Study Notes for NISM Series-XII: Securities Markets Foundation Certification Examination

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EXAMINATION DETAILS

Questions	Mcq - 100x1 mark
Total marks	100
Duration	2 hours
Pass mark	60
Negative marking	-

WEIGHTAGE

Chapter No.	Chapter Name	Weightage (%)
1	Understanding Securities Markets and Performance	10
2	Securities: Types, Features and Concepts of Asset Allocation and Investing	20
3	Primary Markets	20
4	Secondary Markets	20
5	Mutual Funds	20
6	Derivative Markets	10

NISM Series-XII: Securities Markets Foundation Certification Examination

Chapter 1: Understanding Securities Markets and Performance

Securities Markets: Financial markets include money, debt, and equity markets, with securities markets focusing on equity and debt capital flow from investors to businesses.

Role of Securities Markets: Securities markets channel savings to investments, enabling efficient capital allocation for businesses and governments.

Securities Definition: Securities, as per the Securities Contracts (Regulation) Act, 1956, include shares, bonds, derivatives, mutual fund units, and government securities.

Securities Features: Securities represent a monetary exchange between issuers and investors, offering returns and liquidity through regulated contracts.

Equity vs. Debt: Equity securities grant ownership and management participation, while debt securities provide fixed interest and principal repayment.

Risk and Return: Securities involve risk (potential loss of expected returns) and return (benefits like interest or dividends).

Primary Market: The primary market is where issuers raise capital by issuing new securities to investors.

Secondary Market: The secondary market facilitates trading of already-issued securities, providing liquidity and risk transfer.

Investors: Investors, with surplus funds, convert savings into financial assets, categorized as retail (individuals) or institutional (organizations).

Retail Investors: Retail investors invest personal funds, typically in smaller amounts, for personal financial goals.

Institutional Investors: Institutional investors manage large funds with specialized knowledge, including mutual funds, banks, and pension funds.

Issuers: Issuers, such as companies and governments, raise capital by issuing securities to meet short- or long-term needs.

Common Issuers: Companies, governments, financial institutions, and mutual funds issue securities to fund operations or deficits.

Dematerialisation: Securities are issued and held electronically since the mid-1990s, replacing physical certificates.

Intermediaries: Intermediaries facilitate transactions between investors and issuers, including merchant bankers, brokers, and depositories.

Asset Management Companies: AMCs manage pooled investments, such as mutual funds, for a fee.

Portfolio Managers: Portfolio managers manage individual portfolios without pooling funds, charging fees for tailored investment services.

Merchant Bankers: Merchant bankers manage issue processes, including structuring, pricing, and listing securities.

Underwriters: Underwriters guarantee to buy unsold securities in an issue, reducing issuer risk.

Stock Brokers: Brokers execute buy/sell transactions on stock exchanges, earning commissions.

Authorized Persons: Authorized persons extend broker services to a wider investor base, acting as agents.

Clearing Members: Clearing members settle trades by ensuring delivery of securities and funds.

Bankers to an Issue: Bankers collect applications and funds during public issues, transferring them to issuers.

Registrars & Share Transfer Agents: RTAs maintain investor records and update ownership changes.

Depository Participants: DPs enable investors to hold and trade securities in dematerialized form.

Custodians: Custodians hold securities and manage transactions for institutional investors, typically large banks.

Trustees: Trustees oversee asset managers or debenture holders to protect investor interests.

Credit Rating Agencies: Credit rating agencies assess debt securities’ default risk, aiding investor decisions.

Investment Advisers: Advisers help investors select securities based on goals, risk tolerance, and time horizon.

KYC Registration Agencies: KRAs maintain centralized KYC data for SEBI-registered intermediaries, ensuring compliance.

SEBI Role: SEBI, under the SEBI Act, 1992, regulates securities markets, protecting investors and ensuring market growth.

SEBI Functions: SEBI oversees stock exchanges, intermediaries, and capital issuances, enforcing compliance and transparency.

Stock Exchange Regulation: SEBI regulates stock exchanges, requiring periodic reports and approval of bye-laws.

Primary Market Oversight: SEBI's ICDR Regulations, 2018, govern public and rights issues, ensuring proper disclosures.

Surveillance Mechanisms: SEBI monitors intermediaries and stock exchanges to prevent unfair practices like insider trading.

Insider Trading Regulations: SEBI prohibits insider trading, requiring companies to enforce compliance and disclosures.

RBI Role: RBI regulates money and foreign exchange markets, managing government securities and banking norms.

MCA Role: The Ministry of Corporate Affairs regulates corporate functioning and securities issuance under the Companies Act.

MoF Role: The Ministry of Finance oversees capital markets and financial sector reforms through its departments.

