KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed to be University)

(Established Under Section 3 of UGC Act 1956)

Coimbatore – 641 021.

Syllabus

Semester V

		L	T	P	C
16BPU501A	**BUSINESS PROCESS SERVICES IN CAPITAL MARKET**	**6**	**2**	**-**	**6**

Scope

Capital markets for BPS covers kinds of securities, investment banking, mutual funds and risk management. This paper provides knowledge regarding the securities market, investment options, fundamentals of investments and securities.

Objectives

- To familiarize the students in understanding the scope of investment.
- To acquaint them with the stock markets operations.
- To make them understand the various aspects of investment.

Unit I

Securities : Types of Securities – Equities – Fixed income & Government Securities – Derivatives – OTC Products – participants in a Trade & Global Financial Market s – Financial Markets – Exchange - OTC Products – participants in a Trade – Overview of regulators & Important regulations.

Unit II

Investment Banking : Basics of investment banking – Trade Life Cycle – Clearing and Settlement - Securities Lending – Prime Brokerage – Collateral management - Corporate Actions – Mandatory & Voluntary – Corporate Actions : How they affects Securities.

Unit III

Mutual Funds and Hedging: Mutual funds – transactions in Mutual funds – Fund Expenses - Transfer Agency – Hedge Funds – Understanding Hedge funds – hedge fund strategies.

Unit IV

Private Equity: Private equity – Understanding Private Equity Operations - Fund Accounting & NAV Calculations - Performance reporting – Reconciliations in Asset Management.

Unit V

Risk Management: Counterparty Credit Risk Management – Market Risk Management.

Suggested Readings

Text Book

TCS BPS Study Material

Unit I

Securities : Types of Securities – Equities – Fixed income & Government Securities – Derivatives – OTC Products – participants in a Trade & Global Financial Market s – Financial Markets – Exchange - OTC Products – participants in a Trade – Overview of regulators & Important regulations.

Investment

Investment In finance, the purchase of a financial product or other item of value with an expectation of favorable future returns. In general terms, investment means the use money in the hope of making more money.

Investment can be defined in different aspects. These are: Generally, investment is the application of money for earning more money. Investment also means savings or savings made through delayed consumption. In Finance, the purchase of a financial product or other item of value with an expectation of favorable future returns. the practice of investment refers to the buying of a financial product or any valued item with an anticipation that positive returns will be received in the future. In Business, the purchase by a producer of a physical good, such as durable equipment or inventory, in the hope of improving future business.

Investment is defined as a sacrifice made now to obtain a return later. It is current consumption that is sacrificed. Two forms of investment can be defined} ◦ Real investment is the purchase of land, machinery, etc. ◦ Financial investment is the purchase of a "paper" contract

Nature and Scope of Investment

- It helps in making investment decisions. Higher the risk, higher the expected return. One can take decision only after analyzing entire process of investment that starts with fund contribution and ends with getting expectations fulfilled. Higher the time period of investment, lesser the uncertainties of investment.
- Cash has an investment opportunity when you decide to invest it you are deprived of this opportunity to earn a return on that cash. When the general price level rises the purchasing power of cash declines- larger the increase in inflation, the greater the depletion in the buying power of cash. Some investors buy government securities or deposit their money in bank accounts that are adequately secured. In contrast, some others prefer to buy, hold and sell equity shares even when they know that they get exposed to risk.
- Risk is the probability that the actual return on an investment will be different from its expected return. Using this definition of risk, you may} classify various investments into risk categories. Government securities would be seen as} risk free investments because the probability of actual return diverging from expected return is zero.

Factors Influencing Investment Decision

There are many factors which directly or indirectly, influence capital investment decisions, beside the availability of funds to invest, profitability of the investment, market for the product, etc. they are as below:

1. Technological Changes: Technological development changes at present is much more faster than that at past. The new technology increases the productivity of labour and capital. The selection of new technology depends on the net benefit over the cost of having the technology. Benefits from and cost of new technology also influences the investment decision.

2.Competitors' Strategy: If the competitors are installing the new equipment to expand output or to improve of their products, the firm under consideration will have no alternative but to follow suit, else it will be loss. It is therefore, often found that the competitor's strategy regarding capital investment plays a very significant role in forcing capital decision of the firm.

3.Demand Forecast: The long term demand forecast is one of the determinants of investment decision. If the firm finds market potentials for the product in the long run, the firm will have to take decision for investment.

4.Outlook Of Management: Investment decision depends on the management outlook. If the management is progressive in its outlook, the innovations will be encouraged.

5.Fiscal Policy: Various tax policies of the government relating the tax concession on prioritized investment, rebate on new investment, methods allowing depreciation deduction allowance etc. Also have influence on the capital investment.

6.Cash Flow: Every firm makes a cash flow budget. Its analysis influences capital investment decision. On the basis of each cash flow budget the firm plans the funds for acquiring the capital assets. The budget also shows the timing of availibility of cash flows for alternative investment proposals.

7.Expected Return From The Investment: Investment decisions are mostly done anticipation of increased return future. So, it is necessary to estimate future net returns from the investment proposals while evaluating the investment proposals.

8.Non-Economic Factors: The factors which cannot be evaluated in money terms is called non-economic terms or factors. Sometime the non-economic factors also influence investment decisions. Working environment in the firm, safety measures in the operation of machines, brotherhood and good relation among employer and employees, etc. influences the firm's output and also the investment decision

INVESTMENT AND SPECULATION

• Investment involves making a sacrifice of in the present with the hope of deriving future benefits.

• Postponed consumption

• The two important features are : – Current Sacrifice. – Future Benefits.

It also involves putting money into an asset which is not necessarily marketable in the short run in order to enjoy the series of returns the investment is expected to yield.

• People who make fortunes in stock market and they are called investors.

• Decision making is a well thought process.• Key determinant of investment process: – Risk – Expected Return.

Speculation

• Speculation is a financial action that does not promise safety of the initial investment along with the return on the principal sum.

• Its is usually short run phenomenon.

• Speculator the person tend to buy the assets with the expectation that a profit cane earned from subsequent price change and sale.

The main difference between speculating and investing is the amount of of risk undertaken in the trade. Typically, high-risk trades that are almost akin to gambling fall under the umbrella of speculation, whereas lower-risk investments based on fundamentals and analysis fall into the category of investing. Investors seek to generate a satisfactory return on their capital by taking on an average or below-average amount of risk. On the other hand, speculators are seeking to make abnormally high returns from bets that can go one way or the other. It should be noted that speculation is not exactly like gambling because speculators do try to make an educated decision on the direction of the trade, but the risk inherent in the trade tends to be significantly above average.

As an example of a speculative trade, consider a volatile junior gold mining company that has an equal chance over the near term of skyrocketing from a new gold mine discovery or going bankrupt. With no news from the company, investors would tend to shy away from such a risky trade, but some speculators may believe that the junior gold mining company is going to strike gold and may buy its stock on a hunch. This would be speculation.

As an example of investing, consider a large stable multinational company. The company may pay a consistent dividend that increases annually, and its business risk is low. An investor may choose to invest in this company over the long-term to make a satisfactory return on his or her capital while taking on relatively low risk. Additionally, the investor may add several similar companies across different industries to his or her portfolio to diversify and further lower their risk.

The Investment Process

As investors, we would all like to beat the market handily, and we would all like to pick "great" investments on instinct. However, while intuition is undoubtedly a part of the process of investing, it is just part of the process. As investors, it is not surprising that we focus so much of our energy and efforts on investment philosophies and strategies, and so little on the investment process. It is far more interesting to read about how Peter Lynch picks stocks and what makes Warren Buffett a valuable investor, than it is to talk about the steps involved in creating a portfolio or in executing trades. Though it does not get sufficient attention, understanding the investment process is critical for every investor for several reasons:

1. The investment process outlines the steps in creating a portfolio, and emphasizes the sequence of actions involved from understanding the investor?s risk preferences to asset allocation and selection to performance evaluation. By emphasizing the sequence, it

provides for an orderly way in which an investor can create his or her own portfolio or a portfolio for someone else.

1. The investment process provides a structure that allows investors to see the source of different investment strategies and philosophies. By so doing, it allows investors to take the hundreds of strategies that they see described in the common press and in investment newsletters and to trace them to their common roots.
1. The investment process emphasizes the different components that are needed for an investment strategy to by successful, and by so doing explain why so many strategies that look good on paper never work for those who use them.

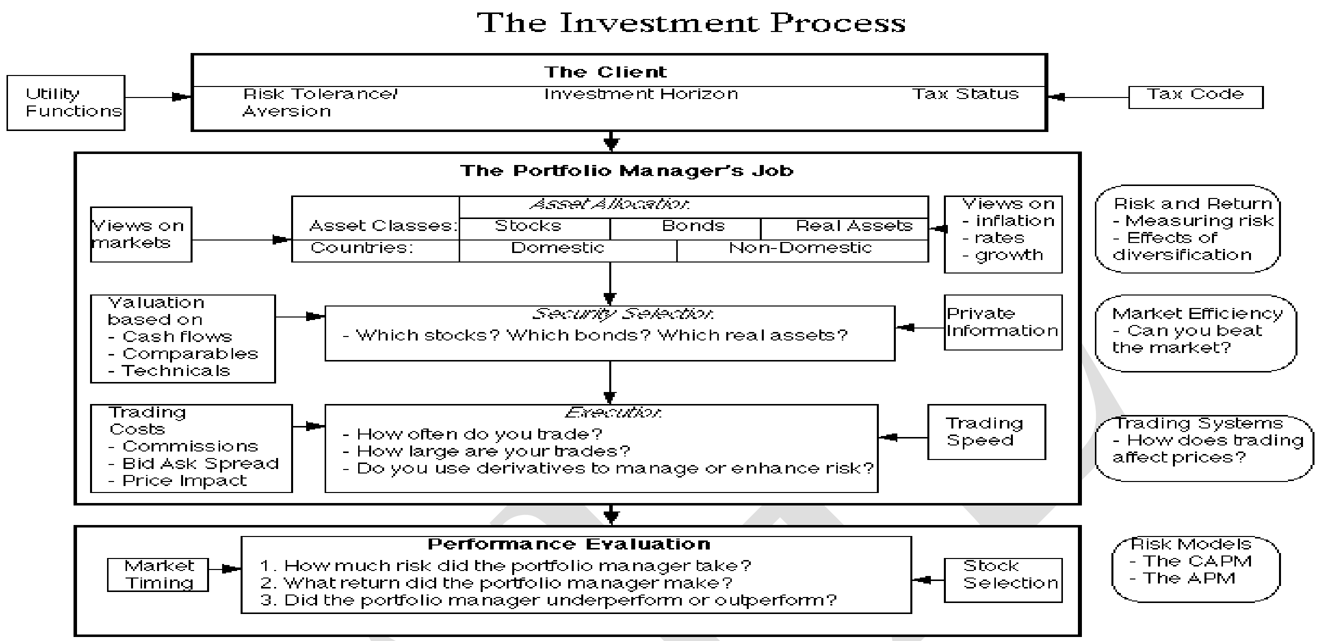
The best way of describing this book is by noting what it does not do. It does not emphasize individual investors or push an investment philosophy. It does not focus heavily on coming up with strategies that beat the market, though there is reference to some of them in the course of the book. Instead, it talks about the process of investing and how this process is the same no matter what investment philosophy one might have.

The book is built around the investment process. The process always starts with the investor and understanding his or her needs and preferences. For a portfolio manager, the investor is a client, and the first and often most significant part of the investment process is understanding the client?s needs, the clients tax status and most importantly, his or her risk preferences. For an individual investor constructing his or her own portfolio, this may seem simpler, but understanding one?s own needs and preferences is just as important a first step as it is for the portfolio manager.

The next part of the process is the actual construction of the portfolio, which we divide into three sub-parts. The first of these is the decision on how to allocate the portfolio across different asset classes defined broadly as equities, fixed income securities and real assets (such as real estate, commodities and other assets). This asset allocation decision can also be framed in terms of investments in domestic assets versus foreign assets, and the factors driving this decision. The second component is the asset selection decision, where individual assets are picked within each asset class to make up the portfolio. In practical terms, this is the step where the stocks that make up the equity component, the bonds that make up the fixed income component and the real assets that make up the real asset component are picked. The final component is execution, where the portfolio is actually put together, where investors have to trade off transactions cost against transactions speed. While the importance of execution will vary across investment strategies, there are many investors who have failed at this stage in the process.

The final part of the process, and often the most painful one for professional money managers, is the performance evaluation. Investing is after all focused on one objective and one objective alone, which is to make the most money you can, given the risk constraints you operate under. Investors are not forgiving of failure and unwilling to accept even the best of excuses, and loyalty to money managers is not a commonly found trait. By the same token, performance evaluation is just as important to the individual investor who constructs his or her own portfolio, since the feedback from it should largely determine how that investor approaches investing in the future.

These parts of the process are summarized in Figure 1, and we will return to this figure to emphasize the steps in the process as we move through the book. The book is built around the same structure. It begins with a chapter that provides an overview of investment management as a business. The first major section is on understanding client needs and preferences, where we look at not only how to think about risk in investing but also at how to measure an investor?s willingness to take risk. The second section looks at the asset allocation decision, while the third section examines different approaches to selecting assets. The fourth section takes a brief look at the execution decision, and the fifth section develops different approaches to evaluating performance.



Securities

A security is a fungible, negotiable financial instrument that holds some type of monetary value. It represents an ownership position in a publicly-traded corporation (via stock), a creditor relationship with a governmental body or a corporation (represented by owning that entity's bond), or rights to ownership as represented by an option.

Types of Securities

Securities can be broadly categorized into two distinct types: equities and debts.

- An equity security represents ownership interest held by shareholders in an entity (a company, partnership or trust), realized in the form of shares of capital stock, which includes shares of both common and preferred stock. Holders of equity securities are typically not entitled to regular payments (though equity securities often do pay out dividends), but they are able to profit from capital gains when they sell the securities (assuming they've increased in value, naturally). Equity securities do entitle the holder to some control of the company on a pro rata basis, via voting rights. In the case of bankruptcy, they share only in residual interest after all obligations have been paid out to creditors.

- A debt security represents money that is borrowed and must be repaid, with terms that stipulates the size of the loan, interest rate and maturity or renewal date. Debt securities, which include government and corporate bonds, certificates of deposit (CDs) and collateralized securities (such as CDOs and CMOs), generally entitle their holder to the regular payment of interest and repayment of principal (regardless of the issuer's performance), along with any other stipulated contractual rights (which do not include voting rights). They are typically issued for a fixed term, at the end of which they can be redeemed by the issuer. Debt securities can be secured (backed by collateral) or unsecured, and, if unsecured, may be contractually prioritized over other unsecured, subordinated debt in the case of a bankruptcy.

Hybrid Securities

Hybrid securities, as the name suggests, combine some of the characteristics of both debt and equity securities. Examples of hybrid securities include equity warrants (options issued by the company itself that give shareholders the right to purchase stock within a certain timeframe and at a specific price), convertible bonds (bonds that can be converted into shares of common stock in the issuing company) and preference shares (company stocks whose payments of interest, dividends or other returns of capital can be prioritized over those of other stockholders).

Although preferred stock is technically an equity security, it's often treated as a debt security, because it "behaves like a bond": It offers a fixed dividend rate and is a popular instrument for income-seeking investors. It is essentially fixed-income security.

Role of Securities

The entity that creates the securities for sale is known as the issuer, and those that buy them are, of course, investors. Generally, securities represent an investment and a means by which municipalities, companies and other commercial enterprises can raise new capital. Companies can generate a lot of money when they go public, selling stock in an initial public offering (IPO), for example. City, state or county governments can raise funds for a particular project by floating a municipal bond issue. Depending on an institution's market demand or pricing structure, raising capital through securities can be a preferred alternative to financing through a bank loan.

On the other hand, purchasing securities with borrowed money, an act known as buying on a margin, is a popular investment technique. In essence, a company may deliver property rights, in the form of cash or other securities, either at inception or in default, to pay its debt or other obligation to another entity. These collateral arrangements have been growing of late, especially among institutional investors.

Other Types of Securities

Certificated securities

Certificated securities are those that are represented in physical, paper form. Securities may also be held in the direct registration system, which records shares of stock in book-entry form. In other words, a transfer agent maintains the shares on the company's behalf without the need for physical certificates. Modern technologies and policies have, in some cases, eliminated the need for certificates and for the issuer to maintain a complete security register. A system has developed wherein issuers can deposit a single global certificate representing all outstanding securities into a universal depository known as the Depository Trust Company (DTC). All securities traded through DTC are held in electronic form. It is important to note that certificated and un-certificated securities do not differ in terms of the rights or privileges of the shareholder or issuer.

Bearer Securities

Bearer securities are those that are negotiable and entitle the shareholder to the rights under the security. They are transferred from investor to investor, in certain cases by endorsement and delivery. In terms of proprietary nature, pre-electronic bearer securities were always divided, meaning each security constituted a separate asset, legally distinct from others in the same issue. Depending on market practice, divided security assets can be fungible or (less commonly) non-fungible, meaning that upon lending, the borrower can return assets equivalent either to the original asset or to a specific identical asset at the end of the loan. In some cases, bearer securities may be used to aid tax evasion, and thus can sometimes be viewed negatively by issuers, shareholders and fiscal regulatory bodies alike. They are therefore rare in the United States.

Registered Securities

Registered securities bear the name of the holder and other necessary details maintained in a register by the issuer. Transfers of registered securities occur through amendments to the register. Registered debt securities are always undivided, meaning the entire issue makes up one single asset, with each security being a part of the whole. Undivided securities are fungible by nature. Secondary market shares are also always undivided.

Letter Securities

Letter securities are not registered with the SEC, and therefore cannot be sold publicly in the marketplace. A letter security (also known as a restricted security, letter stock or letter bond) is sold directly by the issuer to the investor. The term is derived from the SEC requirement for an "investment letter" from the purchaser, stating that the purchase is for investment purposes and is not intended for resale.

Cabinet Securities

Cabinet securities are listed under a major financial exchange, such as the NYSE, but are not actively traded. Held by an inactive investment crowd, it's more likely to be a bond than a stock. The "cabinet" refers to the physical place where bond orders were historically stored off of the trading floor. The cabinets would typically hold limit orders, and the orders were kept on hand until they expired or were executed.

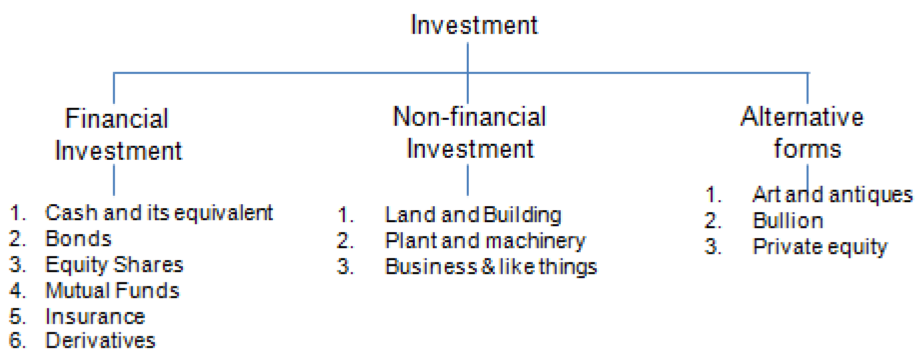
Residual Securities

Residual securities are a type of convertible security – that is, they can be changed into another form, usually that of common stock. A convertible bond, for example, would be a residual security because it allows the bond holder to convert the security into common shares. Preferred stock may also have a convertible feature. Corporations may offer residual securities to attract investment capital when competition for funds is highly competitive.

When the residual security is converted, or exercised, it increases the number of current outstanding common shares. This can dilute the share pool, and their price as well. Dilution also affects financial analysis metrics, such as earnings per share, because a company's earnings now have to be divided by a greater number of shares.

Alternative forms of Investment

Investment alternative refer to those options/instruments that help investor save and invest. These are issued by various banks, financial institutions, stock brokerages, insurance providers, credit card agencies and government sponsored entities. These instruments are categorized in terms of their volatility, risk, liquidity and return.



The various investment options available to an investor are -

1. Shares

These represent ownership of a company. While shares are initially issued by corporations to finance their business needs, they are subsequently bought and sold by individuals in the share market. They are associated with high risk and high returns. Returns on shares can be in the form of dividend payouts by the company or profits on the sale of shares on the stock market (capital appreciation), Shares, stocks, equities and securities are words that are generally used interchangeably.

There are two types of shares - Equity and preference shares. Preference are those shares which have first preference for payment of dividend and refund of capital in case of winding up. Equity shares are those shares which are not preference shares. Preference shares aren't popular in india. These shares may be cumulative, participating and convertible.

Shares of known and financially sound companies are called Blue chip shares and such companies are blue chip companies because of their market reputation and goodwill that they carry. Investors usually prefer investing in blue chip companies due to the safety and attractive returns.

2. Debentures and Government Bonds

These are issued by companies to finance their business operations and by governments to fund expenses like infrastructure and social programs. A debenture is a document issued by a company as an evidence of debt. Bonds are issued by the government and debentures are issued by the private sector companies. Bonds have a fixed interest rate, making the risk associated with them lower than shares. The face value of bonds is recovered at the time of maturity. Debentures may be convertible or non-convertible. If a debenture is convertible into shares at maturity, it is called convertible. Convertible Debentures may be partly or fully convertible.

However the method of raising long term funds through debentures is not very popular in India.

3. Treasury Bills

These are instruments issued by the government for financing short term needs. They are issued at a discount and redeemed at face value. The profit earned is the difference between face value and the price at which the T-bill was issued. It is highly liquid because of the repayment guaranteed by the Government. There are two types of t-bills i.e. regular and ad-hoc (ad- hoc are issued in favour of RBI only). T-bills have maturity period of 91 days or 182 days or 364 days. State Governments do not issue T-bills.

