

Fair Value-related Information in Analysts' Decision Processes: Evidence from the Financial Crisis

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Abstract: We use a sample of conference calls and analyst research reports from international banks to examine how financial analysts request and communicate fair value-related information in their valuation process. We find that analysts devote considerable attention to fair value-related topics. Most of the conference call questions and references in research reports pertain to fair value reclassifications and fair value changes of liabilities resulting from banks' own credit risk. The accounting impact of these one-time effects during the financial crisis and a lack of corresponding firm disclosures help to explain the prevalence of these two topics. The content of the questions and references suggests that analysts have different motives for their interest in fair value-related information. While some analysts adjust reported earnings for unrecognised fair value changes of reclassified assets, most of the observed analysts exclude banks' own credit risk effects from reported earnings. Thus, the use of fair value-related information varies substantially across analysts and across instruments.

Keywords: fair value accounting, fair value reclassifications, own credit risk, bank disclosure, financial analysts, conference calls, analyst reports

1. INTRODUCTION

Little evidence exists on whether and how financial analysts acquire and process information about the fair value of financial instruments, as analysts' thought processes and valuation models are largely unobservable. For the purpose of this study, we use analysts' behaviour in conference calls and analysts' communications in research

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reports as proxies for the acquisition and use of fair value-related information in their decision process. In combination, the evidence from these proxies yields at least an indication of the existence and direction of fair value adjustments in analysts' valuations of banks. While these proxies are admittedly still far from perfect predictors of analysts' decision processes, they overcome other shortcomings, particularly from experimental and survey evidence of analysts' use of fair value information (e.g., Hirst et al., 2004; Gassen and Schwedler, 2010; Gaynor et al., 2011). Most importantly, we observe analysts' behaviour under real-world restrictions where the acquisition and communication of information are costly, thus rendering the revealed preferences more credible. Therefore, our results help to triangulate the prior evidence on the use of fair value information in analysts' decision processes.

We base our analysis on the transcripts of 824 conference calls held by 95 banks reporting under International Financial Reporting Standards (hereinafter IFRS banks) from 30 countries between the first quarter of calendar year 2008 and the last quarter of 2010 and on 552 analyst reports related to these conference calls. We use a custom-designed JAVA script to decode the content of the calls. We find that the number of questions related to a bank's fair value measurement varies considerably over time and across fair value topics. Analysts devote most of the conference call time to two topics. *First*, analysts ask about the fair value reclassifications of financial assets. The International Accounting Standards Board (IASB) introduced the reclassification option during the 2008 financial crisis to enable firms to change the measurement category of financial assets after initial recognition (André et al., 2009). US Generally Accepted Accounting Principles (GAAP) permit a similar choice since the initial adoption of Statement of Financial Accounting Standards (SFAS) No. 115 in 1993. Roughly speaking, a firm's use of the reclassification option is tantamount to a switch from fair value recognition on the balance sheet and income statement to fair value disclosure in the footnotes to the financial statements. This change in the measurement basis potentially affects current and future earnings. *Second*, analysts ask about the inclusion of firms' own credit risk in the fair value measurement of financial liabilities. A firm that elects the fair value option for liabilities is required to separately disclose fair value changes that result from changes in its own credit risk. This mandatory disclosure reveals the past sensitivity of a firm's income to credit risk changes.

We focus our analysis on these two settings because they both offer useful characteristics to infer analysts' demand and processing of fair value-related information. In a first quantitative step, we assess the association of a conference call question with the actual accounting effects of reclassifications and banks' own credit risk as well as firms' reporting about these effects. In this step, we document the bank-specific reporting characteristics that are associated with analysts' interest in fair value-related information; however, we cannot infer the potential reasons for the observed questions from this analysis. Because we are ultimately interested in the analysts' motivation for these information requests, we complement the evidence in a second qualitative step via content analyses involving the *framing* of the two fair value-related topics in (1) analysts' questions during conference calls, and (2) analysts' communication and valuation exercises in their research reports.

We find that the likelihood of a conference call question being about fair value reclassifications or banks' own credit risk in the fair value measurement of liabilities is positively associated with the materiality of the underlying accounting effects (i.e., the impact of the accounting choice on metrics such as income, total assets and regulatory

capital). The likelihood of a conference call question about fair value reclassifications is also negatively associated with the extent of explanatory footnote disclosures in simultaneously published financial reports. These results suggest that financial analysts use conference calls as a substitute for explanatory footnote disclosures when fair value measurement has a considerable impact on accounting metrics. However, the results do not provide insight into analysts' subsequent processing of this information, i.e., how they apply the fair value information in their valuation process.

The content analysis involving the framing of conference call questions and analysts' research reports sheds some light on the use of fair value-related information for valuation purposes. First, we find that analysts *communicate* fair value-related information in their research reports to ensure consistency in their measurements over time, across peers, and in comparisons of actual accounting numbers with their forecasts. Second, in the *valuation context*, variation exists in the treatment of fair value-related topics across analysts, similar to what prior research observed on the use of valuation practices (Barker, 1999; Bradshaw, 2002; Demirakos et al., 2004). The large majority of analysts explicitly exclude the effects of changes in banks' own credit risk from key valuation metrics, i.e., they remove the effects of banks' own credit risk changes in liability measurements as standard adjustments (similar to the treatment of rating agencies and prudential supervisors). In contrast, the treatment of reclassifications is more complex and more diverse. Analysts continue tracking assets that are reclassified out of fair value into the cost categories (held to maturity (HTM) or loans and receivables (L&R)) for prediction purposes. While some analysts add back unrealised fair value changes of reclassified assets going forward, others adjust their predictions of different earnings components because the profit and loss (P&L) effects of reclassified assets shift from trading into interest income and impairments. Taken together, our results suggest that there is no standard processing of fair value-related information in analysts' decision processes, i.e., the decision usefulness and processing of fair value measurements are likely to be context specific.

Our results contribute to two different streams in the accounting literature. First, we add to the debate regarding the decision usefulness of fair value accounting in an attempt to better understand the black box of analysts' information processing. Our evidence complements prior evidence from surveys (e.g., Gassen and Schwedler, 2010) and experimental studies (e.g., Hirst et al., 2004; Gaynor et al., 2011; Koonce et al., 2011). Most notably, the observation of analysts' behaviour under real-world restrictions enables us to examine the external validity of prior findings on analysts' use of fair value information. Our results indicate that the general demand for fair value-related information suggested by analysts in these surveys and experiments persists, even when gathering the information is costly. However, the use of the information is largely context specific. While the simulated results in Barth et al. (2008) indicate that firms' inclusion of own credit risk in liability measurement helps reduce accounting anomalies, our evidence suggests that analysts still generally adjust GAAP income for the own credit risk effect. In contrast, unrecognised fair value changes of reclassified assets remain relevant to at least some analysts' interpretations of a bank's accounting numbers because these assets' values are tracked in subsequent periods.

Second, our results further the understanding of financial analysts' use of accounting information in general. The majority of the prior evidence is based on the associations between accounting adjustments and analysts' earnings or price estimates (e.g., De Franco et al., 2011; Barth et al., 2012). However, little evidence exists

that directly relies on analysts' behaviour during the process of financial analysis (Bradshaw, 2011). This study provides some initial evidence on situations in which analysts use conference calls to collect specific accounting information and communicate this information to their clientele. Although less stringent, the approach is innovative in that it attempts to infer the actual use of different bases of measurements in accounting from the qualitative framing of questions in conference calls and from the analysis of valuation-related text and spreadsheets as disclosed in analyst reports.

Our research is relatively explorative in nature and has obvious limitations that are important to consider when interpreting our results. Analysts' decision processes remain unobservable, and the evidence from both conference calls and analyst reports only provides indirect evidence on the inputs and outputs of these processes. In addition, the two settings that we observe are likely to provide idiosyncratic incentives for analysts' treatment of fair value information. Therefore, how generalisable our results from these specific analyses are to more general contexts in which analysts process fair value-related information remains unclear. Moreover, we cannot draw inferences on the aggregate perception of all analyst participants. Strictly speaking, we can only infer the interests of the one specific analyst who actively decides to request the information during a call or to communicate the information in a report. Finally, our investigation period spans the financial crises, which can be interpreted as either powerful or too specific as a setting for the analysis of fair value-related topics in general.

2. DEMAND FOR FAIR VALUE-RELATED INFORMATION IN CONFERENCE CALLS

Because there is no comprehensive theory or prior evidence on analysts' selection of questions during conference calls, we need evidence on the frequency and content of fair value-related questions to motivate our empirical predictions. This section summarises the evidence and provides the basis for the development of our predictions.

(i) Decoding of Conference Call Content

We base our analysis on all of the conference call transcripts of IFRS banks that are available in the *Thomson Reuters StreetEvents* database for the period from January 1, 2008, to December 31, 2010. We limit the analysis to the universe of financial firms for which accounting data are available in *BvD Bankscope* and capital market data are available in *Thomson Reuters Datastream*. Our final sample comprises 824 distinct transcripts for 95 banks from 30 countries.

We identify all text passages that potentially include relevant analyst questions using an automated keyword search. For this procedure, we apply a custom-designed JAVA script that is able to identify the question and answer (Q&A) session of a call by searching for different keywords and aligning the identified text passages with data on both the involved analyst and the conference call. We use 76 different keywords that capture the term *fair value* and synonyms as well as terms associated with specific aspects of fair value accounting (see Appendix A for details). The automated screening for keywords in all of the conference call transcripts initially returns 925 unique text passages during the Q&A sessions, which we read and process manually in the

next step. Through manual inspection of each automatically generated unique text passage containing a keyword, we identify 205 relevant conference call-specific analyst observations¹ with fair value-related questions in 129 different conference calls. In an additional step, we search for keywords from general accounting terminology (e.g., *other comprehensive income*) to also capture fair value-related questions that do not use fair value-related terminology. This screening yields 3,418 unique text passages, from which we add only four relevant analyst observations and one conference call observation to our sample. Our final sample, thus, comprises 209 analyst observations in 130 different conference calls by 41 banks (of 824 calls by 95 IFRS banks).

(ii) Distribution of Analysts' Questions across Topics and over Time

On average, analysts ask questions about fair value-related information in 15.8% of all of the conference calls in our sample (130 of 824 calls). The distribution of questions varies considerably both across fair value-related topics and over the 12 quarters in our observation period. Table 1 documents that analysts' questions most frequently address two fair value-related topics: (1) the reclassification of financial assets (110 of 209 questions), and (2) the use of the fair value option for liabilities (63 questions).² The first topic, *Reclassification of Financial Assets*, captures questions about the reclassification of financial assets that became possible under the amendment to IAS 39 in October 2008 and that was permitted by US GAAP since the initial adoption of SFAS 115 in 1993. The second topic, *Fair Value Option (Liabilities)* includes questions referring to the use of the fair value option for financial liabilities and the (potential) effect of changes in a firm's own credit risk. Appendix B lists examples of our identification and grouping of relevant text passages. Over time, the number of observations ranges from a high of 45 different questions in 34.7% (26 of 75) of calls during the fourth calendar quarter of 2008 to a low of two questions in 5.1% (2 of 39) of calls during the second calendar quarter of 2010.

Thus, our investigation suggests that analysts use conference calls in very specific situations to request information about a bank's fair value accounting practices. Reclassifications and the fair value option for liabilities are accounting choices that affect a bank's current and future earnings. Both choices result in a one-time effect on earnings that potentially dampens a bank's comparability with peer banks and its persistence of earnings in the future. Because benchmarking against peers and forecasting future earnings are among analysts' core tasks in their decision processes, analysts have particular incentives to better understand the two accounting choices, which helps to explain why they allocate their scarce time during conference calls to these fair value-related topics. Because analysts discuss other fair value-related topics infrequently, our analysis focuses on questions related to these two fair value-related topics.

