

**EXCHANGE TRADED OPTIONS  
PRODUCT DISCLOSURE STATEMENT  
PART 1**

**Incorporating Part 2: SCHEDULE OF FEES**

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**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 or obtain other independent advice before trading in exchange traded options.**

## **PURPOSE OF A PDS**

This PDS has been prepared by ETRADE Australia Securities Ltd (“E\*TRADE”), the issuer of the exchange traded options. This PDS is designed to assist you in deciding whether the products covered in this PDS are appropriate for your needs. This PDS has been prepared to assist you in comparing it with others you may be considering. The PDS is an important document and we recommend you contact us should you have any questions arising from the PDS prior to entering into any transactions with E\*TRADE.

When we use terms ‘we’, ‘us’ or ‘our’ in this PDS, the reference is to E\*TRADE. If you have any questions in relation to this PDS, please do not hesitate to contact us on 1300 658 355 or write to us at:

ETRADE Australia Securities Ltd  
Reply Paid 1346  
ROYAL EXCHANGE NSW 1224

## **PDS IN TWO PARTS**

This Product Disclosure Statement (PDS) is in two parts. The first Part contains all information other than the Schedule of Fees.

The information in this PDS does not take into account your personal objectives, financial situation and needs. Before trading in this product you should be satisfied that such trading is suitable for you in view of those objectives, and your financial situation and needs, and we recommend that you consult your investment advisor or obtain other external advice.

## **WHAT PRODUCTS DOES THIS PDS COVER?**

This is a Product Disclosure Statement for exchange traded options traded on Australian Stock Exchange Limited (**ASX**) and settled and cleared by Australian Clearing House Pty Ltd (the **Clearing House**). It deals with exchange traded equity options and index options (“exchange traded options”) but not Low Exercise Price Options. Exchange traded equity options are options over quoted shares (or other securities) of a range of different companies listed on ASX.

Exchange traded index options are options over an index such as the S&P™/ASX 200™ Index or the S&P™/ASX 200™ Property Trust Index.

A list of companies and indices over which exchange traded options are traded can be found on the ASX website [www.asx.com.au/options](http://www.asx.com.au/options).

## INTRODUCTION

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
- to profit from speculation

Their flexibility stems from the ability to both buy and short sell an option contract and undertake multiple positions targeting specific movements in the overall market and individual equities.

The use of Exchange Traded Options (“ETO”) within an investor's overall investment strategy can provide great flexibility to take advantage of rising, falling and sideways markets. However, both the purchase and sale of exchange traded options involves risks which are discussed at length on pages 12 and 13.

Specific concepts which should be practically understood before engaging in an options strategy are:

- The effect time has on any one position/strategy;
- How volatility changes, both up and down, may change your pay-off diagram for a position;
- 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;
- Liquidity of an options series, the role of market makers, and the effect this may have on your ability to exit a position.

When buying an ETO the initial outlay of capital may be small relative to the total contract value so that transactions are "leveraged" or "geared". Transactions should only be entered into by investors who understand the nature and extent of their rights, obligations and risks associated with trading exchange traded options.

When selling an ETO the initial income may seem attractive but the downside may be unlimited. Risk minimisation strategies should be employed to mitigate losses when a position does not move in a favourable manner.

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 relevant ASX rules.

### **Educational booklets**

Exchange traded options have been traded in Australia since 1976 on the ASX. Over this time, ASX has prepared a number of educational booklets relating to exchange traded options which are available to you via their website, [www.asx.com.au/markets/l4/OptionBooklets\\_AM4.shtml](http://www.asx.com.au/markets/l4/OptionBooklets_AM4.shtml).

In addition to reading this PDS, investors are advised that the PDS cross references certain of the ASX booklets. The ASX booklets that relate to options include “**Understanding Options Trading**”, “**Margins**”, “**Understanding Option Strategies**” which are available free on the ASX website ([www.asx.com.au/options](http://www.asx.com.au/options)). These booklets provide useful information regarding options traded on the ASX, including option features, advantages of options, risks associated with options, option adjustments, option pricing, margins, taxation and option contract specifications.

