

This document is an unofficial consolidation of all amendments to Ontario Securities Commission Rule 91-502 *Trades in Recognized Options*, applying from **September 28, 2009**. This document is for reference purposes only and is not an official statement of the law.

**ONTARIO SECURITIES COMMISSION RULE 91-502  
TRADES IN RECOGNIZED OPTIONS**

**TABLE OF CONTENTS**

<b><u>PART</u></b>	<b><u>TITLE</u></b>
PART 1	DEFINITIONS
1.1	Definitions
PART 2	PROSPECTUS AND REGISTRATION EXEMPTIONS
2.1	Prospectus Exemptions
2.2	Registration Exemptions
PART 3	PROFICIENCY REQUIREMENTS
3.1	Proficiency Requirements
PART 4	ADDITIONAL OR AMENDED OPTIONS
4.1	Additional Non-Equity Accepted Options
4.2	Recognition of Additional Non-Equity Accepted Options Traded on Recognized Markets
4.3	Changes to Recognized Options Traded on Recognized Markets
PART 5	RECOGNIZED MARKET CLEARING CORPORATIONS
5.1	Filing Requirements
5.2	Approval by Commission
5.3	Reporting Requirements
PART 6	EXEMPTION
6.1	Exemption
PART 7	REVOCATION OF BLANKET RULINGS
7.1	Revocation of Blanket Rulings
PART 8	EFFECTIVE DATE
APPENDIX A - DISCLOSURE STATEMENT FOR RECOGNIZED MARKET OPTIONS	
APPENDIX B - RISK DISCLOSURE STATEMENT	

**ONTARIO SECURITIES COMMISSION RULE 91-502  
TRADES IN RECOGNIZED OPTIONS**

**PART 1        DEFINITIONS**

**1.1        Definitions** - In this Rule

"Canadian Options Course" means the course prepared and conducted by The Canadian Securities Institute and so named by that Institute on the date that this Rule comes into force and every predecessor to that course and every successor to that course that does not significantly narrow a subject matter;

"CFA" means the *Commodity Futures Act*;

"clearing corporation" means an association or organization through which trades in options or futures contracts are cleared and settled.

"commodity" has the meaning ascribed to that term in the CFA;

"equity option" means an option that is issued by a clearing corporation the underlying interest of which is one or more equity securities;

"equity security" has the meaning ascribed to that term in subsection 89(1) of the Act;

"non-equity accepted option" means

- (a) an option that is issued by a clearing corporation, other than a commodity futures option within the meaning of the CFA, the underlying interest of which consists only of one or more evidences of indebtedness, interest rates, stock market indices, precious metals or commodities, or
- (b) an option that is issued by a clearing corporation and that is included in an additional category of options accepted by the Director under section 4.1, the underlying interest of which is not an equity security;

"option" means an agreement that provides the holder with the right, but not the obligation, to do one or more of the following on terms or at a price established by or determinable by reference to the agreement at or by a time established by the agreement:

- 1. receive an amount of cash determinable by reference to a specified quantity of the underlying interest of the option.
- 2. purchase a specified quantity of the underlying interest of the option.
- 3. sell a specified quantity of the underlying interest of the option;

"options hedger" means a person or company trading in a recognized option the underlying interest of which relates to a risk to which a business carried on by the person or company is exposed, if

**Unofficial Consolidation – September 28, 2009**

- (a) the risk arises as a necessary part of the business carried on by the person or company, and relates to fluctuations in
  - (i) the price of a commodity related to the business,
  - (ii) the value of liabilities which the person or company has incurred in connection with the business, or
  - (iii) the value of a portfolio of investments which the person or company owns in connection with the business, and
- (b) the person or company offsets or attempts to offset all or a portion of the risk through trading in recognized options, whether or not any particular trade is effected for that purpose;

"recognized dealer" means a person or company

- (a) registered under the Act as a dealer in the category of broker or investment dealer,
- (b) registered under the CFA as a dealer in the category of futures commission merchant and that is a member of The Alberta Stock Exchange, The Toronto Stock Exchange, the TFE, The Montreal Exchange, the Vancouver Stock Exchange, The Winnipeg Commodity Exchange or the Investment Dealers Association of Canada,
- (c) who is a member of The Alberta Stock Exchange, The Toronto Stock Exchange, the TFE, The Montreal Exchange, the Vancouver Stock Exchange, The Winnipeg Commodity Exchange or the Investment Dealers Association of Canada only as to a trade in a recognized option on behalf of an options hedger, or
- (d) who, with respect to an option traded on the TFE, is an Unrestricted Trader Member of the TFE, acting in accordance with the By-laws of the TFE;

