

Study Notes for NISM Series VII : Securities Operations & Risk Management (SORM)

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NISM SERIES VII : SECURITIES OPERATIONS & RISK MANAGEMENT

Exam Details

Total Questions	100 X 1 Marks
Type	Multiple Choice
Pass Score	50%
Duration	2 Hours
Negative marks	-0.25

Chapterwise Weightages

Unit 1: Introduction to Securities Markets	5%
Unit 2: Market Participants in the Securities Markets	10%
Unit 3: Introduction to Securities Broking Operations	20%
Unit 4: Risk Management	15%
Unit 5: Clearing Process	15%
Unit 6: Settlement Process	15%
Unit 7: Investor Grievances and Arbitration	10%
Unit 8: Other Services Provided by Brokers	10%

Chapter 1: Introduction to the Securities Market

Financial market :

Enables efficient **transfer** and **allocation** of financial resources for productive activities in the economy.

- **Providers of surplus funds** : Households, businesses and governments
- **Users of funds** : Businesses, governments and households
- **Intermediaries** : Banks, financial institutions, mutual funds and insurance companies, among others, channelize the available surplus funds from lenders to the users.
- Important function of financial markets – provide **liquidity** and exit **options**.
- Financial Market Comprises – **Securities Market** and **Money market**

Electronic Gold Receipt means an electronic receipt issued on the basis of deposit of underlying physical gold in accordance with the regulations made by the Securities and Exchange Board of India under section 31 of the said Act.

Securities Market :

(Note : Securities as defined in the SCRA, 1956 includes - Shares, scrips, stocks, bonds, debentures, debenture stock, derivatives, Collective Investment Scheme, Security receipt, Mutual funds, Government Securities, Rights or interest in securities)

The securities market has two **interdependent** and **inseparable** segments :

- New issues (the primary market)
- Stock (secondary) market.
- Primary market ensures availability of adequate capital at reasonable rates to finance **expansion, diversification or consolidation** of companies.
- Issuer has direct contact with the investor – Primary market
- Lawyers, Bankers to the issue, Brokers, and Depository participants.

Methods of raising capital in primary market :

- **Initial Public Offer (IPO) or Further Public Offer (FPO)** : It is a public issue, anybody and everybody can subscribe for it.
- **Private Placement** : the issue is made to select group of people.

- **Rights Issue:** fresh shares are issued to existing shareholders at a particular price.
- **Bonus issue/stock split** : Issues without any cost to the existing shareholder (Free Shares).

The secondary market provides liquidity to these instruments (ie., IPO, FPO issued in primary market) through trading and settlement on the stock exchanges.

- An active secondary market promotes the **growth of the primary market** and **capital formation**.
- Provides primary market investors a **continuous market** where they have an option to liquidate their investments.
- Dealings are between two investors and the issuer are indirect - Secondary market

The secondary market operates through two mediums -

- **Over-The-Counter (OTC) market**
- **Exchange Traded Market / Screen Based Trading System (SBTS)**.

OTC markets –

- Informal type of markets where trades are negotiated between the parties.
- Securities are traded and settled bilaterally over the counter

Exchange Traded Market

- Formal type of markets - Trading and settlement is done through the Stock Exchanges.
- The trades executed on the exchange are settled through the clearing corporation, who acts as a counterparty and guarantees settlement.

Capital market intermediaries - Registrars and Transfer Agents, Custodians and Depositories

- Provide important infrastructure services to both the primary and secondary markets.

Money market - is a market for financial assets that are close **substitutes for money**.

- It is a market for short term funds and instruments having a maturity period of ≤ 1 year.
- Provides short term debt financing and investment.
- Deals primarily in short-term debt securities and investments, such as –
 - Banker's acceptances
 - Negotiable certificates of deposit (CDs)
 - Repos and Treasury Bills (T-bills)
 - Call/Notice money market
 - Commercial papers

Equity Markets and its Products :

Equity Shares represents the form of **fractional ownership** in a business venture.

- Equity shareholders collectively own the company - bear its risk and enjoy the rewards of ownership.

Debentures are instruments for raising **long term debt**.

- Secured by **tangible assets**.
- There are fully convertible, non-convertible and partly convertible debentures.
- NCDs are repayable on maturity.
- Debentures can be pure debt or quasi-equity

Government Securities issued by central and state government also traded on Equity segment of the Exchange.

Warrants entitle an investor to buy equity shares after a specified time period at a given price.

A Mutual Fund is an investment vehicle that pools money from numerous investors who wish to save or make investments having similar investment objective

Exchange Traded Fund : An ETF is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. An ETF, or exchange traded fund, is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. The main difference between ETFs and other types of index funds is that ETFs don't try to outperform their corresponding index, but simply replicate the performance of the Index. Unlike regular mutual funds, an ETF trades like a common stock on a stock exchange. The traded price of an ETF changes throughout the day like any other stock, as it is bought and sold on the stock exchange. The trading value of an ETF is based on the net asset value of the underlying stocks that an ETF represents.

Indian Depository Receipt (IDR)

- An IDR is an instrument denominated in Indian Rupees in the form of a depository receipt created by a Domestic Depository (custodian of securities registered with the SEBI) against the underlying equity shares of issuing company to enable foreign companies to raise funds from the Indian securities Markets
- IDRs are issued by foreign companies to Indian investors.

- IDRs are depository receipts which have the equity shares of the issuing company as the underlying security.
- The underlying shares are held by a foreign custodian and the DRs are held in the Indian depository.
- IDRs are listed in the Indian stock exchanges.
- The investor can either hold the IDR, trade in them in the stock exchange or request for redemption into the underlying shares.
- Redemption is permitted after 1 year from the date of listing.
- Two way fungibility of IDRs is permitted i.e. depository receipt can be converted into underlying shares and the underlying shares can be converted into depository receipt

Derivative Market and its Products

Derivative is a product whose value is derived from the value of an underlying asset or group of assets—a benchmark. The derivative itself is a contract between two or more parties. The most common underlying assets for derivatives are stocks, bonds, commodities, currencies, interest rates, and market indexes. Derivative products are in the form of Forwards, Futures, Options and Swaps. Derivatives can trade over-the-counter (OTC) or on an exchange.

Forward contract is a promise to deliver an asset at a pre- determined date in future at a predetermined price.