While the evidence suggests that financial analysts use conference calls to actively request fair value-related information from international banks, judging the economic significance of the observed frequencies is difficult. To provide some intuition, we

1 We aggregate all of the text passages related to the same analyst during one conference call as one observation. Consequently, each observation can include multiple questions on different topics.

2 Among the 47 *Other* questions, the largest number of questions address level 3 fair values or the fair value hierarchy in general (19 questions). The number of observations on these topics is too low to conduct any meaningful analyses.

Table 1
Descriptive Statistics for Fair Value-related Questions

Quarter	Conference Calls Analysed		All Identified Questions			Reclassification of Financial Assets			Fair Value Option (Liabilities)			Other		
	#CC	Col. %	#CC	%	#Q	#CC	%	#Q	#CC	%	#Q	#CC	%	#Q
Q1 2008	63	7.6	10	15.9	14	0	0.0	0	6	9.5	7	5	7.9	8
Q2 2008	70	8.5	7	10.0	10	0	0.0	0	6	8.6	9	2	2.9	2
Q3 2008	69	8.4	5	7.2	5	0	0.0	0	3	4.3	3	3	4.3	3
Q4 2008	75	9.1	26	34.7	45	21	28.0	30	7	9.3	13	2	2.7	2
Q1 2009	68	8.3	19	27.9	30	17	25.0	25	2	2.9	2	5	7.4	5
Q2 2009	63	7.6	15	23.8	26	11	17.5	21	4	6.3	4	2	3.2	3
Q3 2009	68	8.3	10	14.7	20	6	8.8	10	3	4.4	5	4	5.9	5
Q4 2009	68	8.3	10	14.7	22	7	10.3	11	5	7.4	7	3	4.4	6
Q1 2010	78	9.5	8	10.3	9	3	3.8	4	3	3.8	3	3	3.8	3
Q2 2010	39	4.7	2	5.1	2	0	0.0	0	1	2.6	1	1	2.6	1
Q3 2010	87	10.6	12	13.8	16	5	5.7	7	5	5.7	7	2	2.3	2
Q4 2010	76	9.2	6	7.9	10	2	2.6	2	2	2.6	2	5	6.6	7
Total	824	100.0	130	15.8	209	72	8.7	110	47	5.7	63	37	4.5	47

Note:

Table 1 presents the number of conference calls with analysts' questions identified (#CC) as well as the total number of analysts' questions (#Q) by quarter separately for IFRS-reporting banks. The column *All Identified Questions* reports the overall number of conference calls containing at least one analyst question as well as the total number of analysts' questions relating to issues of fair value accounting. The remaining three columns report question frequencies for different topics of fair value accounting that resulted from an explorative examination of identified text passages. *Reclassification of Financial Assets* captures questions about the reclassification of financial assets that became possible under the amendment to IAS 39 in October 2008. The column *Fair Value Option (Liabilities)* captures questions referring to the use of the fair value option for financial liabilities. Other questions on issues of fair value accounting that do not relate to the four aforementioned topics (e.g., fair value hierarchy) are summarised in the column *Other*. Note that each question reported in the column *All Identified Questions* may relate to more than one specific topic of fair value accounting.

benchmark the frequencies of the fair value-related questions that we observed for the IFRS banks (see Table 1) against the frequencies of fair value-related questions in a sample of 2,072 conference calls of 202 US banks³ and the frequencies of questions related to alternative accounting topics that are central to banks' accounting in the IFRS bank sample. First, we find that fair value-related questions occur less frequently in the US benchmark sample, with 76 distinct questions in 3% of calls (63 of 2,072). Most of these questions relate to other fair value-related topics (40 of 76 questions). Notably, we observe only 14 (26) questions relating to fair value reclassification (the fair value option for liabilities), which is consistent with the lower frequency in which US banks apply the reclassification option and the fair value option (e.g., Laux and Leuz, 2010). As a second benchmark, we use our automated script to search for impairments, loan loss provisions, and hedge accounting. We find that 32.2%, 21.6% and 14.3% of the 824 conference calls held by IFRS banks contain questions including the word stems *impair**, *loan loss*, and *hedge**, respectively.⁴ While these findings highlight that fair value-related topics may not be the most important accounting issues mentioned during conference calls in our sample period, the two fair value-related topics that we study still receive comparable attention relative to other prominent accounting topics

3. RELATED LITERATURE AND EMPIRICAL PREDICTIONS

(i) *Related Literature*

Our research contributes to two streams in the accounting literature. First, our findings help to triangulate evidence from prior literature on the use of fair value-related information in financial analyses. Second, we provide evidence on the interaction between firms' disclosure choices and analysts' behaviour during the process of financial analysis.

(a) Financial Analysts' Use of Fair Value-related Information

Prior research has used a variety of methods to investigate the usefulness of fair value information. Our major contribution to the literature is the introduction of another perspective by observing how analysts reveal their demand for fair value-related information in a real-world situation when there are significant costs of requesting and communicating such information. Given the importance of choosing the most useful measurement basis in accounting regulations, evidence from a variety of different research methods is indispensable to fully understand the effects of fair value accounting.

Much of the prior capital market research focuses on associations between banks' accounting numbers under different bases of measurement and stock prices or stock returns (value relevance). The evidence from these studies robustly suggests that the fair values of banks' derivatives, trading and investment securities have

³ The process of selecting the sample and identifying relevant text passages is equivalent to that for the sample of IFRS banks.

⁴ In terms of text passages, the word stem *impair** (*loan loss*, *hedge**) can be found in 572 (279, 168) unique text passages of the Q&A sessions. This result compares to 175 unique text passages identified by the term *fair value* for the sample of 824 conference calls held by IFRS banks.

incremental value relevance over amortised cost (Barth et al., 1996; Eccher et al., 1996; Graham et al., 2003; Ahmed et al., 2006), with the value relevance being a function of the reliability of the fair value measurement as proxied by, for example, the fair value hierarchy (Song et al., 2010; Cheng, 2012). However, the economic mechanisms behind these associations remain largely a black box because how this information is used in individual investors' valuation models is unclear (Barth et al., 2001; Holthausen and Watts, 2001). The context of conference call questions and communications in research reports helps to obtain more direct evidence on whether and how financial analysts process fair value information.

Second, experimental studies in a constructed laboratory address the perceived usefulness of fair value accounting. Hirst et al. (2004) find that bank equity analysts use fair value information that is presented on the balance sheet but are less likely to incorporate footnote information about fair values in their risk judgments. Koonce et al. (2011) suggest that fair value information about assets is perceived to be more relevant than fair value information about liabilities. In a similar vein, Gaynor et al. (2011) report that accounting professionals are prone to misinterpretations of gains and losses from fair value changes of liabilities. While an experimental research design offers several advantages, the extent to which the findings translate into a real-world setting, where the incentives can differ drastically from an experiment, is unclear.

Finally, survey studies and interviews represent a third research method. Gassen and Schwedler (2010) document that professional investors and advisors perceive fair value, on average, to be the most useful measurement basis but that the perceived usefulness substantially decreases if fair values are not derived from readily observable market prices. These results are largely consistent with similar non-academic surveys conducted by the CFA Institute (2010) and auditing firms (e.g., PricewaterhouseCoopers, 2010). However, surveys tend to suffer from response bias when the cost of indicating a demand for more fair value information is negligible. In addition, whether the observed answers are representative of real-world priorities that also reflect the costs of gathering supplementary fair value-related information under the current mixed-attributes model and extant disclosure requirements is unclear. If, for example, the benefit of fair value-related information was very small, survey answers would not adequately reveal that its practical use is limited. In contrast, the consumption of limited conference call time or space in a research report comes at a considerable cost. Therefore, conference calls and analysts' communications with investors offer a natural laboratory with real-world incentives that overcome the general external validity weakness of experiments and surveys.

(b) Analysts' Information Demands and Firms' Financial Reporting

Our study adds to the literature on financial analysts' behaviour in two ways. First, we address how analysts pursue and communicate fair value-related information. Second, we examine how analysts' use of conference call questions interacts with their use of alternative disclosure channels (particularly financial reports). Unique to this research, these two questions focus on the input of the valuation process, whereas most of the prior literature has studied the output of the valuation process (e.g., Ramnath et al., 2008; Bradshaw, 2011).

Francis et al. (1997) present early evidence on the content of management's starting presentation and analysts' questions during conference calls. The evidence indicates

that analysts have a special interest in financial data (i.e., accounting results), but the study does not document any content that is related to the underlying accounting choices. In general, conference call events are associated with abnormal price behaviour (Francis et al., 1997) and trading activity (Frankel et al., 1999), suggesting that conference call disclosures contain relevant news for market participants. The information content varies in several dimensions. Consistent with conference calls being a substitute for financial reporting, Tasker (1998) finds a negative association between managers' use of conference calls and industry-based measures of the information quality of financial statements. Related evidence suggests that management considers the characteristics of the participating analysts when shaping the content of calls (Mayew, 2008; Bushee et al., 2011). However, this literature largely focuses on *managers'* disclosure choices during a conference call (see also Hollander et al., 2010). Thus, prior research provides limited evidence about *analysts'* incentives in shaping the content of a conference call's Q&A session by their information requests. Our study provides initial evidence on the relationship between analysts' choices of conference call questions and alternative disclosure channels.

(ii) Analysts' Demand and Communication of Fair Value-related Information

In this section, we develop predictions of the determinants of fair value-related questions during conference calls and fair value-related references in research reports. The predictions relate to the accounting impact and firms' disclosure of information about fair value reclassifications and own credit risk changes in liability measurement.

(a) Impact of Fair Value Measurement on Key Accounting Metrics

Analysts participate in conference calls as part of their information-gathering process. They expect to receive new information that serves as a useful input for their valuation process (Frankel et al., 1999; Matsumoto et al., 2011). Because time is a limited resource in any conference call, analysts must allocate their limited time to topics that are the most relevant to the context of their economic decisions. We predict variations in analysts' tendencies to ask fair value-related questions across firms because the potential benefit of the information is likely to guide the allocation of conference call time to fair value-related topics. Analysts will only invest their costly time into fair value-related topics if it makes an economically significant difference to their decision process, i.e., when fair value information substantially deviates from amortised cost information. We predict that the impact of fair value accounting (versus amortised cost accounting) on important summary figures triggers such a deviation. The larger the accounting effect of a fair value measurement is, the higher the potential benefit for the valuation process is and, therefore, the more probable the allocation of limited conference call time is. Consequently, we expect to find a positive association between fair value-related questions in conference calls and the potential impact of fair value measurements on key accounting metrics used in financial analyses.

Similar restrictions exist for analysts' communications with investors. Therefore, we expect to find the same association between fair value-related references in analysts' research reports and the accounting impact of the fair value information.

(b) Conference Call Questions and Firms' Financial Reporting

Prior evidence indicates that analysts actively use details from the footnotes to the financial statements (De Franco et al., 2011). Theoretically, the public disclosure of specific information in financial reports can either substitute or complement analysts' information search during a conference call. If public disclosure simply reduces the remaining amount of private information, the release of more public information will mitigate analysts' incentives to acquire private information (Diamond, 1985). Under this condition, public disclosure is a *substitute* for the collection of private information. In contrast, Kim and Verrecchia (1997) model a world in which the collection of private information complements publicly available information from firm announcements. One argument is that the individual skills and expertise developed from the costly acquisition of private information help analysts to improve their interpretation of publicly reported accounting numbers (e.g., Mayew, 2008). The release of public disclosures therefore provides an incentive to invest in the acquisition of additional private information. Under this condition, the collection of private information is a *complement* to the amount of public disclosure.

