ch20

Student: ____

1. An options contract:
   A: is another name for a forward contract
   B. gives the right to buy or sell an underlying asset at a predetermined price by a specified time
   C. may be written for debt securities but not equities
   D. may be written for equities but not debt securities
   Ans: B

2. In the options market, the right to buy an underlying asset lies with:
   A. call buyers
   B. put buyers
   C. European put buyers
   D. writers

3. In a call option, the:
   A. buyer is committed to receive the underlying asset at a specified time
   B. seller is committed to handing over the specified asset at a specified time
   C. seller may choose whether or not to deliver the underlying asset at a specified time
   D. buyer will choose to exercise the option only if the price of the underlying asset falls

4. In a put option, the:
   A. seller is committed to receiving the underlying asset at a specified time
   B. buyer is committed to handing over the specified asset at a specified time
   C. buyer is committed to receiving the underlying asset at a specified time
   D. seller is committed to handing over the specified asset at a specified time

5. An American call option lets the buyer:
   A. buy the underlying asset at the exercise price on or before the expiration date
   B. buy the underlying asset only on the expiration date
   C. sell the underlying asset at the exercise price on or before the contract expiration date
   D. sell the underlying asset only at the expiration date

6. An American put option lets the buyer:
   A. buy the underlying asset at the exercise price on or before the expiration date
   B. sell the underlying asset at the exercise price on or before the expiration date
   C. potentially benefit from a share decrease with less risk than selling the share short
   D. sell the underlying asset only at the contract expiration date

7. For the buyer of an option, the premium paid for the contract represents the:
   A. transaction cost
   B. maximum return
   C. largest potential loss
   D. yield

8. An American put option can be exercised:
   A. only on the expiration date
   B. at any time up to the expiration date
   C. any time in the indefinite future
   D. only after the payment of dividends

9. A European call option can be exercised:
   A. only on the expiration date
   B. at any time up to the expiration date
   C. if the price of the underlying asset falls below the exercise price
   D. immediately after the payment of dividends

10. Options that give the option buyer the right to exercise the option only on the maturity date are:
    A. call options
    B. put options
    C. European-type options
    D. American-type options

11. Options that give the option buyer the right to exercise the option at any time up to the maturity date are:
    A. call options
    B. put options
    C. European-type options
    D. American-type options

12. What security gives the holder an option to purchase a specified number of shares at a predetermined price within a certain period of time?
    A. A convertible bond
    B. A put option
    C. An equity warrant
    D. A repurchase agreement

13. What type of option will an option buyer purchase if they believe a share price will rise?
    A. Call
    B. Put
    C. Warrant
    D. Swaption

14. What type of option will an option buyer buy if they believe a share price will fall?
    A. Call
    B. Put
    C. Warrant
    D. Swaption

15. The price specified in the option contracts for calls and puts is called the:
    A. market price
    B. option price
    C. strike price
    D. expected value

16. The strike price is the price:
    A. an option buyer pays for it
    B. an option writer receives
    C. specified in an options contract at which the buyer can buy or sell the underlying asset
    D. at which a buyer can buy or sell the option in the market

17. In an options contract, the strike price is also known as the:
    A. fixed price
    B. equilibrium price
    C. exercise price
    D. market price

18. The price paid by an option buyer to the writer of the option is the:
    A. call price
    B. premium
    C. put price
    D. strike price

19. A ________ option is an option to purchase a specified number of shares on or before some future date at a specified price, whereas a ________ option is an option to sell a specified number of shares on or before some future date at a specified price. _______ are bought if the share is expected to rise.
    A. put; call; Puts
    B. call; put; Puts
    C. call; put; Calls
    D. put; call; Calls

20. Which of the following statements about calls and puts is INCORRECT?
    A. Options do not provide any funding to the company.
    B. Exchange-traded options are highly standardised.
    C. Options are generally issued by companies.
    D. Options are generally traded on an organised exchange.

21. Which of the following is NOT true of calls and puts?
    A. They are generally traded on organised exchanges.
    B. They can be used to hedge a gain or prevent a loss on a stock holding.
    C. They provide the buyer with an opportunity of greater profits than simply from buying and selling the underlying shares.
    D. They both result in new equity capital for the company.

22. The fee charged by a seller of an option is called the:
    A. call price
    B. futures fee
    C. market price
    D. option premium

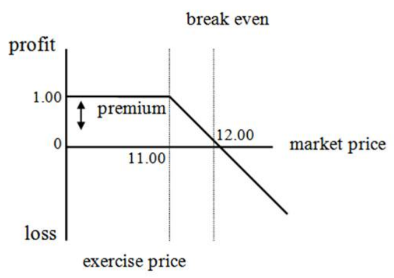
23. The maximum loss a buyer of a share call option can undergo is equal to the:
    A. share price minus the value of the call
    B. strike price minus the share price
    C. call premium
    D. share price

24. The value of a put option rises when the underlying asset:
    A. has reduced volatility
    B. has relatively short maturity
    C. experiences price increases
    D. experiences price falls

25. Which of the following statements about option contracts is INCORRECT?
    A. The seller of a put option loses if the commodity price, plus the premium, is below the exercise price when the option is exercised.
    B. The buyer of a call option benefits if the price of the commodity is above the exercise price when the option is exercised.
    C. The buyer of a put option gains if the price of the commodity is below the exercise price when the option is exercised.
    D. The seller of a call option loses if the commodity price, plus the premium, is below the exercise price when the option is exercised.