IRDAI Role: IRDAI regulates the insurance industry, ensuring efficiency and policyholder protection.

PFRDA Role: PFRDA regulates pension funds, protecting subscribers and ensuring old-age income security.

IBBI Role: IBBI oversees insolvency proceedings under the Insolvency and Bankruptcy Code, 2016.

IFSCA Role: IFSCA regulates financial products and services in International Financial Services Centres, promoting global connectivity.

Capital Allocation: Securities markets enable efficient capital allocation, supporting economic growth.

Disintermediation: Securities markets reduce reliance on banks by allowing direct capital raising through securities.

Productive Investments: Securities mobilize household savings for long-term projects like infrastructure, generating growth.

Liquidity Provision: Secondary markets allow investors to sell securities, converting investments into cash.

Price Discovery: Securities markets determine fair prices through buyer-seller interactions.

Information Signaling: Secondary market prices reflect issuer performance, aiding small investors' decisions.

Technological Advancements: Securities markets transitioned from open outcry to electronic trading in the 1990s.

Online Trading: Investors can trade via online platforms or mobile apps, replacing manual orders.

Cyber Security Risks: Electronic trading increases exposure to cyber-attacks, necessitating robust security measures.

CSCRF Framework: SEBI's Cyber Security and Cyber Resilience Framework addresses cyber threats for regulated entities.

Market Infrastructure Institutions: MIIs like stock exchanges and depositories must comply with CSCRF guidelines.

Cyber Resilience Goals: CSCRF outlines five goals: anticipate, withstand, contain, recover, and evolve.

Governance in CSCRF: Regulated entities must establish cybersecurity policies approved by their boards.

Critical Systems Identification: Entities must classify critical systems based on sensitivity and business impact.

Protection Measures: CSCRF mandates strong access controls, encryption, and periodic audits for security.

Detection Systems: Continuous monitoring is required to detect anomalies and unauthorized activities.

Incident Response: Entities must report cyber incidents via SEBI's portal and maintain response plans.

Recovery Plans: Plans for restoring systems post-cyber-attack are mandatory, with clear stakeholder roles.

Evolving Controls: Entities must adapt cybersecurity strategies to address new vulnerabilities.

Compliance Reporting: Regulated entities submit standardized CSCRF compliance reports to SEBI.

Vendor Compliance: Vendors managing systems for regulated entities must adhere to SEBI guidelines.

Cyber Audits: Periodic cyber audits by CERT-In empanelled auditors are mandatory.

Innovation Sandbox: SEBI's Innovation Sandbox allows FinTech firms to test solutions offline.

Regulatory Sandbox: SEBI's Regulatory Sandbox enables live testing of FinTech innovations under supervision.

Sandbox Eligibility: Only SEBI-registered entities with genuine innovations can participate in the Regulatory Sandbox.

Sandbox Restrictions: No exemptions are granted for investor protection, KYC, or AML rules in the Sandbox.

Historical Context: Securities markets evolved from unorganized street trading to structured electronic systems.

Market Efficiency: Securities markets reduce fraud risks, ensuring safer capital transfers.

Investor Confidence: Liquidity and price discovery boost investor confidence in long-term investments.

SEBI Inspections: SEBI conducts routine inspections to ensure intermediary compliance.

Penalties by SEBI: SEBI can impose suspensions, fines, or prosecutions for violations.

KYC Interoperability: KRAs share KYC data across SEBI intermediaries, simplifying investor processes.

Price Impact: Market prices signal issuer performance, such as declining agricultural stock prices due to poor monsoons.

FinTech Innovation: SEBI encourages FinTech through sandboxes, balancing innovation and regulation.

Chapter 2: Securities: Types, Features and Concepts of Asset Allocation and Investing

Equity Securities: Equity securities represent ownership in a company, offering dividends and capital gains.

Debt Securities: Debt securities are loans to issuers, providing fixed interest and principal repayment.

Equity Financing: Companies issue equity to raise permanent capital without repayment obligations.

Debt Financing: Debt financing involves borrowing with fixed repayment schedules and interest costs.

Equity Characteristics: Equity investors share profits, bear losses, and have voting rights.

Debt Characteristics: Debt securities offer fixed returns, priority in liquidation, but no ownership.

Choosing Equity vs. Debt: Issuers choose based on cost, control, and repayment flexibility.

Hybrid Instruments: Hybrids combine equity and debt features, like convertible bonds.

Commodities as Assets: Commodities like gold are alternative investments with unique risk-return profiles.

Derivatives: Derivatives derive value from underlying assets, used for hedging or speculation.

Asset Allocation: Asset allocation divides investments across asset classes to balance risk and return.

