



NORTHERN FINANCE ASSOCIATION **ANNUAL CONFERENCE 2013**

25th Annual Conference
September 27-29, 2013
Loews Hotel Le Concorde
Québec City, Québec, Canada

www.northernfinance.org/2013



UNIVERSITÉ
LAVAL

Faculté des sciences
de l'administration

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Message from the organizers

Dear Conference participants,

Welcome to beautiful Québec City and to the Northern Finance Association Annual Conference 2013! For 25 years, the NFA Annual Conference has provided a unique opportunity for finance academics, professionals, and PhD students from Canada and around the world to gather to hear and present the latest research in all areas of finance. The NFA 2013 Conference continues to fulfill this legacy with more than 200 registered participants.

This year, we received a record number of 441 submissions but could only accept 108 papers for the program. All papers were blind-reviewed by at least two reviewers and our decisions are based on the recommendations from these reviewers. The competition to be on the program has been tough and we had to reject many high quality papers.

We want to thank our Keynote Speaker, John Y. Campbell, Morton L. and Carole S. Olshan Professor of Economics, from Harvard University, and our two doctoral student panelists, Peter Christoffersen, from the University of Toronto, and Ron Giammarino, from the University of British Columbia.

We are also grateful to all program committee members for their help in selecting the papers for the program and for the best paper awards.

Thank you also to all our partners, sponsors, exhibitors, and to everyone involved in making this event a success, especially professor Gordon Sick, from the University of Calgary, our webmaster, and the Service des communications et des relations avec le milieu, from FSA ULaval. Without their involvement, it would not have been possible to organize this conference. We are especially grateful to FSA ULaval community for their support.

Finally, we thank all of you for submitting your work and agreeing to serve as presenters, session chairs and discussants.

Please enjoy the conference and make sure you take some time to enjoy this beautiful city!

Sincerely,

Stéphane Chrétien
Van Son Lai
Issouf Soumaré
NFA 2013 Chairs
FSA ULaval, Université Laval

Program Summary

Friday, 27 September

16:30–18:00

PhD Student Panel (Pilot)

18:30–20:00

Cocktail Reception (Foyer)

Saturday, 28 September

07:00–08:30

Breakfast (Suzor-Côté)

08:30–10:00

1. Financial Models (Leduc-Fortin)
2. Credit Risk (410)
3. Investment Funds – I (415)
4. Market Microstructure – I (414)
5. Corporate Finance – I (Morrice Lismer)
6. Equity Offerings (Pilot)

10:00–10:15

Coffee break (Foyer)

10:15–11:45

1. Equity Valuation - I (Leduc-Fortin)
2. Financial Intermediation (410)
3. Investment Funds - II (415)
4. Market Microstructure - II (414)
5. Governance – I (Morrice Lismer)
6. Debt Financing (Pilot)

11:45–13:30

Lunch (Suzor-Côté)

13:45–15:15

1. Equity Valuation - II (Leduc-Fortin)
2. Financial Crises (410)
3. Behavioral Finance (415)
4. Market Microstructure - III (414)
5. Corporate Finance – II (Morrice Lismer)
6. Mergers and Acquisitions - I (Pilot)

15:15–15:30

Coffee break (Foyer)

15:30–17:00

1. Equity Valuation - III (SESSION ENDS AT 17:30) (Leduc-Fortin)
2. Bankruptcy (410)
3. Asset Pricing (415)
4. Insider Trading (414)
5. Corporate Finance – III (Morrice Lismer)
6. Governance - II (Pilot)

17:15–18:30

NFA Board Meeting (Salon du conseil/Boardroom)

18:30–22:00

Gala Dinner (Musée national des beaux-arts du Québec)

Sunday, 29 September

07:00–08:30

Breakfast (Suzor-Côté)

08:30–10:00

1. Canadian Markets (Leduc-Fortin)
2. Special Topics (410)
3. International Finance (415)
4. Derivatives (414)
5. Corporate Finance – IV (Morrice Lismer)
6. Governance - III (Pilot)

10:00–10:15

Coffee Break (Foyer)

10:15–11:45

1. Equity Valuation - IV (Leduc-Fortin)
2. Banking (410)
3. Political and Sovereign Risks (415)
4. Fixed Income (SESSION ENDS AT 12:15) (414)
5. Mergers and Acquisitions – II (Morrice Lismer)
6. Institutional Investors (Pilot)

Friday, September 27, 2013

4:30 PM – 6:00 PM

PhD Student Panel (Pilot)

Chair: Van Son Lai, Université Laval

Risk Management & Derivatives (Peter Christoffersen, University of Toronto)

Corporate Decisions & Asset Prices (Ron Giammarino, University of British Columbia)

Synthesis: Past, Present and Future

6:30 PM – 8:00 PM

Cocktail Reception (Foyer)

Saturday, September 28, 2013

7:00 AM – 8:30 AM

Breakfast (Suzor-Côté)

8:30 AM – 10:00 AM

1. Financial Models (Leduc Fortin)

Chair: Tan Wang, University of British Columbia, Canada

Disagreement, Speculation, and Aggregate Investment

Steven Baker, Carnegie Mellon University, United States

Burton Hollifield, Carnegie Mellon University, United States

Emilio Osambela, Carnegie Mellon University, United States

Discussant: Tan Wang, University of British Columbia, Canada

We analyze the impact of differences of opinion on equilibrium investment, asset prices and portfolios in a production economy, characterizing the effects of disagreement on consumption volatility, equity return volatility, and Tobin's q . Comparing a calibrated version of the production economy with differences in opinion to a similar endowment economy with differences in opinion, the production economy has a lower interest rate volatility and a higher equity premium than the endowment economy because the equilibrium investment rate adjusts to differences in opinion. Investment rises when the population becomes more pessimistic, increasing the growth rate and attenuating the decline in interest rates that would occur in the endowment economy. The resulting fluctuations in the investment rate increase consumption volatility relative to the endowment economy and so lead to a higher equity premium relative to the endowment economy. We also report the equilibrium portfolios held by the investors, finding and stochastic large levels of leverage in the production economy.

Information Diversity and Market Efficiency Spirals

Itay Goldstein, University of Pennsylvania, United States

Liyan Yang, University of Toronto, Canada

Discussant: Henry Cao, Cheung Kong Graduate School of Business, China

We analyze a model where the value of a traded security is affected by two different fundamentals and where traders are informed of different fundamentals. We examine the interaction between trading intensities on information about the two fundamentals and characterize when shocks to market efficiency get amplified or attenuated. Amplification occurs because the aggressive trading on information about one fundamental reduces the

uncertainty in trading on information about the other fundamental and encourages traders to trade more aggressively on such information. We show that this effect also generates strategic complementarities in information production.

Measuring Agency Costs over the Business Cycle

Ramona Westermann, Copenhagen Business School, Denmark

Discussant: Hengjie Ai, University of Minnesota, United States

This paper investigates the effects of manager-shareholder agency conflicts on corporate policies in a structural model with intertemporal macroeconomic risk. In the model, a firm consists of assets in place and a growth option, and is run by a self-interested manager who receives part of the firm's free cash flows as private benefits. Fitting the model, parameter estimates imply substantial agency costs due to managerial diversion at issuance (around 3%), and higher agency costs for growth firms than for value firms (3.45% vs. 1.77%). Further, dynamic aggregate agency costs are strongly procyclical (on average, 1.88% in boom and 0.92% in recession periods). The reason for the latter observation is that, in times of recession, firms profit from managerial underleverage, which increases the distance to costly default. Finally, the model also generates predictions regarding default and investment rates, as well as on the intertemporal pattern of investment.

2. Credit Risk (410)

Chair: Jingzhi Huang, Penn State University, United States

A Revisit to the Equity-Credit Market Integration Anomaly

Jingzhi Huang, Penn State University, United States

Zhan Shi, Penn State University, United States

Discussant: Jaewon Chio, University of Illinois, United States

Empirical evidence has documented that while variables suggested by structural credit risk models can explain only a small portion of corporate bond spread changes (Collin-Dufresne, Goldstein, and Martin 2001), these models provide quite accurate predictions of hedge ratios (Schaefer and Strebulaev 2008). The implication of these two findings has been referred to as the "equity-credit market integration anomaly." In this paper we provide evidence that these two findings can be reconciled with each other, in the sense that sensitivities of spread changes to leverage ratio or equity produced from the models are not rejected in time-series tests.

Market Efficiency and Default Risk: Evidence from the CDS and Loan CDS Markets

Lawrence Kryzanowski, Concordia University, Canada

Stylianios Perrakis, Concordia University, Canada

Rui Zhong, Concordia University, Canada

Discussant: Chayawat Ornthanalai, University of Toronto, Canada

We construct a Credit Default Swap (CDS) and Loan CDS (LCDS) parity relation under no arbitrage assumption and document persistent and significant violations of this relation with the cross sectional data from both markets. We identify time-varying and significant positive arbitrage profits from an artificial default risk-free portfolio that trades in both markets and simultaneously participates in opposite legs of the undervalued and overvalued contracts in the two markets for exactly the same underlying firm, maturity, currency and restructure clauses. We show that the profits cannot be accounted for by trading costs or imperfect data about loan recovery rates in the event of default. Using panel regressions with macroeconomic and firm-level variables, we find that firm-level informational asymmetry and difficulty of loan recovery in case of default are much more important than macroeconomic factors in accounting for the arbitrage profits.

Margin-based asset pricing and the determinants of the CDS basis

Liyang Wang, University of South Carolina, United States

Discussant: Jan Ericsson, McGill University, Canada

The Credit Default Swap (CDS) basis should be close to zero according to the law of one price (LoOP). However, it is significantly negative during the 2007-2009 financial crisis. One plausible explanation is that this violation of the LoOP is caused by the different margin-requirements on cash bonds and CDS contracts (Brunnermeier and Pedersen 2009; Garleanu and Pedersen 2011). This paper examines both the time-series and cross-sectional implications of the margin-based asset pricing theories using the single-name CDS data. Our results are consistent with the theories in several aspects. First, we find that the average CDS basis decreases as the credit risk premium, margin

requirements, funding cost, and funding illiquidity increase. Secondly, cross-sectional results show that the systematic risk exposures to credit risk premium, funding cost, and funding liquidity have significant explanatory powers for the CDS basis, even after controlling for the individual liquidity and other bond characteristics. Thirdly, the cross-sectional explanatory power of the margin-requirement related systematic risk exposures dramatically increased from 3% pre-crisis to 13.5% before Lehman bankrupted, and surged to 36% after Lehman bankrupted. The result supports the margin-based theories in that the margin-requirement related systematic risk exposures came into play when the financial institutions suffered substantial loss from the turn of U.S. housing cycle, and became crucial when there was credit crunch because of high uncertainties in the capital market. Moreover, the results in this paper help explain the correlation between the CDS basis and credit risk measures observed in the previous literature.

3. Investment Funds - I (415)

Chair: Vincent Glode, University of Pennsylvania, United States

Indexers and Comovement

Vincent Gregoire, University of Melbourne, Australia

Discussant: Sebastien Betermier, McGill University, Canada

I introduce a general equilibrium model with active investors and indexers. The presence of indexers causes market segmentation, and the degree of segmentation is linked to the relative wealth of indexers in the economy. Any shock to this relative wealth generates excess comovement by inducing correlated shocks to discount rates of index stocks. The wealthier the indexers are, the greater the resulting excess comovement is. In the data, I find that S&P 500 stocks tend to comove more with other index stocks and less with non-index stocks, but this was not the case until the 1970s when indexing gained in popularity. I use passive holdings of S&P 500 stocks as a proxy for the wealth of indexers and find that changes in passive holdings are positively related to changes of excess comovement in S&P 500 stocks.

Is There Persistence After All? New International Evidence on the Berk and Green Model

Miguel Ferreira, Universidade Nova de Lisboa, Portugal

Aneel Keswani, Cass Business School, United Kingdom

Antonio Miguel, Instituto Universitário de Lisboa, Portugal

Sofia Ramos, Instituto Universitário de Lisboa, Portugal

Discussant: Luke Taylor, University of Pennsylvania, United States

The fund management model of Berk and Green predicts that fund performance will not persist. This is because when investment is channelled to the top performing funds, this reduces their future performance as the model assumes decreasing returns to scale in fund management. However, when we examine fund industries from 27 countries we find that in more than two thirds of the industries there is statistically significant persistence. We reconcile these findings in the following way. In our sample the majority of countries do not have decreasing returns to scale which is assumed by the Berk and Green model. If we allow the Berk and Green model to have constant or increasing returns to scale then persistence stays the same or is enhanced as funds grow. We show that such a Berk and Green model with a flexible returns to scale investment technology explains variation in the dynamics of persistence as funds grow across the countries in our sample. The majority of countries not having decreasing returns to scale explains why persistence is present in most countries in our sample. We show that returns to scale differences across countries may be explained by mutual fund industry development.

Scale and Skill in Active Management

Lucian A. Taylor, University of Pennsylvania, United States

Robert F. Stambaugh, University of Pennsylvania, United States

Lubos Pastor, University of Chicago Booth School of Business, United States

Discussant: Timothy Simin, Penn State University, United States

We empirically analyze the nature of returns to scale in active mutual fund management. We find strong evidence of decreasing returns at the industry level: As the size of the active mutual fund industry increases, a fund's ability to outperform passive benchmarks declines. In contrast, estimates that avoid econometric biases do not detect decreasing returns at the fund level. We also find that funds born more recently exhibit more skill. This upward trend in skill coincides with industry growth, which precludes the skill improvement from boosting fund performance. Finally, we find that performance deteriorates over a typical fund's lifetime. This result can also be explained by industry growth and industry-level decreasing returns to scale.

4. Market Microstructure - I (414)

Chair: Brian Smith, Wilfrid Laurier University, Canada

Liquidity, Competition & Price Discovery in the European Corporate Bond Market

Bruno Biais, Toulouse School of Economics, France

Fany Declerck, Toulouse School of Economics, France

Discussant: Andreas Park, University of Toronto, Canada

Using a new trades and quotes dataset, we study European corporate bonds. In this OTC market, Euro denominated bonds trade on average 4 times a day and Sterling bonds 1.5 times a day. Spreads increase with maturity, default risk and dealers' market power. For a €100 bond price, in 2005, effective spreads ranged from 12 cents for small trades to 8 cents for large ones. For Sterling bonds, effective spreads ranged from 28 to 15 pence. Greater competition and liquidity and tighter spreads in the Euro market reflect participation by investors and banks from many countries. Trades have significant information content, especially for bonds with low ratings. It takes at least five trading days for the information content of a trade to be fully impounded in market pricing, reflecting lack of post trade transparency.

Algorithmic Trading and the Cross-Section of Stock Returns

Johannes Skjeltorp, Erasmus University, Norway

Elvira Sojli, Erasmus University, Netherlands

Wing Wah Tham, Erasmus University, Netherlands

Discussant: Ryan Riordan, University of Ontario Institute of Technology, Canada

We investigate the impact of AT by studying the cross-sectional relation between algorithmic trading activities and expected stock returns. We find that stocks with higher AT activity have lower expected returns, after controlling for standard market-, size-, book-to-market-, momentum, and liquidity risk factors. This effect survives a number of robustness checks and is statistically and economically significant. Our analysis highlights the importance of accounting for algorithmic trading in the cross-section of expected stock returns. The AT effect can be explained by the information diffusion hypothesis, AT reduces the cognitive inability of human traders to aggregate large amounts of information from several sources, and by impediments to trade explanations.

