

**UNIVERSITY OF CALICUT**  
**School of Distance Education**

**VI - SEMESTER B.Com. (2017 Admn.)**

**Specialisation - BC6B14 - FINANCIAL DERIVATIVES**

**(Multiple Choice Questions)**

- 1) The payoffs for financial derivatives are linked to
  - (a) securities that will be issued in the future.
  - (b) the volatility of interest rates.
  - (c) previously issued securities.
  - (d) government regulations specifying allowable rates of return.
- 2) Financial derivatives include
  - (a) stocks.
  - (b) bonds.
  - (c) futures.
- 3) Financial derivatives include
  - (a) stocks.
  - (b) bonds.
  - (c) forward contracts.
  - (d) both (a) and (b) are true.
- 4) Which of the following is not a financial derivative?
  - (a) Stock
  - (b) Futures
  - (c) Options
  - (d) Forward contracts
- 5) By hedging a portfolio, a bank manager
  - (a) reduces interest rate risk.
  - (b) increases reinvestment risk.
  - (c) increases exchange rate risk.
  - (d) increases the probability of gains.

- 6) Which of the following is a reason to hedge a portfolio?
- (a) To increase the probability of gains.
  - (b) To limit exposure to risk.
  - (c) To profit from capital gains when interest rates fall.
  - (d) All of the above.
- 7) Hedging risk for a long position is accomplished by
- (a) taking another long position.
  - (b) taking a short position.
  - (c) taking additional long and short positions in equal amounts.
  - (d) taking a neutral position.
- 8) Hedging risk for a short position is accomplished by
- (a) taking a long position.
  - (b) taking another short position.
  - (c) taking additional long and short positions in equal amounts.
  - (d) taking a neutral position..
- 9) A contract that requires the investor to buy securities on a future date is called a
- (a) short contract.
  - (b) long contract.
  - (c) hedge.
  - (d) cross.
- 10) A long contract requires that the investor
- (a) sell securities in the future.
  - (b) buy securities in the future.
  - (c) hedge in the future.
  - (d) close out his position in the future.
- 11) A person who agrees to buy an asset at a future date has gone
- (a) long.
  - (b) short.
  - (c) back.
  - (d) ahead.

- 12) A short contract requires that the investor
- (a) sell securities in the future.
  - (b) buy securities in the future.
  - (c) hedge in the future.
  - (d) close out his position in the future.
- 13) A contract that requires the investor to sell securities on a future date is called a
- (a) short contract.
  - (b) long contract.
  - (c) hedge.
  - (d) micro hedge.
- 14) If a bank manager chooses to hedge his portfolio of treasury securities by selling futures contracts, he
- (a) gives up the opportunity for gains.
  - (b) removes the chance of loss.
  - (c) increases the probability of a gain.
  - (d) both (a) and (b) are true.
- 15) To say that the forward market lacks liquidity means that
- (a) forward contracts usually result in losses.
  - (b) forward contracts cannot be turned into cash.
  - (c) it may be difficult to make the transaction.
  - (d) forward contracts cannot be sold for cash.
- 16) A disadvantage of a forward contract is that
- (a) it may be difficult to locate a counterparty.
  - (b) the forward market suffers from lack of liquidity.
  - (c) these contracts have default risk.
  - (d) all of the above.
- 17) Forward contracts are risky because they
- (a) are subject to lack of liquidity
  - (b) are subject to default risk.
  - (c) hedge a portfolio.
  - (d) both (a) and (b) are true.
- 18) The advantage of forward contracts over future contracts is that they
- (a) are standardized.
  - (b) have lower default risk.
  - (c) are more liquid.
  - (d) none of the above.
- 19) The advantage of forward contracts over futures contracts is that they
- (a) are standardized.
  - (b) have lower default risk.
  - (c) are more flexible.
  - (d) both (a) and (b) are true.