Diversification: Diversification reduces risk by spreading investments across securities and sectors.

Equity Investing Process: Equity investing involves analyzing fundamentals, valuations, and market trends.

Debt Investing Process: Debt investing focuses on credit ratings, yields, and maturity profiles.

Risk in Equity: Equity risk includes market volatility and company-specific risks.

Return in Equity: Equity returns come from dividends and capital appreciation.

Risk in Debt: Debt risks include default risk and interest rate risk.

Return in Debt: Debt returns are primarily interest payments, predictable but limited.

Price vs. Value: Equity price reflects market perception, while value is based on fundamentals.

Valuation Metrics: P/E, P/B, and dividend yield assess equity investment attractiveness.

Debt Terminology: Key terms include coupon rate, yield, and maturity.

Convertible Bonds: Convertible bonds can be converted into equity, offering flexibility.

Preference Shares: Preference shares provide fixed dividends with priority over equity.

Commodities Risk: Commodities face price volatility due to supply-demand dynamics.

Derivatives Use: Derivatives manage risk or speculate on price movements.

Systematic Risk: Market-wide risks affect all securities, like economic downturns.

Unsystematic Risk: Company-specific risks can be mitigated through diversification.

Portfolio Management: Active portfolio management seeks to outperform benchmarks.

Passive Investing: Passive strategies track indices, minimizing active decisions.

Investment Goals: Investors align securities with financial goals like retirement or wealth growth.

Time Horizon: Investment choices depend on short-term or long-term objectives.

Risk Tolerance: Investors' ability to bear losses influences asset selection.

Liquidity Needs: Investors prioritize liquid securities for short-term cash needs.

Equity Analysis: Fundamental analysis evaluates financial health; technical analysis uses price trends.

Debt Analysis: Debt analysis assesses issuer creditworthiness and bond ratings.

Yield to Maturity: YTM measures total return on a bond if held to maturity.

Bond Duration: Duration indicates a bond's sensitivity to interest rate changes.

Market Capitalization: Market cap reflects a company's size, influencing risk and return.

Dividend Yield: Dividend yield shows annual dividends relative to share price.

Price-Earnings Ratio: P/E ratio compares share price to earnings, indicating valuation.

Book Value: Book value represents a company's net asset value.

Credit Risk: Risk of issuer default impacts debt security returns.

Interest Rate Risk: Rising rates reduce bond prices, affecting debt investors.

Commodity Markets: Commodities trade on exchanges like MCX, offering investment avenues.

Structured Products: Structured products combine securities for tailored risk-return profiles.

Distressed Securities: Distressed securities are high-risk investments in troubled companies.

Hedging with Derivatives: Derivatives offset losses in underlying assets through opposite positions.

Speculation in Derivatives: Speculative derivative trades bet on price movements without underlying holdings.

Arbitrage Opportunities: Arbitrage exploits price differences across markets for profit.

Investment Strategies: Strategies include growth, value, or income-focused investing.

Equity Market Trends: Bull and bear markets influence equity investment decisions.

Debt Market Trends: Interest rate trends impact debt security valuations.

Portfolio Diversification: Diversification across asset classes reduces overall portfolio risk.

Risk-Return Tradeoff: Higher potential returns come with increased risk exposure.

Mutual Funds as Vehicles: Mutual funds pool investor money for diversified portfolios.

ETF Characteristics: ETFs track indices and trade like stocks, offering liquidity.

REITs and InvITs: REITs and InvITs provide exposure to real estate and infrastructure.

Alternative Investments: Commodities and structured products diversify traditional portfolios.

Equity Ownership: Equity holders have residual claims after debt obligations.

Debt Priority: Debt holders have priority in liquidation, reducing risk.

Convertible Debentures: Convertible debentures offer debt-to-equity conversion options.

Zero Coupon Bonds: Zero coupon bonds pay no interest, sold at a discount.

Commodity Hedging: Commodities hedge against inflation and currency risks.

Derivative Risks: Derivatives carry counterparty and leverage risks.

Investment Planning: Financial planning aligns investments with life goals.

Equity Volatility: Equity prices are more volatile than debt, increasing risk.

Debt Stability: Debt securities offer stable returns, suitable for conservative investors.

Hybrid Flexibility: Hybrids balance risk and return, appealing to diverse investors.

Commodity Volatility: Commodity prices fluctuate due to global economic factors.

Derivative Leverage: Derivatives amplify gains and losses through leverage.

Asset Correlation: Low correlation between assets enhances diversification benefits.

Fundamental Analysis: Analyzes financial statements to assess company health.

Technical Analysis: Uses price and volume data to predict market trends.

