

DERIVATIVES

PART 1

Watch the first part of the video and answer the following questions by choosing the correct answer A, B, C or D. (0:00-2:30)

- How are derivatives described at the beginning of the video?**
 - As agreements whose value depends on future outcomes
 - As ownership of company shares
 - As physical assets you can store or use
 - As government-issued financial products
- What everyday situation is used to help explain the basic idea of options?**
 - Booking a hotel room
 - Reserving a seat for an event
 - Ordering food in advance
 - Buying travel insurance
- What is the main benefit of an option compared to directly buying an asset?**
 - It guarantees a profit
 - It removes all financial risk
 - It allows a decision to be postponed
 - It locks in the lowest market price
- What does the "strike price" refer to?**
 - The market value at the time of sale
 - The cost of entering the contract
 - The fixed amount agreed for a future transaction
 - The price set by the stock exchange
- Why are options called "derivatives"?**
 - They are calculated using complex formulas
 - They are based on interest rates
 - They always involve borrowing money
 - Their worth is linked to another asset
- Which statement correctly matches the two basic kinds of options?**
 - Calls protect against losses; puts increase profits
 - Calls involve selling; puts involve buying
 - Calls are long-term; puts are short-term
 - Calls give purchasing rights; puts give selling rights
- What distinguishes American-style options from European-style options?**
 - The markets where they are traded
 - The timing flexibility for using them
 - The currency they are priced in
 - The level of risk involved
- In the wheat farmer example, why does buying a put option make sense?**
 - It reduces the impact of falling prices
 - It fixes production costs
 - It guarantees higher market prices
 - It increases demand for wheat

PART 2

Watch the second part of the video and fill in the gaps with missing words or phrases. (2:31-3:17)

- Unlike options, a futures contract creates a firm to complete the transaction when the contract ends.
- In a futures agreement, the price agreed in advance is known as the rather than the term used for options.
- When a futures contract reaches its end date, the transaction takes place automatically, with no chance to the deal.
- For a wheat producer, using a futures contract fixes the selling price in advance, which offers protection if market values
- The disadvantage of this arrangement is that if prices increase, the seller cannot benefit from the market value.

Part 3

Watch the third part of the video and fill in the gaps with missing words or phrases. (4:44-5:29)

- Some derivatives are arranged privately rather than through an exchange, which allows flexibility but increases the risk that the other may not meet their obligations.
- A contract is essentially a privately negotiated version of a futures deal, while a swap involves exchanging one type of financial flow for another.

Read the following text. Some sentences have been removed. Put them in appropriate gaps.

Derivatives is a collective term for financial market products whose value depends on (i.e. is derived from) the price of another underlying asset such as a stock, a stock index (the average value of representative stocks in a given market), a currency, a commodity, etc. The main derivatives are futures, options and swaps. 1. _____ This allows companies to plan more effectively.

Futures contracts are agreements to make or take delivery of specified commodities (foodstuffs, - metals, etc.) or financial instruments at a fixed future date, at a price determined when the contract is made. Futures contracts allow both sellers and buyers to hedge or reduce risks. 2. _____ The seller eliminates the risk that the price will drop, and the buyer the risk that it will rise. The same logic led to the development of financial futures: contracts to buy and sell stocks, stock indexes, interest rates and currencies at a future date.

Options differ from futures in that they give the right, but not the obligation, to buy or sell an asset at a fixed price on or before a given date. Buying a call option gives you the right to buy an asset; buying a put option gives you the right to sell an asset. For example, if you expect the price of a stock to rise you can buy the right to buy that stock in the future at the current market price. 3. _____ If you are wrong, you do not have to exercise the option to buy or sell the stocks, but you lose the price of the option. 4. _____ Obviously, the expectations of the writer of an option about the future value of the assets are opposite to those of the buyer, and the writer does not - expect the option to be exercised. Futures and options are traded by speculators hoping to make a profit from price fluctuations, as well as by companies seeking to hedge. 5. _____

Borrowers and lenders can also swap or exchange future interest payments. A company that has . borrowed money at a floating rate could protect itself from a rise in interest rates by exchanging - this for a fixed interest rate loan with another company or financial institution. 6. _____ Companies can also undertake exchange rate swaps, exchanging funds in two different currencies. At a future date the same amount of the currencies is re-exchanged at a predetermined . exchange rate. Over the term of the agreement, the counterparties exchange fixed or floating rate . interest payments in their swapped currencies.

