Options *on Futures Spreads*

...Mar 2005...4910... May...2005...5018... Jul 05...5108...

...Mar 2006... 5630... Jul 2006... 5780... Dec 2006... 5940

cotton

NYBOT Options on Futures Spreads (OFS) FAQ

What are Options on Futures Spreads (OFS)?

Options on Futures Spread Contracts are a relatively new type of option contract. Where a regular option contract gives the buyer the right, but not the obligation, to establish a futures position at a pre-determined price level, an OFS gives the buyer the right, but not the obligation, to establish a spread position at a pre-determined spread price between the two futures contract months.

An OFS call option contract would give the buyer the right to establish a spread position of long the first futures contract/short the second futures contract. The strike price of the call option is the difference between the prices of the two futures contracts.

Similarly, an OFS put option would give the buyer the right to establish a spread position of short the first futures contract/long the second futures contract. Just as with the call option, the strike price of the put option is the difference between the prices of the two futures contracts.

How are OFS contracts structured and how are they different or similar to regular options?

OFS contracts, for the most part, are structured similarly to regular options (i.e. with regard to minimum price fluctuations, premiums, exercise, last trading day, etc.) However, there are some key differences to regular options and these are explained more fully below.

Underlying Contract

A major difference is what constitutes the underlying contract. For regular options, the underlying is a single contract month of a particular commodity. For example, the underlying contract for the Mar 05 Sugar 11 Call is the Mar 05 Sugar 11 futures contract.

However, since each OFS contract relates to a particular spread and not to a single contract month, the underlying contract for each OFS is a spread involving two contract months of a particular commodity. For example, the underlying contract for the Mar 05/May 05 Sugar 11 Put would be a March 2005/May 2005 Sugar 11 spread.

Spread Price/Strike Price Relationship

One radically different aspect between regular option conventions and OFS is the fact that since the spread relationship between any two months can be in contango (nearby month price is less than the back month price) or backwardation (nearby month price more than the back month price), the strike prices for OFS contracts can be positive, negative or zero.

The Spread Price in an OFS contract is the mathematical result of subtracting the price of the second delivery month of the underlying futures contract in the spread from the price of the first delivery month of the underlying futures contract in the spread.

A positive strike price for an OFS, therefore, means the spread is in backwardation; a negative strike means the spread is in contango; a zero strike means the spread is at even.

NYBOT Options on Spreads Set for Launch

The New York Board of Trade continues to add more dimensions to the many options capabilities offered in each of its markets. With traders utilizing futures spreads as part of longer-term strategies, NYBOT will now offer options on spreads beginning with the Sugar No. 11sm market and Cotton No. 2sm.

Strike Price

The Strike Price for an OFS contract also differs from that of a regular option. For a regular option, the Strike Price is the price at which the futures position will be established following the exercise of a long option. For example, the exercise of a 9.50 July 05 Sugar 11 Put would result in the buyer of the option receiving a short July 05 Sugar 11 futures position at a price of 9.50 cents per pound.

For OFS contracts, however, the Strike Price does not correspond to a particular price level but instead represents the spread value: the difference in price between two futures contract months. For example, the exercise of a -2.00 cent Jul 05/Dec 05 Cotton OFS Call option would result in the buyer receiving a spread position of long a July 2005 cotton future/short a December 2005 cotton future at prices such that the Jul 05 price is 2.00 cents below the Dec 05 price

To illustrate, in the example above if the settlement price for the July 05 cotton futures contract on the day of exercise was 72.30 cents per round, the long July 05 futures position resulting from exercise of the -2.00 call would have been established at 72.30, and the short Dec 05 futures position would have been established as follows: 72.30 — (— 2.00) = 74.30 cents per pound. (In setting actual prices on exercise, the Exchange will set the price of the first month of the spread pair equal to the settlement price of that futures contract on the day of exercise; the futures price on the second month in the pair will be set at the settlement price of the first month in the pair minus the OFS Strike Price).

Premiums

Just as the buyer of a regular option contract pays a premium for the right the seller is granting them, the buyer of an OFS contract will pay a premium for the OFS. OFS trade prices and premiums will be quoted in the same manner as the regular option on the relevant commodity. For example, Cotton OFS contracts will be priced in cents per pound to two decimal places, with a minimum tick of one point equal to 1/100 cent per pound or $5.00 per contract (identical to the regular Cotton option terms).

Expiration

Also, just as each regular option contract has a fixed Expiration Date by which time the buyer must either liquidate the position by an offsetting sale or exercise the right to convert the option into a future, each OFS contract will have an Expiration Date. The general rule for NYBOT OFS contracts is that each OFS will expire on the same date as the regular option on the earlier of the two contract months within that OFS contract. For example, the Mar 05/Mar 06 Sugar 11 OFS would expire on the same day as the regular options on the March 2005 Sugar 11 contract.

Contract Symbols

Traditionally, Exchange, clearing and data vendor systems identify as contract using up to four fields, with each field having a limited field size. Predominant current usage is as follows: Contract Symbol (2 digits), Month/Year (2 digits), Option Type (1 digit) and Strike Price (x digits).