Bond Ratings: Ratings from agencies like CRISIL assess debt credit quality.

Portfolio Rebalancing: Periodic rebalancing maintains desired asset allocation.

Investment Costs: Costs like brokerage and management fees impact returns.

Tax Implications: Tax treatments vary across equity, debt, and derivatives.

Market Sentiment: Investor sentiment influences security prices and market trends.

Liquidity Risk: Illiquid securities may be hard to sell at desired prices.

Global Exposure: Commodities and derivatives provide exposure to global markets.

Chapter 3: Primary Markets

Primary Market Definition: Primary markets facilitate capital raising by issuing new securities to investors.

Functions of Primary Market: Primary markets channel savings to issuers for business or government funding.

Primary vs. Secondary Markets: Primary markets create securities; secondary markets trade existing securities.

Intermediaries in Primary Market: Include merchant bankers, underwriters, bankers, and registrars.

Merchant Bankers Role: Merchant bankers structure, price, and manage the issue process.

Underwriters Role: Underwriters ensure unsold securities are purchased, reducing issuer risk.

Bankers to Issue: Bankers collect applications and funds during public issues.

Registrars Role: Registrars maintain investor records and process allotments.

Types of Issues: Public issues, rights issues, and private placements raise capital.

Public Issue Types: Include IPOs, FPOs, and offer for sale by existing shareholders.

IPO Definition: Initial Public Offering is the first public issuance of equity shares.

FPO Definition: Follow-on Public Offer involves additional share issuance by listed companies.

Offer for Sale: Existing shareholders sell securities to the public via an offer document.

Types of Issuers: Companies, governments, financial institutions, and mutual funds issue securities.

Corporate Issuers: Companies issue equity or debt for operational and expansion needs.

Government Issuers: Governments issue debt securities to finance deficits.

Financial Institutions: Banks and institutions issue securities beyond traditional funding sources.

Mutual Fund Issuers: Mutual funds issue units to pool investor money for investments.

Investor Types: Retail, institutional, and foreign portfolio investors participate in primary markets.

Retail Investors: Individuals investing personal funds in primary issues.

Institutional Investors: Large organizations with specialized investment strategies.

Foreign Portfolio Investors: FPIs invest foreign capital in Indian securities markets.

Regulatory Framework: SEBI's ICDR Regulations, 2018, govern primary market issuances.

SEBI ICDR Regulations: Specify eligibility, disclosures, and processes for public and rights issues.

Listing Agreement: Companies must provide continuous disclosures post-listing.

Public Issue Pricing: Fixed price or book-building determines share prices.

Book Building Process: Demand is assessed to set the price and quantity of securities.

Price Band: A range within which investors bid in book-building issues.

Prospectus Definition: A document detailing issue terms and company information.

Red Herring Prospectus: A preliminary prospectus filed before final pricing.

Application Process: Investors apply via ASBA, blocking funds in bank accounts.

ASBA Facility: Application Supported by Blocked Amount ensures funds are blocked, not debited.

Allotment Process: Shares are allotted based on demand and issue terms.

Oversubscription: Excess applications lead to proportional or lottery-based allotments.

Listing of Shares: Shares are listed on stock exchanges post-issue for trading.

Listing Benefits: Listing enhances liquidity and investor confidence.

Rights Issue Definition: New shares offered to existing shareholders at a fixed ratio.

Rights Issue Process: Streamlined process with shorter timelines than public issues.

Debt Public Issues: Governed by SEBI's Non-Convertible Securities Regulations, 2021.

Debt Issue Process: Involves prospectus filing, credit ratings, and listing.

Private Placements: Securities issued to select investors, not the public.

QIP Definition: Qualified Institutions Placement targets institutional investors.

Preferential Issue: Securities issued to specific investors at preferential terms.

Green Shoe Option: Allows excess share allotment for price stabilization post-listing.

Regulatory Compliance: Issuers must comply with SEBI and Companies Act requirements.

Disclosure Requirements: Detailed financial and operational disclosures ensure transparency.

Investor Protection: SEBI mandates fair treatment and timely information for investors.

Issue Expenses: Include underwriting, legal, and marketing costs borne by issuers.

Lead Managers: Merchant bankers appointed as lead managers oversee the issue.

Firm Allotment: Reserved shares for institutions or employees in public issues.

Lock-in Periods: Promoters' shares may be locked in post-IPO to ensure commitment.

Underwriting Agreement: Underwriters commit to buying unsold shares for a fee.

Credit Rating Mandate: Debt issues require ratings to assess default risk.

Shelf Prospectus: Allows multiple tranches of debt issues under one prospectus.