"recognized market" means a stock exchange recognized under section 21 of the Act on which options are traded;

"recognized market clearing corporation" means a clearing corporation through which trades in options entered into on or through a recognized market are cleared and settled;

"recognized option" means an equity option or a non-equity accepted option

- (a) traded on an exchange or market and cleared at the time this Rule comes into force or thereafter through a clearing corporation that is not a recognized market clearing corporation,
- (b) traded on an exchange or market and cleared at the time this Rule comes into force through a recognized market clearing corporation, or
- (c) recognized under section 4.2;

"risk disclosure statement" means

- (a) on or before January 1, 1999, either the statement attached to this Rule as Appendix A or the statement attached to the Rule as Appendix B, and
- (b) after January 1, 1999, the statement attached to this Rule as Appendix B;

"TFE" means The Toronto Futures Exchange, or any successor organization to The Toronto Futures Exchange; and

"underlying interest" means for an option, the security, commodity, financial instrument, currency, interest rate, foreign exchanges rate, economic indicator, index, basket, agreement or benchmark, and, if applicable, the relationship between any of the foregoing, from or on which the market price, value or payment obligations of the option are derived or based.

## **PART 2 PROSPECTUS AND REGISTRATION EXEMPTIONS**

**2.1 Prospectus Exemptions** - Section 53 of the Act does not apply to a trade in a recognized option entered into by

- (a) a recognized dealer acting as principal; or
- (b) a person or company trading through a recognized dealer if the person or company has been provided with the risk disclosure statement by the recognized dealer.

### **2.2 Registration Exemptions**

- (1) The dealer registration exemptions referred to in section 3.1 of NI 45-106 *Prospectus and Registration Exemptions* and section 8.5(a) of NI 31-101 [sic] *Registration Requirements and Exemptions* are not available for a trade in a recognized option that is a non-equity accepted option.
- (2) The dealer registration requirement does not apply to a trade in a recognized option that is a non-equity accepted option entered into by
  - (a) a recognized dealer acting as principal; or
  - (b) a person or company trading through a recognized dealer.
- (3) The adviser registration requirement does not apply to advice given with respect to a recognized option that is a non-equity accepted option by a person registered as adviser under the CFA or a person or company exempt from the requirement to be so registered.

## **PART 3 PROFICIENCY REQUIREMENTS**

**3.1 Proficiency Requirements** - No person shall trade as agent in, or give advice in respect of, a recognized option unless he or she has successfully completed the Canadian Options Course.

## **PART 4        ADDITIONAL OR AMENDED OPTIONS**

**4.1     Additional Non-Equity Accepted Options** - The Director shall accept an additional category of option as a non-equity accepted option if

- (a)     each condition of the proposed additional category of option would be in conformity with normal commercial practices having regard to, among other things, the trading, exercise and settlement of the option or, if not so in conformity, that there would be reasonable justification for the divergence; and
- (b)     the risks resulting for investors in the proposed additional category of option are adequately described by the risk disclosure statement.

### **4.2     Recognition of Additional Non-Equity Accepted Options Traded on Recognized Markets**

- (1)     A recognized market or a recognized market clearing corporation shall deliver to the Director the contract specifications for any option before the introduction for trading of the option on the market.
- (2)     If the additional option is a non-equity accepted option, the additional option becomes a recognized option unless the Director informs the recognized market within 10 business days after the filing that the Director refuses to accept the additional option as a recognized option.
- (3)     The Director shall not refuse to accept an additional option as a recognized option unless
  - (a)     any condition of the proposed additional option would not be in conformity with normal commercial practices having regard to, among other things, the trading, exercise and settlement of the option without there being reasonable justification for the divergence; or
  - (b)     the risks resulting for investors in the proposed additional option are not adequately described by the risk disclosure statement.

