Primer: Options 101 Basic Concepts and Terminology

What is an Option?

An option is a financial contract between a buyer (holder) and a seller (writer) that gives the buyer the right, but not the obligation, to buy or sell a specified amount of an underlying asset at a predetermined price within a set time frame.

Understanding the basics below provides the foundation for learning how options function in financial markets.

Key Roles

- Buyer (Holder): Has rights under the contract.
- Seller (Writer): Has obligations under the contract.

Types of Options

- Call Option: Gives the holder the right to buy the underlying asset.
- Put Option: Gives the holder the right to sell the underlying asset.

Rights and Obligations

- A call buyer has the right to buy the underlying asset by exercising their option; the call seller has the obligation to sell the underlying asset if assigned an exercise.
- A put buyer has the right to sell the underlying asset by exercising their option; the put seller has the obligation to buy the underlying asset if assigned an exercise.

Options Styles

- American-style: Can be exercised at any time prior to the option's expiration.
- European-style: Can only be exercised at expiration.

Exercise and Assignment

- Exercise: When the option holder uses their right to buy (in the case of a call) or sell (in the case of a put) the underlying asset.
- Assignment: When the seller is obligated to fulfill the obligations of their options contract.

Other Key Terms

- Exercise Price (Strike Price): The agreed-upon price at which the asset can be bought or sold.
- Premium: The price paid by the buyer to the seller for an option.
- Expiration Date: The last date the option can be exercised, after which the option contract ceases to exist.