Tranche Prospectus: Details specific debt issue terms under a shelf prospectus.

Application Limits: SEBI sets UPI limits for retail investors in public issues.

Rights Issue Streamlining: SEBI simplified rights issue processes for efficiency.

Private Placement Benefits: Faster and less regulated than public issues.

QIP Advantages: QIPs allow quick capital raising from institutional investors.

Regulatory Relaxations: SEBI may relax norms for specific issues, except KYC/AML.

Investor Categories: Issues allocate shares to retail, non-institutional, and institutional investors.

Bidding Process: Investors bid within price bands in book-building issues.

Allotment Advice: Notifies successful applicants of their share allocation.

Listing Obligations: Listed companies must comply with continuous disclosure norms.

Rights Issue Pricing: Typically lower than market price to attract shareholders.

Debt Issue Regulations: SEBI's 2021 regulations streamline non-convertible securities issuance.

Public Issue Timeline: Involves offer period, allotment, and listing stages.

Investor Eligibility: Specific criteria apply to retail and institutional investors.

SEBI Oversight: Ensures fair pricing and allocation in primary issues.

Capital Expenditure: Funds raised often finance projects like infrastructure or machinery.

Non-Convertible Debentures: NCDs offer fixed returns without equity conversion.

Issue Documentation: Includes offer documents, applications, and disclosures.

Market Accessibility: Primary markets provide access to diverse investment opportunities.

Investor Education: SEBI promotes awareness for informed primary market participation.

Price Stabilization: Green shoe options stabilize post-listing share prices.

Regulatory Sandbox Impact: FinTech innovations may streamline primary market processes.

Chapter 4: Secondary Markets

Secondary Market Role: Facilitates trading of issued securities, ensuring liquidity.

Market Structure: Comprises stock exchanges, brokers, and clearing corporations.

Stock Exchanges: Platforms like NSE and BSE enable security trading.

Types of Secondary Markets: Equity, debt, and derivatives markets operate separately.

Market Participants: Include brokers, AMCs, FPIs, and individual investors.

Brokers Role: Brokers execute trades on behalf of clients, earning commissions.

Client Acquisition: Brokers onboard clients through KYC and account opening.

Trade Execution: Orders are matched electronically on exchange platforms.

Order Types: Include market, limit, stop-loss, and immediate-or-cancel orders.

Clearing and Settlement: Clearing corporations ensure trade settlement and risk management.

T+1 Settlement: Trades settle one day after execution, per SEBI’s 2021 circular.

Clearing Members: Handle settlement of funds and securities for trades.

Depositories Role: Depositories like NSDL and CDSL hold securities in demat form.

Depository Participants: DPs facilitate investor transactions in dematerialized securities.

Custodians Role: Custodians manage securities and accounts for institutional investors.

Market Makers: Market makers provide liquidity by quoting bid and ask prices.

Liquidity Provision: Secondary markets allow quick conversion of securities to cash.

Price Discovery: Trading determines fair market prices for securities.

Risk Management: Includes capital adequacy, margins, and position limits.

Margin Requirements: Initial and exposure margins ensure trade settlement.

Position Limits: Caps on open positions prevent excessive market risk.

Investor Grievance Redressal: SEBI mandates mechanisms like SCORES for dispute resolution.

Trading Hours: Equity markets operate from 9:15 AM to 3:30 PM on weekdays.

Trading Holidays: Exchanges announce holidays when trading is closed.

Screen-Based Trading: Electronic systems replaced open outcry for efficiency.

Direct Market Access: Institutional investors place orders directly on exchanges.

Block Trading: Large portfolio transactions occur in block deals.

Bulk Deal: Transactions exceeding 0.50% of a company's equity shares.

Circuit Breakers: Trading halts if indices move beyond specified limits.

Market Information: Exchanges provide price, volume, and other trading data.

Regulatory Oversight: SEBI monitors trading to prevent manipulation and fraud.

Insider Trading Prevention: SEBI enforces codes to curb insider trading.

Interoperability: Clearing corporations settle trades across exchanges.

Securities Lending: Exchanges offer platforms for borrowing and lending securities.

Rolling Settlement: Trades settle within a fixed period, typically T+1.

Trade Confirmation: Brokers issue contract notes detailing trade specifics.

Co-location: Trading servers near exchange servers reduce latency.

High-Frequency Trading: Algorithms execute rapid trades for profit.

Market Depth: Indicates the volume of securities available at best prices.

Bid-Ask Spread: Difference between buying and selling prices affects liquidity.

Churning: Excessive trading by brokers to earn commissions is unethical.

Circular Trading: Fraudulent trading to manipulate prices is prohibited.

Clearing Corporation Role: Acts as a central counterparty to all trades.

