

S&P Credit Default Swap (CDS) U.S. Indices

Frequently Asked Questions

1. What is a Credit Default Swap?

A Credit Default Swap (CDS) is an over-the-counter, tradable, credit derivative contract that is similar to an insurance policy. The CDS is a bilateral contract in which one party (usually known as the protection buyer) pays a fee or premium to another party (generally referred to as the protection seller) to protect against a financial loss it may incur if a credit event (usually a default) occurs with respect to the underlying bond issuer (reference entity). If a credit event occurs, the seller of protection will make a prearranged payment to the buyer of the contract in exchange for the underlying bond (reference obligation).

Premiums on a CDS generally increase when perceived credit risks are greater and decrease when the perceived risks decline. CDS contracts can be written on corporate bonds (typically senior unsecured bond issues) as well as sovereign and municipal issuers, asset and mortgage-backed securities, and leveraged loans.

2. Why CDS?

A CDS is a way to transfer credit risk without buying or selling individual securities. CDS can be created when needed and are often more liquid than their cash market equivalents.

3. What is a credit event?

A credit event will trigger a contingent payment by the protection seller to the protection buyer on a credit default swap. Generally, the types of occurrences which can trigger credit events are bankruptcy, failure to pay, certain types of debt restructuring, repudiation/moratorium, and obligation acceleration.

4. Why are CDS important?

Today, CDS have become the engine that drives the credit derivatives market. Much of the growth in the CDS market has come from its flexibility to act as an active portfolio management tool. A CDS gives investors the ability to customize exposure to corporate credit. The performance of the CDS is like that of corporate bonds, in that it is closely related to changes in credit spreads. This makes them a hedging tool that can take on exposure to changes in credit spreads as well as default risk. Credit default swaps also have given rise to new arbitrage opportunities, particularly in less efficient and transparent credit markets.

5. What indices are being offered?

Standard & Poor's has launched three U.S. based CDS indices – U.S. corporate investment grade; U.S. corporate high-yield; and the S&P 100 CDS Index.

- The S&P CDS U.S. Investment Grade (IG) Index consists of 100 equally weighted investment grade U.S. corporate credits.
- The S&P CDS U.S. High-Yield (HY) Index consists of 80 equally weighted high-yield U.S. corporate credits.
- The S&P 100 CDS Index generally consists of 80-90 members of the S&P 100 Equity Index that have CDS with sufficient liquidity. The weight of each constituent in the 100 CDS Index is based on its weight in the 100 Equity Index.

6. What do the S&P CDS U.S. Indices measure?

Each Standard & Poor's CDS Index offers three calculations that reflect the performance of that basket of single name credit default swaps.

- 1) S&P will calculate the performance of each base CDS Index and will remove a reference entity from the index upon a credit event.
- 2) The S&P CDS Event Inclusive Indices (patent pending): S&P will calculate the performance of each CDS Event Inclusive Index retaining any reference obligation where a credit event has occurred. The S&P CDS Event Inclusive Indices also include corporate action adjustments and coupon payments.
- 3) The S&P CDS Rolling Indices: S&P will calculate the performance of the each CDS Rolling Index on a continuous basis, while following the rules for

maintaining the CDS Event Inclusive Indices. There is no final maturity date for the Rolling Index. This unique return calculation gives investors a continuous return perspective on the index series over a long term investment horizon and not simply for the period the index is considered ‘on-the-run.’

7. Why S&P CDS U.S. Indices?

The S&P CDS U.S. Indices are maintained independently by the S&P CDS Index Committee. The indices are characterized by third party pricing, three variations of each index, and weightings and a constituency based on an underlying equity index (S&P 100 CDS Index).

8. What is the pricing source?

Standard & Poor’s uses CMA (Credit Market Analysis), a major supplier of independent pricing data, as its primary source of pricing for these indices. Standard & Poor’s reserves the possibility of selecting alternative or additional sources of pricing data at the discretion of the Standard & Poor’s CDS Index Committee.

