DOWNLOAD PDF THE CREDIT DEFAULT SWAP BASIS

Chapter 1 : Credit default swaps (video) | Credit crisis | Khan Academy

The credit default swap basis (the basis) defines the relationship between the cash and synthetic credit markets. Finance professionals need to understand the drivers of the basis in order to better undertake investment and relative value analysis.

And it has pretty Bloomberg charts! As everyone probably knows by know, a CDS is insurance against default on a bond or bond-like security. If you think about it for a while, you will realize that this means the price of the CDS reflects the market expectation that the issuer will default. For example, right now a Citigroup CDS has a spread of CDS exist for various durations and on many different kinds of debt. That means that the contract will be open for 5 years, during which one party the insured pays premiums and the other the insurer promises to pay off if Citigroup defaults. If there is no default within 5 years, the insurer gets to keep the premiums. Look at it from the standpoint of the insurer. That implies that I think there is about a Actually, my expectation of a default is actually somewhat higher, for a couple of reasons. For example, Lehman bonds were only worth 9 cents on the dollar so insurers had to pay out 91 cents , but Washington Mutual bonds were worth 57 cents. So my net loss will be lower, which means that my expectation of a default is higher. The expectation is the money I expect to gain if there is no default, divided by the net amount I expect to lose if there is a default. Luckily, Bloomberg can calculate all of this for you, and right now they say the chance of a Citigroup default in the next 5 years is You can see the valuation on the right side of the screen below. Because CDS have shown the ability to identify what financial institutions or countries are going to get into trouble next. And this tends to happen before you start reading about that company in the newspaper. Note that the price started climbing steeply in late February. It looks like an instantaneous spike in mid-September, but the price had been climbing steadily, from double digits in May to bp in mid-August to bp on September 4. The first Times article appeared on September 12, again describing events on September By September 10, however, CDS spreads were already up to bp. And this is Iceland. They spent most of July and August this year in the high s, passed in mid-September, and reached bp on Friday, September Iceland only reached the attention of the mainstream media on Monday, September 29 Times article the next day, in which Iceland barely got a mention. So whose CDS spreads are climbing now? That will have to wait for another, or several other, posts. Felix Salmon says that CDS spreads are no longer accurate predictors of defaults.

Chapter 2 : Get Positive Results With Negative Basis Trades

The credit default swap basis: illustrating positive and negative basis arbitrage trades A basis exists in any market where cash and derivative forms of the same asset are traded.

The investor might therefore buy CDS protection on a company to speculate that it is about to default. Investors could go long on a bond without any upfront cost of buying a bond; all the investor need do was promise to pay in the event of default. Note that there is a third possibility in the above scenario; the hedge fund could decide to liquidate its position after a certain period of time in an attempt to realise its gains or losses. After 1 year, the market now considers Risky Corp more likely to default, so its CDS spread has widened from to basis points. In another scenario, after one year the market now considers Risky much less likely to default, so its CDS spread has tightened from to basis points. Transactions such as these do not even have to be entered into over the long-term. Credit default swaps are also used to structure synthetic collateralized debt obligations CDOs. Instead of owning bonds or loans, a synthetic CDO gets credit exposure to a portfolio of fixed income assets without owning those assets through the use of CDS. Naked credit default swaps[edit] Parts of this article those related to legality of naked CDS in Europe need to be updated. Please update this article to reflect recent events or newly available information. November In the examples above, the hedge fund did not own any debt of Risky Corp. Legislation is under consideration by Congress as part of financial reform. Analogizing to the concept of insurable interest , critics say you should not be able to buy a CDSâ€"insurance against defaultâ€"when you do not own the bond. Because naked credit default swaps are synthetic, there is no limit to how many can be sold. They prefer greater transparency and better capitalization requirements. Proponents of naked credit default swaps say that short selling in various forms, whether credit default swaps, options or futures, has the beneficial effect of increasing liquidity in the marketplace. Without speculators buying and selling naked CDSs, banks wanting to hedge might not find a ready seller of protection. A robust market in credit default swaps can also serve as a barometer to regulators and investors about the credit health of a company or country. Congress proposed giving a public authority the power to limit the use of CDSs other than for hedging purposes, but the bill did not become law. A bank, for example, may hedge its risk that a borrower may default on a loan by entering into a CDS contract as the buyer of protection. If the loan goes into default, the proceeds from the CDS contract cancel out the losses on the underlying debt. The bank could sell that is, assign the loan outright or bring in other banks as participants. Consent of the corporate borrower is often required. The bank may not want to incur the time and cost to find loan participants. In addition, the bank simply may not want to sell or share the potential profits from the loan. By buying a credit default swap, the bank can lay off default risk while still keeping the loan in its portfolio. The bank can lay off some of this risk by buying a CDS. Because the borrowerâ€"the reference entityâ€"is not a party to a credit default swap, entering into a CDS allows the bank to achieve its diversity objectives without impacting its loan portfolio or customer relations. This frees resources the bank can use to make other loans to the same key customer or to other borrowers. Holders of corporate bonds, such as banks, pension funds or insurance companies, may buy a CDS as a hedge for similar reasons. In addition to financial institutions, large suppliers can use a credit default swap on a public bond issue or a basket of similar risks as a proxy for its own credit risk exposure on receivables. However, if its outlook worsens then its CDS spread should widen and its stock price should fall. Therefore, a basic strategy would be to go long on the CDS spread by buying CDS protection while simultaneously hedging oneself by buying the underlying stock. Another common arbitrage strategy aims to exploit the fact that the swap-adjusted spread of a CDS should trade closely with that of the underlying cash bond issued by the reference entity. Misalignments in spreads may occur due to technical reasons such as: Specific settlement differences Shortages in a particular underlying instrument The cost of funding a position Existence of buyers constrained from buying exotic derivatives. The difference between CDS spreads and asset swap spreads is called the basis and should theoretically be close to zero. Basis trades can aim to exploit any differences to make risk-free profit. Conception[edit] Forms of credit default swaps had been in existence from at least the early s, [50] with early trades carried out by Bankers Trust in A team