26. An investor purchases a call option at a premium of $1.25, with an exercise price of $7.50 within three months. The holder of the option will:
    A. be in-the-money if the market price of the shares reaches $6.25
    B. only exercise the option if the current market price reaches or exceeds $8.75
    C. exercise the option at any price above $7.50, if necessary
    D. break even at a market price of $7.50, and will exercise the option

27. Which of the following statements best reflects the following profit profile of an option contract?



    A. The profile depicts the short call position of the option seller.
    B. The profile depicts the long call position of the buyer of the option.
    C. The profile depicts the short put position of the option seller.
    D. The profile depicts the long put position of the buyer of the option.

28. Buyers of put options expect the value of the underlying asset to ________, and the sellers of call options expect the value of the underlying asset to _________.
    A. increase; increase
    B. decrease; increase
    C. increase; decrease
    D. decrease; decrease

29. A put option is said to be in –the money if the:
    A. exercise price is less than the share price
    B. exercise price is greater than the share price
    C. exercise price is equal to the share price
    D. price of the put is higher than the price of the call

30. A put option is said to be out –of –the money if the:
    A. exercise price is less than the share price
    B. exercise price is greater than the share price
    C. exercise price is equal to the share price
    D. price of the put is higher than the price of the call

31. An investor holds long call options that may be exercised at any time over the next month. The spot price of the underlying asset is $12.75; the strike price of the option is $15.10; and the premium paid was $2.35. What is the value of the option to the holder?
    A. -$2.35
    B. zero
    C. $10.40
    D. $15.10

32. The main feature of the potential profit and loss profile for a long put party may be best described as:
    A. the further the spot price is above the exercise price, the greater the profit
    B. profits are made from exercising an option when the spot price falls below the exercise price adjusted for the premium
    C. a loss is sustained if the spot price is less than the exercise price
    D. All of the given answers.

33. The most important benefit of an options contract strategy for a hedger is:
    A. the income paid to the writer of the option
    B. risk of loss from unfavourable price movements is limited
    C. the premium is kept by the seller of the option
    D. the option can be exercised at any time

34. Which of the following best reflects the exposure position of a writer of a put option?
    A. A loss is made when the spot price is below the exercise price adjusted by the premium.
    B. The extent of the loss potential is limited to a zero spot price less the premium paid.
    C. The maximum profit to the writer is limited to the extent of the premium paid.
    D. All of the given answers.

35. A covered call position is:
    A. the purchase of a share at the same time as selling a put on that share
    B. the simultaneous purchase of a call and the underlying asset
    C. selling a share short at the same time as selling a call on that share
    D. the purchase of a share at the same time as selling a call on that share

36. 36.A hedge fund has written a call option on shares of a company with an exercise price of $17.45, and simultaneously also buys a call option on the same share with an exercise price of $16.95. The hedge fund is considered to have written a/an:
    A. arbitrage option
    B. naked call/put contract
    C. covered call option
    D. margin call option

37. A covered call position is comparable with a:
    A. long put
    B. short put
    C. long straddle
    D. vertical spread

38. The loss for a writer of a naked call option on a share is potentially:
    A. limited
    B. unlimited
    C. larger the more the share price falls
    D. equal to the call premium

39. Which of the following is NOT a condition applied to call options listed on the Australian Securities Exchange (ASX) on leading ordinary shares?
    A. Typically, there are numerous option contracts offered on a particular share over a range of expiration dates.
    B. A long call option buyer must meet the deposit and margin calls of the clearing house.
    C. Typically, three or more options are traded with the same expiration date, but with different strike prices.
    D. The Options Clearing House Pty Ltd maintains a share script depository.

40. The highly geared option contract on individual stocks on the ASX with an exercise price of between one and ten cents is a/an:
    A. capped warrant
    B. LEPO
    C. instalment warrant
    D. endowment warrant

41. The warrant that has an upper limit applied to the upside profit available for the holder is a/an:
    A. capped warrant
    B. LEPO
    C. instalment warrant
    D. endowment warrant

42. The option that is a highly leveraged option on individual stocks, with an exercise price of between one and ten cents, traded on the ASX, with a European-type expiry, is a:
   A. strip
   B. warrant
   C. barrier option
   D. LEPO

43. A warrant that is made up of a selection of shares from the mining industry is an example of a/an:
   A. basket warrant
   B. index warrant
   C. capped warrant
   D. instalment warrant

44. Suppose that Maxima shares are selling for $10 per share and you own a call option to buy Maxima shares at $7.50. The intrinsic value of your option is:
   A. $10.00
   B. $7.50
   C. $2.50
   D. not determinable without further information

45. The intrinsic value of an option is:
   A. the same as the option premium
   B. the amount the option is actually worth if it is immediately exercised
   C. the amount the option is likely to be worth on its expiration date
   D. impossible to determine given the lack of information on the future prices of the underlying asset

46. A call option is regarded as being in –the money if:
   A. it is written on a Treasury bond or another money market instrument
   B. it has increased in value since it was first written
   C. the price of the underlying asset is currently greater than the strike price
   D. the price of the underlying asset is currently greater than the strike price plus the option premium

47. For a covered option, the:
   A. option premium never alters from the intrinsic value
   B. strike price is always above the exercise price
   C. seller owns the underlying asset
   D. seller does not have an interest in the underlying asset

48. A put option is regarded as being in –the money if:
   A. it is written on a Treasury bond or another money market instrument
   B. it has increased in value since it was first written
   C. the price of the underlying asset is currently less than the strike price
   D. the price of the underlying asset is currently less than the strike price plus the option premium

49. Which of the following factors would tend to increase the size of the premium on an options contract?

   A. The current short-term interest rates are high.
   B. The option is near its expiration date.
   C. The price volatility of the underlying asset is low.
   D. The option is far off its expiration date.