Which of these two effects will persist among the other factors depends on the type of information requested. The more complex the topic is, the larger the potential benefit of obtaining private information is, i.e., the more likely it is that a complementary relationship exists between the public information and the private information. The private information benefit from individual expertise is likely to be small when the public disclosure is a technical accounting issue, such as fair value accounting. Hence, we conjecture that the two disclosure channels act as substitutes for fair value-related information. Specifically, we predict that financial analysts are more likely to request fair value-related information from a bank if details are missing from the bank's financial report. A substitutive relationship also arises if analysts interpret opaque disclosures on important accounting topics to be a negative signal. Under this explanation, the opacity of public disclosure provokes analysts' interest in the specific topic. Accordingly, we expect that analysts' demands for fair value-related information are negatively associated with the extent of the corresponding footnote disclosures in banks' financial reports.

(iii) Analysts' Processing of Fair Value-related Information

In this section, we develop specific predictions regarding analysts' processing of fair value information about reclassified assets and own credit risk changes in liability measurement, which, as discussed in section 2, are the two types of fair value-related information that analysts most frequently enquire about during conference calls and refer to in research reports.

(a) Reclassification of Financial Assets

In October 2008, the IASB amended IAS 39, giving firms the option to retroactively reclassify certain financial assets from fair value into cost categories (André et al., 2009). A simultaneous amendment to IFRS 7 introduced extensive quantitative and

qualitative disclosure requirements on the use of the reclassification option (Bischof et al., 2013). The shift from fair value recognition on the balance sheet and income statement to fair value disclosures in the footnotes could potentially affect current and future earnings and ultimately influence investors' evaluations of banks' profitability and capitalisation.

Ex-ante, how financial analysts use information about the fair values of reclassified assets in their decision processes is unclear. On the one hand, the option provides banks with an opportunity for the discretionary management of accounting numbers. If banks use the option primarily to forgo fair value write-downs, an adjustment of reported accounting numbers for the reclassification effect is likely to provide useful information for financial analysis, especially in comparison to peers that did not reclassify. In this vein, the CFA Institute warned investors to be '*on alert to significant adjustments to reported numbers due to reclassification choices that distort performance reporting, and to situations where these reported numbers are not comparable across different reporting companies*' (Papa, 2013). On the other hand, banks also use the option when the holding intention of an asset changes. Because banking book and trading book assets generate different earnings components that analysts typically forecast separately (Ryan, 2007), a true transfer from the trading book into the banking book would also change the way in which the asset generates future earnings streams. In such a case, analysts will have less of an incentive to adjust earnings for unrecognised fair value changes. Instead, they will be more likely to integrate the bank's accounting choice into their own valuation.

(b) Own Credit Risk Changes in Liability Measurement

Under both IFRS and US GAAP, the fair value of liabilities includes effects from an entity's own credit standing. A decline in a firm's credit standing results in the entity reporting a fair value gain, while an improvement in a firm's credit standing leads to the entity reporting a fair value loss.

Ex-ante, how analysts use this information in their valuation processes is again unclear. On the one hand, the inclusion of changes in a firm's own credit risk in liability measurement mitigates artificial volatility and helps to reduce accounting anomalies (Barth et al., 2008). More predictable earnings could be beneficial for financial analyses. On the other hand, firms have little guidance regarding how to measure their own credit risk effect in practice. The resulting diversity in accounting practices is likely to dampen the comparability of earnings across time and peer firms and, therefore, provide an incentive for analysts to exclude the effect of a firm's own credit risk from the firm's reported earnings.

Consistent with this view, anecdotal evidence suggests that rating agencies generally adjust for the impact of changes in firms' own credit risk on earnings and balance sheet figures. FitchRatings (2012), for example, state that they '*[...] believe it is critical to distinguish between core bank earnings and noncash valuation adjustments that have little to do with the fundamental financial performance of the bank. As a result, we back out DVA [debt valuation adjustments] gains and losses from reported pretax earnings in our analysis of quarterly results and in the computation of relevant credit metrics*' (see also Moody's, 2010, for a similar statement).

4. DETERMINANTS OF ANALYSTS' DEMANDS AND COMMUNICATIONS OF FAIR VALUE-RELATED INFORMATION

(i) Data

We use two different samples in our analysis of the determinants of analysts' conference call questions (Table 2, Panel A). First, for each IFRS bank that encounters a question on reclassifications during its conference calls, we track the reporting period in which the accounting choice is initially disclosed by the bank. We then limit our analysis to conference calls that took place between the public announcement of the amendment to IAS 39 (October 13, 2008) and one calendar year after the first bank-specific reporting period that includes the initial choice of reclassification. We eliminate all other conference call observations to avoid too much time lapse between the call and the initial accounting choice. We do not include non-reclassifying banks in the sample because analysts rarely ask a question about reclassification if no reclassification took place, and, by definition, data on the quantity of reclassifications do not exist for these banks. Second, for each IFRS bank that encounters a question about its own credit risk, we use information from the original financial statement to verify that the bank actually elected the fair value option for financial liabilities. Again, we exclude banks that do not use the option. In total, our analysis includes 162 conference call observations for questions related to the reclassification of financial assets and 425 observations for questions on the use of the fair value option for financial liabilities.

We also use two different samples for the analysis of the determinants of fair value-related communications in analysts' research reports (Table 2, Panel B). We download the relevant analyst reports from the *Thomson Reuters Investext* database. We exclude reports if they were published later than 5 days after the corresponding conference call, do not exceed two pages in length, or are not written in English. To keep the sample manageable for manual inspection, we focus on reports issued for IFRS banks that are part of our reclassification sample, and fiscal quarters in which the bank either initially discloses the reclassification choice or experiences a related question in its earnings conference call. To avoid a bias from multiple reports issued by the same brokerage house (i.e., report updates), we aggregate the observations by broker, bank and fiscal quarter. We further limit the sample to observations during the reporting period of the bank's initial adoption of the reclassification option (to keep a balanced sample). After excluding observations with missing accounting data, these additional filters result in a final testable sample of 291 observations for reclassifications and 235 observations for firms' own credit risk changes.

(ii) Research Design

We run the following general form logit regressions at the conference call and analyst report level, respectively, to provide evidence on the determinants of (1) analysts requesting fair value-related information in conference calls, and (2) analysts communicating this information to investors in their research reports:

$$\Pr(\text{Question_Dummy} = 1) = \beta_0 + \beta_1 \text{Fair Value Impact} + \beta_2 \text{Disclosure} + \sum \beta_j \text{Controls}_j + \varepsilon \quad (1)$$

Table 2
Sample Selection for the Analyses of Conference Calls and Analysts Reports

Panel A: Sample Selection for the Analyses of Conference Calls		
	# Conference Calls	# Banks
<i>Initial sample</i>	824	95
<i>Reclassification of Financial Assets</i>		
Conference call observations for banks that made use of the reclassification option for financial assets	492	49
– Conference call observations outside the relevant time period between the first bank-specific fiscal year ending after the reclassification amendment and one year after this date	–303	
	189	40
– Conference call observations with missing data on accounting or conference call characteristics	–27	
	162	38
<i>Fair Value of Liabilities</i>		
Conference call observations for banks that made use of the fair value option for financial liabilities	582	59
– Conference call observations with missing data on accounting or conference call characteristics	–157	
	425	49
Panel B: Sample Selection for the Analyses of Analysts' Research Reports		
	# Analyst Reports	# Banks
<i>Initial sample</i>	552	45
<i>Reclassification of Financial Assets</i>		
Analyst report observations for banks that made use of the reclassification option for financial assets	552	45
– Analyst report observations not relating to the initial adoption of the reclassification option	–231	
	321	41
– Analyst report observations with missing data on accounting characteristics	–30	
	291	41
<i>Fair Value of Liabilities</i>		
Analyst report observations for banks that made use of the fair value option for financial liabilities	322	32
– Analyst report observations with missing data on accounting characteristics	–87	
	235	32

Note:

Table 2 presents the sample selection of conference call observations (Panel A) and analyst report observations (Panel B) for the analyses of analysts' questions and references in research reports on the reclassification of financial assets and the use of the fair value option for financial liabilities.

$$\Pr(\textit{Reference_Dummy} = 1) = \beta_0 + \beta_1 \textit{Fair Value Impact} + \sum \beta_j \textit{Controls}_j + \varepsilon \quad (2)$$

In each specification, we estimate the model separately for reclassifications of financial assets and the use of the fair value option for financial liabilities. For the analysis of conference calls, the dependent variable, *Question.Dummy*, is an indicator variable that takes a value of one if at least one question relating to fair value reclassifications or the fair value of liabilities is identified in the conference call, and a value of zero otherwise. Similarly, the dependent variable for the analysis of analyst reports, *Reference.Dummy*, is an indicator variable that takes a value of one if the analyst mentions the reclassification of financial assets or changes in the firm's own credit risk in his research report, and a value of zero otherwise.

Test variables capture the accounting effect of the fair value measurement (*Fair Value Impact*) and, for the analysis of conference call questions, the quantity of disclosure related to a fair value topic at the firm level (*Disclosure*). Consistent with our predictions, we expect the coefficient estimates for *Fair Value Impact* to be positive and the coefficient estimates for the *Disclosure* variable to be negative. We include conference call quarter fixed effects in all of the regressions to control for a potential time trend in the likelihood of a conference call question. We include contributor fixed effects in all of the analyst report regressions to control for the idiosyncratic content and reporting style of different brokerage houses. We calculate standard errors clustered by firm to account for potential correlations among residuals within firm observations (Petersen, 2009).

We use setting-specific test variables for *Fair Value Impact* (source: hand collected from the financial reports). To measure the impact of reclassifications, we use (1) the carrying amount of reclassified assets scaled by total assets (*Assets Reclassified*), (2) the reclassification effect on net income scaled by net income before reclassification (*Effect on Net Income*), and (3) the reclassification effect on Tier 1 capital scaled by Tier 1 capital before reclassification (*Effect on Tier 1 Ratio*). While *Assets Reclassified* captures the extent of banks' use of the reclassification choice, we include *Effect on Net Income* and *Effect on Tier 1 Ratio* to capture the effect of the reclassification choice on two accounting-based metrics that are relevant for the analysis of financial institutions.

We also use three proxies to capture the (potential) effect resulting from measuring financial liabilities at fair value and changes in a bank's own credit risk. However, the key difference between the two settings arises from reclassifications as an accounting choice without any underlying direct economic change. In contrast, the fair value effect of changes in firms' own credit risk reflects an actual economic change in the bank's credit standing. Therefore, questions about the latter effect are likely to be motivated by not only the reported accounting outcome but also the analysts' initial expectations on the reporting effect. Observable measures of a bank's own credit risk (such as a bank's credit default swap spread) are likely to shape these expectations. We use the following variables: (1) the carrying amount of financial liabilities measured at fair value scaled by total assets (*Fair Value of Liabilities*), (2) the *reported* accounting effect of changes in banks' own credit risk on net income scaled by total assets (*Reported OCR Effect*), and (3) the *potential* accounting effect of changes in banks' own credit risk (*Expected OCR Effect*).⁵ We measure the potential effect of changes in a bank's own

⁵ Note that the data necessary for *Reported OCR Effect* and *Expected OCR Effect* are not available for some banks, which reduces the sample size from 425 to 271 and 352 conference call observations, respectively.

credit risk as the change in the bank's spread for 5-year credit default swaps between the end of the most recent fiscal quarter and the end of the previous fiscal year (source: *Thomson Reuters Datastream*). In all of the specifications, we winsorise our proxies for the *Fair Value Impact* at the top and bottom 1% and use the natural logarithm in our regressions to mitigate measurement errors from extreme outliers.

We consider two communication channels to investigate the effect of a bank's disclosures on analysts' propensity to ask for fair value-related information: (1) disclosures in the financial report (*Disclosure Financial Report*), and (2) disclosures during management's starting presentation in the conference call (*Disclosure Starting Presentation*). To capture the level of disclosures in financial reports, we hand collect information on mandated disclosure items from the financial reports. Specifically, our proxy for the quantity of disclosures that are related to a bank's reclassifications is based on a score of the six individual disclosure items that are required by IFRS 7, para. 12A, lit. (a)–(f), but for which there is considerable non-compliance (see Bischof et al., 2013). We develop a conceptually similar score related to firms' own credit risk disclosures using the two individual disclosure items that are required by IFRS 7, para.10, lit. (b), and para.11, lit. (a). Under both definitions, *Disclosure Financial Report* is an indicator variable that is equal to one if a bank's disclosure score is above the sample mean, i.e., if the disclosure quantity is high, and equal to zero otherwise.