4. Bank Deposits

These are low risk and low-medium return investments. In India, people trust the banking system more than the stock markets with their money. There are various types of deposits: *Savings* , *Recurring , Current and Fixed*. Savings a/c's give a return from 3-6% pre-tax. Current a/c's are for businessmen and generate no returns. Fixed deposits generate a return from 7-12% pre-tax.

5. Mutual Fund

These are professionally managed financial instruments that involve the diversification of investment into a number of financial products such as shares, bonds and government securities. This helps to reduce an investor's risk exposure, while increasing the profit potential. There are open-ended and close- ended funds.

6. Certificate of Deposit

Certificates of deposit (CDs) are issued by banks, thrift institutions and credit unions. They usually have a fixed term and fixed interest rate.

7. Annuities

These are contracts between investors and insurance companies, wherein the latter makes periodic payments in exchange for financial protection in the event of an unfortunate incident.

8. Derivatives

This includes futures, options, swaps, etc. It is a contract or agreement between two entities to buy or sell the underlying asset at a future date, at today's pre-agreed price.

Futures

A futures contract is an agreement between two parties to buy or sell the underlying asset at a future date at today's future price. Futures contracts differ from forward contracts in the sense that they are standardised and exchange traded. They are exchange-traded. They are standardised. The parties have to deposit certain initial margin (small percentage of the trade amount). They are highly regulated and are liquid. As a result, eliminate the counter-party risk.

Options

An option gives the holder of the option the right to do something. The holder does not have to exercise this right. However for this right the holder pays a price, known as the option premium. The writer of the option receives this premium. There are two types of options - *Call* and *Put*.

9. Real Estate

Investment in real estate include properties like buildings, lands, farm houses, flats or houses. Such properties attract the attention of affluent investors. As the demand increases but the supply of land is limited, the prices tend to increase. Therefore, it is an attractive form of investment but is the most illiquid asset. It is a long term investment, requires payment of stamp duty and a lot of legal formalities along with registration. SEBI has recently come out with guidelines for introduction and functioning of Real Estate Investment Trust (REIT) in the Indian real estate market. Once introduced these REITs will benefit retail investors the most. REIT is a trust which issues real estate in the form of units as a result even a small investors can benefit from capital appreciation, these are liquid and exchange traded.

10. Insurance

When talking about insurance, Life insurance is a kind of investment because it provides family protection to the investor as well as return on investment in he form of yearly bonus on the policy. The return is as low as 6% because of the risk coverage and tax incentives. The amount of premium paid on a life insurance policy is exempt u/s 80C of Income-Tax Act. There are different policies such as whole life policy, endowment policy, money back policy, etc.

11. Gold and silver

They are also called as precious metals or objects. Everybody likes gold and hence requires gold or silver. These two precious metals are used for making ornaments and they hold an emotional value in India. In India, investment in gold is more psychological than calculated, many individuals think that gold is an investment which can never give negative returns. They act as a store of wealth. Gold bars are highly liquid and can be easily sold anytime. The pricing depends on the purity of the objects. The risk faced is of theft and fraud. India is the largest consumers of gold in the world followed by china at the second position. India accounts for about 20 percent of global demand. Recently in India, Gold Exchange Traded Funds (ETF's) were launched which made it easier for individuals to own gold in electronic format. It is less costly, high liquidity and guarantees purity to the investors.

12. Alternative investments

They include investments made in arts, antiques, etc. These investments are not in the form of traditional investments i.e. not availed by the masses. They were availed only by the High Net Worth clients in the past are now availed by retail investors. They are in the form of paintings or their equivalent holding some historic value or just as a hobby. They may fetch good returns if one finds a buyer who is either a huge fan of the artists' work, or is an archaeologist. These works are usually kept in museums or halls.

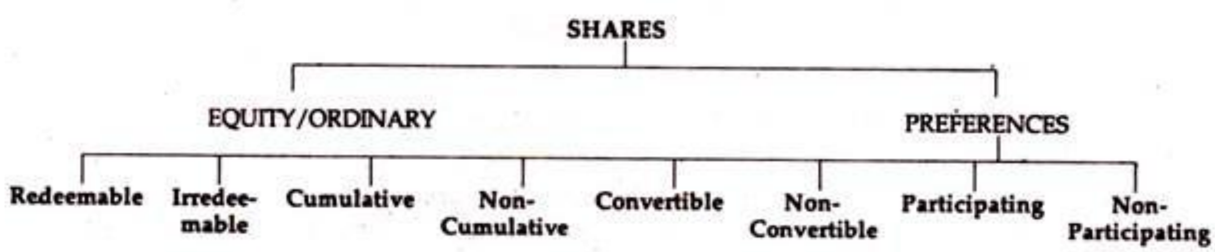
Definition of Shares:

Share may be defined as an interest in the company entitling the owner thereof to receive proportionate part of the profits, if any, and, at the' same time, proportionate part of the assets of the company in case of liquidation.

It can also be expressed as certain invisible units of a fixed amount, i.e., the units are known as 'shares'. It is the interest of a shareholder in the company measured, by a sum of money for the purpose of liability in the first place, and of interest in the second but also consisting of a series of mutual covenants entered into-by all the shareholders.

It may be defined as "an interest having a money value and made up of diverse rights specified under the Articles of Association." In this context it is needless to mention that it has got certain rights and liabilities when the company is a going concern or the company is being wound-up.

According to Indian Companies Act, 1956, the shares of a company may be divided into the following categories:



Types of Shares:

1. Equity Shares:

The holders of such shares participate in divisible profits only after the claims are met of the preference shareholders, i.e., they actually do not enjoy any preferential right either in respect of dividend or in respect of repayment of capital. They are entitled to receive dividend recommended by the directors and declared by the company in general meeting.

Sec. 85(2) states that equity shares are those shares which are not preference shares. The rights and privileges of equity shareholders are laid down in the articles subject to the provisions of the Act.

Features/Characteristics of Equity Shares:

The characteristics of Equity Shares are:

(a) It does not have any maturity date.

(b) It does not saddle the company with a legal requirement about the payment of dividend.

(c) Equity share financing relieves the company from certain restrictions given by the preference shareholders or the creditors.

(d) Payment of dividend to issue by shareholders is subject to dividend tax @ 10% as per Income Tax Act, 1961.

(e) It enjoys the voting rights.

(f) It enjoys the right to sell or transfer the shares.

(g) It enjoys residual claims on assets of the company.

(h) It has got the right to receive the Annual Report of the company.

(i) It has got the preemptive right to subscribe the issue of additional shares, i.e., Right Shares,

(j) It consists of a part of share capital of the company.

Advantages of Equity Share Financing:

(i) No mandatory payment of dividend to shareholders:

Equity share capital does not involve any mandatory payment to the shareholder by way of dividend. It depends on the earning capacity of the company.

(ii) Permanent source of fund:

No doubt equity shares are the permanent source of fund as they do not mature. Of course, if the company so desires it can buy-back its share as per the SEBI guidelines.

(iii) Make further issues by way of Right Shares:

Right shares may be issued as a further issue which do not make any change in ownership and control in management.

(iv) Increase corporate flexibility:

It increases corporate flexibility from the standpoint of a planning capital structure.

2. Preference Shares:

Sec. 85(1) notes that a preference share is one which satisfies the following:

a. They have a preferential right to be paid dividend during the lifetime of the company, and

b. They have a preferential right to the return of capital if the company goes into liquidation.

Moreover, the preference shareholders are entitled to receive a fixed rate of dividend before the dividend is received by the equity shareholders in the event of liquidation.

Features/Characteristics of Preference Shares:

The characteristics of Preference Shares are:

(a) It consists of a part of share capital of a company.

(b) Since it is not considered as a debt, no collateral security/mortgage is required.

(c) As per. Sec. 87 of the Companies Act, it enjoys limited voting rights.

(d) It enjoys a fixed rate of dividend.

(e) Preference dividend is a charge against appropriation of profit.

(f) It enjoys a priority income distribution of income and, at the same time, on assets distribution.

(g) It enjoys the cumulative rights to receive dividends.

(h) It is redeemable after the period of 20 years from the date of issue.

(i) It may or may not be converted into equity shares.

(j) It can be transacted (i.e. purchased/sold) through Stock Exchange.

Advantages of Preference Share Financing:

(i) Less Costly than Equity Shares:

The cost of capital of preference shares is found to be less than equity share as a source of financing

(ii) No control and ownership in management:

Usually the preference shareholders do not enjoy any voting rights or enjoy little voting rights, they cannot take part in, or create any problem to, the management.

(iii) Trading on Equity:

If the company can earn a rate of return which is more than the cost of capital of preference shares, it increase the EPS by trading on equity.

(iv) Provides hedge against inflation:

Financing by preference shares may provide a hedge against inflation due to the fixed financial commitment which is not affected by inflations,

(v) No legal compulsion to pay dividend:

A company does not face liquidation or any legal proceedings even if it fails to pay dividend.

Classification of Shares:

1. Redeemable:

These shares are redeemed at the end of the stipulated period. In India, according to Sec. 80 of the Companies Act, 1956, these shares are redeemed either out of fresh issue of equity shares or by creating Capital Redemption Reserve Fund out of Profit and Loss Account and/or General Reserve, a sum equal to the face value of the shares.

But premium on such redemption, if any, is to be adjusted against Share Premium Account and/or Profit and Loss Account.

2. Irredeemable:

These shares are non-refundable to the holders during the lifetime of the firm. It may be mentioned here that after the commencement of the Companies (Amendment) Act, 1988, which was again amended in 1996, no company, limited by shares, shall issue any redeemable share after a period of 20 years (earlier 10 years) from the date of issue—Sec. 80(5A).

3. Cumulative:

If in any year the dividend on preference shares is not paid due to insufficient profit or loss, the arrear dividend, together with the current one, will be paid at a time out of sufficient profits in subsequent years, i.e., the arrear dividends will accumulate. But if the company goes into liquidation, no arrear dividends are payable unless the Articles contain express provision about it.

4. Non-Cumulative:

Dividend, if it is not paid due to insufficient profit in any year, cannot be claimed by the shareholders, i.e., arrear dividends will not accumulate. But they are to be treated at par with other preference shareholders regarding repayment of capital.

5. Convertible:

Convertible preference shares are those which can be converted into equity shares within a stipulated period of time.

6. Non-Convertible:

Preference shares which are not converted into equity shares are called non-convertible preference shares.

7. Participating:

These shareholders are entitled to take part in the surplus profits in addition to the prescribed fixed rate of dividend if the surplus profits are available. The surplus profits are distributed in a certain agreed ratio between the equity shareholders and the participating preference shareholders. Sometimes they are also entitled to get the share of surplus of assets in case of liquidation if the Articles so provide.

8. Non-Participating:

It is the ordinary preference shares which carry only the fixed rate of dividend. They are not entitled to take part in the surplus profits of the company and are also not entitled to share the surplus which arises after the company goes into liquidation.

Fixed Income Securities

Often companies and governments need to take loans from the public in exchange for interest payments. The debt instruments that are used are called fixed income securities. They can be issued by a corporation, government, or any other entity to raise debt. These entities become borrowers, and the public becomes the lender. These instruments are also commonly known as bonds or money market instruments.

These instruments are called fixed income securities because they provide periodic income payments at a predetermined fixed interest rate. The borrower issues bonds to raise debt from investors with a promise to repay the principal on a fixed date and to make pre-scheduled interest payments.

The principal amount of a bond is called its face value, the fixed annual interest rate is called a coupon, and the date at which the principal amount is to be repaid is called its maturity date. The price at which the bond is sold at is called the price or value of the bond.

For example, a 10-yr bond with 5% coupon and $100 face value would give $5 per year as a coupon for 10 years and will then repay the face value of $100 at the end of 10 years.

Bonds can be classified according to their maturity as follows:

- **Short-term bonds** have a maturity of 1 to 3 years.
- **Medium-term bonds** have a maturity of 3 to 10 years.
- **Long-term bonds** have a maturity of more than 10 years.

Bonds can also be classified on the basis of their price or value:

- A bond whose price is equal to its face value is called to be sold **at par**.
- A bond whose price is less than its face value is called to be sold **below par**.

- A bond whose price is more than its face value is called to be sold **above par**.

Types of Fixed Income Securities

1. Municipal Bonds

Bonds issued by a government entity are called **municipal bonds**. Usually, they are issued by a state, municipality, or any local government body to finance infrastructure projects. These bonds are also commonly called munis. These usually have a maturity of more than 5 years.

2. Corporate Bonds

Bonds issued by companies are called **corporate bonds**. These are issued mainly to fund expansion projects, mergers and acquisitions, or ongoing operations. These bonds are usually medium to long-term bonds and pay regular coupons.

3. Treasury Bills

The government bodies usually issue **Treasury bills**, commonly called T-bills, to raise money from the investors. These are basically similar to bonds but with a maturity up to 1 year. Most commonly available T-bills have maturities of 3-months, 6-months, or 9-months.

T-bills usually don't pay regular interest payments. They are typically sold below par, and the difference between the face value and price of a T-bill becomes the interest payment. Let's look at an example: suppose you purchased a 6-month T-bill with a face value of $100 at the price of $98. At the end of six months, you will get $100, earning $2 as interest.

4. Certificates of Deposit

A **certificate of deposit** is a savings certificate provided to an individual depositing his/her money for a specified period of time at a specified rate of interest. These securities are generally issued by banks, thrift institutions, and credit unions. They are similar to savings accounts but are virtually risk-free.

5. Commercial Papers

A **commercial paper** is a short-term debt instrument issued by a corporation. It is usually not backed by any collateral and is issued below par. The maturity is generally up to 270 days.

Government Security

A government security is a bond or other type of debt obligation that is issued by a government with a promise of repayment upon the security's maturity date. Government securities are usually considered low-risk investments because they are backed by the taxing power of a government. In fact, investment in U.S. treasury securities is probably the safest investment that can be made.

Features of Government Securities

· Issued at face value

· No default risk as the securities carry sovereign guarantee.

· Ample liquidity as the investor can sell the security in the secondary market

· Interest payment on a half yearly basis on face value

· No tax deducted at source

· Can be held in D-mat form.

· Rate of interest and tenor of the security is fixed at the time of issuance and is not subject to change (unless intrinsic to the security like FRBs).

· Redeemed at face value on maturity

· Maturity ranges from of 2-30 years.

· Securities qualify as SLR investments (unless otherwise stated).

The Government Securities are of the following types.

- Dated Securities
- Zero Coupon Bonds
- Floating rate Bonds
- Call / Put Option Bonds

- **Dated Securities:** Dated Securities have fixed maturity and are identified with the date of maturity. They have either fixed rate of interest or coupon rates which are semiannually payable.

  For example: 6.85% GOI 2021 means
    - It will mature in 2021
    - The coupon or interest rate is 6.85% paid annually (at 6 months intervals usually)
- **Zero Coupon Bonds:** Zero Coupon Bonds are the securities which are **issued at Face Value and redeemed at Par Value.**
    - They are not issued now. Zero coupon bonds were issued in 1990s only.
- **Floating Rate Bonds:** These refer to the changing interest rate bonds. The interest rate or coupon rate is higher than a Benchmark rate and usually linked to that benchmark rate. When the benchmark rate increases, the coupon rate also increases.
- **Bonds with Call / Put Option**: The Call/ Put Option bonds were issued in 2002 for the first time. The call and put option means that the bond holder can sell it back to the government and Government could buy it from the bond holder, after a prefixed period.

Derivative

- **Definition:** A derivative is a contract between two parties which derives its value/price from an underlying asset. The most common types of derivatives are futures, options, forwards and swaps.

  It is a financial instrument which derives its value/price from the underlying assets. Originally, underlying corpus is first created which can consist of one security or a combination of different securities. The value of the underlying asset is bound to change as the value of the underlying assets keep changing continuously. Generally stocks, bonds, currency, commodities and interest rates form the underlying asset.

Types of Forward Contract

Futures and Forward Contract

Futures are standardized contracts and they are traded on the exchange. On the other hand, Forward contract is an agreement between two parties and it is traded over-the-counter (OTC).

Futures contract does not carry any credit risk because the clearing house acts as counter-party to both parties in the contract. To further reduce the credit exposure, all positions are marked-to-market daily, with margins required to be maintained by all participants all the time. On the other hand, forward contracts do not have such mechanisms in place. This is because forward contracts are settled only at the time of delivery. The credit exposure keeps on increasing since profit or loss is realized only at the time of settlement.

In derivatives market, the lot size is predefined. Therefore, one cannot buy a contract for a single share in futures. This does not hold true in forward markets as these contracts are customized based on an individual's requirement.

Lastly, future contracts are highly standardized contracts; they are traded in the secondary markets. In the secondary market, participants in the futures can easily buy or sell their contract to another party who is willing to buy it. In the contrast, forwards are unregulated, so there is essentially no secondary market for them.

CHARACTERISTICS	FUTURES CONTRACT	FORWARDS CONTRACT
Meaning	A futures contract is a standardized contract, traded on exchange, to buy or sell underlying instrument at certain date in future, at specified price.	A forward contract is an agreement between two parties to buy or sell underlying assets at specified date, at agreed rate in future.
Structure	Standardized contract	Customized contract
Counterparty Risk	Low	High
Contract size	Standardized/Fixed	Customized/depends on the contract term
Regulation	Stock exchange	Self regulated
Collateral	Initial margin required	Not required
Settlement	On daily basis	On maturity date

Option Contract

Option is the most important part of derivatives contract. An Option contract gives the right but not an obligation to buy/sell the underlying assets. The buyer of the options pays the premium to buy the right from the seller, who receives the premium with an obligation to sell the underlying assets if the buyer exercises his right. Options can be traded in both OTC market and exchange traded markets. Options can be divided into two types - call and put. We shall explain these types in detail in our next article on Options.

SWAP

A swap is a derivative contract made between two parties to exchange cash flows in the future. Interest rate swaps and currency swaps are the most popular swap contracts, which are traded over the counters between financial institutions. These contracts are not traded on exchanges. Retail investors generally do not trade in swaps.

The two major types of markets in which derivatives are traded are namely:

Exchange Traded Derivatives

Over the Counter (OTC) derivatives

Exchange traded derivatives (ETD) are traded through central exchange with publicly visible prices.

Over the Counter (OTC) derivatives are traded between two parties (bilateral negotiation) without going through an exchange or any other intermediaries. OTC is the term used to refer stocks that trade via dealer network and not any centralized exchange. These are also known as unlisted stocks where the securities are traded by broker-dealers through direct negotiations.

With different characteristics, the two types of markets complement each other in providing a trading platform to suit different business needs. On one hand, exchange-traded derivative markets have better price transparency as compared to OTC markets. Also, the counterparty risks are smaller in exchange-traded markets with all trades on exchanges being settled daily with the clearinghouse. On the other hand, the flexibility of OTC market means that they suit better for trades that do not have high order flow or special requirements. In this context, OTC market performs the role of an incubator for new financial products.

Why OTC?

1) The Company may be small and hence not qualifying the exchange listing requirements

2) It is an instrument that is used for hedging, risk transfer, speculation and leverage

3) OTC gives exposure to different markets as an investment avenue

4) In many cases it implies less financial burden and administrative cost for the end users (e.g. corporate)

Swaps are widely regarded as the first modern example of OTC financial derivatives. All OTC derivatives are negotiated between a dealer and the end user or between two dealers. Inter-dealer brokers (IDBs) also play an important role in OTC derivatives by helping dealers (and sometimes end users) identify willing counterparties and compare different bids and offers.

Types of OTC Derivatives

OTC Contracts can be broadly classified on the basis of the underlying asset through which the value is derived:

Interest rate derivatives: The underlying asset is a standard interest rate. Examples of interest rate OTC derivatives include LIBOR, Swaps, US Treasury bills, Swaptions and FRAs.

Commodity derivatives: The underlying are physical commodities like wheat or gold. E.g. forwards.

Forex derivatives: The underlying is foreign exchange fluctuations.

Equity derivatives: The underlying are equity securities. E.g. Options and Futures

Fixed Income: The underlying are fixed income securities.

Credit derivatives: It transfers the credit risk from one party to another without transferring the underlying. These can be funded or unfunded credit derivatives. e.g: Credit default swap (CDS), Credit linked notes (CLN).

OTC markets have two dimensions to it, namely customer market and interdealer market. In customer market, bilateral trading happens between the dealers and customers. This is done through electronic messages which are called dealer-runs providing the prices for buying and selling the derivatives. On the other hand, in the interdealer market, dealers quote prices to one other to offset some of the risk in the trade. This is passed on to other dealers within fractions. This clearly provides a view point on the customer market.

Advantages of OTC

- These derivatives offer companies more flexibility because, unlike the “standardised” exchange-traded products, they can be tailored to fit specific needs, such as the effects of a particular exchange rate or commodity price over a given period.

- Companies say such derivatives play a big part in helping them to provide consumers with stable prices.

RISKS managed using OTC Derivatives

Interest rate risk: Companies prefer to take loans from banks at a fixed rate of interest in order to avoid the exposure to rising rates. This can be achieved through interest rate swap which locks the fixed rate for a term of loan.

Currency Risk: Currency derivatives allow companies to manage risk by locking the exchange rate, beneficial for importer or exporter companies that face the risk of currency fluctuations.

Commodity Price Risk: Financing in terms of expansion can only be available if the future selling price is locked. This price risk protection is provided through customized OTC derivative. e.g. Crude Oil producer would like to increase production in tandem to increase in the demand. The financing will be done only if the future selling price of the crude is locked.

