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Flexible Exchange Options (FLEX)

A Primer

Flexible Exchange Options, or FLEX options, allow investors customizable contract terms, including the exercise style, strike price and expiration date. These contracts are often used by investors when traditional contract terms do not adequately address investment goals or risk considerations.

FLEX options are designed to offer investors the flexibility of over-the counter (OTC) options that allow investors to customize contract terms with their counterparty, often a major investment bank's trading desk. An added benefit of FLEX options is that trades are cleared by the Options Clearing Corporation, which significantly reduces counter-party risk.

Components of a Flexible Exchange Option (FLEX)

The customization available with FLEX options is substantial. Sizes can be as low as a single contract and strike prices may be in penny increments or a percentage of the underlying stock. Premiums may be in the value of specific dollar amounts and are typically in penny increments. An expiration date can be any business day and can be set as far in the future as 15 years from the date of the trade. Expiration styles may be American or European. American expiration allows for exercise at any time before the contract ends. European expiration permits exercise only at the expiration date. Equity FLEX options, both puts, and calls, settle with the delivery of shares of stock if exercised. Index FLEX options settle in cash.

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Position Limits for Flexible Exchange Options

There are no position limits for FLEX options on major market indexes, including the Dow Jones Industrial Average, Nasdaq 100 Index, Russell 2000 Index, Standard & Poor's 500 Index, and S&P 100 Index. However, there are reporting requirements if position sizes exceed certain thresholds.

A FLEX Option Application

An investor with low-basis concentrated stock would like to unlock additional return by selling call options but does not want to risk the stock being called away. By operating in the FLEX market, the investor can sell European style options, which cannot be exercised until expiration, thus limiting the risk of unwanted stock sales.

Disclosures