50. Which of the following variables affect the value of options?
I. Difficulty of interest rates
II. Time to maturity of the option
III. Share price volatility
IV. Dividend yield on the underlying share
A. I and IV only
B. II and III only
C. I, II and IV only
D. I, II, III and IV

51. Which of the following factors is NOT generally regarded as a major determinant of the price of an option?
A. The spot price of the underlying asset, relative to the option exercise price.
B. The elapsed time since the start of the option.
C. The volatility of the spot price of the underlying asset.
D. The level of interest rates.

52. All of the following factors affect the price of a share option EXCEPT the:
A. riskiness of the share
B. risk-free rate
C. time to expiration
D. expected rate of return on the share

53. When interest rates increase, the:
A. price of call options generally falls
B. price of the underlying share usually increases
C. price of put options generally falls
D. volatility of the underlying asset falls

54. When interest rates decrease, the:
A. price of call options generally increases
B. price of the underlying share usually decreases
C. price of put options generally increases
D. volatility of the underlying asset falls

55. The strategy whereby a company buys an interest rate option that puts a maximum level on the interest rate for its borrowing is a:
A. limit option
B. cap option
C. boundary option
D. ceiling option

56. In option language, a 'cap' is a:
A. boundary option
B. ceiling option
C. floor option
D. perimeter option

57. The strategy whereby a company sells an interest rate option that puts a minimum level on how low an interest rate may fall is a:
A. boundary option
B. limit option
C. floor option
D. perimeter option

58. The option that is a combination of a cap option and a floor option is a:
A. boundary option
B. collar option
C. band option
D. range option

59. You purchased a call option and wrote a put option at an exercise price lower than that of the long call option. Your strategy is known as a:
A. long straddle
B. horizontal bull spread
C. vertical bull spread
D. short straddle

60. You purchased a call option and wrote a call option at an exercise price higher than that of the long call option. Your strategy is known as a:
A. call bull spread
B. long straddle
C. horizontal bull spread
D. short straddle

61. You purchased a put option and wrote a call option at an exercise price higher than that of the long put option. Your strategy is known as a:
A. long straddle
B. horizontal bear spread
C. short straddle
D. vertical bear spread

62. You purchased a put option and at the same time wrote a put option at an exercise price lower than that of the long put option. Your strategy is known as a:
A. long straddle
B. bull spread
C. put bear spread
D. short straddle

63. In expectation of increased price volatility, you purchased a call option and at the same time bought a put option with common exercise prices. Your strategy is known as a:
A. horizontal spread
B. vertical spread
C. short straddle
D. long straddle

64. In expectation of increased price volatility, you purchased a call option and at the same time bought a put option, both with out-of-the-money exercise prices. Your strategy is known as a:
A. horizontal spread
B. vertical spread
C. short strangle
D. long strangle

65. In expectation of increased price stability, you sell a call option and at the same time sell a put option with common exercise prices. Your strategy is known as a:
A. vertical spread
B. horizontal spread
C. short straddle
D. long straddle

66. A lender, concerned that its cost of funds might rise during the term of a loan it has made, can hedge this rise without forgoing the chance to profit by a decline in the cost of funds. This is done by:
    A. selling futures contracts on Treasury bills
    B. buying futures contracts on Treasury bills
    C. buying call options on Treasury bills
    D. buying put options on Treasury bills

67. When interest rates are forecasted to rise, a company approaches its bank before the next roll-over date of its current debt facilities, and buys an interest rate cap option. However, the company is concerned at the cost of the cap premium and decides to simultaneously sell an interest rate floor option of the same maturity. Which of the following statements is correct?
    A. The transactions may be described as an exchange traded options contract.
    B. The company has obtained cover with a collar option strategy.
    C. This option strategy will achieve a zero cost outcome for the company.
    D. All of the given answers.

68. When we contrast futures with options contracts, we can say that:
    A. in a futures contract, the buyer and seller have asymmetric rights, whereas in an options contract the buyer and writer have symmetric rights
    B. in a futures contract the buyer and seller have symmetric rights, whereas in an options contract the buyer and writer have asymmetric rights
    C. for both futures contracts and options contracts the buyer and writer have symmetric rights
    D. for both futures contracts and options contracts the buyer and writer have asymmetric rights

69. The decision between selecting a future or an option:
    A. reflects a trade-off between the higher cost of using options and the extra insurance benefits that options provide
    B. reflects the greater risk of using options and the extra insurance benefits that options provide
    C. reflects a trade-off between the higher cost of using futures and the extra insurance benefits that futures provide
    D. depends on whether the underlying instrument is an equity or debt instrument

70. Options are contracts that give the purchaser the obligation to buy or sell an underlying asset.
    True False

71. A put option gives the owner the obligation to sell the underlying security.
    True False

72. The seller of an option has the obligation to buy or sell the underlying asset.
    True False

73. In the options market the short-call party has the right to sell shares at a specified price.
    True False

74. If a buyer of a particular share purchased a call option on it at a strike price of $15 and the share is selling for $12 on the expiration date, the call option is worth $0.
    True False

75. A long-call party would exercise a call option with an exercise price of $9.00 and a premium of $1.50 if the current price of the underlying physical market asset is $8.00.
    True False

76. A short-call party to a call option with an exercise price of $10.00 and a premium of $1.00, if the current price of the underlying asset is $8.00 on the exercise date, would make a loss of $1.00.
    True False

77. The value of a put option rises when the underlying asset experiences price declines.
    True False

78. The intrinsic value of an option is the amount the option is expected to be worth on its expiration date.
True False

79. If interest rates increase the value of a put option declines.
True False

80. Under certain circumstances an options contract may be a preferred hedging instrument. Discuss.

81. Discuss a call option writer's risk exposure and some strategies they might use to minimise any possible loss exposure.

