

Trending Topics from J.P. Morgan Corp Fin Advisory | Week of May 28, 2018

4. The CDS and financing markets are intertwined, after all

Key Takeaways

- Through credit default swaps (CDS), investors can replicate synthetic corporate credit positions with low upfront capital.
- Recently some of these investors have become true capital providers to firms (depending on incentives and willingness to lend).
- Firms have taken these financing lifelines while regulators and market participants are working to better understand the potential legal implications and impact to the CDS market.

Several precedents of this fact pattern have emerged, however each has a different flavor. In each case the party offering financing would protect its CDS position - for a CDS seller, ensuring continued receipt of premia payments, and CDS buyer, a more beneficial/likely payout on contractual default. RadioShack and Sears (reportedly) have had CDS sellers offer financing that would help stave off a default. McClatchy had a CDS seller offer financing along with a reorganization of debt structure, resulting in "orphaned" CDS contracts, significantly reducing any chance of a contractual default. Additionally, Codere and Hovnanian had CDS buyers who offered financing that also involved a technical default on CDS contracts.

These transactions are prevalent in situations where there are sizeable CDS positions relative to debt. When the stars align these third party contracts appear to result in one winner: firms in need of a lifeline.

Disclaimer: This material is not a product of the Research Departments of J.P. Morgan and is not a research report. Unless otherwise specifically stated, any views or opinions expressed herein are solely those of Corporate Finance Advisory, and may differ from the views and opinions expressed by J.P. Morgan's Research Departments or other departments or divisions of J.P. Morgan and its affiliates. Distribution, copy, reprints, and/or forwarding of these materials to non-investment banking clients of J.P. Morgan is not permitted unless specifically approved by J.P. Morgan. Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. In no event shall J.P. Morgan be liable for any decision made or action taken in reliance upon the information contained herein. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument, and is a "solicitation" only as that term is used within CFTC Rule 1.71 and 23.605 promulgated under the U.S. Commodity Exchange Act. Questions regarding swap transactions or swap trading strategies should be directed to one of the Associated Persons of J.P. Morgan's Swap Dealers. JPMorgan Chase and its affiliates do not provide tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

© 2018 JPMorgan Chase & Co. All rights reserved. JPMorgan Chase Bank, N.A. Member FDIC.

J.P. Morgan Corporate & Investment Bank Marketing, 4 New York Plaza, Floor 12, NY 10048, New York, NY, 10004-2413, United States.

Important Reminder: JPMorgan Chase will never send emails that require you to send account information or passwords to us via public email or pop-up windows.