High Frequency Trading in the US Treasury Market: Evidence around macroeconomic news announcements

George Jiang, Washington State University, United States

Giorgio Valente, University of Essex, United Kingdom

Ingrid Ka Man Lo, Bank of Canada, Canada

Discussant: Andriy Shkilko, Wilfrid Laurier University, Canada

This paper investigates high frequency (HF) trading in the US Treasury market around major macroeconomic news announcements. Using a comprehensive tick-by-tick dataset, we identify HF trades and limit orders based on the speed of submission that is deemed to be beyond manual capacity. Our results show that HF trading activity is substantially higher following news announcements. While HF trades and limit orders tend to increase bond return volatility, they have mixed effects on market liquidity in the US Treasury market. In addition, while HF trades are more informative than non-HF trades, HF limit orders are consistently less informative than non-HF counterparts. Finally, we provide evidence that HF trades enhance price efficiency during post-announcement period.

5. Corporate Finance - I (Morrice Lismer)

Chair: Mark Huson, University of Alberta, Canada

An Empirical Assessment of Empirical Corporate Finance

Frank Li, Western Ontario, Canada

Jeffrey Coles, Arizona State University, United States

Discussant: Kai Li, University of British Columbia, Canada

We empirically evaluate 20 prominent contributions to a broad range of areas in the empirical corporate finance literature. We assemble the necessary data and then apply a single, simple econometric method, the connected-groups approach of Abowd, Karmariz, and Margolis (1999), to appraise the extent to which prevailing empirical specifications explain variation of the dependent variable, differ in composition of fit arising from various classes of independent variables, and exhibit resistance to omitted variable bias and other endogeneity problems. In particular, we identify and estimate the role of observed and unobserved firm- and manager-specific characteristics

in determining primary features of corporate governance, financial policy, payout policy, investment policy, and performance. Observed firm characteristics do best in explaining market leverage and CEO pay level and worst for takeover defenses and outcomes. In part, these results suggest where empiricists could look for better proxies for what current theory identifies as important and where theorists could focus in building new models that encompass economic forces not contained in existing models.

Business network, firm connectivity and firm policies

Ruoran Gao, Cornell University, United States

Discussant: Fred Bereskin, University of Delaware, United States

This paper examines firm policies under a network structure based on supplier-customer relationships. I demonstrate from the theoretical perspective that firms in more central positions are more susceptible to liquidity shocks from other firms in that network, and that these firms choose investment and financing policies to prevent these shocks. I provide empirical evidence consistent with my model. More centered firms exhibit three features: a more cyclical investment, lower leverage and higher cash holdings. Through the case studies of the Enron, GM and UA bankruptcies, I demonstrate the dynamics of liquidity shock transfers along the economic network. I show that firms that are more connected to distressed firms suffer a more severe decline in investment after these bankruptcies. Using the 9/11 terrorist attack as an unexpected liquidity shock to the airline industry, I show that firms closer to the airline industry increase their trade credit more than other firms, thus confirming that inter-firm lending channel contributes to the transfer of liquidity shocks. My findings reflect both that network structure is important to understand firm level policies, and that firms choose precautionary policies to mitigate the risk of liquidity shocks from the network.

Product Market Predatory Threats and Contractual Constraints of Debt

Einar Cathrinus Kjenstad, University of Rochester, United States

Xunhua Su, Norwegian University of Science and Technology, Norway

Discussant: Mark Huson, University of Alberta, Canada

We use a variant of the Hotelling (1929) model to illustrate that, when a firm faces hard payment constraint(s), financially strong rivals may adopt predatory strategies to drive the firm out of the product market and hence to obtain extra protection from enhanced market power later on. Predation is more likely to occur if the payment constraint is contingent on the firm's performance. The model predicts that firms facing higher predatory threats in the product market should be less likely to have predation-inducing covenants or the performance-pricing feature in their bank loan contracts. Empirical evidence supports these model predictions. Through a sample of about 16,000 bank loans to U.S. borrowers in 1997-2008, we find that for small firms, higher predatory threats are associated with significantly less use of financial covenants and performance-sensitive debt.

6. Equity Offerings (Pilot)

Chair: Michael Schill, University of Virginia, United States

Do Underwriters Overprice IPOs to Avert Potential Withdrawal by the Issuers?

Walid Busaba, Western University, Canada

Zheng Liu, Western University, Canada

Discussant: Ming Dong, York University, Canada

We argue that underwriters have the incentive to overprice lukewarmly-received offerings in order to avert potential withdrawal by the issuers. Empirical analysis provides supporting evidence. Measuring underwriter's pricing intention by the NASDAQ-adjusted percentage change from the offer price to the closing price three days prior to the end of the quiet period, we find 'deliberate' overpricing to be more pronounced in issues priced exactly at the lower boundary of the preliminary price range, especially when the ex ante withdrawal probability is higher or when the lower boundary represents a smaller percent drop from the range's midpoint.

Effective Junior Equity Market Regulation

Ari Pandes, University of Calgary, Canada

Michael Robinson, University of Calgary, Canada

Discussant: Steven Chong Xiao, Georgia Institute of Technology, United States

In this paper, we study Canada's Capital Pool Company (CPC) program, a program that since late-1986 has been helping high-risk small firms access public equity markets. On the surface, the program is similar to U.S. blind pool

programs which were subject to a number of frauds during the 1980s. In Canada, the first blind pools in 1986 experienced a high level of fraud and in response to this fraud the CPC program was developed. Under this program, VC-like governance mechanisms are placed on the firm's founders, and significant regulations are placed on the firm's underwriters, in an attempt to increase the quality of firm founders and to provide protection to investors. This study documents how the program has expanded over time from being based solely in one province in Canada to being adopted by regulators, issuers, and investors from many jurisdictions. In addition, we provide evidence that the quality of firms using the program to raise capital has been increasing over time and the incidence of fraud in this marketplace has been declining as a result. Quality of firms is measured by the ability of the firms: to become regularly listed firms, to have success as regularly listed firms, and to graduate to a more senior exchange. We also document an increase in the quality of the underwriting firms supporting CPC IPOs. Overall, our empirical analysis shows how the adoption of the CPC regulations created a program that has proven successful for both investors and issuers.

IPO Share Revisions

Arnold Cowan, Iowa State University, United States

Patricia Ryan, Colorado State University, United States

Discussant: Gonul Colak, Florida State University, United States

Building on a long-neglected insight of Hanley (1993), we investigate the effect of primary share increases on the widely reported relation between positive waiting-period price revisions and underpricing. Primary share increases do not weaken the price revision-underpricing relation as would be expected if share increases substituted for partial price adjustment. The results do not support the role of share allocations as a reward for information disclosure predicted by Benveniste and Spindt (1989). Further results include normal post-IPO stock price performance regard-less of whether firms revise primary shares upward, downward or not at all. Post-IPO asset and expenditure items respond to primary share changes in a manner consistent with managers adjusting shares to conform to funding needs for capital expenditure and R&D, and also are consistent with share reductions being forced by unexpectedly low IPO market demand and triggering negative real consequences.

10:00 AM – 10:15 AM

Coffee break (Foyer)

10:15 AM – 11:45 AM

1. Equity Valuation - I (Leduc-Fortin)

Chair: Raymond Kan, University of Toronto, Canada

Beta and Factor Models: Frequency Matters

Thomas Gilbert, University of Washington, United States

Christopher Hrdlicka, University of Washington, United States

Jonathan Kalodimos, University of Washington, United States

Stephan Siegel, University of Washington, United States

Discussant: Alex Horenstein, Miami University, United States

A stock's market exposure, beta, is not the same when measured across different return frequencies. Sorting stocks on the difference in their betas estimated across frequencies yields large positive alphas at high frequencies, but significantly lower alphas at low frequencies. This result occurs even in large and liquid stocks. We develop a rational expectations equilibrium model with delayed information processing for "opaque" stocks that yields a risk-based explanation for frequency dependence of betas. Empirically, we indeed find that differences between quarterly and daily betas are related to proxies of informational opacity. Finally, we show that different linear factor models are necessary for pricing assets at different frequencies. Specifically, neither the CAPM nor the Fama-French-Carhart model are appropriate asset pricing models at high frequencies.

Beta Matrix and Common Factors in Stock Returns

Alex Horenstein, University of Miami, United States

Seung Ahn, Arizona State University, United States

Na Wang, Hofstra University, United States

Discussant: Christopher Hrdlicka, University of Washington, United States

Many variables have been proposed as common risk factors driving asset returns, which we refer to as "empirical factors" to distinguish them from true latent factors. We examine how many true latent factors are correlated with the empirical factors by estimating the rank of the beta matrix corresponding to the empirical factors. We develop a new rank estimation method to handle data with a large number of asset returns. Our results from the analysis of the U.S. individual and portfolio stock returns are consistent with the notion that the three empirical factors of Fama and French (FF, 1993) are correlated with three linearly independent true latent factors. Using more empirical factors in addition to the FF factors increases the rank of the beta matrix by one or two. Using twenty-six empirical factors for testing several models, we find that the only multifactor model that generates a full rank beta matrix is the FF three-factor model.

Is the Beta-Return Relation Too Flat? The Role of Conditioning Information in Time-Series CAPM Tests

Scott Cederburg, University of Arizona, United States

Michael O'Doherty, University of Missouri, United States

Discussant: Narayan Bulusu, Bank of Canada, Canada

We investigate the time-series evidence that beta is under-rewarded relative to the predictions of the Capital Asset Pricing Model (CAPM). Prior studies find that a portfolio that buys high-beta stocks and sells low-beta stocks has a significantly negative unconditional CAPM alpha. We show, however, that the beta for this portfolio covaries negatively with the equity premium and positively with market volatility, causing its unconditional alpha to be a downward-biased estimate of its true alpha. The conditional CAPM thus resolves much of the performance difference between high- and low-beta stocks. We propose a model to explain the observed time-series variation in portfolio betas via the entry of new high-beta firms when valuations are high and the mechanical reweighting of the stock market. While the conditional CAPM holds in the model by construction, the unconditional alpha estimates are often negative and significant. We also confirm several testable implications of the theory. Notably, the current cross-sectional distribution of firm-level betas has important predictive content for market returns, and recent IPO activity forecasts trends in market risk for the beta-sorted test assets.

2. Financial Intermediation (410)

Chair: Michael King, Western University, Canada

The Monitoring Incentive of Transactional and Relationship Lenders: Evidence from the Syndicated Loan Market

Anthony Saunders, New York University, United States

Pei Shao, University of Lethbridge, Canada

Yutao Li, University of Lethbridge, Canada

Discussant: Claudia Champagne, Université de Sherbrooke, Canada

We identify a group of lenders specializing in syndicating tradable loans (referred to as transactional loan originators, "TLOs"). We compare TLO-led loans with relationship lenders-led loans (RL-led loans). We find that TLO-led loans are more likely to be resold into the secondary loan market and involve a greater number of non-bank institutional lenders than RL-led loans. We also show that borrowers borrowing TLO-led loans experience worse operating performance and severer creditworthiness deterioration after a loan origination compared with those borrowing RL-led loans. We conclude that while TLOs may have helped improve loan liquidity, they may also have reduced incentives to monitor borrowers. Our paper provides first hand empirical evidence on the implications of relationship-based banking versus transactional-orientated activities in the loan market.

Adverse Selection and Intermediation Chains

Vincent Glode, University of Pennsylvania, United States

Christian Opp, University of Pennsylvania, United States

Discussant: Katya Malinova, University of Toronto, Canada

We propose a parsimonious model of over-the-counter trading to rationalize the existence of intermediation chains that stand between asymmetrically informed traders. Trading an asset through multiple intermediaries can preserve

the efficiency of trade by spreading an adverse selection problem over many sequential transactions. An intermediation chain that involves moderately informed agents helps ensure that the information asymmetries counterparties face in each transaction are small enough to result in socially efficient trading strategies by all parties involved. Our model makes novel predictions about rent extraction and socially optimal network formation when adverse selection problems impede the efficiency of trade.

Estimating Changes in Supervisory Standards and Their Economic Effects

William Bassett, Federal Reserve Board, United States

Seung Jung Lee, Federal Reserve Board, United States

Thomas Spiller, Federal Reserve Board, United States

Discussant: Michael King, Western University, Canada

The disappointingly slow recovery in the U.S. from the recent recession and financial crisis has once again focused attention on the relationship between financial frictions and economic growth. With bank loans having only recently started growing and still sluggish, some bankers and borrowers have suggested that unnecessarily tight supervisory policies have been a constraint on new lending that is hindering recovery. This paper explores one specific aspect of supervisory policy: whether the standards used to assign commercial bank CAMELS ratings have changed materially over time (1991-2011). We show that models incorporating time-varying parameters or economy-wide variables suggest that standards used in the assignment of CAMELS ratings in recent years generally have been in line with historical experience. Indeed, each of the models used in this analysis suggests that the variation in those standards has been relatively small in absolute terms over most of the sample period. However, we show that when this particular aspect of supervisory stringency becomes elevated, it has a noticeable dampening effect on lending activity in subsequent quarters

3. Investment Funds - II (415)

Chair: Susan Christoffersen, University of Toronto, Canada

Hedge Fund Ownership and Stock Market Efficiency

Lubomir Petrusek, Federal Reserve Board, United States

Charles Cao, Penn State University, United States

Discussant: Laleh Samarbakhsh, Wilfred Laurier University and Ryerson University, Canada

We test two competing hypotheses regarding the role of hedge funds in securities markets. One hypothesis is that hedge funds contribute to market efficiency by taking advantage of inefficiencies in the pricing of securities. Another hypothesis contends that hedge funds may destabilize financial markets because their trading strategies rely on quantitative algorithms, leverage, and high turnover. We examine the empirical relation between changes in hedge fund stock holdings and the informational efficiency of equity prices, and find that, on average, increased hedge fund ownership leads to significant improvements in the informational efficiency of equity prices. The contribution of hedge funds to price efficiency is greater than the contributions of other types of institutional investors, such as mutual funds or banks. Interestingly, greater hedge fund ownership of stocks is associated with less efficient pricing in times of market stress. Our findings suggest that the effect of hedge funds on stock market efficiency depends on funding liquidity.

Do hedge fund managers manage beta risk?

Ethan Namvar, University of California, United States

Blake Phillips, University of Waterloo, Canada

Kuntara Pukthuangthong, San Diego State University, United States

Raghu Rau, University of Cambridge, United Kingdom

Discussant: Laurent Barras, McGill University, Canada

Hedge fund managers preferentially seek to maintain low beta risk across market states, forgoing potential market timing opportunities, but do increase beta risk in response to increasing correlation risk. Better educated and more experienced managers have greater skill in managing beta risk and this ability is more pronounced during down markets. Investors recognize skill in managing systematic and correlation risk and reward funds with persistently low risks with incremental flows. Funds appear to preferentially time fee increases to coincide with decreases in beta and correlation risk. These higher costs are offset for investors by the superior performance of the funds.

