Accounting standards and Information

Discussion

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Overview

1. Summary

- Question: For European banks, does US cross-listing and use of IFRS decrease information asymmetries?

- Comprehensive programme: consider four different measures of information asymmetry
  - bid-ask spread
  - analyst forecast errors
  - analyst forecast dispersion (range)
  - rating disagreement (frequency of split ratings)

- Comprehensive programme: analyse both
  - Cross-sectional equations
  - Changes around the time of switch to US GAAP / IFRS
- Rationale: both techniques have pros and cons
  - Cross-sectional equations prone to omitted variable bias
  - Changes approach akin to fixed effects, controlling for firm characteristics that are invariant to switch. But firm characteristics may change as a result of switch.

Results

	Bid-ask spread		Split ratings	
	Cross-section	Changes	Cross-section	Changes
Cross-listed	(-)	(-)	0	n.a.
IFRS	(-)	(-)	0	n.a.
	Median forecast error		Range of forecast	
	Cross-section	Changes	Cross-section	Changes
Cross-listed	(-)	n.a.	0	n.a
IFRS	(-)	n.a.	0	n.a

2. Specific Comments

Spread equations (Table 9)

- **Volume** (turnover)
  - lowers inventory risk and decreases bid-ask
  - could be higher for cross-listed firms for reasons other than information
  - is standard control in spread regressions , eg Leuz and Verrechia (2002), but <u>missing</u> from the equation

Spread equations, contindued

- Competition from US exchange
  - could lower spreads in home market
  - **Table 8:**
    - median spread in US similar to home market
    - US share of volume traded low on average
    - but US spreads tend to be lower whenever US share is sizeable and high when share is negligible
  - points to <u>potential</u> competition. Contestability of market could limit home spreads

Forecast error equation (Table 6)

- Forecast error decreases (significantly) with cross-listing, but range (dispersion) does not (odd)

- "reconciliation to US GAAP helps analysts predict earnings under home GAAP" (plausible?)

- Alternative: omitted variable bias, wrong standard errors

Forecast error equation (Table 6), continued

- **number of forecasts** (analyst following)
    - is <u>higher</u> for cross-listed firms
    - included in range equation, but not included in error equation
    - could increase information produced and lower forecast error (as well as spread) (eg Alford and Berger, 1999) (<u>omitted variable bias</u>)
    - could also affect the variance of median forecast error and thus standard errors (<u>heteroskedasticity</u>)

Forecast equations (Table 6), continued

- **Size** <u>positive</u> in both forecast error and range equations: odd, eg Lang and Lundholm 1996 find the opposite.
  - "larger banks more opaque"
  - omitted variables?
    - size <u>negative</u> in spread regressions (Table 9)
    - spread regressions include country dummies
    - should also include in forecast equations
    - Swiss banks more opaque?

3. General Comments

- Disclosure is a choice variable. Endogeneity?
  - Authors acknowledge potential problem and "rely on the assumption that unobservable differences (…) are not correlated with measures of information"
  - could test for endogeneity
  - could address potential endogeneity (self-selection bias) by including inverse Mills ratio, calculated from a first-stage probit model of disclosure choice (as in Leuz and Verrecchia, 2002)

- Difficult to decide whether results driven by differences in information, within that
  - accounting information
  - other information, eg SEC requirements for timely release of material information
- interact cross-listing /IFRS variables with
  - frequency of reporting
  - volatility (likelihood of information event occuring)
- Complete programme of the paper by conducting more changes analyses