Does it matter who serves on the Financial Accounting Standards Board?  
Market reactions to Bob Herz’s unexpected resignation

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Abstract

On August 24, 2010, the then FASB chairman Bob Herz resigned unexpectedly. Three months earlier, the FASB passed a highly contested proposal requiring banks to report their loans in fair value on the balance sheet. This proposal was passed by a 3 to 2 ballot with Herz casting the deciding vote. The Wall Street Journal viewed Herz’s departure as providing “an unexpected advantage” for banks who strongly opposed the fair value proposal. We document that banks especially banks that are more sensitive to fair value accounting responded positively to Herz’s resignation. They also responded negatively when the FASB first proposed the standard and positively when the FASB dropped the fair value requirement under the new leadership. This study provides evidence of why practitioners care about who sets accounting standards.

Keywords: the Financial Accounting Standards Board; the FASB, Accounting Standards, Event Study, Individual Effect

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1. Introduction

This study investigates the impact of individual members of the Financial Accounting Standards Board (hereafter FASB) in the context of former FASB chairman Bob Herz’s unexpected resignation amongst the debate on the FASB’s fair value proposal for bank loans. Accounting practitioners and users of financial statements both care about who should serve on the board. Initially, the FASB was required to have at least four certified public accountants, a requirement soon removed due to public concerns that auditors exerted too much influence. While the initial board included one member from the preparers, preparers have argued strongly for “at least two or preferably three members” from the corporate world (Miller and Redding, 1986, 36). The users group also complained about their underrepresentation on the FASB, “it is baffling to us that the Financial Accounting Foundation allowed the FASB to carry on year after year missing the background and experience of at least one financial statement user. We cannot imagine anything more pertinent or germane to the board as it strives to fulfill its mission and put into practice the tenets of its conceptual framework” (AIMR, 1993, 78).

Former FASB chairman Denny Beresford observed “that FASB has traditionally mixed members of different backgrounds according to a set formula: three from public accounting, two from Corporate America, one from academia, and one financial analyst” (Rosen 2006). In fact, the current Financial Accounting Foundation (FAF) by-laws officially specifies the board members’ collective background and experience, “the members of the FASB shall, in the judgment of the Trustees,…. collectively, have knowledge of and experience in investing, accounting, finance, business, accounting education and research” (the FAF by-law, Chapter A, Article II-A, Section 2. 2011).
Despite of the intensive interest among practitioners and the practical importance, limited evidence exists on whether an individual board member may affect accounting standards.

Newman (1981a, b) and Selto and Grove (1982, 1983) find that a board member’s professional background does not predict his voting patterns. Allen and Ramanna (2013) document that the overall composition of FASB members’ background and political affiliation affect the trade-off between reliability and relevance in proposed accounting standards. They concluded that when the board has more members with financial industry experience, it proposes more “relevant” standards, and when the board has more experience in public accounting, it proposes more “reliable” standards. However, they note that excluding any individual board member does not affect their inferences, which means that the overall composition of the board rather than the individual board member matters for accounting policies.

It is possible that individual board members have little influence on accounting standards setting after all. The FASB has a lengthy due process that solicits inputs from different constituents. No single board member has veto power. The board members also rely on the FASB staff to conduct research, propose alternatives and draft standards. It could be the FASB staff rather than the board members that matter more to accounting policies.

It’s also possible that we have focused on the wrong individual characteristics. At the end of the day, practitioners want accounting policies that suit their interests. For example, when asked by the FASB for suggestions of new topics, one practitioner said, “I can’t really say what project you should work on until you tell me what your answer will be” (Beresford 1993). A board member’ background and experience does not perfectly predict his position. For example, Ed Trott, who became a board member as a former auditor, surprised the auditing community by “his support of the fair value accounting—hardly the direction the former KPMG partner was
expected to head” (Rosen 2006). The Financial Accounting Foundation has denied that it considers a candidate’s position on specific accounting issues when selecting new board members. Nonetheless, some observers speculate that such factors are important (FAF 2010).

We rarely have a chance to observe board members’ distinct viewpoints, let alone to measure their influence on accounting policies. In this paper, we take advantage of a unique event that allows us to quantify a board member’s importance on an accounting policy. On August 24, 2010, the FASB announced that Bob Herz, the FASB chairman since 2002 would not serve out his second-five year term ending in 2012. Leslie Seidman was named the interim chairperson and later the official FASB chairman. Herz’s resignation came as a complete surprise to the media and market commentators. At the time, FASB was also “enmeshed in a battle” with banks over a proposal to apply fair value accounting to bank loans. Herz’s departure was viewed as providing banks “an unexpected advantage in the fight” (Reilly and Rapoport 2010). As one Wall Street Journal (WSJ) article titled, “Herz leaving marks boon for banks”, speculates that “a long line of bank lobbyists hopefully suggesting potential candidates” to succeed Herz and “push for a successor who is more friendly to their view on the mark-to-market question” (Reilly 2010).

The controversial proposal was issued on May 26, 2010, titled Proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815). It would require banks to measure loans held for collection at fair value. This proposal caused tremendous pushbacks from the banks, receiving over 2,800 comments letters. It represents the second largest number of comments received for an accounting standard, next to the Financial Accounting Standard 123R, Stock Based
Compensation. Not surprisingly, almost all comments strongly oppose applying fair value to bank loans.

The proposal was also controversial within FASB, because it was passed by a 3 to 2 vote, with Herz casting the deciding majority vote. Incidentally, Herz’s replacement, Seidman voted against the proposal “primarily because it would introduce fair value accounting for some nonmarketable, plain vanilla debt instruments that are held for collection” (FASB 2010). This is the only proposal that has dissenting votes among 12 proposed accounting standards update since the FASB codification project in 2008. It is only the fourth time that Seidman dissents from Herz during their seven-year overlapping tenure at the FASB out of the 80 policies that are publicly voted. During the first month that Seidman started her term as the FASB chairman in 2011, the FASB decided to reverse the May 2010 proposal and keep allowing banks to use amortized cost to report loans held for collection on January 25, 2011. This decision was viewed by the banking industry as a “major decision” and a victory (Rapoport 2011)

The surprising nature of Herz’s departure, the importance of the impending accounting policy to banks, and the sharp differences between Herz and Seidman on this policy provide a powerful setting to conduct an event study, using the stock market to measure individual FASB board member’s influence on accounting policy.\(^1\) Embedded in our research design are two assumptions: 1) the FASB’s fair value proposal would affect banks’ equity value if it is passed; and 2) Herz’s departure and Seidman’s subsequent appointment would change investors’ expectation of whether the FASB’s fair value proposal would be passed. Besides the practitioners’ perspectives, we link to the academic literature on fair value accounting. In

\(^1\) It is rare that an accounting policy maker’s appointment or departure surprises the stock market and his or her vote is important for an impending standard. For example, it was not a surprise when Sir David Tweedie announced that he would retire from the International Accounting Standard Board after finishing his ten year tenure as the Chairman. When the FASB member John Wulff resigned before finishing his term in 2003, there was no controversial accounting policy at stake.
addition, we analyze Herz’s and Seidman’s background more closely in Section 2. The overall evidence leads us to believe these two assumptions are likely to be valid. We expect banks to enjoy positive stock returns when Seidman replaced Herz because it lowers the chance that the FASB would finalize the fair value proposal.

The challenge of conducting an event study is how to filter out other concurrent news that might drive stock prices. The concern of spurious inference is especially high for this study because we only have one event. We take multiple steps to rule out the influence of confounding factors. First, after confirming the accuracy of the event date, we shorten the event window to one day, instead of using two- or three-day windows. Second, we calculate the Fama-French three-factor adjusted abnormal returns that control for a stock’s exposure to the overall market movement, the value/growth effect, and the firm size effect. Third, we use nonbanks’ stock returns to control for news that affect both banks and non-banks similarly. Fourth, to validate that banks’ responses to Herz’s departure are associated with the fair value proposal, we examine banks’ responses when the FASB first proposed the fair value rule on May 26, 2010 and when the FASB eventually dropped the fair value requirement on January 25, 2011.

