



BREAKING THE ICE WITH
OPTIONS



BREAKING THE ICE WITH OPTIONS	1
RESEARCH OVERVIEW	2
KEY FINDINGS	3
WHY INVESTORS FIND OPTIONS DIFFICULT	4
UNDERSTANDING LEADS TO CONSIDERATION	6
COMMUNICATING OPTIONS STRATEGIES	8
I LIKE MY ADVISOR BUT...	10
LEARN MORE ABOUT OPTIONS	12

Breaking the Ice with Options

It is difficult to think of a product more misunderstood by investors than listed options. Many believe options are simply a way to play the stock market and make—or lose—a lot of money. Even those who understand how puts and calls work often do not know that the most common options strategies are selling covered calls to generate income, or buying protective puts to hedge a security or portfolio.

Financial advisors, of course, are well aware of how options can be used to enhance income or reduce portfolio volatility. But, given investors' misperceptions when it comes to options, it can be challenging for advisors to introduce options or explain their benefits to clients and prospects.

To understand why options are often misunderstood, The Options Industry Council (OIC) undertook a qualitative research study among high net worth investors. The study explored the investors' reticence to include options strategies in their portfolios and if educational information on options could alter their attitudes. Dubick & Associates, a research and marketing firm, conducted hour-long, individual conversations with the investors in three cities: Atlanta, Dallas and Seattle.

Research Overview

**32 INVESTORS \$1-\$5 MILLION
IN INVESTABLE ASSETS
WORKING WITH 1 OR MORE
FINANCIAL ADVISORS RANGING
IN AGE FROM 32-67 MEN AND
WOMEN VARYING LEVELS OF
INVESTMENT EXPERIENCE
A MIX OF BUSINESS OWNERS,
RETIREES, HOMEMAKERS, AND
CORPORATE AND GOVERNMENT
EXECUTIVES.**

Each of the 32 investors interviewed had \$1 to \$5 million in investable assets and worked with at least one financial advisor, though most had two or more. Beyond all meeting the criteria of being a high net worth investor, the participants were diverse. They ranged in age from 32 to 67, included men and women, had varying levels of investment experience and were a mix of business owners, retirees, homemakers, and corporate and government executives.

Early in the interviews the participants were asked if they could describe a number of investments, including options. Almost all described options as a high-risk product that they would not consider for their portfolio. During the conversations the research firm explored the participants' current investments, investing philosophy and advisor relationships.

Toward the end of the conversation the participants were asked to read and discuss brief, simple explanations of covered calls and protective puts. They were able to ask questions about the two strategies and at the end were asked to write on a flipchart how they might explain options to a friend.

Key Findings

Several key themes emerged in the course of the conversations:

- ▶ Although the participants read general interest business publications and regularly received information from their financial advisors, no information about options strategies had reached most of the participants beyond advertising for options trading programs, which they believed involved speculating with naked calls and puts.
- ▶ More than three quarters assumed options would never be appropriate for them because they had been taught and believed that investing should be for the long term and options are short term.
- ▶ Initially, the vast majority had difficulty understanding how covered calls and protective puts worked and had to read through the explanation a few times. At the end most were not able to describe options in their own words even though it was clear from their questions they had grasped the concepts.
- ▶ Despite not fully understanding how covered calls and protective puts worked, they recognized that these strategies were very different from their initial understanding of options and a significant majority, who had earlier been critical of options, expressed interest in learning more about them.
- ▶ Participants said they looked to their financial advisors for new ideas and would be open to discussing options strategies with them. Several noted that they were more receptive to new investment ideas when they had at least heard about the concept previously.

Participants' lack of knowledge was not confined to options. Few could describe what was in their portfolios, beyond stock and mutual funds (and they did not know whether these were bond or stock funds). Nonetheless, most believed their portfolios matched their risk tolerance because they were diversified.

Why Investors Find Options Difficult to Understand

There are several reasons options are confusing to investors. In the interviews and particularly during the last section, when the participants were asked to read and explain covered calls and protective puts, these difficulties were apparent:



1 Option strategies, like other investment products, are typically described in terms that are unfamiliar outside the financial services industry. The words put, call or covered when applied to options may as well be a foreign language to many investors.

