END OF CHAPTER EXERCISES

Chapter 7 : Options Markets

Financial Engineering : Derivatives And Risk Management

(Keith Cuthbertson, Dirk Nitzsche)

1. Intuitively, why does the option premium change when the stock price changes?

2. When is a long call 'in-the-money' and when is a long put 'out-of-money' ?

3. European options can only be exercised on the expiry date. Does this mean the holder of a long position in a call or put is 'locked in' to this investment until the expiry date? If not, what are the problems in not holding the option to expiration?

4. Why does the buyer of a call not have to provide margin payments to the options clearing house, whereas the writer of the option does make margin payments?

5. In what sense do calls and puts provide insurance ?

6. If you write a call option on a stock why must you lodge margin payments with the clearing house ? Does this imply that selling an option provides no cash benefits ?

7. If you have written a call option on a stock and also on the S&P500, what will happen at maturity if the two options are in-the-money ?