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ABSTRACT

Insider Trading in Credit Derivatives*

Insider trading in the credit derivatives market has become a significant concern for regulators and participants. This paper attempts to quantify the problem. Using news reflected in the stock market as a benchmark for public information, we report evidence of significant incremental information revelation in the credit default swap (CDS) market, consistent with the occurrence of insider trading. We show that the degree of this activity increases with the number of banks that have lending/monitoring relations with a given firm, and that this effect is robust to controls for non-informational trade. Furthermore, consistent with hedging activity by informed banks with loan exposure, information revelation in the CDS market is asymmetric, consisting exclusively of bad news. We find no evidence, however, that the degree of insider activity adversely affects prices or liquidity in either the equity or credit markets. If anything, with regard to liquidity, the reverse appears to be true.

JEL Classification: D8, G12, G13, G14 and G20

Keywords: adverse selection, asset pricing, bank relationship, credit default swaps and default

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“[B]anks must not use private knowledge about corporate clients to trade instruments such as credit default swaps (CDS), says a report drawn up by five bodies including the International Swaps and Derivatives Association and the Loan Market Association... The warning highlights the challenges credit derivatives pose to banks and regulators trying to build a functioning market infrastructure... [M]any banks and institutions are trading CDS instruments in the same companies they finance - sometimes because they want to reduce the risks to their own balance sheets.” (Financial Times, April 25, 2005 - ‘Banks warned on insider trading threat posed by market for credit derivatives’)

1 Introduction

Credit derivatives have been perhaps the most significant and successful financial innovation of the last decade. The use of credit derivatives has been suggested as an important reason for the observed robustness of banks and financial institutions to the historically high global levels of corporate defaults during the period 2000 to 2004. As Alan Greenspan recently observed: “The new instruments of risk dispersion have enabled the largest and most sophisticated banks in their credit-granting role to divest themselves of much credit risk by passing it to institutions with far less leverage. These increasingly complex financial instruments have contributed, especially over the recent stressful period, to the development of a far more flexible, efficient, and hence resilient financial system than existed just a quarter-century ago.”¹ In addition, markets for credit derivatives have helped banks create synthetic liquidity in their otherwise illiquid loan portfolios.² Not surprisingly, the growth in the size of this market remains unabated as products are expanding to cater to emerging markets, and indices such as iBoxx and iTraxx are becoming industry benchmarks for credit conditions.

¹From Greenspan’s speech “Economic Flexibility” before Her Majesty’s Treasury Enterprise Conference (London, 26 January 2004). A contrasting view is that if regulation such as capital requirements are ill-designed, then credit derivatives can result in inefficient transfers of risk between banks and insurance companies (Allen and Gale, 2005).

²In an important recent example, Citigroup had distributed a large portion of its exposure to Enron through issuance of credit-linked notes at regular intervals (in the two-year period preceding default of Enron). The final effect of Enron’s collapse on the balance sheet of Citigroup was as a result small compared to the size of its loan exposures to Enron.

If credit derivatives are to seamlessly provide the insurance and liquidity-creation roles banks require, then the orderly functioning of these markets becomes an important policy objective. Credit derivatives, however, like all forms of insurance, are subject to moral hazard (see, Duffee and Zhou, 2001) and asymmetric information risks. In this paper, we are concerned with the latter of these risks. Specifically, if some creditor of Company X has private information about the likelihood of default, or can itself influence default, then this creditor may try to exploit its privileged information by buying credit insurance on X from a less well-informed counterparty. Or if loan officers, who deal directly with X, pass on inside information to the traders buying credit derivatives, the institution on the other side of the trade may get a rotten deal. If fears of such behavior are widespread, the liquidity of the market may be threatened.

Of course, asymmetric information and insider trading problems potentially exist in most markets. But the credit derivatives market may be especially vulnerable since, almost by definition, most of the major players are insiders. Firms have a much closer relationship with their private financiers, such as banks, than with investors in their public securities such as stocks and bonds. In particular, firms often provide material and price-sensitive information, such as revenue projection updates or acquisition and divestiture plans, to relationship banks well in advance of its release to the public. Trading desks of many banks and financial institutions act as intermediaries in the credit derivatives market, quoting prices for protection written on corporations to which they have loan exposures. In the absence of perfect “Chinese walls” within banks, the credit derivatives market provides the trading desks of relationship banks a trading mechanism through which the information possessed by loan officers about a firm can be exploited, and, in turn, transmitted in public markets.³

³Indeed, some recent episodes in the credit derivatives markets reveal that this issue may be real with potentially important implications for the efficiency of credit-risk transfer across institutions. In striking recent episodes, managers of Pacific Investment Management Co. (PIMCO), the largest bond investor in the U.S., have cited in their white papers several cases of insider trading in credits such as Household International Inc., AT&T Wireless, and Sprint Corp.: “Credit default markets are a mechanism with which friendly commercial bankers ... can profit by betraying and destroying their clients through the use of inside information,” and “... firms with large lending departments would always come in and buy protection at exactly the right moment.” Such events have also often been acknowledged in press. See, for example, the article in *The Economist*, “Pass the Parcel – Credit Derivatives,” January 18, 2003.

From an academic standpoint, the credit derivatives market is a particularly attractive laboratory for the testing of hypotheses pertaining to insider trading for several reasons: first, the potentially informed players, namely the banks, are well-identified; second, the nature of private information is unambiguous, specifically the likelihood of default; third, incentives to exploit information (i.e. the magnitude of loan exposure and credit risk) are also measurable; and, finally, unlike much of the corporate bond market, daily data on prices of most widely traded credit derivatives is available for the past four years.

Given this motivation, we study empirically the market for trading in credit default swaps (CDS), the most active credit derivative instrument, in order to measure the prevalence of insider trading and then to assess its effects on price and liquidity. We use data on the quoted CDS levels and bid-ask spreads for a cross-section of U.S. firms over the period January 2001 through October 2004. Using news reflected in the stock market as a benchmark for public information, we report evidence of significant incremental information revelation in the CDS market, consistent with the occurrence of informed revision of quotes or insider trading. We show that the information flow from the CDS market to the stock market is greater for sub-samples where we expect a priori that insider trading would be a more significant issue: entities that experience credit deterioration during the sample period, and whose CDS levels are generally high.

Having identified a measure of information flow from the CDS market to the stock market, we next link this directly to a proxy for the number of informed insiders: banking relationships of a firm, calculated using the Loan Pricing Corporation's data. We find that the degree of information flow increases with the number of banks that have ongoing lending (and hence monitoring) relations with a given firm. This finding is robust to controls for non-informational trade, liquidity levels in the CDS and the stock markets, and the level of riskiness of the credit. Crucially, information revelation in the CDS market is asymmetric, consisting exclusively of bad news. This finding is consistent with the incentives of banks to exploit private information being greater upon adverse credit news, that is, in times when they seek to hedge their underlying loan exposures.

If insider trading does exist in these markets, then it is possible that market makers will be less willing to make prices in these derivatives in situations where they perceive the likelihood of private information to be high. In particular, in volatile conditions or when default risks rise, the risk of insider trading may rise, resulting in a loss of liquidity precisely when hedging needs are greatest. Furthermore, the one-sided nature of insider trading risk in this market (i.e. default risk) suggests that the price level at which insurance is purchased may also be affected.

These effects may, however, be counteracted by alternate considerations. The threat of information asymmetry may also induce gains in liquidity provision, depending on the market structure. First, since informed banks are also market makers, they may play a liquidity-provision role to learn about order flow in the relatively opaque markets for credit derivatives (along the lines of the experimental evidence in Bloomfield and O'Hara (1999, 2000)). Second, an increase in the number of banking relationships may increase not only information-based trading, but also uninformed trading from portfolio rebalancing and regulatory arbitrage activities of banks. Finally, an increase in the number of insiders may cause them to compete, revealing information into prices rapidly and without much loss of market liquidity (Holden and Subrahmanyam (1992)). These mechanisms could render the potential harm of insider trading insignificant.

To investigate this issue, we study whether liquidity providers in the CDS markets charge greater bid-ask spreads for credits in times where insider-trading risk is greater, and whether this insider-trading risk affects the level of prices in credit derivatives markets. Answering these questions is important to understanding whether insider-trading risk in the CDS markets is a significant concern for the liquidity and the orderly functioning of these markets.

We find no evidence that the degree of insider activity, proxied by the number of banking relationships, adversely affects prices or liquidity in either the equity or the credit markets (after controlling for their standard determinants). If anything, the reverse appears to be true: CDS markets for corporate entities that have a large number of banking relationships tend to have smaller bid-ask spreads on average. Furthermore, even the direct measure of

illiquidity, the percentage bid-ask spread, has no explanatory power for the level of CDS fees.

While our results highlight the complexity of the process of liquidity determination, they may have important implications for regulators. The institutional response to complaints of insider trading in CDS markets has been to issue voluntary guidelines on information sharing inside banks (issued by agencies such as the Joint Market Practices Forum and the Financial Stability Forum in North America), and on how “material non-public information should be handled by credit portfolio managers in European Union member states” (issued by International Swap Dealers’ Association (ISDA), the Bond Market Association, and the Loan Market Association).⁴ Our results suggest that while the complaints against insider trading in CDS markets do contain merit, it is unclear whether there should be any regulatory action to curb insider trading if the objective of such action is to prevent the loss of liquidity or to avoid adverse pricing in credit derivatives markets. In particular, we do find that the CDS markets appear to be transmitting privileged information into publicly traded securities such as stocks. However, we do not find evidence to support the hypothesis that insider trading in CDS markets is harmful. Indeed, our results suggest that direct trading restrictions on the activity of commercial banks, the potentially informed players in these markets, may result in a reduction in the overall liquidity.

Related literature

Our study integrates two different strands of literature (and also synthesizes analysis of the respective datasets): banking – the specialness of banks in possessing private information about their borrowers (Fama (1985), James (1987)); and, market microstructure – the strategic use of private information by insiders potentially affecting prices and bid-ask spreads (Kyle (1984), Glosten and Milgrom (1985)).