of J. Morgan bankers led by Blythe Masters then sold the credit risk from the credit line to the European Bank of Reconstruction and Development in order to cut the reserves that J. Banks also saw an opportunity to free up regulatory capital. By , investors as speculators, rather than banks as hedgers, dominated the market. An extended market could not emerge until , when ISDA standardized the documentation for credit default swaps. On September 15, , the New York Fed summoned 14 banks to its offices. Billions of dollars of CDS were traded daily but the record keeping was more than two weeks behind. Numbers followed by "Y" indicate years until maturity. The black disc represents the public debt. Since default is a relatively rare occurrence historically around 0. Thus, although the above figures for outstanding notionals are very large, in the absence of default the net cash flows are only a small fraction of this total: Regulatory concerns over CDS[edit] The market for Credit Default Swaps attracted considerable concern from regulators after a number of large scale incidents in , starting with the collapse of Bear Stearns. It has been suggested that this widening was responsible for the perception that Bear Stearns was vulnerable, and therefore restricted its access to wholesale capital, which eventually led to its forced sale to JP Morgan in March. Market participants co-operated so that CDS sellers were allowed to deduct from their payouts the inbound funds due to them from their hedging positions. Dealers generally attempt to remain risk-neutral, so that their losses and gains after big events offset each other. The CDS on Lehman were settled smoothly, as was largely the case for the other 11 credit events occurring in that triggered payouts. In there was no centralized exchange or clearing house for CDS transactions; they were all done over the counter OTC. This led to recent calls for the market to open up in terms of transparency and regulation. ICE collects on every trade. Terhune Bloomberg Business Week Securities and Exchange Commission granted an exemption for Intercontinental Exchange to begin guaranteeing credit-default swaps. According to Deutsche Bank managing director Athanassios Diplas "the industry pushed through 10 years worth of changes in just a few months". By late processes had been introduced allowing CDSs that offset each other to be cancelled. Two of the key changes are: The introduction of central clearing houses, one for the US and one for Europe. A clearing house acts as the central counterparty to both sides of a CDS transaction, thereby reducing the counterparty risk that both buyer and seller face. The international standardization of CDS contracts, to prevent legal disputes in ambiguous cases where what the payout should be is unclear. Trading will be much easier It launched Single Name clearing in Dec On March 3, its proposed acquisition of Clearing Corp. We believe that CME should be in a position soon to provide us with the information necessary to allow the commission to take action on its exemptive requests. Intercontinental said in the statement today that all market participants such as hedge funds, banks or other institutions are open to become members of the clearinghouse as long as they meet these requirements. A clearinghouse acts as the buyer to every seller and seller to every buyer, reducing the risk of counterparty defaulting on a transaction. In the over-the-counter market, where credit- default swaps are currently traded, participants are exposed to each other in case of a default. Morgan losses[edit] In April , hedge fund insiders became aware that the market in credit default swaps was possibly being affected by the activities of Bruno Iksil , a trader for J. Heavy opposing bets to his positions are known to have been made by traders, including another branch of J. Morgan, who purchased the derivatives offered by J. Morgan in such high volume. The disclosure, which resulted in headlines in the media, did not disclose the exact nature of the trading involved, which remains in progress. The period over which default protection extends is defined by the contract effective date and scheduled termination date. The confirmation also specifies a calculation agent who is responsible for making determinations as to successors and substitute reference obligations for example necessary if the original reference obligation was a loan that is repaid before the expiry of the contract , and for performing various calculation and administrative functions in connection with the transaction. By market convention, in contracts between CDS dealers and end-users, the dealer is generally the calculation agent, and in contracts between CDS dealers, the protection seller is generally the calculation agent. It is not the responsibility of the calculation agent to determine whether or not a credit event has occurred but rather a matter of fact that, pursuant to the terms of typical contracts, must be supported by publicly available information delivered along with a credit event notice. Typical CDS contracts do not provide an internal mechanism for challenging the occurrence or non-occurrence of a credit event and rather leave the matter to

