthermore a new pricing algorithm is developed which allows efficient valuation of the contract and its embedded options.

### **Mortality Risk and its Effect on Shortfall and Risk Management in Life Insurance**

**Gatzert, Nadine;** Wesker, Hannah

*University of Erlangen-Nürnberg, Germany*

Discussant: Daniel Bauer

*Time & Location: Friday, 01:45 p.m. - Bldg. 20.14, R103.1*

Mortality risk is a key risk factor for life insurance companies and can have a crucial impact on its risk situation. In general, mortality risk can be divided into three subcategories: unsystematic risk, adverse selection, and systematic risk. In addition, basis risk may arise in case of hedging, e.g., longevity risk. The aim of this paper is to holistically analyze the impact of these different types of mortality risk on the risk situation and the risk management of a life insurer. Toward this end, we extend previous models of adverse selection, empirically calibrate mortality rates, and comprehensively study the interaction among the mortality risk components in a holistic framework of assets and liabilities for a portfolio of annuities and term life insurance contracts. For risk management, we examine natural hedging and mortality contingent bonds. Our results show that particularly adverse selection and basis risk can have crucial impact not only on the effectiveness of mortality contingent bonds, but also on the insurer's risk level, especially when a portfolio consists of several types of products.

### **Price-Default Risk-Demand-Curves and the Optimal Corporate Risk Strategy of Insurers: A Behavioral Approach**

**Gründl, Helmut (1);** Schade, Christian (3); Zimmer, Anja (2)

1: Goethe-Universität Frankfurt am Main, Germany; 2: Humboldt-Universität zu Berlin, Germany; 3: Gesamtverband der Deutschen Versicherungswirtschaft e.V., Germany

Discussant: Paul Körbitz

*Time & Location: Friday, 02:15 p.m. - Bldg. 20.14, R103.1*

This paper empirically studies the effects on an insurer's optimal solvency level when consumers have full information about the insurer's default risk. Using experimentally obtained data on consumer reactions to insurance with default risk, they show that the insurer should choose to be default-free rather than having even a very small default probability. This risk strategy is also optimal when assuming substantial transaction costs for risk management activities to obtain the maximum solvency level. The results suggest that forcing transparency as to the insurer's solvency level would be an effective regulatory instrument for protecting policyholder interests.

### **Does Institutional Environment matter in Executive Compensation? A Multinational Analysis**

**Rapp, Marc Steffen (1);** Hüttenbrink, Alexander (2); Wolff, Michael (3)

*1: Philipps-Universität Marburg, Germany; 2: Technische Universität München, Germany; 3: University of Mainz, Germany*

Discussant: Johannes Raaballe

*Time & Location: Friday, 01:15 p.m. - Bldg. 20.13, R111*

We analyze the influence of the institutional environment on executive pay by using a large sample of US and European firms. Our results suggest that institutional setting and regulation have a substantial impact on executive compensation. For instance, high shareholder protection reduces pay-for-performance, while high disclosure requirements increase pay-for-performance. Moreover, the institutional environment moderates the relationship between firm-specific governance mechanisms and executive pay. High shareholder protection weakens the substitution effect of strong firm-specific governance mechanisms on total compensation but enhances this substitution effect regarding pay-for-performance. Overall, our results suggest that the institutional environment is an important determinant of executive remuneration.

**Financial Constraints and the International Zero-Leverage Phenomenon****Haller, Rebekka (1);** Bessler, Wolfgang (2); Drobetz, Wolfgang (1); Meier, Iwan (3)*1: University of Hamburg, Germany; 2: University of Giessen, Germany; 3: HEC Montreal, Canada*

Discussant: Ulrich Hofbaur

*Time & Location: Friday, 01:45 p.m. - Bldg. 20.13, R111*

Based on a sample of G7 firms, this study documents that extreme debt conservatism is an international phenomenon and has increased over time. While only 5% of our sample firms pursued a zero-leverage policy in 1988, this fraction increased to roughly 15% by 2008. Changing propensities to follow a zero-leverage policy together with the impact of new listings can explain a large proportion of the increasing number of zero-leverage firms. Countries with a capital-market-oriented financial system, a common law origin, high creditor protection, and a classical tax system exhibit the highest percentage of zero-leverage firms. Looking at the firm-level, the characteristics of zero-leverage firms are hard to reconcile with the standard capital structure theories. However, sorting zero-leverage firms into financially constrained and unconstrained firms, we show that only a small number of very profitable firms with high payout ratios deliberately pursue a zero-leverage policy. In contrast, most zero-leverage firms are constrained by debt capacity. They tend to be smaller, riskier, and less profitable, and they are the most active equity issuers. Constrained zero-leverage firms accumulate more cash than all other firms in our sample, presumably to avoid being unable to exploit their growth opportunities.

