

EXCHANGE TRADED OPTIONS
PRODUCT DISCLOSURE STATEMENT

INTERACTIVE BROKERS LLC

ARBN 091 191 141

AFSL 245 574

Date of Issue: 12 February 2014

INDEX

1.	GENERAL INTRODUCTION	4
1.1	Important Information	4
1.2	Purpose of this PDS	4
1.3	About Interactive Brokers	4
1.4	What Products does this PDS cover?	6
2.	WHAT ARE EXCHANGE TRADED OPTIONS?	7
2.1	Types of Exchange Traded Options	7
2.2	Uses of Exchange Traded Options	7
2.3	Understanding some concepts	8
2.4	Educational booklets for ASX Exchange Traded Options	8
3.	BASIC FEATURES OF EXCHANGE TRADED OPTIONS	10
3.1	Standardised Contracts	10
3.2	Sellers (writers) and Buyers (takers)	11
3.3	Call options and put options	11
3.4	Exercise style – American or European	12
3.5	Premium	12
3.6	Adjustments	13
3.7	No Dividends or Entitlements	13
3.8	Expiry	14
3.9	Exercise by the Buyer (taker) and assignment to the Seller (writer)	14
3.10	Automatic exercise	15
3.11	Deliverable or cash settled	15
3.12	Settlement following exercise of Exchange Traded Option	15
3.13	Margin requirements	16
3.14	Cooling off period	16
3.15	Option contracts which are open for trading	16
3.16	Opening an Exchange Traded Option position	16
3.17	Closing out an Exchange Traded Option position	17
3.18	Information on trading strategies	17
4.	EXECUTION, CLEARING AND SETTLEMENT ARRANGEMENTS	18
4.1	Execution arrangements for Exchange Traded Options	18
4.2	Clearing arrangements and the role of the Clearing House	18
4.3	Clearing House Margin	19
4.4	Collateral and the holding of securities	20
4.5	IB's margin requirements	21
4.6	Use of monies to meet other obligations in connection with derivatives	22
4.7	Compensation schemes	22
5.	SIGNIFICANT BENEFITS OF EXCHANGE TRADED OPTIONS	24
6.	SIGNIFICANT RISKS OF EXCHANGE TRADED OPTIONS	26
7.	COSTS ASSOCIATED WITH EXCHANGE TRADED OPTIONS	30

Product Disclosure Statement

7.1	Premium	30
7.2	Margin requirements	30
7.3	Fees and charges	30
8.	DISPUTE RESOLUTION SYSTEM	32
9.	SIGNIFICANT TAXATION IMPLICATIONS	32
9.1	Implications for Australian resident investors	32
9.2	Rules for the Taxation of Financial Arrangement	35

1. GENERAL INTRODUCTION

1.1 Important Information

The information in this Product Disclosure Statement (PDS) does not take into account your personal objectives, financial situation and needs. Before trading in the 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 and needs.

We recommend that you consult your financial adviser before trading in exchange traded options.

1.2 Purpose of this PDS

This Product Disclosure Statement (**PDS**) has been prepared by Interactive Brokers LLC (**IB**) the issuer of the exchange traded options. This PDS is designed to assist you in deciding whether exchange traded options 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 and we recommend you contact us should you have any questions. Our contact details are set out at section 1.3 below.

Although the information in this PDS is up to date as at the date of publication, it is subject to change from time to time. Where such information is not materially adverse, we may provide updates on our website at www.interactivebrokers.com. A paper copy is also available on request at no charge to you.

We may also be required to issue a new PDS or a supplementary PDS as a result of certain changes, in particular where the changes are materially adverse to retail clients. Any supplementary PDS will be posted on our website at www.interactivebrokers.com. A paper copy will also be available on request at no charge to you.

When we use terms 'we', 'us' or 'our' in this PDS, the reference is to IB.

1.3 About Interactive Brokers

(a) The issuer – Interactive Brokers LLC

IB is the issuer of exchange traded options offered under this PDS.

IB holds an Australian financial services licence, number 245574, which authorises IB to deal in exchange traded options.

IB is also regulated in the USA (by the Securities and Exchange Commission, the Commodities and Futures Trading Commission, the Financial Industry Regulatory Authority and the New York Stock Exchange), in the United Kingdom

(by the Financial Conduct Authority) and in Hong Kong (by the Securities and Futures Commission).

IB is a trading participant of ASX 24 market operated by ASX and of the financial market operated by Chi-X Australia. IB is not a trading participant of ASX. For information on the execution, clearing and settlement arrangement which IB has in place for exchange traded options, see section 4.

(b) The Interactive Brokers Group

IB is an affiliate of the Interactive Brokers Group (**IBG**) which comprises of a number of automated global electronic market makers and brokers that specialise in routing orders and executing and processing trades in securities, futures and foreign exchange instruments. IBG affiliates conduct business on more than 60 electronic exchanges and trading venues around the world. IBG, using its proprietary software, provides non-advisory brokerage services to professional traders and investors with direct access to stocks, options, futures, foreign exchange contracts and bonds.

IBG's headquarter is in Greenwich Connecticut, and it has about 880 employees in its offices in the USA, Switzerland, Canada, Hong Kong, UK, Australia, Hungary, Russia, India, China and Estonia.

(c) Contact details

Our contact details are below:

Interactive Brokers LLC Head Office
One Pickwick Plaza
Greenwich, CT 06830

Telephone Numbers:
1-877-442-2757 (from inside the U.S.)
+1-312-542-6901 (from outside the U.S.)

IB - Australian Contact
Grosvenor Place
Level 42, 225 George Street,
Sydney, NSW 2000

Telephone numbers:
+61 (2) 8093 7300

e-mail: help@interactivebrokers.com

Additional contact information, including issue-specific details, is available at <http://individuals.interactivebrokers.com/en/p.php?f=customerService>.

1.4 What Products does this PDS cover?

This PDS relates to exchange traded options traded on a range of exchanges, including the market operated by Australian Securities Exchange Limited (**ASX**). For details of the exchanges on which you can trade exchange traded options through us (**Relevant Exchanges**), please see our website at <https://www.interactivebrokers.com.hk/en/index.php?f=products&p=opt>.

Exchange traded options offered under this PDS include:

- **equity options:** options over quoted shares or interests in managed investment schemes of a range of different companies and managed investment schemes quoted on ASX and other Relevant Exchanges¹.
- **index options:** options over an index (for example, in the case of ASX, the S&P™/ASX 200™ Index or the S&P™/ASX 200™ Property Trust Index).

In this PDS, equity options and index options are collectively referred to as **Exchange Traded Options** or **ETOs**.

If you received this document electronically or if you received any updated or new information other than in writing, we will provide a paper copy free on request.

¹ Note that ASX makes available for trading equity options over various financial products, including shares in companies and interests in managed investment schemes. For ease of reference, we will refer in this PDS to underlying shares, but investors should be aware that the underlying financial product may be another financial product in some cases.