- 20) Forward contracts are of limited usefulness to financial institutions because
- (a) of default risk.
  - (b) it is impossible to hedge risk.
  - (c) of lack of liquidity.
  - (d) both (a) and (c) of the above.
- 21) Futures contracts are regularly traded on the
- (a) Chicago Board of Trade.
  - (b) New York Stock Exchange.
  - (c) American Stock Exchange.
  - (d) Chicago Board of Options Exchange.
- 22) Hedging in the futures market
- (a) eliminates the opportunity for gains.
  - (b) eliminates the opportunity for losses.
  - (c) increases the earnings potential of the portfolio.
  - (d) both (a) and (b) of the above.
- 23) When interest rates fall, a bank that perfectly hedges its portfolio of Treasury securities in the futures market
- (a) suffers a loss.
  - (b) experiences a gain.
  - (c) has no change in its income.
  - (d) none of the above.
- 24) Futures markets have grown rapidly because futures
- (a) are standardized.
  - (b) have lower default risk.
  - (c) are liquid.
  - (d) all of the above.
- 25) On the expiration date of a futures contract, the price of the contract
- (a) always equals the purchase price of the contract.
  - (b) always equals the average price over the life of the contract.
  - (c) always equals the price of the underlying asset.
  - (d) always equals the average of the purchase price and the price of underlying asset.
- 26) The price of a futures contract at the expiration date of the contract
- (a) equals the price of the underlying asset.
  - (b) equals the price of the counterparty.
  - (c) equals the hedge position.
  - (d) equals the value of the hedged asset.

- 27) Elimination of riskless profit opportunities in the futures market is
- (a) hedging. (b) arbitrage.  
(c) speculation. (d) underwriting.
- 28) If you sold a short contract on financial futures you hope interest rates
- (a) rise. (b) fall. (c) are stable. (d) fluctuate.
- 29) If you sold a short futures contract you will hope that interest rates
- (a) rise. (b) fall. (c) are stable. (d) fluctuate.
- 30) If you bought a long contract on financial futures you hope that interest rates
- (a) rise. (b) fall. (c) are stable. (d) fluctuate.
- 31) If you bought a long futures contract you hope that bond prices
- (a) rise. (b) fall. (c) are stable. (d) fluctuate.
- 32) If you sold a short futures contract you will hope that bond prices
- (a) rise. (b) fall. (c) are stable. (d) fluctuate.
- 33) To hedge the interest rate risk on \$4 million of Treasury bonds with \$100,000 futures contracts, you would need to purchase
- (a) 4 contracts. (b) 20 contracts. (c) 25 contracts. (d) 40 contracts.
- 34) Assume you are holding Treasury securities and have sold futures to hedge against interest rate risk. If interest rates rise
- (a) the increase in the value of the securities equals the decrease in the value of the futures contracts.
- (b) the decrease in the value of the securities equals the increase in the value of the futures contracts.
- (c) the increase in the value of the securities exceeds the decrease in the values of the futures contracts.
- (d) both the securities and the futures contracts increase in value.

35) Assume you are holding Treasury securities and have sold futures to hedge against interest rate risk. If interest rates fall

- (a) the increase in the value of the securities equals the decrease in the value of the futures contracts.
- (b) the decrease in the value of the securities equals the increase in the value of the futures contracts.
- (c) the increase in the value of the securities exceeds the decrease in the values of the futures contracts.
- (d) both the securities and the futures contracts increase in value.

36) When a financial institution hedges the interest-rate risk for a specific asset, the hedge is called a

- (a) macro hedge.
- (b) micro hedge.
- (c) cross hedge.
- (d) futures hedge.

37) When the financial institution is hedging interest-rate risk on its overall portfolio, then the hedge is a

- (a) macro hedge.
- (b) micro hedge.
- (c) cross hedge.
- (d) futures hedge.

38) The number of futures contracts outstanding is called

- (a) liquidity.
- (b) volume.
- (c) float.
- (d) open interest.

39) Which of the following features of futures contracts were not designed to increase liquidity?

- (a) Standardized contracts
- (b) Traded up until maturity
- (c) Not tied to one specific type of bond
- (d) Marked to market daily

40) Which of the following features of futures contracts were not designed to increase liquidity?

