

Options Trading A-Z

Edward J Modla
Executive Director, Investor Education
OCC

Michael McCrary
Regional Brokerage Consultant
Fidelity Investments



Disclaimer

Options involve risks and are not suitable for everyone. Individuals should not enter into options transactions until they have read and understood the options disclosure document, Characteristics and Risks of Standardized Options, available by visiting OptionsEducation.org or by contacting your broker, any exchange on which options are traded, or The Options Clearing Corporation at 125 S. Franklin St., #1200, Chicago, IL 60606.

In order to simplify the calculations used in the examples in these materials, commissions, fees, margin, interest and taxes have not been included. These costs will impact the outcome of any stock and options transactions and must be considered prior to entering into any transactions. Investors should consult their tax advisor about any potential tax consequences.

Any strategies discussed, including examples using actual securities and price data, are strictly for illustrative and educational purposes and should not be construed as an endorsement, recommendation, or solicitation to buy or sell securities. Past performance is not a guarantee of future results.

All content in this document is owned, or licensed, by The Options Clearing Corporation ('OCC'). Unauthorized use is prohibited without written permission of OCC. While reasonable efforts have been made to ensure that the contents of this document are accurate, the document is provided strictly "as is", and no warranties of accuracy are given concerning the contents of the information contained in this document, including any warranty that the document will be kept up to date. OCC reserves the right to change details in this document without notice. To the extent permitted by law no liability (including liability to any person by reason of negligence) will be accepted by OCC or its employees for any direct or indirect loss or damage caused by omissions from or inaccuracies in this document.

Trademarks

The following trademarks, logos, and service marks displayed are owned by The Options Clearing Corporation:

The Options Clearing Corporation®

OCC®



The Options Industry Council (OIC)SM

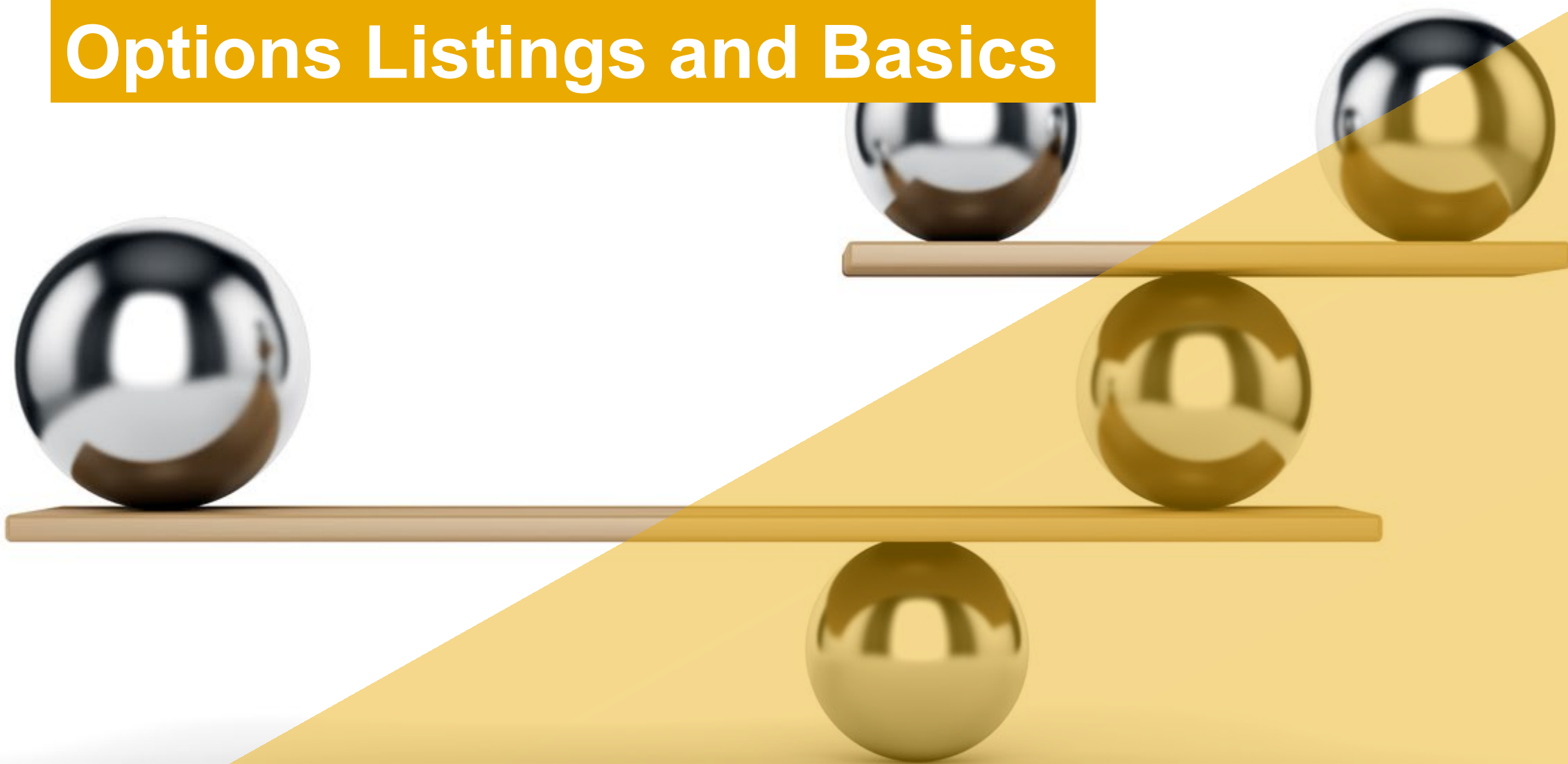


Presentation Outline

- Options Listings
- Basics
- Options Pricing
 - Supply and Demand
 - Moneyness
 - Variables
- Exercise and Assignment
 - Option Holders
 - Option Sellers

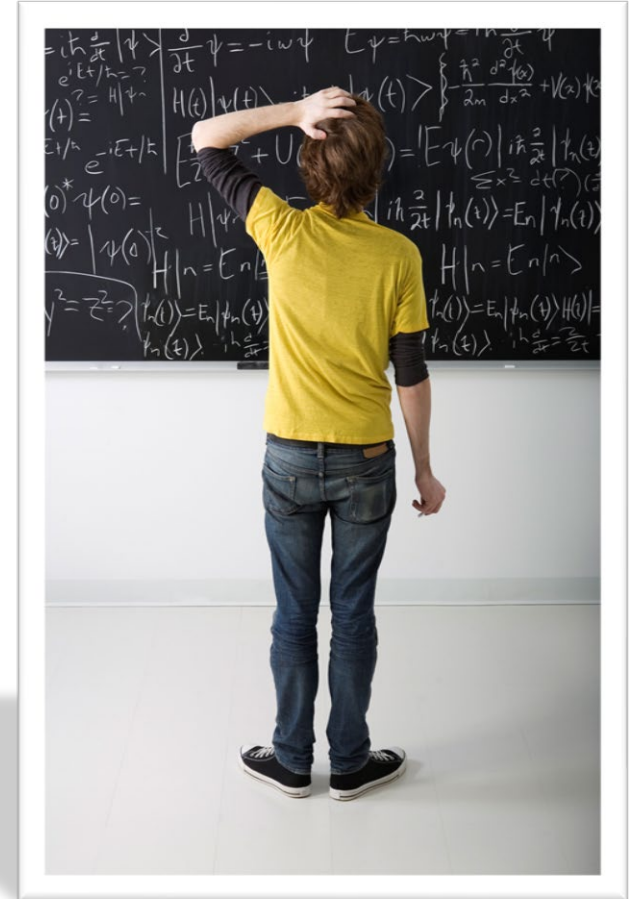


Options Listings and Basics



Options Exchanges Decide

- Pursuant to option exchange rules, securities meeting the following criteria are candidates to have listed options:
 - Shares trading on a national stock exchange
 - Minimum price of \$3 per share for three consecutive trading days prior to listing
 - At least 7 million publicly held shares outstanding
 - At least 2,000 shareholders
 - Criteria typically applies to equity and ETF listings
- ❖ Generally, a minimum of three trading days from the IPO date



Defining an Option

- Options are **contracts** that give:
 - The **buyer** the *right* to buy or sell an underlying asset
 - The **seller** the *obligation* to buy or sell an underlying asset
- At a specified price (**strike price**),
- Prior to the expiration of the contract (**expiration date**)



Buyers and Sellers (Rights and Obligations)

Option contracts give...

	Calls	Puts
Buyer/Holder <i>(Long)</i>	Right to buy	Right to sell
Seller/Writer <i>(Short)</i>	Obligation to sell	Obligation to buy

- Typically 100 shares of the underlying
- at the strike price
- any time before expiration

Options Pricing



Options Pricing

Who makes options prices?

- All market participants (buyers & sellers)
- Individual & Institutional investors
- Professional market-makers
- Best bid/ask is consensus of all bids and offers

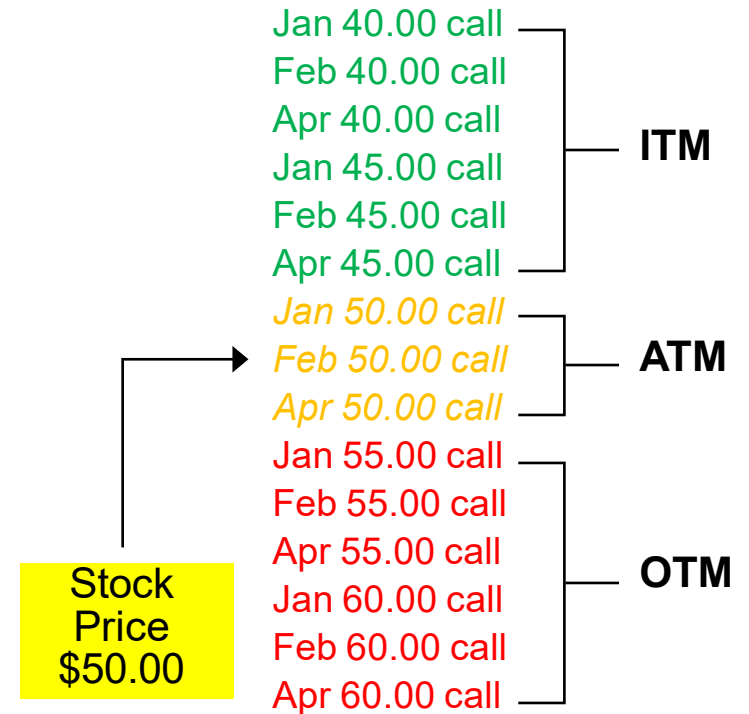
What is an option ultimately worth?