Index/Stock Future is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price

Index / Stock Options are of two types - **Calls** and **Puts**. Calls give the buyer the right, but not the obligation, to **buy** a given quantity of the underlying asset, at a given price on or before a given future date. Puts give the buyer the right, but not the obligation, to **sell** a given quantity of the underlying asset at a given price on or before a given date.

Index future and option contracts are available weekly and monthly and options for some indices up to three year's expiry cycle with quarterly and half-yearly expiries. Weekly Options are the exchange traded options based on an Index with shorter maturity of one or more weeks.

Currency Derivatives trading was introduced in the Indian financial markets with the launch of currency futures trading in the USD-INR pair in 2008. Currently in India, currency futures contracts are traded on four INR pairs i.e., USDINR, EURINR, GBPINR and JPYINR and on three cross currency pairs i.e., EURUSD, GBPUSD and USDJPY on the recognized stock exchanges.

Commodity Derivatives → raw or primary products (gold, silver, metal, energy and agricultural goods) are exchanged.

Interest Rate Derivatives was introduced with introduction of Interest rate futures contract. Interest Rate Futures (IRF) are standardized interest rate derivative contracts traded on a recognized stock exchange to buy or sell a notional security or any other interest-bearing instrument or an index of such instruments or interest rates at a specified future date, at a price determined at the time of the contract.

Debt Market → In India, the debt market is broadly divided into two parts: **government securities** (G-Sec) market and **the corporate bond market**.

Corporate Bond Market or corporate debt market is a market where debt securities of corporate such as corporate bonds, T-bills, commercial papers and certificate of deposits are issued and traded. Corporate Bond secondary market is mainly OTC market, where the trades are negotiated between the participants on phone or through intermediaries. In India, corporate bonds are issued mainly on private placement basis (around 95%) and only small part of the total issuances are through public offer.

Other Asset Classes

Real Estate Investment Trusts (REIT) are trusts registered with SEBI that invest in commercial real estate assets. REIT assets" means real estate assets and any other assets held by the REIT, on a freehold or leasehold basis, whether directly or through a holding company and/or a special purpose vehicle

Infrastructure Investment Trusts (InvIT) are trusts registered with SEBI that invest in the infrastructure sector. The InvIT can raise funds through public issue and/or through private placement. The initial offer shall of atleast Rs. 250 crores and the value of the proposed assets of the InvIT shall minimum be of Rs. 500 crores

Sovereign Gold Bond Scheme (SGB) are government securities denominated in grams of gold. The bonds are issued in denomination of one gram of gold and in denominations thereof. The tenor of the bond is 8 years.

International Financial Services Centres (IFSC) - Financial Centre's that cater to customers outside their own jurisdiction are referred to as international (IFSCs) or offshore Financial Centers (OFCs). All these Centres are 'international' in the sense that they deal with the flow of finance and financial products/services across borders

Chapter 2: Market Participants in the Securities Market

The four important participants of securities markets are the investors, the issuers, the intermediaries and regulators.

Investors in securities market can be broadly classified into **Retail Investors** and **Institutional Investors**.

Retail Investors are individual investors who buy and sell securities for their personal account, and not for another company or organization. This category also includes High Net worth Individuals (HNI) which comprise of people who invest above rupees 2 lakh in a single transaction.

Institutional Investors comprise domestic Financial Institutions, Banks, Insurance Companies, Mutual Funds and FPIs (A Foreign Portfolio investor is an entity established or incorporated outside India that proposes to make investments in India)

Global Depository Receipts (GDRs) is a negotiable financial instrument that is issued by a foreign depository bank other than the US representing a specified number of shares of a foreign company's stock. GDR are generally traded in European Stock Exchanges.

American Depository Receipts (ADRs) is a negotiable certificate issued by a U.S. depository bank representing a specified number of shares of a foreign company's stock. The ADR trades on U.S. stock markets as any domestic shares would.

Foreign Currency Convertible Bonds (FCCBs) are bonds issued by Indian companies and subscribed to by a non-resident in foreign currency. They carry a fixed interest or coupon rate and are convertible into a certain number of ordinary shares at a predetermined price.

External Commercial Borrowings (ECBs) are commercial loans (in the form of bank loans, buyers credit, suppliers credit, securitized instruments, floating rate notes and fixed rate bonds) availed from any internationally recognized source such as bank, export credit agencies, suppliers of equipment, foreign collaborators, foreign equity holders and international capital market. Indian companies have preferred this route to raise funds as the cost of borrowing is low in the international markets.

Masala Bonds are rupee-denominated bonds issued outside India by Indian entities. They are

debt instruments which help to raise money in local currency from foreign investors.

The Securities Contract (Regulation) Act, 1956 (SCRA) defines '**Stock Exchange**' as a body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Trading cum Clearing Member	<ul style="list-style-type: none">•Can do both clearing & Trading•Can clear for other trading members also
Professional Clearing Member	<ul style="list-style-type: none">•Can only do Clearing•No Trading
Self Clearing Member	<ul style="list-style-type: none">•Can Clear Own trades only•Can not clear others trades
Custodian	<ul style="list-style-type: none">•Can only do Clearing•Settles accounts of a client of Trading member

A Clearing Corporation performs three main functions, namely: **clearing** and **settlement** of all transactions executed in the stock market (i.e., completes the process of receiving and delivering shares/funds to the buyers and sellers in the market) and carrying out **risk management**.

The clearing corporation acts as a **central counterparty** to all the trades.

A Custodian is an entity that helps register and safeguard the securities of its clients. Besides safeguarding securities, a custodian also keeps track of corporate actions on behalf of its clients.

Pay-In is a process whereby a Clearing Member and Custodian (in case of Institutional deals) bring in money and/or securities to the Clearing House/ Corporation. This forms the first phase of the settlement activity.

Pay-Out is a process where the Clearing House/ Corporation pays money or delivers securities to the Clearing Member and Custodians. This is the second phase of the settlement activity.

Depository and Depository Participants (DPs)

There are two Depositories in India, Central Depository Services Limited (CDSL) and National Securities Depository Limited (NSDL - established for the purpose of facilitating dematerialization of securities and assisting in trading of securities in the demat form. The Depository provides its services to clients through its agents called depository participants (DPs).

Trading Member / Stock Broker - is a member of the stock exchange. A trading member is allowed to execute trades on his own account as well as on account of his clients. A trading

member can be an individual (sole proprietor), a partnership firm, Limited Liability Partnership, Corporate or a bank who is a member of a Stock Exchange.