2 While to those in the industry covered calls may seem rather straightforward, the research participants had trouble understanding that a covered call was an option on stock already owned. Most thought calls referred only to naked calls, where an investor could control stock without purchasing it, and they found it confusing to think of it in connection with stock already in a portfolio.

3 Investors struggled with the rationale behind protective puts, with several asking why investors would not simply sell a position if they believed it would go down. Some noted that their portfolio's diversification was designed to provide protection.

4 Finally, many saw no need to understand how options worked because they did not see themselves as potential options investors. This was due in part to their investment philosophy that investing should be for the long term and options are short-term instruments. Many said they learned to think long term from their parents and financial advisors and it had been reinforced when their portfolios recovered after the 2008-2009 crash. They described those who do invest in options as speculators, active market participants or investors more willing to accept a loss than they were.

Understanding Leads to Consideration

The participants started out believing that options were only a way to buy stock cheaply or with leverage and therefore an inherently risky investment. Introduced to two conservative options strategies, covered calls and protective puts, they expanded their views. Here are some of their comments:

“ Well, that’s a little opposite of what I thought before. One of the things that I have a big problem with is understanding things in the investment world that I have a preconceived notion are automatically bad because I’ve heard some bad things. I assumed that everything will be lumped into that same category. *(He gave an example of annuities and thinking they were all bad until his advisor explained the differences.)* In the option world, there are some things I would never recommend but some things might fit my world.”

“ So it doesn’t seem as much of a risk as I thought. It seems that there is potential in these. I’m sure these are more of the conservative examples of options and there probably are some options that are more of a risk. But in these examples, it seems that the potential outweighs the risk.”

“ Basically, you know what your worst-case scenario is. That doesn’t seem like a high risk to me—when you know your worst-case scenario.”

“ I think just talking to you about it and reading this about the covered call writing makes me realize there is a market out there that I haven't touched that I should be.”

“ I think you just helped me understand how people use these things. It's like a tool. I know some people use it, it just hasn't been me. I didn't understand it and I didn't come across anybody who could explain it to me and show me how it works.”

“ I would definitely really consider doing research and speaking with people about options and option strategies and investing.”

“ I feel a little bit more educated. It makes me want to read more about it. I'm a little bit intrigued. I'm not sure right from here if I want to get into it because I might mess up but I definitely want to be more knowledgeable about them. My perception was inaccurate about options.”

Communicating Options Strategies

While options are not appropriate for every investor, there are those who might benefit from a covered call or protective put strategy but could reject the idea when the suggestion is first made. The goal of the research was to understand the reasons for investors' negativity toward options and explore how advisors might overcome some of this resistance.

These suggestions are intended to enhance what the advisor already knows about his or her clients and prospects. Not all investors will have the patience or time to learn about options, but below are approaches advisors may want to consider:

Acknowledge that options are complex. Sometimes clients are embarrassed to admit they don't understand something, so telling them that options are complicated and something most clients struggle with may put them at ease. Be encouraging as they master the concepts. Recognize that they may be confused when you explain covered calls or protective puts because they think options are a way to acquire stock. You may need to address the kinds of options strategies you aren't recommending, before explaining the ones you are.

Position options as consistent with investors' values and goals. Many of the research participants believed using options ran counter to their belief that investments should be long term in nature. Advisors may want to reassure clients that setting long-term goals and using strategies to achieve them is still one of the fundamentals of investing. However today, with the financial world more complicated and volatile and investors living longer lives, there are tactics such as options that can help investors achieve their goals.

Focus on education. Participants said they preferred being informed about options rather than sold them. While the end result may be the same, it feels differently to the client. OIC has educational brochures you can send, or you can provide a link to OIC's website where your clients will have access to a library of information including learning modules.

Repeat yourself. Remember the words you'll be using are like a foreign language to your client so repetition and practice will be required before they really understand. Except for advertising on options trading programs they are not reading about options in their daily lives, so create opportunities to expose them to options. For example, include an article on how covered calls can be used to generate income in your newsletter or organize a seminar on basic options strategies.

Help them visualize it. While the participants found the written descriptions of covered calls and protective puts useful, they wanted more. As one participant said, "*I'm a numbers man, show me the numbers.*" Use charts, graphs and examples to facilitate understanding.

