

# Exchange Traded Options

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Product disclosure statement

# Product Disclosure Statement

## Part 1 – PDS Information

### Important information

The information contained in this document is general in nature and is not intended to constitute an investment recommendation or financial advice. This product disclosure statement ('PDS') does not take into account your personal objectives, financial situation, risk profile and particular needs. Before trading in products referred to in this PDS, you should read this PDS and be satisfied that any trading you undertake in relation to those products is appropriate in view of your objectives, financial situation, risk profile and needs.

It is recommended that you consult your financial adviser and tax adviser to obtain other independent advice before trading in Exchange Traded Options. Any opinions expressed reflect Morgans' judgment at the date of this PDS and are subject to change at any time without notice.

Morgans Financial Limited ABN 49 010 669 726 is an Australian Financial Services Licensee (AFSL 235410) and a Participant of ASX Group.

### Purpose of this PDS

This PDS has been prepared by Morgans Financial Limited ABN 49 010 669 726 ('Morgans', 'we', 'us', or 'our'), the issuer of the Exchange Traded Options ('ETOs') and Low Exercise Price Options ('LEPOs').

This PDS is designed to assist you in deciding whether the products covered in this PDS are appropriate for your needs and to assist you in comparing it with other financial products you may be considering. This PDS is an important document which should be retained for future reference and it is recommended that you contact your adviser should you have any questions.

This PDS should be read in conjunction with our terms and conditions, a copy of which can be obtained by contacting your adviser or from our website at [morgans.com.au](http://morgans.com.au) under the Forms and Downloads section.

This PDS is current at the time of printing but may be amended from time to time. New or supplementary PDSs may be issued as a result of changes. For the most up to date version, please refer to our website at [morgans.com.au](http://morgans.com.au) under the Forms and Downloads section.

### PDS in two parts

Morgans is a Participant of ASX Group and holds an Australian Financial Services Licence ('AFSL'). Morgans is a Clearing Participant of ASX Clear Pty Limited ('ASX Clear').

Morgans can help you to meet your financial objectives by providing a full range of investment and financial services. Backed by a large range of experience within our network and associated entities, our investment recommendations are based on our comprehensive market and financial knowledge. Our aim is to work with clients to determine, build and maintain personal investment strategies.

Our success is founded on the depth of knowledge and experience of our advisers, together with our strong research capability. Morgans has a reputation for being one of Australia's leading retail options brokers. Through our experience and high personal client service focus, we are able to demonstrate the benefit which options trading can add to your investment strategy.

Morgans is not a bank or an Authorised Deposit-taking Institute. For a full list of our branches and their contact details please refer to our website at [morgans.com.au](http://morgans.com.au).

### Morgans' services include:

- Internet access to account balances, open-positions, margin details, collateral, details and trading statements from our website at [morgans.com.au](http://morgans.com.au)
- Automatic sweep facility with your Cash Management Trust account provider
- Lodgement of collateral at ASX Clear for any Morgans sponsored holding
- The ability to sell calls over option exchange tradeable scrip held by our recommended margin lenders
- A large number of accredited derivatives advisers
- An experienced and efficient operating team.

If you would like to know more about the services Morgans can provide, please do not hesitate to contact your adviser or visit [morgans.com.au](http://morgans.com.au) or refer to our Financial Services Guide ('FSG') on our website under the Forms and Downloads section.

### Establishing an options account

To establish a Morgans options account you are required to:

1. Read and understand the ASX publication *Understanding Options Trading and/or LEPOs – Low Exercise Price Options Explanatory Booklet* which we have provided or can be accessed on the ASX website.
2. Read the Options Client Agreement form (particularly the section which sets out the terms of your relationship with Morgans), which contains the Options PDS and specific Terms and Conditions applying to options.
3. Sign and return an Options Client Agreement form together with the attached client profile information. ASX regulations prohibit Morgans from accepting orders from clients until we have received the signed Options Client Agreement form. If you wish to keep a copy for your records, please ask your adviser.
4. Open a share trading account by completing the Share Account Application form.
5. Obtain Morgans CHES sponsorship and complete a Collateral Authorisation form.
6. Open a linked cash management trust account to prevent any delays in settlement or the meeting of margin requirements. Morgans have a list of approved cash management facilities. Please speak to your adviser for details of the current approved providers. All settlements and margin calls must be facilitated within 24 hours.
7. Provide an email address, for the delivery of trade confirmations and any other daily and monthly statements applicable to trading in options.
8. In regards to retail clients, complete and pass the Morgans Options Questionnaire.
9. If you have existing open option positions at another broker, you will need to provide us with a copy of the open positions, an options transaction history for a minimum of 12 months and a copy of any collateral you currently have lodged against those positions. Morgans will assess these positions and reserves the right not to accept any or all of those positions.

