

Discussion of

Adam B. Ashcroft / João A. C. Santos

HAS THE CDS MARKET LOWERED THE COST OF CORPORATE DEBT

by

Wolfgang Bühler

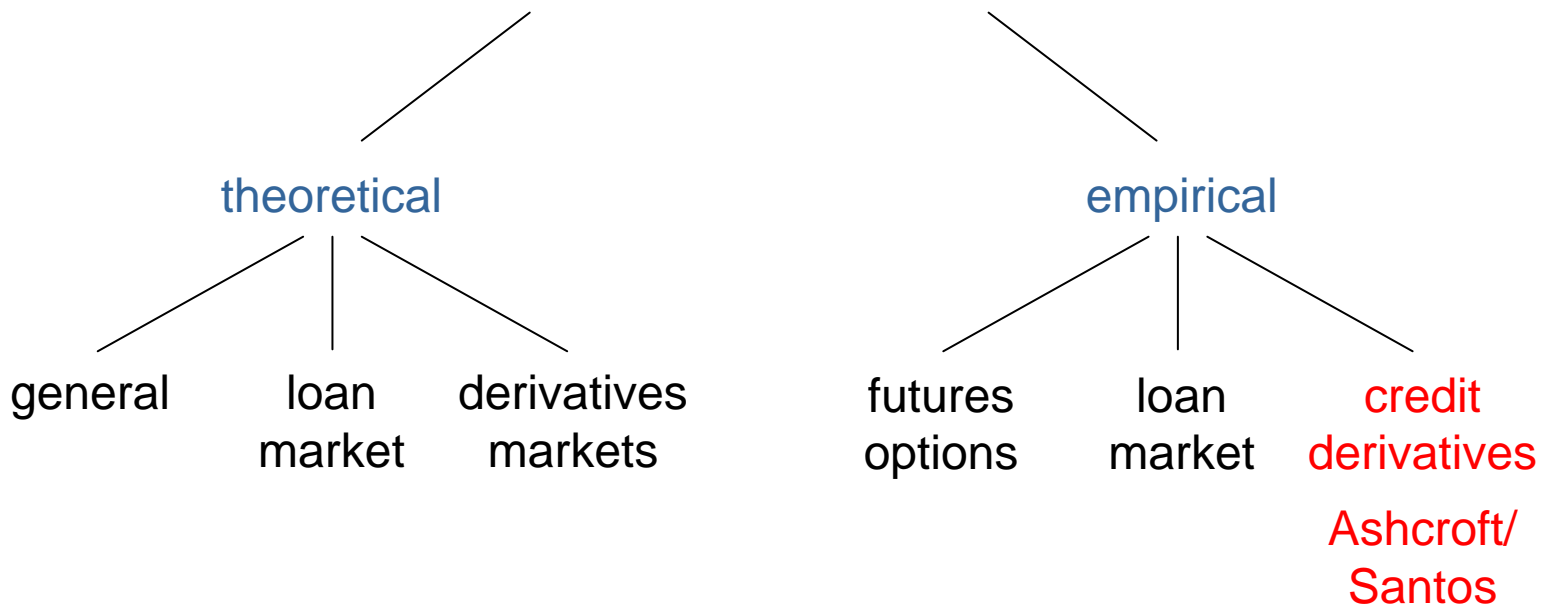
University of Mannheim

Conference on Risk Transfer Mechanisms and Financial Stability

Basel, May 29-30, 2008

PUT THE PAPER INTO PERSPECTIVE

NEW MARKET ADDED TO **INCOMPLETE** MARKET



SHORT REHASH

Does CDS Trading Impact **EX ANTE** Bond Spread and Loan Rates?

reduction of
incompleteness

improvement of
information

reduction of
screening and
monitoring cost

Event Study and Matched Sample

General Result: CDS trading has no effect on **bond spreads**
lowers **loan rates** if **no** loan controls