2. WHAT ARE EXCHANGE TRADED OPTIONS?

The risk of loss in trading in Exchange Traded Options can be substantial. It is important that you carefully consider whether trading Exchange Traded Options is appropriate for you in light of your investment objectives and financial circumstances. Exchange Traded Options are not suitable for some retail investors. You should only trade Exchange Traded Options if you understand the nature of the products and the extent of your exposure to risks.

A description of the significant risks associated with trading in Exchange Traded Options is set out in section 6 of this PDS.

2.1 Types of Exchange Traded Options

The types of Exchange Traded Options traded on Relevant Exchanges offered under this PDS are equity options and index options. These are each discussed briefly below:

(a) **Equity options**

Equity options are options over financial products quoted on a Relevant Exchange, for example shares of listed companies. On ASX, equity options are "deliverable" options in the sense that, on exercise, one party must take "delivery" of the underlying financial product.

(b) **Index options**

Index options are options over an index such as the S&P™/ASX 200™ Index or the S&P™/ASX 200™ Property Trust Index. Index options are "cash settled" options in the sense that, on exercise of an option, the buyer of the option will have the right to receive an amount of money and the writer will have a corresponding obligation to pay that amount (provided the option is "in-the-money"). The amount of money will be determined by the difference between the exercise level (set by the Relevant Exchange) and the settlement mechanism determined by the Relevant Exchange or the clearing house of the Relevant Exchange responsible for the clearing and settlement of Exchange Traded Options (**Clearing House**).

2.2 Uses of Exchange Traded Options

Exchange Traded Options are a versatile financial product which can allow investors to:

- hedge against fluctuations in their underlying share portfolio;
- increase the income earned from their portfolio (through the earning of premium income); and

- profit from speculation.

Their flexibility stems from the ability to both buy (take) and sell (write) an Exchange Traded Option contract and undertake multiple positions targeting specific movements in the overall market and individual underlying shares. Index options can be used to trade a view on the market as whole, or on the sector of the market that is covered by the particular index.

The use of Exchange Traded Options within an investor's overall investment strategy can provide flexibility to take advantage of rising, falling and neutral markets. However, both the purchase and sale of Exchange Traded Options involves risks which are discussed in more detail in section 6.

2.3 Understanding some concepts

Concepts which should be understood before trading in Exchange Traded Options are:

- The effect that time has on a position/strategy;
- How volatility changes, both up and down, may affect the price or value of an option and the potential outcome;
- How to calculate margins and worst-case scenarios for any position;
- The likelihood of early exercise and the most probable timing of such an event;
- The effect of dividends and capital reconstructions on an options position;
- The liquidity of an option, the role of market makers, and the effect this may have on your ability to enter and exit a position.

Whilst this PDS provides product information including information about the risks, characteristics and benefits of Exchange Traded Options, investors should inform themselves and if necessary obtain advice about the specific risks, characteristics and benefits of the Exchange Traded Option they intend to trade and rules of the Relevant Exchange.

2.4 Educational booklets for ASX Exchange Traded Options

In Australia, Exchange Traded Options have been traded in Australia since 1976 on the ASX. ASX has prepared a number of educational booklets relating to Exchange Traded Options. Their current booklets are available free of charge to you via their website at <http://www.asx.com.au/education/download-brochures.htm> as set out below.

This PDS refers to a number of ASX booklets, including:

- **"Understanding Options Trading"**- this booklet discusses the features and contract specifications of Exchange Traded Options, risks and advantages in trading options and gives examples of how Exchange Traded Options work and basic option trading strategies. You can view this booklet online by using the following link:

<http://www.asx.com.au/documents/resources/UnderstandingOptions.pdf>

- **"Understanding Option Strategies"** – this booklet describes in more detail how Exchange Traded Options may be used in various trading strategies. You can view this booklet online by using the following link:

<http://www.asx.com.au/documents/resources/UnderstandingStrategies.pdf>

- **"Margins"** – this booklet explains what margins are, how they are calculated by the Clearing House and how a Clearing Participant may meet its margin obligations to the Clearing House. You can view this booklet online by using the following link:

<http://www.asx.com.au/documents/resources/UnderstandingMargins.pdf>

If you cannot access the ASX booklets via the ASX website, you should contact the ASX. If you would like a hard copy of the **"Understanding Options Trading"** booklet, please contact us and we will arrange to forward a copy of that booklet to you at no charge.

If you have any questions on any aspect of the booklets you should consult us before making any investment decisions.

3. BASIC FEATURES OF EXCHANGE TRADED OPTIONS

The following discussion is not intended to be a detailed discussion of the features of the Exchange Traded Options, but rather to identify some of the key features of Exchange Traded Options. For a more detailed description in relation to Exchange Traded Options traded on ASX, you should refer to the ASX explanatory booklets referred to in the previous section.

3.1 Standardised Contracts

The terms and specifications of Exchange Traded Options (other than the premium, which is negotiated between the buyer and seller) are determined by the Relevant Exchange in accordance with operating rules of the Relevant Exchange.

In relation to Exchange Traded Options traded on ASX, details of contract specifications for Exchange Traded Options are published by the ASX on their website at <http://www.asx.com.au/products/equity-options/options-contract-specifications.htm>. The contract specifications detail the key standardised features of Exchange Traded Options traded on ASX.

The Relevant Exchange determines the key contract specifications for each series of Exchange Traded Options traded on the exchange.

For example, in the context of equity options the Relevant Exchange sets the following:

- the underlying share (eg. BHP);
- whether the option is a call option or a put option;
- the contract size (that is, the number of units of the underlying share to which the option relates) – when an exchange traded equity option series is first opened by ASX for trading, the contract size is usually 100 (eg. 100 BHP shares);
- exercise style – that is American style or European style;
- the exercise price (or strike price) – is the specified price at which the taker (buyer) of an equity option can, if they exercise the option, buy (in the case of a call option) or sell (in the case of a put option) the underlying shares; and
- the expiry date.

Similarly, for index options, the relevant parameters will also be set by the Relevant Exchange, including the underlying index, the index multiplier, the exercise style (European), the exercise level of the option and the expiry date.

Some of the concepts referred to above, such as contract size, exercise style, exercise price and expiry date are discussed in more detail below.

3.2 Sellers (writers) and Buyers (takers)

Every Exchange Traded Option contract has both a Seller (writer) and a Buyer (taker) .

Buyers are referred to as “takers” of an Exchange Traded Option as they take up the right to exercise the option (for example, the right to exercise the option and either buy or sell the underlying shares at the exercise price, in the case of an equity option).

Sellers of Exchange Traded Options are referred to as “writers” because they underwrite (or willingly accept) the obligations which are required to be performed on exercise of the option (for example, to buy or sell the underlying shares at the exercise price, in the case of an equity option).

3.3 Call options and put options

Exchange Traded Options may be call options or put options. The nature of call options and put options will depend on whether the options are equity options or index options.

(a) Equity options

Call options give the buyer (taker) the right, but not the obligation, to buy a standard quantity of underlying shares at a predetermined price on or before a predetermined date. If the taker exercises their right to buy, the seller (writer) to which the exercise notice is assigned by the Clearing House is required to sell the standard quantity of shares at the predetermined exercise price.

