

# Seminar on Derivatives: First List of Readings

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The following is the reading list for the first 10 classes of the course. This is a tentative list; we will likely supplement these with other papers later.

## **Class 1. Structural Models of Credit-Risk: Theory**

1. Merton, R. (1974) On the pricing of corporate debt: The risk-structure of interest rates, *Journal of Finance* 29, 449-470.
2. Black, F. and J. Cox (1976) Valuing corporate securities: Some effects of bond indenture provisions, *Journal of Finance* 31, 351-367.
3. Geske, R. (1977) The valuation of corporate liabilities as compound options, *Journal of Financial and Quantitative Analysis* 12, 541-552.
4. Cooper, I. and A. Mello (1991) The default-risk of swaps, *Journal of Finance* 46, 597-620.
5. Shimko, D., N. Tejima and D. Van Deventer (1993) The pricing of risky debt when interest rates are stochastic, *Journal of Fixed Income* 3, 58-65.
6. Zhou, C. (1996) The term-structure of credit spreads with jump-risk, *Journal of Banking and Finance* 25, 2015-2040.
7. Longstaff, F. and E. Schwartz (1995) Valuing risky debt: A new approach, *Journal of Finance* 50, 789-821.
8. Saa-Requejo, J. and P. Santa-Clara (19xx) Bond pricing with default risk, Working Paper, UCLA.
9. Kim, J., K. Ramaswamy, and S. Sundaresan (1993) Does default-risk in coupons affect the valuation of corporate bonds? A contingent-claims model, *Financial Management* 22, 117-131.
10. Collin-Dufresne, P. and R. Goldstein (2001) Do credit spreads reflect stationary leverage ratios? *Journal of Finance* 56, 1929-1957.

## **Class 2. Structural Models: Empirical Implementation**

1. Jones, E., S. Mason and E. Rosenfeld (1984) Contingent claims analysis of corporate capital structures: An empirical investigation, *Journal of Finance* 39, 611-625.
2. Huang, J., and M. Huang (2003) How much of the corporate-treasury yield spread is due to credit risk? Results from a new calibration approach.
3. Eom, Y., J. Helwege and J. Huang (2004) Structural models of corporate bond pricing: An empirical analysis, *Review of Financial Studies* 17, 499-544.
4. Ericsson, J. and J. Reneby (2004) An empirical study of structural credit risk models using stock and bond prices, *Journal of Fixed Income* 13, 38-49.
5. Ericsson, J. and J. Reneby (2005) Estimating structural bond-pricing models, *Journal of Business* 78.
6. Ericsson, J., J. Reneby and H. Wang (2006) Can Structural Models Price Default Risk? Evidence from Bond and Credit Derivative Markets, mimeo.
7. G. Gemill (2002) Testing Merton's model for credit spreads on zero-coupon bonds, Working Paper, City University Business School, London.
8. Bharath, S.T. and T. Shumway (2006) Forecasting Default with the KMV-Merton Model, mimeo, University of Michigan.
9. T. Shumway (2001) Forecasting bankruptcy more accurately: A simple hazard model, *Journal of Business* 74, 101-124.

### **Class 3. Reduced-Form Models of Credit-Risk: Theory**

1. Litterman, R. and T. Iben (1991) Corporate bond valuation and the term-structure of credit spreads, *Journal of Portfolio Management*, Spring, 52-64.
2. Jarrow, R., and S. Turnbull (1995) Pricing derivatives on financial securities subject to credit risk, *Journal of Finance* 50, 53-85.
3. Duffie, D. and K. Singleton (1999) Modeling Term structures of defaultable bonds, *Review of Financial Studies* 12, 687-720.
4. Madan, D. and H. Unal (1998) Pricing the risks of default, *Review of Derivatives Research* 2, 121-160.
5. Lando, D. (1998) Cox processes and credit-risky securities, *Review of Derivatives Research* 2, 99-120.
6. Schönbucher, P. (1998) Term-structure modeling of defaultable bonds, *Review of Derivatives Research* 2, 161-192.
7. Das, S. and R. Sundaram (2000) A discrete-time approach to arbitrage-free pricing of credit derivatives, *Management Science* 46(1), 46-63.