One of the ASX booklets entitled “Understanding Options Trading” is a booklet which we must give you in accordance with the ASX operating rules when you sign our client agreement to trade exchange traded options. This booklet is also available on line at [www.asx.com.au/markets/pdf/UnderstandingOptions.pdf](http://www.asx.com.au/markets/pdf/UnderstandingOptions.pdf).

If you cannot access the ASX booklets via the ASX website, please contact us immediately and we will arrange to forward copies of the booklets to you at no charge.

If you have any questions on any aspect of the booklets you should consult E\*TRADE before making any investment decisions.

### **ABOUT E\*TRADE**

E\*TRADE has been a leading financial services provider in Australia since 1998.

E\*TRADE: ACN 078 174 973; AFSL No.: 238277

Address – Level 1, 10 Bridge Street, Sydney NSW 2000

Postal address - Reply Paid 1346, Royal Exchange NSW 1224

Phone: 1300 658 355

Fax: 02 9247 4599

Email: [service@etrade.com.au](mailto:service@etrade.com.au)

Website: [www.etrade.com.au](http://www.etrade.com.au)

## **TRADING EXCHANGE TRADED OPTIONS THROUGH E\*TRADE**

Before we will accept orders to trade ETO's on your behalf, you will need to have entered into a Derivatives Client Agreement with E\*TRADE.

## **HOW DO YOUR ORDERS GET EXECUTED?**

Once it approves your orders, and subject to any time delay instructions given by you or your authorised agents, E\*TRADE will place them directly into the ETO market. Unlike online orders it receives from clients wishing to deal in equity products, E\*TRADE does not currently use Automated Order Processing to place ETO orders into the market.

E\*TRADE does not accept orders from clients to trade in LEPO's , Share Ratios or index options.

E\*TRADE offer their clients the ability to place orders in ETO's either by phone or via the internet.

## **WHAT ARE EXCHANGE TRADED OPTION CONTRACTS?**

Exchange traded options may be American or European style exercise. Most ASX options are American style which means they are tradeable and can be exercised at any time prior to the expiry day. European options which includes index options, can only be exercised on the expiry day and not before.

An exchange traded option is a contract between two parties which gives the buyer (the taker) the right, but not the obligation, to buy or sell the shares underlying the option at a specified price (exercise price) on, or before a predetermined date. To acquire this right, the taker pays a premium to the writer (seller) of the contract. When considering options over an index, the same concepts generally apply.

The premium is not a standardised feature of the exchange traded option contract and is established between the taker and writer at the time of the trade. See the discussion on premium for more information.

Exchange traded option sellers are referred to as "writers" because they underwrite (or willingly accept) the obligation to deliver or accept the shares covered by an option. Similarly, buyers are referred to as "takers" of an exchange traded option as they take up the right to buy or sell a parcel of shares. Every exchange traded option contract has both a taker and a writer.

There are two types of exchange traded options, namely call options and put options. All option positions consist of one or more of either a bought call, a sold call, a bought put, or a sold put. A long (or bought) option position is created by the purchase of a call or put. A short (or sold) position is created by the sale of a call or put. By combining two or more of these basic positions, an investor can create a trading strategy that meets a range of investment objectives, including the protection of an existing portfolio of shares. For more information on possible trading strategies we refer you to the ASX Booklet entitled "Understanding Options Strategies" available on the ASX website at [www.asx.com.au/options](http://www.asx.com.au/options).

Call options give the 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) is required to sell a standard quantity of shares at the predetermined exercise price.

Put options give the 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 buy, the seller (writer) is required to buy a standard quantity of shares at the predetermined exercise price. The premium is the price of the option agreed to by the buyer and seller through the market.

The taker will always pay the writer a price (called the premium) to enter into the option contract. The writer receives and keeps the premium but has the obligation to buy from or deliver to the taker the underlying shares at the exercise price if the taker exercises the option.

### **Deliverable or cash settled**

Exchange traded options are either deliverable or cash settled. Most exchange traded equity options are deliverable, that is with physical delivery of the underlying security, whilst index options are cash settled. Cash settlement occurs in accordance with the rules of the Clearing House against the Opening Index Price Calculation (OPIC) as calculated on the expiry date.