the courts if necessary, though actual instances of specific events being disputed are relatively rare. CDS confirmations also specify the credit events that will give rise to payment obligations by the protection seller and delivery obligations by the protection buyer. Typical credit events include bankruptcy with respect to the reference entity and failure to pay with respect to its direct or guaranteed bond or loan debt. CDS written on North American investment grade corporate reference entities, European corporate reference entities and sovereigns generally also include restructuring as a credit event, whereas trades referencing North American high-yield corporate reference entities typically do not. Finally, standard CDS contracts specify deliverable obligation characteristics that limit the range of obligations that a protection buyer may deliver upon a credit event. Trading conventions for deliverable obligation characteristics vary for different markets and CDS contract types. Typical limitations include that deliverable debt be a bond or loan, that it have a maximum maturity of 30 years, that it not be subordinated, that it not be subject to transfer restrictions other than Rule A , that it be of a standard currency and that it not be subject to some contingency before becoming due. The premium payments are generally quarterly, with maturity dates and likewise premium payment dates falling on March 20, June 20, September 20, and December Credit default swap and sovereign debt crisis[edit] Main article: Causes of the European sovereign-debt crisis Sovereign credit default swap prices of selected European countries The European sovereign debt crisis resulted from a combination of complex factors, including the globalisation of finance ; easy credit conditions during the â€" period that encouraged high-risk lending and borrowing practices; the â€" global financial crisis ; international trade imbalances; real-estate bubbles that have since burst; the â€" global recession ; fiscal policy choices related to government revenues and expenses; and approaches used by nations to bail out troubled banking industries and private bondholders, assuming private debt burdens or socialising losses. The Credit default swap market also reveals the beginning of the sovereign crisis. During the Greek sovereign debt crisis, one important issue was whether the restructuring would trigger Credit default swap CDS payments. European Central Bank and the International Monetary Fund negotiators avoided these triggers as they could have jeopardized the stability of major European banks who had been protection writers. An alternative could have been to create new CDS which clearly would pay in the event of debt restructuring. The market would have paid the spread between these and old potentially more ambiguous CDS. This practice is far more typical in jurisdictions that do not provide protective status to insolvent debtors similar to that provided by Chapter 11 of the United States Bankruptcy Code.

Chapter 3 : Can the Credit-Default-Swap Market Be Fixed? - Barron's

Book Description. The growth of the credit derviatives market has produced a liquid market in credit default swaps across the credit curve, and this liquidity has led many investors to access both the credit derivative and cash bond markets to meet their investment requirements.