Should you have any queries, please do not hesitate to contact your adviser.

### Morgans trading rules

Morgans imposes trading restrictions on its clients which limit the risk that we are willing to expose Morgans to. You agree to be bound by these trading rules and trade in accord with requests from your adviser.

### Margin lending

Margin lenders impose restrictions on trading options within a margin lending account and you are required to adhere to these rules. Please refer to the written agreement that you signed with your margin lending provider for specific restrictions.

### What are options?

An option is a contract between two parties giving the buyer (taker) the right, but not the obligation, either to buy or to sell a parcel of shares at a specified price on (or before) a specified date (unless a European style exercise is used – see below).

There are two types of options traded on ASX: **call** options and **put** options.

Call options give the buyer the right, but not the obligation, to buy the underlying shares, while put options give the buyer the right, but not the obligation, to sell the underlying shares.

For example, buying a Newscorp (NWS) October \$12.00 call option gives the buyer the right to buy 100 NWS shares for \$12 each, on or before the expiry date of the option in October. If the buyer exercises the option, the seller (writer) of this option must sell 100 NWS shares for \$12. At the time of the option transaction, the option buyer pays the option seller a premium, which is the cost of the option. Note that the buyer of the

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option is not obligated to exercise the option. The buyer can sell the option before it expires, or alternatively let the contract lapse at expiry, but will forego the option premium.

For example, buying a Newscorp (NWS) January \$10.00 Put Option gives the buyer the right to sell 100 NWS shares for \$10 each, on or before the expiry date of the option in January. If the buyer exercises the option, the seller of this option must buy 100 NWS shares for \$10. At the time of the option transaction, the option buyer pays the option seller a premium, which is the cost of the option. As indicated above the buyer of the option is not obligated to exercise the option. The buyer can sell the option before it expires, or alternatively let the contract lapse at expiry, but will forego the option premium.

Exchange traded share options are options over quoted securities of a range of different companies listed on the ASX. Exchange traded index options are options over an index such as the S&P™/ASX200™ Index or the S&P™/ASX200™ Property Trust Index. A list of companies and indices over which ETOs are traded can be found on the ASX website at [asx.com.au/options](http://asx.com.au/options). Options have been traded in Australia on ASX since 1976. Further educational material and links to the ASX website can be found on the Learning Centre section of our website [morgans.com.au/private-clients/Learning-Centre/Investment-Basics/Options](http://morgans.com.au/private-clients/Learning-Centre/Investment-Basics/Options).

ETOs and index ETOs may be American or European style exercise. The majority of ETOs are American options, which means they are tradeable and can be exercised at any time, prior to, or on the expiry day. European options, which include index options, are also tradeable, but can only be exercised on the expiry day and not before.

ETOs contracts are settled either with the physical delivery of stock as is the case with share options, or cash in the case of index options. With index options cash settlement occurs in accordance with the rules of ASX Clear against the Opening Price Index Calculation ('OPIC') as calculated on the index options expiry date.

Traders in options should have a good understanding of the mechanics of the two different types of options (call and put options), and the nature and extent of the risks, the rights and obligations associated with each.

ASX Clear oversees the clearing and day to day operations of ASX's Options Market. The ease of trading in and out of options on the ASX Options Market is assisted by the standardisation of the option contract components.

The five components of an option contract are as follows:

## 1. Underlying securities/approved indices

Options traded on ASX's Options Market are only available for certain securities and approved indices. These securities are referred to as 'underlying securities' or 'underlying shares'. They must be listed on ASX and are selected by ASX Clear according to specific guidelines. Calls and puts over the same underlying security are termed 'classes' of options.

## 2. Contract size

On ASX's Options Market, an option contract size is standardised at 100 underlying shares. That means, one option contract represents 100 underlying shares. This may change if there is an adjustment such as a new issue or a reorganisation of capital in the underlying share. In the case of index options, contract value is fixed at a certain number of dollars per index point (for example, \$10 per index point). The size of the contract is equal to the index level x the dollar value per index point (for example, for an index at 3400 points, one contract would be 3400 x \$10 = \$34,000).

## 3. Expiry day

Options have a limited lifespan and expire on standard expiry days set by ASX Clear. The expiry day is the day on which all unexercised options in a particular series expire and is the last day of trading for that particular series. For shares, this is usually the Thursday before the last Friday in the month. For index options, expiry is usually the third Thursday of the contract month. However, ASX Clear has the right to change this date should the need arise. In general, all options for a particular class follow one of the three quarterly cycles listed below:

January/April/July/October

February/May/August/November, or

March/June/September/December.