82. Discuss some characteristics of writers of covered and uncovered call options.

83. Option markets have some basic organisation features. Discuss

84. Discuss briefly the two common option contracts for shares and options on futures contracts that are available through the SFE.

ch20 Key

1. An options contract:
A: is another name for a forward contract
B. gives the right to buy or sell an underlying asset at a predetermined price by a specified time
C. may be written for debt securities but not equities
D. may be written for equities but not debt securities
Ans: B

Difficulty: Easy
Viney - Chapter 20 #1
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
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type: EMPTY

2. In the options market, the right to buy an underlying asset lies with:
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B. put buyers
C. European put buyers
D. writers

Difficulty: Easy
Viney - Chapter 20 #2
learning goal: EMPTY
learning objective: EMPTY
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3. In a call option, the:
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B. seller is committed to handing over the specified asset at a specified time
C. seller may choose whether or not to deliver the underlying asset at a specified time
D. buyer will choose to exercise the option only if the price of the underlying asset falls

Difficulty: Medium
Viney - Chapter 20 #3
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

4. In a put option, the:
A. seller is committed to receiving the underlying asset at a specified time
B. buyer is committed to handing over the specified asset at a specified time
C. buyer is committed to receiving the underlying asset at a specified time
D. seller is committed to handing over the specified asset at a specified time

Difficulty: Medium
Viney - Chapter 20 #4
learning goal: EMPTY
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B. buy the underlying asset only on the expiration date
C. sell the underlying asset at the exercise price on or before the contract expiration date
D. sell the underlying asset only at the expiration date

Difficulty: Medium
Viney - Chapter 20 #5
learning goal: EMPTY
learning objective: EMPTY
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type: EMPTY

6. An American put option lets the buyer:
A. buy the underlying asset at the exercise price on or before the expiration date
B. sell the underlying asset at the exercise price on or before the expiration date
C. potentially benefit from a share decrease with less risk than selling the share short
D. sell the underlying asset only at the contract expiration date

Difficulty: Medium
Viney - Chapter 20 #6
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

7. For the buyer of an option, the premium paid for the contract represents the:
A. transaction cost
B. maximum return
C. largest potential loss
D. yield

Difficulty: Medium
Viney - Chapter 20 #7
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

8. An American put option can be exercised:
A. only on the expiration date
B. at any time up to the expiration date
C. any time in the indefinite future
D. only after the payment of dividends

Difficulty: Easy
Viney - Chapter 20 #8
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

9. A European call option can be exercised:

A. only on the expiration date
B. at any time up to the expiration date
C. if the price of the underlying asset falls below the exercise price
D. immediately after the payment of dividends

Difficulty: Easy
Viney - Chapter 20 #9
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

10. Options that give the option buyer the right to exercise the option only on the maturity date are:

A. call options
B. put options
C. European-type options
D. American-type options

Difficulty: Easy
Viney - Chapter 20 #10
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

11. Options that give the option buyer the right to exercise the option at any time up to the maturity date are:

A. call options
B. put options
C. European-type options
D. American-type options

Difficulty: Easy
Viney - Chapter 20 #11
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

12. What security gives the holder an option to purchase a specified number of shares at a predetermined price within a certain period of time?

A. A convertible bond
B. A put option
C. An equity warrant
D. A repurchase agreement

Difficulty: Medium
Viney - Chapter 20 #12
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

13. What type of option will an option buyer purchase if they believe a share price will rise?
A. Call
B. Put
C. Warrant
D. Swaption

Difficulty: Easy
Viney - Chapter 20 #13
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

14. What type of option will an option buyer buy if they believe a share price will fall?
A. Call
B. Put
C. Warrant
D. Swaption

Difficulty: Easy
Viney - Chapter 20 #14
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
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source: EMPTY
type: EMPTY

15. The price specified in the option contracts for calls and puts is called the:
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C. strike price
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Difficulty: Easy
Viney - Chapter 20 #15
learning goal: EMPTY
learning objective: EMPTY
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16. The strike price is the price:
A. an option buyer pays for it
B. an option writer receives
C. specified in an options contract at which the buyer can buy or sell the underlying asset
D. at which a buyer can buy or sell the option in the market

Difficulty: Easy
Viney - Chapter 20 #16
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
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source: EMPTY
type: EMPTY

17. In an options contract, the strike price is also known as the:
A. fixed price
B. equilibrium price
C. exercise price
D. market price

Difficulty: Easy
Viney - Chapter 20 #17
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

18. The price paid by an option buyer to the writer of the option is the:
A. call price
B. premium
C. put price
D. strike price

Difficulty: Easy
Viney - Chapter 20 #18
learning goal: EMPTY
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19. A ________ option is an option to purchase a specified number of shares on or before some future date at a specified price, whereas a _______ option is an option to sell a specified number of shares on or before some future date at a specified price. ______ are bought if the share is expected to rise.
A. put; call; Puts
B. call; put; Puts
C. call; put; Calls
D. put; call; Calls

Difficulty: Medium
Viney - Chapter 20 #19
learning goal: EMPTY
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20. Which of the following statements about calls and puts is INCORRECT?
A. Options do not provide any funding to the company.
B. Exchange-traded options are highly standardised.
C. Options are generally issued by companies.
D. Options are generally traded on an organised exchange.

