

Options

For individuals, companies, trusts and SMSFs

The Options and Lending Facility



Determined to be different

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What are options?

Options are a versatile and powerful investment tool for experienced investors.

With Options you can:

- potentially profit from either a rising or falling market by taking a directional position over selected Australian shares
- take advantage of leverage, giving you the chance to reap profits with only a small initial outlay
- hedge your existing portfolio.

The Commonwealth Bank offers Options on an over-the-counter (OTC) basis. This means the Option is a private contract between the buyer and the seller, rather than traded through a stock exchange. One of the advantages of OTC Options is that the contract can be tailor-made for each transaction to suit the individual needs of each holder.

Who can invest?

Options can be used by individuals, companies, trusts and self managed super funds (in some instances) to support a range of different investment strategies.

Key features of Options

Shares	Up to 40 approved shares are available
Term	Minimum investment term is three days and maximum investment term is five years, unless otherwise agreed
Option style	European and American (except Collar Options which are European style only)
Minimum amount	Minimum value of an Option transaction is \$50,000 based on the notional value of the transaction, unless otherwise agreed
Settlement	Physical or cash (cash settlement must apply when the underlying share is CBA)

Ways to use Options

Under The Options and Lending Facility you have access to:

1. Call Options

Call Options give the holder the right, but not the obligation, to buy an underlying share at a predetermined price (called the exercise price) on or before the expiry date.

You could consider Call Options if you wanted to:

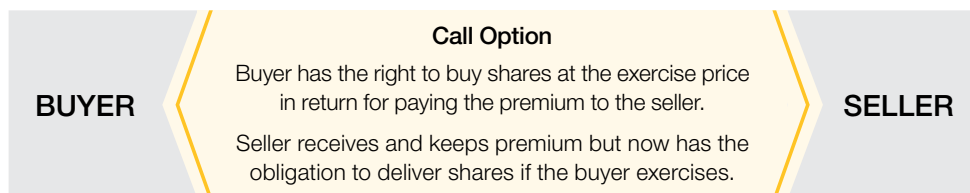
Call Option buyer	Call Option seller
Gain leveraged exposure to a share that you do not own but think will increase in price	Generate additional income from a share you own
Lock in a maximum purchase price for a share you are considering buying	

Selling Call Options is not available to self managed super funds

Example

BHP Billiton (BHP) shares are trading at \$40.00. John chooses to buy an American-style three month Call Option over 2,000 shares with an exercise price of \$40.00. As the buyer of this contract John has the right, but not the obligation, to buy 2,000 BHP shares for \$40.00 per share at any time until the expiry date. For this right, John pays a premium (or purchase price) to the seller of the Option, which in this case is Commonwealth Bank. To take up this right to buy the BHP shares at the specified price John must exercise the Option on or before expiry.

On the other hand the Commonwealth Bank as seller of this Call Option is obliged to deliver 2,000 BHP shares at \$40.00 per share if John exercises the Option. For accepting this obligation the bank receives and keeps the Option premium whether the Option is exercised or not.



The characteristics for both the buyer and seller of a Call Option are summarised below:

Call Option buyer	Call Option seller
Pays premium	Receives premium
Right to exercise and buy the shares	Obligation to sell shares if exercised
Benefits from rising volatility	Benefits from time decay
Profits from price rising	Profits from price falling or remaining neutral
Limited losses, potentially unlimited gains	Potentially unlimited losses, limited gains
Can sell before expiry to close out	Can request to buy back before expiry or before assignment to close out

Selling Call Options is not available to self managed super funds

2. Put Options

Put Options give the holder the right, but not the obligation, to sell an underlying share at the exercise price on or before the expiry date.