Settlement Date: Date when securities and funds are exchanged post-trade.

Investor Protection: SEBI ensures fair treatment and timely grievance redressal.

Market Surveillance: Exchanges monitor trading to detect unfair practices.

Trading Member: Members execute trades on exchanges for clients or themselves.

Brokerage Fees: Commissions charged by brokers for trade execution.

Contract Note: Documents trade details, including price and quantity.

Risk Monitoring: Exchanges track positions to prevent settlement failures.

Margin Collection: Brokers collect upfront margins from clients per SEBI rules.

Debt Market Trading: Debt securities trade on platforms like NSE's RFQ.

RBI Retail Direct: Retail investors access government securities via RBI's platform.

Corporate Bond Trading: RFQ platform facilitates transparent bond trading.

Arbitration Mechanism: Stock exchanges provide arbitration for dispute resolution.

Online Dispute Resolution: SEBI's 2023 circular enables online grievance redressal.

Market Volatility: Circuit breakers curb excessive price swings.

Trading Volume: High volumes indicate active markets and liquidity.

Price Movements: Secondary markets reflect real-time price changes.

Investor Confidence: Liquidity and transparency boost market participation.

Regulatory Compliance: Brokers and exchanges adhere to SEBI's code of conduct.

Electronic Trading: Online platforms enhance accessibility and efficiency.

Clearing Bank: Designated banks handle settlement payments for trades.

Trade Matching: Exchanges ensure buy and sell orders align correctly.

Investor Services: Brokers offer research and recommendations to clients.

Market Indicators: Open interest and trading volume signal market health.

SEBI Circulars: Guide operational and compliance aspects of trading.

Liquidity Risk: Illiquid securities may face price or sale challenges.

Market Access: Brokers provide retail investors access to secondary markets.

Corporate Actions: Adjustments like dividends impact trading prices.

Investor Education: SEBI promotes awareness for informed trading decisions.

Technology Impact: FinTech innovations streamline trading processes.

Risk Management Systems: Ensure market stability through margins and limits.

Secondary Market Benefits: Enhance liquidity, price discovery, and investor flexibility.

Chapter 5: Mutual Funds

Mutual Fund Definition: A mutual fund pools investor money to invest in securities per stated objectives.

Mutual Fund Structure: Comprises sponsors, trustees, AMCs, and custodians.

Sponsors Role: Sponsors establish mutual funds and appoint trustees.

Trustees Role: Trustees ensure AMCs act in investors' best interests.

AMC Role: AMCs manage fund investments and daily operations.

Custodians Role: Custodians hold fund securities and assets securely.

Open-Ended Funds: Allow continuous buying and selling at NAV.

Closed-Ended Funds: Have fixed maturity and trade on exchanges.

NAV Definition: Net Asset Value is the per-unit value of a fund's assets minus liabilities.

Types of Funds: Include equity, debt, hybrid, and solution-oriented funds.

Equity Funds: Invest primarily in stocks for capital appreciation.

Debt Funds: Focus on fixed-income securities for stable returns.

Hybrid Funds: Combine equity and debt for balanced risk-return.

Solution-Oriented Funds: Target specific goals like retirement or education.

Active Management: Fund managers aim to outperform benchmarks.

Passive Management: Funds track indices, minimizing active decisions.

Index Funds: Track specific market indices like Nifty 50.

ETFs: Exchange-traded funds trade like stocks and track indices.

Systematic Transactions: Include SIPs, SWPs, and STPs for disciplined investing.

SIP Definition: Systematic Investment Plan allows regular, fixed investments.

SWP Definition: Systematic Withdrawal Plan provides periodic payouts.

STP Definition: Systematic Transfer Plan shifts funds between schemes.

Mutual Fund Benefits: Offer diversification, professional management, and liquidity.

Costs of Investing: Include expense ratios, exit loads, and transaction fees.

Expense Ratio: Total annual cost of managing a fund, expressed as a percentage.

Exit Load: Fee charged on redeeming units within a specified period.

Mutual Fund Regulations: SEBI's 1996 regulations ensure transparency and investor protection.

Investor Services: AMCs provide account statements and grievance redressal.

KYC Compliance: Investors complete KYC for mutual fund investments.

Fund Categories: SEBI categorizes funds for uniformity, e.g., large-cap, mid-cap.

Large-Cap Funds: Invest in top 100 companies by market capitalization.

Mid-Cap Funds: Focus on 101st to 250th companies by market cap.

Small-Cap Funds: Invest in companies ranked 251st onwards by market cap.

ESG Funds: Focus on environmental, social, and governance factors.

Fund Performance: Measured by returns, risk-adjusted metrics, and benchmarks.

