ESSFM 2017 Corporate Finance Informal Evening Sessions

Date:	Monday 24 July	Tuesday 25 July	Wednesday 26 July	Thursday 27 July
Room:	Bern (Theory)			
20:30-21:00	**David Martinez-Miera (Universidad Carlos III de Madrid and CEPR)** "Markets, banks and shadow banks"	**Lucy White (Boston University and CEPR)** "Optimal Bank Resolution Regimes"	**Hongda Zhong (LSE)** "A Theory of Multi-Period Debt Structure"	**Giorgia Piacentino (Columbia Business School and CEPR)** "Netting"
21:00-21:30	**Anton Tsoy (EIEF)** "Distorted Advice in the Mortgage Market: Theory and Structural Estimation"	**Javier Suarez (CEMFI and CEPR)** "Assessing the Cyclical Implications of IFRS 9: A Recursive Model"	**John Chi-Fong Kuong (INSEAD)** "Securitisation and Optimal Foreclosure"	**Sergio Vicente Rodríguez (Universidad Carlos III de Madrid) "**Bank resolution and the mutualization of the public backstop in a banking union"
21:30-22:00	**Moqi Groen-Xu (LSE)** "Free-riders and underdogs: participation in corporate voting"	**Stephanie Chan (Universiteit van Amsterdam)** "Regulatory Forbearance, CoCos, and Bank Risk-Shifting"	**Vittoria Cerasi (Milano-Bicocca University)** "How post-crisis regulation has affected bank CEO compensation"	**Florian Heider (ECB and CEPR)** "Stock-based pay in an efficient stock market"
Room:	Zürich (Empirical)			
20:30-21:00	**Nikolai Roussanov (University of Pennsylvania)** "Marketing Mutual Funds"	**Nikos Artavanis (University of Massachusetts Amherst)** "Foreclosure Moratorium and Strategic Default"	**Clemens Otto (Singapore Management University)** "CAPM-based Company (Mis)valuations"	**Andrea Polo (Universitat Pompeu Fabra and CEPR)** "Do Fragile Banks Risk-Shift in Crises? Security Register Evidence"
21:00-21:30	**Arpit Gupta (New York University)** "Skin or Skim? Inside Investment and Hedge Fund Performance"	**Daniel Ferreira (LSE and CEPR)** "The Effect of Board Quotas on Female Director Turnover"	**Alminas Žaldokas (Hong Kong University of Science and Technology)** "Naughty Firms, Noisy Disclosure"	**Enrique Schroth (Cass Business School and CEPR)** "Transitory versus permanent shocks: Explaining corporate savings and investment"
21:30-22:00	**Maria Chaderina (WU Vienna University of Economics and Business)** "Which Bonds to Sell in Fire Sales? Liquidity versus Commonality of Holdings"	**Michaela Pagel (Columbia Business School and CEPR)** "The Ostrich in Us: Selective Attention to Financial Accounts, Income, Spending, and Liquidity"	**Nicola Limodio (Bocconi University)** "Deposit Volatility, Liquidity and Long-Term Investment: Evidence from a Natural Experiment in Pakistan"	**Farzad Saidi (Stockholm School of Economics and CEPR)** "Shock Propagation and Banking Structure"

ESSFM 2017 Corporate Finance Informal Evening Sessions

Monday 24 July

20.30 – 21.00

Room: Bern

"Markets, banks and shadow banks"

Presenting author: David Martinez-Miera (Universidad Carlos III de Madrid and CEPR)

Co-author: Rafael Repullo (CEMFI and CEPR)

Abstract: We analyze the effect of bank capital regulation on the structure and risk of the financial system. Banks intermediate between entrepreneurs and investors, and can monitor entrepreneurs' projects. Monitoring is not observed by investors, so there is a moral hazard problem. Banks choose whether to be subject to the regulation, in which case a supervisor certifies their capital, or not be subject to it, in which case they have to resort to more expensive private certification. Market finance, regulated banks, and shadow banks can coexist in equilibrium. Under both flat and risk-based capital requirements, safer entrepreneurs borrow from the market and riskier entrepreneurs borrow from intermediaries. The difference is that flat (risk-based) requirements are especially costly for relatively safe (risky) entrepreneurs which may be better off borrowing from shadow banks. We compare these regulations in terms of welfare, and characterize the optimal requirements taking into account the existence of both market and shadow bank finance.