Finally, we also identify banks that would be more sensitive to fair value accounting to further test if banks’ stock reactions are associated with the fair value proposal. We use three distinct proxies to measure the extent that banks would be affected more by fair value accounting. First, banks that have more loans on their balance sheets would experience the biggest change if they report loans at fair value. Second, banks that already report large portions of assets in fair values complain about fair value accounting loudly during the recent financial crisis and respond positively when the FASB relaxed the fair value rule in 2009 (Bhat, Frankel and Martin 2011). These banks likely oppose more fair values given their asset exposure. They
would welcome Herz’s departure as it signals less fair value accounting in the future. The opposition to fair value accounting becomes stronger during economic downturns (Haldane 2010), because firms worry about falling stock prices. Instead of examining individual asset classes, we use a firm’s market-to-book ratio (M/B) to measure the overall market valuation of a firm’s net book asset. Banks that experience large decline in M/B would care more about price declines and thus are reluctant to apply fair value to their loans.

We find that relative to nonbanks, banks enjoyed a positive abnormal return of 25 basis points when Herz resigned unexpectedly. However, only banks that are more sensitive to fair value accounting experienced such positives returns. Relative to other banks, banks with more loans, banks with more fair value assets, and banks with large declines in M/B experienced positive returns ranging from 40 to 79 basis points. When the FASB first proposed applying fair value to loans, banks did not experience negative returns in general. But relative to other banks, banks that are more sensitive to fair value accountings experienced negative returns ranging from 38 to 100 basis points. When the FASB abandoned the fair value proposal, banks on average enjoyed positive returns of 53 basis points. In addition, banks with large declines in M/B and banks with more loans experience more positive returns of 46 and 65 basis points, respectively than other banks.

Overall our evidence suggests that Herz’s unexpected resignation moved banks’ stock price up because it changed the market expectation of the likelihood that the FASB’s fair value proposal would be passed. Our results provide direct evidence on why accounting practitioners care about who sets accounting standards and indirect evidence on whether individual accounting policymakers matter in setting accounting standards.
This paper helps us understand why accounting practitioners care about who serves on the FASB. Shortly after the FASB was established, Watts (1977) and Watts and Zimmerman (1978) point out that the process of setting accounting standards is political, with many players involved. However, the accounting literature generally focuses on the influence of the preparers and the users (e.g., Dhaliwal 1982; Dechow, Hutton and Sloan 1996; Ramanna 2008; and Bertomeu and Magee 2011). Kothari, Ramanna and Skinner (2010) call for more research to better understand the forces that shape the accounting standards, particularly the role of the standard setters. Responding to this call, Allen and Ramanna (2013) examine the relation between proposed accounting standards and FASB board members’ collective background and political affiliations. Our paper extends Allen and Ramanna (2013) by examining whether individual board members with different views can affect the likelihood of a proposal being passed. Just like Watts and Zimmerman’s (1978) paper helps us understand why firms are interested in particular accounting standards, our findings help understand why practitioners are interested in who serves on the FASB or chairs the board.

Our paper also complements the literature on individuals’ role in corporate decision making. Research in economics and accounting documents that individual managers exhibit distinct styles in a wide range of corporate policies (Bertrand and Schoar 2003; Bamber, Jiang and Wang 2010; Dyreng, Hanlon, and Maydew 2010). Different from the corporate world where top managers like the CEOs play a significant role, the accounting standards are jointly decided by a group of board members who each has one vote, and the chairman has no veto power. Our results indicate that at least the stock market perceives that individual FASB members (i.e., the chairmen) matter for setting accounting policies.
Finally, this paper provides additional insight into the fair value accounting debate. The stock market reactions indicate that bank investors do not welcome the FASB proposal to apply fair value accounting to loans. This finding echoes earlier research that shows that bank investors welcome the FASB’s decision to relax the fair value accounting rule in 2009 (Bhat et al. 2011). However, our findings also suggest that banks investors’ reactions to fair value accounting might be conditional on banks’ changes in market-to-book ratios. The rest of the paper is organized as follows. Section 2 discusses the backgrounds of Bob Herz and his successor Leslie Seidman and develops hypotheses on the stock market’s reactions to events surrounding Herz’s resignation. Section 3 describes our research design. Section 4 discusses the main findings of our study and section 5 concludes.

2. Background and Hypotheses Development

2.1. The FASB Chairman and the Backgrounds of Herz and Seidman

Responsible for issuing high quality accounting standards in the U.S. during the past four decades, the FASB is an independent accounting standard setter with five to seven board members. Although each board member has one vote, the FASB chairman has more responsibilities and plays a bigger role in setting accounting policies. In 2008, the FAF revised its by-laws and granted the chairman the power to set the FASB agenda for the first time. Thus, the chairman can decide which accounting issues for the FASB to consider. The chairman is also the principle officer of the board who can appoint the FASB staff and manages the budget. Given his/her overall power, the chairman sets an upper bound for the influence of individual board members.

Bob Herz joined the FASB as the chairman in 2002, replacing Edmund Jenkins, a former partner of Arthur Andersen. Herz was PricewaterhouseCoopers (PwC) America’s Leader of
Professional, Technical, Risk and Quality. Two aspects of his background stand out. One is his international exposure. He lived in Argentina and attended college in UK. He is both a US Certified Public Accountant and a UK Chartered Accountant. He also served as a part-time member of the International Accounting Standards Board (IASB). Shortly after he joined the FASB, the FASB signed the milestone Norwalk agreement with the IASB, marking the beginning of the close cooperation between the two boards. The other interesting aspect of Herz’s background is his user perspective. He was a member of PwC’ Partner Investment Committee, which manages PwC partners’ retirement fund. According to the FASB website, Herz held “positions involving fiduciary and investment management responsibilities for significant pension plans, endowment funds, and other types of pooled investments.” He co-authored a book, *The Value Reporting Revolution Moving beyond the Earnings Game*, which calls for more transparency from corporate managers such as disclosing to the market every performance measure that they use internally. During his first term, Herz was credited with generating “greater participation of investors and other users of financial information in the Board’s standard-setting process” (FASB 2007).

In contrast to Bob Herz, Leslie Seidman joined the FASB from the preparer side. She replaced board member John Wulff, former CFO of Union Carbide Corporation in 2003. She had been a vice president of accounting policy at J.P. Morgan, developing accounting policies for new financial products and implementing new accounting standards for the firm. Then she joined the FASB as an industry fellow, later as assistant director of research in charge of implementation and practice issues. Afterwards she ran a financial consulting firm serving financial institutions and accounting firms. She also served on the Financial Committee of the Institute of Management Accountant (IMA), advocating accounting standards on behalf of the
members of the IMA. Overall, Seidman has extensive experience in the financial service industry. As a consultant, she co-authored a book titled “Financial Instruments: A Comprehensive Guide to Accounting and Reporting,” which provides a comprehensive coverage of financial instruments for preparers (see Appendix B for more details).