Viewed in another light, our study also integrates the literature on information asym-

⁴As cited earlier, some of the recent debate has explicitly referred to insider-trading risk as proxied in our paper: “Use of material non-public information by securities and credit derivative market participants will be embraced by these new laws on insider dealing. *Knowledge gleaned from bank lending relationships is the main area of scrutiny, so far as the use of non-public information in these markets is concerned.*” Creditflux, January 2005 (www.creditflux.com). Emphasis added.

metries and financial innovations. It is well-known theoretically that in economies with information asymmetries, financial innovations that would otherwise improve risk-sharing can in fact be welfare-reducing (see, e.g., Marin and Rahi (2000), and references therein). In practice, however, investigation of such effects is rendered difficult by the fact that a researcher is generally unable to identify the exact nature of asymmetric information whose effects could get exacerbated by specific innovation. Our investigation helps fill this important gap in the literature.

More generally, analysis of the effects of asymmetric information on contracting and trade is also hampered by the same identification issue. Like Garmaise and Moskowitz (2004), we contribute an exogenous measure of such asymmetry and directly test for its effects on financial decisions.

Insider trading has been the focus of a large body of research in equity markets which has found that insider trading lowers liquidity and increases trading costs (Easley, Kiefer, O'Hara, Paperman (1996), Chun & Charoenwong (1998), Bettis, Coles & Lemmon (2000), Brockman & Chung (2003), and Fische & Robe (2004), among others), that insider trading raises cost of equity capital (Bhattacharya & Daouk (2002)), and that insider trading increases volatility (Du & Wei (2003)). We are not aware of a study that has examined the set of issues we study concerning the effects of insider trading in the credit markets.

There has been somewhat of a surge in studying liquidity in credit markets (Fleming & Remolana (1997, 1999), Fleming (2001), Schultz (2001), Hotchkiss & Ronen (2002), and Chordia, Sarkar, Subrahmanyam (2003)), but this has been contained on studying liquidity in the cash (bond) market and not the credit derivatives markets. The few existing studies on credit derivatives (e.g., Blanco, Brennan and Marsh, 2003, and Longstaff, Mithal and Neis, 2003) focus primarily on explaining the basis between the CDS and the cash (bond) markets.

Crucially, most of the papers studying liquidity in credit markets focus on how quickly the information in equity markets gets incorporated into credit (cash) markets, but not the reverse channel of information flow. Examining the flow of information from the credit

(derivatives) markets to the equity markets and establishing its linkage to bank relationships is key to detecting insider trading in the context of our paper, and also constitutes the most important contribution of our paper. In a related paper, Norden and Weber (2004) study the co-movement of CDS, bond, and stock markets during 2000 and 2002. They find that the stock market leads the CDS and bond markets, that the CDS market is more responsive to the stock market than the bond market, and that there is greater price discovery in the CDS market than in the bond market. However, the focus of their paper is not on insider-trading hypotheses, and they do not examine the conditions under which price discovery in the CDS market is greater.

The remainder of the paper is organized as follows. Section 2 presents our overall approach to detect insider trading in CDS markets, the CDS data we employ, and evidence consistent with insider trading in CDS markets. Section 3 links the information flow effects to direct measures of the number of parties with access to non-public information. Section 4 examines the effect of insider trading risk on the liquidity of CDS and equity markets, and discusses possible interpretations of our findings. Section 5 concludes.

2 Evidence of informed trading in credit derivatives

This section explains how we attempt to identify informed trading, describes the data employed, and presents evidence consistent with the hypothesis that there is indeed insider trading in this market. Given the data limitations, conventional approaches to detecting insider trading are not readily applicable. Hence, it is useful to start with a discussion of the alternatives.

2.1 Identifying informed trading

The most direct way of detecting insider trading is to know the insider's exact identity, identify trades by this insider, and study either the profitability of trading strategies based on insider trades or the impact that insider trades have on prices in the market. For instance,

in the case of corporate insiders, such as CEOs and top management, Section 16(a) of 1934 Securities Exchange Act requires disclosure of insider trades. Exploiting these reports, a large body of research (see, for example, Seyhun, (1986)) has employed daily stock returns and found that insider traders in stock markets do appear to beat the market. Unfortunately, such direct labelling of informed parties and of their trades is not available in other markets.

In cross-market studies, the literature has studied the issue of the choice of informed traders between different instruments and flow of information from one market to the other. Most notably, Easley, O'Hara and Srinivas (1998) build a theoretical model where an informed party chooses between whether to trade in options or in stocks, and show empirically that the sign of the volume in options markets contains information for stock prices. In a somewhat related paper, Pan and Poteshman (2004) obtain proprietary, non-public data on whether trades on Chicago Board of Exchange (CBOE) were initiated by buyers for new positions, and find that certain portfolio strategies based on call/put volumes yield abnormal returns in stock markets.

In our setting, it is not possible to identify the exact informed trades made in the CDS market by a specific set of potentially informed players. The CDS market functions primarily through on-line broker screens (provided by firms such as CreditTrade and GFI), and quotes on these systems are posted in an anonymous fashion and trader identity is revealed to the counterparty only after the trade has been executed. The exact counterparty information on such trades is privileged information of the on-line brokers and their agreements with the participating institutions do not allow them to reveal this to the public. Moreover, volume data is not available for CDS markets rendering it infeasible to calculate any price-impact measures for particular trades.

To summarize, data limitations imply that the detection of insider trading and its intensity in the CDS markets poses a challenge for the empirical researcher. We present below our approach to meeting this challenge.

If agents in credit markets in fact possess insider information, and they occasionally trade on that information, then this would render credit markets more informative than those of

other securities at least some of the times.⁵ We exploit this implication to identify the prevalence of insider trading. More specifically, to detect information revelation in the CDS market relative to other securities, we rely on the following assumptions:

1. *Stock market prices reflect all available public information.*
2. *Information flow from the CDS market to the stock market implies that CDS innovations have a permanent impact on stock prices.*
3. *Not all such information flow is instantaneous.*

The first assumption allows us to use stock price changes to proxy for information revealed through all sources other than the credit markets. Since our sample consists entirely of liquid, large, and well-followed companies, there is every reason to suspect that public information is rapidly incorporated in their equity prices. Hence, any predictable flow of information from credit markets to stocks is highly likely to stem from the availability of non-public information to participants in the credit markets.

The second assumption permits a direct identification of the amount of this information flow. The third renders this identification operational through the use of daily data.⁶

To summarize, the paper's stance is that the presence of permanent information flow from daily CDS returns to future daily stock returns is *sufficient*, though not necessary, to identify the presence of insider trading or, at least, informed revision of quotes in the CDS markets.

⁵It is worth stressing why an informed creditor might (at least occasionally) prefer CDS markets over stock markets in order to trade on private information and/or to hedge its exposures. The CDS contract is designed precisely to provide a good hedge on debt-like exposures to the underlying firm: a creditor can hedge itself *statically* by buying protection through the CDS market, whereas hedges performed through the stock may require *dynamic re-balancing* and thus incur greater transaction costs. Finally, buying protection in the CDS market is easier (in terms of market liquidity) than taking the equivalent position by shorting a corporate bond.

⁶At first sight, the last two assumptions may seem to entail a violation of market efficiency, and hence be at odds with the first. Implicitly, then, our analysis assumes that any predictable relationships uncovered here were not *themselves* known during the sample period. We could also point out that CDS quotes were not widely disseminated during this time, and that the amount of cross-market arbitrage capital may not have been sufficient to produce complete information transmission across markets within a day. Last, based on our empirical results below, the size of information flow is small enough relative to transactions costs to make abnormal profit opportunities unattainable.

Building on this identification, we then go on to refine our measure of information asymmetry by examining its conditional dependence. In particular, we argue that insider trading in the CDS market should imply information flow from the CDS market to the stock market which is greater:

1. *For firms and in times for which the likelihood of distress is greater, since the benefits from insider trading are greater in these cases; and*
2. *For firms which have a large number of banking relationships, since the number of potential insiders in the CDS market, and, in turn, the intensity of insider trading, should be greater for these firms.*

Specifically, since banks have underlying loan exposures, their economic incentives to exploit private information should be greater upon adverse credit news as they seek to undertake hedging in the CDS markets.

By associating information flow with measures of the dissemination of non-public information to banks and of their incentives to exploit that information, we reinforce the case for regarding this flow as evidence of insider trading. The conditional measures further allow us to then assess the effects of the prevalence of the insider trading risk on the markets themselves.

2.2 Data

Our primary data set for this study comes from daily closing quotes for the most widely traded, North American, CDS names (“benchmarks”) from January 1 2001 through October 20 2004. The bid-ask quotes are obtained from CreditTrade, an online trading platform for credit derivatives that attracts a significant portion of trade and quotes in these markets and has participation from all the top players and market-makers (numbering over twenty). The CreditTrade data has also been employed by Blanco, Brennan and Marsh (2003) in their study of the difference between CDS fees and bond market yields.

A firm enters the set of benchmarks when CreditTrade believes its CDS market has become sufficiently liquid to quote a daily closing price. This daily closing price is obtained by looking for actual market prices observed during the day or based on trades brokered on CreditTrade’s platform (or advice obtained on trades on other platforms). In the unlikely scenario that a generally liquid benchmark has no bid and ask quotes or traded prices in a day, then the closing price is obtained by polling the market participants at the end of the day. Thus, the benchmark prices supplied by CreditTrade are not “matrix” prices (calculated by their traders) but are widely perceived to be an accurate indication of where the CDS markets traded and closed for that day. We note that the “closing” in this market is defined as no later than 4:15 p.m. New York Time, and hence that our CDS prices are collected, prior to the end of trading for U.S. stocks. Hence the timing, if anything, biases us against detecting information flow from credit markets to equity markets.

A firm that enters the list of benchmark CDS names does not leave this set unless it defaults during the sample period (e.g., Enron), undergoes a merger or is acquired. In particular, there is no back-filling of data when a benchmark name is added to the data, and, in turn, there is no look-ahead bias.

The CDS levels are calculated as mid prices based on the bid-ask quotes. The quotes are for 10 million USD notional transactions of five year maturity with the underlying reference credit of the firm being of a senior unsecured category. We focus on a total of 79 North American benchmark corporate credits. The names of these entities are listed in Appendix A. Matching information for stock market data and balance-sheet data is obtained for these firms from CRSP and Compustat. While limited in a time-series and a cross-sectional sense, this is some of the best data available on CDS prices. Furthermore, the sample period is among the most interesting in recent history since it witnessed defaults of large U.S. corporations such as WorldCom, Enron and Sprint, and significant credit deterioration for others such as Tyco.