- (a) Standardized contracts
- (b) Traded up until maturity
- (c) Not tied to one specific type of bond
- (d) Can be closed with off setting trade

- 41) Futures differ from forwards because they are
- (a) used to hedge portfolios.
  - (b) used to hedge individual securities.
  - (c) used in both financial and foreign exchange markets.
  - (d) a standardized contract.
- 42) Futures differ from forwards because they are
- (a) used to hedge portfolios.
  - (b) used to hedge individual securities.
  - (c) used in both financial and foreign exchange markets.
  - (d) marked to market daily.
- 43) The advantage of futures contracts relative to forward contracts is that futures contracts
- (a) are standardized, making it easier to match parties, thereby increasing liquidity.
  - (b) specify that more than one bond is eligible for delivery, making it harder for someone to corner the market and squeeze traders.
  - (c) cannot be traded prior to the delivery date, thereby increasing market liquidity.
  - (d) both (a) and (b) of the above.
- 44) If a firm is due to be paid in deutsche marks in two months, to hedge against exchange rate risk the firm should
- (a) sell foreign exchange futures short.
  - (b) buy foreign exchange futures long.
  - (c) stay out of the exchange futures market.
  - (d) none of the above.

45) If a firm must pay for goods it has ordered with foreign currency, it can hedge its foreign exchange rate risk by

- (a) selling foreign exchange futures short.
- (b) buying foreign exchange futures long.
- (c) staying out of the exchange futures market.
- (d) none of the above.

46) If a firm is due to be paid in deutsche marks in two months, to hedge against exchange rate risk the firm should \_\_\_\_\_ foreign exchange futures \_\_\_\_\_.

- (a) sell; short
- (b) buy; long
- (c) sell; long
- (d) buy; short

47) If a firm must pay for goods it has ordered with foreign currency, it can hedge its foreign exchange rate risk by \_\_\_\_\_ foreign exchange futures \_\_\_\_\_.

- (a) selling; short
- (b) buying; long
- (c) buying; short
- (d) selling; long

48) Options are contracts that give the purchasers the

- (a) option to buy or sell an underlying asset.
- (b) the obligation to buy or sell an underlying asset.
- (c) the right to hold an underlying asset.
- (d) the right to switch payment streams.

49) The price specified on an option that the holder can buy or sell the underlying asset is called the

- (a) premium.
- (b) call.
- (c) strike price.
- (d) put.

50) The price specified on an option that the holder can buy or sell the underlying asset is called the

- (a) premium.
- (b) strike price.
- (c) exercise price.
- (d) both (b) and (c) are true.



51) The seller of an option has the

- (a) right to buy or sell the underlying asset.
- (b) the obligation to buy or sell the underlying asset.
- (c) ability to reduce transaction risk.
- (d) right to exchange one payment stream for another.

52) The seller of an option is \_\_\_\_\_ to buy or sell the underlying asset while the purchaser of an option has the \_\_\_\_\_ to buy or sell the asset.

- (a) obligated; right
- (b) right; obligation
- (c) obligated; obligation
- (d) right; right

53) The amount paid for an option is the

- (a) strike price.
- (b) premium.
- (c) discount.
- (d) commission.

54) An option that can be exercised at any time up to maturity is called a(n)

- (a) swap.
- (b) stock option.
- (c) European option.
- (d) American option.

55) An option that can only be exercised at maturity is called a(n)

- (a) swap.
- (b) stock option.
- (c) European option.
- (d) American option.

56) Options on individual stocks are referred to as

- (a) stock options.
- (b) futures options.
- (c) American options.
- (d) individual options.

57) Options on futures contracts are referred to as

- (a) stock options.
- (b) futures options.
- (c) American options.
- (d) individual options.

58) An option that gives the owner the right to buy a financial instrument at the exercise price within a specified period of time is a

- (a) call option.
- (b) put option.
- (c) American option.
- (d) European option.

59) A call option gives the owner

- (a) the right to sell the underlying security.
- (b) the obligation to sell the underlying security.
- (c) the right to buy the underlying security.
- (d) the obligation to buy the underlying security.

60) A call option gives the seller

- (a) the right to sell the underlying security.
- (b) the obligation to sell the underlying security.
- (c) the right to buy the underlying security.
- (d) the obligation to buy the underlying security.

61) An option allowing the holder to buy an asset in the future is a

- (a) put option.
- (b) call option.
- (c) swap.
- (d) premium.

62) An option that gives the owner the right to sell a financial instrument at the exercise price within a specified period of time is a

- (a) call option.
- (b) put option.
- (c) American option.
- (d) European option.

63) A put option gives the owner

- (a) the right to sell the underlying security.
- (b) the obligation to sell the underlying security.
- (c) the right to buy the underlying security.
- (d) the obligation to buy the underlying security.

