National Futures Association is a congressionally authorized self-regulatory organization of the United States futures industry. Its mission is to provide innovative regulatory programs and services that protect investors and ensure market integrity.

NFA has prepared this book as part of its continuing public education efforts to provide information to potential investors. The booklet provides a necessary overview of the opportunities and risks in trading futures and options on futures by presenting important information that investors need to know before they invest.
Actuals
See Cash Commodity.

Aggregation
The policy under which all futures positions owned or controlled by one trader or a group of traders are combined to determine reportable positions and speculative limits.

Arbitrage
The simultaneous purchase and sale of similar commodities in different markets to take advantage of a price discrepancy.

Arbitration
The process of resolving disputes between parties by a person or persons (arbitrators) chosen or agreed to by them. NFA’s arbitration program provides a forum for resolving futures-related disputes between NFA Members or between Members and customers.

Associated Person (AP)
An individual who solicits orders, customers or customer funds on behalf of a Futures Commission Merchant, an Introducing Broker, a Commodity Trading Advisor or a Commodity Pool Operator and who is registered with the Commodity Futures Trading Commission.

At-the-Money Option
An option whose strike price is equal—or approximately equal—to the current market price of the underlying futures contract.

Basis
The difference between the current cash price of a commodity and the futures price of the same commodity.

Bear Market (Bear/Bearish)
A market in which prices are declining. A market participant who believes prices will move lower is called a “bear.” A news item is considered bearish if it is expected to result in lower prices.

Bid
An expression of willingness to buy a commodity at a given price; the opposite of Offer.

Board of Trade
See Contract Market.

Broker
A company or individual that executes futures and options orders on behalf of financial and commercial institutions and/or the general public.

Bull Market (Bull/Bullish)
A market in which prices are rising. A market participant who believes prices will move higher is called a “bull.” A news item is considered bullish if it is expected to result in higher prices.

Call Option (American Style)
An option which gives the buyer the right, but not the obligation, to purchase (“go long”) the underlying futures contract at the strike price on or before the expiration date.

Carrying Broker
A member of a futures exchange, usually a clearinghouse member, through which another firm, broker or customer chooses to clear all or some trades.

Cash Commodity
The actual physical commodity as distinguished from the futures contract based on the physical commodity. Also referred to as Actuals.

Cash Market
A place where people buy and sell the actual commodities (i.e., grain elevator, bank, etc.).
See also Forward (Cash) Contract and Spot.

Cash Settlement
A method of settling certain futures or options contracts whereby the market participants settle in cash (payment of money rather than delivery of the commodity).

Charting
The use of graphs and charts in the technical analysis of futures markets to plot price movements, volume, open interest or other statistical indicators of price movement.
See also Technical Analysis.

Churning
Excessive trading that results in the broker deriving a profit from commissions while disregarding the best interests of the customers.
**Circuit Breaker**
A system of trading halts and price limits on equities and derivatives markets designed to provide a cooling-off period during large, intraday market declines or rises.

**Clear**
The process by which a clearinghouse maintains records of all trades and settles margin flow on a daily mark-to-market basis for its clearing members.

**Clearinghouse**
A corporation or separate division of a futures exchange that is responsible for settling trading accounts, collecting and maintaining margin monies, regulating delivery and reporting trade data. The clearinghouse becomes the buyer to each seller (and the seller to each buyer) and assumes responsibility for protecting buyers and sellers from financial loss by assuring performance on each contract.

**Clearing Member**
A member of an exchange clearinghouse responsible for the financial commitments of its customers. All trades of a non-clearing member must be registered and eventually settled through a clearing member.

**Closing Price**
*See Settlement Price.*

**Closing Range**
A range of prices at which futures transactions took place during the close of the market.

**Commission**
A fee charged by a broker to a customer for executing a transaction.

**Commission House**
*See Futures Commission Merchant.*

**Commodity Exchange Act (CEA)**
The federal act that provides for federal regulation of futures trading.

**Commodity Futures Trading Commission (CFTC)**
The federal regulatory agency established in 1974 that administers the Commodity Exchange Act. The CFTC monitors the futures and options on futures markets in the United States.