### **Standardised Contracts**

Exchange traded options are created by the exchange on which the underlying equity or index is listed. E\*TRADE trades exchange traded options in relation to companies and indices listed on the ASX. The ASX website provides a list of companies and indices over which exchange traded options are traded, these can be found at "[www.asx.com.au/options](http://www.asx.com.au/options)".

ASX determines the key contract specifications for each series of exchange traded options listed, including:

- (a) the underlying security or underlying index;

- (b) the contract size where 1 option contract on ASX usually represents 1000 underlying shares;
- (c) the exercise price (or strike price) – The exercise price (or strike price) is the specified price at which the taker (buyer) of an equity option can buy or sell the underlying shares. The ASX sets the range of exercise prices at specific intervals according to the value of the underlying shares. It is important to note that the exercise price of an equity option may change during the life of an option if the underlying share is subject to a bonus or rights issue or other form of capital reconstruction. The number of underlying shares may also be subject to an adjustment; and
- (d) the expiry date – exchange traded options have a limited pre-determined life span and generally follow one of three cycles, namely:
  - (i) January/April/July/October
  - (ii) February/May/August/November
  - (iii) March/June/September/December.

The ASX may in accordance with its operating rules make an adjustment to any of the above specifications if the listed entity over which the option relates makes a pro-rata change to its ordinary share capital structure (eg. Bonus issues or special dividends are declared). If ASX does make an adjustment it will endeavour to preserve the open positions of takers and writers at the time of the adjustment as best as possible. ASX has issued an Explanatory Guide for Option Adjustments which can be found at [www.asx.com.au/markets/pdf/ExplanatoryNoteforOptionAdjustments.pdf](http://www.asx.com.au/markets/pdf/ExplanatoryNoteforOptionAdjustments.pdf) which provides further information regarding ASX option adjustments.

Full details of all exchange traded options listed on ASX and expiry date information can be found on the ASX website at [www.asx.com.au/options](http://www.asx.com.au/options) or alternatively through information vendors or newspapers. A list of current option codes and delayed price information is available on the ASX website at [www.asx.com.au/options](http://www.asx.com.au/options). Details of the previous day's trading 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.

Details of contract specifications for exchange traded options are published by the ASX on their website at [www.asx.com.au](http://www.asx.com.au)>Trading information>Contract specifications. The contract specifications detail the key standardized features of exchange traded options and index options traded on ASX.

## **Premium**

The premium (price of the option) is not set by the ASX. It 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 share basis so the dollar value payment is calculated by multiplying the premium amount by 1,000 (the number of underlying shares). For example, if you buy a call option with a premium quoted at 25c per share, the total premium will be \$250.00 (being \$0.25 x 1,000). The premium for an index option

is calculated by multiplying the premium 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.

Option premium will fluctuate during the option's life depending on a range of factors including the exercise price, the price of the underlying securities or the level of the index, the volatility of the underlying securities 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 Option Trading" for more information regarding the fundamentals of pricing options. ASX also provides a pricing calculator on the ASX website, [www.asx.com.au/options](http://www.asx.com.au/options).

You can obtain current price information on ETO's via our normal website, or, if you are an active trader, via either E\*TRADE Pro or Power E\*TRADE. Alternatively, you can call us on 1300 303 678.

### **No Dividends or Entitlements**

Exchange traded options do not entitle investors to dividends or other entitlements paid by the issuer of the underlying securities, unless the investor exercises the option to become the holder of the underlying securities at or before the relevant date for dividend or entitlement purposes.

### **Opening an option position**

The establishment of a contract is referred to as opening a position. Once the taker of an exchange traded option has an open position they have three alternatives:

1. The taker can exercise the option.
2. The taker can hold the option to expiry and allow it to lapse.
3. The taker can close out their position by writing (selling) an option in the same series as originally taken and instructing their broker to 'close out' the earlier open position.

The writer of an exchange traded option has two alternatives:

1. 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); or
2. Close out the option by taking (buying) the option in the same series as originally taken (provided it has not been exercised against).

