THE Nigerian
STOCK EXCHANGE

GLOSSARY OF COMMON DERIVATIVES TERMS

Alpha

The difference in performance of an investment relative to its benchmark.

American Style Option

An option that can be exercised at any time from inception as opposed to a European Style option which can only be exercised at expiry. Early exercise of American options may be warranted by arbitrage. European Style option contracts can be closed out early, mimicking the early exercise property of American style options in most cases.

Arbitrage (see also Correlation)

The act of taking advantage of differences in price between markets. For example, if a stock is quoted on two different equity markets, there is the possibility of arbitrage if the quoted price (adjusted for institutional idiosyncrasies) in one market differs from the quoted price in the other. The term has been extended to refer to speculators who take positions on the correlation between two different types of instrument, assuming stability to the correlation patterns. Many funds have discovered that correlation is not as stable as it is assumed to be.

Asset-Liability Management

Closing out exposure to fluctuations in interest rates by matching the timing of cashflows associated with assets and liabilities. This is a technique commonly used by financial institutions and large corporations.

At-the-Money Spot

An option whose strike price is equal to the current market price in the underlying spot market. This option has no intrinsic value, but it may have time value.

At-the-Money Forward

An option whose strike price is equal to the current, prevailing price in the underlying forward market. This option has no intrinsic value, but it may have time value.

Back Testing

Assessing a model portfolio or an investment thesis by applying historical data to determine how the portfolio would have performed had it been bought and held through the historical timeframe of market data conditions.

Backwardation (see also Contango)

A term often used in commodities or futures markets to refer to markets where shorter-dated contracts trade at a higher price than longer-dated contracts. Plotting the prices of contracts against time, with time on the x-axis, shows the commodity price curve as sloping downwards as time increases.

Back contract

The longest maturity futures contract currently trading.

Basis (Gross)

The difference between the relevant cash instrument price and the futures price. Often used in the context of hedging the underlying instrument.

Basis point

One-hundredth of a percentage point (i.e., 0.01%).

Basis risk

The risk that prices in the underlying cash market are not exactly correlated with prices in the futures market. Consequently basis risk is used more generally for the risk that hedges composed of offsetting positions in the cash and derivatives markets become unbalanced.

Basis trading

Trading the spread between the futures (or more generally derivatives) markets and the underlying cash market. See cash-and-carry arbitrage

Beta

A measure of the sensitivity of an asset's return to the market. The returns on a security with a beta of one will move in line with the market; if beta is greater than one the security will exaggerate market returns; if it is less than one it will under-reflect market moves; and if beta is negative, security and market returns move in opposite directions. Beta is a measure of the systematic risk of a security relative to the market. Betas are additive, hence the beta of a portfolio is the weighted average of all the individual betas in a portfolio.

Black-Scholes

An option pricing model which is typically used to determine the price of European put or call options developed by Fischer Black and Myron Scholes in 1973 for which they shared the Nobel Prize in Economics. The closed form solution to the model for European options has the following inputs:

(i) the strike price of the option contract

(ii) current price of the underlying

(iii) time to maturity

(iv) implied volatility

(v) level of interest rates

(vi) Call/Put.

Block Trade

1) A single trade transacted by an asset manager, which may then be allocated to a number of different funds or portfolios managed by that asset manager. See also "allocation".

2) An off-exchange trade that is privately negotiated with quantities at or exceeding exchange minimums. These trades are executed away from open outcry or electronic platforms to avoid price changes within the market at or exceeding exchange minimums.

Blockchain

A sequential transaction database that is distributed across a peer-to-peer network to prevent double spending in an environment with no central issuing authority. It is the public ledger of decentralized digital currency Bitcoin.

Bull spread

A spread that increases in value as the underlying asset price rises.

Butterfly spread

An option position consisting of one long call at a particular exercise price, another otherwise identical long call at a different exercise price, and two otherwise identical short calls at an exercise price between the other two

Buy/Write

Purchase of stock and simultaneous writing of call options against stock position.

Calendar Spread

The sale/purchase of a near month call option/put option and the simultaneous purchase/sale of a longer dated call option/put option of the same exercise price. Also known as a horizontal spread or time spread.