### **Class 4: Reduced-Form Models: Empirical Implementation**

1. Duffee, G. (1998) The relationship between treasury yields and corporate bond yield spreads, *Journal of Finance* 53, 2225-2242.

2. Duffee, G. (1999) Estimating the price of default risk, *Review of Financial Studies* 12, 197-226.
3. Duffie, D., L. Pedersen, and K. Singleton (2003) Modeling sovereign yield spreads: A case-study of Russian debt, *Journal of Finance* 58.
4. Driessen, J. (2005) Is default event risk priced in corporate bonds? *Review of Financial Studies* 18, 165-195.

### **Class 5: Connecting the Dots**

1. Duffie, D. and D. Lando (2001) The term-structure of credit spreads with incomplete accounting information, *Econometrica* 69, 633-664.
2. Jarrow, R. and Protter (2004) Structural versus Reduced Form Models: A New Information Based Perspective, *Journal of Investment Management* 2, 34-43.
3. Carr, P., and V. Linetsky (2006) A Jump to Default Extended CEV Model: An Application of Bessel Processes, to appear in *Finance and Stochastics*.
4. Das, S. and R. Sundaram (2006) A Simple Unified Model for Pricing Derivative Securities with Equity, Interest-rate, and Default Risk, mimeo.
5. Elton, E., M. Gruber, D. Agrawal, and C. Mann (2001) Explaining the rate spread on corporate bonds, *Journal of Finance* 56, 247-277.
6. Collins-Dufresne, P., R. Goldstein, and Martin (2001) The determinants of credit spread changes, *Journal of Finance* 56, 2177-2208.

### **Class 6. Credit-Default Swaps, Bond Spreads, and Liquidity**

1. Longstaff, F., S. Mithal and E. Neis (2004) Corporate Yield Spreads: Default Risk or Liquidity? New Evidence from the Credit Default Swap market, *Journal of Finance*.
2. Blanco, R., S. Brennan, and I. Marsh (2004) An Empirical Analysis of the Dynamic Relation between Investment-Grade Bonds and Credit Default Swaps, *Journal of Finance*.
3. Zhang, F.X. (2001) What did the credit market expect of Argentina default? Evidence from default swap data, mimeo, Federal Reserve Board.
4. Acharya, V. and L. Pedersen (2005) Asset Pricing with Liquidity Risk, *Journal of Financial Economics* 77(2), 375-410.
5. Chacko, G., S. Mahanti, G. Mallick, and M. Subrahmanyam (2006) The determinants of liquidity in the corporate bond markets: An application of latent liquidity, mimeo.
6. De Jong, F. and J. Driessen (2005) Liquidity Risk Premia in Corporate Bond Markets, mimeo, University of Amsterdam.
7. Ericsson, J., J. Reneby, and R. Oviedo (2005) The determinants of credit-default swap premia, mimeo, McGill University.

8. Nashikkar, A. and M. Subrahmanyam (2006)

### **Class 7. The Role of Recovery Rates**

1. Altman, E., A. Sironi, and A. Resti (2001) Analyzing and explaining default recovery rates.
2. Altman, E., A. Sironi, and A. Resti (2003) Default recovery rates in credit risk modeling: A review of the literature and empirical evidence, Working Paper, NYU.
3. Altman, E., B. Brady, A. Sironi, and A. Resti (2003) The link between default and recovery rates: Theory, empirical evidence, and implications, *Journal of Business* 78.
4. Acharya, V., S. Bharath, and A. Srinivasan (2005) Does industry-wide distress affect defaulted firms? Evidence from creditor recoveries, mimeo, London Business School.
5. Dieckmann, S., J.S. Martin, and D. Strickland (2006) Bondholder recovery and time in default: Evidence from the roaring twenties, mimeo, Ohio State University.
6. Das, S.R. and P. Hanouna, Implied Recovery, mimeo, Santa Clara University.
7. Bakshi, G., D. Madan, and F. Zhang (2006) Recovery risk in defaultable debt models: Empirical comparisons and implied recovery rates, mimeo, UMCP.
8. Almeida, H., and T. Phillipon (2006) The Risk-Adjusted Cost of Financial Distress, mimeo, NYU.
9. Guha, R. and Sbuely (2006) Structural recovery of face value at default, mimeo.
10. Karoui, L. (2006) Modeling the term-structure of defaultable bonds under recovery risk, mimeo, McGill University.