Authorized person is not a member of a Stock Exchange. He is appointed by a Stock Broker and provides access to trading platform of a Stock Exchange as an agent of the Stock Broker.

Regulators

- Securities and Exchange Board of India (SEBI) regulates the Securities Industry.
- Reserve Bank of India (RBI) is the authority to regulate and monitor the Banking sector.
- Insurance Regulatory and Development Authority (IRDA) regulates the Insurance sector.
- Pension Fund Regulatory & Development Authority (PFRDA) regulate the pension fund.
- International Financial Services Centres Authority (IFSCA) is a unified authority for the development and regulation of financial products, financial services and financial institutions in the IFSC in India
- Ministry of Finance (MOF)
- Ministry of Corporate Affairs (MCA)

SEBI Act, 1992 - The SEBI Act, 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market.

Securities Contracts (Regulation) Act, 1956

It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives Central Government regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges.

Depositories Act, 1996

The Depositories Act facilitated the establishment of the two depositories in India viz., NSDL and CDSL. Only a company registered under the Companies Act, 1956 and sponsored by the specified category of institutions can set up a depository in India.

A depository established under the Depositories Act can provide any service connected with recording of allotment of securities or transfer of ownership of securities in the record of a depository. A depository cannot directly open accounts and provide services to clients.

Companies Act, 2013

The Companies Act of 2013 deals with issue, allotment and transfer of securities and various

aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, providing annual reports and other information

Securities Contract (Regulation) Rules, 1957

Central Government has made this rules in exercise of the powers conferred by section 30 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956). The SCRR 1957 provide guidelines on application and recognition of stock exchanges, qualifications for membership on a recognised stock exchange, Books of account and other documents to be maintained and preserved by every recognised stock exchange and stock brokers, requirements with respect to the listing of securities, units or any other instrument of a Collective Investment Scheme on a recognised stock exchange.

Prevention of Money Laundering Act, 2002

Money laundering has been defined as “any process or activity connected with proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property”.

Section 4 of the PMLA - punishment - imprisonment of 3 to 7 years and fines.

Section 6 - confers powers on the Central Govt to appoint an Adjudicating Authority

Section 9 - all the rights and title in confiscated property shall vest in the Central Govt

Section 11 - Adjudicating Authority has same powers as civil court under Code of Civil Procedure

Section 12 – record maintenance for 5 years by all reporting entities

Section 12 AA - enhanced due diligence by reporting entities.

Sections 16 and 17 - powers of the authorities to carry out summon, searches and seizures.

Section 24 - burden of proving that proceeds of alleged crime are untainted shall be on accused.

Sections 25 and 26 - establishment of Appellate Tribunal and appeal filing procedures

Section 42 - appeals to high court against order of the Appellate Tribunal.

Section 43 – empowers the Central Govt to designate Courts of Session as Special Courts for the trial of the offence of money-laundering

SEBI (Prohibition of Insider Trading) Regulations, 2015

Insider Trading essentially denotes dealing in a company’s securities on the basis of confidential information relating to the company which is not published or not known to the public (known as unpublished price sensitive information), used to make profits or avoid loss.

Insider Trading is considered as an offence and is hence prohibited as per the SEBI (Prohibition of Insider Trading) Regulations, 2015 .

Regulation 2(g) of the SEBI Insider regulations, defines an '**insider**' any person who is:

- i) a connected person; or
- ii) in possession of or having access to unpublished price sensitive information;

Regulation 2(n) defines unpublished price sensitive information as info related to -

- financial results;
- dividends;
- change in capital structure;
- mergers, de-mergers, acquisitions, delistings, disposals and expansion of business
- changes in key managerial personnel; and
- material events in accordance with the listing agreement.

The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations 2003 enable SEBI to investigate into cases of market manipulation and fraudulent and unfair trade practices.

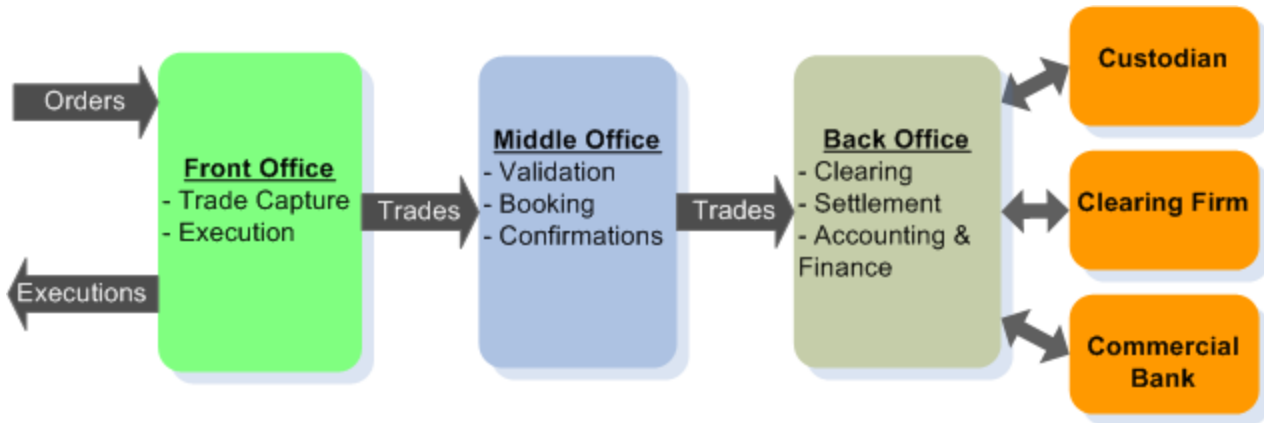
SEBI (Custodian) Regulation, 1996 - Custodian means any person who carries on or proposes to carry on the business of providing custodial service. A Custodian is an entity that is responsible for safeguarding the securities of its clients. Besides safeguarding securities, a custodian also keeps track of corporate actions on behalf of its clients

Chapter 3: Introduction to Securities Broking Operations

A trade is the conversion of an order placed on the exchange which results into pay-in and pay-out of funds and securities. Trade ends with the settlement of the order placed.

The following steps are involved in a trade's life cycle:

1. Placing of Order
2. Risk management and routing of order
3. Order matching and its conversion into trade
4. Affirmation and Confirmation (only for institutional deals)
5. Clearing and settlement



Securities Trade Processing Flow

In the year 2008, SEBI permitted the facility of Direct Market Access for institutional clients . DMA is a facility which allows brokers to offer its institutional clients direct access to the exchange trading system through the broker’s infrastructure. This does not involve any manual intervention of the broker.

