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第 52 卷第 2 期／Vol.52, No.2 (06. 2023)

A Critique on the Regulation of Credit Default Swap (CDS)

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Abstract

Credit Default Swap (CDS) is a financial product used to hedge the default risk of credit counterparties. However, the market was flooded with arbitrageurs using CDS to carry out arbitrage, which eventually led to the collapse of the commodity bubble and became a major culprit of the financial crisis in 2008. CDS has the risk of triggering a systemic crisis and causing a serious financial storm; however, its existence also has its positive function. In addition to helping the market find the price, it can also promote investors to hedge the layout. Therefore, it is still difficult to deny its significance and should not be banned comprehensively. Faced with this dilemma, this thesis argues that Taiwan should also develop a better normative model for CDS so that such financial instruments can function properly without causing systemic risks in the financial market.

CDS is traded in the form of over-the-counter (OTC), which is positioned as a financial derivative but is not regulated by existing laws and regulations, but it is not regulated by the current relevant laws and regulations. In order to achieve the above objectives, this thesis firstly clarifies the nature of credit default swaps. In the second part, this thesis would analyze CDS, determine the nature of this financial instrument, and argue it should be regulated under Securities Exchange Act. In the third part, this thesis describes CDS regulation of U.S.A., which could be introduced to Taiwan. Finally, this thesis suggests that, CDS is regulated by the

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Securities and Exchange Act; in addition, the number of traders involved, the choice of a supervision model, the establishment of a clearinghouse, and the enhancement of transparency and information disclosure in the market should also be targeted to avoid systemic risks and information asymmetries on a larger scale.

Keywords: Credit Default Swap (CDS), Clearinghouse, Over-the-Counter (OTC), Credit Risk, Systemic Risk, Dodd-Frank Act of 2010, Information Asymmetry