Options are usually listed for the next three months in the quarterly expiry cycle. For example, assume it is now June 2011 and ANZ follows the January, April, July, October expiry cycle. There would be currently listed a July 2011, an October 2011 and a January 2012 series. When the July series expires, an April 2012 series will be listed. When the October 2011 series expires, a July 2012 series will be listed and so on. In addition to quarterly expiry cycles, where there is sufficient demand, a current or spot month is also available for most classes of options.

The top ten shares by options volume also have a twelve month expiry cycle listed to provide a longer time frame for investors. There are also longer term option contracts listed over certain classes, some with terms of up to five years. For more information on these types of options, please ask your adviser.

## 4. Exercise (or strike) price

The exercise price is the predetermined buying or selling price for the underlying shares if the option is exercised. ASX Clear sets the exercise prices for all options listed on ASX's Options Market.

Usually there is a range of exercise prices available for options with the same expiry date. New exercise prices are listed as the underlying share price moves. Typically, the range of exercise prices includes one exercise price close to the current price of the underlying share with two exercise prices above and two exercise prices below the current share price.

For example, if the underlying share is trading at \$3.50, it is likely that option contracts with the following strike prices would be listed: \$3.00, \$3.25, \$3.50, \$3.75 and \$4.00. A range of exercise prices allows you to more effectively match your expectations of the price movement in the underlying share to your option position. Exercise prices may also be adjusted during the life of the option if there is a new issue or a reorganisation of capital in the underlying shares.

## 5. Premium

The premium is the price of the option which is arrived at by negotiation between the buyer and the seller of the option. It is the only component of the five option components that is not set by ASX or ASX Clear.

Option premiums are quoted on a cents per share basis. To calculate the full premium payable for a standard size option contract, multiply the quoted premium by the number of shares per contract (usually 100).

For example, a quoted premium of 16 cents represents a total premium cost of \$16.00 (\$0.16 x 100) per contract. To calculate the full premium payable for an index option, you simply multiply the premium by the index multiplier. For example, a premium of 30 points, with an index multiplier of \$10, represents a total premium cost of \$300 per contract.

## Factors affecting option premium

Option premium will fluctuate during the option's life depending on a range of factors including the exercise price, the price of the underlying securities or the level of the index, the volatility of the underlying securities or the underlying index, the time remaining to expiry date, interest rates, dividends and general risks applicable to markets.

For exchange traded options, market expectations and ultimately, the pressures of supply and demand determine the value of options.

## Dividends and voting

The buyer of the call option or the seller of a put option does not receive dividends or have voting rights on the underlying shares. Option information can be monitored on the ASX website, [asx.com.au](http://asx.com.au), or in the Australian Financial Review newspaper.

## Low Exercise Price Options ('LEPOs')

LEPOs are call options with an exercise price of one cent. When you buy a share LEPO, you obtain the right to buy an agreed number of shares (100 shares per contract) at a specified future date, in return for the payment of the exercise price (1 cent) and a premium. Index LEPOs are also available. The seller of a LEPO undertakes to sell the underlying securities at expiry in return for the exercise price and the premium amount at which the LEPO originally traded.

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LEPOs allow investors to profit from movements in the underlying security on a one-for-one basis. Buying a LEPO is similar to a forward purchase of shares, while selling a LEPO is similar to a forward sale of shares.

Because of their low exercise price, LEPOs trade for large premiums. The high premium exposure carries a risk similar to that of owning the securities outright or, for sellers, short selling securities.

An important feature of LEPOs is that both the buyer and the seller are margined. When you buy a LEPO, you do not pay the full amount of the premium upfront. Instead, you pay or receive margins during the life of the LEPO and pay or receive the balance of the premium if and when you exercise the LEPO. LEPOs are European style options, which mean they are only exercisable at expiry.

## Margins

What are margins? A margin is the amount calculated by ASX Clear as necessary to cover the risk of financial loss on an options contract due to an adverse market movement. Simply put, the minimum level of cover required to cover margin obligations is the liquidation value of your option contracts.

If you write (sell) an option contract, you have a potential obligation to the market because the taker (buyer) of the option may exercise their position. A margin is an amount that is calculated by ASX Clear using SPAN margining as necessary to ensure that you can meet that obligation. Margin obligations may arise from:

- written call option contracts over specific stocks or the index (XJO)
- written put option contracts over specific stocks or the index (XJO)
- both taken and written LEPO positions.

ASX Clear calculates margins on a daily basis, taking into account (amongst other factors) the volatility of the underlying security. They may, from time to time, call for intra-day margins or amend the margin intervals on open positions, even if the underlying does/does not go against you (i.e. the ASX could increase margin requirements at anytime and at short notice). The total margin for an ETO is made up of two components:

1. **The premium margin** is the market value of the particular position at the close of business each day. It represents the amount that would be required to close out your option position.

