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Finance Center Münster

DGF Deutsche Gesellschaft für Finanzwirtschaft
German Finance Association

Conference Program

15th Annual Meeting of the German Finance Association

Münster, October 10th - 11th, 2008

Welcome

Welcome to the 15th Annual Meeting of the German Finance Association (DGF) at the University of Münster! We are proud to be hosting this year's meeting and hope you will enjoy your visit to Münster.

Especially we would like to welcome our keynote speaker, Prof. Arnould Boot from the University of Amsterdam, President of the European Finance Association, who will open this meeting with a talk about "Financial Intermediation Theory and the Credit Crisis: What is the Research Agenda?".

The following 80 presentations of the conference were selected out of 231 papers. Each paper was reviewed by at least two reviewers in a double blind process and, in some cases, by a third reviewer. We are indebted to the members of the program committee and more than 90 reviewers for their valuable support. The acceptance rate of about 35% shows the competitiveness of the Meeting and is an indicator for the high quality of the presentations. The papers cover all areas of the latest theoretical and empirical research in modern finance.

The meeting would not have been possible without the help of numerous people and institutions. Financial support was provided by NRW.Bank, Deutsches Institut für Altersvorsorge, Wissenschaftsförderung der Sparkassen-Finanzgruppe and a number of further sponsors (see next pages) which have allowed us to offer a great program. The organizational burden was carried by the whole team of the Finance Center Münster, in particular Andreas Jacobs, Helgard Scherer and Olga Sedova. Our thanks go to all of them as well as to those whom we have failed to mention appropriately.

We wish you a pleasant stay in Münster and hope that you will gain many interesting new insights into finance as well as into the treasures of our city!

Yours sincerely,

Nicole Branger, Thomas Langer, Andreas Pfingsten

Impressum

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1. Registration and Information

1.1. General Information

Conference Office

The DGF 2008 registration and information desk is located in the foyer (ground floor) of the building “Fürstenberghaus”. The conference office is located in room F3 on the first floor.

The registration desk is open at the following times:

- Thursday: 9.00 a.m. – 7.00 p.m.
- Friday: 8.00 a.m. – 7.00 p.m.
- Saturday: 8.00 a.m. – 2.00 p.m.

Get-Together

An informal get-together is arranged for Thursday, October 9th, 2008, starting at 7 p.m. The meeting will take place in the Picasso-Museum Münster (Königsstraße 5, 48143 Münster, see also map at the end of this booklet). Besides the buffet there will also be free guided tours. For detailed information about the museum see also http://www.graphikmuseum-picasso-muenster.de/.

Lunch

Lunch on Friday and the farewell-snack on Saturday will be served in the foyer of the Fürstenberghaus.

Conference Dinner

The conference dinner will take place on Friday, October 10th, 2008 at the “Mühlenhof Freilichtmuseum” (Theo-Breider-Weg 1, 48149 Münster). General information on the location can be found at http://www.muehlenhof-muenster.org/. The event begins at 7.00 p.m. Busses will leave from the conference venue at 6.45 p.m.

The location can also be reached by bus (no. 14; stop “Bockwind-mühle”) or on foot (walking distance from the city center about 30 minutes). If you arrive by car and use a navigation system, enter the destination “Sentruper Straße”, and then follow the signs.

Organizing Committee

Prof. Dr. Nicole Branger, Finance Center Münster
Prof. Dr. Thomas Langer, Finance Center Münster
Prof. Dr. Andreas Pfingsten, Finance Center Münster

Should you have any questions please do not hesitate to contact us:

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Should you have any questions during the conference, please contact the registration and information desk.

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1.5. Practitioners' Event, Thursday, October 9th

On the day before the DGF-Meeting, the Finance Center Münster organizes a practitioners' event on the topic "Perspectives of Retirement Planning" at the Fürstenberghaus in Münster. The event shall foster the exchange between academia and industry.

The meeting is scheduled to run from 1 p.m. through 6.30 p.m. There will be ample opportunity to discuss with the speakers. After the event the Deutsche Institut für Altersvorsorge (DIA) invites the participants to a reception at the Picasso-Museum, where the DIA-Zukunftspreis, a prize for scientific and journalistic contributions in the field of retirement planning, will be awarded.

Attendance of the event is free. However, we would ask participants to register. For information on schedule and registration, please follow the link "Practitioners' Event" on www.dgf2008.de.

Preliminary list of speakers

Harald Huhn (MLP)
Dr. Andreas Kamp (HSBC Trinkaus & Burkhardt AG)
Prof. Dr. Thomas Langer (Finance Center Münster)
Prof. Dr. Raimond Maurer (Goethe-Universität Frankfurt)
Niels Nauhauser (Verbraucherzentrale Baden-Württemberg e.V.)
Gregor Schneider (LBS Bausparkassen)

1.6. Workshop for Ph.D. Students, Thursday, October 9th

On the day before the DGF-Meeting, there is a workshop for Ph.D. students.

Faculty

Prof. Dr. Ralf Elsas (LMU München)
Prof. Dr. Joachim Grammig (Universität Tübingen)
Prof. Dr. Christian Schlag (Goethe-Universität Frankfurt, chair)
Prof. Dr. Erik Theissen (Universität Bonn)

Ph.D. students and presentations

Markus Ampenberger (TU München):
Corporate Governance, Ownership Structures and Organizational Behaviour – An Empirical Analysis of the German Capital Market

Frederik Bauer (Universität Bremen):
Optimal Risk Control, Return-Risk Adjustments and Robustness in Portfolio Management

Tobias Berg (TU München):
The Term Structure of Equity Risk Premia

Sarah Draus (Université Paris-Dauphine):
Stock Market Competition and the Listing Locations of Firms

Susanne Ebert (Universität Mannheim):
Essays in Corporate Finance

Kerstin Kehrle (Universität Tübingen):
Modelling and Forecasting Return Volatility: A New Reduced Form Approach Using Nonparametric Variation Measures

2. Program Overview

2.1. Schedule: Friday, October 10th, 2008

9.00 – 9.15 a.m.	Opening (F1)				
9.15 – 10.15 a.m.	Keynote Lecture (F1) “Financial Intermediation Theory and the Credit Crisis: What is the Research Agenda?”, Prof. Arnould Boot				
10.15 – 10.45 a.m.	Coffee Break				
Session Room	**1** F1	**2** F2	**3** F4	**4** F5	**5** F6
PANEL A 10.45 – 12.45 a.m.	Derivatives 1	International Finance	Portfolio Selection	Regulation	Corporate Finance 1
12.45 – 2.00 p.m.	Lunch Break				
PANEL B 2.00 – 3.30 p.m.	Derivatives 2	Financial Products	Retirement Savings 1	Banking 1	Market Microstructure 1
3.30 – 4.00 p.m.	Coffee Break				
PANEL C 4.00 – 5.30 p.m.	Derivatives 3	Asset Valuation 1	Retirement Savings 2	Banking 2	Market Microstructure 2
5.45 – 6.30 p.m.	GM: General Meeting of the DGF (F1)				
6.45 p.m.	Busses leave from conference venue (meeting point: foyer)				
7.00 – 11.00 p.m.	Conference Dinner at Mühlenhof				

2.2. Schedule: Saturday, October 11th, 2008

Session Room	**1** F1	**2** F2	**3** F4	**4** F5	**5** F6
PANEL D 9.00 – 10.30 a.m.	Risk	Asset Pricing	Behavioral Finance 1	Banking 3	Empirical Finance
10.30 – 11.00 a.m.	Coffee Break				
PANEL E 11.00 – 12.30 a.m.	Performance Measurement	Asset Valuation 2	Behavioral Finance 2	Credit Risk	Corporate Finance 2
from 12.30 p.m	Farewell Snack				

2.3. Overview of Sessions

Panel A: Friday, October 10th, 2008: 10:45 – 12:45

Panel A – Session 1: Derivatives 1

Session Chair: Christian Koziol

Portfolio Policies with Stock Options
(Yuliya Plyakha, Grigory Vilkov)
Discussant: TBA

Trading Strategies with Partial Access to the Derivatives Market
(Matthias Muck)
Discussant: Nicole Branger

Reconciling Smiles for Index and Stock Options
(Nicole Branger, Holger Kraft, Antje Mahayni, Christian Schlag)
Discussant: José Da Fonseca

Impact of Imperfect Information on the Optimal Exercise Strategy for Warrants
(Christian Koziol)
Discussant: Siegfried Trautmann

Panel A – Session 2: International Finance

Session Chair: Andreas Schrimpf

Risk-premia, carry-trade dynamics, and speculative efficiency of currency markets
(Christian Wagner)
Discussant: Maik Schmeling

Multivariate Regime-Switching GARCH with an Application to International Stock Markets
(Markus Haas)
Discussant: Leopold Sögner

International Price and Earnings Momentum
(Harald Lohre, Markus Leippold)
Discussant: Christian Westheide

International Stock Return Predictability under Model Uncertainty
(Andreas Schrimpf)
Discussant: Harald Lohre

Panel A – Session 3: Portfolio Selection

Session Chair: Steffen Meyer

Do Risk Attitude and Household Portfolio Diversification Match? Evidence from German Households' Portfolios
(Nataliya Barasinska, Dorothea Schäfer, Andreas Stephan)
Discussant: Martin Wallmeier

Optimal Tax-Timing and Asset Allocation when Tax Rebates on Capital Losses are Limited
(Marcel Marekwica)
Discussant: Holger Kraft

Wie diversifiziere ich richtig? - Eine Diskussion alternativer Asset Allocation Ansätze zur Konstruktion eines "Weltportfolios".
(Heiko Jacobs, Sebastian Müller, Martin Weber)
Discussant: Marcel Marekwica

An Empirical Study on the Cost of Institutional Boundaries and Lacking Financial Sophistication in the Mutual Fund Selection Process
(René Fischer, Andreas Hackethal, Steffen Meyer)
Discussant: Tatjana Puhan

Panel A – Session 4: Regulation

Session Chair: Hendrik Hakenes

Knightian Uncertainty and Insurance Regulation Decision
(An Chen, Xia Su)
Discussant: Oliver Vins

Foreign listings, US equity markets, and the impact of the Sarbanes-Oxley Act
(Stephan Siegel, Jefferson Duarte, Katie Kong, Lancy Young)
Discussant: Ingrid Stein

To Use or Not To Use - An Empirical Study of Visible Reserves in Bank Accounting in the Light of Regulatory Requirements and Informational Asymmetries
(Sven Bornemann, Susanne Homölle, Carsten Hubensack, Andreas Pfingsten)
Discussant: Karolin Kirschenmann

Looting and Gambling in Banking Crises
(Hendrik Hakenes, John H. Boyd)
Discussant: Rainer Jankowitsch

Panel A – Session 5: Corporate Finance 1

Session Chair: Hannes Wagner

Political Connections and the Allocation of Procurement Contracts
(Jörg Rocholl, Eitan Goldman, Jongil So)
Discussant: Sebastian Lobe

Fairness Opinions and Capital Markets: Evidence from Germany, Switzerland and Austria
(Sebastian Lobe, Nils-Christian Schenk)
Discussant: Jörg Prokop

Economic Consequences of Private Equity Investments on the German Stock Market
(Ann-Kristin Achleitner, Christian Andres, André Betzer, Charlie Weir)
Discussant: Jörg Rocholl

Evolution of Family Capitalism: A Comparative Study of France, Germany, Italy and the UK
(Julian Franks, Colin Mayer, Paolo Volpin, Hannes Wagner)
Discussant: Kristian Rydqvist

Panel B: Friday, October 10th, 2008: 14:00 – 15:30

Panel B – Session 1: Derivatives 2

Session Chair: Martin Wallmeier

Expected Option Returns and the Structure of Jump Risk Premia
(Nicole Branger, Alexandra Hansis, Christian Schlag)
Discussant: Rainer Schöbel

Pricing and Risk Management of Relax Certificates
(Nicole Branger, Antje Mahayni, Judith Schneider)
Discussant: Matthias Muck

Market Pricing of Exotic Structured Products: The Case of Multi-Asset Barrier Reverse Convertibles in Switzerland
(Martin Wallmeier, Martin Diethelm)
Discussant: Beate Breuer

Panel B – Session 2: Financial Products

Session Chair: Julia Hein

Optimal Design of Rating-Trigger Step-Up Bonds: Agency Conflicts Versus Asymmetric Information
(Christian Koziol, Jochen Lawrenz)
Discussant: Christian Hirsch

Why are British Premium Bonds so successful? The effect of saving with a thrill
(Sebastian Lobe, Alexander Hölzl)
Discussant: Hendrik Scholz

The Impact of an Interest Rate Freeze on Residential Mortgage Backed Securities
(Julia Hein, Thomas Weber)
Discussant: Christian Wagner

Panel B – Session 3: Retirement Savings 1

Session Chair: Joachim Inkmann

Annuitization and Retirement Timing Decisions
(Zhen Shi)
Discussant: Christine Kaufmann

Asset Allocation and Location over the Life Cycle with Survival-Contingent Payouts
(Wolfram J. Horneff, Raimond H. Maurer, Olivia S. Mitchell, Michael Z. Stamos)
Discussant: Alex Weissensteiner

How Deep is the Annuity Market Participation Puzzle?
(Joachim Inkmann, Paula Lopes, Alexander Michaelides)
Discussant: Raimond Maurer

Panel B – Session 4: Banking 1

Session Chair: Karolin Kirschenmann

Emergence of Financial Intermediaries on Electronic Markets: The Case of Online P2P Lending
(Fabian Gleisner, Sven Berger)
Discussant: Markus Glaser

Credit Risk Transfer in Banking Markets with Hard and Soft Information
(Isabel Schnabel, Hendrik Hakenes)
Discussant: Dorothea Schäfer

The relation between borrower risk and loan maturity in small business lending
(Karolin Kirschenmann, Lars Norden)
Discussant: Rolf Böve

Panel B – Session 5: Market Microstructure 1

Session Chair: Torsten Schöneborn

A Dynamic Limit Order Market with Diversity in Trading Horizons
(Mark Van Achter)
Discussant: Monika Müller

The Impact of Hidden Liquidity in Limit Order Books
(Stefan Frey, Patrik Sandas)
Discussant: Tim Adam

Liquidation in the Face of Adversity: Stealth Vs. Sunshine Trading, Predatory Trading Vs. Liquidity Provision
(Torsten Schöneborn, Alexander Schied)
Discussant: Christian Dick

Panel C: Friday, October 10th, 2008: 16:00 – 17:30

Panel C – Session 1: Derivatives 3

Session Chair: Marc Oliver Rieger

Hedging (Co)Variance Risk with Variance Swaps
(Jose Da Fonseca, Martino Grasselli, Florian Ielpo)
Discussant: Alexandra Hansis

The Optimal Demand for Retail Derivatives
(Nicole Branger, Beate Breuer)
Discussant: Judith Schneider

The dark side of the moon: structured products from the customer's perspective
(Thorsten Hens, Marc Oliver Rieger)
Discussant: Krzysztof Jajuga

Panel C – Session 2: Asset Valuation 1

Session Chair: Stefan Ruenzi

Extended Dividend, Cash Flow and Residual Income Valuation Models - Accounting for Deviations from Ideal Conditions
(Dieter Hess, Carsten Homburg, Michael Lorenz, Soenke Sievers)
Discussant: Tobias Berg

Vice vs. Virtue Investing
(Sebastian Lobe, Stefan Roithmeier)
Discussant: Dieter Hess