Table 1 provides summary statistics for the credits in our sample. The median CDS level is 81 basis points (bps) with a high of 2400 bps (for Enron close to its bankruptcy).

Interestingly, though the median bid-ask spread in CDS markets is 20 bps, the high is 2000 bps representing a trading cost that is comparable in magnitude to the highest observed CDS level. The median Moody's (S&P) credit rating of firms in our sample is Baa1 (BBB+), market capitalization is 15.82 billion USD, book debt is 8.88 billion USD, and book debt to assets ratio is 21%. The median number of firms for which quotes are observed on a day is 46, reflecting the gradual increase in the number of liquid benchmarks over the sample period.

Since most firms in our sample are reasonably large, trading in their equity market is quite liquid: the median volume is 2.65 million shares per day and the median turnover is 0.56% of the outstanding shares per day. The median of average (annualized) stock return volatility based on daily stock returns is 39% with a high of 83% and a low of 24%. Interestingly, there are firms with no public bond issues outstanding, that is, our sample includes firms that are entirely bank-financed as far as debt financing is concerned. The median number of public bond issues for firms in our sample is 9 with a high of 71.⁷

Next, we discuss our tests aimed at understanding the nature of insider-trading risk in the credit default swap market.

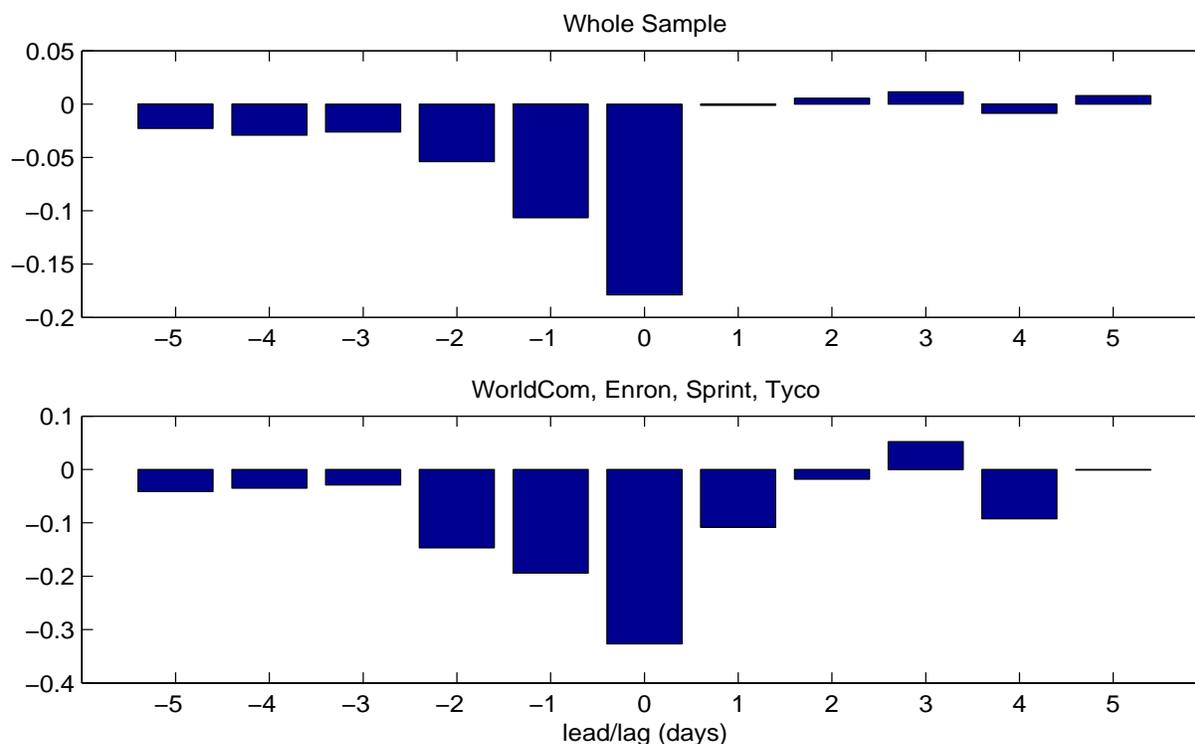
2.3 Preliminary tests

In order to address the question of whether there is insider trading in CDS markets, we conduct some preliminary tests. Specifically, we examine the cross-correlation structure of information revelation in CDS and equity markets. As mentioned earlier, our maintained assumption is that stock market reaction is coincident with public release of information about the firm. Hence, if there is in fact insider trading in CDS markets, then we should at least sometimes observe a flow of information from CDS markets to equity markets.⁸

⁷Our data on corporate bonds comes from the data employed and generously provided to us by Schaefer and Strebulaev (2003). The data includes corporate bonds that are included either in the Merrill Lynch Corporate Master index or the Merrill Lynch Corporate High Yield index. These indices include most rated publicly issued U.S. corporate bonds.

⁸Examining this offers a nice counterpart to the much-studied response of bond prices to stock moves. The literature here has generally found a slow adjustment of bond prices to stock moves in that bond returns have a negative cross-correlation with up to several days' lag of stock returns. This finding of prior literature

Figure 1: *Cross Correlation of Stock Returns and CDS Changes.*



The figure shows the cross-correlation between percent changes in CDS prices at time t and stock returns at time $t+k$ as a function of k . In each panel the cross-correlations for individual firms are averaged across firms.

We provide a graphical representation of cross-correlation structure between daily stock returns and CDS changes in Figure 1. Specifically, the figure shows the cross-correlation between percent changes in CDS prices at time t and stock returns at time $t+k$ as a function of $k = -5, -4, \dots, +5$. In the first panel, results are shown for the whole sample, whereas in the second panel, results are shown for the four large cases of corporate distress in our sample: WorldCom, Enron, Sprint, and Tyco. In each panel, the cross-correlations for individual firms are averaged across firms.

In each of the two panels, there is a negative cross-correlation between CDS changes and lagged equity returns, reflecting a flow of information from equity market to CDS market:

is however most likely due to poor quality of bond data. A recent study by Hotchkiss and Ronen (2002) which employs daily data on corporate bond prices from NASDAQ finds the bond market to be informationally as efficient as the stock market.

when stock returns are positive, there is a decrease in contemporaneous and subsequent price of default protection. In the panel where the entire sample is employed, the cross-correlation between CDS changes and *future* equity returns is essentially zero. In striking contrast, in the panel with four firms of our sample that experienced significant deterioration in credit quality, this cross-correlation structure is different: there is on average a negative cross-correlation between CDS changes and future equity returns, the correlation being highest in magnitude for future date $t + 1$. In other words, for firms for which there was adverse credit information during our sample, we do find evidence of an information flow from today's CDS price to future stock returns. Indeed, for these firms the flow of information is both ways between these markets.

This preliminary evidence is consistent with the hypothesis that if insiders are active in our sample, then firms that experienced severe credit deterioration should exhibit significant cross-correlation of CDS changes with *future* stock returns. In other words, insiders appear to be exploiting information in the CDS market only when there is significant negative information.

Since identifying the “pure” effect of a CDS market innovation at time t on the stock-market return at time $t + k$ should also control for CDS innovations between t and $t + k$, we now conduct more rigorous econometric tests of the hypotheses concerning insider trading.

2.4 Econometric analysis

In this section, we seek to establish rigorously whether or to what extent credit markets actually acquire information prior to the stock market (that is, the market as a whole). First we describe our methodology for isolating innovations in the CDS prices. Then we establish the basic finding that, while there is little unconditional spillover of these innovations to the stock market, there are strong conditional effects linked to certain firms at certain times.

2.4.1 Constructing innovations in CDS market

Since credit and equity markets are highly dependent, the first step in our analysis is to regress changes in our CDS prices on contemporaneous stock returns in order to extract the residual component. We do this by means of separate time-series regressions for each firm, also including five lags of both the CDS changes and the stock returns to absorb any lagged information transmission within the credit market.

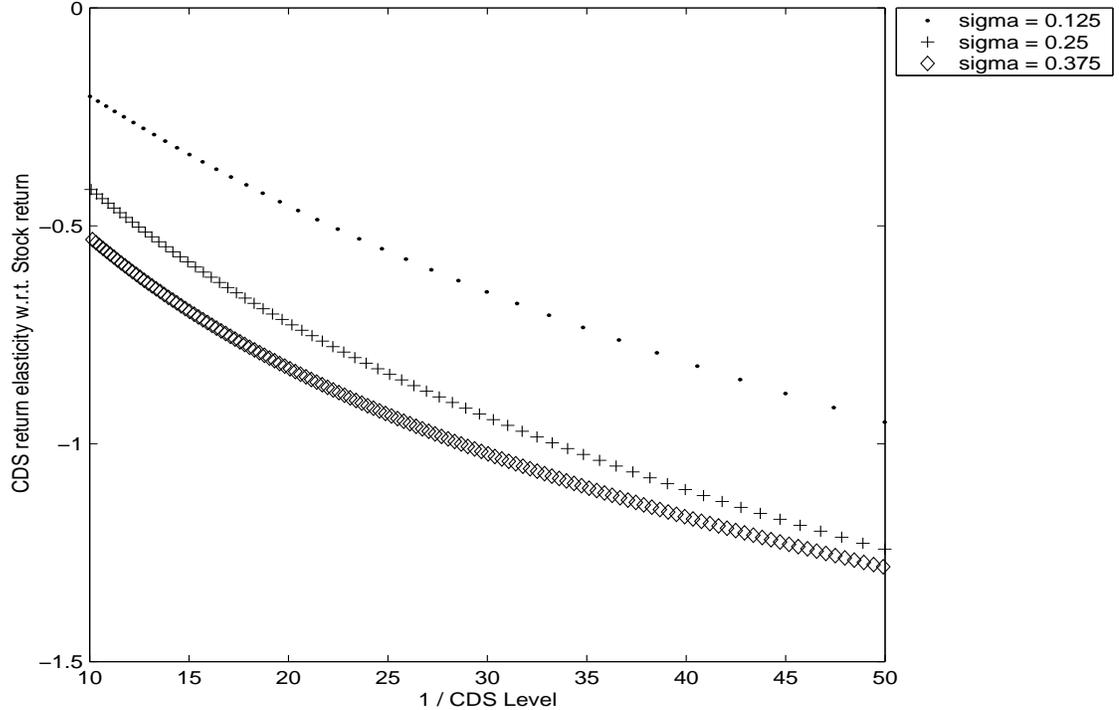
Two points about this step are worth clarifying. First, the CDS changes are defined as log differences in credit spread, or percentages of percentages. Second, we anticipate that the relationship between these changes and stock returns should be inherently nonlinear. This can be seen in the context of any structural model of credit spreads. To illustrate, Figure 2 plots the elasticity of credit spreads with respect to stock prices under the Merton (1973) model of risky debt. This elasticity represents the theoretical relationship that should, under that model, relate percentage changes in stock prices to percentage changes in credit spreads. The figure shows that there is a roughly linear relationship between this elasticity and the inverse level of the credit spread itself.