During their seven-year overlap on the FASB, Herz and Seidman seldom disagree with each other. We only find four times that Seidman dissents from Herz among over 80 pieces of accounting policies that publicly disclose board members’ votes. In these dissents, Seidman frequently raises issues on implementation. For example, in dissenting from FIN46, Consolidation of Variable Interest Entities, Seidman argues that the effective dates do not give enough time for preparers and auditors to “digest the clarified provisions, analyze the effect on their organizations, implement the effect of any changes, and subject them to internal and external audit procedures” (FASB 2003). In dissenting from FAS 141R, Business Combinations, Seidman worries that the cost of estimating goodwill related to noncontrolling interest outweighs the informational value. In dissenting from the fair value proposal in May 2010, she raises concerns that one proposed change “would not be operational,” and “would become an albatross for the Board, requiring interpretation and causing compliance issues in practice” (FASB 2010, BC249). It appears that Seidman’s preparer background does affect her perspective (see Appendix C for more details). However, for our purpose, it is not important why Herz and Seidman differ but whether their views differ on the fair value proposal that the stock market cares about.

2.2. Fair value accounting and the FASB proposal

Fair value or mark-to-market accounting has long been a controversial topic. Banks and bank regulators constantly raise concerns about fair value accounting (Laux and Leuz 2009). As
early as 1938, bank regulators believe that marking to market prevents banks from lending to small businesses and abandon mark-to-market accounting when setting capital requirement (Simonson and Hempel 1993; Haldane 2010). In 1990, then Federal Reserve Chairman Alan Greenspan cautions the SEC about adopting market value accounting for banks. He argues that applying market valuation for bank loans is “interesting, but not a relevant measure of the success of commercial banking” (Greenspan 1990). During the recent recession, banks, commentators and politicians accuse fair value accounting of significantly exacerbating the financial crisis (Wesbury and Stein 2009). The banking industry lobbies the Congress heavily to tie the FASB’s hands. In a series of hearings in March 2009, Congress tells Herz that if the FASB does not move fast enough to fix the accounting rules, the Congress will legislate it directly (Pulliam and McGinty, 2009). Shortly afterwards, the FASB issues two staff positions, relaxing the requirement for testing assets impairment and gives more leeway to bank managers. These measures lead to positive market returns for banks (Bhat et al. 2011).

Critics of fair value accounting argue that during a recession the liquidity shocks depress price and fair value accounting can lead banks to take excessive write-downs and sell assets at fire sale prices, further depressing stock prices and causing contagion effects. Although theoretical work has shown that such contagion effects could happen (Allen and Carletti, 2008; Plantin et al. 2008), empirical evidence suggests that such effects are limited (Bhat et al. 2011; Shaffer 2010; SEC 2008). For example, fair value accounting does not apply to the bulk of banks’ assets, such as commercial loans. Banks also has discretion to move assets to different categories to reduce the impact of marking to market. The impairment losses recognized by banks during the recent recession underestimate rather than overestimate the actual losses.
While most observers conclude that fair value accounting is not responsible for the financial crisis, they also note some deficiencies in the accounting standards that could be improved to better address investors’ information need during the crisis (Lauz and Leuz 2009, 2010; Barth and Landsman 2010; and Financial Crisis Advisory Group 2009). One noted deficiency is the mixed attribute model for financial instruments. Basically, similar instruments are measured differently depending on a firm’s intention or the nature of the firm. For example, debt instruments could be measured at historical cost (e.g., if managers intend to hold some bonds to maturity or some loans for investment), at lower of cost or market value (e.g., if managers intend to hold some loans for sale), or at market value (e.g., if managers hold the securities for trading). These inconsistent and complex treatments likely prevent investors from better assessing a firm’s risk and performance. Against this background on May 26, 2010, the FASB issued a proposed accounting standards update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815). One major change is to require firms to report both the fair value and the amortized cost value of financial instruments including bank loans on the balance sheet, regardless of managers’ intentions. This requirement seems to be a win-win for the supporters of both the historical cost and the fair value accounting. Investors can pick either number that they deem useful.

Seidman and another Board member Larry Smith (former KPMG partner, a FASB director of research before becoming a board member) vote against this proposal “primarily because it would introduce fair value accounting for some nonmarketable, plain-vanilla debt instruments that are held for collection (long-term investment), and most liabilities held for payment, which they believe would not reflect the likely realization of those items in cash and,
therefore, would not be the most relevant way to measure those items in the statement of
financial position and comprehensive income” (FASB 2010, BC244). They argue that for these
debt instruments, “it is inappropriate for subjective, unrealized gains and losses to form the basis
for the entity’s statement of financial position, including book equity, as well as comprehensive
income, when those unrealized gains and losses are expected to reverse” (FASB 2010, BC245).

Banks also strongly oppose to this proposal. According to Hodder and Hopkins (2012),
banks associations likely orchestrate a comment letter campaign to voice their oppositions. The
proposal receives more than 2,800 comment letters, making it the second most commented
standard in the FASB history. Over 85% of the comment letters are from banks or banking
associations, and most banks only express concerns of reporting fair value of loans that are held
for collection, ignoring other proposed changes.

Other respondents including users also disagree with using fair value to measure loans
that are held for collection and for which no readily available market exists (FASB 2011). They
believe that introducing fair value to these loans “would increase subjectivity of reported
information and would not appropriately represent financial results for these instruments based
on the way they are managed” (FASB 2011, Para. 40). This argument is consistent with Seidman
and Smith’s objection. Banks and other respondents are also concerned that the fair value
treatment of bank loans would negatively affect banks’ regulatory capital, leading to
“procyclicality and unnecessary dilutive capital actions” (FASB 2011, Para 41).

Given that the FASB votes on the proposal are publicly disclosed, it is reasonable to
expect market participants to learn the different positions that Seidman and Herz took on this
issue.² For example, the same Wall Street Journal article covering Herz’s resignation mentions

² Herz’s view on fair value is more nuanced. He has voted with Seidman and Smith in March 2009 to relax the fair
values rules, while Tom Linsmeier (former professor at Michigan State University) and Marc Siegel (former head of
that his resignation provides banks an “unexpected advantage” in their fights against the fair value proposal. The article further notes, “with Mr. Herz out of the picture, the future of the rule change may be in doubt. That may cheer some bank investors” (Reilly 2010). On January 25, 2011, shortly after Sediman becomes the FASB chairman, the FASB votes to reverse the proposal and allows banks to only report amortized cost for loans held for collection. A WSJ article reports that the banking industry welcomes the news and mentions Sediman’s earlier dissent from the original proposal back in May 2010 (Rapoport 2011).

The media narratives lead us to conjecture that Herz’s sudden departure reduces the likelihood that the proposed fair value treatment would be passed. If bank investors dislike the FASB’s fair value proposal and understand Herz’ deciding vote on the original proposal, they will be somewhat relieved when Herz resigned and more relieved when the fair value proposal is reversed. In alternative form, our first set of hypotheses is:

**H1a**: Banks’ stocks respond *positively* to Herz’s unexpected resignation on August 24, 2010.

**H1b**: Banks’ stocks respond negatively when the FASB first announced its proposal to require banks to report fair values for loans held for collection on May 26, 2010;

**H1c**: Banks’ stocks respond positively when the FASB abandoned the fair value requirement and allowed banks to report loans held for collection at amortized cost on January 25, 2011.

Banks’ stock reactions to the May 2010 proposal and the January 2011 reversal can help us verify whether any stock reactions to Herz’s resignation are indeed related to bank investors’ assessment of the impact of fair value accounting. . It is possible that some concurrent news unrelated to the fair value proposal also affect banks’ stock returns in the similar patterns on the

accounting analysis group of an investor advocacy company, RiskMetrics Group) dissent. Though Herz joined Linsmeier and Siegel as the majority in passing the May 2010 proposal, he does not prefer measuring banks loans with fair value or historical cost, but an alternative measurement—current value, which is based on discounted cash flows (private correspondence with Herz).
three event days. However it is less likely that the unrelated news would affect banks cross-sectionally in similar patterns as the fair value proposal. To rule out alternative explanations, we partition the banks into two subgroups to see if banks that are more sensitive to fair value accounting react more strongly to these three events. We conduct three sets of cross-sectional tests within banks. First, we use the amount of loans reported on banks’ balance sheets at the end of year 2009 to measure a bank’s sensitivity to the fair value proposal. Banks with more loans will be affected the most if they implement the fair value proposal.

