

Northern Finance Association Conference 2010

Friday, September 24, 2010

4.00 PM - 5.30 PM

Special Panel Discussion "Publishing Strategies for Doctoral Students" (Assiniboine B)

6.00 PM - 8.00 PM

Reception (Crystal Ballroom)

Saturday, September 25, 2010

7.00 AM - 8.30 AM

Breakfast (Provencher)

8.30 AM - 10.00 AM

International Cross-listings (Tache)

Chairperson: Jean-Claude Cosset, HEC Montreal

[Uninvited U.S. Investors? Economic Consequences Of Involuntary Cross-listings](#)

LUKAS ROTH, University of Alberta, Canada

Darius Miller, Southern Methodist University, United States

Peter Iliev, Pennsylvania State University, United States

Discussant: Louis Gagnon, Queen's University

We study a recent SEC regulation change that makes unsponsored (involuntary) cross-listings possible. We document that disclosure deregulation, combined with incentives for fee income, caused depositary banks to cross-list hundreds of foreign companies without the firms' approval or even knowledge. This caused a fundamental shift in the cross-listing landscape to where the majority of foreign firms trading in the U.S. are now here involuntarily, and trade on the OTC rather than major exchange markets. We further document positive wealth effects for the depositary banks and negative effects for many involuntary cross-listed foreign firms, such as those with high stock market liquidity, low information asymmetries, and meeting NYSE listing standards. In contrast, small, illiquid firms with greater information asymmetries and growth opportunities benefited from the unsponsored ADR facility. Our findings suggest that the amendment of Rule 12g3-2(b) interacted with conflicts of interests between foreign firms and depositary banks created significant externalities with unintended consequences.

[Does Cross-listing In The Us Foster Mergers And Acquisitions And Increase Target Shareholder Wealth?](#)

Jean-Claude Cosset, HEC Montreal, Canada

SIHAM MEKNASSI, HEC Montreal, Canada

Discussant: Igor Semenenko, Acadia University

We examine the role of cross-listings in alleviating domestic market constraints and facilitating cross-border mergers and acquisitions. Cross-listing appears to strengthen the bargaining power of target firms, allowing them to extract higher takeover premiums relative to their non-cross-listed peers. Moreover, shareholders of Sarbanes-Oxley-compliant targets seem to benefit from a higher premium. We also find that cross-listed firms are more likely to be an acquisition target. This evidence is consistent with the idea that cross-listing increases firms' attractiveness and visibility on the market for corporate control. Our results are robust to various specifications and to the self-selection bias

arising from the decision to cross-list.

Information Content Of Dividends: Evidence From China's Local And Cross-listed Firms

Min Maung, University of Saskatchewan, Canada

REZA CHOWDHURY, University of Dubai, United Arab Emirates

Wenjun Zhang, University of Alberta, Canada

Discussant: Jean-Claude Cosset, HEC Montreal

This paper revisits the agency and signaling motives of dividend payments by using a sample of local and cross-listed Chinese firms. From our estimations of the impact of firm-specific characteristics on firms' dividend payout decisions, we find that dividend-paying firms are well-governed business entities, regardless of whether they are local or cross-listed. We also find that changes in dividends are followed by changes in future earnings of dividend-paying firms, and that the signaling effect is economically larger for cross-listed firms. Therefore, the announcement of dividend payments provides an important signal to investors about a firm's governance strength and future performance.

Corporate Governance (Gateway)

Chairperson: Vijay Jog, Carleton University

Partial Acquisitions In Emerging Markets: A Test Of The Strategic Market Entry And Corporate Control Hypotheses

PengCheng Zhu, Eberhardt School of Business, University of the Pacific, United States

VIJAY JOG, Sprott School of Business, Carleton University, Canada

Isaac Otchere, Sprott School of Business, Carleton University, Canada

Discussant: Ling Cen, University of Toronto

We examine the motivations behind acquirers undertaking partial acquisitions in emerging markets by testing the performance improvement (market for corporate control) and the market entry hypotheses. Consistent with our conjecture that cross-border acquirers use acquisitions as market entry mechanism, we find that firms partially acquired by foreign bidders have stronger pre-acquisition performance than the control firms while those acquired by local bidders have weaker pre-acquisition performance. In addition, we find that target firms in domestic acquisitions experience significant improvements in operating performance and substantial changes in ownership structure after the acquisition; however, we do not observe such changes in the cross-border acquisitions sample. The evidence suggests that partial acquisitions in emerging markets undertaken by domestic acquirers serve the function of market for corporate control, while cross-border partial acquisitions are motivated by the market entry rationale.

Discipline Or Disruption? Stakeholder Relationships And The Effect Of Takeover Threat

LING CEN, Rotman School of Management, The University of Toronto, Canada

Sudipto Dasgupta, Hong Kong University of Science and Technology, Hong Kong

Rik Sen, Hong Kong University of Science and Technology, Hong Kong

Discussant: Vijay Jog, Carleton University

Threat of hostile takeovers can impair the ability of firms to commit to long-term relationships with important stakeholders, adversely affecting performance. We use the passage of business combination (BC) laws on a state-by-state basis as a source of exogenous reduction in the threat of a hostile takeover to show that this results in a significant increase in ROA for firms that have important product market relationships in the form of large corporate customers. We suggest that since a hostile takeover can disrupt relationships, a reduction in takeover probability allows the supplier to commit to longer term relationships with these customers. As a result, the supplier is able to get lucrative projects from the customer which it could not when its takeover probability was higher. This results in an improvement in operating performance of the supplier. We provide further support by showing that there is an increase in sales for the supplier and an increase in proportion of sales to large customers after the passage of BC law in its

state. We also find that a reduction in threat of takeover leads to a strengthening of the customer-supplier relationship. This is reflected by (a) greater probability of continuation of a relationship, (b) greater sensitivity of supplier's performance to that of the customer, and (c) greater sensitivity of the supplier's investment to that of the customers, suggesting that the supplier undertakes more investments on behalf of the customer. While a sizeable literature suggests that shareholders would always prefer greater vulnerability to hostile takeovers as it reduces agency problems, our results imply that this may not be true for firms for which ability to commit to long-term relationship with stakeholders is important.

Is Corporate Governance Risk Valued? Evidence From Directors' And Officers' Insurance

MARTIN BOYER, HEC Montréal, Canada

Lea Stern, Ohio State University, United States

Discussant: George Blazenko, Simon Fraser University

The role and duty of corporate directors and officers is in constant flux. If the company is sued, corporate directors and officers may be held personally liable for having breached their duty toward the firm's stakeholders. As a consequence, before accepting to sit on the board of any organization would-be directors require that their personal wealth be protected; this protection is provided through what is known as a directors' and officers' liability insurance contract, or D&O insurance. In this paper, we examine whether D&O insurers charge a higher premium to firms that appear to have higher governance risk. We find that common equity firms pay lower D&O insurance premiums than income trusts, an alternative and, arguably, riskier ownership form. This result has wide-ranging implications for investors insofar as the information provided by D&O insurers provides investors with an unbiased signal of the firm's governance risk. The signal is unbiased because it comes from an entity (i.e. the insurer) that has a direct financial incentive to correctly assess an organization's governance risk, in contrast to other ad hoc governance measures and indices.

Bankruptcy (Salon A)

Chairperson: Jean Helwege, University of South Carolina

Fallen Angels And Price Pressure

Brent Ambrose, Penn State University, United States

Kelly Cai, University of Michigan at Dearborn, United States

JEAN HELWEGE, University of South Carolina, United States

Discussant: Lubomir Petrsek, Pennsylvania State University

Previous empirical studies on the extent of price pressure when large quantities of a security are traded typically suffer from information effects. We overcome this problem by examining forced selling of fallen angel bonds by insurance companies. Among these downgraded bonds, we restrict our sample to include only firms whose stock has no significant reaction to the rating change, making their bond sales highly likely to represent regulatory pressure rather than information-motivated trading. Our experiment reveals negligible, if not non-existent, price pressure effects. Moreover, we find that bond liquidity does not explain the variation in bond returns in our informationfree sample. Thus, our results indicate that price pressure is not a major factor in security pricing.

Endogenous Bankruptcy And Expected Recovery

Wulin Suo, Queen's University, Canada

WEI WANG, Queen's University, Canada

Qi Zhang, Queen's University, Canada

Discussant: Georges Dionne, HEC Montreal

Using a large sample of Chapter 11 filings from 1996 to 2007 we investigate whether the expected corporate debt recovery derived from endogenous bankruptcy model (Leland and Toft (1996)) is able to explain recovery observed in the market. We find that the

endogenously determined expected recovery has strong explanatory power on observed market recovery. Our results hold after firm characteristics, industry distress, and macroeconomic conditions are accounted for. In addition, we find that agency conflicts and ex post bankruptcy costs are able to explain the difference between the expected and market recovery.

[Bankruptcy Prediction For U.s. Banks](#)

SEAN CLEARY, Queen's University, Canada

Greg Hebb, Dalhousie University, Canada

Discussant: Jean Helwege, University of South Carolina

We examine the bankruptcy of 119 U.S. banks over the 2002 to November 2009 period, using multivariate discriminant analysis (MDA) to attempt to predict banks that would fail. Our models use variables that measure general financial health, loan reliance, funding of loans, loan management, capital adequacy, and reliance on off-balance sheet items. Our in-sample results suggest that we are able to successfully distinguish between banks that would fail and those that wouldn't 85% of the time, while the most important variables are related to bank profitability, capital adequacy and loan quality. More importantly, our model does a very good job of distinguishing healthy banks from those that are at high risk of failure. In addition, when we apply our model "out-of-sample," it provides useful assessments of bank health. While a statistical model such as ours is no substitute for "on-site" examinations, it does represent an effective supplement to them. In particular, since we are able to effectively classify a large number of firms, it can be used to identify those banks that should be scrutinized in more detail, and hence make use of more detailed qualitative information.

Banking (Salon C)

Chairperson: Gordon Alexander, University of Minnesota

[Endogenous Asset Fire Sales And Bank Lending Incentives](#)

ZHONGZHI SONG, University of British Columbia, Canada

Discussant: Jean-Christophe Statnik , Université de Lille Nord de France – European Center for Corporate Control Studies

This paper provides explanations to two important questions that arise from the recent financial crisis: (i) why don't banks keep enough cash to meet potential liquidity shocks and therefore avoid fire sales of illiquid assets? and (ii) why do banks keep a large amount of cash on their balance sheet without lending after large capital injections from the government? Both questions are answered in a single framework by looking at the lending incentives of banks when facing the risk of liquidity shocks. Banks make their decisions based on tradeoffs of costs (fire sales of illiquid assets) and benefits (high returns from bank loans) of lending. This paper shows that it might be optimal for banks to lend out cash and incur fire sales of assets under liquidity shocks, even if banks are endowed with enough cash to meet the liquidity shock. That is, fire sales of assets could be endogenous phenomena and optimal for banks. At the same time, banks might still keep a large amount of cash after government capital injections to save the cost of fire sales, especially when banks are endowed with a large fraction of illiquid assets. In addition, this analysis also provides policy implications for government intervention.

[Bank Regulation And Risk Management: An Assessment Of The Basle Market Risk Framework](#)

GORDON ALEXANDER, University of Minnesota, United States

Alexandre Baptista, The George Washington University, United States

Shu Yan, University of South Carolina, United States

Discussant: Evan Dudley, University of Florida

The Basel Committee on Banking Supervision requires banks utilize Value-at-Risk (VaR) and Stress Testing (ST) to monitor and control market risk within their trading books. Since some researchers advocate using Conditional Value-at-Risk (CVaR) for doing so, we

examine the effectiveness of a risk management system based on VaR and ST constraints in controlling CVaR. Using historical simulation as most banks do (Perignon and Smith (2010)), we find that these constraints allow the selection of portfolios with relatively large CVaRs. Accordingly, the Basel framework is of dubious effectiveness in preventing such banks from taking substantive market risk within their trading books.

[Better Borrowers, Fewer Banks?](#)

Godlewski Christophe, Université de Strasbourg – LaRGE Research Center & EM Strasbourg Business School, France

Lobez Frédéric, Université de Lille Nord de France – European Center for Corporate Control Studies, France

STATNIK JEAN-CHRISTOPHE, Université de Lille Nord de France – European Center for Corporate Control Studies, France

Ziane Ydriss, IAE Paris-GREGOR, France

Discussant: Zhongzhi Song, University of British Columbia

We investigate the relationship between borrower quality and the structure of the pool of banks. First, we develop a theoretical model where the size of the banking pool is a credible signal of firm quality. We argue that better borrowers seek to disclose their quality in a credible way through the structure of the banking pool involving fewer banks. Second, we test our prediction using a sample of more than 3,000 loans from 19 European countries. We perform regressions of the number of bank lenders on various proxies of borrower quality. Our empirical tests corroborate the theoretical predictions. The size of the banking pool is a signal of borrower quality. Hence, good quality firms have fewer lenders in their banking pools.

Asset Pricing Theory (Assiniboine B)

Chairperson: Raymond Kan, University of Toronto

[On The Hansen-jagannathan Distance With A No-arbitrage Constraint](#)

RAYMOND KAN, University of Toronto, Canada

Nikolay Gospodinov, Concordia University, Canada

Cesare Robotti, Federal Reserve Bank of Atlanta, United States

Discussant: Adlai Fisher, University of British Columbia

We provide an in-depth analysis of the theoretical and statistical properties of the Hansen-Jagannathan (HJ) distance that incorporates a no-arbitrage constraint. We show that for stochastic discount factors (SDFs) that are spanned by the returns on the test assets, testing the equality of HJ-distances with no-arbitrage constraints is the same as testing the equality of HJ-distances without no-arbitrage constraints. A discrepancy can only exist when at least one SDF is a function of factors that are poorly mimicked by the returns on the test assets. Under a joint normality assumption on the SDF and the returns, we derive explicit solutions for the HJ-distance with a no-arbitrage constraint, the associated Lagrange multipliers, and the SDF parameters in the case of linear SDFs. This allows us to show that nontrivial differences between HJ-distances with and without no-arbitrage constraints can only arise when the volatility of the unspanned component of an SDF is large and the Sharpe ratio of the tangency portfolio of the test assets is very high. Finally, we present the appropriate limiting theory for estimation, testing, and comparison of SDFs using the HJ-distance with a no-arbitrage constraint.

