

# Supplemental Terms for Using Margin in Your IRA to Execute Options Spreads

You hereby acknowledge and agree that the following terms, conditions and disclosures relate to your account and are part of the Account Agreement between each account holder and optionsXpress, Inc. ("optionsXpress"). Please read and retain for your files.

## 1. Eligibility and Limitations

- Securities regulations require that Options Spreads occur in a margin account. Your IRA will be subject to the initial and maintenance requirements for margin accounts.
- Your IRA must be approved for Options Spreads trading.
- Options Spreads trading is available to authorized agents only with a Limited Trading Agreement on file.
- If your account is a SEP-IRA or SIMPLE IRA account, you hereby represent that there are no employees participating in the SEP-IRA or SIMPLE IRA and that you meet one of the following criteria:
  - (1) You are the sole proprietor (who individually or with a spouse owns 100% of an unincorporated business);
  - (2) You are a partner of a partnership
  - (3) You are a sole shareholder of the corporation (who individually or with a spouse owns 100% of the corporation); or
  - (4) You are a spouse of an individual described in (1), (2), or (3).

If now or at any time in the future, the SEP-IRA or SIMPLE IRA plan and/or you no longer meet the above criteria, you understand that your account will no longer be eligible for Options Spreads trading, and you agree to immediately notify optionsXpress regarding this change in status.

- These Supplemental Terms to your Account Agreement do not purport to disclose all of the risks and other significant aspects of trading Options Spreads in your IRA. Because there can be serious consequences to these risks, you should carefully consider whether trading in Options Spreads is appropriate for you in light of your experience, knowledge, objectives, financial resources, retirement goals and resources, and other relevant circumstances.

## 2. Authorization and Acceptance of Risks

By applying to add the Options Spreads trading feature to your IRA, you represent that you:

- Understand the risks and potential tax consequences inherent in using margin in your IRA to execute Options Spreads;
- Are financially able to withstand trading losses, including the loss of your entire investment, and the potential tax consequences associated with using margin in your IRA;

- Understand that if you pledge any part of your IRA as security for a loan, the part that you pledge may be treated as a “deemed” distribution to you which may result in tax consequences to you.
- Have determined that Options Spreads trading is suitable for you, considering your financial situation, investment objectives, retirement goals and resources, and other relevant circumstances; and
- Have made this request to engage in Options Spreads trading in your IRA entirely on your own initiative, and the decision to engage in such Options
- Your Options Spreads trading is solely your own. Your decision to engage in Options Spreads trading was not directly or indirectly solicited, nor was any recommendation made, by optionsXpress or any of its affiliates, agents or employees.
- You understand that IRS rules regarding the trading of Options Spreads in your IRA are complex and that optionsXpress has not offered or provided you with any tax advice with respect to your decision to trade Options Spreads in your IRA. You further acknowledge and agree that a determination by optionsXpress to treat a transaction as having a particular tax consequence is for the protection of optionsXpress and not a guarantee that the IRS will treat the transaction in the same manner.

### **3. Acknowledgement of Risks of Options Spreads**

You should be aware that while Options Spreads can sometimes be considered an approach to reduce trading risks, there are serious consequences that can result from executing Options Spreads in your IRA. Some, though not all, of the risks that you should consider before trading Options Spreads include:

- *Early Exercise and Assignment Can Create Risk and Loss*

Options Spreads are subject to early exercise or assignment. All American-style short option positions are liable for assignment at any time. We allocate exercise assignment notices among customer short positions according to an automated procedure. This procedure randomly selects from among all customer short option positions (including positions established on the date of assignment) those contracts that are subject to exercise. You acknowledge that the assignment process may result in multiple partial assignments and/or multiple transactions to fulfill a single assignment, and a separate commission charge will apply to each partial assignment or transaction needed to complete an assignment.

These early assignments can not only remove the very protection that you may have been seeking, but can lead to margin calls and greater losses than anticipated when you entered the trade.

