How Mandatory Disclosure of Forward-Looking Information Affects Financial Intermediation

Sebastian Fleer

Universität Basel

October 20, 2020

Abstract

This paper studies the optimal information system in a model of financial intermediation. The bank provides socially desirable liquidity to depositors. In doing so, the bank is prone to moral hazard. The arrival of private forward-looking information changes the bank's valuation of its asset. We derive the optimal disclosure rule for mandatory reporting of this forward-looking information by the bank. While the full release of forward-looking information resolves the bank's moral hazard problem best, it exposes the bank to rollover risk and impedes the socially desirable liquidity provision to depositors. The optimal disclosure rule incorporates these adverse welfare effects. A threshold disclosure rule like expected credit loss impairments reduces the rollover risk while keeping the moral hazard problem solved. We derive conditions for the optimality of different information systems depending on the severity of the moral hazard problem. The result indicates a necessity for heterogeneous, principle-based accounting standards.

Keywords: Financial Intermediation, Banking, Disclosure Regulation, IFRS 9, Liquidity Provision, Moral Hazard, Fair Value and Historical Cost Accounting.

I thank Sabine Böckem, Georg Nöldeke and Ulf Schiller for extensive and insightful suggestions that have improved the paper. Further, I thank Robert Göx, Hui Chen, Phil Stocken, Dirk Simons, and the participants at the 2019 ARFA Conference for helpful comments.