You could consider Put Options if you wanted to:

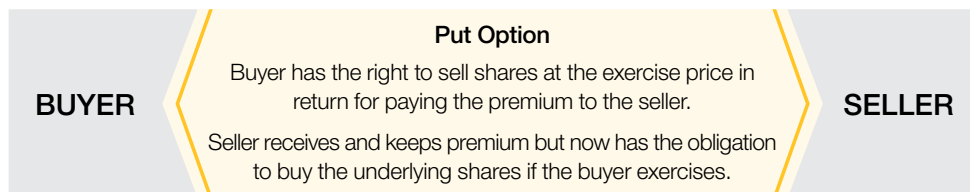
Put Option buyer	Put Option seller
Gain leveraged exposure to a share that you do not own but think will decrease in price	Generate income from a share you do not necessarily own
Reduce your risk of loss if the price of a share you own decreases	Lock in a maximum purchase price for a share you are looking to buy

Example

Woolworths Limited (WOW) shares are trading at \$27.00. Michelle chooses to buy an American-style three month Put Option over 5,000 shares with an exercise price of \$27.00. As the buyer of this contract Michelle has the right, but not the obligation, to sell 5,000 WOW shares for \$27.00 per share at any time until the expiry date. For this right, Michelle pays a premium to the seller, being Commonwealth Bank. In order to take up this right to sell the WOW shares at the specified price, Michelle must exercise the Option on or before expiry.

The Commonwealth Bank is obliged to buy the WOW shares for \$27.00 per share if the Option is exercised. Like Call Options the seller of a Put Option receives and keeps the Option premium whether the Option is exercised or not.

Ways to use options (cont.)



The characteristics for both the buyer and seller of a Put Option are summarised below:

Put Option buyer	Put Option seller
Pays premium	Receives premium
Right to exercise and sell the shares	Obligation to buy shares if exercised
Benefits from rising volatility	Benefits from time decay
Profits from price falling	Profits from price rising or remaining neutral
Limited losses, potentially unlimited gains	Potentially unlimited losses, limited gains
Can sell before expiry to close out	Can request to buy back before expiry or before assignment to close out

3. Collar Options

A Collar Option is a combination of a bought Put Option and a sold Call Option. It enables the holder to set a protection level for their shares, which reduces the impact of a large unexpected drop in share prices. An upside cap is also set which means the holder will benefit from any share price gains up to this level.

Depending on where the protection level and cap is set, implementing a Collar Option may incur a cost to the holder, be zero cost or even result in an amount payable to the holder.

A number of scenarios can occur at maturity:

Method of settlement	Scenario 1 – Final share price < protected price	Scenario 2 – Final share price $2 \geq$ protected price and \leq capped price	Scenario 3 – Final share price > capped price
Cash	Keep your shares and receive a cash settlement amount	The Collar Option expires worthless and you keep your shares	Pay the cash settlement amount on the settlement date
Physical	Sell your shares at the protected price on the settlement date		Sell your shares at the capped price on the settlement date

Collar Options can only be bought, not sold. Collar Options are not available to self managed super funds.

Example

Bill holds 20,000 shares in ANZ. He enters into the following Collar Option:

Share	ANZ
Term	366 days
Current share price	\$24.00
Protection level	\$19.20 (or 80% of current price)
Cap level	\$28.80 (or 120% of current price)
Collar premium	\$382.00 (Bill receives)

Bill is protected if his shares fall below \$19.20 and he will enjoy the benefit of price rises up to \$28.80.

Should Bill decide to diversify his share portfolio he can draw down the equity in his portfolio and apply for a loan (subject to credit approval). Bill can borrow a maximum amount that is equal to the protection level. In this case he could borrow up to \$384,000 (i.e. \$19.20 per share x 20,000 shares).

Getting started

1. Read the Product Disclosure Statement (PDS)

It's important to read The Options and Lending Facility PDS before deciding whether to apply for an Options facility. This document includes important information including the risks, costs and benefits of investing in Options.

2. Apply for an Options facility

Apply by completing the application form included in the PDS, attaching any supporting documentation needed. If a loan is involved, applications are subject to standard credit approval procedures.

3. Executing an Options transaction

Once your application is approved you can invest using Options by signing and returning a term sheet. This sets out the commercial terms of your transaction and may include indicative pricing. Contact your financial adviser to obtain a term sheet.

