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# Options Settlement



Toronto Stock Exchange | TSX Venture Exchange | **Montréal Exchange** | Natural Gas Exchange | Montréal Climate Exchange | Boston Options Exchange

Canadian Derivatives Clearing Corporation | TMX Datalinx | Equicom | PC Bond | Shorcan

# Rights and Obligations



## Option Buyer

CALL = Right to **buy** underlying at a specific price.

PUT = Right to **sell** underlying at a specific price.

## Option Writer

CALL = Obligation to **deliver** at a specific price.

PUT = Obligation to **buy** at a specific price.



# Option Exercise



- The owner of an option can exercise (use) their right to buy or sell the underlying. This is not an obligation.
- Exercise to own the security, if long a **call**.
- Exercise to sell the security, if long a **put**.



# Option Assignment



- An obligation is created by selling or shorting an option.
- If an option holder exercises his/her right, there is a possibility that we may get assigned to fulfill this obligation.
- Short **call** = Deliver the underlying.
- Short **put** = Buy the underlying.



# American Style



- Can be exercised from the time of purchase until expiration.
- Early exercise is a possibility if there is a distinct financial benefit to the option holder.
- Most Canadian and U.S. options are American style.



# European Style



- Can only be exercised on the last trading day before the expiration date.
- It is important to know when the option expires how the contract is settled.





# Cash-Settled Options



- Do not require the physical delivery of the underlying security.
- Difference between the market value of the underlying and the strike of the option.
- The associated dollar amount is added to the account on option expiration.



# Examples of Cash-Settled Options



- Index options
- Interest rate options
- Some currency options



# Physically Settled Options



- Require the actual delivery of the underlying security...
- ... in the equivalent number of shares represented by the number option contracts.
- Full payment per share in the amount of the strike price is exchanged.



# Examples of Physically Settled Options



- Equity options
- Most exchange-traded fund options



# Automatic Exercise



- If the option contract is \$0.01 in-the-money.
- Only triggered at the market close on the last trading day before expiration date.
- The clearinghouse assumes the option holder wishes to exercise their right



# Implications



- For a call option holder, the underlying will automatically be purchased at the strike price.
- For a put option holder, the underlying will be sold at the strike price.
- If the put holder does not already own the underlying, a short position will be created.



# Implications



- The option buyer/holder can offset (sell) the option contract prior to expiration.
- Can also advise the broker not to auto exercise.
- As an option writer/seller, there is no override. The short option must be bought back prior to the end of the trading day on expiration Friday.





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