Management's discussion of the financial results in the formal presentation at the start of a conference call potentially contains additional information about the reclassification of financial assets or the effect of changes in a firm's own credit risk on the measurement of financial liabilities. We identify relevant disclosures by applying the same keyword search strategy as described in section 2 to the presentations at the start of the conference calls. *Disclosure Starting Presentation* is an indicator variable that is equal to one if management's starting presentation includes specific information on the reclassifications or fair values of financial liabilities, and is equal to zero otherwise. If management's discussion only includes unspecific information, general comments or remarks on the topic, the disclosure indicator equals zero. We estimate different specifications including a combined disclosure variable (the maximum of the two variables *Disclosure Financial Report* and *Disclosure Starting Presentation*) and both disclosure variables separately. For the analysis of analysts' references to fair value-related information in their research reports, we include *Disclosure Starting Presentation* as a control variable to address the possibility that analysts merely cite topics that are discussed during management's starting presentation.

We measure firm-level controls at the end of each fiscal year. *Tier 1 Ratio* is a proxy for a bank's capital strength and is calculated as Tier 1 capital divided by risk-weighted assets (source: *BvD Bankscope*). *Return on Assets* is a proxy for a bank's profitability and is calculated as profit before taxes divided by the book value of total assets (source: *BvD Bankscope*). *Total Assets* controls for the size of the bank and is calculated using the natural logarithm (source: *BvD Bankscope*). *Analyst Following* is the average monthly number of 1-year earnings per share analyst estimates included in the firm's I/B/E/S consensus forecast (source: I/B/E/S). *Short-term (Long-term) Stock Performance* is a proxy for a bank's short-term (long-term) performance and is measured as the buy-and-hold return for the last 65 (260) trading days prior to the end of the relevant fiscal quarter (source: *Thomson Reuters Datastream*). *Volatility* is the standard deviation of the bank-specific stock return for the last 65 trading days prior to the end of the relevant fiscal quarter (source: *Thomson Reuters Datastream*). To control for general economic

conditions, we include the country-specific growth of the gross domestic product in the year of the conference call (source: *World Bank*).

In all of the regressions at the conference call level, we further control for conference call characteristics. The characteristics include *Conference Call Length* and *Analysts Participating*, which we measure as the natural logarithm of the number of pages in a conference call document⁶ and the number of analysts actively participating in a conference call. We include *Conference Call Length* to capture the variance in the time restrictions across conference calls. Similarly, *Analysts Participating* controls for the increased likelihood of observing fair value-related questions when more analysts are participating in a call. We winsorise all of the control variables at the top and bottom 1% (before taking the natural logarithm). Appendix C provides definitions of all of the explanatory variables that we use in the determinants analyses.

(iii) Results for Analysts' Demands for Fair Value-related Information

Table 3 presents evidence on the determinants of conference call questions related to the reclassification of financial assets. The descriptive statistics in Table 3, Panel A present the impact of the reclassifications for the banks in our sample. Although all of the conference call observations are from banks that used the reclassification option, these statistics show that substantial variation exists in the extent and resulting accounting effects of reclassifications. On average (median), assets reclassified amount to 2.73% (1.02%) of total assets (book values). Pretax income (Tier 1 capital ratio) differs from the pre-reclassification figure by 35.98% (2.59%), on average, and by 8.79% (1.16%) at the median. While some reclassifying banks reported no impact on net income, five banks in our sample increased their pretax net income by more than 100%. As indicated by an average disclosure indicator of 0.58, the banks in our sample provided footnote disclosures above the overall mean. Only 8% of all of the conference call observations contain detailed information on the impact of reclassifications in management's starting presentation. Overall, the observed variation facilitates the determinants analysis.

Table 3, Panel B presents the results of the logit regressions explaining the conference call questions related to reclassifications of financial assets. The table reports the marginal effects evaluated at the mean (median) of the continuous (binary) independent variables. The table is organised into three blocks that differ by the definition of the test variable *Fair Value Impact*. We consider two specifications of regression model (1) in each block that differ by the inclusion of either the combined disclosure variable or the two individual disclosure variables (*Disclosure Financial Report* and *Disclosure Starting Presentation*).

Consistent with our prediction, the results suggest that the likelihood of a question about fair value reclassifications is positively associated with the magnitude of the reclassification effect. More precisely, the coefficient estimates for the reclassification impact are positive and statistically significant when we measure the impact by *Assets Reclassified* (p -value < 0.01) and *Effect on Tier 1 Ratio* (p -value < 0.05). When we measure the impact by the net income effect (*Effect on Net Income*), the association between the

6 No information exists on the exact duration (in terms of time) of conference calls in *StreetEvents*. However, because *StreetEvents* provides conference call documents in a standardised format, the number of pages in a transcript should be a valid proxy to capture the length of a conference call.

Table 3

Descriptive Statistics and Logistic Regression of Questions on the Reclassification of Financial Assets

Panel A: Descriptive Statistics						
	<i>N</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>P1</i>	<i>Median</i>	<i>P99</i>
Reclassification Variables						
<i>Assets Reclassified</i>	162	2.73	4.61	0.00	1.02	23.01
<i>Effect on Net Income</i>	162	35.98	60.03	0.00	8.79	254.55
<i>Effect on Tier 1 Ratio</i>	162	2.59	3.82	0.00	1.16	16.27
<i>Disclosure</i>	162	0.58	0.50	0.00	1.00	1.00
<i>Disclosure Financial Report</i>	162	0.55	0.50	0.00	1.00	1.00
<i>Disclosure Starting Presentation</i>	162	0.08	0.27	0.00	0.00	1.00
Firm Characteristics						
<i>Tier 1 Ratio</i>	162	10.29	2.96	5.13	9.75	19.93
<i>Return on Assets</i>	162	0.36	0.89	-1.38	0.27	3.40
<i>Total Assets</i>	162	560.90	623.87	24.60	230.98	2,202.42
<i>Analyst Following</i>	162	18.88	6.80	2.00	19.83	35.17
<i>Short-term Stock Performance</i>	162	0.03	0.50	-0.73	-0.04	2.00
<i>Long-term Stock Performance</i>	162	-0.46	0.31	-0.92	-0.52	0.56
<i>Volatility</i>	162	0.05	0.02	0.02	0.05	0.13
Country Characteristics						
<i>GDP Growth</i>	162	-3.19	2.41	-6.99	-3.97	3.77
Conference Call Characteristics						
<i>Conference Call Length</i>	162	21.35	7.70	8.00	21.00	47.00
<i>Analysts Participating</i>	162	8.59	4.17	1.00	8.00	18.00
Panel B: Logit Analysis of Questions on the Reclassification of Financial Assets						
<i>Explanatory Variables</i>	<i>Dependent Variable = Reclassification Question Indicator</i>					
	<i>Assets Reclassified</i>		<i>Effect on Net Income</i>		<i>Effect on Tier 1 Ratio</i>	
	(1)	(2)	(1)	(2)	(1)	(2)
Reclassification Variables						
<i>Fair Value Impact</i>	0.125***	0.084**	0.019	0.016	0.088**	0.059*
	(0.044)	(0.038)	(0.020)	(0.014)	(0.038)	(0.031)
<i>Disclosure</i>	-0.065*		-0.078		-0.088**	
	(0.035)		(0.049)		(0.042)	
<i>Disclosure Financial Statement</i>		-0.081***		-0.102***		-0.105***
		(0.026)		(0.026)		(0.027)
<i>Disclosure Starting Presentation</i>		0.072		0.113		0.102
		(0.056)		(0.074)		(0.068)

Table 3 (Continued)

<i>Explanatory Variables</i>	<i>Dependent Variable = Reclassification Question Indicator</i>					
	<i>Assets Reclassified</i>		<i>Effect on Net Income</i>		<i>Effect on Tier 1 Ratio</i>	
	(1)	(2)	(1)	(2)	(1)	(2)
Control Variables						
<i>Tier 1 Ratio</i>	0.003 (0.009)	0.001 (0.006)	0.001 (0.012)	-0.002 (0.007)	0.000 (0.010)	-0.003 (0.006)
<i>Return on Assets</i>	-0.106* (0.056)	-0.081* (0.044)	-0.130** (0.063)	-0.086* (0.051)	-0.106* (0.060)	-0.070 (0.046)
<i>Ln(Total Assets)</i>	-0.008 (0.022)	-0.009 (0.015)	-0.016 (0.031)	-0.014 (0.020)	-0.028 (0.032)	-0.022 (0.023)
<i>Ln(Analyst Following)</i>	0.012 (0.068)	-0.002 (0.042)	0.064 (0.086)	0.022 (0.050)	0.027 (0.079)	0.001 (0.047)
<i>Short-term Stock Performance</i>	-0.073 (0.086)	-0.037 (0.055)	-0.070 (0.084)	-0.023 (0.049)	-0.052 (0.079)	-0.014 (0.048)
<i>Long-term Stock Performance</i>	-0.044 (0.147)	-0.031 (0.092)	-0.174 (0.180)	-0.123 (0.108)	-0.143 (0.166)	-0.104 (0.099)
<i>Volatility</i>	-2.053* (1.149)	-1.056 (0.771)	-2.533 (1.596)	-1.004 (1.030)	-2.340* (1.318)	-1.052 (0.888)
<i>GDP Growth</i>	0.000 (0.014)	-0.001 (0.010)	0.007 (0.020)	0.005 (0.012)	0.002 (0.019)	0.001 (0.012)
<i>Ln(Conference Call Length)</i>	0.227** (0.105)	0.149* (0.079)	0.254** (0.108)	0.147* (0.079)	0.271** (0.110)	0.165* (0.090)
<i>Ln(Analysts Participating)</i>	0.183** (0.081)	0.141** (0.062)	0.117* (0.071)	0.090* (0.048)	0.119* (0.065)	0.095* (0.049)
Constant	Yes	Yes	Yes	Yes	Yes	Yes
Quarter Fixed-Effects	Yes	Yes	Yes	Yes	Yes	Yes
N	162	162	162	162	162	162
Count R-squared	0.827	0.833	0.809	0.821	0.827	0.858

Note:

Table 3 presents descriptive statistics (Panel A) and results of logit regressions (Panel B) for the analysis of determinants of analysts' questions on the reclassification of financial assets. The analysis is based on the sample of 162 conference call observations (see Table 2, Panel A for details). In Panel B, the dependent variable *Reclassification Question Indicator* is an indicator variable that takes a value of one if at least one question related to the reclassification of financial assets has been identified in a conference call, and zero otherwise. The table reports marginal effects at the mean (median) of all continuous (binary) independent variables and standard errors clustered by firm in parentheses. Please refer to Appendix C for a full description of all variables. ***, **, * indicate statistical significance at the 1%, 5% and 10% levels (two-tailed), respectively.

reclassification impact and conference call questions remains positive but becomes statistically insignificant.

Additionally, we find evidence that analysts' questions during conference calls act as substitutes for firm disclosures in the information collection process. The results indicate that the likelihood of a question about fair value reclassifications is negatively associated with the extent of disclosures. The evidence is consistent with financial analysts demanding specific information in conference calls to substitute for missing mandated information in the financial reports. In contrast, references in management's starting presentation are not associated with analysts' questions about reclassifications.

Table 4 presents the results for the analysis of the determinants of conference call questions about the accounting effects of changes in banks' own credit risk. Panel A reports the descriptive statistics. We observe substantial variation for all three of the proxies that we use to measure the (potential) impact of changes in banks' own credit risk. Again, we find that only approximately 9% of all conference call observations contain detailed information on the impact of measuring financial liabilities at fair value in management's starting presentation.

