Discussion: Operational Risk and Reputation in Financial Institutions: Does Media Tone Make a Difference?

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The paper investigates equity and bond (CDS) market reactions to operational risk announcements.

Focus on the textual tone of the media announcements:
- Negative tone $\Rightarrow$ adverse reputational effects
- Litigious tone $\Rightarrow$ adverse reputational effects
- Uncertainty tone $\Rightarrow$ positive reputational effects
- Alternative sources of information mitigate the reputational effects of textual tones (e.g., loss amount disclosure, third-party announcements)
- The effects also vary by global macro factors (Anglo-Saxon countries, market-based economies)

Overall, reputational effects of media tone matter most when there is more uncertainty and less information disclosed by the media.
Comment 1: Measuring Reputational Effects

- The authors measure reputational losses as follows:

$$RCAR(x, z)_i = CAR(x, z)_i + \frac{\text{OperationalLossAmount}_i}{\text{MarketCapitalization}_i}$$

- How can the reputational loss exceed the total market loss?
  - Shouldn’t CAR be reflective of the $ ops loss plus the reputational loss?
  - In other words, CAR should include the ops loss (assuming the announcement of the loss is new information)
  - Why is setting missing announcement values to $0 conservative?
    - Wouldn’t it imply that all of the market reaction was purely reputational?
The loss-adjusted reaction is a reasonable start, but:
- The big question is how to distinguish between uncertainty about the loss amount and reputation?
- **Suggestion:**
  - Look at a sample of losses that were announced and the amount was fully known on one day.
  - The difference between the market reaction and the known loss amount should be a relatively clean measure of reputational losses.
  - Of course, the down side is that the really interesting losses (usually legal) take time to cure and settle

**Other issues:**
- **CAR estimation:**
  - Fama-French? Momentum?
  - Size anomalies for large banks (Gandhi & Lustig, 2015 *Journal of Finance*)
- Do you control for events that are more likely to be correlated (e.g., fraud) or systematic (i.e., multiple banks in the same suit - LIBOR)
- The CDS spreads are not loss-amount adjusted...so how are the changes in spreads capturing reputation effects?
The hypotheses for the main effects are straightforward for negative and litigious tones.

However, $H_2$ seems to be less clear. Why would “Investors interpret good news as bad news?”

$H_2$: The uncertainty tone in operational risk event announcements is positively associated with loss-adjusted abnormal stock returns and negatively associated with abnormal CDS spreads following the announcements.

Motivation:
- Page 3 mentions that this is the first to study equity and bond market reactions in the same paper.
- **Suggestion**: I think you could leverage this point more in your analysis. The current analysis treats the markets separately.
  - Is there a wealth transfer from equity to bond markets or vice-versa?
Other Comments

- Might want to consider separating legal losses:
  - More uncertainty when considering the first announcement
  - Litigious is obviously different for legal losses
  - Or consider tracing announcements for legal losses over time to see how market perception changes

- Introducing the cross-country macro factors (Anglo-Saxon, market vs. bank based economies, etc.) is confusing until the end of section 4
  - Suggestion: You may consider discussing the language aspect of why “Anglo-Saxon” countries are different than the others. It seems more of a language issue than a cultural issue anyhow.
Summary

- Overall, the paper was interesting to read
- There are a lot of results in there that seem robust and generally intuitive
- I look forward to reading the next version