## **Closing out of option contracts**

An exchange traded option position may be 'closed out' by placing an order equal and opposite in effect to your original order – this effectively cancels out the open position. An investor would close out an option contract:

- when there is a risk of unwanted early exercise (unless an index option as they can only be exercised on expiry day)
- to take a profit
- to limit a loss.

It is important that you advise us if you are seeking to close out an existing position when placing your order. Closing out can be achieved without reference to the original party to the trade because of the process of novation. The Clearing House is able to substitute a new buyer as the contract party when an existing buyer sells to close their position. The process of novation is discussed in more detail below in the section entitled "Trading and clearing options".

## **Expiry**

Exchange traded options have a limited life span and every option within the same series, which has not already been exercised, will expire on the expiry day. The expiry day is a standard day set by the ASX. For exchange traded options the option expires on the Thursday preceding the last Friday in the month, as long as both the Thursday and Friday are business days. Therefore if the last day of the month is a Thursday the option will expire on the Thursday prior. For index options, expiry is usually the third Friday of the contract month. Expiry day information is available on the ASX website at [www.asx.com.au/options>Trading information>Expiry calendar](http://www.asx.com.au/options>Trading information>Expiry calendar).

## **Exercise**

Option takers make the decision to exercise the option contract. This means that an equity option writer may be exercised against at any time prior to expiry. The Clearing House will "randomly" allocate a writer for every exercised taken position. This means that if the taker wants to exercise the options and either buy or sell (depending on whether it is a call or a put) at the predetermined price then ASX randomly allocates a writer of that option and allocates the exercise against them. The writer must then sell the shares at a predetermined price for a call or buy the shares at the predetermined price for a put. The taker of an option will generally only exercise for a profit and therefore the exercise may result in a loss to the writer of the option, depending on their initial costs. Once a writer has been allocated, the writer has lost the opportunity to close out their position and must effect the delivery or cash settlement obligations for the particular equity option contract.

## Automatic exercise

An ETO that is “in the money” on the night of expiry will be automatically exercised by E\*TRADE, unless you or your authorised agent requests us to do otherwise by no later than 4.30pm on the date of expiry. 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”.

## Settlement

Payment for, and the delivery of underlying securities, on exercise of an open exchange traded options contract occurs via the ASX’s Clearing House Electronic Subregister System (CHES) on T+3. E\*TRADE is obligated to make payment to the ASX within this timeframe. For cash settled index options, a cash settlement amount calculated having regard to the opening price index calculation on expiry day, is paid to exercising takers on the day following the expiry date. The level used for settling index options is determined by a special formula. If you intend investing in index options you should take the time to understand these arrangements. For more information on settlement of index options see the ASX Booklet “**Understanding Options Trading**” section on ‘Trading index options’.

E\*TRADE requires that you settle at T+1 (that is within 24 hours from the time the trade occurred) for all cash positions which arise from premiums, interest, and other cash financial transactions. This requirement is reflected in the terms of our client agreement with you. You are required to pay the margin amounts we call from you within 24 hours of being advised of the margin amount by us. Please see the discussion on margins below.

## SIGNIFICANT BENEFITS OF EXCHANGE TRADED OPTIONS

Exchange traded options have a number of advantages and include:

- Risk management where investors can **hedge** (protect) their share portfolio from a drop in value. Put options allow investors holding shares to hedge against a fall in the share price;
- Shareholders can **earn income** by writing call options over shares they already hold. As a writer of options, the investor will receive the premium amount up front. The risk is that the writer may be exercised against and be required to deliver their shares to the taker at the exercise price.
- 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;

- Exchange traded options benefit from standardization and registration with a clearing and settlement facility which reduces **counterparty default risk**. This process provides the benefit that the client's position can be closed out without reference to the original counterparty and the client's risk to that counterparty is transferred to the Clearing House;
- **Speculation** where the flexibility of entering and exiting the market prior to expiry 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;
- Options do not require a rising market to make money, rather 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;
- 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).
- Given the lower initial outlay attaching to options, investors can **diversify their portfolios and gain a broad market exposure** over a range of securities or the index itself.

## SIGNIFICANT RISKS EXPLAINED

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.

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 option trading" (the booklet can be found on the ASX website at [www.asx.com.au/options](http://www.asx.com.au/options)).

