
Fixed Return Optionss

FROs

A Comparison of FROs and Standard Listed Options Settlement



Fixed Return Options

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FROs

- Settlement value is the value used on expiration Friday to determine if a FRO is in-the-money or out-of-the-money.
- Settlement Value will be determined by an all day Amex FRO Settlement Index^(SM) of the underlying security on expiration Friday.
- For a Finish High FRO to be in-the-money, the expiration Friday Amex FRO Settlement Index^(SM) must be above the strike price.
 - For example, if the Amex FRO Settlement Index^(SM) was \$25.01 or higher, the \$25.00 strike price Finish High FRO would be in-the-money.
- For a Finish Low FRO to be in-the-money, the expiration Friday Amex FRO Settlement Index^(SM) must be below the strike price.
 - For example, if the Amex FRO Settlement Index^(SM) was \$24.99 or lower, the \$25.00 strike price Finish Low FRO would be in-the-money.
- If the expiration Friday Amex FRO Settlement Index^(SM) was \$25.00 or less, the \$25.00 strike price Finish High FRO would be out-of-the-money.
- If the expiration Friday Amex FRO Settlement Index^(SM) was \$25.00 or higher, the \$25.00 strike price Finish Low FRO would be out-of-the-money.

Standard Listed Options

- Intrinsic value is determined by the closing price of the underlying security on any given day.
- Since standard listed options are American style settlement, they may be exercised at any time during the life of the contract.
- For a standard listed call option to be in-the-money, the closing price of the underlying must be above the strike price.



- For example, if the closing price of the underlying security was \$25.01 or higher, the \$25.00 strike price call option would be in-the-money.
- For a standard listed put option to be in-the-money, the closing price of the underlying security must be below the strike price.
 - For example, if the closing price of the underlying security was \$24.99 or lower, the \$25.00 strike price put option would be in-the-money.
- If the closing price of the underlying security was \$25.00 or less, the \$25.00 strike price call option would be out-of-the-money.
- If the closing price of the underlying security was \$25.00 or higher, the \$25.00 strike price put option would be out-of-the-money.

\$25.00 Strike Price			Listed Call	Finish High FRO	Listed Put	Finish Low FRO
AFSI*	Above the strike price	\$25.01		ITM		OTM
Closing Price	Above the strike price	\$25.01	ITM		OTM	
AFSI*	Below the strike price	\$24.99		OTM		ITM
Closing Price	Below the strike price	\$24.99	OTM		ITM	
AFSI*	Above the strike price	\$25.01		ITM		OTM
Closing Price	Below the strike price	\$24.99	OTM		ITM	
AFSI*	Below the strike price	\$24.99		OTM		ITM
Closing Price	Above the strike price	\$25.01	ITM		OTM	

*Amex FRO Settlement Index

*ITM = in-the-money

*OTM = out-of-the-money



Settlement Mechanics

FROs

FROs are European style, cash-settled and are automatically exercised if in-the-money on expiration Friday.

- Settlement is based on the all day Amex FRO Settlement Index^(SM) on expiration Friday.
- At expiration, the holder of an in-the-money FRO will automatically receive \$100.00.
- At expiration, the writer of an in-the-money FRO will automatically be debited \$100.00.

Standard Listed Options

Standard listed options are American style, physically settled and must be exercised if in-the-money on expiration Friday. American style standard listed options may be exercised or assigned at any time during the life of the option.

- At expiration, the holder of an in-the-money standard listed option must exercise his long position. In the case of a long call, this will result in the purchase of the underlying security. In the case of a long put, this will result in the sale of the underlying security.
- At expiration, the writer of an in-the-money option will most likely be assigned. In the case of a short call, this will result in the sale of the underlying security. In the case of a short put, this will result in the purchase of the underlying security.

Summary

FROs are European style exercise, which means that they can only be exercised or assigned on expiration. FROs settlement on expiration Friday is based on an all day Amex FRO Settlement Index^(SM). The all day Amex FRO Settlement Index^(SM) will be calculated during the trading day and will be disseminated at least every 15 seconds. Since the Amex FRO Settlement Index^(SM) is an average price it will most likely be different from the closing price of the underlying security. Therefore, it is possible for a standard listed call option to be in-the-money on expiration Friday based on the



underlyings closing price and yet a Finish High FRO with the same strike price will be out-of-the-money based on the all day expiration Friday Amex FRO Settlement Index^(SM). Conversely, it is possible for the Finish High FRO to be in-the-money while the standard listed call option is out-of-the-money. It is important that investors understand this situation and set expiration Friday expectations accordingly. Exercise or assignment of standard listed calls and puts will result in the purchase or sale of securities at expiration. The resultant transaction will alter the original risk/reward parameters of the initial transaction. The subsequent closing of these transactions will add additional transaction costs, which will affect profits and losses. Since FROs are cash-settled, there is no risk of buying or selling securities at expiration and therefore no additional transaction costs.

For the sake of simplicity, the examples shown do not take into consideration commissions and other transaction fees, tax considerations, or margin requirements, which are factors that may significantly affect the economic consequences of a given strategy. An investor should review transaction costs, margin requirements and tax considerations with a broker and tax advisor before entering into any options strategy.

Fixed Return Options (FROs) involve risk and are not suitable for everyone. Prior to buying or selling a FRO, a person must receive a copy of *Characteristics and Risks of Standardized Options*. Copies may be obtained from your broker, one of the options exchanges or The Options Clearing Corporation, One North Wacker Drive, Suite 500, Chicago, IL 60606 or call 1-888-OPTIONS or visit www.888options.com.

FROs exercise and assignment is based on an all day expiration day Amex FRO Settlement Index^(SM) so it is possible for the standard listed options to be in-the-money at expiration and the FROs to be out-of-the-money or for the FROs to be in-the-money and the standard listed options to be out-of-the-money. An investor must understand FROs settlement before entering into any FROs transaction.

Any strategies discussed, including examples using actual securities and price data, are strictly for illustrative and education purposes and are not to be construed as an endorsement, recommendation or solicitation to buy or sell securities. Supporting documentation will be supplied upon written request.

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