Expiry, exercise and assignment

> **EXPIRY AND ASSIGNMENT**
>
> How an option ends: at expiry it is exercised if it has intrinsic value and lapses worthless if it does not - and exercise means the underlying actually changes hands at the strike, unless the contract is cash-settled. The seller who is exercised against is assigned - obliged to deliver or take the underlying - and assignment risk, including early assignment on some options, is a real mechanic the seller must understand before selling anything.

An option ends in one of two ways, and which one has consequences the buyer and seller must both understand - especially the seller, for whom assignment is an obligation that can arrive with real underlying attached.

The two endings

Lapse: an option with no intrinsic value at expiry - out of the money - expires worthless; the buyer loses the premium, the seller keeps it, and nothing changes hands. The common ending for options that did not go the buyer's way.Exercise: an option with intrinsic value is exercised - the right is used, and the underlying changes hands at the strike (or cash settles the difference, for cash-settled contracts); the buyer realises the intrinsic value, the seller meets the obligation.

Assignment, the seller's mechanic

When a buyer exercises, a seller is assigned - selected to meet the obligation: a short call assigned must deliver the underlying at the strike (buying it in the market if they do not hold it - the unbounded risk of lesson 2, realised); a short put assigned must buy the underlying at the strike. Assignment turns the option position into an underlying position, suddenly and not always at a convenient moment. And some options can be exercised early - American-style, exercisable any time before expiry - so the seller of those carries early-assignment risk, the obligation potentially arriving before expiry, particularly around dividends. A seller who does not understand assignment does not understand what they sold.

The style and settlement details

Options differ in exercise style (American, exercisable any time; European, only at expiry) and settlement (physical delivery of the underlying, or cash) - details that are part of the contract and change the risks, exactly as the futures track's contract specifications did. The reader evaluating any option must know its style and settlement, because they decide whether early assignment is possible and whether exercise means real shares or a cash difference. Expiry is where the option's asymmetry finally resolves into cash or underlying - and understanding that resolution, especially the seller's assignment risk, is prerequisite to the risk lessons of module 4.

Check your understanding

1. What is assignment?

a. The buyer choosing a strike

b. When a buyer exercises, a seller is selected to meet the obligation - a short call assigned must deliver the underlying at the strike, a short put must buy it - turning the option into an underlying position

c. The exchange setting the premium

Answer: b. Exercise on one side is assignment on the other. It turns the option position into an underlying position suddenly - and a seller who does not understand it does not understand what they sold.

2. Why does exercise style matter to a seller?

a. It changes the premium

b. American-style options can be exercised early, so their seller carries early-assignment risk - the obligation potentially arriving before expiry, particularly around dividends

c. It changes the strike

Answer: b. Style decides whether early assignment is possible. Like the futures contract specifications, it is part of the contract and changes the risks the seller carries.