9. What new analytic insights do the indices offer?

The S&P 100 CDS Index is the first CDS index based on an underlying, tradable equity index. Since it is designed to track the S&P 100 Equity Index, the index may assist in monitoring the relationship between CDS spreads and equity prices. Not all members of the S&P 100 have actively traded CDS. This accounts for the difference in membership and weights between the two. The S&P 100 CDS members will be added or deleted based on their membership in the S&P 100 index, provided that sufficiently liquid CDS is available on a potential member.

10. How are the indices calculated?

The S&P 100 CDS Index, S&P CDS U.S. Investment Grade Index and the S&P CDS U.S. High-Yield Index are calculated in the same manner.

New indices (Base and Event Inclusive) will be generated every six months with the goal of selecting constituents with sufficient liquidity and seeking to reflect changes in the credit market. All new series will have a tenor of five years. At inception, each index gets a fixed annual coupon. Each day, the coupon, the

USD swap curve, and the hazard curve implied by the latest aggregate spreads of the underlying CDS are used to create a risk adjusted present value for the index. In the case of a credit event, the reference entity in question is (1) either effectively removed from index calculations or (2) the recovery rate is incorporated into index calculations.

11. How are credit events determined?

Credit events are determined and declared by the S&P CDS Index Committee. For a credit event to be declared, the committee must receive confirmation of the event from two public sources of data regarding either bankruptcy filings or a failure to pay outstanding obligations on the bond or class of bonds in question. Standard & Poor's will monitor a variety of public sources for all relevant information.

12. How often are the indices calculated?

The indices will be calculated at the end of each business day and disseminated at approximately 5:45 PM New York time.

13. How much history is available?

History is available beginning March 20, 2007 for the S&P CDS U.S. Investment Grade Index and the S&P 100 CDS Index. History is available beginning September 20, 2007 for the S&P CDS U.S. High-Yield Index.

14. How will constituents affected by corporate actions be addressed by these indices?

Certain corporate actions involving index constituents may result in a succession event, or a change in the reference entity/obligation of a CDS. If it is decided, based on certain quantitative and qualitative criteria, that a succession event has occurred, the acquiring entity(s), if applicable, will replace the original entity in the index. The S&P CDS Index Committee will determine if a successor event has occurred and how it will be treated.

15. Where can I get data?

Data can be found on Standard & Poor's web site at www.fixedincomeindices.standardandpoors.com.

16. What are the key definitions used by S&P in describing the CDS Indices?

Coupon: the fixed periodic cash flow the seller of protection would receive on the basket of CDS reference entities.

S&P CDS Event Inclusive Index (patent pending): a S&P CDS Index basket retaining any reference obligation where a credit event has occurred.

Off-the-run Index: Each S&P CDS Index series will issue a new series every six months. Each series issued prior to the most recently issued series of indices are considered 'off-the-run' indices.

On-the-run Index: Each S&P CDS Index series will issue a new series every six months. The most recently issued series is the 'on-the-run' series.

S&P CDS Rolling Index: an S&P CDS index basket whose returns are calculated on a continuous basis. S&P will calculate the performance of the each CDS Rolling Index on a continuous basis, while following the rules for maintaining the CDS Event Inclusive Indices. There is no final maturity date for the Rolling Index. This unique return calculation gives investors a continuous return perspective on the index series over a long term investment horizon and not simply for the period the index is considered 'on-the-run.'

Tenor: the length, as measured by years, of a CDS contract.

17. Who can I contact at S&P if I have questions about these indices or their constituents?

Questions about the index methodology including the CDS in the index can be addressed to:

David M. Blitzer, Ph.D.

Managing Director and Chairman of the Index Committee

David_blitzer@standardandpoors.com, +1.212.438.3907

Craig Feldman

Director, Index Strategy and Management

Craig_feldman@standardandpoors.com, +1.212.438.3296

18. Is a license from S&P required to use the S&P CDS Indices as a basis for a tradeable security or hedge that a firm wishes to create?

Yes, a license from S&P is required for use of the index.

19. Who do I contact at S&P to license my use of these indices?

Questions regarding licensing the S&P CDS Indices can be addressed to:

Jean Park

Head of Sales and Licensing, North America

Jean_park@standardandpoors.com, +1.212.438.5622

J.R. Rieger

Vice President, Fixed Income Indices

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