Study Notes for NISM Series XXI-A: PMS DISTRIBUTORS Exam

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https://modelexam.in/nism-exams/nism-mock-test.html

Multiple Choice Questions [80 questions of 1 mark each]	80*1 = 80 marks
3 Case-based Questions [2 cases (each case with 5 questions of 1 mark each)] [1 case (with 5 questions of 2 marks each]	2*5*1 = 10 marks 1*5*2=10 marks

Unit	**Name of Units**	**Marks**
1	Investments	5
2	Introduction to securities markets	3
3	Investing in stocks	8
4	Investing in fixed income securities	8
5	Derivatives	5
6	Mutual Funds	5
7	Role of portfolio managers	13
8	Operational aspects of portfolio managers	13
9	Portfolio management process	13
10	Performance measurement and evaluation of portfolio managers	13
11	Taxation	5
12	Regulatory, governance & ethical aspects of portfolio managers	9
Total		**100**

CHAPTER 1: INVESTMENTS

Assets can broadly be categorised as ***financial assets*** such as shares, debentures, bank deposits, public provident fund, mutual fund investments and others, and ***physical assets*** such as gold, diamonds, other precious metals and real estate.

Financial assets have the advantage of greater liquidity, flexibility, convenience of investing and ease of maintaining the investments. They are primarily income generating investments, though some of them, such as equity-oriented investments are held for long-term capital appreciation. There is greater ease of investing in such assets as it allows for small and frequent investments.

Speculation is "the **forming of a theory or conjecture without firm evidence**".

Investment Objectives

Capital Preservation means minimizing or avoiding the chances of erosion in the principal amount of investment. Risk averse investors, short term

Capital Appreciation is an appropriate investment objective for those who want their portfolio value to grow over a period of time and are prepared to take risks (long term)

Current Income is an investment objective pursued when investor wants her portfolio to generate income at regular interval by way of dividend, interest, rental income (retirement)

Tax Saving

Investment is the commitment of rupee for a period of time to earn

a) pure time value of money – for investors postpone their current consumption

b) compensation for expected inflation during the period of investment for the change in the general price levels and

c) risk premium for the uncertainty of future payments.

The compensation for postponement of consumption is the pure time value of money. It is referred as real risk-free rate. Real risk-free rate when adjusted for inflation expectation is referred as nominal risk-free rate. Nominal risk-free rate plus risk premium is required rate of return.

Required rate of return is the minimum rate of return investors expect when making investment decisions. It is to be noted that required rate of return is not guaranteed return or assured return. It is also different from expected or forecasted return. It is also different from realized return.

Real Rate of Return = (1+Nominal Rate / 1+ Inflation Rate) – 1

Types of risks

- Business risk
- **Financial risk** - Financial risk relates to the means of financing assets – debt or equity. increase in uncertainty because of use of fixed cost of financing is referred as financial leverage.
- Liquidity risk - Treasury bills have almost no liquidity risk.
- Exchange rate risk
- Political Risk
- Geo Political Risk
- Regulatory risk is the risk associated with unpredictability about the regulatory framework pertaining to investments.

Types of Investments

Equity: Role and characteristics - represent ownership

- dividend and capital appreciation
- Time diversification benefits refer to the notion that fluctuation in investment returns tend to cancel out through time
- Listed investments are traded on a stock exchange. Unlisted investments are bought and sold over the counter.
- **"illiquidity risk premium".** Buying and selling of unlisted investments takes longer time compared to the listed investments.

Fixed income securities: role and characteristics

Debt instruments can be classified on the basis of issuer into government debt securities and corporate debt securities

Bonds with rating BBB and above as investment grade and bonds below the BBB as high yield or junk bonds. Many institutional investors are prohibited from investing in junk bonds as they involve high default risk.

Money market securities have maturities of one year or less than one year. Treasury bills, commercial papers, certificate of deposits up to one year maturity are referred as money market instruments.

Capital market is a place for long term fund mobilization. **Securities with maturities greater than one year are referred to as capital market securities. Stocks and bonds are capital market securities**. Since the investment horizon in capital market is longer, the uncertainty about the future cash flows go up.

Investors require extra compensation for the same. It is referred as **"term premium".**

<u>Soft commodities</u> are perishable hence they exhibit high volatility in their prices.

higher business cycle risk as their prices are determined by the demand and supply of the end products in which they are consumed. Soft commodities historically have shown low correlation to stocks and bonds. Hence, they provide benefits of risk diversification

<u>Hard commodities</u> Gold, silver, oil, copper and aluminium

Prices of hard commodities are determined by the interaction between global demand and supply. commodities do not generate any current income (only capital appreciation)

Real Estates: Role & Characteristics - commercial or residential real estate.

Distressed securities are the securities of the companies that are in financial distress or near bankruptcy. These may be available at huge discounts

'fallen angels' and many types of funds and institutional investors are prohibited from holding these securities because of the high risk involved. Investment segment among hedge fund managers

Art and paintings and rare collectibles has low correlation with financial investments

Investments through managed portfolios

- Portfolio Managers
- Alternative Investment Funds
- Mutual Funds
- Collective Investment Schemes

<u>Alternative Investment Fund or AIF</u> is a **privately pooled** investment vehicle which collects funds from sophisticated investors, for investing it in accordance with a defined investment policy for the benefit of its investors.
'privately pooled' denote that the fund is pooled from select investors and not from the general public at large
minimum investment value in AIF is **one crore rupees**.

Category I AIF – is an AIF that invests in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall include venture capital funds, SME Funds, social venture funds, infrastructure funds, special situation funds

Category II AIF – is an AIF that does not fall in Category I and III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements
AIFs such as private equity funds or debt funds for which no specific incentives or concessions are given by the government or any other Regulator are included under this category.

Category III AIF – is an AIF that employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. AIFs such as hedge funds or funds which trade with a view to make short term returns

The **portfolio manager is required to accept minimum Rs. 50 lakhs or securities having a minimum worth of Rs. 50 lakhs from the client**. Portfolio manager cannot borrow on behalf of his clients. Portfolio managers provide investment solutions unique to the needs of the investors.
Mutual funds are more stringently regulated compared to AIF and PMS as mutual funds cater to retail investors

CHAPTER 2: INTRODUCTION TO SECURITIES MARKETS

"securities" has been defined in Section 2 (h) of the Securities Contracts (Regulation) Act 1956. The Act defines securities to include:
a) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or a pooled investment vehicle or other body corporate;

b) derivative ;

c) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

d) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

e) units or any other such instrument issued to the investors under any mutual fund scheme (securities do not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938 (4 of 1938);

f) units or any other instrument issued by any pooled investment vehicle

g) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;

h) government securities;

i) such other instruments as may be declared by the Central Government to be securities (including onshore rupee bonds issued by multilateral institutions like the Asian Development Bank and the International Finance Corporation, electronic gold receipts, zero coupon zero principal instruments);

j) rights or interest in securities.

Primary Market: The primary market, also called the new issue market

Public issue**:** Securities are issued to the members of the public, and anyone eligible to invest can participate in the issue. This is primarily a retail issue of securities.

Initial Public Offer (IPO)**:** An initial public offer of shares or IPO is the first sale of a corporate's common shares to investors at large. Minimum requirements for net tangible assets, profitability and net-worth

Further Public Offer (FPO)**:** When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, it is called a further public offer or FPO.

An FPO may also be through an **offer for sale** which usually happens when it is necessary to increase the public shareholding in the company to meet the regulatory requirements.

Rights Issue*:* Shares offered to existing shareholders in proportion to their existing holding in the share capital of the company are termed as "Rights shares". In the rights issue, the shareholders have a right to participate in the issue

Private Placement*:* When an issuer makes an **issue of securities to a select group of persons** and which is neither a rights issue nor a public issue, it is called private placement. According to Companies Act 2013, an offer to subscribe to securities, made to **less than 200 persons**, is called private placement of securities. The requirements of **SEBI's regulations with respect to a public issue does not apply to a private placement**. A privately placed security can be listed on a stock exchange provided it meets the listing requirements of SEBI and the stock exchange. Private placement of securities can be done by a company irrespective of whether it has made a public offer of shares or not.

Preferential Issue: Preferential issue is when a **listed issuer issues shares or convertible securities, to a select group of persons**. The issuer is required to comply with various provisions defined by SEBI relating to pricing, disclosures in the notice, lock-in, in addition to the requirements specified in the Companies Act.

Qualified Institutions Placements (QIPs)**:** Qualified Institutions Placement (QIP) is a private placement of shares made by a listed company to certain identified categories of investors known as **Qualified Institutional Buyers (QIBs).**

Bonus Issues: A bonus issue of shares is made to the existing shareholders of a company without any consideration from them. out of its free reserves built from genuine profits. A company cannot make a bonus issue if it has defaulted on the payment of interest or principal on any debt securities issued or any fixed deposit raised. A bonus issue once announced cannot be withdrawn.

Onshore and Offshore Offerings - If capital is raised from domestic market, it is called onshore offering and if capital is raised from the investors outside the country, it is termed as offshore offering.

Offer for Sale (OFS)**:** An Offer for Sale (OFS) is a form of share sale where the shares offered in an IPO or FPO are not fresh shares issued by the company, but an offer by existing shareholders to sell shares that have already been allotted to them. An OFS does not result in increase in the share capital of the company since there is no fresh issuance of shares. The proceeds from the offer go to the offerors, who may be a promoter(s) or other large investor(s). The disinvestment program of the Government of India, where the government offers shares held by it in Public Sector Undertakings (PSUs), is an example of OFS. It may be stated that OFS is a secondary market transaction done through the primary market route.

Employee Stock Ownership Plan - The dates on which the employees become entitled to exercise the right to acquire the shares is called as "vesting date."

Foreign Currency Convertible Bonds (FCCBs): FCCBs are foreign currency (usually dollar) denominated debt raised by companies in international markets but which have the option of converting into equity shares of the company before they mature. The payment of interest and repayment of principal is in foreign currency. The conversion price is usually set at a premium to the current market price of the shares.

An Indian company that is not eligible to raise equity capital in the domestic market is not eligible to make an FCCB issue either. Unlisted companies that have raised capital via FCCB in foreign markets are required to list the shares on the domestic markets within a stipulated time frame.

FCCBs are regulated by RBI notifications under the Foreign Exchange Management Act, 1999 FEMA). The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism), 1993 lays down the guidelines for such issues.

