Abstract

The most liquid European CDS options are usually of short maturities. This may result from that options with longer maturity have to bear more default risk of the reference company. American CDS options allow the holders to exercise options before option matures so that they can focus on spread movements without worrying about default risk. In this paper, we price American CDS options with one-period CDS spread model presented by Brigo (2004). The primary advantage of this model is that it is similar to LIBOR market model in interest rate theory. Therefore, path-dependent CDS-related products can be easily priced with familiar ideas.

Keyword: CDS, CDS option, one-period CDS spread, least-squares Monte Carlo simulation, LIBOR market model.