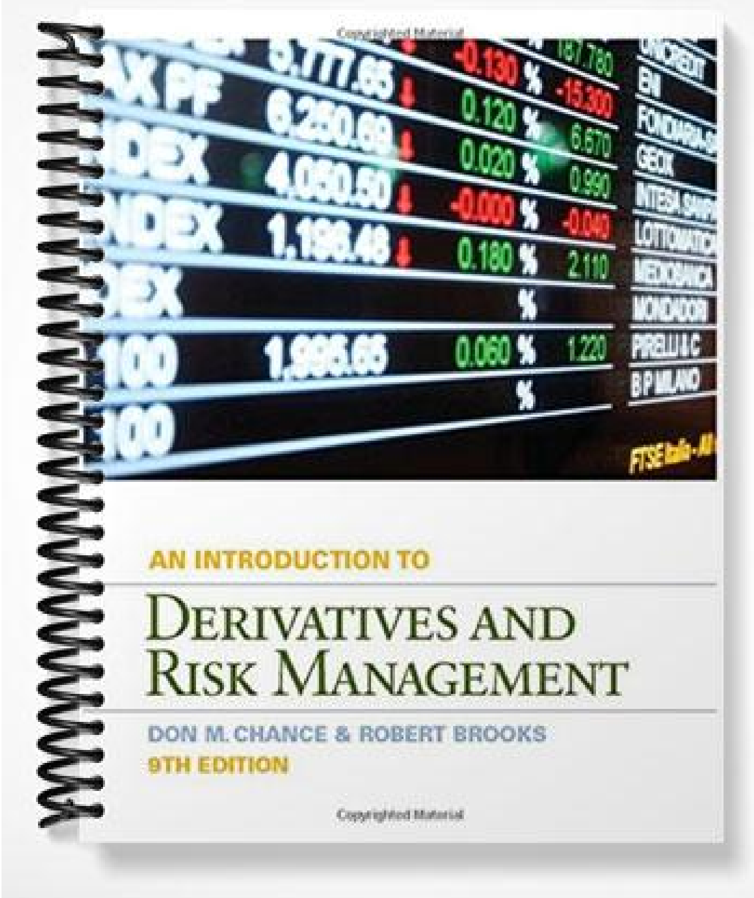
TEST BANK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AN INTRODUCTION TO
DERIVATIVES AND
RISK MANAGEMENT
DON M. CHANCE & ROBERT BROOKS
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CHAPTER 2: STRUCTURE OF OPTIONS MARKETS

MULTIPLE CHOICE TEST QUESTIONS

1. Options are traded on which of the following exchanges?
   a. NYSE Amex
   b. NYSE Euronext (Arca)
   c. Chicago Board Options Exchange
   d. International Securities Exchange
   e. all of the above

2. A call option priced at $2 with a stock price of $30 and an exercise price of $35 allows the holder to buy the stock at
   a. $2
   b. $32
   c. $33
   d. $35
   e. none of the above

3. A put option in which the stock price is $60 and the exercise price is $65 is said to be
   a. in-the-money
   b. out-of-the-money
   c. at-the-money
   d. exercisable
   e. none of the above

4. Organized options markets are different from over-the-counter options markets for all of the following reasons except
   a. exercise terms
   b. physical trading floor
   c. regulation
   d. standardized contracts
   e. credit risk

5. The number of options acquired when one contract is purchased on an exchange is
   a. 1
   b. 5
   c. 100
   d. 500
   e. 8,000

6. The advantages of the over-the-counter options market include all of the following except
   a. customized contracts
   b. privately executed
   c. freedom from government regulation
   d. lower prices
   e. none of the above

7. Which one of the following is not a type of transaction cost in options trading?
   a. the bid-ask spread
   b. the commission
   c. clearing fees
   d. the cost of obtaining a quote
   e. all of the above

8. If the market maker will buy at 4 and sell at 4.50, the bid-ask spread is
   a. 8.50
   b. 4.25
   c. 0.50
   d. 4.00
   e. none of the above

9. Which of the following is a legitimate type of option order on the exchange?
   a. purchase order
   b. limit order
   c. execution order
   d. floor order
   e. all of the above

10. The exercise price can be set at any desired level on each of the following types of options *except*
   a. FLEX options
   b. equity options
   c. over-the-counter options
   d. all of the above
   e. none of the above

11. An investor who owns a call option can close out the position by any of the following types of transactions *except*
   a. exercise
   b. offset
   c. expiring out-of-the-money
   d. buying a put
   e. none of the above

12. Which type of trader legitimately practices dual trading?
   a. floor brokers
   b. off–floor option traders
   c. board brokers
   d. designated primary market makers
   e. none of the above

13. The option price is also referred to as the
   a. strike
   b. spread
   c. premium
   d. fee
   e. none of the above

14. Index options trading on organized exchanges expire according to which of the following cycles?
    a. March, June, September, and December
    b. each of the next four consecutive months
    c. the current month, the next month, and the next two months in one of the other cycles
    d. every other month for each of the next nine months
    e. none of the above

15. An investor who exercises a call option on an index must
    a. accept the cash difference between the index and the exercise price
    b. purchase all of the stocks in the index in their appropriate proportions from the writer
    c. immediately buy a put option to offset the call option
    d. immediately write another call option to offset
    e. none of the above