**Commodity Pool**
An enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures or options contracts. The concept is similar to a mutual fund in the securities industry. Also referred to as a Pool.

**Commodity Pool Operator (CPO)**
An individual or organization which operates and solicits funds for a commodity pool. A CPO may be required to be registered with the CFTC.

**Commodity Trading Advisor (CTA)**
A person who, for compensation or profit, directly or indirectly advises others as to the advisability of buying or selling futures or commodity options. Providing advice includes exercising trading authority over a customer's account. A CTA may be required to be registered with the CFTC.

**Confirmation Statement**
A statement sent by a Futures Commission Merchant to a customer when a futures or options position has been initiated. The statement shows the price and the number of contracts bought or sold. Sometimes combined with a Purchase and Sale Statement.

**Contract Market**
A board of trade designated by the CFTC to trade futures or options contracts on a particular commodity. Commonly used to mean any exchange on which futures are traded. Also referred to as an Exchange.

**Contract Month**
The month in which delivery is to be made in accordance with the terms of the futures contract. Also referred to as Delivery Month.

**Convergence**
The tendency for prices of physical commodities and futures to approach one another, usually during the delivery month.

**Covered Option**
A short call or put option position which is covered by the sale or purchase of the underlying futures contract or physical commodity.
Cross-Hedging
Hedging a cash commodity using a different but related futures contract when there is no futures contract for the cash commodity being hedged and the cash and futures market follow similar price trends (e.g., using soybean meal futures to hedge fish meal).

Customer Segregated Funds
See Segregated Account.

Day Order
An order that if not executed expires automatically at the end of the trading session on the day it was entered.

Day Trader
A speculator who will normally initiate and offset a position within a single trading session.

Default
The failure to perform on a futures contract as required by exchange rules, such as a failure to meet a margin call or to make or take delivery.

Deferred Delivery Month
The distant delivery months in which futures trading is taking place, as distinguished from the nearby futures delivery month.

Delivery
The transfer of the cash commodity from the seller of a futures contract to the buyer of a futures contract. Each futures exchange has specific procedures for delivery of a cash commodity. Some futures contracts, such as stock index contracts, are cash settled.

Delivery Month
See Contract Month.

Derivative
A financial instrument, traded on or off an exchange, the price of which is directly dependent upon the value of one or more underlying securities, equity indices, debt instruments, commodities, other derivative instruments, or any agreed upon pricing index or arrangement. Derivatives involve the trading of rights or obligations based on the underlying product but do not directly transfer that product. They are generally used to hedge risk.

Designated Self-Regulatory Organization (DSRO)
When a Futures Commission Merchant (FCM) is a member of more than one Self-Regulatory Organization (SRO), the SROs may decide among themselves which of them will be primarily responsible for enforcing minimum financial and sales practice requirements. The SRO will be appointed DSRO for that particular FCM. NFA is the DSRO for all non-exchange member FCMs. See also Self-Regulatory Organization.

Disclosure Document
The statement that some CPOs must provide to customers. It describes trading strategy, fees, performance, etc.

Discount
(1) The amount a price would be reduced to purchase a commodity of lesser grade; (2) sometimes used to refer to the price differences between futures of different delivery months, as in the phrase “July is trading at a discount to May,” indicating that the price of the July future is lower than that of May; (3) applied to cash grain prices that are below the futures price.

Discretionary Account
An arrangement by which the owner of the account gives written power of attorney to someone else, usually the broker or a Commodity Trading Advisor, to buy and sell without prior approval of the account owner. Also referred to as a Managed Account.

Electronic Order
An order placed electronically (without the use of a broker) either via the Internet or an electronic trading system.

Electronic Trading Systems
Systems that allow participating exchanges to list their products for trading electronically. These systems may replace, supplement or run along side of the open outcry trading.

Equity
1) The value of a futures trading account if all open positions were offset at the current market price; 2) an ownership interest in a company, such as stock.
Exchange
See Contract Market.

Exercise
The action taken by the holder of a call option if he wishes to purchase the underlying futures contract or by the holder of a put option if he wishes to sell the underlying futures contract.

Exercise Price
See Strike Price.

