

PROPOSAL: INFORMATION CONTENT IN TRADED SYNDICATED LOANS

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The market for bank loans to corporate borrowers has undergone a significant transition over the past 15 years. Bank loans have historically been thought of as assets that are held to maturity by relationship lenders, who can then engage in frequent renegotiations with borrowers. Over the past decade, however, a variety of forces have led the loans to become in many ways more like bonds. Loans are traded, held largely by non-bank investors, undergo less renegotiation, and can be marked to market on a daily basis.

A number of possibly interesting research questions arise immediately. On one hand, several institutional features during the transition have reduced the nominal costs of trading loans, potentially benefitting banks that would like the freedom to better manage their balance sheets. At the same time, ease of trading has also induced non-bank players to enter the space (for example, hedge funds and mutual funds are now large investors in bank debt). As the composition of buyers and sellers changes, adverse selection costs—the risk of trading with a more informed counterparty—also changes. The net effect of lower trading costs together with potentially larger adverse selection costs are not clear. Related to this, we are interested in knowing how informed traders in this market are relative to securities markets for the same firms.

We have relatively unexplored data on daily loan prices for syndicated loans traded in the secondary market. The summer's work will include understanding fundamental patterns in the time series and cross section of loan returns. We will also match individual loans to related securities (equities and CDS for example) as well as the owners of the loans. Mutual funds, for example, since 2004, report total holdings of these assets. For 400 plus loan funds, we can track quarterly holdings to understand the extent to which these funds anticipate or cause price changes.

The scope for exploration is large here. Interested students will need to learn about a new market (one which differs from traditional liquid security markets). Ability to code in Stata and/or willingness to learn will be helpful. Finally, willingness to help painstakingly clean and match new data across different platforms is critical.