4. Market Microstructure - II (414)

Chair: Fany Declerck, Toulouse School of Economics, France

Informed Trading before Unscheduled Corporate Events: Theory and Evidence

Shmuel Baruch, University of Utah, United States

Marios Panayides, University of Pittsburgh, United States

Kumar Venkataraman, Southern Methodist University, United States

Discussant: Bing Han, University of Texas, United States

Despite widespread evidence that informed agents are active before corporate events, there is little work describing how informed agents accumulate positions and what explains their trading strategies. We use the prisoners' dilemma to model the execution risk that informed traders impose on each other and explain why they forgo the price benefit of limit orders and use instead market orders. However the efficient limit-orders outcome is obtained if there is sufficient uncertainty about the presence of informed traders. We link the level of uncertainty to costly short selling and test theoretical predictions using detailed order level data from Euronext Paris. We find strong empirical support for the prediction that informed traders use limit orders when the news is negative, especially when (a) the investor base is not broad, (b) security borrowing costs are high, and (c) the magnitude of the event is small so potential profits cannot justify the cost of borrowing. When the news is positive, we show that informed buyers face more competition and use market orders. These results help explain the buy-sell asymmetry in price impact of trades and provide a framework for surveillance systems that are designed to detect insider trading.

The Externalities of High-Frequency Trading

Mao Ye, University of Illinois, United States

Chen Yao, University of Warwick, United Kingdom

Jiading Gai, University of Illinois, United States

Discussant: Shmuel Baruch, University of Utah, United States

We show that two exogenous technology shocks that increase the speed of trading from microseconds to nanoseconds do not lead to improvements on quoted spread, effective spread, trading volume or variance ratio. However, cancellation/execution ratio increases dramatically from 26:1 to 32:1, short term volatility increases and market depth decreases. We find evidence consistent with "quote stuffing," which involves submitting an extraordinarily large number of orders followed by immediate cancellation in order to generate order congestion. The stock data are handled by six independent channels in the NASDAQ based on alphabetic order of ticker symbols. We detect abnormally high levels of co-movement of message flows for stocks in the same channel using factor regression, a discontinuity test and diff-in-diff test. Our results suggest that an arms race in speed at the sub-millisecond level is a positional game in which a trader's pay-off depends on her speed relative to other traders. This game leads to positional externality (Frank and Bernanke, 2012), in which private benefit leads to offsetting investments on speed, or effort to slow down other traders or the exchange, with no observed social benefit.

Basket Securities in Segmented Markets

Carlos Ramirez, Carnegie Mellon University, United States

Discussant: Fany Declerck, Toulouse School of Economics, France

I study the design and welfare implications of basket securities issued in markets with limited investor participation. Profit-maximizing issuers exploit investors' inability to trade across different markets and choose which market to specialize in. I show that when the issuer is a monopoly, the equilibrium may not be constrained efficient. Increasing competition among issuers increases the variety of baskets issued but does not always improve investors' welfare. Although competition increases the variety of baskets issued, many of them are redundant in the sense that coordination among issuers could improve investors' risk sharing opportunities. The equilibrium basket structure depends on institutional features of a market such as depth and gains from trade. The estimated model provides measures of the effective segmentation an investor encounters when investing in commonly traded index funds. The estimated model suggests that the segmentation in S&P 100 index funds is almost two times larger than the segmentation in S&P 500 index funds. Furthermore, the segmentation in S&P Small Cap 600 index funds is about five times larger than the segmentation in S&P 500 index funds.

5. Governance - I (Morrice Lismer)

Chair: Ron Giammarino, University of British Columbia, Canada

CEO Turnover-Performance Sensitivity in Private Firms

Huasheng Gao, Nanyang Technological University, Singapore

Jarrad Harford, University of Washington, United States

Kai Li, University of British Columbia, Canada

Discussant: Ruoran Gao, Cornell University, United States

We provide a large sample comparison of CEO turnover in public and private firms in order to gain insight into whether and how different governance structures and investor horizons influence CEO firing and hiring decisions. We show that public firms have higher CEO turnover rates and exhibit higher turnover-performance sensitivity than private firms. Public firms are less likely to hire external CEOs than private firms, and are especially less likely to hire external CEOs from private firms. Finally, we show that the performance improvement around CEO turnover is more evident for private firms than for public firms. We discuss differences in agency problems, information environments, and investor myopia as possible explanations for the differences. The evidence of segmentation in the CEO labor market provides an explanation for how differing turnover risks can persist in public versus private firms.

The Causal Effect of Option Pay on Corporate Risk Management: Evidence from the Oil and Gas Industry

Tor-Erik Bakke, University of Oklahoma, United States

Hamed Mahmudi, University of Oklahoma, United States

Chitru Fernando, University of Oklahoma, United States

Jesus Salas, Lehigh University, United States

Discussant: Doron Levit, University of Pennsylvania, United States

We revisit the contentious relation between option compensation and managerial risk-taking by studying how FAS 123R – which eliminated the ability of firms to avoid expensing at-the-money stock option grants for accounting purposes – affected hedging behavior in the oil and gas industry. We hypothesize that a decrease in sensitivity of CEO wealth to stock return volatility (vega) decreases CEO risk-taking incentives, causing affected firms to hedge more. We use the FAS 123R compliance requirement to identify changes in CEO compensation vega that are exogenous to corporate hedging policy for a hand-collected sample of oil and gas firms with detailed hedging data. Using a difference-in-differences approach we find that firms that did not expense executive stock options at fair value before FAS 123R significantly reduced their option pay, which caused them to dramatically increase their average hedging intensity following the change, compared to similar firms that (a) did not use options to pay their CEOs or (b) expensed their executive stock options at fair value voluntarily prior to FAS 123R. Our findings provide strong support for the view that compensation convexity positively affects managerial risk-taking incentives.

CEO Duality and Firm Performance: Evidence from an Exogenous Shock to the Competitive Environment

Tina Yang, Villanova University, United States

Shan Zhao, Grenoble Ecole de Management, France

Discussant: Ron Giammarino, University of British Columbia, Canada

Regulators and governance activists are pressuring firms to abolish CEO duality (Chief Executive Officer also being the Chairman of the Board). However, the literature provides mixed evidence on the relation between CEO duality and firm performance. Using the exogenous shock of the 1989 Canada-United States Free Trade Agreement, we find that duality firms outperform non-duality firms by 3-4% when their competitive environments change. Further, the performance difference is larger for firms with higher information costs and better corporate governance. Our results underscore the benefits of CEO duality in saving information costs and making speedy decisions.

6. Debt Financing (Pilot)

Chair: Harjoat Bhamra, University of British Columbia, Canada

Cash Holdings and Bank Loan Terms

Mark Huson, University of Alberta, Canada

Lukas Roth, University of Alberta, Canada

Discussant: Chris Mitchell, Bank of Canada, Canada

Conspicuously absent from the large literature examining the determinants of contract terms in bank loans is an examination of the impact of firms' cash holdings. Since the effect of cash holdings on loan terms is not clear ex ante we conduct an empirical analysis. We document a significant negative relation between cash and loan spreads that is robust to using cash as reported on the balance sheet, a measure of exogenous cash, and measures of normal and excess cash. The impact of cash on loan spreads is stronger for below investment-grade borrowers, when credit conditions are tight, and for shorter maturity loans. We also find a positive (negative) relation between cash and both loan maturity and the likelihood of borrowing from a single lender (the likelihood that the loan is secured and the number of covenants associated with a loan). Finally, we document a negative relation between cash and covenant tightness. Our results suggest that high cash balances increase both financial and operational flexibility by lowering price and non-price costs of bank loans.

Lending to Innovative Firms: The Role of Lender Expertise and Control Rights

Sudheer Chava, Georgia Institute of Technology, United States

Vikram Nanda, Georgia Institute of Technology, United States

Steven Chong Xiao, Georgia Institute of Technology, United States

Discussant: Einar Cathrinus Kjenstad, University of Rochester, United States

Is bank financing compatible with innovation? We examine whether banks -- particularly those experienced in lending to innovative firms -- recognize the value and salability of a firm's patents in pricing loans ex ante and in exercising control rights ex post if covenants are subsequently violated. Our empirical evidence suggests that lending by experienced banks is consonant with innovative activities in keeping with the tangibility that patent protection confers to intellectual property. Ex ante, firms with significant patent activity receive cheaper bank loans compared to other firms. Experienced banks, in particular, provide cheaper loans when patents are of high quality i.e., are well cited and more general patents. We allay endogeneity concerns by showing that patent related benefits increase following an exogenous change in laws lengthening the patent protection period. Ex post, when covenants are violated and control rights pass to lenders, experienced lenders cut R&D significantly, particularly when the violating firm has lower R&D efficiency. The stock market response is generally more positive following technical covenant violations by innovative firms when the bank is experienced.

Why Do Firms Issue Convertible Bonds? Evidence from the Field

Ming Dong, York University, Canada

Marie Dutordoir, University of Manchester, United Kingdom

Chris Veld, University of Glasgow, United Kingdom

Discussant: Bo Li, Queen's University, Canada

We conduct in-depth interviews with top executives to examine why companies issue convertible bonds. Convertible debt issuers forego straight debt because it is too costly or covenant-heavy, and rule out equity because of perceived equity undervaluation. Managers time their offering based on investor appetite for convertible securities. The evidence provides considerable support for the risk uncertainty theory on convertible issuance, while risk shifting, sequential financing, and backdoor equity theories receive little or no support. A question-conditional analysis of survey responses of a large sample of CFOs corroborates our findings, and highlights the added value of in-depth interviews compared to questionnaires.

11.45 AM – 1.30 PM

Lunch (Suzor-Côté)

NFA Annual General Meeting

Approval of Bylaws

Election of Directors

Best Paper Awards Ceremony

Keynote address

John Y Campbell, Harvard University "Understanding Volatility Risk"

John Y Campbell grew up in Oxford, England, and received a BA from Oxford in 1979. He came to the United States to attend graduate school, earning his PhD from Yale in 1984. He spent the next ten years teaching at Princeton, moving to Harvard in 1994. In 2006 his undergraduate teaching was acknowledged with a Harvard College Professorship.

Campbell has published over 80 articles on various aspects of finance and macroeconomics, including fixed-income securities, equity valuation, and portfolio choice. His books include *The Econometrics of Financial Markets* (with Andrew Lo and Craig MacKinlay, Princeton University Press 1997), *Strategic Asset Allocation: Portfolio Choice for Long-Term Investors* (with Luis Viceira, Oxford University Press 2002), and *The Squam Lake Report: Fixing the Financial System* (with the Squam Lake Group of financial economists, Princeton University Press, 2010).

Campbell served as President of the American Finance Association in 2005 and as President of the International Atlantic Economic Society in 2009. He is a Research Associate and former Director of the Program in Asset Pricing at the National Bureau of Economic Research, a Fellow of the Econometric Society and the American Academy of Arts and Sciences, a Corresponding Fellow of the British Academy and Honorary Fellow of Corpus Christi College, Oxford, and holds honorary doctorates from the University of Maastricht and the University of Paris Dauphine. He is also a founding partner of Arrowstreet Capital, LP, a Boston-based quantitative asset management firm. At Harvard, Campbell helped to oversee the investment of the endowment as a board member of the Harvard Management Company from 2004-2011 and served as Chair of the Department of Economics from 2009-2012.

1.45 PM – 3.15 PM

1. Equity Valuation - II (Leduc-Fortin)

Chair: Timothy Simin, Penn State University, United States

Industry costs of equity: incorporating prior information

Ping Wang, University of Arizona, United States

Discussant: Marco Rossi, University of Notre Dame, United States

Fama and French (1997) conclude that "estimates of the cost of equity for industries are imprecise." This paper applies a Bayesian shrinkage approach to re-estimate the industry betas using the CAPM. I find that an economically motivated shrinkage prior and a hierarchical prior constructed based on industry fundamentals yield more accurate Bayesian beta estimates, which translate into more accurate out-of-sample forecasts of industry costs of equity. Compared to the OLS beta estimates, the Bayesian beta estimates significantly reduce the forecast errors for one-year to five-year forecast horizons. There are two reasons for the outperformance of the Bayesian beta estimates in forecasting industry returns. First, incorporating prior information reduces the OLS estimation errors and yields more accurate beta posterior estimates. Second, industry betas have strong mean reversion property, which is captured by the Bayesian shrinkage approach.

Market Belief Risk and the Cross-Section of Stock Returns

Songtao Wang, NYU Stern School of Business, United States

Rajna Gibson Brandon, University of Geneva and Swiss Finance Institute, Switzerland

Discussant: Marie-Hélène Gagnon, Université Laval, Canada

This paper studies the effect of market belief risk on the cross-section of stock returns. Using actual and analyst EPS forecast data, we construct the market belief as the cross-sectional average of individual beliefs for all sample stocks, with individual belief defined as the mean analyst EPS forecast minus the one derived from an econometric

model. We observe that a portfolio that is long in stocks with the highest sensitivities and short in stocks with the lowest sensitivities to innovations in market belief earns an average yearly return of 5.4%. This positive relationship between market belief risk and stock returns persists after accounting for traditional risk factors and is particularly strong for large-cap stocks. These findings are robust when considering alternative specifications of market belief risk. Finally, we find that stocks' exposure to market belief risk increases with their market beta, volatility, turnover rate, and their sale-to-asset ratio and decreases with their size, momentum, and analyst coverage.

Stocks with Extreme Past Returns: Lotteries or Insurance?

Alexander Barinov, University of Georgia, United States

Discussant: Raymond Kan, University of Toronto, Canada

The paper shows that lottery-like stocks are hedges against unexpected increases in market volatility. The loading on the aggregate volatility risk factor explains low returns to stocks with high maximum returns in the past (Bali, Cakici, and Whitelaw, 2012) and high expected skewness (Boyer, Mitton, and Vorkink, 2010). Aggregate volatility risk also explains the new evidence that the maximum effect and the skewness effect are stronger for the firms with high short-sale constraints, high market-to-book, and low credit rating.

2. Financial Crises (410)

Chair: Alfred Lehar, University of Calgary, Canada

Do Financial Regulations Matter for Firm Performance? Evidence from Systemic Banking Crises

Varouj Aivazian, University of Toronto, Canada

Ding Ding, University of Toronto, Canada

Mohammad Rahaman, Saint Mary's University, Canada

Discussant: Alaa Guidara, Université Laval, Canada

How do financial market regulations affect firm performance? We investigate this question using episodes of systemic banking crises across many countries as identification tools for unanticipated credit contractions and compare firm investment, sales and inventory growth during the crisis and the post-crisis periods relative to the pre-crisis level averages. We exploit variations in our sample firms' external financial dependence and financial constraints to show that credit contractions are costly for firms, but that the costs are borne disproportionately by financially constrained firms and also by firms normally relying more on the external capital market for their financing needs. Furthermore, declines in investment, sales, and inventory growth are greater for an externally dependent and financially constrained firm if the firm is also embedded in an ex-ante "repressively" regulated financial market compared to a similar firm embedded in a "reformed" financial market; these terms refer to the degree of financial market liberalization. Our results suggest that specific financial reform plays a significant role in attenuating the propagation of a banking crisis to the real sector.

