

The premium: what you pay and what you sell

THE PREMIUM

The price of the option - paid by the buyer, received by the seller - and the pivot of every options position: the buyer's maximum loss, the seller's maximum gain, and the amount the underlying must move to make a bought option worth exercising. The premium is quoted per share and multiplied by the contract's share count, and understanding what sets it - intrinsic value, time and volatility - is most of understanding options, which the rest of the module unpacks.

The premium is the number everything in options turns on: it is what changes hands, it bounds the risk on both sides, and its size is set by forces - time, volatility - that shares never had. This lesson fixes what it is; the module unpacks what sets it.

What the premium is

The buyer's maximum loss: a bought option's entire risk is the premium paid - the asymmetry's good half, and the number that makes a long option's downside knowable exactly. The seller's maximum gain: a sold option's entire reward is the premium received - the asymmetry's other half, the fixed income against an open risk. The hurdle: a bought option only pays if the underlying moves enough to cover the premium - the breakeven of lesson 8 - so the premium is the distance the view must travel before it profits.

The contract multiplier

Premiums are quoted per share of the underlying, and a contract covers a fixed number of shares - so the cash premium is the quote times the multiplier, and reading a premium means applying the multiplier the way the futures track applied the point value. A premium quoted as a small per-share figure is a larger cash amount per contract, and the position's real risk and cost are the cash figure - the same per-unit-to-cash discipline every track has taught, on the option's own multiplier.

Why the premium is most of the subject

A share's price is just its price; an option's premium is a computed value with parts - what the option is worth if exercised now (intrinsic), plus what the remaining time and the underlying's volatility are worth (time value) - and those parts move differently, decay differently, and respond differently to the underlying. The rest of module 1 takes the premium apart: intrinsic and time value (lesson 4), how time decays it (lesson 5), how volatility inflates it (lesson 6), and how it all resolves at expiry (lesson 7). The premium is where options stop resembling shares - and understanding it is understanding the instrument.

Check your understanding

1. Why is the premium the pivot of every options position?

- a. It is the only cost
- b. It is the buyer's maximum loss, the seller's maximum gain, and the hurdle a bought option must clear to profit - the number every options position turns on
- c. It equals the strike price

Answer: b. The premium bounds the risk on both sides and sets the distance a view must travel. Understanding what sets it - intrinsic value, time, volatility - is most of understanding options.

2. How is a premium converted to cash risk?

- a. It is already the cash figure
- b. The per-share quote times the contract's share multiplier - the same per-unit-to-cash discipline the futures track applied to point value
- c. It is divided by the strike

Answer: b. Premiums quote per share; a contract covers many. The position's real risk is the cash figure - a small per-share quote is a larger amount per contract.