For example, if an option is valued at \$0.35 at the close of business on day 1, the premium margin component of the total margin requirement the following day would be \$35 per contract. At the end of day 2, if the option is valued at \$0.45 the premium margin component of the total margin requirement the following day would be \$45 per contract. At the end of day 3, if the option is valued at \$0.40, the premium margin component of the total margin requirement the following day would be \$40 per contract.

2. **The SPAN risk margin** covers the potential change in the price of the option contract, assuming the maximum probable adverse movement in the price of the underlying or a shift in option pricing volatility.

Risk margin comprises a short option minimum, intra-commodity spread and inter-commodity concession as well as the scanning risk component. In its simplest form, SPAN can be considered as a risk based portfolio approach system for calculating initial margin requirements. SPAN uses risk arrays (parameters), which are a set of numeric values that specify if a particular contract will gain or lose value under different conditions (risk scenarios). The value for every risk scenario symbolises the gain or loss for that contract for a certain combination of volatility change, price (or underlying price) change, and decrease in time to expiration.

If you have a number of option positions open, the ASX Clear will evaluate the risk associated with your entire options portfolio and calculate your total margin obligation accordingly. There is a possibility that some option positions may offset others, leading to a reduction in your overall margin obligation if each position was margined in isolation and then totalled.

Morgans will require you to provide cash or collateral to cover your margin obligations. While the minimum margin requirements are set by ASX Clear, Morgans reserves the right to impose higher margin requirements at any time.

For more detail on margins, please refer to the *ASX Understanding Margins* booklet on the Morgans website under Learning Centre/Options.

## Payment of margins

Margins are recalculated on a daily basis to ensure an adequate level of margin cover is maintained. This means that you may have to increase your level of margin cover if the market moves against you, or your margins may be reduced if the market moves in your favour. Morgans are required to call these margins under *ASX Operating Rules*. Settlement requirements for trading options are strict. You must pay any margin calls by the time stated in the Options Client Agreement. Under *ASX Operating Rules*, this can be no longer than 24 hours after being advised of the margin call by Morgans.

If you do not meet your margin call in time, Morgans may take action to close out your positions without further reference to you.

## Collateral

ASX Clear accepts cash and a range of collateral to cover an investor's margin obligations. Collateral can be used to cover margins for options and risk margins for LEPOs. Cash is used to purchase options or to cover mark-to-market margins for LEPOs.

ASX Clear may withdraw a security from the list of acceptable collateral and you will be required to submit alternative collateral or cash to cover your margin obligations. This may occur at short notice and is outside the control of Morgans. Shares bought using margin lending accounts may be eligible as collateral for written call option strategies.

If you would like to use collateral to cover your margin obligations, you should discuss this with your adviser.

Details of eligible collateral are published on the ASX website at [asx.com.au/products/acceptable-collateral.htm](http://asx.com.au/products/acceptable-collateral.htm) or go to the Learning Section of our website [morgans.com.au/private-clients/Learning-Centre/Investment-Basics/Options](http://morgans.com.au/private-clients/Learning-Centre/Investment-Basics/Options) and follow the link to the ASX website.

## Benefits of options ownership

The benefits of options ownership include:

### 1. Risk management

Bought put options allow you to hedge against a possible fall in the value of shares you hold. This can be considered similar to taking out insurance against a fall in the share price.

### 2. Time to decide

By buying a call option, the purchase price for the shares is locked in. This gives the call option holder until the expiry day to decide whether or not to exercise the option and buy the shares. Likewise the buyer of a put option has time to decide whether or not to sell the shares.

### 3. Speculation

The ease of trading in and out of an option position makes it possible to trade options with no intention of ever exercising them. If you expect the market to rise, you may decide to buy call options. If expecting a fall, you may decide to buy put options. Either way you can sell the option prior to expiry to take a profit or limit a loss.

### 4. Leverage

Leverage provides the potential to make a higher return from a smaller initial outlay than investing directly. However, leverage usually involves more risks than a direct investment in the underlying shares. Trading in options can allow you to benefit from a change in the price of the share without having to pay the full price of the share.

### 5. Diversification

Options can allow you to build a diversified portfolio for the same or even lower initial outlay than purchasing shares directly.

### 6. Income generation

You can earn extra income over and above dividends by selling call options against your shares. By selling an option you receive the option premium up front. For sold calls you get to keep the option premium, there is a possibility that you could be assigned and have to deliver your shares to the buyer of the option at the exercise price. For sold puts, while you receive the option premium up front, you may be assigned at the exercise price and therefore buy the



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underlying shares. With sold calls or sold puts on Indices, cash settlement occurs should the position finish in the money at expiry.

## 7. Options strategies

By combining different options, or stock with options, you can create a wide range of strategies.