### **4.3     Changes to Recognized Options Traded on Recognized Markets**

- (1)     No change to the contract specifications of any recognized option traded on a recognized market that is material shall be implemented without the prior approval of the Director.
- (2)     A recognized market may apply for the prior approval of the Director by delivering to the Director the details of the proposed change.
- (3)     The recognized market may implement the proposed change unless the Director informs the recognized market, within 10 business days after the filing, that he or she has refused to accept the proposed change.
- (4)     The Director shall not refuse to accept a proposed change to a recognized option unless
  - (a)     the proposed change would result in the option not being in conformity with normal commercial practices having regard to, among other things, the trading, exercise and settlement of the option without there being reasonable justification for the divergence; or

- (b) the risks resulting for investors from the proposed change are not adequately described by the risk disclosure statement.

## **PART 5 RECOGNIZED MARKET CLEARING CORPORATIONS**

**5.1 Filing Requirements** - Every recognized market clearing corporation shall deliver to the Commission each by-law, rule, regulation and policy approved by the board of directors of the recognized market clearing corporation within five days after the date on which it is approved and before its approval by the membership of the recognized market clearing corporation.

### **5.2 Approval by Commission**

- (1) No by-law, rule, regulation or policy of a recognized market clearing corporation shall come into force without the approval of the Commission.
- (2) A by-law, rule, regulation or policy of a recognized market clearing corporation that has not been approved by the Commission within 30 days after the delivery referred to in section 5.1 shall be deemed to be approved by the Commission on the thirtieth day after the delivery unless the Commission or its staff has notified the recognized market clearing corporation that approval of the Commission will not be forthcoming within the 30 day period for any reason, including that further information is required in connection with the by-law, rule, regulation or policy.
- (3) The Commission shall not fail to approve a by-law, rule, regulation or policy of a recognized market clearing corporation unless the by-law, rule, regulation or policy
  - (a) may adversely affect the likelihood that obligations arising out of options cleared through the recognized market clearing corporation would be met in accordance with normal commercial practices;
  - (b) may adversely expose investors to unfair, improper or fraudulent practices;
  - (c) may adversely affect the fostering of fair and efficient capital markets and confidence in the capital markets; or
  - (d) may be prejudicial to the public interest.

**5.3 Reporting Requirements** - Each recognized market clearing corporation shall deliver to the Commission

- (a) within 150 days after the end of each of its fiscal years, its audited financial information for the fiscal year; and
- (b) within five days after the occurrence of a change that is material to information provided to the Commission respecting incorporation, principal or registered office, officers, directors or shareholders, details of the change.

**PART 6 EXEMPTION**

**6.1 Exemption** - The Director may grant an exemption to this Rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

**PART 7 REVOCATION OF BLANKET RULINGS**

**7.1 Revocation of Blanket Rulings** - The following Blanket Rulings of the Commission are revoked:

1. In the Matter of The Recognized Options Rationalization Order and In The Matter of the Options Clearing Corporation (1992), 15 OSCB 3817.
2. In the Matter of the Recognized Options Rationalization Order and In the Matter of The Montreal Exchange (1993), 16 OSCB 4916.

**PART 8 EFFECTIVE DATE**

[Note: This unofficial consolidation does not include PART 8, which contains the original historical coming-into-force provision for this Rule.]

## **RULE 91-502**

### **APPENDIX A - DISCLOSURE STATEMENT FOR RECOGNIZED MARKET OPTIONS**

*No securities commission or similar authority in Canada has in any way passed upon the merits of Options referred to herein and any representation to the contrary is an offence. This document contains condensed information respecting the Options referred to herein. Additional information may be obtained from your broker.*

#### **Disclosure Statement for Recognized Market Options**

A high degree of risk may be involved in the purchase and sale of Options, depending to a large measure on how and why Options are used. Options may not be suitable for every investor. See "Risks in Options Trading" and "Additional Information".

#### **Introduction**

This Disclosure Statement sets forth general information relevant to the purchase and sale of Put and Call Options traded on a recognized market and cleared through a clearing corporation. Information concerning the underlying interests on which Options are traded, the terms and conditions of these Options, the recognized markets on which they trade and the applicable clearing corporations may be obtained from your broker. Information on investment strategies and possible uses of Options may also be obtained from your broker.

This Disclosure Statement refers only to Options and clearing corporations which have been recognized or qualified for purposes of this Disclosure Statement by provincial securities administrators where required. The Options discussed herein trade on markets which, for the purposes of this Disclosure Statement only, are referred to as "recognized markets".