Exchange traded options are not suitable for some retail investors, for example investors who have a low risk tolerance should not enter into exchange traded option trades which have the potential for unlimited losses. In deciding whether or not you should trade exchange traded option contracts, you should be aware of the following matters relating to risk:

- (a) 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.
- (b) 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.
- (c) Exchange traded options are subject to movements in the **underlying market**. Options may fall in price or become worthless at or before expiry.
- (d) The **maximum loss in taking** (buying) an exchange traded option is the amount of premium paid. If the option expires worthless, the taker will lose the total value paid for the option (the premium) plus transaction costs.
- (e) Whilst writers (sellers) 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 well above the current market price.
- (f) Writers 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. Margining is discussed below.
- (g) Under certain conditions, it could become difficult or impossible to **close out** a position. This can happen for example where there is a significant change in price over a short time period.
- (h) The ASX and its Clearing House have discretionary powers in relation to the market. 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.

- (i) The placing of risk **minimisation orders** may not always limit an investor's losses to the amounts that are expected. Market conditions may make it impossible for a broker to execute the risk minimisation orders. Strategies using combinations such as 'spreads' or 'straddles' may be as risky as taking a simple 'long' or 'short' position.
- (j) Trades effected on the ASX may be subject to **dispute**. When a trade is subject to a dispute the ASX 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.
- (k) E\*TRADE has the ability to amend or **cancel the trade** as stated in our Terms and Conditions of Trading and any Confirmation / Contract Note issued. This could cause you to suffer loss or increase your loss. A trade executed on behalf of a client can also be amended or cancelled if requested by the client even where the trade has been confirmed to the client;
- (l) Trades effected on the ASX are traded on an electronic trading platform and cleared through the Clearing House. 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 imposed by the ASX and the Clearing House;

## **COSTS AND AMOUNTS PAYABLE ASSOCIATED WITH TRADING EXCHANGE TRADED OPTIONS**

### **Costs**

Part 2 of this PDS contains information on the commission, brokerage and exchange fees attaching to exchange traded options.

### **Amounts Payable**

#### ***Margins***

The Clearing House calculates margin amounts using a system known as TIMS (Theoretical Intermarket Margining System). Writers of options will be obligated to pay margin.

Margins are generally a feature of all exchange traded derivative products and are designed to protect the financial security of the market. A margin is the amount calculated by the Clearing House as necessary to cover the risk of financial loss on an options contract due to an adverse market movement. This means that if the price of your options moves against you, you will be asked to pay a margin which represents that adverse movement.

We may call more margin from you, compared to the amount that it is obligated to be paid to the clearing house – we do this as a risk management tool.

Clearing House margin obligations may be met by paying cash or by providing certain types of eligible collateral (eg. shares and bank guarantees). The Clearing House applies a 'haircut' in relation to the value of such collateral as a risk management tool, eg. the Clearing House generally values collateral held by it at 70% of its full value. This means that if the shares used by you as collateral have a market value of \$10,000 only 7,000 will be counted as collateral cover for your margin calls.

Total margin for exchange traded options is made up of two components:

Premium margin – this is market value of the particular position at the close of business each day.

Risk margin – this is the potential change in the price of the option contract assuming the maximum probable inter-day price move in the price of the underlying security or index. In times of extreme volatility an intra day margin call may be made by the Clearing House and as a consequence, we may request that you pay this on the same day.

Margin must be paid by you within 24 hours of you being advised of the margin call by us. The margining process used by Clearing House is explained in detail in the ASX booklet "**Understanding Margin Obligations**" which is available on the ASX website at [www.asx.com.au/options](http://www.asx.com.au/options).

Any interest levied on late settlement and margin payments is due and receivable at the time the amount is levied and certainly within 1 business day of a demand being made by E\*TRADE.

## **OTHER SIGNIFICANT CHARACTERISTICS OF EXCHANGE TRADED OPTION CONTRACTS**

### **Trading and clearing options**

Exchange traded options are traded on the ASX's trading platform and cleared through the Clearing House. Participants of ASX must comply with the operating rules of the ASX. Participants who clear option contracts must comply with the operating rules of the Clearing House.

