QBank Quiz December 1, 2017

Test ID: 59459976

Question #1 of 211

Question ID: 605818

If an investor is bearish on the overall market, with no particular opinion on any individual stock, he will *most* likely:

I. buy index calls.
II. buy index puts
III. write index calls.
IV. write index puts.

✓ **A)** II and III.
✗ **B)** II and IV.
✗ **C)** I and IV.
✗ **D)** I and III.

Explanation

Index options are useful for investors who have few opinions about individual stocks and who look at the market overall. If they are bearish, they choose short calls or long puts. Investors who are bullish on the overall market buy calls or sell puts.

Reference: 4.5.1.2 in the License Exam Manual

Question #2 of 211

Question ID: 605814

An investor has a diversified portfolio of common stock with a market value of $1.7 million and a beta of 1.20. If the OEX (S&P 100) is currently quoted at 680, to protect the portfolio against a decline in value, the investor's *best* strategy is to buy:

✗ **A)** 30 calls.
✗ **B)** 25 calls.
✓ **C)** 30 puts.
✗ **D)** 25 puts.

Explanation

Buying puts is the most effective strategy to hedge the risk of decline in a stock portfolio's market value. To determine the number of option contracts necessary to hedge, divide the portfolio value ($1.7 million) by the market value of the index (68,000). Multiply the result (25) by the beta of 1.20. The result is 30 contracts.

Reference: 4.5.1.2 in the License Exam Manual

Question #3 of 211

Question ID: 605862

The individual responsible for the overall supervision of all of a firm's options activities on behalf of its customers must be:

✗ **A)** the financial and operations principal.
✗ **B)** the general securities principal.
✗ **C)** an office manager.
✓ **D)** a registered options principal (ROP).

Explanation

Any firm that transacts options trades will have a registered options principal to oversee trading and a registered options principal designated to carry the ultimate responsibility of supervision and to ensure that options compliance procedures are followed.

Reference: 4.6.3.2 in the License Exam Manual

Question #4 of 211

Question ID: 605796

IBM sold computers to a Soho retailer and agreed to accept payment of 10 million British pounds in 65 days. In which of the following ways could the company protect the payment against adverse foreign currency fluctuations?

- ✗ **A)** Buy pound calls and/or sell pound puts.
- ✗ **B)** Buy U.S. dollar puts and/or sell U.S. dollar calls.
- ✓ **C)** Buy pound puts and/or sell pound calls.
- ✗ **D)** Buy U.S. dollar calls and/or sell U.S. dollar puts.

Explanation

If the company wants to protect its investment, it has to protect against the payment going down in value relative to the cost. To protect against the value of the payment going down in relation to the cost, the company would buy puts on the payment currency. To offset the cost of the puts, the company will also sell calls. The calls will be covered by the ownership of the actual currency.

Reference: 4.5.3.1.8 in the License Exam Manual

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Question ID: 605933

If a customer buys 1 FLB Oct 50 call at 3 and she exercises the option to buy 100 shares when the market is at 60, what is the cost basis of the 100 shares?

- ✗ **A)** 6300.
- ✗ **B)** 6000.
- ✗ **C)** 5000.
- ✓ **D)** 5300.

Explanation

The cost basis of the 100 shares is the total amount the investor spent to acquire them. She paid $300 to purchase the call option. When she exercised the call, she purchased 100 shares of FLB at $50 per share for $5,000, so the cost basis is $5,300.

Reference: 4.7.0.3 in the License Exam Manual

Question #6 of 211

Question ID: 605783

Listed options on U.S. exchanges are available on all of the following currencies EXCEPT the:

- ✓ **A)** U.S. dollar.
- ✗ **B)** Canadian dollar.
- ✗ **C)** Euro.
- ✗ **D)** Japanese yen.

Explanation

In the U.S., exchange listed currency option contracts exist on foreign currencies, not on the U.S. dollar. With U.S. exchange listed currency option contracts, the U.S. dollar is the base currency to which movements in the foreign currency is compared.

Reference: 4.5.3 in the License Exam Manual

Question #7 of 211

Question ID: 605781

A foreign company that exports its products to the United States wishes to protect itself during a time in which the U.S. dollar is expected to be devalued. The company should:

I. buy U.S. dollars.
II. sell U.S. dollars.
III. buy foreign currency.
IV. sell the foreign currency.

- ✓ **A)** II and III.
- ✗ **B)** III and IV.
- ✗ **C)** I and III.

✗ **D)** II and IV.

Explanation

If the company expects the U.S. dollar to become devalued, that means that the foreign currency will become worth more. It would make sense at this time, therefore, for the company to get rid of its U.S. dollars, which are expected to decline in value, and acquire the foreign currency, which will appreciate relative to the U.S. dollar.

Reference: 4.5.3 in the License Exam Manual

Question #8 of 211

Question ID: 605871

If at expiration for XYZ options, XYZ stock closes at 40.15 which of the following open option positions will automatically be exercised by the OCC?

✗ **A)** A member firm long 1 XYZ 45 call.
✓ **B)** A customer long 1 XYZ 40 call.
✗ **C)** A customer long 1 XYZ 40 put.
✗ **D)** A member firm long 1 XYZ 40 put.

Explanation

At expiration, the OCC will automatically exercise open option positions if those positions are in-the-money by .01 or more. In this case, the customer's long 40 call position is in-the-money by .15. The member firm 45 call and the 40 puts are out-of-the-money.

Reference: 4.6.1.4 in the License Exam Manual

Question #9 of 211

Question ID: 605908

If LEAPS options positions are maintained for more than 12 months, which of the following statements are TRUE?
I. The LEAPS writer's gains are taxed as short-term gains.
II. The LEAPS writer's gains are taxed as long-term gains.
III. The LEAPS buyer's gains are taxed as short-term gains.
IV. The LEAPS buyer's gains are taxed as long-term gains.

✗ **A)** I and III.
✓ **B)** I and IV.
✗ **C)** II and IV.
✗ **D)** II and III.

Explanation

The LEAPS writer's premium is taxed as a short-term gain. The LEAPS buyer took a position for longer than 12 months, so any profits are considered long-term capital gains. The writer's gain is short term because by opening with a sale, a holding period is never established.

Reference: 4.7.0.1 in the License Exam Manual

Question #10 of 211

Question ID: 605842

A customer should receive a current option disclosure document before or at the date of:

✗ **A)** settlement.
✓ **B)** account approval.
✗ **C)** the first trade.
✗ **D)** the first monthly statement.

Explanation

The customer must receive a current disclosure document at or before the time his account receives approval for option trading.

Reference: 4.6.3 in the License Exam Manual

Question #11 of 211

Question ID: 605573

A customer sells 3 ABC Feb 25 puts at 4 when ABC is at 24. If the contracts are closed out at intrinsic value when ABC is at 19, the customer has a:

- ✓ **A)** $600 loss.
- ✗ **B)** $200 loss.
- ✗ **C)** $200 gain.
- ✗ **D)** $600 gain.

Explanation

Because the investor sold the puts for a total of $1,200 to open his position, he must buy the options to close out his position. If he buys back the puts when ABC is at 19, the intrinsic value at that time is 6 because puts are in-the-money when the market price is below the strike price (25 − 19 = 6). He pays a total of $1,800 to close out his 3 contracts and, because he paid more than he received, incurs a loss of $600.

Reference: 4.2.8 in the License Exam Manual

Question #12 of 211

Question ID: 605858

Under OCC rules regarding options communications with the public, if an educational piece making no projected performance figures or recommendations is distributed to customers it:

- ✗ **A)** can only be distributed to retail customers.
- ✗ **B)** can only be distributed to institutional customers.
- ✓ **C)** need not be preceded by an options disclosure document (ODD).
- ✗ **D)** need not be approved by a registered options principal.

Explanation

OCC communications rules do not distinguish between retail and institutional customers. Therefore their communications rules apply to all customers. All communications pieces must be approved by a registered options principal (ROP). If the educational piece makes no recommendations or performance projections it need not be preceded by an options disclosure document (ODD) but it must be accompanied by a notice containing a name and address where the ODD can be obtained.

Reference: 4.6.3.2 in the License Exam Manual

Question #13 of 211

Question ID: 605934

If a customer writes 1 Jul 80 put at 7 and the put is exercised when the market price is at 70, for tax purposes, what is the effective cost basis of the stock put to the seller?

- ✗ **A)** 70.
- ✗ **B)** 87.
- ✓ **C)** 73.
- ✗ **D)** 80.

Explanation

The cost basis is 80 (price at which the writer must buy) minus 7 (premium the writer was paid), or $73 per share.

Reference: 4.7.0.3 in the License Exam Manual

Question #14 of 211

Question ID: 605837

Which of the following are characteristics of the volatility market index (VIX)?

I. It is a bullish or bearish measure.
II. It is a measure of implied expectations of market volatility.
III. It is often referred to as the CBOE index
IV. It is often referred to as the "fear" index.

- ✗ **A)** I and IV.

- ✗ **B)** II and III.
- ✓ **C)** II and IV.
- ✗ **D)** I and III.

Explanation

The VIX (volatility market index) is a measure of investors' expectations regarding market volatility. High or low readings are neither bullish nor bearish but instead reflect expectations of volatility in the S&P 500 over the next 30 days. This index is referred to as the "fear" index and VIX options are traded on the CBOE.

Reference: 4.5.1 in the License Exam Manual

Question #15 of 211

Question ID: 605907

The put-call ratio can be used to

- ✗ **A)** calculate how many options contracts are needed to hedge a stock position
- ✗ **B)** determine a stocks beta
- ✗ **C)** determine which institutional trading desks are trading options
- ✓ **D)** gauge investor sentiment as being either bullish or bearish

Explanation

The put-call ratio reflects the current open interest in the trading of put options to call options for a single stock, the broad market, or any market sector. The ratio can be used as a gauge of investor sentiment (bullish or bearish). The higher the ratio is, the more bearish an indicator it is.

Reference: 4.6.3.5.1 in the License Exam Manual

Question #16 of 211

Question ID: 605855

If your client was recently approved to trade options and writes 1 XYZ Oct 60 put, but fails to return the signed option agreement within 15 days of account approval, which of the following orders could you accept?

- ✗ **A)** Buy 1 XYZ Jan 55 put.
- ✗ **B)** Buy 1 XYZ Jan 60 put.
- ✗ **C)** Buy 1 XYZ Oct 55 put.
- ✓ **D)** Buy 1 XYZ Oct 60 put.

Explanation

If a customer fails to return a signed options agreement within 15 days of account approval, your firm can permit closing transactions only. While the customer may offset his existing position, he may not offset a short position in an Oct 60 put by buying an XYZ put with a different expiration month and/or a different strike price.

Reference: 4.6.3.1 in the License Exam Manual

Question #17 of 211

Question ID: 605900

Assuming ABC is subject to a 60,000 contract position limit, which of the following customer accounts are in violation of the exchange's position limits?

I. Long 35,000 ABC January calls; long 30,000 ABC January 08 LEAP calls.
II. Long 35,000 ABC March calls; long 30,000 ABC March puts.
III. Long 35,000 ABC March calls; short 30,000 ABC January 08 LEAP calls.
IV. Long 35,000 ABC March calls; short 30,000 ABC March puts.

- ✗ **A)** II and IV.
- ✓ **B)** I and IV.
- ✗ **C)** III and IV.
- ✗ **D)** I and II.

Explanation

The maximum limit for ABC is 60,000 contracts on the same side of the market. The upside is long calls and short puts; the down side is long puts and short calls. LEAPs are included in the calculation.

Reference: 4.6.1.5 in the License Exam Manual

Question #18 of 211

Question ID: 605791

Which of the following describes the position in a call option on a Swiss franc with a strike price of 120, a premium of 7, and a current market of 126?

- ✗ **A)** Out-of-the-money.
- ✗ **B)** At the money.
- ✓ **C)** In-the-money.
- ✗ **D)** At parity.

Explanation

In this case, the strike price is less than the market price so a call option would be in-the-money by the difference between the strike price and the market price (6 points, in this case). At-the-money means the strike price and the market price are the same; at parity means the premium equals the intrinsic value.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #19 of 211

Question ID: 605582

A registered representative makes the following comment to his client, "Writing options is a good way to increase your income on this stock." Which of the following should be included with this comment?

- ✗ **A)** You will gain the option premium, with no chance of loss.
- ✗ **B)** Your stock covers the option, so you cannot lose.
- ✗ **C)** There is no other possible hedge on a long stock position.
- ✓ **D)** You may lose future profits and risk of loss is still possible.

Explanation

Because the registered representative is recommending covered call writing, he should also explain the risks involved.

Reference: 4.2.2.4 in the License Exam Manual

Question #20 of 211

Question ID: 786010

The writer of an in-the-money put will receive the upcoming dividend from the underlying issuer if the contract is exercised

- ✗ **A)** on or after the ex-date
- ✗ **B)** on the ex-date
- ✓ **C)** before the ex-date
- ✗ **D)** after the ex-date

Explanation

When assigned, the put writer is obligated to purchase the stock. Provided the stock is purchased before the ex-date, its buyer becomes the owner of record on or before the record date, and is therefore entitled to the dividend.

Reference: 4.6.1.3 in the License Exam Manual

Question #21 of 211

Question ID: 605793

If a Japanese exporter wants to hedge a recent sale of stereo equipment to a U.S. buyer, and the exporter will be paid in U.S. dollars upon delivery of the goods, the *best* hedge would be to:

- ✗ **A)** sell Japanese yen calls.

✗ **B)** sell Japanese yen puts.

✓ **C)** buy Japanese yen calls.

✗ **D)** buy Japanese yen puts.

Explanation

The Japanese exporter will be paid in U.S. dollars upon delivery of the equipment. He would be adversely affected if the dollar dropped in value in relation to the yen. To protect his position he should buy calls on his own currency, the yen. Then, if the yen appreciates, his loss on the dollar is offset by his gain on the calls. Exporters buy puts on foreign currency to hedge, but there are no options on the U.S. dollar. The next best strategy is to buy calls on the home currency.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #22 of 211

Question ID: 605882

When determining a position limit, a member firm aggregates which of the following customer positions?

I. Long calls and long puts.
II. Long calls and short puts.
III. Short calls and short puts.
IV. Short calls and long puts.

✗ **A)** I and III.

✓ **B)** II and IV.

✗ **C)** II and III.

✗ **D)** I and IV.

Explanation

Contracts on each side of the market are used for determining position limits. Long calls and short puts are on the same side (bullish); long puts and short calls are on the same side (bearish).

Reference: 4.6.1.5 in the License Exam Manual

Question #23 of 211

Question ID: 786006

If an investor maintaining a short equity option is assigned an exercise notice, which of the following statements is TRUE?

✗ **A)** He may refuse exercise under certain circumstances.

✓ **B)** He must accept the exercise notice.

✗ **C)** He may offset his obligation with a closing transaction until the end of trading on the same day.

✗ **D)** He may offset his obligation with a closing transaction within 3 days.

Explanation

Once exercised, a contract may not be traded to another individual. The assigned party must either deliver (for a call) or buy (for a put) the stock in 2 business days (regular way settlement for stock transactions).

Reference: 4.2.6 in the License Exam Manual

Question #24 of 211

Question ID: 605616

An investor establishes the following position:

Long 1 XYZ Jan 50 put at 2

The maximum potential gain on the position is

✗ **A)** unlimited.

✗ **B)** 200.

✓ **C)** 4800.

✗ **D)** 0.

Explanation

The maximum gain is calculated by subtracting the premium from the strike price (50 − 2 = 48 per share). One contract represents 100 shares, so the buyer's maximum gain is $4,800 (this occurs if the stock becomes worthless).

Reference: 4.2.3.4 in the License Exam Manual

Question #25 of 211

Question ID: 605825

An investor buys a yield-based Sept 70 call on a 30-year T-bond for a premium of 2.50. At expiration, if the yield on the most recently issued T-bond is 7.95%, what is the investor's gain or loss?

✓ **A)** $700 gain.
✗ **B)** $950 gain.
✗ **C)** $700 loss.
✗ **D)** $950 loss.