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit http: By June 8, 4: The talks follow what many see as financial gamesmanship that broke the contracts. Maligned in the financial crisis, CDS are drawing scrutiny again. Even the Vatican has condemned their use. As banks have pulled back from CDS and trading has contracted, users now skew toward investors seasoned in trading distressed assets, who often lock horns in court fights and exploit legal loopholes, wrangling basis points out of corporate distress and one another. And in a low-yielding world, investors have had to get more creative and use ever-sharper elbows, to generate returns. In CDS, sellers agree to pay buyers in the event of a default or other trigger. Fans argue that such contracts have legitimate uses, like offsetting risk or guarding against losses, that can help lower corporate financing costs. As interest rates climb and defaults appear poised to rise, CDS are newly relevant for many investors. How much the contracts pay is set by the cheapest outstanding bond. To control for that, GSO built a cheap bond. GSO denied any wrongdoing. Still, some of its trades have raised hackles. It also helped J. Crew move intellectual property from one debt-issuing unit to another, leaving some lenders with far less value; Eaton Vance and Highland Capital sued. Even within GSO, the creativity of the group spearheading these trades earned it a homemade epithet deriding its use of aggressionâ€”complete with a swear. Blackstone denies the use of the name. Whether such trades are creative or abusive is a matter of perspective. Still, the Hovnanian trade brought scrutiny. No CDS were triggered. The market has chattered about potential copycats: Companies can abruptly decide to issue elsewhere, or pay down debt, or take on more debt. Active CDS users are now looking for changes to thwart future gamesmanship. Investors are paid to be creative, to use every lever to generate returns. One loophole gives way to another. Or make nonpayments to affiliates not count. Even so, the almost-consensus of the working group is trying. With the litigation resolved, it can make suggestions without appearing to take a side. People briefed on the conversations say the group will suggest tweaks that introduce just enough subjectivity to close the loophole and prevent these triggers. So this may not be the end of CDS gamesmanship. CDS users are damned to endlessly edit contracts and launch updated protocols, an eternal loophole Whac-A-Mole. Write to Mary Childs at mary.

DOWNLOAD PDF THE CREDIT DEFAULT SWAP BASIS

Chapter 4 : the credit default swap basis ebooks preview

An up-to-date resource on the intricacies of the credit defaultswap basis While credit default swaps and credit derivatives are of greatconcern to many in the field of finance, the Second Editionof The Credit Default Swap Basis does not directly focus onthese issues.

HPB condition ratings New: Item is brand new, unused and unmarked, in flawless condition. No defects, little usage. May show remainder marks. Older books may show minor flaws. Shows some signs of wear and is no longer fresh. Used textbooks do not come with supplemental materials. Average used book with all pages present. Possible loose bindings, highlighting, cocked spine or torn dust jackets. Obviously well-worn, but no text pages missing. May be without endpapers or title page. Markings do not interfere with readability. All text is legible but may be soiled and have binding defects. Reading copies and binding copies fall into this category. Mint condition or still sealed SS. Absolutely perfect in every way. No defects, little sign of use, well cared for. Not necessarily sealed or unused, but close. Could be an unopened promotional or cut item. Will show some signs that it was played and otherwise handled by a previous owner who took good care of it. Attractive and well cared for, but no longer fresh. Minor signs of wear, scuffing or scratching, but will play almost perfectly. This item is in okay condition. Obviously well-worn and handled. Most vinyl collectors will not buy good or below, but some tracks on CD or vinyl will play. This movie is unopened and brand new. No defects, little sign of use. No skipping; no fuzzy or snowy frames in VHS. Attractive and well cared for but no longer fresh. Minor signs of wear, but will play almost perfectly. This item is in okay condition and basically works well. Basically plays, but may be obviously well-worn with some scratching or tape distortion. Disc or tape is intact, but may be scratched or stretched. There may be skips or distortion or product defects. Sign up for bookish emails And get a coupon for your first purchase.