Call Option

A call option is a financial contract that gives the holder the right (but not the obligation) to buy the underlying asset at a specified price (strike price) during a specified period for a premium. Conversely, the writer of a call option is obligated to sell the underlying asset to the holder at the strike price upon its exercise at any time prior to the expiration date. European call options differ from American primarily insofar as they must be exercised on a specified date rather than at any time before expiration.

A Call is:

In-the-money (ITM) if current price > exercise price;
At-the-money (ATM) if current price = exercise price;
Out-of-money (OTM) if current price < exercise price.

Call Option on Futures Contract

A call option on a futures contract is a financial contract that gives the holder the right but not the obligation to purchase a particular futures contract at the strike price up to the expiration date. For this right, the buyer pays a premium to the seller. Writing a call option on a futures contract obligates the writer to sell the particular futures contract to the holder at the strike price up to the expiration date.

Call Spread

The simultaneous purchase (sale) of a call at one exercise price and sale (purchase) of another call at a higher exercise price.

Cash Settlement

A settlement procedure whereby derivative contracts are settled in cash and without physical delivery. The difference between spot and forward price is paid in cash at expiration.

Central Counterparty (CCP)

A financial institution that performs novation of Contracts and subsequently becomes the Counterparty to all trades in the financial markets for which it provides clearing services. Once interposed, the CCP employs cutting edge risk management techniques and technology techniques to insulate members from any losses should a default occur. Typical functions of a CCP include margin calculation; collateral management; portfolio netting; paying and receiving coupons and fees on trades; receiving and processing post-trade events, such as assignments or terminations.

Central Counterparty (CCP) Link

Links between central counterparties (CCPs) that enable participants to clear positions in any linked CCP without needing to maintain multiple CCP memberships.

Cheapest to deliver

In some futures contracts the seller has a choice of which of a variety of underlying securities to deliver. The security which it is most advantageous for the seller to deliver is called the cheapest to deliver.

Clearing

Post-trade activity where:

1) Trade details from both buyer and seller are matched

2) The central clearing counterparty (CCP) becomes the counterparty for both the seller and the buyer in a trade, which helps to reduce the market risk for trading firms; and

3) The CCP takes certain risk management steps like netting of trades to reduce the total amount of cash flows.

Clearing House

A financial market infrastructure that provides clearing and settlement services and ensures delivery of payments for its members' transactions.

Clearing Member

A member of a clearing organization. All trades of a non-clearing member must be registered with, and eventually settled through a clearing member. There are two types of CCP memberships: clearing and non-clearing. Clearing members must meet the CCP's membership requirements (e.g., a minimum size of trade portfolio, a minimum amount of tier 1 capital and a minimum credit rating) to qualify as a member of the CCP. A non-clearing member usually cannot meet the CCP's membership requirements and needs to clear through a clearing member.

Closing Trade

A trade which is used either to partly offset an open position or to fully offset it and close it out.

Collar (see also Range Forward; Risk Reversal)

A collar is an investment strategy that uses options to limit to a specific range the possible positive or negative returns on an investment in an underlying asset. To establish a collar, an investor simultaneously purchases a put option and sells (writes) a call option on an asset. Doing this locks in the minimum and maximum rates that the collar owner will use to transact in the underlying at expiry.

Commodity derivative

A derivative written on a commodity or physical asset

Contango (see also Backwardation)

A term often used in commodities or futures markets to refer to markets where shorter-dated contracts trade at a lower price than longer-dated contracts. Plotting the prices of contracts against time, with time on the x-axis, shows the commodity price curve as sloping upwards as time increases.

Contract

The individual traded unit of a derivative;

Contract Size

The number of shares of the underlying security that constitute a future contract or option contract. The monetary multiplier value of an index that constitutes an index future contract or index option contract.

Contract Specification

The detailed information in respect of a Contract setting out the standard terms of such Contract, as varied from time to time.

Convergence

The reduction in the futures basis as the spot and futures prices converge as a futures contract approaches expiration.

Convexity

A financial instrument is said to be convex (or to possess convexity) if the financial instrument's price increases (decreases) faster (slower) than corresponding changes in the underlying price. A measure of a bond's price sensitivity to changes in the bond's yield.

