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## Information Asymmetry around Operational Risk Announcements

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**Abstract**

Operational risk incidences are likely to increase the degree of information asymmetry between firms and investors. We analyze operational risk disclosures by U.S. financial firms during 1995-2009 and their impact on different measures of information asymmetry in the firms' equity markets. Effective spreads and the price impact of trades are shown to increase around the first announcements of such events and to revert after the announcement of their settlement. This is especially pronounced for internal fraud and business practices related events. Market makers respond to higher information risk around the first press cutting date by increasing the quoted depth to accommodate an increase in trading volumes.

The degree of information asymmetry around operational risk events may be influenced by the bank's risk management function and the bank's governance structure. We indeed find that information asymmetry increases more strongly after events' first announcements when firms have weaker governance structures—lower board independence ratios, lower equity incentives of executive directors, and lower levels of institutional ownership. In contrast, the firms' risk management function has little to no impact on information asymmetry. We interpret this as evidence that the risk management function is primarily driven by regulatory compliance needs. The results of this study contribute to our understanding of information asymmetry around operational risk announcements. They help to shed light on the role that regulation and corporate governance can play in order to establish effective disclosure practices and to promote a liquid and transparent securities market.

**Keywords:** Operational risk, information asymmetry, market liquidity, bid-ask spread, corporate governance, enterprise risk management.

**JEL Classification Numbers:** D82, G14, G30.

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