higher exercise price than the exercise price of the short, or if the long has an earlier expiration date than the expiration date of the short, then the writer may still be exposed to significant risks from his uncovered writing position.

**AT THE MONEY**—This term means that the current market value of the underlying interest is the same as the exercise price of the option.

**IN THE MONEY**—A call option is said to be in the money if the current market value of the underlying interest is above the exercise price of the option. A put option is said to be in the money if the current market value of the underlying interest is below the exercise price of the option.

*EXAMPLE:* If the current market price of XYZ stock is $43, an XYZ 40 call would be in the money by $3.

**OUT OF THE MONEY**—If the exercise price of a call is above the current market value of the underlying interest, or if the exercise price of a put is below the current market value of the underlying interest, the option is said to be out of the money by that amount.

*EXAMPLE:* With the current market price of XYZ stock at $40, a call with an exercise price of $45 would be out of the money by $5—as would a put with an exercise price of $35.

**INTRINSIC VALUE and TIME VALUE**—It is sometimes useful to consider the premium of an option as consisting of two components: intrinsic value and time value. Intrinsic value reflects the amount, if any, by which an option is in the money. Time value is whatever the premium of the option is in addition to its intrinsic value. An American-style option may ordinarily be expected to trade for no less than its intrinsic value prior to its expiration, although occasionally an American-style option will trade at less than its intrinsic value. Because European-style and capped options are not exercisable at all times, they are more likely than American-style options to trade at less than their intrinsic value when they are not exercisable.

*EXAMPLE OF A CALL WITH INTRINSIC VALUE:* At a time when the current market price of XYZ stock is $46 a share, an XYZ 40 call would have an intrinsic value of $6 a share. If the market price of the stock were to decline to $44, the intrinsic value of the

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