#### **Nature of an Option**

An Option is a contract entered into on a recognized market between a seller (sometimes known as a writer) and a purchaser where all the terms and conditions of the contract (called the "specifications"), other than the consideration (called the "premium") for the Option, are standardized and predetermined by the recognized market. The premium, paid by the purchaser to the seller, is determined in the market on the basis of supply and demand, reflecting such factors as the duration of the Option, the difference between the exercise price of the Option and the market price of the underlying interest, the price volatility and other characteristics of the underlying interest.

There are two types of Options: Calls and Puts. A Call gives the purchaser a right to buy, and a Put the right to sell, a specific underlying interest at a stated exercise price and within a specified period of time or on a specific date. An Option subjects the seller to an obligation to honour the right granted to the purchaser if exercised by the purchaser. Underlying interests can be shares of a specific corporation, bonds, notes, bills, certificates of deposit, commodities, foreign currency, the cash value of an interest in a stock index or any other interest provided for in the specifications.

An Option transaction is entered into on a recognized market by a purchaser and a seller represented by their respective brokers. When the transaction is concluded it is cleared by a clearing corporation affiliated with the recognized market on which the Option is traded. When an Option transaction is cleared by the clearing

corporation it is divided into two contracts with the clearing corporation becoming the seller to the purchaser in the transaction and the purchaser to the seller. Thus on every outstanding Option, the purchaser may exercise the Option against the clearing corporation and the seller may be called upon to perform his obligation through exercise of the Option by the clearing corporation.

Options may also be classified according to delivery requirements: actual delivery and cash delivery. An actual delivery Option requires the physical delivery of the underlying interest if the Option is exercised. A cash delivery Option requires a cash payment of the difference between the aggregate exercise price and the value of the underlying interest at a specified time prior or subsequent to the time the Option is exercised.

Options are issued in series designated by an expiration month, an exercise price, an underlying interest and a unit of trading. At the time trading is introduced in Options with a new expiration month, the recognized market on which the Option is traded establishes exercise prices that reflect the current spot prices of the underlying interest. Generally, three series of Options are introduced with exercise prices at, below and above the current spot price. When the spot price of the underlying interest moves, additional Options may be added with different exercise prices. Options having the same underlying interest and expiration month, but having different exercise prices, may trade at the same time.

### **Specifications of Options**

Specifications of Options are fixed by the recognized market on which they are traded. These specifications may include such items as trading units, exercise prices, expiration dates, last day of trading, and the time for determining settlement values.

An Option may be bought or sold only on the recognized market on which the Option is traded. The recognized market and the clearing corporation may each impose restrictions on certain types of transactions, and under certain circumstances may modify the specifications of outstanding Options. In addition, a recognized market or a clearing corporation may limit the number of Options which may be held by an investor, and may limit the exercise of Options under prescribed circumstances.

### **Exercising Options**

An Option may have either an American style exercise or European style exercise irrespective of where the recognized market is located. An American style Option can be exercised by the purchaser at any time before the expiration. To do this, the purchaser notifies the broker through whom the Option was purchased. A purchaser should ascertain in advance from his broker the latest date on which he may give such notice to his broker. A European style Option may only be exercised by the purchaser on a specified date. Upon receiving an exercise notice from the purchaser's broker, the clearing corporation assigns it to a member which may re-assign it to a client on a random or other predetermined selection basis.

Upon assignment, the seller must make delivery of (in the case of a Call) or take delivery of and pay for (in the case of a Put) the underlying interest. In the case of a cash delivery Option, the seller must, in lieu of delivery, pay the positive difference between the aggregate exercise price and the settlement value of the underlying interest (in the case of both a Call and a Put).

A purchaser of an Option which expires loses the premium paid for the Option and his transaction costs. The seller of an Option which expires will have as his gain the premium received for the Option less his transaction costs.

## **Trading of Options**

Each recognized market permits secondary market trading of its Options. This enables purchasers and sellers of Options to close out their positions by offsetting sales and purchases. By selling an Option with the same terms as the one purchased, or buying an Option with the same terms as the one sold, an investor can liquidate his position (called an "offsetting transaction"). Offsetting transactions must be made prior to expiration of an Option or by a specified date prior to expiration. Offsetting transactions must be effected through the broker through whom the Option was initially sold or purchased.

