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Credit Derivatives and Loan Pricing

discussion by Mark Flood

Data

Series	Descrip	Freq	Source	Maturity	Rating
CDS	Spreads against senior unsecured debt of 300 reference obligors	Daily	CreditTrade, Bank X	Benchmark maturity = 5 yrs.	BBB to AAA
Loans	Spreads on first-lien new loans	Monthly average	S&P	?	B+ to BB
Bonds	High-yield bond index less a fixed-maturity swap rate	Monthly average and end-of-month	Lehman High-yield index, DataStream 5-yr. swap rate	?	BB, B, and non-invest. grade

Net observation period: Jan. 2000 – Dec. 2005 (72 months)

Measurement

- ***Is there overlap between the series?***

$$\Delta L_t = L_t - L_{t-1} \approx \frac{1}{2}(L_t + L_{t-1}) - \frac{1}{2}(L_{t-1} + L_{t-2}) = \frac{1}{2}(L_t - L_{t-2})$$

$$\Delta C_{t-1} = C_{t-1} - C_{t-2}$$

- ***Bond spreads are defined as the Lehman index minus a fixed-maturity (5-year) swap rate - is this really a spread? Table 5C confirms that ΔB_t is dominated by interest rates.***
- ***Data period covers a single business cycle. First-differences may be autocorrelated.***
- ***Data are cointegrated (Table 4).***

Clarifications

- [p. 6] *Does the systematic difference between European and U.S. spreads ($L_{EU} < L_{US}$) really indicate lack of integration?*
- [p. 10] *“Preliminary” analysis showed that U.S. loan spreads are “driven” by global CDS spreads?*
- [p. 34] *Figure 1 is unlabeled. I cannot map to Table 1.*
- [p. 15] *Spreads computed in “absolute” vs. “relative” terms.*
- [p. 18] *Definition of “loan-specific” information.*