Correlation (see also Arbitrage)

Correlation is a statistical measure describing the extent to which prices on different instruments move together over time. Correlation can be positive or negative. Instruments that move together in the same direction to the same extent have highly positive correlations. Instruments that move together in opposite direction to the same extent have highly negative correlations. Correlation between instruments is not stable.

Cost of carry

The cost of holding an asset. This includes interest cost plus (less) any costs (benefits) from holding the asset (e.g., warehouse rent and insurance for physical assets and dividend income and coupon payments for financial assets).

Costless arbitrage

A self-financing arbitrage strategy.

Counterparty

The opposite party in a derivative contract.

Counterparty risk

The risk that a counterparty will default.

Covered Call Option Writing (see Naked Option Writing)

A technique used by investors to help fund their underlying positions, typically used in the equity markets. An individual who sells a call is said to "write" the call. If this individual sells a call on a notional amount of the underlying that he has in his inventory, then the written call is said to be "covered" (by his inventory of the underlying). If the investor does not have the underlying in inventory, the investor has sold the call "naked".

Credit derivative

An agreement concerning the transfer of credit risk between a buyer and seller of this protection.

Credit event

Any event related to a credit risk realization.

Credit risk

The risk of a loss arising from default or credit downgrade of a counterparty that causes the value of their obligations to decrease

Cross-hedging

Any hedge where the asset being hedged is not the specific asset underlying the futures contract.

Daily Cash Settlement

The process of cash settlement effected for a futures Contract on each Trading Day during its lifetime in accordance with the rules for that Contract.

Daily Settlement Amount

The amount payable to or by a Member Firm in relation to each Daily Cash Settlement.

Daily Settlement Price

This is the end-of-day price established by the Exchange clearinghouse (CCP) used in daily marking-to-market of open futures and options contract positions.

Delivery

Closing a derivative contract position by delivering the asset specified in the contract (e.g., a trader who is short maize futures at the futures expiration must deliver the maize to the trader who is long the futures contract).

Delivery date

The date on which the underlying asset is exchanged for cash payment.

Delivery month

The calendar month during which delivery on a futures contract must be made.

Delta

The sensitivity of the change in the financial instrument's price to changes in the price of the underlying cash index.

Delta Neutral

A position where the sum of the deltas of the component legs adds up to 0.

Dynamic hedge

A hedge strategy maintained by dynamically rebalancing portfolio weights.

Early exercise

Exercising an American option prior to the expiration date.

Early exercise premium

The economic value of the right to exercise an American-style option early. Equals the difference between the value of an American-style option and an otherwise comparable European-style option.

Embedded Derivatives (see also Structured Notes)

Derivative contracts that exist as part of securities.

European Style Option

An option that can be exercised only at expiry as opposed to an American Style option that can be exercised at any time from inception of the contract. European Style option contracts can be closed out early, mimicking the early exercise property of American style options in most cases.

Exchange Traded Contracts

A future or option contract traded on organized exchanges such as the Nigerian Stock Exchange by exchange members. Exchange-traded contracts tend to be standardized and limited in complexity, though innovation is changing this.

Exercise

The use of the right by the option holder to purchase the underlying shares at the exercise price if the option is a call, or to sell the underlying shares at the exercise price if the option is a put. 'American-style' options can be exercised by the option holder at any time prior to expiry, while ‘European-style’ options can only be exercised upon expiry. When a call is exercised, the writer is obliged to make delivery of i.e. sell the underlying shares at the exercise price of the option and the buyer is obliged to take delivery i.e. buy. When a put is exercised, the writer is obliged to take delivery of i.e. purchase the underlying shares at the exercise price of the option and the buyer is obliged to make delivery i.e. sell.

Exercise Notice

A formal notification to the Clearing House that the holder of a call (put) option wishes to buy (sell) the underlying at the exercise price.

Exercise Price (see also Strike Price)

The exercise price is the price at which a call's (put's) buyer can buy (or sell) the underlying instrument.

Exotic Derivatives

Any derivative contract that is not a plain vanilla contract. Examples include barrier options, average rate and average strike options, lookback options, chooser options, etc.

Expiration

The moment that a Contract ceases to exist, and therefore is no longer tradable;

Expiry Day

The date on which Expiration occurs;

Expiry Month

The month in which the Expiration Day falls;

Financial Futures

A futures contract written on a financial asset (e.g., stocks, bonds, foreign currencies).

