

LEARNING THE LANGUAGE OF OPTIONS – A REFRESHER COURSE – PART 4

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In last week's article *Learning the Language of Options* we outlined some other key concepts that are unique to options. This week we look at elements of the options market.

ELEMENTS OF THE OPTIONS MARKET



Contract size of exchange traded options

The contract size of an exchange traded option is generally 100 shares per contract. That means that if you see the price of the option at \$1.00, your outlay will be \$100 to buy one option contract. If the price of the option moves to \$1.50 you could sell it to receive \$150. However, there can be circumstances when an option has more or less than 100 shares per contract. This may occur when there are corporate actions such as rights issues or share splits that in the interest of fairness may require adjustment to the relevant option contract size.

Option premium quotations

- In Australia option premiums are expressed in cents. For example, a BHP call option with a premium value of \$3.20 will be expressed as 320.
- In the US option premiums are quoted in dollars and cents per share. For example an option price of \$3.20 will be quoted as 3.20.

In neither case is the dollar-sign included.

Converting premium value to dollar value

To calculate the dollar value of an options premium, look at the example below:

Option premium	x	Shares per option contract	=	Dollar value
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Example: 3.20 x 100 = \$320 per contract

For multiple contracts multiply the dollar value per contract by the number of contracts held. For example if you held five option contracts, to determine the total dollar value, you would do the following:

$$\begin{aligned} &\text{Number of contracts} \times \text{option premium} \times \text{shares per contract} \\ &= 5 \times 3.20 \times 100 = \$1,600 \end{aligned}$$

Strike price quotations

- In Australia the strike price is quoted in cents. For example, a BHP 35.00 call option will be quoted as 3500.
- In the US the strike price is quoted in dollars and cents. For example, a Bank of America 10.00 call option will be quoted as 10.00.

For the sake of clarity we will use the US convention of adding a decimal to strike prices.

The price intervals between option strike prices

In Australia the ASX generally lists option intervals as follows:

Equity options series

- 10 cent intervals for strikes 0 to 199 cents
- 25 cent intervals for strikes 200 to 1000 cents
- 50 cent intervals for strikes greater than 1000 cents

S&P ASX 200 (XJO) index options series

- 25 point intervals for near months (first four months)
- 50 point intervals for mid-dated months (third and fourth quarters)
- 100 point intervals for long-dated months (fifth and sixth quarters)

In the US the CBOE (Chicago Board Options Exchange) generally lists option intervals as follows:

Equity options series

- \$2.50 intervals for strikes between \$5 and \$25
- \$5.00 intervals for strikes between \$25 and \$200
- \$10.00 intervals for strikes above \$200

Long Term Equity Anticipation Securities (LEAPS) usually start with one at the money, one in the money, and one out of the money strike price. The latter two are usually set 20 to 25 per cent away from the former. LEAPS is the name given to US options created with duration of longer than nine months. They have options that expire in January of every year.

Option expiry dates

In Australia the ASX will list series in the first six maturity months and then March, June, September and December expiry months out for a period of two years. For maturities in year three, ASX will list June and December expiry months. With regard to the ETO (Exchange Traded Options) contracts, ASX will list series in the first three maturity months and then March, June, September and December expiry months. ASX will not list index ETO series with expiries beyond 18 months. In the US every option will have the current month plus the following month available to trade. Not all stocks have the same expiry months available. Each stock will belong to a particular option cycle.

The three option cycles which are available are:

- January, April, July and October
- March, June, September and December
- February, May, August and November

Each stock will have at least four expiry months to trade with the later months following the original cycles. Check the exchange websites or ask your broker which months are available for options trading before entering any trade.

Settlement dates for trading options

The settlement date refers to the date on which ownership of the security is actually transferred and money is exchanged between buyer and seller. For options, the settlement date is one day after the trade date. You will often see the abbreviation as T+1 which is the trade date plus one day. Settlement day for ASX shares is typically T+3.

Option expiry details

In Australia option expiry usually occurs on the last Thursday of the month. Index options expire on the third Thursday of the contract month, providing this is a trading day. In the US, option expiry occurs the Saturday immediately following the third Friday of the expiration month. The last trading day for US stock options is normally on the third Friday of each month.

Trading hours for Australian and US stock options

In Australia, trading hours for stock options are from 10.00am to 4.20pm (Sydney time). Despite the official trading times, it is best to trade between 10.20am and 4.00pm as market makers are not obliged and often don't quote outside of these hours.

In the United States, trading hours are from 9:30am to 4:00pm (New York time). During Australian daylight savings time (Sydney time) this is 1.30am to 8.00am. Outside of Australian daylight savings time (Sydney time) this is 11.30pm to 6.00am.

Premium quotations

For Australian options the minimum tick value is \$0.01 per share which is equal to \$1.00 per contract ($\0.01×100 shares per contract).

For US options the minimum tick value is \$0.05 per share which is equal to \$5.00 per contract if the value of the shares is below \$3.00, and \$0.10 per share which is equal to \$10.00 for all other option series.

Costs associated with ASX options trading

Options trading costs consist of clearing fees and brokerage fees.

ASX Clear fees

ASX Clear charges a flat transaction fee of \$0.13 plus GST per share option contract.

If you exercise a share option, ASX Clear charges an exercise fee of \$0.05 plus GST per contract.

If you are assigned on an option position, ASX Clear charges a fee of \$0.05 plus GST per contract.

In the case of index options, ASX Clear charges a registration fee of \$0.45 plus GST per contract and an exercise fee of \$0.35 plus GST per contract.

Brokerage

Broking charges vary and will depend on the level of service required. Brokerage can be a flat fee, a percentage of the amount you are investing, or a combination of the two. Typically, many brokers will charge a flat fee up to a certain dollar value and then a percentage charge thereafter. In the US the brokerage charged will typically be on a per contract basis and will also vary according to the level of service provided.