Why Managers Hold Shares of Their Firms: An Empirical Analysis
(Stefan Ruenzi, Ulf von Lilienfeld-Toal)
Discussant: Sven Bornemann

Panel C – Session 3: Retirement Savings 2

Session Chair: Raimond Maurer

The Evolution of Aggregate Stock Ownership - A Unified Explanation
(Kristian Rydqvist)
Discussant: Joachim Inkmann

Pension Liability Valuation and Asset Allocation in the Presence of Funding Risk
(Joachim Inkmann, David Blake)
Discussant: An Chen

Optimal Life-Cycle Strategies in the Presence of Interest Rate and Inflation Risk
(Raimond Maurer, Christian Schlag, Michael Z. Stamos)
Discussant: Nataliya Barasinska

Panel C – Session 4: Banking 2

Session Chair: Lars Norden

Market Discipline at German savings banks
(Andreas Pfingsten, Norbert Sträter, Daniel Wissing)
Discussant: Daniel Foos

How Politics influence State-owned Banks - the Case of German Savings Banks
(Oliver Vins)
Discussant: Fabian Gleisner

Liberalization, Corporate Governance, and Savings Banks
(Manuel Illueca, Lars Norden, Gregory F. Udell)
Discussant: Daniel Wissing

Panel C – Session 5: Market Microstructure 2

Session Chair: Rainer Jankowitsch

Learning from counterparties' order flow in electronic trading
(Lukas Menkhoff, Maik Schmeling)
Discussant: Stefan Frey

The Risk Microstructure of Corporate Bonds: A Bayesian Analysis of the German Corporate Bond Market
(Leopold Sögner, Manfred Frühwirth, Paul Schneider)
Discussant: Christian Schlag

Price Dispersion in OTC Markets: A New Measure of Liquidity
(Rainer Jankowitsch, Amrut Nashikkar, Marti G. Subrahmanyam)
Discussant: Torsten Schöneborn

Panel D: Saturday, October 11th, 2008: 09:00 – 10:30

Panel D – Session 1: Risk

Session Chair: Alina Maurer

Why do firms hedge selectively? Evidence from the gold mining industry
(<u>Tim Adam</u>, Chitru Fernando, Jesus Salas)
Discussant: Martin Ruckes

Robust Recovery Risk Hedging: Only the First Moment Matters
(Siegfried Trautmann, Monika Müller)
Discussant: Julia Hein

Incorporating the Dynamics of Leverage into Default Prediction
(Gunter Löffler, <u>Alina Maurer</u>)
Discussant: Jochen Lawrenz

Panel D – Session 2: Asset Pricing

Session Chair: Stephan Siegel

The Conditional Relation between Fama-French Betas and Return
(Stefan Koch, <u>Christian Westheide</u>)
Discussant: Martin Rohleder

Long-Horizon Consumption Risk and the Cross-Section of Expected Returns: A Cross-Country Perspective
(Joachim Grammig, Andreas Schrimpf, <u>Michael Schuppli</u>)
Discussant: Stephan Siegel

Consumption-Based Asset Pricing: Durable Goods, Adjustment Costs, and Aggregation
(<u>Stephan Siegel</u>)
Discussant: Michael Schuppli

Panel D – Session 3: Behavioral Finance 1

Session Chair: Thomas Langer

Can Prospect Theory Be Used To Predict Investor's Willingness To Pay?
(Carsten Erner, Alexander Klos, Thomas Langer)
Discussant: Alen Nosic

Overreaction and Investment Choices: An Experimental Analysis
(Bruno Biais, Alen Nosic, Martin Weber)
Discussant: Marc Oliver Rieger

Why the Google IPO might stay exotic – An experimental analysis of offering mechanisms
(Andreas Trauten, Thomas Langer)
Discussant: Mark Van Achter

Panel D – Session 4: Banking 3

Session Chair: Andreas Pfingsten

Why do specialized banks succeed? An empirical investigation of the credit business of cooperative and savings banks
(Rolf Böve, Andreas Pfingsten)
Discussant: Lars Norden

The quiet life hypothesis in banking - Evidence from German savings banks
(Oliver Vins, Michael Kötter, Andreas Hackethal)
Discussant: Christoph Börner

Deposit insurance: An empirical study of private investor's knowledge and perception
(Norbert Sträter, Markus Cornelißen, Andreas Pfingsten)
Discussant: Jens Grunert

Panel D – Session 5: Empirical Finance

Session Chair: Christoph Kaserer

When is Bankruptcy Threat Bad News? Risk and Return Analysis of Firms Announcing Bankruptcy in the US and Germany
(Vladimir Vladimirov)
Discussant: TBA

The Role of Media Coverage in the Information Diffusion Process in the Stock Market
(Philipp Schmitz)
Discussant: Stefan Ruenzi

Market Efficiency Reloaded: Why Insider Trades do not Reveal Exploitable Information
(Christoph Kaserer, Sebastian Dickgiesser)
Discussant: Heiko Jacobs

Panel E: Saturday, October 11th, 2008: 11:00 – 12:30

Panel E – Session 1: Performance Measurement

Session Chair: Hendrik Scholz

Survivorship Bias and Mutual Fund Performance: Relevance, Significance, and Methodical Differences
(Martin Rohleder, Hendrik Scholz, Marco Wilkens)
Discussant: Steffen Meyer

Are Mutual Funds Doomed to Underperform? Evidence from Managerial Turnover and Fund Flows
(Wolfgang Bessler, Peter Lückoff, David Blake, Ian Tonks)
Discussant: Sebastian Müller

Ranking of equity mutual funds: The bias in using survivorship bias-free datasets
(Hendrik Scholz, Oliver Schnusenberg)
Discussant: Peter Lueckoff

Panel E – Session 2: Asset Valuation 2

Session Chair: Holger Kraft

Linking Credit Risk Premia to the Equity Premium
(Tobias Berg, Christoph Kaserer)
Discussant: Yuliya Plyakha

Life-cycle Asset Allocation and Optimal Consumption Using Stochastic Linear Programming
(Michael Hanke, Alois Geyer, Alex Weissensteiner)
Discussant: Zhen Shi

Asset Allocation and Liquidity Breakdowns: What if Your Broker Does not Answer the Phone?
(Peter Diesinger, Holger Kraft, Frank Seifried)
Discussant: Engelbert Dockner

Panel E – Session 3: Behavioral Finance 2

Session Chair: Jens Martin

Managerial Optimism and Corporate Investment: Is the CEO Alone Responsible for the Relation?
(Markus Glaser, Philipp Schäfers, Martin Weber)
Discussant: Jens Martin

Is a Team Different From the Sum of Its Parts? Evidence from Mutual Fund Managers
(Michaela Bär, Alexander Kempf, Stefan Ruenzi)
Discussant: Markus Haas

The impact of optimistic and pessimistic managers on firm performance and corporate decisions
(Jens Martin)
Discussant: Uwe Bloos

Panel E – Session 4: Credit Risk

Session Chair: Christian Hirsch

The real nature of credit rating transitions
(Axel Eisenkopf)
Discussant: Thomas Weber

Tranching and Rating
(Julia Hein, Michael J. Brennan, Ser-Huang Poon)
Discussant: Axel Eisenkopf

A primer on rating agencies as monitors: an analysis of the watchlist period
(Christian Hirsch, Jan Pieter Krahnen)
Discussant: Alina Maurer

Panel E – Session 5: Corporate Finance 2

Session Chair: Klaus Röder

Managerial Preferences and Competition in Internal Capital Markets
(Uwe-Wilhelm Bloos, Christian Gerhardt)
Discussant: Vladimir Vladimirov

Informed Headquarters and Capital Allocation in Multi-Divisional Firms
(Daniel Hoang, Martin Ruckes)
Discussant: Hendrik Hakenes

Do Managers follow the Shareholder Value Principle when applying Capital Budgeting Methods? A Comparison of Theory and Practice based on German Survey Results and Return Data
(Sebastian Lobe, Tobias Niermeier, Wolfgang Essler, Klaus Röder)
Discussant: Christoph Kaserer

3. Abstracts

3.1. Friday, October 10th: 10:45 – 12:45

Panel A - Session 1: Derivatives I

Portfolio Policies with Stock Options

Authors: Yuliya Plyakha, Grigory Vilkov
Presenting Author: Yuliya Plyakha

We study the partial equilibrium portfolio optimization problem for a myopic CRRA investor who can trade options on individual stocks. Applying the parametric portfolio approach of Brandt, Santa-Clara, and Valkanov (forthcoming) to derivatives we show that options characteristics (such as implied volatility and IV smile skew) convey information about the mispricing in the option portfolios. We take the data on all US-traded options to build characteristic-based factor portfolios of options. An investor uses them in addition to the market portfolio and Fama and French (1992) factors in her utility maximization. Surprisingly, portfolios based on the IV smile skew turn out to be less important than IV-based portfolios, and factor portfolios from call options are in general more interesting for an investor than the factors from puts. Market frictions in the form of stock shortsale constraints are compensated by the use of options, and having options with no stock shortsales allowed may even be better than having only stocks with shortsales permitted. Monthly rebalancing leads to extreme transaction costs for an investor facing the full bid-ask spread, providing a limits to arbitrage interpretation of the documented mispricing in the option portfolios.

Keywords: stock options, portfolio analysis, hedge fund policy, implied volatility, skew risk

Trading Strategies with Partial Access to the Derivatives Market

Author: Matthias Muck

This research analyzes implements derivative trading strategies when there are several assets and risk factors. We investigate portfolio improvements if investors have full and partial access to the derivatives markets, i.e. situations in which options are written on some but not all stocks traded in the market. The focus is on markets with jump risk. In these markets the choice of optimal exposure with respect to jump and diffusion risk is linked. In a numerical application we study the potential

benefit from adding derivatives to the market. These considerations might be taken into account by exchanges planning to introduce new derivative contracts.

Keywords: Portfolio Selection, Jumps, Derivatives, Trading Strategies

Reconciling Smiles for Index and Stock Options

Authors: Nicole Branger, Holger Kraft, Antje Mahayni, Christian Schlag
Presenting Author: Nicole Branger

The fact that the implied volatility smiles for equity indices are strongly downward sloping, while the typical individual stock exhibits either a flat or even an upward sloping smile is sometimes considered puzzling. We show that this effect can easily be generated in a simple and parsimonious two-factor stochastic volatility model in the spirit of Bates (2000). From a theoretical perspective our paper adds to the literature by proving a 'diversification' result with respect to idiosyncratic stochastic volatility components of individual stocks, so that in the limit for infinitely many stocks, the prices of index options are solely based on the common volatility component. This result holds without restrictive assumptions on the structure of the correlations between stock returns and volatility changes. We employ Monte Carlo simulation to show that our model can reproduce the empirical observations quite well for an index of 30 stocks similar to the Dow Jones Industrial Average.

Keywords: Stochastic volatility, index options, equity options, volatility components

Impact of Imperfect Information on the Optimal Exercise Strategy for Warrants

Author: Christian Koziol

In this paper, we determine the optimal exercise strategy for corporate warrants if investors suffer from imperfect information and we evaluate the impact of this friction on the value of a warrant. For this purpose, we address both exercises at maturity, where imperfect information about the firm value is present, and exercises before maturity which are impacted by imperfect information about the size of the dividend. We model imperfect information so that all warrant holders know that they obtain biased signals of the true state without observing the signals of other warrant holders. The optimal exercise strategy follows from a complex game among warrant holders in which every individual warrant holder must account for the potential signals of the other warrant holders and

their resulting exercise decisions. The main findings are that due to imperfect information warrant holders optimally start to exercise their warrants later than without imperfect information. Moreover, a simple block exercise strategy is always an equilibrium strategy for a high degree of imperfect information before maturity, even though a partial exercise can be the unique strategy without imperfect information. Remarkably, imperfect information does not necessarily result in a lower warrant value. As long as a warrant holder has a signal that allows for correct exercise decisions, then imperfect information enhances the warrant value due to suboptimal exercises by other investors.

Keywords: Warrant Exercise, Block Exercise, Imperfect Information, Global Games

Panel A - Session 2: International Finance

Risk-premia, carry-trade dynamics, and speculative efficiency of currency markets

Author: Christian Wagner

Foreign exchange market efficiency is commonly investigated by Fama-regression tests of uncovered interest parity (UIP). In this paper, we conjecture a speculative UIP relationship which implies that exchange rate changes comprise a time-varying risk component in addition to the forward premium. This suggests that the forward premium anomaly reported in previous research potentially stems from omitting this component in UIP tests and that the popular carry-trade strategy can be rationalized to some extent. Moreover, while related work focuses on the Fama-regression slope coefficient, we show that also the intercept is important for judging the economic significance of currency speculation. Empirically, we find support for speculative UIP and the existence of a risk-premium.

Keywords:
Exchange rates, Uncovered interest parity, Speculative efficiency, Risk-premia, Carry-trade

Multivariate Regime-Switching GARCH with an Application to International Stock Markets

Author: Markus Haas

We develop a multivariate generalization of the Markov-switching GARCH model introduced by Haas, Mittnik, and Paolella (2004b) and derive its fourth--moment structure. An application to international stock

markets illustrates the relevance of accounting for volatility regimes from both a statistical and economic perspective, including out-of-sample portfolio selection and computation of Value-at-Risk.

Keywords: conditional volatility, Markov--switching, multivariate GARCH

International Price and Earnings Momentum

Authors: Harald Lohre, Markus Leippold
Presenting Author: Harald Lohre

We find that price and earnings momentum are pervasive features of international equity markets when controlling for data snooping biases. For European countries, we find that price momentum is subsumed by earnings momentum on an aggregate level. However, this rationale does not apply to each and every country. While the above explanation is confined to certain time periods in the U.S., earnings momentum nevertheless appears to be a crucial driver of the price momentum anomaly in many markets. Since we cannot establish a decent relation between momentum and macroeconomic risks, we suspect a behavioral-based explanation to be at work. In fact, we find momentum profits to be more pronounced for portfolios characterized by higher information uncertainty. Hence, the momentum anomaly may well be rationalized in a model of investors underreacting to fundamental news. Finally, we find that momentum works better when limited to stocks with high idiosyncratic risk, suggesting that limits to arbitrage deter rational investors from exploiting the anomaly.

Keywords: Earnings Momentum, Price Momentum, Market Efficiency, Multiple Hypotheses, Information Uncertainty

International Stock Return Predictability under Model Uncertainty

Author: Andreas Schrimpf

This paper examines return predictability when the investor is uncertain about the right state variables. A novel feature of the model averaging approach used in this paper is to account for finite-sample of the coefficients in the predictive regressions. Drawing on an extensive international dataset, we find that interest-rate related variables are usually among the most prominent predictive variables, whereas valuation ratios perform rather poorly. Yet, predictability of market excess returns weakens substantially, once model uncertainty is accounted for. We document notable differences in the degree of in-

sample and out-of-sample predictability across different stock markets.