Depository Receipts *- ADR / GDR:* Depository receipts (DRs) are financial instruments that represent shares of a local company but are listed and traded on a stock exchange outside the country. DRs are issued in foreign currency, usually dollars. To issue a DR, a specific quantity of underlying equity shares of a company is lodged with a custodian bank, which authorizes the issue of depository receipts against the shares.

Anchor investor means a qualified institutional buyer who makes an application for a value of ten crore rupees or more in a public issue made through the book building process. volume and value of anchor subscriptions serve as an indicator of the firm's soundness of the offer.

Secondary Market: Facilitates trades in already-issued securities

Over-The-Counter (OTC) Market – counter party risk

Exchange Traded Markets

Trading: A formal contract to buy/sell securities is termed as trading. Electronic order matching

Clearing and Settlement**:** post trading activities. Clearing activity is all about ascertaining the net obligations of buyers and sellers for a specific time period. Settlement is the next step of settling obligations by buyers and sellers by paying money or delivering securities.

clearing corporation is the entity through which settlement of securities takes place for all the trades done on stock exchanges. the clearing corporation provides full novation of contracts between buyers and sellers, which means it acts as buyer to every seller and seller to every buyer. As a result, the operational risk of the transaction is substantially reduced to a trading investor. legal counterparty to all trades and guarantee settlement of all transactions on the Stock Exchanges. It can be a part of an exchange or a separate entity.

Risk Management - clearing corporation, gives settlement guarantee of trades to the counterparties (all buyers and sellers). charges various kinds of margins, most prominent among these margins are Initial or upfront margin and mark to market (MTM) margins.

Initial Margin – VaR – Value at Risk method (99 percentile)

MTM Margin – based on Mkt price movements

Market Infrastructure Institutions and other intermediaries

Stock Exchanges – electronic trading, anonymous order matching. Stock exchanges also appoint clearing and settlement agencies and clearing banks that manage the funds and securities settlement that arise out of these trades.

Depositories - institutions that hold securities in electronic form. Nsdl, cdsl

Depository Participant- (DP) is an agent of the depository

Trading Members/Stock Brokers can be individuals (sole proprietor), Partnership Firms or Corporate bodies. Brokers can trade on their own account using their own funds. Such transactions are called proprietary trades

SEBI also ensures the capital adequacy of brokers by requiring them to deposit a base minimum capital with the stock exchange and limiting their gross exposures to a multiple of their base capital.

Authorized persons (AP): Authorised Persons are agents of the brokers (previously referred to as sub-brokers) and are registered with the respective stock exchanges

Custodians: A Custodian is an entity that is vested with the responsibility of holding funds and securities of its large clients, typically institutions such as banks, insurance companies, and foreign portfolio investors. Besides safeguarding securities, a custodian also settles transactions in these securities and keeps track of corporate actions on behalf of its clients. It helps in:

- Maintaining a client's securities and funds account
- Collecting the benefits or rights accruing to the client in respect of securities held
- Keeping the client informed of the actions taken or to be taken on their portfolios.

Clearing Corporation, Clearing Banks

Merchant Bankers - act as issue managers, investment bankers or lead managers. They help an issuer access the security market with an issuance of securities. evaluate the capital needs of issuers, structure an appropriate instrument, get involved in pricing the instrument and manage the entire issue process until the securities are issued and listed on a stock exchange. They engage and co-ordinate with other intermediaries such as registrars, brokers, bankers, underwriters and credit rating agencies in managing the issue process.

Underwriters - Underwriters are intermediaries in the primary market who undertake to subscribe any portion of a public offer of securities which may not be bought by investors.

When the underwriters make their commitments at the initial stages of the IPO, it is called hard underwriting. .For example, if the shares are not subscribed by investors, then the underwriters have to bring in the amount by subscribing to the shares.

Soft underwriting is the commitment given once the pricing is determined. The shares that devolve are usually placed with other financial institutions, thereby limiting the risk to the underwriter. Soft underwriting also comes with a clause that provides the option to exit from the commitment in the event of certain events occurring. The risk in hard underwriting is much higher than in soft underwriting.

Institutional Participants

Mutual Funds, Pension funds, Insurance Companies, Alternative Investment Funds, Foreign Portfolio Investors (FPIs), Investment Advisers, EPFO, NPS

NPS *– defined contribution.* non-government category there are two categories available: corporate sector and All Citizens of India.

Family Offices - investment management firms catering to ultra-high net worth households/individuals (UHNWI) providing them customized investment management solutions.

Corporate Treasuries - The focus area of corporate treasuries has been debt management to capital structure management with the key responsibility of raising long term funds and minimizing the cost of capital.

Retail Participants - means an individual investor who applies or bids for specified securities for a value of not more than **Rs.2 lakh**.

CHAPTER 3: INVESTING IN STOCKS

cross sectional diversification (i.e. across business sectors and industries). reducing risk by holding equities in many different kinds of businesses at a point in time and also across various geographies of the world. Reaping the benefits of **time diversification** requires investing in equities for a long period of time.

Some businesses may be at peak when the business cycle is in its trough. These products or businesses are called **'counter-cyclical' or defensive businesses**.

Businesses that do better in a recession are called **'recession-proof'** businesses.

Some products, sectors or countries come out of a recession faster than others (these are called as **leading sectors**);

products, sectors or countries may go into recession later than others (these are called **lagging sectors**).

Risks of equity investments

Market risk - Beta is a proxy measure for market risk. Market risk cannot be diversified away, though it can be hedged.

Sector specific risk / Company specific risk

Factors affecting certain sectors might not impact certain other sectors. Such risks are also called **"idiosyncratic risks".**

Liquidity risk - It is measured by **impact cost**. The **impact cost is the percentage price movement caused by a particular order size (let's say an order size of Rs.1 lakh) from the average of the best bid and offer price** in the order book snapshot. **High Impact cost – Less Liquidity or risk is high**

Currency risk

All other macro-economic factors like inflation, fuel prices, interest rates, economic growth, economic slowdown, do influence stock markets.

1. Preference Shares rank above equity shares with respect to the payment of dividends and distribution of company's net assets in case of liquidation.
2. preference shares do not generally have voting rights like equity shares
3. Preference shares share some characteristics with debt securities like fixed dividend payment.
4. Preference shares carry some characteristics of equity share and at the same time some characteristics of the debt securities, they are referred to as ***hybrid or blended securities***.
5. preference shares can be perpetual

6. Dividends on preference shares can be cumulative, non-cumulative, participating, non-participating
7. preference stock is cumulative, the unpaid dividends would accumulate to be paid in full at a later time, whereas in non-cumulative stocks the unpaid or omitted dividend does not get paid.
8. A non-participating preference share is one in which a dividend is paid, usually at a fixed rate, and not determined by a company's earnings.
9. Participating preference share gives the holder the right to receive specified dividends plus an additional dividend based on some pre-specified conditions. Participating preference shares can also have liquidation preferences upon a liquidation event.
10. Preference shares can also be convertible. Convertible preference shares entitle shareholders to convert their preference shares into a specified number of equity shares. Since preference shares carry some characteristics of equity share and at the same time some of the debt securities, they are referred to as hybrid or blended securities.

share with ***differential voting rights (DVRs). can either have superior voting rights (i.e. multiple votes on one share) or inferior voting rights (i.e. a fraction of the voting right on one equity share) or differential rights as to dividend.***

Fundamental analysis is the process of determining intrinsic value for the stock

Top Down approach versus Bottom up Approach

economic (E), industry (I) and company (C) factors

Buy side research versus Sell Side Research

Sell-side and Buy-side researchers and analysts take up similar works, they differ in terms of: for whom they work, how accurate they need to be, and for what are they paid.

Sell-side Analysts work for firms that provide investment banking, broking, advisory services for clients. They typically publish research reports on the securities of companies or industries with ***specific recommendation to buy, hold, or sell the subject security ((“price target”).*** sell-side analysts are paid for providing useful information to be acted upon. In this regard, the expectations from the sell-side research is a ***broad guidance on multiple sectors, rather than accurate price predictions.***

Buy-side Analysts work for fund managers like those of mutual funds, hedge funds, pension funds, or portfolio managers that purchase and sell securities for their own investment accounts or on behalf of their clients. These analysts generate investment recommendations for their ***internal consumption*** viz. use by the fund managers within organization. Research reports of these analysts are generally circulated among the top management/investment managers of the employer firms as these reports contain recommendations about which securities to buy, hold or sell. Therefore the buy-side researchers need to be more ***accurate and they are paid for their investment recommendations.***

Cyclical industries are attractive investments during the early stages of an economic recovery

<u>Industry Life Cycle</u>

Introduction: modest sale and very small or negative profit. high development costs.

Growth: Number of firms in the industry is less. Little competition. High profit margins. This stage is followed by mature industry growth. The rapid growth of the earlier phase attracts competitors contributing profits margins go to normal levels.

Maturity: longest phase. growth rate in the industry normally matches with the economy's growth rate. Competition is high during this stage reducing the profit margin to normal levels

Deceleration of growth and decline

Michael Porter suggests that five competitive forces determine the intensity of competition in the industry

first factor is **rivalry among the existing competitors**

second factor is **threat of new entrants**

third factor is **threat of substitute products**.

fourth factor is **bargaining power of the buyers**,

fifth factor is **bargaining power of the supplier**.

important component of company analysis is SWOT Analysis. ***SWOT analysis involves examination of a firm's, strengths, weaknesses, opportunities, and threats.***

Strengths and weaknesses deal with company's internal ability, like company's competitive advantage or disadvantages.

Opportunities and threats deal with external situations. Opportunities include a favourable tax environment. An example of threat is stringent government regulation.

A defensive strategy is one where the firm positions itself in such a way that its capabilities provide the best means to deflect the effect of competitive forces in the industry. Alternatively, a firm may be following an aggressive strategy in which the firm attempts to use its strengths to affect the competitive forces in the industry.

Michael Porter suggests two major strategies: Cost Leadership and Differentiation.

Cost Leadership: Under this strategy the firm seeks to be the low-cost producer

Differentiation Strategy: Under this strategy, the firm positions itself as unique in the industry.

For the retail sector, footfalls and same store sales (SSS) are important parameters, whereas for banking it is Net Interest Income (NII)/ Net Interest Margin (NIM). For telecom, it is Average Revenue Per User (ARPU) and for hotels, it is average room tariffs

Estimation of intrinsic value

price is available from the stock market and known to all

Price is a Fact but Value is an Opinion

Discounted Cash Flow Model

1. Stream of future cash flows
2. Timings of these cash flows, and
3. Expected rate of return of the investors (called discount rate).