I Like My Advisor But...

Almost all the interviewees liked their advisors, and in only a few cases did they have anything negative to say. In fact, when investors cited a problem with their advisor they usually blamed themselves for failing to pay attention, follow-through or take the advisor's advice. But their regard for their current advisor did not mean they wouldn't consider another one if the idea he or she brought was attractive.

How did you choose your financial advisor?

About half of the participants had chosen their advisors based on a long-term personal relationship with the advisor, through referrals or through a process of interviews and selection. The other half, many with \$2 million-plus portfolios, worked with an advisor because the financial services company had assigned him or her to their account. While sometimes they had then stayed with the advisor for several years, in other instances the company had rotated them through one or more other advisors.

Why do you work with multiple advisors?

Almost all the participants had at least two advisors, and many had more. There were three primary reasons investors worked with multiple advisors. First, investors would end up with accounts at multiple institutions through inheritance, changing jobs or investing in a new product or service that an institution was offering and an advisor was attached to that relationship. Second, they would seek an advisor at a new institution so that they would have diversification on an institutional level. And third, they wanted to try a new advisor to see how the firm and advisor they were currently working with measured up.

What would you change about your advisor?

While criticisms were limited, occasionally investors reported that their advisors were either too aggressive or not aggressive enough. Some who used full-service brokerages said they would prefer lower fees, and a few noted that they wished their advisors were younger, since they will likely retire and the investor will have to find a replacement.

Would you be comfortable if your advisor suggested an options strategy?

All of the participants said they expected their advisors to bring them new products and services and would be comfortable with them recommending options, if the strategy was suitable for them. Many said their advisor had made stock or mutual fund recommendations, and one mentioned being introduced to ETFs by his advisor. While they said they would be open to learning about any new product, many said they would probably prefer that it be something they had already read or heard about.

Under what circumstances would you speak to an advisor you're not working with now?

Almost every participant was willing to speak with a new advisor. Many said they would be happy to speak with any advisor who could bring them a new idea. As high net worth investors they were accustomed to being solicited by advisors.

Many attended lunch and dinner programs—accompanied by a presentation or informal talk—when invited, particularly the 45-plus crowd. They remained skeptical, however, about these advisors' sincerity and motivation. They were most receptive if the advisor's firm was known to them or the advisor was personally referred.

Learn More about Options

Educating clients is a big task but you don't have to do it alone. OIC is committed to helping advisors offer options strategies to their clients. Whether you seek to learn more, need resources to help you inform your clients or want an educational resource that clients can go to directly, OIC has a host of free services including:

Website

At www.OptionsEducation.org advisors can find resources and tools including:

- Online Classes, Videos and Podcasts
- Covered Call and Position Simulators
- Pricing Calculator and Strategy Section with Dynamic Filters
- Legislative Updates, Advisor Brief, White Papers and Research
- Options News, Market Data and Quotes

Investor Services

Advisors can speak with an options professional for assistance understanding a strategy or for educational information. Call 1-888-OPTIONS weekdays from 7:30 AM to 5:00 PM CT.

Live Chat

Chat live with Investor Services via the website weekdays from 8:00-11:00 AM and 1:30-4:00 PM CT. Advisors can also join OIC on Facebook, Twitter and LinkedIn.

Email

Advisors can send their options questions to options@theocc.com. Most emails are returned within two business days.

Training and Collateral

OIC has industry professionals who can provide training to advisor groups. It also offers brochures and collateral materials that advisors can use with clients and co-brand with their company's name. To learn about these resources contact Eric Cott, Director of Advisor Education, at ecott@theocc.com.

This is intended for financial advisors and not for use by the general public. It discusses exchange-traded options issued by The Options Clearing Corporation. No statement is to be construed as a recommendation to purchase or sell a security, or to provide investment advice. Options involve risk and are not suitable for all investors. Prior to buying or selling an option, a person must receive a copy of Characteristics and Risks of Standardized Options at www.optionsclearing.com/about/publications/character-risks.jsp. Copies of this document may also be obtained from a broker, from any exchange on which options are traded or by contacting The Options Clearing Corporation, One North Wacker Dr., Suite 500, Chicago, IL 60606 (1-800-678-4667).

© 2013 The Options Industry Council