Keywords: Stock return predictability, Empirical asset pricing, Bayesian model averaging, Model uncertainty

Panel A - Session 3: Portfolio Selection

Do Risk Attitude and Household Portfolio Diversification Match? Evidence from German Households' Portfolios

Authors: Nataliya Barasinska, Dorothea Schäfer, Andreas Stephan
Presenting Author: Nataliya Barasinska

This paper explores the relationship between the risk attitude and the diversification of assets in household portfolios. The first part examines the impact of manifested risk aversion on the total number of distinct assets held in a portfolio (naive diversification). The second part focuses on a more sophisticated strategy of diversification and asks whether financial theory is compatible with the observed diversification patterns. Based on the German Socioeconomic Panel which provides unique measures for the propensity to take risks in general and in case of investing money, the results of the regression analysis show that along with some socioeconomic characteristics the propensity of taking investment risks is an important predictor for the household's conducted diversification strategy. However, some of our findings are strongly at odds with what the concept of mean-variance utility suggests. JEL: D14, G11

Keywords: household finances, diversification, financial portfolio

Optimal Tax-Timing and Asset Allocation when Tax Rebates on Capital Losses are Limited

Author: Marcel Marekwica

This article analyzes the optimal dynamic consumption portfolio problem in the presence of capital gains taxes. It explicitly takes into account limited capital loss deduction and the 3,000 dollar amount that can be offset against other income. Constantinides (1983) shows that in tax-systems where capital gains and losses are subject to the same taxable treatment, it is optimal to realize capital losses immediately. We generalize this finding to tax-systems where limited amounts of losses can be used against other income. In such tax-systems, the investment decision becomes substantially more difficult for two reasons. First, the investor has the opportunity of offsetting limited amounts of losses

against other income. Hence, she has to make a decision on how to use a loss, i.e. whether to offset it against realized capital gains or to potentially postpone the realization of capital gains and offset it against other income. Second, because the tax rate on other income usually exceeds that on capital gains, in our setting it can be optimal to realize capital gains immediately, which prevents investors from getting locked in and helps to keep portfolios diversified.

Keywords: tax-timing, asset allocation, capital losses, tax loss carry-forward, limits on tax rebates

Wie diversifiziere ich richtig? - Eine Diskussion alternativer Asset Allocation Ansätze zur Konstruktion eines "Weltportfolios"

Authors: Heiko Jacobs, Sebastian Müller, Martin Weber
Presenting Author: Heiko Jacobs

Die vorliegende Studie evaluiert die Effizienz verschiedener Ansätze zur Vermögensallokation aus Sicht eines deutschen Privatanlegers. Neben einem erweiterten Zeitraum von 1973 bis 2007 tragen wir dabei in zweifacher Hinsicht zur Literatur bei. Erstens vergleichen wir heuristische Strategien mit wissenschaftlichen Optimierungsmodellen im Sinne von Markowitz (1952). Zweitens unterscheiden wir in der Untersuchung zwischen zwei prominenten, aber häufig getrennt voneinander analysierten Diversifikationsformen: einer geographischen Streuung des Anlagevermögens im Aktienbereich und einer Verteilung des Anlagevermögens auf verschiedene Anlageklassen. Hierzu berücksichtigen wir neben Aktien zusätzlich Renten und Rohstoffe. Die Zusammenführung dieser beiden Aspekte resultiert in der Diskussion denkbarer Aufteilungsmechanismen zur Konstruktion eines möglichst effizienten "Weltportfolios". In der empirischen Analyse erweist sich im Fall einer Diversifikation im Aktienbereich kein theoretisch fundiertes Optimierungsmodell gegenüber heuristischen Ansätzen (Gleichgewichtung, Marktkapitalisierungsgewichtung und BIP-basierte Gewichtung) als überlegen. Auch unter Einbeziehung von Renten und Rohstoffen bieten Markowitz-Optimierungsmodelle out-of-sample keine besseren Ergebnisse als heuristische, auf zeitstabilen Gewichten beruhende Ansätze, die wir aus bestehenden Empfehlungen in der Literatur ableiten. Auf Grundlage unserer Resultate schlagen wir daher einen einfach und kostengünstig zu implementierenden Ansatz zur Vermögensallokation für private Investoren vor.

Keywords: Portfoliotheorie, Asset Allocation, Investment Management, Heuristiken, Fundamentale Gewichtung

An Empirical Study on the Cost of Institutional Boundaries and Lacking Financial Sophistication in the Mutual Fund Selection Process

Authors: René Fischer, Andreas Hackethal, Steffen Meyer
Presenting Author: Steffen Meyer

This paper contributes to the growing body of literature on private investors investment mistakes in household finance. This paper takes off from the point that investors abstain from chasing alphas in selecting mutual funds, although Gruber (1996) has proven this to be a profitable strategy. He argues that reasons for this behaviour might be lack of investors" sophistication and/or institutional boundaries. Based on a survivorship bias free database of almost 3,000 mutual funds in 6 peer groups, this paper presents two main findings. Firstly, the difference between a sophisticated investor who chases past alpha performance and an unsophisticated investor who chooses a fund randomly is 2.9% p.a. expressed in alpha in the absence of institutional boundaries and 1.3% p.a. in their presence. Costs of institutional boundaries are only of economic relevance for sophisticated investors. In that case, the alpha performance is about 1.6% p.a. larger than in the presence of institutional boundaries. Secondly, we show that applying the newly proposed "Alpha Persistence Ratio" (APR) increases the annual alpha by 0.9% compared to an institutionally unbounded alpha chasing strategy.

Keywords: Cost of investment mistakes, Mutual Funds, Fund performance, Fund selection criterion

Panel A - Session 4: Regulation

Knightian Uncertainty and Insurance Regulation Decision

Authors: An Chen, Xia Su
Presenting Author: An Chen

In contrast to insurance companies, regulatory authorities or regulators can obtain only limited information about the companies' value. It hence leads to some effects on the regulation design, which is however often overlooked in the literature. This paper characterizes the limited/imperfect information as Knightian (1921) uncertainty (ambiguity). In order to stress the analytical effects of ambiguity on the regulation decisions, we firstly carry out an analysis in a standard immediate bankruptcy regulation where default and liquidation are considered as indistinguishable events. It is noticed that ambiguity-averse regulators require more ``ambiguity equity''. We show then that under ambiguity an immediate liquidation policy delivers false liquidation with a positive probability. As an illustrative example to fix the false liquidation problem under ambiguity, a new regulation rule is developed

with a regulatory auditing process. Based on this new model setup, we focus on examining how the riskiness of the firm's value and the debt ratio affect liquidation probability.

Keywords: Ambiguity, ambiguity equity, optimal regulation, default and liquidation design

Foreign listings, US equity markets, and the impact of the Sarbanes-Oxley Act

Authors: Stephan Siegel, Jefferson Duarte, Katie Kong, Lancy Young
Presenting Author: Stephan Siegel

This paper examines the effects of the Sarbanes-Oxley Act (SOX) by studying both foreign firms' decisions to list in the US and local market stock price reactions to US listing announcements. We have three main findings: First, we estimate that if SOX was a complete surprise to the market, US equity values would increase between six and eleven percent. Second, small firms do not react differently to SOX than large firms. Third, minority investors place greater value on the increased manager accountability imposed by SOX than on the costs associated with the increased accountability. In summary, we find no evidence that SOX impose substantial costs on US listed firms.

Keywords: Sarbanes-Oxley; International Listings

To Use or Not To Use - An Empirical Study of Visible Reserves in Bank Accounting in the Light of Regulatory Requirements and Informational Asymmetries

Authors: Sven Bornemann, Susanne Homölle, Carsten Hubensack, Andreas Pfingsten
Presenting Author: Sven Bornemann

The German Commercial Code (’HGB’) allows banks to build visible reserves for general banking risks according to para. 340g HGB. Setting aside these ’GBR-reserves’, in addition to their risk provisioning function, may also be used for enhancing capital endowment, internal financing or earnings management purposes. We analyze German banks’ financial statements for the period from 1993 through 2005 to reveal bank type specific patterns in using GBR-reserves. Our empirical investigation is based on a large, unbalanced panel of German banks including 22,080 observations. We explain our findings by regulatory reasons and existing information asymmetries as well as by the legal status and the ownership structure of the banks. We see (1) the use of

GBR-reserves increasing over time. Furthermore, we can say that GBR-reserves are primarily used by (2) large banks, (3) public banks, (4) banks reporting according to IAS/IFRS, and (5) banks with comparatively low regulatory capital endowment. Moreover, our results show that (6) predominantly banks which are not thrifts and cooperatives are making use of GBR-reserves, and (7) that GBR-reserves are used for earnings management purposes.

Keywords: Bank accounting, bank regulation, earnings management, risk provisioning, visible reserves

Looting and Gambling in Banking Crises

Authors: Hendrik Hakenes, John H. Boyd
Presenting Author: Hendrik Hakenes

We construct a model of the banking firm and use it to study bank behavior and bank regulatory policy during crises. In our model, during a crisis a bank can increase the risk of its asset portfolio ("risk shift"), convert bank assets to the personal benefit of the bank manager ("loot"), or do both. Each action is socially costly. To mitigate such actions, a regulator has three policy tools: it can impose a penalty on risk-shifting; it can impose a penalty on looting; and it can force banks to hold more equity capital. All policies must be implemented before anyone knows if there will be a crisis. Our paper contains three important policy lessons. First, enforcing property rights and punishing theft is the policy that works best and has the fewest side effects. Second, trying to prohibit the bank manager from taking risk may backfire, he may switch to even riskier strategies. Third, there is a conflict of interest between inside and outside equity; outside equity induces looting.

Keywords: Looting, tunneling, gambling, risk shifting

Panel A - Session 5: Corporate Finance 1

Political Connections and the Allocation of Procurement Contracts

Authors: Jörg Rocholl, Eitan Goldman, Jongil So
Presenting Author: Jörg Rocholl

This paper analyzes whether political connections of public corporations in the United States affect the allocation of government procurement contracts. The paper classifies the political affiliation of S&P 500 companies using hand-collected data that detail the past political position of each of their board members. Using this classification, the study

focuses on the change in control of both House and Senate following the 1994 midterm election and on the change in the Presidency following the 2000 election. An analysis of the change in the value of the procurement contracts awarded to these companies before and after 1994 and 2000, respectively, indicates that companies that are connected to the winning (losing) party are significantly more likely to experience an increase (decrease) in procurement contracts. The results remain significant after controlling for industry classifications as well as for several firm characteristics. In total, these findings suggest that the allocation of procurement contracts is influenced, at least in part, by political connections. Thus, our study provides one of the first pieces of evidence showing a direct avenue through which political connections add value to U.S. companies.

Keywords: Politics, Corporate Governance, Boards, Procurement Contracts

Fairness Opinions and Capital Markets: Evidence from Germany, Switzerland and Austria

Authors: Sebastian Lobe, Nils-Christian Schenk
Presenting Author: Sebastian Lobe

In this paper, we provide the first empirical evidence of fairness opinions in Europe. Legal requirements concerning the use of fairness opinions in mergers and acquisitions are significantly different in Germany, Switzerland, and Austria. We examine the determinants of target fairness opinions in these various regulatory settings and, moreover, investigate the impact of such opinions on abnormal target returns. Whilst in Germany and Austria market participants do not deem fairness opinions important, they do create value for shareholders in Switzerland. Because conflicts of interest between target board and bidder are a main determinant of fairness opinions in Switzerland, we conclude that, when target management faces such conflict, external expert advice replaces the board's opinion on the offer.

Keywords: Fairness opinions, mergers and acquisitions, target board, abnormal returns

Economic Consequences of Private Equity Investments on the German Stock Market

Authors: Ann-Kristin Achleitner, Christian Andres, André Betzer, Charlie Weir
Presenting Author: André Betzer

This paper investigates the wealth effects of private equity (PE) investor purchases of shares in German quoted companies. It is the first study to analyze these effects for the German market which is particularly interesting due to its distinct characteristics with regard to the ownership structure of publicly listed companies and the protection of minority shareholders. We find that PE investors generate positive wealth effects for target shareholders of 5.66% around the event day (t-1 to t0). In addition, we find that the wealth effects of PE investor involvement in Germany are positively related to the target's tax liabilities and degree of undervaluation and negatively related to the target's leverage and the shareholding of the second largest ownership block. The latter effect can be interpreted as a supplementary monitoring effect of the management or a monitoring effect of the largest shareholder through which private benefits of control are reduced. We find no evidence that PE investors adversely affect employment or wages in target companies.

Keywords: Private Equity, Corporate Governance, Agency Theory, Event Study

Evolution of Family Capitalism: A Comparative Study of France, Germany, Italy and the UK

Authors: Julian Franks, Colin Mayer, Paolo Volpin, Hannes Wagner
Presenting Author: Hannes Wagner

This paper analyzes the trade-off between family control and dispersed ownership along three dimensions. First, we emphasize the dynamic aspect of the trade-off by focusing on the evolution of ownership over time comparing 1996 with 2006. This enables us to study the stability of control as well as the frequency of changes of control. Second, we analyze ownership across countries (France, Germany, Italy and the UK) and compare outsider versus insider systems. Third, we examine how the trade-off applies to publicly traded firms on the one hand and to private firms on the other. We find that family control is less common in outsider than in insider systems not only among listed companies, which is well known, but also among private companies. Our explanation is that younger family firms in outsider systems are more inclined to sell out than in insider systems and this is reflected in the negative correlation between firm age and family ownership in outsider systems. Over the last decade family ownership has declined significantly in Continental Europe with a corresponding rise in widely held firms, as these countries have come to share more of the characteristics of outsider systems.

Keywords: ownership, family firms, evolution, cross-country study

3.2. Friday, October 10th: 14:00 – 15:30

Panel B - Session 1: Derivatives 2

Expected Option Returns and the Structure of Jump Risk Premia

Authors: Nicole Branger, Alexandra Hansis, Christian Schlag
Presenting Author: Alexandra Hansis

The paper analyzes expected option returns in a model with stochastic volatility and jumps. A comparison with empirically documented returns shows that the ability of the model to explain these returns can differ significantly depending on the holding period and depending on whether we consider call or put options. Furthermore, we show that the size of the jump risk premium and its decomposition into a premium for jump intensity risk, jump size risk, and jump variance risk has a significant impact on expected option returns. In particular, expected returns on OTM calls can even become negative if e.g. jump variance risk is priced.

Keywords: option returns, put puzzle, jump risk premia, volatility risk premium

Pricing and Risk Management of Relax Certificates

Authors: Nicole Branger, Antje Mahayni, Judith Schneider
Presenting Author: Judith Schneider

Relax certificates are written on several underlying stocks. Their payoffs are initially equal to those of a coupon bond with a quite attractive coupon rate, which are, however, canceled and replaced by the worst-performing stock in case any of the underlying stocks loses a usually rather high fraction of its initial value. We analyze the pricing and risk management of these contracts, which can be decomposed into a knock-out bond component and a knock-in minimum option. First, we show that the prices of relax certificates are decreasing in the number of underlying stocks and in the volatilities of these stocks, while they increase in the correlation between the stocks. The price discount due to the knock-out feature is significant. Thus, even if the losses in any of the underlyings have to be very high for the investor to receive the worst-performing stock instead of a repayment of the notional, this risk cannot be neglected. Second, we derive upper price bounds for relax certificates. These upper price bounds also give superhedging strategies the issuer of relax certificates can use to hedge his position without being exposed to the risk of the delta-hedging strategy becoming unstable when the lower barrier is approached.