"the intrinsic value of any asset, should be equal to the present value of future benefits that accrue from owning it".

As per Capital Asset Pricing Model (CAPM) ,the **cost of equity** is computed as follows:
Ke = Rf + β * (Rm – Rf)

Asset Based Valuation **-** used in some businesses where the business is asset heavy, and the assets are usually reflected in the financial statements at fair market value, like financial Institutions, firms in real estate and gold, gems and jewellery. Under this method, the value of the firm is equal to the ***"adjusted current market values of Net Tangible, Intangible, Financial, and Net Current Assets".***

Value of equity is "value of firm less value of all outsider liabilities".

Drawback : it does not recognise the value of future profits and cashflows of the firm, and all future possible value creation the firm can do due to its research and innovation.

Relative Valuation (Multiple Based)

the value of a firm or equity, by multiplying either a financial metric or a non-financial metric of a firm with some number. This number is called a "**multiple**". The multiple is created as a "**ratio**" by relating historical market values of either the firm, or its equity, to any chosen financial or non-financial metric. The multiple is calculated for the comparable firms, and then the average value of the same is chosen to value the target company. The value of the target firm is calculated as ***"the product of the target firm's financial or non-financial metric TIMES the comparable firm's multiple"***

The ***assumption*** of this approach is that ***"a company into confectionary products would not be worth more than any other similar confectionary company currently traded and operating in the market".***

Non financial metric - "Average Revenue per Mega Byte" "Average Revenue per User" in the case of Telecom companies, "Plant Load Factor" in the case of Power companies, "Occupancy Rates" in the case of Lodging Hotels, "Footfall" in the case of Retail sector, etc

P/E ratio – Price / EPS
Price to Book Value Ratio

P/S Ratio - price-to-sales ratio

company's market capitalization (the number of outstanding shares multiplied by the share price) and divide it by the company's total sales or revenue over the past 12 months

Price Earnings to Growth Ratio – PEG

Technical Analysis

Technical analysis is based on the assumption that all information that can affect the performance of a stock, the company fundamentals, the economic factors and market sentiments, are reflected already in its stock prices

Price volume data – **Chartists**

Assumptions in technical analysis
1. History of past prices provides indications of underlying trend and its direction.

2. The volume of trading that accompanies price movements provides important inputs on the underlying strength of the trend.
3. The time span over which price and volume are observed influences the strength or weakness of the underlying trend.

1. The market price is determined by the interaction of supply and demand.
2. Supply and demand are governed by many rational and irrational factors.
3. Price adjustments are not instantaneous and prices move in trends
4. Trends persist for appreciable lengths of time.
5. Trends change in reaction to shifts in supply and demand relationships.
6. These shifts can be detected in the action of the market itself.

Fundamental analysis involves determining the ***intrinsic worth of the stock*** and comparing it with the prevailing market price to make investment decisions.

Trend-Line Analysis
peak and trough, along with a rising trend channel, a flat trend channel, a declining trend channel,
Moving-Average Analysis
5, 10, 30, 50, 100, and 200 days moving averages are calculated.
buy when the price is sufficiently below the moving average and sell when the price is sufficiently above the moving average.
Bollinger-Band Analysis
normal distribution to calculate the deviation of the market price from the moving average.
price goes two standard deviations above the moving average, the stock might be regarded as **overbought**. If the price goes **two standard deviations below** the moving average, the stock might be regarded as **oversold**.

Dividend Discounting Model. $P = D1 / (k-g)$
$D1$= is the dividend that is expected one year hence. This can be as D0*(1+g) where 'g' denote expected growth in dividend, and D0 indicates current dividend. 'k' is the discount rate

CHAPTER 4: INVESTING IN FIXED INCOME SECURITIES

zero coupon bonds which do not make any coupon payments. Typically, a zero coupon bond is issued for less than its face value and the face value is paid on the maturity date

Perpetual bonds, which do not have any maturity date exist forever bonds with a year or less than a year maturity are termed as **money market securities**. **Long-term obligations** with maturities in excess of 1 year, are referred as **capital market securities**. Thus, long term bonds as they move towards maturity become money market securities.

issue price, coupon, maturity period, face value, redemption value are important intrinsic features of a bond.

All **G-Secs** are normally coupon bearing and have **semi-annual coupon** or interest payments with a tenor of between 5 to 30 years.

- When coupons and the prevailing market rate of interest are not the same, market price of the bond can be lower or higher than principal value.
- If the market interest rate is above the coupon rate, the bond will sell at a discount to the par value.
- If the market rate is below the bond's coupon, the bond will sell at a premium to the par value.

Yield on a bond is a consensus interest rate that emerged due to the ***demand and supply forces*** of the investors in the market, and their required rate of return was definitely ***influenced by the ongoing government benchmark interest rates***.

Bonds with options

bonds with call option, bonds with put option and convertible bonds

A **callable bond** gives the issuer the right to redeem all or part of the outstanding bonds before the specified maturity date. higher level of **reinvestment risk**

A **put provision** gives the bondholders the right to sell the bond back to the issuer at a pre-determined price on specified dates.

A **convertible bond** is a combination of a plain vanilla bond plus an embedded equity call option. It gives the **bondholder the right to exchange the bond for a specified number of common shares** of the issuing company.

Indenture - It is the legal agreement between the firm issuing the bond and the bondholders, providing the specific terms of the debt agreement.

All the features of the bond i.e. its par value, coupon rate, maturity period, periodicity of coupon payments, collateral for the bond, seniority of the payments will be set forth in the indenture. Indenture also provides information on covenants.

Covenants are clauses specifying the rights of the bond holders and restrictions on the bond issuers.

Positive covenants are actions which issuers are required to do, whereas ***negative covenants*** specify what issuers are prohibited from doing.

Credit rating symbols and Definitions for Long Term Instruments
Long term debt instruments: The instruments with original maturity exceeding one year

Credit Rating : AAA, AA, A, BBB, BB, B, C,D

***Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AA to C*. The modifiers reflect the comparative standing within the category.**

Credit Rating Symbols and Definitions for Short Term Debt instruments
Short term debt instruments: The instruments with original maturity of upto one year
A1, A2, A3, A4, D
***Modifier {"+" (plus)} can be used with the rating symbols for the categories A1 to A4.* The modifier reflects the comparative standing within the category.**

Valuation of Bonds

If the calculated yield is greater than the required yield or required rate of return of the investor, then the investor can buy the bond.
Similarly, if the yield is lesser than what the investor requires, then the bond could be sold.

Intrinsic Value of a Bond

The intrinsic value of a bond is the **sum of present value of all future cash flows** of the bond discounted at a required rate of return.
PRICE, YIELD, PV function

Bond holders receive return from one or more of the following sources:
1. The coupon payments made by the issuer;

2. The capital gain (or capital loss) when the bond is sold/matured; and

3. Income from reinvestment of the interest payments that is interest-on-interest.

The **coupon yield** is the coupon payment as a **percentage of the face value**. It can be considered as a **nominal interest payment** on a fixed interest bond.

The **current yield** is the coupon payment as a **percentage of the bond's current market price.**
Yield to Maturity (YTM) is that rate which discounts the future cash flows from a bond, and makes the sum of the present values of such cashflows equal to the current market price of the bond.
It is the rate of return that can be expected in a bond investment, when purchased at the ongoing market price, and when it is held until its maturity.

YTM can also be considered as the Implied Rate of Return, or Internal Rate of Return of the bond.

Settlement (the date on which the bond is going to be purchased)	01-01-2022
Maturity (the date of maturity reckoned from date of purchase)	01-01-2027
Rate (Coupon rate depicted on per annum basis)	12%
Price (Current Market Price of the Bond, expressed per Rs.100)	97.5
Redemption (The value proportionately expressed per Rs.100)	100
Frequency (It takes number 1 for yearly, 2 for half-yearly, 4 for quarterly, 12 for monthly)	2

Day count convention refers to the method used for arriving at the holding period (number of days) of a bond to calculate the accrued interest.
Indian market for bonds is 30/360,
Whereas in the **money market** the day count convention followed is **actual/365**,

1. When the market price of a bond is less than its face value, i.e., the bond is selling at a discount, then YTM would be > Coupon Yield.
2. When the market price of a bond is more than its face value, i.e., the bond is selling at a premium, then YTM would be < Coupon Yield .
3. When the market price of a bond is equal to its face value, i.e., the bond is selling at par, then YTM would be = Coupon Yield.

Yield to call

The price and date at which a bond can be called is mentioned at the time of issue. and it is referred to as ***"Call Price"***
Yield to call measures the estimated rate of return for bond held till the first call date.

Measuring Price Volatility of bonds

Market price of a bond is a function of four factors: (1) Par value of the bond; (2) Coupon rate of the bond; (3) Maturity period i.e. no. of years to maturity and (4) Prevailing market interest rate.

1. Bond prices and the interest rates have inverse relationship.
2. Bond price volatility is inversely related to coupon. **Bonds with higher coupons show smaller percentage price fluctuation for a given change in interest rates .**
3. Bond price volatility is directly related to term to maturity
4. Bond price movements resulting from equal absolute increases or decreases in yield are not symmetrical. A decrease in yield raises bond prices by more than an increase in yield of the same amount lowers prices.

Interest rate risk

Interest Rate Risk is defined as the risk emanating from changes in the market interest rates

Reinvestment risk is when the investor may not be able to reinvest the intermittent cash flows (coupons) at yields prevalent at the time of making the investment due to either decrease or increase in interest rates prevailing at the time of receipt of cash flows by investors.

Concept of Duration

price sensitivity of a Bond for a given change in the market interest rates, yields, or required rates of return of the bond investor.

Duration (also known as Macaulay Duration) of a bond is popularly known as a ***measure of time taken to recover the initial investment in present value terms***

a **zero coupon bond** (a bond with no coupons) will have **duration equal to its remaining maturity.**

Modified Duration is calculated as
Macaulay's Duration in Years / (1 + YTM adjusted to frequency of coupon payment)

% change in the price = - Modified Duration * Change in market interest rates in decimals.

