Chapter 20 - Practice Questions

1. The price that the buyer of the option pays to acquire the option is called the
   A) strike price.
   B) exercise price.
   C) execution price.
   D) acquisition price.
   E) premuim.

2. An American call option allows the buyer to
   A) sell the underlying asset at the exercise price on or before the expiration date.
   B) buy the underlying asset at the exercise price on or before the expiration date.
   C) sell the option in the open market prior to expiration.
   D) A and C.
   E) B and C.

3. A European put option allows the holder to
   A) buy the underlying asset at the striking price on or before the expiration date.
   B) sell the underlying asset at the striking price on or before the expiration date.
   C) potentially benefit from a stock price decrease with less risk than short selling the stock.
   D) sell the underlying asset at the striking price on the expiration date.
   E) C and D.

4. A European put option can be exercised
   A) any time in the future.
   B) only on the expiration date.
   C) if the price of the underlying asset declines below the exercise price.
   D) immediately after dividends are paid.
   E) none of the above.

5. All else equal, call option values are lower
   A) in the month of May.
   B) for low dividend payout policies.
   C) for high dividend payout policies.
   D) A and B.
   E) A and C.

6. The intrinsic value of an out-of-the-money call option is equal to
   A) the call premium.
   B) zero.
   C) the stock price minus the exercise price.
   D) the striking price.
   E) none of the above.

7. Before expiration, the time value of a call option is equal to
   A) zero.
   B) the actual call price minus the intrinsic value of the call.
   C) the intrinsic value of the call.
   D) the actual call price plus the intrinsic value of the call.
   E) none of the above.

8. All of the following factors affect the price of a stock option **except**
   A) the risk-free rate.
   B) the riskiness of the stock.
   C) the time to expiration.
   D) the expected rate of return on the stock.
   E) none of the above.

9. A collar with a net cost of approximately zero is an options strategy that
   A) combines a put and a call to lock in a price range for a security.
   B) uses the gains from sale of a call to purchase a put.
   C) uses the gains from sale of a put to purchase a call.
   D) both A and B.
   E) both A and C.

10. Asian options differ from American and European options in that
    A) they are only sold in Asian financial markets.
    B) they never expire.
    C) their payoff is based on the average price of the underlying asset.
    D) both A and B.
    E) both A and C.

11. HighFlyer Stock currently sells for $48. A one-year call option with strike price of $55 sells for $9, and the risk free interest rate is 6%. What is the price of a one-year put with strike price of $55?
    A) $9.00
    B) $12.89
    C) $16.00
    D) $18.72
    E) $15.60

Answer Key

1. E
2. E
3. E
4. B
5. C
6. B
7. B
8. D
9. D
10. C
11. B