Charles W. Calomiris

Commentary

Disclosure is costly. Is it worth the cost? The paper by Ursel Baumann and Erlend Nier provides an excellent beginning to examining the potential value of disclosure by focusing on the effect of disclosure on the volatility of stock returns. The paper employs a promising database of nearly 600 banks in thirty-one countries. The central finding of the paper is that more disclosure tends to reduce volatility. The effect is highly significant statistically, even after having controlled for other determinants of bank risk using a standard list of control variables.

But is the effect of disclosure on volatility of returns economically important? That is the most important question to ask when performing a cost-benefit analysis of disclosure, but it is not a question addressed directly in this paper. Indeed, the authors do not give us much information on the estimated importance of the effect. For example, we do not know what the adjusted R^2 of the ordinary least squares (OLS) regressions is with the disclosure variables included (the results reported in Table 4), and so we cannot see how much explanatory power is gained by adding the disclosure variables.

We can glean some evidence on the importance of the coefficients in Table 4 by using the fact that the within-country standard deviation of the disclosure index is 0.17. Table 4 holds country effects constant, which implies that one can interpret the coefficient in Table 4 as indicating that a one-standard-deviation increase in the disclosure index results in a volatility reduction of $(0.17) \times (0.0096)$, which is roughly equal to 0.002.

Since the mean of volatility is 0.05 and its standard deviation is 0.03, that effect does not strike me as very economically important. I conclude that banks' choices about disclosure do not seem to materially affect volatility.

Of course, that does not mean that disclosure is unimportant. The results in Table 4 and the calculation performed in the previous paragraph control for the level of disclosure within the country. Table 4 only calculates the effects of a bank's disclosing more than the average bank in its country. Table 4's coefficients can be interpreted as measuring the effect of *unusual voluntary* disclosure on volatility, after controlling for the effects of *mandatory* disclosure and *other voluntary standard practices* within the country. The country averages differ markedly from one another (from a high of 0.73 to a low of 0.28, as shown in Table A2). Those country averages probably largely reflect differences in regulatory requirements.

Note, however, that if that interpretation is correct, then these results have nothing to say about the value of mandatory disclosure, since country dummy variables effectively control for mandatory disclosure. It is true that much of the variation in bank disclosure is voluntary (the within-country standard deviation of 0.17 is larger than the across-country standard deviation of 0.12), but that does not mean that the variation in the index produced by voluntary disclosure is more *important* than the variation produced by mandatory disclosure. Unusual voluntary disclosure is unlikely to be about data that are as important as those items typically covered by mandatory

Charles W. Calomiris is the Henry Kaufman Professor of Financial Institutions at Columbia University's Graduate School of Business.

disclosure. After all, mandatory disclosure's intention is to identify precisely those measures that are the most important. Thus, I think it would be interesting to report the results without country dummy variables, but with a country-level measure of the average degree of disclosure in the country. It is possible that the size of the coefficient for that variable in the volatility regression could dwarf the effect measured in Table 4. I recognize that there are other econometric pitfalls associated with removing country controls, but I still think that this would be a worthwhile exercise.

I would also want to include an interaction term in the regression for the within-country disclosure choice and the country-level measure of average disclosure. I would expect that banks operating in an environment with little mandatory disclosure probably would benefit more from a little more voluntary disclosure than banks operating in environments of high mandatory disclosure. The reason is that low country-level disclosure implies more opportunity for meaningful unusual voluntary disclosure.

If one failed to find a greater negative coefficient on the country-level disclosure variable than on the unusual voluntary disclosure variable, and if one failed to find any effect from the interaction term, those results would also be interesting. They would suggest that the items mandated for disclosure by regulators are not unusually important disclosures.

The effects described above might also depend in interesting ways on the specific disclosures that are mandated in a country. Here it may be useful to distinguish between types of disclosure that are very commonly mandated (observed to be part of the average country effect in many countries) and those that are not. For example, imagine that country X is the only country in the world not to mandate disclosure of item A. In contrast, item B is mandated by roughly half of the countries and not by the other half. Because the frequency with which an item is mandated may indicate its importance, it may be that the unusual voluntary choice of a bank operating in country X to disclose item A would have a larger effect than the unusual voluntary choice to disclose item B by a bank operating in a country that does not mandate disclosure of item B.

In summary, the paper by Baumann and Nier marks an excellent beginning to examining the effects of bank disclosure on equity volatility. My main comment is that future empirical research should attempt to distinguish mandatory from voluntary disclosure, measure the relative importance of the two kinds of disclosure for reducing equity volatility, and consider whether some forms of mandatory disclosure are more important than others. Doing so will help us to judge the extent to which current mandatory disclosures are worth their costs.