Put options give the buyer (taker) the right, but not the obligation to sell a standard quantity of underlying shares at a predetermined price on or before a predetermined date. If the taker exercises their right to sell, the seller (writer) to which the exercise notice is assigned by the Clearing House is required to buy the standard quantity of shares at the predetermined exercise price.

(b) Index options

Call options (in the case of index options) give the buyer (taker) the right, but not the obligation to exercise the option. If the closing level of the index exceeds the exercise level of the index option, the taker will, on exercise of the option, have

the right to receive an amount of money which is determined by multiplying the difference between the closing level and the exercise level by the index multiplier specified by the Relevant Exchange. If the taker exercises the option, the seller (writer) to which the exercise notice is assigned by the Clearing House is required to pay the corresponding amount.

Put options (in the case of index options) give the buyer (taker) the right, but not the obligation to exercise the option. If the closing level of the index is less than the exercise level of the index option, the taker will, on exercise of the option, have the right to receive an amount of money which is determined by multiplying the difference between the closing level and the exercise level by the index multiplier specified by the Relevant Exchange. If the taker exercises the option, the seller (writer) to which the exercise notice is assigned by the Clearing House is required to pay the corresponding amount.

3.4 Exercise style – American or European

Exchange Traded Options may be American or European exercise style. *American style* options can be exercised at any time prior to and including the expiry day. *European style* options can only be exercised on the expiry day and not before. Most ASX exchange traded equity options are American style options. ASX exchange traded index options are European style.

3.5 Premium

As noted above, the only term of an option contract an investor trades on a Relevant Exchange which is not set and pre-determined by the Relevant Exchange is the price of the contract. The price, known as the "Premium" is negotiated between the buyer and seller of the Exchange Traded Option through the market.

The premium for an equity option is quoted on a cents per underlying share basis so the dollar value payment is calculated by multiplying the premium amount by the number of underlying shares. As discussed above, for ASX Exchange Traded Options this is usually 100 at the time the option series is opened, but may be adjusted by ASX. For example, if you buy a call option with a premium quoted at 25c per share and the contract size is 100, the total premium is \$25.00 (being 0.25×100).

The premium for an index option is calculated by multiplying the premium (specified in terms of the number of points of the index) 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.

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

Most option pricing involves the use of a mathematical formula which includes calculating the intrinsic and time value of the particular option. You should refer to the section entitled "Option pricing fundamentals" in the ASX Booklet "**Understanding Options Trading**" available at the link provided in section 2 above for more information regarding the fundamentals of pricing options. ASX also provides a pricing calculator on the ASX website at

<http://www.asx.com.au/prices/calculators.htm>.

You can obtain current price information from your adviser at IB.

For further information on trading index options and examples on how trading index options can work for you, refer to the ASX booklet **Understanding Options Trading** available at the link provided in section 2 above.

3.6 Adjustments

A Relevant Exchange or Clearing House may in accordance with its operating rules make an adjustment to any of the specifications of an option to reflect corporate actions in respect of the underlying shares, for example if the issuer makes a bonus issue, rights issue, special dividend, capital reduction or other similar event. If a Relevant Exchange does make an adjustment it will generally endeavour to do so in a way which puts the writer and taker in substantially the same economic position they would have been in had the adjustment event not occurred, so as to preserve the value of open positions of takers and writers at the time of the adjustment. In some cases, a Relevant Exchange may decide not to make an adjustment for a corporate action and, instead, direct that open positions be terminated or closed out. When a Relevant Exchange makes an adjustment to the terms of an option series, the Clearing House will make a corresponding adjustment to the terms of contracts which are already open.

ASX has issued an **Explanatory Note for Option Adjustments** which can be found at http://www.asx.com.au/documents/resources/explanatory_note_option_adjustments.pdf which provides further information regarding ASX option adjustments.

3.7 No Dividends or Entitlements

The parties to an equity option do not, under the terms of the option, have any entitlement to dividends, franking credits or other entitlements paid or made by the issuer of the

underlying shares. Of course, the seller of a call option or the buyer of a put option who holds the underlying shares will have an entitlement to dividends, franking credits and other entitlements, but these are entitlements of the holders of the shares, not through the option contract.

If the buyer (taker) of a call option wants to participate in a prospective dividend or entitlement, the buyer will need to first exercise the option, allowing sufficient time to become the registered holder prior to the Ex Dividend or Ex Entitlement date. The resulting sale and purchase of underlying shares on the exercise of an equity option will settle on the third business day following the exercise of the option (see the discussion below under the heading "*Settlement following exercise of Exchange Traded Option*").

3.8 Expiry

Exchange Traded Options have a limited life span. For example, for ASX Exchange Traded Options, all Exchange Traded Options have an expiry month, which generally follow one of three cycles, namely:

- (i) January/April/July/October;
- (ii) February/May/August/November; and
- (iii) March/June/September/December.

The options expire on a specified day in the expiry month, as determined by ASX. For equity options, the option expires on the Thursday preceding the last Friday in the expiry month, as long as both the Thursday and Friday are full business days. Therefore if the last day of the month is a Thursday the option will expire on the Thursday prior. Index Options expire on the third Thursday of the contract month provided that day is a business day. For ASX Exchange Traded Options, ASX's Clearing House, ASX Clear Pty Ltd (**ASX Clear**) has the right to change these expiry dates should the need arise. Expiry day information is available on the ASX website at <http://www.asx.com.au/about/expiry-calendar.htm>.

3.9 Exercise by the Buyer (taker) and assignment to the Seller (writer)

The taker of an Exchange Traded Option has the right (but not the obligation) to exercise the option contract. This means that the writer of an Exchange Traded Option may be exercised against at any time prior to expiry (American style only). When the taker exercises an option, the Clearing House will randomly assign that exercise to an open position held by a writer in the relevant option series.

3.10 Automatic exercise

We will automatically exercise your taken exchange traded option contract if your contract is one cent in the money or one point for indexes. For call options the option will be in the money where the exercise price is below the price of the underlying shares. For put options the option will be in the money where the exercise price is higher than the price of the underlying shares. All unexercised option contracts will expire on the expiry date.

3.11 Deliverable or cash settled

Exchange Traded Options are either deliverable or cash settled.

Options are described as *deliverable* where the obligations of the buyer and seller are settled by the "delivery" of the underlying share. Equity options are deliverable, because on exercise, one party is required to transfer the underlying shares to the other at the exercise price.

Options are described as *cash settled* where the obligations of the buyer and seller are settled by the buyer and seller settling their obligations by the payment and receipt of a cash amount. Index options are cash settled.

3.12 Settlement following exercise of Exchange Traded Option

When an equity option is exercised by a Buyer, and the exercise is assigned by the Clearing House to an open position of a Seller, a contract for the sale and purchase of the underlying shares at the exercise price will arise between the Seller and the Buyer.

Payment for, and the delivery of underlying shares occurs via the Relevant Clearing House. For example, in relation to ASX Exchange Traded Options, settlement occurs through ASX Settlement, the settlement facility for ASX transactions and settlement will occur in accordance with the operating rules of ASX Settlement. Your obligations in relation to settlement are set out in IB's terms and conditions.