Affirmation and Confirmation (For Institutional Clients) - In 2004, SEBI had mandated that all the institutional trades executed on the Stock Exchanges should be processed through the **Straight through Processing (STP) system**. STP is a mechanism that automates the end-to-end processing of transactions of the financial instruments.

It involves use of a single system to process or control all elements of the work-flow of a financial transaction, including what is commonly known as the Front, Middle, and Back office, and General Ledger. STP can be defined as electronically capturing and processing transactions in one pass, from the point of first ‘deal’ to final settlement.

Algorithmic Trading - Any order that is generated using automated execution logic shall be known as algorithmic trading.

Automated Trading shall mean and include any software or facility by the use of which, upon the fulfillment of certain specified parameters, without the necessity of manual entry of orders, buy/sell orders are automatically generated and pushed into the trading system of the Exchange for the purpose of matching.

High frequency trading (HFT) is a type of algorithmic trading which is latency sensitive and is characterized by a high daily portfolio turnover and high order-to trade ratio (OTR).

Contract Notes

- Contract note is the legal record of any transaction carried out on a stock exchange through a stockbroker. It serves as the confirmation of trade done on a day on behalf of a client on a stock exchange.

- Every stock broker shall issue a contract note to its clients for trades executed in such format as specified by the Exchanges.
- It establishes a legally enforceable relationship between the stock broker and the client in respect of settlement of trades executed on the Exchange as stated in the contract note.
- Contract note should be issued within 24 hours and in the format prescribed by exchanges/SEBI.
- Stock brokers are required to maintain proof of dispatch of contract notes in the case of delivery of physical contract notes through post/courier. In the case of Digitally Signed Electronic Contract Note (ECN), log of sending ECN to client's email id should be maintained
- The contract notes should be serially numbered starting from the beginning of the financial year. They should be issued with the client's name, PAN and client's code written on them. It should also contain the exact order number, order entry time, trade number, trade time, quantity of securities transacted, rates/price, etc.
- The contract notes should be signed by stock broker or by an authorised signatory of the stock broker.
- Contract should also mention all statutory charges like Securities Transaction Tax (STT), GST, stamp duty etc.), Regulatory levies / charges (e.g., SEBI turnover fees, Exchange transaction charges, etc.), Brokerage etc. Contract notes should be affixed with the brokers note stamps, as a percentage of the total value of the contract, as per the respective state government stamp acts / rules.

Front Office Operations

The front office is responsible for trade capture and execution. This is where the trade originates and the client relationship is maintained. The front office makes/takes orders and executes them. Traders and sales staff are considered front office staff.

Account Opening Kit

- 1) **Client Account Opening Form** which is in two parts.
 - a) Know Your Client (KYC) - form capturing the basic information about the client and instruction/check list to fill up the form and
 - b) Additional Document capturing additional information about the client related to trading account.
- 2) Document stating the **Rights & Obligations of stock broker** (Member-Client Agreement), sub-broker and client for trading on Exchanges
- 3) **Uniform Risk Disclosure Documents (RDD)** for all segments/Exchanges.
- 4) **Guidance Note** detailing Do's and Don'ts for trading on Exchanges.
- 5) Document describing the **Policies and Procedures of the stock broker**
- 6) **A tariff sheet** specifying various charges, including brokerage, payable by the

client to avoid any disputes at a later date.

SEBI has prescribed a new simplified **Account Opening Form ('AOF') or 'SARAL AOF'** for new individual investors participating in the cash segment of the Exchange but not availing facilities such as internet trading, margin trading, derivative trading and use of power of attorney.

KYC is an acronym for "**Know your Client**", a term commonly used for Customer Identification Process. SEBI has prescribed certain requirements relating to KYC norms for Financial Institutions and Financial Intermediaries including Mutual Funds and Stock Brokers to 'know' their clients. This entails verification of identity and address, financial status, occupation and such other personal information as may be prescribed by guidelines, rules and regulation.

UID – Unique Identification Number (Aadhaar) can be a proof of Identity.

The **e-KYC** service launched by UIDAI is accepted as a valid process for KYC verification, provided the client has authorized the intermediary to access his data through UIDAI system.

Authority Letter for settle account- The settlement of funds shall be done within 24 hours/ 1 working day of the payout, unless specifically authorized by client to maintain running account. However, the client can authorize the Broker to retain funds in his Trading Account and maintain it as Running Account. This is called Running Account Authorization. To facilitate this SEBI has approved brokers to collect running authority letter from the client. Authorization shall be signed by the client only & not by any POA holder. In spite of this letter, actual settlement of funds shall be done by the broker, at least once in a calendar quarter or month depending on preference of the client.

KRA – Know Your Client Registration Agency

The new KRA system was developed for centralization of KYC records in the securities markets. It is applicable from January 1, 2012. The members may upload the KYC data on the KRA system and send the relevant KYC documents within 10 working days.

Central Know Your Client (CKYC)

CKYC refers to Central KYC (Know Your Customer), an initiative of the Government of India which aims to have a system which allows investors to complete their KYC only once before interacting with various entities across the financial sector. CKYC is managed by **CERSAI (Central Registry of Securitization Asset Reconstruction and Security Interest of India)**, which is authorized by Government of India to function as the Central KYC Registry

(CKYCR). Thus, **CKYCR** will act as centralized repository of KYC records of investors in the financial sector with uniform KYC norms and inter-usability of the KYC records across the sector. CKYC requires additional information (for e.g. -**investor's maiden name, mother's name, FATCA** information etc.) to be collected and submitted to CERSAI for completion of the CKYC formalities of an investor. Currently, CKYC is applicable only to Individuals (both Resident Individuals and Non-Resident Individuals (NRIs)).

Unique Client Code

Once the formalities of KYC and other details thereon are complete, each client is assigned a unique client code (UCC) by the broker. This acts as an identity for the client with respect to the broker.

Brokerage rule for equity segment:

- Maximum brokerage - 2.5% of the trade value.
- If the value of share is Rs.10/- or less, a maximum brokerage of 25 paise per share can be collected.

There is no minimum brokerage requirement specified.

Brokerage rule for F&O segment:

- Brokerage for F&O is similar to the equity segment except for options contract
- Options contracts - maximum brokerage can be 2.5% of the option premium or Rs.100/- per contract whichever is higher.