4. Confirmation of your Options transaction

You and, if applicable, your financial adviser will receive a letter within five business days confirming the transaction.

Frequently asked questions

Question	Answer												
Why use Options?	Options can be used by investors to achieve a variety of investment outcomes. Some of the key reasons to use Options include: <table border="1"> <thead> <tr> <th>Strategy</th> <th>Explanation</th> <th>Transaction</th> </tr> </thead> <tbody> <tr> <td>Defend</td> <td>Lock in a future purchase or sale price for a share</td> <td>Buy Call Options (to buy shares) Buy Put Options (to sell shares)</td> </tr> <tr> <td>Hedge</td> <td>Protect shares from a possible decline in value</td> <td>Buy Put Options Buy Collar Options</td> </tr> <tr> <td>Take a view</td> <td>Take a leveraged view on a share price movement</td> <td>Buy Call Options (bullish view) Buy Put Options (bearish view)</td> </tr> </tbody> </table>	Strategy	Explanation	Transaction	Defend	Lock in a future purchase or sale price for a share	Buy Call Options (to buy shares) Buy Put Options (to sell shares)	Hedge	Protect shares from a possible decline in value	Buy Put Options Buy Collar Options	Take a view	Take a leveraged view on a share price movement	Buy Call Options (bullish view) Buy Put Options (bearish view)
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What Option styles are there?	An American-style Option can be exercised on or before the maturity date, while a European-style Option can only be exercised on the maturity date. Both Option styles are available for Put and Call Options. Collar Options are only available in European-style.												
What is the exercise price?	The exercise price is the amount of money which must be paid by the buyer of a Call Option or the seller of a Put Option for the transfer of the underlying shares acquired upon exercise of the Option.												

Frequently asked questions (cont.)

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<p>How is the Option premium determined?</p>	<p>Options are flexible in that the parameters can be determined to suit your individual needs.</p> <p>The parameters you choose will impact the Option premium paid or received.</p> <table border="1" data-bbox="311 568 1047 1422"> <tbody> <tr> <td data-bbox="311 568 555 722"> <p>Volatility</p> </td> <td data-bbox="557 568 1047 722"> <p>In general, the more volatile the price of the underlying share, the higher the Option premium. This is due to the wider range over which the stock can potentially move.</p> </td> </tr> <tr> <td data-bbox="311 726 555 963"> <p>The relationship between the exercise price and the share price</p> </td> <td data-bbox="557 726 1047 963"> <p>The closer the exercise price is to the market price of the share, the greater the Option premium. For Collar Options the relationship is uncertain because a Collar Option is comprised of elements of both Call and Put Options for which the respective Option premiums are netted against each other.</p> </td> </tr> <tr> <td data-bbox="311 967 555 1058"> <p>Time to expiry</p> </td> <td data-bbox="557 967 1047 1058"> <p>The longer the time to expiry, the greater the Option premium.</p> </td> </tr> <tr> <td data-bbox="311 1061 555 1209"> <p>Interest rates</p> </td> <td data-bbox="557 1061 1047 1209"> <p>A rise in interest rates will push Call Option premiums up and Put Option premiums down. For a Collar Option the Option Premium will generally be lower.</p> </td> </tr> <tr> <td data-bbox="311 1212 555 1422"> <p>Dividends</p> </td> <td data-bbox="557 1212 1047 1422"> <p>If a dividend is payable during the life of an Option the premium of a Call Option will be lower and the premium of a Put Option higher than if no dividend was payable. Holders of Options who do not own the underlying shares are not eligible for dividends payable on those shares.</p> </td> </tr> </tbody> </table>	<p>Volatility</p>	<p>In general, the more volatile the price of the underlying share, the higher the Option premium. This is due to the wider range over which the stock can potentially move.</p>	<p>The relationship between the exercise price and the share price</p>	<p>The closer the exercise price is to the market price of the share, the greater the Option premium. For Collar Options the relationship is uncertain because a Collar Option is comprised of elements of both Call and Put Options for which the respective Option premiums are netted against each other.</p>	<p>Time to expiry</p>	<p>The longer the time to expiry, the greater the Option premium.</p>	<p>Interest rates</p>	<p>A rise in interest rates will push Call Option premiums up and Put Option premiums down. For a Collar Option the Option Premium will generally be lower.</p>	<p>Dividends</p>	<p>If a dividend is payable during the life of an Option the premium of a Call Option will be lower and the premium of a Put Option higher than if no dividend was payable. Holders of Options who do not own the underlying shares are not eligible for dividends payable on those shares.</p>
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Question	Answer
<p>What does ‘in-the-money’, ‘at-the-money’ and ‘out-of-the-money’ mean?</p>	<p>A Call Option is termed ‘in-the-money’ when the current price of the underlying share is greater than the exercise price of the Option. In the case of a Put Option, it is when the price of the underlying share is less than the exercise price of the Option.</p> <p>An Option is termed ‘at-the-money’ when the current price of the underlying share equals the exercise price of the Option.</p> <p>A Call Option is termed ‘out-of-the-money’ when the current price of the underlying share is less than the exercise price of the Option. In the case of a Put Option it is when the price of the underlying share is greater than the exercise price of the Option.</p>
<p>What are corporate actions?</p>	<p>A corporate action is an event that may alter the capital structure of a company. For example, special dividends, entitlement offers, a takeover and bonus issues. As each corporate action is unique it is not possible to explain in advance the impact on your Option.</p> <p>We may, however, be required to make adjustments to the exercise price, maturity date, capped price, protected price or any other term of your Option transaction. Corporate actions may also change your tax liability associated with the Option transaction.</p>
<p>What happens at expiry?</p>	<p>Whether you have bought or sold Options, if the Option is in-the-money and therefore to be exercised on the maturity date, the Commonwealth Bank will:</p> <ul style="list-style-type: none"> • in the case of physical settlement, arrange for the delivery of the shares; or • in the case of cash settlement, arrange for the payment of the settlement amount. <p>Any delivery of shares will occur on the settlement date.</p>