- *Execution of Spread Orders Is Often “Not Held” and at the Discretion of the Marketplace*

Because Options Spreads are a combination of standardized put and call contracts, they have no benchmarks such as “time and sales” or “NBBO” (National Best Bid/Offer); therefore, the “market” cannot be “held” to a price

- *Spread Pairing*

When you establish a spread position, the purchased option is required to expire in the same or later date than the option sold. When there is more than one possible way to pair available options

in your IRA, the systems of optionsXpress determine spread pairings and may pair options in a manner that does not produce the lowest-possible margin requirements.

- *Spreads Are Bona-Fide Trades and Not “Legged” or “Paired” of Individual Separate Trades*

Consolidated quotes may be confusing when trading Options Spreads. An option may be offered on one exchange and bid on another exchange that can lead the investor to believe that a spread order should be filled, when, in fact, the bids and offers must be on the SAME exchange. All bona-fide spreads are routed and executed on one exchange.

- *Spreads Are Generally Entered on a Single Exchange and Are Acted Upon by a Market Maker or Floor Broker*

Spreads are executed at the discretion of a market maker or floor broker and when cancelled or filled may require that the market maker take manual action and require manual reporting at times. Delays for reporting of fills and cancels may create additional risks in fast or changing markets.

- *Closing Transactions May Not Be Possible*

If a secondary market in options were to become unavailable, investors could not engage in closing transactions, and an option writer would remain obligated for indefinite periods or until expiration or assignment.

- *Risks of Put Spreads*

In the case of put spreads, optionsXpress may take action in your Account to make available funds needed for you to maintain the resulting equity position. This action may include, without limitation, exercising the long side of the spread, selling the long side of the spread, or selling other option or equity positions in your account to cover any potential deficit condition.

- *Risks of Call Spreads*

In the case of call spreads, if there is an assignment on the short side of the spread, optionsXpress may take action in your Account to close out the resulting short equity position. This action may include, without limitation, exercising the long side of the spread, selling the long side of the spread, or selling other option or equity positions in your Account to generate sufficient cash to cover the closing transaction of the short position.

#### **4. Acknowledgement of Tax Risks in Using Margin in Your IRA to Execute Options Spreads**

- *General Tax Considerations*

Under Section 408(e)(4) of the Internal Revenue Code, if an account holder uses his or her IRA or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual. optionsXpress does not give tax advice. You should consult with a professional tax advisor prior to agreeing to the Supplemental Terms for Using Margin in Your IRA to Execute Options Spreads to determine any tax implications for you and your IRA with respect to using margin in your IRA and engaging in Options Spreads trading.. In addition, if there is an actual extension of credit as a result of the margin account (e.g., failed margin call), optionsXpress may be required to report the transaction as a taxable distribution from your IRA.

- *Deemed Distributions and Withholding*

Deemed distributions from an IRA are subject to the same withholding requirements that apply to regular distributions—10% withholding on the taxable portion. In the event of a deemed distribution as a result of the margin account, the IRA owner elects out of income tax withholding. However, you remain liable for the tax to the IRS and any applicable state taxing authorities. Account holders under age 59½ may also be subject to a 10% early withdrawal penalty. Should there be a deemed distribution, optionsXpress will be required to report the deemed distribution to the IRS on Form 1099-R. You will also have an obligation to report any deemed distributions to the IRS.

- *Deemed Contributions*

Deemed contributions may arise where there are failed margin calls and loan write-offs. optionsXpress will be required to report on Form 5498 any deemed contributions to the IRA. In addition, deemed contributions may also subject you to a 6% excise tax.

- *Unrelated Business Income Tax (UBIT)*

IRAs are subject to UBIT. Income attributable to debt actually incurred by your IRA is likely to be taxable to the IRA at your individual tax rate.

- *Limits on Additional Contributions*

Trades requiring margin, including American-style Options Spreads, may require a deposit of additional funds to your account to maintain sufficient margin. However, the Internal Revenue Code places restrictions and limits on the amount of funds that can be contributed to an IRA in any tax year. Deposits to the account in excess of such limits may result in adverse tax consequences to you, including, but not limited to, forfeiture of tax advantages and/or the risk of penalties imposed by the IRS.