Index options are cash settled. When an index option is exercised by a taker, and the exercise is assigned by the Clearing House to an open position of a Seller, the Seller of the option must pay the cash settlement amount to the Clearing House. For example, in relation to ASX Exchange Traded Options, that amount will be determined by the difference between the exercise level (set by ASX) and the Opening Index Price Calculation (OPIC) as calculated by ASX on the expiry date. Cash settlement occurs in accordance with the rules of the Clearing House. For more information on settlement of ASX index options see the section entitled "Trading index options" in the ASX Booklet "**Understanding Options Trading**" available at the link provided in section 2 above.

3.13 Margin requirements

Exchange Traded Options are subject to margin requirements. For a discussion of our margin requirements, see section 4.

3.14 Cooling off period

There are no cooling-off arrangements for Exchange Traded Options.

3.15 Option contracts which are open for trading

Details of Exchange Traded Options available on the Relevant Exchanges are commonly available on the websites of the Relevant Exchanges.

For example, details of Exchange Traded Options listed on ASX and expiry date information can be found on the ASX website at <http://www.asx.com.au/products/equity-options.htm> or alternatively through information vendors or newspapers. A list of current option codes and delayed price information is available on the ASX website at <http://www.asx.com.au/products/equity-options/options-data.htm>.

Details of the previous day's trading for ASX Exchange Traded Options are published in summary form in the Australian Financial Review and more comprehensively in The Australian. If you cannot access the above information, please contact us and we will arrange to provide you with the information.

3.16 Opening an Exchange Traded Option position

Unlike shares, Exchange Traded Options are not instruments which a person buys or sells in the ordinary sense. The Relevant Exchange sets the terms of the Exchange Traded Options and, if we enter into a contract for you as Buyer (taker) or Seller (writer), we are regarded as having "opened" the contract for you.

If you have opened a position as the taker of an Exchange Traded Option, you have three alternatives:

- You can exercise the option.
- You can hold the option to expiry and allow it to lapse.
- You can close out the position by selling (writing) an option in the same series and instructing us to "close out" the open position.

Similarly, if you have opened a position as the writer of an Exchange Traded Option, you have two alternatives:

- You can let the option go to expiry and risk being exercised against (if it is not exercised against, it will expire without any further obligation or liability on the writer).
- You can close out the option by buying (taking) an option in the same series (provided it has not been exercised against).

3.17 Closing out an Exchange Traded Option position

An Exchange Traded Option may be "closed out" by entering into an option in the same series, but in the opposite position. In other words, if you have an open position in an option as a Buyer (taker), you can close out that position by entering into an option in the same series as a Seller (writer). This effectively cancels out the open position. For example, an investor might close out an open option contract in the following scenarios:

- The Seller (writer) of an option may want to close out the option (by taking an option in the same series) to avoid the risk of having a Buyer's (taker's) exercise notice allocated to the Seller's (writer's) option.
- The investor may want to take a profit. For example, the buyer of a call option may have paid a premium of \$1.00 per option, and the same option series may now be able to be sold for a premium of \$1.20, because the price of the underlying shares has increased. The buyer may therefore close out his or her position by selling an option in the same series, profiting from the difference of \$0.20 per underlying share.
- The investor may want to limit a loss. For example, the buyer of a call option may have paid a premium of \$1.00 per option, and the same option series may now be able to be sold for only \$0.80, because the price of the underlying shares has decreased or because the time to expiry has reduced. The buyer may therefore close out his or her position by selling an option in the same series, crystallising a loss of the difference of \$0.20 per underlying share.

It is important that you advise us if you are seeking to "close out" an existing position when placing your order.

3.18 Information on trading strategies

For information and examples regarding trading strategies using Exchange Traded Options, refer to the "Pay-off" section on page 24 of "**Understanding Options Trading**" available at the link provided in section 2 above.

4. EXECUTION, CLEARING AND SETTLEMENT ARRANGEMENTS

4.1 Execution arrangements for Exchange Traded Options

IB is a trading participant of some, but not all, of the Relevant Exchanges. In relation to Relevant Exchanges where IB is a direct participant, IB executes your transactions in Exchange Traded Options directly on the Relevant Exchange. Where IB is not a direct participant, it arranges for the execution of your transactions in Exchange Traded Options.

In Australia, IB is not a participant of ASX which operates the Exchange Traded Options market. IB therefore has an arrangement with its affiliated company, Timber Hill Australia Pty Limited (ABN 25 079 993 534) (**THA**), through which IB executes Exchange Traded Options on ASX for you. THA is a trading participant of ASX.

4.2 Clearing arrangements and the role of the Clearing House

Transactions in Exchange Traded Options on a market operated by a Relevant Exchange are cleared through the Clearing House responsible for clearing those transactions. For example, Exchange Traded Options traded on ASX are cleared through ASX Clear, a wholly owned subsidiary of ASX and a licensed clearing and settlement facility under the *Corporations Act 2001* (Cth) (**Corporations Act**).

Interactive Brokers is not a participant (**Clearing Participant**) of all Relevant Clearing Houses. Where it is not a Clearing Participant, it has an arrangement with a Clearing Participant of the relevant Clearing House to clear your Exchange Traded Options transactions. Clearing Participants are bound by the operating rules of the relevant Clearing House (**Clearing Rules**).

When we arrange, or enter into an Exchange Traded Option for you, the transaction is reported to the Clearing House for registration. On registration of a contract by the Clearing House, the original traded contract is in most markets, such as ASX, terminated and replaced by two contracts. One of those is between the Clearing Participant who clears the contract for the taker of the option contract and the Clearing House. The other is between the Clearing Participant who clears the contract for the writer of the option contract and the Clearing House. This process of registration and creation of two new contracts is known as "novation" and is described briefly in the section entitled "You and your broker" in the ASX booklet, "**Understanding Options Trading**" available at the link provided in section 2 above.

You, as the client, are not party to either of those contracts actually registered with the Clearing House. Although we may act on your instructions or for your benefit, upon registration of the Exchange Traded Option with the Clearing House in the name of the

Clearing Participant, the Clearing Participant incurs obligations to the Clearing House as principal, even though the Exchange Traded Option may have been entered into on your instructions.

In Australia, IB has arranged for ABN AMRO Clearing Sydney Pty Limited ABN 36 081 279 889 (**AACS**) to be the Clearing Participant for your ASX Exchange Traded Options Transactions. AACS holds an Australian financial services licence, number 225136 which authorises it to clear Exchange Traded Options. In accordance with the arrangements described above, AACS is the party to all ASX Exchange Traded Options Transactions registered with ASX Clear. AACS regards IB as its customer in respect of these positions, and IB in turn holds the benefit of these positions for you, in accordance with the terms of your customer agreement with IB. In other jurisdictions where IB is not the Clearing Participant of the Relevant Clearing House, similar arrangements are in place for IB to hold the benefit of your positions for you.