Explanation

A September 70 call means that the holder is buying a 7% yield. The investor can close the option at its intrinsic value: (7.95 − 7.00 = 0.95; 0.95 × 10 × $100 = $950 received upon close). Subtract $250 premium paid for a total profit of $700.

Reference: 4.5.2 in the License Exam Manual

Question #26 of 211

Question ID: 605578

Which of the following strategies would be considered *most* risky in a bull market?

✗ **A)** Writing naked puts.
✗ **B)** Buying calls.
✓ **C)** Writing naked calls.
✗ **D)** Buying a put.

Explanation

Writing naked calls provides unlimited liability and the most risk. Buying a call would be an attractive strategy in a bull market with risk limited to calls paid. Writing naked puts risks only the difference between the strike price and zero, less any premium received. Buying a put is a bearish strategy with risk limited to the amount paid for the put.

Reference: 4.2.2.6 in the License Exam Manual

Question #27 of 211

Question ID: 605937

A taxable gain or loss on a long call option transaction would be recognized when

I. the option is purchased.
II. the option expires.
III. the option is sold.
IV. the option is exercised.

✗ **A)** I and II.
✗ **B)** III and IV.
✓ **C)** II and III.
✗ **D)** I and IV.

Explanation

In addition to being exercised, call options can either be sold or allowed to simply expire. If either of these situations occurs, the owner of the call would determine his gain or loss (for tax purposes) at the time of expiration or sale. This would be determined by comparing what he paid for the call versus the price at which he sold the call. If it expires, the entire amount of the premium originally paid is considered a loss. Gains or losses are not determined at the time that calls are exercised. Once exercised, the underlying security must then be sold at the CMV. Then the owner of the call would calculate his profit or loss, taking into account the premium paid, what he paid for the stock, and what he subsequently sold the stock for.

Reference: 4.7.0.2 in the License Exam Manual

Question #28 of 211

Question ID: 605836

An investor holding a broad based diversified portfolio of stocks feels the market, which has slowed recently, may be poised for a brief fall before it continues an upward trend long-term. The investor does not want to incur the cost of selling a portion of their holdings nor the risk of mistiming the market. A possible strategy would be to:

- ✗ **A)** sell an index put option.
- ✗ **B)** sell an index call option.
- ✓ **C)** buy an index put option.
- ✗ **D)** buy an index call option.

Explanation

By not liquidating the client can benefit if the market increases. Because the portfolio is broad based and diversified, it should move with the market. An index option also moves with the market, and therefore, would be a good hedge vehicle. A long put should be used because it will increase in value if the market should decline.

Reference: 4.5.1.2 in the License Exam Manual

Question #29 of 211

Question ID: 605879

A firm may assign option exercises using which of the following methods?

I. FIFO
II. LIFO
III. Random assignment
IV. To the holders of the smallest positions

- ✓ **A)** I and III
- ✗ **B)** I and IV
- ✗ **C)** II and IV
- ✗ **D)** II and III

Explanation

A firm may assign an exercise either randomly or using the FIFO accounting method. LIFO is not permitted nor is assigning by position size, smallest or largest.

Reference: 4.6.3 in the License Exam Manual

Question #30 of 211

Question ID: 605878

The OCC automatically exercises an open equity option contract if, at expiration, the contract is in-the-money by

I. .10 or more for a public customer.
II. .01 or more for a member firm.
III. .01 or more for a public customer.
IV. .10 or more for a member firm.

- ✓ **A)** II and III.
- ✗ **B)** I and II.
- ✗ **C)** I and IV.
- ✗ **D)** III and IV.

Explanation

At expiration, the OCC automatically exercises options that are in-the-money by .01 or more for both customer and member firm accounts.

Reference: 4.6.1.4 in the License Exam Manual

Question #31 of 211

Question ID: 605822

How many business days after an index option is exercised should a cash settlement occur?

- ✗ **A)** 3.
- ✗ **B)** 2.
- ✗ **C)** 5.
- ✓ **D)** 1.

Explanation

Exercised stock index options settle on the next business day.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #32 of 211

Question ID: 605880

Listed options expire at

- ✗ **A)** 4:00 pm ET on the third Friday of the expiration month
- ✓ **B)** 11:59 pm ET on the third Friday of the expiration month
- ✗ **C)** 3:00 pm ET on the third Saturday of the expiration month
- ✗ **D)** 4:30 pm ET on the Saturday immediately following the third Friday of the expiration month

Explanation

Options expire on the third Friday of the expiration month at 11:59 pm ET.

Reference: 4.6.1.2 in the License Exam Manual

Question #33 of 211

Question ID: 605608

Individuals with diversified stock holdings in their portfolios write covered calls to:

- ✗ **A)** benefit from share price increases.
- ✓ **B)** increase their rate of return on the stocks held in their portfolio.
- ✗ **C)** increase the number of shares they own.
- ✗ **D)** lock in profits.

Explanation

Covered call writing is frequently used by persons who own the underlying stock to increase rate of return. If the options expire unexercised, the writer keeps the premium, which provides additional portfolio income.

Reference: 4.2.2.2 in the License Exam Manual

Question #34 of 211

Question ID: 605888

If trading is halted in a listed stock, what happens to the trading in the stock's listed options?

- ✓ **A)** It is halted.
- ✗ **B)** It is restricted to closing transactions.
- ✗ **C)** It increases.
- ✗ **D)** It continues to trade.

Explanation

Options trading is always halted when the trading of the underlying security is halted. Options rely primarily on the underlying market value for premium determination.

Reference: 4.6 in the License Exam Manual

Question #35 of 211

Question ID: 605887

All of the following are fixed option contract terms EXCEPT the:

- ✓ **A)** premium in a stock option.
- ✗ **B)** expiration month in a debt option.
- ✗ **C)** units of currency in a currency option.
- ✗ **D)** multiplier in an index option.

Explanation

The premium is not a predetermined characteristic of the option contract. The premium continually changes throughout the life of the option; reflecting changes in the price of the underlying security, dividends (if any), and interest rates.

Reference: 4.6.3 in the License Exam Manual

Question #36 of 211

Question ID: 605865

In determining a violation of position limits, short calls are aggregated with:

- ✓ **A)** long puts.
- ✗ **B)** short puts.
- ✗ **C)** long calls.
- ✗ **D)** all of these.

Explanation

Position limits are measured by the number of contracts on the same side of the market. Long calls and short puts are on the bull side; short calls and long puts are on the bear side.

Reference: 4.6.1.5 in the License Exam Manual

Question #37 of 211

Question ID: 605807

Which of the following is TRUE concerning yield-based (interest rate) debt options?

- ✗ **A)** Debt securities are delivered by the writer of the contract when the contract is exercised
- ✗ **B)** Strike prices reflect dollar amounts
- ✗ **C)** Debt securities are delivered to the contract owner when exercised
- ✓ **D)** European style exercise

Explanation

Yield-based debt options are European style contracts meaning that they can only be exercised on the last day of trading. All yield-based contracts when exercised are settled in cash. There is no delivery of debt instruments when these contracts are exercised. All strike prices reflect yield (35 strike price represents 3.5% yield).

Reference: 4.5.2 in the License Exam Manual

Question #38 of 211

Question ID: 605902

DWQ declares a quarterly cash dividend of $.20. After the ex-dividend date, what will be the exercise price of a listed DWQ May 25 call option?

- ✗ **A)** 24.8.
- ✓ **B)** 25.
- ✗ **C)** 24.75.
- ✗ **D)** 25.25.

Explanation

Because a listed option is not adjusted for a cash dividend, the exercise price of a DWQ May 25 call option remains the same: $25.

Reference: 4.6.3.3 in the License Exam Manual

Question #39 of 211

Question ID: 605870

Which of the following procedures are required to open and maintain an options account?

I. The registered representative must document that the client has received a current OCC disclosure document.
II. The client must verify and return their background and financial information within 15 days.
III. If there is a material change in the client's financial status, amendment of the options agreement is required.
IV. Any recommendations made must consider the financial needs and situation of the client.

- ✗ **A)** II and III.
- ✗ **B)** I and II.
- ✓ **C)** I, II, III and IV.
- ✗ **D)** III and IV.

Explanation

The client must have a current OCC Disclosure Document. An understanding of the client's financial situation is required to make any recommendations. Changes in the client's status must be updated as soon as possible, and the option agreement form must be returned within 15 days of account approval.

Reference: 4.6.3.1 in the License Exam Manual

Question #40 of 211

Question ID: 605889

All of the following statements about trading index options on the CBOE are true EXCEPT:

- ✗ **A)** limit orders are maintained in an order official's book.
- ✗ **B)** floor brokers may execute orders for others on a commission basis.
- ✗ **C)** market makers may trade for their own accounts .
- ✓ **D)** market orders entered by a market maker have priority over public orders.

Explanation

Public orders must be filled before member orders.

Reference: 4.6.2 in the License Exam Manual

Question #41 of 211

Question ID: 605580

A customer buys 2 ABC Feb 20 puts at 2 when ABC is trading at 19. If the contracts are closed at 4 when ABC is trading at 17, the customer has a:

- ✗ **A)** $200 loss.
- ✗ **B)** $400 loss.
- ✗ **C)** $200 gain.
- ✓ **D)** $400 gain.

Explanation

When closing an option, a gain or loss is the difference between premiums paid and premiums received. The customer bought two contracts at $200 each ($400 cost) and sold both contracts at $400 each ($800 sale). The gain is $400.

Reference: 4.2.8 in the License Exam Manual

Question #42 of 211

Question ID: 605568

All of the following accounts are permitted to write calls EXCEPT:

- ✓ **A)** a corporation against its own stock.
- ✗ **B)** a custodian in an UTMA account against a long-stock position.
- ✗ **C)** an individual in a margin account.
- ✗ **D)** a mutual fund against a long stock position.

Explanation

Corporations are not permitted to write calls against their own stock. If exercised, they would have to issue shares at the strike price, and this would have a dilutive effect on shareholders.

Reference: 4.2.2 in the License Exam Manual

Question #43 of 211

Question ID: 605592

If a customer bought a put option and the underlying security declined, the put would probably:

- ✗ **A)** decline in value.
- ✓ **B)** be exercised.
- ✗ **C)** be worthless.
- ✗ **D)** not be exercised.

Explanation

This is exactly what most put option buyers are looking for: they want the stock to go down. Since the market price of the stock declining would cause the option to be in-the-money, the investor would either exercise his option or sell it.

Reference: 4.2.3.1 in the License Exam Manual

Question #44 of 211

Question ID: 605593

A customer buys 1 XYZ Jan 65 put at 3.50 when XYZ is trading at 63.10. Just prior to expiration, with the option trading at 6.65 bid-6.70 asked, the customer closes his position with a market order. The gain is:

- ✓ **A)** 315.
- ✗ **B)** 190.
- ✗ **C)** 320.
- ✗ **D)** 350.

Explanation

The gain or loss is the difference between the price paid for buying the option, which is $350, and the price received for selling the option, which is $665. This equals $315. Remember, you buy at the asked price and sell to the bid.

Reference: 4.2.8 in the License Exam Manual

Question #45 of 211

Question ID: 605603

Buying a put option on a security he holds allows an investor to

I. participate in additional gains if the security continues to increase in price.
II. buy more stock if he exercises the put.
III. protect a profit on his current stock position.
IV. receive the premium for the purchase of the put.

- ✓ **A)** I and III.
- ✗ **B)** I and II.
- ✗ **C)** III and IV.
- ✗ **D)** II and III.

Explanation

Purchasing a put allows the stockholder to lock in a sale price. If the price continued to rise, the investor would not exercise the put. He would let it expire and sell the stock at the higher market price thus continuing to participate in the additional gains. If the stock fell the investor would exercise the right to sell the stock at the strike price and in this way protects a gain on the stock. Remember that options buyers pay the premium, they do not receive it, and exercising a put gives one the right to sell the stock, not buy it.

Reference: 4.2.3.3 in the License Exam Manual

Question #46 of 211

Question ID: 605897

All of the following are characteristics of unlisted options EXCEPT:

- ✓ **A)** active secondary trading.
- ✗ **B)** negotiated exercise prices.
- ✗ **C)** premiums determined by participants.
- ✗ **D)** negotiated expiration dates.

Explanation

Unlike listed options, unlisted options do not trade continuously in an organized secondary market; trades are negotiated between individuals.

Reference: 4.6 in the License Exam Manual

Question #47 of 211

Question ID: 605919

Which of the following transactions in the same security will affect the holding period of a security held for 12 months or less?

I. Buy a put.
II. Buy a call.
III. Sell short.
IV. Sell a put.

- ✓ **A)** I and III.
- ✗ **B)** II and IV.
- ✗ **C)** II and III.
- ✗ **D)** I and II.

Explanation

The holding period of a capital asset is based on the amount of time the asset is held at risk. When there is no longer the possibility of a loss, there is no longer any risk. Buying a put or selling short effectively removes the risk from a transaction and destroys any short-term holding period. The short-term holding period will not become a long-term holding period for tax purposes, as long as the offsetting position (put or short) is maintained.

Reference: 4.7.1 in the License Exam Manual

Question #48 of 211

Question ID: 605795

Japan discovers oil in the Pacific, while earthquakes in England cause havoc. A customer who reads the above article would be *most* likely to take which of the following actions?

I. Buy yen calls.
II. Buy yen puts.
III. Buy pound calls.
IV. Buy pound puts.

- ✗ **A)** I and III.
- ✗ **B)** II and IV.
- ✗ **C)** II and III.
- ✓ **D)** I and IV.

Explanation

Here, the yen will go up and the pound will fall. Thus, a customer would be most likely to buy yen calls and pound puts.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #49 of 211

Question ID: 605802

A customer buys 10 DEC 91.50 calls on the Canadian dollar for 6.70. ($10,000 CD per contract). At the time of purchase, the spot rate for the Canadian dollar was 92.25. What is the margin requirement for the purchase?

- ✓ **A)** 6700.
- ✗ **B)** 9225.
- ✗ **C)** 3350.
- ✗ **D)** 9150.

Explanation

The client purchased 10 calls at 6.70 for a total of $6,700. The margin requirement is 100% of the premium.

Reference: 4.5.3.1.3 in the License Exam Manual

Question #50 of 211

Question ID: 605587

A covered call could be written to:

- ✗ **A)** lock in a profit.
- ✗ **B)** purchase future securities.
- ✗ **C)** protect a short stock position.
- ✓ **D)** improve the return on a portfolio.

Explanation

Writing a call will not necessarily lock in the profit. In the form of increased cash flow, it will improve the return on the portfolio.

Reference: 4.2.2.2 in the License Exam Manual

Question #51 of 211

Question ID: 605575

A customer writes 1 ABC July 60 put at 3 when ABC is at 61. ABC subsequently declines to 54 and the option is exercised. If the customer later sells his long stock position at 58, the customer has a:

- ✗ **A)** loss of $400.
- ✓ **B)** gain of $100.
- ✗ **C)** gain of $400.
- ✗ **D)** loss of $100.

Explanation

The investor receives $300 for writing the put, then pays $60 per share to acquire the stock when the put is exercised, giving him a cost basis of $5,700. Because the stock is later sold for $58, the investor ends up with an overall gain of $100 ($5,800 - $5,700).

Reference: 4.2.4.3 in the License Exam Manual

Question #52 of 211

Question ID: 721416

Your customer is opening a new options account. Which of the following need NOT occur to open the account?

- ✗ **A)** The registered representative must document that the client has received a current OCC disclosure document.
- ✓ **B)** OCC must verify the financial information supplied by the client to ultimately approve the account.

✗ **C)** The client must agree that any material change in financial status requires the broker-dealer be notified and the options agreement will be amended.

✗ **D)** The background and financial information provided by the client must be verified by the client and returned within 15 days of the time the account was approved.

Explanation

The client must have a current OCC disclosure document. This is verified by the client's signature on the options agreement form which must be signed and returned within 15 days of account approval. The client must agree to notify the firm of any changes in financial status as soon as possible and the options agreement amended if necessary. OCC approval for an options account is not required nor do they verify any information given by the client.

