Primer: Index Options – Cash Settled Products

What are Index Options?

Index options are contracts based on a stock market index, allowing investors to speculate on or hedge against the movement of the particular index. These contracts are settled in cash, not shares.

Index options simplify broad market exposure with cash-only outcomes.

Key Characteristics

- No physical delivery; payout is the cash difference between the strike price and the value of the deliverable at expiration, multiplied by the contract multiplier
- Often used for hedging or broad market speculation

Settlement Styles

- AM-Settled: Based on opening prices of index components
- PM-Settled: Based on closing prices

Example

An investor who purchases a broad-based index call option with a \$4,100 exercise price has the right to receive cash settlement upon exercise. If the index settles at \$4,150 on expiration, the holder receives \$5,000 ((\$4,150 - \$4,100) × 100) in cash.

Purchase

Buys \$4,100 Call

INDEX OPTIONS CONTRACT

Index Settlement Value

\$4,150

Upon Exercise

Receives \$5,000
((\$4,150-\$4,100=\$50)x\$100) in cash

Options involve risks and are not suitable for everyone. Individuals should not enter into options transactions until they have read and understood the risk disclosure document, Characteristics and Risks of Standardized Options, available by visiting OptionsEducation.org. To obtain a copy, contact your broker or The Options Industry Council at 125 S. Franklin St., Chicago, IL 60606. Individuals should not enter into options transactions until they have read and understood this document.