Options on Futures Spreads, since they inherently reference two distinct futures contract months, cannot be depicted using the current symbol methodology.

The most desirable symbol methodology would incorporate the existing commodity codes (i.e. CT for Cotton, SB for Sugar 11, etc.) for ease of use and continuity. In order for this methodology to be adopted, however, a third digit within the contract field must be allowable for in-house as well as outside clearing firms and data vendors. This systems enhancement has been realized and therefore, NYBOT OFS would incorporate the third digit in the Contract field in the following manner to describe an option on a spread:

CT1 K5, for instance, would designate a Cotton No. 2 May 2005/ July 2005 spread; where the K5 represents the first month in the pair (May 2005), CT is the standard Cotton No. 2 commodity code, and the "1" (the new third digit in the Contract field) represents the number of listed months forward from the named K5 month and therefore designates the second month in the pair as 1 listed month past K5. July 2005 is the 1st listed month past May.

CT2 K5, therefore would represent a May/Oct 2005 spread (K5 = May 05; "2" = second listed month forward from May 05, which is Oct 05).

What OFS Products are planned?

The first OFS product launch will be on the Sugar 11^{sm} and Cotton No. 2^{sm} contracts. Following these launches, the Exchange will ascertain the interest in launching OFS products on Coffee, Cocoa and FCOJ contracts.

Cotton No. 2^{sm} OFS

Draft Contract Specs 2/3/05

Strike Price Intervals

Every 25 points; on first day, open at the money strikes, plus 3 up and 3 down. Additional strikes listed upon demand.

Contract Months

1. Month Series: Each of the first four listed months paired with consecutive listed months; **2.** Month Series: Each of the first three listed months paired with the 2nd listed month forward from that listed month; **3.** Month Series: Each of the first two listed months paired with the 3rd listed month forward from that listed month; **4.** Month Series: The first listed month paired with the 4th listed month; **5.** Month (Annual) Series: Each of the first five listed months paired with the 5th listed month forward from that month.

Price Quotation

Premiums priced in cents per pound, to 2 decimal places. 200 points = $0.02 per pound, or $1,000 per contract.

Minimum Tick

1 point, or $5.00 per contract.

Listing Cycle

Five Series listed at all times: the 1 Month, 2 Month, 3 Month, 4 Month and 5 Month Series.

Contracts or Pairs Permitted (16 pairs)

H1K1	K1N1	N1V1	V1Z1	Z1H2
H1N1	K1V1	N1Z1	V1H2	Z1K2
H1V1	K1Z1	N1H2	V1K2	Z1N2
H1Z1	K1H2	N1K2	V1N2	Z1V2
H1H2	K1K2	N1N2	V1V2	Z1Z2

(Total of 25 pairs)

Listing Cycle

- On theoretical first trading day of January 1, 2005, contract months would be: CT1 H5, CT2 H5, CT3 H5, CT4 H5, CT5 H5, CT1 K5, CT2 K5, CT3 K5, CT5 K5, CT1 N5, CT2 N5, CT5 N5, CT1 V5, CT5 V5, CT5 Z5 (15 contracts)
- Following the expiration of the March options, listed months would be: CT1 K5, CT2 K5, CT3 K5, CT4 K5, CT5 K5, CT1 N5, CT2 N5, CT3 N5, CT5 N5, CT1 V5, CT2 V5, CT5 V5, CT1 Z5, CT5 Z5, CT5 H6 (15 contracts)
- Following the expiration of the May options, listed months would be: CT1 N5, CT2 N5, CT3 N5, CT4 N5, CT5 N5, CT1 V5, CT2 V5, CT3 V5, CT5 V5, CT1 Z5, CT2 Z5, CT5 Z5, CT1 H6, CT5 H6, CT5 K6 (15 contracts)
- Following the expiration of the July options, listed months would be: CT1 V5, CT2 V5, CT3 V5, CT4 V5, CT5 V5, CT1 Z5, CT2 Z5, CT3 Z5, CT 5 Z5, CT1 H6, CT2 H6, CT 5 H6, CT1 K6, CT5 K6, CT5 N6 (15 contracts)
- Following the expiration of the October options, listed months would be: CT1 Z5, CT2 Z5, CT3 Z5, CT4 Z5, CT5 Z5, CT1 H6, CT2 H6, CT3 H6, CT5 H6, CT1 K6, CT2 K6, CT5 K6, CT1 N6, CT5 N6, CT5 V6 (15 contracts)

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This brochure serves as an introduction to Options on Futures Spreads at the New York Board of Trade (NYBOT). Examples and descriptions are designed to foster a better understanding of the futures and options market. The examples and descriptions are not intended to serve as investment advice and cannot be the basis for any claim. While every effort has been made to ensure accuracy of the content, the New York Board of Trade does not guarantee its accuracy, or completeness or that any particular trading result can be achieved. The New York Board of Trade cannot be held liable for errors or omissions in the content of this brochure. Futures and options trading involves risk and is not suitable for everyone. Trading on the NYBOT is governed by specific rules and regulations set forth by the Exchange. These rules are subject to change. Contact a licensed broker for additional information. For more detailed information and specifications on any of the products traded on the Exchange, contact NYBOT or your broker.

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