Forward Contracts

A financial contract that requires its buyer to purchase an underlying asset at a fixed price on a fixed future date. No cash flows is paid until the delivery date. Examples include forward foreign exchange contracts in which one party is obligated to buy foreign exchange from another party at a fixed rate for delivery on a pre-set date.

Forward curve

The relation between forward prices and maturity.

Forward market

A market in which forward contracts are traded.

Forward option

An option on a forward contract.

Forward Premium

A positive difference between the forward price and the current spot price.

Forward price

The delivery price written in a forward contract.

Fundamental analysis

Predicting price movements based on the fundamental factors influencing an asset's value.

Futures Contracts

An exchange-traded obligation to buy or sell a financial instrument or to make a payment at one of the exchange's fixed delivery dates, the details of which are transparent publicly on the trading floor and for which contract settlement takes place through the exchange's clearinghouse. An agreement between two parties, a buyer and a seller, to exchange an asset or currency at a later date at price fixed today. Distinguished from a forward contract by virtue of the futures exchange's daily settlement procedure (i.e., marking to market).

Futures Price

The level (price) at which the counterparties agree to trade. It is the delivery price written in a futures contract.

Futures-style settlement

A settlement procedure used by an exchange in which buying a contract requires no immediate cash outlay. Cash settlement is made daily based on the change in the contract price.

Gamma

Gamma (or convexity) is the degree of curvature in the financial contract's price curve with respect to its underlying price. It is the rate of change of the delta with respect to changes in the underlying price. Positive gamma is favourable. Negative gamma is damaging in a sufficiently volatile market. The price of having positive gamma (or owning gamma) is time decay. Only instruments with time value have gamma.

Hedge

A transaction that offsets an exposure to fluctuations in financial prices of some other contract or business risk. It may consist of cash instruments or derivatives.

Historical Volatility

A measure of the volatility (a statistical measure of dispersion) estimated using historical return data.

Implied forward rate

A forward rate of interest implied by two spot rates of different maturities (e.g., the forward rate on a one-year loan in one year is implied by the prevailing spot rates on a one-year and a two-year loan).

Implied Volatility

Option pricing models rely upon an assumption of future volatility as well as the spot price, interest rates, the expiry date, the delivery date, the strike, etc. If we are given simultaneously all of the parameters necessary for determining the option price except for volatility and the option price in the marketplace, we can back out mathematically the volatility corresponding to that price and those parameters. This is the implied volatility.

In-The-Money Spot (see also Intrinsic Value; At-The-Money; Out-of-The-Money)

An option with positive intrinsic value with respect to the prevailing market spot rate. If the option were to mature immediately, the option holder would exercise it in order to capture its economic value. For a call price to have intrinsic value, the strike must be less than the spot price. For a put price to have intrinsic value, the strike must be greater than the spot price.

In-The-Money-Forward (see also Intrinsic Value; At-The-Money; Out-of-The-Money)

An option with positive intrinsic value with respect to the prevailing market forward rate. If the option were to mature immediately, the option holder would exercise it in order to capture its economic value. For a call price to have intrinsic value, the strike must be less than the spot price. For a put price to have intrinsic value, the strike must be greater than the spot price.

Index futures

A futures contract written on a stock index.

Index Option

An index option is a call or put option on an index (e.g., the NSE30). It is cash settled.

Interest rate derivative

A derivative security whose value depends on the level of or the difference between interest rates.

Interest rate futures

A futures contract on an interest rate instrument.

Interest rate option

An option contract on an interest rate instrument.

Intracommodity spread

A spread between two futures contracts written on the same commodity but with different delivery months.

Intrinsic Value

The economic value of a financial contract, as distinct from the contract's time value. One way to think of the intrinsic value of the financial contract is to calculate its value if it were a forward contract with the same delivery date. If the contract is an option, its intrinsic value cannot be less than zero.

Last Trading Day

The final day for dealing in options contracts for a particular expiry month.

Leverage

The ability to control or gain exposure to a large nominal amount of an underlying asset with a relatively small amount of capital. Futures and options are leveraged because with relatively small down payments (of margin or premium) the buyer gains exposure to large amounts of the underlying.