Guided by this, our specification of expected CDS returns includes interactions of the stock returns (both contemporaneous and lagged) with the inverse CDS level. We could impose the functional form of the Merton (1973) or any other structural model in this stage. But we choose to remain agnostic about the degree of the nonlinearity. As a result, we are, in effect purging the credit market innovations of any level-dependent dynamics. This limits our ability to separately identify such level-dependent effects in the cross-market dynamics studied below.

To summarize, for each firm i , a regression is estimated of CDS percentage changes on a constant, five lags of CDS percentage changes, the contemporaneous stock return, the product of that return and the inverse CDS level, and five lags of the latter two terms:

$$(\text{CDS return})_{i,t} = \alpha_i + \sum_{k=0}^5 [\beta_{i,t-k} + \gamma_{i,t-k} / (\text{CDS level})_{i,t}] (\text{Stock return})_{i,t-k}$$

Figure 2: *Merton (1973) model credit-spread elasticity.*



The figure plots the elasticity of the credit spread s with respect to equity value E under the Merton (1973) model. Specifically, zero-coupon debt with face value of 100 maturing in 5 years is considered, with risk-free interest rate set to 4%. Three values for firm-value volatility are considered: 12.5%, 25% and 37.5%. The firm value V is varied in order to generate different values of the credit spread s and equity value E . The credit-spread elasticity is calculated as $(\frac{ds}{dV}/s)$ divided by $(\frac{dE}{dV}/E)$. This elasticity is plotted against the reciprocal of the credit spread s for different values of V .

$$+ \sum_{k=1}^5 \delta_{i,t-k} (\text{CDS return})_{i,t-k} + u_{i,t}.$$

We view the residuals $u_{i,t}$ from each of these regressions as independent news arriving in the credit markets, which is either not relevant or simply not appreciated by the stock markets at the time.

It is worth noting that these credit innovations are not small. Although the debt and equity returns are highly correlated, and although our specification errs on the side of imposing too few restrictions, the R^2 from our regressions are mostly in the single digits.⁹

⁹This, in itself, is a somewhat surprising finding which perhaps points to the inherent limitations on the explanatory power of structural models.

2.4.2 Information flows from credit markets to stock markets

In this section, we study the information flow from the CDS to equity markets for different credit conditions. We allow the information flow to vary conditionally on whether (i) firms experienced significant credit deterioration on some day during our sample period; (ii) firms experienced a general widening of credit spread during our sample period; and, (iii) credit rating of firms is low. Specifically, we estimate the panel specification

$$\begin{aligned}
 (\text{stock return})_t &= a + \sum_{k=1}^5 [b_k + b_k^D \cdot (\text{Credit-condition Dummy})_t] (\text{CDS innovation})_{t-k} \\
 &+ \sum_{k=1}^5 [c_k + c_k^D \cdot (\text{Credit-condition Dummy})_t] (\text{stock return})_{t-k} + \epsilon_t.
 \end{aligned}$$

Note that we allow the own lag effects on stock returns to also vary conditionally, in order to ensure that any apparent CDS lag effects are not artifacts of unmodelled dynamics in the share price itself.

We estimate this specification for three credit-condition dummies in Table 2. In specification (A), the dummy is one if the firm experienced a one-day decline in credit spread level exceeding 50 basis points between time t and end of the sample period. In specification (B), the dummy is one whenever the firm's credit spread level remained at a level greater than 100 basis points between time t and end of the sample period. Finally, in specification (C), the dummy is one if the credit rating of the firm at time t was low (A3/A- or worse). We examine $\sum_{k=1}^5 b_k$ and $\sum_{k=1}^5 b_k^D$ as measures of unconditional and conditional permanent information flows from CDS market to stock market, respectively.

Table 2 shows that the evidence is consistent with there being greater information flow from the CDS to equity markets for those firms which experienced, or were more likely to experience, "credit" events in future. In each of the three specifications, there is no unconditional flow from CDS to equity markets ($\sum_{k=1}^5 b_k$ is essentially zero). However, conditional on the credit-condition dummy, the flow is present and is significant. For firms that actually experienced credit deterioration (specifications A and B), the sum of the coefficients on lagged CDS innovations, $\sum_{k=1}^5 (b_k + b_k^D)$, is negative. The flow measure ($\sum_{k=1}^5 b_k^D$) is both

negative and statistically significant and represents around 5% transmission of information in CDS innovation to future stock-market returns. For firms that are more likely to experience credit deterioration (the low-rated firms), the flow is negative but not as statistically significant.

Overall, this provides some evidence that CDS prices impound information about adverse credit developments before that information is reflected in stock prices.

A feature of the panel estimation described above is that it forces all firms to have the same dynamic properties, except in so far as captured by the conditioning introduced in the lagged-response terms. We also estimate separate dynamics for each firm and then study the cross-firm variation in response to credit market information. This analysis addresses the possibility that our previous finding of a significant conditional effect from the CDS innovations was actually driven by uncaptured variation in the other terms (the intercept and stock lag coefficients).

Here we follow the methodology of Hou and Moskowitz (2005) who study cross-firm variation in lagged response to market news. Specifically, for each firm i we run the time-series regression

$$(\text{stock return})_{i,t} = a_i^f + \sum_{k=1}^5 b_{i,k}^f (\text{CDS innovation})_{i,t-k} + \sum_{k=1}^5 c_{i,k}^f (\text{stock return})_{i,t-k} + \epsilon_t.$$

We then define a measure of the permanent information flow from CDS market to the stock market for firm i as

$$\theta_i = \sum_{k=1}^5 b_{i,k}^f.$$

For firms for which the information flow is large and permanent, θ should be large and negative; if the information flow is partially reversed within five days, then θ should be less negative; and, θ should be close to zero for firms for which there is not much information flow in the first place. Panel A of Table 3 shows the summary statistics for the estimated θ_i 's. The mean is 0.0043 and statistically insignificant. That is, there is not much of an unconditional effect once the full dynamics are allowed to be firm specific.

Next we sort our firms into quintiles based on their lagged response and examine the average firm characteristics of each. Panel B of Table 3 reveals that the main evidence of insider activity is confined to the lowest θ quintile. Firms in this set are on average larger, more actively traded, and somewhat more volatile than the sample as a whole. (Note that the table reports medians, and is thus not sensitive to individual outliers.) Neither credit rating nor leverage varies much across quintiles. However credit risk, as measured by CDS level, does rise monotonically as θ falls, echoing the observation that trading on the basis of adverse non-public information about a firm's credit prospects responds to the incentive represented by increased risk to bank portfolios.

In terms of the magnitude of the information flow documented here,

we note that while a θ of -0.11 (e.g. for a lowest quintile firm) is economically significant, it does not imply a gross violation of market efficiency. The time-series standard deviation of weekly CDS changes for these firms is roughly five percent, implying a predictable stock return of about half a percent, which is on the order of the round-trip trading costs in these stocks. We do not regard numbers of this size as implausible. It is also worth noting that the magnitudes themselves are not important for our analysis. We simply use the cross-sectional variation in these information flow measures to study patterns in, and effects of, information asymmetry.

To summarize, our empirical methodology provides a way of identifying insider trading or at least informed revision of quotes in the CDS markets. We have shown that such activity is present, and is concentrated in the names for which credit risk is highest. However, we have not yet tied this to any direct measure of asymmetric information. The next section explores the banking relationships of our sample of borrowers to establish this link.

3 Information Flow and Bank Relationships

The evidence in the last section suggests that, under certain market conditions, information revelation (or price discovery) in the credit markets precedes that in the equity markets. If

indeed this is due to the activity of insiders with access to non-public information, we would expect the effect to be bigger when there are more players with access to such information. In this section, we identify a class of such insiders – commercial banks having an ongoing lending relationship with the company – and test this hypothesis.

While it seems natural to conjecture that more insiders would lead to more insider trading, it may be worthwhile to begin by articulating precisely why this should be so.

One view would be that more insiders implies more information gathering. In our case, the lending banks have both an incentive and a responsibility to actively monitor each borrower. Indeed, some theories of banking (e.g. Fama (1985)) postulate that the differential monitoring ability of banks is their primary reason for existence, and that firms undertake bank loans precisely to commit an outsider to monitor them (among other reasons). It could then be that the technology of monitoring is such that more monitors with a sufficient incentive produce more information than do fewer with larger incentives; or that a larger number of relationships would be optimal *ex ante* precisely when this was true.

A second motivation for our hypothesis does not rely on assumptions about information gathering *per se*, but rather concerns the incentives *not* to exploit non-public information through trading. Whether or not such exploitation is literally illegal may be secondary to the inhibitions that could come from damaging other relationships. Unloading dangerous exposures on the market could be seen as harmful to the banks' trading counterparties (customers and other banks) on whom it may rely for hedging. It could also be seen as a violation of an implicit contract with other members of the lending syndicate if the result is a lower value of the positions they continue to hold. However, the more members there are of a given syndicate, the greater the chance that for *some* of them these implicit contracts fail to bind because the relationships that are damaged are simply not as valuable as the immediate benefits of avoiding losses.

Finally, a third theory would build on the insight of the market microstructure literature that more insider trading will occur when it is easier to hide. Here the concern is not with hiding from regulators (although that may matter too), but with concealing the fact

that the trading is informed so as to minimize its price impact. In this case, we might anticipate that uninformed trading volume in the credit markets would rise with the number of exposed banks (for example, due to informationless trading), eliciting greater informed trading through higher liquidity.