CHAPTER 5: DERIVATIVES

1. **Forwards agreement** made directly between two parties to buy or sell an asset on a specific date in the future, at the terms decided today.
2. Widely used in commodities, FOREX, equity and interest rate markets.
3. Bilateral contract - OTC

4. All terms of the contract like price, quantity and quality of underlying, delivery terms like place, settlement procedure etc. are fixed on the day of entering into the contract
5. Alteration in the terms of the contract is possible if both parties agree to it.
6. Corporations, traders and investing institutions extensively use OTC transactions
7. Liquidity risk, counterparty risk
8. **Futures** contract is an agreement made through an organized exchange to buy or sell a fixed amount of a commodity or a financial asset on a future date at an agreed price.
9. Standardised forward contracts that are traded on an exchange.
10. Exchange becomes counterparty to both buyer and seller of a futures contract through a clearing house
11. Futures create an obligation on both buyer and seller's part.
12. A trader, who buys futures contract, takes a long position and the one, who sells futures, takes a short position.
13. Margins are payable by both the parties
14. Quality decided today (standardized)
15. Quantity decided today (standardized)

Options

1. An Option is a contract that gives its buyers the right, but not an obligation, to buy or sell the underlying asset on or before a stated date/day, at a stated price, for a premium (price).
2. The party taking a long position i.e. buying the option is called buyer/ holder of the option and the party taking a short position i.e. selling the option is called the seller/ writer of the option.
3. Option, which gives buyer a right to buy the underlying asset, is called Call option and the option which gives buyer a right to sell the underlying asset, is called Put option.
4. Strike price or exercise price. – contract price
5. Upfront payment for BUYING the option – option premium / price of the option
6. In-the-Money option – options which will result in profit when exercised
7. Out-of-the money – LOSS

Swaps

A swap is a contract in which two parties agree to a specified exchange of cash flows on a future date(s). Swaps are common in interest rate and currency markets.

swap in this contract is that one party pays a fixed rate to the other, and receives a floating rate in return. The principal amount on which the interest will be computed is agreed upon between counterparties and is never exchanged. Only the interest rate on this amount is exchanged on each settlement date (every quarter) between counterparties. The principal amount is also known as notional amount.
swap transactions are OTC, they are governed by rules and regulations accepted by Swap Dealer Associations

Fixed Income Market and Derivatives Association of India(FIMMDA).

1. principal interface with the regulators
2. developmental activities, such as, introduction of benchmark rates and new derivatives instruments
3. training and development
4. arbitrator for disputes
5. standardized sets of documentation

In India, the following derivative products are available on various stock exchanges:
• Equity index options , • Equity index futures
• Individual stock options ,• Individual stock futures
• Currency options and futures on select currency pairs
• Interest rate futures
• Commodity futures for a select set of commodities

Purpose of Derivatives
Hedging - protect the desired value of that investment
Speculation A speculative trade in a derivative is not supported by an underlying existing investment in asset or portfolio.
trading strategy based on a view about the future prices of the relevant asset
Arbitrage
The ***law of one price*** states that two goods (assets) that are identical, cannot trade at different prices in two different markets.
Arbitrageurs are specialists who identify such **price differential** in two markets and indulge in trades that reduce such differences in price.

Currency Derivatives are available on four currency pairs viz. US Dollars (USD), Euro (EUR), Great Britain Pound (GBP) and Japanese Yen (JPY). Cross Currency Futures & Options contracts on EUR-USD, GBP-USD and USD-JPY are also available for trading in Currency Derivatives segment.

Zero Sum Game - the net positions of the both the buyer and seller are considered, it always amounts to zero.

Settlement Mechanism - SEBI has mandated **physical settlement** (settlement by delivery of underlying stock) for all stock derivatives.

Margining Process - Margin is defined as the funds or securities which must be deposited by Clearing Members as collateral before executing a trade.

The initial margin has two components; **SPAN margins and ELM margins** based on exposure. Both margins have to be mandatorily deposited before taking a trade. **The initial margin should be large enough to cover the loss in 99 per cent** of the cases. The greater the volatility of the stock, greater the risk and, therefore greater is the initial margin.

Premium Margin is charged to trading members trading in Option contracts. The premium margin is paid by the buyers of the Options contracts and is equal to the value of the **options premium multiplied by the quantity of Options purchased.**

Open interest is the total number of **outstanding derivative contracts** that have **not been settled**. The open interest number **only changes when a new buyer and seller enter the market**, creating a new contract, or when a buyer and seller meet—thereby closing both positions.

Open interest is a measure of market activity. It is not trading volume. Open interest is a measure of the flow of money into a futures or options market. Increasing open interest represents new or additional money coming into the market while decreasing open interest indicates money flowing out of the market.

Portfolio managers are permitted to invest in derivatives, including transactions for the purpose of hedging and portfolio rebalancing, through recognised stock exchanges.

CHAPTER 6: MUTUAL FUND

- Mutual fund is a vehicle (in the form of a "trust") to mobilize money from investors, to invest in different markets and securities, in line with stated investment objectives.
- The money mobilized from investors is invested by the mutual fund scheme in a portfolio of securities as per the stated investment objective.
- SEBI (Mutual Fund) Regulations, 1996 define "mutual fund" as "a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, money market instruments, gold or gold-related instruments, silver or silver related instruments, real estate assets and such other assets and instruments as specified by SEBI from time to time."

- The mutual fund trust is created by one or more Sponsors
- Every trust has beneficiaries. The beneficiaries, in the case of a mutual fund trust, are the investors or Unit Holders
- Day to day management of the schemes is handled by an Asset Management Company (AMC). The AMC is appointed by the sponsor or the Trustees.
- custody of the assets of the scheme (securities, gold, gold-related instruments & real estate assets) is with a Custodian, who is appointed by the Trustees.
- The record of investors and their unit-holding may be maintained by the AMC itself, or it can appoint a Registrar & Transfer Agent (RTA)
- Compliance Officer signs a due-diligence certificate to the effect that all regulations have been complied with
- Fund Management team can be broken into three sub-teams, viz., the analysts, the fund managers, and the dealers.
- dealers, whose responsibility is to place orders with securities brokers based on the instructions of the fund managers.
- Operations and customer services team - Registrar and Transfer Agency (RTA), which is a big part of this unit, maintains investor records as well as allots or redeems units, processes purchase/redemption/switch requests, dividends, etc.. It also generates the account statement that an investor receives.
- Custody Team within this group that interacts with the custodian for the purpose of settlement of various transactions that the fund management team initiates.
- Fund accounting team maintains books of accounts of each individual mutual fund scheme and calculates NAV on a daily basis.
- Cash management team works as an interface between the banks and the fund management team–they ensure that money received in the bank when investors purchase units are passed on to the fund managers for further investment in securities and the investors get the redemption proceeds when they submit the redemption request.
- Open ended funds allow investors to enter or exit at any time, after the NFO.
- Close-ended funds have a fixed maturity. Investors can buy units of a close-ended scheme, from the fund, only during its NFO. post-NFO through listing of the units on a stock exchange. Such listing is compulsory for close-ended schemes to provide liquidity to the investors.
- Interval funds combine features of both open-ended and close-ended schemes.
- The periods when an interval scheme becomes open-ended, are called ‘transaction periods’;
- the period between the close of a transaction period, and the opening of the next transaction period is called ‘interval period’.

- Actively managed funds are funds where the fund manager has the flexibility to choose the investment portfolio
- Investors expect actively managed funds to perform better than the market.
- Passive funds invest on the basis of a specified index; whose performance it seeks to track. Thus, a passive fund tracking the S&P BSE Sensex would buy only the shares that are part of the composition of the S&P BSE Sensex.
- They are not designed to perform better than the market. Such schemes are also called index schemes.
- the fund manager has no role in deciding on investments. Therefore, these schemes have low running costs.
- The PAN is mandatory information. PAN need not be provided is where investments made by an individual investor, either as lump sum or SIP, do not exceed Rs. 50,000 per annum per mutual fund.
- NFO will be open for a period of 15 days
- Units of close ended mutual funds are mandatorily listed on the stock exchange
- The fund factsheet contains the basic information of each scheme such as the inception date, corpus size (AUM), current NAV, benchmark and a pictorial depiction of the fund's style of managing the fund.
- An investor's investment in a mutual fund is represented by the number of units holding and a mutual fund investor is called a unit holder.
- The NAV is the current value of a mutual fund unit. This will depend upon the current mark to market (MTM) value of the securities held in the portfolio of the fund and any income earned such as dividend and interest.

CHAPTER 7: ROLE OF PORTFOLIO MANAGERS

On the basis of provider of the services PMS can be classified as:
1. PMS by asset management companies
2. PMS by brokerage houses
3. Boutique (independent) PMS houses

They can further be classified on the basis of product class as:
1. Equity based PMS
2. Fixed Income based PMS
3. Commodity PMS
4. Mutual Fund PMS
5. Multi Asset based PMS

Portfolio managers may classify their clients on the basis of their net-worth.

Discretionary Services - a portfolio manager who under a contract relating to portfolio management, exercises or may exercise, any degree of discretion as to the investment of funds or management of the portfolio of securities of the client, as the case may be.

Non-Discretionary Services

Non-discretionary portfolio manager manages the funds in accordance with the directions of the client. The portfolio manager does not exercise his/her discretion for the buy or sell decisions. The portfolio manager has to consult the client for every transaction. Decisions such as **'What to buy/sell?' and 'When to buy/sell?' vests with the investor.** The execution of trade is done by the portfolio manager. So in this case, the Portfolio Manager provides **investment execution services but not investment management services.**

Advisory Services

In advisory role, the portfolio manager suggests the investment ideas or provides ***non-binding investment advice***. The investor take the decisions. The investors also executes the transactions. These kinds of services are typically used for institutional clients, who manages portfolio's on their own, but typically hires country experts in each country.

Organizational structure of PMS in India

A portfolio manager is a body corporate who, pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise), the management or administration of a portfolio of securities or the funds of the client.

Except for the portfolio manager and co-investment portfolio manager who provides only the advisory services, every portfolio manager shall appoint a custodian in respect of securities managed or administered by it.

The portfolio manager is required to preserve the books of account and other records and documents for preceding five accounting years and furnish to SEBI as and when required.

(a) a copy of balance sheet at the end of each accounting period;
(b) a copy of the profit and loss account for each accounting period;
(c) a copy of the auditor's report on the accounts for each accounting period;
(d) a statement of financial position and;
(e) records in support of every investment transaction or recommendation which will indicate the data, facts and opinion leading to the investment decision.

portfolio manager shall maintain separate client-wise accounts

Every portfolio manager ***shall appoint a compliance officer*** who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc., issued by SEBI or the Central Government and for redressal of investors' grievances. The compliance officer shall immediately and independently report to SEBI any non- compliance observed.

The agreement between the portfolio manager and the client includes the investment approach.

An investment approach is a broad outlay of the type of securities and permissible instruments to be invested in by the portfolio manager for the customer, taking into account factors specific to clients and securities.

