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The British Put Option

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Abstract

We present a new put option where the holder enjoys the early exercise feature of American options whereupon his payoff (deliverable immediately) is the 'best prediction' of the European payoff under the hypothesis that the true drift of the stock price equals a contract drift. Inherent in this is a protection feature which is key to the British put option. Should the option holder believe the true drift of the stock price to be unfavourable (based upon the observed price movements) he can substitute the true drift with the contract drift and minimize his losses. The practical implications of this

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to the conclusions above and shows that with the contract drift properly selected the British put option becomes a very attractive alternative to the classic American put.

Q Key Words:

British put option

American put option

European put option

arbitrage-free price

rational exercise boundary

liquid/illiquid market

geometric Brownian motion

optimal stopping

parabolic free-boundary problem

nonlinear integral equation

local time-space calculus

non-monotone free boundary

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