Our data on bank relationships is based on the Loan Pricing Corporation (LPC)'s DealScan database. For each borrower on a given date, we look back as far as 1996 for any outstanding syndicated loan facilities undertaken by this borrower, as well as its affiliated and predecessor companies. Summing over all such active facilities, we compute on each date the number of unique banks with which the borrower has an on-going relationship.¹⁰ Our results are insensitive to excluding affiliated company debt, and to defining relationship length based on a fixed five-year window.

Our primary measure of relationships counts lead banks only, although we examine participant banks as well. We further focus on the top 100 large, commercial and investment banks which together account for most of the market share in syndicated lending in the LPC database over our sample period. (These banks are listed in Appendix B.) We restrict attention to these banks in order not to overstate the number of informed parties, and to focus on the players most likely to possess both an informational advantage and access to the credit derivatives markets. We note, however, that *every* member of a bank syndicate has the same right to information gathered by the lead banks or any delegated member, (c.f. Lee and Mullineaux (2004)) and that this information is actively and instantaneously disseminated via electronic networks, such as IntraLinks.¹¹ Also, to the extent that small players in the syndicated loan market, such as foreign banks and hedge funds, may be the most inclined to exploit private information (as discussed above), our more restricted definition may be less appropriate.¹² When we include all banks in our relationship measure, the statistical

¹⁰Our approach to calculating the number of bank relationships is similar in spirit to the one described in detail in Bharath, Dahiya, Saunders and Srinivasan (2004).

¹¹Further, as stressed by Lee and Mullineaux (2004), there is a regulatory requirement that each participating bank perform independent due-diligence for each loan.

¹²It also must be noted that the set of players with access to private syndicate information can change due to the rise of secondary market trading in bank loans. We have no way of tracking this, but Sufi (2004) reports that less than 10 percent of outstanding syndicated debt is ever traded. Still, we may be missing an

importance of this number in the tables below generally strengthens.

The large amount of merger and acquisition activity in the banking sector over our sample period, and to some extent in the corporate sector, requires us to make careful adjustments while employing the LPC data. The data on bank merger and acquisition activity is obtained from the data employed and generously provided to us by Bharath et al. (2004), Sufi (2004), and from the web-site of Federal Reserve Bank of Chicago. The data on corporate merger and acquisition activity is obtained from the SDC Platinum database. Bank relationships are computed at the level of parent banks, and are assumed to merge whenever a merger takes place at the bank level or at the level of the borrowing firms.

The top panel of Table 4 gives some summary statistics on the relationships of the benchmark companies that we study. Besides the number of relationships, we also tabulate the number and notional amount of all active facilities at each date.¹³ The median number of lead banking relationships is 16 with the mean being 29. There is substantial cross-sectional variation: there are firms with no syndicate banking relationships and firms with as many as 50 lead-bank relationships. The median number of loan facilities is 4 with the median total amount per firm being about 4 billion USD. The average duration of active relationships has a median of 4.1 years in the sample.

In looking at bank relationships, might we inadvertently be measuring other firm-specific characteristics? Prior research (Lee and Mullineaux (2004), Sufi (2004)) has presented evidence that larger syndicates are formed for more transparent firms, and some evidence that more risky firms tend to have larger syndicates. The bottom panel of Table 4 shows weak evidence supportive of both. Firms with more banks are slightly more volatile and leveraged than those with few (although there is no difference in ratings). On the Standard and Poors

important source of insider activity: hedge funds are reported to commonly purchase small syndicate stakes precisely to acquire non-public information to aid them in arbitrage trading. See “The New Insider Trading? Concerns mount that private information furnished to lenders is seeping into trading”, *Investment Dealers Digest*, 13 June 2005.

¹³LPC data does not give detailed bank-by-bank break-up for each loan facility. It is thus not possible to come up with a precise loan-size-weighted measure of the number of banking relationships that would incorporate actual exposure data.

transparency scale¹⁴, which for US firms effectively runs from 7 to 9, firms with more banks are marginally more transparent. The last few lines of the table show that the primary determinant of number of banks is simply scale. Not surprisingly, there is a strong monotonic relation between banks and firm size or amount of borrowing. The regressions below will control for scale effects in isolating the role of relationships.¹⁵

To start, we present the most direct tests of our main hypothesis: that the degree of informed trading in the CDS market – measured by information flow – is a function of the number of informed participants. To do so, we run regressions of the form:

$$\begin{aligned} \text{stock return}_t = & a_0 + [b_0 + b_1(\text{number of insiders})](\text{CDS innovation})_{t-1} \\ & + \sum_{k=1}^5 c_k(\text{stock return})_{t-k} + \epsilon_t \end{aligned}$$

where the CDS innovation is constructed as described in the previous section. Our proxy for the number of insiders varies substantially across firms and over time. To exploit this, we estimate the model using panel data specifications.

Table 5 show several versions of the specification. Column (A) shows that, unconditionally, there is a small but statistically significant spillover of yesterday’s CDS innovation to today’s stock return. In column (B) we see that this unconditional effect is completely absorbed by the inclusion of the number of banking relationships. For a firm with 10 relationships there is essentially no spillover, whereas for one with 50 relationships the spillover is around 4%. The tests in columns (C) and (D) distinguish between the effect of positive and negative CDS innovations. In (C) there is no difference in the unconditional response: both are about the same as that found in (A) and the p value of the t test for their equality is 0.64. However, the conditional responses are quite different. Only positive CDS shocks (i.e. bad news) are now found to have a significant impact on future stock prices. The coefficient b_1^+ is around eight times larger (with p value for no difference of 0.00) than b_1^-

¹⁴See Patel and Dallas (2002).

¹⁵In the next section we will be more concerned with the endogeneity of relationships with respect to the dependent variables. In this section, where the dependent variables are stock returns, endogeneity is not a concern.

and implies approximately 6% spillover for a firm with 50 relationships. The fact that the information flow occurs primarily for negative news is consistent with the interpretation of hedging activity by asymmetrically informed banks with positive loan exposures.

The last two columns augment the specification with further lags of CDS innovations, so that the conditional response term looks like

$$\sum_{k=1}^5 a_k [b_0 + b_1 (\text{number of insiders})_{t-k}] (\text{CDS innovation})_{t-k}.$$

This specification allows us to check whether the leading relationship we have identified is merely a transient effect, possibly due to some short-term price pressure from the hedging activity of debt-market participants in the stock market.¹⁶ Column (E) implies that there is no significant unconditional contribution to information flow at any other lag. The last column shows some evidence (though not statistically significant) of a partial reversal of the bank-related information flow at two days' lag. However, looking back a week, the total lagged conditional effect is even stronger than the one-day effect, due to a highly significant contribution at four days' lag. While we have no explanation for a four-day effect, we can conclude that the conditional information flow we have documented is not transitory.

To check that the core results in Table 5 are not driven by outliers or other inferential problems, we present some alternative estimators and standard errors in Table 6. We first test the OLS estimates with robust standard errors, then we re-estimate the coefficients after some outlier controls, and, finally, we compute both the first and second stages of our estimation simultaneously in a GMM setting to correct for the estimation error in the first stage. In each case, we report the (two-sided) p value for the test that our bank coefficient b_1 is zero. (The table caption provides some further detail.) The message is clear: none of these affects the main finding. The role of bank relationships in driving information flow is robust with respect to corrections for cross-sectional dependence, heteroscedasticity, extreme observations, and errors in variables. We next ask whether the results are robust once we control for other factors that may also influence information flow.

¹⁶This specification is estimated by nonlinear least squares and the a_k terms are measured relative to a_1 which is set equal to one for purposes of identification.

Table 7 shows panel regressions, similar to those in Table 5, which model the CDS innovation component as a function of other controls. That is,

$$\begin{aligned} (\text{stock return})_t &= a_0 + [b_0 + b_1(\text{number of banks}) + b'(\text{other controls})](\text{CDS innovation})_{t-1} \\ &\quad + \sum_{k=1}^5 c_k(\text{stock return})_{t-k} + \epsilon_t \end{aligned}$$

We limit the specification here to one lag of the CDS innovation, but, as before, include five own lags of each stock's return.¹⁷

We have in mind several factors that could potentially lead to a role for relationships, aside from informed trading. First, the number of banks is clearly related to the scale of a firm: bigger firms have bigger loans, which always involve bigger lending syndicates. Perhaps credit markets react quicker for all bigger firms. That is, debt markets may, as a whole, be better informed if there are more participants of every kind. If this is so, the role of relationship banks may have nothing to do with their differential ability to gather information.

Specifications (A) - (B) in the table include controls for the scale of each firm in the cross-market reaction coefficient. Column (A) shows that our results are driven by neither the overall equity value of the firm nor the book value of its debt (both in logs). This is important given the obvious scaling relationship seen in Table 4. Column (B) also includes the notional face value of active bank facilities. This variable measures the total amount of debt that informed traders might *want* to hedge. As such, we would not be surprised if it captured some of the insider trading effect. Moreover, being strongly correlated with the number of banks, it is highly significant when used alone. However including them both, it turns out to be insignificant, leaving the bank effect somewhat diminished (mostly due to a larger standard error) but still significant.

The next specifications attempt to control for other determinants of liquidity. Scale itself may not matter, but amount of secondary market (informationless) trading still might. Column (C) includes controls for debt market liquidity. Besides the book value of debt,

¹⁷Given the results in the previous table, we present only OLS estimates and t statistics here.

we include the percentage bid/ask spread on each firm's credit default swap; the number of public bond issues of each firm at each date; an indicator variable if any of these issues is a convertible bond; and the number of *non-lead* (participant) banks for outstanding loan syndicates. This last variable is included because some researchers (e.g. Sufi (2004)) view participants as uninformed players who depend on the lead banks for information. In that case, the number of them may capture informationless hedging activity.

The results in (C) show that the role of banks is undiminished by these liquidity controls. The number of public debt issues shows up with a positive sign, meaning that there is *less* lagged information flow for firms with more non-bank debt. We interpret this as indicating that cross-market arbitrage is probably more active in these names, i.e., that any informational advantage in debt markets is exploited faster.

Interestingly, the influence of non-lead banks, is apparently larger than that of leads (although the p value for no difference is 0.17). It does not lessen the effect of leads, and so does not support the idea that our main effect is due to informationless activity. Instead, it appears that these banks may provide an even stronger measure of *informed* activity. This is perhaps not surprising given the facts discussed above that (a) non-leads have all the same rights and responsibilities for monitoring as leads; (b) private information is instantly shared electronically; and (c) non-leads may have less incentive *not* to exploit this information.