Second, banks that already report more assets at fair value might resist more fair value accounting. Banks and bank supporters blame fair value accounting for exacerbating the recent financial crisis and thus oppose to more fair value accounting. During the financial crisis, the US GAAP only requires most financial instruments (not including loans) to be marked to market on the balance sheet, with even fewer items’ changes in fair values reported in the income statement (Barth and Landsman 2010). Given banks’ consistent opposition to fair value accounting, we expect banks that are already exposed to more fair value accounting to be more sensitive to applying fair value to loans. They likely view Herz as a strong supporter of fair value accounting and welcome his departure as it indicates less fair value accounting policy in the future.

Finally, banks’ opposition to fair value accounting seems to be associated with economic recessions. As Haldane (2010) observes that historically the oppositions to fair value became stronger as the economy goes in trouble. Banks’ recent experience during the financial crisis no doubt contributes to their strong sentiments against expanding fair value accounting to loans. For example, Edward Yingling, the President and Chief Executive of the American Bankers Association worried that banks would have to write down loan values right after making the loans (Rapoport 2010), which assumes that the market value of loans would keep declining.
Based on these observations, we predict that banks experiencing larger price reductions are more resistant to more fair value reporting on the balance sheet. Among other things, a bank’s market-to-book ratio (M/B) comprehensively measures the stock market’s valuation of its net book assets (Laux and Leuz 2010). A larger reduction of M/B might alert banks of further price decline, increasing their reluctance to recognize loans at fair value.\(^3\) Focusing on the change of M/B also eliminates the impact of bank-specific factors that hinder cross-sectional comparisons.

Taken together, we propose the following hypotheses to test for cross-sectional differences in banks’ stock reactions to the three events related to Herz’ resignation (stated in alternative form).

**H2a:** Banks with more loans on the balance sheet respond more positively when Herz resigned and when the FASB later reversed the fair value proposal, and more negatively when the FASB first proposed the fair value rule comparing to other banks.

**H2b:** Banks that already report more fair value assets on the balance sheet respond more positively when Herz resigned and when the FASB later reversed the fair value proposal, and more negatively when the FASB first proposed the fair value rule comparing to other banks.

**H2c:** Banks that experience large reductions of M/B respond more positively when Herz resigned and when the FASB later reversed the fair value proposal, and more negatively when the FASB first proposed the fair value rule comparing to other banks.

We try to make each test as distinct as possible to capture the different dimensions of the impact of fair value accounting on different banks. H2a-H2c each includes three tests on the three event dates. In addition, we use a one-day event window to mitigate the influence of concurrent events. We carefully examine these event dates to make sure they are the original decision dates.

**3. Research Design**

**3.1 Model Specification**

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\(^3\) Even under the current mixed attribute framework, none-than-temporary price declines of financial instruments would lead to write-down of the book values. The expansion of the fair value accounting potentially makes the link between price and book value tighter.
To test the first set of hypotheses (H1a-H1c), we estimate the following model:

\[ AbRet = a_0 + a_1*Bank + Errors \]  (1)

In Model (1), \( AbRet \) is a firm’s one-day abnormal returns on the three event dates after adjusting for the Fama-French (1993) three-factors (see Appendix A for more details). The constant term captures nonbank firms’ abnormal returns on the event dates. \( Bank \) is an indicator variable that equals one when a firm is a banking holding company. The coefficient on \( Bank \) captures the difference in returns between banks and nonbanks. Therefore model (1) essentially applies a difference-in-difference design, where the abnormal returns of nonbank firms serves to control for any concurrent news that affects banks and nonbanks similarly.

To test our second set of hypotheses (H2a-H2c), we separate banks into two groups where one subgroup of banks might react more strongly to the three events than the other banks. Specifically, we estimate the following model:

\[ AbRet = a_0 + a_1*Bank + a_2*Bank*\text{Subgroup\_Indicator} + Errors \]  (2)

The \text{Subgroup Indicator} equals one if a bank belongs to a group that is likely more sensitive to the fair value proposal (\textit{More Loans, Large Fair Value, and Large Decline in M/B}). The coefficient on the interaction term (\( Bank * \text{Subgroup\_Indicator} \)) captures the differences in abnormal returns between banks that are more sensitive to fair value accounting and those that are not.

We estimate both models (1) and (2) using Ordinary Least Square. To account for the correlations among stock returns we calculate the robust standard errors. We also exclude observations whose absolute value of the studentized residuals is more than 2 to mitigate the influence of outliers.

3.2. \textit{Sample Selection and Variable Definitions}
From the Compustat/CRSP merged database, we obtain 3,597 U.S. publicly listed firms (share code 10 or 11) with available stock returns on all three event dates: 1) August 24, 2010 when Herz unexpectedly resigned, 2) May 26, 2010 when the FASB first proposed applying fair value to loans, and 3) January 25, 2011 when the FASB dropped the fair value requirement on bank loans. Among these firms, we identify 340 bank holding companies based on the Bank Regulatory Database that are available from WRDS.

For these 340 banks, we gather the amount of loans and the amount of assets reported at fair value at the end of fiscal year 2009 from the Compustat/CRSP merged Bank Annual File. If a bank’s loan amount exceeds the sample median, we set an indicator variable, More Loan, equal to one. Because a bank’s loan amount is highly associated with its reported fair value assets, we scale a bank’s fair value assets by its total assets following Song et al. (2009. When a bank’s relative fair value assets exceed the sample median we code Large_FV, an indicator variable, as one. Finally, we calculate each bank’s change in market-to-book ratio (M/B) between fiscal years 2009 and 2008. Most banks experience declines in M/B during those two years. So we set an indicator variable Large_ChgMB to one if a bank’s M/B decline is greater than the sample median. We do not consider the stock price changes from 2007 to 2008 to avoid the market panic period. See Appendix A for more details on variable constructions.

4. Results

4.1. Descriptive Statistics

Panel A of Table 1 reports descriptive statistics on our sample. It appears that banks have much higher leverage than nonbanks. On average, banks have $25 billion in total assets, but their equity value is only worth $2.2 billion at the end of 2009. In contrast, nonbanks on average have $3.6 billion in equity and $6.6 billion in total assets. Banks also have lower market-to-book
ratios than nonbanks. One dollar in banks’ equity is worth $0.77 whereas one dollar of nonbanks’ equity is worth $2.30. The difference shows that investors are still quite pessimistic about banks’ prospects at the end of 2009. Banks’ lower market-to-book ratio also indicates that investors may also perceive banks’ equity value as overstated. In addition, from 2008 to 2009, while on average nonbanks’ market-to-book ratios increase by 0.97, banks’ market-to-book ratios decrease by 0.19. Further comparing banks’ book values and market values in 2008 and 2009, we find the decline in banks’ average market-to-book ratio is due to the decline in banks’ equity values despite the increase in banks’ book values.

Table 1 Panel A also indicates that loans are the most significant asset on a bank’s balance sheet. Banks’ average loans are $12 billion, representing two-thirds of total assets. In contrast, the asset class that already reports fair value is only $7.4 billion, representing 17% of banks’ total assets, and mainly consists of financial securities that banks hold (Laux and Leuz 2010).

The large amount of loans shows that applying fair value to loans would significantly affect banks’ balance sheets. Banks declining market-to-book ratios also suggest that the fair value of loans might drop even further. All these factors suggest that requiring banks to report loans at fair value would likely weaken banks’ balance sheets, driving the banks to strongly oppose to the FASB’s fair value proposal.