Various option strategies (e.g. covered calls, sold puts, bull put spreads, etc.) can be implemented depending on a client's investment strategy, risk tolerance and experience. Each strategy has its own inherent risk and may be more appropriate under different market conditions. For more detail regarding specific option strategies, please refer to the *ASX Options Strategies* booklet located on the Morgans website under Learning Centre/Options [morgans.com.au/private-clients/Learning-Centre/Investment-Basics/Options](http://morgans.com.au/private-clients/Learning-Centre/Investment-Basics/Options) or alternatively go to the ASX website [asx.com.au/products/equity-options/strategies.htm](http://asx.com.au/products/equity-options/strategies.htm). Before implementing any option strategy you should discuss appropriateness of them with your adviser.

## Benefits of LEPO ownership

When you open a LEPO contract you gain exposure to the full value of the underlying securities but actually pay only a fraction of the full premium of the LEPO up front. This potentially provides a greater return to the investor but also means LEPOs have a higher risk profile.

Selling a LEPO gives you exposure to a decline in the value of the underlying asset, enabling you to profit if the price of the asset falls. The sale of a LEPO can be compared to a short stock position. However, the advantage of the LEPO position is that it can be established more easily and at lower cost than short selling a stock. Using a LEPO can also be a cost-effective alternative to borrowing to fund a purchase of shares.

Credit margins from existing open positions may be used to reduce the initial margin payable. This can further reduce the cash outlay when opening a contract. LEPOs are European style options, meaning they are only exercisable at expiry.

## Risks of options ownership

Trading in derivatives is only suitable for some investors. In light of the risks associated with trading ASX derivative products, you should invest in them only if you understand the nature of the products (specifically, your rights and obligations) and the extent of your exposure to risk. Before you invest, you should carefully assess your experience, investment objectives, financial resources and all other relevant considerations and discuss these with your adviser. You should not rely on this product disclosure statement as a complete explanation of the risks of investing in ASX derivative products.

The purchaser of an ETO, whether it is a call option or a put option, has a known and limited potential loss. If a purchased option expires worthless, the purchaser will lose the total value paid for the option (known as the premium), plus transaction costs.

Selling ('writing') options may entail considerably greater risk than purchasing options. The premium received by the seller of an ETO is fixed and limited, however the seller may incur losses significantly greater than that amount.

The value of an ETO will depend on a range of factors, particularly the following:

### 1. Market risks

A range of factors affect the market value of options. They may fall in price or become worthless on or before expiry. Changes in the price of the underlying security may result in changes to the price of an option, but the change can sometimes be in a different direction or of a different magnitude to the change in the price of the underlying security.

### 2. Options are a wasting asset

Options have an expiry date and therefore a limited life. An option's time value erodes over its life and this accelerates as an option nears expiry. It is important to assess whether the options selected have sufficient time to expiry for your market views to be realised.

### 3. Effect of 'leverage' or 'gearing'

The initial outlay of capital may be small relative to the total contract value with the result that options transactions are 'leveraged' or 'geared'. A relatively small market movement may have a proportionately larger impact on the value of the contract. This may work against you, or for you. The use of leverage can lead to large losses as well as large gains.

### 4. Option sellers face potentially unlimited losses

Selling options may entail considerably greater risk than buying options. The premium received by the seller is fixed and limited; however the seller may incur losses significantly greater than that amount. The seller who does not own the underlying securities or have offsetting option positions has a potentially unlimited loss position and potential profits and losses can be much greater than the money initially outlaid.

### 5. Margin calls

You may lose the total amount of margin funds deposited with your broker in relation to your positions. Your liability in relation to a written option contract is not limited to the amount of the margin paid to you. 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, or upon settlement of contracts. If you fail to comply with a request for additional funds within the time prescribed, Morgans may close out your positions and you will be liable for any loss that might result.

### 6. Illiquidity and pricing relationships

Market conditions may increase the risk of loss by making it difficult or impossible to effect transactions or close out existing positions. Normal pricing relationships may not exist in certain circumstances, for example, in periods of high buying or selling pressure, high market volatility or illiquidity in the market for a particular option series.

### 7. Risk-reducing orders or strategies

The placing of 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.

### 8. Suspension or restriction of trading and pricing relationships

Market conditions or actions by ASX or ASX Clear may increase the risk of loss by making it difficult or impossible to effect transactions or close out existing positions.

ASX and ASX Clear have broad powers under the *ASX Operating Rules* and *ASX Clear Operating Rules* to take action in the interests of maintaining fair and orderly markets, or providing services in a fair and effective way and, in some circumstances; this may affect your positions.

Similarly, regulatory authorities such as the Australian Securities and Investment Commission (ASIC) may direct the ASX or ASX Clear to suspend or cease dealing in certain products, and this may affect your positions. These powers include the ability to suspend trading, impose position limits or exercise limits, and terminate open contracts.

