FACULTÉ DE DROIT, D'ÉCONOMIE ET DE FINANCE

**Date of the event:**

On Wednesday 24th March 2010
From 01:00 PM to 2:00 PM

**Location:**

Luxembourg School of Finance
University of Luxembourg
4 Rue Albert Borschette
2nd Floor
Modigliani Miller Auditorium (E02-003)
L-1246 Luxembourg

**Registrations:**

- Free seminar (with lunch included)
- Registrations by email before March 22, 2010
- At the following address : lsf-events@uni.lu

**Information:**

Ms Caroline Herfroy
Tel : +352 46 66 44 6335

http://www.lsf.lu/eng/Research/Seminars-and-Conferences/Seminars-Workshops

uni.lu UNIVERSITÉ DU LUXEMBOURG

FACULTÉ DE DROIT, D'ÉCONOMIE ET DE FINANCE

LSF LUXEMBOURG SCHOOL OF FINANCE

**The LSF is pleased to invite you to the following lunch seminar:**

# What Accounts for Time Variation in the Price of Default Risk?

***By Professor Ronald W. Anderson***
*London School of Economics*

uni.lu UNIVERSITÉ DU LUXEMBOURG

**Wednesday 24th March 2010**
**From 01:00 PM to 2:00 PM**

The **L**uxembourg **S**chool of **F**inance

Is pleased to invite you to the

**LSF Seminar**

UNIVERSITÉ DU LUXEMBOURG

# *What Accounts for Time Variation in the Price of Default Risk?*

***By Ronald w. Anderson***

**W**e study the market for credit default swaps (CDS) between 2003 and 2008 in order to understand origins of the well documented tendency for credit spreads on diverse issues to periodically undergo large, common adjustments in the same direction and of similar magnitudes. Our methodology allows us to distinguish co-movements that reflect common revisions in the statistical default distribution from common factors driving time variation in the market price of default risk. We estimate the *risk neutral* default distribution using a latent variable model which assumes that defaults on a name follow a jump process where the log intensity of arrivals of defaults itself follows an Ornstein-Uhlenbeck process. Estimates of this model are used to find the implied times series of the risk neutral default intensity for each firm. A principal components analysis suggests that a very high fraction of time variations in the implied default intensities of diverse firms is explained by a single common factor. We then combine these estimates with estimates of the *statistical* default process based on a hazard model in order compute the implied market price of default risk. We show that a relatively high fraction of the observed variation of this market price of default risk can be accounted for by a linear model of the market price of default risk using as observed covariates macro indicators, firm indicators and indicators of equity market and credit market conditions. Our estimates show a strong association between that credit market conditions and the market price of risk. The estimated coefficients have the correct signs. Overall, our results provide evidence of the partial segmentation of credit and equity markets.

LUXEMBOURG SCHOOL OF FINANCE