Another hypothesis about our results is that the lead-lag relationship is due to the *relative* liquidities of debt and equity markets for each firm. Under this view, slower information transmission may be an artefact of relatively *less* liquid stock markets for companies which have many banks. Specification (D) includes proxies for stock and debt liquidity. For the stock market we include volume and turnover, as well as Amihud's (2002) measure of market impact computed at daily level.

The inclusion of these quantities again fails to diminish the role of banks in explaining the lead-lag effect, and even increases its statistical significance. Stock volume alone appears to be an additional significant conditioning variable. Curiously, its negative sign implies that CDS lagged innovations matter *more* for more highly traded stocks. This may be due to

unmodelled heteroscedasticity: volume is known to be positively associated with volatility. Both are driven by the quantity of news released about a given stock. The result here then could simply be telling us that there is more information flow when there is more information.

The last alternative interpretation of the role of banks that we explore concerns its relationship to risk. In the previous section, we documented that the lead-lag effect is higher when the threat of losses is larger. In addition, there is some evidence that firms with higher risk have larger lending syndicates¹⁸ and hence more relationships. So it is worthwhile to ask whether credit risk is the driving factor behind our bank effect. Another possibility is that asset value risk drives our information flow affect, and that the association with banks is entirely coincidental. Columns (E) and (F) employ measures of debt and equity risk as additional conditioning variables in the lagged response coefficient.

There is no evidence that these have any influence on the bank term, which actually becomes stronger statistically. Credit rating (using the integer scale of Odders-White and Ready (2005) which increases with credit quality) has the hypothesized sign. Credit spread level is insignificant, as is long-term stock volatility. The one noteworthy contribution comes from very short-term risk. The degree of lagged information flow increases strongly with the absolute value of yesterday's stock return. This supports the notion that risk affects information flow, but in a way that is entirely consistent with banks responding to risk incentives.

To summarize this section, the evidence presented here supports the interpretation that the information flows we have documented stem from banks using their monitoring role to uncover relevant credit information about borrowers and then engaging in informed hedging when negative information arises. Our measure of informed activity, developed in the previous section, has been shown to be singularly driven by the number of parties with access to non-public information. We have ruled out several alternative explanations for this effect, and also found supporting evidence. The effect is stronger for non-lead banks, who may have less disincentive to exploit private information, and it rises with some measures of risk, i.e.

¹⁸See Sufi (2004), although his finding here is at odds with Lee and Mullineaux (2004).

as the incentive to exploit such information increases.

4 Effects of Informed Trading

Does insider trading in the credit derivatives markets matter? As discussed in the introduction, there is abundant evidence that participants, regulators, and industry bodies all regard it as a serious threat to the integrity of the market. Having isolated some strong predictors of relative insider activity, we are now in a position to offer evidence on this topic.

To do so, we need to first consider what is actually perceived as being under threat. Our interpretation of the prevailing view is that the situation is analogous to the classic moral hazard dilemma in any other insurance market. The threat of informed purchase of insurance leads to a lemon's problem in which insurance premia are set too high and the quantity of insurance written in equilibrium is too low.

Since we have no information on the amount of credit risk insured and, anyway, cannot hope to gauge the efficient amount of such transfer, our approach is to try to detect the effect of information asymmetry on bid and ask prices in the CDS market. If the threat of informed trading drives a wedge between the reservation prices of buyers and sellers, then the effect is the same as in classic microstructure models in finance (where uninformed market makers face potentially informed buyers *and* sellers). Unlike most microstructure settings, the one-sidedness of the threat in the CDS market, further implies that we could see an effect in the levels of prices, i.e., insurance may be too expensive.

Relying on our results above, throughout this section we will use number of bank relationships as our measure of the prevalence of non-public information in the credit market. At this point, we need to address the endogeneity of this measure with respect to credit risk and liquidity. There are two *potential* endogeneity biases, stemming from the possible roles of information quality and *ex ante* default risk in determining the amount of a firm's borrowing and the number of banks, given that amount. For the purposes of this section, these two influences work in opposite directions. If more risky firms have more banks, then

this could bias us towards inferring a positive effect of non-public information on borrowing costs or liquidity. Conversely, if more transparent firms have bigger syndicates, this could mask any such positive effect.

It turns out that, for our set of firms, the number of bank relationships passes all the tests we can think of for exogeneity. In (unreported) pooled regressions, we cannot reject the hypothesis that, controlling for firm size, the number of banks is unrelated to rating, stock volatility, recent price performance, or S&P's index of transparency. (If anything, there is tendency for more risk to imply *fewer* banks.) Hence, without disputing the findings in the banking literature (which pertain to much broader cross-sections of firms), we proceed to employ our proxy directly – along with controls for firm scale – as an independent variable.

Table 8 shows regressions of stock and CDS liquidity measures on this proxy, as well as on some standard control variables. We examine stock liquidity because the evidence of informed trading uncovered above is not necessarily evidence of asymmetric information *within* the credit markets. An alternative interpretation is that the CDS market *as a whole* is better informed, in certain circumstances, than other investors. Under this view, the threat of asymmetric information, if it exists, might be to the liquidity of other markets. Results are shown for both panel regressions with time fixed effects, and for Fama-MacBeth (1973) regressions. In the latter case, standard errors are corrected for autocorrelation of up to six months; in the former case, the reported t statistics are clustered at the firm level.

Both methodologies lead to the same conclusions. In the first two columns, stock liquidity is shown to be largely insensitive to the bank relationship variable. More interestingly, the second two columns indicate that these relationships do affect credit market illiquidity – but with a negative sign. Hence, to the extent that more banks implies more informed players, the evidence suggests that this leads to, or is associated with, narrower spreads and greater liquidity provision. In further tests, we find this result to hold during periods of overall market stress, when average credit spreads are high, and on days with negative credit news. These findings provide no support to the view that the presence of informed players threatens the stability of the CDS market.

Table 9 investigates whether the risk of informed trading shows up in the cost of credit insurance, i.e. the CDS levels themselves. In principle, the moral hazard effect could raise these prices even if there is no direct effect on liquidity. However the first two columns establish that, controlling for known determinants of credit spreads, bank relationships play no additional role. Finally we check whether our one direct measure of liquidity, the bid/ask spreads of the default swaps, influence prices directly. This test allows for the possibility that, in using bank relationships, we have simply failed to isolate a valid proxy for asymmetric information. However, the regressions in the rightmost columns show no influence of bid-ask spreads on levels.¹⁹ We have replicated these results using numerous additional controls, including non-linear terms, transparency ratings, and other structural indicators. It does not appear that asymmetric information or liquidity are priced in this market.

To summarize, returning to the policy question at issue, we find no evidence that the presence of informed insiders adversely affects liquidity provision or raises the price of credit insurance.

4.1 Interpretation

As described in the introduction, there are a number of possible microstructural mechanisms that could counteract the adverse liquidity (and price) effects of insider trading risk. We provide a few candidate explanations that are consistent with our findings and briefly discuss their relative merits.

The first candidate explanation is based on the observation that even informed players need to know the nature of the order flow (the pattern of uninformed trading) in order to strategically disguise their informed trades. CDS markets are relatively opaque. In particular, quotes posted at CreditTrade are anonymous: until a trade takes place, the counterparty information is not revealed to the two involved parties. Bloomfield and O’Hara

¹⁹These results contrast with those of Chen, Lesmond, and Wei (2005) who report a significant, positive, role for illiquidity in determining credit spreads on corporate bonds. The different findings may together be consistent with the liquidity impact being absorbed in the “basis” between CDS fees and bond yields. The arbitrage relation between these two quantities breaks down primarily when the bonds themselves are less liquid.

(1999, 2000) have shown through trading experiments that in opaque markets, the informed players emerge as liquidity-providers and post narrower bid-ask spreads (compared to other agents and more transparent markets). This is consistent with the informed players learning about liquidity for a strategic reason and in the process providing liquidity to the market.²⁰ Since privately informed banks are also intermediaries in the CDS markets, this explanation can potentially rationalize the greater information revelation for those CDS names that have more relationship banks, who enjoy greater liquidity compared to those names with fewer relationship banks.

The second candidate explanation views the informed not as liquidity providers, but simply as responding to exogenous fluctuations in volume to time their trades so as to minimize their price impact and trading costs. Firms with more relationship banks may naturally have more uninformed trading due to the portfolio rebalancing of those banks, or due to hedging of residual CDO tranches and regulatory-arbitrage activities. This would increase the attractiveness of these credits to informed players. If an increase in banking relationships sufficiently increases the relative intensity of uninformed trading to informed trading, then there would be greater liquidity for CDS names with more bank relationships, and, simultaneously, a greater information discovery.

The final explanation we propose is based on the idea of competition among informed agents. Holden and Subrahmanyam (1992) show that if a large number of informed agents receive the same piece of information about an asset's value, then they trade aggressively, revealing instantaneously most of this information. The depth of the market in the limiting case becomes infinite as the informed compete and erode each other's profits. It is possible that all relationship banks receive the same quantum of credit information about the underlying CDS name (e.g. in a meeting arranged by the firm for its syndicate banks), and in an attempt to capitalize on this information, transmit all of this information into prices. This would also simultaneously generate a greater information release and greater liquidity for CDS names that have more bank relationships. Note, however, that in our

²⁰See also Hong and Rady (2002) for strategic timing of trades by the informed when they are uncertain about the exact nature of uninformed trading.

specific setting, we would expect the competing informed banks to also trade in the stock markets, an outcome of which would be a coincident release of information in the CDS and stock markets. Since our CDS innovations are orthogonal to contemporaneous stock-market innovations, the information flow from CDS innovations to future stock-market changes is necessarily due to information revealed *only* in the CDS markets.²¹

The data and tests we have employed so far cannot shed conclusive light on the relative merit of these candidate explanations. The general finding of liquidity rising with information asymmetry runs counter to much of accepted wisdom in market microstructure. So, further investigation of this topic is certainly warranted. Future work employing better proxies of insider-trading risk, perhaps using intra-day data on actual transactions in the CDS market, would be valuable in shedding further light on these issues.