### 9. Terms and conditions of contracts

Under certain circumstances the specifications of outstanding contracts may be modified by ASX or by ASX Clear. The extent to which you may recover money or property is governed by the *Corporations Act 2001* and other legislation and rules. In certain circumstances you may have a claim against the National Guarantee Fund.

### 10. Trading facilities

As with all trading facilities and systems, the systems used in the market are vulnerable to temporary disruption or failure. This may result in your order not being executed in accordance with your instructions or not being executed at all.

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## 11. Trading disputes

The client indemnifies Morgans, its directors, officers, agents, employees and Authorised Representatives from actual or potential loss, cost expense, or damage suffered as a result of a system failure caused by, amongst other things, a market operator or their relevant service provider, an act of God or anything beyond our reasonable control.

## 12. Corporate activity in underlying stock

You should be aware that all options transactions on ASX are subject to the rules, procedures and practices of ASX and ASX Clear, and the *ASIC Market Integrity Rules*. Under the *ASX Operating Rules*, certain trading disputes between market participants (e.g. errors in traded prices that do not relate to fair market or intrinsic value) may lead to ASX cancelling or amending a trade. In these circumstances client consent is not required to cancel the trade.

## 13. Corporate activities in underlying stock

Where corporate activity (e.g. takeover, bonus issue, rights issue etc.) occurs in the underlying stock, this may have an effect on open option positions over that stock. Morgans has no control over the effect of the corporate activity on open option positions and cannot foresee the specific risk or outcome as this is determined by ASX at the time of the corporate activity in question.

## Risks of LEPO ownership

LEPOs are subject to all of the risk factors that affect an ETO. However, as LEPOs have a low exercise price, the full premium amount will be closer to the full value of the underlying instrument than a standard ETO. Although the buyer of a LEPO may only be required to outlay a relatively small amount of money as margins when the LEPO is entered into, at expiry, if the buyer of a LEPO does not exercise the LEPO, they will lose an amount approximately equal to the then current premium of the LEPO.

LEPOs are leveraged investments and potential profits and losses can be greater than the money initially outlaid. Both buyers and sellers of LEPOs are required to pay margins to ASX Clear.

## Pricing of options

You can find out the price of an option by contacting your Morgans adviser. Option codes and prices are also available in the options section of the ASX website at [asx.com.au](http://asx.com.au). Details of the previous day's trading are published in summary form in the Australian Financial Review. When considering an option, it is important to understand how the premium is calculated. Option premiums change according to a range of factors including the price of the underlying security and the time left to expiry. An option premium can be separated into two parts: intrinsic value and time value. Different factors influence intrinsic and time value.

### Intrinsic value

Intrinsic value is the difference between the exercise price of the option and the market price of the underlying shares at any given time.

### Time value

Time value represents the amount you are prepared to pay for the possibility that the market might move in your favour during the life of the option.

Time value is influenced by the following factors:

- time to expiry
- market volatility
- interest rates
- dividend payments
- market expectations.

### Time to expiry

As time draws closer to expiry, and the opportunities for the option to become profitable decline, the time value declines. This erosion of option value is called time decay. Time value does not decay at a constant rate, but becomes more rapid towards expiry. As a general guide, an option will lose 1/3 of its time value during the first half of its life and 2/3 during the second half.

The amount of time value will depend on whether the option is in-the-money, at-the-money or out-of-the-money. At any given time, the at-the-money option will have the greatest time value. The further in- or out-of-the-money the option, the less time value it will have.

A call option is said to be in-the-money where the exercise price is less than the share price. A call option is said to be at-the-money where the exercise price equals the share price. A call option is said to be out-of-the-money where the exercise price is greater than the share price. A put option is said to be in-the-money where the exercise price is greater than the share price. A put option is said to be at-the-money where the exercise price equals the share price. A put option is said to be out-of-the-money where the exercise price is less than the share price.

### Volatility

Volatility is one of the most important factors in an option's price as it measures the amount by which an underlying asset is expected to fluctuate in a given period of time. Volatility significantly impacts the price of an option's premium and heavily contributes to an option's time value. In basic terms, volatility can be viewed as the speed of change in the market. The higher the volatility, the more chance an option has of becoming profitable by expiration. That's why volatility is a primary determinant in the valuation of options' premiums.

In general, the more volatile the market, the higher the premium will be. This is due to the fact that the seller is exposed to a greater probability of incurring a loss. Sellers are compensated for this added risk by receiving higher premium income.

### Interest rates

A rise in interest rates will push call option premiums up and put option premiums down.

### Dividend payments

If a dividend is payable during the life of an option, the premium of a call option will be lower, and the premium of a put option higher, than if no dividend was payable. Holders of option contracts who do not own the underlying securities are not eligible for dividends payable on those shares.