20.30 – 21.00

Room: Zürich

"Marketing Mutual Funds"

Presenting author: Nikolai Roussanov (University of Pennsylvania)

Co-authors: Hongxun Ruan (University of Pennsylvania) and Yanhao Wei (University of Southern California)

Abstract: Marketing expenses constitute a large fraction of the cost of active management in the mutual fund industry. We investigate the role of these costs on capital allocation and on returns earned by mutual fund investors by estimating a structural model of costly investor search and fund competition with endogenous marketing expenditures. We find that marketing is as important as performance and fees in determining fund size. Restricting the amount that can be spent on marketing substantially improves investor welfare, as more capital is invested with passive index funds and price competition drives down fees on actively managed funds. Average alpha increases as active fund size is reduced.

ESSFM 2017 Corporate Finance Informal Evening Sessions

21.00 – 21.30

Room: Bern

"Distorted Advice in the Mortgage Market: Theory and Structural Estimation"

Presenting author: Anton Tsoy (EIEF)

Co-authors: Luigi Guiso and Andrea Pozzi (both EIEF and CEPR), Leonardo Gambacorta (Bank of International Settlement and CEPR) and Paolo Mistrulli (Banca d'Italia)

Abstract: Many households lack the sophistication required to make complex financial decisions, which exposes them to the risk of being exploited when seeking advice from intermediaries. We set up a structural model of financial advice, in which banks aim at issuing their ideal mix of fixed and adjustable rate mortgages and can achieve such a goal by setting rates and providing advice to their clientele. "Sophisticated" households know the mortgage type best for them, whereas "naive" are susceptible to the bank's advice. Using the data on the universe of Italian mortgages, we recover the primitives of the model and quantify the welfare implications of distorted financial advice. The cost of the distortion is equivalent to increasing the annual mortgage payment by 1,145 euros. Losses are bigger for naive households, but sophisticated households suffer as well. However, since even distorted advice conveys information, banning advice altogether is not welfare improving and would instead result in a loss of 723 euros per year on average. A financial literacy campaign is beneficial for all, though in different degrees.

21.00 – 21.30

Room: Zürich

"Skin or Skim? Inside Investment and Hedge Fund Performance"

Presenting author: Arpit Gupta (New York University)

Co-author: Kunal Sachdeva (Columbia Business School)

Abstract: We document novel patterns of insider investment in hedge funds and explore the implications for fund returns. Using a comprehensive and survivor-bias free dataset of U.S. hedge funds, we find that funds with greater investment by insiders are smaller and outperform funds with less "skin in the game" on a factor-adjusted basis, consistent with a role for capacity constraints in driving hedge fund performance. Our results have implications for optimal portfolio allocations of institutional investors and models of delegated asset management.

ESSFM 2017 Corporate Finance Informal Evening Sessions

21.30 – 22.00

Room: Bern

"Free-riders and underdogs: participation in corporate voting"

Presenting author: Moqi Groen-Xu (LSE)

Co-authors: Dragana Cvijanovic (University of North Carolina at Chapel Hill) and Kostas Zachariades (Queen Mary University of London)

Abstract: How do shareholders decide whether to vote? We propose a rational choice model where the participation decision depends on the probability of being pivotal and the costs and benefits of voting. We show that more homogeneity in ex-ante preferences among shareholders yields lower participation rates (free-rider effect), while higher disagreement yields higher participation rates (underdog effect). The model admits a closed-form solution for the equilibrium participation rates. This allows us to calculate hitherto unobserved statistics on the turnout by supporters of either side, as well as, the perceived importance of proposals, isolated from other variables that affect the probability of being pivotal such as the ownership structure. We document a number of novel stylized facts: shareholder proposals are perceived as more important than management proposals and the most important shareholder proposals are about restructuring.

21.30 – 22.00

Room: Zürich

"Which Bonds to Sell in Fire Sales? Liquidity versus Commonality of Holdings"

Presenting author: Maria Chaderina (WU Vienna University of Economics and Business)

Co-authors: Alexander Muermann ((Vienna University of Economics and Business and VGSF) and Christoph Scheuch (VGSF)

Abstract: We analyze the problem of optimal bond liquidation when institutional investors are hit with a liquidity shock. Institutions fail to fully account for the effect of selling commonly-held bonds on other market participants. The over-selling of these bonds generates substantial price impacts. In data, there are few liquid bonds and they are more commonly-held. In re-sales liquid bonds exhibit larger price impacts than illiquid ones. However, controlling for commonality of the bond, liquid bonds have smaller price impacts. We argue that even when portfolios have low similarity the commonality of liquid bonds matters for re-sales losses and financial stability.

