OIC The Options Industry Council℠

Options Trading A-Z

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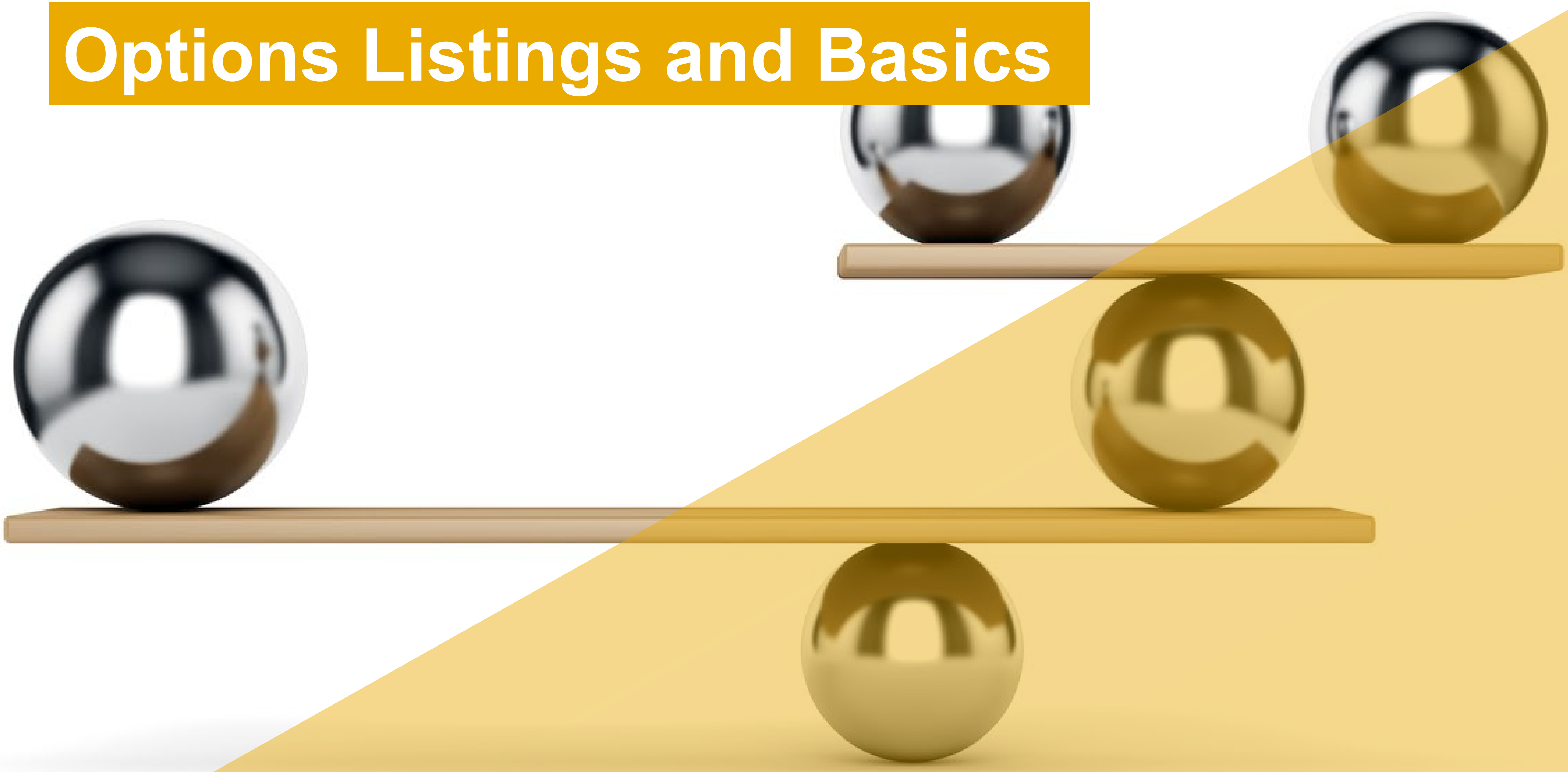
Presentation Outline