Panel B of Table 1 reports both the one-day raw returns and the Fama-French three-factor adjusted abnormal returns for banks and nonbanks on the three event dates. We find that when Herz resigns unexpectedly, both banks and nonbanks experience negative raw returns. After filtering out returns associated with size, market-to-book and the general market movement, banks’ average abnormal returns are close to zero, while nonbanks’ abnormal returns are still
negative. When the FASB first proposes fair value treatment for loans, both banks and nonbanks experience positive raw returns, but abnormal returns are not significant. When the FASB abandons the fair value proposal, banks experience both positive raw and abnormal returns, while nonbanks reports negative raw and abnormal returns.

Panel C of Table 1 reports the Pearson correlation among the three indicator variables we use to partition banks into those that are more and those that are less sensitive to fair value accounting. Panel C shows that a bank’s existing fair value assets deflated by total assets are positively associated with its loans ($\rho=0.14$) and changes in its market-to-book ratio ($\rho=0.12$), but a bank’s loans are not associated with changes in its market-to-book ratio. These relatively weak correlations indicate that the three indicator variables capture different dimensions of banks’ opposition to FASB’s fair value proposal.

4.2. Main Results

Table 2 reports the results of testing H1. Column 1 shows that when Herz resigns unexpectedly, nonbanks experience negative abnormal returns of 25 basis points. Relative to nonbanks, banks enjoy positive abnormal returns of 25 basis points. This is consistent with our conjecture that banks react positively to Herz’ resignation. For the median bank in our sample with a market value of $94$ million, 25 basis points in returns represent slightly less than a quarter million value increase in one day.

Table 1 Column 2 shows that when the FASB first proposes the fair value rule for loans in May 2010, banks do not experience negative stock returns. While this is inconsistent with our hypothesis that banks should react negatively to the fair value proposal, it is possible that the banks are not surprised by the proposal or other concurrent events offset the influence of the proposal. Column 3 shows that when the FASB announces that it would no longer require banks
to report fair value for loans in January 2011, banks experience highly significant positive abnormal returns of about 53 basis points, comparing to nonbanks that have negative returns of about 15 basis points. The result is consistent with our hypothesis that banks view FASB’s fair value retreat favorably. The abnormal returns of 53 basis points roughly translate to half a million market value increase for the median bank.

Overall results in table 2 are somewhat mixed. These mixed results indicate that our conjecture on Herz’s resignation might not hold. The difficulty to isolate the causal factors in an event study can also drive the mixed findings. So we turn to table 3 for more powerful tests that compare the subgroups of banks that are more (less) sensitive to the FASB’s fair value proposal and to Herz’s resignation.

We separate banks into two subgroups and conjecture that some banks might be more sensitive to FASB’s fair value proposal than others. Specifically, we expect banks with more loans, high percentage of assets reported in fair values, and large declines in market-to-book ratio are more reluctant to adopt FASB’s fair value proposal. Our variable of interest is the interaction term between the indicator variable that breaks banks into different subgroups and the bank indicator variable. This interaction term captures the incremental returns of one bank subgroup relative to the other.

The first three columns in Table 3 indicate that all three bank subgroups experience significantly positive abnormal returns when Herz resigns unexpectedly. Banks with more loans enjoy positive returns of about 79 basis points (p=.001). Banks that already report higher percentage of fair value assets experience positive returns of about 47 basis points (p=0.02). Finally, banks with larger declines in market-to-book ratio enjoy positive returns of about 40 basis points (p=0.04). In contrast, the remaining banks do not experience different returns than
nonbanks. The difference in returns between banks that are more sensitive to fair value and banks that are not is also significant at the 1% significance level. These results suggest that sharper cross-sectional tests better detect the impact of Herz’s departure.

The middle three columns in Table 3 indicate that all three bank subgroups experience significantly negative abnormal returns when the FASB first proposes fair value reporting for loans in May 2010. Banks with more loans suffer one day negative returns of about one percent (p<0.001). Banks that already report higher percentage of fair value assets suffer negative returns of 38 basis points (p=0.07). And banks with larger declines in market-to-book ratio suffer negative returns of about 53 basis points (p=0.02). In contrast, the remaining banks either have positive returns or no significant returns compared to nonbanks. The difference in returns between banks that are more sensitive to fair value accounting and those that are not is also significant at the 10% significance level. Thus, in contrast to the results in Table 2 Column 2 where banks as a whole experience no significant returns on May 26, banks that are more sensitive to fair value accounting did respond negatively to FASB’s initial fair value proposal.

The last three columns in Table 3 report that two of the three bank subgroups have significant positive returns when under Seidman’s leadership the FASB drops the fair value requirement for bank loans in January 2011. We find that banks with greater amount of loans experience positive returns of 65 basis points and banks with larger reductions in market-to-book ratio have positive returns of 46 basis points. Banks that already report higher percentage of fair value assets have positive but insignificant returns of 11 basis points, compared to other banks that already report 45 basis points of positive returns than nonbank firms.

In sum, Table 3 indicates that banks that are more sensitive to fair value accounting indeed respond more positively to Herz’s resignation and the FASB rule reversal. The results
support our predictions that Herz’s resignation changes the market’s expectation of how likely
the fair value proposal for loans would be finalized. Among the three dimensions that we use to
identify banks that are more sensitive to FASB’s proposal, the amount of loans is the most
effective identifier: banks with more loans respond the most strongly to the three events than
banks with fewer loans. This is intuitive because FASB’s proposal directly affects bank loans.

4.3. Robust Tests

We exclude outliers in Tables 2 and 3 by excluding observations with absolute value of
studentized residuals bigger than 2. However, the inferences remain the same without excluding
the outliers. In addition, the inferences in Table 2 and 3 are based on the comparisons of mean
abnormal returns. To check if our inferences are robust, we also compare the median abnormal
returns in Table 4. For each of the three events, we compare the median returns between four
groups - first between banks and nonbanks, and then between the three pairs of bank subgroups.

Panel A of Table 4 shows that when Herz resigns unexpectedly, all four median
comparisons are consistent with our predictions. The median abnormal returns for banks, 16
basis points, is significantly larger than the negative abnormal returns of 20 basis points for
nonbanks (p=0.01). The median abnormal returns for banks with larger amount of loans (44 basis
points) are significantly larger than the negative median abnormal returns for banks with fewer
loans (12 basis points) (p=0.01). The median abnormal returns for banks with more fair value
assets (47 basis points) is significantly larger than the negative abnormal returns for banks with
less fair value assets (p<0.01). Finally, the median abnormal returns for banks with larger
declines in market-to-book ratio (44 basis points) is significantly larger than the negative
abnormal returns for other banks (17 basis points) (p=0.03).
Panel B of Table 4 shows that when the FASB proposed the fair value rule for bank loans on May 20, 2010, three out of the four median comparisons are consistent with our predictions. While the median abnormal returns for banks do not differ from for nonbanks, the median returns for the three bank subgroups are all significantly different from other banks in the predicted directions (p<=0.10). Panel C shows that when the FASB reversed the fair value proposal on January 25, 2010, three out of the four median comparisons are consistent with our predictions. The median returns for banks with more loans do not differ from the median returns for banks with fewer loans. The remaining median comparisons are all significant in the predicted directions (p<=0.04).

Taken together, ten out of the 12 median comparisons are consistent with our predictions, similar to our mean tests in Tables 2 and 3. While some results are weak, the overall patterns in the data seem to be consistent with our expectations.