Disadvantages of OTC

- Lack of a clearing house or exchange, results in increased credit or default risk associated with each OTC contract.
- Precise nature of risk and scope is unknown to regulators which lead to increased systemic risk.
- Lack of transparency.
- Speculative nature of the transactions causes market integrity issues.

Over The Counter

An **over the counter** security is traded through a dealer network rather than through a centralized, formal exchange (such as the NYSE, Nasdaq, or London StockExchange). Assets traded OTC are usually traded by private securities dealers who negotiate directly with buyers and sellers.

The primary reason a stock is traded "over the counter" is because the company may be too small to meet the formal exchange listing requirements. OTC stocks may be referred to as "unlisted stocks" because they are traded privately through broker-dealers over the phone and computer networks.

Instead of being listed on the NYSE or another formal exchange, OTC stocks are usually listed in the Over the Counter Bulletin Board (OTCBB) and/or on pink sheets. OTC stocks can sometimes be purchased through an online broker.

Bonds are considered over the counter because they are not traded on a formal exchange. To trade a bond, an investor must call the investment bank that the bond is traded through and ask for rates to perform the over the counter exchange.

Over the counter securities are important because they offer investors alternatives to just investing in the listed companies on the NYSE and Nasdaq. It also gives investors an great opportunity to invest in stocks of small and/or overlooked companies that have plenty of growth potential.

Because most are not required to report to the SEC, many OTC stocks are either penny stocks or are offered by companies with bad credit records. But not all listed OTC traded companies have bad credit ratings; many companies simply don't want to participate in the expensive reporting process. Because they are less highly regulated, potential investors should do a lot of research before diving into this type of asset.

Functions of Participants in the Financial Market

1. Banks:

Banks participate in the capital market and money market. Within the capital market, banks take active part in bond markets. Banks may invest in equity and mutual funds as a part of their fund management. Banks take active trading interest in the bond market and have certain exposures to the equity market also. Banks also participate in the market as clearing houses.

2. Primary Dealers (PDs):

PDs deal in government securities both in primary and secondary markets. Their basic responsibility is to provide two-way quotes and act as market makers for government securities and strengthen the government securities market.

3. Financial Institutions (FIs):

FIs provide/lend long term funds for industry and agriculture. FIs raise their resources through long-term bonds from financial system and borrowings from international financial institutions like International Finance Corporation (IFC), Asian Development Bank (ADB) International Development Association (IDA), International Bank for Reconstruction and Development (IBRD), etc.

4. Stock Exchanges:

A Stock exchange is duly approved by the Regulators to provide sale and purchase of securities by **"open cry"** or **"on-line"** on behalf of investors through brokers. The stock exchanges provide clearing house facilities for netting of payments and securities delivery. Such clearing houses guarantee all payments and deliveries. Securities traded in stock exchanges include equities, debt, and derivatives.

Currently, in India, only dematerialized securities are allowed to be traded on the stock exchanges. Settlement in securities account is made by depositories through participants' accounts. It is essential that stock exchanges are corporatised and de-mutualised so that there can be greater transparency in the trades and better governance in markets.

5. Brokers:

Only brokers approved by Capital Market Regulator can operate on stock exchange. Brokers perform the job of intermediating between buyers and seller of securities. They help build up order book, price discovery, and are responsible for a contract being honoured. For their services brokers earn a fee known as brokerage.

6. Investment Bankers (Merchant Bankers):

These are agencies/organisations regulated and licensed by SEBI, the Capital Markets Regulator. They arrange raising of funds through equity and debt route and assist companies in completing various formalities like filing of the prescribed document and other compliances with the Regulator and Regulators.

They advise the issuing company on book building, pricing of issue, arranging registrars, bankers to the issue and other support services. They can underwrite the issue and also function as issue managers. They may also buy and sell on their account.

As per regulatory stipulations, such own account business should be separately booked and confined to scrip’s where insider information is not available to the investment/merchant banker. Investment/Merchant banking can be an exclusive business. A bank can also undertake these activities.

7. Foreign Institutional Investors (FIIs):

FIIs are foreign based funds authorized by Capital Market Regulator to invest in countries’ equity and debt market through stock exchanges. They are allowed to repatriate sale proceeds of their holdings, provided sales have been made through an authorized stock exchange and taxes have been paid. FIIs enjoy de-facto capital account convertibility.

FII operations provide depth to equity and debt markets and result in increased turnover. In India, these activities have brought in technological advancements and foreign funds in equity and debt market.

8. Custodians:

Custodians are organizations which are allowed to hold securities on behalf of customers and carry out operations on their behalf. They handle both funds and securities of Qualified Institutional Borrowers (QIBs) including FIIs.

Custodians are supervised by the Capital Market Regulator. In view of their position and as they handle the payment and settlements, banks are able to play the role of custodians effectively. Thus most banks perform the role of custodians.

9. Depositories:

Depositories hold securities in demat (electronic) form, maintain accounts of depository participants who, in turn, maintain accounts of their customers. On instructions of stock exchange clearing house, supported by documentation, a depository transfers securities from buyers to sellers' accounts in electronic form.

Depositories are important for ensuring efficiency in the market. They facilitate lending against securities and ensure avoidance of settlement risk or bad delivery.

Global Financial System

The **global financial system** is the worldwide framework of legal agreements, institutions, and both formal and informal economic actors that together facilitate international flows of financial capital for purposes of investment and trade financing. Since emerging in the late 19th century during the first modern wave of economic globalization, its evolution is marked by the establishment of central banks, multilateral treaties, and intergovernmental organizations aimed at improving the transparency, regulation, and effectiveness of international markets. In the late 1800s, world migration and communication technology facilitated unprecedented growth in international trade and investment. At the onset of World War I, trade contracted as foreign exchange markets became paralyzed by money market illiquidity. Countries sought to defend against external shocks with protectionist policies and trade virtually halted by 1933, worsening the effects of the global Great Depression until a series of reciprocal trade agreements slowly reduced tariffs worldwide. Efforts to revamp the international monetary system after World War II improved exchange rate stability, fostering record growth in global finance.

A series of currency devaluations and oil crises in the 1970s led most countries to float their currencies. The world economy became increasingly financially integrated in the 1980s and 1990s due to capital account liberalization and financial deregulation. A series of financial crises in Europe, Asia, and Latin America followed with contagious effects due to greater exposure to volatile capital flows. The global financial crisis, which originated in the United States in 2007, quickly propagated among other nations and is recognized as the catalyst for the worldwide Great Recession. A market adjustment to Greece's noncompliance with its monetary union in 2009 ignited a sovereign debt crisis among European nations known as the Eurozone crisis.

A country's decision to operate an open economy and globalize its financial capital carries monetary implications captured by the balance of payments. It also renders exposure to risks in international finance, such as political deterioration, regulatory changes, foreign exchange controls, and legal uncertainties for property rights and investments. Both individuals and groups may participate in the global financial system. Consumers and international businessesundertake consumption, production, and investment. Governments and intergovernmental bodies act as purveyors of international trade, economic development, and crisis management. Regulatory bodies establish financial regulations and legal procedures, while independent bodies facilitate industry supervision. Research institutes and other associations analyze data, publish reports and policy briefs, and host public discourse on global financial affairs.

While the global financial system is edging toward greater stability, governments must deal with differing regional or national needs. Some nations are trying to orderly discontinue unconventional monetary policies installed to cultivate recovery, while others are expanding their scope and scale. Emerging market policymakers face a challenge of precision as they must carefully institute sustainable macroeconomic policies during extraordinary market sensitivity without provoking investors to retreat their capital to stronger markets. Nations' inability to align interests and achieve international consensus on matters such as banking regulation has perpetuated the risk of future global financial catastrophes.

CAPITAL MARKET :-

Capital market deals with medium term and long term funds. It refers to all facilities and the institutional arrangements for borrowing and lending term funds (medium term and long term). The demand for long term funds comes from private business corporations, public corporations and the government. The supply of funds comes largely from individual and institutional investors, banks and special industrial financial institutions and Government.

CAPITAL MARKET IN INDIA

a) Primary market b)Secondary market

a) Primary Market :-

Primary market is the new issue market of shares, preference shares and debentures of non-government public limited companies and issue of public sector bonds.

b) Secondary Market

This refers to old or already issued securities. It is composed of industrial security market or stock exchange market and gilt-edged market.

ROLE AND IMPORTANCE OF CAPITAL MARKET IN INDIA :-

Capital market has a crucial significance to capital formation. For a speedy economic development adequate capital formation is necessary. The significance of capital market in economic development is explained below :-

1. Mobilisation Of Savings And Acceleration Of Capital Formation :-

In developing countries like India the importance of capital market is self evident. In this market, various types of securities helps to mobilise savings from various sectors of population. The twin features of reasonable return and liquidity in stock exchange are definite incentives to the people to invest in securities. This accelerates the capital formation in the country.

2. Raising Long - Term Capital :-

The existence of a stock exchange enables companies to raise permanent capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The stock exchange resolves this dash of interests by offering an opportunity to investors to buy or sell their securities, while permanent capital with the company remains unaffected.

3. Promotion Of Industrial Growth :-

The stock exchange is a central market through which resources are transferred to the industrial sector of the economy. The existence of such an institution encourages people to invest in productive channels. Thus it stimulates industrial growth and economic development of the country by mobilising funds for investment in the corporate securities.

4. Ready And Continuous Market :-

The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities. Easy marketability makes investment in securities more liquid as compared to other assets.

5. Technical Assistance :-

An important shortage faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in capital market play an important role.

6. Reliable Guide To Performance :-

The capital market serves as a reliable guide to the performance and financial position of corporates, and thereby promotes efficiency.

7. Proper Channelisation Of Funds :-

The prevailing market price of a security and relative yield are the guiding factors for the people to channelise their funds in a particular company. This ensures effective utilisation of funds in the public interest.

8. Provision Of Variety Of Services :-

The financial institutions functioning in the capital market provide a variety of services such as grant of long term and medium term loans to entrepreneurs, provision of underwriting facilities, assistance in promotion of companies, participation in equity capital, giving expert advice etc.

9. Development Of Backward Areas :-

Capital Markets provide funds for projects in backward areas. This facilitates economic development of backward areas. Long term funds are also provided for development projects in backward and rural areas.

10. Foreign Capital :-

Capital markets makes possible to generate foreign capital. Indian firms are able to generate capital funds from overseas markets by way of bonds and other securities. Government has liberalised Foreign Direct Investment (FDI) in the country. This not only brings in foreign capital but also foreign technology which is important for economic development of the country.

11. Easy Liquidity :-

With the help of secondary market investors can sell off their holdings and convert them into liquid cash. Commercial banks also allow investors to withdraw their deposits, as and when they are in need of funds.

12. Revival Of Sick Units :-

The Commercial and Financial Institutions provide timely financial assistance to viable sick units to overcome their industrial sickness. To help the weak units to overcome their financial industrial sickness banks and FIs may write off a part of their loan.

FACTORS CONTRIBUTING TO THE GROWTH AND DEVELOPMENT OF CAPITAL MARKET :-

1) Growth Of Development Banks And Financial Institutions :-

For providing long term funds to industry, the government set up Industrial Finance Corporation in India (IFCI) in 1948. This was followed by a number of other development banks and institutions like the Industrial Credit and Investment Corporation of India (ICICI) in 1955, Industrial Development Bank of India (IDBI) in 1964, Industrial Reconstruction Corporation of India (IRCI) in 1971, Foreign Investment Promotion Board in 1991, Over the Counter Exchange of India (OTCEI) in 1992 etc. In 1969, 14 major commercial banks were nationalised. Another 6 banks were nationalised in 1980. These financial institutions and banks have contributed in widening and strengthening of capital market in India.

2) Setting Up **Of SEBI :-**

The Securities Exchange Board of India (SEBI) was set up in 1988 and was given statutory recognition in 1992.

3) Credit Rating Agencies :-

Credit rating agencies provide guidance to investors / creditors for determining the credit risk. The Credit Rating Information Services of India Limited (CRISIL) was set up in 1988 and Investment Information and Credit Rating Agency of India Ltd. (ICRA) was set up in 1991. These agencies are likely to help the development of capital market in future.

4) Growth Of Mutual Funds :-

The mutual funds collects funds from public and other investors and channelise them into corporate investment in the primary and secondary markets. The first mutual fund to be set up in

India was Unit Trust of India in 1964. In 2007-08 resources mobilised by mutual funds were Rs. 1,53,802 crores.

5) Increasing Awareness :-

During the last few years there have been increasing awareness of investment opportunities among the public. Business newspapers and financial journals (The Economic Times, The Financial Express, Business India, Money etc.) have made the people aware of new long-term investment opportunities in the security market.

6) Growing Public Confidence

A large number of big corporations have shown impressive growth. This has helped in building up the confidence of the public. The small investors who were not interested to buy securities from the market are now showing preference in favour of shares and debentures. As a result, public issues of most of the good companies are now over-subscribed many times.

7) Legislative Measures :-

The government passed the companies Act in 1956. The Act gave powers to government to control and direct the development of the corporate enterprises in the country. The capital Issues (control) Act was passed in 1947 to regulate investment in different enterprises, prevent diversion of funds to non-essential activities and to protect the interest of investors. The Act was replaced in 1992.

8) Growth Of Underwriting Business :-

The growing underwriting business has contributed significantly to the development of capital market.

9) Development Of Venture Capital Funds :-

Venture capital represents financial investment in highly risky projects with a hope of earning high returns After 1991, economic liberalisation has made possible to provide medium and long term funds to those firms, which find it difficult to raise funds from primary markets and by way of loans from FIs and banks.

10) Growth Of Multinationals (MNCs) :-

The MNCs require medium and long term funds for setting up new projects or for expansion and modernisation. For this purpose, MNCs raise funds through loans from banks and FIs. Due to the presence of MNCs, the capital market get a boost.

11) Growth Of Entrepreneurs :-

Since 1980s, there has been a remarkable growth in the number of entrepreneurs. This created more demand for short term and long term funds. FIs, banks and stock markets enable the entrepreneurs to raise the required funds. This has led to the growth of capital market in India.

12) Growth Of Merchant Banking :-

The credit for initiating merchant banking services in India goes to Grindlays Bank in 1967,followed by Citibank in 1970. Apart from capital issue management, merchant banking divisions provide a number of other services including provision of consultancy services relating to promotion of projects, corporate restructuring etc.

REFORMS I DEVELOPMENTS IN CAPITAL MARKET SINCE 1991:-

The government has taken several measures to develop capital market in post-reform period, with which the capital market reached new heights. Some of the important measures are

1) Securities And Exchange Board Of India (SEBI) :-

SEBI became operational since 1992. It was set with necessary powers to regulate the activities connected with marketing of securities and investments in the stock exchanges, merchant banking, portfolio management, stock brokers and others in India. The objective of SEBI is to protect the interest of investors in primary and secondary stock markets in the country.

2) National Stock Exchange (NSE) :-

The setting up to NSE is a landmark in Indian capital markets. At present, NSE is the largest stock market in the country. Trading on NSE can be done throughout the country through the network of satellite terminals. NSE has introduced inter-regional clearing facilities.

3) Dematerialisation Of Shares :-

Demat of shares has been introduced in all the shares traded on the secondary stock markets as well as those issued to the public in the primary markets. Even bonds and debentures are allowed in demat form. The advantage of demat trade is that it involves Paperless trading.

4) Screen Based Trading :-

The Indian stock exchanges were modernised in 90s, with Computerised Screen Based Trading System (SBTS), It cuts down time, cost, risk of error and fraud and there by leads to improved operational efficiency. The trading system also provides complete online market information through various inquiry facilities.

5) Investor Protection :-

The Central Government notified the establishment of Investor Education and Protection Fund (IEPF) with effect from 1st Oct. 2001: The IEPF shall be credited with amounts in unpaid dividend accounts of companies, application moneys received by companies for allotment of any securities and due for refund, matured deposits and debentures with companies and interest accrued there on, if they have remained unclaimed and unpaid for a period of seven years from the due date of payment. The IEPF will be utilised for promotion of awareness amongst investors and protection of their interests.

6) Rolling Settlement :-

Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day (T) are settled after certain days (N). This is called T + N rolling settlement. Since April 1, 2002 trades are settled' under T + 3 rolling settlement. In April 2003, the trading cycle has been reduced to T + 2 days. The shortening of trading cycle has reduced undue speculation on stock markets.

7) The Clearing Corporation Of India Limited (CCIL) :-

The CCIL was registered in 2001, under the Companies Act, 1956 with the State Bank of India as the Chief Promoter. The CCIL clears all transactions in government securities and repos and also Rupee / US $ forex spot and forward deals All trades in government securities below Rs. 20 crores would be mandatorily settled through CCIL, white those above Rs. 20 crores would have the option for settlement through the RBI or CCIL.

8) The National Securities Clearing Corporation Limited (NSCL) :-

The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of NSE. It has put in place a comprehensive risk management system, which is constantly monitored and upgraded to pre-expect market failures.

9) Trading In Central Government Securities :-

In order to encourage wider participation of all classes of investors, Including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nation wide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

10) Credit Rating Agencies :-

Various credit rating agencies such as Credit Rating Information services of India Ltd. (CRISIL – 1988), Investment Information and credit Rating Agency of India Ltd. (ICRA – 1991), etc. were set up to meet the emerging needs of capital market. They also help merchant bankers, brokers, regulatory authorities, etc. in discharging their functions related to debt issues.

11) Accessing Global Funds Market :-

Indian companies are allowed to access global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Further Indian financial system is opened up for investments of foreign funds through Non-Resident Indians (NRIs), Foreign Institutional investors (FIls), and Overseas Corporate Bodies (OCBs).

12) Mutual Funds :-

Mutual Funds are an important avenue through which households participate in the securities market. As an investment intermediary, mutual funds offer a variety of services / advantages to small investors. SEBI has the authority to lay down guidelines and supervise and regulate the working of mutual funds.

13) Internet Trading :-

Trading on stock exchanges is allowed through internet, investors can place orders with registered stock brokers through internet. This enables the stock brokers to execute the orders at a greater pace.

14) Buy Back Of Shares :-

Since 1999, companies are allowed to buy back of shares. Through buy back, promoters reduce the floating equity stock in market. Buy back of shares help companies to overcome the problem of hostile takeover by rival firms and others.

15) Derivatives Trading :-

Derivatives trading in equities started in June 2000. At present, there are four equity derivative products in India Stock Futures, Stock Options, Index Futures, Index Options.

Derivative trading is permitted on two stock exchanges in India i.e. NSE and BSE. At present in India, derivatives market turnover is more than cash market.

16) PAN Made Mandatory :-

In order to strengthen the “Know your client" norms and to have sound audit trail of transactions in securities market, PAN has been made mandatory with effect from January 1, 2007.

New Issue Market

New issues are offered in the primary market and sold to the public for the first time as initial public offerings, or IPOs. New issues are usually handled for a corporation by an underwriting syndicate comprised of investment banks and selling groups. An underwriter will advise the issuing corporation on the best price at which to offer shares of the new security to the public. Factors considered in arriving at a price include prevailing market conditions, indications of interest from the underwriter's book of business, prices of similar companies and the company's general financial health.

The industrial securities market in India consists of new issue market and stock exchange. The new issue market deals with the new securities which were not previously available to the investing public, i.e., the securities that are offered to the investing public for the first time. The market, therefore, makes available a new block of securities for public subscription. In other words, new issue market deals with raising of fresh capital by companies either for cash or for consideration other than cash.

The new issue market encompasses all institutions dealing in fresh claim. These claims may be in the form of equity shares, preference shares, debentures, right issues, deposits etc. All financial institutions which contribute, underwrite and directly subscribe to the securities are part of new issue market.

Functions of New Issue Market

The main function of the New Issue Market is to facilitate the ‘transfer of resources’ from savers to users. Conceptually, however, the New Issue Market should not be conceived as a platform only for the purpose of raising finance for new capital expenditure.

In fact, the facilities of the market are also utilised for selling existing concerns to the public as going concerns through conversions of existing proprietary enterprises or private companies into public companies.

It, therefore, becomes imperative at this stage to classify new issues. One classification suggested by R.F. Henderson (c.f. The New Issue Market & Finance for Industry, 1951), categorises new issues into those by:

(a) New companies also called ‘initial issues’ and

(b) Old companies also called ‘further issues’.

These bear no relation to the age of the company, but are based on the fact whether the company already has stock exchange listing. This classification is thus concerned only with the flow of ‘new money’. Another classification (c.f. Merrett, Howe & New bould “Equity Issues and the London Capital Market” 1967) distinguishes between flow of funds into the market and flow of “new money” hence we have ‘new money issues’ or issues of capital involving newly created share and ‘no new money issues’ i.e. sale of securities already in existence and sold by their holders.

This is more an “exclusive” classification in that two types of issues are excluded from the category of new issues.

(a) Bonus/capitalisation issues which represent only book keeping entries.

(b) Exchange issues: by which shares in one company are/exchanged for securities of another.

Now, the main function of the New Issue Market, i.e. channelling of investible funds, can be divided, from the operational stand-point, into a triple-service function:

(a) Origination

(b) Underwriting

(c) Distribution

The institutional setup dealing with these can be said to constitute the New Issue Market organisation. Let us elucidate a little on all of these.

(a) Origination :

Origination refers to the work of investigation and analysis and processing of new proposals. This in turn may be:

(i) A preliminary investigation undertaken by the sponsors (specialised agencies) of the issue. This involves a/careful study of the technical, economic, financial and/legal aspects of the issuing companies to ensure that/it warrants the backing of the issue house.

(ii) Services of an advisory nature which go to improve the quality of capital issues. These services include/advice on such aspects of capital issues as: determination of the class of security to be/issued and price of the issue in terms of market conditions; the timing and magnitude of issues; method of flotation; and technique of selling and so on.