- If you think the price of a stock will fall in the next few weeks or months you can buy the right to sell it in the future at the current price.
- This is the premium the writer or seller of the option receives from the buyer.
- For example, a cocoa grower can agree a price, quantity and delivery date with a chocolate - manufacturer.
- These are interest - rate swaps.
- In fact, much more derivative usage is based on speculation than hedging nowadays.
- They were developed to allow companies to reduce uncertainty by guaranteeing future prices, at a reasonable cost.
- This is the premium the writer or seller of the option receives from the seller.

Read the text again and decide which answer is correct.

1. What is the primary function of derivatives?
 - A. To allow companies to reduce uncertainty by guaranteeing future prices.
 - B. To provide a platform for speculative trading and profit-making.
 - C. To facilitate the exchange of funds in different currencies.
 - D. To enable borrowers and lenders to swap future interest payments.
2. Which of the following is not mentioned as a main type of derivative?
 - A. Futures
 - B. Options
 - C. Swaps
 - D. Bonds
3. Which of the following statements best describes the key difference between futures and options contracts?
 - A. Futures contracts are traded on exchanges, while options are traded over-the-counter.
 - B. Futures contracts involve an obligation to buy or sell, while options give the right but not the obligation.
 - C. Futures contracts are used primarily for hedging, while options are used primarily for speculation.
 - D. Futures contracts have a fixed future date, while options can be exercised on or before a given date.
4. What is the primary reason companies use derivatives?
 - A. To make a profit from price fluctuations.
 - B. To hedge against risks and uncertainties.
 - C. To swap interest payments with other companies.
 - D. To exchange funds in different currencies.
5. How do the expectations of the writer and buyer of an option contract differ?
 - A. The writer and buyer have the same expectations about the future value of the asset.
 - B. The writer expects the option to be exercised, while the buyer does not.
 - C. The writer receives a premium from the buyer, but the buyer does not expect to exercise the option.
 - D. The writer and buyer take opposite positions in terms of the future value of the asset.
6. What is the purpose of an interest rate swap?
 - A. To exchange future interest payments in the same currency.
 - B. To exchange future interest payments in different currencies.
 - C. To protect a company borrowing at a floating rate from a rise in interest rates.
 - D. To provide a platform for speculation on interest rate movements.
7. What trend in the use of derivatives is mentioned in the passage?
 - A. The use of derivatives is declining due to increased regulation.
 - B. The use of derivatives is evenly split between hedging and speculation.
 - C. More derivatives are being used for hedging than for speculation.
 - D. Much more derivatives usage is based on speculation than hedging nowadays.

Decide if the statement is true or false. Correct the false ones.

1. A *put option* gives the holder the right to buy an asset at a specified price.
2. *Exchange rate swaps* are used to manage currency risk in international transactions.
3. A *speculator* invests in assets to reduce risk.
4. *Commodities* are intangible assets like software licenses.
5. *Fluctuations* in market prices are always predictable.
6. *Floating rates* remain fixed throughout the term of a loan.
7. A *derivative* is a type of fixed-income investment.
8. An investor who anticipates market changes to profit is a *speculator*.

Warren Buffett: Derivatives Set the Stage for the Next Financial Crisis?

Warren Buffett will be answering a question about derivatives. Watch and fill in the gaps with missing information.

1. In September and October of 2008, the Federal Reserve poured 85 billion into to prevent a financial crisis.
2. Hank Paulson guaranteed money market funds at a time when million Americans were panicking.
3. The amount of money that left the non-government money market funds in just 3 days was billion.
4. The actions taken by Bernanke and Paulson during the panic demonstrated that strong leadership is needed to
5. According to the speaker, the ability to print money was crucial during the panic, as it allowed leaders to say they would do
6. Section 133 of the Federal Reserve Act was likely not intended to be used for
7. The speaker expresses concern that Congress is hesitant to give too much authority to the
8. The speaker notes that it is challenging to write regulations that prevent people from acting, especially when such behaviour has been profitable.
9. The analogy of Cinderella at the ball suggests that people often believe they will be able to leave the situation before it
10. The speaker reflects on the uncertainty of when the next panic will occur, stating that when it happens, the focus will be on whether people will