16. Which of the following are long-term options?
    a. Bond options
    b. LEAPS
    c. currency options
    d. Nikkei put warrants
    e. none of the above

17. The exchange with the largest share of the options market is the
    a. American Stock Exchange
    b. Boston Options Exchange
    c. Chicago Board Options Exchange
    d. Pacific Stock Exchange
    e. Philadelphia Stock Exchange

18. A writer selected to exercise an option is said to be
    a. marginal
    b. assigned
    c. restricted
    d. designated
    e. none of the above

19. All of the following are forms of options *except*
    a. convertible bonds
    b. callable bonds
    c. warrants
    d. mutual funds
    e. none of the above

20. Which of the following index options is the most widely traded?
    a. S&P 500
    b. Nikkei 225
    c. Technology Index
    d. New York Stock Exchange Index
    e. none of the above

21. In which city did organized option markets originate?
  a. New York
  b. Chicago
  c. Philadelphia
  d. San Francisco
  e. none of the above

22. Who determines whether options on a company's stock will be listed?
  a. the clearing house
  b. Securities Exchange Commission
  c. the company
  d. the exchange
  e. none of the above

23. An order that specifies a maximum price to pay if buying is a
  a. stop order
  b. market order
  c. limit order
  d. all or none order
  e. none of the above

24. What amount must a call writer pay if a cash–settled index call is exercised?
  a. difference between the index level and the exercise price
  b. exercise price
  c. difference between the exercise price and the index level
  d. index level
  e. none of the above

25. Option traders incur which of the following types of costs?
  a. margin requirements
  b. taxes
  c. stock trading commissions
  d. a and b
  e. a, b and c

26. The total number of long option contracts outstanding at any given time is called the
  a. market cap
  b. sum options outstanding (SOO)
  c. option wealth outstanding (OWO)
  d. open interest
  e. none of the above

27. "Wal-Mart calls" are an example of
  a. an option series
  b. an option class
  c. an option grade
  d. a and b
  e. none of the above

28. This individual maintains and attempts to fill public option orders but does not disclose them to others.
  a. liquidity provider

b. board broker
c. order book official
d. registered option trader
e. none of the above

29. What intermediary guarantees an option writer’s performance?
a. credit worthiness rating company
b. brokerage
c. good-till-canceled order
d. clearinghouse
e. none of the above

30. Suppose you hold a call option. The stock price has recently been increasing-making your call option more valuable. Through what process might you take advantage of the liquid nature of the options market?
a. offsetting order
b. contract reconciliation
c. mark to market order
d. settling up
e. none of the above

CHAPTER 2: STRUCTURE OF OPTIONS MARKETS

TRUE/FALSE TEST QUESTIONS

T F 1. The exercise price is also called the striking price.

T F 2. The Put and Call Brokers and Dealers Association created the first organized options exchange.

T F 3. An out-of-the-money call option has an exercise price less than the stock price.

T F 4. A put option increases in value when the stock price decreases.

T F 5. All of the options on Microsoft comprise an option class.

T F 6. The AT&T October puts are an option series.

T F 7. Exercise prices are set in $5 increments for options on exchanges.

T F 8. The over-the-counter options market is much larger than the exchange-listed options market.

T F 9. Exchange-listed options expire on the Saturday following the third Friday of the month.

T F 10. Position limits are restrictions on the number of transactions an investor can execute on a given day.

T F 11. Exercise limits are restrictions on the number of options that can be exercised by an investor in a given day or series of days.

T F 12. A market maker is an options trader who buys and sells options off of the exchange floor.

T F 13. The bid price is the price paid to buy an option from a market maker.

T F 14. Options traders who hold their positions for very short periods of time are called position traders.

T F 15. An order placed by an investor for the broker to buy an option at the best available price is called a market order.

T F 16. The number of option contracts outstanding at any given time is called the open interest.

T F 17. Most investors close their positions by exercising their options.

T F 18. Over-the-counter options are not subject to default.

T F 19. Indices measuring options market activity are simple to construct and widely quoted.

T F 20. The spread between the bid price and the ask price is a transaction cost to the option trader.

T F 21. The options market is regulated by the Securities Investor Protection Corporation.

T F 22. Index options have less volume than stock options.

T F 23. The Options Clearing Corporation guarantees the obligations of traders on options exchanges.

T F 24. Offsetting an over-the-counter option contract cancels both contracts.

T F 25. The order book official executes limit order option trades for the general public.

T F 26. CBOE option market makers are also called liquidity providers.

T F 27. Over-the-counter options dealers do not have to be members of an options exchange.

T F 28. A market maker always avoids the cost of the bid-ask spread.

T F 29. The majority of options exchanges in the U.S. are fully automated.

T F 30. Option commissions are set by the Chicago Board Options Exchange.

T F 31. On the CBOE, option tables represent each option with a series of letters and number, such as, MSFT\12B17\20.0. The last number represents the calendar date, the 20th of the month in this example.

T F 32. Again, on the CBOE, option tables represent each option with a series of letters and number, such as, MSFT\12B17\20.0. The middle letter represents the calendar month and whether it is a call or put.

T F 33. An investor who is long an over-the-counter call option is exposed to the risk that the call writer will default on her obligations should the call option end up in-the-money.

T F 34. Exercising a stock put option means the put seller must sell stock at the stated strike price.

T F 35. A call option to buy euros expressed in $/€ is equivalent to a put option to sell dollars expressed in €/$.