Panel B summarises the results of the logit regressions of the likelihood of a conference call question about a bank's own credit risk. Consistent with our prediction, the likelihood of a conference call question is significantly positively associated with the reported net income effect (*Reported OCR Effect*) and the expected net income effect of a bank's own credit risk changes (*Expected OCR Effect*). However, the results are weak when we measure *Fair Value Impact* by the book value of fair value option liabilities (*Fair Value of Liabilities*). This result corroborates the notion that analysts' information demands are driven by the impact of fair value measurement on key accounting metrics rather than by the accounting treatment *per se*.

In contrast to the results for the reclassification of financial assets, we find that the likelihood of conference call questions related to changes in a bank's own credit risk *increases* with the quantity of disclosures provided by the bank. However, the coefficient estimates for the individual disclosure proxies show that this significant, positive association mainly results from references to the issue in management's starting presentation. Disclosures in management's starting presentation may thus not only provide additional information but also highlight specific and presumably important accounting topics.

Overall, the analysis of the determinants of fair value-related conference call questions generally supports our predictions. The evidence from both analyses is consistent with the notion that analysts demand more fair value-related information when the impact of fair value accounting on key accounting metrics is large. At least for the reclassification of financial assets, we also find evidence that analysts demand less fair value-related information if a bank provides more explanatory footnote disclosures in its financial report. This observation suggests that footnote disclosures in financial reports and conference call questions are substitute information sources for financial analysts.

(iv) Results for Analysts' Communications of Fair Value-related Information

Tables 5 and 6 document our analysis of the determinants of analysts' communications of fair value-related information in their research reports to investors. Panel A (Panel B) reports the descriptive statistics for the full sample of 291 (235) observations of reports discussing the reclassification of financial assets (changes in banks' own credit risk). Overall, the descriptive statistics are comparable to the previous analysis of conference calls.

Table 6 presents the results of the logit regressions for the likelihood that analysts' reports refer to the reclassification of financial assets (Columns 1 to 3) and banks' own credit risk changes in liability measurement (Columns 4 to 6). Consistent with our expectations, the likelihood of references to fair value-related information in analysts' research reports is positively associated with the corresponding fair value

Table 4
Descriptive Statistics and Logistic Regression of Questions on the Fair Value of Liabilities

Panel A: Descriptive Statistics						
	<i>N</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>P1</i>	<i>Median</i>	<i>P99</i>
Fair Value of Liabilities Variables						
<i>Fair Value of Liabilities</i>	425	5.08	6.22	0.00	3.24	30.17
<i>Reported OCR Effect</i>	271	0.04	0.06	0.00	0.01	0.28
<i>Expected OCR Effect</i>	352	0.75	0.87	0.00	0.54	5.21
<i>Disclosure</i>	425	0.63	0.48	0.00	1.00	1.00
<i>Disclosure Financial Report</i>	425	0.61	0.49	0.00	1.00	1.00
<i>Disclosure Starting Presentation</i>	425	0.09	0.29	0.00	0.00	1.00
Firm Characteristics						
<i>Tier 1 Ratio</i>	425	10.11	2.27	6.39	9.70	17.70
<i>Return on Assets</i>	425	0.41	0.70	-1.38	0.37	2.41
<i>Total Assets</i>	425	606.52	632.50	24.60	355.32	2,515.72
<i>Analyst Following</i>	425	20.73	7.21	2.00	20.75	34.58
<i>Short-term Stock Performance</i>	425	-0.02	0.30	-0.65	-0.07	1.06
<i>Long-term Stock Performance</i>	425	-0.14	0.49	-0.86	-0.24	1.63
<i>Volatility</i>	425	0.04	0.02	0.01	0.03	0.12
Country Characteristics						
<i>GDP Growth</i>	425	-0.30	3.41	-6.99	-0.08	9.16
Conference Call Characteristics						
<i>Conference Call Length</i>	425	21.31	6.83	8.00	21.00	42.00
<i>Analysts Participating</i>	425	8.69	4.20	1.00	9.00	18.00
Panel B: Logit Analysis of Questions on the Fair Value of Liabilities						
	<i>Dependent Variable = FVL Question Indicator</i>					
	<i>Fair Value of Liabilities</i>		<i>Reported OCR Effect</i>		<i>Expected OCR Effect</i>	
<i>Explanatory Variables</i>	(1)	(2)	(1)	(2)	(1)	(2)
Fair Value of Liabilities Variables						
<i>Fair Value Impact</i>	0.050 (0.036)	0.032 (0.025)	1.430*** (0.306)	1.055*** (0.327)	0.132** (0.055)	0.086* (0.049)
<i>Disclosure</i>	0.215** (0.101)		0.203** (0.096)		0.233 (0.144)	
<i>Disclosure Financial Statement</i>		0.087 (0.059)		0.076 (0.053)		0.106 (0.084)
<i>Disclosure Starting Presentation</i>		0.169*** (0.053)		0.172*** (0.046)		0.170*** (0.066)
Control Variables						
<i>Tier 1 Ratio</i>	-0.010 (0.010)	-0.018* (0.010)	-0.019 (0.012)	-0.026*** (0.009)	-0.011 (0.011)	-0.018 (0.012)
<i>Return on Assets</i>	-0.037 (0.042)	-0.017 (0.027)	-0.026 (0.039)	-0.010 (0.026)	-0.055 (0.059)	-0.030 (0.036)
<i>Ln(Total Assets)</i>	0.058** (0.029)	0.044* (0.023)	0.051** (0.025)	0.042* (0.023)	0.048 (0.048)	0.036 (0.036)

Table 4 (Continued)**Panel B: Logit Analysis of Questions on the Fair Value of Liabilities**

Explanatory Variables	<i>Dependent Variable = FVL Question Indicator</i>					
	<i>Fair Value of Liabilities</i>		<i>Reported OCR Effect</i>		<i>Expected OCR Effect</i>	
	(1)	(2)	(1)	(2)	(1)	(2)
Ln(<i>Analyst Following</i>)	0.118 (0.100)	0.033 (0.050)	0.267** (0.118)	0.138 (0.088)	0.173 (0.129)	0.078 (0.073)
<i>Short-term Stock Performance</i>	-0.199** (0.080)	-0.143*** (0.053)	-0.334*** (0.097)	-0.273*** (0.065)	-0.267*** (0.091)	-0.185*** (0.057)
<i>Long-term Stock Performance</i>	0.063 (0.060)	0.066* (0.036)	0.132* (0.079)	0.128** (0.057)	0.118* (0.069)	0.110** (0.048)
<i>Volatility</i>	-0.850 (1.435)	-0.047 (0.890)	0.768 (1.894)	0.944 (1.286)	-1.523 (2.157)	-0.369 (1.258)
<i>GDP Growth</i>	-0.044** (0.019)	-0.033** (0.015)	-0.047*** (0.015)	-0.036*** (0.012)	-0.039* (0.022)	-0.030 (0.018)
Ln(<i>Conference Call Length</i>)	0.076 (0.067)	0.036 (0.053)	0.126 (0.078)	0.077 (0.063)	0.063 (0.075)	0.032 (0.061)
Ln(<i>Analysts Participating</i>)	0.056** (0.025)	0.039** (0.017)	0.037 (0.026)	0.038 (0.025)	0.055** (0.028)	0.039** (0.017)
Constant	Yes	Yes	Yes	Yes	Yes	Yes
Quarter Fixed-Effects	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	425	425	271	271	352	352
Count R-squared	0.913	0.920	0.900	0.893	0.906	0.915

Note:

Table 4 presents descriptive statistics (Panel A) and results of logit regressions (Panel B) for the analysis of determinants of analysts' questions on the use of the fair value option for financial liabilities. The analysis is based on the full sample of 425 conference call observations (see Table 2, Panel A for details). In Panel B, the dependent variable *Fair Value of Liabilities (FVL) Question* is an indicator variable that takes a value of one if at least one question related to the fair value of liabilities has been identified in the conference call, and zero otherwise. The table reports marginal effects at the mean (median) of all continuous (binary) independent variables and standard errors clustered by firm in parentheses. Please refer to Appendix C for a full description of all variables. ***, **, * indicate statistical significance at the 1%, 5% and 10% levels (two-tailed), respectively.

impact. For references to the reclassification of financial assets, we find a positive and statistically significant association across all three of the proxies. For references to changes in banks' own credit risk, the likelihood of a reference is significantly positively associated with the reported net income effect (*Reported OCR Effect*) and the expected net income effect of the banks' own credit risk changes (*Expected OCR Effect*). Overall, analysts tend to include information related to the reclassification of financial assets or changes in banks' own credit risk in their communications to investors if these measurement choices have a considerable impact on the relevant accounting metrics.

5. ANALYSTS' PROCESSING OF FAIR VALUE-RELATED INFORMATION

Our observation that financial analysts actively demand and communicate fair value-related information is not necessarily evidence of the usefulness of fair values in their decision process. Ex-ante, whether analysts ask and communicate about fair

Table 5
Descriptive Statistics for the Analysis of Analysts' Research Reports

Panel A: Reclassification of Financial Assets						
	<i>N</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>PI</i>	<i>Median</i>	<i>P99</i>
Reclassification Variables						
<i>Assets Reclassified</i>	291	2.40	4.02	0.00	1.03	15.37
<i>Effect on Net Income</i>	291	44.03	65.27	0.00	18.97	254.55
<i>Effect on Tier 1 Ratio</i>	291	3.20	4.16	0.00	1.33	16.27
<i>Disclosure Starting Presentation</i>	291	0.54	0.50	0.00	1.00	1.00
Firm Characteristics						
<i>Tier 1 Ratio</i>	291	8.96	1.98	5.13	8.60	14.80
<i>Return on Assets</i>	291	0.20	0.74	-1.38	0.17	2.40
<i>Total Assets</i>	291	803.03	779.45	24.60	474.07	2,515.72
<i>Analyst Following</i>	291	21.07	7.27	2.00	21.17	35.17
<i>Short-term Stock Performance</i>	291	-0.29	0.23	-0.73	-0.30	0.19
<i>Long-term Stock Performance</i>	291	-0.57	0.21	-0.95	-0.61	-0.01
<i>Volatility</i>	291	0.06	0.02	0.02	0.06	0.16
Country Characteristics						
<i>GDP Growth</i>	291	-2.59	2.41	-6.99	-2.91	1.80
Panel B: Fair Value of Liabilities						
	<i>N</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>PI</i>	<i>Median</i>	<i>P99</i>
Fair Value of Liabilities						
<i>Fair Value of Liabilities</i>	235	4.42	4.56	0.03	3.54	17.56
<i>Reported OCR Effect</i>	170	0.05	0.06	0.00	0.02	0.26
<i>Expected OCR Effect</i>	210	0.83	0.69	0.00	0.75	4.13
<i>Disclosure Starting Presentation</i>	235	0.44	0.50	0.00	0.00	1.00
Firm Characteristics						
<i>Tier 1 Ratio</i>	235	10.35	2.57	5.13	10.10	15.40
<i>Return on Assets</i>	235	0.09	0.57	-1.38	0.19	1.43
<i>Total Assets</i>	235	987.03	687.09	24.60	903.01	2,515.72
<i>Analyst Following</i>	235	25.09	7.76	2.00	28.50	35.17
<i>Short-term Stock Performance</i>	235	-0.16	0.35	-0.73	-0.28	0.63
<i>Long-term Stock Performance</i>	235	-0.46	0.31	-0.95	-0.57	0.39
<i>Volatility</i>	235	0.05	0.03	0.02	0.06	0.16
Country Characteristics						
<i>GDP Growth</i>	235	-3.04	2.49	-6.99	-3.78	4.16

Note:

Table 5 presents descriptive statistics for the analysis of determinants of references in analysts' research reports to the reclassification of financial assets (Panel A) and the use of the fair value option for financial liabilities (Panel B). The analysis is based on the sample of 291 (235) relevant analyst report observations with data available on the reclassification of financial assets (fair value option for financial liabilities). Please refer to Table 2 Panel B for details on the sample selection of relevant report observations. Appendix C includes a full description of all variables.

value-related topics because they include or exclude specific fair values from their valuations is unclear. Because we ultimately want to learn about how analysts process fair value-related information, we complement the evidence with a content analysis of conference call questions and analysts' research reports.