<u>Registration requirements of a Portfolio Manager</u>

Certificate of registration from SEBI ; ***Networth– 5 crores***

Application needs to be made in ***Form A*** **of Schedule I.**

List of major shareholders/ partners of the Applicant (holding 5% or more voting rights)
Business Plan (for three years)
Projected Profitability (Next three years) (Targets, *modus operandi* to achieve targets, Resultant Income)
Details of all settled and pending disputes of previous 3 years

Before issuing a certificate of registration, the regulator will ensure **whether**:

- the applicant is a body corporate;
- the applicant has the necessary infrastructure;
- the applicant has appointed a compliance officer;

The principal officer of the applicant has
a) a professional qualification in finance
b) ***experience of at least five years*** in related activities in the securities
c) the relevant NISM certification

addition to the Principal Officer and Compliance Officer, the applicant has in its employment at least one person who has a graduation an experience of at least two years in related activities in the securities market including

The certificate of registration granted shall be valid unless it is suspended or cancelled by SEBI.

Portfolio Manager should

1. act in a fiduciary capacity
2. segregate each client's holding in securities in separate accounts.
3. the funds of all clients in a separate account
4. **shall not borrow** funds or securities on behalf of the client
5. **shall not lend securities** held on behalf of the clients
6. portfolio manager while **investing in units of mutual funds through direct plan shall not charge any kind of distribution related fees to the client.**
7. **shall not leverage the portfolio** of its clients for investment in derivatives.
8. **shall not deploy** the clients' funds in **bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies**.
9. shall not invest the clients' funds in the portfolio managed or administered by another portfolio manager.
10. portfolio manager shall not invest client's fund based on the advice of any other entity.

shall not while dealing with clients' funds indulge in ***speculative transactions*** i.e., it shall not enter into ***any transaction for purchase or sale of any security which is periodically or ultimately settled otherwise than by actual delivery*** or transfer of security except the transactions in derivatives.

portfolio manager shall, ordinarily purchase or sell securities separately for each client. However, in the event of aggregation of purchases or sales for economy of scale, *inter se* allocation shall be done on a *pro rata* basis and at weighted average price of the day's transactions. The portfolio manager shall not keep any open position in respect of allocation of sales or purchases effected in a day.

shall not hold the securities belonging to the portfolio account, in its own name on behalf of its clients

shall not execute off market transfers in client's account except:
(a) for settlement of the clients' own trades;
(b) for providing margin/ collateral for clients' own positions;
(c) for dealing in unlisted securities in accordance with the regulations;
(d) with specific consent of the client for each transaction;
(e) for any other reason specified by SEBI from time to time.

CHAPTER 8: OPERATIONAL ASPECTS OF PORTFOLIO MANAGERS

Following entities can invest in PMS - minimum investment of Rs. 50 Lakhs

• Individuals
• Non-resident Indians (as per the RBI guidelines)
• Hindu Undivided Family
• Proprietorship firms
• Association of person
• Partnership Firms
• Limited liability Partnership
• Trust
• Body Corporate

SEBI (Portfolio Managers) Regulation 2020 requires that the ***disclosure document*** is to be given to the prospective client along with the account opening form prior to signing of the agreement.

Contents of the disclosure document

- **Disclaimer clause** - This Document has neither been approved or disapproved by SEBI nor has SEBI certified the accuracy or adequacy of the contents of the Document.
- **Portfolio Management performance of the portfolio manager for the last three years**, and in case of discretionary portfolio manager disclosure of performance indicators calculated using **'Time Weighted Rate of Return'** method .
- **Audit observations of the preceding 3 years**
- **Investment management and advisory fees. Custodian fee Registrar and transfer agent fee Brokerage and transaction cost.**
- dealing team (DT) which shall be responsible for order placement and execution of all orders

Hurdle Rate **-** Profit sharing/performance related fees are usually charged by portfolio managers upon exceeding a hurdle rate or benchmark as specified in the agreement

High Water Mark is the highest value that the portfolio/account has reached. The portfolio manager charges performance-based fee only on increase in portfolio value in excess of the previously achieved high water mark.

Regulation of Fees and Charges

1. As provided in Regulation 22 (11) of the PMS Regulations, **no upfront fees** shall be charged by the Portfolio Managers, either directly or indirectly, to the clients.

2. Brokerage at actuals shall be charged to clients as expense.

3. **Operating expenses excluding brokerage, over and above the fees charged for Portfolio Management Service, shall not exceed 0.50% per annum** of the client's average daily Assets under Management (AUM).

4. In case client portfolio is redeemed in part or full, the exit load charged shall be as under:
a) In the first year of investment, maximum of 3% of the amount redeemed.
b) In the second year of investment, maximum of 2% of the amount redeemed.
c) In the third year of investment, maximum of 1% of the amount redeemed.
d) After a period of three years from the date of investment, no exit load.

Costs, expenses and fees of investing in PMS

Investment management and advisory fee: The fee so charged may be a fixed fee or a return-based fee or a combination of both. These are typically on actuals and reimbursed to Portfolio Manager.

Custodian fee / Depository fee: The charges relating to opening and operation of dematerialized accounts, custody and transfer charges for shares, bonds and units, dematerialization and other charges in connection with the operation and management of the depository accounts.

Registrar and Transfer agent fee: Charges payable to registrars and transfer agents in connection with effecting transfer of securities and bonds.

Brokerage and transaction costs: Brokerage and related transaction costs, are part of the acquisition cost / sale realization including STT, stamp duty etc.. Brokerage at actuals shall be charged to clients as expense.

Certification charges, Fund Accounting charges and Professional fee: Any charges payable for outsourced professional services like fund accounting, taxation, auditing, and any legal services, franking charges, affidavits, notarizations, courier etc. incurred on behalf of the client by the portfolio manager.

Out of Pocket and Other Incidental Expenses: Charges in connection with day-to-day operations like service tax, other statutory levies, telephone expenses, opening of bank, trading and demat accounts and any other out of pocket expenses incurred by the portfolio manager, on behalf of the client.

Financial Intelligence Unit - India (FIU-IND) is the central, national agency responsible for receiving, processing, analysing and disseminating information relating to suspect financial transactions to enforcement agencies and foreign FIUs.

The portfolio manager is required to report any **suspicious transaction within 7 working days to FIU.**

Securities and Exchange Board of India ('SEBI') has introduced an **Online Dispute Resolution Portal (ODR Portal),** a platform for resolution of disputes arising in the Indian Securities Market with Market participants.
ODR Portal named **SMART ODR** Portal – '**Securities Market Approach for Resolution Through ODR**' is being made available for investors on https://smartodr.in/login.

The portfolio manager is required to appoint a **compliance officer** who shall be responsible for monitoring redressal of investors' grievances.

Chapter V the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 includes the following actions in case of default:
1) suspension of certificate of registration for a specified period;
2) cancellation of certificate of registration;
3) prohibiting the portfolio manager to take up any new assignment or contract or launch a new scheme for the period specified in the order;
4) debarring a principal officer of the portfolio manager from being employed or associated with any registered intermediary or other registered person for the period specified in the order;
5) debarring a branch or an office of the portfolio from carrying out activities for the specified period;
6) warning the portfolio manager.

Joint Holder in PMS

- The investment records are created in the name of the first holder and all the benefits of the investment such as dividends, interest and redemption proceeds are made to the first holder's account
- All the joint holders must sign the application and comply with the requirements of PAN and KYC norms
- The mode of operating the account may be single, joint or anyone or survivor. Any change to the mode of operation, or addition or deletion of joint holders can be done only with the signatures of all holders.
- In case of a demat account, addition or deletion of holders is not allowed once the account is opened.

In case of a discretionary portfolio manager; a condition that the liability of a client shall not exceed his investment with the portfolio manager;

KYC for Non-Residents - Certified True Copy of Passport, Certified True Copy of the Overseas address, Permanent address, A certified true copy of the PIO Card (for PIOs), Merchant Navy NRIs, Mariner's declaration or certified copy of CDC (Continuous Discharge Certificate) is to be submitted.

NRI Demat account

NRIs can open a demat account with any Depository Participant in India.
NRI's needs to mention the type ('NRI' as compared to 'Resident') and the sub-type ('Repatriable' or 'Non- Repatriable') in the account opening form.
No permission is required from RBI to open a demat account.
NRI must open separate demat accounts for holding 'repatriable' and 'non-repatriable' securities.
NRIs can hold joint demat accounts. For the purpose of determining ownership of holding, the first holder is taken into account. Hence, even though other joint holders may be person residing in India, the sale proceeds of such securities can be repatriated in case the first holder is permitted to repatriate funds.

NRI Trading account

- NRI investors can open a trading account with a registered broker of a stock exchange.
- NRIs can have two separate trading accounts linked to NRE & NRO accounts.
- NRIs cannot trade in securities which are in the breach list (List of companies where foreign investment has reached its permissible limit as applicable for FPI/NRI/Overall Sectoral Limit).
- Clear funds should be available for purchases.
- Securities should be available before making a sell order.
- Depending upon whether the purchases are made on repatriation/non-repatriation basis, pay-out of the securities is transferred to the respective demat account.
- Purchase/Sale transactions in cash segment are settled by delivery only.
- The contract notes in original have to be submitted to the designated branch where the investor holds the PIS account within the time specified.
- PIS account - Portfolio Investment Scheme

CHAPTER 9: PORTFOLIO MANAGEMENT PROCESS

Correlation measures the strength and direction of relationship between two variables. ***Correlation coefficients vary in the range −1 to +1*.**

A value of +1 (-1) indicates a perfect positive (negative) relationship between the two variables. A positive relationship between two variables means that they both move together in the same direction, either in an upward trend or downward trend. Negative relationship means the opposite. The value of the correlation coefficient indicates the strength of the relationship between the two variables.

Correlation is the most relevant factor in reaping the benefits of risk **diversification** i.e. in reducing portfolio risk.

The first step in the process of portfolio management is development of ***Investment policy statement*** for the portfolio. ***It is a road map that identifies investors risk appetite and defines investment objectives, goals and investment constraints.***
Since investors requirement's change over a period time, IPS also needs to be updated and revised periodically. IPS forms the basis for strategic asset allocation

There are four important purposes the policy statement serves:
1. It enables investors to have realistic return expectation from their investments.
2. It enables portfolio manager to make effective investment decisions.
3. It provides a framework for portfolio managers evaluation with respect to the investments.
4. It protects the investor against portfolio manager's inappropriate investment decisions or unethical behaviour.

Emergency Cash: The emergency cash reserve is usually measured **as two to three months' spending,** but it could be more if the individual's source of income is at risk or volatile.