The importance of the specialised services provided by the New Issue Market organisation in this respect can hardly be over-emphasized. On the thoroughness of investigation and soundness of judgement of the sponsoring institution depends, to a large extent, the allocative efficiency of the market. The origination, however, thoroughly done, will not by itself guarantee success of an issue. A second specialised service i.e. "Underwriting" is often required.

(b) Underwriting:

The idea of underwriting originated on account of uncertainties prevailing in the capital market as a result of which the success of the issue becomes unpredictable. If the issue remains undersubscribed, the directors cannot proceed to allot the shares, and have to return money to the applicants if the subscription is below a minimum amount fixed under the Companies Act. Consequently, the issue and hence the project will fail.

Underwriting entails an agreement whereby a person/organisation agrees to take a specified number of shares or debentures or a specified amount of stock offered to the public in the event of the public not subscribing to it, in consideration of a commission the underwriting commission.

If the issue is fully subscribed by the public, there is no liability attaching to the underwriters; else they have to come forth to meet the shortfall to the extent of the under- subscription. The underwriters in India may broadly be classified into the following two types:

(i) Institutional Underwriters;

(ii) Non-Institutional Underwriting.

Institutional Underwriting in our country has been development oriented. It stands as a major support to those projects which often fail to catch the eye of investing public. These projects rank high from the points of view of national importance e.g. steel, fertilizer, and generally receive higher priority by such underwriters.

Thus institutional underwriting may be broadly recognised, in the context of development credit, as playing a decisive role in directing the economic resources of the country towards desired activities.

This does not mean that they are barred entrance in the issue market from so called glamorous issues to which public can be expected to readily subscribe. They may be underwriting in such cases, but what is expected of them is their support to projects in the priority sector.

One of the principal advantages they offer is that resource-wise they are undoubted. They are in a position to fulfill their underwriting commitments even in the worst foreseeable situations.

The public financial institutions namely IDBI, IFCI, ICICI, LIC and UTI, underwrite a portion of the issued capital. Usually, the underwriting is done in addition to granting term finance by way of loans on debentures. These institutions are usually approached when one or more of the following situations prevail:

(i) The issue is so large that broker-underwriting may not be able to cover the entire issue.

(ii) The gestation period is long enough to act as distinctive

(iii) The project is weak, inasmuch as it is being located in a backward area.

(iv) The project is in the priority sector which may not be able to provide an attractive return on investment.

(v) The project is promoted by technicians.

(vi) The project is new to the market.

The quantum of underwriting assistance varies from institution to institution according to the commitments of each of them for a particular industry.

However, institutional underwriting suffers from the following two drawbacks:

1. The institutional handling involves procedural delays which sometimes dampen the initiative of the corporate managers or promoters.

2. The other disadvantage is that the institutions prefer to wait and watch the results to fulfill their obligations only where they are called upon to meet the deficit caused by under subscription.

(c) Distribution :

The sale of securities to the ultimate investors is referred to as distribution; it is another specialised job, which can be performed by brokers and dealers in securities who maintain regular and direct contact with the ultimate investors. The ability of the New Issue Market to cope with the growing requirements of the expanding corporate sector would depend on this triple-service function.

Stock Exchanges in India

Sr. No.	**Name of the Exchange**
1	Ahmedabad Stock Exchange Ltd.
2	BSE Ltd.
3	Bangalore Stock Exchange Ltd.
4	Bhubaneswar Stock Exchange Ltd
5	Calcutta Stock Exchange Ltd.
6	Cochin Stock Exchange Ltd
7	Delhi Stock Exchange Ltd.,
8	Gauhati Stock Exchange Ltd.
9	Inter-Connected Stock Exchange of India Limited
10	Jaipur Stock Exchange Ltd

11	Ludhiana Stock Exchange Ltd.
12	MCX - Stock Exchange Limited
13	Madhya Pradesh Stock Exchange Ltd
14	Madras Stock Exchange Ltd.
15	Magadh Stock Exchange Ltd.
16	National Stock Exchange of India Ltd.
17	OTC Exchange of India
18	Pune Stock Exchange Ltd
19	The Vadodara Stock Exchange Ltd.
20	U.P. Stock Exchange Limited
21	United Stock Exchange of India Limited

NSE

The **National Stock Exchange of India Ltd.** (**NSE**) is an Indian stock exchange located at Mumbai, Maharashtra, India. National Stock Exchange (NSE) was established in 1992 as a demutualised electronic exchange. NSE provides a modern, fully automated screen-based trading system, with over two lakh trading terminals, through which investors in every nook and corner of India can trade.

NSE has a market capitalization of more than US$1.4 trillion making it one of the world's top twenty stock exchanges by market capitalization.[1] Though a number of other exchanges exist, NSE and the Bombay Stock Exchange are the two most significant stock exchanges in India, and between them are responsible for the vast majority of share transactions. NSE's flagship index, the **CNX Nifty**, is used extensively by investors in India and around the world to take exposure to the Indian equities market.

NSE was started by a clutch of leading Indian financial institutions at the behest of the Government of India to bring transparency to the Indian market, and has a diversified shareholding comprising domestic and global investors. The domestic investors includes Life Insurance Corporation of India, GIC, State Bank of India and Infrastructure Development Finance Company (IDFC) Ltd, while the foreign investors include MS Strategic (Mauritius) Limited, Citigroup Strategic Holdings Mauritius Limited, Tiger Global Five Holdings and Norwest Venture Partners X FII-Mauritius. It offers trading, clearing and settlement services in equity, debt and equity derivatives. It is India's largest exchange, globally in cash market trades, in currency trading and index options. As on June 2013, NSE has 1673 VSAT terminals and 2720 leaselines, spread over more than 2000 cities across India.

The exchange was incorporated in 1992 as a tax-paying company and was recognized as a stock exchange in 1993 under the Securities Contracts (Regulation) Act, 1956, when Mr. P. V. Narasimha Rao was the Prime Minister of India and Dr. Manmohan Singh was the Finance Minister. NSE commenced operations in the Wholesale Debt Market (WDM) segment in June 1994. The Capital market (Equities) segment of the NSE commenced operations in November 1994, while operations in the Derivatives segment commenced in June 2000.

OTCEI

Securities markets in developed countries are multi-tiered with an element of in-built competition amongst various layers. This prevents monopolisation of securities exchange and makes the markets more efficient. In India, however, the situation has been altogether different because of the virtual monopoly enjoyed by stock exchanges till recently.

The multi-tier securities exchange model was adopted in our country in October 1990 with the establishment of the Over the Counter Exchange of India (OTCEI). The object of the OTCEI “is to provide an alternate market for the securities of smaller companies, public-sector companies, closely-held companies desirous of listing, etc.

It has been promoted jointly by UTI, ICICI, IDBI, SBI Capital Markets Ltd., IFCI, GIC and Canbank Financial Services Ltd. The Government has conferred it the status of a 'recognised stock exchange' under Sec. 4 of the Securities Contracts Regulation Act. Consequently, companies listed with OTCEI will practically be at par with companies listed on any stock exchange in the country.

The OTCEI is 'floor-less exchange' where all the activities are computerised be it trading, billing, payments, etc. OTC designated dealers operate through their computer terminals which are hooked to a central computer. All quotes and transactions are recorded and processed here.

The dealers are spread over the country and have access to the central computer. Besides, PTI OTC scan is available to each dealer which displays the best bids and offers of the market makers in respect of each scrip. A transaction can be effected by entering the bid or offer in a dealer's computer counter. The exact transaction price alongwith other details is also displayed in the counter computer.

The trading documents of OTCEI include: (a) Counter Receipt (CR) which is handed over to the buyer when a deal is made. It is a tradeable document and hence must be preserved carefully. It is akin to a share certificate so far as its contents are concerned; (b) Sale Confirmation Slip (SCS) which is passed on to the seller when a deal is made. The seller also must preserve it carefully since he gets the payment against this slip later on.

Trading at OTCEI will be permitted only in respect of the securities of the listed companies. Listing may be obtained by (i) Companies with issued equity capital between Rs. 30 lacs to 25 crores; (ii) Closely held companies interested in listing; (iii) Venture capital companies; (iv) Companies which are not listed on any other recognised stock exchange provided:

(a) they offer to the public at least 40% of the issued equity or Rs. 20 lacs, whichever is higher, where the issued equity ranges between Rs. 30 lacs to less than Rs. 300 lacs (i.e. 3 crores),

(b) they offer to the public at least 60% of the issued equity v. .ore issued equity is between 3 crores to 25 crores of rupees,

(c) they offer at least 25% of the issued equity to the public in case of a venture capital company,
(d) where the issued equity ranges between 3 crores to 25 crores of rupees, the norms for listing on a recognised stock exchange must be satisfied,
(e) the company is not carrying on the business of investment, leasing, finance, hire-purchase or amusement parks.

OTCEI promoters have been designated as 'sponsor members' and they alone are entitled to sponsor a company for listing here. Before recommending a company for enlistment, such members have to carry out the appraisal of the project to ensure its technological and financial viability.

They also ensure that all government rules and regulations have been complied with. They are required to clarify the investment worthiness of the company and its project.

Finally, they would value the shares of the company, comply with SEBI guidelines for the issue of securities and manage the public issue. OTCEI requires such sponsor members to act as 'market makers' in that scrip for at least 3 years and also to appoint an additional market maker for that scrip for a period of at least one year.

SEBI relaxed norms for listing on the OTCEI during March 1995. The minimum post- issue capital to be offered to the public to enable listing was lowered from 40 per cent to 25 per cent. SEBI also permitted finance and leasing companies to get listed on the OTCEI.

In April 1995, OTCEI modified its guidelines to allow listing of finance companies-albeit with more stringency. The minimum issued capital was increased from Rs. 30 lakh to Rs. 1 crore for finance companies.

Further, a three-year track record of profitability was made compulsory before listing takes place. The new guidelines also state that the OTCEI- sponsor of these companies should hold at least 10 per cent of the public offer as market making inventory as against 5 per cent for other companies. However, till December 1996, no companies engaged in finance or leasing services was listed on the OTCEI.

To facilitate offers for sale of bought-out deals, OTCEI changed its guidelines in January 1996. The revised guideline did away with the requirement of making an offer for sale of the entire bought-out deal to the public, except the market making inventory. The offered can now offer a minimum of 25 per cent of the bought-out deal to the public.

At the same time, the ratio of involvement of OTCEI members to non-OTCEI members has been brought down from 60:40 to 10:90. These guidelines came into effect from 22 January 1996 and were made applicable to all the bought-out deals registered with SEBI and the offer documents for offers for sale which were awaiting SEBI clearance.

Later in August 1996, SEBI exempted offers for sale of bought-out deals registered with OTCEI on or before 16 April 1996 from the new guidelines governing entry norms for public issues.

Briefly, the new guidelines issued by SEBI stated that any company wanting to make a public issue should have a track record of dividend payment for at least three in the immediately preceding five years before the making public issue.

If companies do not satisfy this requirement, then they must at least get their project appraised by a financial institution or a nationalised bank which would participate in the public issue to an extent of at least 10 per cent of the total project outlay. The relaxation would benefit the 50-odd bought out deals registered with the OTCEI.

With a view to review the working of the OTCEI and to make recommendations for its further improvement, SEBI appointed an eight-member committee under the chairmanship of Dr. S.A. Dave on 17 April 1996. On the recommendations of the Committee, SEBI has made the eligibility criteria for companies desirous of making a public issue very stringent.

The companies unable to make a public issue as a consequence of these guidelines be allowed to seek listing on the OTCEI, albeit with some checks. Currently, only those companies which have a track record of dividend payment of three years out of the immediately preceding five years can make a public issue.

If the company does not have such a teach record, then the project for which the company is entering the capital market needs to be appraised by a financial institution or a nationalised bank. Further, there should be a minimum participation of 10 per cent of the project outlay by the appraiser, in the form of equity or long-term debt.

The committee has recommended that companies which do not satisfy these criteria should be allowed to get listed on the OTCEI provided they appoint a sponsor and two market makers to the issue. The committee has also recommended that companies which do not meet the minimum shareholding norm of having at least 5 shareholders for every Rs. 1 lakh of issued capital can get listed on the OTCEI but should appoint sponsors and market makers.

Companies which get delisted from regional stock exchanges should be allowed to list on the OTCEI since shareholders of delisted companies do not have a platform to off load their holdings. These companies should, however, be traded under a separate category on the OTCEI.

Further, all the companies discussed above should be allowed listing on the OTCEI with a minimum lock-in period of three years. After three years, these companies may either choose to remain on the OTCEI or seek listing on other stock exchanges.

The committee has recommended that the ceiling of Rs.25 crore on the equity capital of a company seeking listing on the OTCEI be removed. It has also suggested that the current rolling settlement system of three days (known as T ± 3) should be increased to five days.

The committee has also stressed upon the need of increased involvement of the promoters of OTCEI. The main promoters of the exchange are Unit Trust of India, Industrial Development Bank of India, Industrial Credit & Investment Corporation of India, Industrial Finance Corporation of India, Life Insurance Corporation and General Insurance Corporation.

The report points out that the some of these entities have promoted the National Stock Exchange which has grown at a much faster pace than the OTCEI. One recommendation for increased promoter participation is that the promoters should have an OTCEI-dedicated fund of a corpus of around Rs.100 crore which would invest in fundamentally sound companies of the OTCEI.

OTCEI is intended to provide easy marketability and better liquidity of securities to an investor. Besides, it also offers facilities for transfer of shares listed here. The investor can submit the transfer documents at any of the OTCEI counters in the country. There is total transparency and fairness so far as the deals are concerned. It takes lesser time to finalise a deal too. The companies listed with OTCEI are also benefitted to a large extent.

Raising of funds becomes cheaper since they are priced fairly and the investor base is large. The company can obtain enlistment even with 40% public issue (which is 60% in case of listing on a recognised stock exchange).

The company has also the option of allotting all the shares to a sponsor. In this case, the company has only to negotiate the issue price with the sponsor who finally markets the issue.

Despite being in existence for a number of years, the exchange does not have a major presence amongst stock exchanges of the country.

BSE

The Bombay Stock Exchange is the oldest Stock Exchange in Asia situated in Dalal Street, Mumbai in India.The Bombay Stock Exchange was started in 1875 as the “Native Share and Stock Brokers Association” in 1875, it earned a formal status under the Securities and Exchange Board of India (SEBI) in 1956. Market Capitalization of the BSE was about Rs 33.4 trillion as on 2006, October, the Bombay Stock Exchange uses the Bombay Stock Exchange Sensex as the market indicator in Asia and India.

The Bombay Stock Exchange deals with trading in derivatives, equity and other debt instruments, the Bombay Stock Exchange introduces the first Exchange Traded Index Derivative Contract in 2000. the Index Options started to be traded from 2001 whereas the single stock futures were traded from 2002. The weekly options were introduced in 2004.

Index Futures

Index futures are mainly futures whose original asset is the BSE index itself, no commodity or stock constitutes the underlying asset.

Index options

The index options like any option gives the holder the right but not compulsion to purchase or sell the underlying asset at the specified date and price, then underlying asset in the case of the index option is again the BSE index itself.

Stock Futures and Options

Stock futures and the stock options have the common characteristics as any other stock future or option traded by any index where the underlying asset is some stock.

Equity futures and options

The equity futures and options that were introduces by the Bombay Stock Exchange have a highest expiry period of 3 months.

Weekly options

The weekly options are similar to the monthly options apart from for the fact that these options are introduced on every Monday of each week and the option matures in a two weeks time.

There are various other indices that are used by the Bombay Stock Exchange and they are listed as follows :

- BSE 500
- BSE 100
- BSE 200
- BSE PSU
- BSE MIDCAP
- BSE SMLCAP
- BSE BANKEX
- BSE Tech

- BSE Auto
- BSE Pharma
- BSE Fast Moving Consumer Goods
- BSE Consumer Durables
- BSE Metal

Capital market Regulator and Important Regulations

SEBI Laws

An improved corporate governance is the key objective of the regulatory framework in the securities market. Accordingly, Securities and Exchange Board of India (SEBI) has made several efforts with a view to evaluate the adequacy of existing corporate governance practices in the country and further improve these practices. It is implementing and maintaining the standards of corporate governance through the use of its legal and regulatory framework, namely:-

1. Securities Contracts (Regulation) Act, 1956

This Act was enacted to prevent undesirable transactions and to check speculation in the securities by regulating the business of dealing therein. Any stock exchange, which is desirous of being recognised, may make an application in the prescribed manner to the Central Government. Every application shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts as well as a copy of the rules relating in general to the constitution of the stock exchange, and in particular to:- (i) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted; (ii) the powers and duties of the office bearers of the stock exchange; (iii) the admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and re-admission of members there from or there into; (iv) the procedure for the registration of partnerships as members of the stock exchange, in cases where the rules provide for such membership; and the nomination and appointment of authorized representatives and clerks.

Every recognized stock exchange shall furnish the Central Government with a copy of the annual report, and such annual report shall contain such particulars as may be prescribed. It may make rules or amend any rules made by it to provide for all or any of the following matters, namely:- (i) the restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting; (ii) the regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange; (iii) the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange; etc.

If, in the opinion of the Central Government, an emergency has arisen and for the purpose of meeting the emergency, the Central Government considers it expedient so to do, it may, by notification in the Official Gazette, for reasons to be set out therein, direct a recognised stock exchange to suspend such of its business for such period not exceeding seven days and subject to such conditions as may be specified in the notification, and, if, in the opinion of the Central Government, the interest of the trade or the public interest requires that the period should be extended, it may, by like notification extend the said period from time to time.

Securities Contracts (Regulation) Amendment Act, 2007 has been enacted in order to further amend the Securities Contracts (Regulation) Act, 1956, with a view to include securitization instruments under the definition of 'securities' and provide for disclosure based regulation for issue of the securitized instruments and the procedure thereof. This has been done keeping in view that there is considerable potential in the securities market for the certificates or instruments under securitization transactions. Further, replication of the securities markets framework for these instruments would facilitate trading on stock exchanges and, in turn, help development of the market in terms of depth and liquidity.

2. Securities and Exchange Board of India Act, 1992

This Act was enacted to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto. For this purpose, the SEBI (the Board), by regulation, specify:- (i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and (b) the manner in which such matters shall be disclosed by the companies.

No stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act.

No depository, participant, custodian of securities, foreign institutional investor, credit rating agency, or any other intermediary associated with the securities market as the Board may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act.

Further, no person shall sponsor or cause to be sponsored or carry on or caused to be carried on any venture capital funds or collective investment scheme including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations.

Every application for registration shall be in such manner and on payment of such fees as may be determined by regulations. The Board may, by order, suspend or cancel a certificate of registration in a prescribed manner, as may be determined by regulations under this Act. However, no order shall be made unless the person concerned has been given a reasonable opportunity of being heard.

3. Depositories Act, 1996

This Act was enacted to provide for regulation of depositories in securities and for matters connected therewith or incidental thereto. It provides for the introduction of scrip less trading system and settlement, which is considered necessary for the effective functioning of the securities markets. As per the Act, the term 'depository' means "a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992".

No depository shall act as a depository unless it obtains a certificate of commencement of business from the Board (the SEBI). The Board shall grant a certificate only if it is satisfied that the depository has adequate systems and safeguards to prevent manipulation of records and transactions. However, a certificate shall not be refused unless the depository concerned has been given a reasonable opportunity of being heard.

A depository shall enter into an agreement with one or more participants as its agent, in such form as may be specified by the bye-laws. Any person, through a participant, may enter into an agreement, in such form as may be specified by the bye-laws, with any depository for availing its services. Any such person shall surrender the certificate of security, for which he seeks to avail the services of a depository, to the issuer in such manner as may be specified by the regulations. The issuer, on receipt of certificate of security, shall cancel the certificate of security and substitute in its records the name of the depository as a registered owner in respect of that security and inform the depository accordingly. A depository shall, on receipt of information, enter the name of the person referred in its records, as the beneficial owner.

On receipt of intimation from a participant, every depository shall register the transfer of security in the name of the transferee. If a beneficial owner or a transferee of any security seeks to have custody of such security, the depository shall inform the issuer accordingly.

Every person subscribing to securities offered by an issuer shall have the option either to receive the security certificates or hold securities with a depository. Where a person opts to hold a security with a depository, the issuer shall intimate such depository the details of allotment of the security, and on receipt of such information the depository shall enter in its records the name of the allottee as the beneficial owner of that security.

A depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. However, it shall not have any voting rights or any other rights in respect of securities held by it. The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

The Board, on being satisfied that it is necessary in the public interest or in the interest of investors so to do, may, by order in writing,:- (i) call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or (ii) authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

SEBI

The **Securities and Exchange Board of India** (frequently abbreviated **SEBI**) is the regulator for the securities market in India. It was established in the year 1988 and given statutory powers on 12 April 1992 through the SEBI Act, 1992.

It was established by The Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament. SEBI has its Headquarters at the business district of Bandra Kurla Complex in Mumbai, and has Northern, Eastern, Southern and Western Regional Offices in New Delhi, Kolkata, Chennai and Ahmedabad respectively.

Controller of Capital Issues was the regulatory authority before SEBI came into existence; it derived authority from the Capital Issues (Control) Act, 1947.

Initially SEBI was a non statutory body without any statutory power. However in the year of 1995, the SEBI was given additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992. In April, 1988 the SEBI was constituted as the regulator of capital markets in India under a resolution of the Government of India.