Keywords: Certificates, Exchange Option, Minimum Option, Correlation Structure, Model Risk

Market Pricing of Exotic Structured Products: The Case of Multi-Asset Barrier Reverse Convertibles in Switzerland

Authors: Martin Wallmeier, Martin Diethelm
Presenting Author: Martin Wallmeier

The market for structured financial products in Switzerland is considered the largest in the world. Its most successful products are multi-asset reverse convertibles with knock-in barriers. We analyze whether these complex instruments are fairly priced. Using a numerical, tree-based valuation method, we obtain an average overpricing of at least 3.4% for 468 certificates outstanding in April 2007. This premium on the entire product corresponds to a price discount of 29% on its embedded short put. The overpricing is positively related to the coupon level, indicating that investors tend to overweight the sure coupon and underestimate the risk involved. This behavioral bias appears to be important in explaining the success of the product.

Keywords: Structured Products, Reverse Convertibles, Multi-Asset Options, Barrier Options, Financial Engineering

Panel B - Session 2: Financial Products

Optimal Design of Rating-Trigger Step-Up Bonds: Agency Conflicts Versus Asymmetric Information

Authors: Christian Koziol, Jochen Lawrenz
Presenting Author: TBA

In this paper, we analyze corporate bonds with a rating-triggered step-up provision in a continuous-time framework with bankruptcy costs and tax benefits. While without any further frictions, step-up bonds do not add firm value relative to straight debt, agency conflicts and asymmetric information are two possible explanations for the issuance of these instruments. We treat both motives (separately) in a unified framework to obtain conclusions about both the optimal design and the conditions for the use of step-up bonds. The closed-form solutions for the optimal contract design reveal that step-up bonds issued by firms that face a risk-shifting problem fundamentally differ from those in the case of asymmetric information. Furthermore, we show that firms with a high initial risk only use step-up bonds to overcome problems of asymmetric

information but not to mitigate risk-shifting problems. A further difference between the two motives is that in the case of risk-shifting, step-up bonds are only used when the agency conflict is sufficiently severe, while for signalling reasons even a modest problem of asymmetric information supports the use of step-up bonds.

Keywords: Asset substitution/risk incentive problem, signalling, tradeoff theory, optimal capital structure, continuous-time finance

Why are British Premium Bonds so successful? The effect of saving with a thrill

Authors: Sebastian Lobe, Alexander Hölzl
Presenting Author: Sebastian Lobe

The British Premium Bond, which offers a monthly uncertain return solely based on a lottery, is an immense success. Why? We find that the bond bears relatively low risk in terms of CARA and CRRA utility. Since prizes are tax-free, the higher an individual’s tax bracket, the more it pays to invest in the lottery bond. However, we demonstrate that the CARA and CRRA coefficients (before and after taxes) do not directly influence sales of the Premium Bond. Rather, our ARIMA model strongly suggests that prize skewness and the maximum holding amount are the salient influencing factors.

Keywords: Premium Bond, lottery bond, risk tolerance, skewness

The Impact of an Interest Rate Freeze on Residential Mortgage Backed Securities

Authors: Julia Hein, Thomas Weber
Presenting Author: Julia Hein

This paper analyses the effect of an interest rate freeze in subprime mortgages on residential mortgage backed securities (RMBS). In particular we study shifts in the portfolio's repayment distributions as well as changes in the payment profile of RMBS-tranches. We show that the positive effects of a rate freeze, e.g. less foreclosures and a stabilizing housing market, can outweigh the negative effect of lower interest income such that investors might be better off.

Keywords: Interest Rate Freeze, Subprime Mortgages, Residential Mortgage Backed Securities (RMBS)

Panel B - Session 3: Retirement Savings 1

<u>*Annuitization and Retirement Timing Decisions*</u>

Author: Zhen Shi

This paper analyzes retirement timing decisions of DC (Defined Contribution) pension plan members. In this paper the optimal annuitization timing decision is incorporated into the retirement timing decision. I first develop a retirement decision model and generate a forward looking retirement likelihood measure from this model. This measure describes the probability that an individual will retire within the next few years. In the model, the individual obtains utility from leisure, labor income before retirement and pension benefit after retirement. The DC pension benefit is the income from the annuity which is bought at the optimal time. The retirement likelihood measure is then tested with the English Longitudinal Study of Ageing (ELSA) data. From investigating the retirement decisions of the sample members in the second wave of ELSA, I conclude that the retirement likelihood measure is a good predictor of actual retirement decisions.

Keywords: Retirement, Annuitization, Optimal Stopping Time

<u>*Asset Allocation and Location over the Life Cycle with Survival-Contingent Payouts*</u>

Authors:Wolfram J. Horneff, Raimond H. Maurer, Olivia S. Mitchell, Michael Z. Stamos
Presenting Author: Raimond H. Maurer

This paper shows how lifelong survival-contingent payouts can enhance investor wellbeing in the context of a portfolio choice model which integrates uninsurable labor income and asymmetric mortality expectations. Our model generates optimal asset location patterns indicating how much to hold in liquid versus illiquid survival-contingent payouts over the lifetime, and also asset allocation paths, showing how to invest in stocks versus bonds. We confirm that the investor will gradually move money out of her liquid saving into survival-contingent assets to retirement and beyond, thereby enhancing her welfare by as much as 50 percent. The results are also robust to the introduction of uninsurable consumption shocks in housing expenses, income fl ows during the worklife and retirement, sudden changes in health status, and medical expenses.

Keywords: Retirement Savings

How Deep is the Annuity Market Participation Puzzle?

Authors: Joachim Inkmann, Paula Lopes, Alexander Michaelides
Presenting Author: Joachim Inkmann

Using U.K. microeconomic data, we analyze the empirical determinants of voluntary annuity market demand. We find that annuity market participation increases with financial wealth, life expectancy and education and decreases with other pension income and a possible bequest motive for surviving spouses. We then show that these empirically-motivated determinants of annuity market participation have the same, quantitatively important, effects in a life-cycle model of annuity demand, saving and portfolio choice. Moreover, reasonable preference parameters predict annuity demand levels comparable to the data, thereby questioning the conventional wisdom that limited annuity market participation is a puzzle to be explained.

Keywords: Annuities, portfolio choice, bequest motive

Panel B - Session 4: Banking 1

Emergence of Financial Intermediaries on Electronic Markets: The Case of Online P2P Lending

Authors: Fabian Gleisner, Sven Berger
Presenting Author: Fabian Gleisner

We analyze the role of intermediaries on electronic markets using detailed data of more than 14,000 originated loans on an electronic P2P (person-to-person) lending platform. On such an electronic credit market lenders bid for supplying a private loan. Screening of potential borrowers and the monitoring of loan repayment can be delegated to designated group leaders. We find that these market participants act as financial intermediaries and significantly improve borrowers' credit conditions. As suggested by traditional intermediation theory (e.g. Diamond 1984; Leland and Pyle 1976), the intermediary creates value by reducing information asymmetries between borrowers and lenders. Our findings are robust to self-selection and characteristics of the financial transactions, and may be surprising given the long discussion on disintermediation due to electronic marketplaces.

Keywords: Asymmetric information, Intermediation, Social lending, Electronic markets

Credit Risk Transfer in Banking Markets with Hard and Soft Information

Authors: Isabel Schnabel, Hendrik Hakenes
Presenting Author: Isabel Schnabel

We consider a banking model in which firms' access to credit is constrained due to the banks' limited risk-bearing capacities. We show that such constraints may be relaxed by allowing banks to transfer risks to outside investors. However, the market for credit risk transfer (CRT) works smoothly only if loans are based on hard, i. e., verifiable information. In contrast, the market for CRT either breaks down or operates at a comparably low scale for soft-information loans. The reason is that banks have an incentive to grant loans with negative NPV and transfer the risks to other parties, which leads to a lemons premium for CRT. In contrast to the hard-information case, the access to finance in the economy improves only slightly, but aggregate risk increases.

Keywords: Credit risk transfer, credit derivatives, hard and soft information, access to credit, bank competition

The relation between borrower risk and loan maturity in small business lending

Authors: Karolin Kirschenmann, Lars Norden
Presenting Author: Karolin Kirschenmann

Debt maturity is an important element in financial contracting that ultimately affects the borrower's financial flexibility and financing costs. We investigate the relation between borrower risk and loan maturity in small business lending which represents a well-suited institutional environment to study financial contracting under asymmetric information. Analyzing data on new loan approvals and renewals made by a German bank in 2005, we find a robust, significantly positive and monotonic risk-maturity relation. This relation is stronger for loans granted under relatively high asymmetric information and weaker if borrower bargaining power is high. Our results are consistent with theoretical models on adverse selection and the view that relationship lenders concede favorable loan terms to those borrowers that are most likely to need a "helping hand".

Keywords: Relationship lending, Debt maturity, Asymmetric information, Bargaining power

Panel B - Session 5: Market Microstructure 1

<u>A Dynamic Limit Order Market with Diversity in Trading Horizons</u>

Author: Mark Van Achter

This paper considers a trading game in which sequentially arriving liquidity traders either opt for a market order or for a limit order. One class of traders is considered to have an extended trading horizon, implying their impatience is linked to their trading orientation. More specifically, sellers are considered to have a trading horizon of two periods, whereas buyers only have a single-period trading scope (the extended buyer-horizon case is completely symmetric). Clearly, as the life span of their submitted limit orders is longer, this setting implies sellers are granted a natural advantage in supplying liquidity. This benefit is hampered, however, by the direct competition arising between consecutively arriving sellers. Closed-form characterizations for the order submission strategies are obtained when solving for the equilibrium of this dynamic game. These allow to examine how these forces affect traders' order placement decisions. Further, the analysis yields insight into the dynamic process of price formation and into the market clearing process of a non-intermediated, order driven market.

Keywords: Order Placement Strategy, Order Flow

<u>The Impact of Hidden Liquidity in Limit Order Books</u>

Authors: Stefan Frey, Patrik Sandas
Presenting Author: Stefan Frey

We report evidence that the presence of hidden liquidity is associated with greater liquidity in the order books, greater trading volume, and smaller price impact. Limit and market order submission behavior changes when hidden liquidity is present consistent with at least some traders being able to detect hidden liquidity. We estimate a model of liquidity provision that allows us to measure variations in the marginal and total payoffs from liquidity provision in states with and without hidden liquidity. We measure the expected surplus to providers of visible and hidden liquidity and show that often the surplus for both types is positive. We approximate the difference in the surplus of liquidity demanders in order books with visible and hidden liquidity. Our results suggest that collectively, the liquidity providers and demanders, may obtain a higher expected surplus when there is hidden liquidity in the order books. The magnitude of the estimated gain is between 25 and 35% of the quoted bid-ask spreads per trade. We interpret our results as evidence that a less than fully transparent limit order book may enhance

the welfare of all market participants.

Keywords: Hidden Liquidity, Iceberg Orders, Limit Order Markets, Limit Order Books, Liquidity Provision

Liquidation in the Face of Adversity: Stealth Vs. Sunshine Trading, Predatory Trading Vs. Liquidity Provision

Authors: Torsten Schöneborn, Alexander Schied
Presenting Author: Torsten Schöneborn

We consider a multi-player situation in an illiquid market in which one player tries to liquidate a large portfolio in a short time span, while some competitors know of the seller's intention and try to make a profit by trading in this market over a longer time horizon. We show that the liquidity characteristics, the number of competitors in the market and their trading time horizons determine the optimal strategy for the competitors: they either provide liquidity to the seller, or they prey on her by simultaneous selling. Depending on the expected competitor behavior, it might be sensible for the seller to pre-announce a trading intention ("sunshine trading") or to keep it secret ("stealth trading").

3.3. Friday, October 10th: 16:00 – 17:30

Panel C - Session 1: Derivatives 3

Hedging (Co)Variance Risk with Variance Swaps

Authors: Jose Da Fonseca, Martino Grasselli, Florian Ielpo
Presenting Author: Jose Da Fonseca

In this paper we introduce a new criterion in order to measure the variance and covariance risks in financial markets. Unlike past literature, we quantify the (co)variance risk by comparing the spread between the initial wealths required to obtain the same final utility in an incomplete and completed market case. We provide explicit solutions for both cases in a stochastic correlation framework where the market is completed by introducing volatility products, namely Variance Swaps. Using real data on major indexes, we find that this criterion provides a better measure of the market risks with respect to the (misleading) traditional approach based on the hedging demand.

Keywords: Wishart Affine Stochastic Correlation model, complete and incomplete markets, variance swaps, optimal portfolio choice

The Optimal Demand for Retail Derivativies

Authors: Nicole Branger, Beate Breuer
Presenting Author: Beate Breuer

It has been shown that investors can benefit from including derivatives into their portfolios. For retail investors, however, a direct investment in derivatives is often too complicated. Investment certificates offer a potential solution to this problem and may help the investor to come closer to a complete market. We analyze if retail investors who buy and hold their portfolio for one year can indeed benefit from an investment in these certificates. We use a model with stochastic volatility and jumps calibrated to the German stock market index DAX. We find that the benefit of investing in typical retail products is equivalent to an annualized risk-free excess return of at most 35 basis points for a CRRA investor with a low risk aversion. If we take transaction costs into account, this number reduces to at most 14 bp. In terms of the types of contracts, we find that discount certificates perform best, while more sophisticated certificates, in particular those with knock-in or knock-out features, should often not be held by investors at all. Therefore, standard preferences cannot explain the large observed demand for investment certificates.

Keywords: Asset Allocation, Risk Premia, Structured Products

The dark side of the moon: structured products from the customer's perspective

Authors: Thorsten Hens, Marc Oliver Rieger
Presenting Author: Marc Oliver Rieger

Structured financial products have gained more and more popularity in recent years, but nevertheless has their success so far not thoroughly been analyzed. In this article we develop a theoretical framework for the design of optimal structured products and analyze the maximal utility gain for an investor that can be achieved by introducing structured products. We demonstrate that most successful structured products are not optimal for a perfectly rational investor and investigate the reasons that make them nevertheless look so attractive for many investors.

Keywords: Structured financial products, behavioral finance, capital asset pricing model.

Panel C - Session 2: Asset Valuation 1

Extended Dividend, Cash Flow and Residual Income Valuation Models - Accounting for Deviations from Ideal Conditions

Authors: Dieter Hess, Carsten Homburg, Michael Lorenz, Soenke Sievers
Presenting Author: Dieter Hess

Standard equity valuation approaches (i.e. DDM, DCF, and RIM) are based on restrictive assumptions regarding the availability and quality of payoff data. Therefore, we provide extensions of the standard approaches being suitable under less than ideal conditions (e.g. dirty surplus accounting and inconsistent steady state growth rates). Empirically, our extended models yield considerably smaller valuation errors, suggesting that markets are aware of the standard models' deficiencies. Moreover, obtaining identical value estimates across the extended models, our approach provides a benchmark implementation. This allows to quantify the magnitude of errors resulting from individual violations of ideal conditions.

Keywords: Dividend Discount Model, Residual Income Model, Discounted Cash Flow Model, Ideal Conditions, Dirty Surplus, Terminal Value, Steady State, Valuation Error

Vice vs. Virtue Investing

Authors: Sebastian Lobe, Stefan Roithmeier
Presenting Author: Sebastian Lobe

Whether virtue investing yields abnormal positive stock returns, has been under scrutiny for years. Academic findings on socially responsible investing (SRI) reveal heterogeneous results for the performance of SRI indices. However, recent research indicates an outperformance of sin stocks. Can investors then better their performance by incorporating virtue or vice screens into their investment process? Answering this question is the key contribution of our paper. Extending prior studies on sin investment, we find that publicly traded companies involved in the alcohol, gambling, tobacco, sex, arms and nuclear power industry are able to generate abnormal returns. Employing a self-constructed worldwide index of more than 700 unethical firms, we provide evidence that the risk-return characteristics of sin stocks are superior in comparison to regular stocks as well as socially responsible stocks.

