

Sen Finance FIN301, Derivatives, Practice Questions - I
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Question 1: Which of the following is not a usual feature of a derivative contract?

- A) Settlement Date
- B) Face Value
- C) Underlying
- D) All the above are usual features

Question 2: There is credit risk for derivatives that are:

- | | Exchange Traded | Over the Counter |
|----|-----------------|------------------|
| A) | Yes | Yes |
| B) | Yes | No |
| C) | No | Yes |
| D) | No | No |

Question 3: I) "Marking to Market" is done for OTC traded derivatives and decreases the possibility of default.

II) "Marking to Market" is done for exchange traded derivatives and increases the possibility of default.

I&II are: A) TT B) TF C) FT D) FF

Question 4: For a Forward contract we have:

- | | Price Decided | Delivery or Settlement |
|----|---------------|------------------------|
| A) | Today | Today |
| B) | Today | Future |
| C) | Future | Today |
| D) | Future | Future |

Question 5: Suppose on Jan 1, 20X0 you enter into a contract to deliver 1,000 IBM shares with settlement date April 1, 20X0 with price \$30 per share. On settlement date the price of IBM is \$30.75. Your net cash flow due to the contract is:

- A) -\$30,750
- B) -\$750
- C) +\$750
- D) +\$30,750

Information for questions 6 & 7: Suppose on July 1, 20X2 you enter into a forward contract to deliver 1,000 IBM shares with settlement date July 1, 20X3 with price \$30.00 per share. There is no cash flows today. The riskless rate on July 1, 20X2 is 4.5% (six-month rate annualized).

Question 6: What is the forward price on July 1, 20X2?

- A) \$28.71
- B) \$29.34
- C) \$30.00

D) \$31.37

Question 7: Suppose on Jan 1, 20X3 the price of IBM in the market is \$32.80. The riskless rate on Jan 1, 20X3 is 6% (six-month rate annualized). What is the value of your forward contract on Jan 1, 20X3?

- A) -2.42
- B) -\$2.35
- C) +\$2.35
- D) +\$2.42

Question 8: A call option on a stock has a strike price of \$50. The premium paid for the call was \$5. Currently the price of the stock is \$54. The intrinsic value of the call is:

- A) 4
- B) 1
- C) -1
- D) 54

Question 9: I) A forward contract does not involve cash flows at inception.

II) Cash settlement is common for forward contracts on financial assets.

I&II are: A) TT B) TF C) FT D) FF

Question 10: I) In Contango the prices for future delivery are higher than spot prices.

II) In Backwardation the prices for near future delivery are lower than prices for delivery farther in the future.

I&II are: A) TT B) TF C) FT D) FF

Question 11: I) Higher storage costs can lead to prices being in contango.

II) Convenience yield can be a reason for oil prices being in contango during the summer driving season (when demand for oil is higher than average).

I&II are: A) TT B) TF C) FT D) FF

Question 12: Forward of 100 GOOG shares with Settlement Date of January 1, 20X4 while today is January 1, 20X2. Price of GOOG today is \$500. Each July 1 GOOG will pay a dividend of \$20 per share. Discount rate is 2.5% per six months (not annualized). The forward price $F(0,T)$ is:

- A) 518.55
- B) 520.76
- C) 511.73
- D) 609.20

- 1) B
- 2) C
- 3) D
- 4) B

- 5) C
- 6) D*
- 7) C
- 8) B*
- 9) A
- 10) B
- 11) C
- 12) B

Answer 6: Annual rate by convention reported as twice six-month rate. Therefore, six month rate is $4.5\%/2 = 2.25\%$. Also financial assets like shares do not incur storage costs.

Answer 8: Intrinsic value is the amount by which the call is in the money.

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