## **5. Margin Terms and Disclosure of Credit Policies for Margin Accounts Within IRAs**

- *Payment for Transactions*

When you execute Options Spreads in the margin portion of your IRA, you should have the required initial equity in your account and maintain your equity at the required levels. However, optionsXpress reserves the right to liquidate at any time (including on or before the settlement date) depending on market conditions. In addition, you agree to contribute to your IRA as necessary to pay any debit remaining. You understand that such a contribution could have adverse tax consequences to you. Option transactions are settled on the first business day after the day your order is executed. We may decline to accept your order to purchase option contracts if there are not sufficient cleared funds (that is, funds on which no holds or other restrictions are imposed) available in your IRA to pay the purchase price, if you do not have sufficient equity in your IRA to meet applicable margin requirements or for other reasons subject to our discretion. In all cases, Options Spreads must be settled on the first business day after the day your order is executed, and it is your responsibility to have the necessary funds and maintain sufficient equity in your IRA account.

- *Maintenance of Collateral*

You represent that Options Spreads in your IRA will not require collateral or result in liabilities or obligations in excess of the value of the assets in your IRA. You agree that a sufficient cash balance will be available in your IRA to cover any potential assignment arising from any Options Spreads. If an assignment creates a short position or debit balance in the margin portion of your IRA, the deficit condition will be covered immediately with assets in your IRA. You understand that amounts available for purchases within your IRA may be limited due to amounts needed to satisfy margin obligations. You further understand that transactions in an IRA account are financially supported only by cash and assets in that account. any one IRA. Purchases and sales are never collateralized by cash or securities in another IRA or brokerage account.

- *Liquidation*

If you do not maintain enough equity in your IRA to secure your option obligations adequately, or if you do not satisfy, in a timely manner, any money or collateral call (relating to settlement of a trade or otherwise), we may (but are not required to), without prior notice, take any action with respect to and for your IRA that we, in the reasonable exercise of our business judgment, consider necessary for our protection. **Holders of long options in an IRA MUST have a cash balance equal to or greater than the requirement (“Requirements Cash”) to exercise the options in the Account on the last trading day prior to expiration or we may close out the position in the open market on a “best-effort” basis prior to the market close.** Please take note that Requirements Cash results from your decision, as the IRA Account Holder, to engage in certain options trades such as cash secured short puts and spreads. You agree that Requirement Cash will be excluded from the cash that otherwise would sweep to Charles Schwab Bank, as applicable to your Cash Feature. Instead, you authorize us to pay interest on the Requirement Cash as a Free Credit Balance, you understand that we may adjust the rate periodically and we intend generally to set the rate on Free Credit Balances by matching the same rate your Sweep Bank pays on your Deposit Accounts.

Whenever it is necessary for our protection or to satisfy a margin call, deficiency, debit or other obligation owed us, we may (but are not required to) sell, assign and deliver all or any part of the securities and other property in your IRA securing your obligations, or close any or all transactions in your IRA. With respect to your Options Spreads transactions associated with your IRA margin account, optionsXpress will not seek collateral from any of your other accounts as security for your obligations in your IRA.

It is our policy to attempt to contact you, when practicable, before taking any action described in this section. However, we reserve the right to take any such action without prior notice or demand for additional collateral, and free of any right of redemption. Any prior demand, call or notice will not be considered a waiver of our right to sell or buy without demand, call or notice.

We may choose which securities or other property in your IRA to buy or sell, which transactions to close, and the sequence and timing of liquidation. We may take such actions on whatever exchange or market and in whatever manner (including public auction or private sale) that we choose in the exercise of our business judgment. You agree not to hold us liable for the choice of which securities or other property to buy or sell, or of which transactions to close, or for the timing or manner of the liquidation.

You agree to pay on demand any account deficiencies after liquidation, whether liquidation is complete or partial.

