Press Release **Nice, March 8, 2011**

EDHEC-Risk Institute Warns the European Parliament of the Dangers of Banning Naked Sales of Credit Default Swaps

In an open letter of March 8, 2011 addressed to the Chair of the Economic and Monetary Affairs Committee of the European Parliament, Sharon Bowles, and Pascal Canfin, the Committee's Rapporteur on the draft EU regulation on short selling and credit default swaps, EDHEC-Risk Institute has warned of the dangers of prohibiting "naked" sales of sovereign credit default swaps.

Besides the fact that the lack of convergence on these issues with the US authorities leaves little hope of the measures being effective, EDHEC-Risk Institute thinks that this ban would pose numerous problems and run up against legal and practical obstacles that would make it inapplicable or even counterproductive:

- It will be impossible for intermediaries and ultimately for regulators to verify investors' holdings of the securities representative of the risk the credit default swaps are assumed to cover.
- This prohibition would make it harder for countries to manage the interest rate risk on their debt actively, as their counterparties would then no longer be able to hedge the country risk of the interest rate swaps they may have entered into. This active management of the yield curve is a major component in the optimisation of the cost of public debt.
- More harmful still is that a very strict definition of a naked sale would keep investors who finance public investment or companies that enter into contracts with sovereign nations or with state-owned companies from hedging the default risk of their counterparties. At a time when public-private partnerships and private financing of public infrastructure projects are considered one of the drivers of global growth, making it harder to manage country risk may, at the very least, increase the costs of these partnerships and this financing and, at worst, prove a major hurdle to their development.
- Finally, by making the market for hedging default risk more complex, the markets may be deprived of the debt of countries with low ratings, of investors, and thus of liquidity, which will inevitably increase the cost of this debt.

A copy of the open letter can be found here:

EDHEC-Risk Institute Letter to Economic and Monetary Affairs Committee of the European Parliament, March 8, 2011

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About EDHEC-Risk Institute

EDHEC-Risk Institute is part of EDHEC Business School, one of Europe's leading business schools and a member of the select group of academic institutions worldwide to have earned the triple crown of international accreditations (AACSB, EQUIS, Association of MBAs). Established in 2001, EDHEC-Risk Institute has become the premier European centre for financial research and its applications to the industry. In partnership with large financial institutions, its team of 66 permanent professors, engineers and support staff implements six research programmes and eleven research chairs focusing on asset allocation and risk management in the traditional and alternative investment universes. The results of the research programmes and chairs are disseminated through the three EDHEC-Risk Institute locations in London, Nice and Singapore.

EDHEC-Risk Institute validates the academic quality of its output through publications in leading scholarly journals, implements a multifaceted communications policy to inform investors and asset managers on state-of-the-art concepts and techniques, and forms business partnerships to launch innovative products. Its executive education arm helps professionals to upgrade their skills with advanced risk and investment management seminars and degree courses, including the EDHEC-Risk Institute PhD in Finance.

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