Keywords: Socially responsible investing, Sin stocks, financial markets, indices

Why Managers Hold Shares of Their Firms: An Empirical Analysis

Authors: Stefan Ruenzi, Ulf von Lilienfeld-Toal
Presenting Author: Stefan Ruenzi

We examine the relationship between CEO ownership and stock market performance. Firms in which the CEO voluntarily holds a considerable share of outstanding stocks outperform the market by more than 10 percent p.a. after controlling for traditional risk factors. The effect is most pronounced in firms that are characterized by large managerial discretion of the CEO. The abnormal returns we document are one potential explanation why so many CEOs hold a large fraction of their own company’s stocks. We also examine several potential explanations why the existence of an owner CEO is not fully reflected in prices but leads to abnormal returns.

Keywords: Asset Valuation, Corporate Finance, Empirical Finance, Theory of Capital Markets

Panel C - Session 3: Retirement Savings 2

The Evolution of Aggregate Stock Ownership-A Unified Explanation

Author: Kristian Rydqvist

Since World War II, the fraction of stocks owned directly by households has decreased by more than 40 percentage points in the United States, the United Kingdom, Sweden, and Finland, and by more than 20 percentage points in Canada, Japan, Germany, and France. We argue that tax policy is the driving force. Using data from eight countries, we show that tax-favored investors have replaced households as stockholders and that the fraction of household ownership decreases with measures of the effective marginal tax rate. These findings are important for policy considerations on effective taxation and for financial economics research on the long-term effects of taxation on corporate finance and asset prices.

Keywords: Tax incidence, tax clienteles, stock ownership

Pension Liability Valuation and Asset Allocation in the Presence of Funding Risk

Authors: Joachim Inkmann, David Blake
Presenting Author: Joachim Inkmann

Defined benefit pension liabilities are usually computed by discounting future pension promises with yields of risk-free or AA-rated bonds. We argue that a pension plan in financial distress should use discount rates that reflect the inherent funding risk. We propose a new valuation approach that utilizes the term structure of funding-risk-adjusted discount rates. These discount rates depend on the current asset allocation of the pension plan which affects future funding ratios. We show that an optimal asset allocation which accounts for this dependency varies in a nonlinear way with the initial funding ratio of the pension plan.

Keywords: pension plan, liability valuation, asset allocation, funding risk

Optimal Life-Cycle Strategies in the Presence of Interest Rate and Inflation Risk

Authors: Raimond Maurer, Christian Schlag, Michael Z. Stamos
Presenting Author: Raimond Maurer

The worldwide shift from public pay-as-you-go pension systems to privately funded pension schemes is accompanied by a huge increase in

the households capital stock mounting to trillions of dollars worldwide which pour into defined contribution pension plans. In order to assess how these funds should be optimally invested, we derive the optimal time-dependent portfolio allocation strategy taking into account long-term stock market, term structure, and inflation risk. Our results confirm that the often advised so-called life-cycle strategy is optimal if non-financial wealth is taken into account. We also benchmark common long-term defined contribution asset allocation strategies relative to the optimum in order to the assess welfare implications for varying investment horizons and risk aversions. The outcome of utility heavily depends on whether the risk aversion of the investor is estimated appropriately. Misestimation of this parameter and hence wrong investment advice can lead to utility losses of around 60 percent in terms of certainty equivalent wealth.

Keywords: Optimal Portfolio Choice, Life-Cycle Asset Allocation, Defined Contribution Plans

Panel C - Session 4: Banking 2

Market Discipline at German savings banks

Authors: Andreas Pfingsten, Norbert Sträter, Daniel Wissing
Presenting Author: Daniel Wissing

Several theoretical studies suggest that only uninsured depositors have an incentive to discipline their banks, i.e. react with changes in deposit volumes or in required interest rates as a reaction to changes in banks' risk. This paper empirically investigates whether German savings banks are disciplined by their depositors although should be regarded as fully insured due to public guarantees. Using accounting data for the years 1998 through 2005 we analyze whether the withdrawal behavior and the required risk premia change as predicted by the theory. We find that insured depositors, too, discipline banks by demanding higher interest rates and to a moderate extent by withdrawing their deposits. Thus, depositors apparently exert market discipline even when they are fully insured against losses.

Keywords: Banking regulation, market discipline, deposit insurance, savings banks, Germany

How Politics influence State-owned Banks - the Case of German Savings Banks

Author: Oliver Vins

This paper is one of the first to analyse political influence on state-owned savings banks in a developed country with an established financial market: Germany. Combining a large dataset with financial and operating figures of all 457 German savings banks from 1994 to 2006 and information on over 1,250 local elections during this period we investigate the change in business behavior around elections. We find strong indications for political influence: the probability that savings banks close branches, lay-off employees or engage in merger activities is significantly reduced around elections. At the same time they tend to increase their extraordinary spendings, which include support for social and cultural events in the area, on average by over 15 %. Finally, we find that savings banks extend significantly more loans to their corporate and private customers in the run-up to an election. In further analyses, we show that the magnitude of political influence depends on bank specific, economical and political circumstances in the city or county: political influence seems to be facilitated by weak political majorities and profitable banks. Banks in weak areas seem to be less prone to political influence.

Keywords: savings banks, political influence, government-owned banks, corporate governance, political economy, state-owned enterprises, electoral cycle

Liberalization, Corporate Governance, and Savings Banks

Authors: Manuel Illueca, Lars Norden, Gregory F. Udell
Presenting Author: Lars Norden

We study the effects of the interplay between banking deregulation and corporate governance on the lending behavior of savings banks in Spain. The removal of branching barriers that constrained these banks has led to a nationwide expansion, increasing the number of their branches and their commercial lending volume dramatically. Analyzing a unique data set combining information on the geographic distribution of bank branches and matched lender-borrower financial statements during 1996-2004, we provide evidence that suggests that the governance of those banks affects the way in which they expand their lending activities. In particular, political influence affects where they expand and their ex ante risk taking behavior. Because most countries have a portion of their banking system that is not privately owned, the behavior of these Spanish savings banks may have broader implications about the impact of global banking deregulation and industry consolidation and their interaction with bank governance.

Keywords: Deregulation, Bank lending, Bank branching, Geographic expansion, Distance

Panel C - Session 5: Market Microstructure 2

Learning from counterparties' order flow in electronic trading

Authors: Lukas Menkhoff, Maik Schmeling
Presenting Author: Maik Schmeling

This paper shows how traders learn from each other in a currency limit order market. We find that traders react on the revelation of counterparty identity after the trade by reversing their order flow in line with the better informed. This result holds when controlling for proxies of other private and public information. Moreover, we find that informed traders process infor-mation differently from uninformed. Informed focus more on public information, whereas uninformed amplify price discovery by learning from the informed.

Keywords: market microstructure, informed trading, trader size, foreign exchange

The Risk Microstructure of Corporate Bonds: A Bayesian Analysis of the German Corporate Bond Market

Authors: Leopold Sögner, Manfred Frühwirth, Paul Schneider
Presenting Author: Leopold Sögner

This article presents joint econometric analysis of interest rate risk, issuer-specific risk (credit risk) and bond-specific risk (liquidity risk) in a reduced-form framework. Although our model includes correlation between interest rate risk and issuer-specific risk, it allows sequential estimation of the risk-free term structure parameters and the issuer-specific as well as bond-specific components. Within the Bayesian framework we develop a methodology to estimate the model parameters and to separate the different components of risk. Via Markov Chain Monte Carlo methods and data augmentation we infer a risk-free term structure process from swap market data and, based on these estimates, estimate issuer-specific and bond-specific risk from corporate bond data in the German market. We find that bond-specific risk plays a crucial role in the pricing of corporate bonds. As regards issuer-specific risk, we find a strong impact of time, the (level and slope of the) risk-free term structure, the KMV distance to default and the lagged component and only a weak impact of the stock market variables (stock market index changes, returns of this particular stock, stock market volatility) on the issuer-specific component while there is no impact of the debt to value ratio. As regards bond-specific risk, we observe a strong impact of level and slope of the risk-free term structure and the lagged terms as well as a weak impact of the stock market variables and the distance to default on

the bond-specific component without any impact of time or debt to value ratio. Among the bonds analyzed we observe large differences between the relative influence of issuer-specific vs. bond-specific spread and its volatility.

Keywords: Credit risk, Liquidity risk, MCMC

Price Dispersion in OTC Markets: A New Measure of Liquidity

Authors: Rainer Jankowitsch, Amrut Nashikkar, Marti G. Subrahmanyam
Presenting Author: Rainer Jankowitsch

In this paper, we model price dispersion effects in over-the-counter (OTC) markets to show that in the presence of inventory risk for dealers and search costs for investors, traded prices may deviate from the expected market valuation of an asset. We interpret this deviation as a liquidity effect and develop a new liquidity measure quantifying the price dispersion in the context of the US corporate bond market. This market offers a unique opportunity to study liquidity effects since, from October 2004 onwards, all OTC transactions in this market have to be reported to a common database known as the Trade Reporting and Compliance Engine (TRACE). Furthermore, market-wide average price quotes are available from Markit Group Limited, a financial information provider. Thus, it is possible, for the first time, to directly observe deviations between transaction prices and the expected market valuation of securities. We quantify and analyze our new liquidity measure for this market and find significant price dispersion effects that cannot be simply captured by bid-ask spreads. We show that our new measure is indeed related to liquidity by regressing it on commonly-used liquidity proxies and find a strong relation between our proposed liquidity measure and bond characteristics, as well as trading activity variables. Furthermore, we evaluate the reliability of end-of-day marks that traders use to value their positions. Our evidence suggests that the price deviations are significantly larger and more volatile than previously assumed. Overall, the results presented here improve our understanding of the drivers of liquidity and are important for many applications in OTC markets, in general.

Keywords: liquidity, corporate bonds, market microstructure, OTC markets

3.4. Saturday, October 11th: 09:00 – 10:30

Panel D - Session 1: Risk

Why do firms hedge selectively? Evidence from the gold mining industry

Authors: Tim Adam, Chitru Fernando, Jesus Salas
Presenting Author: Tim Adam

We study the selective hedging puzzle, using quarterly data on the derivatives transactions of a sample of North American gold mining firms. We find that smaller firms speculate more than larger firms, contrary to the hypothesis that larger firms are more likely to possess an information advantage relative to smaller firms and hence should be more likely to speculate. We also find that the extent of selective hedging increases as the probability of bankruptcy (as measured by Altman's Z-score) rises. Our findings on the relation between managerial incentives and selective hedging provide no support for – indeed contradict – the possibility that managers may be speculating in their own self interest. We find that rewarding managers through common stock and stock options, and also insider ownership of the firm's shares, actually work to reduce corporate speculation.

Keywords: Corporate risk management; selective hedging; speculation; managerial compensation; bankruptcy

Robust Recovery Risk Hedging: Only the First Moment Matters

Authors: Siegfried Trautmann, Monika Müller
Presenting Author: TBA

Credit derivatives are subject to at least two sources of risk: the default time and the recovery payment. This paper examines the impact of modeling the recovery payment on hedging strategies in a reduced-form model as well as a Merton-type model. We show that quadratic hedging approaches do only depend on the *expected* recovery payment at default and not the whole shape of the recovery payment distribution. This justifies assuming a _certain_ recovery payment conditional on the default time. Hence, this result allows a simplified modeling of credit risk.

Keywords: Credit Risk, Recovery Risk, Hedging

Incorporating the Dynamics of Leverage into Default Prediction

Authors: Gunter Löffler, Alina Maurer
Presenting Author: Alina Maurer

A firm's current leverage ratio is one of the core characteristics of credit quality used in statistical default prediction models. Based on the capital structure literature which shows that leverage is mean reverting to a target leverage we forecast future leverage ratios and include them in the set of default risk drivers. The analysis is done with a discrete duration model. Out-of-sample analysis of default events two to five years ahead reveals that the discriminating power of the duration model increases substantially when leverage forecasts are included. We further document that credit ratings contain information beyond the one contained in standard variables but that this information is unrelated to forecasts of leverage ratios.

Keywords: Default prediction, discrete duration model, leverage targeting, mean reversion

Panel D - Session 2: Asset Pricing

The Conditional Relation between Fama-French Betas and Return

Authors: Stefan Koch, Christian Westheide
Presenting Author: Christian Westheide

Although the CAPM has been empirically rejected, many previous papers find a conditional relation between market beta and return. In this study, we apply the conditional approach to the predominant model in asset pricing, the Fama-French three-factor model. Our results reveal that the size and book-to-market betas retain their explanatory power once the conditional nature of the relation between betas and return is taken into account. While other papers stop their analysis at this point, we derive a procedure to test if beta risk is priced within the conditional approach and show that the adjusted test leads to qualitatively identical results to the widely used Fama-MacBeth test.

Keywords: Empirical Asset Pricing, Beta Risk, Fama-French, Asymmetric Risk, Bootstrap

Long-Horizon Consumption Risk and the Cross-Section of Expected Returns: A Cross-Country Perspective

Authors: Joachim Grammig, Andreas Schrimpf, Michael Schuppli
Presenting Author: Michael Schuppli

This paper investigates the explanatory power of the long-horizon Consumption CAPM (LH-CCAPM) for explaining size and value premia in major international stock markets (US, UK and Germany). We modify the estimation approach by Parker and Julliard (2005) taking commonalities in size and book-to-market sorted portfolios into account. Our findings suggest that the long-horizon CCAPM typically delivers more plausible estimates (i.e. lower estimates of risk aversion) than the standard CCAPM. However, contrary to the results by Parker and Julliard, we find that the model falls short of providing an accurate description of the cross-section of returns under our modified empirical approach. This result holds true for all stock markets considered.

Keywords: Consumption-based Asset Pricing, Long-Run Consumption Risk, Value Puzzle, International Stock Markets

Consumption-Based Asset Pricing: Durable Goods, Adjustment Costs, and Aggregation

Author: Stephan Siegel

In this paper, we investigate the implications of non-separable preferences over durable and nondurable consumption for asset pricing tests when adjusting durable consumption is costly. In an economy without adjustment costs, in which a frictionless rental market exists for the durable good, the standard Euler equation with respect to nondurable consumption will hold for each individual agent as well as for aggregate data. If the adjustment of the durable good is costly, however, aggregation generally fails. We use aggregate data to find substantial deviations from the frictionless model, consistent with the presence of non-convex adjustment costs for the durable good. We also show how empirical asset pricing tests that use aggregate data can be affected by these deviations. We then propose and implement asset pricing tests that are robust to the presence of adjustment costs by relying on microeconomic data. Using household-level observations of nondurable food and durable housing consumption, our estimation results suggest that preferences are indeed non-separable in the two consumption goods and that reasonable structural parameters characterize agents' intertemporal utility optimizations.

Keywords: Consumption Based Asset Pricing

Panel D - Session 3: Behavioral Finance 1

Can Prospect Theory Be Used To Predict Investor's Willingness To Pay?

