

Research & Product Development

October 1, 2007

Page 1 of 2

CME Credit Index Event Contract – Series 3

Introduced in the mid 1990s, credit derivatives are the fastest growing segment of the over-the-counter (OTC) derivatives market with an outstanding notional value of ~ \$45.5 trillion (ISDA) as of mid-2007. Credit indexes, marketed under brand names CDX or iTraxx represent the fastest growing segment of this market. These products are not “indexes” in the traditional sense ... rather, they are derivatives tied to a bundle of corporate credits.

CME Credit Index Event Contracts – Are based upon an index of North American (NA) Investment Grade (IG) High-Volatility (HV) Reference Entities designated the CME North American Investment Grade High-Volatility Index Series 3.

CME Credit Index Event Contracts settle on the Final Settlement Date at a Final Settlement Value (FSV) = $NV \times [\sum E_i \times W_i \times F_i]$ where NV=contract Notional Value; $E_i=1$ if credit event occurs for index constituent i or $E_i=0$ in absence of credit event; W_i =Weight of constituent i ; F_i =Final Settlement Rate for constituent i . *E.g.*, assume that 1 constituent in an index of 32 equally-weighted names experiences a credit event with $NV=\$100,000$, and $F=60\%$, then $FSV=\$1,875$. If 2 constituents experience credit events with $F=60\%$ then $FSV=\$3,750$; if 5 experience credit events then $FSV=\$9,375$. If 0 credit events are experienced then $FSV=\$0$.

Credit Event Protocol – Protection buyers may deliver defaulted corporate bonds to protection sellers upon declaration of a credit event at par per a standard OTC single-name CDS. Sometimes, more CDSs are outstanding than corporate bonds, resulting in a squeeze. This is often addressed in the context of the OTC indexes per the 2005 ISDA protocol, providing for cash-settlement of defaulted names. But this process may be cumbersome and time consuming. CME Credit Index Event Contracts are streamlined by assigning a Final Settlement Rate of $F\%$ for each individual name in satisfaction of a credit event. CME Credit Index Event Contracts are triggered by a Reference Entity’s bankruptcy, or failure to pay.

Accounting Treatment - In order to conform these contracts with bookkeeping practices, they are quoted in terms of the total remaining value of the credit protection. *E.g.*, a contract with a 5-year term quoted as 3750 bps implies an annualized quote of approximately 50 bps. In the absence of a credit event, daily mark-to-market procedures ensure that the value of credit protection is transferred from buyer to seller as the contract approaches expiration. The value of accumulated payouts, due to declared credit events, is transferred from seller to buyer as the contracts approach expiration.

Digital Final Settlement	Final Settlement Value (FSV) = $NV \times [\sum E_i \times W_i \times F_i]$ where NV=contract Notional Value; $E_i=1$ if credit event occurs for index constituent i or $E_i=0$ in absence of credit event; W_i =Weight for constituent i ; F_i =Final Settlement Rate for constituent i . <i>E.g.</i> , IF one constituent of 32 equally-weighted names ($W=3.125\%$) experiences credit event with $NV=\$100,000$, and $F=60\%$ THEN $FSV=\$1,875$. IF 2 constituents experience credit events with $F=60\%$ THEN $FSV=\$3,750$; IF 5 experience credit events THEN $FSV=\$9,375$. If no credit events are realized, contract settles on Final Settlement Date at $FSV=\$0$.
Index Constitution	Index comprised of 32 North American Investment Grade High-Volatility Reference Entities (“CME North American Investment Grade High-Volatility Index Series 3”) and associated Reference Obligations
Credit Event	Credit Event deemed to occur in the event of: 1) Bankruptcy, or 2) Failure to Pay.
Quotation Convention	Quoted as total price of credit protection for remainder of term, expressed as fraction of Notional Value in basis points (bps). <i>E.g.</i> , contract worth 75 bps per annum with 5 years to expiration may be quoted at ~375.0 bps. The “time decay” in total price allows buyer effectively to compensate seller for cost of credit protection over time.
Tick Size	0.5 Basis Points (bps), IF Notional Value = \$100,000 THEN 0.5 bps = \$5.00
Contract Months	Listed five (5) years out in June and December
Final Termination of Trading Date	Trading terminates at 12:00 noon on the Final Termination of Trading Date. The Final Termination of Trading Date shall be the second London bank business day immediately preceding the third Wednesday of the contract expiration month. Contract may terminate early if Credit Events are declared for all Index reference entities.
Final Settle Date	The first business day following the Final Termination of Trading Date.