Regulatory constraints - an Indian resident individual can only invest up to $250,000 overseas per year. Indian resident individual investors cannot make investments greater than the amount specified by the regulator

Tax Constraint - a thorough understanding of the tax code applicable to the investor needs to be part of the IPS.

An investment approach is a broad outlay of the type of securities and permissible instruments to be invested in by the portfolio manager for the investor, taking into account factors specific to investor and securities. It should also include the type of instruments and proportion of exposure. **investors have idiosyncratic concerns**

Personal financial statements include a statement of net worth-balance sheet and income-expense statements.

It is suggested that **net worth is to be calculated periodically, at least once in a year.**

Psychographic analysis of investor bridges the gap between standard finance which treats investors as rational human beings and behavioural finance which view them as normal human beings (irrational) who have biases and make cognitive errors.

Bailard, Biehl & Kaiser (BB&K) classification of investors

classifies investor personalities by focusing on two aspects: the **level of confidence and the method of action.**

Level of confidence deals with how the investor approaches life in terms of career, wealth or money.

Method of action - deals with whether investor is careful, methodical and analytical in the approach towards life

two "axis" of individual psychology: one axis is the confidence/anxiousness the other is carefulness/ impetuousness.

upper-right corner - **adventurer**-people who are willing to put it all in one major bet and "go for it" because they have confidence. **entrepreneurial people**. stick their necks out in their careers or in their money management strategies. They normally have their own ideas about investing. They are willing to take risks, and they normally **do not go for the investment advisers**. They prefer **concentrating their bets**.

lower-right quadrant – **celebrity** - people like to be **where the action** is. **afraid of being left out. "Should I be in this, or should I be in that?** do not have their own ideas about investments. normally **go for investment advisers**. Most difficult investors to handle

upper-left quadrant – Individualist – **confident, careful, methodical, and analytical.** do their own research and tend to avoid extreme volatility. often **contrarian investors**

lower-left quadrant – guardian - older and begin considering retirement. cautiously trying to preserve their wealth. They are definitely not interested in volatility or excitement.

Straight-Arrow - ***well balanced that they cannot be placed in any specific quadrant, so they fall near the centre***. relatively balanced composite of each of the other four investor types, and by implication a group willing to be exposed to medium risk.

Life cycle analysis of investor

Accumulation Phase

- net worth is typically small relative to liabilities
- Investments are fewer and typically non-diversified
- Goals may include children's education, a house, and if possible, investments for future financial independence
- high-return, high-risk capital gain-oriented investments

Consolidation Phase

- mid-to-late-career stage
- income exceeds expenses
- investors may start looking for capital preservation. High capital gain investments are balanced with some lower-risk assets.

Spending Phase:

- living expenses are covered not from earned income but from accumulated assets such as investments and retirement corpus
- stability in investment portfolio. Preference will be on investment that generate dividend, interest, and rental income.

Gifting Phase:

- final phase when a person realizes that she has more assets than she will need for spending
- Investments at this stage may be made to leave legacy, support a charitable cause

investment policy statement needs to provide a framework for evaluating the performance of the portfolio. It will typically include a benchmark portfolio which matches in composition of the investor's portfolio.

If the ***investment is made in large cap equities, then the BSE 30 or NIFTY 50 index can be an appropriate benchmark.***

An ***investment approach (IA) is the documented investment philosophy to be adopted by the Portfolio Managers while managing the client funds in order to achieve client's investment objectives.***

Each investment approach (IA) shall be tagged to one and only one strategy ('equity', 'debt', 'hybrid' and 'multi-asset'.)

Association of Portfolio Managers of India (APMI) shall prescribe a **maximum of three benchmarks for each strategy. These benchmarks shall reflect the crore philosophy of the Strategy. While tagging an investment approach to a particular strategy, the portfolio manager shall select one benchmark from those prescribed for that strategy**

Once an IA is tagged to a Strategy and/or to a benchmark, the tagging shall be changed only after offering an option to subscribers to the IA to exit without any exit load.

The performance track record (of the specific IA whose tagging with Strategy/ benchmark was changed) prior to the change shall not be used by the Portfolio Manager for performance reporting

Strategic versus Tactical Asset Allocation

asset allocation decision which is made after taking into **consideration investor's characteristics is strategic asset allocation (SAA)**. It is the **target policy portfolio**. It provides target allocation among the major asset classes; in that sense it is essentially **translation of an investment policy statement into asset weights. SAA is the long-term asset allocation decision**.

Tactical asset allocation (TAA) is short-term asset allocation decision. Dynamic asset allocation

In TAA, portfolio managers time markets, i.e., determine which asset classes are likely to go up more than expected and which less than expected. temporarily shift money from one asset class to another to exploit discrepancy in market

TAA attempts to beat the markets. **SAA decisions involve "time in the market" whereas TAA is for "timing the markets".**

Rebalancing of Portfolio

To keep the portfolio's original risk-and-return characteristics, the portfolio may require rebalancing. Portfolio may also require re-balancing due to changes in investor's goals and objectives, risk tolerance

IPS should include a policy regarding rebalancing the portfolio answering questions relating to rebalancing like "how often" and "how much" i.e. the periodicity for portfolio rebalancing and the tolerance for deviation from target policy portfolio.

Portfolio rebalancing involves a simple trade-off: the cost of rebalancing versus the cost of not rebalancing.

There are two types of cost – transaction cost and tax cost. Transaction costs is the time and money costs like research cost, brokerage etc., for buying and selling securities.

Relatively illiquid investments like private equity and real estate pose challenges in rebalancing as they pose higher transaction costs.
Rebalancing is comparatively easier with relatively more liquid asset like listed equities or government bonds.

CHAPTER 10: PERFORMANCE MEASUREMENT AND EVALUATION OF PORTFOLIO MANAGERS

Holding period return - total return or point-to-point return.
Time weighted Rate of Return (TWRR) versus Money weighted Rate of return (MWRR)

IRR is also referred as MWRR (Money Weighted rate of return).
MWRR is the annual rate of return at which the cumulative contributions grow over the measurement period. MWRR depends on the timing of the cash flow.

time-weighted rate of return as a "calculation that computes period by period returns on an investment, and removes the effects of external cash flows, which are generally client driven, and best reflects the portfolio manager's ability to manage assets according to a specified strategy or objective."

TWRR is the compound rate of growth over the stated period. ***In TWRR, portfolio will be valued every time there is an external cash flow. If there is no external cash flow, TWRR is equivalent of HPR.***
chain linking these subperiod return, we have to calculate ***wealth relatives***.
Wealth relative is ending value of one unit of money.
Cumulative wealth relative tells us what one rupee has grown over a period of time,

The TWRR is the same as geometric return.
unless the subperiods constitute exactly one year, time-weighted rate of return will not be expressed as an annual rate, and we have to annualize the return.

SEBI (Portfolio Managers) Regulation, 2020 prescribes discretionary portfolio managers to disclose performance using 'Time Weighted Rate of Return' for the immediately preceding three years.

Arithmetic Mean Return (AMR) vs. Geometric Mean Return (GMR)
a one-year holding period the arithmetic and geometric returns are identical, since both calculate the total return over one year. But over longer holding periods the geometric average return is always less than the arithmetic return except when all the individual yearly returns are exactly the same, in which case the geometric return equals the arithmetic return

<u>Gross versus net return</u>
gross return is the total return generated on investment before the deduction of any fees, expenses or commissions. Gross return is stated for a specified period of time. Net return is calculated after adjusting gross return for fees, expenses or commissions. Net return is the return investor actually makes,

1. Capital
2. Less Upfront fees
3. AUM
4. Add profit or loss
5. Gross value
6. Less other expenses
7. Less Fixed Management fee charged on average of capital contribution and gross value of portfolio
8. Portfolio value
9. Required Portfolio value based on Hurdle rate
10. Less performance fee for profits over hurdle level
11. Less exit load
12. Net value of the portfolio

Pre-tax versus post tax return

Post-tax return = Pre-Tax Return x (1-tax rate)

Pre-Tax return enables comparisons across different investments and strategies, since different investors may be subject to different levels of taxation. However, what really matters to the investor is post-tax return.

Compounded Annual Growth Rate

Compounded Annual Growth Rate is a measure of an investment's annual growth rate over time, with compounding. It assumes that the any dividend/income/rent declared by the investment is re-invested in the same investment on that day's market price.

Cash drag adjusted return

Portfolio managers may not invest the entire capital contribution made by investors for variety of reasons. However, while computing return, for the investment period, the capital contribution made by investors need to be taken into consideration including the cash component maintained by the Fund Manager

Alpha and Beta return

CAPM theorizes that risk consists of a **systematic component** (that is non-diversifiable) and a **unsystematic (idiosyncratic or unique)** component that is diversifiable. Risk that is unsystematic can be diversified away hence an investor should not expect compensation for bearing this type of risk. As per this model, investments are to be priced for their market risk i.e. non-diversifiable risk.

the required return on a security or portfolio is computed as:

Required return = Rf + β (Rm – Rf)

Alpha is the return generated by the portfolio over the over the required rate of return as per CAPM.

This is also referred as **Jensen alpha**.

Alpha return is a reward for bearing non-market risk. **Beta return is a reward for bearing market risk.** Some professionals make a distinction between alpha and Jensen alpha. They refer to the excess return over the market benchmark return as alpha.

Portfolio Return

The return of the portfolio is the weighted average return of individual securities in it.

Security	Return	Weight in the portfolio
A	15%	30%
B	10%	20%
C	12%	20%
D	18%	30%

Portfolio return = (15% X 30%) + (10% X 20%) + (12% X 20%) + (18% X 30%)

Portfolio return = 4.5% + 2% + 2.4% + 5.4% = 14.3%

Total risk and downside risk

Risk in a generic sense is the possibility of loss, damage, or harm.

It can be defined as variability in the expected return - total risk.

Standard deviation as a measure of total risk

Standard deviation and variance are measures of dispersion in return. Standard deviation is the square root of variance. It quantifies the degree to which returns fluctuate around their average. A higher value of standard deviation means higher risk.

