China Will Allow Credit Default Swaps, As Long As They Are Not Naked

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I have repeatedly argued that naked credit default swaps should be banned.

"Naked credit default swaps" is the term coined to describe the situation where the buyer is not the referenced entity.

The American government hasn't banned naked CDS. Instead, the government let the largest CDS traders write impotent laws which won't fundamentally change the ongoing danger from derivatives.

But the Chinese are being smarter.

As Bloomberg notes:

> China will introduce credit-default swaps by the end of this year, according to Shi Wenchao, secretary general of the state-backed National Association of Financial Market Institutional Investors.
>
> Investors in the derivatives will be required to own the underlying risk, Shi said today in an interview with reporters in New York. China plans to limit the amount of leverage used in the contracts to avoid the kind of financial crisis faced in the U.S. two years ago, he said.

In other words, China will allow CDS, but will prohibit naked CDS.

Such a move shows – once again – that China is being much more realistic about the dangers of derivatives than the U.S. See this, this and this.