ESSFM 2017 Corporate Finance Informal Evening Sessions

Tuesday 25 July

20.30-21.00

Room: Bern

“Optimal Bank Resolution Regimes”

Presenting author: Lucy White (Boston University and CEPR)

Co-author: Ansgar Walther (University of Warwick)

Abstract: Recent policy reforms endow financial regulators with broad powers to “bail-in” the creditors of troubled banks, with the aim of avoiding future “bail-outs.” We analyze equilibrium bail-in policies during financial crises and study the optimal design of regulatory regimes. We show that such powers, when discretionary, will have limited impact. Regulators with discretion conduct weak interventions in order to avoid revealing adverse private information and triggering bank runs. Optimal resolution regimes allow discretion whenever public news is favorable, but tie the regulator’s hands after bad news. The optimal regime can be implemented by supplementing bail-in powers with contingent capital instruments.

20.30 – 21.00

Room: Zürich

“Foreclosure Moratorium and Strategic Default”

Presenting author: Nikos Artavanis (University of Massachusetts Amherst)

Co-author: Ioannis Spyridopoulos (Rice University)

Abstract: We identify strategic default behavior by exploiting the provisions of a foreclosure moratorium on primary residence mortgages and a debt discharge process that protects primary dwellings from liquidation in Greece. Using proprietary data from a large bank, we conservatively estimate that 28% of defaults in primary residence mortgages are strategic, which corresponds to 5-5.8 billion euros in non-performing loans. Strategic defaults are more pronounced for customers that are self-employed, work in law or financial services, and have higher credit scores and reported income. Pensioners, military personnel, and single parent families exhibit the lowest levels of strategic default. We find evidence suggesting that strategic defaults spread through homeowners’ social networks, and evaluate the implications of policies that induce moral hazard on the health of the financial system.

ESSFM 2017 Corporate Finance Informal Evening Sessions

21.00 – 21.30

Room: Bern

"Assessing the Cyclical Implications of IFRS 9: A Recursive Model"

Presenting author: Javier Suarez (CEMFI and CEPR)

Co-author: Jorge Abad (CEMFI)

Abstract: IFRS 9 is the new accounting standard for the valuation of financial assets and liabilities. Its key innovation is the shift from an incurred loss approach to an expected loss approach to the measurement of credit impairment losses. The new allowances must equal the discounted one-year expected losses when exposures have not suffered a significant deterioration of credit quality and the discounted lifetime expected losses otherwise. This paper develops a recursive model for the assessment of the implications of different measurement approaches for the average levels and dynamics of the allowances of a bank's loan portfolio. Its application to a portfolio of European corporate loans suggests that IFRS 9 will tend to frontload the impact of credit losses on P/L and CET1 right at the beginning of deteriorating phases of the economic cycle, which raises concerns about its procyclicality. Such impact, however, seems absorbable for banks with fully loaded capital conservation buffers.

21.00 – 21.30

Room: Zürich

"The Effect of Board Quotas on Female Director Turnover"

Presenting author: Daniel Ferreira (LSE and CEPR)

Co-authors: Edith Ginglinger, Marie-Aude Laguna and Yasmine Skalli (all Université Paris–Dauphine, PSL Research University)

Abstract: The annual rate of turnover of female directors falls by about a third following the introduction of a board gender quota in France in 2011. This decline in turnover is more pronounced for quota-induced new appointments, especially in boards that regularly hire directors who are members of the French business elite. By contrast, the quota has no effect on male director turnover. The evidence suggests that, by changing the director search technology used by firms, the French quota has improved the stability of director-firm matches.

ESSFM 2017 Corporate Finance Informal Evening Sessions

21.30 – 22.00

Room: Bern

“Regulatory Forbearance, CoCos, and Bank Risk-Shifting”

Presenting author: Stephanie Chan (Universiteit van Amsterdam)

Co-author: Sweder van Wijnbergen (Universiteit van Amsterdam and CEPR)

Abstract: Contingent convertible capital (CoCo) is a debt instrument that converts to equity or is written off if the issuing bank fails to meet a prespecified threshold. We examine the setting when conversion is subject to regulatory discretion. A regulator that faces conversion costs will only convert CoCos if it causes the bank's equity level to exceed a threshold such that it chooses to liquidate its bad assets rather than to gamble for resurrection. But if the conversion costs are high enough, or if conversion does not switch a bank's decision, regulatory forbearance is observed. We endogenize the conversion costs by casting them as bank run probabilities. The initial asset choice of the bank depends on what it anticipates the regulator will do, as well as how much CoCos are in place. Only when there are relatively few CoCos will banks be induced to choose safe assets ex ante, which undermines the loss absorption capacity of the CoCos.

