



**Actuarial
Research Centre**

Institute and Faculty
of Actuaries

Actuarial Research Centre (ARC)

PhD studentship output

The Actuarial Research Centre (ARC) is the Institute and Faculty of Actuaries' network of actuarial researchers around the world.

The ARC seeks to deliver research programmes that bridge academic rigour with practitioner needs by working collaboratively with academics, industry and other actuarial bodies.

The ARC supports actuarial researchers around the world in the delivery of cutting-edge research programmes that aim to address some of the significant challenges in actuarial science.



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Workshop on Bond Spreads and Liquidity, 8 May 2013

Venue: Council Chamber, Staple Inn, High Holborn

Workshop time: 13:00 – 17:00
Light lunch served from 12:00

Organisers:

Professor Andrew Cairns, Actuarial Research Centre
Professor Alexander McNeil, Scottish Financial Risk Academy
Alex Veys, CIO, Partnership Assurance

Sponsors:

The Institute and Faculty of Actuaries, Scottish Financial Risk Academy,
Partnership Assurance

Rationale for Event

The Actuarial Research Centre, in association with the above sponsors, is directing a three-year PhD project at Heriot-Watt University to investigate the value in corporate bond spreads. This early event will bring together a group of market participants, consultants and academics to discuss and dissect this value. Discussion will focus on a variety of factors including the notorious liquidity/ illiquidity premium. Indeed, given the current debate, and high profile of this issue in regulation, one of the aims of this short conference is to achieve greater clarity on the factors that contribute to a corporate bond's spread and thus allow a more robust view of market-consistent valuation.

Questions of interest include:

- What components contribute to the spread of a corporate bond's yield over risk free rates?
- What is a risk free rate?
- Do different market participants have different views on the factors that contribute to the fair value, or spread, of corporate bonds?
- Can liquidity and/or illiquidity premia be robustly quantified?
- Do liquidity and/or illiquidity premia have a role in market-consistent valuation for solvency purposes?



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Light lunch served from 12:00

Welcome (13:00 – 13:05)

Session 1 (13:05 – 14:45)

Practitioner insights into the nature of corporate bond spreads

Session chair: Alex Veys (Partnership Assurance)

Scene Setting Contributions 13:05 - 13:40

13:05 Alex Veys

13:10 Etienne Comon (Goldman Sachs)

13:20 Tony Gould (JP Morgan)

13:30 Discussion of Data, Paul van Loon (Heriot-Watt University)

Discussion 13:40 – 14:45

Coffee break (14:45 – 15.15)

Session 2 (15.15 – 17.00)

Current thinking on the use (or abuse) of liquidity/illiquidity premia

Session chair: John Hibbert

Spoken contributions 15.15 – 15.55

15.15 John Hibbert

15.25 Philipp Keller (Deloitte)

30 minute talk “Liquidity Premium and other Aberrations”

Discussion 15.55 – 17.00

Closing Comments (17:00)

Workshop on Bond Spreads and Liquidity
May 8, 2013, Staple Inn, London
Hosted by the Actuarial Research Centre

Sponsors:

- ^ Scottish Financial Risk Academy
- ^ Partnership Life Assurance
- ^ The Institute and Faculty of Actuaries

Attendees: 25 in total from a wide range of relevant backgrounds including insurance, banking, bond investors, consultants and academics.

The meeting began with introductory remarks by Andrew Cairns and Alex Veys, setting the scene and outlining objectives for the afternoon ahead. The two sessions each had two parts: some introductory remarks by invited speakers followed by around one hour of free discussion. The meeting was conducted under the Chatham House Rule. Both sessions gave rise to very lively discussions helped by the variety of backgrounds of those present and most of the workshop participants contributed to the discussions.

Session 1 started with focused on components of the credit spread. Identification of the credit spread itself was even an issue with some disagreement over what was the appropriate risk free (zero-coupon) yield curve: one speaker favouring SONIA and another the gilts curve. Components of the credit spread include credit risk (including default and rerating), liquidity, taxes and management costs, and funding costs (the opportunity cost of having funds tied up in bonds); each category is then subdivided into the true expected cost and an additional component for the risk associated with each component (risk premium). Part of these risk premia reflects the varying levels of investors' aversion to each risk type. One speaker noted the changing nature of the market and how the role of key stakeholders is changing: assessment of illiquidity premia over time needs to reflect this. The third speaker (Paul van Loon, the sponsored PhD student) outlined the iBoxx dataset that has been acquired for the project. He discussed some of the interesting features of the data and how the database might be used to filter out illiquidity premia. Invited speakers and discussants expressed a variety of views on the levels of illiquidity premia and how these vary over time. An important and invaluable element of the discussion concerned what other data sources might be relevant in the identification of the illiquidity premium.

Session 2 involved discussion of the role of illiquidity premia in the valuation of insurance liabilities. There were two invited speakers: one in favour of using an illiquidity premium; the other against. Both speakers gave well founded arguments to back up their points of view. In the discussion, a clear majority of those present were in favour of using illiquidity premia in the valuation of liabilities, although there seemed to be some disagreement over details of how to do this.

Overall, the day was considered to be a success: the only regret being that the lively discussions could have gone on for longer. The PhD team benefited greatly from the presentations and discussion and have a number of good ideas to reflect upon and develop as part of the project beyond what had been considered so far.

Andrew Cairns, 14 May 2013