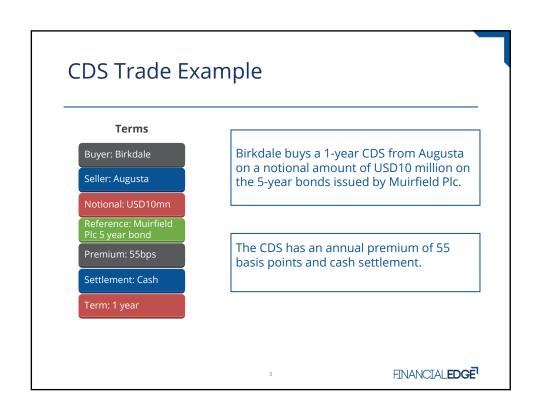


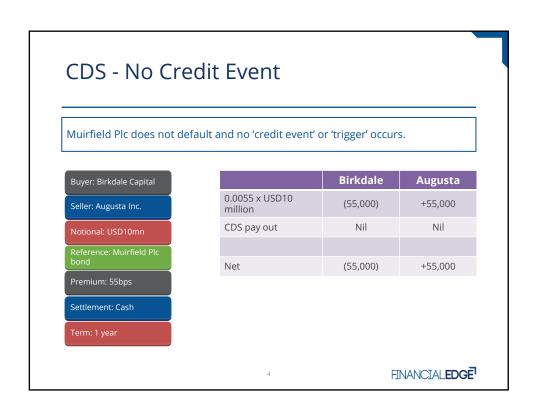
Credit Default Swaps - CDS's

A Credit Default Swap is a derivative contract through which two parties transfer the credit exposure to bonds between them

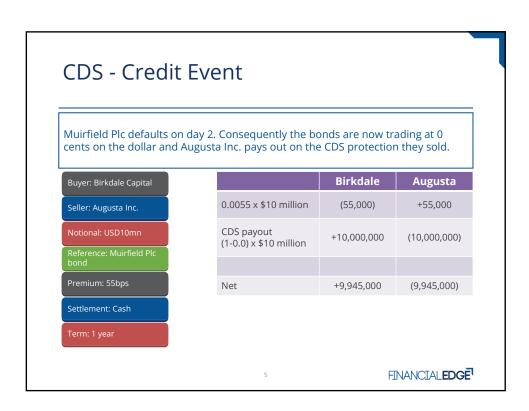
Key terms		
Buyer	The buyer of credit protection	
Seller	The seller of credit protection	
Notional	Face value of the unrestricted credit bet between the two counterparties	
Reference obligation	The underlying bond	
Premium	The premium payable in basis points of the Notional amount	
Settlement	Usually in cash	
Term	Duration of contract	
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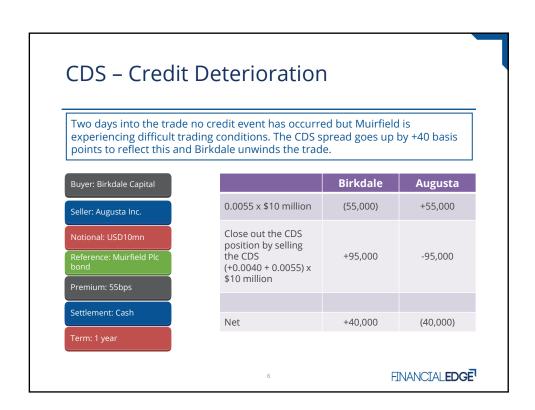














CDS - Credit Improvement

Two days into the trade no credit event has occurred. Muirfield is experiencing better trading conditions and the CDS spread goes down by (30) basis points to reflect this. Birkdale unwinds the trade.

Buyer: Birkdale Capital	
Seller: Augusta Inc.	
Notional: US\$10mn	
Reference: Muirfield Plc bond	
Premium: 55bps	
Settlement: Cash	
Term: 1 year	

Birkdale	Augusta
(55,000)	+55,000
+25,000	-25,000
(30,000)	+30,000
	(55,000) +25,000

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CDS – Credit Event and Counterparty Default

Muirfield Plc defaults before the end of the year and the bonds are trading at 0 cents on the dollar but Augusta Inc. fails to pay out on the CDS $\,$

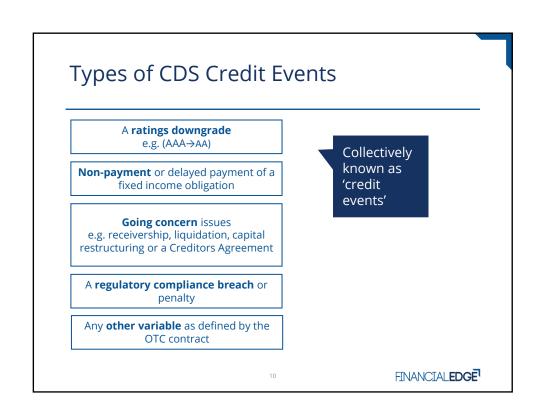


	Birkdale	Augusta
0.0055 x \$10 million	(55,000)	+55,000
CDS pay out	Nil	Nil
Net	(55,000)	+55,000

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CDS - Indices

Allows for buying or selling credit protection on an Index using Standardised contracts

Examples:

iTraxx Europe ("The Main")

125 most liquid European credits

HiVol

30 high spread credits

Xover

75 subinvestment grade credits

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Swaptions - Options on Swaps

Swaptions

The right but not the obligation to enter into a Swap

The underlying Swap will have pre determined dates, rates and term

Can be agreed on any type of Swap

An option on entering into a Swap contract!

Receiver swaption

gives buyer the right to sell a CDS in the future (i.e. go **long** in underlying bond)

Payer swaption

gives buyer the right to buy a CDS in the future (i.e. go **short** in underlying bond)

12

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