How Does Bank Trading Activity Affect Performance? An Investigation Before and After the Financial Crisis

Michael King, Western University, Canada

Nadia Massoud, York University, Canada

Keke Song, Dalhousie University, Canada

Discussant: Chen Liu, Queen's University, Canada

The current debate on the impact of proposed regulations to ban or limit proprietary trading activities in the banking industry (Volcker Rule, Vickers Report and Liikanen Report) has motivated us to examine whether the exposure of US bank holding companies (BHC) to trading assets has an adverse impact on their risk and profitability. The diversification literature and the conglomerate discount literature provide conflicting predictions about how a BHC could benefit from combining different lines of business. It is unclear whether expanding into trading activities improves or weakens a BHC's financial performance. We find that trading assets and trading income shares of operating income are positively correlated with a BHC's riskiness and negatively correlated with their profitability, especially during and after the 2007-2009 financial crisis. BHCs with higher equity buffers and more funding from deposits are less affected. These results are supportive of the proposed restrictions on proprietary trading in the banking industry.

Liquidity Emergency Facilities in the Recent Crisis: Flexibility vs Signalling in the Discount Window and TAF

Celine Gauthier, Université du Québec, Canada

Alfred Lehar, University of Calgary, Canada

Hector Perez Saiz, Bank of Canada, Canada

Moez Souissi, International Monetary Fund, Kuwait

Discussant: Scott Hendry, Bank of Canada, Canada

In this paper, we empirically and theoretically study the access of US banks to two liquidity facilities that played a relevant role during the recent crisis: the discount window (DW) and the term auction facility (TAF). During the period following the event of Lehman's failure, banks that relied more heavily on wholesale funds were willing to pay a premium to participate in the TAF rather than the more flexible DW. In the months after the failure of Lehman, this behavior ceased, and we observe that TAF rates were actually lower than DW rates. Combining this data with FDIC Call Reports, we also ...find that in the post Lehman's failure period, banks that accessed the TAF had significantly lower funding costs than banks that accessed the DW facility. In addition, banks that accessed the DW experienced higher failure rates than TAF banks. We propose a signaling model that is consistent with the pattern described above. In this model, during periods of large asymmetric information in fund markets, some banks may decide to signal themselves as 'good' banks by paying a higher price for funds in TAF. By doing so, these banks not only avoid stigma effects but also give up the flexibility benefits associated with the DW. When information becomes less asymmetric in the markets, the signaling effects are reduced, with banks being less tempted to bid high price for funds in the TAF, and the flexibility gains of using DW becomes predominant reason for accessing the DW.

3. Behavioral Finance (415)

Chair: Warren Bailey, Cornell University, United States

Firm Heterogeneity and Investor Inattention to Friday Earnings Announcements

Roni Michaely, Cornell University, United States

Amir Rubin, Simon Fraser University, Canada

Alexander Vedrashko, Simon Fraser University, Canada

Discussant: Mark Kamstra, York University, Canada

DellaVigna and Pollet (2009) argue that the documented underreaction to Friday earnings announcements can be attributed to investors' inattention on Friday relative to other days of the week. Using four approaches, we examine the impact of firm heterogeneity on the immediate reaction and drift for Friday earnings announcements. First, we identify that Friday underreaction is generated only by announcements made after trading hours on Friday and find that firms that have made a Friday evening announcement experience a reduced reaction to earnings news announced not only on Friday but also on non-Friday weekdays. Second, we match Friday evening announcements to other weekday-evening announcements based on firm characteristics, such as market capitalization, institutional holdings, and analyst following. There is no difference in the response to earnings announcements between the two groups. Third, we find that firm fixed effects eliminate the Friday effect. Fourth, the market response to Friday evening earnings announcements is not different from the market response to earnings announcements of the very same firms on other evenings of the week. Finally, we find that the smaller trading volume found by DellaVigna and Pollet for Friday announcements is not earnings-related. We conclude that while inattention may explain certain patterns in the behavior of investors and prices in financial markets, it is not the reason for the reduced reaction to earnings announced on Friday.

Seasonally Varying Preferences: Theoretical Foundations for an Empirical Regularity

Mark Kamstra, York University, Canada

Lisa Kramer, University of Toronto, Canada

Maurice Levi, University of British Columbia, Canada

Tan Wang, University of British Columbia, Canada

Discussant: Vincent Glode, University of Pennsylvania, United States

Equity and Treasury returns exhibit distinct seasonal cycles that are difficult to reconcile in a standard asset pricing framework. We investigate a representative agent asset pricing model in which we allow agents' preferences to cycle between two semi-annual seasons, with high risk aversion in one season and low risk aversion in the other. We explore whether any reasonable parameterization of this model can generate the observed seasonal patterns that equity and Treasury returns exhibit, and whether such a parameterization can match the observed magnitudes of seasonal return cycles. Calibrating to consumption data and incorporating the use of levered equity, we produce

returns that match the qualitative and quantitative characteristics of observed equity and Treasury returns across the seasons. Specifically, during the season when the representative agent is more risk averse, risky asset returns are higher and risk-free returns are lower or stable; and further, risky asset returns vary seasonally more than risk-free returns. While a model with seasonally varying risk aversion is sufficient to match the directions of seasonal changes and rough magnitudes in returns, a novel result of our study is that additionally allowing seasonal variation in the intertemporal elasticity of substitution provides an even closer match to features of the data.

The Effect of A CEO's Prior Performance on Her Risk Taking

Jiyeon Lee, University Of Illinois, United States

Discussant: Lisa Kramer, University of Toronto, Canada

I examine how a CEO's prior performance affects her managerial decision making. Specifically, I test whether and how a CEO's risk taking is influenced by her prior gain/loss relative to potential reference points. To this end, I employ two reference points that take into account the CEO's performance in the past and/or industry effects. As a proxy for the riskiness of projects, I employ two measures of a firm's asset volatility. Controlling for CEO fixed effects, I find that CEOs choose less risky projects after making gains. This result suggests that after a good performance, a CEO feels relaxed because she is less likely to be fired and thus prefers to work on safe and easy projects. This finding is consistent with a CEO's value function being S-shaped as in prospect theory, in which a CEO is in a more concave part of her value function after making a gain. In addition, I conduct a set of tests to rule out the possibility that such relationship arises because of reasons other than the CEO's bias. Lastly, I examine how a CEO's risk taking is affected by her compensation structure. If a CEO's risk taking is determined by balancing her desire to live a quiet life against her desire to increase wealth, then she can be induced to take optimal (riskier) projects by increasing stock-based compensation. The empirical result supports this hypothesis. I find a negative relationship between asset volatility and prior gains only among CEOs with lower proportions of stock-based compensation.

4. Market Microstructure - III (414)

Chair: Burton Hollifield, Carnegie Mellon University, United States

Disclosure and Efficiency in Noise-Driven Markets

Bing Han, University of Texas, United States

Yu-Jane Liu, Peking University, China

Ya Tang, Peking University, China

Liyan Yang, University of Toronto, Canada

Lifeng Yu, Peking University, China

Discussant: Joshua Slive, Bank of Canada, Canada

Disclosure can negatively affect market efficiency and real investment performance in markets populated with uninformed noise traders whose trading is affected by disclosure. This paper formalizes this idea by proposing a model where disclosure attracts noise trading and where firms look into stock prices to guide their real investment decisions. The model predicts that disclosure can reduce the amount of information learned by firms from the price, thereby harming the investment efficiency. Using accounting and financial data in the Chinese market, the largest emerging market dominated by noise traders, we find strong support for these predictions regarding the dark side of disclosure for both informational and allocative efficiency.

High Frequency Trading and End-of-Day Manipulation

Douglas Cumming, York University, Canada

Feng Zhan, York University, Canada

Michael Aitken, University of New South Wales, Australia

Discussant: Mao Ye, University of Illinois, Canada

Controlling for country, market, legal and other differences across exchanges and over time, and using a variety of robustness checks, we show that the presence of high frequency trading has significantly mitigated the frequency and severity of end-of-day price manipulation, counter to recent concerns expressed in the media. The effect of HFT is more pronounced than the role of trading rules, surveillance, enforcement and legal conditions in curtailing the frequency and severity of end-of-day manipulation. We show our findings are robust to different measures of end-of-day manipulation, including but not limited to option expiry dates, among other things.

Informed Trading and Maker-Taker Fees in a Low-Latency Limit Order Market

Michael Brolley, University of Toronto, Canada

Katya Malinova, University of Toronto, Canada

Discussant: Patrik Sandas, University of Virginia, United States

We model a financial market where privately informed investors trade in a limit order book monitored by low-latency liquidity providers. Price competition between informed limit order submitters and low-latency market makers allows us to capture tradeoffs between informed limit and market orders in a methodologically simple way. We apply our model to study maker-taker fees --- a prevalent, but controversial exchange fee system that pays a maker rebate for liquidity provision and levies a taker fee for liquidity removal. When maker-taker fees are passed through to all traders, only the total exchange fee per transaction has an economic impact, consistent with previous literature. However, when investors pay only the average exchange fee through a flat fee per transaction---as is common practice in the industry---maker-taker fees have an impact beyond that of a change in the total fee. An increase in the maker rebate lowers trading costs, increases trading volume, improves welfare, but decreases market participation by investors.

5. Corporate Finance - II (Morrice Lismer)

Chair: Kai Li, University of British Columbia, Canada

Capital Income Taxation and Corporate Payout Policy

Chris Mitchell, Bank of Canada, Canada

Discussant: Brian Smith, Wilfrid Laurier University, Canada

This paper presents new evidence that firms adjust corporate payout in response to capital income tax rate changes. The analysis is carried out with a unique data set on share repurchase programs executed by Canadian corporations listed on the Toronto Stock Exchange, and with new estimates of average Canadian marginal tax rates on dividend income and realised capital gains income. The results suggest that total payout levels are positively related to changes in the capital gains tax rate, and are unaffected by changes in the dividend tax rate. These results are consistent with the new view model of corporate payout policy, while they are inconsistent with the Traditional view model. Additionally, it is found that share repurchase levels are positively related to changes in the dividend tax rate and negatively related to changes in the capital gains tax rate, whereas dividend levels are positively related to changes in the capital gains tax rate and negatively related to changes in the dividend tax rate.

Optimal Contracts under Capital Accumulation

Kyoung Jin Choi, University of Calgary, Canada

Discussant: Felipe Aguerrevere, University of Alberta, Canada

This paper studies a continuous-time moral hazard problem with capital accumulation when output shocks depend on firm size. We explicitly analyze the incentive scheme when both the principal and the agent are risk-averse and technology is linear with respect to capital and effort. We investigate implications of the size dependent shock for the optimal effort level, the incentive scheme, investment decisions over firm size, and other interesting features in firm dynamics. These results differ considerably from those that do not consider the firm size effect, and are consistent with empirical regularities regarding growth rates, investment rates, and payout policies. An important application of this model is that it can also explain the firm-level poverty trap puzzle: why many small firms do not save to grow, even though, while external financing is constrained, they seem to have sufficient profits.

Refinancing Risk, Managerial Risk Shifting, and Debt Covenants: An Empirical Analysis

Bo Li, Queen's University, Canada

Discussant: Elena Simintzi, University of British Columbia, Canada

This paper identifies a special channel (the long-term debt maturity structure) through which the credit crisis of 2008 affected corporate investment. I provide empirical evidence of shareholders' risk-shifting behavior in the investment decisions by exploiting the real effects of ex-ante heterogeneity of long-term debt maturity structure. The first hypothesis, which examines the relationship between financial frictions and risk-shifting behavior, demonstrates that: (i) firms whose long-term debt was maturing at the peak of crisis in 2008 experienced close to 2% increase in investment than similar firms whose debt became mature prior to 2008. The second hypothesis, which studies the effectiveness of debt covenants in mitigating agency conflicts, indicates that: (ii) covenant restrictions increase market-to-book ratio by 3.8% for distressed firms than similar firms without covenants. Furthermore, I use event study to show that firm stock price performance deteriorates following the refinancing activity and improves with

stronger creditor control. I highlight the importance of debt maturity structure for corporate financing and investment policies. More than merely showing the risk-shifting issue itself, my analysis suggests that accounting-based covenants can serve as a corporate governance tool in mitigating investment distortions arising from financial market shocks.

6. Mergers and Acquisitions - I (Pilot)

Chair: Sandra Betton, Concordia University, Canada

Havenly Acquisitions

Burcin Col, Pace University, United States

Vihang Errunza, McGill University, Canada

Discussant: Melissa Toffanin, Ryerson University, Canada

We explore the valuation consequences of tax avoidance. Using an international sample of cross-border mergers that involve tax haven targets and/or acquirers over the period 1989 to 2010, we find that the announcement returns to targets and acquirers of tax haven firms are lower relative to a control sample of non-tax motivated M&As. The evidence is consistent with the agency costs from weaker disclosure and corporate governance laws as well as taxpayer backlash that more than offset tax savings.

Acquisitions by CEOs with Supply-chain Expertise

Tu Nguyen, Drexel University, United States

Discussant: Pablo Moran, University of British Columbia, Canada

Is the experience of the bidding CEO in the target's supply chain related to the acquirer's gain from the deal? This paper shows that acquisitions by CEOs with this supply-chain experience exhibit higher acquirer abnormal returns at deal announcement. Supply-chain expertise is also associated with improved long-term operating performance at the merged firm. However, there is no evidence that CEOs with supply-chain expertise receive higher compensation or lower pay-for-performance sensitivity following an acquisition. In general, my findings indicate that acquisitions by CEOs with expertise in the target's supply chain generate substantial gains for the acquiring shareholders.

When Banks Compete, Who Wins? The Loosening of Financial Constraints and Private Firm Sales

Daniel Greene, Georgia State University, United States

Discussant: Yuan Wang, Concordia University, Canada

I examine sales of private firms to better understand the effects of loosening financial constraints on firm valuation. Empirical tests exploit an exogenous shock to competition among banks at the state level caused by deregulation of interstate bank branching restrictions. This shock is likely to reduce financial constraints on private firms located in the state. On a sample of 564 sales of private firms to public acquirers, I find that increased competition among banks leads to a statistically significant increase of 7.75% in private firm valuations. I also find an increase in private firm valuation multiples benchmarked to public firm valuation multiples, which indicates that corporate liquidity discounts are affected by the private firm's banking environment. The impact on private firm valuations and valuations benchmarked to public firm valuations is greater for private firms that are smaller or have negative operating cash flows. Acquirer abnormal stock returns are lower and acquirer abnormal wealth gains per dollar paid to the target are lower when competition among banks in the private firm's state increases. These effects are not observed for public targets, which are likely to be less dependent on local banks. The evidence is consistent with private firms substituting bank credit for some of the financing benefits provided by acquirers when financial constraints are loosened.

3.15 PM – 3.30 PM

Coffee break (Foyer)

1. Equity Valuation - III (SESSION ENDS AT 17:30) (Leduc-Fortin)

Chair: Bing Han, University of Texas, United States

Robust Inference in Linear Asset Pricing Models

Raymond Kan, University of Toronto, Canada

Nikolay Gospodinov, Concordia University, Canada

Cesare Robotti, Federal Reserve Bank of Atlanta, United States

Discussant: Daniel Andrei, University of California-Los Angeles, United States

Many asset pricing models include risk factors that are only weakly correlated with the asset returns. We show that in the presence of a factor that is independent of the returns ("useless factor"), the standard inference procedures for evaluating its pricing ability could be highly misleading in misspecified models. Our proposed model selection procedure, which is robust to useless factors and potential model misspecification, restores the standard inference and proves to be effective in eliminating factors that do not improve the model's pricing ability. The practical relevance of our analysis is illustrated using simulations and an empirical application.