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question type: EMPTY
source: EMPTY
type: EMPTY

21. Which of the following is NOT true of calls and puts?
A. They are generally traded on organised exchanges.
B. They can be used to hedge a gain or prevent a loss on a stock holding.
C. They provide the buyer with an opportunity of greater profits than simply from buying and selling the underlying shares.
D. They both result in new equity capital for the company.

Difficulty: Medium
Viney - Chapter 20 #21
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

22. The fee charged by a seller of an option is called the:
A. call price
B. futures fee
C. market price
D. option premium

Difficulty: Easy
Viney - Chapter 20 #22
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

23. The maximum loss a buyer of a share call option can undergo is equal to the:
A. share price minus the value of the call
B. strike price minus the share price
C. call premium
D. share price

Difficulty: Easy
Viney - Chapter 20 #23
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

24. The value of a put option rises when the underlying asset:
A. has reduced volatility
B. has relatively short maturity
C. experiences price increases
D. experiences price falls

Difficulty: Medium
Viney - Chapter 20 #24
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

25. Which of the following statements about option contracts is INCORRECT?

A. The seller of a put option loses if the commodity price, plus the premium, is below the exercise price when the option is exercised.

B. The buyer of a call option benefits if the price of the commodity is above the exercise price when the option is exercised.

C. The buyer of a put option gains if the price of the commodity is below the exercise price when the option is exercised.

D. The seller of a call option loses if the commodity price, plus the premium, is below the exercise price when the option is exercised.

Difficulty: Medium
Viney - Chapter 20 #25
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

26. An investor purchases a call option at a premium of $1.25, with an exercise price of $7.50 within three months. The holder of the option will:

A. be in-the-money if the market price of the shares reaches $6.25

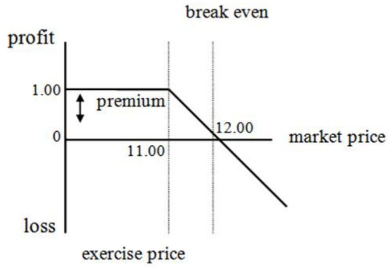
B. only exercise the option if the current market price reaches or exceeds $8.75

C. exercise the option at any price above $7.50, if necessary

D. break even at a market price of $7.50, and will exercise the option

Difficulty: Hard
Viney - Chapter 20 #26
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

27. Which of the following statements best reflects the following profit profile of an option contract?



A. The profile depicts the short call position of the option seller.

B. The profile depicts the long call position of the buyer of the option.

C. The profile depicts the short put position of the option seller.

D. The profile depicts the long put position of the buyer of the option.

Difficulty: Hard
Viney - Chapter 20 #27
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

28. Buyers of put options expect the value of the underlying asset to _______, and the sellers of call options expect the value of the underlying asset to ________.

A. increase; increase
B. decrease; increase
C. increase; decrease
D. decrease; decrease

Difficulty: Medium
Viney - Chapter 20 #28
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

29. A put option is said to be in –the money if the:

A. exercise price is less than the share price
B. exercise price is greater than the share price
C. exercise price is equal to the share price
D. price of the put is higher than the price of the call

Difficulty: Medium
Viney - Chapter 20 #29
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

30. A put option is said to be out –of –the money if the:

A. exercise price is less than the share price
B. exercise price is greater than the share price
C. exercise price is equal to the share price
D. price of the put is higher than the price of the call

Difficulty: Medium
Viney - Chapter 20 #30
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

31. An investor holds long call options that may be exercised at any time over the next month. The spot price of the underlying asset is $12.75; the strike price of the option is $15.10; and the premium paid was $2.35. What is the value of the option to the holder?

A. -$2.35
B. zero
C. $10.40
D. $15.10

Difficulty: Medium
Viney - Chapter 20 #31
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

32. The main feature of the potential profit and loss profile for a long put party may be best described as:

A. the further the spot price is above the exercise price, the greater the profit

B. profits are made from exercising an option when the spot price falls below the exercise price adjusted for the premium

C. a loss is sustained if the spot price is less than the exercise price

D. All of the given answers.

Difficulty: Medium
Viney - Chapter 20 #32
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

33. The most important benefit of an options contract strategy for a hedger is:

A. the income paid to the writer of the option

B. risk of loss from unfavourable price movements is limited

C. the premium is kept by the seller of the option

D. the option can be exercised at any time

Difficulty: Medium
Viney - Chapter 20 #33
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

34. Which of the following best reflects the exposure position of a writer of a put option?

A. A loss is made when the spot price is below the exercise price adjusted by the premium.

B. The extent of the loss potential is limited to a zero spot price less the premium paid.

C. The maximum profit to the writer is limited to the extent of the premium paid.

D. All of the given answers.

Difficulty: Medium
Viney - Chapter 20 #34
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