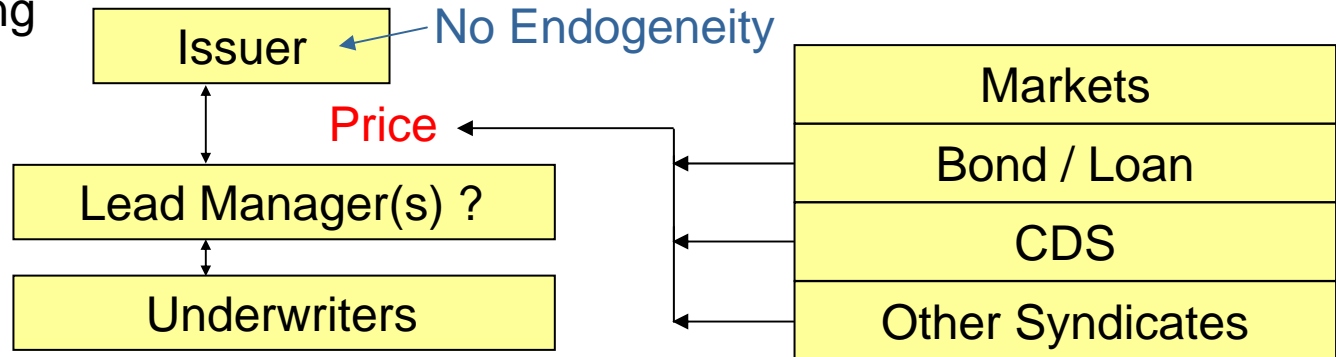
Refined Result: transparent, low risk borrowers **benefit**
opaque, high risk borrowers **suffer**