4.3 Clearing House Margin

This section contains a description of the basis upon which a Clearing House calls margin from its Clearing Participants. These margins may or may not correspond with the margin we call from you. For a description of our margin requirements and arrangements, see section 4.5.

As the Clearing House contracts with Clearing Participants as principals, where a Clearing Participant has an exposure under an Exchange Traded Option contract to the Clearing House, the Clearing House will call amounts of money known as "Margin" from the Clearing Participant as cover. Margins are generally a feature of all exchange traded derivative products and are designed to protect the Clearing House against default. A margin is the amount calculated by the Clearing House as necessary to cover the risk of financial loss on an Exchange Traded Option contract due to an adverse market movement.

The writer of an Exchange Traded Option will ordinarily be required to pay margin in respect of that contract or provide collateral acceptable to the Clearing House. That is because the Clearing House is exposed to the risk that the writer will not perform its obligations if and when the option is exercised. The taker of an Exchange Traded Option will not be required to pay margin in respect of that contract, because they are not "at risk" – they must pay the premium up front and that is the maximum amount the taker of the option can lose in respect of that contract (plus transaction costs).

The total margin called by the Clearing House for Exchange Traded Options is generally made up of two components, in each case, determined by the Clearing House:

- Variation margin (also known as premium margin) – this is determined by reference to the market value of the underlying share at the close of business each day.
- Initial margin (also known as risk margin) – this is the potential change in the price of the option contract assuming a maximum probable inter-day price move in the price of the underlying security or index.

Amounts of margin are determined daily by the Clearing House, following the close of trading each day. In times of extreme volatility an intra day margin call may be made by the Clearing House.

4.4 Collateral and the holding of securities

Clearing House margin obligations may be met by paying cash or by providing certain types of eligible collateral (eg. shares). For example, in relation to ASX Exchange Traded Options, shares (held by you) which are acceptable to the Clearing House may be lodged with the Clearing House as collateral for margin obligations relating to Exchange Traded Option positions. When shares are lodged with the Clearing House, the shares are held by the Clearing House as 'third party security' in the sense that they represent collateral provided by you to secure the obligations of the Clearing Participant to the Clearing House. The lodged shares cannot be used by us or the Clearing Participant in relation to our dealings or for our other clients in relation to their dealings unless authorised by you.

As a risk management tool, the Clearing House may apply a 'haircut' in relation to the value of collateral lodged. For example, if you lodge \$10,000 worth of collateral and the Clearing House applies a 30% haircut, only \$7,000 will be considered as collateral cover for any margin obligations.

The margining process used by Clearing House is explained in detail in the ASX booklet "**Margins**" which is available on the ASX website or by following the link below:

<http://www.asx.com.au/documents/resources/UnderstandingMargins.pdf>

Where you hold securities through us, we act as your custodian in relation to those securities. In markets where IB does not have direct access to the settlement system for the relevant securities markets, IB may appoint a sub-custodian to hold these securities. For example, in relation to ASX quoted securities, IB has appointed a third party clearing and settlement participant's nominee to hold securities in the ASX Settlement system for the benefit of IB, which in turn holds them as custodian for the benefit of its customers who are entitled to those securities. Similar arrangements may apply in other jurisdictions outside Australia.

4.5 IB's margin requirements

We have discussed above the margin requirements which are imposed by Clearing Houses on Clearing Participants. Where IB is the Clearing Participant, it must meet these requirements directly. Where IB is not the Clearing Participant, the Clearing Participant imposes margin requirements to IB. In any event IB imposes its own margin requirements under its customer agreement with you. We discuss these in this section.

(a) Single universal account

When you open an Account with IB, you open a single account through which you can trade not only Exchange Traded Options, but other products such as shares, futures and foreign exchange contracts. When we calculate your margin requirement, we have regard to the assets and liabilities in your Account as a whole.

(b) Risk based portfolio analysis

We determine the margin requirement for your Account by risk based portfolio analysis models, also having regard to the margin called by Relevant Exchanges and Clearing Houses. A summary with examples on how IB calculates ETO margins is available via the following link to IB's website:
<https://www.interactivebrokers.com/en/index.php?f=marginnew&p=opt>.

(c) Regulatory requirements

IB is regulated by the US regulators and is subject to strict regulation regarding the amount of leverage it can extend to its customer and the amount of margin it is required to call from its customers.

(d) Real-time margining and real-time monitoring

The value of assets and positions held in your Account is marked to market by IB's real-time credit management system. IB uses a real-time risk management system to allow you to see your trading risk at any moment of the day. Our real-time margin system calculates margin requirements throughout the day for new trades and trades already on the books and enforces initial margin requirements at the end of the day, with real-time liquidation of positions instead of delayed margin calls. Your margin requirement and current equity is monitored by IB and displayed online in real time to the customer via the various trading interfaces, as well as the online client portal. For more information about real-time margin monitoring, please visit our margin information page at <https://www.interactivebrokers.com/en/index.php?f=margin&p=overview2>.

It is your responsibility to actively monitor and manage your open positions and ensuring that you meet your margin obligations. It is also your responsibility to ensure that you are aware of any changes in margin obligations. All margin requirements must be met immediately. This means that sufficient cleared funds must be on deposit in your account to enable you to meet margin requirements immediately.

(e) **New positions must be covered in advance**

IB's real-time margining means that you will not be able to execute a transaction if to do so would cause your Account to go into margin deficit. For example, if your margin requirement would increase as a result of an initial margin obligation under an Exchange Traded Option, and there were insufficient assets in the Account to cover the initial margin obligation, IB's system would reject an order to execute the transaction concerned.

(f) **Consequences of a margin deficit**

Pursuant to your customer agreement, if your Account goes into margin call (that is, if there are insufficient assets in your Account to cover the margin requirement), IB is authorised to liquidate all, or part of, the assets held in your Account, or otherwise close your open positions to eliminate the shortfall. IB WILL NOTIFY YOU WHEN A MARGIN DEFICIENCY ARISES, BUT IS NOT OBLIGED TO GIVE YOU AN OPPORTUNITY TO PROVIDE FURTHER FUNDS. IB WILL INSTEAD GENERALLY LIQUIDATE POSITIONS IN YOUR ACCOUNT IN ORDER TO SATISFY MARGIN REQUIREMENTS. Any losses resulting from IB closing out your positions will be debited to your Account and you may be required to provide additional funds to IB to cover any shortfall.

4.6 Use of monies to meet other obligations in connection with derivatives

The Corporations Act provides that client money which you pay to us in connection with derivatives (such as Exchange Traded Options) can be used by us for the purposes of meeting margin obligations, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives (including dealings on behalf of our other clients).

4.7 Compensation schemes

Various Relevant Exchanges and Clearing Houses have compensation schemes in place to compensate clients of Interactive Brokers and Clearing Members.