E\*TRADE is licensed to execute exchange traded options on the ASX's trading platform and to clear them through the Clearing House.

The Clearing House stands between the buying and selling brokers (the ASX participants) and guarantees the performance to each of them. This process is known as

'novation'. Importantly the Clearing House does not have an obligation to you, the underlying client. The rules of the ASX's equities clearing house govern arrangements once a deliverable exchange traded option has been exercised.

### **Client Trust Accounts and collateral**

In order for us to trade an exchange traded option contract for you, we require you to provide us with money or property to enable us to manage the risks associated with our dealings for you in exchange traded options. Client money and property paid or given by you in connection with our advising or dealing in exchange traded options must be held by us in trust in accordance with the Corporations Act and the ASX rules. On the date of settlement with the Clearing House, E\*TRADE will transfers funds relating to your dealings in exchange traded options into the E\*TRADE trust account from the bank account it establishes in its name, identifying you as the beneficiary, and which it holds in trust for you.

The Corporations Act provides that money held in the E\*TRADE trust account can be used for specific purposes such as meeting margin obligations, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives.

CHESS securities (held by you) may be lodged in your name with the Clearing House as collateral for margin obligations relating to option trades. When CHESS securities are lodged with the Clearing House, the securities are held by the Clearing House as a 'third party security'. The lodged securities cannot be used by us in relation to our dealings or for our other clients in relation to their dealings unless authorised by you as third party collateral. Shares in a client's superannuation fund cannot be used as third party collateral for any other account.

### **National Guarantee Fund**

The National Guarantee Fund (NGF) provides investors with protection in the following circumstances:

1. If a stock option is exercised, the NGF guarantees completion of the resulting trades in certain circumstances; and
2. if you have entrusted property to E\*TRADE in the course of dealing in options, and E\*TRADE later becomes insolvent, you may claim on the NGF, in accordance with the rules governing the operation of the NGF, for any property which has not been returned to you or has not otherwise been dealt with in accordance with E\*TRADE's obligations to you. There are limits on claims to the NGF for property entrusted.

For more information on the possible protections offered by the NGF see [www.segc.com.au](http://www.segc.com.au).

## **DISPUTE RESOLUTION SYSTEM**

If you have any concerns or comments about the financial service or financial products provided to you, you should take the following steps:

1. Send your complaint in writing to the Compliance Manager at ETRADE Australia Securities Ltd, Level 1, 10 Bridge Street, Sydney NSW 2000. If you have not received a satisfactory response or 45 days have elapsed you may refer the matter to Financial Industry Complaints Service ("FICS").
2. E\*TRADE is a member of the FICS. FICS can be contacted on 1800 335 405 or PO Box 579 Collins Street West, Melbourne VIC 8007. This service is provided to you free of charge.
3. You may also choose to refer the matter to the Australian Securities and Investments Commission (ASIC). ASIC may be contacted on their freecall Infoline on 1300 300 630.

If you require further information on how complaints are handled by E\*TRADE, please visit our website on [www.etrade.com.au](http://www.etrade.com.au) or refer to your Financial Services Guide.

## **SIGNIFICANT TAXATION IMPLICATIONS**

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

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.

### **Implications for Australian Resident Investors**

#### **Revenue Account**

##### ***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.

### ***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.

## **Capital Account**

### ***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 writers 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.

### ***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.

## **GOODS AND SERVICES TAX**

The purchase and disposal of exchange traded options over shares and the share price index by investors is not subject to GST. GST does, however, apply to commissions charged by E\*TRADE and to fees charged by the Clearing House.

This PDS has applied to Exchange Traded Options transactions on your E\*TRADE Australia account since 30 January 2004 and is dated 21 April 2004.

**EXCHANGE TRADED OPTIONS  
PRODUCT DISCLOSURE STATEMENT  
Part 2: SCHEDULE OF FEES**

**Issued by: ETRADE AUSTRALIA SECURITIES LTD**

Australian Financial Services Licence No. 238277

ABN: 93 078 174 973

Date of Issue: 11 March 2004

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## **THIS PDS COMPRISES TWO PARTS**

This is Part 2 of the E\*TRADE PDS and should be read in conjunction with Part 1 of the PDS dated 11 March 2004 which describes the exchange traded option products traded by E\*TRADE.