5. Conclusions and limitations

In this paper, we empirically measure individual FASB board members’ influence on accounting standard setting by utilizing the unique setting of former FASB chairman Bob Herz’s unexpected resignation in the context of a highly contested FASB proposal that requires banks to apply fair value to loans. While Herz supported the fair value proposal, his successor, Leslie Seidman, voted against it publicly. We find that banks, especially those that are more sensitive to fair value accounting, such as banks with more loans, with higher percentage of assets reported at fair value, and with larger reduction in market-to-book ratio, view Herz’s departure as good news. These banks experienced negative returns when the FASB first announced the fair value proposal during Herz’s tenure, but enjoyed positive returns when the FASB abandoned the fair value requirement under Seidman’s leadership. These patterns suggest that banks interpret
Herz’s departure as lowering the chance that the fair value requirement would be finalized. These results provide direct evidence on why accounting practitioners care deeply about who serves on the FASB because they believe individual board members exert significant influences on particular accounting issues.

While a board member’s professional background and experience are the focus of policy discussion and prior research, it is not clear that they fully explain why Herz and Seidman disagree with each other on the fair value issue. Our results suggest that accounting practitioners’ attitude toward any candidates for the FASB board member or the chairman positions might be associated with the candidate’s specific views rather than his or her personal background. Firms likely lobby for or against a particular candidate based on his or her past positions on individual accounting issues.

One limitation of our study is that we cannot pin down why Herz and Seidman disagree on the fair value proposal. Another limitation is that our paper focuses on a single event and one particular accounting issue on fair value for bank loans. To the extent that accounting policymakers rarely disagree with each other, the effects we document in this study may represent an upper bound of individual board members’ perceived influence on accounting standard setting. On the other hand, if the FASB chairman exerts his/her influence mainly through setting the FASB’s agenda, selecting staff with similar views, or persuading other board members privately, then the effects we observe might underestimate the influence of the FASB chairman. Future research can seek more evidence to assess whether the results in our study can be generalized.
References


Figure 1
Timeline of Event Dates

Appendix A

Variable Definitions

From the Compustat/CRSP merged database, we select 3,597 U.S. publicly listed firms (share code 10 or 11) that have returns data on all three event dates: August 24, 2010 when Herz resigned, May 26, 2010 when the FASB first proposed applying fair value to loans, and January 25, 2011 when the FASB dropped the fair value requirement. Among them, we identify 340 bank holding companies based on the Bank Regulatory Database that are available from WRDS.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AbRet_HerzResign</td>
<td>The abnormal returns in basis points for August 24, 2010, when Herz resigned. We estimate the Fama-French (1993) three-factor model, which controls for firms’ exposure to the overall stock market movements, a value/growth effect and a small firm effect following Becker et al. (2012). The estimation period starts at 249 days before and ends at 26 days before our event date. The daily returns are from the CRSP. The daily factor returns are from Ken French’s data library.</td>
</tr>
<tr>
<td>AbRet_FV_Proposed</td>
<td>The abnormal returns in basis points for May 26, 2010, when the FASB proposed applying fair values to loans. The estimation procedure is as above.</td>
</tr>
<tr>
<td>AbRet_FV_Dropped</td>
<td>The abnormal returns in basis points for January 25, 2011, when the FASB decided to drop the fair value requirement. The estimation procedure is as above.</td>
</tr>
<tr>
<td>Ret_HerzResign</td>
<td>Raw returns in basis points for August 24, 2010.</td>
</tr>
<tr>
<td>Ret_FV_Dropped</td>
<td>Raw returns in basis points for January 25, 2011.</td>
</tr>
<tr>
<td>Bank</td>
<td>Equals one if a firm is a bank holding company as defined by the Bank Regulatory Database and zero otherwise.</td>
</tr>
<tr>
<td>Loan</td>
<td>The total loan value, the Net of Unearned Income Loans from the CRSP/COMPUSTAT Merged Bank Annual File, following Bhat et al (2011)</td>
</tr>
<tr>
<td>More_Loan</td>
<td>Equals one if a firm’s total loan value is above the sample median.</td>
</tr>
<tr>
<td>Fair Value</td>
<td>Banks’ total fair value assets at the end of fiscal year 2009. Data are from the CRSP/COMPUSTAT Merged Bank Annual File.</td>
</tr>
<tr>
<td>Large_FV</td>
<td>Equals one if a bank’s Fair value scaled by the total book value of exceeds the sample median for all banks.</td>
</tr>
<tr>
<td>Market-to-book (M/B)</td>
<td>Equals the market value of equity (price* common shares outstanding) divided by the book value of equity at the end of fiscal year 2009.</td>
</tr>
<tr>
<td>ChgMB</td>
<td>Equals the M/B at the end of fiscal year 2009 minus the M/B at the end of year 2008.</td>
</tr>
<tr>
<td>Large_ChgMB</td>
<td>Equals one if a bank’s change in M/B is below the sample median for all banks.</td>
</tr>
</tbody>
</table>
# Appendix B

## Some biographic information of Bob Herz and Leslie Seidman

<table>
<thead>
<tr>
<th></th>
<th>Bob Herz</th>
<th>Leslie Seidman</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Age</strong></td>
<td>Born in June 1953, age 48 when joining the FASB in 2002.</td>
<td>Born in July 1962, age 41 when joining the FASB in 2003</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td>Attended high school in Argentina; B.A. Economics, University of Manchester, U.K. 1974</td>
<td>B.A. English, Colgate University, 1984; M.S. Accounting, New York University, 1985</td>
</tr>
<tr>
<td><strong>Political contribution</strong></td>
<td>Made contribution to Chris Dodd’s political committee in 1997 and Charles Schumer’s political committee in 2000</td>
<td>No information found</td>
</tr>
</tbody>
</table>

## Appendix C

### More details of the four accounting policies that Seidman dissented from Herz

<table>
<thead>
<tr>
<th>Date</th>
<th>Contested Standards</th>
<th>Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003/12</td>
<td>Consolidation of variable interest entities (Interpretation 46); Seidman and Batavick dissented.</td>
<td>“Find it troubling that entities with the same contractual structures could reach different conclusions about whether the entity is a variable interest entity and who should consolidate it.” Effective date is too soon for preparers and auditors to implement.</td>
</tr>
<tr>
<td>2007/12</td>
<td>Business combinations (FAS 141 Revise); Seidman dissented;</td>
<td>Disagree with when to measure goodwill; Disagree with the scope of goodwill calculation. Goodwill shouldn’t include portions involving noncontrolling interest. “The incremental informational value of capturing the portion relating to the noncontrolling interest does not outweigh the cost of developing it, especially if the acquired entity is a private company”</td>
</tr>
<tr>
<td>2007/12</td>
<td>Noncontrolling interests in consolidated financial statements (FAS 160); Seidman dissented;</td>
<td>Disagree with treating the noncontrolling interests in subsidiaries as equity. Preferring to wait for the FASB settle the definition of equity and liability in the conceptual framework. to resolve other conceptual issues; Disagree with reporting in earnings the effects of remeasuring a firm’s investment in a subsidiary after deconsolidation of the subsidiary. Should be a separate component in other comprehensive income.</td>
</tr>
<tr>
<td>2010/05</td>
<td>Proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815); Seidman and Smith dissented</td>
<td>“Ms. Seidman and Mr. Smith dissent from several aspects of the proposed guidance, primarily because it would introduce fair value accounting for some nonmarketable, plain-vanilla debt instruments that are held for collection (long-term investment), and most liabilities held for payment, which they believe would not reflect the likely realization of those items in cash and, therefore, would not be the most relevant way to measure those items in the statement of financial position and comprehensive income.” Worry about implementation: The proposed measure for the core deposit liabilities of a depository institution introduces “a new element of complexity”. “The amortized cost exception for some financial liabilities lacks an underlying concept, is rules based in nature, and would not be operational”. About the change in accounting for yields on debt investments, “Ms. Seidman seriously questions the cost-benefit tradeoff of that proposed change”. Deferring application date for small nonpublic entity “raises significant questions about the operationality of the proposed standard and whether the improvements in financial reporting and related benefits intended would be achieved in a timely fashion, if at all.”</td>
</tr>
</tbody>
</table>

