

Credit Default Options and Credit Default Basket Options

Credit default options are based on debt securities of one or more issuers or guarantors other than the U.S. Treasury. A significant difference between such debt securities and Treasury securities is the non-negligible risk that an issuer or guarantor of debt securities other than Treasury securities may default on its obligations. For example, the issuer might not pay the full interest and face amount of the securities when due or might file for bankruptcy, thereby making it nearly certain that it will not make timely payment of the full interest and face amount. Financial market participants call this credit risk. Credit risk is an important component of the value of most debt securities.

Credit default options relate to the credit risk presented by one or more specified debt securities, called reference obligation(s), of one or more specified issuers or guarantors, each of which is called a reference entity. The reference obligation(s) and each reference entity for a class of credit default options are selected by the listing options market. When a credit default option is based on reference obligation(s) of more than one issuer or guarantor, it is referred to as a credit default basket option. There are further variations on credit default basket options as described below.

A credit default option is automatically exercised and pays a fixed cash settlement amount if a credit event is confirmed for one or more reference obligations of a reference entity prior to expiration of the option. The reference obligations of a reference entity may include all of the outstanding debt securities constituting general obligations of the reference entity or direct claims on the reference entities (excluding any non-recourse debt). A credit event includes a failure to make a payment on a reference obligation as well as certain other events that the listing options market may specify at the time a class of credit default options is listed. The specified credit events will be defined in accordance with the terms of the reference obligation(s). However, not every event that might constitute an event of default by the reference entity under the terms of the reference obligations will necessarily be specified by the listing options market as a credit event. Investors should be certain that they understand the various possible events that will or will not constitute credit events. The determination of whether a particular event meets the criteria of a credit event, however defined, for a specific credit default option is within the sole discretion of the listing options market.

In order to result in automatic exercise of the option, a credit event must be confirmed to have occurred during the covered period (i.e., the period between the initial listing of the series of options and the time specified by the options market as the last day of trading of the option series prior to the expiration date). An event that would otherwise be deemed a credit event will not result in an exercise of the option if it occurs either before or after this period. A series of credit default options ordinarily does not expire until a specified number of business days following the end of the covered period in order to provide the listing options market an opportunity to confirm whether or not a credit event