### Market expectations

Ultimately, supply and demand determine the market value of all options. During times of strong demand, premiums will be higher.

## Dispute resolution

If you are not happy with the service you receive from us, you are entitled to complain. Morgans have established procedures in place to ensure that all enquiries and complaints are properly dealt with.

To save yourself valuable time, gather all the facts and documents about the complaint, think about the questions you want answered and decide what action you want us to take. The following process has been established to address your concerns as quickly as possible:

Contact your Morgans adviser or their immediate superior and explain the problem. Most issues can be resolved quickly in this way.

If you are unable to resolve the issue within 3 days, please contact the Complaints Officer on (07) 3334 4888 or send your details in writing to:

GPO Box 202, Brisbane Qld 4001

If we are unable to resolve the matter to your satisfaction, you can refer your case to an independent complaint handling body.

Morgans is a member of:

Australian Financial Complaints Authority (AFCA)  
GPO Box 3, Melbourne Victoria 3001

AFCA can be contacted on 1800 931 678

For complaints above the AFCA monetary limit you can also contact the ASX Complaints Officer (PO Box H224, Australia Square, Sydney, NSW 1215).

Additionally, ASIC operates an infoline on 1300 300 630.

## Compensation arrangements

We are required by the *Corporations Act 2001* and *ASX Operating Rules* to have adequate compensation arrangements in place. Morgans have a comprehensive Professional Indemnity insurance policy to cover claims in relation to the conduct of Authorised Representatives/employees.

# Product Disclosure Statement

## National Guarantee Fund

The National Guarantee Fund (NGF) provides investors with protection in the following circumstances:

1. If a stock option is exercised, the NGF guarantees completion of the resulting trades in certain circumstances; and
2. If you have entrusted property to Morgans in the course of dealing in options, and Morgans later becomes insolvent, you may claim on the NGF, in accordance with the rules governing the operation of the NGF, for any property which has not been returned to you or has not otherwise been dealt with in accordance with Morgans' obligations to you. There are limits on claims to the NGF for property entrusted.

For more information on the possible protections offered by the NGF see [segc.com.au](http://segc.com.au).

## Privacy

We are committed to maintaining your privacy and ensuring the security of your information. A copy of our Privacy Policy is available from your adviser or from our website at [morgans.com.au](http://morgans.com.au).

## Taxation implications

Taxation issues will vary for each investor and will depend on your individual circumstances and trading strategies you adopt. You should take taxation implications into consideration when you are investing in options, just as you would when investing in shares.

Some of the issues that may be relevant include:

- Are you classified as a trader, as a speculator or as a hedger?
- Is an option trade on revenue account or on capital account?
- Are there timing issues, for example when an option position is opened in one tax year and closed in the next tax year?
- Where an option strategy is in place around the time a stock goes ex-dividend, are you in danger of not satisfying the 45-day Holding Period Rule and therefore being disqualified from receiving the franking credits attached to the dividend?
- Could the exercise of an option position crystallise a taxation event for the underlying shareholding?

This is by no means a comprehensive list of the taxation issues of options trading. It is therefore important to discuss your taxation situation with your Tax adviser or accountant, to ensure that any options trades you enter will not have adverse taxation implications, particularly if the assumption is that any premiums received or paid and resulting profits or losses have potential capital gains tax (CGT) implications.

Please refer to the ASX website at [asx.com.au/products/equity-options.htm](http://asx.com.au/products/equity-options.htm) to locate a booklet on the **Taxation Treatment of Options**.

on the volume and size of option transactions that occur on your account. All brokerage charges are shown on your Confirmation/Contract Note.

### 3. Adviser commissions

Morgans advisers are remunerated by way of salary and/or a percentage share of commissions earned by Morgans from business written by the adviser. The exact split of commissions, brokerage and fees varies based on a number of factors. Commission based advisers may receive between 0% and 50% of all commissions received over and above the first \$25 per options transaction. In relation to exchange traded options, this would be after any third party fee is deducted. A Register of alternative remuneration is maintained by Morgans to record any such remuneration given or received from representatives and AFS Licensees. The Register is available for inspection on request by the public and a copy will be provided within 7 days.

### 4. ASX Clear fees (Effective 1 June 2021)

AC charges a tiered transaction fee for Exchange Traded Options (ETO) ranging from \$0.05 up to \$0.31 (excluding GST) per ETO contract. For option contracts being \$0.01 or lower the AC fee will be zero. The AC fees are applied across five (5) Tiers and are subject to a six (6) monthly review. If you are exercised or assigned a share option, AC charges an exercise fee of \$0.55 per contract and in the case of Index options, AC charges \$0.50 per contract, including GST, for both the transaction fee and exercise fee. Note: these fees are subject to change at any time by the AC.