## **COSTS ASSOCIATED WITH TRADING EXCHANGE TRADED OPTIONS**

All fees and charges quoted include GST, unless otherwise specified.

E\*TRADE provides the facility to trade Exchange Traded Options (“ETO’s”) to both its online retail clients and to clients of other Australian Financial Services Licensees (“Intermediaries”) that utilise the execution, clearing and settlement services of E\*TRADE.

### **Online Retail Clients**

#### **(a) Fees and Charges**

##### **(i) Brokerage**

#### **Opening or closing an ETO contract**

E\*TRADE charges retail clients, using E\*TRADE’s online ETO trading facility to open or close a Single-Leg ETO contract, a standard brokerage rate of the greater of \$44.95 per trade or 0.55% of the traded value of the contract.

Executed Single-Leg Option orders placed by phone will be charged at the standard brokerage rates set out above brokerage rates, plus \$38.50. Multi-Leg Option orders can only be placed by phone, and, when executed, will be charged per leg at the standard brokerage rates set out above (executed Multi-leg orders will not incur any additional phone charges).

#### **Buy Write Trading**

Buy Write trading is available by phone only and is charged using a combination of the cost of both the Option and Equity trade components.

- Standard Brokerage for the Options component is the greater of \$44.95 or 0.55% of trade value.
- Standard Brokerage for the Equity component is \$32.95 on trade value up to \$30,000, or 0.11% of trade value for trades above \$30 000.

### **Exercising Options**

- Options exercised will incur brokerage at the maximum of \$44.95 or 0.22% of trade value.

### ***(ii) Other Charges***

#### **Australian Clearing House (ACH) Fees**

ACH charges a transaction fee of \$1.12 per ETO contract. If you exercise a share option, ACH charges an exercise fee of \$0.55 per contract. The ACH fees and GST applicable thereto are shown separately on your Confirmation/Contract Note.

#### **Government Taxes**

GST is charged on all brokerage and ACH fees at the rate of 10%, and is disclosed separately on your Confirmation/Contract Note.

### **(b) Rebates to Online Retail Clients**

E\*TRADE provides rebates to online retail clients who trade ETO's more than 10 times per calendar month, on the following basis:

- For the 11<sup>th</sup> to 20<sup>th</sup> ETO trade per calendar month, a \$5 rebate for each of those trades; for the 21<sup>st</sup> and subsequent ETO trades per calendar month, a \$10 rebate for each of those trades. Equities trades do not count towards ETO trade rebates.

## **Intermediaries' Clients**

### **(a) Fees and Charges**

#### ***(i) Brokerage***

The rates of brokerage for ETO's are set by the Intermediary – not E\*TRADE - and may differ between Intermediaries. If you are a client of an Intermediary, you should refer any questions regarding brokerage charges to that Intermediary.

#### ***(ii) Other Charges***

#### **Australian Clearing House (ACH) Fees**

ACH charges a transaction fee of \$1.12 per ETO contract. If you exercise a share option, ACH charges an exercise fee of \$0.55 per contract. The ACH fees and GST applicable thereto are shown separately on your Confirmation/Contract Note.

#### **Government Taxes**

GST is charged on all brokerage and ACH fees at the rate of 10%, and is disclosed separately on your Confirmation/Contract Note.

### **(b) Rebates to Intermediaries' Clients**

No rebates of brokerage are paid to Intermediaries' clients.

### **(c) Remuneration of Intermediaries**

E\*TRADE pays Intermediaries the brokerage charged on your contract note, after deducting a charge of \$35.00 per ETO trade.

## **GENERAL INFORMATION (ALL CLIENTS)**

### **Charges**

All brokerage, ACH fees and GST charges are shown separately on your Confirmation / Contract Note.

Brokerage and fees that are charged on your Confirmation/Contract Note may be tax deductible. You must confirm this with your own Tax Adviser or Accountant, in relation to your specific situation.

This PDS has applied to Exchange Traded Options transactions on your E\*TRADE Australia account since 30 January 2004 and is dated 21 April 2004.