Research & Product Development

October 1, 2007

Page 2 of 2

CME Credit Index Event Contracts – Series 3

Initial Index – The “CME North American Investment Grade High-Volatility Index, Series 3” is comprised of 32 Reference Entities as shown in the table below. “High-Volatility” Reference Entities generally include investment grade corporate names with ratings of BBB- or better (or equivalent rating) from rating agencies such as Standard & Poor’s and Fitch. These names are considered “Hi-Vol” in the sense that they may be close to the investment grade/high-yield rating barrier and as such have

experienced high volatility and activity in the OTC CDS markets. The specific corporate names are selected based upon a survey of liquidity in the CDS marketplace.

Reconstituted Series - New index series are to be constituted semi-annually in March and September with original terms up to 5 years. Further indexes may be introduced reflecting other market segments, *e.g.*, investment grade (IG), crossover (XO), high-yield (HY), etc.

CME North American Investment Grade High-Volatility Index, Series 3

	Reference Entity	S&P Rating	Industry Sector	Weight (W)	Final Settlement Rate (F)
1	Arrow Electronics, Inc.	BBB-	Industrial	3.125%	60%
2	Belo Corp.	BBB-	Communications	3.125%	60%
3	CBS Corporation	BBB	Communications	3.125%	60%
4	Centex Corporation	BBB	Consumer Cyclical	3.125%	60%
5	CenturyTel, Inc.	BBB	Communications	3.125%	60%
6	Countrywide Home Loans, Inc.	A-	Financial	3.125%	60%
7	CSX Corporation	BBB	Industrial	3.125%	60%
8	CVS Caremark Corporation	BBB+	Consumer Cyclical	3.125%	60%
9	Embarq Corporation	BBB-	Communications	3.125%	60%
10	Fortune Brands, Inc.	BBB	Consumer Non-Cyclical	3.125%	60%
11	Gannett Co., Inc	A-	Communications	3.125%	60%
12	The Home Depot, Inc.	BBB+	Consumer Cyclical	3.125%	60%
13	IAC/InterActiveCorp	BBB-	Communications	3.125%	60%
14	J. C. Penney Company, Inc.	BBB-	Consumer Cyclical	3.125%	60%
15	The Kroger Co.	BBB-	Consumer Non-Cyclical	3.125%	60%
16	Lennar Corporation	BBB	Consumer Cyclical	3.125%	60%
17	Limited Brands, Inc.	BBB-	Consumer Cyclical	3.125%	60%
18	Macy’s Corporation	BBB	Consumer Cyclical	3.125%	60%
19	Masco Corporation	BBB+	Industrial	3.125%	60%
20	MeadWestvaco Corporation	BBB	Basic Materials	3.125%	60%
21	MGIC Investment Corp	A	Financial	3.125%	60%
22	The PMI Group, Inc	A	Financial	3.125%	60%
23	Pulte Homes, Inc.	BBB-	Consumer Cyclical	3.125%	60%
24	R R Donnelley & Sons Company	BBB+	Consumer Non-Cyclical	3.125%	60%
25	The Ryland Group, Inc.	A	Consumer Cyclical	3.125%	60%
26	Sprint Nextel Corporation	BBB	Communications	3.125%	60%
27	Starwood Hotels & Resorts Worldwide, Inc.	BBB-	Consumer Cyclical	3.125%	60%
28	Time Warner Inc.	BBB+	Communications	3.125%	60%
29	Transocean Inc.	BBB+	Energy	3.125%	60%
30	Universal Health Services	BBB-	Health Care	3.125%	60%
31	Weyerhaeuser Company	BBB	Basic Materials	3.125%	60%
32	Whirlpool Corporation	BBB	Consumer Cyclical	3.125%	60%

Please contact John Nyhoff, Director, Research & Product Development at 312-930-2310; or Jonathan Kronstein, Associate Director, Interest Rate Products at 312-930-3472 for more information.