Reference: 4.6.3.1 in the License Exam Manual

Question #53 of 211

Question ID: 605797

A Japanese manufacturer sells recorders to a U.S. retailing firm. The manufacturer is to receive $1 million (U.S. dollars) in 90 days. How can he *best* protect himself against a decline in the dollar?

✗ **A)** Sell yen calls.

✓ **B)** Buy yen calls.

✗ **C)** Buy yen puts.

✗ **D)** Sell yen puts.

Explanation

Because he is receiving U.S. dollars, his risk is that the U.S. dollar will go down in value against the Japanese yen. If the dollar goes down against the yen, the yen will rise. Therefore, to protect his risk against a rising yen, he should buy yen calls. The yen calls will increase in value if the yen rises.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #54 of 211

Question ID: 605913

A customer buys XYZ Oct 75 put at 7 when XYZ is trading at 72. The stock falls to 69 and the customer exercises the put. For tax purposes, sales proceeds are:

✗ **A)** 6500.

✗ **B)** 7500.

✗ **C)** 6200.

✓ **D)** 6800.

Explanation

When a put is exercised, the holder is selling stock at the strike price (75). However, the tax rules require that, if exercised, the cost basis of stock purchased or sales proceeds of stock sold, is adjusted to the breakeven point of the option. For puts, breakeven is strike price minus premium (75 − 7 = 68).

Reference: 4.7.0.3 in the License Exam Manual

Question #55 of 211

Question ID: 605840

European-style foreign currency options can

I. be exercised at any time
II. only be exercised at expiration
III. be traded at any time
IV. only be traded at expiration

✗ **A)** I and IV

✗ **B)** I and III

✗ **C)** II and IV

✓ **D)** II and III

Explanation

All US exchange listed currency contracts are European-style exercise, which can only be exercised at expiration. However, positions can be closed at any time until expiration.

Reference: 4.5.3.1.7 in the License Exam Manual

Question #56 of 211

Question ID: 605896

Which of the following positions violate the rules governing position limits? (Assume SSS stock is subject to a 100,000 option position limit.)

I. Long 50,000 SSS Aug 40 calls; short 55,000 SSS Aug 40 puts.
II. Long 50,000 SSS Aug 40 calls; short 55,000 SSS Jan 40 puts.
III. Long 50,000 SSS Aug 40 calls; short 30,000 SSS Jan 40 calls.
IV. Long 50,000 SSS Sep 40 puts; short 45,000 SSS Sep 40 calls.

- ✓ **A)** I and II.
- ✗ **B)** III and IV.
- ✗ **C)** I and IV.
- ✗ **D)** II and III.

Explanation

The expiration dates and strike prices may be different or the same. However, the total number of contracts on the same side of the market is limited to 100,000 for this stock; long calls and short puts are on the same side of the market (the bull side); short calls and long puts are on the same side of the market (the bear side).

Reference: 4.6.1.5 in the License Exam Manual

Question #57 of 211

Question ID: 605901

Regarding rules addressing acting in concert, each of the following must observe position and exercise limits EXCEPT:

- ✗ **A)** two or more individuals who have an agreement to act together.
- ✗ **B)** an investment adviser placing exercise orders for his discretionary accounts.
- ✓ **C)** a registered representative accepting unsolicited orders to exercise options.
- ✗ **D)** an individual with accounts at several brokerage firms.

Explanation

An individual investor or a group of investors acting in concert must observe position and exercise limits. These limits apply to an individual adviser acting for a group of discretionary accounts and to an individual who has accounts with several firms. Acting in concert does not apply to a registered representative (RR) simply accepting exercise order instructions from customers.

Reference: 4.6.1.5 in the License Exam Manual

Question #58 of 211

Question ID: 605784

A U.S. company that sells stereo equipment places an order for Japanese stereo components for its inventory. Payment must be made in Japanese yen in 3 months. The U.S. company thinks that the U.S. dollar may weaken against the yen. Which of the following foreign currency option transactions would *best* protect the U.S. company from a weakening of the U.S. dollar against the yen?

- ✗ **A)** Buy puts on Japanese yen.
- ✗ **B)** Sell puts on Japanese yen.
- ✗ **C)** Sell calls on Japanese yen.
- ✓ **D)** Buy calls on Japanese yen.

Explanation

The U.S. company is concerned that the value of the Japanese yen will rise. Therefore, the company should buy calls on the yen to lock in the lowest possible price to buy yen for payment of the contract. Importers buy calls to hedge.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #59 of 211

Question ID: 605801

Trading in foreign currency options would most likely be an appropriate hedging tool for

I. individual investors who want to hedge the risk on specific US exchange listed stocks
II. a multinational corporation
III. someone traveling on vacation for two weeks abroad
IV. a firm in the import and export business

- ✗ **A)** II and III
- ✗ **B)** I and II
- ✓ **C)** II and IV
- ✗ **D)** I and III

Explanation

Generally, any time the potential need to deliver a foreign currency or accept payment of a foreign currency can be anticipated, currency options are a useful hedge. While this could apply to individuals, it is most likely applicable to, and appropriate for, business entities doing business abroad.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #60 of 211

Question ID: 605857

After being approved for options trading, a customer establishes several long option positions but does not return the signed option agreement within the required time period. The broker/dealer may:

- ✗ **A)** sell out the customer's positions and freeze the account for 90 days.
- ✓ **B)** only allow the customer closing transactions.
- ✗ **C)** only allow the customer opening transactions.
- ✗ **D)** permit no further transactions until the signed agreement is returned .

Explanation

If the customer does not sign and return the option agreement within 15 days of account approval, she may maintain or close out existing positions, but cannot enter any opening transactions until the agreement is returned.

Reference: 4.6.3 in the License Exam Manual

Question #61 of 211

Question ID: 605583

Which of the following transactions would be acceptable investments for a pension fund?

- ✗ **A)** Writing a naked call
- ✗ **B)** Writing a put
- ✗ **C)** Writing an S&P Index option
- ✓ **D)** Writing a covered call

Explanation

Writing a covered call has less risk than writing a naked option. A covered call writer is merely using options to increase the income on his portfolio. Fiduciaries such as those who invest for pension fund portfolios should avoid risky transactions.

Reference: 4.2.2.4 in the License Exam Manual

Question #62 of 211

Question ID: 605853

An investor owning an option contract liquidates the position. The liquidation is

- ✗ **A)** an opening sale.

- ✗ **B)** an opening purchase.
- ✓ **C)** a closing sale.
- ✗ **D)** a closing purchase.

Explanation

When an investor liquidates an existing option position that is owned, the investor is entering a sale that closes the existing position.

Reference: 4.6.3.4 in the License Exam Manual

Question #63 of 211

Question ID: 605590

An investor would sell a put:

- ✗ **A)** as an inflation hedge.
- ✗ **B)** because he is bearish.
- ✓ **C)** because he is bullish.
- ✗ **D)** as a substitute for a short sale.

Explanation

A put seller (writer) will benefit as long as the market price of the underlying security does not drop substantially. His position is bullish.

Reference: 4.2.4 in the License Exam Manual

Question #64 of 211

Question ID: 605906

Your client currently holds XYZ stock in her portfolio. You notice that the put-call ratio for options trading on XYZ stock has been increasing over the past several days. The increase in the ratio would indicate that

- ✗ **A)** investors are becoming more and more bullish on XYZ stock
- ✗ **B)** for the underlying XYZ stock, more calls than puts are being traded
- ✓ **C)** for the underlying XYZ stock, more puts than calls are being traded
- ✗ **D)** for the underlying XYZ stock, straddles are being purchased

Explanation

The ratio is a measure of puts traded to calls traded and is calculated by dividing the number of traded puts by the number of traded calls (puts ÷ calls). As the ratio increases, it reflects that more puts than calls are being traded and is, therefore, a more bearish indicator of investor sentiment.

Reference: 4.6.3.5.1 in the License Exam Manual

Question #65 of 211

Question ID: 605808

Yield-based options expire on the

- ✓ **A)** last day of trading
- ✗ **B)** day after the last day of trading
- ✗ **C)** day following the third Friday of the month
- ✗ **D)** third Wednesday of the month

Explanation

Yield-based options expire like stock options; on the third Friday of the expiration month which is the last day of trading.

Reference: 4.5.2 in the License Exam Manual

Question #66 of 211

Question ID: 605585

Which of the following positions exposes a customer to unlimited risk?

- ✗ **A)** Short 200 shares of XYZ and short 2 XYZ puts.
- ✗ **B)** Short 200 shares of XYZ.
- ✗ **C)** Short 2 XYZ calls.
- ✓ **D)** All of these.

Explanation

All of the positions expose the client to unlimited risk.

Reference: 4.2.2.6 in the License Exam Manual

Question #67 of 211

Question ID: 605874

If the holder of a call tenders an exercise notice after the ex-dividend date for a cash dividend, which of the following statements is TRUE?

- ✗ **A)** He must pay the dividend to the writer.
- ✗ **B)** He is entitled to the dividend only if he sells the underlying stock.
- ✗ **C)** He is entitled to the dividend.
- ✓ **D)** He is not entitled to the dividend.

Explanation

If the holder of a call exercises before the ex-date, the trade settles on or before the record date and he is on record for the dividend. If the holder exercises on or after the ex-date, the trade settles after the record date and he is neither on record for the dividend nor entitled to it.

Reference: 4.6.1.3 in the License Exam Manual

Question #68 of 211

Question ID: 605867

A customer recently approved to trade options writes an OEX put for the account's initial transaction. If the customer fails to return the signed option agreement within 15 days of account approval, which of the following transactions is the customer permitted to make?

- ✓ **A)** Closing purchase.
- ✗ **B)** Closing sale.
- ✗ **C)** Opening sale.
- ✗ **D)** Opening purchase.

Explanation

If a customer fails to return the signed option agreement within 15 days of account approval, the customer is permitted closing transactions only. Because the customer opened a position by selling, the only transaction permitted would be a closing purchase.

Reference: 4.6.3.1 in the License Exam Manual

Question #69 of 211

Question ID: 605790

If an American exporter will be paid 25 million Japanese yen when her goods arrive in 45 days, her *best* hedge is to:

- ✗ **A)** buy yen calls.
- ✗ **B)** sell yen calls.
- ✓ **C)** buy yen puts.
- ✗ **D)** sell yen puts.

Explanation

The exporter does not want to see the value of the yen fall. If she owns yen puts and the yen does fall, her profit on the puts would help compensate for the decrease in the value of the yen. Selling yen calls would also provide protection if the yen fell in value, but only to the extent of the premium received. Exporters buy puts in order to hedge; importers buy calls on the foreign currency to hedge.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #70 of 211

Question ID: 605829

If the strike price of a yield-based option is 62.50, this represents a yield of:

- ✗ **A)** 0.625.
- ✓ **B)** 0.0625.
- ✗ **C)** 0.000625.
- ✗ **D)** 0.00625.

Explanation

To calculate the percentage yield of the underlying Treasury security, divide the strike price by 10 (62.50 / 10 = 6.25%).

Reference: 4.5.2 in the License Exam Manual

Question #71 of 211

Question ID: 605883

A customer wishes to close a short option position. The order ticket must be marked as:

- ✗ **A)** a closing sale.
- ✗ **B)** an opening sale.
- ✗ **C)** an opening purchase.
- ✓ **D)** a closing purchase.

Explanation

The investor opened with a sale, so the position must close with a purchase.

Reference: 4.6.3.4 in the License Exam Manual

Question #72 of 211

Question ID: 605875

The Options Clearing Corporation uses which of the following methods to assign exercise notices?

- ✓ **A)** Random selection.
- ✗ **B)** First in, first out (FIFO).
- ✗ **C)** Assign it to the member firm holding a long position that first requests an exercise .
- ✗ **D)** Assign it on the basis of the largest position.

Explanation

The OCC assigns exercise notices to member firms on a random basis; the members may choose the customers to be exercised on either a random basis or FIFO basis.

Reference: 4.6.3 in the License Exam Manual

Question #73 of 211

Question ID: 605804

One cost efficient solution, or strategy, regarding the trading of options around certain news releases or events would be to use

- ✗ **A)** long-term equity anticipation (LEAP) contracts
- ✗ **B)** standard contracts bought on the first day they are issued
- ✗ **C)** broad-based index contracts
- ✓ **D)** weekly option contracts

Explanation

Weekly contracts offer a cost-efficient way to trade options around certain news releases like economic data or earnings reports by virtue of the low premiums they carry. Remember that part of an option contracts premium is a function of the time remaining until expiration. Because "weeklies" only have 1 week between the time they are issued and the time they expire, premiums tend to be low.

Reference: 4.5.1.2 in the License Exam Manual

Question #74 of 211

Question ID: 605830

Your client with a short call position in the S&P 100 index (OEX) is assigned an exercise notice. The obligation is fulfilled by delivering:

- ✗ **A)** 100 shares of a particular stock in the index selected by the option holder.
- ✗ **B)** 100 shares of each of the 100 stocks in the index.
- ✓ **C)** cash equal to the difference between the closing value of the index and exercise price.
- ✗ **D)** a long call in the OEX at the same or lower strike price.

Explanation

Unlike equity options, index options are settled in cash only. Upon exercise, cash equal to the amount that the option is in-the-money (i.e., excess of market value over strike for a call or excess of strike over market value for a put) is delivered on the settlement date.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #75 of 211

Question ID: 605613

On which of the following positions does the potential loss equal the premium?

- ✗ **A)** Uncovered puts.
- ✓ **B)** Long puts.
- ✗ **C)** Covered calls.
- ✗ **D)** Covered puts.

Explanation

The premium paid to acquire the option represents the most an investor stands to lose on a long option position. "Covered" and "uncovered" are terms that relate to short option positions.

Reference: 4.2.3.5 in the License Exam Manual

Question #76 of 211

Question ID: 605615

An investor establishes the following position:

Long 1 XYZ Sep 40 call at 2

The maximum potential gain on the position is:

- ✗ **A)** $38 per share.
- ✗ **B)** $42 per share.
- ✓ **C)** unlimited.
- ✗ **D)** $40 per share.

Explanation

The maximum gain on a long call is unlimited because, theoretically, a rise in stock price is unlimited.

Reference: 4.2.1.5 in the License Exam Manual

Question #77 of 211

Question ID: 605924

An investor who is long TCB stock for 6 months buys 1 call on TCB. If the call expires in 8 months and the investor sells the stock 3 months after the call expires, what does he realize on the stock?

- ✗ **A)** Short-term gain or loss.
- ✓ **B)** Long-term gain or loss.
- ✗ **C)** Short-term gain or long-term loss.
- ✗ **D)** Long-term gain or short-term loss.

Explanation

The purchase of a call has no effect on a long stock position's holding period. The call only allows more stock to be purchased; it does not allow the stock to be sold. The investor held the stock for 17 months, exceeding the holding period required for long-term capital gains treatment (more than 1 year).

Reference: 4.7 in the License Exam Manual

Question #78 of 211

Question ID: 605823

The OEX index (Standard & Poor's 100) closes at 379.70, up .60 from the prior day's close. The holder of 10 in-the-money calls makes an unrealized gain of:

- ✗ **A)** 6.
- ✗ **B)** 6000.
- ✓ **C)** 600.
- ✗ **D)** 60.

Explanation

This unrealized gain is $600 (10 calls × .60 × $100 = $600).

Reference: 4.5.1.1.1 in the License Exam Manual

Question #79 of 211

Question ID: 605788

If a customer opens a spread on Canadian dollars (10,000 units) by purchasing 1 Dec 74 call for 2.30 and selling 1 Dec 77 call for 1.50, what is the total cost of this debit spread?

- ✗ **A)** 700.
- ✗ **B)** 800.
- ✓ **C)** 80.
- ✗ **D)** 970.

Explanation

The customer pays a premium of 2.30 ($230) and receives a premium of 1.50 ($150) for a net debit of .80, or $80.