DOWNLOAD PDF THE CREDIT DEFAULT SWAP BASIS

Chapter 5 : The Credit Default Swap Basis - Moorad Choudhry - Google Books

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The negative basis trade has experienced that type of heyday, specifically for trades involving single corporate issuers. This concept can be transferred to the credit derivatives market, where basis represents the difference in spread between credit default swaps CDS and bonds for the same debt issuer and with similar, if not exactly equal maturities. In the credit derivatives market, basis can be positive or negative. A negative basis means that the CDS spread is smaller than the bond spread. The spread they are talking about is the difference between the bid and ask price over the treasury yield curve treasuries are generally considered a riskless asset. Because interest rates and bond prices are inversely related, a larger spread means the security is cheaper. So you might hear a fixed-income trader mention the difference in spread between synthetic and cash bonds when they are talking about negative basis opportunities. Executing a Negative Basis Trade To capitalize on the difference in spreads between the cash market and the derivative market, you need to buy the "cheap" asset and sell the "expensive" asset, just like the old adage of "buy low, sell high. You can think of this as an equation: As the basis narrows, the negative basis trade will become more profitable. The trade is usually done with bonds that are trading at par or at a discount, and a single-name CDS as opposed to an index CDS of a tenor equal to the maturity of the bond the tenor of a CDS is akin to maturity. The cash bond is purchased, while simultaneously the synthetic single-name CDS is shorted. When you short a credit default swap, this means you have bought protection, much like an insurance premium. While this might seem counterintuitive, just remember that buying protection means you have the right to sell the bond at par value to the seller of protection in the event of default or another negative credit event. So, buying protection is equal to a short. What Is Short Selling? While the basic structure of the negative basis trade is fairly simple, the complications arise when trying to identify the most viable trade opportunity, then monitoring that trade for the best opportunity to take profits. Market Conditions Create Opportunities There are technical market-driven and fundamental conditions that create negative basis opportunities. Negative basis trades are usually done based on technical reasons as it is assumed that the relationship is temporary and will eventually revert to a basis of zero. Many people use the synthetic products as part of their hedging strategies, which can cause valuation disparities vs. At these times traders prefer the synthetic market because it is more liquid than the cash market. Holders of cash bonds may be unwilling or unable to sell the bonds they hold as part of their longer-term investment strategies. Therefore, they might look to the CDS market to buy protection on a specific company or issuer rather than simply sell their bonds. Magnify this effect during a crunch in the credit markets , and you can see why these opportunities exist during market dislocations. Nothing Lasts Forever Since market dislocations or " credit crunches " create the conditions for a negative basis trade to be possible, it is very important for the holders of this trade to be monitoring the marketplace constantly. Once market conditions revert back to historical norms, spreads also go back to "normal" and liquidity returns to the cash market, the negative basis trade will no longer be attractive. But as history has taught us, another trading opportunity is always around the corner. It never takes very long for markets to correct inefficiencies, or to create new ones. Trading Center Want to learn how to invest? Get a free 10 week email series that will teach you how to start investing. Delivered twice a week, straight to your inbox.

Chapter 6 : The Credit Default Swap Basis by Moorad Choudhry

A credit default swap (CDS) is a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a debt default (by the debtor) or other credit event. That is, the seller of the CDS insures the buyer against some reference asset defaulting.

While institutions that issue these forms of debt may have a relatively high degree of confidence in the security of their position, they have no way of guaranteeing that they will be able to make good on their debt. Because these kinds of debt securities will often have lengthy terms to maturity , like ten years or more, it will often be difficult for the issuer to know with certainty that in ten years time or more, they will be in a sound financial position. If the security in question is not well-rated, a default on the part of the issuer may be more likely. Credit Default Swap as Insurance A credit default swap is, in effect, insurance against non-payment. Through a CDS, the buyer can mitigate the risk of their investment by shifting all or a portion of that risk onto an insurance company or other CDS seller in exchange for a periodic fee. In this way, the buyer of a credit default swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the debt security. For example, the buyer of a credit default swap will be entitled to the par value of the contract by the seller of the swap, should the issuer default on payments. If the debt issuer does not default and if all goes well the CDS buyer will end up losing some money, but the buyer stands to lose a much greater proportion of their investment if the issuer defaults and if they have not bought a CDS. As such, the more the holder of a security thinks its issuer is likely to default, the more desirable a CDS is and the more the premium is worth it. Credit Default Swap in Context Any situation involving a credit default swap will have a minimum of three parties. The first party involved is the financial institution that issued the debt security in the first place. These may be bonds or other kinds of securities and are essentially a small loan that the debt issuer takes out from the security buyer. Yet, because the debt issuer cannot guarantee that they will be able repay the premium, the debt buyer has taken on risk. The debt buyer in question is the second party in this exchange and will also be the CDS buyer should they agree to enter into a CDS contract. The third party , the CDS seller, is most often an institutional investing organization involved in credit speculation and will guarantee the underlying debt between the issuer of the security and the buyer. If the CDS seller believes that the risk on securities that a particular issuer has sold is lower than many people believe, they will attempt to sell credit default swaps to people who hold those securities in an effort to make a profit. CDS trading is very complex and risk-oriented and, combined with the fact that credit default swaps are traded over-the-counter meaning they are unregulated , the CDS market is prone to a high degree of speculation. Speculators who think that the issuer of a debt security is likely to default will often choose to purchase those securities and a CDS contract as well. This way, they ensure that they will receive their premium and interest even though they believe the issuing institution will default. On the other hand, speculators who think that the issuer is unlikely to default may offer to sell a CDS contract to a holder of the security in question and be confident that, even though they are taking on risk, their investment is safe. In fact, CDS contracts can be bought or sold at any point during their lifetime before their expiration date and there is an entire market devoted to the trading of CDS contracts. It is even possible for investors to effectively switch sides on a credit default swap to which they are already a party. For example, if a speculator that initially issued a CDS contract to a security-holder believes that the security-issuing institution in question is likely to default, the speculator can sell the contract to another speculator on the CDS market, buy securities issued by the institution in question and a CDS contract as well in order to protect that investment.

