SDA Bocconi

Bocconi School of Management

Empower your Knowledge.

MILANO | ITALY

Research Division Claudio Dematté Seminar Series

Joint Seminar: DIR SDA and Department of Accounting

June 27, 2012 - 12:30pm

Via Roentgen 1 – 5B3 SR01

Unfair "Fair Value" in an Opaque Credit Default Swap Market: How Marking-to-Market May Have Pushed the International Credit Crunch

Presenter: Joshua Ronen (Leonard N. Stern School of Business, New York University)

Abstract

We investigate (1) the effects of mark-to-market accounting write-downs by financial institutions on equity returns, trading volume, and credit default swap ("CDS") premiums and (2) whether the write-downs induced contagion effects on similar institutions without write-downs. Specifically, we examine whether equity returns and CDS premiums of similar institutions responded significantly to write-downs by peer firms. We find that firms that write down assets to their exit values in accordance with FAS 157 not only experience

RICERCHE ACCADEMICHE

significant abnormal negative returns and a spike in the premiums of CDS written on their obligations – indicating higher default probability – but that similar firms without write downs also exhibit sympathetic and significant negative abnormal returns at the same time as the write-down firms. This is clear evidence of contagion effects induced by FAS 157 mark-to-market accounting. The analysis shows significant cross-sectional determinants of both equity abnormal returns and CDS premiums to generally include the measurement levels under FAS 157, liquidity, the amount of the write-down and rating changes.