21.30 – 22.00

Room: Zürich

“The Ostrich in Us: Selective Attention to Financial Accounts, Income, Spending, and Liquidity”

Presenting author: Michaela Pagel (Columbia Business School and CEPR)

Co-author: Arna Olafsson (Copenhagen Business School)

Abstract: number of theoretical research papers across multiple fields in economics analyze attention but direct empirical evidence on attention remains scarce. This paper investigates the determinants of attention to financial accounts using panel data from a financial management software provider containing daily logins, income, spending, balances, and credit limits. We first explore whether individuals pay attention in response to the arrival of income payments. Here, we utilize that weekends and holidays generate exogenous variation in regular payment arrival using a fixed-effects approach. We find that individuals are five times more likely to log in because they get paid, even though the new information associated with regular income payments should be very limited. Moreover, we estimate a comparable marginal propensity to log in using plausibly exogenous income payments. Beyond looking at the causal effect of income on attention, we examine how attention depends on spending and individual financial standing, such as cash holdings, savings, and

liquidity. We find that attention is decreasing in individual spending and overdrafts and increasing in cash holdings, savings, and liquidity. Finally, attention jumps discretely when balances change from negative to positive. All of these results are consistent with Ostrich effects and anticipatory utility as the first-order motivation for checking financial accounts. To rationalize our findings, we set up a model assuming individuals experience utility over news, or changes in expectations about consumption, as proposed by Koszegi and Rabin (2009). Because agents dislike bad news more than they like good news, paying attention to financial account is considered unpleasant, especially when remaining cash holdings are low.

Wednesday 26 July

20.30 – 21.00

Room: Bern

"A Theory of Multi-Period Debt Structure"

Presenting author: Hongda Zhong (LSE)

Co-authors: Chong Huang (University of California, Irvine) and Martin Oehmke (Columbia Business School and LSE)

Abstract: We develop a model of multi-period debt structure. A simple trade-o↵ between the termination threat required to make repayments incentive compatible and the desire to avoid early liquidation determines the number of repayments, their timing, and repayment amounts. For mature firms with risky cash flows, frequent repayments maximize pledgeable income—for example, by rolling over short-term debt. In contrast, for firms with cash-flow growth or significant risk-free cash flows, adding risky repayments can decrease pledgeable income. In some cases, a single risky bullet repayment maximizes pledgeable income, effectively a long-term debt contract.

ESSFM 2017 Corporate Finance Informal Evening Sessions

20.30 – 21.00

Room: Zürich

"CAPM-based Company (Mis)valuations"

Presenting author: Clemens Otto (Singapore Management University)

Co-authors: David Thesmar (MIT and CEPR), Olivier Dessaint (University of Toronto) and Jacques Olivier (HEC Paris)

Abstract: The CAPM is the predominant model of risk and return taught by academics and used by practitioners for capital budgeting purposes. However, the CAPM does not fit the data. We document that the divergence between CAPM-implied and realized returns has important implications for the market's reaction to firms' investment decisions. Focusing on mergers and acquisitions, we show that bids for low beta targets entail a significantly more negative stock market reaction than bids for high beta targets. Bidders that rely on the CAPM to estimate the cost of capital will tend to overvalue (undervalue) low (high) beta targets, leading to bids that are perceived as too high (low) by the market. Consistent with this effect, we find that bidders' cumulative abnormal returns (CARs) around bid announcements are significantly lower (higher) when bidding for low (high) beta firms. Importantly, we do not find any evidence of return reversal in subsequent years, suggesting long-lasting wealth effects for shareholders.

21.00 – 21.30

Room: Bern

"Securitisation and Optimal Foreclosure"

Presenting author: John Chi-Fong Kuong (INSEAD)

Abstract: Does securitisation distort the foreclosure decision of non-performing mortgages? In a model in which an informed securitiser jointly designs the mortgage-backed security and the foreclosure policy, we find that the securitiser with high-quality pool optimally adopts an excessive foreclosure policy and sells a risky debt (the senior tranche) to uninformed investors. Foreclosure effectively mitigates the adverse selection friction in securitisation by making the risky debt less information sensitive. Our model predicts that foreclosure likelihood, loan loss, mortgage servicers' capacity and incentive to modify delinquent loans endogenously vary with the quality of the underlying mortgage pool. Policies that aim to restore ex post efficient foreclosures may inadvertently reduce mortgage originators' screening effort.