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

Options Listings and Basics



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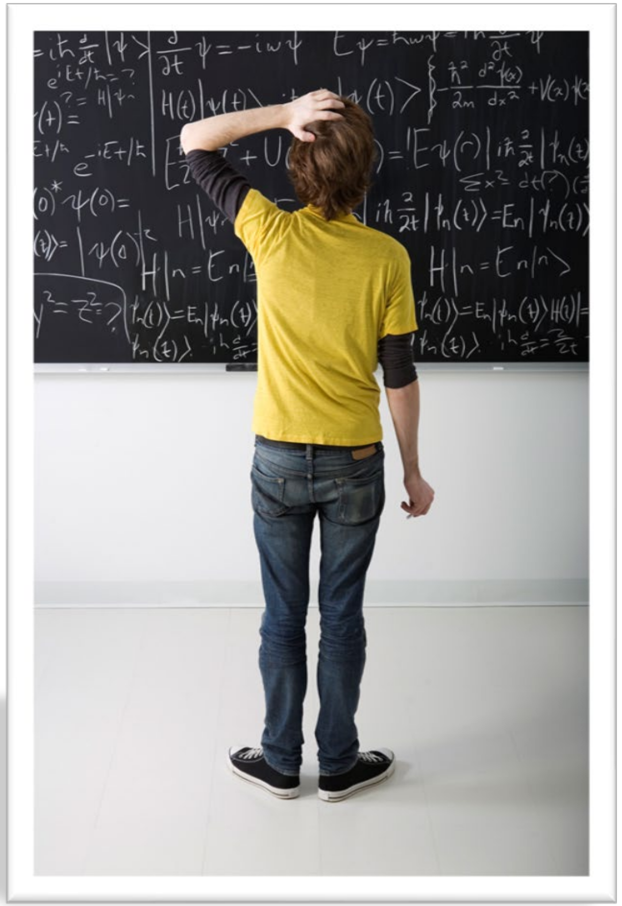
Options Exchanges Decide

- 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



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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 *(Long)*	**Right** to buy	**Right** to sell
Seller/Writer *(Short)*	**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?

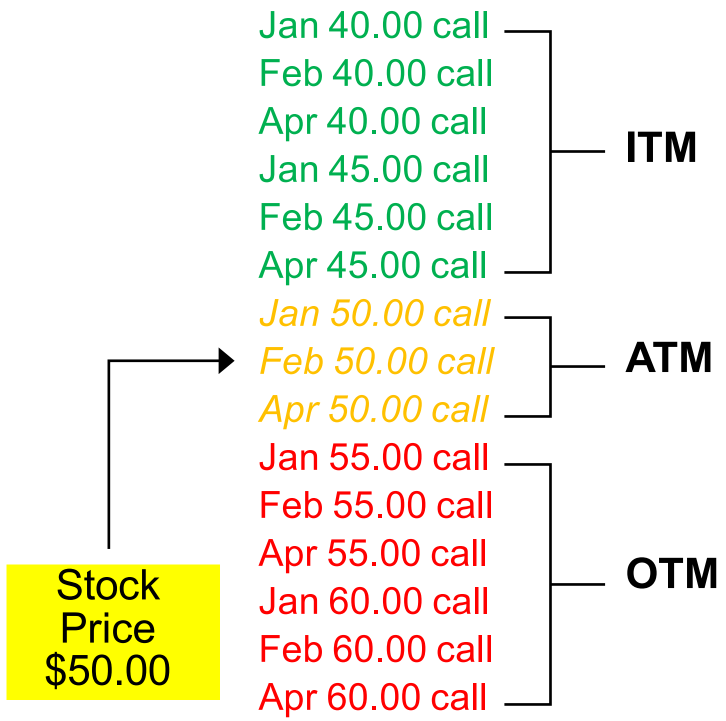
- All market participants (buyers & sellers)
- Individual & Institutional investors
- Professional market-makers
- Best bid/ask is consensus of all bids and offers

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

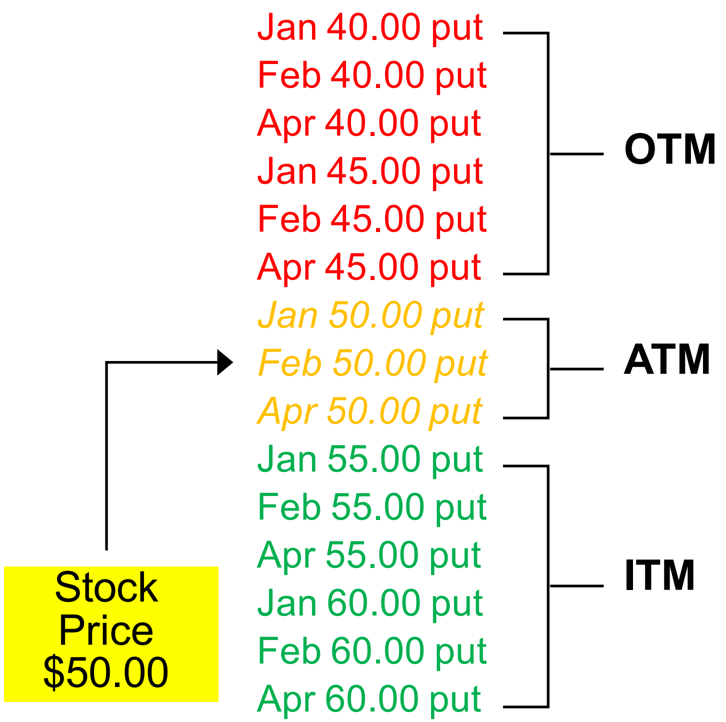
Calls: In-the-Money, At-the-Money, Out-of-the-Money

