GESY Newsletter
Governance and The Efficiency of Economic Systems

Sonderforschungsbereich Transregio 15 • A cooperation of: FU Berlin • HU Berlin • Universität Bonn • Universität Mannheim • ZEW Mannheim • LMU München

Newsletter No. 3 March 2015

SFB/TR 15 Seminars

Mannheim

Date	Speaker (Institution)	Title
March 3	Frederic Warzynski (Aarhus University)	Import Competition, Productivity and Multi-Product Firms
March 10	Bruno Jullien (Toulouse School of Economics)	tba
March 17	Jorge Balat (Johns Hopkins University)	Heterogeneous Firms: Skilled-Labor Productivity and Export Destinations

Munich

Date	Speaker (Institution)	Title
April 13	Johannes Boehm (Sciences Po)	tba

Conferences Organized by SFB/TR15 Members

Name	Topic	Dates
Stephan Lauermann Mehmet Ekmekci	Workshop: “Information Aggregation" in Bonn (Hotel Guennewig).	June 26-28
Matthias Kräkel (joint with Uschi Backes-Gellner, Oliver Fabel, Kerstin Pull, Florian Englmaier, Christine Harbring)	18th Colloquium on Personnel Economics, University of Vienna	March 25-27

External Research Visits, Lectures and Seminars of SFB/TR 15 Members

A4 (Schmidt)

Name	Topic	Dates
Klaus Schmidt	“Auctions vs Negotiation – The Effects of Renegotiation”, Seminar presentation at Central European University, Budapest	February 2
Joachim Winter	"Plan switching and inertia in Medicare Part D: Evidence from administrative data", Universität Zürich	February 17
Joachim Winter	Can survey participation alter household saving behavior?", Ökonometrischer Ausschuss des Vereins für Socialpolitik, Rauischholzhausen	February 27
Matthias Fahn	"Capital Structure Choice and the Cost of Enforcing Contracts - Theory and Evidence” (joint with Valeria Merlo and Georg Wamser), University of Bonn	January 9

Matthias Fahn	"Capital Structure Choice and the Cost of Enforcing Contracts - Theory and Evidence" (joint with Valeria Merlo and Georg Wamser), WHU Koblenz	February 9
Matthias Fahn	Research visit at the University of California, San Diego	March 3 – 30

A7 (Strausz/Wolfstetter)

Name	Topic	Dates
Roland Strausz	Optimal Sales Contracts with Withdrawal Rights, Annual Meeting of the Committee for Industrial Economics	February 25-27
Matthias Lang	visits the University Bocconi, Milan	February 11 – April 15

A9 (Corneo)

Name	Topic	Dates
Giacomo Corneo	"Democratic Redistribution and Rule of the Majority", Department of Economics Seminar, Uppsala University	March 3

C5 (Nocke)

Name	Topic	Dates
Nicolas Schutz	Humboldt University Berlin, SFB TR15 Seminar, Presentation of "Merger Policy in a Quantitative Model of International Trade" (joint with Holger Breinlich and Volker Nocke)	February

New Discussion Papers

B8 (Adam)

Name	Title	Number
Tobias Berg, Christoph Kaserer	**Does contingent capital induce excessive risk-taking?** **Abstract**: In this paper, we analyze the effect of the conversion price of CoCo bonds on equity holders' incentives. First, we use an option-pricing context to show that CoCo bonds can magnify equity holders' incentives to increase the riskiness of assets and decrease incentives to raise new equity in a crisis in cases in which conversion transfers wealth from CoCo bond holders to equity holders. Second, we present a clinical study of the CoCo bonds issued so far. We show that i) almost all existing CoCo bonds are designed in a way that implies a wealth transfer from CoCo bond holders to equity holders at conversion and ii) this contractual design is reflected in traded prices of CoCo bonds. In particular, CoCo bonds are short volatility with a magnitude five times greater than that which can be observed for straight bonds. These results are robust and economically significant. We conclude that the CoCo bonds issued so far can create perverse incentives for banks' equity holders. *Keywords*: Contingent capital, banking regulation, risk-taking incentives, asset substitution, debt overhang, credit crunch	488