Trading member can be a full service broker, discount broker or an online broker.

- Full service broker charges higher commission
- Discount brokers charge a much lower commission
- Online brokers cater to niche segment of retail clients.

Order Management consists of entering orders, order modification, order cancellation and order matching. The main components of an order are: Price, Time, Quantity, Security (What to buy and what to sell)), Action (Buy / Sell) & Client identity (UCC)

Types of order

A market order is where a trader purchases or sells their security at the best market price available. In the market order there is no need to specify the price at which a trader wants to purchase or sell.

Market order without Protection – Best available price in the market at that time

Market order with Protection – Best Available price within a specified range

Limit Order - the trader here needs to specify the price.

Stop Orders (orders with stop loss triggers) –an order which gets activated only when the market price of the security reaches or crosses a threshold price. Until then the stop order does not enter the market.

Time Condition

DAY - An order which is valid for the day on which it was entered.

IOC - Immediate or Cancel **GTC** - A Good Till Cancelled

GTD - A Good Till Days/Date (GTD) order allows the Trading Member to specify the days/date up to which the order should stay in the system

Quantity Condition

Disclosed Quantity (DQ)- An order with a DQ condition allows the Trading Member to disclose only a part of the order quantity to the market

MF - Minimum Fill (MF) orders allow the Trading Member to specify the minimum quantity by which an order should be filled.

AON - All or None orders allow a Trading Member to impose the condition that only the full order should be matched against. If the full order is not matched it will stay in the books till matched or cancelled.

Middle Office is a hybrid function between the front and back office. The middle office handles validations, bookings and confirmations. Risk Management and Surveillance typically forms the main function of the middle office.

Types of Risk

Operational risk -Loss resulting from inadequate or failed internal processes, people and systems or external events. For the stock broker, operations risk is essentially counter-party risks such as non-payment, non-delivery of scrip, denial of matched order by client/s, trading errors, and sudden closure of banks where funds are deposited.

Market risk - Loss from adverse changes in financial asset prices such as stock prices or interest rates. This risk entails the erosion of value of marketable securities and assets, due to factors beyond an enterprise's control. Market risk is usually affected by economic developments, political destabilization, rising fiscal gap, and national debt, terrorism, energy price shocks, increase in interest rates, all resulting in a drop inequity prices.

Credit risk is the risk of default on a debt that may arise from a borrower failing to make required payments. The credit risk for broker can arise on account of Loans to Group

Companies/ Related Parties, debit balance of clients, funding of clients, short collection of margins, Non-confirmation of DVP trade by custodian etc.

Back Office exists for three reasons: confirmation, payments, settlements & accounting. The back office monitors the post-market processing of transactions. The back office is where the trade ends

Trade Enrichment is performed automatically after each trade execution. In this step, all necessary details for the clearing of futures and option contracts, or the settlement of cash securities are added. Trade enrichment is defined as process of including additional information in one instruction in a trade which is already being executed.

Trade Allocation - In the case of institutional trades, the front office may enter a single order for a particular client and subsequently distribute it across various sub schemes of the client at the back office end. For example, hedge fund makes a trade, and manages several portfolios. Often, they will choose to allocate their trade to various portfolios for a number of reasons

Clearing and Settlement Process is a post trading activity that constitutes the core part of equity trade lifecycles. Clearing house/corporation is an entity through which settlement of securities takes place. The details of all transactions performed by the brokers are made available to the Clearing House/Corporation by the Stock Exchange.

The Clearing House/Corporation gives an obligation report to the brokers and custodians who are required to settle their money/securities obligations within the stipulated time period, failing which they are required to pay penalties. This obligation report serves as statement of mutual contentment.

In India, the pay-in of securities and funds happens on T+ 2 day by 10.30 a.m., and pay-out of securities and funds happen on T+2 by 1.30 p.m.

Accounting

The stock brokers are required to maintain books of account as prescribed by the Securities Contracts (Regulation) Rules, SEBI (Stock brokers and Sub-brokers) Regulations and requirements of Exchanges. These are to be maintained for a minimum period of 5 years.

The **register of transactions (sauda book)** - Details of each transaction with the name of the security, its value, rates gross and net of brokerage and names of the clients.

- The **client's ledger** - has the details of all clients and their transactions
- The **general ledger** - transactions including expenses, overheads salaries, petty cash, etc.

- The **journal** is the accounting book of the general ledger. Any adjustment entries for e.g., interest receivable, etc., is accounted here.
- **The cash and bank book** contain records of all cash and cheque transactions and are normally balanced daily.
- **The securities register** is required to be maintained client-wise and scrip-wise. The details provided would include date of receipt/delivery of the security, quantity received/delivered, party from whom delivered/to whom delivered, the purpose of receipt/delivery and the balance quantity.
- **A contract note** is a confirmation of trade done on a day for and on behalf of a client.
- **The margin deposit book**- details of margins paid/collected/payable/ collectable.

Securities Transaction Tax

S.No.	Taxable securities transaction	Rates w.e.f June 1, 2016	Payable by
1	Purchase of an equity share	0.1 Percent	Purchaser
2	Sale of an equity share	0.1 Percent	Seller
3	Sale of a unit of an equity oriented fund	0.001 Percent	Seller
4	Sale of an equity share where there is no delivery	0.025 percent	Seller
5	Sale of an option in securities	0.05 per cent on premium	Seller
6	Sale of an option in securities, where option is exercised	0.125 per cent	Purchaser
7	Sale of a futures in securities	0.01 percent	Seller

Bulk Deal is defined as "all transactions in a scrip (on an Exchange) where the total quantity of shares bought/sold is more than 0.5% of the number of equity shares of the company listed on the Exchange". However, the quantitative limit of 0.5% could be reached through one or more transactions executed during the day in the normal market segment.

Block Deals - A trade, with a minimum value of Rs. 10 crore executed through a single transaction on this separate window of the stock Exchange constitutes a "block deal" as distinguished from "bulk" deal.