Price movements in the underlying interest of an Option will generally be reflected to some extent in the secondary market value of the Option and the purchaser who wishes to realize a profit will have to sell or exercise his Option during the life of the Option or on the specified date for exercise, as the case may be.

## **Costs of Options Trading**

### ***Margin Requirements***

Prior to trading Options, a seller must deposit with his broker cash or securities as collateral (called "margin") for the obligation to buy (in the case of a Put) or sell (in the case of a Call) the underlying interest if the Option should be exercised. Minimum margin rates are set by the recognized market on which the Option trades. Higher rates of margin may be required by the seller's broker.

Margin requirements of various recognized markets may differ. In addition, they are subject to change at any time and such changes may apply retroactively to Option positions previously established.

### ***Commission Charges***

Commissions are charged by brokers on the purchase or sale of Options as well as on the exercise of Options and the delivery of underlying interests.

## **Risks in Options Trading**

Options can be employed to serve a number of investment strategies including those concerning investments in or related to underlying interests. **SOME STRATEGIES FOR BUYING AND SELLING OPTIONS INVOLVE GREATER RISK THAN OTHERS.**

The following is a brief summary of some of the risks connected with trading in Options:

- (i) Because an Option has a limited life, the purchaser runs the risk of losing his entire investment in a relatively short period of time. If the price of the underlying interest does not rise above (in the case of a Call) or fall below (in the case of a Put) the exercise price of the Option plus premium and transaction costs during the life of the Option, or by the specified date for exercise, as the case may be, the Option may be of little or no value and if allowed to expire will be worthless.
- (ii) The seller of a Call who does not own the underlying interest is subject to a risk of loss should the price of the underlying interest increase. If the Call is exercised and the seller is required to purchase the underlying interest at a market price above the exercise price in order to make delivery, he will suffer a loss.

(iii) The seller of a Put who does not have a corresponding short position (that is an obligation to deliver what he does not own) in the underlying interest will suffer a loss if the price of the underlying interest decreases below the exercise price, plus transaction costs minus the premium received. Under such circumstances, the seller of the Put will be required to purchase the underlying interest at a price above the market price, with the result that any immediate sale will give rise to a loss.

(iv) The seller of a Call who owns the underlying interest is subject to the full risk of his investment position should the market price of the underlying interest decline during the life of the Call, or by the specified date for exercise, as the case may be, but will not share in any gain above the exercise price.

(v) The seller of a Put who has a corresponding short position in the underlying interest is subject to the full risk of his investment position should the market price of the underlying interest rise during the life of the Put, or by the specified date for exercise, as the case may be, but will not share in any gain resulting from a decrease in price below the exercise price.

(vi) Transactions for certain Options may be carried out in a foreign currency. Accordingly, purchasers and sellers of these Options using Canadian dollars will be exposed to risks from fluctuations in the foreign exchange market as well as to risks from fluctuations in the price of the underlying interest.

(vii) There can be no assurance that a liquid market will exist for a particular Option to permit an offsetting transaction. For example, there may be insufficient trading interest in the particular Option; or trading halts, suspensions or other restrictions may be imposed on the Option or the underlying interest; or some event may interrupt normal market operations; or a recognized market could for regulatory or other reasons decide or be compelled to discontinue or restrict trading in the Option. In such circumstances the purchaser of the Option would only have the alternative of exercising his Option in order to realize any profit, and the seller would be unable to terminate his obligation until the Option expired or until he performed his obligation upon being assigned an exercise notice.

(viii) The seller of an American style Option has no control over when he might be assigned an exercise notice. He should assume that an exercise notice will be assigned to him in circumstances where the seller may incur a loss.

(ix) In unforeseen circumstances there may be a shortage of underlying interests available for delivery upon exercise of actual delivery Options, which could increase the cost of or make impossible the acquisition of the underlying interests and cause the clearing corporation to impose special exercise settlement procedures.

(x) In addition to the risks described above which apply generally to the buying and selling of Options, there are timing risks unique to Options that are settled by the payment of cash.

The exercise of Options settled in cash results in a cash payment from the seller to the purchaser based on the difference between the exercise price of the Option and the settlement value. The settlement value is based on the value of the underlying interest at a specified time determined by the rules of the recognized market. This specified time could vary with the Option. For example, the specified time could be the time for establishing the closing value of the underlying interest on the day of exercise or in the case of some Options based on a stock index the time for establishing the value of the underlying interest which is based on the opening prices of constituent stocks on the day following the last day of trading. Options for which the settlement value is based on opening prices may not, unless the applicable recognized market announces a rule change to the

contrary, trade on that day.