5 Conclusion

In this paper, we provided empirical evidence that there is an information flow from the credit default swaps markets to equity markets and this flow is permanent and more significant for entities that have a greater number of bank relationships. This information flow is concentrated on days with negative credit news, and for entities that experience or are more likely to experience adverse credit events. These findings are consistent with the existence of insider trading in these markets. However, we do not find evidence that this form of insider-trading risk affects adversely the liquidity provision in the credit derivatives or the equity markets of these entities. Our study is the first in the literature to examine insider trading in credit markets and its effect on the liquidity of these markets. Our findings also constitute a first step towards understanding whether there is a case for the current regulatory response to complaints of insider trading in these markets.

²¹This last point makes it clear that the first two explanations implicitly rely on imperfect competition between informed players in the CDS markets.

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Table 1: Summary Statistics

	Low	Median	High
CDS level (mid price, BP)	13	81	2400
CDS bid-ask spread (BP)	1	20	2000
Credit rating	Ba3/BB-	Baa1/BBB+	AAA/Aaa2
Firm size (equity mkt val, \$mm)	720	15820	412900
Firm debt (book val, \$mm)	9	8874	312684
Firm leverage (debt at book val)	0.00	0.21	0.65
Average stock volume (mm shrs/day)	0.14	2.65	76.1
Average stock turnover (pct/day)	0.2	0.56	2.68
Average stock volatility (ann std dev)	0.24	0.39	0.83
Number of Bond Issues	0	9	71
Observations/day	9	46	62

The table describes the firm characteristics for our sample of credit derivatives. Sample statistics are computed across all observations, except average stock trading statistics which are computed across firms.

Table 2: Information flow from CDS market to stock market for different credit conditions (Panel estimation)

	(A)	(B)	(C)
a	0.0003 (2.19)	0.0003 (2.21)	0.0003 (2.04)
$\sum_{k=1}^5 b_k$	0.0033 (0.44)	0.0050 (0.66)	0.0111 (0.91)
$\sum_{k=1}^5 b_k^D$	-0.0492 (2.36)	-0.0465 (2.52)	-0.0224 (1.51)
$\sum_{k=1}^5 c_k$	-0.0413 (3.22)	-0.0399 (3.00)	0.0183 (0.97)
$\sum_{k=1}^5 c_k^D$	0.1917 (5.90)	0.1338 (4.68)	-0.0488 (2.02)

The table shows OLS estimates and t -statistics for the coefficients of a regression of daily stock returns on a constant, lagged CDS innovations, and lagged stock returns, as follows:

$$\begin{aligned}
 (\text{stock return})_t &= a + \sum_{k=1}^5 [b_k + b_k^D \cdot (\text{Credit-condition Dummy})_t] (\text{CDS innovation})_{t-k} \\
 &+ \sum_{k=1}^5 [c_k + c_k^D \cdot (\text{Credit-condition Dummy})_t] (\text{stock return})_{t-k} + \epsilon_t.
 \end{aligned}$$

That is, the regression also includes interaction terms of the lagged CDS innovations and stock returns with an indicator equal to one for firm i at date t if (i) the firm experiences a credit deterioration of more than 50 basis points between date t and the end of the sample (specification A); (ii) the firm's credit spread level remained at a level greater than 100 basis points between time t and end of the sample period (specification B); and, (iii) the credit rating of the firm at time t was low, that is, A3/A- or worse (specification C).

Table 3: Information flow from CDS market to stock market for different credit conditions (Cross-sectional estimation)

PANEL A: PROPERTIES OF θ

Mean	=	0.0043
t-stat	=	0.4600
Min	=	-0.1961
Max	=	0.3262

Panel A shows univariate properties of θ , the firm-specific measure of permanent information flow from CDS innovations to stock markets. In the first stage, we run for each firm i the time-series regression

$$(\text{stock return})_{i,t} = a_i^f + \sum_{k=1}^5 b_{i,k}^f (\text{CDS innovation})_{i,t-k} + \sum_{k=1}^5 c_{i,k}^f (\text{stock return})_{i,t-k} + \epsilon_t.$$

Then, θ_i is the measure of permanent information flow from CDS market to the stock market for firm i , defined as $\theta_i = \sum_{k=1}^5 b_{i,k}^f$.

PANEL B: PROPERTIES (MEDIANS) OF FIRMS IN DIFFERENT θ -QUINTILES

	Q1	Q2	Q3	Q4	Q5
Average θ	-11%	-2%	1%	4%	8%
CDS level (mid price, BP)	185	108	101	79	68
CDS bid-ask spread (BP)	26	21	20	18	17
Credit rating (Moody's)	Baa1	Baa1	Baa2	Baa1	Baa2
Credit rating (S&P)	BBB+	BBB+	BBB	BBB+	BBB
Firm size (equity mkt val, \$mm)	28021	12477	9663	12677	13862
Firm debt (book val, \$mm)	12785	7178	4136	6864	6380
Firm leverage (debt at book val)	0.28	0.32	0.33	0.33	0.27
Average stock volume (mm shrs/day)	8.07	2.10	1.37	1.71	2.49
Average stock turnover (pct/day)	5.4	6.4	4.8	5.0	5.6
Average stock volatility (ann std dev)	0.40	0.37	0.33	0.33	0.33
Number of Bond Issues	12.6	7.1	5.2	12.0	5.8

For Panel B, firms are ranked into quintiles based on the first-stage estimates of θ , Q1 being the quintile with the smallest (most negative) estimates, and Q5 being the quintile with the largest estimates. The summary statistics reported for each quintile are the medians (across firms) of the time-series means of the characteristics for each firm.

Table 4: Bank Relationship Summary Statistics

PANEL A: DISTRIBUTION ACROSS ALL OBSERVATIONS

	Low	Median	High
Number of Bank Relationships (leads)	0	16	50
Number of Bank Relationships (all)	0	29	69
Average Relationship Length (yrs.)	0.3	4.1	7.2
Number of Active Facilities	0	4	36
Amount of Active Facilities (\$mm)	0	4019	66099

PANEL B: FIRM CHARACTERISTICS

	Few (0-11)	Middle (12-22)	Many (23-50)
Rating	Baa1/BBB+	Baa1/BBB+	Baa1/BBB+
Volatility (ann std dev)	0.36	0.38	0.39
Leverage (debt at book val)	0.18	0.26	0.22
S & P Transparency (2002)	8	8	9
Size (equity mkt val, \$mm)	11478	13470	25845
Debt (book val, \$mm)	4463	8120	19168
Number of Active Facilities	2	4	11
Amount of Active Facilities (\$mm)	1642	3636	10206

Bank relationship statistics are reported for all firm-date observations for the sample studied in Section 3. Relationships are defined to be by outstanding syndicated loan commitments originated after 1996. Only the top 100 syndicated lenders are included in the count. The top panel shows the range of some relationship statistics. The bottom panel shows the average of firm characteristics when the observations are sorted into three groups based on the number of (lead) relationships.

Table 5: Regressions of stock returns on CDS innovations

	(A)	(B)	(C)	(D)	(E)	(F)
b_0	-0.0080 (2.93)	0.0095 (1.78)			-0.0057 (1.96)	0.0155 (3.22)
b_1		-0.00094 (3.81)				-0.00093 (3.62)
b_0^+			-0.0095 (2.27)	0.0216 (2.793)		
b_1^+				-0.0016 (4.78)		
b_0^-			-0.0065 (1.52)	-0.0031 (0.39)		
b_1^-				-0.0002 (0.52)		
a_1					1.0 NA	1.0 NA
a_2					-0.052 (0.10)	-0.507 (1.52)
a_3					-0.110 (0.23)	-0.083 (0.28)
a_4					-0.124 (0.25)	1.193 (2.60)
a_5					0.082 (0.16)	0.226 (0.68)

The table shows the results of regressing daily stock returns on lagged values of CDS innovations. The lag coefficient is modelled as $b_0 + b_1 \cdot (\text{number of bank relationships})$ in the first two columns. The second two columns allow the coefficients to differ depending on the sign of the lagged CDS innovation. For these four specifications, OLS t -statistics appear in parentheses. The final two columns include five lags, with each constrained to have the same values of b_0 and b_1 . These specifications are estimated by NLS. Numerical standard errors are used for the t -statistics shown in parentheses. All regressions also include an intercept and five lags of the dependent variable.

Table 6: Stock return regressions – alternative inference

PANEL A: OLS			
	<i>coef</i>	<i>p-values</i>	
		bootstrap	White
b_0	0.0095	0.22	0.23
b_1	-0.00094	0.046	0.042

PANEL B: TRIMMED			
	<i>coef</i>	<i>p-values</i>	
b_0	0.0078	0.24	
b_1	-0.00091	0.002	

PANEL C: STANDARDIZED			
	<i>coef</i>	<i>p-values</i>	
b_0	0.0142	0.14	
b_1	-0.00122	0.008	

PANEL D: GMM			
	<i>coef</i>	<i>p-values</i>	
b_0	0.0088	0.27	
b_1	-0.00108	0.026	

The table shows the results of the regression specification (B) from Table 5, using alternative methodologies. Panel A presents the OLS estimates with heteroscedasticity consistent and bootstrapped standard errors. The former are computed by resampling cross-sections with replacement. The latter are as per White (1980). Panel B shows the OLS results when each firm’s stock returns and CDS innovations have been truncated at ± 2 standard deviations. Panel C standardizes each firm’s stock returns and CDS innovations by scaling by their standard deviation. Panel D gives the results of estimating the CDS innovation equation and the stock return regression jointly in a just-identified GMM system so that the standard errors reflect the joint uncertainty about both sets of coefficients. All reported p values are two sided.

