



# *Oversight for Credit Default Swap (CDS)*

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# *Risks of CDS*

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- **Market risk**
- **Credit risk**
- **Counterparty risk**
- **Operational risk**
- **Liquidity risk**
- **Legal risk**
- **Systemic risk**
- **Risk of Market misconducts**



## *Concerns for Market Oversight*

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- **Lack of transparency; pricing**
- **Risks of market misconducts; price manipulation, spreading rumor, insider trading..**
- **Co-relation between CDS spreads and stock prices of referenced entities**
- **Need for oversight for CDS transactions**

# *Possible market misconducts involving CDS*



- **Manipulation of CDS spreads**
- **Spreading rumor relating to referenced entities of CDS**
- **Affecting stock prices of referenced entities through manipulation of CDS spreads**
- **Insider trading using non-public information of referenced entities**



# *Regulatory regime for CDS*

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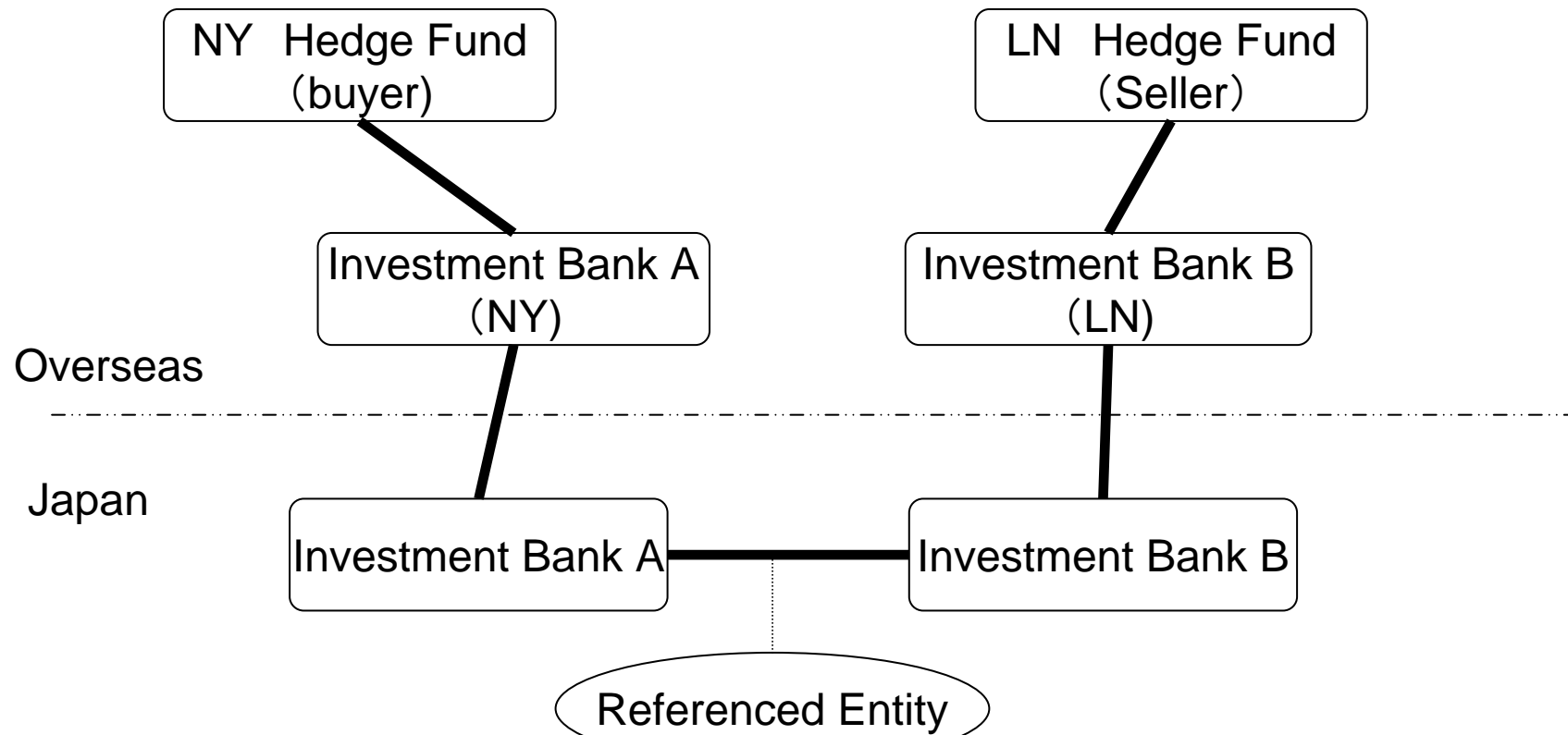
- **CDS is defined as OTC derivatives**
- **CDS is subject to regulations for market misconducts**
  - **Section 157: Securities fraud**
  - **Section 158: Spreading rumor and deceptive measures**
  - **Section 159: Price manipulation**
  - **Section 166: Insider trading**

# *Trading of Japanese Name CDS*



- **Trading desks: Tokyo**
- **Booking: London or New York**
- **Risk management: Tokyo, but global risk management in London or New York**

# Trading of Japanese Single Name CDS; Typical Example





# *Co-relation between spreads and stock prices*



- No consensus among market participants
- Apparent co-relation since 2008
- Stock prices → CDS spreads; Yes?
- CDS spreads → Stock prices; No?





## *Market misconducts using CDS*

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- **Most of the views are negative;**
  - professional markets
  - limited liquidity
  - cost
- **Views hoping for more transparency about pricing**



## *Monitoring of CDS Transactions from market integrity perspectives (1)*

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**Among market participants,**

- **A few cases of dedicated monitoring of CDS**
- **Generally, as part of overall monitoring including stocks**
- **However, increasing understanding of enhanced monitoring of CDS transactions from market integrity perspectives**



## *Monitoring of CDS Transactions from market integrity perspectives (2)*

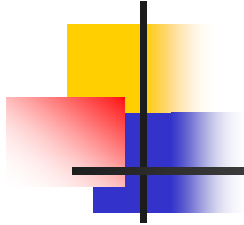
- **Currently, monitoring practices for CDS are limited to insider trading by staff within market maker (investment banks); Control room function, wall crossing...**
- **However, no monitoring against**
  - **insider trading by end users of CDS (hedge funds...)**
  - **market manipulation and spreading rumor**



## *Further issues*

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- **Data collection of CDS as OTC products**
  - from CCP
  - from market maker; reporting requirement
  - cooperation with foreign regulators, in particular, the U.S. , in relation to DTCC
- **Evaluation of CDS spreads; criteria for fair price**
- **SESC's Monitoring and Surveillance approach for CDS transactions for market integrity**



*Thank you*

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