

The put writer's exposure to margin requirements can be eliminated if the put writer elects to deposit cash equal to the option exercise price with his brokerage firm. Under this strategy, known as cash-secured put writing, the option writer is not subject to any additional margin requirements regardless of what happens to the market value of the underlying interest. In the meantime, the option writer might earn interest by having the cash invested in a short-term debt instrument—for example, in a Treasury bill. However, a cash-secured put writer is still subject to a risk of loss if the value of the underlying interest declines.

EXAMPLE: An investor receives a \$500 premium for writing an XYZ 50 put option with six months remaining until expiration and deposits with his broker \$5,000 invested in Treasury bills which, over the six month option life, will earn interest of \$250. If he has not been assigned an exercise by expiration, the investor will have a total return of \$750 (option premium of \$500 and interest of \$250). On the other hand, if the price of XYZ stock were to fall below \$42-1/2 and the investor is then assigned an exercise, he would have a net loss—that is, the market price of the XYZ stock he would be required to purchase would be below the exercise price by more than the combined premium income and interest earned.

5. The risk of being an option writer may be reduced by the purchase of other options on the same underlying interest—and thereby assuming a spread position—or by acquiring other types of hedging positions in the options markets or other markets. However, even where the writer has assumed a spread or other hedging position, the risks may still be significant. See paragraph 1 under "Other Risks" below.

6. The obligation of a writer of an uncovered call or of a put that is not cash-secured to meet applicable margin requirements creates additional risks. If the value of the underlying interest moves against the writer's position, or if there is a significant change in the volatility or liquidity of the underlying interest, related interests, or the option, or if the writer's brokerage firm otherwise requires, the firm may request significant additional margin payments. If those payments are not made, the firm may have the right to liquidate the options positions and other securities positions in the writer's account with little or no prior notice.

7. Since the leverage inherent in an option can cause the impact of price changes in the underlying