[Assessing Misspecifications In Asset Pricing Models With Nonlinear Projections Of Pricing Kernels](#)

CAIO ALMEIDA, Getulio Vargas Foundation, Brazil

René Garcia, EDHEC Business School, France

Discussant: Raymond Kan, University of Toronto

We develop a new approach to evaluate asset pricing models (APMs) based on Minimum Discrepancy (MD) projections that generalize the Hansen-Jagannathan (HJ, 1997)

distance to account for an arbitrary number of moments of asset returns. The Minimum Discrepancy projections correct APMs to become admissible stochastic discount factors (SDF) through nonlinear functions of the basis assets returns, contrasting with the linear corrections from the HJ method. These nonlinear corrections make our method more effective than available methods in detecting sources of model specifications, specially in economies with nonlinear priced risk, or when the APMs being tested contain nonlinear functions of basis assets. We provide a geometric interpretation and also a theoretical example to illustrate our point. In the example, the CAPM is diagnosed in an economy where the true SDF prices coskewness risk with respect to the market portfolio (Kraus and Litzenberger (1976)). It is shown that while methods that use the HJ distance can not identify the correct source of misspecification of the CAPM in this economy (a quadratic term in the market return), there are nonlinear projections in the class of MD problems that correctly capture the misspecified term. Also, in order to explore the empirical structure of the MD projections, we provide a full example of estimation and diagnosis of the CCAPM model based on several discrepancy measures.

[Mobility, Human Capital And Expected Stock Returns](#)

Andrés Donangelo, University of California, Berkeley, Haas School of Business, United States

Esther Eiling, University of Toronto, Rotman School of Management, Canada

MIGUEL PALACIOS, Vanderbilt University, Owen Graduate School of Management, United States

Discussant: Harry Turtle , Washington State University

We present a model in which labor mobility affects risk and expected returns of equity and human capital. Our setup is based on a multi-industry dynamic economy with production. Workers are endowed with different types of general and industry-specific skills. Generalist workers can move between industries, while specialist workers and physical capital cannot. The presence of mobile workers affects how aggregate risk in the economy is divided between physical and human capital. We show that consumption and aggregate wealth increase when mobile workers are more important in the economy. However, at the same time, shocks to productivity are amplified when generalist workers move around and as a result aggregate risk and the equity premium also increase. The model suggests that a measure of labor mobility is a promising novel macroeconomic variable for asset pricing.

Behavioural Finance (Selkirk)

Chairperson: Stephen Foerster, University of Western Ontario

[Double Then Nothing: Why Individual Stock Investments Disappoint](#)

STEPHEN FOERSTER, University of Western Ontario, Canada

Discussant: Amir Barnea, Claremont McKenna College

Tversky and Kahneman (1974) argue that individuals often rely on heuristics that reduce the complexity involved in predicting values, but such heuristics can lead to severe and systematic errors. This paper tests their argument in the context of investments by focusing on a simple heuristic whereby “positive feedback traders” (DeLong et al. (1990)) are attracted to buying stocks that have recently doubled in price in anticipation of further gains. I show that such a strategy can lead to predictable disappointment and severe underperformance (-28% over a four-year period) for these investors, whereas investors who avoid relying on this simple heuristic are likely to perform as expected, on average similar to the overall market. The “doubling” variable is a significant predictor of future price reversals in addition to past performance per se, as uncovered by DeBondt and Thaler (1985). I also show that a “doubling” portfolio (made up of stocks that have recently doubled in price) is quite different from the DeBondt and Thaler “winner” portfolio and yet displays just as strong a reversal effect.

[Nature Or Nurture: What Determines Investor Behavior?](#)

AMIR BARNEA, Claremont McKenna College, United States

Henrik Cronqvist, Claremont McKenna College, United States
Stephan Siegel, University of Washington, United States
Discussant: Stephen Foerster, University of Western Ontario

Using data on identical and fraternal twins' complete financial portfolios, we decompose the cross-sectional variation in investor behavior. We find that a genetic factor explains about one third of the variance in stock market participation and asset allocation. Family environment has an effect on the behavior of young individuals, but this effect is not long-lasting and disappears as an individual gains experiences. Frequent contact among twins results in similar investment behavior beyond a genetic factor. Twins who grew up in different environments still display similar investment behavior. Our interpretation of a genetic component of the decision to invest in the stock market is that there are innate differences in factors affecting effective stock market participation costs. We attribute the genetic component of asset allocation - the relative amount invested in equities and the portfolio volatility - to genetic variation in risk preferences.

10.15 AM - 11.45 AM

Capital Structure (Tache)

Chairperson: Kai Li, University of British Columbia

Debt Structure And Debt Specialization

Paolo Colla, Bocconi, Italy

Filippo Ippolito, Bocconi, Italy

KAI LI, Sauder School of Business, UBC, Canada

Discussant: Robert Kieschnick, University of Texas at Dallas

This paper provides the first large sample evidence on the patterns and determinants of debt structure using a new database of publicly listed U.S. firms. Within what is generally referred to as debt financing, we are able to distinguish between commercial paper, revolving credit facilities, term loans, senior and subordinated bonds and notes, and capital leases. We first show that most of the sample firms concentrate their borrowing in only one of these debt instruments, and only the low growth, low risk large firms with high profitability and the highest level of leverage borrow through multiple debt instruments. We then show that the extent of debt specialization is increasing in firm growth opportunities, cash flow risk, and asset maturity, while decreasing in asset tangibility. Finally, we find that firm characteristics that are known to be associated with their leverage decisions also affect their usage of different debt instruments. Our paper suggests that debt structure decisions, like capital structure decisions, are made based on a cost and benefit analysis to maximize firm value.

Capital Structure And The Changing Role Of Off-balance-sheet Lease Financing

Laurel Franzen, Loyola Marymount University, United States

Kimberly Rodgers, American University, United States

TIM SIMIN, The Pennsylvania State University, United States

Discussant: Lukas Roth, University of Alberta

Using trend regression analysis, we demonstrate the remarkable increase in off-balance-sheet (OBS) lease financing and simultaneous decrease in capital (on-balance-sheet) leases over the last 27 years. This trend is consistent with the contentions of regulators and popular press that firms intentionally structure leases to qualify for OBS accounting treatment. Moreover, we find that firms rely heavily on this OBS financing in addition to, not merely in lieu of, conventional debt. We include a proxy for the benefits of the OBS accounting treatment as an additional explanatory variable in a traditional capital structure model and find a significantly negative relationship: as abnormal OBS lease activity increases, conventional debt ratios fall. Our results suggest common financial risk metrics underestimate the risk of such firms as the lower debt ratios may be associated with higher OBS debt financing. Our results should be of interest to a host of market

participants as the US considers changes in accounting treatment of lease financing.

Geography And Capital Structure

XIAOQIAO WANG, Queen's University, Canada

Jin Wang, Queen's University, Canada

Lewis Johnson, Queen's University, Canada

Discussant: Alexander Vedrashko, Simon Fraser University

In this paper, we investigate the impact of geographic location on firms' capital structure decisions. We find strong evidence that location of a firm influences its capital structure. In particular, we find that centrally located firms have lower leverage ratios than remotely located ones. Moreover, consistent with the hypothesis that those remotely located firms face more severe adverse selection problems, the effect of geographic location on capital structure is more pronounced when information asymmetry is higher.

Market Timing (Gateway)

Chairperson: Walid Busaba, University of Western Ontario - Ivey School of Business

Ipo Waves, Information Spillovers, And Analyst Biases

Susan Christoffersen, McGill University, Canada

AMRITA NAIN, McGill University, Canada

Ya Tang, McGill University, Canada

Discussant: J. Ari Pandes, Haskayne School of Business

We document significant variation in the quality of firms going public within an IPO wave. In the early stages of an IPO wave, when initial returns and IPO demand are high, the average quality of IPO stock is low. Later in the IPO wave, when initial returns and IPO demand are low, firms going public have better operating performance, higher market share and higher long-term abnormal stock returns. Despite the poorer long-term performance of early movers, analysts affiliated with the underwriters provide disproportionately more positive recommendations to early movers than to late movers. The bias of affiliated analysts suggests that underwriters are less selective about the firms they take public when the market for IPOs is strong. Institutional investors are not fooled by affiliated analysts and appear savvy to the performance patterns of early and late-mover IPOs. Specifically, institutional investors take advantage of the short-term high returns offered by early IPOs but, in the longer term, exit out of the early-mover IPOs in favor of late-mover IPOs.

Market Volatility And The Timing Of Ipo Filings

WALID BUSABA, University of Western Ontario - Ivey School of Business, Canada

Daisy Li, University of Western Ontario - Ivey School of Business, Canada

Guorong Yang, University of Western Ontario - Ivey School of Business, Canada

Discussant: Xiaowei Xu, University of Alberta

We investigate how aggregate IPO filing volume responds to changes in stock market volatility. The filing volume we study consists of all non-financial firms that filed with the SEC between 1984 and 2004. Controlling for factors shown to impact primary market activity, notably stock market returns, we find filing volume to be positively related to changes in market volatility, and the relation is especially pronounced when stock market return is at 'normal' levels, i.e. neither too high nor too low. The relation also holds at the industry level, in a pooled time-series cross-industry regression context. The relation is more pronounced for IPO filings in 'new' industries (computers, software, electronic equipment, and telecommunications) relative to traditional industries. These results are consistent with the hypothesis that the ability to discover investor valuations before deciding to sell shares gives firms filing with the SEC an 'option' on the uncertain offer price. This option has value not only in a strong stock market but also in a volatile market. Furthermore, option theory implies that the marginal effect of volatility is highest in 'normal' stock markets. We therefore find evidence in support of a distinct type of

'window of opportunity' for firms attempting to go public, one that is characterized not by a strong stock market but rather by increased market volatility.

[Merger Waves, Strategy Commonalities And Post-merger Performance In The Mutual Fund Industry](#)

Henrik Cronqvist, Claremont McKenna College, Robert Day School of Economics and Finance, United States

Ethan Namvar, University of California - Irvine, United States

BLAKE PHILLIPS, University of Waterloo, Canada

Discussant: Keke Song, Dalhousie University

This study examines mutual fund mergers between 1962 and 2008, focusing on the determinants of cross-sectional variation in post-merger performance. We hypothesize that performance variation is a function of merger timing relative to broad market factors and commonalities (or synergies) in the strategies of the merging funds. We find that mergers between funds with similar management objectives, as reflected by portfolio book-to-market ratio, price-earnings ratio, beta and market capitalization values, outperform mergers between funds with dissimilar strategies. These performance gains transcend lower portfolio rebalancing costs which might be realized between more similar funds, suggesting that mutual fund mergers create collaborative benefits between funds with similar strategies. We also find that mutual fund mergers tend to cluster in waves following poor market performance and following aggregate net asset outflows from equity funds. Merger waves can also be predicted by common proxies for economic conditions, the term (TERM) and default (DEF) spreads in the bond market. Mergers undertaken in the heels of negative performance and asset flows tend to result in lower synergy fund pairings which are value destroying for investors. Lastly, we examine if fund governance structures influence the fund pairing process, testing if stronger fund oversight mitigates pairing mismatches. We find that less independent boards and boards with higher compensation are related to greater strategic mismatches. Board of trustee oversight of the pairing process is only significant for mergers within the same fund family, for which agency conflicts between fund managers and investors are most acute. These results suggest that more entrenched boards are more tolerant of fund mismatches which benefit the investment company but are not in investor's best interests. Collectively our results show that merger timing and the fund pairing process are significant factors in the potential for mergers to be value-enhancing for both managers and investors.

[Strategic Waiting In The Ipo Markets](#)

Gonul Colak, Florida State University, United States

HIKMET GUNAY, University of Manitoba, Canada

Discussant: Amrita Nain, McGill University

We analyze the strategic waiting tendencies of IPO firms. Our model shows why some high quality firms may strategically delay their initial public offering until a favorable signal about the economic conditions is generated by other issuing firms. Survival analysis suggests that IPOs in the highest quality decile have significantly higher median waiting days (since the start of a rising IPO cycle) than the IPOs in the lowest decile. During the early stages of an expanding IPO cycle the average firm quality is lower than in its later stages. We find supporting evidence also from the IPOs of future S&P500 firms.

Investment Banking (Salon A)

Chairperson: Lynnette Purda, Queen's University

[Analyst Disagreement And Aggregate Volatility Risk](#)

ALEXANDER BARINOV, University of Georgia, United States

Discussant: Madhu Kalimipalli, Wilfrid Laurier University

The paper explains why firms with high dispersion of analyst forecasts earn low future returns. These firms beat the CAPM in the periods of increasing aggregate volatility and

thereby provide a hedge against aggregate volatility risk. I show that both aggregate volatility and analyst disagreement increase during recessions. The increase in analyst disagreement causes real options to respond to higher aggregate volatility by a lower decline in value than what the CAPM predicts. First, all else equal, real options increase in value when disagreement about the underlying asset value goes up, and this effect increases with the level of disagreement. Second, higher disagreement means that real options become less sensitive to the underlying asset value and, therefore, less risky. I find empirically that the aggregate volatility risk factor can explain the abnormal return differential between high and low disagreement firms. I also find that this return differential is higher for the firms with abundant real options (growth firms and low credit rating firms), and this fact can be explained by aggregate volatility risk. Aggregate volatility risk is also capable of explaining why the link between analyst disagreement and future returns is stronger for the firms with low institutional ownership and high short sale constraints, but not why the link between analyst disagreement and future returns is stronger for illiquid firms.

[Firm Cash Holdings, Idiosyncratic Risk, And Analyst Coverage](#)

Van Son Lai, Laval University, Canada

William Sodjahn, New York University, United States

ISSOUF SOUMARE, Laval University, Canada

Discussant: Hamed Mahmudi, Rotman School of Management, University of Toronto

This article examines how idiosyncratic risk and degree of analyst coverage affect firms' cash holdings and shareholders' valuation. To disentangle business and nonbusiness risk, we decompose idiosyncratic risk into two components: (i) cash flow, or business, risk and (ii) residual, or nonbusiness, risk. Analyst coverage has been shown to improve performance and governance. We find that idiosyncratic risk has a negative effect on cash holdings, controlling for cash flow volatility. This finding runs contrary to the precautionary savings motive and suggests that endogenous high idiosyncratic risk is cash destroying. Yet further investigation reveals that firms with high idiosyncratic risk have small cash reserves only when analyst coverage is low. Firms with large cash reserves are likely to barely beat analysts' forecasts only when their earnings are low. For firms with intense analyst coverage, their business risk has a positive effect on the market value of cash, whereas their nonbusiness risk has a negative effect.

[Is There Life After Loss Of Analyst Coverage?](#)

SIMONA MOLA, Arizona State University, United States

Raghavendra Rau, Purdue University, United States

Ajay Khorana, Georgia Institute of Technology, United States

Discussant: Issouf Soumare, Laval University

This paper examines the value of sell-side analysts to firms by evaluating the long-term consequences of losing all analyst coverage for periods of at least one year. Our findings are consistent with the hypothesis that analysts add value to a firm by maintaining investor recognition for that firm's stock. In particular, we find that, in the years after the loss of coverage, sample firms experience a decrease in trading volume, stock liquidity, and institutional ownership, while their operating prospects are similar to their covered peers. Analysis of delisting rates indicates that sample firms are significantly more likely to delist than their covered peers, which are control firms matched on the propensity for bankruptcy and the potential for generating brokerage revenue. We find similar results when we examine a subsample of firms that lose all analyst coverage following an exogenous shock. Our results provide insight into the reasons why firms place so much importance on analyst coverage.