Source: FASB website, quotes are directly from each accounting policy.
Appendix D

Sample of Wall Street Journal headline news on the three events days

The potential confounding events are numerous:

*When Herz resigned unexpectedly on August 24, 2010:*

- Housing Slump Spooks Investors
- Fed Split On Move To Bolster Sluggish Economy
- U.S. Housing: Fears of Red Ink Prompt Loan Insurer to Raise Charges
- H-P Trumps Dell With Offer for 3PAR
- Some Chrysler Dealers See Un Problema in Fiat's Plans

*When the FASB announced its proposal to apply fair value to bank loans on May 26, 2010:*

- Bernanke Continues Fight Against More Fed Scrutiny
- Still Broken: Banks Trim Debt, Obscuring Risks
- Apple's Dealings In Music Examined
- Microsoft Realigns Gadget Unit
- BP Cites Crucial 'Mistake' --- 'Very Large Abnormality' in the Well Wasn't Heeded Hours Before Fatal Explosion

*When the FASB decided not to require banks to report loans in fair values on January 25, 2011:*

- A 'Short' Plays Washington
- No State Bailouts, Lawmaker Says
- Penney to Give Activists a Say
- Justices Extend Protection Over Workplace Retaliation
- Honda Probe Finds Improper Dealings
### Table 1 Descriptive Statistics and Correlations

**Panel A: Descriptive statistics of firm characteristics for 340 banks and 3,257 nonbank firms at the end of fiscal year 2009**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Significant Diff</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Lower Quartile</th>
<th>Median</th>
<th>Higher Quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Assets ($M)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>25380</td>
<td>178146</td>
<td>810</td>
<td>1621</td>
<td>4481</td>
</tr>
<tr>
<td>Nonbank</td>
<td></td>
<td>6604</td>
<td>48465</td>
<td>131</td>
<td>543</td>
<td>2247</td>
</tr>
<tr>
<td><strong>Market Value ($M)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>2172</td>
<td>14047</td>
<td>32</td>
<td>94</td>
<td>390</td>
</tr>
<tr>
<td>Nonbank</td>
<td></td>
<td>3602</td>
<td>15026</td>
<td>94</td>
<td>413</td>
<td>1730</td>
</tr>
<tr>
<td><strong>Book Value ($M)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>2494</td>
<td>16872</td>
<td>66</td>
<td>134</td>
<td>414</td>
</tr>
<tr>
<td>Nonbank</td>
<td></td>
<td>1755</td>
<td>7873</td>
<td>52</td>
<td>216</td>
<td>824</td>
</tr>
<tr>
<td><strong>Market-to-book Ratio</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>0.77</td>
<td>0.50</td>
<td>0.37</td>
<td>0.66</td>
<td>1.06</td>
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<tr>
<td>Nonbank</td>
<td></td>
<td>2.30</td>
<td>16.40</td>
<td>0.97</td>
<td>1.60</td>
<td>2.71</td>
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<tr>
<td><strong>Change in M/B\textsuperscript{2009-2008}</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>-0.19</td>
<td>0.34</td>
<td>-0.36</td>
<td>-0.14</td>
<td>0.01</td>
</tr>
<tr>
<td>Nonbank</td>
<td></td>
<td>0.97</td>
<td>37.93</td>
<td>-0.17</td>
<td>0.23</td>
<td>0.73</td>
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<tr>
<td><strong>Loan Value ($M)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>11996</td>
<td>73289</td>
<td>541</td>
<td>1087</td>
<td>3049</td>
</tr>
<tr>
<td><strong>Loan Value/Total Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>0.67</td>
<td>0.12</td>
<td>0.62</td>
<td>0.68</td>
<td>0.75</td>
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<tr>
<td><strong>Fair Value Assets ($M)</strong></td>
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<td></td>
<td></td>
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<tr>
<td>Bank</td>
<td></td>
<td>7409</td>
<td>62563</td>
<td>119</td>
<td>263</td>
<td>721</td>
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<tr>
<td><strong>Fair Value Assets/Total Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td></td>
<td>0.18</td>
<td>0.10</td>
<td>0.10</td>
<td>0.17</td>
<td>0.23</td>
</tr>
</tbody>
</table>

Variable definitions are in Appendix A. The significant differences between banks and nonbanks are based on the t-statistics of means and the z-statistics of Wilcoxon Rank Sum Tests of median (p<0.10).
Table 1 (continued)

Panel B: Descriptive statistics of the event day returns measured in basis points for 340 banks and 3,257 nonbanks

<table>
<thead>
<tr>
<th>Variable</th>
<th>Significant Diff</th>
<th>Mean</th>
<th>Std. Dev</th>
<th>Lower Quartile</th>
<th>Median</th>
<th>Higher Quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Ret_ HerzResign</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank $B &lt; 0$</td>
<td>-78.60</td>
<td>301.90</td>
<td>301.90</td>
<td>-196.08</td>
<td>-53.98</td>
<td>38.84</td>
</tr>
<tr>
<td>Nonbank $N &lt; 0$</td>
<td>-138.70</td>
<td>294.00</td>
<td>294.00</td>
<td>-258.72</td>
<td>-136.77</td>
<td>-11.43</td>
</tr>
<tr>
<td><em>AbRet_ HerzResign</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank $B \approx 0$</td>
<td>-26.60</td>
<td>328</td>
<td>328</td>
<td>-143.41</td>
<td>15.78</td>
<td>127.88</td>
</tr>
<tr>
<td>Nonbank $N &lt; 0$</td>
<td>-31.50</td>
<td>300.90</td>
<td>300.90</td>
<td>-145.16</td>
<td>-19.61</td>
<td>99.14</td>
</tr>
<tr>
<td><em>Ret_FV_Proposed</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank $B &gt; 0$</td>
<td>89.18</td>
<td>388.30</td>
<td>388.30</td>
<td>-85.66</td>
<td>36.16</td>
<td>197.22</td>
</tr>
<tr>
<td>Nonbank $N &gt; 0$</td>
<td>43.55</td>
<td>304.10</td>
<td>304.10</td>
<td>-91.99</td>
<td>16.55</td>
<td>165.07</td>
</tr>
<tr>
<td><em>AbRet_ FV_Proposed</em></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Bank $B \approx 0$</td>
<td>16.00</td>
<td>403.20</td>
<td>403.20</td>
<td>-149.74</td>
<td>-7.59</td>
<td>140.74</td>
</tr>
<tr>
<td>Nonbank $N \approx 0$</td>
<td>4.20</td>
<td>308.60</td>
<td>308.60</td>
<td>-136.60</td>
<td>-6.10</td>
<td>134.46</td>
</tr>
<tr>
<td><em>Ret_FV_Dropped</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank $B &gt; 0$</td>
<td>44.25</td>
<td>381.60</td>
<td>381.60</td>
<td>-82.79</td>
<td>33.48</td>
<td>151.96</td>
</tr>
<tr>
<td>Nonbank $N &lt; 0$</td>
<td>-8.70</td>
<td>277.70</td>
<td>277.70</td>
<td>-109.80</td>
<td>-3.73</td>
<td>84.75</td>
</tr>
<tr>
<td><em>AbRet_FV_Dropped</em></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank $B &gt; 0$</td>
<td>47.40</td>
<td>379.80</td>
<td>379.80</td>
<td>-80.47</td>
<td>33.96</td>
<td>148.71</td>
</tr>
<tr>
<td>Nonbank $N &lt; 0$</td>
<td>-10.60</td>
<td>278.60</td>
<td>278.60</td>
<td>-111.31</td>
<td>-8.04</td>
<td>83.97</td>
</tr>
</tbody>
</table>

Variable definitions are in Appendix A. The significant difference column indicate whether the returns are significantly differently from zero based on both the mean and median test (p-value <0.10).