For example, in relation to ASX, the National Guarantee Fund (**NGF**) provides investors with various protections. For example, if an equity option is exercised, the NGF

Product Disclosure Statement

guarantees completion of the resulting trades in certain circumstances. Also, if property is entrusted to a member of ASX (such as our designated Clearing Participant), and it later becomes insolvent, you may, through us, have claim on the NGF. Interactive Brokers is not a participant of ASX, and therefore does not itself have NGF coverage. There are limits on claims to the NGF for property entrusted. For more information on the possible protections offered by the NGF see <http://www.segc.com.au/>

IB is also regulated by the US Securities and Exchange Commission and Financial Industry Regulatory Authority. IB is a member of the Securities Investor Protection Corporation (**SIPC**), SIPC protects cash and securities held with IB as specified in the Securities Investor Protection Act of the US. SIPC protects cash and securities held in your Account for up to US\$500,000 (US\$100,000 for cash). Funds that are deposited in your options trading account are not covered by SIPC.

5. SIGNIFICANT BENEFITS OF EXCHANGE TRADED OPTIONS

Exchange Traded Options have a number of advantages. These include the following:

- (a) **Hedging.** Investors can **hedge** (protect) their share portfolio against a drop in value by, for example, buying equity put options over particular shares.
- (b) **Income.** Shareholders can **earn income** by writing call options over an underlying shares they already hold. As a writer of options, the investor will receive the premium amount up front, when the option is entered into. The risk is that the writer will need to maintain margin obligations throughout the life of the position and may be exercised against. This exercise will result in the writer being required to deliver the underlying shares to the taker at the exercise price.
- (c) **Time to decide.** By taking a call option, the purchase price for the underlying shares is locked in. This gives the call option holder **time to decide** whether or not to exercise the option and buy the shares. The holder has until the expiry date to make his/her decision. Likewise the taker of a put option has time to decide whether or not to sell the shares.
- (d) **Reduce risk.** Exchange Traded Options benefit from standardisation and registration with a clearing and settlement facility which reduces **counterparty default risk**. The Clearing Participant's risk is to the Clearing House, not to a third party. This process also provides the benefit that an open position can be closed out without having to deal with the original counterparty.
- (e) **Speculation.** Exchange Traded Options can be used for **speculation** where the flexibility of entering and exiting the market prior to expiry (subject to liquidity) permits an investor to take a view on market movements and trade accordingly. In addition the variety of option combinations allows investors to develop strategies regardless of the direction of the market.
- (f) **Profit in rising or falling market.** Investors can **profit from both rising and falling** markets depending on the strategy they have employed. Strategies may be complex and strategies will have different levels of risk associated with each strategy.
- (g) **Leverage.** The initial outlay for an options contract is not as much as investing directly in the underlying shares. Trading in options can allow investors to benefit from a change in the price of the share without having to pay the full price of the share. An investor can therefore purchase an option (representing a larger number of underlying shares) for less outlay and still benefit from a price move in the underlying shares. The ability to make a higher return for a smaller initial

outlay is called **leverage**. Investors however, need to understand that leverage can also produce increased risks (see below).

- (h) **Diversify portfolios.** Given the lower initial outlay attaching to options, investors can **diversify their portfolios and gain a broad market exposure** over a range of shares or the index itself.

6. SIGNIFICANT RISKS OF EXCHANGE TRADED OPTIONS

The risk of loss in trading in Exchange Traded Options can be substantial. It is important that you carefully consider whether trading Exchange Traded Options is appropriate for you in light of your investment objectives and financial circumstances. Exchange Traded Options are not suitable for some retail investors. You should only trade Exchange Traded Options if you understand the nature of the products and the extent of your exposure to risks. The risks attached to investing in Exchange Traded Options will vary in degree depending on the option traded – see the risks outlined below.

This PDS does not cover every aspect of risk associated with Exchange Traded Options. For further information concerning risks associated with Exchange Traded Option trading you are referred to the ASX booklet “**Understanding Options Trading**” and in particular the section entitled “Risks of options trading”. This booklet is available at the link provided in section 2 above.

- (a) **Price sensitive announcements.** As a general rule, price movements in the underlying share can significantly affect the value of Exchange Traded Options. The value of the underlying share is affected by information that is announced to the Relevant Exchange in relation to the share. Accordingly, it is advisable that an investor in Exchange Traded Options regularly reviews information announced to the exchange in relation to relevant underlying shares. Price sensitive announcements in relation to shares are available on the ASX website at: <http://www.asx.com.au/asx/statistics/todayAnns.do>.
- (b) **High leverage.** the **high level of leverage** that is obtainable in trading Exchange Traded Options (due to the low level of initial capital outlay) can work against an investor as well as for the investor. Depending on the market movement, the use of leverage may lead to large losses as well as large gains.
- (c) **Limited life span.** Exchange Traded Options have a **limited life span** as their value erodes as the option reaches its expiry date. It is therefore important to ensure that the option selected meets the investors investment objectives.
- (d) **Market movements.** Exchange Traded Options are subject to movements in the **underlying market**. Options may fall in price or become worthless at or before expiry.
- (e) **Loss of premium for Buyers.** The **maximum loss in taking** (buying) an Exchange Traded Option is the amount of premium paid plus transaction costs. If the option expires worthless, the taker will lose the total value paid for the option (the premium) plus transaction costs.

- (f) **Unlimited loss for Sellers.** Whilst Sellers (writers) of Exchange Traded Options earn premium income, they may also incur **unlimited losses** if the market moves against the option position. The premium received by the writer is a fixed amount; however the writer may incur losses greater than that amount. For example, the writer of a call option has increased risk where the market rises and the writer does not own the underlying shares. If the option is exercised, the writer of the option is forced to buy the underlying shares at the current (higher) market price in order to deliver them to the taker at the exercise price. Similarly where the market falls, the writer of a put option that is exercised is forced to buy the underlying shares from the taker at a price above the current market price.
- (g) **Loss of margin for Sellers.** Sellers of options could sustain a total **loss of margin funds** deposited with their broker where the market moves against the option position. In addition, the writer may be obligated to pay additional margin funds (which may be substantial) to maintain the option position or upon settlement of the contract. Our margining requirements are discussed at 4.5 above.
- (h) **Close-out difficulties.** Under certain conditions, it could become difficult or impossible to **close out** a position and the relationship between the price of Exchange Traded Options contracts and the underlying share may be distorted. Examples of when this may happen are:
 - (i) if there is a significant change in the price of the underlying share over a short period of time;
 - (ii) if there is an absence or reduction in the number of willing buyers and sellers in either the Exchange Traded Options market or the underlying market;
 - (iii) if the market is suspended or disrupted for any reason.
- (i) **Underlying market.** Similarly, events such as these in relation to the **underlying market** for the share may make it difficult for you to hedge or maintain your exposure under an open Exchange Traded Option contract;
- (j) **Contingent orders difficult.** The placing of contingent orders (such as a 'stop-loss' order)² may not always limit your losses to the amounts that you may want. **Market conditions may make it impossible to execute such orders.** For example, if the price of the underlying share moves suddenly, your order may not

² Is an order that becomes a market order (and hence executed) when the derivatives market reaches the designated price.

be filled, or may be filled at a different price to that specified by you, and you may suffer losses as a result.