Liquidity Risk

The risk that a financial market entity will not be able to find a price (or a price within a reasonable tolerance in terms of the deviation from prevailing or expected prices) for one or more of its financial contracts in the secondary market. Consider the case of a counterparty who buys a complex option on European interest rates. He is exposed to liquidity risk because of the possibility that he cannot find anyone to make him a price in the secondary market and because of the possibility that the price he obtains is very much against him and the theoretical price for the product.

Long

An open "bought" position.

Long Hedge

A hedge involving a short position in the spot market and a long position in the futures.

Long-term equity anticipation securities (LEAPS)

Options on stocks and stock indexes with times to expiration of more than one year

Margin

Margin - good faith 'collateral' deposit, specified as a percentage of the value of the financial instrument in question. This is paid in cash (and in some cases securities) and held by the CCP in order to manage counterparty risk associated with every position and ensure integrity of the derivatives market.

Initial margin - The minimum amount of money that a customer must deposit with his or her futures broker to establish a futures or options position. Margin is required to guarantee that a customer honor his or her contract obligations and may be deposited in the form of interest-bearing securities.

Maintenance margin - The minimum amount of money that must be kept in a margin account on any day.

Variation margin - The additional amount of cash you are required to deposit to your futures trading account after your futures position have taken sufficient losses to bring it below the maintenance **margin.**
Margin call - A demand for additional margin funds to bring margin deposits up to initial levels

Mark to Market

A method of accounting in which contracts are revalued at regular intervals using prevailing market prices. It is used by futures exchanges to maintain a minimum level of margin equity for a given futures or option contract position by calculating the gain or loss in each contract position resulting from changes in the price of the futures or option contracts at the end of each trading day. These amounts are added or subtracted to each account balance.

Market Neutral Strategy

A market neutral strategy is a trading strategy that involves the purchase of securities long and the sale of securities short in order to protect a portfolio from exposure to broad market moves. The goal is to profit from relative mispricings between related instruments – going long on those that are perceived to be underpriced while going short on those perceived to be overpriced – while avoiding systematic risk.

Market Risk

The exposure to potential loss from fluctuations in market prices (as opposed to changes in credit status).

Naked Option Writing

The act of selling options without having any offsetting exposure in the underlying cash instrument.

Nearby contract

The futures contract with the shortest time to expiration.

Netting

When there are cash flows in two directions between two counterparties, they can be consolidated into one net payment from one counterparty to the other thereby reducing the settlement risk involved.

Novation

The replacement of one or more derivative contracts with new ones, often also with one of the counterparties replaced by a new one. One common use of novation is in CCP Clearing where the CCP becomes the buyer to the seller and the seller to the buyer.

Offsetting order

A liquidating trade that has exactly the opposite terms of an outstanding position.

Open Interest

The number of derivative contracts that have been established but not yet been offset or exercised.

Optimal Hedge

The number of derivative contracts that should be bought or sold in order to minimize the risk of changes in the value of the overall portfolio.

Option

A contract that provides the right to buy or sell an asset at a specified price (i.e., the exercise price) over a specified period (i.e., the time remaining to expiration).

Option Class

All listed options of a particular type (i.e., call or put) on a particular underlying instrument, e.g., all NSE30 call options form an option class.

Option Sensitivities [Greeks] (see Delta, Gamma, Theta, Vega, Rho)

Reflect the nature and extent of changes in the value of an option, given changes in the behavior of the underlying asset over time. These sensitivities are critical in determining appropriate hedging strategies.

Option Series

One of the options within an option class. Uniquely identified by;

(i) option type (call or put)

(ii) exercise price

(iii) expiration day.

NSE30 call options with the same strike price and same expiry date form an option series.

Option Type

An option is designated as either a call or a put.

OTC derivatives

Derivatives traded in the over-the-counter market, that is, negotiated between private parties.

Out-of-The-Money Spot (see also At-The-Money; In-The-Money)

An option with no intrinsic value with respect to the prevailing market spot rate. If the option were to mature immediately, the option holder would let it expire. For a call price to have intrinsic value, the strike must be less than the spot price. For a put price to have intrinsic value, the strike must be greater than the spot price.