ESSFM 2017 Corporate Finance Informal Evening Sessions

21.00 – 21.30

Room: Zürich

"Naughty Firms, Noisy Disclosure"

Presenting author: Alminas Žaldokas (Hong Kong University of Science and Technology)

Co-authors: Thomas Bourveau and Guoman She (both Hong Kong University of Science and Technology)

Abstract: We empirically study how collusion in the product markets affects firms' financial disclosure strategies. By exploiting exogenous variations to the costs of illegal price-fixing, we find that U.S. firms start sharing more detailed information in their financial disclosure about their customers, contracts, and products, potentially benefiting peers and helping to tacitly coordinate actions in product markets. At the same time, the disclosure on firms' competitive environment, which might benefit antitrust regulators, becomes more murky. Our findings suggest that transparency in financial statements can come at the expense of consumer welfare.

21.30 – 22.00

Room: Bern

"How post-crisis regulation has affected bank CEO compensation"

Presenting author: Vittoria Cerasi (Milano-Bicocca University)

Co-authors: Sebastian M. Deininger (University of Basel), Leonardo Gambacorta (BIS and CEPR) and Tommaso Oliviero (CSEF)

Abstract: This paper assesses whether compensation practices for bank Chief Executive Officers (CEOs) changed after the Financial Stability Board (FSB) issued post-crisis guidelines on sound compensation. Banks in jurisdictions which implemented the FSB's Principles and Standards of Sound Compensation in national legislation changed their compensation policies more than other banks. Compensation in those jurisdictions is less linked to short-term profits and more linked to risks, with CEOs at riskier banks receiving less, by way of variable compensation, than those at less-risky peers. This was particularly true of investment banks and of banks which previously had weaker risk management, for example those that previously lacked a Chief Risk Officer.

21.30 – 22.00

Room: Zürich

"Deposit Volatility, Liquidity and Long-Term Investment: Evidence from a Natural Experiment in Pakistan"

Presenting author: Nicola Limodio (Bocconi University)

Co-author: M. Ali Choudhary (State Bank of Pakistan)

Abstract: Deposit volatility and costly bank liquidity increase the long-term lending rates offered by banks, which reduce loan maturities, long-term investment and output. We formalise this mechanism in a banking model and analyse exogenous variation in deposit volatility induced by a Sharia levy in Pakistan. Data from the credit registry and a firm-level survey show that deposit volatility and liquidity cost: 1) reduce loan maturities and lending rates; 2) leave loan amounts and total investment unchanged; 3) redirect investment from fixed assets towards working capital. A targeted liquidity program is quantified to generate yearly output gains between 0.042% and 0.205%.

Thursday 27 July

20.30 – 21.30

Room: Bern

"Netting"

Presenting author: Giorgia Piacentino (Columbia Business School and CEPR)

Co-author: Jason R Donaldson (Washington University in St. Louis)

Abstract: We present a model to explain why banks hold off-setting debts without netting them out. We find that off-setting debts help a bank to raise liquidity with new debt from a third party, since diluting old debt subsidizes the new debt. Even though a diluted bank is worse off ex post, a network of gross debts is stable ex ante. This is because it provides banks with valuable liquidity co-insurance, since each bank exercises its option to dilute when it needs liquidity most. However, the network harbors systemic risk: since one bank's liabilities are other banks' assets, a liquidity shock can transmit through the network in a default cascade.

ESSFM 2017 Corporate Finance Informal Evening Sessions

20.30 – 21.00

Room: Zürich

“Do Fragile Banks Risk-Shift in Crises? Security Register Evidence”

Presenting author: Andrea Polo (Universitat Pompeu Fabra and CEPR)

Co-authors: José-Luis Peydró (Universitat Pompeu Fabra and CEPR) and Enrico Sette (Banca d’Italia)

Abstract: We study securities trading by banks during crises. We use a supervisory proprietary dataset that provides information on security-level holdings for all banks in Italy, a bank-dominated economy, at a monthly frequency from 2005 to 2013. We show that less capitalized banks, having less risk-bearing capacity, reduce their exposure to securities with high yields (also after controlling for the correlation with the rest of the portfolios) in response to financial markets distress, which is not consistent with the risk-shifting hypothesis. We show that this result is confined to available for sale and trading portfolios (not in held to maturity), which suggests that in crisis times low capital banks cannot afford to buy risky securities, which could further damage their balance sheet. Results hold also when we look at other sources of bank balance sheet fragility, as the exposure to the interbank market, or when we look at alternative measures of risk-taking, as the concentration risk.

