

all exercises could be impaired. As noted in Chapter XI, the prospectus of OCC relating to options is available from OCC or any of the U.S. options markets, and the registration statement of OCC, which includes OCC's financial statements, is available for inspection at OCC's office and may be obtained from the SEC.

### **SPECIAL RISKS OF INDEX OPTIONS**

1. Writers of cash-settled index call options cannot provide in advance for their potential settlement obligations by acquiring and holding the underlying interest. A call writer can offset some of the risk of his writing position by holding a diversified portfolio of securities similar to those on which the underlying index is based. However, except where the underlying index is a specialized one based on relatively few securities, most investors cannot, as a practical matter, acquire and hold a portfolio containing exactly the same securities in the same proportions as the underlying index. Most writers of cash-settled index calls who also hold positions in securities will therefore bear the risk that the market prices of those securities will not increase as much as the index.

2. Even if the writer of a cash-settled index call option could assemble a securities portfolio that exactly reproduced the composition of the underlying index, the writer still would not be fully covered from a risk standpoint because of the "timing risk" inherent in writing cash-settled options. When a cash-settled index option is exercised, the amount of cash that the holder is entitled to receive is determined by the difference between the exercise price and the exercise settlement value, which is based on the prices of the constituent securities at a particular time on or in relation to the date on which the option is exercised. As with most other kinds of options, the writer will not learn that he has been assigned until the next business day, at the earliest. The time lag between exercise and notice of assignment poses no risk for the writer of a covered physical delivery call, because that writer's obligation is to deliver the underlying interest and not to pay its value as of a fixed time in the past. So long as the writer of a physical delivery call already owns the underlying interest, he can satisfy his settlement obligations simply by delivering it, and the risk that its value may decline after the exercise date is borne by the exercising holder. In contrast, even if the writer of a cash-settled index call holds securities that exactly match the composition of the underlying index, he will