Anomalies (Salon C)

Chairperson: Charles Mossman, University of Manitoba

[The Accrual Volatility Anomaly](#)

ALAN HUANG, University of Waterloo, Canada
Sati Bandyopadhyay, University of Waterloo, Canada
Tony Wirjanto, University of Waterloo, Canada
Discussant: Oleg Rytchkov, Temple University

We find that quarterly cash flow shocks are more likely to be offset by contemporaneous accruals than to be reported as earnings. We examine the pricing implications of a consistent deviation of earnings from cash flow. Measuring the consistent deviation by accrual volatility, we find a strong and long-lasting negative association between accrual volatility and future stock returns. In decile portfolios that rank accrual volatility, a hedge portfolio that goes long in the lowest decile and short in the highest decile generates an annual, risk-adjusted return in the order of 10% from one-month to five-year horizon. These results are robust to common risk factors and return-informative variables, extend to both operating accruals and discretionary accruals, are distinct from the accrual anomaly, and are not subsumed by transaction costs and short-sale constraints. In addition, an accrual-volatility mimicking portfolio provides additional explanatory power to returns on the Fama-French 25 size/book to market portfolio. The accrual volatility effect is consistent with the information uncertainty effect where higher historical information uncertainty leads to lower future returns, and is also consistent with the earnings fixation hypothesis—we find that investors overprice the transitory accruals component of earnings in high accrual volatility stocks.

Stages In The Life Of The Weekend Effect

Dennis Olson, American University of Sharjah, United Arab Emirates
Nan-Ting Chou, University of Louisville, United States
CHARLES MOSSMAN, University of Manitoba, Canada
Discussant: Bo Young Chang, McGill University

This paper hypothesizes a five-stage life for stock market anomalies involving identification, exploitation, decline, reversal, and disappearance. Data for seven U.S. stock indices for 1973 – May 2007 suggest that the weekend effect may have already gone through this entire cycle. The negative weekend effect declined first for large stocks and now has mostly disappeared even for small stocks. The reverse weekend effect found in large stocks in the 1990s has similarly declined since 2000. Across all stock indexes, the weekend effect appears to be in the last stage of its cycle—disappearance.

Ranking Stocks And Returns: A Non-parametric Analysis Of Asset Pricing Anomalies

Denys Maslov, University of Texas at Austin, United States
OLEG RYTCHKOV, Temple University, United States
Discussant: Alan Huang, University of Waterloo

In this paper, we apply a non-parametric rank-based technique to analyze nine asset pricing anomalies. We demonstrate that the relation between almost every anomalous characteristic and abnormal returns is non-monotonic. In particular, many anomalies are detectable only for high values of characteristics. We argue that due to the presence of non-monotonicity the similarity between anomalous characteristics should be examined separately for different ranges of each variable. We demonstrate how the standard linear regression i) may significantly overstate or understate the strength of relation between characteristics and returns; ii) may fail to recognize the similarity as well as the difference between anomalies. We also introduce the distance between asset pricing anomalies and perform a cluster analysis in the anomaly space. We find that for stocks with extreme characteristics almost all considered anomalies appear to be statistically different.

Financial Crises (Assiniboine B)

Chairperson: Sean Cleary, Queen's University

Should Short-selling Be Restricted During A Financial Crisis?

Iftekhar Hasan, Lally School of Management & Technology, Rensselaer Polytechnic Institute,

United States

Nadia Massoud, Schulich School of Business, York University, Canada

Anthony Saunders, Stern School of Business, New York University, United States

KEKE SONG, Dalhousie University, Canada

Discussant: Andriy Shkilko, Wilfrid Laurier University

This paper investigates the short selling of financial company stocks around the time of the SEC September 2008 short-selling ban. More specifically, this paper examines whether this short selling, mainly by hedge funds and other types of sophisticated investors, was purely speculative or whether it was driven by rational behaviour in response to a financial company's risk exposure, such as its holdings of subprime-related assets and its credit risk exposure. Our results show that the short-selling activities of financial firms were not significantly larger than those of non-financial firms even after controlling for credit risk. More importantly, our results show that short sellers rationally short sold those financial company stocks with the greatest subprime and credit risk exposure. This finding has important implications regarding banning short selling, since it suggests that such a regulation may have muted the disciplinary effects of investors in the financial market on those financial companies with the greatest risk exposure.

[Stress Testing Credit Risk: The Great Depression Scenario](#)

SIMONE VAROTTO, University of Reading, United Kingdom

Discussant: Nadia Massoud, York University

By using Moody's historical corporate default histories we explore the implications of scenarios based on the Great Depression for banks' economic capital and for existing and proposed regulatory capital requirements. By assuming different degrees of portfolio illiquidity, we then investigate the relationship between liquidity and credit risk and employ our findings to estimate the Incremental Risk Charge (IRC), the new credit risk capital add-on introduced by the Basel Committee for the trading book. Finally, we compare our IRC estimates with stressed market risk measures derived from a sample of corporate bond indices encompassing the recent financial crisis. This allows us to determine the extent to which trading book capital would change in stress conditions under newly proposed rules. We find that, typically, banking book regulation leads to minimum capital levels that would enable banks to withstand Great Depression-like events, except when their portfolios have long average maturity. We also show that although the IRC in the trading book may be considerable, the capital needed to absorb market risk related losses in stressed scenarios can be more than twenty times larger.

[The Cleansing Effect Of Recession: Evidence From Corporate M&a Activities](#)

DING DING, University of Toronto, Canada

Mohammad M. Rahaman, Saint Mary's University, Canada

Discussant: Simone Varotto, University of Reading

Do firms fail because of exogenous economic disturbances beyond their control or do they fail because of unsound corporate policies? We utilize the clustering of firm-level M&A activities in industry expansionary episodes, and the clustering of corporate failures in subsequent aggregate contractionary episodes, to show that firms that concentrate most of their M&A activities in the good time (economic expansion) fail more often in a subsequent recession than firms that distribute M&A investment decisions to non-expansionary times. We find that hyperactive bidders typically have overvalued equity in good times and that they use their stocks as acquisition currencies to finance an above-average level of M&A activities. We show that hyperactive bidders in expansions accumulate relatively more business risk (volatility of operating cash-flow) than non-hyperactive bidders after an expansionary period (the good time) as well as register lower firm efficiency. The increased level of business risk and the decreased level of firm efficiency eventually precipitate failure for these firms more often in a recession (the bad time) than other times. These results suggest that a cleansing effect of recession is at work in the business sector and firms need to carefully examine their investment policies

in good times to cushion against failure in bad times.

[The Impact Of Government Interventions On Cds And Equity Markets](#)

ZOE TSESMELIDAKIS, Goethe University Frankfurt, Germany

Frederic Schweikhard, Goethe University Frankfurt, Germany

Discussant: Ding Ding, University of Toronto

In the midst of the ongoing debate on government activism during the financial crisis and the policies to adopt in the future, using a large sample of 432 companies from the US and major European countries, we provide empirical evidence on how the default risk implied from stock and equity option prices using a structural credit pricing model has drifted apart from the default risk explicitly priced in credit default swap premia. We show that while debt and equity markets used to be closely linked in the pre-crisis period, they have been decoupled during the crisis, especially in the banking sector. A possible explanation is the asymmetric treatment of debt and equity in rescue measures, which tend to exclusively save debt. A deeper investigation of the misalignment between the two markets reveals that it persists after controlling for well-known drivers of credit spreads not included in pricing models. We find that firm size, default correlation, macroeconomic crisis indicators and actual intervention events positively affect the spread deviations, thus supporting the too-big-to-fail hypothesis.

Options (Selkirk)

Chairperson: Peter Klein, Simon Fraser University

[Modeling Default Risk Using Bonds With Make Whole Call Provision](#)

OLFA MAALAOUI CHUN, , Korea, Republic Of

Discussant: Gang "Nathan" Dong, Rutgers University & Columbia University

We use a reduced-form approach to estimate default probabilities implicit in the transaction prices of a new type of call provision called make-whole. With make-whole bonds, the strike price is not specified in the debt contract; rather it varies inversely with the risk-free interest rate and has a floor at the par value. Because of the lack of models, credit characteristics of this new type of issue are still unexplored even though this new provision recently supplanted fixed call provision. We model the default-adjusted interest rate and the make-whole strike price as a square root type process. The default risk is modeled as a time varying spread, with the magnitude of this spread impacting the probability of a Poisson process governing default arrival. We use an implicit finite difference scheme to price make-whole call bonds. Default probabilities and default risk obtained from prices of make-whole call bonds are consistent with bond characteristics and Moody's ratings.

[Counterparty Credit Risk And American Options](#)

PETER KLEIN, Simon Fraser University, Canada

Jun Yang, ,

Discussant: Olfa Maalaoui Chun

This paper analyzes the effect of credit risk on optimal early exercise policy and value of American options. It finds that the price of the underlying asset at which early exercise is optimal can be significantly different for a vulnerable American option as compared to its non-vulnerable twin. Under general assumptions we show that it is not always optimal to exercise when a credit event is pending yet it is sometimes optimal to exercise for credit reasons well before the occurrence of a credit event. As a result, the common practice of valuing vulnerable options by discounting the payoff at a higher risk-adjusted rate, may lead to inaccurate results. Numerical examples illustrate that premature early exercise can mitigate only approximately one third of the expected credit loss for vulnerable American options. This is in contrast with existing literature that claims premature early exercise can largely eliminate such expected credit loss. The remaining expected credit loss can be attributed to two sources: the write-down of the payoff if financial distress

occurs; and the reduction in the payoff amount if exercise has been premature in order to avoid a write-down. These findings have important risk management and accounting implications for vulnerable American options.

[The Joint Discipline Of Option And Debt: Theory And Evidence From Ceo Equity Holding, Capital Structure And Executive Compensation](#)

GANG "NATHAN" DONG, Rutgers University & Columbia University, United States

Discussant: Peter Klein , Simon Fraser University

I develop a principal-agent model to analyze the interaction among CEO's equity holding, firm's capital structure and executive compensation. Unlike a strand of literatures in corporate finance investigating only capital structure and compensation contract, this paper asks the question whether executive's equity holding and firm's financial leverage jointly affect CEO compensation design. The model characterizes CEO equity holdings as an aggregated option contract with single strike and expiration. The optimal solution of this model indicates that high leverage and high strike price of manager's equity holding exert disciplinary control over manager's behavior. In particular, the manager with high strike-to-price ratio in her equity option holding is associated with low pay-for-performance sensitivity. The discipline of high debt level on the manager's compensation contract depends on her skill: high leverage is associated with low pay-for-performance sensitivity if the manager's skill is low, whereas high leverage is associated with high pay-for-performance sensitivity if the manager's skill is high. The joint effect between strike and debt on pay-for-performance is also determined by manager's skill. The empirical result provides cross-sectional evidence supporting this joint discipline of CEO's equity holding and firm's capital structure in determining the profit-sharing rule in optimal executive compensation. This disciplinary effect is weaker for firms with larger institution ownership and worse corporate governance.

11.45 AM - 1.30 PM

Luncheon with Keynote Speaker Presentation by Dr. Randall Morck (Provencher)

1.45 PM - 3.15 PM

Liquidity (Tache)

Chairperson: David Michayluk, University of Technology, Sydney

[Dynamic Dark Pool Trading Strategies In Limit Order Markets](#)

SABRINA BUTI, University of Toronto, Canada

Barbara Rindi, Bocconi University, Italy

Ingrid Werner, The Ohio State University, United States

Discussant: Andreas Storkenmaier, Karlsruhe Institute of Technology

We model a dynamic financial market where traders submit orders either to a limit order book (LOB) or to a Dark Pool (DP). We show that there is a positive liquidity externality in the DP, that orders migrate from the LOB to the DP, but that overall trading volume increases when a DP is introduced. We also demonstrate that DP market share is higher when LOB depth is high, when LOB spreads are narrow, and when the tick size is larger. Further, while inside quoted depth in the LOB always decreases when a DP is introduced, quoted spreads can narrow for liquid stocks and widen for illiquid stocks. We also show that the interaction of DP and LOB generates systematic patterns in order flow: the probability of a continuation is greater than that of a reversal only for liquid stocks, and when depth decreases on one side of LOB, liquidity is drained from DP. When a DP is added to a LOB, total welfare as well as institutional traders' welfare increase but only for liquid stocks; retail traders' welfare instead always decreases. Finally, when flash orders provide select traders with information about the state of the DP, we show that more orders migrate from the LOB to the DP, and DP welfare effects are enhanced.

[Public Information Arrival: Price Discovery And Liquidity In Electronic Limit Order Markets](#)

ANDREAS STORKENMAIER, Karlsruhe Institute of Technology, Germany
Martin Wagoner, Karlsruhe Institute of Technology, Germany
Ryan Riordan, Karlsruhe Institute of Technology, Germany
Discussant: Carmen Stefanescu, ESSEC

This paper studies the impact of news wire messages on intraday price discovery, liquidity, and trading intensity in an electronic limit order market. News wire messages represent most of the real time information traders receive. In this paper news are clustered on their ex-ante sentiment (positive, negative, or neutral). We find higher adverse selection costs around news messages. Negative messages induce significantly higher adverse selection costs than positive news messages. Liquidity increases around positive and neutral news messages whereas liquidity slightly decreases around negative news messages. As expected, trading intensity increases around all news. Our results suggest different information gathering and information processing capabilities of market participants.

[Liquidity Comovement In The Foreign Exchange Market](#)

Aditya Kaul, University of Alberta, Canada
CARMEN STEFANESCU, ESSEC, France
Discussant: Sabrina Buti, University of Toronto

This paper documents strong comovement in currency spreads at both the intraday and the daily frequency. We also show that currency spreads co-move with aggregate U.S. equity market spreads. This comovement remains strong after we control for inventory effects and funding constraints, pointing to the existence of correlated adverse selection effects across currencies as well as across currencies and stocks. Thus, our results suggest that aggregate private information is an important driver of correlated liquidity. From a practical perspective, our results indicate that international diversification strategies are unlikely to be effective in reducing the liquidity risk that arises in domestic portfolios.

Cost of Capital (Gateway)

Chairperson: Dev Mishra, University of Saskatchewan

[Asset Liquidity And The Cost Of Capital](#)

HERNAN ORTIZ-MOLINA, University of British Columbia, Canada
Gordon M. Phillips, University of Maryland, United States
Discussant: Chuntai Jin, University of Manitoba

We study the effect of real asset liquidity on a firm's cost of capital. We find an aggregate asset-liquidity discount in firms' cost of capital that is strongly counter-cyclical. At the firm-level we find that asset liquidity affects firms' cost of capital both in the cross section and in the time series: Firms in industries with more liquid assets and during periods of high asset liquidity have lower cost of capital. This effect is stronger when the asset liquidity is provided by firms operating within the industry. We also find that higher asset liquidity reduces the cost of capital by more for firms that face more competitive risk in product markets, have less access to external capital or are closer to default, and for those facing negative demand shocks. Our results suggest that asset liquidity is valuable to firms and, more generally, that operating inflexibility is an economically important source of risk.

