SOA Sample Questions for *Derivatives Markets*, Problem No. 26, and Dr. Ostaszewski’s online exercise No. 240 posted December 19, 2009

Which of the following positions have an unlimited loss potential from adverse price movement in the underlying asset, regardless of the initial premium received?

I. Short 1 forward contract
II. Short 1 call option
III. Short 1 put option

A. I only  B. I and II only  C. I and III only  D. II and III only  E. I, II, and III

Solution.

I is true, because the forward seller has unlimited exposure if the underlying asset’s price increases. II is true, as the call issuer has unlimited exposure if the underlying asset’s price rises. Finally, III is false, because the maximum loss on selling a put is the future value of the put premium minus the put strike price.

Answer B.

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