You are responsible for monitoring the status of your Account, for ensuring that sufficient collateral is maintained in the Account and for liquidating positions to minimize losses. Any action we take or do not take to issue a margin call or liquidate collateral is undertaken solely to protect our interest

as a creditor. You agree that we do not have any responsibility to issue a margin call, to liquidate positions in your Account or to select the securities to be liquidated or the manner or timing of the liquidation in order to prevent or minimize losses to you.

- *Short Sales and Other Borrowing*

optionsXpress will not permit the borrowing of funds or the ability to have a debit balance in your IRA. You may not sell stock short or sell naked (uncovered) calls.

- *Interest on Debit Balances*

Debit balances are not permitted in your IRA. No other interest will be charged.

- *Account Agreement*

All transactions in the margin portion of your IRA are subject to this Agreement in its entirety and any other written agreements between you and optionsXpress, all as amended from time to time. In the event of a conflict between the terms of this Agreement and any other agreement to which optionsXpress or any of its affiliates and you are parties, the terms of this Agreement will control.

## 6. Release

You acknowledge and agree that neither optionsXpress nor any of its officers, directors, employees, agents or representatives will have any liability for any consequential, incidental, special, exemplary, punitive or any other damages with respect to your decision to engage in Options Spreads in your IRA. To the extent permitted by law, you agree to indemnify optionsXpress and each person named above from any and all liability or responsibility for any and all claims of whatever nature, losses, costs, charges, fees, expenses, penalties and damages in any way arising from or as a result of optionsXpress's effecting and/or executing any Options Spreads in your IRA, or the failure or breach at any time of any representation, warranty or covenant made by you in this Agreement.

## 7. Margin Risk Disclosure

**The following is a copy of our standard Margin Risk Disclosure statement. Notwithstanding the general purpose of this disclosure for traditional margin accounts, the margin account associated with your IRA is limited to option spread margin requirements and may not be used for borrowing.**

When considering the use of a margin account, you should determine how the use of margin fits your own investment philosophy. Because of the risks involved, it is important that you fully understand the rules and requirements involved in trading securities on margin. The following paragraphs highlight some of these critical aspects of margin trading:

- *Margin trading increases your level of market risk.*

Margin trading increases your buying power, allowing you to purchase a greater amount of securities with your investing dollar. Therefore, your exposure to market volatility increases—a declining market could result in even greater losses. **A decline in the value of your securities that you purchase on margin may require you to provide additional funds to optionsXpress in order to avoid the forced sale of those securities or other securities in your Account.**

- *Your downside is not limited to the collateral value in your margin account.*

If the securities in your account decline in value, so does the value of the collateral supporting your loan. When the value of the collateral falls below the maintenance margin requirements, or optionsXpress's higher "house" requirements, optionsXpress can move to protect its position. In order to cover margin deficiencies, optionsXpress may issue you a margin call—a request for additional cash—or sell securities from your account. If a sale does not cover the deficiency, you will be responsible for any shortfall.

- *optionsXpress may initiate the sale of any securities in your account, without contacting you, to meet a margin call.*

optionsXpress will attempt to involve you in the case of margin deficiency; however, market conditions may require the firm to quickly sell any of your securities without your consent. optionsXpress has the right to decide which securities to sell in order to protect its interests. Even if optionsXpress has contacted you and provided a specific date by which you can meet a margin call, the firm can still take necessary steps to protect its financial interests, including immediately selling the securities without prior notice to you.

- *optionsXpress may increase its "house" maintenance margin requirements at any time and is not required to provide you with advance written notice.*

Changes in optionsXpress's policy regarding "house" maintenance margin requirements often take effect immediately and may result in the issuance of a maintenance margin call. Your failure to satisfy the call may cause optionsXpress to liquidate or sell securities in your Account.

- *You are not entitled to an extension of time on a margin call.*

While an extension of time to meet margin requirements may be available to customers under certain conditions, a customer does not have a right to the extension.