Central Clearing and Collateral Demand [*]

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Abstract

We use an extensive data set of bilateral exposures on credit default swap (CDS) to estimate the impact on collateral demand of new margin and clearing practices and regulations. We decompose collateral demand for both customers and dealers into several key components, including the "velocity drag" associated with variation margin movements. We demonstrate the impact on collateral demand of more widespread initial margin requirements, increased novation of CDS to central clearing parties (CCPs), an increase in the number of clearing members, the proliferation of CCPs of both specialized and non-specialized types, and client clearing. Among other results, we show that system-wide collateral demand is increased significantly by the application of initial margin requirements for dealers, whether or not the CDS are cleared. Given these dealer-to-dealer initial margin requirements, however, mandatory central clearing is shown to *lower*, not raise, system-wide collateral demand, provided there is no significant proliferation of CCPs. Central clearing does, however, have significant distributional consequences for collateral requirements across various types of market participants.

JEL codes: G20, G28, G15.

Keywords: Central clearing party, margin, credit default swap, collateral, client clearing.

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