The SEBI is managed by its members, which consists of following: a) The chairman who is nominated by Union Government of India. b) Two members, i.e. Officers from Union Finance Ministry. c) One member from The Reserve Bank of India. d) The remaining 5 members are nominated by Union Government of India, out of them at least 3 shall be whole-time members.

The office of SEBI is situated at SEBI Bhavan, Bandra Kurla Complex, Bandra East, Mumbai-400051, with its regional offices at Kolkata, Delhi,Chennai & Ahmadabad. It has recently opened local offices at Jaipur and Bangalore and is planning to open offices at Guwahati, Bhubaneshwar, Patna, Kochi and Chandigarh in Financial Year 2013 - 2014.

Functions and responsibilities

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto".

SEBI has to be responsive to the needs of three groups, which constitute the market:

- the issuers of securities
- the investors
- the market intermediaries.

SEBI has three functions rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three-member tribunal and is presently headed by Mr. Justice J P Devadhar, a former judge of the Bombay High Court. A second appeal lies directly to the Supreme Court. SEBI has taken a very proactive role in streamlining disclosure requirements to international standards.

Powers

For the discharge of its functions efficiently, SEBI has been vested with the following powers:

1. to approve by−laws of stock exchanges.sebi
2. to require the stock exchange to amend their by−laws.
3. inspect the books of accounts and call for periodical returns from recognized stock exchanges.
4. inspect the books of accounts of a financial intermediaries.
5. compel certain companies to list their shares in one or more stock exchanges.
6. registration brokers.

There are two types of brokers.

1.circuit broker 2.merchant broker

SEBI Committees

1. Technical Advisory Committee
2. Committee for review of structure of market infrastructure institutions
3. Members of the Advisory Committee for the SEBI Investor Protection and Education Fund
4. Takeover Regulations Advisory Committee
5. Primary Market Advisory Committee (PMAC)
6. Secondary Market Advisory Committee (SMAC)
7. Mutual Fund Advisory Committee
8. Corporate Bonds & Securitization Advisory Committee

SEBI Role

Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the functions of securities market. SEBI promotes orderly and healthy development in the stock market but initially SEBI was not able to exercise complete control over the stock market transactions.

It was left as a watch dog to observe the activities but was found ineffective in regulating and controlling them. As a result in May 1992, SEBI was granted legal status. SEBI is a body corporate having a separate legal existence and perpetual succession.

Reasons for Establishment of SEBI:

With the growth in the dealings of stock markets, lot of malpractices also started in stock markets such as price rigging, 'unofficial premium on new issue, and delay in delivery of shares, violation of rules and regulations of stock exchange and listing requirements. Due to these malpractices the customers started losing confidence and faith in the stock exchange. So government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI).

Purpose and Role of SEBI:

SEBI was set up with the main purpose of keeping a check on malpractices and protect the interest of investors. It was set up to meet the needs of three groups.

1. Issuers:

For issuers it provides a market place in which they can raise finance fairly and easily.

2. Investors:

For investors it provides protection and supply of accurate and correct information.

3. Intermediaries:

For intermediaries it provides a competitive professional market.

Objectives of SEBI:

The overall objectives of SEBI are to protect the interest of investors and to promote the development of stock exchange and to regulate the activities of stock market. The objectives of SEBI are:

1. To regulate the activities of stock exchange.
2. To protect the rights of investors and ensuring safety to their investment.
3. To prevent fraudulent and malpractices by having balance between self regulation of business and its statutory regulations.
4. To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

Functions of SEBI:

The SEBI performs functions to meet its objectives. To meet three objectives SEBI has three important functions. These are:

i. Protective functions
ii. Developmental functions
iii. Regulatory functions.

1. Protective Functions:

These functions are performed by SEBI to protect the interest of investor and provide safety of investment.

As protective functions SEBI performs following functions:

(i) It Checks Price Rigging:

Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities. SEBI prohibits such practice because this can defraud and cheat the investors.

(ii) It Prohibits Insider trading:

Insider is any person connected with the company such as directors, promoters etc. These insiders have sensitive information which affects the prices of the securities. This information is not available to people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e.g., the directors of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue. This is known as insider trading. SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading.

(iii) SEBI prohibits fraudulent and Unfair Trade Practices:

SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person.

(iv) SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.

(v) SEBI promotes fair practices and code of conduct in security market by taking following steps:

(a) SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in midterm.

(b) SEBI is empowered to investigate cases of insider trading and has provisions for stiff fine and imprisonment.

(c) SEBI has stopped the practice of making preferential allotment of shares unrelated to market prices.

2. Developmental Functions:

These functions are performed by the SEBI to promote and develop activities in stock exchange and increase the business in stock exchange. Under developmental categories following functions are performed by SEBI:

(i) SEBI promotes training of intermediaries of the securities market.

(ii) SEBI tries to promote activities of stock exchange by adopting flexible and adoptable approach in following way:

(a) SEBI has permitted internet trading through registered stock brokers.

(b) SEBI has made underwriting optional to reduce the cost of issue.

(c) Even initial public offer of primary market is permitted through stock exchange.

3. Regulatory Functions:

These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

Possible Questions

Part – A (Online Examination)

Part – B (2 Marks Questions)

1. Define Securities.
2. Name any four fixed income Securities.
3. List any four Government Securities.
4. What is meant by Equity?
5. What is meant by Debenture?
6. Define derivatives.
7. Mention any four financial products trading in OTC market.
8. List out participants in security trade.
9. State the meaning of financial market.
10. What are global financial markets?
11. What is stock exchange?
12. List the main features of BSE.
13. Mention the Features of NSE.
14. Who is called capital market regulators?
15. Define SEBI.
16. State the functions of SEBI.

Part – C (6 Marks Questions)

1. Define securities and explain the different kinds of securities with their features.
2. Explain the global financial system.
3. Define Stock exchange. What are the features? Explain the functions of Stock Exchange.
4. Explain the participants in a trade.
5. Define derivatives and discuss out the different types of derivatives with its features.
6. Discuss the important capital market regulations and important regulations.
7. What do you meant by securities market? Explain the benefits of securities market in detail.
8. "Investment is both importance and useful in the context of present day conditions" analyze the statement.
9. Explain the Indian financial system in detail.
10. Explain various operation functions performed by BSE and NSE.

S.NO.	QUESTION	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
1	A ------------------ is the allocation of funds to assets and securities after considering their return and risk features	gambling	Investment	Speculation	Bonds	Investment
2	Investment in gold and silver is considered ------------- investment	real investment	risk free	risk	certain	real investment
3	The stock that higher rate of growth than the industrial growth rate in profitability are referred to as -----------	growth shares	equity	preference	debenture	growth shares
4	Gambling is a	very long term investment	very short term investment	medium investment	average investment	very short term investment
5	The securities issued by the central , state and quasi-government are known as ----------	face value	real investment	government securities	intrinsic securities	govt securities
6	A ----------------is an activity that is engaged in by people who have savings	gambling	Investment	Speculation	Bonds	investment
7	An example of money market instrument is	bond	debenture	stock certificate	certificate of deposit	certificate of deposit
8	Government bond is a	Long-term security	short-term security	medium-term securities	neither long-term or short-term	Long-term security

9	Investing money in a private business is known as -------	financial investment	economic investment	business investment	social investment	business investment
10	LIC is primarily a	broker	money market intermediary	Secondary market intermediary	lenders	money market intermediary
11	Financial systems includes	financial market	share market	financial and share market	capital market	financial market
12	The differences between the sale price and the purchase price is called -----------------	depreciation	capital appreciation	investment	gambling	capital appreciation
13	Money market is a market for purely	long term funds	medium term funds	short term funds	certain period	short term funds
14	A ----- is an optimistic speculator	bear	stag	bear	lame duck	bull
15	The financial system as it existed in India at	1988	1947	1926	1977	1947
16	Investment is the	net addition made to the nation's capital stock	person's commitment to buy a flat	employment of funds on assets to earn return	monetary system	employment of funds on assets to earn return
17	Gambling is	an intelligent speculation	based on rumors	successful speculation	game	based on rumors
18	If the investment is properly undertaken, then	the return will commensurate with the risk	the return will be certain	it will be liquid	not commensurate	the return will commensurate with the risk
19	Investors buy	high grade securities	low grade securities	securities for short-term purposes	cost of purchase	high grade securities

20	The negotiable financial investment differs from non-negotiable financial investment in terms of	face value	transferability	maturity period	interest rate	transferability
21	Investment made in real estate is a	real investment	financial investment	non-financial investment	intangible investment	real investment
22	Which one of the following is not a fixed income bearing security?	debentures	bonds	fixed deposits	equity shares	equity shares
23	Which one the following scheme helps in reducing tax liability?	investment in real estate	national saving certificate	equity shares	savings bank account	national saving certificate
24	Which one of the following is a contingent investment?	recurring deposit	bonds	equity shares	life insurance policy	life insurance policy
25	A current account is a	liquid period	running account	mutual	temporary	running account
26	The component of a capital market is	treasury bill market	govt. securities market	commercial bill market	RBI	govt. securities market
27	Government securities are	risky securities	not risky securities	expected securities	mutual securities	not risky securities
28	Long term loan market is	capital market	money market	primary market	secondary market	capital market
29	Government securities are issued in the form	pledge	new method	promissory note	prepaid	promissory note
30	________includes the financial markets and the financial institutions	financial system	fiscal policy	economy rates	nature of the firm	financial system

31	_________Includes call money market, treasury bills market, commercial bills, and short term loan market	Insurance company	LIC	RBI	the imperial bank of India	the imperial bank of India
32	The price of preference shares is determined by ____	Demand	Supply	Demand and Supply	Return	Demand and Supply
33	The terminal value of real estate is	Certain	Uncertain	Risk	Return	Uncertain
34	________ are the integral part of an investment decision	Risk	Uncertainty	Risk & Uncertain	Return	Risk & Uncertain
35	_____ risk is also called as operating risk	Financial risk	Business risk	Management risk	Political risk	Business risk
36	The objectives of any investments made by an investor	Maximization of return	Maximization of return and Maximum of risk	Minimization of return	Minimization of risk	Maximization of return and Maximum of risk
37	A voluntary provident fund scheme called Public Provident Fund is operated by	Post office	Certain authorized Banks	Employee Provident fund organization	Post office and Certain authorized Banks	Post office and Certain authorized Banks
38	Fixed income securities are subject to ________ risk	Interest rate	Performance	Capital	Dividends	Interest rate
39	______ is operated by Post office and Certain authorized Banks	Public Provident Fund	LIC Scheme	Employee Provident fund	Equity capital fund	Public Provident Fund
40	building , machinery & land are considered as	Tangible properties	Intangible properties	Tangible and Intangible properties	Visible properties	Tangible properties

41	the __________ acquire bonds and automatically accept the indenture	shareholder	investor	bondholder speculator	broker	bondholder speculator
42	The activities of ___________have been divided into three points. i.e. origination, underwriting and distribution	New issue market	stock exchange	secondary market	SEBI	stock exchange
43	It is transaction generally made by the bear speculator whereby the speculator acquire a right to sell is known as	call option	put option	the jobber	trader	put option
44	Investment in debentures is known as ---------- securities	debtor ship	creditor ship	assets	liabilities	creditor ship
45	The Stock exchanges in India are regulated by the securities contract act	Feb 20 1955	Feb 20 1957	Feb 20 1958	Feb 20 1960	Feb 20 1957
46	A doctorate of stock exchange was setup in	1956	1957	1958	1969	1969
47	Capital issues control act was passed in	1940	1945	1947	1957	1947
48	The most popular method for floating shares in new issue market is____	Prospectus	Offer for sale	Placement	Rights issue	Prospectus
49	The financier in the stock exchange is called	Budiwalla	Tarniwalla	Floorbroker	Oddlot dealer	
50	Bombay stock exchange was recognized on a permanent basis in the year	1956	1992	1958	1959	1992

51	OTCEI is	a national stock exchange	a regional stock exchange	primary market	a government undertaking	a national stock exchange
52	Members of OTCEI are	corporate only	individual only	corporate as well as individual	government	corporate only
53	NSE was set up	1956	1992	1986	1987	1992
54	NSE is a fully automated	screen based	brokerage	marketing	transferring	screen based
55	NSE trading ensures total ________of the transaction	identity	grievances	transparency	security	transparency
56	The identity of the NSE trading members is kept	secrecy	transparency	wide	circulating	secrecy
57	NSE aims at	short term settlement	long term settlement	Both a&b	medium term	short term settlement
58	The premium of the call option is directly related to	stock price	market price	current price	standard price	stock price
59	The option buyer gains in the	stock market	primary market	secondary market	bearish market	secondary market
60	The main function entrusted with SEBI is	capital formation	regulating the business stock exchanges and any other securities market	issue of securities	giving financial assistance to stock exchange	regulating the business stock exchanges and any other securities market

Unit II

Investment Banking : Basics of investment banking – Trade Life Cycle – Clearing and Settlement - Securities Lending – Prime Brokerage – Collateral management - Corporate Actions – Mandatory & Voluntary – Corporate Actions : How they affects Securities.

Investment Banking

Investment banking is a special segment of banking operation that helps individuals or organizations raise capital and provide financial consultancy services to them. They act as intermediaries between security issuers and investors and help new firms to go public. They either buy all the available shares at a price estimated by their experts and resell them to public or sell shares on behalf of the issuer and take commission on each share.

Investment banking is among the most complex financial mechanisms in the world. They serve many different purposes and business entities. They provide various types of financial services, such as proprietary trading or trading securities for their own accounts, mergers and acquisitions advisory which involves helping organizations in M&As,; leveraged finance that involves lending money to firms to purchase assets and settle acquisitions, restructuring that involves improving structures of companies to make a business more efficient and help it make maximum profit, and new issues or IPOs, where these banks help new firms go public.

Investment banking is the division of a bank or financial institution that serves governments, corporations, and institutions by providing underwriting (capital raising) and mergers and acquisitions (M&A) advisory services. Investment banks act as intermediaries between investors (who have money to invest) and corporations (who require capital to grow and run their businesses). This guide will cover what investment banking is and what bankers actually do.

Investment Banking Operations

There can sometimes be confusion between an investment bank and the investment banking division (IBD) of the bank. Full-service investment banks offer a wide range of services that include underwriting, M&A, sales and trading, equity research, and asset management. The investment banking division provides only the underwriting and M&A advisory services.

Full-service banks offer the following services:

- **Underwriting** – Capital raising and underwriting groups work between investors and companies that want to raise money or go public via the IPO process. This function serves the primary market or "new capital".
- **Mergers & Acquisitions (M&A)** – Advisory roles for both buyers and sellers of businesses, managing the M&A process start to finish.
- **Sales & Trading** – Matching up buyers and sellers of securities in the secondary market. Sales and trading group act as agents for clients and also can trade the firm's own capital.
- **Equity Research** – The equity research group research or "coverage" of securities to help investors make investment decisions and support trading of stocks.
- **Asset Management** – Managing investments for a wide range of investors including institutions and individuals, across a wide range of investment styles.

Underwriting services

Underwriting is the process of raising capital through selling stocks or bonds to investors (e.g. an initial public offing IPO) on behalf of corporations. Businesses need money to operate and grow their businesses, and the bankers help them get that money by marketing the company to investors.

There are generally three types of underwriting:

- **Firm Commitment** – The underwriter agrees to buy the entire issue and assume full financial responsibility for any unsold shares.
- **Best Efforts** – Underwriter commits to selling as much of the issue as possible at the agreed-on offering price but can return any unsold shares to the issuer without financial responsibility.
- **All-or-None** – If the entire issue cannot be sold at the offering price, the deal is called off and the issuing company receives nothing.

Once the bank has started marketing the offering, the following book-building steps are taking to price and complete the deal.

M&A advisory services

Mergers and acquisitions (M&A) advisory is the process of helping corporations and institutions find, evaluate, value, and complete acquisitions of businesses. Banks use their extensive networks and relationships to find opportunities and help negotiate on their client’s behalf. Bankers advise on both sides of M&A transactions, representing either the “buy side” or the “sell side” of the deal.

Investment banking clients

Investment bankers advise a wide range of clients on their capital raising and M&A needs. These clients can be located around the world.

Investment banks’ clients include:

- **Governments** – Investment banks work with governments to raise money, trade securities, and buy or sell crown corporations.
- **Corporations** – Bankers work with private and public companies / operating businesses (known as “corporations” or “corporate”) to help them go public (IPO), raise additional capital, growth their business, make acquisitions, sell business units, provide research for them and general corporate finance advice.

- **Institutions** – Banks work with institutional investors who manage other people's money (known as "institutions") to help them trade securities and provide research.

Investment banking skills

Investment banking work requires a lot of financial modelling and valuation. Whether for underwriting or M&A activities, Analysts and Associates at banks spend a lot of time in Excel building financial models and use various valuation methods to advise their clients and complete deals.

Bankers require the following skills:

- Financial modeling
- Business valuation
- Pitch books and presentations
- Transaction documents
- Relationships management
- Sales and business development
- Negotiation

Trade Life Cycle

It is a process of **buying and selling** any financial instrument. Just like any other product even a trade has its life cycle involving several steps, as those with a career in investment banking know.

Steps involved in a Trade Life Cycle

Overview of the Process

1. Sale

- This is a process of **client acquisition** in which HNIs or Institutional clients are **introduced to various investment products** or vehicles.
- These vehicles or products are **available with an Investment Manager or Bank** by whom the client's investments are managed.
- The investments are **collectively called a Mutual or a Hedge fund**.

2. Trade Initiation and Execution

- This is the process of **placing an order in the market**.
- Trade Initiation and Execution **can be done both in Order and Quote-driven markets**.
- This **depends on the choice of a marketplace and on the external platform**.
- Once the order is **placed and it gets matched**, the trade is said to be **executed**.

3. Trade Capture

- Trades are then **booked internally in an FO system** for it to **flow** down to the **operating systems**.
- It is booked in a **Risk Management System** (RMS)

4. Trade Validation and Enrichment – Reference data team set up the static and dynamic details which help middle office teams to validate the trade, before releasing instructions into the market.

Repository for data management

SSIs	Security Identifier
Currency	Counterparty
Holiday Calendar	Markets

5. **Trade Confirmation**

- This is an extremely **critical step** for the trade settlement.
- Trade **details and SSIs are agreed** with the counterparty **at least a day prior** to settlement date. Confirmation via depositories like Euro clear/DTCC

6. Trade Settlement – This is the process of simultaneous exchange of **cash versus securities for a security trade** or **cash versus cash for a Derivative trade**.

7. **Reconciliation** – Reconciliation involves matching ledgers against statements to ensure correct accounting of all trade booked.

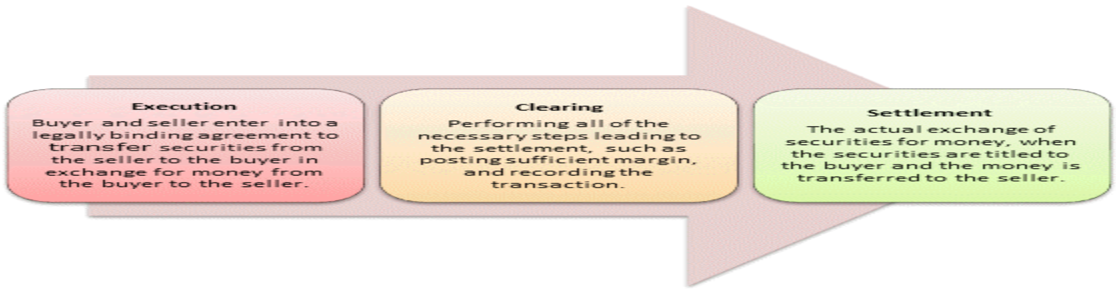
Clearing and Settlement

Any transfer of financial instruments, such as stocks, in the primary or secondary markets involves 3 processes:

1. execution
2. clearing
3. settlement

Execution is the transaction whereby the seller agrees to sell and the buyer agrees to buy a security in a legally enforceable transaction. Thereafter, all the processes that lead up to settlement is referred to as clearing, such as recording the transaction. Settlement is the actual exchange of money, or some other value, for the securities.

Clearing is the process of updating the accounts of the trading parties and arranging for the transfer of money and securities. There are 2 types of clearing: bilateral clearing and central clearing. In **bilateral clearing**, the parties to the transaction undergo the steps legally necessary to settle the transaction. **Central clearing** uses a third-party — usually a clearinghouse — to clear trades. Clearinghouses are generally used by the members who own a stake in the clearinghouse. Members are generally broker-dealers. Only members may directly use the services of the clearinghouse; retail customers and other brokerages gain access by having accounts with member firms. The member firms have financial responsibility to the clearinghouse for the transactions that are cleared. It is the responsibility of the member firms to ensure that the securities are available for transfer and that sufficient margin is posted or payments are made by the customers of the firms; otherwise, the member firms will have to make up for any shortfalls. If a member firm becomes financially insolvent, only then will the clearinghouse make up for any shortcomings in the transaction.



Clearing and settlement process

For buying shares

Day 1 – The trade (T Day), Monday

Assume on 23rd June 2014 (Monday) you buy 100 shares of Reliance Industries at Rs.1,000/- per share. The total buy value is Rs.100,000/- (100 * 1000). The day you make the transaction is referred to as the trade date, represented as 'T Day'.

By the end of trade day your broker will debit Rs.100,000/- and the applicable charges towards your purchase. Assuming the trade is executed through Zerodha, the applicable charges would be as follows:

Sl No	Chargeable Item	Applicable Charges	Amount
01	Brokerage	0.1% or Rs.20/- whichever is lower	20/-
02	Security Transaction Charges	0.1% of the turnover	100/-
03	Transaction Charges	0.00325% of the turnover	3.25/-
04	Service Tax	12% of Brokerage + Transaction charges	2.79/-
05	Education Cess	2% of service tax	0.0558/-
06	Higher education Cess	1% of service tax	0.0279/-
07	SEBI Charges	Rs.20 per crore of transaction	0.2/
Total			**126.32/-**

So an amount of Rs.100,000/- plus Rs.126.32/- (which includes all the applicable charges) totalling Rs.100,126.32/- will be debited from your trading account the day you make the transaction. Do remember, the money goes out of your account but the stock has not come into your DEMAT account yet.