[Does Corporate Social Responsibility Affect The Cost Of Capital?](#)

Sadok EI Ghoul, University of Alberta, Canada
Omrane Guedhami, University of South Carolina, United States
Chuck Kwok, University of South Carolina, United States
DEV MISHRA, University of Saskatchewan, Canada
Discussant: Zhou Zhang, University of Regina

We examine the effect of corporate social responsibility (CSR) on the cost of equity capital for a large sample of U.S. firms. Using several approaches to estimate firms' ex ante cost of equity, we find that firms with better CSR rankings exhibit cheaper equity financing. In particular, our findings suggest that investment in improving responsible employee relations, environmental policies, and product strategies contributes substantially to reducing firms' cost of equity. Our results also show that participation in two "sin" industries, namely, tobacco and nuclear power, increases firms' cost of equity. These findings support arguments in the literature that firms with socially responsible practices have higher valuation and lower risk.

Fixed Income (Salon A)

Chairperson: Lawrence Kryzanowski, Concordia University

Corporate Cost Of Borrowing: Trace On Syndicated Loans

MARKUS J. FISCHER, Goethe University Frankfurt, Germany

Discussant: Claudia Champagne, Université de Sherbrooke

Traditionally, the pricing of debt is solely seen dependent on firm or debt characteristics. However, increased price transparency as occurred in the corporate bond market with the introduction of TRACE reduces corporate bond yields (Goldstein et al., 2007). We aim to measure the 'spill-over' effect of increased price transparency of one major corporate financing source (corporate bonds) on the cost of corporate borrowing of another major financing alternative (syndicated loans). Our results indicate that loans to firms with no bonds outstanding became more expensive after the complete implementation of TRACE compared to before-TRACE-times. On the contrary, for firms with bonds outstanding (with a credit of either 'A' or 'BBB') the average spread is lower after the complete implementation of TRACE. Further, we find that first-disseminated firms pay ceteris paribus lower loan spreads compared to later-disseminated firms. However, this difference fades away after all firms with bonds are captured by the TRACE system. We can conclude that a positive 'spill-over' effect of TRACE is not only present for firms with bonds compared to firms with no bonds but has also been visible among firms with bonds outstanding. Our results are consistent to the inclusion of additional robustness checks.

Information Asymmetry In Syndicated Loans: The Cost Of The Distribution Method

CLAUDIA CHAMPAGNE, Université de Sherbrooke, Canada

Frank Coggins, Université de Sherbrooke, Canada

Discussant: Markus J. Fischer, Goethe University Frankfurt

This paper examines the impact of the distribution method on the loan syndicate structure and spread. Although club deals are associated with riskier and less transparent borrowers than syndications, their average loan spread is lower. Multivariate regressions show that country effects and syndicate structure differences can explain, at least partly, this lower spread. Specifically, club deals are associated with syndicates that are smaller, are more homogeneous in terms of lender industries and countries, are more concentrated and denser. However, propensity score matching models show that even after removing the differences in characteristics between the two groups, club deals have a lower average spread than syndications.

Macroeconomic Announcements And Risk Premia In The Treasury Bond Market

FABIO MONETA, Queen's University, Queen's School of Business, Canada

Discussant: George F. Tannous, Edwards School of Business, University of Saskatchewan

The bond risk premia associated with important macroeconomic variables are examined in this paper. The main question is whether a risk premium is earned by risk-averse agents investing in Government bonds exposed to macroeconomic news. The news measures are based on macroeconomic announcements and market consensus forecasts covering more than twenty-five years of data (1983-2008) and more than twenty types of announcements. Procyclical variables are found to carry a statistically significant price of

risk. This result is confirmed by examining both cross-sectional regressions and the expected returns of maximum-correlation portfolios mimicking the macroeconomic variables. This result is also robust controlling for the effects of other risk factors. Advantages of using high frequency data are documented. Among the different announcements, the most important appear to be the labor market and business confidence announcements. One factor appears sufficient to explain the cross-section of average returns on Government bonds. Time variation in the risk premia is also documented.

Hedge Funds (Salon C)

Chairperson: Nadia Massoud, York University

Funding Risk And Expected Hedge Fund Returns

EVAN DUDLEY, University of Florida, United States

Mahendrarajah Nimalendran, University of Florida, United States

Discussant: Mehdi Beyhaghi, York University

We empirically examine how funding risk affects average realized hedge fund returns. Funding risk, which captures the extent to which a fund can leverage its positions, is measured using margins on equity, currency, and interest rate futures contracts. Using data from January 1990 to May 2009, we find a statistically significant risk premium for funding risk in hedge fund returns. The magnitude of this premium is much higher during both the LTCM crisis of August 1998 and the sub-prime crisis of October 2008. Estimates of the stochastic discount factor show that the funding risk factor helps explain variation in hedge fund returns after controlling for other risk factors commonly employed in the literature.

Hedge Funds In Chapter 11

Wei Jiang, Columbia University, United States

Kai Li, University of British Columbia, Canada

WEI WANG, Queen's University, Canada

Discussant: Keke Song, Dalhousie University

This paper examines the roles of hedge funds in the Chapter 11 process and their effects on bankruptcy outcomes, using a comprehensive sample of 474 Chapter 11 filings from 1996 to 2007. We first show that hedge funds' strategic choices in the timing of their presence and their entry point in the capital structure allow them to have a big impact on reorganization. Their presence as creditors is associated with a higher probability of emergence, and their presence as shareholders is associated with more deviations from the absolute priority rule. Further, hedge fund involvement is positively associated with more frequent adoptions of key employee retention plans and increased CEO turnover. Our research suggests that hedge funds are an emerging force underlying the changing nature of Chapter 11.

Hedge Funds In M&a Deals: Is There Exploitation Of Private Information?

RUI DAI, York University, Canada

Nadia Massoud, York University, Canada

Debarshi Nandy, York University, Canada

Anthony Saunders, New York University, United States

Discussant: Kai Li, University of British Columbia

This paper investigates the recent increase in allegations regarding the misuse of insider information in M&A deals. We analyze this issue by using a unique and comprehensive hedge fund dataset which allows us to analyze the trading pattern of hedge funds around corporate mergers and acquisitions in both the equity and the derivatives markets. In general, our results are consistent with the idea of hedge funds with short-term horizons taking advantage of private information and engaging in trading based on such information. We show that short-term hedge funds take abnormally long positions on

target's stock in M&A deals with high target premium in the quarter prior to the deal's announcement while having no prior stake in the firm over the preceding year. We also find evidence consistent with informed abnormal short selling and put buying in the corresponding acquirer's stock prior to M&A announcements when short-term hedge funds take larger stakes in target firms. In addition, we show that such a strategy is potentially very profitable. We consider alternative explanations for such opportunistic hedge fund holdings in target firms, but our results seem inconsistent with these alternative explanations and suggest that such holdings and trading patterns arise primarily due to exploitation of private information. Our results have important implications regarding the recent debate on hedge fund regulation.

Asset Pricing and Risk (Assiniboine B)

Chairperson: Harry Turtle, Washington State University

Conditional Stock Performance With Fundamental Valuation Information

HARRY TURTLE, Washington State University, United States

Kainan Wang, Washington State University, United States

Discussant: Lynnette Purda, Queen's University

We examine the ability of fundamental accounting information to form superior conditional portfolio performance. Aggregated financial statement information provides potentially valuable fundamental information that managers may use to generate marginal portfolio performance. Our resultant conditional Jensen's alphas vary over time and in relation to fundamental changes in a company's fundamental state. Empirical findings support and extend the conclusions of Graham and Dodd (1934), Lev and Thiagarajan (1993), and Piotroski (2000, 2005). After correcting for systematic risk sources, portfolios with strong fundamental values tend to display strong positive marginal performance. Because our research design may be layered upon an underlying equilibrium model for expected returns, our results also address the risk-based interpretation of Fama and French (2006). In addition to finding significant positive marginal performance in firms with strong fundamentals, we also observe persistence in performance consistent with the slow resolution story of Zhang (2006). Finally, as a by-product of our analysis, we develop easily implemented conceptual p-values for conditional alphas that closely match our in-sample bootstrapped p-values.

Market Skewness Risk And The Cross-section Of Stock Returns

BO YOUNG CHANG, McGill University, Canada

Peter Christoffersen, McGill University, Canada

Kris Jacobs, McGill University, Canada

Discussant: Ranjini Jha, University of Waterloo

The cross-section of stock returns has substantial exposure to risk captured by higher moments in market returns. We estimate these moments from daily S&P 500 index option data. The resulting time series of factors are thus genuinely conditional and forward-looking. Stocks with high sensitivities to innovations in implied market volatility and skewness exhibit low returns on average, whereas those with high sensitivities to innovations in implied market kurtosis exhibit high returns on average. The results on market skewness risk are extremely robust to various permutations of the empirical setup. The estimated premium for bearing market skewness risk is between -6.00% and -8.40% annually. This market skewness risk premium is economically significant and cannot be explained by other common risk factors such as the market excess return or the size, book-to-market, momentum, and market volatility factors. Using ICAPM intuition, the negative price of market skewness risk indicates that it is a state variable that negatively affects the future investment opportunity set.

Dividend Volatility And Asset Prices: A Loss Aversion/narrow Framing Approach

Yan Li, Temple University, United States

LIYAN YANG, University of Toronto, Canada

Discussant: Miguel Palacios, Vanderbilt University

This paper documents that the aggregate dividend growth rate exhibits strong volatility clustering. We incorporate this feature into a theoretical model and study the role of dividend volatility in asset prices when investors are loss-averse over fluctuations in the value of their financial wealth. We find that our model explains many salient features of the stock market, including the high mean, excess volatility, and predictability of stock returns; the low correlation between consumption growth and stock returns; time-varying Sharpe ratios; the GARCH effect and the volatility feedback effect in stock returns; and the decline of equity premiums in the postwar period.

Option Valuation (Selkirk)

Chairperson: Jason Wei, University of Toronto

Illiquidity Premium In The Equity Options Market

Peter Christoffersen, McGill University, Canada

Ruslan Goyenko, McGill University, Canada

Kris Jacobs, University of Houston, United States

MEHDI KAROUI, McGill University, Canada

Discussant: Siu Kai Choy, University of Toronto

Illiquidity has been shown to be a significant determinant of stock and bond returns in the time series and cross-section. Illiquidity effect in the option markets has not been studied yet. This paper reports illiquidity premium in the option markets. An increase in option illiquidity decreases current option price and predicts higher expected option return. This impact is statistically and economically significant. The result holds for both cross-section of individual equity options and for portfolios, and after controlling for stock market illiquidity. Moreover, option illiquidity helps explain the shape, i.e. the "level", the "moneyness" slope and the "term" slope, of implied volatility curve.

Jump-diffusion Option Valuation Without A Representative Investor: A Stochastic Dominance Approach

STYLIANOS PERRAKIS, Concordia University, Canada

Ioan Oancea, National Bank of Canada, Canada

Discussant: Saqib Khan, University of Regina

We present a new method of pricing plain vanilla call and put options when the underlying asset returns follow a jump-diffusion process. The method is based on stochastic dominance insofar as it does not need any assumption on the utility function of a representative investor apart from risk aversion. It develops discrete time multiperiod reservation write and reservation purchase bounds on option prices. The bounds are valid for any asset dynamics and are such that any risk averse investor improves her expected utility by introducing a short (long) option in her portfolio if the upper (lower) bound is violated by the observed market price. The bounds are evaluated recursively for a general discretization of the continuous time jump-diffusion returns. The limiting forms of the bounds are then found as the time partition becomes continuous. It is found that the two bounds tend to the common limit equal to the Black-Scholes-Merton price when there is no jump component, but to two different limits when the jump component is present.

Retail Clientele And Option Returns

SIU KAI CHOY, University of Toronto, Canada

Discussant: Mehdi Karoui, McGill University

Does investor clientele matter for option returns? This paper empirically shows that a higher retail trading proportion (RTP) is related to lower delta-hedged option returns. The phenomenon is more pronounced before earnings announcements and among stocks with more time-varying and positively skewed volatility. The results are robust to a number of fundamental factors. Furthermore, a self-financing investment strategy involving options

on low and high RTP stocks generates positive abnormal returns. The results suggest that retail investors speculate and pay a lottery premium on the expected future volatility, resulting in more expensive options in terms of higher implied volatilities. This systematic deviation of option-implied volatility from realized volatility suggests retail clientele as a behavioral-based driving force of volatility risk premium.

3.30 PM - 5.00 PM

Law and Finance (Tache)

Chairperson: Melanie Cao, York University

[Creditor Rights And Lbos](#)

Jerry Cao, Singapore Management University, Singapore

DOUGLAS CUMMING, York University Schulich School of Business, Canada

Meijun Qian, National University of Singapore, Singapore

Xiaoming Wang, Shanghai University of Finance and Economics, China

Discussant: Robert Kieschnick, University of Texas at Dallas

This paper examines the relation between legal conditions and leveraged buyouts (LBOs) in 49 countries. The data indicate that sophisticated PE fund managers carrying out large international LBOs can only partially mitigate costs associated with inefficient legal protections. LBOs are more active in countries with strong creditor rights. Club deals are more likely to occur in countries with weak creditor rights. Cross-border LBO investment is more common from strong creditor rights countries to weak creditor rights countries. Premiums offered to shareholders are on average negatively correlated with creditor rights for both domestic and cross-border LBOs.

[Listing Standards And Ipo Performance: Is More Regulation Better?](#)

IGOR SEMENENKO, Acadia University, Canada

Vikas Mehrotra, University of Alberta, Canada

Aditya Kaul, University of Alberta, Canada

Discussant: Dan Li, Schulich School of Business, York University

Decline in confidence in free market mechanisms in the past decade has provoked an increase in interest in regulatory issues. This paper seeks to answer one question: Are exchange listing rules an effective screening mechanism? Using a sample of IPO firms listing on major U.S. exchanges in 1984-2005, we find that (i) firms listing on different trading floors exhibit different characteristics; (ii) introduction of higher standards on one market tier does not prevent entry of low quality firms. Our findings call in question the exchanges' ability to create effective screens imposing tighter listing rules, but speak in favour of further market segmentation.