### **Acquisitions as Lotteries: Do Managerial Gambling Attitudes Influence Takeover Decisions?**

**Schneider, Christoph (1);** Spalt, Oliver (2)

1: University of Mannheim, Germany; 2: Tilburg University

Discussant: Wolfgang Drobetz

*Time & Location: Friday, 02:15 p.m. - Bldg. 20.13, R111*

This paper analyzes takeover announcements for public US targets from 1987 to 2008. Consistent with the hypothesis that gambling attitudes matter for takeover decisions, both acquiror announcement returns and expected synergies are lower in acquisitions where the target's stock has characteristics similar to those of attractive gambles. The effects are stronger in companies where managers are more entrenched, where the disciplining force of product market competition is lower, where recent acquiror performance has been poor, during economic downturns, for younger CEOs in the acquiring firm, and for acquirors headquartered in areas in which local gambling propensity is higher. Targets with lottery features are more likely to be taken over and direct evidence from hand-collected synergy disclosure data shows that the market reacts less favorably to higher synergy forecasts if they are issued in the context of a lottery acquisition. Overall, our results suggest that corporate acquisitions are influenced by managerial gambling attitudes and that value destruction for acquirers in gambling-related transactions is substantial.



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**Empirical Finance**

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**Expected and Unexpected Bond Excess Returns: Macroeconomic and Market Microstructure Effects****Fricke, Christoph***Leibniz University Hannover, Germany*

Discussant: Georg Bestelmeyer

*Time & Location: Friday, 01:15 p.m. - Bldg. 20.13, R109*

This paper shows that order flow is a determinant for future bond excess returns which cannot be captured by macroeconomic or forward rate information. For the German bond market between 06/2003-06/2007 we apply the Adrian and Moench (2010) term structure model for decomposing excess returns into expected and unexpected excess term. The forecasting power of order flow stems from its predictability for expected excess returns. Additionally, expectations are linked to macroeconomic information and forward rates, namely the Cochrane-Piazzesi-factor (Cochrane and Piazzesi, 2005). Order flow and changes of the economic environment and of the Cochrane-Piazzesi-factor determine unexpected excess returns.

### **Implied Risk Premium and the Business Cycle: You Can't Always Get What You Want**

**Bestelmeyer, Georg;** Dicke, Kristian; Hess, Dieter

*University of Cologne, Germany*

Discussant: Harald Kinateder

*Time & Location: Friday, 01:45 p.m. - Bldg. 20.13, R109*

We analyze the link between investor's risk premia demands and overall business conditions. In contrast to previous studies we focus on ex-ante risk premia expectations implied in market prices and earnings forecasts rather than ex-post realized excess returns. We find that risk premia demands are counter-cyclical and strongly driven by the economic environment. On average, expected risk premia are higher (lower) when the economy is contracting (expanding). Moreover, risk premia are highly sensitive to macroeconomic risk factors such as term- and default spreads. Their impact is at least as strong as that of firm-specific risk factors. Our findings emphasize that risk premia demands are time varying and strongly tied to the business cycle.