Authors: Carsten Erner, Alexander Klos, Thomas Langer
Presenting Author: Carsten Erner

Cumulative prospect theory (CPT) is widely considered to be the most successful descriptive theory for decision making under risk and uncertainty. Recently, sophisticated methods have been developed to reliably elicit CPT parameters on an individual basis (e.g., Abdellaoui, Bleichrodt, and Paraschiv 2007). The aim of this paper is to analyze whether such methods are suited to be applied in real world situations, in particular, in the context of investment counseling. Specifically, we examine whether CPT parameters elicited via standardized computer tools are successful in predicting the individual's willingness to pay (WTP) for different investment products. In a two-stage computerized experiment, we determine the CPT parameters for 200 subjects. We then elicit WTPs for various investment products and compare those to the WTPs that the subjects should have stated based on their individual CPT parameters. Surprisingly, we find hardly any predictive power of the elicited CPT parameters on the willingness to pay. We discuss several possible explanations for this finding, including domain specificity, competence effects, and decision error propagation in the elicitation of CPT parameters and WTPs. These explanations can account for at most only part of the low predictive power, which thus remains a puzzle. We therefore conclude that state-of-the-art methods of CPT parameter elicitation are not suited to be applied in a context of real world investment counseling.

Keywords: Cumulative Prospect Theory, Preference Elicitation, Error Propagation, Experimental Finance, Structured Financial Product

Overreaction and Investment Choices: An Experimental Analysis

Authors: Bruno Biais, Alen Nosic, Martin Weber
Presenting Author: Alen Nosic

We study the degree of overreaction and its potential causes and consequences in a controlled experimental setting with 104 participants. The majority of participants tend to overreact, however, the degree of overreaction is heterogeneous. A few subjects even underreact. We also measure the overconfidence of the participants with a miscalibration scale. In line with theoretical predictions we find that more overconfident subjects overreact more. We also find that overreaction is associated with higher levels of risk taking after good signals and lower levels of risk

taking after bad signals. Finally, overreaction harms portfolio efficiency, as measured by the Sharpe ratio.

Keywords: Overreaction, Underreaction, Overconfidence, Portfolio Performance, Portfolio Risk

Why the Google IPO might stay exotic – An experimental analysis of offering mechanisms

Authors: Andreas Trauten, Thomas Langer
Presenting Author: Thomas Langer

Despite their theoretical efficiency in selling shares to the public, auctions are not the preferred mechanisms in Initial Public Offerings (IPOs). Chemmanur and Liu (2006) and Sherman (2005) provide a rational explanation for this “IPO auction puzzle” based on the notion that issuers are not only interested in maximizing the offering proceeds, but also care about the secondary market price and thus try to induce many investors to produce information about the IPO. In this paper, we report an experimental study that was set up to test the mechanisms underlying this reasoning. Our findings strongly sup-port the theoretical argument. If the issuer has some discretion in setting the offering price (as with bookbuilding or fixed-price offerings), he can maintain investors’ propensity to produce information by appropriately adjusting the offering price even if information costs are high. In auctions, however, high information costs inevitably result in a low propensity to produce information. This is a consequence of investors’ competitive bidding behavior which prevents them from recovering the costs of information production. Our results provide experimental support for the theoretical argument that an auction is not the preferable offering mechanism for young and risky IPO firms since the costs of producing information about such firms are high, but there is also a strong need to generate information.

Keywords: Initial Public Offerings, IPO auctions, fixed-price offerings, endogenous entry, experimental finance

Panel D - Session 4: Banking 3

Why do specialized banks succeed? An empirical investigation of the credit business of cooperative and savings banks

Authors: Rolf Böve, Andreas Pfingsten
Presenting Author: Rolf Böve

There is empirical evidence that specialization in lending leads on average to lower loan loss provisions and a higher profitability. In this paper we examine whether a better monitoring quality and/or lending to industries with lower loss rates are able to explain these results. The main results are as follows: Specialized banks show a lower ratio of actual to expected losses, i.e. they possess a higher monitoring quality than diversified banks. Specialized cooperative banks particularly lend to low-risk industries. The level of specialization has a stronger explanatory content with respect to the monitoring quality than monitoring expenses.

Keywords: bank lending, loan portfolio, diversification, expected loss, savings and cooperative banks

The quiet life hypothesis in banking - Evidence from German savings banks

Authors: Oliver Vins, Michael Kötter, Andreas Hackethal
Presenting Author: Oliver Vins

The 'quiet life hypothesis (QLH)' posits that banks enjoy the advantages of market power in terms of foregone revenues or cost savings. We suggest a unified approach to measure competition and efficiency simultaneously to test this hypothesis. We estimate bank-specific Lerner indices as measures of competition and test if cost and profit efficiency are negatively related to market power in the case of German savings banks. We find that both market power and average revenues declined among these banks between 1996 and 2006. While we find clear evidence supporting the QLH, estimated effects of the QLH are small from an economical perspective.

Keywords: savings banks, competition, efficiency, quiet life hypothesis

<u>Deposit insurance: An empirical study of private investor's knowledge and perception</u>

Authors: Norbert Sträter, Markus Cornelißen, Andreas Pfingsten
Presenting Author: Andreas Pfingsten

Theory predicts that fully insured depositors never will withdraw their savings prematurely to avoid the negative consequences of bank runs (Diamond and Dybvig (1983)). However, the bank run on Northern Rock in the U.K. demonstrates that depositors may rapidly lose their trust in the solvency of their bank in case of a serious crisis. Therefore, it is essential that the public is informed about the benefits and limitations of a deposit insurance system (Financial Stability Forum (2001)). It is surprising that there is hardly any empirical work on this issue and a study of the complex relationship between i) the extent of knowledge about insurance systems, ii) the demand for deposit security, and iii) the perceived degree of deposit security is lacking. Additionally, our paper extends the literature in the following directions. First, the investigation of our research questions for Germany is especially interesting since although Germany has three private deposit insurance schemes, the German banking system is generally regarded as a very stable system with secure deposits. Second, there is currently no thorough empirical study on the effect of banks' reputation on the perceived level of deposit security. Therefore, we develop the construct of perceived deposit security and present the results of an exploratory study examining the impact of bank's reputation on perceived deposit security. Thus, we analyze the following questions: 1. Do private depositors have a sound understanding of the deposit insurance systems? 2. Is the security of deposits important for investment decisions of private depositors? 3. Do private depositors perceive their deposits to be safe? 4. Do private depositors assign banks different levels of deposit security? And if so, can these differences in perceived deposit security be partly explained by differing reputation levels of the banks? We will shed light on these questions by analyzing a comprehensive survey (756 private investors) which was conducted between October and December 2007. The results indicate that although the security of deposits seems to be important to German depositors, they are relatively ill-informed about the deposit insurance systems. Despite their lack of knowledge, German depositors are confident of the security of their deposits. Additionally, the findings show that depositors indeed perceive differences in the safety levels across banks. These differences can be partly explained by the banks' reputation. Furthermore, our study reveals that depositor characteristics play an important role regarding knowledge about, demand for, and perception of deposit insurance.

Keywords: Banking regulation, deposit insurance, public awareness, private investors

Panel D - Session 5: Empirical Finance

When is Bankruptcy Threat Bad News? Risk and Return Analysis of Firms Announcing Bankruptcy in the US and Germany

Author: Vladimir Vladimirov

The bankruptcy announcement is a critical moment in the history of a firm. The value destruction connected with it is however greater for some firms than for others. In this empirical analysis of 1160 US and 116 German firms, having filed for bankruptcy between 1999 and 2007, an economic explanation is given for this phenomenon. Taking the perspective of the equity holders, different market and balance sheet based data are used to explain the wild stock reaction around the bankruptcy announcement. Using a matched sample of US and German firms, the paper further makes a comparison between the two bankruptcy codes. It shows that equity holders do not necessarily fare better under a debtor friendly procedure. Not only do they suffer more often from bankruptcy announcements, but they also lose more and accumulate these losses faster than their German counterparts. The results further suggest larger value destruction in the USA due to agency and bankruptcy costs, thereby giving support to current findings in the literature that debtor friendly codes trigger mechanisms making shareholders eventually worse off.

Keywords: Bankruptcy, Bankruptcy Announcements, Bankruptcy Law, Default Risk, International Comparison

The Role of Media Coverage in the Information Diffusion Process in the Stock Market

Author: Philipp Schmitz

In this paper we present results from an event study based on a unique data set of corporate news in the media. The data is provided by Media Tenor, a research institute which collects and rates all corporate news from the most important German daily newspapers and TV news. Our analysis is based on roughly 300,000 corporate news on 125 large- and medium-sized companies in 5 large daily newspapers and 7 TV news shows from Germany between July 1998 and October 2006. Since media analysts rate the news, we have an exogenous measure whether news are good or bad news for a company. Based on this data we can show that the incorporation of information in prices is fairly fast. The main price reaction occurs on the day of the arrival of the new information. This price jump is especially large if the news coverage in the media is accompanied by ad hoc announcements made by the corporation itself. While there is only a very short-term post-event drift after good news,

prices tend to drift for several days after bad news. The post-event trading volume is significantly higher than before the news for several days for good as well as bad news. To provide a test of the model of Hong and Stein (1999) we define several proxies for the speed of the information diffusion through different investor groups. We find that for smaller companies with lower abnormal media coverage the information diffusion is indeed slower, as predicted by theory.

Keywords: information diffusion, corporate news, media coverage, post-event price drift, stock market efficiency

Market Efficiency Reloaded: Why Insider Trades do not Reveal Exploitable Information

Authors: Christoph Kaserer, Sebastian Dickgiesser
Presenting Author: Christoph Kaserer

Insider trading studies related to the German market have emphasized that outside investors may earn excess returns by mimicking the transactions of corporate directors. Such a result, provided that it holds, would constitute a serious violation of the efficient market hypothesis. The results presented in this paper, though, show that this anomaly is mainly caused by a subset of stocks with high arbitrage risk as measured by their idiosyncratic volatility. This restrains arbitrageurs from engaging in otherwise profitable and price-correcting trades. As arbitrage risk is positively related to a stock's bid/ask-spread, we show that the information conveyed by insider trades cannot be exploited in terms of generating abnormal re- turns once these transaction costs are taken into account. We conclude that the market's under-reaction to reported insider trades can mainly be explained by the cost associated with risky arbitrage. Our findings provide evidence that the German stock market is efficient with respect to insider trades in the sense that prices reflect publicly available information to the point where the marginal benefit of acting on information exceeds marginal costs.

Keywords: Insider Trading, Directors' Dealings, Arbitrage Risk, Market Efficiency

3.5. Saturday, October 11th: 11:00 – 12:30

Panel E - Session 1: Performance Measurement

Survivorship Bias and Mutual Fund Performance: Relevance, Significance, and Methodical Differences

Authors: Martin Rohleder, Hendrik Scholz, Marco Wilkens
Presenting Author: Hendrik Scholz

This paper is the first to systematically test the significance of survivorship bias using a comprehensive database and to test the significance of the differences of survivorship biases resulting from different methodical approaches. We apply the various methods most commonly used in the literature on a uniform dataset. In addition, we analyze the performance of closed funds as the driver of survivorship bias and the performance of new funds as the driver of incubation bias. Our main findings are: i) Ignoring closed funds leads to a significantly positive survivorship bias. This is in line with previous research. ii) The choice of methods leads to statistically and economically significant differences in survivorship bias estimates. We are able to suggest a bias-minimizing combination of methods if survivorship bias-free data is not available. iii) The performance of closed funds drives survivorship bias since these funds underperform surviving funds years before they are closed. iv) We find evidence for incubation bias in our data but its impact is rather small and clearly depends on the methods applied.

Keywords: Mutual Fund Performance, Survivorship Bias

Are Mutual Funds Doomed to Underperform? Evidence from Managerial Turnover and Fund Flows

Authors: Wolfgang Bessler, Peter Lückoff, David Blake, Ian Tonks
Presenting Author: Peter Lückoff

We investigate the impact of managerial turnover and fund flows on performance persistence of U.S. equity mutual funds. Both, the replacement of a bad performing fund manager by the fund company and the withdrawal of money by investors can be seen as control mechanisms in delegated money management for underperforming funds. On the other end of the performance spectrum, poaching of outperforming fund managers by competing fund companies or high fund inflows from investors into outperforming funds might pose a threat on the sustainability of good performance results. Using a sample of 9,316 U.S. equity mutual funds from 1992 to 2004 and ranked portfolio tests as well as survival tests our results confirm this relationship for the impact of managerial turnover on performance. Top funds without manager change show stronger persistence than top funds experiencing a change in management. The replacement of bottom fund managers improves the subsequent performance of the fund. The results for the impact of flows on performance support our hypothesis that winner funds suffer from large inflows. Loser funds, in contrast, do not seem to profit from outflows to the same degree. However, neither flows nor managerial turnover can explain the lack of persistence among top funds documented in the literature. Our results are robust to a variety of alternative ranking procedures.

Keywords: Mutual Funds, Performance Persistence, Fund Flows, Managerial Turnover

Ranking of equity mutual funds: The bias in using survivorship bias-free datasets

Authors: Hendrik Scholz, Oliver Schnusenberg
Presenting Author: Hendrik Scholz

Using survivorship bias-free datasets to rank mutual fund performance introduces a market climate bias that depends on the period during which mutual funds without return data over the full evaluation period existed. We first illustrate the mathematical relationship between different performance measures and fund-specific characteristics according to the Carhart (1993) four-factor model. This shows how these measures are influenced by market climate. This bias tends to create different rankings of mutual funds depending on the measure used to evaluate fund performance. Using a survivorship bias-free sample of US equity mutual funds, we find that non-surviving funds existing in a bull market exhibit above-average Sharpe and Treynor ratios but below-average one-, three-, and four-factor alphas. Non-full-data funds existing a high proportion of their lifetimes in a bear market exhibit below-average Sharpe and Treynor ratios but above-average alphas. Once the performance measures of non-full-data funds are time-period adjusted based on fund-specific characteristics according to the four-factor model, performance rankings become clearly more consistent across the various performance measures.

Keywords: Portfolio performance evaluation, mutual funds, survivorship bias, data-availability, market conditions

Panel E - Session 2: Asset Valuation 2

Linking Credit Risk Premia to the Equity Premium

Authors: Tobias Berg, Christoph Kaserer
Presenting Author: Tobias Berg

Although the equity premium is - both from a conceptual and empirical perspective - a widely researched topic in finance, there is still no consensus in the academic literature about its magnitude. In this paper, we propose a different estimation method which is based on credit valuations. The main idea is straigtforward: We use structural models to link equity valuations to credit valuations. Based on a simple Merton model, a simple estimator for the market Sharpe ratio can be derived. This estimator has several advantages. First, it offers a new line of thought for estimating the equity premium which is not directly linked to current methods. Second, it is only based on observable parameters. We do neither have to calibrate dividend or earnings growth - which is usually necessary in dividend/earnings discount models - nor do we have to calibrate asset values or default barriers - which is usually necessary in traditional applications of structural models. Third, it is robust to model changes. We examine the model of Duffie/Lando (2001) - which is one of the most sophisticated structural models currently discussed in the literature - to show this robustness. In an empirical analysis we have used CDS spreads of the 125 most liquid CDS in the U.S. from 2003 to 2007 to estimate the equity premium. We derive an average implicit market Sharpe ratio of appr. 40%. Adjusting for taxes and other parts of the credit spread not attributable to credit risk yields an average market Sharpe ratio below 30%. This confirms research on the equity premium, which indicates that the historically observed Sharpe ratio of 40-50% - corresponding to an equity premium of 7-9% and a volatility of 15-20% - was partly due to one-time effects. In addition, our research can be used to explain empirical findings about credit risk premia, which are usually measured as the ratio of risk-neutral to actual default probabilities. We show that the behavior of these ratios can be directly inferred from a simple Merton model and that this behavior is robust to model changes.