[Ponzi Schemes](#)

YUNHUA ZHU, Wilfrid Laurier University, Canada

Discussant: Stylianos Perrakis, Concordia University

Ponzi schemes are of considerable current interest in the wake of the Madoff fraud. This paper uses a simple model to capture the dynamics of an investment fund which is operated as a Ponzi scheme. We model the operator's decision strategy by assuming the promoter maintains two accounts. One is a real account which records the dynamics of his wealth, and the other is a fictitious account which his investors regard as a legitimate operation. The promoter's problem is to select his consumption and the return he promises to pay the investors at each period to maximize his expected utility subject to certain constraints. These constraints include a requirement that the announced returns are neither too high to avoid suspicion nor too low so that he can still attract new investors. In addition, the promoter will wish to avoid detection by the regulators. We show how to solve for the promoter's optimal announced return. The promoter can convert the desired annual returns into a set of monthly returns with given risk

characteristics that will on average approximate the promoter's desired return distribution. It is hoped this research will help investors and regulators better understand Ponzi schemes.

Corporate Governance and Ownership (Gateway)

Chairperson: Vikas Mehrotra, University of Alberta

[External Shareholders: Incentives And Returns](#)

Anders Ekholm, Hanken School of Economics, Finland

BENJAMIN MAURY, Hanken School of Economics, Finland

Discussant: Claire Liang, University of Alberta

We explore the relation between external shareholder incentives and investment returns using a unique transactions data set representing all the more than 1.3 million different shareholders active in the Finnish stock market during a 12-year period. We develop a novel Incentive Index that gauges how concentrated the shareholders' holdings are in each firm. We find that our Incentive Index is significantly positively related to the operating returns, as measured by ROA and ROI, suggesting that shareholders who focus their investments perform a valuable monitoring role. We also find that the Incentive Index is significantly positively related to stock returns.

[Non-financial Stakeholders And Corporate Cash Holdings](#)

Kee-Hong Bae, York University, Canada

JIN WANG, Queen's University, Canada

Discussant: Min Maung, University of Alberta

In this paper we provide evidence that firms' relationships with non-financial stakeholders affect their optimal cash holdings. We find that firms that depend more on principal customers tend to hold more cash. The positive relation between firms' dependence on principal customers and cash holdings is more pronounced for firms that sell more unique products and are closer to financial distress. Importantly, we show that this positive relation arises not because firms treat cash as negative debt. Furthermore, we show that the market value of cash holdings is higher for firms that rely on principal customers, especially during economic downturns. Finally, we provide similar evidence that firms that have dependent suppliers tend to hold more cash, especially when these firms sell unique products. Overall, our results indicate that higher financial distress costs due to relationship-specific investments lead to higher optimal cash holdings.

[Ownership Structure And Corporate Investment Behaviour](#)

Yuting Fu, Edwards School of Business, University of Saskatchewan, Canada

Marie Racine, Edwards School of Business, University of Saskatchewan, Canada

GEORGE TANNOUS, Edwards School of Business, University of Saskatchewan, Canada

Discussant: An Hunter, University of South Dakota

This study suggests that in comparison with concentrated ownership firms, widely-held firms face higher levels of financing constraints and exhibit less value maximizing behaviour. Once we separate the family-controlled from the institution-controlled firms and control for other factors we find that the family-controlled and widely-held firms face significantly more binding financial constraints than institution controlled firms.

Mutual Funds (Salon A)

Chairperson: Robert Grauer, Simon Fraser University

[On Time Varying Mutual Fund Performance](#)

XIAOLU WANG, Rotman School, University of Toronto, Canada

Discussant: Robert Grauer, Simon Fraser University

Actively managed mutual funds, in general, underperform a passive benchmark; however, recent studies find they, in fact, outperform the benchmark in bad economic states. In

this paper, I investigate the sources of these recent findings, and find supportive evidence for a state dependent risk shifting hypothesis. Piece-wise linear regression results indicate that the flow-performance relationship is non-linear in good states, but close to linear in bad states. Thus, the risk shifting incentives are only expected in good states. I empirically measure the risk shifting incentives, and show that average incentives are positive in good states and that higher risk shifting incentives are associated with lower fund performance. Finally, I show that inferior fund performance in good states mainly concentrates over the second half of the year, in which agency conflict induced risk shifting incentives are more likely to occur.

[Mutual Fund Tournaments](#)

IWAN MEIER, HEC Montréal, Canada

Aymen Karoui, HEC Montréal, Canada

Discussant: Xiaolu Wang, Rotman School, University of Toronto

This paper studies risk tournament among 1,233 actively managed U.S. equity funds over the period 1991-2005. Using a contingency methodology, we reach mixed results related to the existence of a tournament phenomenon: loser (winner) funds do not systematically increase (decrease) their risk in the second half year. We show that sorting on cumulative returns suffers from an upward (downward) tournament bias and downward (upward) inverse tournament bias if the correlation between risk and return is positive (negative). When we sort funds on an orthogonalized measure of cumulative returns, we observe qualitative changes in the final results. We find that about 10% of additional correlation between risk and returns artificially adds 1% in tournament frequencies. Furthermore, we link the risk adjustment ratio (RAR) to fund characteristics. We find that the RAR is higher for funds that exhibit low flow-performance dependence, high mean returns, low total risk and high inflows. Age and TNA are also negatively related to the RAR. Finally, when analyzing holdings of funds, we find no strong evidence that loser (winner) funds increase (decrease) the allocation in riskier stocks for the second half year.

Term Structure of Interest Rate (Salon C)

Chairperson: Adlai Fisher, University of British Columbia

[A Forward-looking Model Of The Term Structure Of Interest Rates](#)

ALBERT LEE CHUN, Copenhagen Business School, Denmark

Discussant: Alberto Romero, University of British Columbia

We propose a model and estimation method that facilitates the inclusion of a generalized structure of observable factors in a forward-looking dynamic term structure model. The model allows for forward-looking factors to be taken from market-based information and from survey data. Our method effectively accommodates the time-varying forecast horizon issue often found in survey forecasts by extracting fixed-horizon forecasts that are consistent with the underlying P-dynamics. The estimation can be rendered consistent with both forward-looking and historical information.

[A Multifrequency Theory Of The Interest Rate Term Structure](#)

Laurent Calvet, HEC Paris, France

ADLAI FISHER, University of British Columbia, Canada

Liuren Wu, Baruch College, United States

Discussant: Antonio Diez de los Rios, Bank of Canada

We develop a class of affine term structure models that accommodates many interest-rate factors with few parameters. The model builds on a short-rate cascade, a parsimonious recursive structure that naturally ranks the latent state variables by their rates of mean reversion, each revolving around the next lowest frequency factor equating to a level in the cascade. With appropriate assumptions on factor volatilities and risk premia, the model overcomes the curse of dimensionality associated with general affine models, permitting a finite parameter vector to describe term-structure dynamics for an arbitrary

number of factors. Using a panel of 15 LIBOR and swap rates, we estimate models using from one to 15 latent factors and only five parameters. High-dimensional specifications substantially outperform lower-dimensional specifications both in- and out-of-sample. The in-sample fit is near exact, with absolute pricing errors averaging less than one basis point, permitting yield-curve stripping in an arbitrage-free, dynamically consistent environment. Out-of-sample interest rate forecasting shows significant improvements over traditional benchmarks, and cross-maturity correlations are more accurate than low-dimensional models.

[Extraction Of Financial Markets Expectations About Inflation And Interest Rates From A Liquid Market](#)

JOSE MANUEL MARQUES-SEVILLANO, Banco de España, Spain

Ricardo Gimeno, Banco de España, Spain

Discussant: Murray Carlson, University of British Columbia

In this paper we propose an affine model that uses as observed factors the Nelson and Siegel (NS) components summarising the term structure of interest rates. By doing so, we are able to reformulate the Diebold and Li (2006) approach to forecast the yield curve in a way that allows us to incorporate a non-arbitrage opportunities condition and risk aversion into the model. These conditions seem to improve the forecasting ability of the term structure components and provide us with an estimation of the risk premia. Our approach is somewhat equivalent to the recent contribution of Christensen, Diebold and Rudebusch (2008). However, not only does it seem to be more intuitive and far easier to estimate, it also improves that model in terms of fitting and forecasting properties. Moreover, with this framework it is possible to incorporate directly the inflation rate as an additional factor without reducing the forecasting ability of the model. The augmented model produces an estimation of market expectations about inflation free of liquidity, counterparty and term premia. We provide a comparison of the properties of this indicator with others usually employed to proxy the inflation expectations, such as the break-even rate, inflation swaps and professional surveys.

Asset Pricing and Liquidity (Assiniboine B)

Chairperson: Esther Eiling, University of Toronto, Rotman School of Management

[Precarious Politics And Return Volatility](#)

HITESH DOSHI, McGill University, Canada

Maria Boutchkova, University of Leicester, United Kingdom

Art Durnev, McGill University, Canada

Alexander Molchanov, Massey University, New Zealand

Discussant: Fabio Moneta, Queen's University, Queen's School of Business

We examine whether and how politics affect returns volatility. While earlier work had primarily focused on the outcomes of dramatic politically-generated shocks (e.g., wars or revolutions), we examine the effects of the “normal political processes”, such as elections, party orientation, and the degree of autocracy. We use an inter-industry approach that allows us to make stronger claims about the causal impact of politics on volatility after acknowledging numerous feedback effects among economic, political, and institutional variables. We claim that some industries are more sensitive to political events than others and, using a large panel of industry-country-year observations, examine volatility patterns of various industry sensitivities to local and global political events. We find that with higher political risk, industries that are more dependent on trade, require better contract enforcement, and use more labor, exhibit greater volatility. National elections among trading partners of trade dependent industries similarly result in higher volatility, which is even higher when elections’ results are less certain. The foreign trade exposure channel reveals the role of foreign political uncertainty on domestic sectors returns volatility. Volatility is also higher for labor-intensive industries under leftist governments. On the other hand, autocracy has a stabilizing effect for international trade-dependent and labor-intensive industries, highlighting the contrast between the effects of political

risk and the degree of autocracy.

Stock Market Returns And Annuitization

ALESSANDRO PREVITERO, UCLA Anderson School of Management , United States

Discussant: Esther Eiling, University of Toronto, Rotman School of Management

I document a strong negative relationship between stock market returns and annuitization. Using a novel dataset with more than 103,000 actual payout decisions, I find that positive stock market returns decrease the likelihood of employees choosing an annuity over a lump sum, and vice versa. More precisely, only recent market performance drives annuitization with almost no weight assigned to returns two years before the decision date. Investigating two additional datasets, I document that financial education does not mitigate this result and that stock market returns affect individual annuity sales in a similar way. Several explanations can account for these findings: wealth effects generated by movements of the stock market; endogenous timing of retirement; volatility of stock market returns and time varying risk aversion; and expectations about labor income or inflationary periods. After addressing these explanations, I present evidence consistent with employees extrapolating from recent stock market returns.

The Effects Of Innovation On Stock Liquidity And Systematic Risk: Evidence From The Pharmaceutical Industry

ACHIM HIMMELMANN, Tech University Darmstadt, Germany

Discussant: Jan Bena, University of British Columbia

We analyze the relationship between new product introductions, stock trading activities, and systematic risk changes. Using a unique hand-collected data set on new drug approvals, we find opposing results to previous work that suggests changes in systematic risk. After adjusting for potential biases caused by increased leverage and frictional trading, estimates for systematic risk do not significantly change before and after the new product announcement. However, stock liquidity does change after new product announcements. Stocks temporarily exhibit strong abnormal trading volume, lower spreads, and permanently become more liquid. Our results suggest that the initial positive wealth effect of a new product introduction reflects both positive information content and liquidity improvements.

Value Versus Growth In Dynamic Equity Investing

GEORGE BLAZENKO, Simon Fraser University, Canada

Yufen Fu, Simon Fraser , Canada

Discussant: Liyan Yang, University of Toronto

We develop an expected return measure from a dynamic equity valuation model. We show that expected return from Blazenko and Pavlov's (2009) dynamic equity valuation model has two terms: one that is easy to calculate with readily available financial market measures and does not require statistical estimation and a component that depends on earnings volatility. We entitle the first portion as static growth expected return (SGER). We use analysts' earnings forecasts as an SGER input to rank firms for portfolio inclusion. We find that SGER discriminates stocks with significant excess returns—non-zero alphas—in two conditional asset pricing models. The estimated alpha difference between high and low SGER portfolios is as great as 0.91% per month. Consistent with the dynamic model, returns increase with profitability to a greater extent for value compared to growth firms. Without generating abnormal returns for investors, we find that analysts make favorable stock recommendations and most optimistically forecast earnings for high SGER firms. We find little statistical or economic significance for earnings volatility beyond SGER for returns. This observation is consistent with SGER as a large portion of expected return from the dynamic model. We conclude that SGER on its own is a useful return measure for common share investing.

Managerial Compensation (Selkirk)

Chairperson: Nancy Ursel, University of Windsor

Managerial Compensation In The Financial Service Industry

FELIX SUNTHEIM, Bocconi University, Italy

Discussant: Vishaal Baulkaran, Wilfrid Laurier University

CEO compensation in the financial sector has been a controversial topic following the recent financial crisis. I use a new dataset with detailed information on CEO compensation of major international banks from 1997 to 2008 to explain how managerial incentives influence banks' policy choices and bank risk taking. Differently to previous studies with a focus on U.S. banks, I can show that remuneration had an impact on bank performance during the financial crisis. Banks which endowed their top management with high risk taking incentives performed worse in the period after the Lehman collapse. Banks which granted more stocks to their CEOs performed better. Moreover using simultaneous equation models I show that over time bank risk has been positively correlated with CEOs risk taking incentives. From a bank policy perspective CEOs choose riskier, fee based activities but do not increase leverage as a reaction to their compensation packages.

Executive Compensation In Closely-held Firms: The Impact Of Dual Class Structure And Family Management

VISHAAL BAULKARAN, Wilfrid Laurier University, Canada

Ben Amoako-Adu, Wilfrid Laurier University, Canada

Brian Smith, Wilfrid Laurier University, Canada

Discussant: Mohammad Rahaman, Saint Mary University

We examine how two different forms of concentrated control affect executive compensation. We compare executive compensation in dual class with that in single class closely-held companies. Although both samples of companies have agency problems associated with concentrated control, dual class companies have additional problems associated with controlling shareholders holding smaller equity positions. We show that executives of dual class companies are paid significantly more than those of single class closely-held companies with much of the excess being in the form of soft money (bonuses and stock options). Furthermore, the highest total compensation is paid to family executives of dual class companies. Thus, dual class structure leads to greater transfer of wealth from minority shareholders to controlling shareholders. This is a reflection of the bigger agency problems and costs associated with dual class structure.

How Do Ceos Create Value For Their Firms?