**Market Risk Prediction Under Long Memory: When VaR is Higher than Expected****Kinateder, Harald;** Wagner, Niklas*Passau University, Germany*

Discussant: Christoph Fricke

*Time & Location: Friday, 02:15 p.m. - Bldg. 20.13, R109*

Several authors, including Andersen and Bollerslev (1998), stress the importance of long-term volatility dependence for value-at-risk (VaR) prediction. The present paper addresses multiple-period market risk forecasts under long memory effects in market volatility. To this aim, we propose volatility forecasts based on a combination of the GARCH(1,1)-model with potentially fat-tailed and skewed innovations and a long memory specification of the slowly declining influence of past volatility shocks. As the square-root-of-time rule is known to be mis-specified, we use the GARCH setting of Drost and Nijman (1993) as a sophisticated benchmark model. Our empirical study of equity market risk is based on daily index returns during the period January 1975 to December 2010. We study the out-of-sample accuracy of VaR predictions for five, ten, 20 and 60 trading days and document that our approach remarkably improves VaR forecasts for the longer horizons. The result is only in part due to higher predicted risk levels. Ex-post calibration to equal unconditional risk levels shows that consideration of long memory properties enhances efficiency in allocating VaR capital through time. Conventional approaches tend to underestimate longer-term levels of market risk.

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## Restaurant & Café List

€€€ Exclusive, €€ Midrange, € Budget

### German Cuisine

Gastdozentenhaus	Engesserstr. 3/ Campus	€€
Schlosscafé	Karlsruhe Castle	€€
Bacchus	Durlacher Allee 20	€
Badische Weinstuben	Botanic garden (West of Castle)	€€€
Kap	Kapellenstraße 68	€
Harmonie	Kaiserstr. 57	€
Hotel Kaiserhof	Karl-Friedrich-Str. 12	€€€
Oberländer Weinstube	Akademiestraße 7	€€€
Kleiner Ketterer	Adlerstr. 34	€€
Litfass	Kreuzstr. 10	€
Multi-Kulti	Schlossplatz 19	€
Mensa	Campus near Forum	€
Vogelbräu	Kapellenstr. 50	€

### International Cuisine

El Taquito	Waldstr. 22	€€
Maredo Steakhouse	Zähringerstr. 69	€€
Besitos	Am Marktplatz	€€
Burger King	Kaiserstr. 64	€
Renaissance-Hotelrestaurant	Mendelssohnplatz	€€€
Taverne– Der Grieche	Kaiserstr. 16	€

### Italian Cuisine

Il Caminetto	Kronenstr. 5	€
Weisser Stern	Am Künstlerhaus 45	€
L'incontro	Leopoldstr. 3	€€

### Cafés

Café Extrablatt	Waldstraße 32	€€
Café am Marktplatz	Am Marktplatz	€€
Café Wien	Fasanenstr. 6	€
Schlosscafé	Karlsruhe Castle	€€
Zero	Kaiserstr. 133	€

# Timetable

Thursday					
Location:	Track 1 20.13-006	Track 2 20.14-103.2	Track 3 20.14-103.1	Track 4 20.13-111	Track 5 20.13-109
08:00 AM - 09:00 AM	Registration				
09:00 AM - 10:30 AM	Welcome Keynote: Prof. Milton Harris Location: Tulla HS				
10:30 AM - 11:00 AM	Coffee Break				
11:00 AM - 01:00 PM	Economics of Banking	Asset Pricing I	Math. Issues in Banking & Insurance	Governance	Retail Investments
01:00 PM - 02:30 PM	Lunch Break				
02:30 PM - 04:00 PM	Systemic Risk & Contagion	Asset Pricing II	Insurance and Information	Focus Session: Minimum Variance Portfolio	News
04:00 PM - 04:30 PM	Coffee Break				
04:30 PM - 06:00 PM	Banking: Regulation	Portfolio Selection	Annuities	Government and Corporate Finance	Institutional Trading
06:00 PM - 07:00 PM	Break				
07:00 PM	Conference Dinner				

<b>Friday</b>					
Location:	Track 1 20.13-006	Track 2 20.14-103.2	Track 3 20.14-103.1	Track 4 20.13-111	Track 5 20.13-109
09:00 AM - 10:30 AM	Banking: Empirical	Delegated Portfolio Management & Mutual Funds	Contemporary Issues in Insurance	Debt Financing	Market Micro- structure
10:30 AM - 11:00 AM	Coffee Break				
11:00 AM - 12:00 AM	Keynote: Dr. Thomas Mayer Location: Tulla HS				
12:00 PM - 01:15 PM	Lunch Break				
01:15 PM - 02:45 PM	Credit Risk	Commodity & Energy Finance	Insurance & Risk Management	Empirical Corporate Finance	Empirical Finance

Notes

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