Return Predictability under the Alternative

Marco Rossi, Notre Dame University, United States

Timothy Simin, Penn State University, United States

Daniel Smith, QUT Business School, Australia

Discussant: Masa Watanabe, University of Alberta, Canada

We propose a new standard error estimator useful in tests of long-run return predictability. Our standard error exhibits substantial power gains with only minor size distortions relative to popular tests, does not require imposing the null hypothesis that returns are unpredictable, and does not require estimation of additional autocovariance terms. Deriving the covariance matrix without imposing the null hypothesis also produces two new terms in the spectral density matrix capturing the volatility of the shock to the regressor and the correlation between the shocks of the predictor variable equation and the prediction equation. Empirically, we show that failure to detect return predictability at longer horizons is partially due to the lower power of tests derived under the null hypothesis. For many predictors, giving the alternative a chance allows short-run predictability to survive in long-horizon regressions.

Asset Pricing with a Bank Risk Factor

Joao Pedro Pereira, Instituto Universitário de Lisboa, Portugal

Antonio Rua, Banco de Portugal, Portugal

Discussant: Scott Cederburg, University of Arizona, United States

This paper studies how the state of the banking sector influences stock returns of nonfinancial firms. We consider a two-factor pricing model, where the first factor is the traditional market excess return and the second factor is the change in the average distance to default of the banking sector. We find that this bank factor is priced in the cross section of U.S. nonfinancial firms. Controlling for market beta, the expected excess return for a stock in the top quintile of bank risk exposure is on average 2.67% higher than for a stock in the bottom quintile.

Carbon Emissions and Stock Returns: Evidence from the EU Emissions Trading Scheme

Marcel Oestreich, University of Guelph, Canada

Ilias Tsiakas, University of Guelph, Canada

Discussant: Sebastien Betermier, McGill University, Canada

This paper provides an empirical investigation of the effect of the European Union's Emissions Trading Scheme on German stock returns. We find that on average firms that received free carbon emission allowances under the scheme significantly outperformed firms that did not. This suggests the presence of a large and statistically significant "carbon premium," only a small part of which can be explained by the market value of carbon emission allowances. The carbon premium is unrelated to industry effects, size and market-to-book ratios.

2. Bankruptcy (410)

Chair: Usha Mittoo, University of Manitoba, Canada

Human Capital Loss in Corporate Bankruptcy

John Graham, Duke University, United States

Hyunseob Kim, Cornell University, United States

Si Li, Wilfrid Laurier University, Canada

Jiaping Qiu, McMaster University, Canada

Discussant: Wendy Rotenberg, University of Toronto, Canada

This paper quantifies the "human costs of bankruptcy" by estimating employee wage losses induced by the bankruptcy filing of employers using employee-employer matched data from the U.S. Census Bureau's LEHD program. We find that employee wages begin to deteriorate one year prior to bankruptcy. One year after bankruptcy, the magnitude of the decline in annual wages is 30% of pre-bankruptcy wages. The decrease in wages persists (at least) for five years post-bankruptcy. The present value of wage losses summed up to five years after bankruptcy amounts to 29-49% of the average pre-bankruptcy market value of firm. Furthermore, we find that the ex-ante wage premium to compensate for the ex-post wage loss due to bankruptcy can be of similar magnitude with that of the tax benefits of debt.

Financial Distress Innovations and the Distress-Return Relation

Mark Rachwalski, Emory University, United States

Quan Wen, Emory University, United States

Discussant: Ranjini Jha, University of Waterloo, Canada

In the cross-section of stocks, financial distress innovations are negatively related to subsequent returns. Because risk innovations are correlated with risk levels, this is consistent with previous work that estimates a negative distress-return relation. However, controlling for recent innovations, returns are positively related to distress risk. The evidence is consistent with temporary investor underreaction to distress risk innovations and a positive underlying price of distress risk. This explains the surprising negative distress risk-return relation found in previous empirical work. Distress risk can explain the anomalous returns of size-sorted portfolios. However, we find no evidence that distress risk can explain the value premium.

Distance as a Bankruptcy Filing Cost

Vyacheslav Mikhed, University of Alberta, Canada

Barry Scholnick, University of Alberta, Canada

Discussant: Lynnette Purda, Queen's University, Canada

This paper is the first in the literature to hypothesize that the distance to bankruptcy professionals will impact bankruptcy filing costs. We test if longer distances between debtors and their closest bankruptcy professionals, implying higher transactions costs, leads to debtors demanding larger financial benefits from their bankruptcy (e.g. larger amounts of unsecured credit card debt discharged) to make the bankruptcy worthwhile. Our unique data consists of the full balance sheets and geographic location of all Canadian bankruptcy E-filers. We show that distance related costs are particularly important in rural areas, where distances to the closest bankruptcy professionals are typically large.

3. Asset Pricing (415)

Chair: Mark Kamstra, York University, Canada

Stochastic Idiosyncratic Operating Risk and Real Options: Implications for Stock Returns

Harjoat Bhamra, University of British Columbia, Canada

Kyung Shim, University of New South Wales, Australia

Discussant: Efsthios Avdis, University of Alberta, Canada

We combine real options and stochastic idiosyncratic operating risk in a simple equity valuation model of firms to capture the cross-sectional variation of stock returns associated with idiosyncratic return volatility. Our model is able to simultaneously explain two main disparate empirical anomalies: the positive contemporaneous relation between risk-adjusted returns and idiosyncratic return volatility, and the poor risk-adjusted performance of stocks with high idiosyncratic risks, among some others. The model further predicts that (i) risk-adjusted returns increase (decrease) following large rises (drops) in idiosyncratic return volatility – the switch effect – and that (ii) the anomalies and the

switch effect are stronger for firms that are more abundant in real options and undergo larger changes in idiosyncratic return volatility. Simulations and empirical analysis strongly support these predictions.

Risk Adjustment and the Temporal Resolution of Uncertainty: Evidence from Options Markets

Darien Huang, University of Pennsylvania, United States

Ivan Shaliastovich, University of Pennsylvania, United States

Discussant: Hitesh Doshi, University of Houston, United States

Risk-neutral probabilities, observable from options data, contain information on physical probabilities and risk adjustments. Under further assumptions on the preference structure, such as state-independent expected utility, physical probabilities and risk adjustments can be separately recovered from risk-neutral probabilities alone. We extend the market-based recovery approach to the recursive utility structure, which allows for a preference for the timing of the resolution of uncertainty. We implement a market-based recovery using S&P 500 options and find that the data strongly supports a specification of early resolution of uncertainty. Failure to account for the magnitude of the preference for early resolution of uncertainty can significantly overstate the implied probability of bad events, understate risk adjustments, and as a consequence under-estimate average market returns.

Sharpe Ratio Volatility: Is It a Puzzle?

Alberto Romero, University of British Columbia, Canada

Discussant: Aytek Malkhozov, McGill University, Canada

Recent literature empirically documents large time-series variation in the market Sharpe ratio, spurring theoretical explanations of this phenomenon. I revisit the empirical evidence and ask whether estimates of Sharpe ratio volatility may be biased due to limitations of the standard OLS methods used in estimation. Based on simulated data from a standard calibration of the long-run risks model, I find that OLS methods used in prior literature produce Sharpe ratio volatility five times larger than its true variability. The difference arises due to measurement error. To address this issue, I propose the use of filtering techniques that account for the Sharpe ratio's time variation. I find that these techniques produce Sharpe ratio volatility estimates of less than 15% on a quarterly basis, which matches more closely the predictions of standard asset pricing models. Additionally, my results have practical implications for portfolio allocation, where upward-biased estimates of Sharpe ratio volatility imply excessive portfolio rebalancing.

4. Insider Trading (414)

Chair: Lawrence Kryzanowski, Concordia University, Canada

Board Member Private Information and Insider Trading around CEO Turnovers

Yingzhen Li, Boston College, United States

Discussant: Melissa Toffanin, Ryerson University, Canada

Theories of corporate boards assume that board members of a firm generate private information about the quality of its CEO and use this information to decide whether or not to fire him. In this paper, I make use of data on insider trading around CEO turnovers to analyze, for the first time in the literature, whether top corporate insiders indeed possess such private information about CEO quality. I document the trading pattern of board members, top corporate officers excluding the CEO, and the CEO himself. I then study whether trading by insiders (board members and top corporate officers excluding the CEO) has predictive power for the nature of CEO turnovers; the announcement effect of CEO turnovers; and the long-run post-turnover stock return performance of the firm. My findings are as follows. First, trading by board members has predictive power for the nature of CEO turnovers, the announcement effect of forced CEO turnovers, and the subsequent long-run stock return performance after such turnovers. Further, trading by members of more independent boards has greater predictive power. Second, trading by top corporate officers (excluding the CEO) has predictive power for the announcement effect of forced CEO turnovers and post-turnover stock return performance, but not for the nature of CEO turnovers. Third, trading by the CEO himself is significantly different prior to voluntary versus forced turnovers. Overall, my results are broadly consistent with the notion that board members possess private information about the firm and its CEO around the time of a CEO turnover.

Firm Opacity and Insider Trading Informativeness

Zhenyang Tang, University of Alberta, Canada

Xiaowei Xu, University of Alberta, Canada

Rengong Zhang, University of Alberta, Canada

Discussant: Michael Bourdeau-Brien, Concordia University, Canada

Using a sample of filed insider purchases, we find a positive association between firm opacity and insider trading informativeness. Specifically, insider purchases better predict future returns in firms with more earnings management and less firm-specific return variation. These associations are stronger for trades from key insiders like directors, and weaker for trades from beneficiary owners, who are less involved in firm operations. Our findings suggest that insider trading is more informative when alternative information sources are of poorer quality.

News Coverage and Insider trading

Lili Dai, Erasmus School of Economics, Netherlands

Jerry Parwada, University of New South Wales, Australia

Bohui Zhang, University of New South Wales, Australia

Discussant: Lawrence Kryzanowski, Concordia University, Canada

This paper introduces a new antecedent to the insider trading literature - the dual role of news coverage as a disciplining and coordination tool for insiders' equity trades. First, we examine how news coverage of insiders' trades reduces their information advantage and hence trading profits; second, we explore how insiders, through transactions, take advantage of pricing errors triggered by news releases. Using a comprehensive dataset of corporate news coverage with partitioned into insider-trading or non-insider-trading related news over the sample period from years 2001 to 2010, our empirical evidence supports the dual role of news coverage in both attenuating insiders' profits and guiding insiders to trade profitably.

5. Corporate Finance - III (Morrice Lismer)

Chair: Gordon Sick, University of Calgary, Canada

Ambiguity in Corporate Finance: Real Investment Dynamics

Lorenzo Garlappi, University of British Columbia, Canada

Ron Giammarino, University of British Columbia, Canada

Ali Lazrak, University of British Columbia, Canada

Discussant: Tom Cottrell, University of Calgary, Canada

We study the effect of ambiguity on corporate investment decisions using a non-Bayesian multi-prior approach. Within a canonical corporate finance problem where an entrepreneur faces a real investment decision with expansion and contraction options, we contrast the implications of ambiguity models with complete preferences, such as Gilboa and Schmeidler's (1989) Minimum Expected Utility (MEU), to those of models with incomplete preferences, such as Bewley's (1986) Expected Utility (BEU) model. We show that MEU entrepreneurs' behavior is indistinguishable from that of pessimistic single-prior entrepreneurs: they are reluctant to expand an ambiguous project and eager to abandon it. In contrast, BEU entrepreneurs' behavior is incompatible with that of single-prior entrepreneurs: they are reluctant to both expand and abandon projects, a behavior consistent with "hanging on to losers" and "escalating commitment." In a dynamic context, we show that anticipation of future reluctance to abandon may induce BEU entrepreneurs to forego an attractive investment. In this setting, financial contracts, such as convertible bonds, can weaken the effect of this anticipation and induce the entrepreneur to invest. These findings provide new insights on real investment and contracting dynamics and can be used to empirically distinguish different approaches to ambiguity. Importantly, because the BEU approach to ambiguity is equivalent to a model of group decisions making under unanimity, we argue that the framework is also suitable to study team decisions at the corporate level, thus broadening the scope of the empirical implications of our analysis.

Generalised MAD for Real Option Valuation

Carol Alexander, University of Sussex, United Kingdom

Xi Chen, University of Reading, United Kingdom

Charles Ward, University of Reading, United Kingdom

Discussant: Yuanshun Li, Ryerson University, Canada

This paper extends the marketed asset disclaimer (MAD) approach for real option valuation under the assumption of market completeness and demonstrates that it is more intuitive to apply than the original MAD approach. This

approach can be applied using alternative assumptions, either about the dynamics of cash flows or about the dynamics of the investment value itself. Geometric Brownian motion (GBM) assumptions for both investment value and cash flows can only be compatible under certain conditions. We derive conditions under which the assumptions used for the real option valuation are consistent with those used for the valuation of the underlying investment.

Increased Access to Financing and Firm Productivity

Karthik Krishnan, Northeastern University, United States

Debarshi Nandy, Brandeis University, United States

Manju Puri, Duke University, United States

Discussant: Carlton Osakwe, Mount Royal University, Canada

We analyze how increased access to financing affects firm productivity using a large sample of manufacturing firms from the U.S. Census Bureau's Longitudinal Research Database (LRD). We exploit a natural experiment following the interstate bank branching deregulations that increased access to bank financing and relate these deregulations to firm level total factor productivity (TFP). Our results indicate that firms' productivity increased subsequent to their states implementing the bank branching deregulations. The increased productivity following the deregulation is long lived. Further, TFP increases after the bank branching deregulations are greater for financially constrained firms. In particular, firms that are close to but not eligible for financial support from the U.S. Small Business Administration (and thus more financially constrained) have higher TFP increases after the deregulation than firms that just satisfy eligibility criteria (and are hence less financially constrained). Our results support the idea that greater access to financing can increase financially constrained firms' access to productive projects (i.e., positive NPV projects) that they may otherwise not be able to take up. Our results emphasize that availability of financing is important not only for startup activity (as prior research suggests), but also for increased productivity and the continued success of existing entrepreneurial and small firms.

6. Governance - II (Pilot)

Chair: Andras Marosi, University of Alberta, Canada

Philanthropy, Corporate Culture and Misconduct

Fred Bereskin, University of Delaware, United States

Terry Campbell, University of Delaware, United States

Simi Kedia, Rutgers University, United States

Discussant: Frank Li, Western University, Canada

We use firms' philanthropic behavior as a means of estimating their corporate culture. We find that the decision to engage in philanthropy and the amount of giving are negatively associated with corporate misconduct. Our results persist after the Sarbanes-Oxley Act and are robust to differing approaches to defining misconduct. Our findings are consistent with firms' giving activities reflecting a culture that discourages misbehavior. Consistent with this result, we show that firms' philanthropic behavior is positively associated with employee whistle-blowing, and of the CEO being terminated upon fraud discovery. These results have implications to the wide-ranging effects of corporate culture and the channels through which culture mitigates misconduct.