- What the market is willing to pay
- Pricing models used as guideline
- **Supply/demand** & market dynamics can override theoretical values



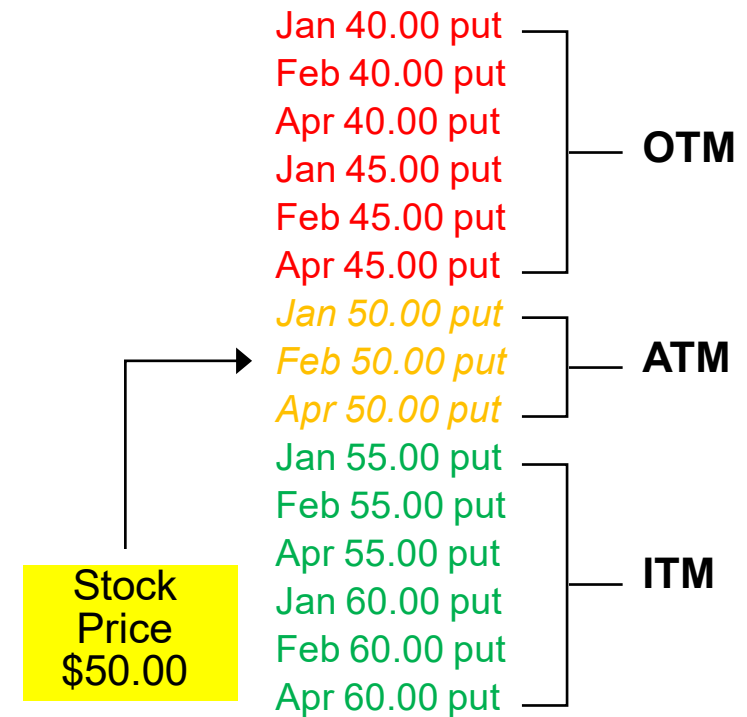
Calls: In-the-Money, At-the-Money, Out-of-the-Money

- Call is in-the-money (ITM)
 - Strike price **below** stock price
- Call is at-the-money (ATM)
 - Strike price **same** as stock price
- Call is out-of-the-money (OTM)
 - Strike price **above** stock price



Puts: In-the-Money, At-the-Money, Out-of-the-Money

- Put is in-the-money (ITM)
 - Strike price **above** stock price
- Put is at-the-money (ATM)
 - Strike price **same** as stock price
- Put is out-of-the-money (OTM)
 - Strike price **below** stock price



Options Pricing Models

Mathematical formulas that can be a useful tool in establishing a trading plan

- **Pricing Model Inputs**
 - Stock price
 - Strike price
 - Implied Volatility (IV)
 - Time until expiration
 - Cost of money (interest rates less dividends)
- **Output**
 - Call and put premiums (theoretical values)



In addition to pricing factors there is unpredictable ***supply and demand***

Exercise and Assignment

Exercise: Buy or Sell Underlying Stock

- The option **buyer** has the **right**:
 - to buy (for a call) or sell (for a put)
 - Typically 100 shares of underlying stock/ETF
 - at the strike price per share
 - **if he/she exercises a long contract**
- To exercise, the buyer issues an exercise notice to his/her brokerage firm (or Auto-ex)
- Only option **buyers** may **exercise** an options contract

Assignment: Buy or Sell Underlying Stock

- The option **seller** has the **obligation**:
 - to sell (for a call) or buy (for a put)
 - Typically 100 shares of underlying stock/ETF
 - at the strike price per share
 - **if he/she is assigned an exercise notice**
- Assignment notice is received from seller's brokerage firm
- Only option **sellers** may be **assigned** on an options contract



The information provided in this communication is solely for educational purposes and should not be construed as advice or an investment recommendation. Fidelity Investments is a separate company, unaffiliated with the Options Clearing Corporation. There is no form of partnership, agency affiliation, or similar relationship between the Options Clearing Corporation and Fidelity Investments, nor is such a relationship created or implied by the information herein. Fidelity Investments has not been involved with the preparation of the content supplied by the Options Clearing Corporation and does not guarantee or assume any responsibility for its accuracy or completeness.