Risk in Mutual Funds: Includes market, credit, and liquidity risks.

Return Potential: Varies by fund type, with equity funds offering higher returns.

Fund Selection: Based on goals, risk tolerance, and investment horizon.

Offer Document: Includes SID, SAI, and KIM for fund details.

SID Definition: Scheme Information Document details fund objectives and terms.

SAI Definition: Statement of Additional Information provides AMC details.

KIM Definition: Key Information Memorandum summarizes scheme details.

Fund Factsheet: Monthly reports on portfolio, performance, and expenses.

Dividend Option: Renamed as IDCW (Income Distribution cum Capital Withdrawal).

Growth Option: Reinvests earnings for capital appreciation.

Redemption Process: Investors redeem units at NAV, subject to exit loads.

Switch Transactions: Allow moving investments between fund schemes.

Liquidity in Funds: Open-ended funds offer daily liquidity at NAV.

Taxation: Capital gains and dividends are taxed based on holding period.

Long-Term Capital Gains: Taxed at lower rates for longer holdings.

Short-Term Capital Gains: Higher tax rates apply to shorter holdings.

Portfolio Disclosure: Funds disclose holdings monthly for transparency.

Benchmark Comparison: Fund performance is compared to relevant indices.

Riskometer: Indicates fund risk level, from low to very high.

Investor Charter: SEBI mandates disclosure of complaints and investor rights.

Voting by AMCs: AMCs must vote on shareholder resolutions per SEBI rules.

Cut-Off Timings: Determine NAV applicability for transactions.

Liquid Funds: Invest in short-term securities with high liquidity.

Overnight Funds: Invest in securities maturing in one day for safety.

Passive Fund Growth: SEBI encourages passive funds like ETFs for low costs.

Silver and Gold ETFs: Track precious metal prices, offering diversification.

NFO Process: New Fund Offers allow initial subscriptions to new schemes.

ASBA in NFOs: Extended to mutual fund NFOs for blocked funds.

Fund Manager Role: Makes investment decisions aligned with fund objectives.

Investor Education: AMCs promote awareness for informed investing.

Grievance Redressal: SEBI's SCORES platform resolves investor complaints.

Fund Diversification: Reduces risk by investing across securities and sectors.

Performance Metrics: Sharpe ratio and alpha measure risk-adjusted returns.

Fund Expenses: Impact net returns and vary by fund type.

Regulatory Oversight: SEBI ensures AMCs adhere to investor protection norms.

Systematic Plans: Discipline investing and withdrawal for financial planning.

Fund Ratings: Independent agencies rate funds based on performance and risk.

Investor Protection: SEBI mandates timely disclosures and fair practices.

Fund Transparency: Regular updates on NAV, portfolio, and expenses.

Market Linkage: Mutual funds link retail investors to securities markets.

Cost Efficiency: Passive funds offer lower costs than active funds.

Investment Flexibility: Funds cater to diverse goals and risk profiles.

Regulatory Updates: SEBI's amendments enhance mutual fund governance.

Investor Accessibility: Online platforms simplify mutual fund investments.

Chapter 6: Derivatives Markets

Derivatives Definition: Derivatives derive value from underlying assets like stocks or indices.

Underlying Assets: Include equities, indices, commodities, and currencies.

Derivative Types: Futures, options, forwards, and swaps are common derivatives.

Futures Contracts: Standardized agreements to buy/sell assets at a future date.

Options Contracts: Give the right, not obligation, to buy/sell at a strike price.

Forwards: Customized, non-exchange-traded contracts between two parties.

Swaps: Agreements to exchange cash flows based on underlying assets.

Derivative Markets Structure: Comprises exchange-traded and over-the-counter markets.

Exchange-Traded Derivatives: Standardized contracts traded on exchanges like NSE.

OTC Derivatives: Customized contracts traded directly between parties.

Hedging Purpose: Derivatives protect against price volatility in underlying assets.

Speculation Purpose: Derivatives allow betting on price movements without holdings.

Arbitrage Purpose: Exploits price differences across markets for profit.

Trading Process: Derivatives trade on exchange platforms with specified timings.

Settlement Process: Involves daily mark-to-market and final settlement on expiry.

Daily Settlement: Futures settle daily based on the weighted average price.

Final Settlement: Futures settle at the underlying's closing price on expiry.

Options Settlement: Premiums settle daily; exercised options settle at strike price.

European Options: Exercised only on expiry date, common in India.

American Options: Can be exercised anytime before expiry, not traded in India.

Strike Price: Fixed price at which options can be exercised.

Premium in Options: Price paid for the option contract.