Expiration Date
Generally the last date on which an option may be exercised. It is not uncommon for an option to expire on a specified date during the month prior to the delivery month for the underlying futures contracts.

Extrinsic Value
See Time Value.

First Notice Day
The first day on which notice of intent to deliver a commodity in fulfillment of an expiring futures contract can be given to the clearinghouse by a seller and assigned by the clearinghouse to a buyer. Varies from contract to contract. 1) The value of a futures trading account if all open positions were offset at the current market price; 2) an ownership interest in a company, such as stock.

Floor Broker
An individual who executes orders on the trading floor of an exchange for any other person.

Floor Trader
An individual who is a member of an exchange and trades for his own account on the floor of the exchange.

Forward (Cash) Contract
A contract which requires a seller to agree to deliver a specified cash commodity to a buyer sometime in the future, where the parties expect delivery to occur. All terms of the contract may be customized, in contrast to futures contracts whose terms are standardized.

Fully Disclosed
An account carried by a Futures Commission Merchant in the name of an individual customer; the opposite of an Omnibus Account.

Fundamental Analysis
A method of anticipating future price movement using supply and demand information.

Futures Commission Merchant (FCM)
An individual or organization which solicits or accepts orders to buy or sell futures contracts or commodity options and accepts money or other assets from customers in connection with such orders. An FCM must be registered with the CFTC.

Futures Contract
A legally binding agreement to buy or sell a commodity or financial instrument at a later date. Futures contracts are normally standardized according to the quality, quantity, delivery time and location for each commodity, with price as the only variable.

Grantor
See Writer.

Guaranteed Introducing Broker
A Guaranteed Introducing Broker is an IB that has a written agreement with a Futures Commission Merchant that obligates the FCM to assume financial and disciplinary responsibility for the performance of the Guaranteed Introducing Broker in connection with futures and options customers. A Guaranteed Introducing Broker is not subject to minimum financial requirements.

Hedging
The practice of offsetting the price risk inherent in any cash market position by taking an opposite position in the futures market. A long hedge involves buying futures contracts to protect against possible increasing prices of commodities. A short hedge involves selling futures contracts to protect against possible declining prices of commodities.

High
The highest price of the day for a particular futures or options on futures contract.

Holder
The opposite of a Grantor. See also Option Buyer.
In-the-Money Option
An option that has intrinsic value. A call option is in-the-money if its strike price is below the current price of the underlying futures contract. A put option is in-the-money if its strike price is above the current price of the underlying futures contract.

Independent Introducing Broker
An Independent Introducing Broker is an IB subject to minimum capital requirements.

Initial Margin
The amount a futures market participant must deposit into a margin account at the time an order is placed to buy or sell a futures contract. See also Margin.

Intrinsic Value
The amount by which an option is in-the-money.

Introducing Broker (IB)
A firm or individual that solicits and accepts commodity futures orders from customers but does not accept money, securities or property from the customer. All Introducing Brokers must be registered with the CFTC.

Last Trading Day
The last day on which trading may occur in a given futures or option.

Leverage
The ability to control large dollar amounts of a commodity with a comparatively small amount of capital.

Limit
See Position Limit, Price Limit, Variable Limit.

Liquidate
To sell a previously purchased futures or options contract or to buy back a previously sold futures or options position. Also referred to as Offset.

Liquidity (Liquid Market)
A characteristic of a security or commodity market with enough units outstanding and enough buyers and sellers to allow large transactions without a substantial change in price.

Local
A member of an exchange who trades for his own account.

Long
One who has bought futures contracts or options on futures contracts or owns a cash commodity.

Low
The lowest price of the day for a particular futures or options on futures contract.

Maintenance Margin
A set minimum amount (per outstanding futures contract) that a customer must maintain in his margin account to retain the futures position. See also Margin.

Managed Account
See Discretionary Account.

Margin
An amount of money deposited by both buyers and sellers of futures contracts and by sellers of options contracts to ensure performance of the terms of the contract (the making or taking delivery of the commodity or the cancellation of the position by a subsequent offsetting trade). Margin in commodities is not a down payment, as in securities, but rather a performance bond. See also Initial Margin, Maintenance Margin and Variation Margin.

