The costs of exercise and assignment

> **EXERCISE AND ASSIGNMENT COSTS**
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> Exercise and assignment are not free: exercising a call means buying the underlying (paying its cost and tying up the capital), assignment can arrive unexpectedly and convert an option into an underlying position with its own frictions, and the pin risk near expiry can leave a position ambiguously exercised. The option's costs do not end at the premium and spread - the endings have their own, and the seller's especially.

An option that reaches expiry with value resolves into exercise or assignment, and those resolutions have costs the premium never showed - especially for the seller, for whom assignment is an obligation arriving with real underlying and real frictions.

The costs at the ending

Exercise creates an underlying position: exercising a call means actually buying the underlying at the strike - paying its cost, tying up the capital, and inheriting the equity position's own frictions (the all-in cost of the underlying, now owned).Assignment is involuntary and frictional: a seller assigned must deliver or take the underlying, converting the option into an underlying position at a moment not of their choosing - with the spread and commission of unwinding that position on top.Early assignment's surprise: American-style options can be assigned early (module 1), particularly around dividends, so a seller can be handed an underlying position before expiry, unexpectedly, with all its costs.

Pin risk, the expiry-day cost

Near expiry, an option whose underlying sits close to the strike carries pin risk: it may or may not be exercised, and the holder does not know until after the fact whether they will be left with an underlying position - a genuine uncertainty with a cost, because the resulting position must then be managed, possibly over a weekend, at whatever the underlying does next. Pin risk is the options-specific expiry cost the futures track's convergence did not have - the ambiguity of an at-the-strike expiry, resolved only after the holder can act.

The costing completeness

A complete options cost includes the ending: for positions that may reach expiry, the exercise or assignment frictions and the pin risk are real costs, additional to the premium, spread and commission. Most options are closed before expiry precisely to avoid these - closing the option position rather than letting it resolve into an underlying one - and that closing is itself a spread and commission paid. The honest options cost accounts for how the position ends, not just how it begins; the endings carry frictions the premium never showed, and the seller's assignment risk is the sharpest of them.

Check your understanding

1. What does exercising a call actually cost?

a. Only the premium

b. It creates an underlying position: buying the underlying at the strike, paying its cost, tying up capital, and inheriting the equity position's own frictions

c. Nothing - it is automatic

Answer: b. Exercise converts the option into an owned underlying position with all its costs. The option's costs do not end at the premium - the endings have their own.

2. What is pin risk?

a. The risk of a price spike

b. Near expiry with the underlying close to the strike, an option may or may not be exercised - the holder does not know until after the fact whether they hold an underlying position

c. The commission at expiry

Answer: b. The ambiguity of an at-the-strike expiry, resolved only after the holder can act. The options-specific expiry cost the futures convergence did not have.