- **Carefully** done Empirical Study
- **Unexpected** Results

COMMENTS

THEORETICAL ARGUMENTS

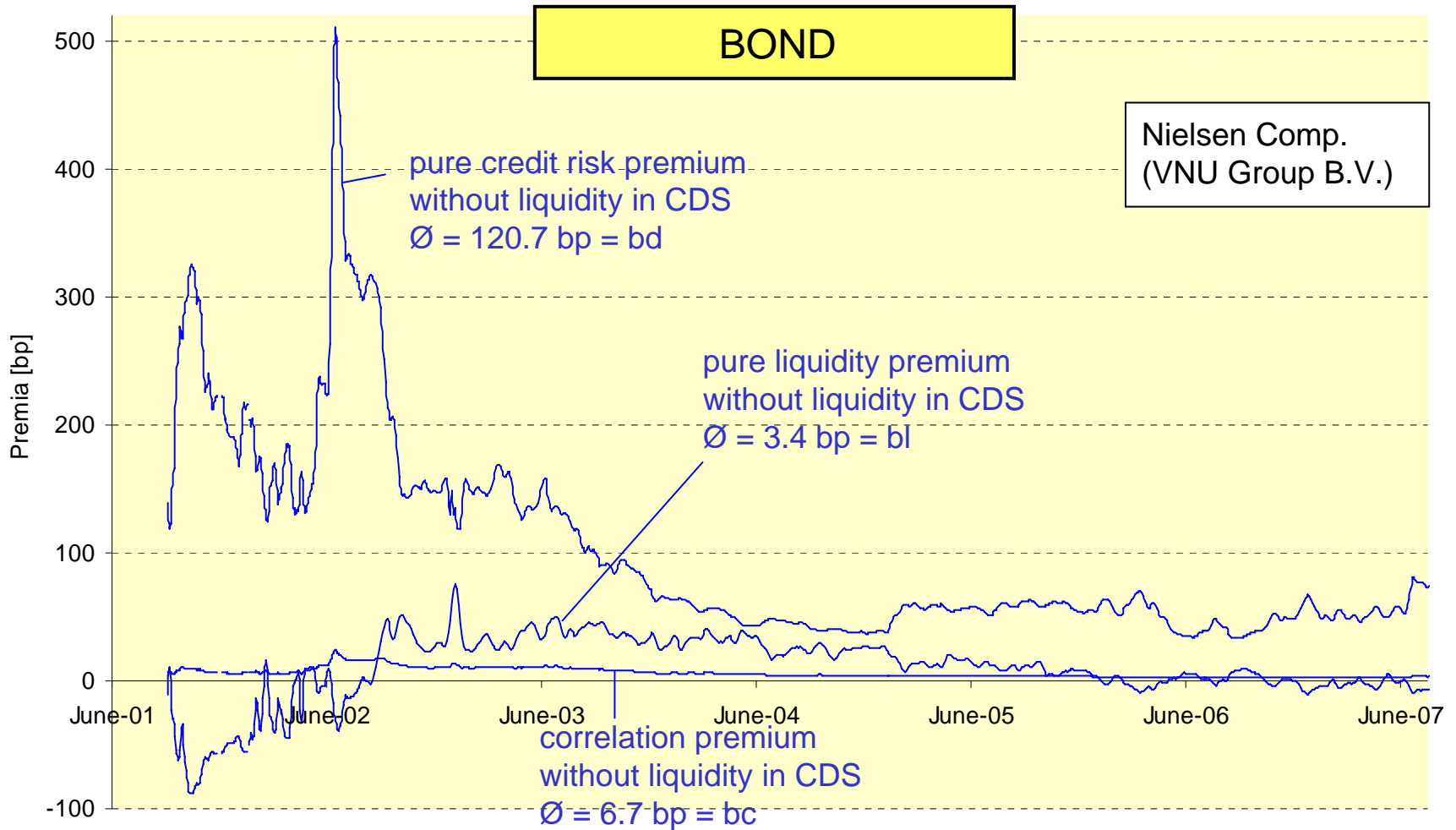
(1) Rate Setting



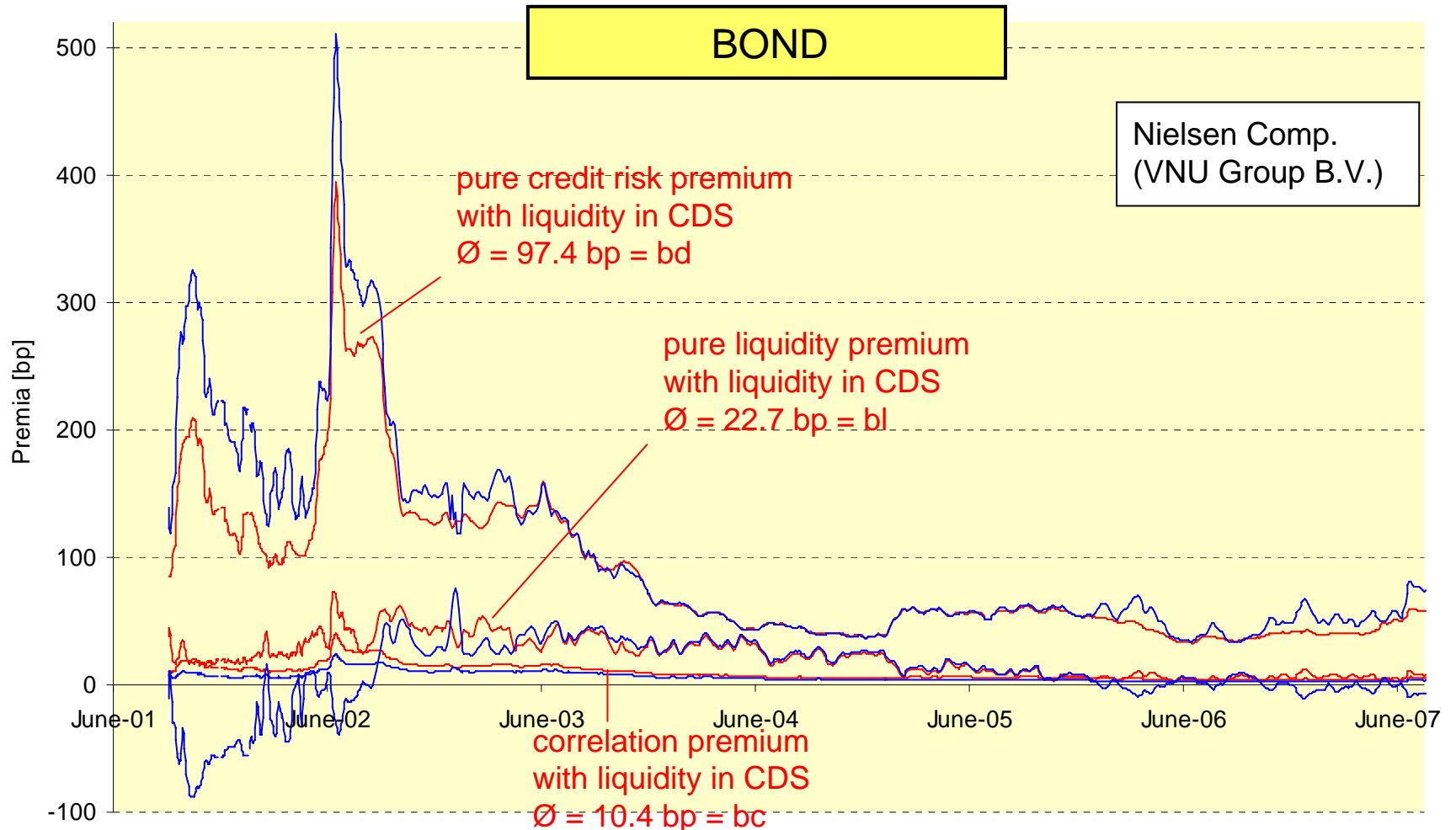
- Bond Spreads: Screening Component – **NO** Monitoring Component
- Loan Rates: Screening Component – Monitoring Component
- CDS Prices: Reflect Deliverable Instruments
 - Senior, Subordinate
 - Old Instruments before CDS trading
 - Reflect Reduced Screening / Monitoring?
- Other Syndicates: Competition, Reputation