Table 7: Stock return regressions with controls

	<i>scale</i>		<i>liquidity</i>		<i>risk</i>	
	(A)	(B)	(C)	(D)	(E)	(F)
b_0	0.0003 (0.01)	0.0091 (0.21)	-0.0110 (0.45)	0.0729 (1.68)	-0.0549 (1.53)	-0.0556 (1.53)
<i>banks</i>	-0.0010 (3.15)	-0.0008 (1.89)	-0.0009 (2.70)	-0.0010 (3.10)	-0.0011 (4.16)	-0.00011 (4.26)
<i>nonleads</i>			-0.0017 (3.73)			
<i>size</i>	0.0003 (0.10)	0.0007 (0.22)				
<i>debt</i>	0.0007 (0.20)	0.0013 (0.31)	0.0046 (1.45)	0.0036 (1.04)		
<i>loan amt</i>		-0.0031 (0.64)				
<i>CDS b/a</i>			0.0078 (0.37)			
<i>bonds</i>			0.0157 (1.82)	0.0117 (1.37)		
<i>CB ind</i>			-0.0004 (1.15)			
<i>volume</i>				-0.0085 (2.10)		
<i>turnover</i>				0.0021 (0.74)		
<i>ILLIQ</i>				-0.0045 (1.63)		
<i>credit spread</i>					0.0019 (1.10)	0.0027 (1.15)
<i>rating</i>					0.0024 (1.78)	0.0024 (1.79)
$ r_{t-1} $						-0.4024 (4.29)
σ_{6mo}						0.0238 (1.46)

CAPTION TO TABLE 7 The table shows the results of regressing daily stock returns on one lag of CDS innovations. The lag coefficient is modelled as $b_0 + b_1 \cdot (\text{number of bank relationships}) + b'$ (other controls). The controls are: *nonleads* (number of participant banks in active loan facilities); *size* (log of market capitalization); *debt* (log of Compustat book value of debt); *loan amt* (log notional value of active loan facilities); *CDS b/a* (percentage bid/ask spread of credit default swap); *bonds* (number of public dollar denominated bonds of parent company); *CB ind* (indicator = 1 if any of the bonds counted in the previous variable is convertible and = 0 otherwise); *volume* (log daily stock market volume in millions); *turnover* (daily stock market turnover); *ILLIQ* (absolute value of stock returns divided by volume); *credit spread*: (mid-market CDS level); *rating*: (integer scale of credit rating); $|r_{t-1}|$ (lagged absolute stock return); σ_{6mo} (standard deviation of last 6 months' stock returns). All regressions also include an intercept and five lags of the dependent variable. OLS *t*-statistics appear in parentheses.

Table 8: Illiquidity Regressions

	STOCK ILLIQ		CDS % B/A	
	FM	Panel	FM	Panel
<i>size</i>	-0.2365 (10.75)	-0.2650 (5.32)	0.0480 (8.59)	0.0499 (3.55)
<i>volume</i>	-0.2197 (5.21)	-0.2078 (2.99)	-0.0414 (10.59)	-0.0429 (6.02)
r_{1mo}	-0.3098 (4.10)	-0.4386 (3.33)	-0.0144 (0.48)	-0.0364 (1.42)
σ_{1mo}	0.6789 (5.59)	0.5982 (5.54)	0.0561 (1.71)	0.0780 (2.42)
<i>banks</i>	-0.0030 (2.21)	-0.0037 (0.99)	-0.0029 (8.18)	-0.0026 (2.75)
<i>obs</i>	947	71232	947	44932
R^2	0.3834	0.2424	0.2646	0.1365

Stock and credit market illiquidity measures are the dependent variables in daily regressions using both Fama-MacBeth (1973) regressions and panels. STOCK ILLIQ is absolute returns divided by dollar volume (c.f. Amihud (2002)). CDS % B/A is the bid-ask spread as a percentage of the midmarket quote for our sample of credit default swaps. The controls are log market capitalization, stock volume, one month stock return, and one month stock standard deviation. Bank relationships are as described in the text. For the Fama-MacBeth regressions, *obs* is the number of cross-sections, R^2 is the arithmetic average of the R^2 s from the individual regressions, and the *t* statistics have been corrected for six months autocorrelation. For the panels, the specification includes time fixed-effects, and the reported *t* statistics are adjusted for clustering at the firm level.

Table 9: Credit Spread Regressions

	(A)		(B)	
	FM	Panel	FM	Panel
r_{6mo}	-90.43 (4.19)	-92.25 (4.94)	-71.60 (2.91)	-93.31 (4.84)
σ_{6mo}	260.5 (6.35)	439.5 (5.02)	212.6 (3.91)	439.0 (4.80)
$debt$	15.59 (2.79)	10.39 (1.03)	12.75 (1.87)	13.26 (1.73)
$leverage$	-9.12 (0.22)	73.26 (1.02)	-20.33 (0.39)	65.69 (0.98)
$tangible$	53.26 (2.19)	46.23 (1.23)	52.95 (2.32)	44.65 (1.28)
$rating$	-20.92 (6.70)	-17.01 (3.77)	-19.57 (5.78)	-17.57 (4.23)
EDF	0.6424 (1.73)	0.1325 (2.03)	1.3303 (1.30)	0.1325 (1.97)
$banks$	-0.2946 (0.97)	0.4508 (0.45)		
bid/ask			-74.30 (1.70)	-8.98 (0.18)
obs	891	39964	891	39964
R^2	0.6140	0.5283	0.6343	0.5276

The table shows regressions of credit default swap levels in basis points on proxies for asymmetric information. The controls are lagged 6-month equity return and standard deviation, log book value of debt, leverage using market value of equity, tangible asset ratio, credit rating, and estimated default frequency from the Merton (1974) model. Bank relationships are as described in the text. The CDS bid/ask spread is expressed as a percentage of the CDS level. For the Fama-MacBeth regressions, obs is the number of cross-sections, R^2 is the arithmetic average of the R^2 s from the individual regressions, and the t statistics have been corrected for six months autocorrelation. For the panels, the specification includes time fixed-effects, and the reported t statistics are adjusted for clustering at the firm level.

APPENDIX A: CORPORATE ENTITIES WITH CDS AND STOCK MARKET DATA
 IN OUR SAMPLE FROM JAN 2001 TILL OCT 2004

ALBERTSONS INC AMR CORP AMERICAN INTERNATIONAL GROUP AOL TIME WARNER INC AT&T CORP AT&T WIRELESS SERVICES INC BELLSOUTH CORPORATION BOEING CO BURLINGTON NORTHERN SANTA FE CORP CAMPBELL SOUP CO CARNIVAL CORP CATERPILLAR INC CENDANT CORP CENTEX CORP CITIZENS COMMUNICATIONS CO. COCA-COLA ENTERPRISES INC COMCAST CABLE COMMUNICATIONS INC COMPAQ COMPUTER CORP COOPER TIRE & RUBBER COX COMMUNICATIONS INC CSX CORP CVS CORP DANA CORP DEERE AND CO DELL INC DELPHI CORP DELTA AIRLINES INC DOW CHEMICAL CO EASTMAN KODAK CO ELECTRONIC DATA SYSTEMS CORP ENRON CORP FEDERATED DEPARTMENT STORES INC FEDERAL EXPRESS CORP FORD MOTOR CREDIT CO GENERAL ELECTRIC CAPITAL CORP GENERAL MOTORS ACCEPTANCE CORP GEORGIA-PACIFIC CORP GOODYEAR TIRE AND RUBBER CO HARRAHS OPERATING CO INC HEWLETT-PACKARD CO	HILTON HOTELS CORP INTERNATIONAL BUSINESS MACHINES CORP INTERNATIONAL PAPER CO INTERPUBLIC GROUP COS. INC LIBERTY MEDIA CORP LOCKHEED MARTIN CORP LUCENT TECHNOLOGIES INC MARRIOTT INTERNATIONAL INC MAY DEPARTMENT STORES CO MAYTAG CORP MGM MIRAGE INC MOTOROLA INC NEIMAN MARCUS GROUP INC NEWS AMERICA INC NORDSTROM INC NORFOLK SOUTHERN CORP NORTHROP GRUMMAN CORP OMNICOM GROUP PARK PLACE ENTERTAINMENT CORP PHILIP MORRIS COS INC QWEST CAPITAL FUNDING INC RAYTHEON CO RJ REYNOLDS TOBACCO HOLDINGS INC SAFEWAY INC SBC COMMUNICATIONS INC SEARS ROEBUCK ACCEPTANCE SOUTHWEST AIRLINES CO SPRINT CORP SUN MICROSYSTEMS INC TARGET CORP TOYS R US INC TRW INC TYCO INTERNATIONAL LTD VERIZON GLOBAL FUNDING CORP VIACOM INC VISTEON CORP WAL-MART STORES INC WALT DISNEY CO WORLDCOM INC
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APPENDIX B: SYNDICATED LOAN ORIGINATING/PARTICIPATING BANKS

<p>ABN AMRO Bank Allfirst Bank ANZ Banking Group Banca Commerciale Italiana Banca di Roma Banca Nazionale del Lavoro Banca Popolare di Milano Banco Bilbao Vizcaya Argentaria Bank Brussels Lambert Bank of America Bank of Boston Bank of Hawaii Bank of Montreal Bank of New York Bank of Nova Scotia Bank of Tokyo-Mitsubishi BANK ONE Corp. Bankers Trust Co. Barclays Bank Bayerische Hypo-und Vereinsbank Bayerische Landesbank BNP Paribas CIBC CIC Banques Citicorp Comerica Bank Commerzbank CoreStates Bank Credit Agricole Credit Lyonnais Credit Suisse Crestar Bank Dai-Ichi Kangyo Bank Danske Bank</p>	<p>Deutsche Bank DG Bank Dresdner Bank Fifth Third Bank First Chicago Corp. First Hawaiian Bank First Tennessee Bank First Union Corp. Firststar Bank Fleet Bank Fortis Bank Fuji Bank Goldman Sachs & Co Hibernia National Bank HSBC HypoVereinsbank Industrial Bank of Japan ING Bank IntesaBci J.P. Morgan JP Morgan-Chase KBC Bank KeyCorp Kredietbank International Lehman Brothers Lloyds Bank Long Term Credit Bank Mellon Bank Merrill Lynch & Co Mitsubishi Trust & Banking Mizuho Bank Morgan Stanley National Australia Bank</p>	<p>National City Corp. NationsBank NatWest Bank Norddeutsche Landesbank Northern Trust Corp. PNC Bank Rabobank Regions Bank Royal Bank of Canada Royal Bank of Scotland Sakura Bank Salomon Smith Barney San Paolo IMI Santander Central Hispano Sanwa Bank Societe Generale Standard Chartered Bank State Street Bank & Trust Sumitomo Bank Suntrust Swiss Bank Corp. Tokai Bank Toronto Dominion Bank U.S. Bancorp UFJ Bank Union Bancorp Union Bank of Switzerland Wachovia Bank Wells Fargo Bank Westdeutsche Landesbank WestLB Westpac Banking Corp. William Street</p>
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