35. A covered call position is:

A. the purchase of a share at the same time as selling a put on that share

B. the simultaneous purchase of a call and the underlying asset

C. selling a share short at the same time as selling a call on that share

D. the purchase of a share at the same time as selling a call on that share

Difficulty: Medium
Viney - Chapter 20 #35
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

36. 36.A hedge fund has written a call option on shares of a company with an exercise price of $17.45, and simultaneously also buys a call option on the same share with an exercise price of $16.95. The hedge fund is considered to have written a/an:

A. arbitrage option
B. naked call/put contract
C. covered call option
D. margin call option

Difficulty: Hard
Viney - Chapter 20 #36
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

37. A covered call position is comparable with a:

A. long put
B. short put
C. long straddle
D. vertical spread

Difficulty: Hard
Viney - Chapter 20 #37
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

38. The loss for a writer of a naked call option on a share is potentially:

A. limited
B. unlimited
C. larger the more the share price falls
D. equal to the call premium

Difficulty: Medium
Viney - Chapter 20 #38
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

39. Which of the following is NOT a condition applied to call options listed on the Australian Securities Exchange (ASX) on leading ordinary shares?

A. Typically, there are numerous option contracts offered on a particular share over a range of expiration dates.
B. A long call option buyer must meet the deposit and margin calls of the clearing house.
C. Typically, three or more options are traded with the same expiration date, but with different strike prices.
D. The Options Clearing House Pty Ltd maintains a share script depository.

Difficulty: Easy
Viney - Chapter 20 #39
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

40. The highly geared option contract on individual stocks on the ASX with an exercise price of between one and ten cents is a/an:
A. capped warrant
B. LEPO
C. instalment warrant
D. endowment warrant

Difficulty: Medium
Viney - Chapter 20 #40
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

41. The warrant that has an upper limit applied to the upside profit available for the holder is a/an:
A. capped warrant
B. LEPO
C. instalment warrant
D. endowment warrant

Difficulty: Hard
Viney - Chapter 20 #41
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

42. The option that is a highly leveraged option on individual stocks, with an exercise price of between one and ten cents, traded on the ASX, with a European-type expiry, is a:
A. strip
B. warrant
C. barrier option
D. LEPO

Difficulty: Medium
Viney - Chapter 20 #42
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

43. A warrant that is made up of a selection of shares from the mining industry is an example of a/an:
A. basket warrant
B. index warrant
C. capped warrant
D. instalment warrant

Difficulty: Medium
Viney - Chapter 20 #43
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

44. Suppose that Maxima shares are selling for $10 per share and you own a call option to buy Maxima shares at $7.50. The intrinsic value of your option is:
A. $10.00
B. $7.50
C. $2.50
D. not determinable without further information

Difficulty: Medium
Viney - Chapter 20 #44
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

45. The intrinsic value of an option is:
A. the same as the option premium
B. the amount the option is actually worth if it is immediately exercised
C. the amount the option is likely to be worth on its expiration date
D. impossible to determine given the lack of information on the future prices of the underlying asset

Difficulty: Medium
Viney - Chapter 20 #45
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

46. A call option is regarded as being in –the money if:
A. it is written on a Treasury bond or another money market instrument
B. it has increased in value since it was first written
C. the price of the underlying asset is currently greater than the strike price
D. the price of the underlying asset is currently greater than the strike price plus the option premium

Difficulty: Medium
Viney - Chapter 20 #46
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

47. For a covered option, the:
A. option premium never alters from the intrinsic value
B. strike price is always above the exercise price
C. seller owns the underlying asset
D. seller does not have an interest in the underlying asset

Difficulty: Medium
Viney - Chapter 20 #47
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

48. A put option is regarded as being in –the money if:
A. it is written on a Treasury bond or another money market instrument
B. it has increased in value since it was first written
C. the price of the underlying asset is currently less than the strike price
D. the price of the underlying asset is currently less than the strike price plus the option premium

Difficulty: Medium
Viney - Chapter 20 #48
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

49. Which of the following factors would tend to increase the size of the premium on an options contract?

A. The current short-term interest rates are high.
B. The option is near its expiration date.
C. The price volatility of the underlying asset is low.
D. The option is far off its expiration date.

Difficulty: Medium
Viney - Chapter 20 #49
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

50. Which of the following variables affect the value of options?
I. Difficulty of interest rates
II. Time to maturity of the option
III. Share price volatility
IV. Dividend yield on the underlying share
A. I and IV only
B. II and III only
C. I, II and IV only
D. I, II, III and IV

Difficulty: Medium
Viney - Chapter 20 #50
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

51. Which of the following factors is NOT generally regarded as a major determinant of the price of an option?
A. The spot price of the underlying asset, relative to the option exercise price.
B. The elapsed time since the start of the option.
C. The volatility of the spot price of the underlying asset.
D. The level of interest rates.