⇒ Does CDS Trading Increase **PURE CREDIT SPREAD?**

FIRM-SPECIFIC ANALYSIS



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(2) What makes Hedging of **Bond Risk** by CDS different from Hedging of **Loan Risk**?

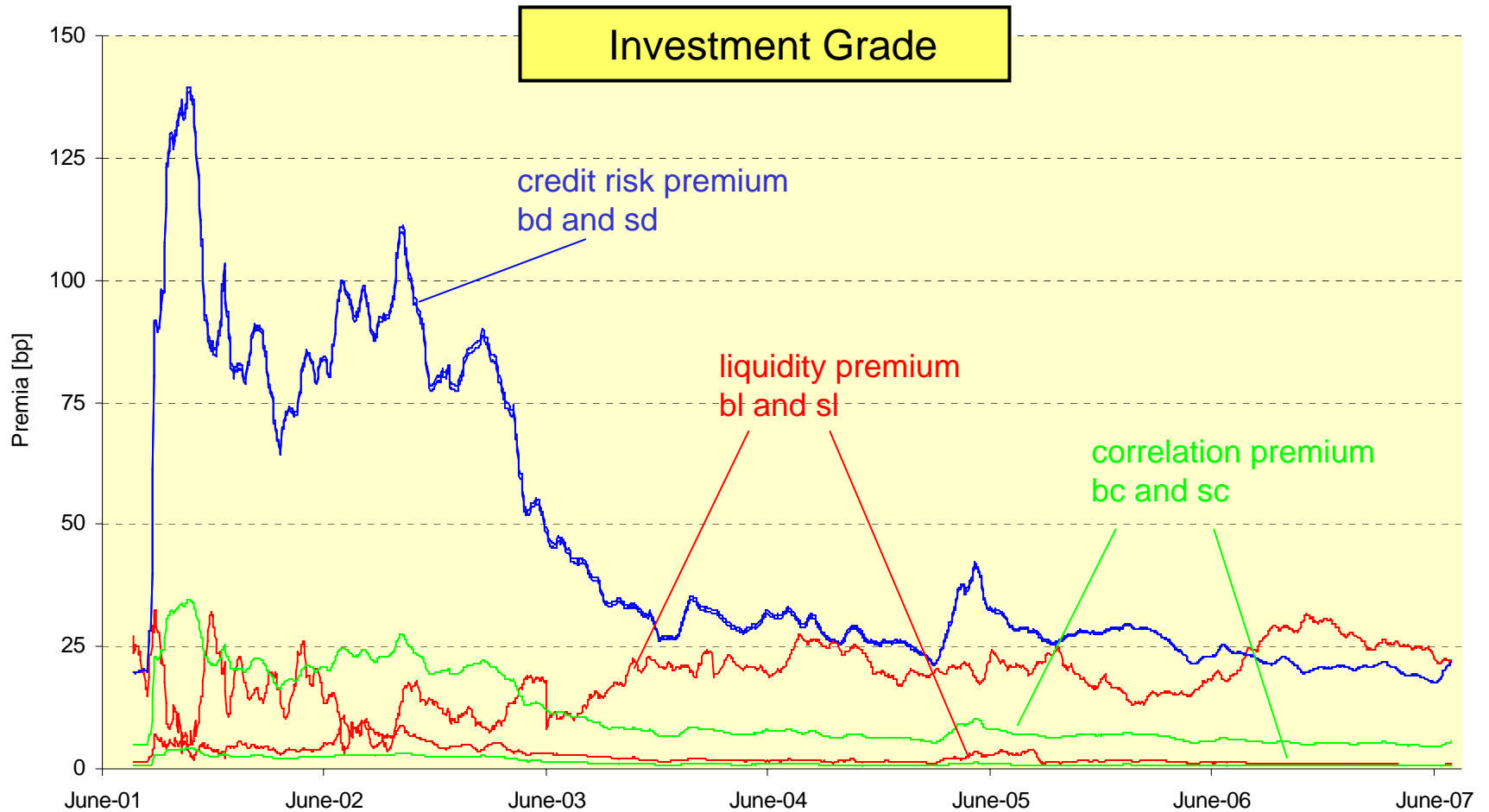
- Bonds are considered for sale: **no monitoring**
⇒ **Loan rate lower than bond spread (same firm)**
(Cook / Spellman (2006))
- Loans more probably considered for **sale** have **higher rates**
(Kamstra / Roberts / Shao (2006) but Güner (2006))
- Loans more probably considered for **securitization** have **higher** default rates
(Keys / Mukherjee / Serin / Vig (2008))

⇒ Comparison of bonds and loans **probable for sale**
not probable for sale

EMPIRICAL ARGUMENTS

- Period from **2001-2003** important
 - Strong increase of first CDS trades
 - Enron and WorldCom turbulences