- (k) **Exchange and Clearing House powers.** Relevant Exchanges and Clearing Houses commonly have **discretionary powers** in relation to the market and the operation of the clearing facility. They have power to suspend the market operation, or lift market suspension in options while the underlying securities are in trading halt if the circumstances are appropriate, restrict exercise, terminate an option position or substitute another underlying security (or securities), impose position limits or exercise limits or terminate contracts - all to ensure fair and orderly markets are maintained as far as practicable. These actions can affect an investor's option positions.
- (l) **Trading disputes.** Trades effected on a Relevant Exchange may be subject to **dispute**. When a trade is subject to a dispute the Relevant Exchange or Clearing House commonly has powers, in accordance with its rules, to request that a broker amend or cancel a trade, which will in turn result in the contract with the client being amended or cancelled. In some situations, the Relevant Exchange or Clearing House may also exercise powers to cancel or vary, or direct the cancellation or variation, of transactions.
- (m) **Trade amendments and cancellations.** Under our terms and conditions, we have the ability to **amend or cancel the trade**. This could cause you to suffer loss or increase your loss. A trade executed on your behalf can also be amended or cancelled even where the trade has been confirmed to the client;
- (n) **System outages.** Trades effected on a Relevant Exchange are traded on an electronic trading platform and cleared through the Clearing House, which also relies on electronic systems. As with all such electronic platforms and systems, they are subject to failure or **temporary disruption**. If the system fails or is interrupted we will have difficulties in executing all or part of your order according to your instructions. An investor's ability to recover certain losses in these circumstances will be limited given the limits of liability commonly imposed by the Relevant Exchange and the Clearing House. Any market disruption may mean a client is unable to deal in Exchange Traded Options when desired, a client may suffer a loss as a result. Common examples of disruption include a fire or other exchange emergency. The exchange could, for example, declare an undesirable situation has developed in a particular Exchange Traded Option contract and suspend trading. Exchanges or participants may also be able to cancel transactions under their operating rules.
- (o) **Capital loss.** By trading in Exchange Traded Options, you are exposed to the **risk of losing capital**. Speculators should not risk more capital than they can

afford to lose. A good general rule is never to speculate with money which, if lost, would alter your standard of living.

- (p) **Default.** If you fail to meet your obligations to us under your customer agreement with you, we may, in addition to any other rights which we may have against you, and without giving prior notice to you, take any action, or refrain from taking action, which we consider reasonable in the circumstances in connection with the open positions in your Account with us and you must account to us as if those actions were taken on your instructions and you are, without limitation, liable for any deficiency and are entitled to any surplus which may result
- (q) **Automatic liquidation on margin shortfall.** As discussed in section 4.5 above, IB will generally liquidate positions automatically upon a margin deficit arising. Whilst IB will notify you if a deficit arises, IB is not obliged to give you any opportunity to deposit further funds to meet a shortfall.
- (r) **Dealing on markets outside Australia.** The execution and clearing of Exchange Traded Options on Relevant Exchanges outside of Australia are subject to the rules of the Relevant Exchange and Clearing Houses, which may differ from the rules of ASX and ASX Clear. Similarly, such execution and trading is subject to then laws of the relevant jurisdictions, which may differ from Australian laws and to the supervision and regulation by overseas regulators, whose functions and powers may differ from those of Australian regulators such as the Australian Securities and Investments Commission.
- (s) **Exchange rate risk.** If you trade in Exchange Traded Options on Relevant Exchanges outside of Australia, the positions are likely to be denominated in a currency other than Australian dollars. The holding of positions denominated in a foreign currency exposes you to the potential risk (and potential benefit) of exchange rate fluctuations.

7. COSTS ASSOCIATED WITH EXCHANGE TRADED OPTIONS

7.1 Premium

If you are the taker of an Exchange Traded Option, you will be required to pay a premium in connection with the purchase of the Exchange Traded Option contract.

If you are the writer of an Exchange Traded Option, you will be entitled to receive a premium in the connection with the sale of the Exchange Traded Option contract.

For further detailed information on the premium in respect of an Exchange Traded Options contract, refer to "Option pricing fundamentals" on page 9 of the "**Understanding Options**" booklet available following the link provided in section 2 above and also the ASX's "Options Calculator" available by following the link below:

<http://www.asx.com.au/prices/calculators.htm>.

7.2 Margin requirements

If you the writer of an Exchange Traded Options contract, you will be required to meet our margin requirements all times. See section 4.5 for a more detailed discussion of our margining requirements.

7.3 Fees and charges

The following is a summary of the fees and charges associated with trading in Exchange Traded Options.

The fees and charges differ depending on the Relevant Exchange and Clearing House concerned. We set out below references to various links on our website which provide more detailed information on these fees and charges.

(a) Commissions

We charge commission, at set flat rates, for the execution and close out of Exchange Traded Option positions. See <https://www.interactivebrokers.com.au/en/index.php?f=commission&p=options> for further information.

(b) Referral mark ups and billings

Advisers and/or brokers may charge their clients for services rendered either through automatic billing, electronic invoice or direct billing. Your advisor/broker determines the referral mark-up at the time of the registration, and this mark-up can be modified from time to time. At the time of your Account registration, you

will be given a notice with the details of your referrer as well as the details of any mark ups charged. The available billing methods including caps and limitations are described at the IB website at www.interactivebrokers.com.

(c) **Interest**

If you have a debit balance on your Account after all fees and costs have been deducted (in other words, you owe money to meet the margin requirement and other amounts) you must pay interest on the debit balance. Interest is calculated daily based on your positions, margin requirement and balances on your daily statement for that date. Interest is usually posted once a month on your Account. This generally occurs within five business days following the end of the month. See <https://www.interactivebrokers.com/en/index.php?f=interest&p=schedule2> for further information and examples.

(d) **Administrative fees and charges**

IB charges certain administrative fees for matters such as order cancellation and modifications, trade busts (cancellations) and adjustments, prime broker take-ups, deposits and withdrawals, exercise and assignments, American Depository Receipts (ADRs) and fees for bounced checks, stop payments. The list of administrative fees and charges is available on the IB website at <https://www.interactivebrokers.com/en/index.php?f=1580>.

(e) **Taxes**

Transaction taxes, such as value added taxes may apply in some jurisdictions. The taxation implications of trading in Exchange Traded Options will depend on your particular circumstances and it is recommended that you obtain your own independent taxation advice. See section 9 for a more detailed discussion of significant taxation implications.

(f) **Market data, fundamentals and news**

If you access market data, fundamentals or news through IB, there may be a cost to you to subscribe for this information. See <https://www.interactivebrokers.com/en/index.php?f=1576> for further information on the costs of accessing such data through IB.

Relevant fees and charges associated with a transaction will be disclosed on the confirmation for the transaction.

8. DISPUTE RESOLUTION SYSTEM

If you have any concerns or comments about the financial service or financial products provided to you, you should send your complaint in writing to:

Legal & Compliance Department
Interactive Brokers LLC
One Pickwick Plaza
Greenwich, CT 06830

If you have not received a satisfactory response or 45 days have elapsed you may refer the matter to the Financial Ombudsman Service (**FOS**). IB is a member of FOS. FOS can be contacted on 1300 08 08 or GPO Box 3, Melbourne, Victoria, 3001. This service is provided to you free of charge.