The settlement value for Options, futures contracts and futures options may not be calculated in the same manner even though each may be based on the same underlying interest.

Where the settlement value of a cash delivery Option is determined after the exercise period, the purchaser who exercises such Option will suffer from any unfavourable change in the value of the underlying interest from the time of his decision to exercise to the time settlement value is determined. With actual delivery Options, this risk can be covered by a complementary transaction in the actual market for the underlying interest.

The seller of a cash delivery Option is not informed that he has been assigned an exercise notice until the business day following exercise, at the earliest, and the seller will suffer from any unfavourable change in the value of the underlying interest from the time of determination of the settlement value to the time he learns that he has been assigned. Unlike the seller of an actual delivery Option, the seller of a cash delivery Option cannot satisfy his assignment obligations by delivery of the lower valued underlying interest, but must pay cash in an amount determined by the settlement value.

The type of risk discussed above makes spreads and other complex option strategies involving cash delivery Options substantially more risky than similar strategies involving actual delivery Options.

### **Tax Consequences**

The income tax consequences of trading in Options are dependent upon the nature of the business activities of the investor and the transaction in question. Investors are urged to consult their own professional advisers to determine the consequences applicable to their particular circumstances.

### **Additional Information**

Before buying or selling an Option an investor should discuss with his broker:

- . His investment needs and objectives
- . The risks he is prepared to take
- . The specifications of Options he may wish to trade
- . Commission rates
- . Margin requirements
- . Any other matter of possible concern

Specifications for each Option are available on request from your broker and from the recognized market on which the Option is traded. Should there be any difference in interpretation between this document and the specifications for a given Option, the specifications shall prevail.

**RULE 91-502**  
**APPENDIX B - RISK DISCLOSURE STATEMENT**

**Risk Disclosure Statement for Futures and Options**

This brief statement does not disclose all of the risks and other significant aspects of trading in futures and options. In light of the risks, you should undertake such transactions only if you understand the nature of the contracts (and contractual relationships) into which you are entering and the extent of your exposure to risk. Trading in futures and options is not suitable for many members of the public. You should carefully consider whether trading is appropriate for you in light of your experience, objectives, financial resources and other relevant circumstances.

**Futures**

**1. Effect of "Leverage" or "Gearing"**

Transactions in futures carry a high degree of risk. The amount of initial margin is small relative to the value of the futures contract so that transactions are "leveraged" or "geared". A relatively small market movement will have a proportionately larger impact on the funds you have deposited or will have to deposit: this may work against you as well as for you. You may sustain a total loss of initial margin funds and any additional funds deposited with the firm to maintain your position. If the market moves against your position or margin levels are increased, you may be called upon to pay substantial additional funds on short notice to maintain your position. If you fail to comply with a request for additional funds within the time prescribed, your position may be liquidated at a loss and you will be liable for any resulting deficit.

**2. Risk-reducing Orders or Strategies**

The placing of certain orders (e.g. "stop-loss" order, where permitted under local law, or "stop-limit" orders) which are intended to limit losses to certain amounts may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as "spread" and "straddle" positions may be as risky as taking simple "long" or "short" positions.

**Options**

**3. Variable Degree of Risk**

Transactions in options carry a high degree of risk. Purchasers and sellers of options should familiarize themselves with the type of option (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs.

The purchaser of options may offset or exercise the options or allow the options to expire. The exercise of an option results either in a cash settlement or in the purchaser acquiring or delivering the underlying interest. If the option is on a future, the purchaser will acquire a futures position with associated liabilities for margin (see the section on Futures above). If the purchased options expire worthless, you will suffer a total loss of your investment which will consist of the option premium plus transaction costs. If you are contemplating purchasing deep-out-of-the-money options, you should be aware that the chance of such options becoming

profitable ordinarily is remote.

Selling ("writing" or "granting") an option generally entails considerably greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavourably. The seller will also be exposed to the risk of the purchaser exercising the option and the seller will be obligated to either settle the option in cash or to acquire or deliver the underlying interest. If the option is on a future, the seller will acquire a position in a future with associated liabilities for margin (see the section on Futures above). If the option is "covered" by the seller holding a corresponding position in the underlying interest or a future or another option, the risk may be reduced. If the option is not covered, the risk of loss can be unlimited.