Reference: 4.5.3.1.3 in the License Exam Manual

Question #80 of 211

Question ID: 605577

If your customer owns 100 shares of a volatile stock and wants to limit downside risk, you may recommend:

- ✗ **A)** buying calls.
- ✗ **B)** shorting the same stock.
- ✓ **C)** buying puts.
- ✗ **D)** writing calls and selling puts.

Explanation

Downside risk is reduced by purchasing a put with a strike price at or close to the stock's purchase price. Should the stock decline below the strike price, the investor can exercise the put at the strike price. Selling put options will increase the downside risk. Buying calls is a bullish strategy that increases downside risk. Shorting stock will lock in the current price but will limit upside potential.

Reference: 4.2.3.3 in the License Exam Manual

Question #81 of 211

Question ID: 605852

Your clients' option position has been adjusted due to a 2 for 1 stock split. Which of the following regarding this 2 for 1 adjustment is TRUE?

- ✗ **A)** The number of shares per contract will increase.
- ✓ **B)** The number of contracts owned will increase.
- ✗ **C)** The strike price will remain unchanged.
- ✗ **D)** The strike price will increase.

Explanation

For even splits (i.e., 2 for 1 or 3 for 1), the number of contracts owned will increase proportionately. The number of shares per contract will remain unchanged and the strike price will decrease proportionately.

Reference: 4.6.3.3 in the License Exam Manual

Question #82 of 211

Question ID: 605605

An investor wants to purchase TCB stock (currently trading at 38), and he expects the price of TCB stock to decline in the short term before rising. If he wants to purchase the stock below its current market value and generate additional income, he could:

- ✗ **A)** buy a 40 call and exercise the option.
- ✗ **B)** write a call at 35.
- ✓ **C)** write a put at 35.
- ✗ **D)** buy a put and exercise the option.

Explanation

If the investor writes a put, he collects a premium. If the stock price rises, the put expires worthless and the investor keeps the premium. However, if the stock price declines as the customer anticipates, the put will force the customer to buy stock at 35. The effective cost of the stock is the breakeven point (strike price minus the premium).

Reference: 4.2.4.3 in the License Exam Manual

Question #83 of 211

Question ID: 605929

If an investor writes 2 DWQ Jan. 60 puts at 3 in September and the investor buys back the 2 puts at 4.50 two months later, the result for tax purposes is a:

- ✗ **A)** $300 short-term capital gain.
- ✗ **B)** $150 short-term capital gain.
- ✗ **C)** $150 short-term capital loss.
- ✓ **D)** $300 short-term capital loss.

Explanation

A $900 closing cost minus $600 opening proceeds equals a $300 short-term loss.

Reference: 4.7.0.2 in the License Exam Manual

Question #84 of 211

Question ID: 605881

Trading in expiring options series concludes the same day as expiration at

- ✗ **A)** 12:00 pm ET
- ✓ **B)** 4:00 pm ET
- ✗ **C)** 5:00 pm ET
- ✗ **D)** 11:00 pm ET

Explanation

The official close is 4:00 pm ET on the 3rd Friday of the expiration month. Expiring options may be exercised until 5:30 pm ET on the same day.

Reference: 4.6.1.2 in the License Exam Manual

Question #85 of 211

Question ID: 605916

An investor long 100 shares of stock writes a call against the long stock position. If the call is exercised and the investor must deliver the stock, which of the following tax consequences will occur?

- ✗ **A)** Both cost basis and sales proceeds must be adjusted.
- ✓ **B)** Sales proceeds are adjusted for the stock.
- ✗ **C)** Cost basis is adjusted for the stock.
- ✗ **D)** There are no adjustments for cost basis or sales proceeds for tax purposes.

Explanation

When the call is exercised the owner of the stock will be obligated to sell the shares owned at the strike price. The sales proceeds for the stock will be adjusted upwards by the amount of the premium received when the call was sold.

Reference: 4.7.0.3 in the License Exam Manual

Question #86 of 211

Question ID: 605868

Options sales literature:

I. must be preceded or accompanied by an OCC disclosure booklet.
II. need not be preceded or accompanied by an OCC disclosure booklet.
III. can include recommendations.
IV. cannot include recommendations.

- ✗ **A)** II and IV.
- ✗ **B)** II and III.
- ✗ **C)** I and IV.
- ✓ **D)** I and III.

Explanation

All options sales literature must be preceded or accompanied by an OCC disclosure booklet. Options sales literature (e.g., a research report) may include recommendations; options advertising may not.

Reference: 4.6.3.1 in the License Exam Manual

Question #87 of 211

Question ID: 605799

A customer buys an Oct 79.50 foreign currency call on the Australian dollar. The Australian dollar spot price is 89.73, and the option contract size is 10,000 Australian dollars. If the option contract is offered at 11, what was the customer's total premium paid for the contract?

- ✓ **A)** 1100
- ✗ **B)** 8973
- ✗ **C)** 10000
- ✗ **D)** 11000

Explanation

Currency options are quoted in U.S. cents per dollar and one point equals $100. A quote of 11.00 is equal to $1,100 per contract.

Reference: 4.5.3.1.3 in the License Exam Manual

Question #88 of 211

Question ID: 605586

At expiration, if the market price of the underlying stock is the same as the strike price, which of the following positions would be profitable?

I. Short call
II. Long straddle
III. Long call
IV. Short put

- ✗ **A)** I and III
- ✗ **B)** II and III
- ✗ **C)** II and IV
- ✓ **D)** I and IV

Explanation

Writers of option contracts are profitable if an option expires worthless because they keep the premiums received. If the strike price and the market price are the same at expiration, an option contract will not be exercised by the contract owner (buyer). This leaves the writer with the premiums received when the contract expires and thus profitable by that amount.

Reference: 4.2.6 in the License Exam Manual

Question #89 of 211

Question ID: 605599

A person who buys a put will be profitable if just before expiration the price of the underlying stock is

- ✗ **A)** anywhere near the exercise price, above or below
- ✗ **B)** greater than the exercise price
- ✓ **C)** less than the exercise price
- ✗ **D)** the same as the exercise price

Explanation

A long put is profitable if the price of the underlying stock falls below the exercise price at least by the amount of the premium paid; if the price rises above the exercise price or is the same as the exercise price, the put will expire worthless.

Reference: 4.2.3 in the License Exam Manual

Question #90 of 211

Question ID: 605843

When must a new options customer return a signed option agreement?

- ✗ **A)** Before the account is approved by a registered options principal.
- ✗ **B)** Before the first order is entered.
- ✓ **C)** Within 15 days of the account approval.
- ✗ **D)** At or before the customer receives the options disclosure document.

Explanation

The option agreement must be signed and returned within 15 days of account approval. This agreement states the customer will abide by the rules of the options exchange and the OCC, and will not violate position or exercise limits. If it has not been returned, the customer can only close out existing positions. No new positions may be opened.

Reference: 4.6.3 in the License Exam Manual

Question #91 of 211

Question ID: 605895

Automatic exercise will occur for equity options at expiration that are in-the-money by at least:

- ✗ **A)** 1/8 of a point.
- ✓ **B)** 0.01.
- ✗ **C)** 0.05.
- ✗ **D)** 1/4 of a point.

Explanation

Automatic exercise will occur for equity options at expiration that are in-the-money by at least .01, unless specific instructions are given by the customer not to do so.

Reference: 4.6.1.4 in the License Exam Manual

Question #92 of 211

Question ID: 605911

If a customer buys 1 ABC October call at 7 on March 10 and sells it for 3 on Oct 10, the customer has a capital:

- ✗ **A)** gain of $400.
- ✓ **B)** loss of $400.
- ✗ **C)** gain of $700.
- ✗ **D)** loss of $700.

Explanation

The investor paid $700 to buy the call and received $300 to sell the call for a net loss of $400. Options are capital items. If a put or call on a stock expires unexercised, the amount a writer receives is a short-term capital gain. The amount a buyer pays is a capital short term loss.

Reference: 4.7.0.2 in the License Exam Manual

Question #93 of 211

Question ID: 605838

As the price of the VIX (volatility market index) rises investors should expect:

- ✗ **A)** a decrease in put premiums only.
- ✓ **B)** call and put option premiums to rise.
- ✗ **C)** a decrease in call premiums only.
- ✗ **D)** call and put option premiums to fall.

Explanation

The VIX is a measure of investor expectations regarding market volatility. If the VIX is rising, this reflects an expectation of an increase in market volatility. More market volatility will generally cause all options premiums, both puts and calls to increase to some extent.

Reference: 4.5.1 in the License Exam Manual

Question #94 of 211

Question ID: 605917

A customer sells 1 ABC Corporation put for 2 on February 22, 2007, with a strike price of 50 and an expiration date of March 16, 2007. On March 15, 2007, ABC is put to the customer. Which of the following statements about this transaction is CORRECT?

- ✓ **A)** He has an acquisition cost of $4,800 and a date of acquisition of March 15, 2007.
- ✗ **B)** He has a $200 short-term gain on the sale of his put. His cost of acquisition is $5,000 and the date of acquisition is February 22, 2007.
- ✗ **C)** He has an acquisition cost of $4,800 and a date of acquisition of February 22, 2007.
- ✗ **D)** He has an acquisition cost of $5,000 and a date of acquisition of March 16, 2007.

Explanation

When a put is exercised, the cost of acquisition is the cost that the writer has to pay (strike price) less the amount of premium the writer originally received. The date of acquisition is the trade date in exercising the option.

Reference: 4.7.0.3 in the License Exam Manual

Question #95 of 211

Question ID: 605576

At expiration, the market price of the underlying stock is the same as the strike price of the option. Which of the following positions result in a profit?

I. Short call
II. Long call
III. Short put
IV. Long put

✓ **A)** I and III
✗ **B)** II and III
✗ **C)** II and IV
✗ **D)** I and IV

Explanation

The option has no intrinsic value if the market price of the underlying stock is equal to the strike price of an option (put or call). If an option has no intrinsic value at expiration, it is theoretically worthless. If an option expires worthless, the writer profits.

Reference: 4.2.2.1 in the License Exam Manual

Question #96 of 211

Question ID: 605904

Buying back an option contract that was previously written or selling an option contract that was previously purchased is known as:

✗ **A)** dollar-cost averaging.
✗ **B)** exercising.
✗ **C)** indexing.
✓ **D)** closing out a position.

Explanation

When an investor sells a security they are long or buys back a security they are short, they are closing out an existing position.

Reference: 4.6.3.4 in the License Exam Manual

Question #97 of 211

Question ID: 605927

In February, a customer sells 1 GHI Oct 60 put for 3 and buys 1 GHI Oct 70 put for 11. If the customer closes the Oct 70 put before expiration, which of the following statements regarding the resulting profit or loss is TRUE?

✓ **A)** It is treated as a capital gain or loss.
✗ **B)** It is treated as ordinary income or loss.
✗ **C)** It depends on the disposition of the short Oct 60 put.
✗ **D)** It cannot be determined from the information given.

Explanation

All listed options trades with resulting gains or losses are treated as capital gains or losses.

Reference: 4.7.0.2 in the License Exam Manual

Question #98 of 211

Question ID: 605918

A gain on the sale of a long equity put option is:

✓ **A)** always a short-term capital gain.
✗ **B)** a short- or long-term capital gain.
✗ **C)** always a long-term capital gain.
✗ **D)** ordinary income.

Explanation

Any trading in options produces only short-term gains or losses; therefore any gain on the sale of a long put option must always be a short-term capital gain. (If a question wishes you to consider LEAPS, the question will refer to them.)

Reference: 4.7.0.2 in the License Exam Manual

Question #99 of 211

Question ID: 605846

When must a new options customer-who has not yet traded options-receive the Options Clearing Corporation's current disclosure document?

- ✗ **A)** Within 15 days of the ROP's approval of the customer's account for options trading.
- ✗ **B)** At or before the time the registered representative signs the customer approval form.
- ✗ **C)** No later than 15 days after the ROP signs the options customer approval form.
- ✓ **D)** At or before the time the account receives approval for options trading.

Explanation

Customers must receive the OCC Disclosure Booklet at, or prior to, the time their account is approved for options trading.

Reference: 4.6.3.1 in the License Exam Manual

Question #100 of 211

Question ID: 605619

An investor has researched XYZ Corporation and is convinced the company's stock will soon decline in value. If the investor wishes to act on that conviction, which investment strategy will allow the investor to take advantage of the anticipated decline in share value with the smallest cash investment?

- ✓ **A)** Purchase a put option
- ✗ **B)** Purchase a call option
- ✗ **C)** Sell the company's stock short
- ✗ **D)** Purchase a call spread

Explanation

Buying a put is a basic option strategy utilized when one is bearish on a stock. If the stock declines as anticipated, the investor could exercise the put which allows the stock to be sold at the strike price and then repurchase it at its lower current market price for a profit. The premium paid to buy the put costs less than the margin required if one were to sell the stock short. Purchasing a call or a call spread are bullish options strategies.

Reference: 4.2.3 in the License Exam Manual

Question #101 of 211

Question ID: 605905

Three family members each hold sizable call option positions with the same underlying equity security in their individual accounts. Over the course of 3 days, Monday through Wednesday, each of the customers calls your broker/dealer and gives instructions to exercise all of their call options in that security. You recognize this as a potential violation of

- ✓ **A)** OCC exercise limit rules
- ✗ **B)** the Uniform Practice Code
- ✗ **C)** the Code of Procedure
- ✗ **D)** front running rules

Explanation

OCC exercise rules limit the maximum number of contracts in the same underlying security that can be exercised within a 5 business day period. Three customers, all related, and all giving instructions to exercise their long calls in the same underlying security within 3 business days should, at a minimum, raise the question of whether or not they are acting in concert in order to circumvent the OCC exercise limit rules.

Reference: 4.6.1.6 in the License Exam Manual

Question #102 of 211

Question ID: 605595

Which of the following option strategies besides going long a call can be used to purchase stock below its current market value?

✗ **A)** Short straddle.
✓ **B)** Short put.
✗ **C)** Short call.
✗ **D)** Long put.

Explanation

If the put is exercised by the owner the writer of the put will be obligated to purchase the stock. The cost of the stock is reduced by the amount of premium taken in when the put was written allowing the investor to purchase the stock at a net cost lower than the stock's current market value.

Reference: 4.2.4.3 in the License Exam Manual

Question #103 of 211

Question ID: 605936

If an investor buys 300 shares of FLB, and one month later buys 1 FLB Jul 50 put, how does this affect the holding period on his or her stock?

✓ **A)** It stops the holding period on 100 shares.
✗ **B)** It ends the holding period on the put.
✗ **C)** It has no impact on the holding period for any of the shares owned by the investor.
✗ **D)** It stops the holding period on 300 shares.

Explanation

The put purchase ends the holding period for any shares the put subsequently allows the holder to sell. Because the holder owns 1 put, this stops the holding period on 100 shares owned. The other 200 shares are unaffected.

Reference: 4.7.1 in the License Exam Manual

Question #104 of 211

Question ID: 605598

Compared with selling short, buying a put option:

✗ **A)** does not require meeting the locate requirement for short sales.
✗ **B)** requires a smaller capital commitment.
✓ **C)** all of these.
✗ **D)** has a lower loss potential.

Explanation

Buying a put requires a smaller capital commitment than does shorting the stock and has a lower loss potential (the premium only) because selling short involves unlimited risk. When selling stock short on an exchange, the shares to be borrowed must be located before the sale. This is not a requirement when buying a put.

Reference: 4.2.3 in the License Exam Manual

Question #105 of 211

Question ID: 605848

Customers seeking to open an options account may be granted approval by the:

✓ **A)** branch manager initially, with the subsequent approval of a ROP.
✗ **B)** registered financial advisor.
✗ **C)** branch manager only.
✗ **D)** registered representative.

Explanation

Initially, the branch manager approves an options account. However, all options accounts must be ultimately approved by the ROP.

