ISDA Safe, Efficient Markets

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ISDA Publishes New Academic Paper on Single-name CDS Market

NEW YORK, September 12, 2016 – A new academic literature review commissioned by the International Swaps and Derivatives Association, Inc. (ISDA) and published today 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.

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.

The review shows that 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 also 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.

Another key finding is that single-name CDS provide useful information about the likelihood of future adverse credit events, including rating agency downgrades and defaults. This information is often available well before it is apparent in bond and sometimes equity markets.

"The empirical literature reviewed in this new paper supports the view that the single-name CDS market plays a useful role in the global economy. The data indicates the CDS market has a positive impact on credit supply to reference entities, and provides useful information about the likelihood of future adverse credit events," says Scott O'Malia, ISDA's Chief Executive. "We will continue to work with our members and the wider industry to support the functioning of this market."

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The paper also explores common criticisms of the single-name CDS market, including the claim that the instrument was a causal factor in the eurozone sovereign debt crisis from 2010. The literature review finds little evidence to support this, with most research instead indicating that CDS spreads reflected underlying fiscal problems in the single currency system and global macroeconomic risk factors.

While the literature review suggests single-name CDS are a source of interconnectivity in the financial system, the empirical evidence does not support the claim that these products are a fundamental cause of market stress.

ISDA has worked to support liquidity in the single-name CDS market – for instance, by reducing the frequency with which single-name CDS roll to new on-the-run contracts, and coordinating a commitment to clear single-name CDS contracts by a group of buy-side firms.

The paper, *Single-name Credit Default Swaps: A Review of the Empirical Academic Literature*, can be viewed by clicking here.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.