Managerial Attributes, Incentives, and Performance

Zhichuan Li, Western University, Canada

Jeffrey Coles, Arizona State University, United States

Discussant: Ramona Westermann, Copenhagen Business School, Denmark

This paper examines the relative importance of observed and unobserved firm- and manager-specific heterogeneities in determining the primary aspects of contract design and the implications of these associated incentives for firm policy, risk, and performance. We focus on the sensitivity of managerial wealth to stock price (delta) and the sensitivity of expected managerial wealth to stock volatility (vega) for executives. First, following Graham, Li, and Qiu (2010), who apply the econometric approach of Abowd, Karmarz, and Margolis (1999) to executive pay level, we decompose the variation in executive incentives into time variant and invariant firm and manager components. We find that manager fixed effects and observable firm attributes combined supply 80-90% of explained variation in delta and vega. Second, accommodating unobserved firm and manager heterogeneity and controlling for matching of executives to firms alters parameter estimates and corresponding inference on observed firm and manager characteristics, most notably board independence, firm risk, and market-to-book. Third, we explore the economic content of the estimated executive delta and vega fixed effects. There is a strong empirical association between the executive delta and vega fixed effects and attributes of managers and firms that are seen to

proxy for manager human capital and risk aversion and firm marginal revenue product in application of manager skill. Moreover, larger CEO delta fixed effects are associated with higher Tobin's Q and ROA. Larger CEO vega fixed effects are associated with riskier corporate policies, including higher R&D, lower capital expenditures, and lower fixed assets, and higher aggregate firm risk.

Do Excess Control Rights Benefit Debtholders? Evidence from Dual-Class Firms

Ting Xu, University of British Columbia, Canada

Discussant: Daniel Greene, Georgia State University, United States

This paper uncovers the bright side of excess control rights from a debtholder's perspective. Using a sample of US dual-class firms where insiders have voting power in excess of their cash flow rights, I first provide direct evidence on the risk-avoiding behavior of dual-class firms compared to similar single-class firms. Consistent with controlling insiders' emphasis on long-term firm survival to ensure continuous private benefits of control, dual-class firms exhibit lower ROA volatility, undertake safer investments, and are significantly less likely to default or violate debt covenants. This translates into lower borrowing costs for dual-class firms. On average, dual-class firms enjoy 16 to 28 basis points lower loan spreads than single-class firms, with the effect being stronger after controlling for selection using instrument variables. A difference-in-difference analysis of a sample of dual-class firms that unified their shares into a single class further confirms my results. In addition, lenders seem to be able to protect themselves against potential expropriation activities ex ante by using more expropriation-related covenants on dual-class borrowers. Overall, my results show that, in contrast to the negative effect widely documented on (minority) equityholders, excess control rights can benefit debtholders. This paper also highlights the importance of evaluating different governance mechanisms from the perspective of other stakeholders than shareholders.

5:15 PM – 6:30 PM

NFA Board Meeting (Salon du conseil/Boardroom)

6:30 PM – 10:00 PM

Gala Dinner (Musée national des beaux-arts du Québec)

Sunday, September 29, 2013

7:00 AM – 8:30 AM

Breakfast (Suzor-Côté)

8:30 AM – 10:00 AM

1. Canadian Markets (Leduc-Fortin)

Chair: Scott Hendry, Bank of Canada, Canada

Should we be afraid of the dark? Dark trading and market quality

Sean Foley, University of Sydney, Australia

Talis Putnins, University of Technology Sydney, Australia

Discussant: Andreas Park, University of Toronto, Canada

Regulators and exchanges around the world are concerned that the increasing proportion of trades executed without pre-trade transparency, so called "dark trading", may have a negative impact on market quality. These concerns led Canadian regulators to implement novel restrictions on dark trading, which reduced its level by 25% literally overnight. We exploit this natural experiment together with proprietary trade-level data from dark trading venues to examine the impact of dark trading on liquidity and informational efficiency. We find that low levels of

dark trading, as is the case in Canada, are largely beneficial to the marketplace, improving quoted, effective and realized spreads as well as informational efficiency, despite reducing quoted depth. Our results are consistent with the notion that the existence of dark venues increases competition for order flow amongst informed traders that seek to profit from their information whilst minimizing the leakage of such information. Our results suggest that there may be a “tipping point” beyond which dark trading is detrimental. Finally, we do not find any evidence that the Canadian regulation is associated with “regulatory flight” of dark trading to the US amongst cross-listed securities.

Fragmentation and Market Quality In the Canadian Equity Markets

Liam Cheung, McGill University, Canada

Discussant: Philippe Grégoire, Université Laval, Canada

We study the relation between market quality and fragmentation over largely undifferentiated marketplaces in the Canadian equity market using a proprietary database of recorded market data from all Alternative Trading Systems (ATSs). First, we confirm that fragmentation is associated with higher market quality on an aggregated stock basis. Second, based on segmented data from each individual marketplace, we determine that the larger alternative marketplaces are the primary sources of the positive relation to market quality on an aggregate basis. Third, after adjusting for selection bias, we find that total ATS market share has a negative relation to effective spread and a positive relation to market impact. While certain ATSs still have a positive relation between effective spread and market share, the size of the ATS is no longer a determinant in the association of marketplaces and improved market quality. Subsequent tests on individual stocks reveal that days with higher fragmentation have a positive (negative) relation to market quality for high (low) volume stocks. Our findings indicate therefore that the increased fragmentation of equity markets may not be a uniformly beneficial practice for equity market quality.

Less is more: Evidence from international asset pricing models

Marie-Claude Beaulieu, Université Laval, Canada

Marie-Hélène Gagnon, Université Laval, Canada

Khalaf Lynda, Carleton University, Canada

Discussant: Francesca Carrieri, McGill University, Canada

In the context of international asset pricing models, we study the impact of enlarging the factor base on estimation uncertainty in the presence of possibly redundant factors using an identification robust procedure. Working with North American data, we compare the informational content of a wide class of international asset pricing models using an inverted Hotelling statistic. Results illustrate the adverse effects of factor abundance in cross-section: we find that adding firm specific factors to the market factor often leads to identification problems and spurious inference. As for model selection, the international CAPM model with Black' (1972) constraint on the intercept is identified in most sub-periods and provides flexibility to determine the relevant sources (domestic or global) of market risk rendering financial market integration tests possible.

2. Special Topics (410)

Chair: Glen Donaldson, University of British Columbia, Canada

The Annuity Duration Puzzle

Narat Charupat, McMaster University, Canada

Mark Kamstra, York University, Canada

Moshe Milevsky, York University, Canada

Discussant: Sylvain Benoit, Université d'Orléans, France

It is typically assumed, implicitly or explicitly, in the pension annuity literature that market prices promptly and fully respond to changes in market interest rates. Using a unique database consisting of over three million weekly U.S. annuity quotes over the period from September 2004 to May 2012, we find that annuity prices are far less sensitive to interest rate movements than predicted by theory. In addition, we find that the response to changes in interest rates is asymmetric. Annuity prices react more rapidly and with greater sensitivity to an increase than to a decrease in interest rates. The results are robust with respect to annuity purchase ages, lengths of guarantee periods, choice of reference interest rates, and subsets of annuity providers. Overall our findings are inconsistent with a standard annuity-pricing model used by many researchers. As such, our results have implications for the existing literatures relying on this model, including those that consider portfolio choice decisions, the optimal timing of an annuity purchase, the money's worth ratio calculations and the inference of mortality expectations from observed annuity prices.

Implied Risk Exposures

Christophe Perignon, HEC Paris, France

Christophe Hurlin, Université d'Orléans, France

Sylvain Benoit, Université d'Orléans, France

Discussant: Bruno Feunou, Bank of Canada, Canada

We show how to reverse engineer bank's risk disclosures, such as Value-at-Risk, to obtain an implied measure of their exposures to equity, interest rate, foreign exchange, and commodity risks. Factor Implied Risk Exposures (FIRE) are obtained by breaking down a change in risk disclosure into an exogenous volatility component and an endogenous risk-exposure component. In a study of large US and international banks, we show that (1) changes in risk exposures are negatively correlated with market volatility and (2) changes in risk exposures are positively correlated across banks, which is consistent with banks exhibiting herding behavior in trading.

Capital adjustment and insolvency risk under underwriting cycles : A study of Canadian property-liability insurance firms

Alaa Guidara, Université Laval, Canada

Van Son Lai, Université Laval, Canada

Discussant: Alfred Lehar, University of Calgary, Canada

We simultaneously study the impact of underwriting and investment strategies on both capital adjustment level and speed. We show that if insurers want to increase capital adjustment speed, they may rely on an aggressive investment strategy. An internal capital target may also significantly contribute to increase capital adjustment speed. If insurers wish to increase capital level, regardless of its speed, they could rely on a higher reinsurance based underwriting strategy. One main policy implication from this paper is that insurance regulators may use a countercyclical (to underwriting cycles) capital scheme to enhance capital adequacy regulation. The cyclicity could be drawn on past (ex-post) observation of aggregate levels of underwritten premium. Regardless of the prevailing insurance cycles, we document that overcapitalized insurers and mutual insurance companies exhibit higher capacity in adjusting their capital.

3. International Finance (415)

Chair: Vihang Errunza, McGill University, Canada

The Invisible Hand of Short Selling: Does Short Selling Discipline Earnings Manipulation?

Massimo Massa, INSEAD, France

Bohui Zhang, University of New South Wales, Australia

Hong Zhang, INSEAD, France

Discussant: Hai Ta, University of Winnipeg, Canada

We hypothesize that short selling has a disciplining role vis-à-vis the managers forcing them to reduce earnings manipulation. Using firm-level short-selling data over the sample period of 2002 to 2009 across 33 countries, we document a significantly negative relationship between lending supply and activism in the short-selling market and earnings manipulation. Using an instrumental variable approach as well as focusing on exogenous events (cross-sectional and time series regulatory and market restrictions), we provide evidence of a causal link from short selling potential to lower earnings manipulation. Overall, our findings suggest that short selling provides an external governance mechanism to discipline managerial incentives.

Geography and Capital: Foreign Listings of U.S. Railroads during the First Era of Financial Globalization

David Chambers, Cambridge University, United Kingdom

Serge Sarkissian, McGill University, Canada

Michael Schill, University of Virginia, United States

Discussant: Kee-Hong Bae, York University, Canada

We study motivations for the globalization of capital markets by examining the role of geography in the financing of U.S. railroad investment from 1866 to 1913. The selected industry and period provide a natural experiment to study the first globalization wave due to the relative underdevelopment of contemporary U.S. financial markets, the dramatic change in global communication technology, the enormity of capital investment needs, and the unique geography-specific nature of railroad assets. We observe an intense level of foreign listing activity in the European markets of London, Amsterdam, and Frankfurt on a scale much larger than that studied in more recent work. We find strong cross-regional variation in foreign listing frequency and its effects. In particular, foreign listing activity of

U.S. railroads is inversely related to the distance from U.S. capital sources. In addition, while the overall foreign listing activity of U.S. railroads increases with strong U.S. economic performance, foreign debt listings rise during periods of high U.S. default rates. Our evidence therefore suggests that differences in capital constraints have a profound impact on the geographic distribution of foreign listing activity.

Financial Integration and the Optimal Design Of A Fiscal Union

Jonathan Hoddenbagh, Boston College, United States

Mikhail Dmitriev, Boston College, United States

Discussant: David Schumacher, McGill University, Canada

We study the optimal design of a fiscal union within a currency union using an open economy model with nominal rigidities. We show that the optimal design of a fiscal union depends crucially on the degree of financial integration across countries as well as the elasticity of substitution between domestic and foreign goods. Empirical estimates of substitutability range between 1 and 12. If substitutability is low (around 1), risk-sharing occurs naturally via terms of trade movements even in financial autarky, country-level monopoly power is high and losses from terms of trade externalities dominate other distortions. On the other hand, if substitutability is high (greater than 1), risk-sharing does not occur naturally via terms of trade movements, country-level monopoly power is low and losses from nominal rigidities dominate other distortions. We show that members of a fiscal union should (1) coordinate labor and consumption taxes when substitutability is low to eliminate terms of trade distortions, and (2) coordinate contingent cross-country transfers when substitutability is high to improve risk-sharing, particularly when union members lose access to international financial markets. Contingent fiscal policy at the national level is also necessary to eliminate nominal rigidities in the presence of asymmetric shocks, and yields large welfare gains when goods are close substitutes.

4. Derivatives (414)

Chair: Henry Cao, Cheung Kong Graduate School of Business, China

Liquidity Risk in Credit Default Swap Markets

Benjamin Junge, École Polytechnique Fédérale De Lausanne & Swiss Finance Institute, Switzerland

Anders B. Trolle, École Polytechnique Fédérale De Lausanne & Swiss Finance Institute, Switzerland

Discussant: Liang Ma, University of Wisconsin-Madison, United States

We analyze whether liquidity risk, in addition to expected illiquidity, affects expected returns on credit default swaps (CDSs). First, we construct a market-wide CDS illiquidity measure from divergences between published credit index levels and their theoretical counterparts, the so called index-to-theoretical bases. Non-zero and time-varying bases are observed across credit indices referencing North American and European names of both the investment grade and high yield universes, and the market-wide CDS illiquidity measure correlates with transaction costs, funding costs, and other commonly used illiquidity proxies. Then, we construct a tradable liquidity risk factor highly correlated with innovations to the market-wide CDS illiquidity measure and estimate a factor pricing model, which accounts for market risk and default risk in addition to liquidity risk and expected illiquidity. Unconditionally, liquidity risk is priced in the cross-section of single-name CDS returns and has a larger contribution to expected returns than expected illiquidity. A conditional analysis shows that the magnitude and price of liquidity risk were particularly high during the most intense phases of the financial crisis.

Optimal hedging when the underlying asset follows a regime-switching Markov process

Pascal François, HEC Montréal, Canada

Geneviève Gauthier, HEC Montréal, Canada

Frédéric Godin, HEC Montréal, Canada

Discussant: Vincent Gregoire, University of Melbourne, Australia

We develop a flexible discrete-time hedging methodology that minimizes the expected value of any desired penalty function of the hedging error within a general regime-switching framework. A numerical algorithm based on backward recursion allows for the sequential construction of an optimal hedging strategy. Numerical experiments comparing this and other methodologies show a relative expected penalty reduction ranging between 0.9% and 12.6% with respect to the best benchmark.

Options on Initial Public Offerings

Chemmanur Thomas, Boston College, United States
Chayawat Ornthanalai, University of Toronto, Canada
Padma Kadiyala, Pace University, United States

Discussant: Brian Coulter, University of Oxford, United Kingdom

Using a sample of IPOs from 1996 to 2008, we empirically analyze, for the first time in the literature, the determinants and consequences of option listing on the equity of newly public firms. We explore four important issues. First, we study the determinants of the time to list options following the IPO, and find that options are listed earlier on venture backed firms and those with larger IPO proceeds, but later on IPOs with higher reputation underwriters. Second, we analyze the effect of option listing on subsequent long-run stock returns and find significant underperformance persisting for more than a year after listing. This underperformance is greater for venture backed firms but smaller for IPOs underwritten with higher reputation underwriters. Third, we test three hypotheses regarding the causes of the above equity underperformance and find the following: a significant increase in the short-interest ratio after option listing, indicating a relaxation of the short-sale constraint on the IPO firm equity; a significant decrease in insider equity holdings in the IPO firm in the months following option listing, indicating significant insider selling of the stock; and significantly higher put prices relative to call prices for several months following option listing, indicating that informed speculators are using put options to take short positions in the IPO firm stock during this period. Finally, we analyze the profitability of investment strategies in the newly listed options on IPO firm equity, and find significant excess returns from investing in long-maturity put options and holding them to maturity.