B8 (Adam)		
Name	**Title**	**Number**
Tobias Berg, Anthony Saunders, Sascha Steffen	**The Total Costs of Corporate Borrowing in the Loan Market: Don't Ignore the Fees** **Abstract**: More than 80% of US syndicated loans contain at least one fee type and contracts typically specify a menu of spread and different types of fees. We test the predictions of existing theories about the main purposes of fees and provide supporting evidence that: (1) fees are used to price options embedded in loan contracts such as the draw-down option for credit lines and the cancellation option in term loans; and (2) fees are used to screen borrowers about the likelihood of exercising these options. We also propose a new total-cost-of-borrowing measure that includes various fees charged by lenders.	489

B8 (Adam)		
Name	**Title**	**Number**
Daniel Streitz	**The Impact of Credit Default Swap Trading on Loan Syndication** **Abstract**: We analyze the impact of CDS trading on bank syndication activity. Theoretically, the effect of CDS trading is ambiguous: on the one hand, CDS can improve risk-sharing and hence be a more flexible risk management tool than loan syndication; on the other hand, CDS trading can reduce bank monitoring incentives. We document that banks are less likely to syndicate loans and retain a larger loan fraction once CDS are actively traded on the borrower's debt. We then discern the risk management and the moral hazard channel. We find no evidence that the reduced likelihood to syndicate loans is a result of increased moral hazard problems. *Keywords:* Loan Sales, Credit Default Swaps, Syndicate Structure, Syndicated Loans JEL-Classification: G21, G32	490

B8 (Adam)

Name	Title	Number
Haina Ding	**Innovation strategies and stock price informativeness** **Abstract**: This paper models the interactions among technological innovation, product market competition and information leakage via the stock market. There are two firms who compete in a product market and have an opportunity to invest in a risky technology either early on as a leader or later once stock prices reveal the value of the technology. Information leakage thus introduces an option of waiting, which enhances production efficiency. A potential leader may nevertheless be discouraged from investing upfront, when anticipating its competitor to invest later in response to good news. I show that an increase in product market competition increases the option value of waiting but has an ambiguous effect on information production. It may thus be the case that intense competition leads to more leakage such that no firm would invest, especially so in a smaller market. Given a moderate level of competition, price informativeness may also improve investment outcome when investment profitability and the market size are relatively large. The model predicts that, under these conditions, the investment of a follower firm is more sensitive to share price movements. JEL Classification Code: G14, G31, D43 Keywords: Price efficiency; Information leakage; Innovation; Feedback	491

B8 (Elendner)

Name	Title	Number
Alexander Eisl, Hermann W. Elendner, Manuel Lingo	**Re-Mapping Credit Ratings** **Abstract**: Rating agencies report ordinal ratings in discrete classes. We question the market's implicit assumption that agencies define their classes on identical scales, e.g., that AAA by Standard & Poor's is equivalent to Aaa by Moody's. To this end, we develop a non-parametric method to estimate the relation between rating scales for pairs of raters. For every rating class of one rater this, *scale relation* identifies the extent to which it corresponds to any rating class of another rater, and hence enables a rating-class specific re-mapping of one agency's ratings to another's. Our method is based purely on ordinal co-ratings to obviate error-prone estimation of default probabilities and the disputable assumptions involved in treating ratings as metric data. It estimates all rating classes' relations from a pair of raters jointly, and thus exploits the information content from ordinality. We find evidence against the presumption of identical scales for the three major rating agencies Fitch, Moody's and Standard & Poor's, provide the relations of their rating classes and illustrate the importance of correcting for scale relations in benchmarking. *Key words*: credit rating, rating agencies, rating scales, comparison of ratings *JEL*: C14, G24	492

Publications

B7 (Marin)		
Name	**Topic**	**Dates**
Alexander Tarasov	Trade Costs, Conflicts, and Defense Spending (with Michael Seitz and Roman Zakharenko); Journal of International Economics 95 (2015), pp. 305-318	

SFB/TR 15 speaker: Prof. Dr. Klaus M. Schmidt. Editorial: Alexandra Frank, Ludwigstr. 28 RG, 80539 München.
URL: http://www.sfbtr15.de, phone 089/2180-3405, fax 089/2180-3510, e-mail: sfb-tr15@vwl.lmu.de