Varouj Aivazian, University of Toronto, Canada

Tat-Kei Lai, University of Toronto, Canada

MOHAMMAD RAHAMAN, Saint Mary University, Canada

Discussant: Felix Suntheim, Bocconi University

A much debated issue in corporate finance is how idiosyncratic managerial attributes affect firm value. Using CEO turnover as an identification mechanism, we empirically identify the effect of CEO human capital on firm value and show that this effect can be partially explained by the reduction in bankruptcy costs and also by firm-policy changes related to CEO human-capital. In particular, we show that when a CEO with more general managerial human capital is matched with a firm relying more on general skills, the firm reduces leverage, invests less in intangibles and increases operational efficiency, relative to firms relying on CEOs with more firm-specific skills. Changes in firm policies lower business risk and reduce the costs associated with financial distress. These findings are economically significant and are robust to endogeneity, sample selection, and reverse causality. Our results suggest that CEO human capital affects firm value, and illustrate possible channels through which managerial human capital creates value for corporate stakeholders.

5.15 PM - 6.00 PM

Keynote Speaker Presentation "Bankruptcy Design" by Dr. Espen Eckbo (Provencher)
6.15 PM - 8.30 PM

Depart for Reception at the Royal Canadian Mint
Sunday, September 26, 2010

7.00 AM - 8.30 AM

Breakfast (Provencher)

8.30 AM - 10.15 AM

Mergers and Acquisitions (Gateway)

Chairperson: Wendy Rotenberg, University of Toronto

[**Does Asymmetric Information Affect The Premium In Mergers And Acquisitions?**](#)

GEORGES DIONNE, HEC Montreal, Canada

Melissa La Haye, HEC Montreal, Canada

Anne-Sophie Bergeres, HEC Montreal, Canada

Discussant: Ling Cen, Rotman School of Management, University of Toronto

Our objective is to test the influence of information asymmetry between potential buyers on the premium paid for an acquisition. We analyze mergers and acquisitions as English auctions with asymmetric information. The theory of dynamic auctions with private values predicts that more informed bidders should pay a lower price for an acquisition. We test that prediction with a sample of 1,026 acquisitions in the United States between 1990 and 2007. We hypothesize that blockholders of the target's shares are better informed than other bidders because they possess privileged information on the target. Information asymmetry between participants is shown to influence the premium paid. Blockholders pay a much lower conditional premium than do other buyers (around 70% lower). Tests also show that the characteristics of the target, specifically the runup, sales growth and size, affect the premium. The size of the target relative to the buyer, the choice of a public takeover bid and the hostility of the bid are also influential.

[**Capital Punishment: Signalling Takeover Intentions By Raising Capital**](#)

FREDERICK DAVIS, Queen's University, Canada

Discussant: Wendy Rotenberg, University of Toronto

Using a sample of 1060 acquisitions from 1981 - 2006, this study is the first to document significant short-run target cumulative average abnormal returns (CAARs) occurring at the time the bidding firm last announced raising capital prior to the acquisition, on average 225 days prior to the acquisition announcement date. In addition, an examination of the pre-bid runup period finds that raising capital closer in proximity to the acquisition announcement date results in both significantly higher target runups and significantly higher takeover premiums, thereby punishing the bidder for the 'revelation' of takeover intentions. Price-volume dynamics support the predictions of the market anticipation hypothesis as opposed to the insider trading hypothesis. Results are robust to various factor-model measures of benchmark performance, equal- and value-weighted returns, event-period clustering, variance shifts over the event period, and even to ensuring a measure of informed trading occurs over this issue date announcement event window. In sum, evidence strongly supports the notion that raising capital can act as both a statistically and economically significant signal of a forthcoming takeover attempt.

[**Risk Homeostasis And Mergers And Acquisitions**](#)

MAURICE LEVI, University of British Columbia, Canada

Kai Li, University of British Columbia, Canada

Feng Zhang, University of British Columbia, Canada

Discussant: Michael Schill , University of Virginia, Darden School

The idea of adjusting behavior to maintain risk is known as “risk homeostasis.” This paper considers the implications of this phenomenon in the context of mergers and acquisitions (M&As). Using a sample of M&As over 1980-2007, we first show that when bidders’ risks happen to decline relative to industry- and size-matching non-bidding peer firms prior to an M&A, relative risk levels subsequently return towards original levels. We argue that this pattern is consistent with risk homeostasis whereby the bidder has a preferred level of risk—the risk of its peer. We then develop a simple model of risk homeostasis in the context of M&As. The main predictions of our model are: when a bidder’s relative risk declines, the greater is the risk of a target firm, the smaller is the investment in that target; and for a target firm smaller than the bidder, the larger is the correlation between the target and the bidder returns, the smaller is the investment in that target. Evidence from risk dynamics of bidder and target firms and results from multiple regressions provide support for a risk homeostasis perspective of M&As.

[The Price Of Growth: Evidence Of The Pedestrian Nature Of Post-merger Returns](#)

MICHAEL SCHILL, University of Virginia, Darden School, United States

Sandra Mortal, University of Memphis, United States

Discussant: Vikas Mehrotra, University of Alberta

A large literature examines the returns associated with acquiring firms, presupposing that the returns associated with these firms are in some way unique. We assert that the distinguishing characteristic associated with the returns of these firms is more precisely the magnitude of the expansion of their balance sheet rather than the completion of an acquisition per se. Examining post-deal returns, we observe no difference in returns between firms that grow through merger and those that grow organically at the same rate. The relatively poor returns documented for stock deals are due rather to the relatively greater asset growth associated with these deals. The evidence suggests that the long-run returns associated with acquiring a business is not unique to mergers, but is part of a broader asset growth effect.

Venture Capital (Salon A)

Chairperson: Douglas Cumming, York University - Schulich School of Business

[Disclosure, Venture Capital And Entrepreneurial Spawning](#)

Douglas Cumming, York University - Schulich School of Business, Canada

APRIL KNILL, Florida State University, United States

Discussant: Olfa Hamza, Université du québec a Montréal

Venture capital funds (as well as private equity funds and hedge funds) in many countries around the world are facing increasing regulatory scrutiny since the 2007 financial crisis, particularly in respect of calls for increased disclosure requirements. In this paper, we examine whether more stringent securities regulation and disclosure requirements helps or hinders the supply and performance of venture capital. Further, we examine international differences in the impact of venture capital on new business creation. Based on data from 34 countries over the years 1998-2007, we find more stringent regulation and disclosure has a positive impact on the supply and performance of venture capital around the world, and a positive impact on entrepreneurial spawning induced by venture capital.

[Does Ventuapitalists Reputation Improve The Survival Profile Of Ipo Firms?](#)

OLFA HAMZA, Université du québec a Montréal, Canada

Maher Kooli, Université du québec a Montréal, Canada

Discussant: Vijay Jog, Carleton University

This paper examines the effect of Venture Capital (VC) reputation on the survival profile of U.S. Initial Public Offerings (IPOs) firms for the 1985-2005 period. To do so, we construct a VC quality index and develop multinomial logit models based on the information contained in the prospectus. The main findings of the paper are that VC

reputation does indeed improve the IPO survival profile. While we find that leaving money on the table is a bad survival signal, we confirm that having a prestigious underwriter to market the issue is a good survival signal. Further, we find that Sarbanes-Oxley Act adoption has a positive effect on IPO survival. We also confirm our result after controlling for self selection bias and estimating an accelerated-failure-time model as robustness tests.

[Speed And Consequences Of Venture Capitalist Post-ipo Exit](#)

Imants Paeglis, Concordia University, Canada

PARIANEN VEEREN, Concordia University, Canada

Discussant: April Knill, Florida State University

We examine the speed of venture capitalist post-IPO exit and its influence on firm value. We hypothesize that the speed of VC exit will be influenced by founder ownership, which both impedes liquidity of a firm's stock and significantly influences its post-exit value. Our results suggest that this is indeed the case. In particular, we find a concave relationship between founder ownership and the speed of venture capitalist exit and a convex relationship between founder ownership and the impact of VC exit on firm value.

[The Determinants And Persistence Of Initial Capital Structure](#)

NILANJAN BASU, Concordia University, Canada

Imants Paeglis, Concordia University, Canada

Dogan Tirtiroglu, University of Adelaide, Australia

Discussant: Dan Li, Schulich School of Business, York University

Using a sample of newly public firms, we examine the determinants of a firm's initial capital structure. We conjecture that leverage will be determined by the interaction between the quality of a firm's projects and its founder's control considerations. Our results suggest that this is indeed the case. In particular, we find a convex relation between leverage and family ownership. We also find a similar relation between firm value and family ownership. The observed relations are robust to alternative measures of leverage, alternative econometric specifications, and controls for insider and CEO ownership. In addition, we find a similar relation between leverage and family ownership for a sample of private firms. The aforementioned framework sheds new light on the persistence of leverage.

Corporate Financing Decisions (Salon C)

Chairperson: Robert Kieschnick, University of Texas at Dallas

[The Determinants Of The Composition Of U.s. Corporate Finances Over Time](#)

ROBERT KIESCHNICK, University of Texas at Dallas, United States

Kaisheng Song, University of North Texas, United States

Feng Zhao, University of Texas at Dallas, United States

Discussant: Dev Mishra, University of Saskatchewan

Prior research on the financing of corporations has either focused on the use of particular forms of financing (e.g., trade credit) or on a firm's "capital structure," often defined as a ratio of debt to equity. Such research either ignores other forms of financing chosen by firms or is subject to variations in results due to variations in how a firm's capital structure is measured. We take a different approach and focus on the determinants of the composition of U.S. corporate finances over time. Specifically, we examine the influence of the prior composition of financing, asset composition, corporate operating performance, macroeconomic conditions, and financial market conditions on the current composition of U.S. corporate finances. Our results suggest that each of these factors influences the use of different forms of financing differently and so demonstrates the problems with using typical capital structure measures, as well as provides new insights in the use of forms of financing typically ignored in prior research.

Corporate Payout Policy, Cash Savings, And The Cost Of Consistency: Evidence From A Structural Estimation

HAMED MAHMUDI, Rotman School of Management, University of Toronto, Canada

Michael Pavlin, Rotman School of Management, University of Toronto, Canada

Discussant: Jin Wang, Queen's University

We develop a dynamic model in which firms choose their optimal financing, investment, dividends, and cash holdings while facing costly equity issuance, debt and capital adjustments costs, and taxed interest on cash balances. We solve the model numerically to estimate the volatility of payout and optimal level of cash holdings. Comparing these results with a large sample of U.S. firms from 1988 to 2007, we show that on average firms excessively smooth their payout while maintaining larger than optimal levels of cash (excess cash) on their balance sheets. We further extend the base-case model to capture the effect of a manager, who perceives a cost to cutting payout. Applying simulated method of moments (SMM) to the dynamic model we infer the magnitude of this downward adjustment cost. In particular, we find that a managerial preference for payout smoothing leads to increased accumulation of excess cash. Estimated payout consistency cost is larger for firms which are larger, have more dispersed analyst forecasts, which compensate their CEOs with low pay-performance packages, are monitored by institutional investors, and pay larger fractions of their payout as dividends. Applying SMM to a recent subsample of the data (2002-2006), we show that the parameter of managerial preference for consistent payout continue to account for a similar equity value loss of approximately 7%.

Managerial Incentives, Entrenchment, And Firm Value

FENG ZHANG, University of British Columbia, Canada

Discussant: Ning Tang, Wilfrid Laurier University

This paper investigates the interaction between two corporate governance mechanisms: managerial incentives and the market for corporate control. We find that the firm value effect of managerial ownership crucially depends on the firm's vulnerability to takeovers. For firms with high level of takeover vulnerability, there is an inverse U-shaped relation between managerial ownership and firm value. For firms with low level of takeover vulnerability, however, increasing managerial ownership damages firm value. In addition, managerial ownership significantly decreases as the firm adopts more antitakeover provisions. The findings are robust to industry effects, various measures of managerial ownership, different estimation methods, and endogeneity concerns. The evidence supports a complementary relation between managerial incentives and the market for corporate control.

Ipo Pricing And Wealth Allocation

Fabricio Perez, Wilfrid Laurier University, Canada

Andriy Shkilo, Wilfrid Laurier University, Canada

NING TANG, Wilfrid Laurier University, Canada

Discussant: Feng Zhang, University of British Columbia

This study examines wealth allocation between IPO issuers and subscribers using a new measure inspired by Purnanandam and Swaminathan [2004. Are IPOs really underpriced? Review of Financial Studies 17, 811-848]. We show that, in IPOs that are underpriced and overvalued at the same time, underwriters persistently set offer prices so that more than 70% of the total overvaluation goes to the issuers, leaving the remaining share on the table for subscribers. Thus, our findings suggest that underwriters favor issuers over subscribers. We further examine determinants of wealth allocation and find that the level of market sentiment and underwriter quality are negatively related to the percent of total overvaluation left on the table, whereas change in sentiment and information asymmetry are positively related to the percent of total overvaluation left on the table.

International Capital Raising (Assiniboine A)

Chairperson: Brian Smith, Wilfrid Laurier University

[Debt Issuance Under Rule 144a And Equity Valuation Effects](#)

Peter Carayannopoulos, Wilfrid Laurier University, Canada

SUBHANKAR NAYAK, Wilfrid Laurier University, Canada

Discussant: Anis Samet, Abu Dhabi University

The paper explores factors that affect the decision to issue corporate debt under Rule 144A as opposed to issuing in the public market. We find that while the decision to issue a convertible bond under Rule 144A is influenced strongly by an issuer's prior stock run-up, the decision to issue nonconvertible debt under Rule 144A is not influenced by an issuer's prior stock performance. Subsequently, we document the presence of negative (positive) stock effects around the announcement date for issuers of convertible (nonconvertible) debt under Rule 144A over and above effects associated with issuing debt in the public market.

[Multimarket Trading And The Cost Of Debt: Evidence From Global Bonds](#)

LUBOMIR PETRASEK, Pennsylvania State University, United States

Discussant: Subhankar Nayak, Wilfrid Laurier University

Global bonds are international securities designed to be traded and settled efficiently in multiple markets. This article studies global bonds to examine the effects of multimarket trading on corporate bond liquidity and prices. Using a sample of secondary market transactions matched by issuer, this paper finds that global bonds command a significant liquidity advantage over comparable domestic bonds, and their greater liquidity is priced. They trade at yields 15 to 25 basis points below domestic bonds of the same issuers, with the difference being greater for speculative grade bonds and during liquidity crises. The liquidity advantage of global bonds helps to explain prior evidence that global bond offerings reduce the cost of debt.

[International Cross-listings And Subsequent Security-market Choices: Evidence From Adrs](#)

Narjess Boubakri, American University of Sharjah, United Arab Emirates

Jean-Claude Cosset, HEC Montreal, Canada

ANIS SAMET, Abu Dhabi University, United Arab Emirates

Discussant: Dennis Ng, University of Manitoba

In this paper, we study the link between the ADR-listed firms' attributes and their subsequent security-market choices. First, we find that following ADR listings, foreign firms increase their equity and debt issues, especially emerging market firms. We find that being an emerging market firm increases the primary shares in new equity issues after ADR listings. We also find that large firms are more likely to issue debt and less likely to issue equity. Following SOX, we find that more emerging market firms, under Level III and Rule 144A, issue equity compared to the pre-SOX period. Moreover, we find that after SOX, Level III ADR firms increase their public equity issues on U.S. markets. Finally, we find that ADR firms rely more on primary-equity resources than on debt following their listings, especially for emerging market firms.