Keywords: equity premium, credit risk premium, credit risk, structural models of default

Life-cycle Asset Allocation and Optimal Consumption Using Stochastic Linear Programming

Authors: Michael Hanke, Alois Geyer, Alex Weissensteiner
Presenting Author: Alex Weissensteiner

We consider optimal consumption and (strategic) asset allocation of an investor with uncertain lifetime. The problem is solved using a multi-stage stochastic linear programming (SLP) model to be able to generalize the closed-form solution obtained by Richard (1975). We account for aspects of the application of the SLP approach which arise in the context of life-cycle asset allocation, but are also relevant for other problems of similar structure. The objective is to maximize the expected utility of consumption over the lifetime and of bequest at the time of death of the investor. Since we maximize utility (rather than other objectives which can be implemented more easily) we provide a new approach to optimize the breakpoints required for the linearization of the utility function. The uncertainty of the problem is described by discrete scenario trees. The model solves for the rebalancing decisions in the first few years of the investor's lifetime, accounting for anticipated cash flows in the near future, and applies Richard's closed-form solution for the long, subsequent steady-state period. In our numerical examples we first show that available closed-form solutions can be accurately replicated with the SLP-based approach. Second, we add elements to the problem specification which are usually beyond the scope of closed-form solutions. We find that the SLP approach is well suited to account for these extensions of the classical Merton setting.

Keywords: life-cycle asset allocation, stochastic linear programming, scenario trees

Asset Allocation and Liquidity Breakdowns: What if Your Broker Does not Answer the Phone?

Authors: Peter Diesinger, Holger Kraft, Frank Seifried
Presenting Author: Holger Kraft

This paper analyzes the portfolio decision of an investor facing the threat of illiquidity. In a continuous-time setting, the efficiency loss due to illiquidity is addressed and quantified. We show that the efficiency loss for a logarithmic investor with 30 years until the investment horizon is a significant 22.7% of current wealth if the illiquidity part of the model is calibrated to the Japanese data of the aftermath of WW II. Furthermore, it is demonstrated that the threat of illiquidity can change the demand for risky securities tremendously and that a logarithmic investor will not behave myopically anymore.

Keywords: Illiquidity, Blackout Period, Portfolio Decision, Efficiency Loss, Rare Disasters

Panel E - Session 3: Behavioral Finance 2

Managerial Optimism and Corporate Investment: Is the CEO Alone Responsible for the Relation?

Authors: Markus Glaser, Philipp Schäfers, Martin Weber
Presenting Author: Markus Glaser

Why should aggregate investment of large conglomerates depend on personal characteristics of one single person, the CEO? In reality, decision processes are complex. Are personal characteristics of all senior managers together perhaps a better predictor of corporate decisions than the CEOs' characteristics alone? This is the question we tackle empirically in this paper for the case of managerial optimism and corporate investment. In contrast to existing empirical studies we do not only focus on optimism measures of single managers like the CEO or CFO of a firm as investment decisions of firms are usually not made by only one single person. Instead, our optimism measure is based on the insider stock transaction behavior of all senior managers that they have to report to the German Federal Financial Supervisory Authority. The main results can be summarized as follows. Managers are optimistic. Managers voluntarily increase their exposure to company specific risk more often than they reduce it, although they should, if anything, reduce their exposure. Furthermore, we find that firms with optimistic managers invest more. Moreover, the investment-cash flow sensitivity is higher for firms with optimistic managers. Consistent with theory, these results are stronger for financially constrained firms. As new insights, we find that optimism of all insiders has also explanatory power when compared to pure CEO optimism and that the higher managerial optimism, the lower the excess value of a company. We also identify moderating variables that determine when the CEO is more relevant for corporate investment (firm size, corporate governance, type of investment). CFO optimism has no explanatory power. These findings show that it is crucial to analyze how the exact decision process works within a firm.

Keywords: Optimism, corporate investment, investment-cash flow sensitivity, behavioral corporate finance

Is a Team Different From the Sum of Its Parts? Evidence from Mutual Fund Managers

Authors: Michaela Bär, Alexander Kempf, Stefan Ruenzi
Presenting Author: TBA

This paper provides the first empirical test of the diversification of opinion theory and the group shift theory using real business data. Our

data set covers management teams and single managers of US equity mutual funds. All our results clearly reject the group shift theory and support the diversification of opinion theory: extreme opinions of single team managers average out and, consequently, teams take less extreme decisions than individuals do. We find that teams follow less extreme risk strategies and less extreme investment styles than single managers do. Consequently, teams are much less likely to achieve extreme performance outcomes.

Keywords: Mutual Funds, Team Management, Investment Behaviour

The impact of optimistic and pessimistic managers on firm performance and corporate decisions

Author: Jens Martin

This paper investigates if and to which extent managerial behavior, its mindset and potential behavioral biases can be accounted for the underperformance of companies. We include behavioural explanations, such as optimistic managers, as well as rational theories, for example agency costs or that informed managers take advantage of a possible window of opportunity. Using the data of IPOs and SEOs going public in the US from 1990 to 2003, we find evidence that optimistic managers as well as pessimistic managers help to explain the long run underperformance of new equity offerings. We furthermore investigate into the investment decisions taken by these groups of managers after the share issuance. We see distinct different investment behaviour by each type of manager in terms of capital expenditures, debt rebalancing and cash holdings.

Keywords: Long run performance, IPOs, SEOs, optimistic manager, window of opportunity

Panel E - Session 4: Credit Risk

The real nature of credit rating transitions

Author: Axel Eisenkopf

It is well known that credit rating transitions exhibit a serial correlation, also known as a rating drift. This is clearly confirmed by this analysis, which also reveals that the credit rating migration process is mainly influenced by three completely different non-observable hidden risk situations, providing an individual environment for each successive rating. This finding violates the common stationary assumption. The hidden risk situations in turn also serially depend on each other in successive periods. Taken together, both represent the memory of a credit rating transition process and influence the future rating. To take this into account, I introduce an extension of a higher order Markov model and a new Markov mixture model. Especially the later one allows capturing these complex correlation structures, to bypass the stationary assumption and to take each hidden risk situation into account. An algorithm is introduced to derive a single transition matrix with the new additional information. Finally, by means of different CVaR simulations by CreditMetrics, I show that the standard Markov process overestimates the economic risk.

Keywords: Rating migration, rating drift, memory, higher order Markov process, Hidden Markov Model, Double Chain Markov Model, Markov Transition Distribution model, CVaR

Tranching and Rating

Authors: Julia Hein, Michael J. Brennan, Ser-Huang Poon
Presenting Author: Julia Hein

In this paper we analyze the arbitrage gains from marketing structured debt securities at yields that reflect the credit ratings of ratings agencies when the ratings depend on either the probabilities of default or the expected default losses of the securities issued. We consider the gains both from choosing the collateral against which the debt securities are written, and from dividing the debt into tranches with different priority. We derive general results and characterize the gains for examples that are based on the CAPM and the Merton (1974) debt pricing model.

Keywords: Credit Ratings, Collateralized Debt Obligations, expected loss rate, default

A primer on rating agencies as monitors: an analysis of the watchlist period

Authors: Christian Hirsch, Jan Pieter Krahnen
Presenting Author: Christian Hirsch

In much of the literature, rating agencies are seen as institutions providing informational services to the market. Our paper contributes to this literature by looking closely at the watchlist period, a particularly well-defined monitoring event. We are interested in the evolution of default risk expectations over the watchlist period. The change in the firm's distance to default, relative to a benchmark group of firms, serves as our metric of market expectations. Using a complete data set of Moody's watchlist operations since 1991, we find that sorting of firms by abnormal change in distance to default only partially explains the rating decision. Relying on a clean sample of watchlist initiations with no prior, we find a significant abnormal return which can be explained by proxies for the agency cost of debt. Since market expectations rely on publicly available information, we conclude that private information plays a role in the eventual rating assignment. Our results provide indirect evidence for an active monitoring role of rating agencies, as recently suggested by Boot, Milbourn, and Schmeits (2006).

Keywords: Credit Rating Agencies; Watchlist; Distance to Default; Rating Actions; Event Study

Panel E - Session 5: Corporate Finance 2

Managerial Preferences and Competition in Internal Capital Markets

Authors: Uwe-Wilhelm Bloos, Christian Gerhardt
Presenting Author: Uwe-Wilhelm Bloos

It is often argued that managers follow some preference function. The internal capital market literature, for example, most commonly treats managers as empire builders who receive increased private benefits from having more funds under their control. However, recent empirical work (Bertrand and Mullainathan 2003), shows that some managers might prefer to be left to run a limited number of projects. This "enjoying the quiet life" constitutes an alternative type of managerial behavior. In this contribution, we demonstrate how empire building and quiet life preferences work under competition. Our analysis shows that quiet life managers can generally only be motivated by threatening them with competition, while empire builders also value enhanced investment prospects. As we also demonstrate, this leads to different optimal wages in regard to managerial preferences. Additionally we identify two

organizational ways to improve managerial incentives. Namely, by letting managers with different investment prospects compete for funds and by altering the ex ante distribution of funds among the department managers. Again, results vary significantly with different managerial preferences.

Keywords: Internal Capital Market, Quiet Life, Empire Building, Managerial Preferences

<u>Informed Headquarters and Capital Allocation in Multi-Divisional Firms</u>

Authors: Daniel Hoang, Martin Ruckes
Presenting Author: Martin Ruckes

This paper develops a theory of resource allocation in internal capital markets that is consistent with the empirical finding that multi-division firms bias their investment levels in favor of divisions with weaker investment prospects. We characterize an internal capital market as an informed principal-agent relationship in which headquarters with control rights over internal funds has private information about the relative quality of future investment opportunities of its divisions. Then capital allocation may serve as a signal to divisional managers. Headquarters' optimal policy involves strategic distortions in favor of divisions with poorer investment opportunities.

Keywords: Capital Budgeting, Internal Capital Markets, Asymmetric Information

<u>Do Managers follow the Shareholder Value Principle when applying Capital Budgeting Methods? A Comparison of Theory and Practice based on German Survey Results and Return Data</u>

Authors: Sebastian Lobe, Tobias Niermeier, Wolfgang Essler, Klaus Röder
Presenting Author: Klaus Röder

This paper presents a comprehensive comparison of theory and practice of the most established capital budgeting methods in Germany based on our survey results. For this purpose we have sent questionnaires to CEOs and CFOs of all companies listed in the German all share index (CDAX) to find out which capital budgeting methods are currently used by German managers and how accurately they apply them. We cover with our survey not only the most important capital budgeting methods classified in the three groups of fundamental capital budgeting methods, risk adjustment methods and valuation methods but also other relevant fields of corporate finance like cost of capital and capital structure. We confront some of our survey results with prior German and recent international studies to obtain an insight into current domestic developments and to gauge how up-to-date German managers are in an international context. Based on these findings, we are able to examine whether executives follow the shareholder value principle when applying capital budgeting methods. We regress the most prominent corporate performance figures, return on equity and total investment return on the application frequency of particular capital budgeting methods to assess whether the usage of such methods has an impact on performance. To the best of our knowledge our paper is the first to exploit this approach. We conclude that German managers do not seem to follow the shareholder value principle when applying capital budgeting methods. Furthermore, we show that executives seem to be hesitant to implement residual income valuation methods as a key tool for the ex post performance measurement of a company. Finally, we provide evidence that the usage of capital budgeting methods and their proper application has a much greater impact on corporate performance than observable personal characteristics of top managers and fundamental properties of their companies.

Keywords: Shareholder value, performance, capital budgeting, cost of capital, valuation

4. Travel

The location of the conference is the Fürstenberghaus at the University of Münster (Domplatz 20-22, see detailed plan in Section 5).

4.1. Arriving by car

... from A1 (coming from Osnabrück/Bremen)

- Take the exit Münster Nord (exit 77) and head towards Münster.
- After approximately 6 km, you will see the palace on your right. At the traffic lights, turn left into Universitätsstraße. Follow the road for about 200 m.
- Turn slightly left into Bispinghof and follow the road (which changes its name into Johannisstrasse) for about 300 m. You will find a parking garage (Aegidii-Parkhaus) to your right.
- From the parking garage, turn into Pferdegasse. After 200 m, the conference venue Fürstenberghaus is on your left.

… from A1 and A43 (coming from Dortmund/Recklinghausen)

- From the A1, take the exit Münster Süd (exit 78) and head on the A43 towards Münster. Follow the signs Innenstadt (city centre).
- After approximately 7 km, you will see the Aasee (lake) on your left.
- After another 0.5 km, you will pass the courthouse on your left. At the traffic lights, turn right into Universitätsstraße. Follow the road for about 200 m.
- Turn slightly left into Bispinghof and follow the road (which changes its name into Johannisstrasse) for about 300 m. You will find a parking garage (Aegidii-Parkhaus) to your right.
- From the parking garage, turn into Pferdegasse. After 200 m, the conference venue Fürstenberghaus is on your left.

4.2. Arriving by public transport

... by train

Central Station

All busses to the conference leave from the bus stop B1. To get to this bus stop, please turn right after you have left the main entrance of the central station (do not cross the street). Tickets can be bought from the driver. You can take one of the following busses:

- bus no. 1 (direction Münster Roxel Hallenbad).
- bus no. 12 (direction Münster Heekweg),
- bus no. 13 (direction Münster Eissporthalle),
- bus no. 14 (direction Münster Zoo).

Get off the bus at the station "Domplatz" and turn left. You should have the Dome of Münster to your right (and the post office as well as the cafés Floyd and Marktcafé to your left). The Fürstenberghaus is then in front of you.

In case you prefer going by taxi, give the destination "University of Münster, Fürstenberghaus, Domplatz 20-22".