Reference: 4.6.3.1 in the License Exam Manual

Question #106 of 211

Question ID: 605909

If a customer writes 1 ABC Nov 60 put at 3.50, and the put is exercised when ABC is 57.50, the customer' s cost basis in ABC stock is:

- ✗ **A)** 57.5.
- ✗ **B)** 60.
- ✗ **C)** 54.
- ✓ **D)** 56.5.

Explanation

At exercise, the premium of the contract affects the cost basis of the stock acquired. Because the premium of 3.50 was received when the put was written, the cost basis of the stock will be $60 per share less the premium, or 56.50.

Reference: 4.7.0.1 in the License Exam Manual

Question #107 of 211

Question ID: 605815

Which of the following statements regarding stock index options are TRUE?

I. Trades are settled the next business day.
II. Trades are settled on the third business day.
III. Exercise settlement involves the delivery of stock.
IV. Exercise settlement involves the delivery of cash.

- ✗ **A)** I and III.
- ✗ **B)** II and IV.
- ✓ **C)** I and IV.
- ✗ **D)** II and III.

Explanation

Index option trades settle the next business day and cash is delivered upon exercise of the option. Exercised index options also settle next business day.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #108 of 211

Question ID: 605854

An option writer liquidates a position by purchasing an option. This order must be marked as:

- ✗ **A)** an opening sale.
- ✗ **B)** an opening purchase.
- ✓ **C)** a closing purchase.
- ✗ **D)** a closing sale.

Explanation

Writers liquidate (close) their short positions by purchasing back an option of the same series as the one they wrote. This order is known as a closing purchase transaction.

Reference: 4.6.3.4 in the License Exam Manual

Question #109 of 211

Question ID: 605601

Which of the following strategies is considered *most* risky in a strong bull market?

- ✗ **A)** Writing naked puts.
- ✗ **B)** Buying calls.
- ✓ **C)** Writing naked calls.
- ✗ **D)** Buying a put spread.

Explanation

Writing naked calls gives unlimited risk. If the market rises, naked puts expire. In the latter case, the writer profits from the premiums.

Reference: 4.2.2.6 in the License Exam Manual

Question #110 of 211

Question ID: 786011

XYZ Corp. has set Friday, January 23rd, as the record date for its next quarterly dividend distribution. To receive the dividend, a customer, long 1 XYZ Feb 40 call, must issue exercise instructions on or before

- ✗ **A)** Monday, January 19th
- ✗ **B)** Tuesday, January 20th
- ✗ **C)** Friday, January 23rd
- ✓ **D)** Wednesday, January 21st

Explanation

Dividends are paid to investors who are owners of record as of the close of business on the record date. When a call option is exercised, money and stock are exchanged (settlement) on the second business day after notice is given to the OCC. Therefore, an investor who wishes to receive a dividend must exercise a call no later than the second business day prior to the record date (i.e., the day before the ex-date).

Reference: 4.6.1.3 in the License Exam Manual

Question #111 of 211

Question ID: 605886

If a writer of an XYZ equity call option is assigned, which of the following should be delivered to the OCC?

- ✓ **A)** The underlying XYZ security
- ✗ **B)** Rights or warrants exercisable to purchase the underlying XYZ security
- ✗ **C)** Any listed security of comparable value to XYZ
- ✗ **D)** Cash equal to the market value of the underlying XYZ security

Explanation

When a call is exercised, that specific security must be delivered by the assigned writer. The option contract does not allow for exercise settlement in cash, securities of equivalent value, or securities exercisable to purchase the underlying securities such as rights or warrants.

Reference: 4.6.1.3 in the License Exam Manual

Question #112 of 211

Question ID: 605847

When a registered representative opens a new options account, in which order must the following actions take place?

I. Obtain approval from the branch manager.
II. Obtain essential facts from the customer.
III. Obtain a signed options agreement.
IV. Enter the initial order.

- ✗ **A)** I, II, IV, III.
- ✓ **B)** II, I, IV, III.
- ✗ **C)** I, II, III, IV.
- ✗ **D)** II, I, III, IV.

Explanation

The steps in opening an options account occur in the following order: obtain essential facts about the customer; give the customer an options disclosure document; have the manager approve the account; enter the initial order; and have the customer sign the options agreement within 15 days.

Reference: 4.6.3.1 in the License Exam Manual

Question #113 of 211

Question ID: 605910

A customer buys 100 shares of ABC at 56.50 and writes 1 ABC Aug 60 call at 2. If the call is exercised, the consequences are

I. a cost basis of $56.50 per share.
II. a cost basis of $58.50 per share.
III. sales proceeds of $60 per share.
IV. sales proceeds of $62 per share.

- ✗ **A)** II and III.
- ✗ **B)** I and III.
- ✓ **C)** I and IV.
- ✗ **D)** II and IV.

Explanation

The premium of the option affects the basis of the stock (bought or sold) as a result of exercise, adding the premium per share ($2) to the price per share ($60) for a total sales proceeds of $62. The original cost basis is not affected by the exercise, so it remains $56.50.

Reference: 4.7.0.1 in the License Exam Manual

Question #114 of 211

Question ID: 605845

When determining position limits for listed options contracts and LEAPS contracts on the same side of the market, which of the following statements is TRUE?

- ✓ **A)** The contracts must be aggregated.
- ✗ **B)** The contracts do not have position limits.
- ✗ **C)** The contracts are considered separately.
- ✗ **D)** The contracts are added to increase the position limits.

Explanation

LEAPS and listed options on the same side of the market, on the same underlying security, must be aggregated and remain within position limits.

Reference: 4.6.1.5 in the License Exam Manual

Question #115 of 211

Question ID: 605574

A customer sells 6 ABC calls for total premiums of $750. One month later, the customer closes his position when the contract is trading at 3 and the result is a:

- ✗ **A)** gain of $1,050.
- ✗ **B)** gain of $450.
- ✓ **C)** loss of $1,050.
- ✗ **D)** loss of $450.

Explanation

This customer opens his position with a credit of $750 to his account. He closes his position with a debit of $300 per contract multiplied by 6 contracts, or $1,800. The result is a loss of $1,050.

Reference: 4.2.8 in the License Exam Manual

Question #116 of 211

Question ID: 605935

Which of the following actions could affect the holding period on a long position in IBS stock?

- ✗ **A)** Sale of 1 IBS out-of-the-money call.
- ✗ **B)** Sale of 1 IBS out-of-the-money put.
- ✓ **C)** Purchase of 1 IBS put.
- ✗ **D)** Purchase of 1 IBS call.

Explanation

The purchase of a put affects a stock's holding period when the stock has been held short term. The holding period begins anew once the put position is closed.

Reference: 4.7.1 in the License Exam Manual

Question #117 of 211

Question ID: 605859

Which of the following would be in compliance with the CBOE and OCC Rules concerning the nondiscriminatory assignment of an option exercise notice by a firm to one of its customers?

- ✗ **A)** Assignment to the customer with the largest position in the underlying security.
- ✓ **B)** Assignment to the customer with the oldest position in the option.
- ✗ **C)** Assignment to the customer with the smallest position in the option.
- ✗ **D)** Assignment to the customer with the largest position in the option.

Explanation

You cannot discriminate between large and small customers. First in, first out (FIFO) is not considered to be discriminatory.

Reference: 4.6.3 in the License Exam Manual

Question #118 of 211

Question ID: 605893

With regard to position limits, what is the bullish, or "buy" side of the market?

I. Long calls.
II. Short calls.
III. Long puts.
IV. Short puts.

- ✓ **A)** I and IV.
- ✗ **B)** II and III.
- ✗ **C)** III and IV.
- ✗ **D)** I and II.

Explanation

Long calls give the holder the right to purchase stock, while short puts obligate the writer to buy stock, and both are bullish strategies.

Reference: 4.6.1.5 in the License Exam Manual

Question #119 of 211

Question ID: 605610

If a customer writes one uncovered in-the-money put, the maximum gain would be:

- ✗ **A)** the strike price plus the premium multiplied by 100 shares.
- ✓ **B)** 100% of the premium.
- ✗ **C)** the strike price minus the premium multiplied by 100 shares.
- ✗ **D)** unlimited.

Explanation

The maximum gain to an option writer is the premium received.

Reference: 4.2.4.4 in the License Exam Manual

Question #120 of 211

Question ID: 605866

All of the following actions must be completed prior to a customer entering his first option trade EXCEPT:

- ✗ **A)** completion of the new account form.
- ✓ **B)** completion of the options agreement.
- ✗ **C)** delivery of an OCC Disclosure Booklet.
- ✗ **D)** approval by a sales supervisor.

Explanation

Customers do not have to complete (sign) the options agreement prior to entering an order, although, under exchange rules, the agreement must be signed and returned by the customer within 15 days of account approval.

Reference: 4.6.3.1 in the License Exam Manual

Question #121 of 211

Question ID: 605877

If a 5% stock dividend is declared, the owner of 1 XYZ Jul 30 call owns:

- ✓ **A)** 1 contract for 105 shares with an effective exercise price of $28.57.
- ✗ **B)** 2 contracts for 100 shares with an exercise price of 30.
- ✗ **C)** 1 contract for 100 shares with an exercise price of 30.
- ✗ **D)** 2 contracts for 105 shares with an exercise price of 30.

Explanation

When a company pays a stock dividend or effects a fractional stock split, the underlying option is adjusted by increasing the number of shares the contract covers (5% × 100 shares = 5 additional shares). The number of contracts owned remains the same and the effective exercise price is adjusted so that the position value before and after the adjustment remains the same ($3000 / 105 = $28.57).

Reference: 4.6.3.3 in the License Exam Manual

Question #122 of 211

Question ID: 605817

Index options are frequently used to protect a portfolio against which of the following risk types?

- ✗ **A)** Inflation.
- ✓ **B)** Systematic.
- ✗ **C)** Business.
- ✗ **D)** Credit.

Explanation

Index options protect investor portfolios from the risk of overall market movement, also known as systematic risk.

Reference: 4.5.1.2 in the License Exam Manual

Question #123 of 211

Question ID: 605864

Your investor decides that he would like to open an options account. Which of the following is your responsibility as his registered representative?

- ✗ **A)** Obtain approval from the ROP to open the account no later than 1 business day after the first options trade.
- ✗ **B)** Provide an options disclosure document no later than 15 days after the first trade.
- ✓ **C)** Review with the client the risks involved when trading options and determine what types of options trading are appropriate for this client before the first options trade.
- ✗ **D)** Assure that an options agreement has been signed prior to the first trade taking place.

Explanation

It is imperative that suitability and risk be addressed with the client before allowing option trading to take place.

Reference: 4.6.3.1 in the License Exam Manual

Question #124 of 211

Question ID: 605579

Which of the following positions exposes a customer to unlimited risk?

- ✓ **A)** All of these.
- ✗ **B)** Short 200 shares of XYZ.
- ✗ **C)** Short 2 XYZ uncovered calls.
- ✗ **D)** Short 200 shares of XYZ and short 2 XYZ puts.

Explanation

All of the positions expose the client to unlimited risk because a loss will occur if the stock price rises.

Reference: 4.2.2 in the License Exam Manual

Question #125 of 211

Question ID: 605898

A Designated Primary Market Maker on the floor of the CBOE:

- ✓ **A)** may trade for his own account.
- ✗ **B)** is not a CBOE member.
- ✗ **C)** may only act as an agent.
- ✗ **D)** is an employee of the CBOE.

Explanation

A Designated Primary Market Maker on the floor of the CBOE is an exchange member who acts as both an agent assisting in maintaining the electronic order book on behalf of the CBOE and a market maker who may trade for their own account.

Reference: 4.6.2.1 in the License Exam Manual

Question #126 of 211

Question ID: 605591

The investor with the greatest potential risk if the price of XYZ goes up is the one who is:

- ✓ **A)** short calls.
- ✗ **B)** short puts.
- ✗ **C)** long puts.
- ✗ **D)** long calls.

Explanation

Only bearish investors are at risk if the stock price goes up. The bearish options are short calls and long puts. Short calls are the riskiest position. Put buyers stand to lose the premium paid, but call writers have an unlimited risk. They can be required to deliver stock at the exercise price, and to do so, they will have to purchase stock at the market price, no matter how high.

Reference: 4.2.2.6 in the License Exam Manual

Question #127 of 211

Question ID: 605602

Which of the following has unlimited risk if it is the only position in an account?

- ✗ **A)** Long put.
- ✓ **B)** Short call.
- ✗ **C)** Short put.
- ✗ **D)** Long call.

Explanation

Uncovered short calls carry unlimited risk.

Reference: 4.2.2.6 in the License Exam Manual

Question #128 of 211

Question ID: 605806

If a customer believes the Swiss franc will depreciate against the U.S. dollar, which of the following option strategies may *best* take advantage of the expected depreciation?

- ✓ **A)** Uncovered call writing.
- ✗ **B)** Credit put spread.
- ✗ **C)** Uncovered put writing.
- ✗ **D)** Debit call spread.

Explanation

Call writing is bearish, while credit put spreads, debit call spreads, and uncovered put writing are bullish.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #129 of 211

Question ID: 605809

The writer of an IRX yield based option, if exercised, must:

- ✗ **A)** receive cash.
- ✗ **B)** receive T-notes.
- ✗ **C)** deliver T-bills.
- ✓ **D)** deliver cash.

Explanation

Yield based options settle in cash if the option is exercised. The writer must deliver the in-the-money amount in cash.

Reference: 4.5.2 in the License Exam Manual

Question #130 of 211

Question ID: 605611

If a customer sells 3 DEF Feb 25 Puts at 4 when DEF is at 24, the maximum potential gain is:

- ✓ **A)** 1200.
- ✗ **B)** 800.
- ✗ **C)** 400.
- ✗ **D)** unlimited.

Explanation

The maximum gain when a put (or any option) is sold is the premium received. Since there are 3 contracts, the gain is 3 multiplied by $400, or $1,200.

Reference: 4.2.4 in the License Exam Manual

Question #131 of 211

Question ID: 605816

Due to an escalating trade war, the portfolio manager of an equity mutual fund anticipates a negative impact on his fund's assets. To protect his investment portfolio, the fund manager would:

- ✗ **A)** buy S&P 500 index calls.
- ✗ **B)** sell S&P 500 index calls.
- ✗ **C)** sell S&P 500 index puts.
- ✓ **D)** buy S&P 500 index puts.

Explanation

A portfolio manager who expects a decline in the market as a result of a trade war (or any factor that might hurt stock prices) would buy puts on a broad market index such as the S&P 500 to protect his position. Selling calls limits upside potential, and only protects the portfolio to the extent of the income received from the sale of the calls.

Reference: 4.5.1.2 in the License Exam Manual

Question #132 of 211

Question ID: 605569

If a customer writes 1 ABC 60 put at 5 when ABC is trading at 58, which of the following statements are TRUE?

I. The time value of the option is 2 points.
II. The time value of the option is 3 points.
III. Breakeven is 65.
IV. Breakeven is 55.

- ✗ **A)** I and IV.
- ✗ **B)** II and III.
- ✓ **C)** II and IV.
- ✗ **D)** I and III.

Explanation

Puts (long or short) are in-the-money if the market price is below the strike price. In this case, the put is in-the-money by 2 points. The total premium is 5 points, and the time value is 3 points. Option premiums consist of 2 components: intrinsic value and time value. Once the in-the-money amount is determined, it is easy to back into time value. Breakeven for puts (long or short) is the strike price minus premium.

Reference: 4.2.4 in the License Exam Manual

Question #133 of 211

Question ID: 605831

On Friday, September 15, an investor goes long 1 OEX Dec 575 call at 7 when the index is at 581.96. At expiration, the investor closes out the long position at intrinsic value when the index is at 580. What amount of money will be deposited in the investor's account on the following Monday, and what will the profit or loss be to the investor?

- ✗ **A)** $500/$200 gain.
- ✗ **B)** $696/$196 gain.
- ✗ **C)** $500/$196 loss.
- ✓ **D)** $500/$200 loss.

Explanation

Index options settle in cash on the next business day. Each point in an index option is valued at $100. On settlement, the investor will receive the difference between 580 and 575 (5 × 100) or $500. With a cost of 7 ($700), this will create a $200 loss.

