There are 4 versions of this quiz. Please find your version.
1. There are four uses of derivatives. For each of the following situations, state the use that is being described. Each use will be used once.

Insurance companies are restricted by law from owning stocks in excess of 10% of their surplus. Therefore, an insurance company decides to buy forward contracts instead of stocks because there is no limit on forward contracts.

Use: Regulatory Arbitrage

Beckley Farms has production costs related to corn which are 5.00 per bushel of corn. A six month forward on corn has a forward price of 7.00. Beckley decides to purchase the forward contract in order to lock in a profit its corn crop.

Use: Risk Management or Hedging

Sammy believes that Conklin Stock will increase in value. Therefore, to benefit from an increase in the price of Conklin Stock, Sammy decides to purchase a forward contract instead of the stock because the commissions on the purchase are lower.

Use: Reduce Transaction Costs

Shannon believes that Conklin stock will increase in value. She buys a forward contract as a bet that the stock will go up without having to invest any money since the forward contract has a cost of zero.

Use: Speculation
2. Xin sells 1000 shares of Zhang Company stock at the same time that Mengzhi buys 1000 share of Zhang Company stock. The bid price for a share of Zhang Company stock is 28. The bid ask spread is 0.50.

Xin pays a commission of 0.25 per share of stock while Mengzhi pays a commission of 1% of the purchase price.

Calculate the total transaction costs incurred by Xin and Mengzhi added together.

Solution:

Bid Price = 28.00    Ask Price = 28.50

Mengzhi ➔ (1000)(28.50)(1.01) = 28,785

Xin ➔ (1000)(28.00) – (1000)(0.25) = 27,750

Total Transaction Costs = 28,785 – 27,750 = 1035
3. I would like to receive credit for this question since I wrote my name on the front cover of the quiz.

True or False
1. Xin sells 1000 shares of Zhang Company stock at the same time that Mengzhi buys 1000 share of Zhang Company stock. The bid price for a share of Zhang Company stock is 28. The bid ask spread is 0.50.

Xin pays a commission of 1% of the selling price while Mengzhi pays a commission of 0.25 per share of stock.

Calculate the total transaction costs incurred by Xin and Mengzhi added together.

Solution:

Bid Price = 28.00  Ask Price = 28.50

Mengzhi ➔ (1000)(28.50)+(1000)(0.25) = 28,750

Xin ➔ (1000)(28.00)(1-0.01) = 27,720

Total Transaction Costs = 28,750 − 27,720 = 1030
2. There are four uses of derivatives. For each of the following situations, state the use that is being described. Each use will be used once.

Sammy believes that Conklin Stock will increase in value. Therefore, to benefit from an increase in the price of Conklin Stock, Sammy decides to purchase a forward contract instead of the stock because the commissions on the purchase are lower.

Use: ______ Reduce Transaction Costs

Shannon believes that Conklin stock will increase in value. She buys a forward contract as a bet that the stock will go up without having to invest any money since the forward contract has a cost of zero.

Use: _____ Speculation

Insurance companies are restricted by law from owning stocks in excess of 10% of their surplus. Therefore, an insurance company decides to buy forward contracts instead of stocks because there is no limit on forward contracts.

Use: _____ Regulatory Arbitrage

Beckley Farms has production costs related to corn which are 5.00 per bushel of corn. A six month forward on corn has a forward price of 7.00. Beckley decides to purchase the forward contract in order to lock in a profit its corn crop.

Use: _____ Risk Management or Hedging
3. I would like to receive credit for this question since I wrote my name on the front cover of the quiz.

True  or  False
1. Xin buys 1000 shares of Zhang Company stock at the same time that Mengzhi sells 1000 share of Zhang Company stock. The ask price for a share of Zhang Company stock is 28. The bid ask spread is 0.50.

Xin pays a commission of 1% of the purchase price while Mengzhi pays a commission of 0.25 per share of stock.

Calculate the total transaction costs incurred by Xin and Mengzhi added together.

Solution:

Ask Price = 28.00  Bid Price = 27.50

Xin $\rightarrow$ $(1000)(28.00)(1.01) = 28,280$

Mengzhi $\rightarrow$ $(1000)(27.50) - (1000)(0.25) = 27,250$

Total Transaction Costs = 28,280 – 27,250 = 1030
2. There are four uses of derivatives. For each of the following situations, state the use that is being described. Each use will be used once.

Sammy believes that Conklin Stock will increase in value. Therefore, to benefit from an increase in the price of Conklin Stock, Sammy decides to purchase a forward contract instead of the stock because the commissions on the purchase are lower.

Use: ___________________________ Reduce Transaction Costs

Insurance companies are restricted by law from owning stocks in excess of 10% of their surplus. Therefore, an insurance company decides to buy forward contracts instead of stocks because there is no limit on forward contracts.

Use: ___________________________ Regulatory Arbitrage

Beckley Farms has production costs related to corn which are 5.00 per bushel of corn. A six month forward on corn has a forward price of 7.00. Beckley decides to purchase the forward contract in order to lock in a profit its corn crop.

Use: ___________________________ Risk Management or Hedging

Shannon believes that Conklin stock will increase in value. She buys a forward contract as a bet that the stock will go up without having to invest any money since the forward contract has a cost of zero.

Use: ___________________________ Speculation
3. I would like to receive credit for this question since I wrote my name on the front cover of the quiz.

True or False
1. There are four uses of derivatives. For each of the following situations, state the use that is being described. Each use will be used once.

Beckley Farms has production costs related to corn which are 5.00 per bushel of corn. A six month forward on corn has a forward price of 7.00. Beckley decides to purchase the forward contract in order to lock in a profit its corn crop.

Use: __________ Risk Management or Hedging

Sammy believes that Conklin Stock will increase in value. Therefore, to benefit from an increase in the price of Conklin Stock, Sammy decides to purchase a forward contract instead of the stock because the commissions on the purchase are lower.

Use: __________ Reduce Transaction Costs

Insurance companies are restricted by law from owning stocks in excess of 10% of their surplus. Therefore, an insurance company decides to buy forward contracts instead of stocks because there is no limit on forward contracts.

Use: __________ Regulatory Arbitrage

Shannon believes that Conklin stock will increase in value. She buys a forward contract as a bet that the stock will go up without having to invest any money since the forward contract has a cost of zero.

Use: __________ Speculation
2. Xin buys 1000 shares of Zhang Company stock at the same time that Mengzhi sells 1000 shares of Zhang Company stock. The ask price for a share of Zhang Company stock is 30. The bid ask spread is 1.00.

Xin pays a commission of 2.5% of the purchase price while Mengzhi pays a commission of 1.00 per share of stock.

Calculate the total transaction costs incurred by Xin and Mengzhi added together.

Solution:

Ask Price = 30.00   Bid Price = 29.00

Xin $\Rightarrow (1000)(30)(1.025) = 30,750$

Mengzhi $\Rightarrow (1000)(29.00) - (1000)(1.00) = 28,000$

Total Transaction Costs = 30,750 – 28,000 = 2750
3. I would like to receive credit for this question since I wrote my name on the front cover of the quiz.

True or False