66.7% probability - portfolio return would be between mean return +/- 1 Sigma

95% probability - portfolio return would be between mean return +/- 2 Sigma

99% probability - portfolio return would be between mean return +/ – 3 Sigma

Semi variance / Semi Standard deviation as a measure of downside risk

Semi variance measures the dispersion of the return below the mean return. Target Semi variance measures the dispersion of the return below the target return.

symmetrically distributed return, semi variance will be proportional to variance and provides no additional insight. Forecasting asymmetrical distribution of return is very difficult and may not be a good forecast of future risk. (jus read)

Portfolio risk versus individual risk

portfolio standard deviation is not the weighted average standard deviation of individual investments in a portfolio

Portfolio risk depends on the weights of the investments, their individual standard deviations and more importantly the correlation across those investments as shown

$$\sigma_p = \sqrt{w_1^2\sigma_1^2 + w_2^2\sigma_2^2 + 2w_1w_2\rho_{1,2}\sigma_1\sigma_2}$$

$$\sigma_p = \sqrt{w_1^2\sigma_1^2 + w_2^2\sigma_2^2 + 2w_1w_2Cov_{1,2}}$$

covij is the covariance of the returns of individual assets. **Covariance is a product of coefficient of correlation between the assets returns and their individual standard deviations.**

Systematic Risk and Unsystematic Risk

Systematic risk is defined as risk due to common risk factors, like interest rates, exchange rates, commodities prices. It is linked to supply and demand in various marketplaces. All investments get affected by these common risk factors directly or indirectly. Systematic risks cannot be diversified away, though it can be hedged. Systematic risk is measured by Beta.
Risks due to sector specific/company specific factors is referred as unsystematic risks. These risks can be diversified away. Alpha return is a reward for bearing unsystematic risk.

Beta measures Systematic risk . Beta relates the return of a stock or a portfolio to the return on market index. It reflects the sensitivity of the fund's return to fluctuations in the market index.
Beta = Cov (MrPr) / Var(Mr)
Where
Cov (MrPr) = Covariance between the market's return and the portfolio return
Var(Mr) = Variance in the Market return

Beta of the portfolio can also be calculated by taking the weighted average beta of the individual securities/investments in the portfolio.

if stock A has a beta of 1.2 and stock B has a beta of 1.1 and they make up the portfolio in the ratio of 60:40, the Beta of the portfolio (β p) would be:

Tracking error

Tracking error is the ***standard deviation of the difference between the portfolio and its target benchmark portfolio total return***.

Tracking Error is always calculated against the Total Returns Index which shows the returns on the Index portfolio, inclusive of dividend

Tracking errors primarily arises due to mismatches between portfolio's risk profile and the benchmark's risk profile.

Risk-adjusted return

Sharpe Ratio - It measures Reward to Variability

$$Sharpe\ Ratio = \frac{R_p - R_f}{\sigma_p}$$

Higher the Sharpe ratio, better is the portfolio's risk adjusted performance.

The Treynor Ratio

Treynor measure adjusts excess return for systematic risk. It is computed by dividing a portfolio's excess return, by its beta

$$Treynor\ Ratio = \frac{r_p - r_f}{\beta_p}$$

For a ***completely well-diversified portfolio, the two measures give identical ranking, because total risk and systematic risk would be the same. However, for a poorly diversified portfolio, the raking based on Treynor Ratio could be higher than that on Sharpe ratio as Treynor ratio, ignores unsystematic risk.***

Sortino Ratio

portfolio's return in excess of the risk-free return is divided by the portfolio's semi-standard deviation. Thus, Sortino Ratio adjusts portfolio's excess return to the downside risk.

Sortino Ratio = (Rp – Rf)/ Semi Standard deviation of the portfolio

Information Ratio (Appraisal ratio)

IR = (Rp – Rb)/Stdev (Rp – Rb)
Where:
IR = the information ratio,
Rp = Return on the portfolio
Rb = Return on the benchmark
Stdev (Rp – Rb)= Standard deviation of the difference between the return of the portfolio and return of the benchmark

The numerator is often referred to as the active return on the portfolio whereas denominator is referred to as the active risk. The point to be noted is that active risk is nothing but tracking error of the portfolio.

M2 Measure

Calculation of Sharpe ratio

Multiplying Sharpe ratio with the standard deviation of the benchmark

Adding the risk-free rate of return to the outcome

Compare with Market

Performance Evaluation: Benchmarking and peer group analysis

GIPS defines Benchmark as an independent rate of return (or hurdle rate), forming an objective test of the effective implementation of investment strategy.

A good benchmark should be able to satisfy the following criteria

- Identity of constituents and their weights in the benchmark are clearly defined.
- The benchmark is investable (passive) and performance of the benchmark is measurable
- The benchmark is consistent with the portfolio's investment approach
- same risk-return profile as the portfolio

Customized Benchmark
The disadvantage is that the costs of construction and maintenance of these benchmarks would be much higher than the fee paid for using market-based indices.
Managers' universe analysis - peer group analysis
portfolio managers with the similar investment approach and strategies can be taken as the yardstick

Performance attribution analysis

Fama - dissect the return into majorly two components: return driven by the benchmark and the differential return

Differential return can be achieved by choosing to ***over-invest in (or overweight) a particular economic sector that outperformed the total benchmark (sector allocation) for that period or to underinvest in or avoid (or underweight) an asset category that underperformed the total benchmark (asset allocation).***

Differential return can also be achieved by selecting securities that performed well relative to the benchmark or avoiding benchmark securities that performed relatively poorly.

Local currency versus foreign currency denominated investment return

An Indian investor has invested Rs. 50 lacs in a US equity fund when Rupee was 70 per US dollar. The fund has generated a return of 15%. During the period rupee appreciated to 65 per US dollar. What is the return investor has made?

Valuation of Securities by Portfolio Managers

APMI shall prescribe standardized valuation norms for Portfolio Managers. Valuation of the portfolio debt and money market securities by portfolio managers shall be carried out in accordance with these standardized valuation norms prescribed by APMI.

Global Investment Performance Standards (GIPS)

set of ethical standards for investment management firms to follow when presenting their performance results to potential clients.

GIPS mandates use of time weighted rate of return. SEBI Portfolio Managers Regulation 2020 has also prescribed the use of TWRR for communicating the past performance.

CHAPTER 11: TAXATION

Section 2(31) of the ITA provides an inclusive definition of a person. It provides that a person includes:
a) an Individual;
b) a Hindu undivided family (HUF);
c) a Company;
d) a firm;
e) an Association of Person (AOP) or Body of Individual (BOI), whether incorporated or not;
f) Local authority and
g) every artificial juridical person

Residential status

An assessee can be categorized into following residential status during the previous year:
a) Resident in India

- Resident and Ordinarily Resident
- Resident but Not-ordinarily Resident

b) Non-Resident in India
c) Deemed Resident - an Indian citizen is deemed as resident in India irrespective of his stay in India if his total income, excluding income from foreign sources, [hereinafter referred to as 'Indian Income'] exceeds Rs. 15 lakhs during the previous year and he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

An individual is treated as **resident in India** if he stays in India for:
(a) 182 days or more during the relevant previous year; or
(b) 60 days or more (but less than 182 days) during the relevant previous year and for 365 days or more in the last 4 years.

Nature of income	Resident and ordinarily resident	Resident but not ordinarily resident	Non-resident
Income received or is deemed to be received in India	Taxable	Taxable	Taxable
Income accrues or arises or is deemed to accrue or arise to him in India	Taxable	Taxable	Taxable
Income accrues or arises outside India if it is derived from a business controlled in India or a profession set up in India	Taxable	Taxable	Not-taxable
Income accrues or arises outside India (from a business controlled from outside India or from a profession set up outside India)	Taxable	Not-taxable	Not-taxable

A PMS Client may earn:
• Income from dividend on shares and units of mutual funds
• Income from interest on Fixed Income Securities
• Short-term and/or long-term capital gains (or losses) on sale of Securities (shares, debentures, rights renunciations, units, etc.), if gains are categorized as capital gains
• Business Income (loss) from purchase and sale of Securities (shares, debentures, rights renunciations, units, etc.), if gains are categorized as business income

Any profits or gains arising from the transfer of a capital asset is taxable under the head 'capital gains'

Capital asset is deemed as 'short-term' if it is held by an assessee for a period of not more than 36 months,

Following capital assets are treated as short-term capital asset if they are held for not more than 24 months immediately preceding the date of transfer:
a) Unlisted shares of a company (equity shares or preferences shares);
b) An immovable property, being land or building or both.

Following capital assets are treated as short-term capital asset if they are held for not more than 12 months immediately preceding the date of transfer:
a) Listed Shares of a company on recognised stock exchange (equity shares or preference shares)
b) Listed securities (Debentures, Bonds, Derivatives, Government securities etc.)
c) Units of UTI (Listed or Unlisted)
d) Units of Equity Oriented Fund (Listed or Unlisted)
e) Zero Coupon Bonds (Listed or Unlisted)

capital gains on redemption/ transfer of units of Specified Mutual Fund (i.e. a mutual fund where not more than 35% is invested in equity shares of an Indian company) acquired on or after 1 April 2023 or Market Linked Debentures shall be deemed to be capital gains arising from a Short-Term Capital Asset, irrespective of the period of holding.

<u>Indexation</u>

Indexed cost = Cost of Acquisition X (CII of year sold / CII of year bought)

If STT is not applicable, the short-term capital gain shall be taxable at applicable rate.

Sr. No	Particulars	Resident investors	Non-resident investors	FPI
1	STCG – Listed Equity, Units of an equity oriented mutual fund	15%	15%	15%
2	Any other short-term capital gains	As per slab	30% (in case of firms/ LLP/ foreign non-corporates)/	30%

			40% (in case of foreign company)	
3	Long-term capital gains on Listed Equity shares & Units of Equity MF	10% on income in excess of INR 1 lakh	10% on income in excess of INR 1 lakh	
4	Long term capital gains on sale of listed bonds or listed debentures	10% (without indexation)	10% (without indexation)	10% (without indexation)
5	Long-term capital gains on transfer of unlisted bonds or unlisted debentures	20% (without indexation)	10%	10%
6	Long-term capital gains on transfer of unlisted securities (other than unlisted bonds and unlisted debentures)	20% (with indexation)	10%	10%

The income in the nature of dividend on securities is taxable in the hands of the assessee under the head 'income from other sources'.

'Dividend' usually refers to the distribution of profits by a company to its shareholders.

The deemed dividend, as defined in Section 2(22) of the ITA includes the following:
a) Distribution of accumulated profits to shareholders entailing release of the company's assets;
b) Distribution of debentures, debenture-stock or deposit certificates to shareholders out of the accumulated profits of the company and issue of bonus shares to preference shareholders out of accumulated profits;

c) Distribution made to shareholders of the company on its liquidation out of accumulated profits;
d) Distribution to shareholders out of accumulated profits on the reduction of capital by the company; and
e) Loan or advance made by a closely held company to its shareholder out of accumulated profits

Interest income The income in the nature of interest on securities is taxable in the hands of the assessee under the head 'income from other sources'.

