Frailty Correlated Default

We analyze portfolio credit risk in light of dynamic “frailty,” in the form of incompletely observed default. Common dependence by firms on unobservable time-varying default covariates is estimated to cause large changes in conditional mean default rates above and beyond those predicted by observable factors, and large increases in the fatness of the tails of the distributions of portfolio default losses for U.S. corporates. We also allow for unobserved heterogeneity across firms.

Joint work with Andreas Eckner, Guillaume Horel, and Leandro Saita.