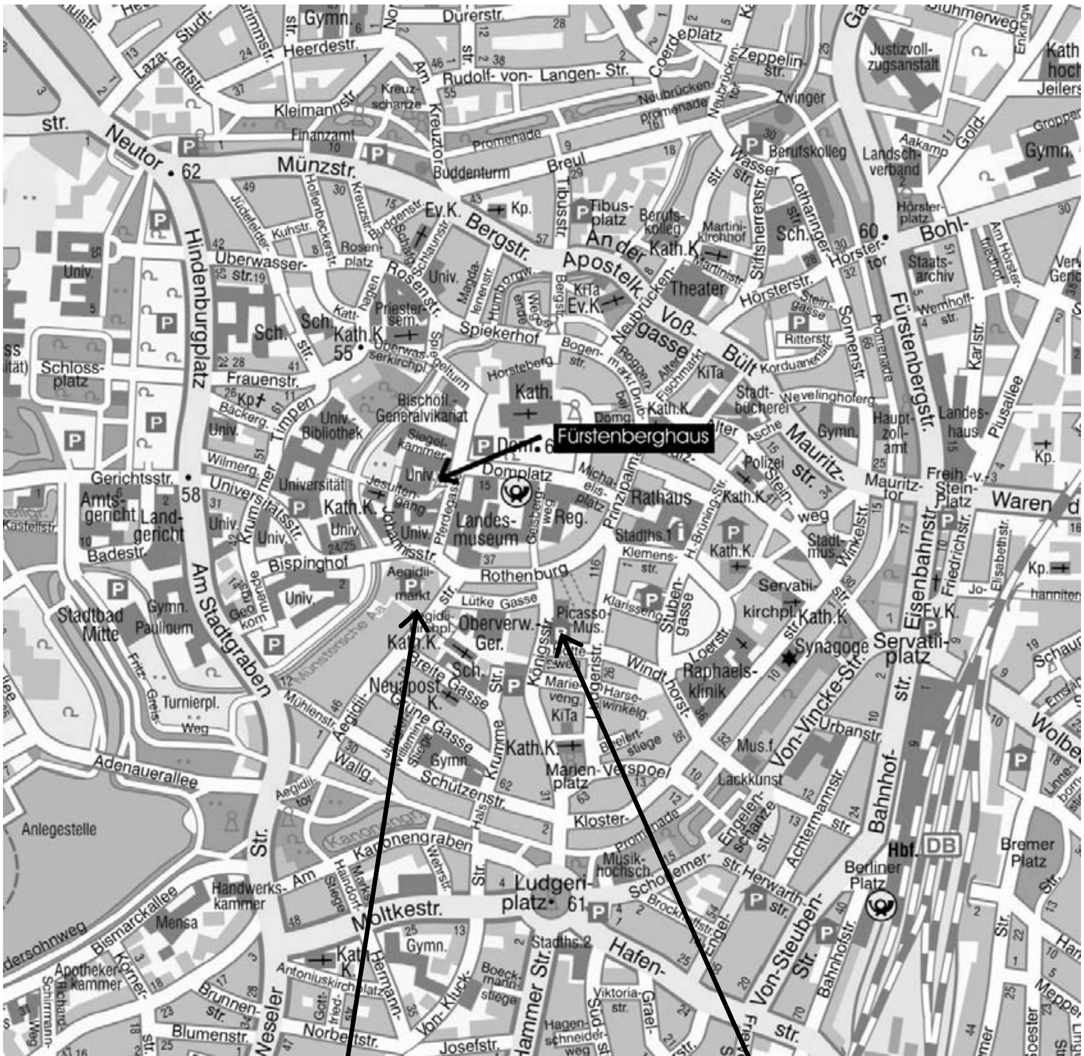
... by plane

The airport is located north of the city. A taxi-trip to the location of the conference costs about 38 Euro; the destination is "University of Münster, Fürstenberghaus, Domplatz 20-22".

You can also get to Münster (central station) in 35 - 45 minutes by bus. The busses to Münster depart from the bus stop 1/A at the airport.

5. Maps

5.1. Münster



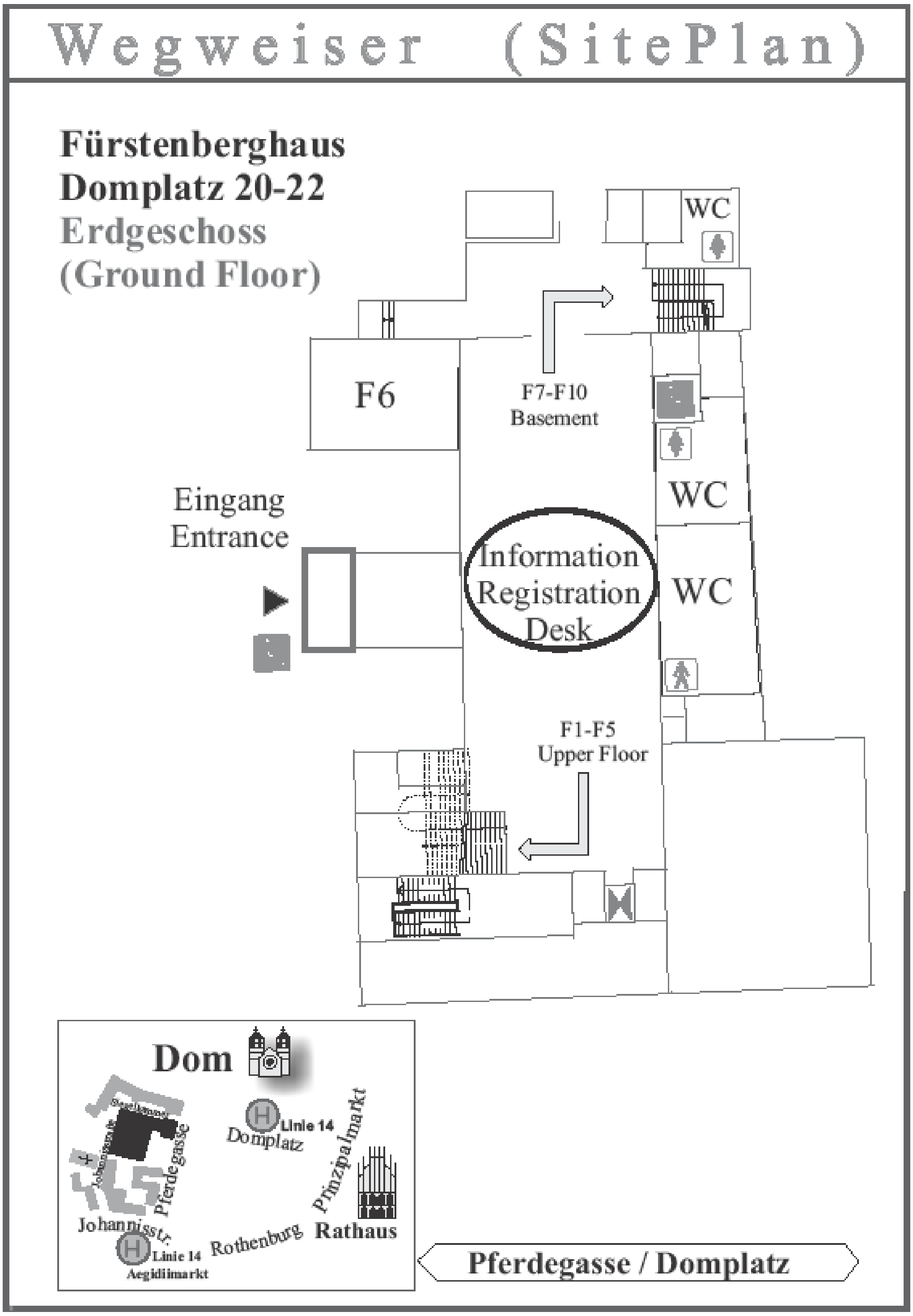
Vervielfältigt mit Genehmigung des Vermessungs- und Katasteramtes der Stadt Münster vom 02.09.2008;

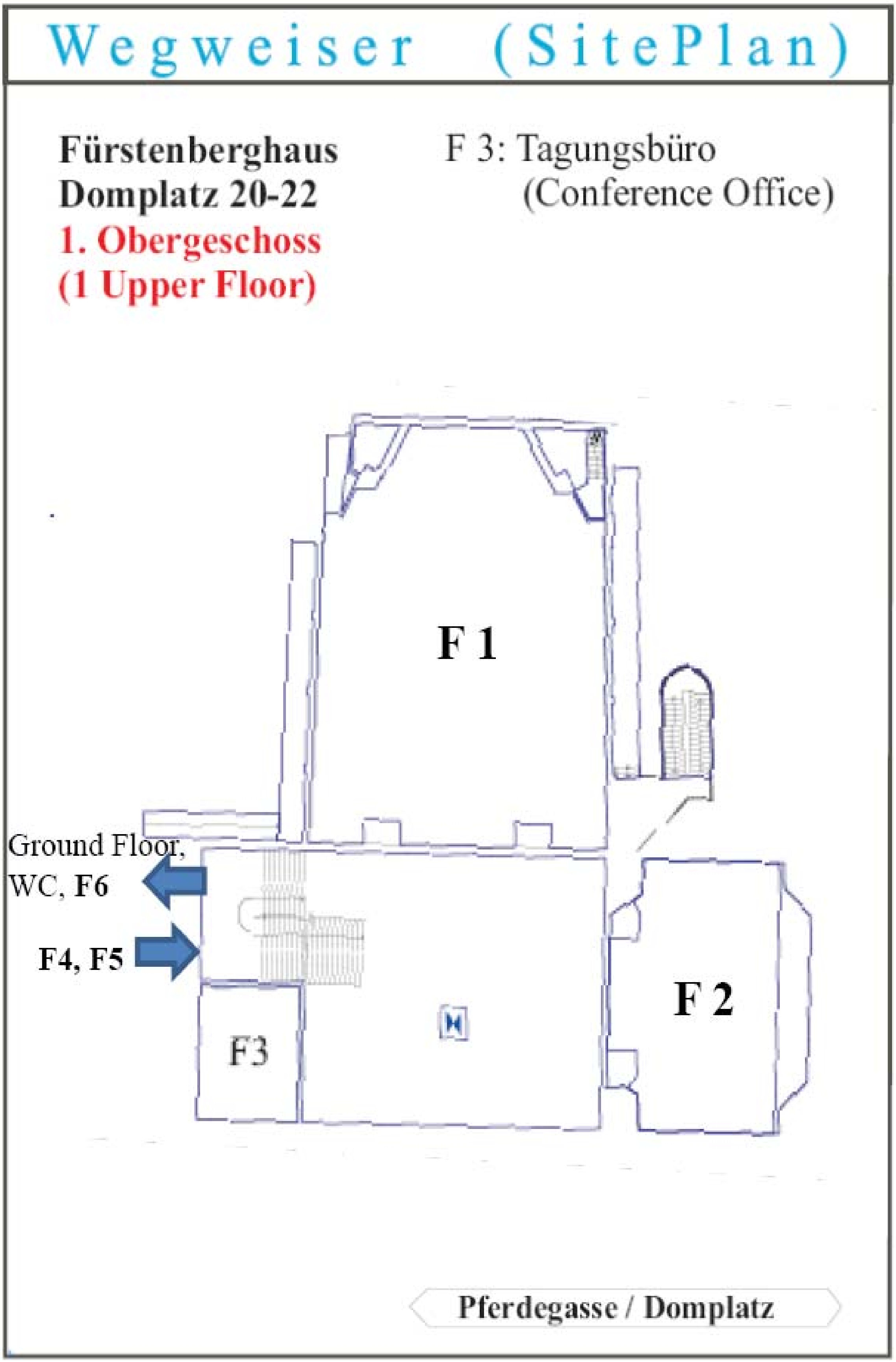
Kontrollnummer: 6222.91.08

Parking Garage Aegidii-Parkhaus

Picasso Museum

5.2. Fürstenberghaus (Conference Venue)




Wegweiser (SitePlan)
Fürstenberghaus
Domplatz 20-22
1. Obergeschoss
(1 Upper Floor)
F 3: Tagungsbüro
(Conference Office)
F 1
Ground Floor,
WC, F6
F4, F5
F3
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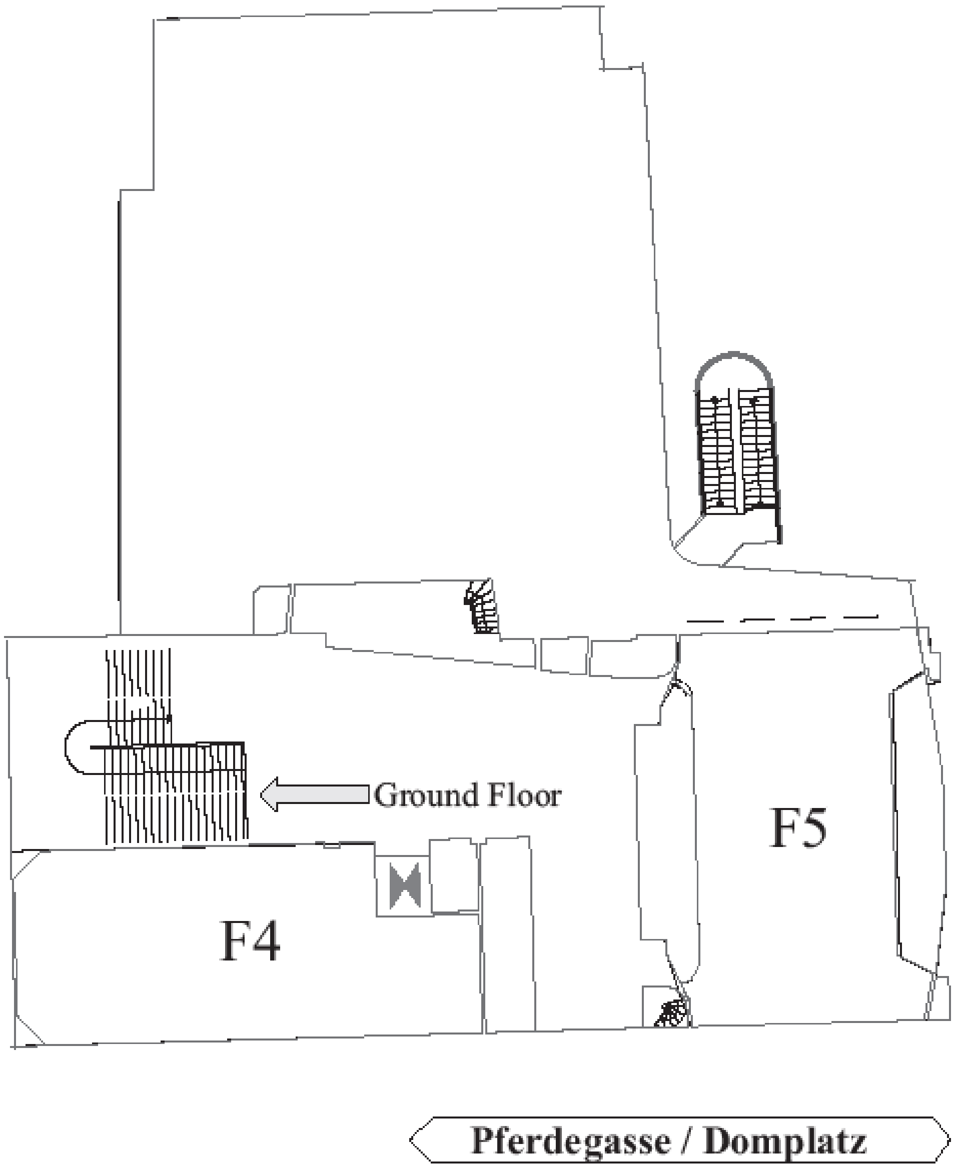
Pferdegasse / Domplatz

Wegweiser (SitePlan)

Fürstenberghaus
Domplatz 20-22
2.Obergeschoss
(2 Upper Floor)



6. Important Telephone Numbers

Conference Office
Mrs. Helgard Scherer
Tel.: (0251) 83-30516 (Conference Office)
Tel.: (0251) 83-30518 (Registration/Information Desk)
Fax: (0251) 83-30517

Emergency / Medical Help
Police: 110
Fire Department: 112
Emergency Medical Services (Emergency Doctor): 112
Medical / Dental Emergency: (02571) 19-292

Taxi
Tel.: (0251) 25-500
Tel.: (0251) 600-11
Tel.: (0251) 433-00
http://www.taxi-muenster.de

Public Transportation (Stadtwerke Münster)
Tel.: (01803) 50-4030
http://www.stadtwerke-muenster.de/fahrgaeste/service.html

Train (Deutsche Bahn AG)
Tel.: 11861
http://www.bahn.de

Airport Münster-Osnabrück
Tel.: (02571) 94-3360
http://www.flughafen-fmo.de

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