Chapter 7 : Credit Default Swap (CDS) - A Major Player in the Financial Crisis

Understanding the drivers of basis between Credit Default Swaps (CDS) and bond spreads is important in correctly interpreting prices from each market.

Key unfunded credit derivative products[edit] Credit default swap[edit] Main article: Credit default swap The credit default swap or CDS has become the cornerstone product of the credit derivatives market. This product represents over thirty percent of the credit derivatives market. A powerful recent variation has been gathering market share of late: A credit linked note is a note whose cash flow depends upon an event, which may be a default, change in credit spread, or rating change. The definition of the relevant credit events must be negotiated by the parties to the note. A CLN in effect combines a credit-default swap with a regular note with coupon, maturity, redemption. Typically, an investment fund manager will purchase such a note to hedge against possible down grades, or loan defaults. Numerous different types of credit linked notes CLNs have been structured and placed in the past few years. Here we are going to provide an overview rather than a detailed account of these instruments. The most basic CLN consists of a bond, issued by a well-rated borrower, packaged with a credit default swap on a less creditworthy risk. However, from the point of view of investors, the risk profile is different from that of the bonds issued by the country. If the bank runs into difficulty, their investments will suffer even if the country is still performing well. The credit rating is improved by using a proportion of government bonds, which means the CLN investor receives an enhanced coupon. Through the use of a credit default swap, the bank receives some recompense if the reference credit defaults. There are several different types of securitized product, which have a credit dimension. Credit-linked note is a generic name related to any bond whose value is linked to the performance of a reference asset, or assets. This link may be through the use of a credit derivative, but does not have to be. Collateralized debt obligation CDO: Collateralized bond obligations CBO: Bond issued against a pool of bond assets or other securities. Bond issued against a pool of bank loan. Collateralized debt obligations[edit] Main article: For example, a CDO made up of loans is merely a securitizing of loans that is then tranched based on its credit rating. This particular securitization is known as a collateralized loan obligation CLO and the investor receives the cash flow that accompanies the paying of the debtor to the creditor. Essentially, a CDO is held up by a pool of assets that generate cash. The main difference between CDOs and derivatives is that a derivative is essentially a bilateral agreement in which the payout occurs during a specific event which is tied to the underlying asset. Pricing of credit derivative is not an easy process. The complexity in monitoring the market price of the underlying credit obligation. Understanding the creditworthiness of a debtor is often a cumbersome task as it is not easily quantifiable. The incidence of default is not a frequent phenomenon and makes it difficult for the investors to find the empirical data of a solvent company with respect to default. Even though one can take help of different ratings published by ranking agencies but often these ratings will be different. Risks[edit] Risks involving credit derivatives are a concern among regulators of financial markets. The US Federal Reserve issued several statements in the Fall of about these risks, and highlighted the growing backlog of confirmations for credit derivatives trades. These backlogs pose risks to the market both in theory and in all likelihood , and they exacerbate other risks in the financial system. Incentive may be indirect, e.

Chapter 8 : The Credit Default Swap Basis [Book]

The price of a credit default swap is referred to as its "spread," and is denominated in basis points (bp), or one-hundredths of a percentage point. For example, right now a Citigroup CDS has a spread of bp, or %.

Chapter 9 : Credit Default Swap (CDS)

One of these was the decoupling of corporate bonds from credit default swaps (CDS). This relationship is measured as

the "basis", which refers to the difference between the CDS spread for a particular borrower and the credit spread on the same borrower's bonds.