



TOPICS:

Market risk

SOURCE

European Systemic Risk Board

ESRB: Credit Default Swaps – Analysis and Policies

- The ESRB's report critically examines **the structure, regulation and systemic implications of single-name credit default swap (CDS) markets**. Despite significant post-crisis reforms, CDS markets continue to exhibit vulnerabilities, notably in terms of concentration, illiquidity, and opacity. The report highlights that CDS spreads - used extensively in credit risk assessment - can drive contagion during market stress due to their influence on funding costs and market sentiment, often amplifying financial instability.
- The report identifies **three core market imperfections: limited liquidity, high concentration** among trading counterparties and significant **information asymmetries**. It finds that price-forming CDS trades are infrequent and dominated by a small number of participants, especially around major market events or contract rollover dates. Additionally, a large proportion of CDS contracts - particularly those referencing EU sovereigns and global systemically important banks (G-SIBs) - remain outside EU post-trade transparency and clearing mandates.

Cross-border exposures further hinder oversight, as transactions involving non-EU counterparties frequently evade EU reporting regimes.

- **Data quality issues** persist over a decade after EMIR's implementation, with missing or inconsistent reporting on key metrics such as variation margins and reference obligations. These deficiencies limit supervisors' ability to monitor systemic risk and assess market resilience effectively.
- To address these challenges, **the report proposes** four policy measures aligned with three objectives: **improving market functioning, enhancing transparency and strengthening supervisory oversight**. Key proposals include expanding post-trade transparency to all CDSs referencing EU G-SIBs and sovereigns, improving data standardisation and quality, enhancing international cooperation and reducing overreliance on CDS spreads in risk assessments.

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