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The impact of central clearing on banks' lending discipline

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Abstract

In this paper, I investigate the impact of central clearing in credit risk transfer markets on a loan-originating bank's lending behavior. Under the current market regulation, central clearing undermines banks' lending discipline. The regulatory design of the credit risk transfer market in terms of capital requirements, disclosure standards, risk retention, and access to uncleared credit risk transfer can mitigate this problem. I also show that the lending discipline channel is an essential element of the impact of central clearing on banks' loan default loss exposure, which is a first-order consideration for systemic risk analysis.

Keywords: Credit Risk Transfer, Central Clearing, Lending Discipline

JEL Classification: G18, G28

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