If you require further information on how we handle complaints, please visit our website www.interactivebrokers.com or refer to our Financial Services Guide.

9. SIGNIFICANT TAXATION IMPLICATIONS

The information below is based on existing tax law and established interpretations as at the date of this PDS.

The taxation information provided below is intended as a brief guide only and does not cover every aspect of taxation related with the use of Exchange Traded Options. The information applies to Australian resident investors only. It is important to note that your tax position when trading Exchange Traded Options will depend on your individual circumstances, in particular whether you are trading on revenue or capital account (refer below for further discussion).

The taxation of options can be complex and may change over time. Accordingly, you are recommended to seek professional tax advice before entering in to or disposing of an Exchange Traded Option.

9.1 Implications for Australian resident investors

(a) Revenue account

(i) Writer of the option

Where a writer of an option writes an option in the ordinary course of business or the option has been written over an underlying revenue asset, the option will be treated as being on revenue account.

The premium received by the writer of the option will be assessable on a due and receivable basis. Where any premium is credited to the writer's Clearing House account the amount will still be assessable on this basis.

Any subsequent margin calls are not deductible when they are deposited by the writer into their Clearing House account. These margins will merely reduce any net position of the writer upon the close-out, settlement or exercise of the option by the taker.

Where interest is received by the writer on the margins held in their Clearing House account, this is required to be included in the writer's assessable income.

(ii) Taker of the option

A taker will generally hold an option on revenue account when it is held or traded in the ordinary course of business, or the option is used to hedge an underlying revenue asset.

Where this is the case, any premium paid by the taker is generally regarded as being deductible on a due and payable basis. This will generally be at the time the option is entered into.

Where an option on revenue account lapses, there are no further tax implications. However, where an option on revenue account is exercised, the option strike price will form part of the acquisition cost or disposal proceeds for the underlying asset in question.

Alternatively, where the option is closed-out prior to its expiration, any gain or loss on the option position will be treated as assessable or deductible as the case may be.

(b) Capital account

(i) Writer of the option

Where a writer writes an option over an underlying capital transaction, the option will be held on capital account. Consequently, any income tax implications will be determined in accordance with the Capital Gains Tax (CGT) provisions.

The premium received by the writer of the option will give rise to an assessable capital gain on a received or a receivable basis. Where any

premium is credited to the writer's Clearing House account the amount will still be assessable on this basis.

Any subsequent margin calls will merely reduce any net position of the writer upon the close-out, settlement or exercise of the option by the taker.

Where interest is received by the writer on the margins held in their Clearing House account, this is required to be included in the writer's assessable income.

Exercise of a call option

Where a call option is exercised, the option premium and the proceeds on the sale of the underlying asset should be treated as a single transaction. Accordingly, both the premium and the proceeds received will form part of the writer's capital proceeds for CGT purposes.

This may have practical implications for writers of options where the premium and sale proceeds are received in different financial years.

Exercise of a put option

Where a put option is exercised, the option premium paid and exercise price will form part of the cost base of the underlying asset for the investor. Accordingly, both the premium and the strike price paid will form part of the writer's cost base of the underlying asset for CGT purposes.

This may have practical implications for writers of options where the premium is received in a different financial year to the payment of the strike price and acquisition of the underlying capital asset.

(ii) Taker of the option

A taker will generally hold an option on capital account where an underlying capital transaction is being hedged. Consequently, any income tax implications will be determined in accordance with the CGT provisions.

At the time the premium is paid, there are no taxation consequences for the taker in respect of any premium paid for options which are held on capital account.

Where an option on capital account lapses, the taker will realise a capital loss at this time, equal to the amount of the premium paid.

When an option is settled or closed-out, the taker will realise a capital gain or loss depending on the amount paid (being the premium plus any incidental costs) for the option and the amount received on settlement.

Exercising a call option

Where a call option is exercised, the option premium and exercise price will form part of the cost base of the underlying asset for the taker.

Exercising a put option

Where a put option is exercised, the taker will generally deduct the option price from the proceeds received on the disposal of the underlying asset.

(c) **Goods and Services Tax**

The purchase and disposal by investors of Exchange Traded Options over financial products and indices is not subject to GST.

9.2 Rules for the Taxation of Financial Arrangement

The taxation of financial arrangements will change with the introduction of the new Taxation of Financial Arrangements (**TOFA**) rules. ETOs covered by this PDS are expected to qualify as financial arrangements and therefore the TOFA rules are likely to have a significant impact on the taxation of ETOs. Briefly, the rules:

- will generally deem gains and losses from financial arrangements to be on revenue account;
- are likely to impact on the timing of the recognition of the gains and losses; and
- may cause unrealised gains and losses to become subject to tax.

Below is a brief summary of the rules. The TOFA rules are complex and it is strongly recommended that you seek specific tax advice on the application of the rules to your dealings.

(a) **Who will the TOFA rules apply to?**

Generally, the TOFA rules will not apply to individuals, small superannuation funds and small securitisation vehicles. However, the rules will apply to these taxpayers if the financial arrangement involves substantial tax deferral.

The TOFA rules do apply to most corporate taxpayers provided certain turnover and other tests are met.

(b) When will the TOFA rules commence?

Generally, the TOFA rules apply from 1 July 2010. However, taxpayers may elect for the rules to start applying from 1 July 2009.

If the taxpayer has a substituted accounting period for tax purposes, a later date may apply, e.g. if the taxpayer has a 31 December year end, the new rules will apply from 1 July 2011 (or from 1 January 2010 by election).

(c) How will the TOFA rules impact on the taxation of ETOs?

The TOFA rules allow taxpayers to make a number of elections that determine how gains and losses from financial arrangements will be taxed. The elections are generally irrevocable.

If you did not make any elections (other than the election to enter into the TOFA regime early), the rules should treat most of the gains and losses from ETOs on a realisation basis. Gains from exercising ETOs will not contribute to the cost base of the assets received upon the exercise. However, the accruals method may apply in some cases to spread the recognition of some gains and losses over the life of the ETO.

The fair value and financial report elections include in the tax calculation gains and losses from financial arrangements that are reflected in the profit and loss statement (for example, financial arrangements that, for accounting purposes, are classified as held for trading or designated as valued at fair value through profit and loss). This means that unrealised gains and losses may be subject to tax. If you made a valid fair value or financial reports election and it did not cease to apply to you, the gains and losses from ETOs for tax will be aligned to the gains and losses recognised in the profit and loss for accounts.

The hedging election allows tax matching of the gains and losses from the underlying hedged item. The matching is both timing (i.e. over the time the underlying item is held) and character (i.e. will take on tax character, revenue or capital, of the underlying item). The Arrangement subject to the hedging election

Product Disclosure Statement

will not be subject to the fair value or financial reports elections, even if those are made.

If you made a valid hedging election and an ETO qualifies for the hedging election treatment, the gains and losses from the ETO will be matched to the gains and losses from the underlying hedged item. The conditions for the hedging election are complex and include documentation and hedge effectiveness requirements.