Difficulty: Hard
Viney - Chapter 20 #51
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

52. All of the following factors affect the price of a share option EXCEPT the:
A. riskiness of the share
B. risk-free rate
C. time to expiration
D. expected rate of return on the share

Difficulty: Medium
Viney - Chapter 20 #52
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

53. When interest rates increase, the:
A. price of call options generally falls
B. price of the underlying share usually increases
C. price of put options generally falls
D. volatility of the underlying asset falls

Difficulty: Medium
Viney - Chapter 20 #53
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

54. When interest rates decrease, the:
A. price of call options generally increases
B. price of the underlying share usually decreases
C. price of put options generally increases
D. volatility of the underlying asset falls

Difficulty: Medium
Viney - Chapter 20 #54
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

55. The strategy whereby a company buys an interest rate option that puts a maximum level on the interest rate for its borrowing is a:
A. limit option
B. cap option
C. boundary option
D. ceiling option

Difficulty: Medium
Viney - Chapter 20 #55
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

56. In option language, a 'cap' is a:
A. boundary option
B. ceiling option
C. floor option
D. perimeter option

Difficulty: Medium
Viney - Chapter 20 #56
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

57. The strategy whereby a company sells an interest rate option that puts a minimum level on how low an interest rate may fall is a:
A. boundary option
B. limit option
C. floor option
D. perimeter option

Difficulty: Medium
Viney - Chapter 20 #57
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

58. The option that is a combination of a cap option and a floor option is a:
A. boundary option
B. collar option
C. band option
D. range option

Difficulty: Hard
Viney - Chapter 20 #58
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

59. You purchased a call option and wrote a put option at an exercise price lower than that of the long call option. Your strategy is known as a:
A. long straddle
B. horizontal bull spread
C. vertical bull spread
D. short straddle

Difficulty: Hard
Viney - Chapter 20 #59
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

60. You purchased a call option and wrote a call option at an exercise price higher than that of the long call option. Your strategy is known as a:

A. call bull spread
B. long straddle
C. horizontal bull spread
D. short straddle

Difficulty: Hard
Viney - Chapter 20 #60
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

61. You purchased a put option and wrote a call option at an exercise price higher than that of the long put option. Your strategy is known as a:

A. long straddle
B. horizontal bear spread
C. short straddle
D. vertical bear spread

Difficulty: Hard
Viney - Chapter 20 #61
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

62. You purchased a put option and at the same time wrote a put option at an exercise price lower than that of the long put option. Your strategy is known as a:

A. long straddle
B. bull spread
C. put bear spread
D. short straddle

Difficulty: Hard
Viney - Chapter 20 #62
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

63. In expectation of increased price volatility, you purchased a call option and at the same time bought a put option with common exercise prices. Your strategy is known as a:

A. horizontal spread
B. vertical spread
C. short straddle
D. long straddle

Difficulty: Hard
Viney - Chapter 20 #63
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

64. In expectation of increased price volatility, you purchased a call option and at the same time bought a put option, both with out-of-the-money exercise prices. Your strategy is known as a:

A. horizontal spread
B. vertical spread
C. short strangle
D. long strangle

Difficulty: Hard
Viney - Chapter 20 #64
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

65. In expectation of increased price stability, you sell a call option and at the same time sell a put option with common exercise prices. Your strategy is known as a:

A. vertical spread
B. horizontal spread
C. short straddle
D. long straddle

Difficulty: Hard
Viney - Chapter 20 #65
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
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question type: EMPTY
source: EMPTY
type: EMPTY

66. A lender, concerned that its cost of funds might rise during the term of a loan it has made, can hedge this rise without forgoing the chance to profit by a decline in the cost of funds. This is done by:

A. selling futures contracts on Treasury bills
B. buying futures contracts on Treasury bills
C. buying call options on Treasury bills
D. buying put options on Treasury bills

Difficulty: Hard
Viney - Chapter 20 #66
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
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question type: EMPTY
source: EMPTY
type: EMPTY

67. When interest rates are forecasted to rise, a company approaches its bank before the next roll-over date of its current debt facilities, and buys an interest rate cap option. However, the company is concerned at the cost of the cap premium and decides to simultaneously sell an interest rate floor option of the same maturity. Which of the following statements is correct?

A. The transactions may be described as an exchange traded options contract.
B. The company has obtained cover with a collar option strategy.
C. This option strategy will achieve a zero cost outcome for the company.
D. All of the given answers.

Difficulty: Hard
Viney - Chapter 20 #67
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

68. When we contrast futures with options contracts, we can say that:

A. in a futures contract, the buyer and seller have asymmetric rights, whereas in an options contract the buyer and writer have symmetric rights

B. in a futures contract the buyer and seller have symmetric rights, whereas in an options contract the buyer and writer have asymmetric rights

C. for both futures contracts and options contracts the buyer and writer have symmetric rights

D. for both futures contracts and options contracts the buyer and writer have asymmetric rights

Difficulty: Medium
Viney - Chapter 20 #68
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

69. The decision between selecting a future or an option:

A. reflects a trade-off between the higher cost of using options and the extra insurance benefits that options provide

B. reflects the greater risk of using options and the extra insurance benefits that options provide

C. reflects a trade-off between the higher cost of using futures and the extra insurance benefits that futures provide

D. depends on whether the underlying instrument is an equity or debt instrument

Difficulty: Medium
Viney - Chapter 20 #69
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

70. Options are contracts that give the purchaser the obligation to buy or sell an underlying asset.

FALSE

Options are contracts that give the purchaser the right to buy or sell an underlying asset.

Difficulty: Easy
Viney - Chapter 20 #70
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

71. A put option gives the owner the obligation to sell the underlying security.

FALSE

A put option gives the owner the right to sell the underlying security.

Difficulty: Easy
Viney - Chapter 20 #71
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

72. The seller of an option has the obligation to buy or sell the underlying asset.
TRUE

The seller or writer is obliged to carry out the contract for which they demand a premium to compensate them for the risk.