[The Evolving World Of Rule 144a Market: A Cross-country Analysis](#)

Usha Mittoo, University of Manitoba, Canada

ZHOU ZHANG, University of Regina, Canada

Discussant: Arnold R. Cowan, Iowa State University

We compare debt issuances by U.S. and international firms to examine differences in the borrowing costs, measured by yield spread, between the Rule 144A and public debt markets across countries and over time in 1991-2008 period. We find that the yield spread is 48 basis points higher in the 144A market than in public bond market, after controlling for other determinants of yield spread. The non-U.S. developed country issuers pay a similar borrowing cost as their U.S. peers do, but emerging country issuers pay

significantly higher costs to access the U.S. debt market. The results hold after controlling for additional country-specific legal and institutional variables. We also find that the borrowing costs increased after the enactment of the 2002 Sarbanes-Oxley Act, and surged to the highest level in 2008 during the financial crisis for both U.S. and international issuers.

Equity and Bond Markets (Assiniboine B)

Chairperson: Gady Jacoby, Seton Hall University

Yield Spreads And Real Interest Rates

Jonathan Batten, Hong Kong University of Science and Technology, Hong Kong

GADY JACOBY, Seton Hall University, United States

Rose C. Liao, Rutgers University, United States

Discussant: Jose Manuel Marques, Banco de España

The effect of inflation on credit spreads is investigated utilizing real instead of nominal interest rates in extensions of the models proposed by Longstaff and Schwartz (1995) and Collin-Dufresne et al. (2001). Inflation is a critical non-default component incorporated in nominal bond yields whose effect has not been considered by existing credit spread theory. In this sense the only true test of the various theoretical models of credit spread pricing must utilise real rates. Importantly, a unique database of Canadian bond data is utilized, which accommodates callability and the tax effects otherwise present in U.S. bond markets. The relation with historical default rates of both U.S. and Canadian bonds is also investigated since this approach is clean of both callability and tax effects. Overall, the analysis provides additional insights into the theoretical drivers of credit spreads as well as helping to explain observed corporate bond yield behaviour in financial markets.

Do Common Factors Drive Stock Split Decisions?

Fabricio Perez, Wilfrid Laurier University, Canada

ANDRIY SHKILKO, Wilfrid Laurier University, Canada

Discussant: Alexander Paseka, University of Manitoba

Are split decisions firm-specific, or are there market factors that influence all firms' incentives to split their stock? Baker, Greenwood, and Wurgler [2009. Catering through nominal share prices. *Journal of Finance* 64, 2559-2590.] argue that there exists at least one such common factor, namely, investors' time-varying preference for companies with low share prices. In this study, we revisit the significance of this preference. Using recent advances in factor analysis of latent dependent variables with binary realizations, we formally measure the importance of a common factor in split decisions. We show that firms' decisions to split are not driven by any common factors and are entirely idiosyncratic. Investor preferences do not appear to be a common factor and only matter for split decisions by a trivially small number of firms.

Information Linkages Between Stock And Corporate Bond Markets

MADHU KALIMIPALLI, Wilfrid Laurier University, Canada

Subhankar Nayak, Wilfrid Laurier University, Canada

Marcos F. Perez, Wilfrid Laurier University, Canada

Discussant: Gady Jacoby, Seton Hall University

Our primary objective in this paper is to explore the dynamic relationships over time between corporate bonds and underlying equities by studying the information flows between them. We first study how bond spreads (i.e. excess of corporate bond yields over equal maturity benchmark yields), liquidity, and trading activity interact in the corporate bond market. We also explore the dynamic linkages between corporate bond and underlying equity markets, by examining the inter-temporal relationships between bond spreads and corresponding equity volatility, liquidity and trading activity. In the preliminary results we report in this paper, we identify a structural break for credit

spreads on the first quarter of 2000. The effects of the break are increasing mean and variance for spreads, and increased volatility risk. Liquidity risk remains constant after the break. We also identify that liquidity shocks are immediately absorbed by bonds prices, while volatility shocks are more persistent, being absorbed after one or two weeks.

Corporate Transparency And Firm Growth:evidence From Real Estate Investment Trusts (reits)

HENG AN, University of South Dakota , United States

Len Zumpano, University of Alabama, United States

Doug Cook, University of Alabama, United States

Discussant: Subhankar Nayak, Wilfrid Laurier University

Using a panel data set of Real Estate Investment Trusts (REITs), we find that corporate transparency is positively associated with REIT growth. These results suggest that greater transparency facilitates firm growth by relaxing the information-based constraints on external financing. The magnitude of this effect is larger in the equity market than in the debt market. Moreover, the sensitivity of investment to cash flows is decreasing in transparency, evidence that transparency relaxes liquidity constraints. Finally, we find more transparent REITs are less likely to crash, a result that is consistent with Jin and Myers (2006).

Commodities and Derivatives (Selkirk)

Chairperson: Gordon Sick, University of Calgary

The Equilibrium Of A Real Options Bargaining And Exercise Game: Evidence From The Natural Gas Industry

YUANSHUN LI, Ryerson University, Canada

Gordon Sick, University of Calgary, Canada

Discussant: Tom Cottrell, University of Calgary

This paper empirically examines the equilibrium of firms' investment decision given a context in which firms' output price and production volume are uncertain, firms may choose to invest cooperatively or competitively, and there are economies of scale (network effects). In this setting, interacting firms play a real option bargaining and exercise game under incomplete information. The results from duration analysis show that output commodity prices have a negative effect on the duration of investment lag and the network effect has a positive effect on the duration of investment lag. In addition, the logit model results show that the real option exercise price has a negative effect on the probability of cooperation, and the network effect has a positive effect on the probability of cooperation.

The Term Structure Of The Crude Oil Variance Risk Premium

Sang Baum Kang, McGill University, Canada

XUHUI PAN, McGill University, Canada

Discussant: Gordon Sick, University of Calgary

We investigate the impact of the variance risk premium in the crude oil market analyzing horizons beyond one month. The existing literature restricts attention to the one month contract but commodity hedging plans very often have much longer horizons. We find that macroeconomic variables combined with crude oil specific variables explain up to 22% of the time variation in the variance risk premium. Further we provide the first predictability study in the literature for futures returns that uses the information contained in the term structure of the variance risk premium. As suggested by theory, the storage level and hedging pressure are important determinants of spot and futures returns. But importantly we find that the term structure of the variance risk premium further increases the predictability of futures returns. This finding is robust across various implementations of the predictor variables.

[Expected Equilibrium Commodity Price Reversion](#)

SAQIB KHAN, University of Regina, Canada

Zeigham Khokher, University of Western Ontario, Canada

Timothy Simin, The Pennsylvania State University, United States

Discussant: Sang Baum Kang, McGill University

In this article, we study the conditions under which market participants infer commodity price shocks to be temporary. Expectations that commodity spot price shocks will revert are reflected in co-movement of the futures term slope with spot prices; this covariance is often traced to relative scarcity of the commodity. We document evidence that this expected equilibrium commodity price reversion cannot be attributed to conditions of scarcity alone.

[Market Efficiency And The Risks And Returns Of Dynamic Trading Strategies With Commodity Futures](#)

LORNE SWITZER, Concordia University, Canada

Hui Jiang, Concordia University, Canada

Discussant: Yuanshun Li, Ryerson University

This paper investigates dynamic trading strategies, based on structural components of returns, including risk premia, convenience yields, and net hedging pressures for commodity futures. Significant momentum profits are identified in both outright futures and spread trading strategies when the spot premium and the term premium are used to form winner and loser portfolios. Profits from active strategies based on winner and loser portfolios are partly conditioned on term structure and net hedging pressure effects. High returns from a popular momentum trading strategy based on a ranking period of 12 months and a holding period of one month dissipate after accounting for hedging pressure effects, consistent with the rational markets model.

10.30 AM - 12.15 PM

Financial Reporting (Gateway)

Chairperson: Scott Hendry, Bank of Canada

[How News Reports On Economy-wide Risks And Uncertainties Affect Stock Market Liquidity And Returns](#)

MELANIE CAO, York University, Canada

Michelle Alexopoulos, University of Toronto, Canada

Discussant: Scott Hendry, Bank of Canada

There is a general belief that media reports on economic and financial news affect investors' trading decisions. This paper investigates how the U.S. media reports on economy-wide risks and uncertainties affect the U.S. stock market liquidity and returns. To do so, we propose a Newspaper-based Economic Uncertainty Sentiment (NEUS) index which quantifies the Main Street's understanding and sentiment to risks and uncertainties presented to the U.S. economy. We then examine the relationship between the NEUS index and the stock market trading activities for NYSE, AMEX and NASDAQ markets. We find three intuitive and interesting effects. First of all, more media reports on economic uncertainties induce larger percentage bid-ask spreads, higher trading volumes and bigger velocity. Second, the incremental changes in news reports on economic uncertainties will suppress stock market returns. Third, the weekend news reports on economic uncertainty can largely explain the weekend return anomaly. The intuition for the first two effects findings is that, when the media features more articles on economic uncertainties, people tend to interpret this as bad forecasts which leads to selling actions. As a result, the trading volume and percentage bid-ask spread increase while return decreases because of the selling pressure. These findings are robust to alternative tests.

[Reading Between The Lines: Detecting Fraud From The Language Of Financial Reports](#)

LYNNETTE PURDA, Queen's University, Canada
David Skillicorn, Queen's University, Canada
Discussant: Charles Mossman, University of Manitoba

We ask whether the text of the Management Discussion and Analysis section (MD&A) of quarterly and annual reports holds important clues regarding the integrity of the financial report. By building a detection algorithm based on all words present in a sample of 4,895 fraudulent and truthful reports, we correctly classify approximately 87% of all reports as either fraudulent or not. This rate falls to 80% for a hold-out-sample excluded from the training set. While the method is particularly strong in correctly capturing financial misrepresentations, truthful statements are incorrectly labeled as fraudulent approximately 16% of the time. These false positive classifications frequently occur in quarters immediately surrounding actual occurrences of fraud with approximately 16% happening within one quarter of the fraud and 46% happening within one year. We compare our method to a more traditional approach suggested by Dechow, Ge, Larson and Sloan (2009) that is based on quantitative financial variables. Correct classification rates for both truthful and fraudulent reports are higher using the text of the MD&A report compared to quantitative variables alone. We find that the correlation between predictions from the two methods is only 0.13 suggesting that the text of financial reports can be a powerful supplement to the identification of fraudulent reports.

[Text Mining And The Information Content Of Bank Of Canada Communications](#)

SCOTT HENDRY, Bank of Canada, Canada
Alison Madeley, Bank of Canada, Canada
Discussant: Wei Wang, Queen's University

This paper uses Latent Semantic Analysis to extract information from Bank of Canada communication statements and investigates what type of information affects returns and volatility in short-term as well as long-term interest rate markets over the 2002-2008 period. Discussions about geopolitical risk and other external shocks, major domestic shocks (SARS and BSE), the balance of risks to the economic projection, and various forward looking statements are found to significantly affect market returns and volatility, especially for short-term markets. This effect is over and above that from the information contained in any policy interest rate surprise.

[Reporting Incentives And Economic Factors In Recognizing Goodwill Impairment During And After The Transition To Sfas 142](#)

ARNOLD R. COWAN, Iowa State University, United States
Cynthia Jeffrey, Iowa State University, United States
Discussant: Wenxia Ge, University of Manitoba

Statement of Financial Accounting Standards 142, Goodwill and Other Intangible Assets (FASB 2001b) affords significant managerial discretion regarding the timing and size of goodwill impairment charges. We investigate whether charges under SFAS 142 reflect economic factors potentially related to fair value or reporting incentive proxies. We evaluate whether there is an impact of different incentives during and after a transitional period. We find evidence of both earnings-management incentives and economic factors. The probability of a goodwill impairment charge is negatively related to proxies for the presence of debt covenants, managerial equity market concerns, analyst coverage, recent earnings management to beat analyst forecasts and the visibility of impairment charges to analysts. The sizes of impairment charges are strongly related to proxies for both "big bath" and "earnings smoothing" reporting incentives. However, there is no evidence that firms smooth the degree to which they beat analyst forecasts. The results are consistent with the existence of sufficient managerial discretion under SFAS 142 to permit manipulation of impairment charges.

Managerial Compensation Design (Salon A)
Chairperson: Sarath Abeysekera, University of Manitoba

Financial Policy And Compensation: Payout Policy, Dividend Covenants And Pay-performance Sensitivity

Alan Douglas, University of Waterloo, Canada

RANJINI JHA, University of Waterloo, Canada

Discussant: Pierre Chaigneau, HEC Montreal

We extend John and John's (1993) theoretical analysis of financial policy and managerial incentives to incorporate free cash flow, payout policy, and debt covenants, and derive empirical predictions. Efficient investment incentives are maintained when the manager's pay-performance sensitivity declines with the firm's dividend payout. A flexible payout policy, including intermittent share repurchases, is optimal when the firm faces stochastic cash flows, and since management does not participate in repurchase programs, pay-sensitivity increase with repurchases. The flexibility in payout policy creates an opportunity for expropriating dividends that reduce bond values and distort investment choices. The manager's incentive to choose such a dividend increases with pay sensitivity, but can be controlled with a dividend covenant, creating a positive relation between covenant use and pay-sensitivity. We investigate the predicted relationships between compensation and financial policy, and find them to be supported by the data.

Market Timing And Managerial Talent

Amir Rubin, Simon Fraser University, Canada

ALEXANDER VEDRASHKO, Simon Fraser University, Canada

Discussant: Ranjini Jha, University of Waterloo

This paper analyzes the relation between CEO trading performance in her company's stock and the quality of the CEO in running the company. The paper distinguishes between two hypotheses that describe the relation between CEO trading profits and firm performance. A negative relation is expected if CEOs use their access to important nonpublic information to enrich themselves at the expense of shareholders. In this case, CEO trading profits are associated with higher levels of agency costs and reduced company performance. An alternative view is that a positive relation between CEO trading profits and firm performance is expected because both types of decisions require an understanding of how the economic environment affects the firm. In this latter case, CEO trading ability is associated with managerial talent. The empirical results of the paper show that on average CEOs trade well and time their trades better than the average investor 70% of the time. More importantly, this paper finds that CEOs who trade in their firm's stock better than their peers demonstrate superior performance in running their firms. In further support to the association between managerial talent and timing ability, those CEOs with better ability to time their trades have a higher level of compensation, are employed by companies that demonstrate good corporate governance, and head their respective firms for longer periods. This is consistent with a notion that the quality of both trading and managerial decisions depends on the CEO's ability to infer how the economic environment affects the firm.

