Credit default swaps around the world: Investment and financing effects

S. Bartram, J. Conrad, J. Lee, and M. Subramanyam

Discussion by Ekkehart Boehmer, SMU

ABFER meeting, Singapore 2019

Contributing to the “Real Effects” series

- Do CDS introductions have direct consequences for “real” decisions within the firm?
- Do CDS introductions affect firm decision making indirectly, e.g. through their effects on leverage, investments, or their riskiness?

- The authors study a comprehensive set of outcome variables that are affected by CDS introductions.
- Structural hypotheses derived from a Bolton and Oemke (2011) extension.

These are important issues and we don’t have as much evidence as we should have.

These authors' approach

- Global analysis, using standard global data
- Sample spans 56,000 firms, 50 countries, 15 years

Data issues

- Are 1,100 firms per year-market too many?
- Is it feasible to clean and maintain a data set with 1,100 firms per month?

  - Heavy weights on US and Japan – are we looking at one, largely integrated market? Or do we have two or more markets that arise from segmentation?
  - This matters for interpretation

<u>Suggestion</u>:
Add tests using *only* US data, *only* Japan, then *only* the rest. This would give us more confidence about how the heavy weights on US and Japan relate to the result.

Findings

- Introduction of CDS affects real decisions
- The effect is analyzed using a pool of variables that reflect firm behavior, legal uncertainty, etc.
- One problem is that all these variables are endogenous, which the authors acknowledge.

- Are there too many variables? What happens to variables not in the model? How do you map variables into financial concepts?

CDS effect on secondary market liquidity vs. effect on firm characteristics

- Related Securities and Equity Market Quality: The Case of CDS
  Ekkehart Boehmer, Sudheer Chava, Heather Tookes
  JFQA 2015 (from JFQA's "most cited collection").

- So which is more important: CDS effects on market characteristic, or effects on other corporate variables?

Endogeneity concerns

- The authors acknowledge endogeneity. They address it using a new propensity-weighting approach (Li, Morgan, and Zaslavsky, 2017)
  - Similar to other methods that use propensity scores, e.g. for matching.
  - I agree with the authors that the method is new to finance, but one would then expect some evidence that the method is, in fact, in some sense better or new.
  - For example, what is the efficiency loss (?) from using propensity score matching over propensity weighting?

Financial vs corporate CDS

The authors claim novelty for their analysis of *corporate* CDS.

But it seems that all financial stocks are removed from the sample.

- I'd be curious what is different between financial and corporate firms regarding the determinants/effects of their CDS introductions.

- It would be nice to document what proportion of sample/firms relates to non-financial CDS.
- If analysis of corporate CDS is in fact new, then we should at least verify that a sample of financial-firm CDS show similar effects.

Conclusions

What we learn

- The introduction of CDS affects real decisions.
- CDS introductions affect choices within the firm
- Legal and market conditions influence the impact of CDS.

Data

- The authors have to nurture a large number of variables.

Overall, the paper contributes valuable and timely new evidence to our understanding of CDS.