As per Section 2(28B) of the ITA, 'interest on securities' means:
a) Interest on any security of the Central Government or a State Government;
b) Interest on debentures/other securities for money issued by or on the behalf of a local authority or a company or a corporation, established by a Central or State or Provincial Act.

the interest on securities can arise from the following securities:

1. Bonds; 2. Debentures or debenture stock; 3. Government securities

'profits and gains of business or profession',

'speculative' - Section 43(5) of the ITA a transaction of purchase or sale of any commodity (including stocks and shares) is considered as a 'speculative transaction' if it is settled otherwise than through the actual delivery except where transaction is entered into to safeguard against losses (i.e., hedging transaction). **Transaction in derivatives** (including commodity derivatives) carried out in a recognised stock exchange are **not considered as a speculative transaction**.

'non- speculative

If any loss is suffered from a speculative business, it cannot be set off or adjusted against any profit from the non-speculative business. Further, such losses can be carried forward for 4 years only in contrast to 8 years allowed for non-speculative business losses.

Section 9A of ITA

SEBI (Portfolio Managers) Regulations, 2020 provides for an enabling framework for fund managers desirous of providing their services to overseas funds.

Section 9A was inserted in the ITA to provide a 'safe harbour' to overseas funds availing fund management services from India based managers

Section 9A of the ITA provides that in case an eligible investment fund, established or incorporated or registered outside India, collects funds from its members and invests in India then such fund shall not be deemed to have a business connection nor will be regarded as resident in India just because fund management activity is carried out through a eligible fund manager located in India.

Eligible investment fund

a. the fund is not a person resident in India;

b. the fund is a resident of such country with which India has a tax treaty or the investment fund is established or incorporated in a specified country notified by the Central Government;

c. the aggregate participation or investment in the fund by person resident in India shall not exceed 5% of the corpus fund. for the purpose of calculation of said aggregate participation or investment in the fund, any contribution made by eligible fund manager during the first three years of the operation of the fund, not exceeding INR 25 crore, shall not be taken into account;

d. the fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;

e. the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

f. Any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

g. The aggregate participation interest, directly or indirectly, of 10 or less members along with their connected persons in the fund, shall be less than 50%.

h. The fund shall not invest more than twenty per cent of its corpus in any entity

i. the fund shall not make any investment in its associate entity;

j. the monthly average of the corpus of the fund shall not be less than INR 100 crore.

k. the fund shall not carry on or control and manage, directly or indirectly, any business in India;

l. the fund is neither engaged in any activity which constitutes a business connection in India nor has any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf;

m. the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken by him on its behalf is not less than the amount calculated in the prescribed manner.

Eligible fund manager

(a) the person is not an employee of the eligible investment fund or a connected person of the fund;

(b) the person is registered as a fund manager or an investment advisor in accordance with the either SEBI (Portfolio Managers) Regulations, 2020, SEBI (Investment Advisers) Regulations, 2013 or SEBI (Mutual Fund) Regulations, 1996;

(c) the person is acting in the ordinary course of his business as a fund manager;

(d) the person along with his connected persons shall not be entitled, directly or indirectly, to more than 20% of the profits accruing or arising to the eligible investment fund

CHAPTER 12: REGULATORY, GOVERNANCE AND ETHICAL ASPECTS OF PORTFOLIO MANAGERS

- All cash transactions of the value of more than Rs. 10 lakh or its equivalent in foreign currency.
- All series of cash transactions integrally connected to each other which have been valued below Rs. 10 lakh or its equivalent in foreign currency where such series of transactions take place within one calendar month and the aggregate value of such transaction exceeds Rs. 10 lakh.
- All suspicious transaction whether or not made in cash. For the purpose of suspicious transactions apart from 'transactions integrally connected', 'transactions remotely connected or related' shall also be considered.

for a period of 10 years from the date of cessation of the transactions between the clients and the banking company or financial institution or intermediary

Any person found indulging in any offence of money laundering as defined in section 3 of the PMLA, shall be punished as per provisions mentioned in section 4 of the Act.

Section 12 AA of PMLA stipulates enhanced due diligence by reporting entities

(a) verify the identity of the clients undertaking such specified transaction

(b) take additional steps to examine the ownership and financial position, including sources of funds of the client

(c) take additional steps as may be prescribed to record the purpose behind conducting the specified transaction and the intended nature of the relationship between the transaction parties.

information obtained while applying the enhanced due diligence measures shall be maintained for a period of five years

Specified transaction

- any withdrawal or deposit in cash, exceeding such amount
- any transaction in foreign exchange, exceeding such amount
- any transaction in any high value imports or remittances
- such other transaction or class of transactions, in the interest of revenue or where there is a high risk of money-laundering or terrorist financing

'Principal Officer' needs to be designated who shall be responsible for ensuring compliance of the provisions of the PMLA

SEBI (Prohibition of Insider Trading) Regulations 2015

Schedule C of the regulation specifies the minimum standards

The compliance officer shall report to the board of directors at least once in a year

1. All information shall be handled within the organisation on a need-to-know basis and no unpublished price sensitive information shall be communicated to any person except in furtherance of legitimate purposes, performance of duties or discharge of legal obligations. The code of conduct shall contain norms for appropriate Chinese Wall procedures, and processes for permitting any designated person to "cross the wall".
2. Designated persons and immediate relatives of designated persons in the organisation shall be governed by an internal code of conduct governing dealing in securities
3. Designated persons may execute trades subject to compliance with these regulations. Trading by designated persons shall be subject to pre-clearance by the compliance officer(s), if the value of the proposed trades is above such thresholds as the board of directors or head(s) of the organisation may stipulate.
4. The compliance officer shall confidentially maintain a list of such securities as a "restricted list" which shall be used as the basis for approving or rejecting applications for pre-clearance of trades.
5. Prior to approving any trades, the compliance officer shall seek declarations to the effect that the applicant for pre-clearance is not in possession of any unpublished price sensitive information.
6. The code of conduct shall specify any reasonable timeframe, which in any event shall not be more than seven trading days, within which trades that have been pre-cleared have to be executed by the designated person, failing which fresh pre-clearance would be needed
7. The code of conduct shall specify the period, which in any event shall not be less than six months, within which a designated person who is a connected person of the listed company and is permitted to trade in the securities of such listed company, shall not execute a contra trade. The compliance officer may be empowered to grant relaxation from strict application of such restriction for reasons to be recorded in writing

provided that such relaxation does not violate these regulations. Should a contra trade be executed, inadvertently or otherwise, in violation of such a restriction, the profits from such trade shall be liable to be disgorged for remittance to the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act.

12. All designated persons shall be required to disclose name and Permanent Account Number or any other identifier authorized by law of the following to the intermediary or fiduciary on an annual basis and as and when the information changes:

a) immediate relatives

b) persons with whom such designated person(s) shares a material financial relationship

1. c) Phone, mobile, and cell numbers which are used by them

In addition, names of educational institutions from which designated persons have graduated and names of their past employers shall also be disclosed on a one time basis.

"material financial relationship" shall mean a relationship in which one person is a recipient of any kind of payment such as by way of a loan or gift from a designated person during the immediately preceding twelve months, equivalent to at least 25% of the annual income of such designated person but shall exclude relationships in which the payment is based on arm's length transactions.

SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003

Dealing in securities shall be deemed to be a manipulative, fraudulent or an unfair trade practice if it involves any of the following:

a) knowingly indulging in an act which creates false or misleading appearance of trading in the securities market;

b) dealing in a security not intended to effect transfer of beneficial ownership but intended to operate only as a device to inflate, depress or cause fluctuations in the price of such security for wrongful gain or avoidance of loss;

c) inducing any person to subscribe to an issue of the securities for fraudulently securing the minimum subscription to such issue of securities, by advancing or agreeing to advance any money to any other person or through any other means;

SEBI (Portfolio Managers) Regulations, 2020

Portfolio means the total holdings of securities and goods belonging to any person;

Principal officer means an employee of the portfolio manager who has been designated as such by the portfolio manager and is responsible for (i) the decisions made by the portfolio manager for the management or administration of portfolio of securities or the funds of the client, as the case may be; and (ii) all other operations of the portfolio manager.

The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client. Any renewal of portfolio on maturity of the initial period shall be deemed as a fresh placement.

the funds or securities can be withdrawn by the client before the maturity of the contract under the following circumstances, namely
a) voluntary or compulsory termination of portfolio management services by the portfolio manager or the client;
b) suspension or cancellation of the certificate of registration of the portfolio manager by SEBI;
c) bankruptcy or liquidation of the portfolio manager.

discretionary portfolio manager shall invest funds of his clients in the securities listed or traded on a recognized stock exchange, money market instruments,39 units of Mutual Funds and other securities as specified by SEBI from time to time, on behalf of their clients.

non-discretionary or advisory services to clients may invest or provide advice for investment up to 25% of the assets under management of such clients in unlisted securities, in addition to the securities permitted for discretionary portfolio management

portfolio manager may offer discretionary or non-discretionary or advisory services for investment upto 100 % of the assets under management of the large value of accredited investors in unlisted securities

Every portfolio manager shall appoint a custodian in respect of securities managed or administered by it, however, this regulation shall not apply to a) portfolio manager who provides only advisory services b) co-investment portfolio manager.

The investor charter details different services provided by the portfolio managers to the investors along with estimated timelines, like account opening, agreement with the portfolio manager, periodic statements to the investors, investor grievance redressal mechanism, responsibility of investors at one single for ease of reference

Soft dollar practices

Investment management firms pay commission to brokerage firms for executing trades. Soft dollar arrangements are the one where investment managers pay a higher commission to the brokerage firm in lieu of enjoying additional services like access to their research reports, hardware, software or even non-research-related services, etc
In portfolio management services, the investor is charged the brokerage fee. Soft dollar arrangement must be avoided as it is abusive in nature. There

CFA Institute has developed Research Objectivity Standards (ROS)
A fundamental principle of ethical investment practice is that the best interests of the investing client must always take precedence over the interests of investment professionals and their employers.

Employees of the firm who present and discuss their research and recommendations in public appearances to fully disclose personal and firm conflicts of interest to the host or interviewer and, whenever possible, to the audience.

All the Best ☺

MODELEXAM

Email: myakshaya@gmail.com, WhatsApp only : 98949 49988

https://modelexam.in/nism-exams/nism-mock-test.html