Also, on the same day the broker generates a 'contract note' and sends you a copy of the same. A contract note is like a bill generated detailing every transaction your made. This is an important document which is worth saving for future reference. A contract note typically shows a break up of all transactions done during the day along with the trade reference number. It also shows the breakup of charges charged by the broker.

Day 2 – Trade Day + 1 (T+ day, Tuesday)

The day after you made the transaction is called the T+1 day. On T+1 day you can sell the stock that you purchased the previous day. If you do so, you are basically doing a quick trade called "Buy Today, Sell Tomorrow" (BTST) or "Acquire Today, Sell Tomorrow" (ATST). Remember the stock is not in your DEMAT account yet. Hence, there is a risk involved, and you could be in trouble for selling a stock that you don't really own. This doesn't mean, every time you do a BTST trade you end up in trouble, but it does once in a way especially when you trade B group and illiquid stocks. The reason why this happens is a little convoluted, and we deliberately will not touch this topic now.

If you are starting fresh in the markets, I would suggest you do not do BTST trades unless you understand the risk involved.

From your perspective nothing happens on T+1 day. However in the background the money required to purchase the shares is collected by the exchange along with the exchange transaction charges and Security transaction tax.

Day 3 – Trade Day + 2 (T+2 day, Wednesday)

On day 3 or the T+2 day, around 11 AM shares are debited from the person who sold you the shares and credited to the brokerage with whom you are trading, who will in turn credit it to your

DEMAT account by end of day. Similarly money which was debited from you is credited to the person who sold the shares.

The shares will now start reflecting in the DEMAT account indicating that you own 100 shares of Reliance.

So for all practical purposes if you buy a share on day T Day, you can expect to receive the shares in your DEMAT account only by end of T+2 day. The shares are available for transaction on T+3day.

For sell a stock

The day you sell the stocks is again called the trade day, represented as 'T Day'. The moment you sell the stock from your DEMAT account, the stock gets blocked .Before the T+2 day the blocked shares are given to the exchange. On T+2 day you would receive the funds from the sale which will be credited to your trading account after deduction of all applicable charges.

Outline of C & S

1. The day you make a transaction, it is called the trade date, represented as 'T Day'
2. The broker is required to issue you a contract note for all the transactions carried out by end of T day
3. When you buy a share, the same will be reflected in your DEMAT account by end of T+2 day
4. All equity/stock settlements in India happen on a T+2 basis
5. When you sell shares, the shares are blocked immediately and the sale proceeds credited again on T +2 day

Securities Lending

Securities lending or **stock lending** refers to the lending of securities by one party to another. The terms of the loan will be governed by a "Securities Lending Agreement", which requires that the borrower provides the lender with collateral, in the form of cash or non-cash securities, of value equal to or greater than the loaned securities plus agreed upon margin. Non-cash refers to the subset of collateral that is not pure cash, including equities, government bonds, convertible bonds, corporate bonds, and other products. The agreement is a contract enforceable under relevant law, which is often specified in the agreement.

As payment for the loan, the parties negotiate a fee, quoted as an annualized percentage of the value of the loaned securities. If the agreed form of collateral is cash, then the fee may be quoted as a "short rebate", meaning that the lender will earn all of the interest which accrues on the cash collateral, and will "rebate" an agreed rate of interest to the borrower. Key lenders of securities include mutual funds, insurance companies, pension plans and other large investment portfolios.

Securities lending is an important means of eliminating "failed" transactions as well as enabling hedge funds and other investment vehicles to sell shares short.[3]

Securities lending is legal and clearly regulated in most of the world's major securities markets. Most markets mandate that the borrowing of securities be conducted only for specifically permitted purposes, which generally include;

1. to facilitate settlement of a trade,
2. to facilitate delivery of a short sale,
3. to finance the security, or
4. to facilitate a loan to another borrower who is motivated by one of these permitted purposes.

When a security is loaned, the title of the security transfers to the borrower.[7] This means that the borrower has the advantages of holding the security, as they become the full legal and beneficial owner of it. Specifically, the borrower will receive all coupon and/or dividend payments, and any other rights such as voting rights. In most cases, these dividends or coupons must be passed back to the lender in the form of what is referred to as a "manufactured dividend".

The initial driver for the securities lending business was to cover settlement failure. If one party fails to deliver stock to you it can mean that you are unable to deliver stock that you have already sold to another party. In order to avoid the costs and penalties that can arise from settlement failure, stock could be borrowed at a fee, and delivered to the second party. When your initial stock finally arrived (or was obtained from another source) lender would receive back the same number of shares in the security they lent.

The principal reason for borrowing a security is to cover a short position. As you are obliged to deliver the security, you will have to borrow it. At the end of the agreement you will have to return an *equivalent* security to the lender. Equivalent in this context means *fungible*, i.e. the securities have to be completely interchangeable. Compare this with lending a ten euro note. You do not expect exactly the same note back, as any ten euro note will do.

As a result of Regulation SHO, adopted by the SEC, short sellers typically must either possess the shares they are selling short or have a right to obtain them in order to cover the short sale.

Securities classification and easy-to-borrower

In securities lending, securities are classified by their availability to be borrowed. Highly liquid securities are considered "easy"; these products are easily found on the market should someone decide to borrow them for the purpose of selling them short. Securities that are illiquid in the market are classified as "hard". Due to various regulations, a short sale transaction in the United States and some other countries must be preceded by locating the security and quantity that one would like to be able to sell short in order to avoid naked shorting. However, the lending broker can create a list of securities that do not require such a locate. This list is referred to as an easy-to-borrow (abbreviated as ETB) list, and is also known as blanket assurances. Such a list is generated by broker-dealers based on "reasonable assurance"[8] that the securities on the list are readily available upon customer request. However, if a security on the list cannot be delivered as promised (a "failure to deliver" would occur), the assumption of reasonable grounds no longer applies. In order to provide better grounding for such assumptions, the ETB list must be at most 24 hours old.

Securities lenders

Securities lenders**,** often simply called sec lenders, are institutions which have access to 'lendable' securities. This can be asset managers, who have many securities under management, custodian banks holding securities for third parties or third party lenders who access securities automatically via the asset holder's custodian. The international trade organization for the securities lending industry is the International Securities Lending Association. According to a June 2004 survey, their members had euro 5.99 billion worth of securities available for lending. In the US, the Risk Management Association publishes quarterly surveys among its (US based) members. In June 2005, these had USD 5.77 billion worth of securities available. Other industry associations of note include the Australian Securities Lending Association (ASLA), the Canadian Securities Lending Association (CASLA), the Pan Asia Securities Lending Association (PASLA), and the South African Securities Lending Association (SASLA).

Securities lending lifecycle

Unlike a buy / sell trade, a securities lending transaction has a lifecycle that starts with the trade settling, and continues through until it is finally returned. During this life cycle, various life cycle events will occur:

Settlement – Perhaps obvious, but both the initial trade and the subsequent return have to be instructed to market correctly and settlement monitored

1. **Collateralization** – As mentioned above, the lender must receive collateral to ensure that they are adequately covered in the event of borrower default. Securities lending is very safe for lenders, since they will always receive the additional margin value above the value of the securities lent – margins range from 2–10% usually, depending upon lender risk profile and the settlement market. The collateral process differs depending on collateral method – main ones used are cash, cash pool, bilateral collateral and RQV through a triparty provider (such as Bank of New York, JP Morgan Chase, Euro clear or Clear stream).
2. **Billing** – For most securities lending transactions, fees or rebates will accrue and will then be reconciled and paid on a monthly billing cycle. This ensures again that the lender is receiving their fee for the trade in a timely manner, and able to pass it along to the original beneficial owner.
3. **Dividends** – If a security is borrowed over an announced cash dividend record date, then the borrow must 'manufacture' back the dividend to the original owner of the securities through a dividend payment.
4. **Corporate actions** – If a security is borrowed over an announced corporate action record date – are it mandatory or voluntary in nature – the borrower must process the corporate action as per the instructions from the lender.
5. **Returns** – Once the borrower no longer requires a security, they can initiate a return by calling it in to the trading desk of the lender.

Prime Brokerage

Prime brokerage involves services such as securities lending, risk management, cash management, leverage buyouts, and more, which are offered to qualified customers, i.e. bulge bracket banks like Morgan Stanley or Goldman Sachs.

A brokerage firm may also provide leveraged financing and custodian services to individual investors. The financial crisis of 2008 led several brokerage firms to restructure. JP

Morgan absorbed Bear Stearns; Barclays and Nomura acquired Lehman Brothers; Bank of America acquired Merrill Lynch. On the other hand, Goldman Sachs and Morgan Stanley remained untouched, although they had greater exposure to risk.

History of Prime Brokerage

The growth in the number of hedge funds as well as the scale of their operations quickly created the need for a special kind of intermediary that would cater to their needs. This intermediary was the "prime broker". The prime brokerage business quickly caught the attention of many investment banks as it became a significant source of revenue.

Today all major investment banks have a prime brokerage business and it forms a significant chunk of their revenues. Also, hedge funds are almost the only clients that prime brokerages have. An increase in the number of prime brokerage firms while the number of hedge funds has remained constant has caused intense competition in the industry.

Prime brokerages evolved from the ever increasing scale of hedge fund operations. As hedge funds started trading regularly, their operations became complex and difficult to manage. The technology and infrastructure required to manage these operations was expensive and since it was not a part of the hedge fund's core business, it was not a worthwhile investment.

However, major investment banks already had the infrastructure in place to manage investments worth billions of dollars. They would therefore provide this service to the hedge funds in return for a fee. The services provided were many and varied. It is for this reason that it has been difficult to come to a precise definition of what constitutes a prime brokerage firm. Some of the services provided by prime brokerage firms are mentioned below.

Services Provided By Prime Brokerage

- **Funding:** Hedge funds, by definition, are highly levered business entities. The money received from investors is further levered by taking loans from prime brokerages. A prime broker provides access to a virtually unlimited pool of money at short notice for reasonable interest rates. In return for providing this service, they get the brokerage business of hedge funds. Hedge funds use the money provided by these brokerage firms to buy securities. Later, they use the same securities as collateral to borrow even more! Leverage ratios of 10:1 are very common and prime brokerage firms are comfortable proving these supposedly risky services for a reasonable fee.

- **Settlements:** Hedge funds usually have a lot of open positions open across asset classes. Also, the turnover rate is quite high meaning that assets are replaced by other assets quite frequently. Hence, the process of clearing and settlement for these trades has to be highly efficient. Hedge funds do not have the infrastructure required to manage these trades. However, since prime brokerages are investment banks, they do have such infrastructure. Therefore as a value added service, prime brokers provide clearing and settlement services to their clients.
- **Reporting:** The large and varied portfolio of hedge funds warrants the use of a specialist to track the positions and provide data to the decision makers. The speed and accuracy of this data is crucial since decisions need to be made really quickly. Once again investment banks have the infrastructure to provide such services and allow their prime brokerage units to use it to provide a value added service in order to retain the client.

Since prime brokerages provide these generic services, there is a lot of competition amongst them. This competition is benefitting the hedge fund industry. Many prime brokers go as far as providing some sort of seed fund for the hedge fund to lure a hedge fund to take up their services.

Regulation

The prime brokerage industry is virtually unregulated across the world. However, in the United States there is some amount of regulation. For instance, a prime broker cannot open an account unless there is at least $500000 in equity in the case of an individual or $1000000 in equity in case of an organization. Ambiguity arises when prime brokerages based out of United States fund operations within the United States. The regulation is not quite strong enough and market participants are able to find quite a few loopholes.

Financial market participants are averse to any kind of regulation. This has caused a lot of hedge funds to shift their businesses to offshore locations. For instance, Morgan Stanley has been amongst the first firm to start an international prime brokerage desk at its London office.

Collateral Management

Collateral management is a process. It helps to reduce counterparty credit exposures. It is normally used with over-the-counter derivatives like swaps and options. If two parties agree to enter into collaterisation this is what happens.

1. The two parties negotiate and execute a collateral support document, (CSD), this contains the terms and conditions under which collateralization will take place.

2. The trades subject to collateral are regularly marked-to-market. Their net valuation is then agreed.

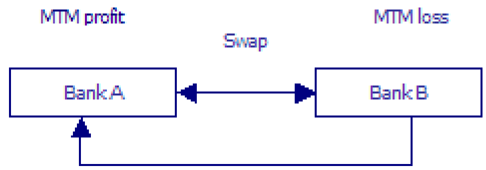
3. The party with the negative MTM on the trade portfolio delivers collateral to the party with the positive MTM.

4. As prices move and new deals are added the valuation of the trade portfolio will change.

5. Depending on what is agreed the valuation is repeated at frequent intervals-typically daily, weekly or monthly.

6. The collateral position is then adjusted to reflect the new valuation. The process continues unless one of the parties defaults.

In simple terms the collateral process is very similar to futures variation margining. The party that has a MTM loss must post collateral, (see the diagram below).



The party with the MTM loss provides collateral to the party with the MTM profit. The process is repeated daily and the posted collateral changes with the value of the trades.

Suppose your counterparty defaulted and from your perspective the trade portfolio is "in-the-money", normally you would have an unsecured credit exposure.

But with collateral, provided you serve the appropriate legal notices, you can terminate the trades and use the collateral as repayment. Provided the collateral value is sufficient your MTM profit is protected. Your credit risk has been mitigated.

This all sounds simple. But there is more to collateral than meets the eye. Let's look at some of the issues.

This market is growing. According to ISDA there were over 70,000 collateral agreements in place covering USD1.017 trillion of collateral in 2005. As derivative markets have grown today's figure will be higher. If you use OTC derivatives it is likely you have collateral agreements in place. If not it is probable that you will be asked. Agreeing collateral documentation is a process of negotiation you do not have to accept all the terms requested and you can impose some of your own.

Collateral management has benefits. It can reduce potential credit losses and capital usage, it can increase the number of transactions you do with a party and may also reduce dealing spreads.

Normally OTC derivatives are subject to collateral. Careful consideration should be given to the trades included. If you cannot accurately value the trade you will be reliant on the valuation made by the counterparty. This is why some parties restrict collateral to swaps and exclude complex trades.

The most popular form of collateral is cash. In 2005 ISDA indicated that USD and EUR cash accounted for 73% of collateral assets.

Why is cash so popular? Because cash has big advantages, it is easy to value, transfer and hold.

When you give cash collateral you receive interest. When you take cash collateral you pay interest. In the documentation it is normal to mutually agree the use of an overnight index rate like EONIA.

`It can also use other forms of collateral like bonds. Depending on their credit rating and liquidity they may be subject to a valuation percentage or haircut.

It can think of collateral management as a process that exchanges credit risk for operational risk. If you are considering implementing collateral management you may wish to consider the following points:

- still need to assess the creditworthiness of your counterparty.
- The reasons why you are using collateral should be documented.

- The legal agreements used must be suitable and enforceable.
- The regular process of collateral calls and returns will need to be carried out by a responsible individual or team.
- Timely and accurate valuation data needs to be used.
- They will need to know what type of collateral is applicable, the valuation percentages, independent amounts, thresholds, minimum transfer amounts, rounding amounts and currencies that apply.
- They will also need to know what collateral is currently in transit and what events are pending each day.
- The reduction in credit risk as a result of collateralization needs to be captured by credit management systems.
- Failure by the counterparty to deliver collateral will need to be swiftly followed up.
- There needs to be the appropriate escalation processes for disputes and defaults.

Some of the terms used are explained in more detail below:

Call & return amounts: The collateral amount that is being requested or given back.

Credit support document (CSD): CSDs are the documents that are agreed between the two parties that are establishing a collateral relationship. Normally the trades are documented under an ISDA Master Agreement, the CSDs then take the form of an annex or supplement to the Master Agreement.

Independent Amounts: The independent amount is an additional credit support amount that is required over and above the market value of the trade portfolio. The main purpose of the independent amount is to cater for changes in the market value of the trades between collateral calls. The independent amount can be a fixed amount or a percentage of the nominal size of the portfolio. There is resistance to providing an independent amount because it can adversely affect a firm's liquidity.

Mark-to-market (MTM): The current market value of a trade or trade portfolio.

Minimum transfer amount (MTAs): Collateral calls for amounts smaller than the MTA are not permitted. MTAs are designed to prevent the calling of nuisance amounts. This avoids unnecessary costs involved in small transfers. Typically the MTA will lie in the range of $50,000-$1,000,000. Increasingly there is a trend to set the independent amount at zero and use the MTA as a type of threshold.

Netting: Netting permits individual trade values to be added together to provide a single exposure. This is important to collateral management. If netting cannot be enforced you may end up with a gross exposure to the counterparty and insufficient collateral to cover it.

Threshold amounts: The threshold amount is an unsecured credit exposure that the parties are prepared to accept before asking for collateral. Ideally threshold amounts are set at relatively low levels in order to maximise credit risk mitigation.

Trade portfolio: The trades that are subject to the collateral process.

Valuation percentage: This is also called a "haircut". It is a percentage by which the market value of the collateral will be reduced. For example, collateral with a market value of $10m and a valuation percentage of 98% is only recognised as $9.8m for collateral purposes. Valuation percentages protect the collateral taker against falls in the value of the collateral during the period between collateral calls.`

Corporate Action

A **corporate action** is an event initiated by a public company that will bring an actual change to the securities—equity or debt—issued by the company. Corporate actions are typically agreed upon by a company's directors and authorized by the shareholders. Examples of corporate actions include stock splits, dividends, mergers and acquisitions, rights issues, and spin-offs.

Some corporate actions such as a dividend (for equity securities) or coupon payment (for debt securities) may have a direct financial impact on the shareholders or bondholders; another example is a call (early redemption) of a debt security. Other corporate actions such as stock split may have an indirect impact, as the increased liquidity of shares may cause the price of the stock to decrease. Some corporate actions, such as name changes or symbol changes to better reflect a company's business focus, have no direct financial impact on the shareholders; they may have to get a new CUSIP, however For example, "Apple Computers" changed its name to Apple Inc.

Types

There are three types of corporate actions: voluntary, mandatory, and mandatory with choice.

1. Mandatory corporate action:

A mandatory corporate action is an event initiated by the board of directors of the corporation that affects all shareholders. Participation of shareholders is mandatory for these corporate actions. An example of a mandatory corporate action is cash dividend. A shareholder does not need to act to receive the dividend. Other examples of mandatory corporate actions include stock splits, mergers, pre-refunding, return of capital, bonus issue, asset ID change, and spin-offs. Strictly speaking, the word "mandatory" is not appropriate because the shareholder is not required to do anything; the shareholder is just a passive beneficiary in all the cases cited above. There is nothing the shareholder has to do or does in a Mandatory Corporate Action.

Mandatory Corporate Actions Includes Cash Dividend, Stock Splits, Mergers, Pre-refunding, Return of capital, Bonus Issue, Asset ID Change, Pari-passu and Spinoffs.

- **Stock Split and Reverse Spilt**: A corporate action in which a company's existing shares are divided into multiple shares. For Ex. A company with 100 shares of stock price Rs 50 per share (100*50 = 5000). The company splits it shares 2 for 1. There are now 200 shocks for Rs 25 each (200*25 = 5000) . The reason why companies split their stock is to make them more affordable to investors because stock price reduces after it is split. Likewise, reverse split increases the stock price while reducing number of outstanding shares.
- **Spin-Offs**: Spin off means a company breaking up itself into smaller units. The creation of an independent company through the sale or distribution of new shares of an existing business/division of a parent company.
- **Dividend Payouts**: Dividend is the payment made to the investor for sharing the profits a company has made.
- **Mergers and Acquisitions**: Mergers is a event where two or more companies merge into one aiming to be more competitive and for more profitability. Likewise Acquisition means a bigger company acquiring a smaller one for further expansion.
- **Bonus Issue**: It is an additional dividend given to the shareholders that can be in cash or in the form of stock. When companies have outstanding performance with surplus profit, they may decide to issue bonus to the shareholders.

2. Voluntary corporate action:

A voluntary corporate action is an action where the shareholders elect to participate in the action. A response is required for the corporation to process the action. An example of a voluntary corporate action is a tender offer. A corporation may request shareholders to tender their shares at a predetermined price. The shareholder may or may not participate in the tender offer. Shareholders send their responses to the corporation's agents, and the corporation will send the proceeds of the action to the shareholders who elect to participate. Other types of voluntary actions include rights issue, making buyback offers to the shareholders while delisting the company from the stock exchange.

Voluntary corporate actions are actions requiring a decision from the investor on whether or not to participate. Corporation will not process these actions automatically because the decision on whether to participate will vary for every investor. Shareholders may choose to take no action which will leave their securities unaffected by the Corporate Action. Voluntary corporate action includes Tender Offer, Rights issue, making buyback offers to the share holders while delisting the company from the stock exchange etc.

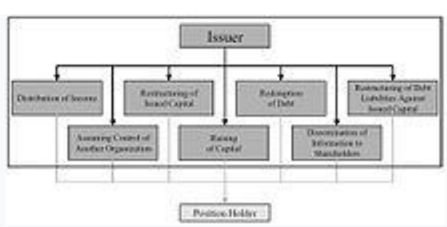
- **Buyback**: Buyback is an action in which company offers to buys back its stock from the current share holders at an attractive price. The reason is to reduce the shares outstanding in the market or to reduce the stake of shareholders in company.
- **Rights Issue**: It refers to offering additional shares to the current shareholders of the stock. This is done by companies to raise capital for further expansion which provide its existing shareholders the right to buy the stock at discounted rates than price making it more lucrative.

