
Municipal Credit Default Swap Activity Jumps, But Overall Market Is Still Thin.

Summary

- In recent weeks the notional principal traded on U.S. states (9) and cities (1) has jumped up from very low levels.
- Only 11 sub-sovereign or municipal issues have traded since the DTCC began reporting weekly trade activity in July 2010.
- Trading is still very thin, but the rise in activity recently is something all investors in municipal bonds should monitor closely.

The bankruptcy of Detroit brings new pressure on municipal bond investors and related exchange-traded funds like HYD, NUV, PML, PZA, IIM, NIO and VMO specializing in municipal bonds to heighten risk management and to hedge where appropriate. One potential tool in that regard is the single name credit default swap market, which is featured almost constantly in discussions of municipal entity credit risk. A recent example is "Traders Find Short Bets on Puerto Rico a Challenge," a Wall Street Journal blog. The author notes:

"Default insurance on Puerto Rico, sold in the form of derivatives called credit-default swaps, is available from few dealer banks. The contracts also have barely traded because the protection is not available to buy in meaningful amounts and disclosures from the Commonwealth have been limited, some market participants said."

The purpose of this note is to bring clarity and precision to discussions of municipal credit default swaps by providing facts from the Depository Trust & Clearing Corporation trade warehouse. It is simply not the case that Puerto Rico credit default swaps have "barely traded." The DTCC data makes clear that Puerto Rico credit default swaps have never traded in any week since the DTCC began reporting weekly on trading volume beginning with the week ended July 16, 2010. In fact, only 11 municipal or sub-sovereign names have ever been reported as trades to the DTCC trade warehouse during the 2010-2014 period. This note explains the details.

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