Block Deal Windows – 8.45am to 9am & 2.05pm to 2.20pm

The orders may be placed in this window at a price not exceeding **+1%** of the applicable reference price in the respective block deal window

Chapter 4: Risk Management

Risk Management framework consists of the following components:

- Margin • Liquid Asset • Base minimum capital • Pre-trade risk control • Risk Reduction mode

Margining is a process by which a clearing corporation computes the potential loss that can occur to the open positions (both buy and sell) held by the members

VaR Margin is a margin intended to cover the largest loss that can be encountered on 99% of the days (99% Value at Risk)

Scrip sigma means the volatility of the security computed as at the end of the previous trading day. The computation uses the exponentially weighted moving average method applied to daily returns in the same manner as in the derivatives market.

Liquidity Categorization	VaR Margin
Group I (Liquid Securities)	Based on 6σ , subject to minimum of 9%
Group II (Less Liquid Sec.)	Based on 6σ , subject to minimum of 21.5%
Group III (Illiquid Securities)	50% if traded at least once per week ; 75% otherwise

Mark to Market Margin/ Loss is calculated by marking each transaction in security to the closing price of the security at the end of trading.

In case the net outstanding position in any security is NIL, the difference between the buy and sell values is considered as notional loss for the purpose of calculating the mark to market margin payable.

Extreme Loss Margin covers the expected loss in situations that go beyond those envisaged in the 99% value at risk estimates used in the VaR margin.

The Extreme Loss Margin shall be 3.5% for any stock and 2% for ETFs that track broad based market indices and do not include ETFs which track sectoral indices.

The Extreme Loss Margin shall be collected/ adjusted against the total liquid assets of the member on a real time basis.

The Extreme Loss Margin shall be collected on the gross open position of the member. For this purpose, there would be no netting off of positions across different settlements. The Extreme Loss Margin collected shall be released on completion of pay-in of the settlement.

Liquidity Categorization	Trading Frequency	Impact Cost
Group I (Liquid Securities)	At least 80 percent of the days	<= 1%
Group II (Less Liquid Sec.)	At least 80 percent of the days	> 1%
Group III (Illiquid Securities)	Less Than 80 percent of the days	n/a

Base minimum capital is the deposit a stock broker has to make with the stock exchange to gettrading rights on the exchange.

Categories	BMC Deposit
Only Proprietary trading without Algorithmic trading (Algo)	Rs.10 Lacs
Trading only on behalf of Client (without proprietary trading) and without Algo	Rs.15 lacs
Proprietary trading and trading on behalf of Client without Algo	Rs.25 lacs
All Trading Members/Brokers with Algo	Rs.50 lacs

Dynamic Price Bands

Stock Exchange shall set the dynamic price bands at **10 percent** of the previous closing price for the Stocks on which derivatives products are available

In the event of a market trend in either direction, the dynamic price bands shall be relaxed by the Stock Exchanges in increments of **5 percent**.

Initial margin is payable on all open positions of clearing members, up to client level and shall be payable upfront by Clearing Members in accordance with the margin computation mechanism adopted by the Clearing Corporation. Initial margin shall include SPAN margins, Margin on consolidated crystallized obligation, delivery margins

Calendar Spread Charge

Index Derivatives - 1.75% of the far month contract

Single Stock Derivatives - 2.2% of the far month contract

Net Option Value is computed as the difference between the long option positions and the short option positions, valued at the last available closing price of the option contract and shall be updated intraday at the current market value of the relevant option contracts at the time of generation of risk parameters The Net Option Value shall be added to the Liquid Net Worth of the clearing member. Thus, mark to market gains and losses shall not be settled in cash for options positions.

Delivery Margins shall be levied on lower of potential deliverable positions or in-the-money long option positions four (4) days prior to expiry of derivative contract which must be settled through delivery.

Extreme Loss Margin

Product	Extreme Loss Margin
Index Futures	2% of the notional value of the gross open positions in futures
Single Stock Futures	3.5% of the notional value of the gross open positions in futures
Short Index Options	2% of the notional value of the short open position
Short Stock Options	3.5% of the notional value of the short open position

Cross Margining introduced by SEBI to improve the efficiency of the use of the margin capital by market participants. Cross margining across Cash and Derivatives segment are available to all categories of market participants. The positions of clients in both the Capital market and F&O segments to the extent they offset each other shall be considered for the purpose of cross margining.

Graded Surveillance Measure (GSM) and Additional Surveillance Measure (ASM)

To enhance market integrity and safeguard interest of investors, SEBI has introduced Graded Surveillance Measures (GSM) on securities which witness an abnormal price rise not commensurate with financial health and fundamentals like Earnings, Book value, Fixed assets, Net-worth, P/E multiple, etc. Similarly, 'Additional Surveillance Measures' (ASM) on securities with surveillance concerns viz. Price variation, Volatility etc. have been introduced too.

The main objective of these measures is:

- To alert and advice investors to be extra cautious while dealing in these securities
- To advice market participants to carry out necessary due diligence while dealing in these securities.

Core Settlement Guarantee Fund - SEBI has directed clearing corporation to have a fund called Core SGF (Settlement Guarantee Fund) for each segment of each Recognized Stock Exchange (SE) to guarantee the settlement of trades executed in respective segment of the Stock Exchange. In the event of a clearing member (member) failing to honour settlement commitments, the Core SGF shall be used to fulfill the obligations of that member and complete the settlement without affecting the normal settlement process.

Chapter 5: Clearing Process

The clearing process follows the trading process.

1. At the end of the day's trade, all trade details are sent by stock Exchanges to the clearing house/corporation.
2. The clearing corporation/house then groups the trades under the various clearing members and informs them about the transactions of their respective clients.
3. clearing members/custodians then confirm back institutional trades by 1.00p.m. next day.
4. The clearing house/corporation then performs multilateral netting and determines the final obligations of all CM's. These details are then sent to clearing members by 2.30 p.m.

Role of the Clearing Agency / Corporation/House

When a trade occurs on the Stock Exchange it is a legal contract between the buyer and seller. If there is a default by either the buyer or the seller the counter party to the trade will have to bear the loss. The process of "novation" addresses this risk.

Novation - The Act of a clearing corporation interposing itself between both parties of every trade, being the legal counterparty to both

In India, there are three clearing corporations, viz., the **NSE Clearing Limited (NCL)**, **Indian Clearing Corporation Limited (ICCL)** and **Metropolitan Clearing Corporation of India Ltd. (MCCIL)**.

