

Credit default options are binary options in that they have a specified, all-or-nothing cash settlement amount. Credit default options, however, have additional unique characteristics. For example, credit default options have no exercise price and cannot be in the money and have no intrinsic value. The discussion of these terms in Chapter I and/or Chapter II of the Booklet is therefore inapplicable to credit default options. In addition, a credit default option is automatically exercised whenever a credit event occurs within the covered period. Credit default options are thus a unique style of options and are neither American-style nor European-style.

A credit default basket option is similar to an aggregation of individual credit default options, each based on one or more reference obligations of a different reference entity. All of the outstanding debt securities constituting general obligations of each reference entity or direct claims on reference entities (excluding non-recourse debt) in the basket may be included in the reference obligations.

There are two different kinds of credit default basket options. A single payout credit default basket option is automatically exercised and pays a specified cash settlement amount upon the confirmation of the first credit event to occur with respect to a reference obligation of any one of the basket's reference entities. It is exercised only once. Once exercised, the expiration of the option will be accelerated to correspond to the exercise date. A multiple payout credit default basket option automatically pays a specified cash settlement amount each time a credit event is confirmed with respect to a reference obligation of any one of the reference entities during the covered period. In the case of either single payout or multiple payout credit default basket options, the listing options market may specify a different cash settlement amount for different reference entities or may specify the same cash settlement amount for each reference entity in the basket. The percentage of the total cash settlement amount that is attributable to any individual reference entity is referred to as its weight in the basket. Investors should note that the options markets on which credit default basket options trade may determine "weight" according to their own specified rules, and investors should contact the listing options market for information about how it determines weight. In the case of a multiple payout credit default basket option, a cash settlement amount will be paid only once with respect to any particular reference entity, after which time the affected reference entity will be removed from the credit default basket.

Premiums for both credit default options and credit default basket options are expressed in points and decimals. In order to obtain the aggregate premium for a single option, the quoted premium is multiplied by a premium multiplier specified by the listing options market.