Margin Call
A call from a clearinghouse to a clearing member, or from a broker or firm to a customer, to bring margin deposits up to a required minimum level.

Mark-to-Market
To debit or credit on a daily basis a margin account based on the close of that day’s trading session. In this way, buyers and sellers are protected against the possibility of contract default.

Market Order
An order to buy or sell a futures or options contract at whatever price is obtainable when the order reaches the trading floor.

Maximum Price Fluctuation
See Price Limit.
Minimum Price Fluctuation
See Tick.

Naked Option
See Uncovered Option.

National Futures Association (NFA)
Authorized by Congress in 1974 and designated by the CFTC in 1982 as a “registered futures association,” NFA is the industrywide self-regulatory organization of the futures industry.

Nearby Delivery Month
The futures contract month closest to expiration. Also referred to as the Spot Month.

Net Asset Value
The value of each unit of participation in a commodity pool. Basically a calculation of assets minus liabilities plus or minus the value of open positions when marked to the market, divided by the total number of outstanding units.

Net Performance
An increase or decrease in net asset value exclusive of additions, withdrawals and redemptions.

Offer
An indication of willingness to sell a futures contract at a given price; the opposite of Bid.

Offset
See Liquidate.

Omnibus Account
An account carried by one Futures Commission Merchant (FCM) with another FCM in which the transactions of two or more persons are combined and carried in the name of the originating FCM rather than of the individual customers; the opposite of Fully Disclosed.

Open
The period at the beginning of the trading session officially designated by the exchange during which all transactions are considered made “at the open.”

Open Interest
The total number of futures or options contracts of a given commodity that have not yet been offset by an opposite futures or option transaction nor fulfilled by delivery of the commodity or option exercise. Each open transaction has a buyer and a seller, but for calculation of open interest, only one side of the contract is counted.

Open Outcry
A method of public auction for making bids and offers in the trading pits of futures exchanges.

Open Trade Equity
The unrealized gain or loss on open positions.

Opening Range
The range of prices at which buy and sell transactions took place during the opening of the market.

Option Buyer
The purchaser of either a call or put option. Option buyers receive the right, but not the obligation, to assume a futures position. Also referred to as a Holder.

Option Contract
A contract which gives the buyer the right, but not the obligation, to buy or sell a specified quantity of a commodity or a futures contract at a specific price within a specified period of time. The seller of the option has the obligation to sell the commodity or futures contract or to buy it from the option buyer at the exercise price if the option is exercised. See also Call Option and Put Option.

Option Premium
The price a buyer pays (and a seller receives) for an option. Premiums are arrived at through the market process. There are two components in determining this price—extrinsic (or time) value and intrinsic value.

Option Seller
See Writer.

Out-of-the-Money Option
A call option with a strike price higher or a put option with a strike price lower than the current market value of the underlying asset (i.e., an option that does not have any intrinsic value).
**Over-the-Counter Market (OTC)**
A market where products such as stocks, foreign currencies and other cash items are bought and sold by telephone, Internet and other electronic means of communication rather than on a designated futures exchange.

**Pit**
The area on the trading floor where trading in futures or options contracts is conducted by open outcry. Also referred to as a ring.

**Pool**
See Commodity Pool.

**Position**
A commitment, either long or short, in the market.

**Position Limit**
The maximum number of speculative futures contracts one can hold as determined by the CFTC and/or the exchange where the contract is traded. See also Price Limit, Variation Limit.

**Position Trader**
A trader who either buys or sells contracts and holds them for an extended period of time, as distinguished from a day trader.

**Premium**
Refers to (1) the price paid by the buyer of an option; (2) the price received by the seller of an option; (3) cash prices that are above the futures price; (4) the amount a price would be increased to purchase a better quality commodity; or (5) a futures delivery month selling at a higher price than another.

**Price Discovery**
The determination of the price of a commodity by the market process.

**Price Limit**
The maximum advance or decline, from the previous day's settlement price, permitted for a futures contract in one trading session. Also referred to as Maximum Price Fluctuation. See also Position Limit, Variation Limit.