Trading Lot: Minimum contract size, ensuring value exceeds Rs. 5 lakhs.

Price Step: Minimum price movement for futures and options is Re. 0.05.

Expiry Dates: Futures and options expire on the last Thursday of the month.

Trading Cycle: Includes near, next, and far month contracts for trading.

Order Types: Include regular lot, stop-loss, and immediate-or-cancel orders.

Corporate Action Adjustments: Exchanges adjust prices for dividends, splits, etc.

Clearing Members: TM-CMs, PCMs, and SCMs handle trade settlements.

Risk Management: Involves capital adequacy, margins, and position limits.

Capital Adequacy: Members maintain base capital and liquid net worth.

Initial Margin: Covers potential losses over a two-day horizon.

Exposure Margin: Based on the notional value of open positions.

Premium Margin: Collected on option premiums until settlement.

Assignment Margin: Levied for option exercise settlement obligations.

Position Limits: Caps on open positions to prevent settlement risks.

Online Monitoring: Exchanges track positions in real-time to ensure compliance.

Hedging Strategy: Uses derivatives to offset losses in underlying assets.

Speculative Risk: Speculation involves high risk due to leverage and volatility.

Arbitrage Benefits: Exploits price differences for risk-free profits.

Open Interest: Measures outstanding contracts, indicating market liquidity.

Put-Call Ratio: Ratio of put to call options signals market sentiment.

Market Liquidity: High open interest relative to volume reduces trading costs.

Counterparty Risk: Mitigated by clearing corporations in futures and options.

Clearing Corporation Role: Acts as a counterparty to ensure trade settlement.

Trading Hours: Derivatives trade from 9:15 AM to 3:30 PM on weekdays.

Margin Collection: SEBI mandates upfront margin collection from clients.

Price Band: Options have daily price bands set by exchanges.

Base Price: Theoretical price at contract introduction, using MIBOR.

Settlement Price: Weighted average of last 30 minutes for daily MTM.

Clearing Bank: Handles settlement payments for clearing members.

Risk of Default: Margins and capital requirements reduce default risks.

Derivative Benefits: Enable hedging, enhance liquidity, and improve price discovery.

Derivative Costs: High leverage increases potential losses.

Market Indicators: Open interest and PCR provide insights into market trends.

Futures Pricing: Based on underlying price and implied interest costs.

Option Premiums: Determined by market demand and underlying volatility.

Trading Volume: High volumes indicate active derivative markets.

Liquidity Impact: Derivatives increase underlying market liquidity.

Regulatory Oversight: SEBI regulates derivatives to prevent manipulation.

Position Monitoring: Alerts prevent breaches of position limits.

Margin Penalties: Non-payment of margins leads to trading restrictions.

Hedging Example: Investors use futures to lock in prices for portfolios.

Speculation Example: Traders buy futures expecting price rises.

Arbitrage Example: Buying low in one market and selling high in another.

Market Sentiment: PCR indicates bullish or bearish market views.

Exchange Rules: Define contract specifications and trading protocols.

Risk Management Tools: Margins and limits ensure market stability.

Derivative Accessibility: Retail and institutional investors trade derivatives.

Trading Platforms: Electronic systems facilitate efficient derivative trading.

Settlement Efficiency: T+1 settlement reduces counterparty risks.

Investor Protection: SEBI ensures fair practices in derivatives markets.

Market Volatility: Derivatives amplify price movements due to leverage.

Regulatory Updates: SEBI's circulars enhance derivative market governance.

Investor Education: Awareness programs promote informed derivative trading.

Important Formulae

Net Asset Value (NAV): NAV = (Total Assets - Total Liabilities) / Number of Units Outstanding

Yield to Maturity (YTM): YTM = [C + (F - P) / n] / [(F + P) / 2], where C = Coupon Payment, F = Face Value, P = Price, n = Years to Maturity

Dividend Yield: Dividend Yield = Annual Dividend per Share / Current Share Price

Price-Earnings Ratio (P/E): P/E = Share Price / Earnings per Share

Book Value per Share: Book Value per Share = Total Equity / Number of Shares Outstanding

Initial Margin (Futures): Initial Margin = VaR-based estimate of potential loss over 2-day horizon

Exposure Margin (Futures): Exposure Margin = Percentage of Notional Contract Value

Put-Call Ratio (PCR): PCR = Number of Put Options Outstanding / Number of Call Options Outstanding

Bond Duration: Duration = Σ [t * Ct / (1 + YTM)^t] / P, where t = Time, Ct = Cash Flow, P = Bond Price

Market Capitalization: Market Capitalization = Number of Shares Outstanding * Current Market Price

IMPORTANT NOTE :

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

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All the Best ☺

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