Out-of-The-Money-Forward (see also At-The-Money; In-The-Money)

An option with no intrinsic value with respect to the prevailing market forward rate. If the option were to mature immediately, the option holder would let it expire. For a call price to have intrinsic value, the strike must be less than the spot price. For a put price to have intrinsic value, the strike must be greater than the spot price.

Outright Position

A position involving only the future contract, but not the underlying or related securities.

Over-the-Counter

Any transaction that takes place between two counterparties and does not involve an exchange is said to be an over-the-counter transaction.

Passive Hedge

A hedge that consists of buying/selling derivatives and holding them to expiration.

Payoff

The amount of money received from a transaction at the end of the holding period.

Physical Settlement

This is the settlement of a futures or options contract by the delivery of the underlying security.

Position

The composition of a trader's portfolio.

Position Limit

This is a limit applied from time to time by an Exchange whether generally or in relation to a particular Member Firm imposing limits on the number of Contracts of any type which may be held by a Member Firm.

Position Trader

A trader who typically holds a position for longer than a day.

Potential Exposure

An assessment of the future positive intrinsic value in all of the contracts outstanding with an individual counterparty who may choose (or may be unable) to make their obligated payments.

Premium

The sum of money that an option buyer pays for the right to acquire the option, and that an option seller receives for incurring the obligation the option entails. Option premiums are expressed as a cost in ₦ per share. The total cost of an option contract for 100 shares (referred to as a 'lot') would therefore be 100times the premium, e.g. one contract with a premium of ₦0.5 would cost ₦50 (100x0.5). Premium is a combination of intrinsic value and time value and usually applies to options contracts.

Price Limit

An exchange rule limiting the maximum price increase or decrease on a particular contract during one trading day.

Price risk

The risk of not knowing the level of price at some future date.

Protective Put

An investment strategy involving buying a put to limit possible declines in the price of the underlying asset.

Put Option

A put option is a financial contract that gives the holder the right (but not the obligation) to sell the underlying asset at a strike price during a specified period for a premium. Conversely, the writer of a put option is obligated to buy the underlying asset from the holder at the strike price upon its exercise at any time prior to the expiration date. European put options differ from American insofar as they must be exercised on a specified date rather than at any time before expiration.

Put Option on Futures Contract

A put option on a futures contract is a financial contract that gives the holder the right, but not the obligation, to sell a particular futures contract at the strike price up to the expiration date. For this right, the buyer pays a premium to the seller. Writing a put option on a futures contract obligates the writer to buy the particular futures contract from the holder at the strike price up to the expiration date.

Put-Call Parity Theorem

A long position in a put combined with a long position in the underlying forward instrument, both of which have the same delivery date has the same behavioral properties as a long position in a call for the same delivery date. This can be varied for short positions, etc.

Put Spread

The simultaneous purchase (sale) of a put at one exercise price and the sale (purchase) of a put at a lower exercise price.

Rollover

The transfer of a futures or options position from one delivery/expiry month to another - involving the purchase (sale) of the nearby month and the simultaneous and corresponding sale (purchase) of a further delivery or expiry month.

Rho

The sensitivity of a financial contract's value to small changes in interest rates.

Settlement

The process of moving cash and/or the physical Underlying (where applicable) between Member Firms, normally resulting from trading activities such as Assignment, Exercise, Opening Transactions, Closing Transactions etc.

Settlement Risk

The risk of non-payment of an obligation by a counterparty to a transaction, exacerbated by mismatches in payment timings.

Short

A position created by selling.

Short Hedge

A hedge involving a long position in the spot market and a short position in the futures.

Single Stock Future

A future contract on a common stock.

Single Stock Option

An option contract on a common stock.

Speculation

Taking positions in financial instruments without having an underlying exposure that offsets the positions taken. This trading position is established to profit from a directional move in the price of the contract.

Speculative Bubble

A rapid increase in price due to a rush of buyers unrelated to fundamental qualities of a security but hoping to profit from the price trend.

Spot

The price in the cash market for delivery using the standard market convention. In the foreign exchange market, spot is delivered for value two days from the transaction date or for the next day in the case of the Canadian dollar exchanged against the US dollar.