### 5. Stamp duty

No stamp duty is payable on option transactions or securities transactions arising from options exercise.

### 6. Impact on returns from applicable charges

Charges relating to brokerage including GST and ASX fees will impact the potential returns or losses, on trading options. They can increase potential losses and decrease potential returns. For clients undertaking multiple legs, as part of the option strategies being implemented, applicable charges will likely apply to each leg of the strategy thus magnifying the costs involved. As an example, if the minimum brokerage charge is \$82.50 plus \$0.143 ACH fees per options contract and your options strategy involves you selling (writing) a put and buying a put at the same time, the brokerage cost would be a minimum of \$165 (not \$82.50) plus \$0.286 in ACH fees.

## Part 2 – Schedule of Fees

### Costs of trading options

When you trade an option, the value of the trade is generally lower than if you were to trade the same number of the underlying shares. Because of this, options are generally a cost efficient way to trade your view of a stock. The summary of costs involved in trading an option is outlined below:

#### 1. Government taxes

GST will be charged on all brokerage and fees at the rate of 10%. This has been included in all fees stated in the PDS.

#### 2. Brokerage

Brokerage is payable by you when Morgans buy or sell exchange traded options on your behalf on a sliding scale subject to a minimum of \$82.50:

Premium Value	Brokerage
\$0 - \$5,000	2.75%
\$5,001 - \$15,000	2.20%
\$15,001 +	1.65%

The brokerage charged by Morgans for LEPO's is 0.5% of the Premium Value subject to a minimum of \$82.50. A different rate of brokerage may be negotiated with your adviser. Consideration will be given to a negotiated rate and could for instance, be dependent

### Queensland

Brisbane	+61 7 3334 4888
Stockbroking, Corporate Advice, Wealth Management	
Brisbane Edward Street	+61 7 3121 5677
Brisbane Tynan Partners	+61 7 3152 0600
Brisbane North Quay	+61 7 3245 5466
Bundaberg	+61 7 4153 1050
Cairns	+61 7 4222 0555
Gladstone	+61 7 4972 8000
Gold Coast	+61 7 5581 5777
Holland Park	+61 7 3151 8300
Kedron	+61 7 3350 9000
Mackay	+61 7 4957 3033
Milton	+61 7 3114 8600
Newstead	+61 7 3151 4151
Noosa	+61 7 5449 9511
Redcliffe	+61 7 3897 3999
Rockhampton	+61 7 4922 5855
Springfield-Ipswich	+61 7 3202 3995
Spring Hill	+61 7 3833 9333
Sunshine Coast	+61 7 5479 2757
Toowoomba	+61 7 4639 1277
Townsville	+61 7 4725 5787

### Northern Territory

Darwin	+61 8 8981 9555
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### New South Wales

Sydney	+61 2 9043 7900
Stockbroking, Corporate Advice, Wealth Management	
Sydney Grosvenor Place	+61 2 8215 5000
Sydney Reynolds Securities	+61 2 9373 4452
Sydney Currency House	+61 2 8216 5111
Armidale	+61 2 6770 3300
Ballina	+61 2 6686 4144
Balmain	+61 2 8755 3333
Bowral	+61 2 4851 5555
Chatswood	+61 2 8116 1700
Coffs Harbour	+61 2 6651 5700
Gosford	+61 2 4325 0884
Hurstville	+61 2 8215 5079
Merimbula	+61 2 6495 2869
Mona Vale	+61 2 9998 4200
Neutral Bay	+61 2 8969 7500
Newcastle	+61 2 4926 4044
Orange	+61 2 6361 9166
Port Macquarie	+61 2 6583 1735
Scone	+61 2 6544 3144
Wollongong	+61 2 4227 3022

### Australian Capital Territory

Canberra	+61 2 6232 4999
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### Victoria

Melbourne	+61 3 9947 4111
Stockbroking, Corporate Advice, Wealth Management	
Brighton	+61 3 9519 3555
Domain	+61 3 9066 3200
Geelong	+61 3 5222 5128
Hawthorn	+61 1300 382 075
South Yarra	+61 3 9006 9955
Southbank	+61 3 9037 9444
Traralgon	+61 3 5176 6055
Warrnambool	+61 3 5559 1500

### Western Australia

West Perth	+61 8 6160 8700
Stockbroking, Corporate Advice, Wealth Management	
Perth	+61 8 6462 1999

### South Australia

Adelaide	+61 8 8464 5000
Stockbroking, Corporate Advice, Wealth Management	
Exchange Place	+61 8 7325 9200
Norwood	+61 8 8461 2800
Unley	+61 8 8155 4300

### Tasmania

Hobart	+61 3 6236 9000
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Get in touch:



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