Interoperability among Clearing Corporations - SEBI introduced the concept of Interoperability among Clearing Corporations which necessitates linking of multiple Clearing Corporations. Inter-operability among Clearing Corporation (CC) will enable a Clearing Member to select the Clearing Corporation of its choice to clear and settle trades executed in multiple exchanges. It allows market participants to consolidate their clearing and settlement functions at a single Clearing Corporation, irrespective of the stock exchange on which the trade is executed

Clearing Banks acts as an important intermediary between a clearing member(s) and the clearing corporation. Every clearing member needs to maintain an account with any of the empanelled clearing banks at the designated clearing bank branches. The clearing accounts are to be used exclusively for clearing & settlement operations.

It is mandatory for CM to open demat accounts with both CDSL and NSDL. This account is called a **clearing member settlement pool account**. Separate accounts are to be opened for all the exchanges

Depositories & Depository Participants

A "Depository" is an entity facilitating holding securities in electronic form and enables transfer of securities by book entry.

In the depository system both transferor and transferee have to give instructions to its depository participants [DPs] for delivering [transferring out] and receiving of securities. However, transferee can give 'Standing Instructions' [SI] to its DP for receiving in securities. If SI is not given, transferee must give separate instructions each time securities have to be received.

Transfer of securities may be done for any of the following purposes:

- a. Transfer due to a transaction done between 2 persons (off-market transaction)
- b. Transfer arising out of a transaction done on a stock exchange.
- c. Transfer arising out of transmission and account closure.

A beneficiary account can be debited only if the beneficial owner has given '**Delivery Instruction Slip**' [DIS] .

Any trade that is cleared and settled without the participation of a clearing corporation is called **off-market trade**.

A **market trade** is one that is settled through participation of a Clearing Agency

Clearing Process

The clearing function of the clearing corporation is designed to work out a) what members are due to deliver and b) what members are due to receive on the settlement date.

In the stock exchanges this is done by a process called **multilateral netting**. This process is performed by the clearing agency (clearing corporation/clearing house). The clearing agency guarantees that all contracts which are traded will be honoured.

Clearing Process for Derivatives

The clearing mechanism essentially involves working out open positions and obligations of clearing members. This position is considered for exposure and daily margin purposes. The open positions of clearing members are arrived at by aggregating the open positions of all the brokers/trading members and all custodial participants clearing through them.

The stock brokers are allowed to net the clients account within the firm

Chapter 6: Settlement Process

In the Indian equities market for all trades done on recognised stock exchange, T+2 settlement cycle is followed, which means that a transaction entered into on Day 0 has to

be settled on the Day T+ 2 working days, when funds pay in or securities pay out takes place. T+2 here, refers to Trade day + 2 working days.

In case of exchange-traded equity derivatives contracts in India, some of the derivatives contracts (such as those based on the Indices) are **cash-settled** and some of the contracts (such as those based on individual securities) are **physically settled**.

The daily & final settlement of derivative trades is done on T+1 working day basis except for final settlement of equity derivatives contracts which are settled by delivery and are effected on Expiry+2 days. The final settlement in currency derivatives segment place on a T+2 basis.

Product	Settlement	Price
Futures Contracts on Index or Individual Security	Daily	Closing price of the futures contracts on the trading day (closing price = last half an hour weighted average price)
Un-expired illiquid futures contracts	Daily	Theoretical Price $F=S *e^{rt}$
Futures & Options Contracts on Index or Individual Securities	Final	Closing price of the relevant underlying index / security in the Capital Market segment of NSE, on the last trading day of the futures contracts.
Currency Futures	Daily	Last half an Hour weighted avg price
Un-expired illiquid futures contracts	Daily	$F=S *e^{(r-rf)t}$
Currency Futures and Options	Final	FBIL reference rate / Rate derived from FBIL reference rate
Cash Settlement GOI Bond Futures	Daily	Last half an Hour weighted avg price
Un-expired illiquid futures contracts	Daily	Theoriticial price = Cash Price + Financing cost – Income on cash position
Cash Settlement GOI Bond Futures & Options	Final	Last 2 Hours Weighted avg price on NDS-OM (min 5 trades) or FBIL price

Corporate Actions to be adjusted

The corporate actions may be broadly classified under **stock benefits and cash benefits**.

The various stock benefits declared by the issuer of capital are:

- Bonus • Rights • Merger / De-merger • Amalgamation • Splits • Consolidations • Hive-off
- Warrants, and • Secured Premium Notes (SPNs) among others.

The cash benefit declared by the issuer of capital is cash dividend

Adjustment - Modifications to positions / contract specifications listed below

- Strike Price , Position , Market Lot / Multiplier

Bonus - Ratio A:B	Adjustment factor : (A+B)/B
Stock Splits / Consolidations Ratio - A : B	Adjustment factor : A/B

Dividends which are **below 2% of the market value** of the underlying stock, would be deemed to be **ordinary dividends** and no adjustment in the Strike Price would be made for ordinary dividends.

For **extra-ordinary dividends**, **>=2% of the market value** of the underlying security, the total dividend amount would be reduced from all the strike prices of the option contracts on that stock.

Chapter 7: Investor Grievances and Arbitration

Grievance Redressal Mechanism:

Level 1 – Approach the Stock Broker at the designated Investor Grievance e-mail ID of the stock broker. The Stock Broker will strive to redress the grievance immediately, but not later than 30 days of the receipt of the grievance.

Level 2 – Approach the Stock Exchange using the grievance mechanism mentioned at the website of the respective exchange.

Level 3 – The complaint not redressed at Stock Broker / Stock Exchange level, may be **lodged with SEBI on SCORES** (a web based centralized grievance redressal system of SEBI) at: <https://scores.gov.in>

SEBI Complaints Redressal System (SCORES)

- SEBI handles the investor grievances through a system called SEBI Complaints Redressal System (SCORES) .Its a 24x7, web based centralized system to capture investor complaints against listed companies and registered intermediaries.
- It allows the investors to lodge their complaints and track the status online. When a complaint is lodged on SCORES, an email acknowledgement is generated for reference and tracking.
- Stock Exchanges and Depositories designate a person to resolve the complaints reported through SCORES within 15 days from the date of receipt on SCORES. If additional information is required, then it is mandated to be sought within 7 days of receipt of complaint.

- The stock exchanges are required to maintain a record of complaints which are not addressed within 15 days from the date of receipt of the complaint along with reason for such delay.

