

CFA® SAMPLE QUESTION - LEVEL I

Derivatives

Q: An investor must decide between buying a swap or a cash-settled forward contract. These contracts are similar in that both:

CORRECT ANSWER:

(b) Do not require posting any initial funds at contract initiation.

Forward contracts and swaps are similar in two ways. First, neither requires the posting of an initial investment/funding at initiation. Second, both have counterparty risk because there is no clearinghouse to guarantee payments.

Choice "a" is incorrect. A cash-settled forward contract requires only one future payment. In contrast, swaps normally involve multiple payments over the life of the swap.

Choice "c" is incorrect. Both contracts have counterparty risk because there is no clearinghouse to act as an intermediary. In contrast, a clearinghouse does guarantee payments on futures contracts, which eliminates counterparty risk.



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