### **Class 8. Credit Risk and Equity Returns**

1. Shumway, T. (2001) The de-Listing bias in CRSP returns, *Journal of Finance* 52, 327-340.
2. Vassalou, M. and Y. Xing (2003) Default risk in equity returns, *Journal of Finance* 59, 831-868.
3. L. Garlappi, T. Shu, and H. Yan (2005) Default risk, shareholder advantage and stock returns, mimeo, University of Texas.
4. Campbell, J., J. Hilscher, and J. Szilagyi (2005) In search of distress risk, mimeo, Harvard University.
5. Da, Z. and P. Gao (2005) Liquidity, limit-to-arbitrage, and premium for financial distress, mimeo, Northwestern University.
6. Avramov, D., T. Chordia, G. Jostova, and A. Philipov (2005) Momentum and credit rating, mimeo, University of Maryland.

### **Class 9. Liquidity and its Role in Credit Markets**

1. Chen, L., D. Lesmond, and J. Wei (2007) Corporate yield spreads and bond liquidity, *J. Finance* 62, 119-149.
2. DeJong, F., and J. Driessen (2006) Liquidity premia in corporate bond markets, Working paper, University of Amsterdam.
3. Edwards, A., L. Harris, and M. Piwowar (2007) Corporate bond market transaction costs and transparency, *J. Finance* 62, 1421-1451.
4. Green, R.C. (2007) Presidential Address: Issuers, underwriter syndicates, and after-market transparency, *J. Finance* 62, 1529-1550.
5. Green, R.C., B. Hollifield, and N., S (2007a) Dealer intermediation and price behavior in the aftermarket for new bond issues, *J. Fin. Econ.* 86, 643-682.
6. Green, R.C., B. Hollifield, and N., S (2007b) Financial intermediation and the costs of trading in an opaque market, *Rev. Fin. Stud.* 20, 274-314.
7. Houwelling, P., A. Mentink, and T. Vorst (2003) How to measure corporate bond liquidity, Working Paper, Erasmus University.
8. Mahanti, S., A. Nashikkar, M. Sunrahmanyam, G. Chacko, and G. Mallik (2008) Latent liquidity: A new measure of liquidity with an application to corporate bonds, *J. Fin. Econ.* forthcoming.

#### **Class 10. Structural Models: Corporate-Finance Extensions**

1. Black, F. and J. Cox (1976) Valuing corporate securities: Some effects of bond indenture provisions, *Journal of Finance* 31, 351-367.
2. Leland, H. (1994) Corporate debt value, bond covenants, and optimal capital structure, *Journal of Finance* 49, 1213-1252.
3. Leland, H., and K.-B. Toft (1996) Optimal capital structure, endogenous bankruptcy, and the term-structure of credit spreads, *Journal of Finance* 51, 987-1019.
4. Anderson, R. and S. Sundaresan (1996) Design and valuation of debt contracts, *Review of Financial Studies* 9, 37-68.
5. Mella-Barral, P. and W. Perraudin (1997) Strategic Debt Service, *Journal of Finance* 52, 531-566.
6. Anderson, R., S. Sundaresan, and P. Tychon (1997)
7. Fan, and S. Sundaresan

#### **Class 11. Correlated Default Modeling and the Subprime Crisis**

1. To be listed.