Stock Exchange shall resolve service related complaints at its end. However, in case the complainant is not satisfied with the resolution, the same may be referred to the Investor Grievance Redressal Committee ("IGRC")/ Grievance Redressal Committee (GRC)

The composition of the IGRC/GRC shall be as follows:

- The IGRC/GRC shall comprise of a single person for claims up to Rs. 25 Lakh, whereas, for claims above Rs. 25 Lakh, the IGRC/IGRP shall comprise of three persons.
- The IGRC/GRC shall comprise of independent persons with qualifications in the area of law, finance, accounts, economics, management or administration and experience in financial services, including securities market.
- Further, the 3 members Committee shall comprise of at least 1 technical expert for handling complaints related to technology issues

Members of IGRC/GRC shall not be associated with a TM in any manner.

Investor Protection Fund - Stock Exchanges have set up and managed Investor Protection Fund (IPF) to compensate clients who suffer financial loss due to their member being declared defaulter

Arbitration which is a quasi judicial process, is an alternate dispute resolution mechanism prescribed under the Arbitration and Conciliation Act, 1996

A stock exchange shall provide an arbitration mechanism for settlement of disputes between a client and a member through arbitration proceedings.

The Exchanges have a panel of arbitrators that consists of retired judges from High-Courts, Chartered Accountants, Advocates and other Professionals having knowledge related to the Capital Markets. Arbitration facility is provided at all centers which are specified by SEBI from time to time. SEBI has now identified 16 such centers where investor services as well arbitration facility are to be provided by stock exchanges.

The list of arbitrators across all stock exchanges are pooled together and called "Common pool". This list grouped centre wise, is made available to the investors on the stock exchanges' websites. The applicants can choose any arbitrator for the required centre from the "Common Pool". If they fail to do so, the arbitrator will be chosen by an 'automatic process' which is a randomised computer generated selection process.

Arbitration claims \leq Rs. 25 lakh \rightarrow decided by a sole arbitrator

Claim $>$ Rs.25 lakh \rightarrow by a panel of 3 arbitrators.

The stock exchange must ensure that the process of appointment of arbitrator(s) is completed within 30 days from the date of receipt of application from the applicant.

Speaking awards \rightarrow Awards passed upon hearing both the parties i.e. the complainant and the respondent.

The arbitration reference shall be concluded by way of issue of an arbitral award within 4 months from the date of appointment of arbitrators. Additional Extension of time – 2 months

Arbitration Fees

Amount of claim /counter (whichever is higher)	If claim is filed within six months	If claim is filed after six months
$\leq 10,00,000$	1.3% subject to a minimum of Rs. 10,000	3.9% subject to a minimum of Rs. 30,000
$> 10,00,000 - \leq 25,00,000$	Rs. 13,000 plus 0.3% amount above Rs. 10 lakh	Rs. 39,000 plus 0.9% amount above Rs. 10 lakh
$\geq 25,00,000$	Rs. 17,500 plus 0.2% amount above Rs. 25 lakh subject to a maximum of Rs. 30,000	Rs. 52,500 plus 0.6% amount above Rs. 25 lakh subject to maximum of Rs. 90,000

Appellate Arbitration - A party aggrieved by an arbitral award may appeal to the appellate panel of arbitrators of the stock exchange against such award. An appeal before the appellate panel of arbitrators may be filed within 1 month from the date of receipt of arbitral award. The appellate panel consists of 3 arbitrators who are different from the ones who passed the arbitral award appealed against. For appellate arbitration, at least 1 member of the panel should be a Retired Judge.

Chapter 8: Other Services provided by Brokers

- Investment advice & Research reports and market review * Depository services
- Direct Market Access (DMA) * Mobile trading & Smart Order Routing (SOR)
- Algorithmic trading * IPOs & Mutual Funds Distribution
- Internet-based Online Trading (IBT) * Margin funding

“Application Supported by Blocked Amount (ASBA)” - The application money remains in the investor’s account till finalization of basis of allotment in the issue. If an investor is applying through ASBA, his application money is debited from the bank account only if the investor’s application is selected for allotment after the basis of allotment is finalized, or the issue is with-drawn/failed.

Trading of Mutual Fund Units - The Exchanges provides platform (e.g. Mutual Fund Service System of NSE and BSE Star MF) to trading member and mutual fund distributors for trading in open ended mutual fund scheme. The trading members who are AMFI Registration Number (ARN) holders and have passed the NISM certification examination are permitted to participate in the trading of the mutual funds units through the exchange trading platform

MF Settlement Procedure - The settlement for MF platform provided by Exchanges is carried out by Clearing Corporations (CCs) through the depository and bank interface. The Exchange/CCs does NOT offer any settlement guarantee as the respective AMC is the counter-party for all transactions

PMS - Many stock brokers also offer Portfolio Management Services (PMS) to their High NetWorth clients. Portfolio manager can be discretionary or non-discretionary.

The **discretionary** portfolio manager **individually** and **independently manages** the funds of each client

The **non-discretionary** portfolio manager manages the funds in **accordance with the directions of the client.**

SEBI fee structure & Eligibility criteria

- Non-refundable Application fee (Renewal / Registration)- Rs. 1 lakh.
- Initial Registration fee – Rs10 Lakhs
- Renewal Fees – Rs 5 Lakhs every 3 years.
- Minimum networth of portfolio manager - 5 crore rupees.

Margin Trading - Only corporate brokers with networth of at least Rs.3 crore are eligible for providing margin trading facility to their clients.

Securities eligible for margin trading

Group 1 stocks in F&O - VaR + (3 x Extreme Loss Margin)
Group 1 stocks NOT in F&O - VaR + (5 x Extreme Loss Margin)

Leverage and Exposure Limits - At any point of time, the total indebtedness of a broker for the purpose of margin trading shall not exceed 5 times of his net worth and the maximum allowable exposure of the broker towards the margin trading facility shall not exceed the borrowed funds and 50% of his "net worth".

Broker providing the margin trading facility shall ensure that:

- a) Exposure to any single client shall not exceed 10% of the broker's max allowable exposure.
- b) Exposure towards stocks purchased under margin trading facility and collateral kept in the form of stocks are well diversified.

Net worth Requirement: The broker must have a minimum net worth of Rs.50 lacs if the broker is providing the Internet based facility on his own

IMPORTANT NOTE :

1. Attend ALL Questions
2. For the questions you don't know the right answer – Try to eliminate the wrong answers and take a guess on the remaining answers.
3. DO NOT MEMORISE the question & answers. It's not the right way to prepare for any NISM exam. Good understanding of Concepts is essential.

All the Best 😊

MODELEXAM

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