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Derivatives usage, securitization, and the crash sensitivity of bank stocks*

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ABSTRACT

We show that the information on derivatives usage and securitization activities of U.S. banks as disclosed in their pre-crisis 10-K filings explains extreme equity returns of banks during the financial crisis. Stocks of banks that had previously disclosed a more extensive use of financial derivatives and loan securitization were more likely to experience extreme losses. Our findings are consistent with investors viewing banks that used derivatives for non-hedging purposes as highly vulnerable to the crisis. Moreover, banks which had significant securitization activities and were thus potentially exposed to under-capitalized risks from conduits possess a higher vulnerability of their equity to market downturns.

Keywords: Financial Crisis, Equity Tail Risk, Derivatives, Securitization, Risk Disclosure.
JEL Classification: G32, M40, G01.

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