The Optimal Timing Of Compensation With Managerial Short-termism

PIERRE CHAIGNEAU, HEC Montreal, Canada

Discussant: Pei Shao, UNBC

We propose a new continuous-time principal-agent model to study the optimal timing of stock-based incentives, when the effects of managerial actions materialize with a lag and are only progressively understood by shareholders. On the one hand, early contingent compensation hedges the manager against the accumulation of exogenous shocks. On the other hand, the fact that initial information asymmetries between the manager and shareholders are progressively resolved suggests that contingent compensation should be postponed. We introduce two possible types of managerial short-termism, and show that they both result in lower-powered incentives and more deferred compensation.

Empirical Methods (Salon C)

Chairperson: Lorne Switzer, Concordia University

[Market Regimes, Sectorial Investments, And Time-varying Risk Premiums](#)

Payton Liu, Dalhousie University, Canada

Kuan Xu, Dalhousie University, Canada

YONGGAN ZHAO, Dalhousie University, Canada

Discussant: Steven Zheng, University of Manitoba

As an extension to the Fama and French three factor model (FF), this paper investigates the time-varying risk premiums of sector exchange traded funds (ETF) under a Markov regime-switching framework. In addition to the three style factors in the FF model, three macro factors: changes in market volatility, yield spread, and credit spread, are included in the proposed model. Using a maximum likelihood method, we categorize the economic market into three regimes: bull, bear, and transition. We find all regimes are persistent with the bull market being the most persistent and the bear market being the least persistent over time. Risk premiums of the sector ETFs are highly regime dependent and the sensitivity of the funds to the risk factors are also regime dependent with positive or negative relations depending on the regimes. In contrast with the FF model, the proposed model yields substantial improvement in explaining the variation of the funds' returns using the selected six factors. Under the regime-switching framework, the sensitivities of the funds to the style and macro factors are shown to be more significant than the model without regime-switching.

[Misleading Results In Regression Tests About](#)

Jeffrey Pai, University of Manitoba, Canada

STEVEN ZHENG, University of Manitoba, Canada

Discussant: John Qi Zhu, Shanghai Jiao Tong University

We examine the regression model used in the literature to test the signalling model in Leland and Pyle (1977) and find that the model may produce positive and significant coefficients for the independent variables even if the inputs are randomly generated. The problem is illustrated by two examples: a theoretical proof based on a uniform distribution and a bootstrap simulation based on actual data. Our studies show that the misleading results are caused by some natural constraints in the regression model.

[The Cross Section Of Jumps Around Earnings Announcements](#)

Haigang Zhou, Cleveland State University, United States

JOHN QI ZHU, Shanghai Jiao Tong University, China

Discussant: Yonggan Zhao, Dalhousie University

Jump dynamics vary greatly across stocks. However, little is known about the causes of such variations and their associations to various firm characteristics. Controlling for information shocks from quarterly earnings announcements, we examine cross-sectional determinants of jumps in stock prices and find that small, illiquid, and growth firms with high trading volume, high turnover, and low return volatility are more susceptible to jumps. Moreover, the magnitude of jumps decreases with firm size, liquidity, return volatility, and book-to-market ratio, but increases with pre-announcement trading volume and turnover. The results are robust to alternative model specifications and estimation methods.

International Capital Markets (Assiniboine A)

Chairperson: Louis Gagnon, Queen's University

[Corporate Event Risk: Canadian Financial Restatements](#)

LAWRENCE KRYZANOWSKI, Concordia University, Canada

Ying Zhang, Concordia University, Canada

Discussant: Michael Robinson, University of Calgary

Increased information asymmetry, lower liquidity and significant negative abnormal

returns (ARs) are associated with Canadian financial restatements announced in the period 1997-2006. Relative quoted and effective spreads increase upon announcement and remain higher post-restatement, and are lower for financially restating firms that are cross-listed in the U.S. and after the enactment of the Sarbanes-Oxley Act in 2002. The adverse selection (order processing) spread component increases (decreases) and PIN remains unchanged following restatement announcements. Increases in total residual volatility and its information-based permanent component from a GARCH model with an asymmetric effect are associated with financial restatement announcements. Relative (not absolute) spreads, volatilities, Amihud illiquidity estimates and the proportion of zero returns (synchronicity measure) increase for revenue recognition restatements. R2 (alternative synchronicity measure) increases following announcements of securities-related restatements. ARs are more negative for revenue recognition and company-initiated restatements, and are related to downward revisions of analysts' earnings forecasts.

[The Impact Of Political Convergence On Financial Integration](#)

MARIE-HELENE GAGNON, Université Laval, Canada

Beaulieu Marie-Claude, Université Laval, Canada

Khalaf Lynda, Carleton University, Canada

Discussant: Caio Almeida, Getulio Vargas Foundation

In this paper, we test financial market integration in North America from January 1984 to December 2003. We use an Arbitrage Pricing Theory (APT) framework to estimate in time series several unconditional and conditional factor models. We estimate several domestic and international models and test different hypotheses of integration from partial to strong integration. We assess the performance of the model in term of the joint significance of the intercept along with the study of financial market integration. Our main objectives in this paper are: 1) to study the impact of conditioning information on tests of financial integration and on the performance of multivariate asset pricing models in terms of the joint significance of the intercept. 2) To assess the contributions of several risk factors known as asset pricing anomalies (size, book-to-market and momentum) in the performance of multivariate asset pricing models and whether their inclusion in the model affect the outcome of the integration tests. The results show three important conclusions: 1) tests of financial market integration are affected by conditioning variables. While the unconditional models support strong financial integration, the evidence toward financial integration is weaker when conditioning variables are introduced. We explain this result by the increased power to reject the hypotheses of integration in the conditional models compared to the unconditional models. In term of the joint significance of the intercept, international conditional models fare better than the other models estimated. 2) Asset pricing anomalies such as size, book-to-market and momentum as well as the information set of conditioning variable vary across time and country. 3) Our results show that the outcome of financial market integration tests are generally not affected by the systematic risk specification especially regarding the size, book-to-market and momentum risk factors. More specifically, the addition of risk factors in the model does not change the outcome of the integration tests. Therefore, we conclude that variations in asset pricing anomalies have little incidence on financial market integration.

[Mccallum Rules, Exchange Rates, And The Term Structure Of Interest Rates](#)

ANTONIO DIEZ DE LOS RIOS, Bank of Canada, Canada

Discussant: Shubo Wang, University of British Columbia

McCallum (1994a) proposes a monetary rule where central banks have some tendency to resist rapid changes in exchange rates to explain the forward premium puzzle. We estimate this monetary policy reaction function within the framework of an affine term structure model to find that, contrary to previous estimates of this rule, the monetary authorities in Canada, Germany and the U.K. respond to nominal exchange rate movements. Our model is also able to replicate the forward premium puzzle.

Investments (Assiniboine B)

Chairperson: Tim Simin , The Pennsylvania State University

Components Of Bull And Bear Markets: Bull Corrections And Bear Rallies

YONG SONG, University of Toronto, Canada

John Maheu, University of Toronto, Canada

Thomas McCurdy, University of Toronto, Canada

Discussant: Daniel Smith, Simon Fraser University

Existing methods of partitioning the market index into bull and bear regimes do not identify market corrections or bear market rallies. In contrast, our probabilistic model of the return distribution allows for rich and heterogeneous intra-regime dynamics. We focus on the characteristics and dynamics of bear market rallies and bull market corrections, including, for example, the probability of transition from a bear market rally into a bull market versus back to the primary bear state. A Bayesian estimation approach accounts for parameter and regime uncertainty and provides probability statements regarding future regimes and returns. A Value-at-Risk example illustrates the economic value of our approach.

Limiting Losses May Be Injurious To Your Wealth

ROBERT GRAUER, Simon Fraser University, Canada

Discussant: Yong Song, University of Toronto

I examine the effects of imposing solvency, portfolio insurance and Value-at-Risk (VaR) constraints on power-utility and risk-neutral investors in a discrete-state discrete-time framework. Using an example I document the effect the constraints have in the absence of measurement error. Then, I examine the in- and out-of-sample effects of imposing loss constraints in a real-world asset-allocation setting covering the 1934-2008 period. Solvency constraints have no effect on power-utility investors and a pronounced effect on risk-neutral investors. VaR constraints have little or no effect on more risk-averse investors and significant effects on the investment policies, realized returns and accumulated wealth of less risk-averse investors.

Macroprudential Capital Requirements And Systemic Risk

Celine Gauthier, Bank of Canada, Canada

ALFRED LEHAR, University of Calgary, Canada

Moez Souissi, Bank of Canada, Canada

Discussant: Tim Simin, The Pennsylvania State University

In the aftermath of the financial crisis, there is interest in reforming bank regulation such that capital requirements are more closely linked to a bank's contribution to the overall risk of the financial system. In our paper we compare alternative mechanisms for allocating the overall risk of a banking system to its member banks. Overall risk is estimated using a model that explicitly incorporates contagion externalities present in the financial system. We have access to a unique data set of the Canadian banking system, which includes individual banks' risk exposures as well as detailed information on interbank linkages including OTC derivatives. We find that macroprudential capital allocations can differ by as much as 50% from observed capital levels and are not trivially related to bank size or individual bank default probability. Macroprudential capital allocation mechanisms reduce default probabilities of individual banks as well as the probability of a systemic crisis by about 25%. Our results suggest that financial stability can be enhanced substantially by implementing a systemic perspective on bank regulation.

Time-varying Risk Aversion And The Risk-return Relation

DANIEL SMITH, Simon Fraser University, Canada

Robert Whitelaw, New York University, United States

Discussant: Alfred Lehar, University of Calgary

Time-varying risk aversion is the economic mechanism underlying several recent theoretical models that appear to match important features of equity return data at the market level. In this paper, we estimate a time-varying risk-return relation using only market level data that allows for feedback from both news about volatility and news about risk-aversion. Allowing for feedback effects dramatically improves our ability to explain variation in returns, and the estimated model exhibits statistically and economically significant variation in the price of risk. Consistent with theoretical intuition, the price of risk varies counter-cyclically, with risk aversion increasing substantially over the course of economic contractions. Interestingly, it is variation in the price of risk, not in the quantity of risk, that is the dominant component of the equity risk premium. This phenomenon may partially account for the puzzling results that often arise in estimating models with an assumed constant price of risk.

Institutional Investors (Selkirk)

Chairperson: Michael Schill , University of Virginia, Darden School

Institutional Ownership And Stock Volatility: An Information Asymmetry Perspective

BETTY YING-CHU NGAI, The Hong Kong Polytechnic University, China

Steven Shuye Wang, The Hong Kong Polytechnic University, China

Discussant: Sara Ding, Queen's University

This paper shows that the relation between institutional ownership and stock return volatility is non-linear: volatility is a convex function of institutional ownership, with the minimum occurring at approximately 60% of institutional shareholding. As the fraction of informed institutional investors increases, two opposing forces affect price volatility. While better information quality reduces volatility, growing asymmetric information among investors increases volatility. We posit and find that the information quality effect initially dominates the information asymmetry effect when institutional ownership level is low, but then the latter is increasingly salient and dominates the former when the level of institutional ownership is high.

Institutional Trader Monitoring And Firm Performance

BRANDON CHI-WEI CHEN, University of New South Wales, Australia

Peter Swan, University of New South Wales, Australia

Discussant: Elvira Sojli, Rotterdam School of Management, Erasmus University

Recent works show that agency costs can be reduced even in an environment of diffused ownership (Edmans and Manso (2009); Chen and Swan (2010)). In particular, the CEO is likely to put in more efforts when there are multiple (institutional) informed traders in the market because their competition for trading profits, driven purely by self-interest, helps expunge more extraneous information from the price than in the case where merely one single large shareholder is in the presence. Observing that price becomes more sensitive with respect to the manager's own actions, the CEO would spend more time and effort maximizing firm value. This alternative monitoring mechanism in the form of informed trading should boost firm value. This is indeed the case empirically. This paper links research on corporate governance to research on price efficiency due to informed trading. In particular, it confirms that the positive effect of institutional trader monitoring on firm value more than outweighs the negative effect of potentially increasing agency costs due to the reduced use of equity-based compensation to CEOs revealed by Chen and Swan (2010). Our results are also robust to various measures of performance (stock returns, Tobin's Q, and ROA) as well as different specifications dealing with the issue of endogeneity.

Local And Foreign Institutional Investors, Information Asymmetries, And State Ownership

SARA DING, Queen's University, Canada

Yang Ni, Queen's University, Canada

Discussant: Betty Ying-Chu Ngai, The Hong Kong Polytechnic University

Evidence is mixed on whether local investors or foreign investors are better informed. We offer a new perspective by examining two market segments within one country but separated by the relevance of local knowledge. Prior literature has documented that state ownership is associated with higher information asymmetry due to lower governance transparency and poorer financial transparency; thus, investing in firms with state ownership requires more local knowledge and experience. This paper examines how the state ownership of listed firms affects the information role of local and foreign institutional investors in China. We find that state ownership has a dramatic asymmetric effect on local and foreign institutional investors. In state-owned enterprises (SOEs), local institutional ownership has strong forecasting power for future stock returns, while foreign institutional ownership has no such ability. In non-state-owned enterprises (non-SOEs), foreign institutional ownership strongly predicts future stock returns, whereas local institutional ownership does not. Moreover, the return predictive ability of local institutional investors is less evident in SOEs with high board independence and better audit quality. Our results indicate that local (foreign) institutional investors have an informational advantage in SOEs (non-SOEs). Our findings reconcile the two opposing views in the literature and suggest that the relative advantages of local and foreign investors vary with the relevance of local knowledge. Our paper also suggests that taking into account firm-level characteristics especially corporate governance measures can enhance our understanding in the behaviour of institutional investors. Additionally our paper is one of the first evidence to show that local political institutions can be barriers faced by international investors.

[The Impact Of Foreign Government Investment: Sovereign Wealth Fund Investments In The U.s.](#)

ELVIRA SOJLI, Rotterdam School of Management, Erasmus University, Netherlands

Wing Wah Tham, Erasmus School of Economics, Erasmus University, Netherlands

Discussant: Brandon Chi-Wei Chen, University of New South Wales

Foreign and politically connected large investors, like Sovereign Wealth Funds (SWFs), improve firm value through the provision of SWF domestic market access and government-related contracts. In the short run, the market welcomes SWF investments in expectation of potential monitoring and internationalization benefits. In the long run, the target firms' degree of internationalization and Tobin's q increase substantially after SWF investments. The increase in q is directly related to the number of government-related contracts granted by SWF countries. The target companies contribute to SWF markets by increasing their competitiveness, providing certification to their domestic markets, and transferring technological know-how.