Certain exchanges in some jurisdictions permit deferred payment of the option premium, exposing the purchaser to liability for margin payments not exceeding the amount of the premium. The purchaser is still subject to the risk of losing the premium and transaction costs. When the option is exercised or expires, the purchaser is responsible for any unpaid premium outstanding at that time.

### **Additional Risks Common to Futures and Options**

#### **4. Terms and Conditions of Contracts**

You should ask the firm with which you deal about the terms and conditions of the specific futures or options which you are trading and associated obligations (e.g., the circumstances under which you may become obligated to make or take delivery of the underlying interest of a futures contract and, in respect of options, expiration dates and restrictions on the time for exercise). Under certain circumstances the specifications of outstanding contracts (including the exercise price of an option) may be modified by the exchange or clearing house to reflect changes in the underlying interest.

#### **5. Suspension or Restriction of Trading and Pricing Relationships**

Market conditions (e.g. illiquidity) and/or the operation of the rules of certain markets (e.g. the suspension of trading in any contract or contract month because of price limits or "circuit breakers") may increase the risk of loss by making it difficult or impossible to effect transactions or liquidate/offset positions. If you have sold options, this may increase the risk of loss.

Further, normal pricing relationships between the underlying interest and the future, and the underlying interest and the option may not exist. This can occur when, for example, the futures contract underlying the option is subject to price limits while the option is not. The absence of an underlying reference price may make it difficult to judge "fair" value.

#### **6. Deposited Cash and Property**

You should familiarize yourself with the protections accorded money or other property you deposit for domestic and foreign transactions, particularly in the event of a firm insolvency or bankruptcy. The extent to which you may recover your money or property may be governed by specific legislation or local rules. In some jurisdictions, property which had been specifically identifiable as your own will be prorated in the same manner as cash for purposes of distribution in the event of a shortfall.

## **7. Commission and Other Charges**

Before you begin to trade, you should obtain a clear explanation of all commission, fees and other charges for which you will be liable. These charges will affect your net profit (if any) or increase your loss.

## **8. Transactions in Other Jurisdictions**

Transactions on markets in other jurisdictions, including markets formally linked to a domestic market, may expose you to additional risk. Such markets may be subject to regulation which may offer different or diminished investor protection. Before you trade you should enquire about any rules relevant to your particular transactions. Your local regulatory authority will be unable to compel the enforcement of the rules of regulatory authorities or markets in other jurisdictions where your transactions have been effected. You should ask the firm with which you deal for details about the types of redress available in both your home jurisdiction and other relevant jurisdictions before you start to trade.

## **9. Currency Risks**

The profit or loss in transactions in foreign currency-denominated contracts (whether they are traded in your own or another jurisdiction) will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the contract to another currency.

## **10. Trading Facilities**

Most open-outcry and electronic trading facilities are supported by computer-based component systems for the order-routing, execution, matching, registration or clearing of trades. As with all facilities and systems, they are vulnerable to temporary disruption or failure. Your ability to recover certain losses may be subject to limits on liability imposed by the system provider, the market, the clearing house and/or member firms. Such limits may vary; you should ask the firm with which you deal for details in this respect.

## **11. Electronic Trading**

Trading on an electronic trading system may differ not only from trading in an open-outcry market but also from trading on other electronic trading systems. If you undertake transactions on an electronic trading system, you will be exposed to risks associated with the system including the failure of hardware and software. The result of any system failure may be that your order is either not executed according to your instructions or is not executed at all. Your ability to recover certain losses which are particularly attributable to trading on a market using an electronic trading system may be limited to less than the amount of your total loss.

## **12. Off-exchange Transactions**

In some jurisdictions, and only then in restricted circumstances, firms are permitted to effect off-exchange transactions. The firm with which you deal may be acting as your counterparty to the transaction. It may be difficult or impossible to liquidate an existing position, to assess the value, to determine a fair price or to assess the exposure to risk. For these reasons, these transactions may involve increased risks.

Off-exchange transactions may be less regulated or subject to a separate regulatory regime. Before you undertake such transactions, you should familiarize yourself with applicable rules.