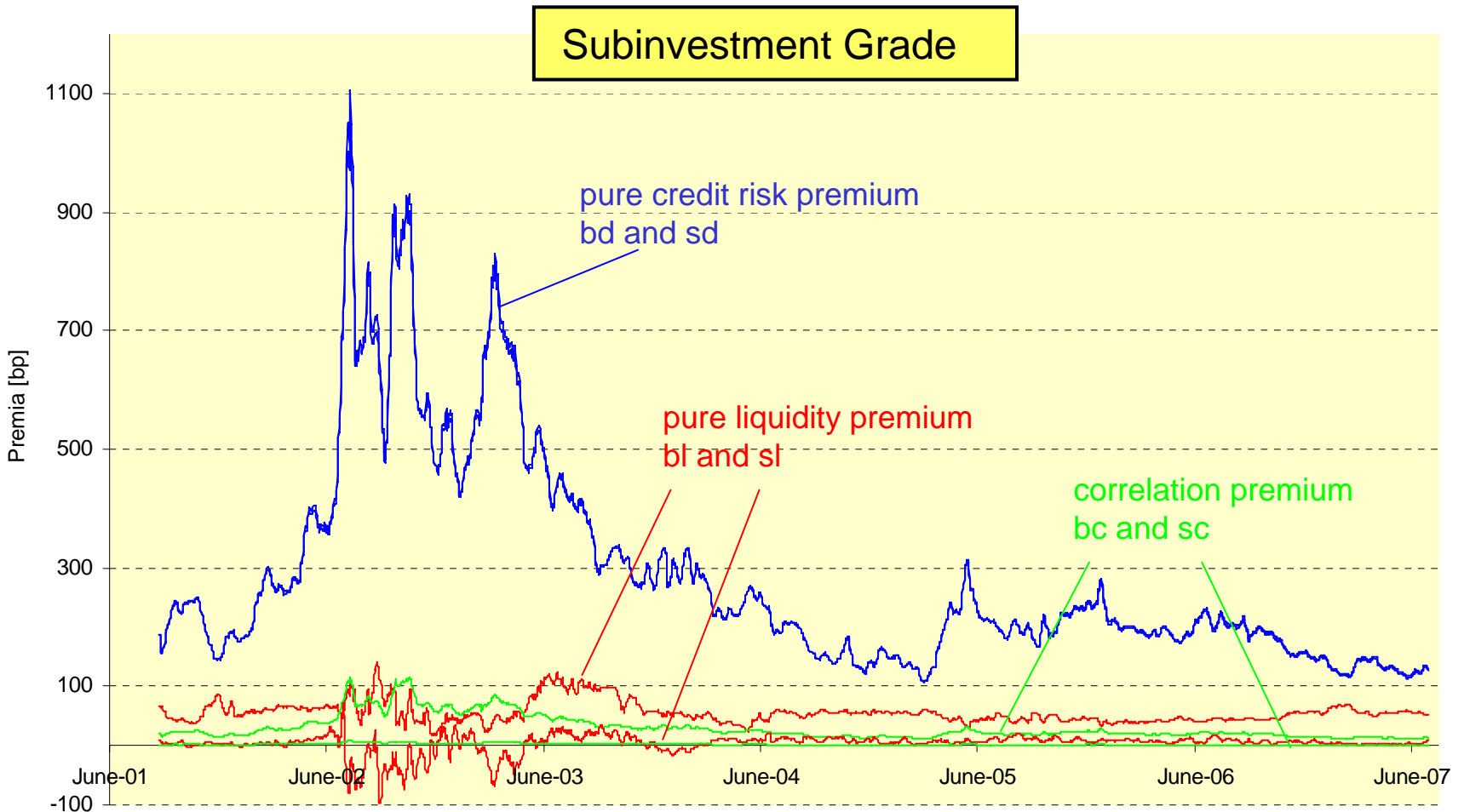
MEAN CREDIT RISK, LIQUIDITY AND CORRELATION PREMIA