We scan all of the relevant conference call questions and analyst reports to identify frequently used frames associated with reclassifications and banks' own credit risk changes. We conceptually frame this information into indications that discuss (1)

Table 6
Logit Analysis of Fair Value-related Information in Analysts' Research Reports

Explanatory Variables	Reclassification of Financial Assets			Fair Value of Liabilities		
	Assets Reclassified (1)	Effect on Net Income (2)	Effect on Tier 1 Ratio (3)	Fair Value of Liabilities (4)	Reported OCR Effect (5)	Expected OCR Effect (6)
<i>Fair Value Impact</i>	0.218*** (0.039)	0.037* (0.020)	0.156*** (0.049)	0.069 (0.046)	3.870*** (1.073)	0.319** (0.126)
Control Variables						
<i>Disclosure Starting Presentation</i>	0.254*** (0.065)	0.285*** (0.068)	0.303*** (0.066)	0.226*** (0.037)	0.634** (0.272)	0.213*** (0.076)
<i>Tier 1 Ratio</i>	-0.046* (0.025)	-0.037 (0.028)	-0.031 (0.024)	-0.015 (0.024)	-0.133** (0.063)	0.027 (0.024)
<i>Return on Assets</i>	-0.164*** (0.059)	-0.182*** (0.067)	-0.104* (0.054)	0.276*** (0.068)	0.937*** (0.345)	0.510*** (0.102)
<i>Ln (Total Assets)</i>	0.117*** (0.026)	0.077*** (0.025)	0.059*** (0.023)	0.330*** (0.081)	0.844*** (0.242)	0.363*** (0.071)
<i>Ln (Analyst Following)</i>	-0.024 (0.044)	-0.010 (0.059)	-0.066 (0.060)	-0.127*** (0.046)	-0.224 (0.147)	-0.033 (0.037)
<i>Short-term Stock Performance</i>	0.176 (0.261)	0.178 (0.331)	0.204 (0.278)	0.076 (0.077)	0.700 (0.482)	0.347** (0.165)
<i>Long-term Stock Performance</i>	-0.359 (0.326)	-0.625* (0.340)	-0.505 (0.321)	-1.333*** (0.314)	-4.839*** (1.682)	-2.106*** (0.415)
<i>Volatility</i>	-3.224 (2.834)	-4.951 (3.054)	-3.919 (2.869)	-11.056** (4.301)	-13.984 (9.129)	-5.003 (3.460)
<i>GDP Growth</i>	0.126*** (0.027)	0.089*** (0.028)	0.086*** (0.026)	0.103*** (0.026)	0.234*** (0.080)	0.129*** (0.026)
Constant	Yes	Yes	Yes	Yes	Yes	Yes
Quarter Fixed-Effects	Yes	Yes	Yes	Yes	Yes	Yes
Contributor Fixed-Effects	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	291	291	291	235	170	210
Count R-squared	0.794	0.763	0.773	0.864	0.818	0.848

Note:

Table 6 documents the results from logit regressions for the analysis of determinants of fair value-related references in analysts' research reports. Columns (1) to (3) present the results for references to the reclassification of financial assets, while columns (4) to (6) present the results for references to own credit risk changes in liability measurement. The dependent variable is an indicator variable that takes a value of one if the analyst report contains at least one reference to the reclassification of financial assets or changes in own credit risk, respectively, and zero otherwise. The table reports marginal effects at the mean (median) of all continuous (binary) independent variables and standard errors clustered by firm in parentheses. Please refer to Appendix C for a full description of all variables. ***, **, * indicate statistical significance at the 1%, 5% and 10% levels (two-tailed), respectively.

any disruption in the process caused by changes in the basis of the underlying measurement (across time, relative to peers, or relative to the forecasting basis at the start of the quarter); (2) the impact of reclassifications on comparable, static valuation metrics, such as price/earnings multiples; and (3) the impact on forecasting and dynamic (multi-period) valuation models, such as discounted cash flow models. We use the term "framing" to underscore that the approach necessarily involves the interpretation of qualitative indicators revealed in analysts' demands for and communication of fair value-related information.⁷ This qualitative analysis aims to

⁷ We refer to the concept of framing as it has been developed in the political and social science literature (e.g., Chong and Druckman, 2007).

identify common indicators in text, tables, and figures that provide an intuition about how analysts process reclassifications and banks' own credit risk changes in their valuation practices.

(i) Reclassification of Financial Assets

The analysis of conference call questions related to the reclassification of financial assets reveals four non-mutually exclusive framing categories (Table 7, Panel A): questions about the current or future impact on earnings and other profitability measures (*Profitability Impact*); the impact on equity, regulatory capital, or risk-weighted assets (*Capital Impact*); characteristics or similar details on the portfolio composition of reclassified assets (*Asset/Portfolio Details*); and banks' primary motivation to use or not use the accounting option (*Use/Reason*).⁸ The descriptive statistics of the frequencies of these frames show a relatively broad demand for information about fair value reclassifications. Most of the questions concern the direct impact on current or future earnings (46 of 110 questions), but a considerable share of the questions are related to the impact of reclassifications on banks' capital, details about the reclassified assets, or the underlying reasons for the use and scope of the option. We interpret these results as evidence of analysts trying to understand the underlying motivation for changes in the measurement of reclassified assets; however, the results do not provide any clear indication of the treatment of fair value reclassifications in the valuation context.

Frames in analyst reports primarily include references to the impact of reclassifications on the current period's earnings or capital (*Impact*) (62.5%), justifications for deviations from prior forecasts (*Forecast Deviation Justification*) (17.5%), comparisons across peers with different treatments of the reclassification option (*Comparison across Peers*), designations as a one-time or non-recurring accounting effect (*Accounting One-off*), and indications that the analyst performs adjustments in forecasts or valuation metrics to address changes in the basis of measurement in pro-forma financial statements (*Adjustment Indication*). Panel B of Table 7 reports the frequency of these frames separately for reports relating to quarters with initial reclassifications and subsequent reporting quarters for which the bank experienced an information demand in its earnings conference call. These cases provide initial evidence that analysts track assets reclassified out of fair value categories in subsequent periods.

In total, 23 reports (14.4%) provide enough details to observe how analysts adjust for reclassifications in static and dynamic (multi-period) valuation approaches. We observe considerable variation in the type of adjustments. In 13 reports, analysts explicitly reverse the effect of reclassifications by adding unrecognised fair value changes back into tangible common equity or net asset value. In most cases, these metrics serve as the basis for a valuation multiple in the comparable company analysis. Other analysts revise their earnings forecasts to reflect the effect of reclassifications on earnings to be reported in the future, i.e., they forecast earnings in accord with the bank's accounting choice.⁹

We further observe that a considerable number of analysts track reclassified assets over time (46 reports, 28.7%) and then explicitly discuss actual or potential changes

⁸ We include examples of questions from each of these groups in Appendix B.

⁹ See Example 5 in Appendix D.

Table 7

Content Analysis of Conference Call Questions and Information in Analysts' Research Reports related to the Reclassification of Financial Assets

Panel A: Conference Call Questions								
<i>Conference call questions relating to the reclassification of financial assets</i>	<i>Profitability Impact</i>		<i>Use/Reason</i>		<i>Asset/Portfolio Details</i>		<i>Capital Impact</i>	
	#	Percent	#	Percent	#	Percent	#	Percent
	110	46	41.8	32	29.1	20	18.2	18

Panel B: Information in Analysts' Research Reports							
	<i>Initial Reclassification Quarters</i>		<i>Subsequent Quarters</i>		<i>Total</i>		
	#	Percent	#	Percent	#	Percent	
	Full sample of analyst reports (contributor adjusted)	275		277		552	
Reports with reference to the reclassification of financial assets	95	34.5	65	23.5	160	29.0	
With reference to:							
<i>Impact</i>	71	74.8	29	44.6	100	62.5	
<i>Tracking (All)</i>	12	12.6	34	52.3	46	28.7	
<i>Tracking (Impairments/LLP)</i>	11	11.6	19	29.2	30	18.8	
<i>Forecast Deviation</i>	21	22.1	7	10.8	28	17.5	
<i>Adjustment Indication</i>	10	10.5	13	20.0	23	14.4	
<i>Comparison across Peers</i>	9	9.4	4	6.2	13	8.1	
<i>Accounting One-off</i>	6	6.3	1	1.5	7	4.4	

Note:

Table 7 presents results for the content analysis of questions and references related to the reclassification of financial assets. Panel A lists the absolute and relative frequency of frames included in questions on the reclassification of financial assets that have been identified in the sample of 824 conference calls for IFRS-reporting banks. *Profitability Impact* identifies questions asking for the current and/or possible future impact of the reclassification on net income, shareholders' equity and/or other profitability measures. *Use/Reason* includes all questions relating to whether the bank made use of the reclassification amendment or not. This category also includes questions on the reason for using/not using the reclassification option. Analysts' questions are classified as *Asset/Portfolio Details* if they ask for more details about the reclassification, e.g., details about the assets being reclassified or changes in portfolio composition. The category also includes questions about whether it is possible to use the reclassification option for specific assets. *Capital Impact* identifies questions about the impact of the reclassification on reported asset values and risk-weighted assets. Appendix B includes examples of the classification of frames identified in conference call questions. Panel B reports the absolute and relative frequency of frames on the reclassification of financial assets that have been identified in financial analysts' research reports. *Impact* identifies references to the impact of reclassifications on current period's earnings or capital. *Tracking (All)* and *Tracking (Impairments/LLP)* refer to frames that track reclassified assets over time and explicitly discuss actual or potential changes in impairments or loan loss provisions resulting from assets being reclassified into loans and receivables or held-to-maturity. *Forecast Deviation* captures frames that use references to reclassifications to justify a deviation from prior forecasts. Indications that analysts' perform adjustments in forecasts or valuation metrics to address the reclassification impact are classified as *Adjustment Indication*. Finally, *Comparison across Peers* and *Accounting One-off* identify frames that compare the use of the reclassification option across peers or designate the reclassification impact as a one-time or non-recurring accounting effect. Appendix D includes examples of the content of analysts' research reports.

in impairments and loan loss provisions resulting from assets reclassified into L&R or HTM assets (30 reports, 18.8%). Note that the reclassification of financial assets not only affects the measurement basis of these assets but also changes the underlying composition of the asset portfolios in the trading and banking books. If assets are reclassified out of fair value through profit or loss (i.e., held for trading) into cost categories (L&R or HTM), earnings previously recognised in trading income shift into banking book income, i.e., interest income or impairments. As a result, the shift between the portfolios affects multiple earnings components that analysts forecast separately. Thus, these analysts work within the mixed-attributes model and follow the bank's accounting practice by using amortised cost for the valuation of the reclassified assets (we nevertheless do not observe whether they find fair values useful in predicting impairments going forward).

The evidence from these 46 reports suggests that in most cases, analysts continue tracking reclassified assets for prediction purposes because they estimate different impairment rates for reclassified assets.¹⁰ However, again, in a number of reports (8 of the 46), analysts track reclassified assets to add unrecognised fair value changes back into the underlying accounting basis for multiple valuation, i.e., because they keep working with the original fair value model. Overall, the framing of content in conference call questions and analysts' reports shows no clear indication of a *standard* adjustment for reclassifications.

