Idiosyncratic Risk and Textual Analysis Attributes of SEC Comment Letters

Abstract

The recent developments in textual analysis has led to considerable interest in respect to financial reporting. Among the methods that are of particular interest is the sentiment analysis of financial reporting texts that are submitted mandatory by firms. In this study we attempt to examine if information on risk, reflected in comment letters of the U.S. Securities and Exchange Commission (SEC) to the firms, has incremental information content for stock crash risk. Controlling for a number of variables that have been found in previous studies to be determinants of stock crash risk like, opacity we find that textual analysis characteristics of these letters have incremental predictive ability for stock crash risk. More importantly, those textual characteristics seem to also affect the relation between opacity and stock crash risk.

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