- 64) A put option gives the seller
- (a) the right to sell the underlying security.
  - (b) the obligation to sell the underlying security.
  - (c) the right to buy the underlying security.
  - (d) the obligation to buy the underlying security.
- 65) An option allowing the owner to sell an asset at a future date is a
- (a) put option.
  - (b) call option.
  - (c) swap.
  - (d) forward contract.
- 66) If you buy a call option on treasury futures at 115, and at expiration the market price is 110,
- (a) the call will be exercised.
  - (b) the put will be exercised.
  - (c) the call will not be exercised.
  - (d) the put will not be exercised.
- 67) If you buy a call option on treasury futures at 110, and at expiration the market price is 115,
- (a) the call will be exercised.
  - (b) the put will be exercised.
  - (c) the call will not be exercised.
  - (d) the put will not be exercised.
- 68) If you buy a put option on treasury futures at 115, and at expiration the market price is 110,
- (a) the call will be exercised.
  - (b) the put will be exercised.
  - (c) the call will not be exercised.
  - (d) the put will not be exercised.
- 69) If you buy a put option on treasury futures at 110, and at expiration the market price is 115,
- (a) the call will be exercised.
  - (b) the put will be exercised.
  - (c) the call will not be exercised.
  - (d) the put will not be exercised.
- 70) The main advantage of using options on futures contracts rather than the futures contracts themselves is that
- (a) interest rate risk is controlled while preserving the possibility of gains.
  - (b) interest rate risk is controlled, while removing the possibility of losses.
  - (c) interest rate risk is not controlled, but the possibility of gains is preserved.
  - (d) interest rate risk is not controlled, but the possibility of gains is lost.

71) The main reason to buy an option on a futures contract rather than the futures contract is

- (a) to reduce transaction cost.
- (b) to preserve the possibility for gains.
- (c) to limit losses.
- (d) remove the possibility for gains.

72) The main disadvantage of hedging with futures contracts as compared to options on futures contracts is that futures

- (a) remove the possibility of gains.
- (b) increase the transactions cost.
- (c) are not as an effective a hedge.
- (d) do not remove the possibility of losses.

73) If a bank manager wants to protect the bank against losses that would be incurred on its portfolio of treasury securities should interest rates rise, he could

- (a) buy put options on financial futures.
- (b) buy call options on financial futures.
- (c) sell put options on financial futures.
- (d) sell call options on financial futures.

74) Hedging by buying an option

- (a) limits gains.
- (b) limits losses.
- (c) limits gains and losses.
- (d) has no limit on option premiums.

75) All other things held constant, premiums on options will increase when the

- (a) exercise price increases.
- (b) volatility of the underlying asset falls.
- (c) term to maturity increases.
- (d) (a) and (c) are both true.

76) All other things held constant, premiums on call options will increase when the

- (a) exercise price falls.
- (b) volatility of the underlying asset falls.
- (c) term to maturity decreases.
- (d) futures price increases.

77) An increase in the exercise price, all other things held constant, will \_\_\_\_\_ the call option premium.

- (a) increase
- (b) decrease
- (c) increase or decrease
- (d) Not enough information is given.

78) All other things held constant, premiums on options will increase when the

- (a) exercise price increases.                      (b) volatility of the underlying asset increases.  
(c) term to maturity decreases.                      (d) futures price increases.

79) An increase in the volatility of the underlying asset, all other things held constant, will \_\_\_\_\_ the option premium.

- (a) increase    (b) decrease  
(c) increase or decrease                                      (d) Not enough information is given.

### **Answer Key**

QN NO	ANS	QN NO	ANS	QN NO	ANS	QN NO	ANS
1	C	21	A	41	D	61	B
2	C	22	D	42	D	62	B
3	C	23	C	43	D	63	A
4	A	24	D	44	A	64	D
5	A	25	C	45	B	65	A
6	B	26	A	46	A	66	C
7	B	27	B	47	B	67	A
8	A	28	A	48	A	68	B
9	B	29	A	49	C	69	D
10	B	30	B	50	D	70	A
11	A	31	A	51	B	71	B
12	A	32	B	52	A	72	A
13	A	33	D	53	B	73	A
14	D	34	B	54	D	74	B
15	C	35	A	55	C	75	C
16	D	36	B	56	A	76	A
17	D	37	A	57	B	77	B
18	D	38	D	58	A	78	B
19	C	39	B	59	C	79	A
20	D	40	D	60	B		

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