Question #1 of 4

Question ID: 1463641

The *most likely* use of a forward rate agreement is to:

A) lock in an interest rate for future borrowing or lending. ✓

B) exchange a floating-rate obligation for a fixed-rate obligation. ✗

C) obtain the right, but not the obligation, to borrow at a certain interest rate. ✗

Explanation

The purpose of a forward rate agreement (FRA) is to manage interest rate risk by locking in an interest rate for future borrowing or lending. An FRA is a forward commitment rather than a contingent claim. An interest rate swap is used to exchange a floating-rate obligation for a fixed-rate obligation.

(Module 52.1, LOS 52.b)

Question #2 of 4

Question ID: 1463639

For an underlying asset that has no holding costs or benefits, the value of a forward contract to the long during the life of the contract is the:

A) spot price minus the present value of the forward price. ✓

B) difference between the spot price and the forward price. ✗

C) present value of the difference between the spot price and the forward price. ✗

Explanation

During the life of a forward contract on an underlying asset with no holding costs or benefits, the value to the long equals the spot price minus the present value of the forward price:

$$V_t(T) = S_t - F_0(T)\,(1 + Rf)^{-(T-t)}.$$

(Module 52.1, LOS 52.a)

Question #3 of 4

Question ID: 1463638

The value of a forward or futures contract is:

A) specified in the contract.

B) typically zero at initiation.

C) equal to the spot price at expiration.

Explanation

The value of a forward or futures contract is typically zero at initiation, and at expiration is the difference between the spot price and the contract price. The *price* of a forward or futures contract is defined as the price specified in the contract at which the two parties agree to trade the underlying asset on a future date.

(Module 52.1, LOS 52.a)

Question #4 of 4

Question ID: 1463640

At time *t*, prior to its settlement date at time *T*, the value V_t of a long forward with a price of *F* will be related to the spot price, *S*, of an asset that has a zero net cost of carry by:

A) $V_t = S_t - F_0(T)(1 + Rf)^{-(T - t)}$.

B) $V_t = F_0(T) - S_t(1 + Rf)^{-(T - t)}$.

C) $V_t = (S_t - F_0(T))(1 + Rf)^{-(T - t)}$.

Explanation

The value of a long position in a forward contract prior to settlement (expiration) is:

$V_t = S_t - F_0(T)(1 + Rf)^{-(T - t)}$ when the net cost of carry is zero.

(Module 52.1, LOS 52.a)