(ii) Banks' Own Credit Risk Changes in Liability Measurement

We identify four different and non-mutually exclusive frames in conference call questions related to the use of the fair value option for liabilities (Table 8, Panel A). We observe a first category of questions where analysts explicitly express their interest in accounting numbers excluding the effect of changes in the banks' own credit risk (*Own Debt Impact Excluded*). This frame captures questions that do not address a bank's own credit risk changes directly but that aim to obtain information about the development of balance sheet or earnings items *before* the recognition of the effects of the bank's own credit risk. Other frames include questions that directly address the impact of banks measuring their own debt at fair value on net income, equity, or other profitability measures (*Profitability/Capital Impact*), future fair value changes of liabilities (*Expectations*), and banks' primary motivation to use (or not use) the fair value option for their financial liabilities (*Use/Reason*).¹¹ The content of questions on banks' own credit risk effects provides initial evidence that a number of analysts use accounting figures that exclude banks' own credit risk effects.

In their research reports (Table 8, Panel B), many analysts discuss the impact of banks' own credit risk changes on profitability or capital (84 of 112 reports), with the majority of analysts explicitly stating that they exclude the impact from changes in banks' own credit risk from relevant earnings or valuation metrics (63 reports). Most of the adjustments relate to "clean" earnings or net asset numbers (as labelled by the analyst). Analysts then use the "clean" earnings number as a basis for forecasting or a "clean" net asset value in valuation multiples. Our evidence suggests that this

10 For example, some analysts adjust their expectations for loan loss provisions as a result of different probabilities of default associated with assets reclassified out of fair value into loans. See Example 3 in Appendix D.

11 Examples of questions from each of these groups are included in Appendix B.

Table 8

Content Analysis of Conference Call Questions and Information in Analysts' Research Reports related to Own Credit Risk Changes in Liability Measurement

Panel A: Conference Call Questions

<i>Conference call questions relating to own credit risk changes</i>	<i>Profitability/Capital Impact</i>		<i>Own Debt Impact Excluded</i>		<i>Use/Reason</i>		<i>Expectations</i>	
	#	Percent	#	Percent	#	Percent	#	Percent
63	26	41.3	24	38.1	9	14.3	5	7.9

Panel B: Information in Analysts' Research Reports

	#	Percent
Full sample of analyst reports (contributor adjusted)	552	
Analyst reports including a reference to own credit risk changes	112	20.3
With reference to:		
<i>Impact</i>	84	75.0
<i>Adjustment Indication</i>	63	56.2
<i>Accounting One-off</i>	27	24.1
<i>Forecast Deviation</i>	19	17.0
<i>Comparison across Peers</i>	19	17.0

Note:

Table 8 presents results for the content analysis of questions and references related to the fair value of liabilities and own credit risk changes. Panel A lists the absolute and relative frequency of frames included in questions related to the use of the fair value option for financial liabilities that have been identified in the sample of 824 conference calls for IFRS-reporting banks. *Profitability/Capital Impact* identifies analysts' questions on the impact of measuring own debt at fair value on net income, equity or other profitability measures. This also includes questions clarifying the impact of measuring own debt at fair value. *Own Debt Impact Excluded* captures all questions on net income, profitability, shareholders' equity, etc. explicitly excluding the effect of fair value measurement and/or changes in own credit risk on own debt. This category also includes questions about whether an effect and/or management guidance includes or excludes the effect of measuring own debt at fair value. *Use/Reason* includes all questions relating to whether the bank made use of the fair value option to measure its own liabilities at fair value. This category also includes questions on the reason for using/not using the fair value option for financial liabilities. Finally, *Expectations* captures questions relating to expectations on the potential future development of financial liabilities measured at fair value. Appendix B includes examples of the classification of frames identified in conference call questions. Panel B reports the absolute and relative frequency of frames on own credit risk changes that have been identified in financial analysts' research reports. These frames are defined equivalently to the reclassification of financial assets (Table 7, Panel B). Appendix D includes examples of the content of analysts' research reports.

is a systematic adjustment for many analysts. These analysts are working under their own accounting definitions, and they define "street earnings" as earnings before fair value changes resulting from banks' own credit risk. For example, J.P. Morgan analysts frequently refer to net income or net asset value "ex own debt".

Overall, the evidence from analyst reports is consistent with the interpretation that many conference call participants explicitly exclude the effect after asking about summary performance figures. The nature and appearance of the adjustment indicators strongly suggest that a considerable number of financial analysts, under the current reporting practices of banks, treat the impact from changes in banks' own credit risk on the fair value of liabilities as a standard adjustment in their valuation

process.¹² Many analysts justify their treatment of fair value changes resulting from banks' own credit risk with increased comparability across peers (19 of 112) or refer to the accounting effect as extraordinary or non-recurring (27 of 112). Thus, we cannot disentangle whether it is an inconsistent application of the reporting rule across our sample of international banks or analysts' discontent with the concept that drives the adjustment decisions.

6. CONCLUSIONS

We examine how financial analysts request and communicate fair value-related information. The usefulness of fair value-related information for investors is controversial, as prior evidence from experimental studies (e.g., Hirst et al., 2004; Gaynor et al., 2011; Koonce et al., 2011), survey studies (e.g., Gassen and Schwedler, 2010), and archival capital market studies (e.g., Barth et al., 1996; Ahmed et al., 2006) provides mixed evidence. Our content-based analysis of conference calls and analyst reports between 2008 and 2010 is designed to triangulate prior findings and provide indirect evidence regarding whether financial analysts use fair value information in their financial analyses of banks.

Our results indicate that analysts use conference calls to request fair value-related information. Most of their questions relate to the effects of fair value reclassifications and changes in banks' own credit risk on the fair value of liabilities. Furthermore, we find that the demand for fair value-related information varies considerably over time and across banks. Our analyses indicate that the likelihood of a fair value-related question is positively associated with the impact of the fair value information on a bank's accounting metrics. Additionally, at least for fair value reclassifications, the likelihood of a fair value-related question is negatively associated with the quantity of the accompanying explanatory footnote disclosures in the financial report, suggesting a substitutive relationship between public disclosure in financial reports and information requests during conference calls.

The content analysis of conference calls and analyst reports further highlights how analysts use fair value-related information for valuation purposes. The use of such information varies across analysts and across instruments. The large majority of observed analysts explicitly exclude the effects of changes in banks' own credit risk from key valuation metrics, i.e., they remove the effects of banks' own credit risk changes in liability measurement as standard adjustments (similar to the treatment of such effects by rating agencies and prudential supervisors). In contrast, the treatment of reclassifications is more complex and more diverse. While some analysts add unrecognised fair value changes of reclassified assets back into key accounting metrics, such as earnings or capital, others adjust their predictions of different earnings components because the P&L effects of reclassified assets shift from trading into interest income and impairments. Overall, these results suggest that analysts have no standard way of processing fair value-related information in their decision process. Under extant accounting rules, the decision usefulness and processing of fair value measurement is rather context specific.

¹² This approach is consistent with that of rating agencies (Moody's, 2010; Fitch Ratings, 2012) and prudential supervisors who follow different objectives (CEBS, 2007).

APPENDIX A
Keywords Applied in the Automated Search for
Fair Value-Related Conference Call Questions

	<i>Keywords</i>	<i>Keyword Group</i>
<i>Fair Value-Specific Keyword Categories</i>	<p><i>fair value, fair-value, FV, AFS, available for sale, available-for-sale, HFT, held for trading, held-for-trading, HTM, held to maturity, held-to-maturity, hold to maturity, hold-to-maturity, mark to market, mark-to-market, marked, marking, mark to model, mark-to-model, loans & receivables, loans and receivables, L&R, market value, market-value, current value, current-value, exit price, exit-price, entry price, entry-price, sales value, sales-value, fair value option, fair-value option, fair-value-option, fv option, fv-option</i></p> <p><i>recl[*], amend[*], IAS 39, re-class[*]</i></p> <p><i>own credit risk, OCR, credit risk, own debt, own credit, credit worthiness, own liabilities, debt valuation adjustment, DVA</i></p> <p><i>level III, level 3, level three, level II, level 2, level two, level I, level 1, level one, hierarchy, SFAS 157, FAS 157, input, assum[*], reliab[*], unobservable parameters</i></p>	<p>Fair Value and Accounting for Financial Instruments</p> <p>Reclassification of Financial Assets</p> <p>Fair Value of Liabilities and Own Credit Risk</p> <p>Fair Value Hierarchy</p>
<i>Additional Keywords</i>	<p><i>IFRS, IAS, GAAP, SFAS, FAS, accounting, other comprehensive income, OCI, revaluation reserve, net interest income, net interest margin, charged to income, charged to equity, liabili[*], loans, rating, level, amorti[*], amortized cost, at cost, historical cost, otti, other than temporary, trading, maturity, banking book, trading book, adjustment, measurement, unrealized gain, unrealized loss</i></p>	

Note:

An asterisk (*) indicates the use of different keywords based on the same root. Note that the search process is not case sensitive, i.e., upper case or lower case letters are irrelevant.

APPENDIX B
Examples of the Manual Coding of Conference Call Questions

<i>Conference Call</i>	<i>Quote</i>	<i>FV-Topic</i>	<i>Frame</i>
Banca Monte Dei Paschi (Italy) Mar. 27, 2009	"[...] And then there is no indication about IAS 39. Also, another Italian bank hasn't given an indication about this. I want to ask you an important question. Has there been movements between the available for sale to loan portfolio in Q3 and Q4, and what has the impact of IAS 39 in the year when it comes to BBT, net interest income, and revaluation reserve which doubled from EUR200 million to EUR400 million in Q4. Can you tell me something about this? [...]"	Reclassification of Financial Assets	Profitability Impact Use/Reason
Credit Agricole (France) Nov. 13, 2008	"[...] And, on your CDOs, are most of them synthetic? So, i.e., can you use the amendment of IAS 39 to reclassify them? [...]"	Reclassification of Financial Assets	Details
UBS (Switzerland) May 05, 2009	"[...] The first was on the reclassification of financial assets, page 78. Sorry to go into accounting, but I'm just trying to understand why you would – avoided further write-downs, as in what asset class it is that these are reclassified, and how you see this playing out over time, because there's quite a big difference between the fair value and carrying value, and I can't quite get what assets this relates to. And I think you saved CHF1.2 billion in the first quarter, so your results would have been CHF1.2 billion lower if you hadn't done this. [...]"	Reclassification of Financial Assets	Profitability Impact Details
Danske Bank (Denmark) Feb. 05, 2009	"[...] First of all, when you reclassify your assets from the trading book to AFS, did that have any capital impact and, if so, how much? [...]"	Reclassification of Financial Assets	Capital Impact
J.P. Morgan Chase & Co. (United States) Oct. 15, 2008	"And have you made any changes to mark-to-market accounting? I guess there's been a lot of noise the SEC[sic]. And there's an IASB proposal for European banks that would allow them to move assets from fair value accounting to more loan type accounting. Any views on all this? Any changes ahead or any changes already made?"	Reclassification of Financial Assets	Other

APPENDIX B (Continued)

<i>Conference Call</i>	<i>Quote</i>	<i>FV-Topic</i>	<i>Frame</i>
Barclays (United Kingdom) Aug. 07, 2008	"I have two questions. One is on the gain on widening of spread on own liability. I think in the past [I've] been able to reconcile this for you and for others [who] do this by [moving] some of their own credit risk spreads. And that certainly worked in the first quarter when there was a widening. And then in April I think you indicated a narrowing. What I find difficult to interpret is why, although your overall credit spreads seem to have narrowed, your gain on liabilities has widened?"	Fair Value Option (Liabilities)	Profitability/Capital Impact
Deutsche Bank (Germany) Jul. 28, 2009	"[...] The first one is, when you went through slide 20, I think you made a comment that there was a reversal of gain on own debt of around EUR113 million, which is not a big number. But from memory I seem to recall that Deutsche Bank stated on the Q1 and Q4 results calls that you are one of the few investment banks that doesn't mark-to-market your own that, and it's quite possible I got that wrong. But please can you just update us on that, if that's the case or not? [...]"	Fair Value Option (Liabilities)	Use/Reason
HSBC (United Kingdom) Mar. 01, 2010	"[...] If we look at first half, second half, with revenues going down and costs going up, it looks like the pre-impairment profit excluding the fair value of own debt, is something like \$17 billion in the second half of the year. So I guess the question is are you guiding us to any sense of growth in that number until interest rates start rising in the US? Or are we running at a – is that a better reflection of steady state?"	Fair Value Option (Liabilities)	Own Debt Impact Excluded

APPENDIX C
Definition of Variables Used in the Determinant Analysis

Reclassification of Financial Assets

Assets Reclassified
Percentage of assets that have been reclassified at the first fiscal year ending after the reclassification amendment (source: manual collection from financial reports). In all the regression analyses we take the natural logarithm to account for the skewness of this variable. For conference call observations prior to the first reclassification observation, the variable takes the value zero.