Frequently asked questions (cont.)

Question	Answer
What are the advantages of Option trading?	<ul style="list-style-type: none">• Risk management – Put Options allow you to hedge against a possible fall in the value of shares you hold.• Time to decide – buying a Call Option allows the holder to lock in a share purchase price, giving them time to decide whether or not to exercise the Option and purchase the shares. Similarly, the buyer of a Put Option has time to decide whether or not to sell the shares.• Speculation – if you expect the market to rise you may decide to buy Call Options. If you expect a fall you may decide to buy Put Options. Either way you can request to sell the Option prior to expiry and take a profit or limit a loss.• Leverage – gives you the potential to make a higher return from a smaller initial outlay than investing in the underlying share directly. That said, leverage usually involves more risks than a direct investment in the underlying shares.• Diversification – Options can give you the opportunity to gain leveraged exposure to a diversified portfolio for a smaller initial outlay than directly purchasing the underlying shares.• Income generation – by selling Call Options you will receive the Option premium upfront. Although you keep the premium there is a possibility that you could be exercised and obliged to deliver your shares at the exercise price.

Question	Answer
<p>What are the risks?</p>	<p>Like all investments, there is a range of risks associated with Options, including but not limited to:</p> <ul style="list-style-type: none"> • Performance and investment risk – the risk the Option or underlying security won't perform as expected. • Market risk – the risk that volatility will affect financial markets. • Tax risk – the risk that tax laws will change and affect the value of the Option or your tax liability. • Counterparty risk – the risk other parties in a transaction are unable to complete the contract. • Operational risk – the risk the contract won't be settled in a timely manner. • Legal risk – the risk international laws preclude the bank transacting with certain investors.
<p>What are the costs?</p>	<p>Some of the costs associated with Options include premiums, break costs, government stamp duty and brokerage. A full list of costs associated with Options is detailed in the PDS.</p>

Contact us

Our team of specialists can show you how to use Options to mitigate risk and improve investment returns.

Contact us on:



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Important information

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