**Purchase and Sale Statement (P&S)**
A statement sent by a Futures Commission Merchant to a customer when a futures or options position has been liquidated or offset. The statement shows the number of contracts bought or sold, the prices at which the contracts were bought or sold, the gross profit or loss, the commission charges and the net profit or loss on the transaction. Sometimes combined with a Confirmation Statement.

**Put Option**
An option which gives the buyer the right, but not the obligation, to sell the underlying futures contract at a particular price (strike or exercise price) on or before a particular date.

**Quotation**
The actual price or the bid or ask price of either cash commodities or futures or options contracts at a particular time.

**Range**
The difference between the high and low price of a commodity during a given trading session, week, month, year, etc.

**Regulations (CFTC)**
The regulations adopted and enforced by the CFTC in order to administer the Commodity Exchange Act.

**Reparations**
The term is used in conjunction with the CFTC's customer claims procedure to recover civil damages.

**Reportable Positions**
The number of open contracts specified by the CFTC when a firm or individual must begin reporting total positions by delivery month to the authorized exchange and/or the CFTC.

**Round Turn**
A completed futures transaction involving both a purchase and a liquidating sale, or a sale followed by a covering purchase.

**Rules (NFA)**
The standards and requirements to which participants who are required to be Members of National Futures Association must subscribe and conform.
Scalper
A trader who trades for small, short-term profits during the course of a trading session, rarely carrying a position overnight.

Segregated Account
A special account used to hold and separate customers' assets for trading on futures exchanges from those of the broker or firm. Also referred to as Customer Segregated Funds.

Self-Regulatory Organization (SRO)
Self-regulatory organizations (i.e., the futures exchanges and National Futures Association) enforce minimum financial and sales practice requirements for their members. See also Designated Self-Regulatory Organization.

Settlement Price
The last price paid for a futures contract on any trading day. Settlement prices are used to determine open trade equity, margin calls and invoice prices for deliveries. Also referred to as Closing Price.

Short
One who has sold futures contracts or plans to purchase a cash commodity.

Speculator
A market participant who tries to profit from buying and selling futures and options contracts by anticipating future price movements. Speculators assume market price risk and add liquidity and capital to the futures markets.

Spot
Usually refers to a cash market for a physical commodity where the parties generally expect immediate delivery of the actual commodity.

Spot Month
See Nearby Delivery Month.

Spreading
The buying and selling of two different delivery months or related commodities in the expectation that a profit will be made when the position is offset.

Stop Order
An order that becomes a market order when the futures contract reaches a particular price level. A sell stop is placed below the market, a buy stop is placed above the market.

Strike Price
The price at which the buyer of a call (put) option may choose to exercise his right to purchase (sell) the underlying futures contract. Also called Exercise Price.

Technical Analysis
An approach to analysis of futures markets which examines patterns of price change, rates of change, and changes in volume of trading, open interest and other statistical indicators. See also Charting.

Tick
The smallest increment of price movement for a futures contract. Also referred to as Minimum Price Fluctuation.

Time Value
The amount of money options buyers are willing to pay for an option in anticipation that over time a change in the underlying futures price will cause the option to increase in value. In general, an option premium is the sum of time value and intrinsic value. Any amount by which an option premium exceeds the option's intrinsic value can be considered time value. Also referred to as Extrinsic Value.

Uncovered Option
A short call or put option position which is not covered by the purchase or sale of the underlying futures contract or physical commodity. Also referred to as a Naked Option.

Underlying Futures Contract
The specific futures contract that the option conveys the right to buy (in case of a call) or sell (in case of a put).

Variable Limit
A price system that allows for larger than normal allowable price movements under certain conditions. In periods of extreme volatility, some exchanges permit trading at price levels that exceed regular daily price limits. See also Position Limit, Price Limit.
Variation Margin
Additional margin required to be deposited by a clearing member firm to the clearinghouse during periods of great market volatility or in the case of high-risk accounts.

Volatility
A measurement of the change in price over a given time period.

Volume
The number of purchases and sales of futures contracts made during a specified period of time, often the total transactions for one trading day.

Writer
A person who sells an option and assumes the potential obligation to sell (in the case of a call) or buy (in the case of a put) the underlying futures contract at the exercise price. Also referred to as an Option Grantor.

Yield
A measure of the annual return on an investment.