Reference: 4.5.1.1.6 in the License Exam Manual

Question #134 of 211

Question ID: 721415

As a registered representative you often have customers who are interested in learning about derivative products such as options and different derivative strategies. Of the following customer profiles which would writing calls be considered least suitable for?

- ✗ **A)** Mr. Clark, a small business owner nearing the sale of his business to take an early retirement at age 52. A lump sum annuity has been in place in anticipation of the early retirement and the business sale proceeds will be more than adequate for his early anticipated living expenses. Current savings total $55,000 and his investment account objective is growth.
- ✗ **B)** Miss Smith, age 41, able to add to her savings each month after living expenses from her monthly income. Currently building retirement account balances in an IRA and company sponsored 401k plan. Recently investing in an income producing vacation property her savings outside of retirement accounts currently total $70,000. Growth is listed on her investment account as her objective.

- ✗ **C)** Mr. and Mrs. Johnson, both young professionals with a combined annual income of $80,000. Both making small annual IRA contributions and participating in company sponsored 401k plans. Mrs. Johnson will also be eligible for pension plan payments after retirement several years away. Current savings total $25,000 and their joint investment account objective is growth.
- ✓ **D)** Mr. and Mrs. Jones, both retired, covering monthly expenses with their social security and annual mandatory IRA withdrawals. Savings outside of retirement accounts total $25,000. Income is the investment objective listed on the account.

Explanation

While these profiles offer some guidance and any of them could be considered incomplete to some extent the one for whom writing calls would be considered the least suitable is the retired joint account; Mr. and Mrs. Jones. Factors to note would be the nominal total savings and that both are in retirement needing social security and mandatory IRA withdrawals to meet current living expenses. Consider that while writing calls brings income into an account it is a strategy that is high in risk with an unlimited maximum loss potential; not suitable for a retired couple in their position.

Reference: 4.2.2.6 in the License Exam Manual

Question #135 of 211

Question ID: 605850

For a customer who has purchased stock and wants to write a call option, the option ticket would be marked:

- ✗ **A)** opening purchase.
- ✗ **B)** closing sale.
- ✗ **C)** closing purchase.
- ✓ **D)** opening sale.

Explanation

An opening transaction is used when establishing a new option position. It is an opening purchase if your client is buying the option. It is an opening sale if your client is writing the option. "Closing" is the term used when the client eliminates an existing option position through a trade of the contract.

Reference: 4.6.3.4 in the License Exam Manual

Question #136 of 211

Question ID: 605572

A customer writes 10 XYZ Jan 60 calls at 3.50 when XYZ is trading at 61. Which of the following statements regarding gain and loss are TRUE?

I. Maximum gain is $56,500.
II. Maximum gain is $3,500.
III. Maximum loss is $63,500.
IV. Maximum loss is unlimited.

- ✗ **A)** I and IV.
- ✗ **B)** I and III.
- ✗ **C)** II and III.
- ✓ **D)** II and IV.

Explanation

For any writer, maximum gain is limited to the premium received (in this case it is $3,500). For uncovered call writers, maximum loss potential is unlimited.

Reference: 4.2.2 in the License Exam Manual

Question #137 of 211

Question ID: 605589

Which of the following has the *least* amount of risks?

I. Long a call in a rising market.
II. Long a put in a falling market.
III. Short a call in a rising market.
IV. Short a put in a falling market.

- ✗ **A)** II and III.
- ✓ **B)** I and II.
- ✗ **C)** I and IV.
- ✗ **D)** III and IV.

Explanation

If the market goes up, the value of call options increases and the value of put options decreases. The opposite is true in a falling market. To be long an option is always less risky than being short, because in a long position, the most one can lose is the option premium. If the market acts unfavorably, simply let the option expire. Such is not the case when writing options; there is no control over when the stock will be put to or called away from the customer.

Reference: 4.2.5.1 in the License Exam Manual

Question #138 of 211

Question ID: 605821

An investor wants to profit from a speculative, near-future market advance, but he is uncertain which stocks will be affected. To limit his risk to a specific amount, which of the following actions would *best* meet his objectives?

- ✓ **A)** Buy calls on a broad-based stock index.
- ✗ **B)** Sell puts on a narrow-based stock index.
- ✗ **C)** Buy calls on a narrow-based stock index.
- ✗ **D)** Purchase several blue-chip stocks on margin.

Explanation

Broad-based index options allow investors to profit on their beliefs about movement in the overall market. Index calls profit the investor if the index closes above the strike price plus the premium paid. The investor has limited risk, because only the premium of the option can be lost if the market moves downward. Narrow-based index options involve a single market sector only (for example, technology stocks).

Reference: 4.5.1.2 in the License Exam Manual

Question #139 of 211

Question ID: 605609

What is the maximum potential loss for a naked put option?

- ✗ **A)** Premium.
- ✗ **B)** Unlimited.
- ✓ **C)** Strike price minus premium.
- ✗ **D)** Strike price plus premium.

Explanation

The maximum loss on a naked put is equal to the breakeven (strike price minus premium for puts). The maximum loss is breakeven multiplied by the number of shares covered by the contracts.

Reference: 4.2.4.5 in the License Exam Manual

Question #140 of 211

Question ID: 605841

Which of the following would be the least considered factor in determining if a particular type of options trading is suitable for a customer?

- ✗ **A)** Willingness to assume risk
- ✓ **B)** Ability to meet margin calls
- ✗ **C)** Understanding maximum gain or loss potential
- ✗ **D)** Understanding the strategy being employed

Explanation

Remember that while most firms require that options trades be done in margin accounts, options purchases are not marginable. Therefore, of the choices listed, the ability to meet margin calls would be the least considered factor regarding suitability.

Reference: 4.6.3.1 in the License Exam Manual

Question #141 of 211

Question ID: 786008

Which of the following statements regarding the exercise of options contracts are TRUE?

I. The exercise of equity options settles the next business day.
II. The exercise of equity options settles in 2 business days.
III. The exercise of index options settles next business day.
IV. The exercise of index options settles in 2 business days.

- ✗ **A)** I and IV
- ✗ **B)** I and III
- ✗ **C)** II and IV
- ✓ **D)** II and III

Explanation

Listed equity options, if exercised, settle in 2 business days (regular way settlement for equities). Index options, if exercised, settle on the next business day in cash.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #142 of 211

Question ID: 605832

The manager of a portfolio that consists predominately of large- and mid-cap stocks could hedge against a market downturn and generate additional income by

- ✗ **A)** buying broad index puts.
- ✗ **B)** buying broad index calls.
- ✓ **C)** selling broad index calls.
- ✗ **D)** selling broad index puts.

Explanation

The only way to generate income through the use of options is to sell them. If one is concerned that the market may fall, selling calls is the appropriate strategy.

Reference: 4.5.1.2 in the License Exam Manual

Question #143 of 211

Question ID: 605803

If a U.S. corporation exports machine tools to Switzerland and will be paid in Swiss francs, to protect against foreign-exchange risk it should:

- ✗ **A)** sell SF calls.
- ✗ **B)** sell SF puts.
- ✗ **C)** buy SF calls.
- ✓ **D)** buy SF puts.

Explanation

To hedge, exporters buy puts on foreign currency. The U.S. exporter's risk is that the value of the Swiss franc will be falling against the U.S. dollar. Owning the SF puts would benefit the U.S. corporation should this risk occur.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #144 of 211

Question ID: 605932

On January 1, an investor buys 1 FLB Apr 50 call at 4 and 1 FLB Apr 50 put at 2.50. If both options expire unexercised, what are the tax consequences for the investor?

- ✗ **A)** $150 net capital loss.
- ✗ **B)** $150 net capital gain.
- ✓ **C)** $400 loss on the call, $250 loss on the put.
- ✗ **D)** $400 gain on the call, $250 gain on the put.

Explanation

In a straddle the options are treated separately for tax purposes. The investor has a $400 capital loss on the call and a $250 capital loss on the put. Both are short-term losses.

Reference: 4.7.0.1 in the License Exam Manual

Question #145 of 211

Question ID: 605856

If a 50% stock dividend is declared, the owner of 1 XYZ Jul 30 call owns:

- ✗ **A)** 2 contracts for 100 shares with an exercise price of 20.
- ✓ **B)** 1 contract for 150 shares with an exercise price of 20.
- ✗ **C)** 1 contract for 100 shares with an exercise price of 20.
- ✗ **D)** 2 contracts for 150 shares with an exercise price of 30.

Explanation

When a company pays a stock dividend or effects a fractional stock split the number of contracts remains the same but each contract is adjusted by increasing the number of shares the contract covers (100 × 150% = 150 shares). The effective strike price is adjusted so that the position value remains the same before and after the adjustment. In this case 20 ($3,000 / 150 shares = $20).

Reference: 4.6.3.3 in the License Exam Manual

Question #146 of 211

Question ID: 605894

Which of the following are on the same side of the market?

- ✗ **A)** Short 1 XYZ call and short 1 XYZ put.
- ✓ **B)** Short 1 XYZ call and long 1 XYZ put.
- ✗ **C)** Long 1 XYZ call and long 1 XYZ put.
- ✗ **D)** Long 1 XYZ call and short 1 XYZ call.

Explanation

Long calls and short puts are on the same side (bullish); long puts and short calls are on the same side (bearish). The number of contracts on the same side of the market are used to calculate whether or not position limits have been violated.

Reference: 4.6.1.5 in the License Exam Manual

Question #147 of 211

Question ID: 605903

If an investor buys 1 DWQ Apr 70 call at 5, giving him the right to buy 100 shares of DWQ at $70 per share, which aspect of the transaction is NOT set or standardized by the OCC?

- ✗ **A)** Contract size of 100 shares.
- ✗ **B)** Expiration date in April.
- ✗ **C)** Exercise price of 70.
- ✓ **D)** Premium of 5.

Explanation

The OCC sets standard exercise prices and expiration dates for all listed options, but the options premiums that buyers pay are determined by the market.

Reference: 4.6.3 in the License Exam Manual

Question #148 of 211

Question ID: 605607

Under which of the following circumstances would an investor risk an unlimited loss?
I. Short 1 IBS Jul 50 put.
II. Short 100 shares of IBS stock.
III. Short 1 IBS Jul 50 uncovered call.
IV. Short 1 IBS Jul 50 covered call.

✗ **A)** I and II.
✓ **B)** II and III.
✗ **C)** II and IV.
✗ **D)** I and III.

Explanation

A short stock position gives an investor unlimited risk potential if the stock should rise because the investor must eventually buy back the stock at the higher price. Because stock can rise an unlimited amount, there is unlimited risk. The sale of a naked call requires that, if exercised, the writer must buy the stock in the market and deliver it at the strike price.

Reference: 4.2.1.6 in the License Exam Manual

Question #149 of 211

Question ID: 605588

Which of the following listed option positions is *most* unsuitable for a customer whose investment objectives include minimal risk?

✗ **A)** Long call.
✗ **B)** Short put.
✗ **C)** Long put.
✓ **D)** Short call.

Explanation

The sale of the call option burdens the investor with unlimited upside potential risk.

Reference: 4.2.2.6. in the License Exam Manual

Question #150 of 211

Question ID: 605885

Performance of the terms of a standardized listed option contract are guaranteed by the:

✓ **A)** OCC.
✗ **B)** SEC.
✗ **C)** CBOT-CME.
✗ **D)** NYBOT.

Explanation

The Options Clearing Corporation issues, guarantees, and handles the exercise and assignment of listed options.

Reference: 4.6.3 in the License Exam Manual

Question #151 of 211

Question ID: 605914

A customer, long 100 shares of ABC at 73, writes 1 ABC Apr 75 call at 2 to generate additional income. ABC stock subsequently moves higher at which time the customer is exercised. For tax purposes, which of the following statements are TRUE?
I. Cost basis is $73 per share.
II. Cost basis is $71 per share.
III. Sales proceeds are $75 per share.
IV. Sales proceeds are $77 per share.

- ✗ **A)** I and III.
- ✗ **B)** II and IV.
- ✗ **C)** II and III.
- ✓ **D)** I and IV.

Explanation

If a covered call writer is exercised, cost basis (for tax purposes) is the cost of stock purchased. Sales proceeds are adjusted (strike price plus premium) to reflect the premium received.

Reference: 4.7.0.3 in the License Exam Manual

Question #152 of 211

Question ID: 605928

If an investor sells 1 TCB Jan 50 put at 7 on July 15, 2013, and the put expires unexercised, what are the tax consequences?

- ✗ **A)** $700 ordinary income reportable for tax year 2013.
- ✓ **B)** $700 short-term capital gain reportable for tax year 2014.
- ✗ **C)** $700 ordinary income reportable for tax year 2014.
- ✗ **D)** $700 short-term capital gain reportable for tax year 2013.

Explanation

For tax purposes, any premiums earned are recognized at the expiration date. In this case the January contract purchased in July, 2013 will expire in January, 2014. Options writers always have short-term gains or losses.

Reference: 4.7.0.1 in the License Exam Manual

Question #153 of 211

Question ID: 605827

Using yield-based options, which of the following hedging strategies offers a bond portfolio manager the greatest protection against rising long-term interest rates?

- ✗ **A)** Buy 30-year T-bond yield-based puts.
- ✓ **B)** Buy 30-year T-bond yield-based calls.
- ✗ **C)** Sell 30-year T-bond yield-based calls.
- ✗ **D)** Sell 30-year T-bond yield-based puts.

Explanation

In this example, the options would increase in value as the actual yield on the 30-year Treasury bonds rose above the yield value represented by the strike price of the option.

Reference: 4.5.2 in the License Exam Manual

Question #154 of 211

Question ID: 605931

If an investor buys a LEAPS contract on issuance and allows it to expire unexercised, what is the investor's tax consequence at expiration?

- ✗ **A)** Long-term capital gain.
- ✗ **B)** Short-term capital gain.
- ✓ **C)** Long-term capital loss.
- ✗ **D)** Short-term capital loss.

Explanation

A LEAPS contract has an expiration of more than one year. Upon expiration, the buyer incurs a long-term capital loss equal to the amount of the premium paid.

Reference: 4.7.0.1 in the License Exam Manual

Question #155 of 211

Question ID: 605828

Which of the following securities underlies a yield-based option?

- ✗ **A)** Income bonds.
- ✗ **B)** Debentures.
- ✓ **C)** Treasury securities.
- ✗ **D)** Revenue bonds.

Explanation

Yield-based interest rate options are based on the yields of Treasury bills, notes, and bonds.

Reference: 4.5.2 in the License Exam Manual

Question #156 of 211

Question ID: 605890

A customer is long 10 XYZ Jan 60 calls, and XYZ declares a 20% stock dividend. On the ex-date, the customer will have:

- ✗ **A)** 10 XYZ Jan 50 calls (100 shares per contract).
- ✗ **B)** 12 XYZ Jan 60 calls (120 shares per contract).
- ✗ **C)** 10 XYZ Jan 60 calls (100 shares per contract).
- ✓ **D)** 10 XYZ Jan 50 calls (120 shares per contract).

Explanation

When adjusting options contracts for stock dividends and fractional splits, the number of contracts held will not change. The number of shares covered by each contract is increased (100 shares × 120%) so that in this example each adjusted contract now represents 120 shares. The effective exercise price is adjusted so that the position value remains the same before and after the adjustment. Therefore the new strike price will be 50 ($6,000 / 120 shares = $50).

Reference: 4.6.3.3 in the License Exam Manual

Question #157 of 211

Question ID: 605811

If 1 OEX 375 call is purchased at 3.25 and exercised when the S&P 100 closes at 381, the writer delivers which of the following to the holder?

- ✓ **A)** $600 cash.
- ✗ **B)** $325 cash.
- ✗ **C)** $600 in stocks.
- ✗ **D)** $381 in securities.

Explanation

Index options settle in cash. Physical delivery does not occur. The call buyer receives cash equal to the difference between the strike price and the index closing value on the day the option is exercised.

