

Asymmetric Information and Asset Pricing following Regulatory Change: The Case of European Energy Utilities

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Abstract

This paper examines the impact of asymmetric information on asset pricing in the context of regulatory change. We examine shifts in financial return and volatility profiles for 93 European energy utility companies between 1996 and 2013. We identify sources of superior restructuring information from the ordinary legislative procedure and European law archives, compiling a comprehensive list of 43 European energy sector restructuring publications. Results show strong evidence that informed investors exist in the utility sector. Moreover, informed investors trading *before* publication produce superior risk-adjusted returns compared to uninformed investors. These results suggest an increased cost of capital for utilities due to the adverse selection problem. Ironically, policy makers are asking utilities to raise capital for massive investments in a smart, decarbonized energy grid. Our paper contributes to a better understanding of how information about regulatory change is incorporated into assets prices. From this enhanced understanding, we provide related policy recommendations

Keywords: Informed investors, Asset pricing, Asymmetric information, Market microstructure, Energy Sector

JEL classification: G02; G12; G18; L51

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