68 DERIVATIVE INSTRUMENT AND DERIVATIVE MARKET FEATURES

1. Which of the following statements regarding exchange-traded derivatives is least accurate? Exchange-traded derivatives:
   (A) are backed by a central clearinghouse.
   (B) are illiquid.
   (C) often trade in a physical location.

2. An investor hedges her long position in her shares of Jaffrey Ltd. (Jaffrey) by taking a position in a forward contract where she agrees to sell the shares of Jaffrey. Which of the following statements best describe the investor's position regarding the forward contract?
   (A) The investor will have a gain on the forward contract when the price of the shares of Jaffrey falls.
   (B) The investor will have a gain on the forward contract when the price of the shares of Jaffrey rises.
   (C) The investor will have neither a gain nor a loss on the forward contract because her position is hedged.

3. Josh Amie purchases a one-year interest rate forward contract based on the market reference rate (MRR). At settlement, the MRR has risen and Amie will have:
   (A) a loss on the forward contract.
   (B) a gain on the forward contract.
   (C) neither a loss nor a gain on the forward contract.

4. Party A takes a position in a forward contract to purchase 200 shares of Squealer Inc. (Squealer) for $40 per share three months from now. Party B takes the opposite position to sell 200 shares of Squealer for $40 per share three months from now. The relevant discount rate is 5%.
   The value of the forward contract to Party A at the initiation of the contract is closest to:
   (A) $7,900.
   (B) $0.
   (C) $8,000.

5. A derivative is defined as a security that has a value:

(A) based on another security, commodity, or index.

(B) established outside an organized exchange.

(C) stated in a contract between two counterparties.

6. A forward contract specifying that only the gains and losses are exchanged at settlement is called a:

(A) deliverable contract.

(B) cash-settled contract.

(C) netted contract.

7. Which of the following statements regarding derivatives and/or cash market transactions is most accurate?

(A) Investors can easily gain exposure to risk through derivatives but at a relatively high cost.

(B) Initiating a derivatives position is most likely to have a greater impact on market prices of the underlying, relative to initiating an equivalent position in the underlying through a cash market transaction.

(C) Transaction costs for a derivatives position are often lower than for the equivalent cash market trade.

8. For exchange-traded derivatives, the role of the central clearinghouse is to:

(A) maintain private insurance that can be used to provide funds if a trader defaults.

(B) stabilize the market price fluctuations of the underlying commodity.

(C) guarantee that all obligations by traders will be honoured.

9. In futures markets, the primary role of the clearinghouse is to:

(A) reduce transaction costs by making contract prices public.

(B) act as guarantor to both sides of a futures trade.

(C) prevent arbitrage and enforce federal regulations.