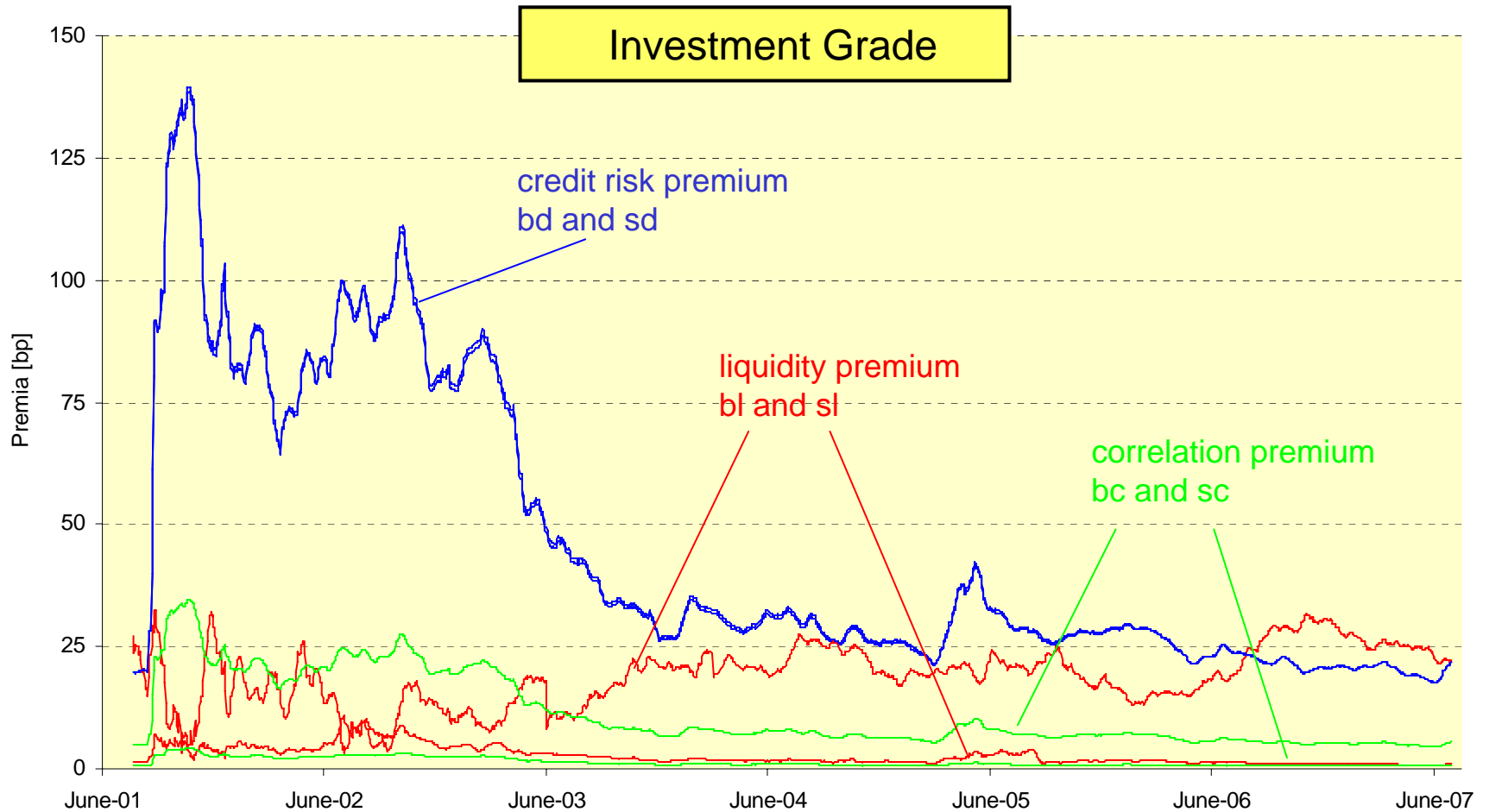
EMPIRICAL ARGUMENTS

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- Stratification of **investment** and **subinvestment** grade bonds / loans

