



Early Assignments

American style options, generally used for equities, can be assigned at any point. Assignment ruins simple trading strategies and destroys complicated strategies. If you sold any option or have short options in your strategy, you have the chance to be assigned.

Understanding the assignment process and when you are most likely to be assigned is absolutely essential for avoiding losses. After each trading day brokerages with short positions are added to a list of potential assignments. Before expiration the assignments are selected randomly. After expiration, all in the money options are exercised. By early morning (Eastern Time for US traders) the list of assignments will be made and sent to the trader's accounts.

Early Assignment is based on other people choosing to exercise their options. Buyers of calls and puts may exercise for differing reasons. You are always more likely to be exercised against if your call is in the money, since it is profitable for the option holder. One of the most common reasons for exercise is dividends. Call owners often exercise calls before ex-dividend dates. This forces short call holders to sell shares below market value immediately before the dividend payout list is assembled. You're more likely to be assigned if you hold these short positions. Put holders can force someone else to buy an underlying asset, which results in other people potentially receiving the dividend. They're highly unlikely to give away a dividend, so you probably won't be assigned on a short put before an ex-dividend date.

There are multiple ways to handle an early assignment. The first is simply allowing the assignment to occur and absorbing the consequences. The second is taking an offsetting position. You can close the short option, since the options clearing house closes trades before handling assignments. If you will be forced to sell the underlying, purchase the corresponding shares on the market if you do not own them. If you will be forced to buy the underlying, absorb the assignment and sell the asset on the market. You can offset the purchase in advance by short selling the underlying asset. Note: This occurs at greater risk since prices may change between the two periods, resulting in a loss.

Weigh the costs of each way of handling the assignment. You only have until the end of the day to decide how you will handle your early assignment.