21.00 – 21.30

Room: Bern

“Bank resolution and the mutualization of the public backstop in a banking union”

Presenting author: Sergio Vicente Rodríguez (Universidad Carlos III de Madrid)

Co-author: Anatoli Segura (Banca d'Italia)

Abstract: We develop a two-country model in which domestic bank failures may lead to sovereign crises. The resolution of a failing bank involves either the bail-out of its creditors or their bail-in, which can generate local contagion costs that are private information of domestic authorities. The possibility that the bail-out of a bank leads to a sovereign crisis gives risk-sharing motives to mutualize public backstops. Yet, mutualization distorts bank resolution decisions due to the informational asymmetry on bail-in costs. We study the aggregate welfare maximizing bank resolution and public backstop mutualization decisions in this framework. We show that under the optimal banking union the probability of bailing out a failing bank can be either larger or lower than in the first-best. We also find that the probability of sovereign crises may increase in a banking union relative to that in autarky. We extend the model to

analyze the interaction between direct and indirect forms of foreign support, the effect of country asymmetry, and the need of stability enhancing fiscal rules.

21.00 – 21.30

Room: Zürich

"Transitory versus permanent shocks: Explaining corporate savings and investment"

Presenting author: Enrique Schroth (Cass Business School and CEPR)

Co-authors: Sebastian Gryglewicz (Erasmus University Rotterdam), Loriano Mancini (Ecole Polytechnique Federale de Lausanne and Swiss Finance Institute), Erwan Morellec (Ecole Polytechnique Federale de Lausanne and Swiss Finance Institute and CEPR) and Philip Valta (University of Bern, University of Geneva, and Swiss Finance Institute)

Abstract: We model the investment and cash holdings decisions of a firm facing financing frictions and subject to permanent and transitory cash flow shocks. While cash holdings increase and investment decreases with the volatilities of either type of shocks, a higher correlation between these shocks makes the firm hold less cash and invest more. We verify these predictions using a sample of publicly traded U.S. firms from 1975 to 2014 and estimates of the permanent and transitory cash flow shocks obtained via structural estimation. Our analysis demonstrates that corporate policies are better understood when recognizing the separate effects of permanent and transitory shocks on cash flow risk.

21.30 – 22.00

Room: Bern

"Stock-based pay in an efficient stock market"

Presenting author: Florian Heider (ECB and CEPR)

Co-author: Riccardo Calcagno (EMLYON Business School)

Abstract: We provide a simple model of CEO moral hazard, stock-based pay, and endogenous trading of the company stock in a semi-strong efficient market. Contrary to standard intuition whereby an optimal incentive contract places less weight on a less precise performance measure, the CEO receives more stock-based pay if informed traders have less precise information about the value of the firm. When traders have less precise information about the value of the asset they trade, there is less adverse selection in the order flow and hence, more liquidity in the market. But in a more liquid market, the stock price reacts less to the order flow and hence, reacts less to the value consequences of CEO actions, including shirking. To restore the sensitivity of optimal pay to shirking, the CEO must receive more skin-in-the-game, i.e., more stock-based pay. Our model can explain the prevalence of stock-based pay in hard-to-value firms and generates new insights about the role of market conditions such as liquidity for optimal incentive contracts, as well as about the value of disclosing information to the market.

21.30 – 22.00

Room: Zürich

"Shock Propagation and Banking Structure"

Presenting author: Farzad Saidi (Stockholm School of Economics and CEPR)

Co-author: Mariassunta Giannetti (Stockholm School of Economics, ECGI and CEPR)

Abstract: We conjecture that lenders' decisions to provide liquidity are affected by the extent to which they internalize any spillover effects of negative shocks. We show that lenders with a larger share of loans outstanding in an industry are more likely to provide liquidity to industries in distress. High-market-share lenders' propensity to provide liquidity is higher when negative spillovers are expected to be stronger, such as in industries in which fire sales are more likely to ensue. Lenders with a large share of outstanding loans are also more likely to provide liquidity to customers and suppliers of industries in distress, especially when the disruption of supply chains is expected to be more costly. Our results provide a novel channel, unrelated to market power, explaining why concentration in the credit market may favor financial stability.