MEAN CREDIT RISK, LIQUIDITY AND CORRELATION PREMIA



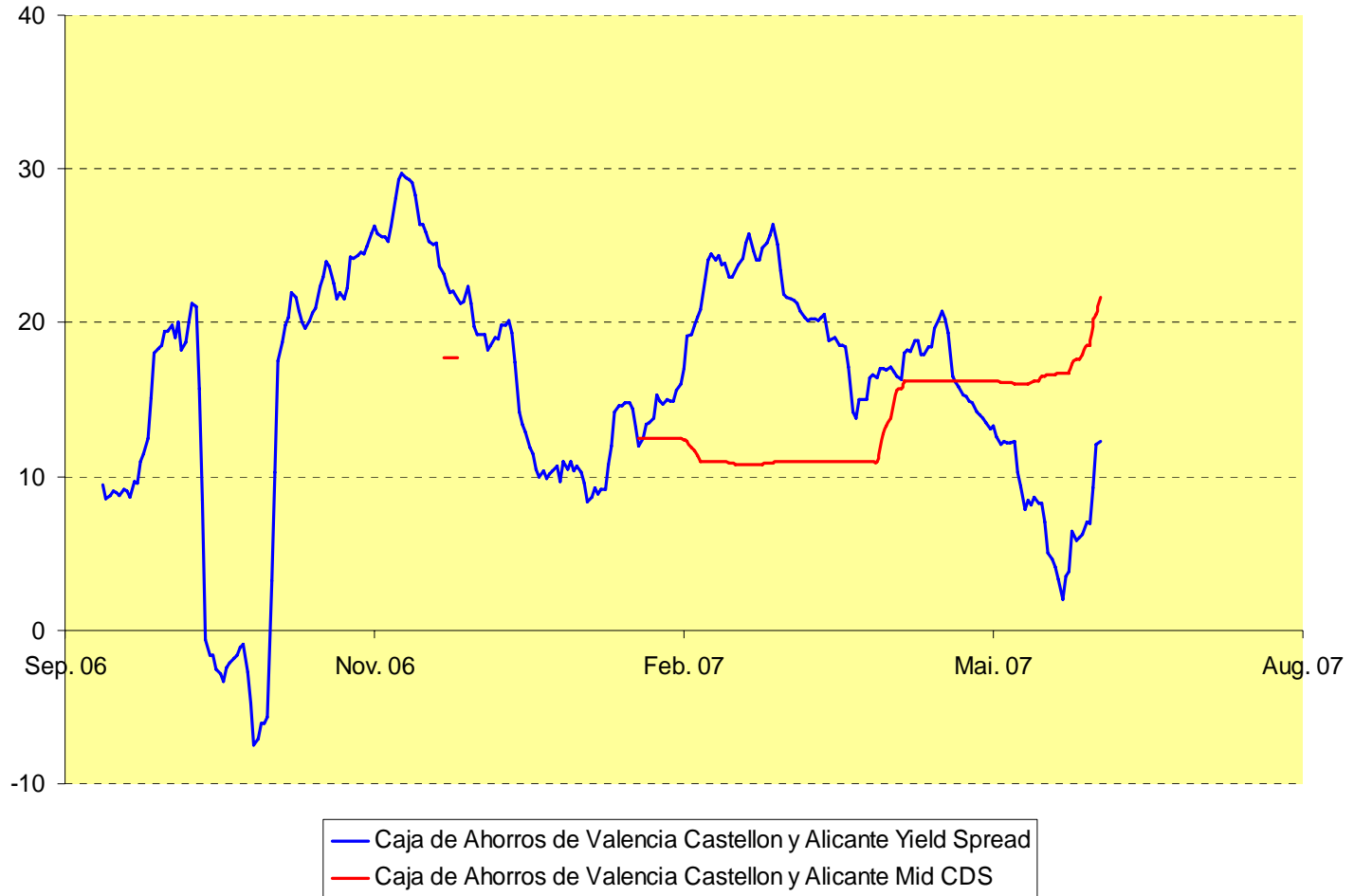
MEAN CREDIT RISK, LIQUIDITY AND CORRELATION PREMIA



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- CDS effect for **traded** bonds and loans
- **Gaps** in CDS trading after first trade

ONSET OF CDS TRADING



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 - Strong increase of first CDS trades
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- Stratification of **investment** and **subinvestment** grade bonds / loans
- CDS effect for **traded** bonds and loans
- **Gaps** in CDS trading after first trade
- Minor comments
 - bond spread for callable / puttable bonds
 - issue price vs. fixed reoffer price
 - CDS: relation of reference entity, deliverable obligation to bond / loan

IMPORTANT SUBJECT

INTERESTING PROBLEM

CAREFULLY DONE EMPIRICAL STUDY

END