Effect on Net Income

Absolute percentage effect of the reclassification on net income at the first fiscal year ending after the reclassification amendment (source: manual collection from financial reports). The relative effect is calculated by scaling the reclassification effect on net income by net income before reclassifications. In all the regression analyses we take the natural logarithm to account for the skewness of this variable. For conference call observations prior to the first reclassification observation, the variable takes the value zero.

Effect on Tier 1 Ratio

Absolute percentage effect of the reclassification on the tier 1 capital ratio at the first fiscal year ending after the reclassification amendment (source: manual collection from financial reports). The relative effect is calculated by scaling the reclassification effect on the tier 1 capital ratio by the tier 1 capital ratio before reclassifications. In all the regression analyses we take the natural logarithm to account for the skewness of this variable. For conference call observations prior to the first reclassification observation, the variable takes the value zero.

Reclassification Disclosure Financial Report

Indicator variable equal to one if a bank's disclosure score for reclassification disclosure items in the financial report (as required by IFRS 7, para 12A, lit. (a)–(f)) is above the sample mean, and zero otherwise (source: manual collection from financial reports).

Reclassification Disclosure Starting Presentation

Indicator variable equal to one if the starting presentation of the conference call includes information on the impact of the reclassification on profitability/capital, and zero otherwise (source: manual collection from conference calls, Thomson Reuters StreetEvents).

Reclassification Disclosure

Indicator variable that combines the disclosure scores for the financial report and the conference call starting presentation. The variable equals one if either *Reclassification Disclosure Financial Report* or *Reclassification Disclosure Starting Presentation* equal one, and zero otherwise.

Fair Value of Liabilities

Fair Value of Liabilities

Percentage of financial liabilities measured at fair value (source: manual collection from financial reports). In all the regression analyses we take the natural logarithm to account for the skewness of this variable.

Reported OCR Effect

Reported quarterly or annual effect of changes in own credit risk measured in percentage of total assets (source: manual collection from financial reports). In all the regression analyses we take the natural logarithm to account for the skewness of this variable.

APPENDIX C (Continued)

<i>Expected OCR Effect</i>	Difference between the spread for 5-year credit default swaps at the conference call-relevant fiscal quarter ending and the spread at the previous fiscal year ending (source: <i>Datastream</i>). In all the regression analyses we take the natural logarithm to account for the skewness of this variable.
<i>FVL Disclosure Financial Report</i>	Indicator variable equal to one if a bank's disclosure score is above the sample mean, and zero otherwise (source: manual collection from financial reports). The disclosure score captures the two disclosure items required by IFRS 7, para. 10. lit. (b) and para. 11, lit. (a).
<i>FVL Disclosure Starting Presentation</i>	Indicator variable equal to one if the starting presentation of the conference call includes information on the impact of measuring liabilities at fair value on profitability/capital, and zero otherwise (source: manual collection from conference calls, <i>Thomson Reuters StreetEvents</i>).
<i>FVL Disclosure</i>	Indicator variable that combines the disclosure scores for the financial report and the conference call starting presentation. The variable equals one if either <i>FVL Disclosure Financial Report</i> or <i>FVL Disclosure Starting Presentation</i> equal one, and zero otherwise.
Control Variables	
<i>Tier 1 Ratio</i>	Bank-specific tier 1 capital ratio measured at the fiscal year end (source: <i>BvD Bankscope</i>).
<i>Return on Assets</i>	Bank-specific return on assets measured at the fiscal year end and calculated as profit before taxes divided by total assets (source: <i>BvD Bankscope</i>).
<i>Total Assets</i>	Bank-specific amount of total assets measured at the fiscal year end (source: <i>BvD Bankscope</i>).
<i>Analyst Following</i>	Bank-specific analyst following defined as the average monthly number of 1-year EPS analyst estimates included in the firm's I/B/E/S consensus forecast (source: <i>I/B/E/S</i>).
<i>Short-term Stock Performance</i>	Bank-specific buy-and-hold stock return for the last 65 trading days before the relevant fiscal quarter ending (source: <i>Datastream</i>).
<i>Long-term Stock Performance</i>	Bank-specific buy-and-hold stock return for the last 260 trading days before the relevant fiscal quarter ending (source: <i>Datastream</i>).
<i>Volatility</i>	Standard deviation of the bank-specific stock return for the last 65 trading days before the relevant fiscal quarter ending (source: <i>Datastream</i>).
<i>GDP Growth</i>	Country-specific annual growth in the gross domestic product in the year of the conference call (source: <i>World Bank</i>).
<i>Conference Call Length</i>	Number of pages of the relevant conference call transcript (source: <i>Thomson Reuters StreetEvents</i>).
<i>Analysts Participating</i>	Number of analysts participating in a conference call (source: <i>Thomson Reuters StreetEvents</i>).

APPENDIX D

Examples of the Treatment of Fair Value-Related Information
in Analysts' Research Reports**Example 1: Adjustment Indication Tangible Common Equity***Setting: Reclassification of Financial Assets*

"Aareal Bank reported total equity equal to nearly EUR46 per share but several adjustments are required to result a current tangible equity per share. First, minorities of some EUR6 per share need to be deducted, second, the Soffin participation capital of more than EUR12 per share is to be subtracted [sic]. Third, we adjust for the reclassification effect of more than EUR4 per share and deduct the tangible equity of EUR2 per share. We result a current tangible equity per share of EUR21.5.

As the current share price is only 0.3–0.4 x P/TE (depending on the treatment of the reclassification effect) the market indicates that it is either concerned about the long-term profitability potential of the company or the risk of further reductions in tangible equity (or both)."

Example 2: Adjustment Indication Net Asset Value*Setting: Reclassification of Financial Assets/Changes in Own Credit Risk*

"In order to make the number comparable with European peers, we need to adjust for cumulative fair value gains on own debt taken (despite the economic charge in this quarter, UBS' retained earnings still contains SFr2697 million of gains taken in previous periods), and the impact of IAS39 reclassifications (as with Deutsche Bank, we are taking these out gross of tax, reflecting our uncertainty about whether a tax shield would be available). We also adjust the NAV for our estimate of the cost of settling the DoJ case; we are assuming SFr1.5 billion, somewhat lower than press reports. The calculations are set out below, on the basis of the 3,471 million fully diluted share count in the 4Q 08 report and accounts.

Equity from 2008 FY results	42,116
Minorities	–8,002
Intangible assets	–12,935
MCN adjustment	6,000
Tangible NAV	27,179
Per fully diluted share	7.8
<hr/>	
Estimated fair value gains on own debt	–2,691
Estimated cost of DoJ settlement	–1,500
IAS 39 use	–3,300
Adjusted tangible NAV	19,688
<hr/>	
Per fully diluted share	5.7

The lower number might be considered a little harsh, given that we have taken the less favourable option under both IAS 39 and the fair value on debt, and not allowed for tax shields. However in our opinion, it is appropriate to use conservative assumptions about NAV to form a basis for valuation. On the basis of the calculations above, UBS is trading on between 1.7x and 2.4x proforma tangible book."

Example 3: Tracking Reclassified Assets over Time*Setting: Reclassification of Financial Assets*

"In the legacy assets we believe our expectations for further credit deterioration across the IAS 39 reclassified assets of €36 billion are already baked into our current estimates. To put into context, these assets comprise ~13% of the loan book at H109 but drove 48% of provisions and 40% I Q3. Within these assets we expect CRE deterioration to pick up in 2010 as we expect DBK to keep provisions at ~€3 billion in 09e after €1.5 billion already accounted for in H109. In the table below we break down into IAS 39, PBC and other, as we feel the most transparent way to assess the loan book."

[...]

APPENDIX D (Continued)

IAS 39 reclassified assets comprise only 13% of group loans ...

IAS 39 Reclassified assets (H109)	€bn	% of Loans
Leverage Finance	7	3%
Commercial real Estate	9	3%
DB sponsored conduits	10	4%
Collateralised transactions	5	2%
Other	5	2%
Total	36	13%
Total Group Loans	268	

... but ~40% of provisions in Q3 09 (vs. 78% of troubled assets)

Provisions (€m)	IAS 39 assets	PBC	Other	Total	% IAS 39 assets
H208	257	384	186	827	31%
H109	726	382	418	1,526	48%
Q309	215	209	120	544	40%
Q409e	350	235	105	690	51%
2010e	1,200	925	555	2,680	45%
2011e	750	833	390	1,972	38%
Total	3,498	2,968	1,773	8,239	42%

Example 4: Tracking Reclassified Assets over Time*Setting: Reclassification of Financial Assets*

“The reclassification under IAS39 transferred some CHF27.2 billion assets from the trading desks into the loan book. This means UBS no longer needs to recognise mark-to-market valuation losses through the P&L, but can treat them as normal loans, which only need to be written down when true impairments occur. Unfortunately, this seems to be the case right now in a large part of the portfolio, evidenced by the sharp rise in non-performing loans to CHF13.5 billion for the group. Out of this, CHF11 billion pertain to the investment bank, pushed by CHF7.2 billion from the reclassified assets.”

Example 5: Adjustment Indication (Short-term) EPS Forecast/Accounting One-off*Setting: Reclassification of Financial Assets/Changes in Own Credit Risk*

“Though HSBC report that group profit before tax for the third quarter was higher than in the prior year, stated profit in the quarter benefited from a number of one-off items, including:

- Gains on own debt of \$3.4 billion in 3Q08 far offset US\$600 million of trading position impairments,
- US\$2.4 billion profit on sale of French subsidiaries,
- The reclassification of U\$13 billion of trading assets under new accounting rules “saved” the group U\$835 million of impairment charges in 3Q08. Though this does not add to the earnings in the quarter, when thinking about the year on year comparison it seems sensible to argue that 3Q07 credit trading and leveraged loan impairments of US\$925 million would have been lower had these reclassifications been in effect at that point.

Our 2H08 forecast for underlying EPS, which excludes the impact of the above items, is 53cps, down 25% YoY.”

APPENDIX D (Continued)

Example 6: Adjustment Indication Clean Earnings

Setting: Changes in Own Credit Risk

“CASA reported pre-tax of E322 million and net income of E202 million. Adjusting for the items listed below, clean pre-tax stood at E630 million vs. JPMe E564 million. After tax (rate of 30%) and minorities, we get to clean net income of E397 million vs. JPMe E415 million and consensus of E350 million.”

[...]

€ million

Pretax	322
Writedowns	500
Macro hedge gains	−367
MtM CDS	121
Own debt	54
Clean pretax	630
Net income clean	397

Example 7: Accounting One-Off

Setting: Changes in Own Credit Risk

“Natixis published their Q3 loss of €234 million versus our forecasts of €440 million loss. This included a large number of non-recurring items.

- One-off items in CIB revenues: −€263 million on monolines (we expected €602 million and this explains the biggest difference versus our forecast), −€216 million on CDO (we expected −€235 million), +€186 million FV adjustment on own debt (we expected +€200 million).”

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