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Single-name CDS Review – Executive Summary

A new review of empirical academic literature commissioned by ISDA shows that single-name credit default swaps (CDS) remain an efficient tool for hedging credit risk and can have a positive impact on the economy.

USEFUL

- According to the literature review, the single-name CDS market has a positive impact on the supply of credit to many reference entities underlying traded CDS, suggesting the ability of lenders to hedge their credit exposures can make them more willing to extend credit. The paper cites research that finds banks make larger and longer-dated loans to CDS reference entities.
- The empirical evidence suggests the availability of single-name CDS often results in lower borrowing costs for some corporate and sovereign reference entities, especially those that are lower risk and more transparent.
- The review of academic literature finds that single-name CDS play a valuable role in aggregating and reflecting information on the likelihood of future credit events at corporate and sovereign reference entities and market expectations on recovery rates, often well before bond (and sometimes equity) markets.

SAFE

- The literature review suggests single-name CDS are a source of interconnectivity in the financial system, but empirical evidence does not support the claim that these products are a fundamental cause of market stress.
- There is little evidence to suggest that single-name CDS were a causal factor in the eurozone sovereign debt crisis of 2010, but instead reflected underlying fiscal problems in the single currency system and global macroeconomic risk factors.
- The literature review suggests evidence for the 'empty creditor' hypothesis is mixed. Although some evidence appears to support the hypothesis, which suggests lenders that have hedged their extensions of credit to companies have an incentive to push distressed borrowers into bankruptcy, other research presents evidence that is at odds with this theory.

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THE MARKET

- Notional outstanding in the single-name CDS market was $7.2 trillion at the end of 2015, according to the Bank for International Settlements. The market is less than half the size it was in 2011.
- Changes have been made to the market to bolster trading activity, including a reduction in the frequency with which single-name CDS roll to new on-the-run contracts, and a commitment to CDS clearing from large buy-side participants.

THE RESEARCH

Written by Dr. Christopher Culp and Dr. Andria van der Merwe, both research fellows at the Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise, and Bettina Stärkle, a consultant at Risk Management Consulting Services, Inc., the paper summarizes the empirical analyses from more than 260 published academic articles and working papers on the benefits and costs of single-name CDS.

Further Reading

Single-name Credit Default Swaps: A Review of the Empirical Academic Literature: *http://isda.link/singlenamecds*

ISDA press release – 25 Investment Management Firms Commit to Single-Name CDS Clearing: *http://isda.link/singlenamecdsclear*

ISDA press release – ISDA Publishes Recommendation for an Amendment to the Single-Name CDS Roll Frequency: *http://isda.link/singlenamecdsroll*