Difficulty: Easy
Viney - Chapter 20 #72
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

73. In the options market the short-call party has the right to sell shares at a specified price.
FALSE

The short-call party has the obligation to sell shares at a specified price, not the right.

Difficulty: Medium
Viney - Chapter 20 #73
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

74. If a buyer of a particular share purchased a call option on it at a strike price of $15 and the share is selling for $12 on the expiration date, the call option is worth $0.
TRUE

The option has expired out –of –the money as the strike price is more than the actual price.

Difficulty: Medium
Viney - Chapter 20 #74
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

75. A long-call party would exercise a call option with an exercise price of $9.00 and a premium of $1.50 if the current price of the underlying physical market asset is $8.00.
FALSE

The physical asset price needs to move upwards to $11.00 to be in the money.

Difficulty: Medium
Viney - Chapter 20 #75
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

76. A short-call party to a call option with an exercise price of $10.00 and a premium of $1.00, if the current price of the underlying asset is $8.00 on the exercise date, would make a loss of $1.00.
FALSE

Given V = P -max(S-X, 0) they would make a profit of $1.00.

Difficulty: Medium
Viney - Chapter 20 #76
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

77. The value of a put option rises when the underlying asset experiences price declines.
TRUE

A put option gives the holder the right to sell at a specified price.

Difficulty: Medium
Viney - Chapter 20 #77
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

78. The intrinsic value of an option is the amount the option is expected to be worth on its expiration date.
FALSE

The intrinsic value is the market price of the underlying asset relative to the option exercise price.

Difficulty: Medium
Viney - Chapter 20 #78
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

79. If interest rates increase the value of a put option declines.
TRUE

There is a greater opportunity cost if one assumes the holder of the put owns the underlying asset.

Difficulty: Medium
Viney - Chapter 20 #79
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

80. Under certain circumstances an options contract may be a preferred hedging instrument. Discuss.

As an options contract gives the option buyer the right, but not the obligation, to buy or sell a specified commodity or financial instrument at a predetermined price on or before a specified date, if it is not in the option buyer's best interest it need not be exercised. So an option buyer will not exercise a right to sell if the physical market price is above the exercise price of the option. Likewise an option buyer will not exercise the right to buy if the physical market price is below the exercise price of the option. The buyer of an options contract has paid a premium for the flexibility of the option and the hedging of uncertain outcomes.

Viney - Chapter 20 #80
difficulty: EMPTY
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

81. Discuss a call option writer's risk exposure and some strategies they might use to minimise any possible loss exposure.

The writer of a call option is exposed to potentially unlimited loss if the spot share price increases indefinitely. Given that the maximum profit that is made by the writer is from the receipt of the premium, once the option is in –the money the writer's premium is reduced or turned into a loss. If it appears that the spot price is increasing, it is expected that the option writer would immediately close out a negative position or maintain a covered position obtained by owning the actual shares before the price rise began.

Viney - Chapter 20 #81
difficulty: EMPTY
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
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question type: EMPTY
source: EMPTY
type: EMPTY

82. Discuss some characteristics of writers of covered and uncovered call options.

For an exchange-traded option the writer will typically need to meet margin requirements, unless a covered option is written guaranteeing that the writer of the option can complete the contract should the holder decide to exercise the option. This would be the case for a writer who owned a sufficient quantity of the underlying asset, such as listed shares, to meet the requirement. Another alternative for a covered call is if a third party provides a guarantee that the option writer may borrow from them the underlying asset on or before the option contract settlement date. Another cover arrangement would be when a call option writer was the holder of a call option in the same asset but with a lower exercise price. If a writer did not have cover, as previously mentioned, they are considered to have written an uncovered call. Recently, the rules on covered and uncovered short selling have been tightened dramatically owing to the turmoil in global financial markets.

Viney - Chapter 20 #82
difficulty: EMPTY
learning goal: EMPTY
learning objective: EMPTY
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question type: EMPTY
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type: EMPTY

83. Option markets have some basic organisation features. Discuss

Option markets now operate in the major financial centres around the world. Prior to 1973 and the creation of the Chicago Board Options Exchange (CBOE), option contracts were private contracts between parties. However, market trading of standardised contracts was stimulated by the establishment of the CBOE and the adoption of formal trading practices and similar exchanges developed quite quickly around the world. The organisation of options markets is similar to futures. All exchange-traded options contract transactions are recorded by a clearing house. Once the clearing house has entered as the counterparty to both the seller and buyer of the option the options clearing house guarantees the performance of all contracts. It also handles the assignment of option contract exercise notices submitted by buyers.

Viney - Chapter 20 #83
difficulty: EMPTY
learning goal: EMPTY
learning objective: EMPTY
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question type: EMPTY
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84. Discuss briefly the two common option contracts for shares and options on futures contracts that are available through the SFE.

The Australian Securities Exchange (ASX) offers exchange-traded contracts through its subsidiary, the SFE. Option contracts on underlying futures contracts include 90-day bank-accepted bills futures contracts, S&P/ASX 200 Index futures contracts and three-year, and 10-year Treasury bonds futures contracts. There are also share options with varying exercise prices on leading company ordinary shares.

Viney - Chapter 20 #84
difficulty: EMPTY
learning goal: EMPTY
learning objective: EMPTY
level: EMPTY
lo: EMPTY
question type: EMPTY
source: EMPTY
type: EMPTY

ch20 Summary

Category	*# of Questions*
Difficulty: Easy	19
Difficulty: Hard	16
Difficulty: Medium	44
Viney - Chapter 20	84