5. Corporate Finance - IV (Morris Lismor)

Chair: Vikas Mehrotra, University of Alberta, Canada

Incorporation in Offshore Financial Centers: Naughty or Nice?

Warren Bailey, Cornell University, United States
Edith Liu, Cornell University, United States

Discussant: Sean Cleary, Queen's University, Canada

We study associations between measures of firm value and quality and the firm's choice of legal and regulatory environment through incorporation in an offshore financial center. Preliminary empirical results suggest that incorporation in such a jurisdiction, or switching incorporation to one, is associated with lower value as measured by Tobin's q. This effect varies with the quality of the firm's home country environment and the offshore domicile it selects.

The Cash Effect: Market Reaction and Corporate Fallout

Sean Cleary, Queen's University, Canada
Fatma Sonmez, Queen's University, Canada

Discussant: Warren Bailey, Cornell University, United States

Firms have been building up cash and reducing debt steadily over the last three decades. Using data over the 1980 to 2012 period, we confirm these patterns and many of the variables that affect cash "hoarding" by firms. We provide evidence that market returns for high cash firms have exceeded those for low cash firms. In particular, a trading strategy based on buying "High Cash" firms and selling "Low Cash" firms would have generated abnormal returns of over 7 percent per year, after controlling for industry, size, value, and other firm-specific characteristics. In addition, despite concerns that cash hoarding has damaged firm growth and investment behavior (or will do so), we do not find evidence that this has happened, or that maintaining high cash holdings adversely affects future growth in a material way.

From IPO to M&A: Further Evidence

Salma Ben Amor, Université du Québec à Montréal, Canada
Maher Kooli, Université du Québec à Montréal, Canada
Discussant: Xiaowei Xu, University of Alberta, Canada

We investigate the acquisition motive for initial public offerings. Specifically, we adopt survival analysis technique in order to examine both the likelihood of the M&A event and its timing relative to the initial public offering of the acquirer firm. Further, we explore why some IPO firms engage in only one acquisition while some others carry out frequent acquisitions over the few years following their IPO. We find that IPO firms with greater underpricing

conduct significantly more stock-financed acquisitions in the five years following the IPO. However, if the extent of information asymmetry faced by the target in evaluating the acquirer is high, the underpricing effect loses its significance. Our results also show that IPOs with lower post-IPO insider ownership and venture backed IPOs are more likely to make acquisitions than their counterparts. Further, we find that IPO firms with higher underpricing and proceeds and those with past acquisition activity are more likely to be frequent acquirers.

6. Governance - III (Pilot)

Chair: Ranjini Jha, University of Waterloo, Canada

How costly is corporate bankruptcy for top executives?

Espen Eckbo, Dartmouth College, United States

Karin Thorburn, Norwegian School of Economics, Norway

Wei Wang, Queen's University, Canada

Discussant: Si Li, Wilfrid Laurier University, Canada

We provide estimates of CEO human capital losses from corporate bankruptcy which, for the first time, account for CEO post-bankruptcy employment. Fully half of the incumbent CEOs maintain full-time executive employment with a median estimated labor income loss of zero. CEOs who fail to maintain executive employment experience a median loss equal to five times their pre-departure labor income. Executives with greater predicted income loss are more likely to be forced out, suggesting that these managers were earning supra-competitive rents. The proportion equity pay in the CEO's compensation package is decreasing in the predicted income loss, similar to a labor-contract hedge. Finally, greater stock ownership lowers the probability that the CEO leaves the distressed firm voluntarily.

The Labor Market for Directors and Externalities in Corporate Governance

Doron Levit, University of Pennsylvania, United States

Nadya Malenko, Boston College, United States

Discussant: Raluca Roman, University of South Carolina, United States

This paper studies how directors' reputational concerns in the labor market affect board structure, corporate governance, and firm value. In our setting, directors affect their firms' governance, and governance, in turn, affects firms' demand for new directors. Whether the labor market rewards a shareholder-friendly or management-friendly reputation is endogenous and depends on aggregate governance. We show that directors' desire to be invited to other boards creates strategic complementarity of corporate governance across firms. Directors' reputational concerns amplify the governance system: strong systems become stronger and weak become weaker. We derive implications for multiple directorships, transparency, shareholder activism, and board size.

Ownership structure and power: evidence from US corporations

Nilanjan Basu, Concordia University, Canada

Imants Paeglis, Concordia University, Canada

Mohammad Rahnamaei, Concordia University, Canada

Discussant: Yaxuan Qi, University of Hong Kong, China

We examine the influence of ownership structure on a blockholder's power in a firm. We first describe the presence and ownership stakes of blockholders in a comprehensive sample of US firms. We develop a measure of the influence of the ownership structure on a blockholder's power and show that an average blockholder loses 12% of her potential power due to the presence and size of the ownership stakes of other blockholders. Further, the influence of ownership structure varies systematically with a blockholder's rank and identity, with the second and non-family manager blockholders experiencing the largest loss of power.

10:00 AM – 10:15 AM

Coffee Break (Foyer)

1. Equity Valuation - IV (Leduc-Fortin)

Chair: Lisa Kramer, University of Toronto, Canada

Asset Pricing Tests at the Micro Portfolio Level: New Evidence on the Value Premium

Laurent Barras, McGill University, Canada

Discussant: Akiko Watanabe, University of Alberta, Canada

This paper revisits the value premium by exploiting information from a very large cross section of book-to-market "micro" portfolios. Containing a few stocks only, these portfolios are not highly-diversified, and, therefore, not subject to the strong factor structure that possibly make previous tests too accommodating or too stringent. While the human capital and conditional CAPMs still produce a large proportion of mispriced portfolios, they largely outperform the CAPM. There is strong evidence that value portfolios are more leveraged, and that both models are able to capture this leverage risk. Finally, performance among micro-cap stocks is weak, and points out to liquidity as an important factor.

Credit Conditions and Time-Varying Value Premium

Liang Ma, University of Wisconsin-Madison, United States

Discussant: Lorenzo Garlappi, University of British Columbia, Canada

We document that the TED spread, a popular gauge of credit conditions, is a significant negative predictor of value premium. Over 1990 to 2011, a 1% increase in lagged TED spread predicts a 3.3% decrease of CAPM-adjusted value premium, with an R-squared value of 8.2%. We then argue that this finding is consistent with the mechanism that equity expected returns become lower under tighter credit conditions through shareholders' strategic default. We incorporate this mechanism into a model in the spirit of Garlappi and Yan (2011) and derive more testable hypotheses. Consistent with these hypotheses, we further find that the negative relationship between value premium and lagged TED spread comes mainly from value stocks, stocks with lower credit ratings, stocks with lower cash flows, and stocks with higher shareholders' bargaining power and higher liquidation costs. These results also have direct implications to value-based trading strategies.

2. Banking (410)

Chair: Sean Cleary, Queen's University, Canada

Capital Recycling and Moral Hazard In The Securitization Market

Brian Coulter, University of Oxford, United Kingdom

Discussant: Toni Ahnert, London School of Economics, United Kingdom

Securitization allows the recycling of scarce bank capital but exacerbates the moral hazard problem inherent in banks' private choices of loan monitoring. In a model combining these aspects of securitization, I show that banks' inability to contract on proportional retention results in them maintaining minimal exposure to structured securities. I then consider if rating agencies may mitigate this moral hazard. Instead, I illustrate that rating inflation may occur even with perfectly rational investors and no regulation. Government intervention may further exacerbate this rating inaccuracy. I conclude that even given market imperfections, governments may optimally leave the securitization market largely unregulated.

Shareholder Activism and Consequences in Banking: Performance, Risk Taking, Capital, and Turnover

Raluca Roman, University of South Carolina, United States

Discussant: Hector Perez Saiz, Bank of Canada, Canada

This paper tests shareholder activism as a channel of corporate governance in banking and its effects on performance, risk-taking, capital, and turnover, during both normal times and financial crises. We focus on the conflicts between bank creditors/depositors and shareholders, and between bank managers and shareholders. We show that activism is a destabilizing mechanism during normal times, which creates market returns for shareholders, but lowers operating performance, reduces financial stability and increases turnover. This is consistent with the creditor-shareholder conflict, which predicts that activist shareholders induce managers to take higher risk to increase returns at the expense of creditors, given creditors' difficulty to monitor the banks. Activism differs significantly during financial crises, resulting in better market and operating performance and more stability. This is consistent with the healthy-books effect, under which activists induce banks to look healthier to regulators so they are allowed to increase risk-taking in the future.

The Informational Content of the Loan Market

Claudia Champagne, Université de Sherbrooke, Canada

Stéphane Chrétien, Université Laval, Canada

Frank Coggins, Université de Sherbrooke, Canada

Discussant: Mohamed Al Guindy, Queen's University, Canada

This paper examines the informational content of the loan market by testing whether signals based on loan market activity as well as indirect information captured by loan terms can provide valuable information regarding the performance and risk of borrowers. A portfolio approach is used to test the value of loan market information with a conditional performance model that controls for the financial and economic context surrounding the signal. Results show that primary loan announcements provide positive information regarding the performance of borrowers. Secondary market signals such as loan sales and loan price variations are also informative regarding both the performance and risk of borrowers, even more so when combined with loan term information such as spreads.

3. Political and Sovereign Risks (415)

Chair: Marie-Claude Beaulieu, Université Laval, Canada

Comparing Sovereign Risk Outcomes: Government Default vs Debt Monetization in a Banking Model

Glen Donaldson, University of British Columbia, Canada

Discussant: Mark Jenkins, University of Pennsylvania, United States

We develop a banking model, with money and heterogeneous borrowers and lenders, to compare the impacts of a government defaulting on its bonds versus printing the money to pay them off; i.e., debt monetization. Default reduces the value of the government bonds that banks hold as reserves, which can disrupt intermediation thus reducing firm investment/output and household consumption. Monetization changes asset prices, which transfers wealth between borrowers and lenders and can impact bank value on a marked-to-market basis, which can harm both depositors and firms. The relative impacts of default vs monetization (vs taxation) depend in part on the nature of liquidity risk, the correlation between firm productivity factors and the precise role of banks. We find that monetization often, but not always, has fewer negative effects than default; the least damaging policy is a combination of default and monetization.

Real Economic Shocks and Sovereign Credit Risk

Patrick Augustin, Stockholm School of Economics and Swedish House of Finance, Sweden

Romeo Tedongap, Stockholm School of Economics and Swedish House of Finance, Sweden

Discussant: Steven Baker, Carnegie Mellon University, United States

We show that U.S. macroeconomic risk is a major channel for sovereign credit risk over and above financial risk. This conclusion is motivated by new empirical evidence that expected consumption growth and volatility in the U.S. explain 75% of the first two common factors in the CDS term structure of 38 geographically dispersed countries, and a similar fraction of the level, slope and curvature. The results pass the horse race against financial market variables, which at best have explanatory power for the level, but not the slope factor. Our evidence suggests that time-varying expected returns may bear some responsibility for the strong co-movement of spreads. To rationalize these findings, we embed a reduced-form default process into an equilibrium model for CDS spreads. The representative agent has generalized disappointment averse preferences, and both the price of risk and the default process are driven by global expected consumption growth and macroeconomic uncertainty. Countries differ cross-sectionally through their sensitivity to aggregate risk. Exploiting the high-frequency information in CDS spreads, we estimate the full model and find preference parameters consistent with preference for early resolution of uncertainty. The model quantitatively matches term structure moments up to the fourth moment as well as historically observed cumulative default probabilities. In addition, for an investor who is sensitive to downside risk, the model conditionally matches the magnitude of the slope reversal for distressed sovereign borrowers in states of bad macroeconomic fundamentals.

Political Uncertainty and Public Financing Costs: Evidence from U.S. Gubernatorial Elections and Municipal Bond Markets

Pengjie Gao, University of Notre Dame, United States

Yaxuan Qi, City University of Hong Kong, China

Discussant: Glen Donaldson, University of British Columbia, Canada

This research investigates how political uncertainty around U.S. gubernatorial elections influences the borrowing costs of public debt, measured by yields of municipal bonds. We find that yields of municipal bonds increase sharply by 6 to 8 basis points before elections and then reverse afterward. Elections have more pronounced impact during economic downturns, when outcomes are less predictable, and when states have more outstanding debt. Several state institutions, such as GAAP-budgeting, spending limits and tax-increase limits, help to mitigate the adverse impact of political uncertainty. Evidence from detailed municipal bonds transactions suggests that declining demand due to investor aversion to political uncertainty is the driving force behind the increases in yields prior to elections. The findings suggest that investors are averse to political uncertainty and demand compensation for bearing this risk.

4. Fixed Income (SESSION ENDS AT 12:15) (414)

Chair: Pascal François, HEC Montréal, Canada

A New Linear Estimator for Gaussian Dynamic Term Structure Models

Antonio Diez de los Rios, Bank of Canada, Canada

Discussant: Simon Lalancette, HEC Montréal, Canada

This paper proposes a novel regression-based approach to the estimation of Gaussian dynamic term structure models that avoids numerical optimization. This new estimator is an asymptotic least squares estimator defined by the no-arbitrage conditions upon which these models are built. We discuss some efficiency considerations of this estimator, and show that it is asymptotically equivalent to maximum likelihood estimation. Further, we note that our estimator remains easy-to-compute and asymptotically efficient in a variety of situations in which other recently proposed approaches lose their tractability. We provide an empirical application in the context of the Canadian bond market.

Forecasting Inflation and the Inflation Risk Premium using Nominal Yields

Bruno Feunou, Bank of Canada, Canada

Jean-Sébastien Fontaine, Bank of Canada, Canada

Discussant: Pascal Létourneau, University of Wisconsin, United States

We provide an accurate decomposition of nominal yields into a real yield, expected inflation and the inflation risk premium when real bonds are not available. We combine yields with surveys of inflation forecasts within a no-arbitrage model that is easy to estimate and where the latent inflation expectation is spanned by the history of the data. The Sharpe ratio distribution is restricted to obtain plausible risk premiums. The inflation risk premium (i) is positive, (ii) rises when unemployment increases and when yields decrease, implying that (iii) real yields are significantly more pro-cyclical than nominal yields. The filtering problem is trivial and several out-of-sample comparisons show that our decomposition produces the best monthly inflation forecasts and matches quarterly survey forecasts. Results improve relative to a VAR model but they are robust to time-varying inflation volatility.

The Sensitivity of Interest Rate Options to Monetary Policy Actions: A Regime-Shift Pricing Approach

René Ferland, Université du Québec à Montréal, Canada

Geneviève Gauthier, HEC Montréal, Canada

Simon Lalancette, HEC Montréal, Canada

Discussant: Mathieu Fournier, University of Toronto, Canada

We look at whether monetary actions constitute a significant macro-finance risk for interest rate options and related implied volatilities. We devise an option pricing model based on the dynamics of the Federal Reserve's target rate via a regime-shift approach modelled as discrete Markov chain capturing the timing of Federal Open Market Committee meetings. We find that the regime-shift risk is significantly priced and that the downward and stable regimes of the target rate, associated with a decline in real activity, display higher probabilities of occurrence under the risk-neutral measure. We also observe that implied volatilities display a counter-cyclical behaviour.