Reference: 4.5.1.1.6 in the License Exam Manual

Question #158 of 211

Question ID: 605570

The market attitude of an investor with no other position who writes an at-the-money put is:

- ✗ **A)** bullish.
- ✗ **B)** bearish/neutral.
- ✓ **C)** bullish/neutral.
- ✗ **D)** bearish.

Explanation

Writers of puts are bullish. However, an investor who writes an at-the-money put profits even if the market price of the stock does not move (neutral) because the option will expire worthless. The customer also profits if the stock rises out-of-the-money.

Reference: 4.2.4 in the License Exam Manual

Question #159 of 211

Question ID: 605794

If a customer went long 10 Swiss franc puts (10,000 SF per contract) for a premium of 5.25 each, how much can the client lose on the total position of 10 contracts?

- ✗ **A)** 781.25.
- ✗ **B)** 525.
- ✓ **C)** 5250.
- ✗ **D)** 1250.

Explanation

When long an option contract, the maximum loss is the amount paid. Because the premium is in cents, multiply the figures to determine the total dollar amount ($.0525 × 10,000 × 10 contracts = $5,250).

Reference: 4.5.3.1.3 in the License Exam Manual

Question #160 of 211

Question ID: 605620

All of the following can be advantages of buying an option contract EXCEPT

- ✗ **A)** to limit risk
- ✓ **B)** time value dissipation
- ✗ **C)** to position against a written option
- ✗ **D)** leverage

Explanation

The purchase of an option allows an investor to speculate and fully participate in the price movement of the underlying security at a fraction of the cost of the shares involved, thus leveraging his investment. When used to position against a written option (a spread), the purchase of an option will reduce the risk of loss involved with a single written option. Used in conjunction with a securities position, the purchase of an option can act as an insurance policy to reduce the risk of loss (hedging); therefore, options offer all of these advantages but only for a limited period of time. As the contract gets nearer to expiration its time value dissipates. This is not considered an advantage of owning options contracts.

Reference: 4.2 in the License Exam Manual

Question #161 of 211

Question ID: 721422

Jerry Avery bought 100 shares of DMF at 30 and two weeks later bought a 9-month DMF put at 4. The put expired. What was Jerry's tax consequence?

- ✓ **A)** $400 short-term loss.
- ✗ **B)** None, the cost of the put is added to the cost of the stock.
- ✗ **C)** $2,600 loss.
- ✗ **D)** $400 long-term loss.

Explanation

When the put expired worthless, Jerry had a short-term loss of $400. Because the put was bought two weeks after the stock it is not considered a "married put" for tax purposes. Married put scenarios have their own unique tax consequences.

Reference: 4.7.0.1 in the License Exam Manual

Question #162 of 211

Question ID: 605891

If a customer is long ABC Sep 30 calls and the stock becomes subject to a trading halt on the floor of the NYSE, the customer is permitted to:

- ✗ **A)** establish a long straddle.
- ✗ **B)** enter a closing sale.

- ✓ **C)** issue exercise instructions.
- ✗ **D)** establish a long call spread.

Explanation

If trading in the underlying security is halted, options trading on that security is also halted. However, the customer may still issue exercise instructions to the OCC because this is an off-floor transaction.

Reference: 4.6 in the License Exam Manual

Question #163 of 211

Question ID: 605789

If an investor purchases 2 Dec 81.50 Swiss franc calls at 2.5, (each contract is 10,000 francs), how much does the investor pay for the position?

- ✗ **A)** 81500.
- ✗ **B)** 250.
- ✓ **C)** 500.
- ✗ **D)** 2500.

Explanation

One call offered at 2.5 is equal to $250 multiplied by 2 contracts, for a total premium of $500.

Reference: 4.5.3.1.3 in the License Exam Manual

Question #164 of 211

Question ID: 605600

A customer who writes (sells) a naked call will profit if:

- ✓ **A)** the option contract expires without being exercised by the owner.
- ✗ **B)** the price of the underlying stock rises above the strike price plus the premium received.
- ✗ **C)** the price of the option contract rises.
- ✗ **D)** the customer is assigned on the contract.

Explanation

The writer of a call will profit if the contract expires unexercised. In which case, the premium received when the contract was written will be the profit. If the call writer is assigned, which means that it was exercised by the owner, it would be because the stock price has risen to greater than the strike price plus the premium; good for the call owner, but not the call writer. Remember that as the underlying security rises in price, so will the price of the call contract; once again, good for the call owner but not the call writer.

Reference: 4.2.2 in the License Exam Manual

Question #165 of 211

Question ID: 605571

The market attitude of an investor with no other position who writes an at-the-money call is:

- ✓ **A)** bearish/neutral.
- ✗ **B)** bullish.
- ✗ **C)** bullish/neutral.
- ✗ **D)** bearish.

Explanation

Writers of calls are bearish. However, when an investor writes an at-the-money call, the investor profits even if the market price of the stock does not move (neutral) because the option will expire worthless. The customer profits to the same degree if the stock falls out-of-the-money.

Reference: 4.2.2 in the License Exam Manual

Question #166 of 211

Question ID: 605798

US exchange listed foreign currency option premiums are quoted in which of the following?

- ✗ **A)** Units of foreign currency
- ✗ **B)** Both units of foreign currency and the percentage of value of the foreign currency
- ✓ **C)** US dollars
- ✗ **D)** Percentage of value of the foreign currency

Explanation

Foreign currency option premiums are quoted in US dollars. Because one point equals $100, a premium quote of 1.70 equals $170.

Reference: 4.5.3.1.3 in the License Exam Manual

Question #167 of 211

Question ID: 605860

When does a customer have to receive the Options Disclosure Document?

- ✗ **A)** Within 15 days of account approval by the firm's ROP.
- ✗ **B)** With the confirmation of his first options transaction.
- ✓ **C)** Before the first order.
- ✗ **D)** Within 5 business days of the first options trade.

Explanation

When opening an account to trade options, the owner must be told about the risks involved with trading options. By providing the owner with an Options Disclosure Document entitled "Understanding the Risks and Uses of Options", the broker/dealer satisfies the risk disclosure requirements. This document is used instead of the Options Clearing Corporation's (OCC's) prospectus.

Reference: 4.6.3.1 in the License Exam Manual

Question #168 of 211

Question ID: 605581

A customer writes 1 XYZ Jul 70 call at 5 when XYZ is trading at 72. If the stock subsequently rises to 76 and the contract is exercised, the customer has:

- ✗ **A)** a gain of $900.
- ✓ **B)** a loss of $100.
- ✗ **C)** no gain or loss.
- ✗ **D)** a gain of $100.

Explanation

The customer was forced to sell stock at 70. To deliver the stock, the customer must buy it at the market for 76, for a $600 loss. However, the customer received a premium of $500 so the overall loss is $100. Alternatively, breakeven is 75 (strike price plus premium). Writers of calls, who are bearish, make money if the stock stays below the breakeven point. Above the breakeven point, writers of calls lose money. Because the contract was exercised when XYZ was 76 (1 point above the breakeven point), the customer has a $100 loss.

Reference: 4.2.6 in the License Exam Manual

Question #169 of 211

Question ID: 605813

Index options differ from stock options in which of the following ways?

- ✗ **A)** The trade settlement date is the next business day.
- ✗ **B)** They are subject to closing purchases as well as closing sales.
- ✓ **C)** The exercise settlement is in cash.
- ✗ **D)** The expiration date is the third Friday of the expiration month.

Explanation

When an index option is exercised, cash is paid to the option holder for the amount in-the-money. In contrast, exercising a stock option involves delivering the underlying stock. Both index options and stock options have the same expiration date and the same trade settlement date. Closing transactions can be purchases or sales for any option, regardless of the underlying asset.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #170 of 211

Question ID: 605930

On February 7, a customer buys 100 shares of LMN at $39 per share and simultaneously writes an LMN Oct 35 call option at 6. If the call is exercised on July 19, what will he report for tax purposes?

- ✗ **A)** $600 gain.
- ✗ **B)** $200 loss.
- ✗ **C)** $600 loss.
- ✓ **D)** $200 gain.

Explanation

The premium received for writing a call becomes part of the stock sales proceeds for a total of $4,100. Because the investor bought the stock 5 months earlier for $3,900, he incurred a $200 capital gain (short-term).

Reference: 4.7.0.3 in the License Exam Manual

Question #171 of 211

Question ID: 605922

If a customer buys 1 OXY Oct 50 call at 3, and the holder exercises the option when the stock is trading at 60, what is the cost basis of the 100 shares?

- ✗ **A)** 6000.
- ✗ **B)** 6300.
- ✗ **C)** 5000.
- ✓ **D)** 5300.

Explanation

The cost basis of acquiring the shares is 100 multiplied by the strike price of 50, which equals $5,000, plus the cost of the call, $300. Total cost or cost basis is $5,300.

Reference: 4.7.0.3 in the License Exam Manual

Question #172 of 211

Question ID: 721414

Call-buying strategies include all of the following EXCEPT

- ✗ **A)** an increase in leverage with limited risk
- ✓ **B)** covering a long stock position
- ✗ **C)** protection of a profit on a short sale of stock
- ✗ **D)** acquisition of a stock position

Explanation

Long stock and long calls have the same market attitude: bullish. Therefore, covering a long stock position cannot be accomplished by buying calls. The remaining answer selections are all strategies that could warrant call buying: increased leverage, acquisition of stock, and hedging a short stock position.

Reference: 4.2.1 in the License Exam Manual

Question #173 of 211

Question ID: 605604

Which of the following would not be a concern for an investor writing a naked option?

- ✗ **A)** the loss potential.

✓ **B)** the premium the investor must pay for the contract.
✗ **C)** the risk/reward ratio.
✗ **D)** the possibility of exercise.

Explanation

The writer of any option contract receives the premium they do not pay it. A naked option writer would consider the risk/reward ratio, the loss potential, and the possibility that the contract would be exercised by the party who purchased it.

Reference: 4.2.2.6 in the License Exam Manual

Question #174 of 211

Question ID: 605876

Which of the following statements regarding the discussion of options with customers is TRUE?

✗ **A)** An OCC options disclosure document must be in a customer's hands before options can be discussed.
✓ **B)** In every discussion about the benefits of options, a statement must be made regarding the corresponding risks.
✗ **C)** Buying or selling straddles only would require no risk disclosures.
✗ **D)** Covered call writing has such a limited risk that it is unnecessary to point out risk factors.

Explanation

Any description of options must include a description of the risks. This rule applies to all communications with the public, written, electronic, or in person.

Reference: 4.6.3.1 in the License Exam Manual

Question #175 of 211

Question ID: 786007

Which of the following statements regarding index options are TRUE?

I. Exercise is settled in cash.
II. Exercise settlement value is based on the value of the index at the time exercise instructions are received.
III. Exercise settlement value is based on the closing index value on the day exercise instructions are tendered.
IV. Exercise settlement is T + 2.

✗ **A)** I and II
✓ **B)** I and III
✗ **C)** II and III
✗ **D)** II and IV

Explanation

All index option exercises are settled in cash. The amount a writer owes the holder is known as the intrinsic value of the option, and the settlement value is based on the closing index value on the day exercise instructions are tendered. Exercise settlement is next business day.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #176 of 211

Question ID: 605819

A customer shorts 1 OEX (S&P 100) 935 call at 7. If the customer is assigned an exercise notice on the call when the OEX closes at 944, the customer realizes:

✓ **A)** a $200 loss.
✗ **B)** a $700 gain.
✗ **C)** a $900 loss.
✗ **D)** a $1,600 loss.

Explanation

The call is in-the-money by 9 (944 − 935). The writer must deliver cash to the buyer equal to the intrinsic value. To determine the investor's profit or loss, the intrinsic value is reduced by the premium paid (9 − 7 = 2). Since each index point is worth $100, the investor has a loss of $200 because the money paid on exercise exceeded the premium received.

Reference: 4.5.1.1.6 in the License Exam Manual

Question #177 of 211

Question ID: 605824

The holder of a yield-based call option would be more likely to profit if
I. rates rise
II. rates fall
III. debt prices rise
IV. debt prices fall.

- ✗ **A)** II and IV.
- ✗ **B)** II and III.
- ✗ **C)** I and III.
- ✓ **D)** I and IV.

Explanation

Holders of yield-based call options profit if rates rise. Prices of debt securities fall if rates rise.

Reference: 4.5.2 in the License Exam Manual

Question #178 of 211

Question ID: 605861

Which of the following will halt trading in listed options when there is a trading halt in the underlying stock?

- ✗ **A)** The exchange on which the stock is listed.
- ✗ **B)** The OCC.
- ✗ **C)** The SEC.
- ✓ **D)** The options exchange on which the option is listed.

Explanation

If trading is halted in any stock on which options trade, trading in those options is also halted by the CBOE.

Reference: 4.6 in the License Exam Manual

Question #179 of 211

Question ID: 605844

An option confirmation must include all of the following EXCEPT:

- ✗ **A)** the type of option and commission.
- ✗ **B)** the number of contracts and premium.
- ✗ **C)** the strike price.
- ✓ **D)** the positions market attitude (bullish or bearish).

Explanation

An option transaction's confirmation must completely recap the essential elements of the trade including the number of contracts traded, the description of the security traded (type of option and strike price), the price of the security traded (premium), and any commission charges. The positions market attitude (bullish or bearish) is not included on the confirmation.

Reference: 4.6.3 in the License Exam Manual

Question #180 of 211

Question ID: 605786

An investor who believes the U.S. dollar will strengthen against the Canadian dollar should profit from which of the following strategies?

I. Buying puts on the Canadian dollar.
II. Writing puts on the Canadian dollar.
III. Writing a straddle on the Canadian dollar.
IV. Establishing a call credit spread on the Canadian dollar.

- ✗ **A)** II and IV.
- ✗ **B)** III and IV.
- ✓ **C)** I and IV.
- ✗ **D)** I and III.

Explanation

The investor who is bearish on the Canadian dollar should buy puts, write calls, and call spreads. Short straddles pay off when the market does not move either way.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #181 of 211

Question ID: 605820

A customer who owns a portfolio of blue-chip stocks believes the securities will provide long-term appreciation, but fears that the market will decline over the short term. Which index options strategy should protect against the expected decline and allow the customer to generate additional income?

- ✗ **A)** Buy puts.
- ✗ **B)** Buy calls.
- ✓ **C)** Sell covered calls.
- ✗ **D)** Sell covered puts.

Explanation

Selling calls will generate income and protect the downside to the extent of the premiums received.

Reference: 4.5.1.2 in the License Exam Manual

Question #182 of 211

Question ID: 605884

Listed stock options cease to trade on the

- ✗ **A)** first Wednesday of the month
- ✗ **B)** last Friday of the month
- ✓ **C)** third Friday of the month of expiration
- ✗ **D)** last Saturday of the month of expiration

Explanation

Expiring options cease trading at 4:00 pm ET on the same day as expiration which is the third Friday of the month.

Reference: 4.6.1.2 in the License Exam Manual

Question #183 of 211

Question ID: 605851

A member firm is assigned an exercise notice by the Options Clearing Corporation. The member firm may assign the exercise notice to its customers by any of the following methods EXCEPT:

- ✓ **A)** to the customer having the largest short position.
- ✗ **B)** on a random-selection basis.
- ✗ **C)** to the customer having the oldest short position.
- ✗ **D)** in any way that is fair and equitable.

Explanation

While the OCC can assign exercise notices using only the random selection basis, a member firm may use any method that is fair and equitable. The two most common methods are first in, first out (FIFO) and random selection. It would not be considered fair to assign customers based on the size of their short position.

Reference: 4.6.3 in the License Exam Manual

Question #184 of 211

Question ID: 605805

A UK company exports sweaters to the U.S. and will be paid in U.S. dollars on delivery. To hedge foreign-exchange risk using listed currency options, the UK company should:

- ✓ **A)** buy British pound calls.
- ✗ **B)** buy British pound puts.
- ✗ **C)** sell British pound puts.
- ✗ **D)** sell British pound calls.