- 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



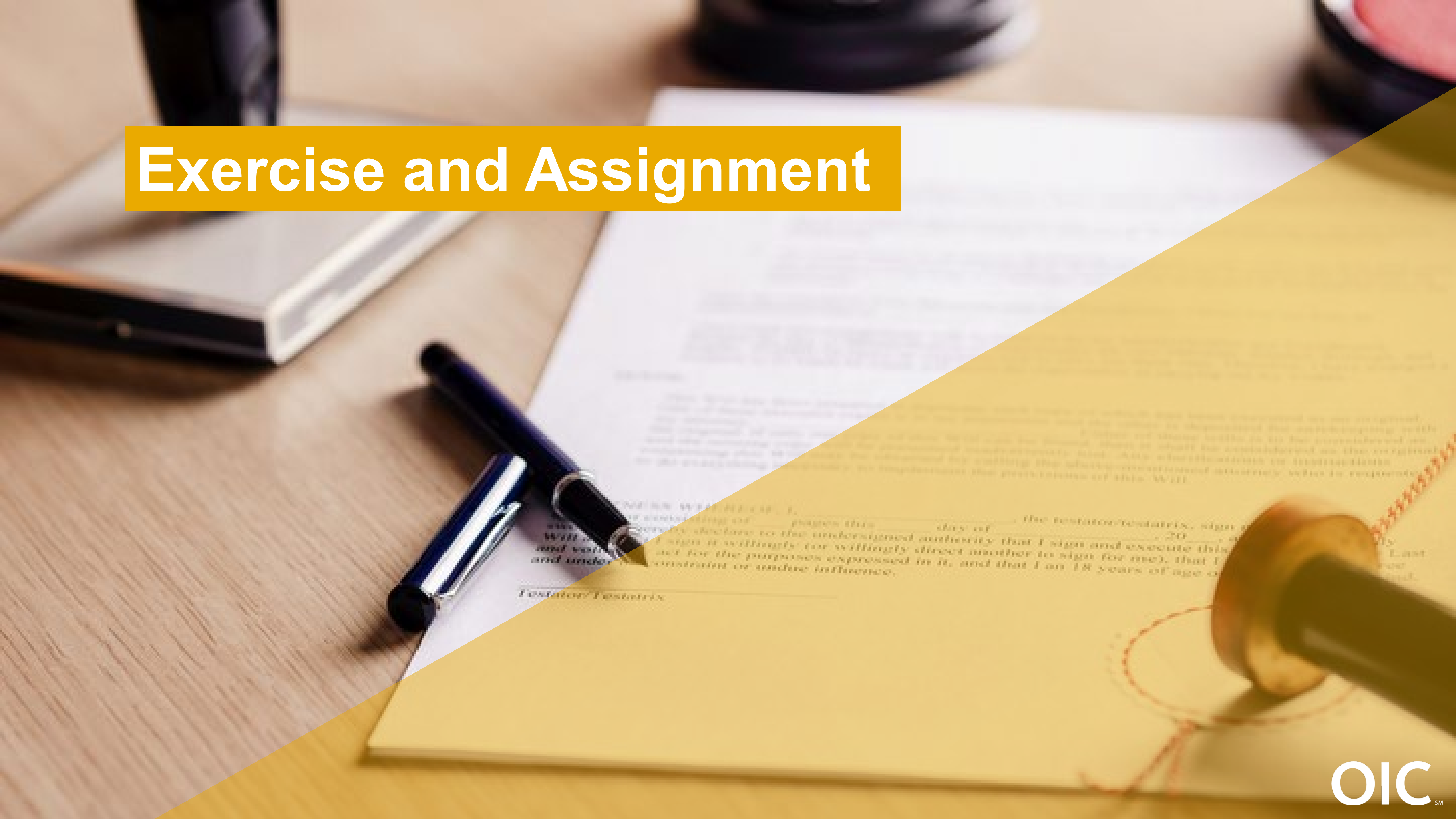
Options Pricing Models

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 **<u>buyer</u>** has the **<u>right</u>**:
  - 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 <u>exercises</u> a long contract**
- To exercise, the buyer issues an exercise notice to his/her brokerage firm (or Auto-ex)
- Only option <u>buyers</u> may <u>exercise</u> an options contract

Assignment: Buy or Sell Underlying Stock

- The option **<u>seller</u>** has the **<u>obligation</u>**:
  - 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 <u>assigned</u> an exercise notice**
- Assignment notice is received from seller’s brokerage firm
- Only option <u>sellers</u> may be <u>assigned</u> on an options contract