Unspanned risk factors in the Cap volatility surface: a non-linear approach.

Pascal Létourneau, University of Wisconsin, United States

Pascale Valéry, HEC Montréal, Canada

Discussant: Antonio Diez de los Rios, Bank of Canada, Canada

Classical models for fixed income derivatives pricing are based on the principle that all derivatives of a same underlying share the same risk factors. Evidence in the literature suggests that factors unspanned by the Term Structure of interest rates might affect the prices of interest rates derivatives. In this paper, we add to the existing literature by first accounting for non-linear effects essential to derivatives pricing. Second, we do not assume the additional factors are unspanned, but provide a testing methodology, and third, we consider the market as a whole using a VARMA model. We find evidence for the presence of one unspanned factor. Thus, practitioners cannot identify the price of risk of one market by using a model of another.

5. Mergers and Acquisitions - II (Morris Lismer)

Chair: Arnold Cowan, Iowa State University, United States

Financing Conditions and Going Private Decisions: Leveraged Buyouts (LBOs) versus Management Buyouts (MBOs)

Dennis Ng, University of Manitoba, Canada

Usha Mittoo, University of Manitoba, Canada

Discussant: Chen Liu, Queen's University, Canada

This paper examines the effects of financing conditions and firm characteristics in a sample of U.S. firms that went private through LBOs, MBOs, and non-LBO/MBO transactions from 2000 to 2011 relative to the firms that went public during this period. We find significant differences between the LBO and MBO samples. Debt financing conditions and financial visibility are the major factors affecting LBOs but do not matter for MBOs. In addition, while liquidity and growth opportunities are negatively correlated with the probability of going private for both LBOs and MBOs, the latter plays a stronger role for MBOs. Our results are robust to different estimation models, including multinomial logit, the Cox proportional hazard model, and competing risks regression models. We also examine the probability of going private for firms going public via an initial public offering (IPO) and through a non-IPO (in which firms typically trade over-the-counter before migrating to a larger exchange). We find that firms going public via a non-IPO mechanism have a higher (lower) probability of exiting through an LBO (MBO). Our paper extends the going private literature by comparing the determinants of going private decisions for LBOs, MBOs, and non-LBOs/MBOs. To the best of our knowledge, this is the first study that documents that the firm's going public (IPO or non-IPO) mechanism also affects the probability of going private.

Merger Negotiations with Stock Market Feedback

Sandra Betton, Concordia University, Canada

Espen Eckbo, Dartmouth College, United States

Rex Thompson, Southern Methodist University, United States

Karin Thorburn, Norwegian School of Economics, Norway

Discussant: Ambrus Kecskes, Virginia Tech, United States

Do pre-offer target stock price runups increase bidder takeover cost? To answer this question, we propose a costly market feedback loop in which the bidder increases the offer price with the target runup although it reflects market anticipation of target deal synergies. By relaxing the conventional assumption of cross-sectionally constant takeover gains, the model delivers new and interesting pricing implications. We focus foremost on the cross-sectional correlation between target runups and offer price markups (the offer price less the runup) implied by market efficiency and rational bidding. Our costly feedback loop implies a positive correlation, which is strongly rejected by large-sample tests. We also discover an economically significant positive correlation between bidder and target takeover gains which suggests that the merger partners share in total takeover synergies.

When Acquirers Get Cold Feet: What is The Value of The Reverse Termination Fee?

Aazam Virani, University of Toronto, Canada

Hamed Mahmudi, University of Oklahoma, United States

Xiaofei Zhao, University of Texas, United States

Discussant: Wei Wang, Queen's University, United States

We posit that a reverse termination clause, which enables the acquiring firm to abandon an acquisition after signing a merger agreement, transforms the merger contract into a real option on the assets of the target firm. We model the reverse termination fee in a simple cash transaction as the price of such an option and incorporate bargaining power in our framework. Using hand collected data on a sample of cash transactions from 1994 to 2011, we find evidence consistent with the model predictions. Variables affecting transaction option value explain variation in both the inclusion and size of reverse termination fees. Our results also suggest that the reverse termination fee increases in the bargaining power of the target relative to the acquirer, measured using pre-announcement positive news events that affect the target firm.

6. Institutional Investors (Pilot)

Chair: Scott Linn, University of Oklahoma, United States

Bond Covenants and Institutional Blockholding

Xinde Zhang, Shanghai University of Finance and Economics, China

Simiao Zhou, Shanghai University of Finance and Economics, China

Discussant: Hamed Mahmudi, University of Oklahoma, United States

Using a sample of 10,513 public bonds issued between 1979 and 2008, we find that institutional blockholding significantly increases the restrictiveness of bond covenants. This effect is robust to different measures of blockholding and alternative regression models, and cannot be explained away by the endogeneity of institutional blockholding. We find that the positive effect of blockholding is stronger for active blockholders and short-term blockholders, suggesting that stronger shareholder rights aggravate concerns on ex-post bondholder-shareholder conflicts. While covenants enhance bondholder governance, we find that bond covenants also benefit shareholders by reducing their borrowing costs that are related to agency conflicts.

Who are informed? The evidence from institutional trades

Yan Wang, McGill University, Canada

Discussant: Scott Linn, University of Oklahoma, Canada

Using the relation between institutional trades and sequential public information, this paper provides a systematic way to identify institutional trades that are informative about future equity returns. By studying actively managed U.S. institutions from 1994 to 2010, I show that institutional trades initiated by managers responding proactively to upcoming informational signals strongly predict future stock returns. A hedging portfolio based on these trades generates an average risk-adjusted abnormal return of approximately 3% per quarter. The predictability is more pronounced for stocks with higher information asymmetry, such as those of firms with high volatility and young age. I also find that the most informed institutional traders are likely to have short-term investment horizon, large block holdings, high industry portfolio concentrations, as well as reside in financial centers. My results indicate that the informedness of certain institutional investor groups is substantially reduced after Regulation FD.

How do Institutions Trade around Corporate News?

Alan Huang, University of Waterloo, Canada

Hongping Tan, University of Waterloo, Canada

Russ Wermers, University of Maryland, United States

Discussant: Laurent Barras, McGill University, Canada

Combining a comprehensive database of news releases during 2000 to 2010 with a large high-frequency database of institutional trades, we examine how institutions trade on the qualitative information embedded in public news releases. We find that institutions trade on the tone of news on the days of news releases but not around news arrivals. That institution trade speedily on but do not predict qualitative information in corporate news suggests that institutions' informational advantage, if any, stems mostly from their ability to process information in a highly timely manner.

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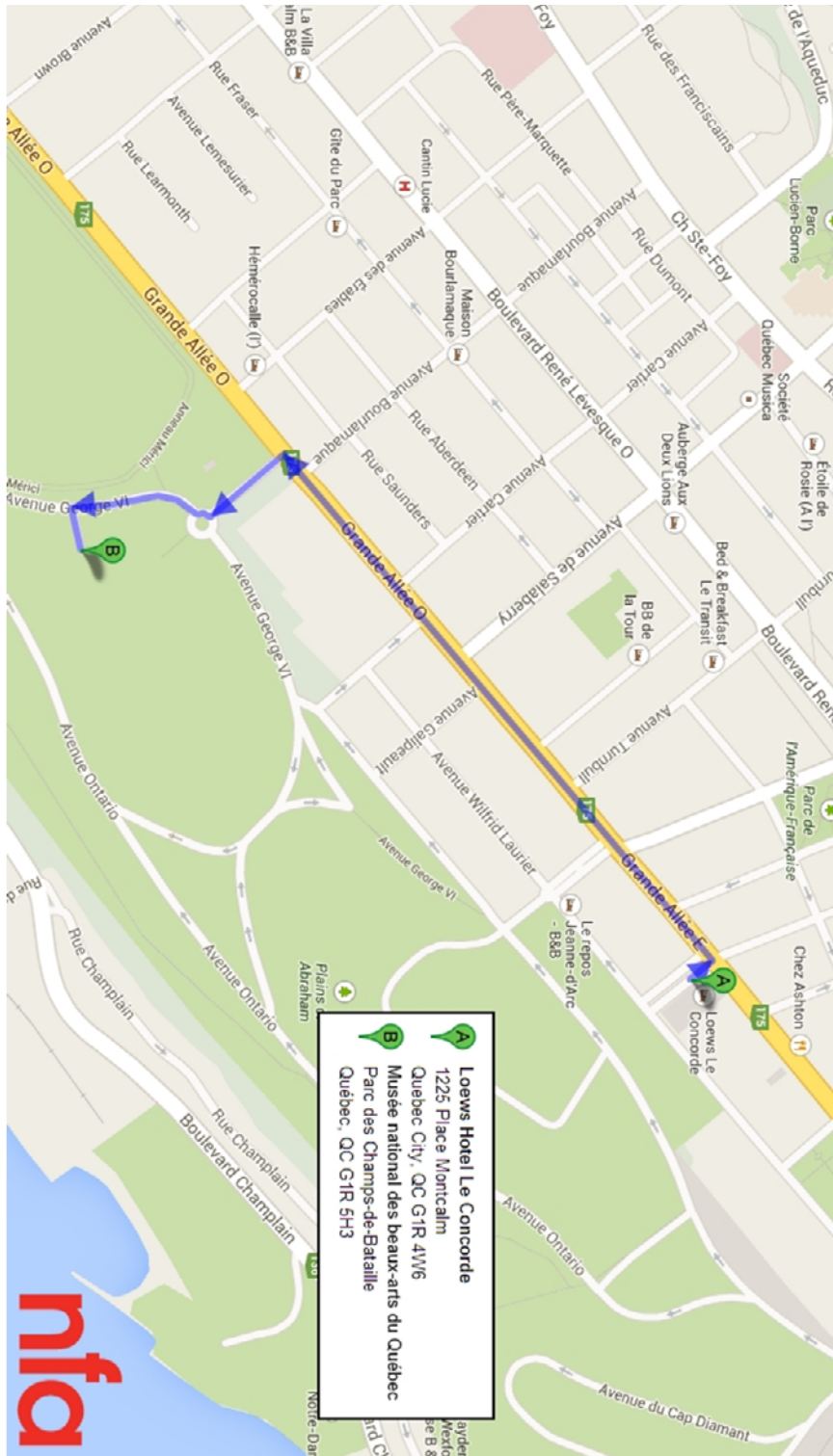
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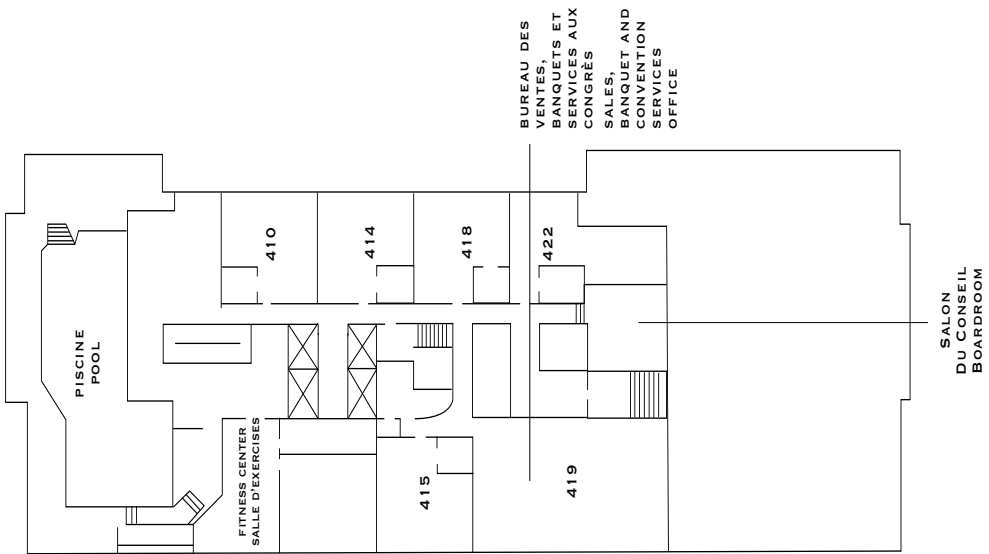
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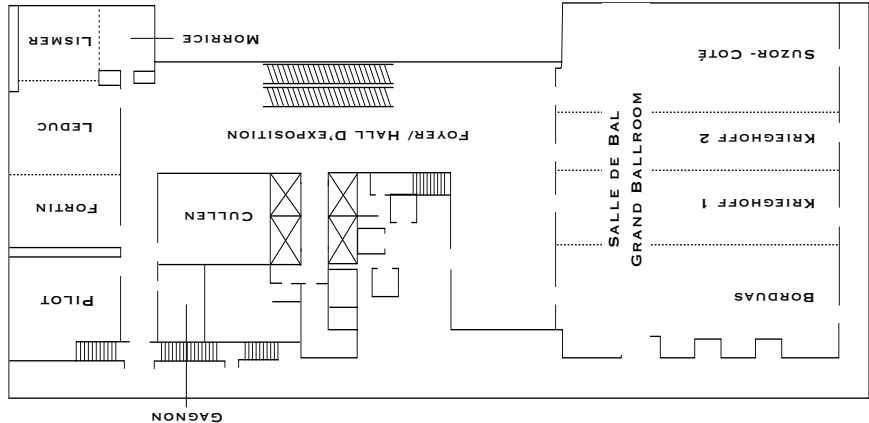
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Map

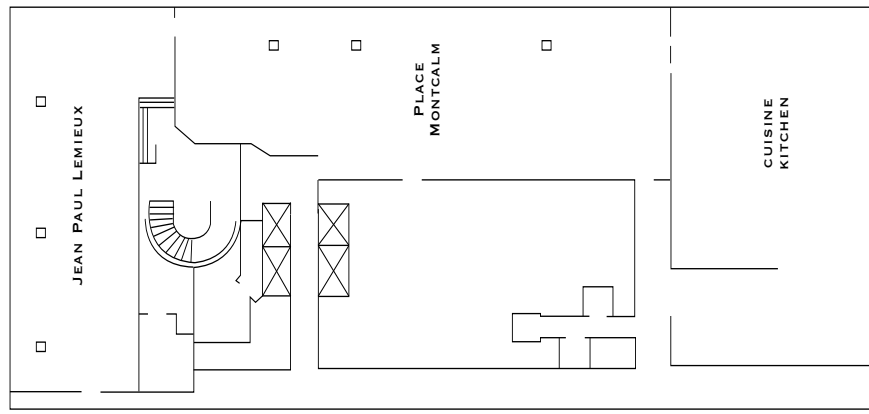




QUATRIÈME ÉTAGE
FOURTH FLOOR



TROISIÈME ÉTAGE
THIRD FLOOR



ÉTAGE INFÉRIEUR
LOWER LEVEL

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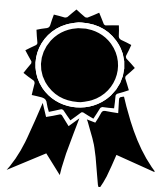
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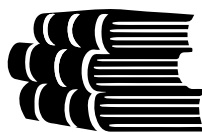
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