Pills
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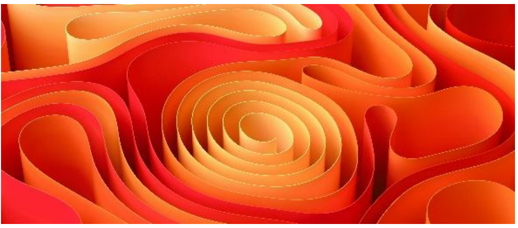

TOPICS:
Market risk

SOURCE
European Central Bank

ECB: Local Institutional Ownership and Price Discovery Around Extreme Weather Events

- This study investigates **how local institutional ownership (LIO) affects stock price reactions to extreme weather events in European markets.** Using data from 2014–2022, the authors analyze publicly listed firms' exposure to physical climate risks and apply event study methodologies to quantify the market response to storms and floods. The core finding is that LIO plays a significant mitigating role in dampening negative abnormal stock returns that typically follow extreme weather events.
- **Firms affected by storms exhibit an average negative abnormal return** of 99 basis points on the event date. **However**, this negative return is offset by 1.3 percentage points for each additional percentage point of LIO. This effect supports the information hypothesis: **local institutional investors possess better information about firm-specific risks due to geographic proximity and familiarity**, enabling them to anticipate and price in potential losses before such events occur.
- The study also finds that **the effectiveness of LIO in stabilizing prices diminishes** with increased geographic distance between a firm's headquarters and the affected facility. This reinforces the role of informational distance in exacerbating market inefficiencies. Notably, storms trigger stronger investor reactions than floods, which tend to be more predictable and localized, allowing for greater risk anticipation and mitigation.
- **To assess physical risk**, the authors use the Eurosystem's methodology for estimating expected annual losses (EAL) from climate events. This incorporates land use, facility data from the European Pollutant Release and Transfer Register (E-PRTR), and damage functions based on event intensity.

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