Explanation

Normally, exporters buy puts on foreign currency in order to hedge. There are no listed currency options available on the U.S. dollar, so the British company should buy calls on its own currency.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #185 of 211

Question ID: 605863

You and your spouse like to invest in option contracts. You each have separate individual accounts with different brokers for executing your trades. The current level of contract position limits for ABC stock is 75,000 contracts. Which of the following would be a violation of the contract limit?

- ✗ **A)** You are long 36,650 ABC calls; your spouse is long 38,350 ABC puts.
- ✗ **B)** You are short 38,650 ABC calls; your spouse is short 36,345 ABC calls.
- ✓ **C)** You are long 37,650 ABC puts; your spouse is short 37,560 ABC calls.
- ✗ **D)** You are long 37,950 ABC calls; your spouse is short 37,020 ABC calls.

Explanation

A violation would occur if you exceed the 75,000 contract position limit for ABC stock with combined positions that are on the same side of the market. A long put and a short call each represent a bearish position, and the combined positions in the correct answer exceed 75,000. Even though you each have individual accounts, it is deemed that you would each have control over the other's account for determination of contract position limit violations.

Reference: 4.6.1.5 in the License Exam Manual

Question #186 of 211

Question ID: 605839

Index options contracts that are commonly referred to as the "fear" gauge and based on the expected or implied volatility of the S&P 500 index are known as:

- ✗ **A)** the OEX or S&P 100 index options.
- ✗ **B)** the banking sector index options.
- ✗ **C)** the SPX or S&P 500 index options.
- ✓ **D)** the VIX or volatility market index options.

Explanation

VIX (volatility market index) options contracts are based on expected or implied volatility of the S&P 500. The VIX is commonly referred to as the "fear" gauge or index. When the VIX is high, it is neither a bullish nor bearish indicator but rather an indication of expected volatility in the market.

Reference: 4.5.1 in the License Exam Manual

Question #187 of 211

Question ID: 605782

A speculative investor believes the market in Japanese yen will remain stable for several months. Which of the following positions might allow the investor to take advantage of a lack of movement in the exchange rate between yen and U.S. dollar?

✗ **A)** Put debit spread.

✓ **B)** Short straddle.

✗ **C)** Call debit spread.

✗ **D)** Long straddle.

Explanation

If the spot price does not move, at least one option, perhaps both, will expire unexercised. The other positions will not yield profit without price movement. Note that a short straddle carries unlimited loss potential.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #188 of 211

Question ID: 605826

Which of the following entities guarantees a listed yield-based option?

✗ **A)** Broker/dealer.

✓ **B)** OCC.

✗ **C)** U.S. government.

✗ **D)** FRB.

Explanation

The Options Clearing Corporation (OCC) guarantees the performance of listed option contracts.

Reference: 4.5.2 in the License Exam Manual

Question #189 of 211

Question ID: 605869

If a registered representative wants to appear on a radio talk show to discuss various options strategies, which of the following statements is TRUE?

✓ **A)** The appearance must be approved by the ROP designated by the firm to handle compliance and supervisory issues.

✗ **B)** No approval is required, provided the representative does not make any recommendations.

✗ **C)** The appearance must be approved by FINRA.

✗ **D)** The appearance must be approved by the branch manager.

Explanation

If the topic to be discussed is options, the appearance must be approved by the firm's ROP designated to handle all options compliance and supervisory issues.

Reference: 4.6.3.2 in the License Exam Manual

Question #190 of 211

Question ID: 605800

All US exchange listed foreign currency options
I. are settled in the underlying foreign currency
II. are settled in cash (US dollars)
III. expire on the third Friday of the expiration month
IV. expire every Friday of each month.

✗ **A)** II and IV

✗ **B)** I and III

✗ **C)** I and IV

✓ **D)** II and III

Explanation

US exchange listed currency options are settled in cash (US dollars) and expire on the third Friday of the expiration month, just like equity options do.

Reference: 4.5.3.1 in the License Exam Manual

Question #191 of 211

Question ID: 605899

It would be fair and equitable for a brokerage firm to assign an option exercise notice to a customer:

- ✗ **A)** with the smallest open position in that option.
- ✗ **B)** with the largest open position in that option.
- ✗ **C)** who last wrote that option.
- ✓ **D)** who first wrote that option.

Explanation

The assignment of options contracts can be done on a FIFO basis (first in, first out) or by any other method that the OCC considers fair (i.e., random). Determining assignment by size of contract or on a LIFO (last in, first out) basis is not considered fair.

Reference: 4.6.3 in the License Exam Manual

Question #192 of 211

Question ID: 605606

An investor writes 1 TCB 320 put for 21.35 and the stock closes at 304.50. He makes a closing transaction at the intrinsic value and the result is a:

- ✗ **A)** $585 loss.
- ✗ **B)** $155 profit.
- ✓ **C)** $585 profit.
- ✗ **D)** $155 loss.

Explanation

The investor opened the position and received 21.35 for selling the option. He closed the position by buying the option at its intrinsic value, which equals the difference between the stock's market price and the option's strike price. In this example, 320 - 304.50 equals an intrinsic value of 15.50. The investor's gain is the difference between the sale price of 21.35 and the purchase price of 15.50, which equals 5.85, or $5.85. His profit is $5.85 multiplied by 100, or $585.00.

Reference: 4.2.4 in the License Exam Manual

Question #193 of 211

Question ID: 605923

If an investor who has owned FLB stock for 2 years now buys 1 FLB Oct put, this will:

- ✓ **A)** have no effect on the holding period.
- ✗ **B)** end the holding period and cause any loss to be long term and any gain to be short term.
- ✗ **C)** end the holding period and cause any gain or loss to be short term.
- ✗ **D)** end the holding period and cause any gain or loss to be long term.

Explanation

The investor already held the stock long term when the put was acquired so there is no effect on the holding period.

Reference: 4.7.1 in the License Exam Manual

Question #194 of 211

Question ID: 605915

If a customer who is long stock writes out-of-the-money calls against the position, and the calls subsequently expire worthless, for tax purposes the customer has a

- ✓ **A)** short-term gain.
- ✗ **B)** long-term loss.
- ✗ **C)** long-term gain.
- ✗ **D)** short-term loss.

Explanation

If short calls expire worthless, the gain (for tax purposes) is considered a short-term capital gain.

Reference: 4.7.0.1 in the License Exam Manual

Question #195 of 211

Question ID: 605921

If a customer buys 300 ABC at 53 and writes 3 ABC June 55 calls at 4, and the contracts expire unexercised the customer's cost basis in ABC stock at expiration is:

- ✗ **A)** 57.
- ✗ **B)** 51.
- ✗ **C)** 49.
- ✓ **D)** 53.

Explanation

The cost basis in the stock remains at the original purchase price. The premium received must be declared by the investor as a capital gain for tax purposes. Premiums on options will only affect the stock's cost basis or sales proceeds if the option is exercised, or if (on the same day) a customer buys stock and buys a put.

Reference: 4.7.0.1 in the License Exam Manual

Question #196 of 211

Question ID: 605849

An account initially approved only for covered call writing must be reapproved for which of the following?

I. Ratio writing.
II. Spreads.
III. Naked option writing.
IV. Straddles.

- ✗ **A)** II and III.
- ✗ **B)** I and II.
- ✓ **C)** I, II, III and IV.
- ✗ **D)** III and IV.

Explanation

An options account only approved for covered call writing must be reapproved in writing for any other option-related activity.

Reference: 4.6.3.1 in the License Exam Manual

Question #197 of 211

Question ID: 605612

If a customer writes 10 DEF Aug 50 calls at 1 when DEF is trading at 44, what is the maximum gain?

- ✓ **A)** 1000.
- ✗ **B)** 500.
- ✗ **C)** Unlimited.
- ✗ **D)** 100.

Explanation

When writing options, the maximum gain is equal to the premium received. Because there are 10 calls with a premium of $100 each, the maximum gain is 10 multiplied by $100, or $1,000.

Reference: 4.2.2.5 in the License Exam Manual

Question #198 of 211

Question ID: 605614

All of the following option positions have limited potential loss EXCEPT:

- ✗ **A)** short uncovered puts.
- ✓ **B)** short uncovered calls.
- ✗ **C)** long calls.
- ✗ **D)** long puts.

Explanation

A short uncovered call has unlimited potential loss because, theoretically, a stock's price can rise indefinitely. The potential loss on a short uncovered put can be large but is limited to the put's strike price minus the premium received per share. The potential loss on a long call or a long put is limited to the premium paid.

Reference: 4.2.2.6 in the License Exam Manual

Question #199 of 211

Question ID: 605810

If an index option is exercised, the holder's account will be:

- ✗ **A)** credited the out-of-the money amount.
- ✓ **B)** credited the in-the-money amount.
- ✗ **C)** debited the in-the-money amount.
- ✗ **D)** debited the out-of-the money amount.

Explanation

When index options are exercised, settlement is in cash rather than stock. The option writer delivers cash to the option buyer equal to the amount that the option is in-the-money.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #200 of 211

Question ID: 605596

All of the following are call buyers' objectives EXCEPT:

- ✗ **A)** diversifying holdings.
- ✗ **B)** delaying a decision to buy stock.
- ✓ **C)** hedging a long stock position against falling prices.
- ✗ **D)** speculating for profit on the rise in price of stock.

Explanation

Long stock positions are best hedged with the purchase of a long put. Call buyers protect short stock positions, speculate on the upward movement of a stock's price, diversify their holdings, and delay the decision to buy stock because of the expiration period.

Reference: 4.2.1 in the License Exam Manual

Question #201 of 211

Question ID: 605597

All of the following are advantages of buying a put versus selling stock short EXCEPT:

- ✗ **A)** one need not locate securities to be borrowed to buy a put.
- ✓ **B)** the put's time value, which gradually dissipates, is added to the intrinsic value.
- ✗ **C)** buying a put has a lower dollar-loss potential than does selling stock short.
- ✗ **D)** buying a put would require a smaller capital commitment.

Explanation

Selling short could result in unlimited loss, whereas buying a put limits loss to the premium and requires a smaller capital outlay than does selling short. Remember that short sales must be done in a margin account and 50% of the short market value (SMV) is required to be deposited by the short seller. Short sales require locating the securities to be borrowed; buying a put does not. The time value that erodes in a put option is a disadvantage because for each day that elapses, the option's time value decreases.

Reference: 4.2.3 in the License Exam Manual

Question #202 of 211

Question ID: 605812

A customer would buy index calls if he is:

- ✗ **A)** bearish on the Fortune 500 stocks.
- ✗ **B)** bearish on a particular blue-chip stock.
- ✓ **C)** bullish on the broad market.
- ✗ **D)** bullish on a particular OTC stock.

Explanation

An index option is based on the value of the broad market, not the value of an individual security. A person who believes the overall market is rising could take a bullish position and buy calls on the index's value.

Reference: 4.5.1.2 in the License Exam Manual

Question #203 of 211

Question ID: 605787

If an investor is long 5 Dec puts on the Canadian dollar, these options will expire in December on

- ✗ **A)** the Saturday after the third Friday
- ✓ **B)** the third Friday of the expiry month
- ✗ **C)** the Wednesday after the third Saturday
- ✗ **D)** the Friday preceding the third Wednesday

Explanation

Currency options, like equity options, expire on the third Friday of the expiry month.

Reference: 4.5.3.1.5 in the License Exam Manual

Question #204 of 211

Question ID: 605792

Your customer tells you that she sees the exchange rate for the British pound in the spot market is listed at 148.47. What do you tell her when she asks you what this means?

- ✓ **A)** One pound equals $1.4847.
- ✗ **B)** One pound equals 14.847 U.S. cents.
- ✗ **C)** $1 equals 14.847 pounds.
- ✗ **D)** $1 equals 1.4847 pounds.

Explanation

The exchange rate refers to U.S. cents per British pound; 148.47 equals $1.4847.

Reference: 4.5.3.1.3 in the License Exam Manual

Question #205 of 211

Question ID: 605912

Which of the following affects the holding period of XYZ stock, a position that has been held for 6 months?

I. Buying an in-the-money put
II. Buy an out-of-the-money put
III. Writing an in-the-money call
IV. Writing an out-of-the-money call.

- ✗ **A)** I and IV.
- ✗ **B)** III and IV.
- ✓ **C)** I and II.
- ✗ **D)** II and III.

Explanation

Buying a put (in or out-of-the-money) on a stock held short term (one year or less) stops the holding period until the put is disposed of.

Reference: 4.7.1 in the License Exam Manual

Question #206 of 211

Question ID: 605925

If an investor sells 1 TCB Jul 40 put and buys 1 TCB Jul 50 put, and subsequently sells the Jul 50 put, what is the consequence?

- ✓ **A)** Capital gain or loss.
- ✗ **B)** Short-term capital gain if he sells at a profit, or long-term capital loss if he sells at a loss.
- ✗ **C)** Long-term capital gain if he sells at a profit, or short-term capital loss if he sells at a loss.
- ✗ **D)** Passive income or loss.

Explanation

The investor opens with a vertical (price) spread. If he closes out one of the legs of the spread, he has a capital gain or loss for tax purposes as of the closing trade date.

Reference: 4.7.0.2 in the License Exam Manual

Question #207 of 211

Question ID: 786009

The writer of an equity call option who is assigned

- ✗ **A)** must deliver stock in 1 business day
- ✗ **B)** can enter a closing transaction any time before exercise settlement
- ✗ **C)** can enter a closing transaction on the day the exercise notice is received
- ✓ **D)** must deliver stock in 2 business days

Explanation

If exercised, the assigned call writer must deliver the underlying stock within 2 business days (regular way settlement for equity transactions).

Reference: 4.6.1.3 in the License Exam Manual

Question #208 of 211

Question ID: 605617

With the same dollar amount either paid or received, which of the following strategies can cause an investor to experience the greatest loss?

- ✗ **A)** Buying a straddle.
- ✗ **B)** Selling a covered put option.
- ✗ **C)** Selling a naked put option.
- ✓ **D)** Selling a naked call option.

Explanation

Selling a naked call option has an unlimited loss potential. If the holder of the option exercises, the call writer is obligated to deliver the shares of stock at the strike price. The naked call writer does not own the stock and must purchase the shares in the open market in order to fulfill the obligation.

Reference: 4.2.2.6 in the License Exam Manual

Question #209 of 211

Question ID: 605785

An investor believes that the U.S. dollar will rise in value against the British pound. To profit with limited risk, which of the following foreign currency option transactions would you recommend?

- ✗ **A)** Buy British pound calls.
- ✗ **B)** Sell British pound calls.

- ✗ **C)** Sell British pound puts.
- ✓ **D)** Buy British pound puts.

Explanation

This investor should buy puts on the British pound to lock in the highest possible price at which to sell pounds. Any answer must be framed in terms of the British pound because there are no listed options on the U.S. dollar.

Reference: 4.5.3.1.8 in the License Exam Manual

Question #210 of 211

Question ID: 605833

An index option differs from an equity option in that

- ✗ **A)** trading ends earlier in the day.
- ✗ **B)** they use European-style exercise.
- ✓ **C)** the exercise settlement is in cash.
- ✗ **D)** premiums tend to be somewhat higher.

Explanation

When an index option is exercised, settlement takes place in cash on the next business day.

Reference: 4.5.1.1.3 in the License Exam Manual

Question #211 of 211

Question ID: 605926

Having held 100 shares of GHI stock for 15 months, a customer purchases 1 GHI Jan 50 put in December. If the put is exercised before the expiration date and the long stock is delivered, which of the following statements are TRUE?

I. The premium is added to the sale proceeds.
II. The premium is deducted from the sale proceeds.
III. Any gain is long-term.
IV. Any gain is short-term.

- ✓ **A)** II and III.
- ✗ **B)** I and III.
- ✗ **C)** II and IV.
- ✗ **D)** I and IV.

Explanation

Because the customer already held the stock long term when he purchased the put, he was not trying to stretch a short-term gain into a long-term gain. There is no effect on his established holding period of 15 months. Whenever a put is exercised, the stock's sale price (exercise price) is reduced by the premium paid for buying the put.

Reference: 4.7.0.3 in the License Exam Manual