Panel C: Pearson correlations (p-value) between the three subgroup indicator variables

<table>
<thead>
<tr>
<th></th>
<th>Large_FV</th>
<th>Large_ChgMB</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>More_Loan</em></td>
<td>0.01</td>
<td>0.14</td>
</tr>
<tr>
<td></td>
<td>(0.83)</td>
<td>(0.01)</td>
</tr>
<tr>
<td><em>Large_FV</em></td>
<td>-0.04</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.52)</td>
<td></td>
</tr>
</tbody>
</table>

Variable definitions are in Appendix A.
Table 2: Test whether banks experience abnormal returns during the three event dates with nonbanks as the benchmark groups

\[ AbRet = a_0 + a_1 \times Bank + \text{Errors} \quad (1) \]

<table>
<thead>
<tr>
<th>Dep. Variable:</th>
<th>( AbRet_{\text{HerzResign}} )</th>
<th>( AbRet_{\text{FV_Proposed}} )</th>
<th>( AbRet_{\text{FV_Dropped}} )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>-25.15*** ((&lt;.01))</td>
<td>-1.84 (0.64)</td>
<td>-14.82*** ((&lt;.01))</td>
</tr>
<tr>
<td>Bank</td>
<td>25.39** (0.04)</td>
<td>-1.74 (0.90)</td>
<td>52.84*** ((&lt;.01))</td>
</tr>
<tr>
<td>Adjusted ( R^2 )</td>
<td>0.11%</td>
<td>0.00%</td>
<td>0.69%</td>
</tr>
</tbody>
</table>

Observations of Banks/Nonbanks: 319/3,110, 310/3,127, 310/3,146

Detailed constructions are in Appendix A. The abnormal returns are in basis points. Underneath each coefficient estimate in parenthesis, we report p-values based on robust standard errors that account for the potential correlations among the error terms. To control for outliers, we eliminate observations whose absolute studentized residuals are greater than two. ***, ** and * denotes significance at 0.01, 0.05 and 0.10 level. We use a one-tailed test for Bank and two-tailed test for Intercept.
Table 3 Test whether banks that are more sensitive to fair value accountings respond more strongly to the three events

\[ AbRet = a_0 + a_1 \times \text{Bank} + a_2 \times \text{Bank} \times \text{Subgroup Indicator} + \text{Errors} \]  

<table>
<thead>
<tr>
<th></th>
<th>( AbRet_{\text{HerzResign}} )</th>
<th>( AbRet_{\text{FairValue Proposed}} )</th>
<th>( AbRet_{\text{FairValue Dropped}} )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>-24.95***</td>
<td>-25.15***</td>
<td>-25.15***</td>
</tr>
<tr>
<td></td>
<td>(&lt;.01)</td>
<td>(&lt;.01)</td>
<td>(&lt;.01)</td>
</tr>
<tr>
<td>Bank</td>
<td>-18.18</td>
<td>3.60</td>
<td>7.71</td>
</tr>
<tr>
<td></td>
<td>(0.35)</td>
<td>(0.85)</td>
<td>(0.66)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(&lt;0.01)</td>
<td>(0.01)</td>
</tr>
<tr>
<td>( \text{Bank} \times )\text{More Loan}</td>
<td>79.01***</td>
<td>-140.15***</td>
<td>65.29***</td>
</tr>
<tr>
<td></td>
<td>(&lt;.01)</td>
<td>(&lt;.01)</td>
<td>(&lt;.01)</td>
</tr>
<tr>
<td>( \text{Bank} \times )\text{Large FV}</td>
<td>46.89**</td>
<td>-38.21*</td>
<td>11.31</td>
</tr>
<tr>
<td></td>
<td>(0.02)</td>
<td>(0.07)</td>
<td>(0.31)</td>
</tr>
<tr>
<td>( \text{Bank} \times )\text{Large Chg MB}</td>
<td>39.97**</td>
<td>-53.09**</td>
<td>46.02**</td>
</tr>
<tr>
<td></td>
<td>(0.04)</td>
<td>(0.02)</td>
<td>(0.02)</td>
</tr>
<tr>
<td>Adjusted R2</td>
<td>0.42%</td>
<td>0.23%</td>
<td>0.19%</td>
</tr>
<tr>
<td></td>
<td>0.87%</td>
<td>0.02%</td>
<td>0.08%</td>
</tr>
<tr>
<td></td>
<td>0.90%</td>
<td>0.61%</td>
<td>0.75%</td>
</tr>
<tr>
<td>Banks/Nonbanks</td>
<td>318/3,107</td>
<td>318/3,108</td>
<td>316/3,110</td>
</tr>
<tr>
<td></td>
<td>309/3,126</td>
<td>307/3,127</td>
<td>309/3,127</td>
</tr>
<tr>
<td></td>
<td>309/3,146</td>
<td>309/3,146</td>
<td>309/3,146</td>
</tr>
</tbody>
</table>

The one-day returns are reported in basis points. All variables definitions are in Appendix A. Underneath each coefficient estimate in parenthesis, we report p-values based on robust standard errors that account for the potential correlations among the error terms. To control for outliers, we eliminate observations whose absolute studentized residuals are greater than two. ***, ** and * denotes significance at 0.01, 0.05 and 0.10 level. We use a one-tailed test for the interaction terms, \( \text{Bank} \times \text{More Loan}, \text{Bank} \times \text{Large FV}, \) and \( \text{Bank} \times \text{Large Chg MB} \) and two-tailed test for other coefficient estimates.
Table 4: Median comparisons of the these event day abnormal returns measured in basis points

When Herz resigned unexpectedly on August 24, 2010:

<table>
<thead>
<tr>
<th>Prediction</th>
<th>Banks &gt; Nonbanks</th>
<th>Banks with more loans &gt; others</th>
<th>Banks with more fair value assets &gt; others</th>
<th>Banks with large decline in M/B &gt; others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual</td>
<td>15.80 &gt; -19.60***</td>
<td>46.78 &gt; -37.60***</td>
<td>43.90 &gt; -12.30***</td>
<td>43.90 &gt; -17.20**</td>
</tr>
</tbody>
</table>

When the FASB announced its proposal to apply fair value to bank loans on May 26, 2010:

<table>
<thead>
<tr>
<th>Prediction</th>
<th>Banks &lt; Nonbanks</th>
<th>Banks with more loans &lt; others</th>
<th>Banks with more fair value assets &lt; others</th>
<th>Banks with large decline in M/B &lt; others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual</td>
<td>-7.60 &lt; -6.10</td>
<td>-47.70 &lt; 55.27***</td>
<td>-25.30 &lt; 8.38*</td>
<td>-31.60 &lt; 15.62*</td>
</tr>
</tbody>
</table>

When the FASB decided not to require banks to report loans in fair values on January 25, 2011:

<table>
<thead>
<tr>
<th>Prediction</th>
<th>Banks &gt; Nonbanks</th>
<th>Banks with more loans &gt; others</th>
<th>Banks with more fair value assets &gt; others</th>
<th>Banks with large decline in M/B &gt; others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual</td>
<td>33.96 &gt; -8.00***</td>
<td>51.77 &gt; 9.06**</td>
<td>42.70 &gt; 28.41</td>
<td>54.39 &gt; 13.11**</td>
</tr>
</tbody>
</table>

All abnormal returns are in basis points. ***, ** and * denotes significance at 0.01, 0.05 and 0.10 level. The p-values are based on one-tailed Wilcoxon Two-Sample Rank Sum Test.