3. **Mandatory with choice corporate action**:

This corporate action is a mandatory corporate action where shareholders are given a chance to choose among several options. An example is cash or stock dividend option with one of the options as default. Shareholders may or may not submit their elections. In case a shareholder does not submit the election, the default option will be applied.

- **Dividend Payouts**: Dividend is the payment *made to the investor for sharing the profits* a company has made. It can be cash dividend or stock dividend where company offers stock as a dividend to the current shareholders.

Purpose

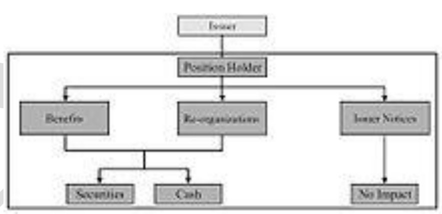


Purpose of corporate actions

The primary reasons companies use corporate actions are:

- **Return profits to shareholders**: Cash dividends are a classic example where a public company declares a dividend to be paid on each outstanding share. Bonus is another case where the shareholder is rewarded. In a stricter sense, the bonus issue should not impact the share price but in reality, in rare cases, it does and results in an overall increase in value.
- **Influence the share price**: If the price of a stock is too high or too low, the liquidity of the stock suffers. Stocks priced too high will not be affordable to all investors and stocks priced too low may be delisted. Corporate actions such as stock splits or reverse stock splits increase or decrease the number of outstanding shares to decrease or increase the stock price respectively. Buybacks are another example of influencing the stock price where a corporation buys back shares from the market in an attempt to reduce the number of outstanding shares thereby increasing the price.
- **Corporate restructuring**: Corporations restructure in order to increase profitability. Examples include mergers (where two companies that are competitive or complementary join forces) and spin-offs (where a company breaks itself up in order to focus on its core competencies).

Impact



Beneficial impact of corporate actions

As an owner, the impact of a corporate action is usually measured in terms of changes to the securities and/or cash positions, so corporate actions can be divided into two categories:

- **Benefits**: Actions that result in an increase to the position holder’s securities or cash position, without altering the underlying security. Examples include bonus issues, which is a Mandatory with Options Action/Event.
- **Reorganizations**: Actions that reshape or restructure the beneficial owner's underlying securities position, which sometimes also results in a cash payout. Examples include equity restructures, conversions, and subscriptions.

Possible Questions

Part – A (Online Examination)

Part – B (2 Marks)

1. Define Investment banking.
2. What is trade life cycle?
3. What do you mean by clearing?
4. What is settlement?
5. Define Security Lending.
6. Write a short not on prime brokerage.
7. What is mean by Collateral Management?
8. Define Corporate Action.
9. List out the types of corporate action.
10. How the corporate actions affect securities trade?

Part – C (6 Marks)

1. Discuss the various functions of investment banking.
2. Describe the major types of corporate actions.
3. Define trade life cycle? Explain the various stages involved in trade life cycle.
4. What is collateral management? Explain the parties involved in collateral management.
5. Explain the roles and responsibilities of clearing house.
6. Distinguish between mandatory and voluntary corporate action.
7. Write a short notes on
   i. Security lending ii. Prime Brokerage iii. Collateral management
8. What do you mean by Corporate Action? Explain the various reasons for Corporate Actions.
9. Explain the SEBI regulations for non banking financial companies.
10. What are the various types of corporate actions? Explain with suitable examples.

S.NO.	QUESTION	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
1	The investment professionals that arrange the sale of new securities are	Arbitragers	Traders	Investment bankers	Specialists	Investment bankers
2	Investment bankers operate in the	Primary market	Secondary market	Third market	Fourth market	Primary market
3	Investment bankers perform the following role ____________	Market new stock and bond issues for firms	Provide advice to the firms as to market conditions, price, etc	Design securities with desirable properties	Advertise for needed investments	Provide advice to the firms as to market conditions, price, etc
4	Another name for stockbrokers is	specialists	registered representatives	security analysts	Portfolio managers	registered representatives
5	Investment professionals whose jobs may depend on their performance relative to the market are the	registered representatives	security analysts	investment bankers	portfolio managers	registered representatives
6	Most financial advisors are registered with the Securities and Exchange Commission as:	Registered representatives	Registered investor advisors.	Registered financial planners	Registered securities consultants	Registered financial planners
7	______ day is also called as settlement day	First day	Second Day	Fifth day	Sixth day	Second Day

8	The step in initial public offering in which the hired agents act on behalf of owners is classified as	hiring problems	agency problems	corporation internal problems	corporation external problems	agency problems
9	All the partners have limited liability in	unlimited liability partnership	limited liability partnership	controlled partnership	uncontrolled partnership	limited liability partnership
10	The process of selling company stock at large to the general public and get lending from banks is classified as an	initial public offering	external public offering	internal public offering	unprofessional offering	initial public offering
11	The partners who are only liable for their own part of investment are considered as	venture partners	corporate partners	limited partners	general partners	limited partners
12	The legal entity separation from its legal owners and managers with the help of state laws is classified as	controlled corporate business	Corporation	limited corporate business	unlimited corporate business	Corporation

13	What is a bought deal?	The underwriter of a security issuance buys all the securities andsubsequently worries about reselling them in financial markets	The underwriter of a security issuance neither buys any securities norprovides any guarantees to be able to place the securities. The underwriter merely promises its best efforts during the issuance process	It is a deal in which an investment banking division accepts deposits from itsclient	It is a deal that an investment banker makes while attending a symphonyconcert	The underwriter of a security issuance buys all the securities andsubsequently worries about reselling them in financial markets
14	The step in initial public offering in which the hired agents act on behalf of owners is classified as	Hiring problems	agency problems	corporation internal problems	corporation external problems	agency problems
15	The process of selling company stock at large to the general public and get lending from banks is classified as an	initial public offering	external public offering	internal public offering	unprofessional offering	initial public offering

16	The legal entity separation from its legal owners and managers with the help of state laws is classified as	controlled corporate business	Corporation	limited corporate business	unlimited corporate business	Corporation
17	Which is the investment bank?	Citigroup is an example	Merrill Lynch is an example	Merrill Lynch is an example	All the above	All the above
18	Which of the following are financial assets?	Bonds	Machines	Plant	Land	Bonds
19	The first to introduce mortgage pass-through securities	Chase Manhattam	FNMA	GNMA	Citi crop	GNMA
20	An example of a primitive sec urity is	a common shar e of General M otors	a call option on Mobil st ock	a call option on a stock of a firm based i n a Third Wo rld country	Put option	a common share of General Moto rs
21	Money market funds were a financial innovation partly inspired to circumvent	Regulation B, which is still in existence	Regulation	Regulation Q, which is no longer in existence	Regulation M	Regulation Q, which is no longer in existence
22	a way U. S. investor can invest in foreign companies	ADRs	IRAs	SDRs	Krugerrands	ADRs
23	Firms that specialize in helpin g companies raise capital by s elling securities are called	commercial ban ks	investment banks	savings bank s	Credit union	investment banks

24	The sale of a mortgage portfolio by setting up mortgage pass-through securities is an example of	credit enhance ment	unbundling	securitization	derivatives	securitization
25	Corporate shareholders are best protected from incompetent management decisions by	the ability to engage in proxy fights	managemen t's control of pecuniary rewards	the ability to call sharehol der meetings	the threat of tak eover by other f irms	the threat of take over by other fir ms
26	The liquidity status of certificate of deposit which is more negotiable is considered as	C**ertified liquidity**	term liquidity	more liquid	less liquid	more liquid
27	The equilibrium interest rate decreases and the economic conditions increases then supply curve must shift to	up and to the left	up and to the right	down and to the left	down and to the right	down and to the right
28	The stocks or shares that are sold to investors without transacting through financial institutions are classified as	direct transfer	indirect transfer	global transfer	pension transfer	direct transfer
29	The special provisions that can have adverse or beneficial effects and are reflected in interest rates does not include	tax-ability	covert ability	call ability	inflation premium	inflation premium
30	Which securities law requires that public offerings be registered with the federal government before they are sold?	Blue Sky Laws.	Securities Exchange Act of 1933.	Underwritten Rule 144a	Securities Exchange Act of 1934.	Securities Exchange Act of 1933.

31	An arrangement with a single investment banker or group of investment bankers to "stand by" and be ready to underwrite any unsold portion of an issue, is referred to as a (an) __________.	underwriting syndicate	registration statement	standby arrangement	red herring	standby arrangement
32	Which of the following is privately placed common stock that cannot be immediately resold?	Initial public offering.	Letter stock.	Red herring	Right.	Letter stock.
33	Which of the following is a short-term option to buy a certain number of securities from the issuing corporation?	Right	Red herring	Letter stock	Initial public offering	Right
34	A temporary combination of investment banking firms formed to sell a new security issue can be referred to as a (an) __________.	red herring	registration statement	standby arrangement	underwriting syndicate	underwriting syndicate
35	What happens, according to the text, to the average common stock price immediately after the announcement of a new equity issue by a publicly traded firm?		The average stock price decreases a few percentage points.	The average stock price does not generally change because of asymmetric information	The average stock price does not generally change because no new information is provided to investors.	The average stock price decreases a few percentage points.

36	Which of the following is not a method a firm can use to finance their long-term needs externally?	Public issue	Privileged subscription	Retained earnings.	Private placement	Retained earnings.
37	How investment bankers are generally compensated under traditional underwriting?	The stockbroker, representing the investment banker, charges a commission to investors.	The leader underwriter in the underwriting syndicate dictates the commission that the other firms must charge so that investors pay for a majority of the underwriting expense.	The issuing firm pays a flat fee, usually $1 million, plus all of the commissions charge by stockbrokers who are ultimately selling the securities to investors.	Investment bankers earn a spread based on the difference between the purchase price from the firm and the sales price to investors of the securities being underwritten.	Investment bankers earn a spread based on the difference between the purchase price from the firm and the sales price to investors of the securities being underwritten.
38	If the market price of a stock "rights-on" is $50 a share, the subscription price is $40 a share, and it takes nine rights to buy an additional share of common stock, the theoretical value of a right when the stock is selling "rights-on " is	$1.11	$4.00	$1.00	$5.00	$1.00

	how much?					
39	The __________ is a disclosure document filed with the SEC in order to register a new security and includes the prospectus and other SEC required information.	registration statement	red herring	underwriting syndicate	Standby arrangement	registration statement
40	The difference between face value of the bond and the call price of the bond is considered as	call premium	call provision	discount premium	discount provision	call premium
41	For given change in interest rates, the percentage change in the present value of bond is classified as	price sensitivity	yield sensitivity	maturity sensitivity	premium sensitivity	price sensitivity
42	The type of swaps in which the fixed payments of interest are exchanged by two counterparties for floating payments of interest are called	float-fixed swaps	interest rate swaps	indexed swaps	counter party swaps	interest rate swaps
43	Permits what is known as a shelf registration.	SEC Rule 144	SEC Rule 144a	SEC Rule 415	SEC Form 13D	SEC Rule 415

44	If an investment banker has agreed to sell a new issue of securities on a *best-efforts basis*, the issue	Most likely involves an unusually large stock offering.	Most likely involves bonds instead of common stock.	Results in no assumption of underwriting risk by the investment banker.	Most likely involves a well-established, large company.	Results in no assumption of underwriting risk by the investment banker.
45	The investment professionals that arrange the sale of new securities are	Arbitragers	Traders	Investment bankers	Specialists	Investment bankers
46	Underlying all investments is the tradeoff between	Expected return and actual return	Low risk and high risk	Actual return and high risk	Expected return and risk.	Expected return and actual return
47	Which of the following investment areas is heavily tied to work using mathematical and statistical models?	Security analysis	Portfolio managemen t	Institutional investing	Retirement planning.	Security analysis
48	Investment made in real estate is a	real investment	financial investment	non-financial investment	intangible investment	real investment
49	Which media of investment will give a balanced growth in investment?	corporate stock	provident fund	insurance	Fixed deposit	Fixed deposit
50	Investment professionals whose jobs may depend on their performance relative to the market are the	Registered representatives	Security analysts	Investment bankers	Portfolio managers	Security analysts

51	Investment bankers operate in the	Primary market	Secondary market	Third market	Fourth market	Primary market
52	Investment bankers perform the following role ____________	Market the stock and bond issues for firms which is already existing	Provide advice to the firms as to market conditions, price, etc	Doesn't help in designing the securities with desirable properties	Does not helps in promoting the securities	Provide advice to the firms as to market conditions, price, etc
53	Investment decision making traditionally consists of two steps	investment banking and security analysis	buying and selling	Risk and expected return	Security analysis and portfolio management	buying and selling
54	Which of the following is not a characteristic of investments companies?	pooled investing	Diversificati on	Managed portfolios	Reduced expenses	Reduced expenses
55	Equity does NOT include	cash and paid-in capital	common stock and paid-in capital	paid-in capital and retained earnings	common stock, paid-in capital and retained earnings	cash and paid-in capital
56	A ---------- means a document which either creates or acknowledge a debt	share	bond	Debentures	debt	debentures
57	Primary market is	an issue marketability outstanding securities	a new issue market	a profitable market	security	a new issue market

58	State which one of the following is the method of floating new issue	origination	underwritin g	placement	liquidity	placement
59	At par means	shares issued at premium	shares issued at discount	shares issued at face value	actual value	shares issued at face value
60	Mr. buys 100 shares of Ponds India Ltd., from Mr,Y. this is a	primary market activity	secondary market activity	money market activity	SEBI	secondary market activity

Unit III

Mutual Funds and Hedging: Mutual funds – transactions in Mutual funds – Fund Expenses - Transfer Agency – Hedge Funds – Understanding Hedge funds – hedge fund strategies.

INTRODUCTION

A mutual fund is a professionally managed firm of collective investments that collects money from many investors and puts it in stocks, bonds, short-term money market instruments, and/or other securities. The fund manager, also known as portfolio manager, invests and trades the fund's underlying securities, realizing capital individual investors.

•***Mutual funds***

a. A mutual fund is a fund exchanged between the public and the capital market through a corporate body.

*b**. The Securities and Exchange Board of India Regulations***, 1993 defines a mutual fund as a fund established in the form of a trust by a sponsor, to raise monies by the trustees through the sale of units to the public, under one or more schemes, for investing in securities in accordance with these regulations'.

c. Kamm, J.O. defines an open end investment company or Mutual fund company in U.S.A as an organization formed for the investment of funds obtained from individuals and institutional investors who in exchange for the funds receive shares which can be redeemed at any time at their underlying asset values'.

d According to Weston j. Fred and Brigham, Eugene, F. Unit Trusts in U.K. are Corporations Thus mutual fund is nothing but a form of collective investment. It is formed by the coming together of a number of investors who transfer their surplus funds to a professionally qualified organization to manage it. To get the surplus funds from investors, the fund adopts a simple technique. Each fund is divided in to a small is allocated units in proportion to the size of his investment. Thus, every investor, whether big or small, will have a stake in the fund and can enjoy the wide portfolio of the investment held by the fund. Hence, mutual funds enable millions of small and large investors to participate in and derive the benefit of the capital market growth. It has emerged as a popular vehicle of creation of wealth due to high return, lower cost and diversified risk.

Objectives

Mutual funds came into existence in order to attract the savings of lower and middle income group people and give them the benefit of corporate profits by distributing attractive dividends at the end of the year. Mutual funds cater the different types of customers who are interested in

(a)Fixed income or

(b) A higher return for investment or

(c) Who is growth oriented.

Mutual Funds Set Up In India

The structure of mutual fund operations in India envisages a three tier establishment namely:**(II)** A ***Sponsor*** institution to promote the fund **(III)**A team of ***Trustees to*** oversee the operations and to provide checks for the efficient, profitable and transparent operations of the fund and **(IV)**An ***Asset Management Company*** to actually deal with the funds. ***Sponsoring Institution*** The Company which sets up the Mutual Fund is call criteria to be met by the sponsor. These criteria mainly deal with adequate experience, good past tract record, net worth etc.

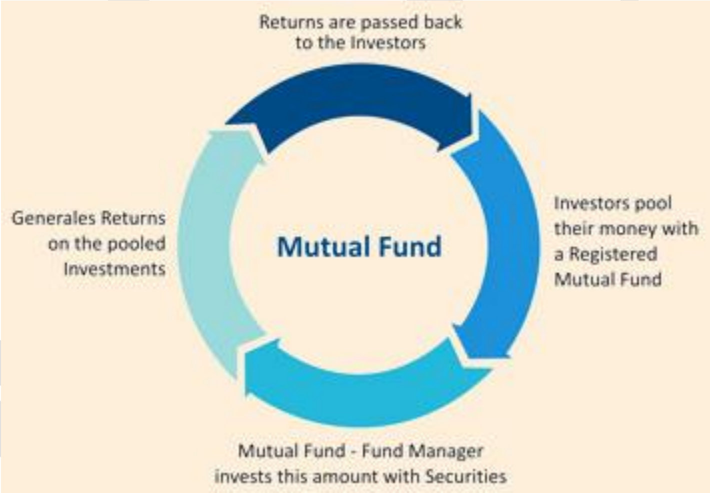
Trustees: Trustees are people with long experience and good integrity in their respective fields. They carry the crucial responsibility of safeguarding the interest of investors. For this purpose, they monitor the operations of the different schemes. They have wide ranging powers and they can even dismiss Asset Management Companies with the approval of the SEBI.

Asset Management Company (AMC) The AMC actually manages the funds of the various schemes. The AMC employs a large number of professionals to make investments, carry out research and to do agent and investor servicing. Infect, the success of any Mutual Fund depends upon the efficiency of this AMC. The AMC submits a quarterly report on the functioning of the mutual fund to the trustees who will guide and control the AMC.

A mutual fund is set up in the form of a trust that has a Sponsor, Trustees, Asset Management Company (AMC). The trust is established by a sponsor(s) who is like a promoter of a company and the said Trust is registered with Securities and Exchange Board of India (SEBI) as a Mutual Fund. The Trustees of the mutual fund hold its property for the benefit of unit holders. An Asset Management Company (AMC) approved by SEBI manages the fund by making investments in various types of securities.

The trustees are vested with the power of superintendence and direction over the AMC. They monitor the performance and compliance of SEBI regulations by the mutual fund. The trustees are vested with the general power of superintendence and direction over AMC. They manage the performance and compliance of SEBI Regulations by the mutual fund.

Operation of Mutual Fund



A mutual fund company collects money from several investors, and invests it in various options like stocks, bonds, etc. This fund is managed by professionals who understand the market well, and try to accomplish growth by making strategic investments. Investors get units of the mutual fund according to the amount they have invested. The Asset Management Company is responsible for managing the investments for the various schemes operated by the mutual fund. It also undertakes activities such like advisory services, financial consulting, customer services, accounting, marketing and sales functions for the schemes of the mutual fund

Net Asset Value

Net Asset Value (NAV) is the total asset value (net of expenses) per unit of the fund and is calculated by the AMC at the end of every business day. In order to calculate the NAV of a mutual fund, you need to take the current market value of the fund's assets minus the liabilities, if any and divide it by the number of shares outstanding. NAV is calculated as follows:

$$\text{NAV (₹)} = \frac{\text{Market/Fair Value of Securities + Accrued Income + Receivable + other assets + Accrued Expenses – payables – other liabilities}}{\text{No of Units outstanding of the Scheme / Option}}$$

For example, if the market value of securities of a Mutual Fund scheme is ₹500 lakh and the Mutual Fund has issued 10 lakh units of ₹10 each to investors, then the NAV per unit of the fund is ₹50.

Types of Mutual Funds

1 Close Ended Funds Close ended funds are funds which have definite period or target amount. Once the period is over and or the target is reached, the door is closed for the investors. They cannot purchase any more units. These units are publicly traded through stock exchange and generally, there is no repurchase facility by the fund. The main objective of this fund is capital appreciation. Thus after the expiry of the fixed period, the entire corpus is disinvested and the proceeds are distributed to the various unit holders in proportion to their holding. Thus the fund ceases to be a fund, after the final distribution. E.g. UTI Master Share, 1986.

2 Open Ended Funds Open ended funds are those which have no fixed maturity periods. Open ended scheme consists of mutual funds which sell the units to the public. These mutual funds can also repurchase the units. Initial Public Offer (IPO) is open for a period of 30 days and then reopens as an open-ended scheme after a period not exceeding 30 days from the date of closure of the IPO. Investors can buy or repurchase units at net asset value or net value related prices, as decided by the mutual fund. Example: Unit Trust of India's Growth sector funds.

Classification of Mutual Funds

On The Basis Of Yield and Investment

1. Income Fund Income funds are those which generate regular income to the members on a periodical basis. It concentrates more on the distribution of regular income and it also sees that the average return is higher than that of the income from bank deposits. a. The investor is assured of regular income at periodical intervals b. The main objective is to declare regular dividends and not capital appreciation. c. The investment pattern is towards high and fixed income yielding securities d. It is concerned with short run gains only.

2. **Growth Fund** Growth are those which concentrate mainly on long term gains i.e., capital appreciation. Hence they are termed as ***"Nest*** investments ***Eggs"***. a. It aims at meeting the investors need for capital appreciation. b. The investor's strategy conforms to investing the funds on equities with high growth potential. c. The Investment tries to get capital appreciation by taking much risks and investing on risk bearing equities and high growth equity shares. d. The fund declares dividends. e. It is best suited to salaried and business people.