Spread

1. A market position involving a degree of risk offset in two or more positions. For options such strategies as ratio, horizontal and vertical spreads are used across strikes prices and expiry months. The difference in price or yield between two assets that differ by type of financial instrument, maturity, strike or some other factor. A credit spread is the difference in yield between a corporate bond and the corresponding government bond. A yield curve spread is the spread between two government bonds of differing maturity.

2. A trading strategy that consists of buying one contract and selling another similar contract.

Spreader

A trader who engages in spread transactions.

Stack Hedge

A hedge in which short-term futures contracts are used to hedge long-term commitments.

Straddle

The simultaneous purchase (sale) of a call and put option in the same expiry month with the same exercise price.

Strangle

The simultaneous purchase (sale) of a call option at one exercise price and a put option at a lower exercise price but with the same expiry date.

Strap

A trading strategy that consists of:

(i) buying (selling) two calls; and

(ii) buying (selling) one put;

where all options are written on the same underlying asset and have the same exercise price and expiration date.

Strike Price

The price at which an option contract will be settled if exercised or assigned. The right to buy or sell at the Strike Price is secured by the payment of a Premium. Payment of Premium is defined in the contract specifications.

Strip

A trading strategy that consists of:

(i) buying (selling) one call; and

(ii) buying (selling) two puts;

where all options are written on the same underlying asset and have the same exercise price and expiration date.

Strip hedge

A hedge in which a series of futures contracts of successively longer expirations are bought or sold.

Stress Testing

The act of simulating different financial market conditions for their potential effects on a portfolio of financial instruments.

Structured Notes

Fixed income instruments with embedded derivative products.

Synthetic Asset

A long (short) call together with a short (long) put where both options have the same underlying, exercise price, and expiration date.

Synthetic Derivative

A portfolio of traded securities that replicates the cash flows of a derivative contract.

Synthetic Long Call

Generated by buying the underlying asset and buying the put with the same exercise price. The cost of the position is financed at the short-term interest rate.

Synthetic Long Put

Generated by selling the underlying asset and buying a call put. The net proceeds from establishing the position are invested at the short-term interest rate.

Synthetic Short Call

Generated by selling the underlying asset and selling a put. The proceeds from the sale are invested at the short-term interest rate.

Synthetic Short Put

Generated by buying the underlying asset and selling a call. The net cost of establishing the position is financed at the short-term interest rate.

Tailing the hedge

Adjusting the hedging ratio to account for the interest paid or received from the daily settlement of the futures position.

Theta

The sensitivity of a derivative product's value to changes in time to expiration, all other factors staying the same.

Tick Size

The smallest increment by which the quoted price can be changed.

Time Value (see also Intrinsic Value; Premium)

For a derivative contract with a non-linear value structure, time value is the difference between the intrinsic value and the premium. The amount, if any, by which an option's premium exceeds its intrinsic value. If an option is not in the money, its premium consists entirely of time value.

Time Value Decay

The process whereby the value of an option premium is eroded as expiry approaches.

Underlying

This is the index, commodity, stock, bond, interest rate, currency or any other financial instrument on which a future or option contract may be based.

Value-at-Risk or VaR

The calculated value of the maximum expected loss for a given portfolio over a defined time horizon (typically one day). VaR measures the maximum unfavorable change in portfolio value that can be expected over a specific time period and confidence interval, due to the movements of economic variables such as interest rates, exchange rates, commodity prices, equity prices, etc.

Value of a Basis Point

The change in the value of a financial instrument attributable to a change in the relevant interest rate by 1 basis point (i.e. 1/100 of 1%).

Vega

The sensitivity of a derivative product's value to changes in implied volatility, all other factors staying the same.

Vega-Neutral

A portfolio whose value is insensitive to movements in volatility.

Vertical Spread

A spread that consists of:

(i) buying one option; and

(ii) selling an otherwise identical option with a different exercise price.

Volatility (see also Standard Deviation; Implied Volatility)

The statistical measure of dispersion of a time series around its mean; the expected value of the difference between the time series and its mean; the square root of the variance of the time series.

Volatility Trade

A recognized option strategy which involves the simultaneous purchase (sale) of calls against the sale (purchase) of the underlying or the simultaneous purchase (sale) of puts against the purchase (sale) of the underlying in one single transaction.

Volume

Number of contracts traded in a particular interval of time.