

Default Contagion and Systemic Risk in the Presence of Credit Default Swaps *

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Abstract.

We consider a clearing system of an interbank market in the case cross-ownerships of credit default swaps among banks are present, and investigate the effect of CDSs on financial stability. The existence of a clearing payment vector is proved under the assumption of the *fictitious default algorithm with financial covenants*, which reflects technical defaults often observed in actual financial markets.

Keywords: Credit default swap, default costs, default contagion, systemic risk.

JEL classification: G13, G32, G33, L14.

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