Credit default swaps (CDS) of RBI

November 2, 2020

In news:

RBI will soon issue fresh guidelines on credit default swaps (CDS).

More information:

- CDS is a **financial derivative instrument to hedge risks in bond investments.**
- The enactment of the Bilateral Netting of Qualified Financial Contracts law paves the way for an active CDS market.
- The government is working with financial sector regulators, SEBI, RBI, IRDA and PFRDA to build a robust and vibrant bond market.
- Enhancing the bond markets is very important for the requirement of infrastructure financing, particularly the projects lined up in the National Infrastructure Pipeline.

What is CDS?

- A credit default swap (CDS) is a financial derivative or contract that allows an investor to “swap” or offset his or her credit risk with that of another investor.
- E.g. if a lender is worried that a borrower is going to default on a loan, the lender could use a CDS to offset or swap that risk.
- To swap the risk of default, the lender buys a CDS from another investor who agrees to reimburse the lender in the case the borrower defaults.
- Most CDS will require an ongoing premium payment to

maintain the contract, which is like an insurance policy.

- A CDS is the most common form of credit derivative and may involve municipal bonds, emerging market bonds, mortgage-backed securities or corporate bonds.