

CFA® SAMPLE QUESTION - LEVEL I

Derivatives

Q: Which of the following BEST DESCRIBES both forward and futures contracts?

CORRECT ANSWER:

(b) A forward contract is considered a flexible derivatives instrument while a futures contract is relatively inflexible.

Flexibility is a characteristic of a forward contract, not a futures contract. The customization of a forward contract to meet the unique needs of the counterparties makes it a flexible instrument. The standardization of contract terms, posting of margin, and trading on organized exchanges make futures contracts inflexible but does make them liquid with much less credit risk.

Choice "a" is incorrect. Forward contracts do trade on the over the counter (OTC) market, but they are not regulated. Futures contracts are regulated and trade on an organized futures exchange.

Choice "c" is incorrect. The opposite is true. Forward contracts can be customized, while futures contracts require standardized terms.



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