3. Balanced Fund It is a balance between income and growth fund. This is called as Income cum growth. It aims at distributing regular income as well as capital appreciation. Thus the investments are made in high growth equity shares and also the fixed income earning securities.

4. Specialized Funds These are special funds to meet specific needs of specific categories of people like pensioners, widows etc.

Money Market Mutual Funds The funds are invested in money market instruments. These funds basically have all the features of open ended funds but they invest in highly liquid and safe securities like commercial paper, banker's acceptances, and certificates of deposits treasury bills. These funds are called money funds in the U.S.A. The RBI has fixed the minimum amount of investment as Rs.1 Lakh; it is out of the reach of many small investors. However, the private sector funds have been permitted to deal in money market mutual funds. It is best suited to institutional investors like banks and other financial institutions.

6. Taxation Funds It is a fund which offers tax rebated to the investors either in the domestic or foreign capital market. It is suitable to salaried people who want to enjoy tax rebates particularly during the month of February and March. An investor is entitled to get 20% rebated in Income Tax for investments made under this fund subject to a maximum investment of Rs.10,000 per annum. E.g. Tax Saving Magnum of SBI Capital Market Limited.

7. Other Classification

i. Leveraged Funds: Also called as borrowed funds as they are used primarily to increase the size of the value of portfolio of a mutual fund. When the value increases, the earning capacity of the fund also increases.

ii. Dual Funds: It is a fund which gives a single investment opportunity for two different types of investors. It sells income shares and capital. Those investors who seek current investment income can purchase incomes shares. The capital shares receive all the capital gains earned on those shares and they are not entitled to receive any dividend of any type.

iii. Index Fund: It is a fund based the some broad market index. This is done by holding securities in the same proportion as the index itself. The value of these index linked funds will automatically go up whenever the market index goes up and vice versa.

iv. Bond Funds: The funds have portfolios consisting mainly of fixed income securities like bonds. The main thrust is income rather than capital gains.

v. Aggressive Growth Funds: These funds are capital gains oriented and thus the thrust area of these funds is capital gains. Hence, these funds are generally invested in speculative stocks They may also use specialized investment techniques like short term trading, option writing etc.,

vi. Off shore Mutual Funds: These funds are meant for nonresident investors. These funds facilitate flow of funds across different countries, with free and efficient movement of capital for investment and repatriation.

vii. Property Fund: These funds are real estate mutual funds. Its investment also includes shares/bonds of companies involved in real estate and mortgage backed companies.

viii. Fund of Funds: It is a fund that invests in other mutual fund schemes. The concept in prevalent in abroad.

History of Mutual Funds in India

The Mutual fund concept in India was launched by Unit Trust of India (UTI) in the year 1964 by a special Act of Parliament. The first scheme offered was the ―US-64. A host of other fund schemes were subsequently introduced by the UTI. The basic objective behind the setting up of the Trust was to mobilize small savings and to allow channeling of those savings into productive sectors of the economy, so as to accelerate the industrial and economic development of the country. In 1987, the Government of India permitted commercial banks in the public sector to set up subsidiaries operating as trusts to perform the functions of mutual funds by amending the Banking Regulation Act. SBI set its first mutual fund, followed by Canara Bank. Later many large financial institutions under government control also came out with mutual funds subsidiaries. Recently, with the beginning of the economic reforms and liberalization of the economy, based on the recommendations of the Abid Hussain committee, foreign companies were also permitted to start mutual funds in India. The government introduced a number of regulatory measures, through various agencies such as the SEBI, to the benefit the investors, esp. the small investors.

Mutual Fund

An open-ended fund operated by an investment company which raises money from shareholders and invests in a group of assets, in accordance with a stated set of objectives.

Mutual funds raise money by selling shares of the fund to the public, much like any other type of company can sell stock in itself to the public. Mutual funds then take the money they receive from the sale of their shares (along with any money made from previous investments) and use it to purchase various investment vehicles, such as stocks, bonds and money market instruments. In return for the money they give to the fund when purchasing shares, shareholders receive an equity position in the fund and, in effect, in each of its underlying securities. For most mutual funds, shareholders are free to sell their shares at any time, although the price of a share in a mutual fund will fluctuate daily, depending upon the performance of the securities held by the fund.

Benefits of mutual funds include diversification and professional money management. Mutual funds offer choice, liquidity, and convenience, but charge fees and often require a minimum investment.

A closed-end fund is often incorrectly referred to as a mutual fund, but is actually an investment trust. There are many types of mutual funds, including aggressive growth fund, asset allocation fund, balanced fund, blend fund, bond fund, capital appreciation fund, clone fund, closed fund, crossover fund, equity fund, fund of funds, global fund, growth fund, growth and income fund, hedge fund, income fund, index fund, international fund, money market fund, municipal bond fund, prime rate fund, regional fund, sector fund, specialty fund, stock fund, and tax-free bond fund.

A mutual fund is a professionally-managed trust that pools the savings of many investors and invests them in securities like stocks, bonds, short-term money market instruments and commodities such as precious metals. Investors in a mutual fund have a common financial goal and their money is invested in different asset classes in accordance with the fund's investment objective. Investments in mutual funds entail comparatively small amounts, giving retail investors the advantage of having finance professionals control their money even if it is a few thousand rupees.

Mutual funds are pooled investment vehicles actively managed either by professional fund managers or passively tracked by an index or industry. The funds are generally well diversified to offset potential losses. They offer an attractive way for savings to be managed in a passive manner without paying high fees or requiring constant attention from individual investors. Mutual funds present an option for investors who lack the time or knowledge to make traditional and complex investment decisions. By putting your money in a mutual fund, you permit the portfolio manager to make those essential decisions for you.

Types of Mutual Fund

Based on the maturity period

Open-ended Fund

An open-ended fund is a fund that is available for subscription and can be redeemed on a continuous basis. It is available for subscription throughout the year and investors can buy and sell units at NAV related prices. These funds do not have a fixed maturity date. The key feature of an open-ended fund is liquidity.

Close-ended Fund

A close-ended fund is a fund that has a defined maturity period, e.g. 3-6 years. These funds are open for subscription for a specified period at the time of initial launch. These funds are listed on a recognized stock exchange.

Interval Funds

Interval funds combine the features of open-ended and close-ended funds. These funds may trade on stock exchanges and are open for sale or redemption at predetermined intervals on the prevailing NAV.

Based on investment objectives

Equity/Growth Funds

Equity/Growth funds invest a major part of its corpus in stocks and the investment objective of these funds is long-term capital growth. When you buy shares of an equity mutual fund, you effectively become a part owner of each of the securities in your fund's portfolio. Equity funds invest minimum 65% of its corpus in equity and equity related securities. These funds may invest in a wide range of industries or focus on one or more industry sectors. These types of funds are suitable for investors with a long-term outlook and higher risk appetite.

Debt/Income Funds

Debt/ Income funds generally invest in securities such as bonds, corporate debentures, government securities (gilts) and money market instruments. These funds invest minimum 65% of its corpus in fixed income securities. By investing in debt instruments, these funds provide low risk and stable income to investors with preservation of capital. These funds tend to be less volatile than equity funds and produce regular income. These funds are suitable for investors whose main objective is safety of capital with moderate growth.

Balanced Funds

Balanced funds invest in both equities and fixed income instruments in line with the pre-determined investment objective of the scheme. These funds provide both stability of returns and capital appreciation to investors. These funds with equal allocation to equities and fixed income securities are ideal for investors looking for a combination of income and moderate growth. They generally have an investment pattern of investing around 60% in Equity and 40% in Debt instruments.

Money Market/ Liquid Funds

Money market/ Liquid funds invest in safer short-term instruments such as Treasury Bills, Certificates of Deposit and Commercial Paper for a period of less than 91 days. The aim of Money Market /Liquid Funds is to provide easy liquidity, preservation of capital and moderate income. These funds are ideal for corporate and individual investors looking for moderate returns on their surplus funds.

Gilt Funds

Gilt funds invest exclusively in government securities. Although these funds carry no credit risk, they are associated with interest rate risk. These funds are safer as they invest in government securities.

Some of the common types of mutual funds and what they typically invest in:

Type of Fund	**Typical Investment**
Equity or Growth Fund	Equities like stocks
Fixed Income Fund	Fixed income securities like government and corporate bonds
Money Market Fund	Short-term fixed income securities like treasury bills
Balanced Fund	A mix of equities and fixed income securities
Sector-specific Fund	Sectors like IT, Pharma, Auto etc.
Index Fund	Equities or Fixed income securities chosen to replicate a specific Index for example S&P CNX Nifty
Fund of funds	Other mutual funds

Other Schemes

Tax-Saving (Equity linked Savings Schemes) Funds

Tax-saving schemes offer tax rebates to investors under specific provisions of the Income Tax Act, 1961. These are growth-oriented schemes and invest primarily in equities. Like an equity scheme, they largely suit investors having a higher risk appetite and aim to generate capital appreciation over medium to long term.

Index Funds

Index schemes replicate the performance of a particular index such as the BSE Sensex or the S&P CNX Nifty. The portfolio of these schemes consist of only those stocks that represent the index and the weight age assigned to each stock is aligned to the stock's weight age in the index. Hence, the returns from these funds are more or less similar to those generated by the Index.

Sector-specific Funds

Sector-specific funds invest in the securities of only those sectors or industries as specified in the Scheme Information Document. The returns in these funds are dependent on the performance of the respective sector/industries for example FMCG, Pharma, IT, etc. The funds enable investors to diversify holdings among many companies within an industry. Sector funds are riskier as their performance is dependent on particular sectors although this also results in higher returns generated by these funds. Benefits of Investing in Mutual Funds

Benefits of investing in mutual funds:

Professional Management

When you invest in a mutual fund, your money is managed by finance professionals. Investors who do not have the time or skill to manage their own portfolio can invest in mutual funds. By investing in mutual funds, you can gain the services of professional fund managers, which would otherwise be costly for an individual investor.

Diversification

Mutual funds provide the benefit of diversification across different sectors and companies. Mutual funds widen investments across various industries and asset classes. Thus, by investing in a mutual fund, you can gain from the benefits of diversification and asset allocation, without investing a large amount of money that would be required to build an individual portfolio.

Liquidity

Mutual funds are usually very liquid investments. Unless they have a pre-specified lock-in period, your money is available to you anytime you want subject to exit load, if any. Normally funds take a couple of days for returning your money to you. Since they are well integrated with the banking system, most funds can transfer the money directly to your bank account.

Flexibility

Investors can benefit from the convenience and flexibility offered by mutual funds to invest in a wide range of schemes. The option of systematic (at regular intervals) investment and withdrawal is also offered to investors in most open-ended schemes. Depending on one’s inclinations and convenience one can invest or withdraw funds.

Low transaction cost

Due to economies of scale, mutual funds pay lower transaction costs. The benefits are passed on to mutual fund investors, which may not be enjoyed by an individual who enters the market directly.

Transparency

Funds provide investors with updated information pertaining to the markets and schemes through factsheets, offer documents, annual reports etc.

Well regulated

Mutual funds in India are regulated and monitored by the Securities and Exchange Board of India (SEBI), which endeavours to protect the interests of investors. All funds are registered with

SEBI and complete transparency is enforced. Mutual funds are required to provide investors with standard information about their investments, in addition to other disclosures like specific investments made by the scheme and the quantity of investment in each asset class.

Risk involved in Mutual Fund

Mutual funds invest in different securities like stocks or fixed income securities, depending upon the fund's objectives. As a result, different schemes have different risks depending on the underlying portfolio. The value of an investment may decline over a period of time because of economic alterations or other events that affect the overall market. Also, the government may come up with new regulations, which may affect a particular industry or class of industries. All these factors influence the performance of Mutual Funds.

Risk and Reward: The diversification that mutual funds provide can help ease risk by offsetting losses from some securities with gains in other securities. On the other hand, this could limit the upside potential that is provided by holding a single security.

Lack of Control: Investors cannot determine the exact composition of a fund's portfolio at any given time, nor can they directly influence which securities the fund manager buys.

5 Good Reasons to Invest

"Save for a rainy day" goes a wise old saying. While saving worked in the past, today, you need to invest. If you believe that saving and investing imply the same thing, think again.

While saving is a part of your income that you put away regularly, it does not necessarily provide returns and it can only meet your short-term needs. Investing on the other hand, provides returns and helps you grow your capital, which in turn, will help you fulfil your financial goals.

Now that you are convinced that investing is a 'must', getting started is the next challenge. Everyone needs some motivation to get started. It is more tempting to spend what you have today than put it away for the future. Our needs for today seem far more pressing than tomorrow's. Here are five reasons that will change the way you think and make you more determined to invest:

Be prepared for emergencies: A sudden medical emergency or unemployment can cause a financial crisis. For instance, do you have the means to provide for your family if you were hit by unforeseen circumstances such as an illness that makes you unable to work, or an accident that immobilizes you? Investing helps you create a financial cushion for your family. Ideally you should have investments to the extent of at least six months' income at all times. Debt-oriented Unit Linked Insurance Plans (ULIPs) will help you accumulate the funds you need for this purpose.

Financial security: Your financial security depends on how much you invest and how efficiently you do so. Investments can help you build a corpus so that you can generate a large cash reserve. A large cash reserve means no anxiety about your financial security and more empowerment. Investing regularly in equity-oriented ULIPs over the long term has the potential to help you build a sizeable corpus to fulfil this purpose.

Fulfilling financial goals: Buying your own home, or a bigger home, buying a new car, your children's education and their marriage are some goals that are important to you. To fulfil these goals, you need the right type of investment plans. Depending on when the financial goal will come up for fulfilment, you can select investment-oriented insurance plans. For goals that will arise in the near future (say 5-7 years hence) debt-oriented or balanced ULIPs would be suitable. You could also choose investment-oriented traditional plans such as endowment plans which mature at around the time the goal comes up for fulfilment or money back plans which provide funds at fixed intervals of time (these are usually suitable for children's education needs). For goals that will arise in the distant future (beyond 7 years), equity-oriented ULIPs would be more suitable since these ULIPs have the potential to provide you higher returns over a longer period of time.

Wealth creation: In order to create wealth you need investment options that add an element of growth to your money. Equity-oriented ULIPs have the potential to help you build your wealth kitty over an investment horizon of 7-10 years and beyond.

Fighting inflation: Inflation eats away at your savings. With each passing year, prices keep rising. Investments help you protect your capital against price rise. A good way to beat inflation is to park your money in investments that offer returns that are higher than the rate of inflation. Equity-oriented and balanced ULIPs come to the rescue here. Historically, equity investments have given returns that are higher than the inflation rate thereby providing investors real returns (real returns = investment returns *minus* inflation rate).

Mutual Fund Fees and Expenses

Mutual fund fees and expenses are charges that may be incurred by investors who hold mutual funds. Running a mutual fund involves costs, including shareholder transaction costs, investment advisory fees, and marketing and distribution expenses. Funds pass along these costs to investors in a number of ways.

Some funds impose "shareholder fees" directly on investors whenever they buy or sell shares. In addition, every fund has regular, recurring, fund-wide "operating expenses". Funds typically pay their operating expenses out of fund assets—which means that investors indirectly pay these costs. Seemingly negligible, fees and expenses can substantially reduce an investor's earnings.

For the reasons cited above, it is important for a prospective investor to compare the fees of the various funds under consideration. Investors should also compare fees against industry benchmarks and averages. There are many different types of fees, as discussed below. To facilitate comparison of funds, it is helpful to compare the total expense ratio. The following table shows the median total expense ratios for different types of mutual funds as published by Morningstar.

MEDIAN NET EXPENSE RATIOS				
Bond Funds				
Category	**Front Load (%)**	**Deferred Load (%)**	**No Load (%)**	**Institutional (%)**
Government Funds	0.90	1.67	0.65	0.56
Municipal Bond	0.82	1.52	0.60	0.60
Ultra-Short Bond	0.82	1.55	0.50	0.45
Short-Term Bond	0.88	1.58	0.67	0.50
Intermediate-Term Bond	0.90	1.65	0.70	0.53
Multi sector Bond	1.06	1.74	0.81	0.68
World Bond	1.10	1.80	0.84	0.75
High-Yield Bond	1.11	1.82	0.85	0.72
Convertibles	1.17	1.88	0.83	0.89
Allocation Funds				
Category	**Front Load (%)**	**Deferred Load (%)**	**No Load (%)**	**Institutional (%)**
Conservative Allocation	1.15	1.90	0.88	0.79
Moderate Allocation	1.20	1.96	1.00	0.80
World Allocation	1.28	1.99	0.97	0.99
Equity Funds				
Category	**Front Load (%)**	**Deferred Load (%)**	**No Load (%)**	**Institutional (%)**

Large Cap	1.22	1.95	0.95	0.81
Mid-Cap	1.34	2.06	1.15	0.99
Small Cap	1.45	2.14	1.20	1.08
World Stock	1.45	2.20	1.15	1.09
Foreign Large	1.47	2.20	1.12	1.02
Foreign Small	1.60	2.32	1.35	1.17
Diversified Pacific/Asia/Japan	1.73	2.47	1.37	1.37
Emerging Market Stock	1.80	2.59	1.47	1.38
Long-Short	1.78	2.55	1.91	1.65
Specialty	1.45	2.13	1.14	1.04

Transfer Agency

A **stock transfer agent** or **share registry or Transfer Agency** is a company, usually a third party unrelated to stock transactions, which cancels the name and certificate of the shareholder who sold the shares of stock, and substitutes the new owner's name on the official master shareholder listing. Stock transfer agent is the term used in the United States and Canada. Share registry is used in the United Kingdom, Australia and New Zealand. Transfer secretary is used in South Africa. Usually Transfer Agency service provided along with Fund Accounting as a "package" for hassle-free services. TA and FA are interdependent, hence it's beneficial for Fund manager to give both services to single party.

Transfer agents perform below main functions:

1. **Issuance and Transfer:** Issue and cancel certificates to reflect changes in ownership. For example, when a company declares a stock dividend or stock split, the transfer agent issues new shares. Transfer agents keep records of who owns a company's stocks and bonds and how those stocks and bonds are held—whether by the owner in certificate form, by the company in book-entry form, or by the investor's brokerage firm in street name. They also keep records of how many shares or bonds each investor owns.
2. **Record Keeping**: Transfer agents "track, record, and maintain on behalf of issuers the official record of ownership of each issuer’s securities."
3. **Registration**: Transfer agents monitor "the issuance of [company] securities with a view to preventing unauthorized issuance, a function commonly performed by a person called a registrar."
4. **Paying Agent**: A transfer agent may also serve as the company's paying agent to pay out interest, cash and stock dividends, or other distributions to stock- and bondholders. In addition, a transfer agent may act as a tender agent (tendering shares in a tender offer) or exchange agent (exchanging a company's stock or bonds in a merger).
5. **Shareholder Liaison**: Transfer agents "facilitate communications between issuers and registered security holders." Transfer agents often act as a proxy agent (sending out

proxy materials) and a mailing agent (mailing the company's quarterly, annual, and other reports). Transfer agents may also run annual meetings as inspector of elections, proxy voting, and special meetings of shareholders. In this case they are considered the official keeper of the corporate shareholder records.

6. **Repository**: Handle lost, destroyed, or stolen certificates. Transfer agents help shareholders and bondholders when a stock or bond certificate has been lost, destroyed, or stolen. Also a medallion signature stamp officer is the transfer agent.
7. **Treasury Manager**: Transfer agent work to settle monetary transactions. They may hold shareholder's cash and Company's cash in separate accounts as per local regulations, in order to prevent loss in the event of bankruptcy and mismanagement of money.

Hedge Funds

A hedge fund is a regulated investment fund that is typically open to a limited range of investors who pay a performance fee to the fund's investment manager. As we will discuss below, every hedge fund has its own investment philosophy that determines the type of investments made and strategies employed. In general, the hedge fund community undertakes a much wider range of investment and trading activities than traditional long-only investment funds (mutual funds, asset managers, etc.). Hedge funds invest in a broader range of assets, including long and short positions in equity, bonds, commodities, and derivatives.

Hedge Fund History

Hedging out unwanted risk has been a common activity in the financial markets for centuries. In the 1800s, for example, commodity producers and merchants started using forward contracts to protect themselves against futures changes in commodity prices—these contracts hedged out the risk of adverse market fluctuations beyond their control. Such forward contracts are still traded to this day in the futures market.

Alfred Jones is credited with the creation of the term "Hedge Fund" in 1949. He created A.W. Jones, a partnership with four friends, and through this vehicle he invested $100,000 in stocks, using both long and short positions. During the first year, the fund returned 17.3%. The idea has caught fire since.

Hedge funds were later popularized by the likes of managers such as Julian Robertson and George Soros. They have been trading since the mid-1980s, generally outperforming the markets, and making excellent returns with substantially less volatility than long-only investments in risky assets classes such as equities. In 1992, Soros' Quantum Investment Fund rattled the markets when it bet $1 billion on the devaluation of the British pound. The U.K. estimated that this cost Britain about $6 billion, driving Britain to pull out of the Exchange Rate Mechanism and spiking interest rates. Needless to say, Quantum made a killing on this position!

Hedge Fund Industry Size

Since 2008, Assets Under Management (AUM) have sharply fallen due to the credit crunch, trading losses, and withdrawal of assets from hedge funds by investors (i.e., redemptions). Still, it is estimated that the hedge fund industry, currently consisting of approximately 8,000-10,000 hedge funds, manages close to $2 trillion in the United States alone.

Largest Hedge Fund Managers

As of December 2009, the largest 25 hedge fund managers had $520 billion in assets under management. Some of these include Bridgewater Associates, Paulson & Co., and Soros Fund Management.

Hedge Fund Fees

Hedge funds make money by charging both a management fee and a performance fee. While this varies by fund, typical management fees constitute 1-2% of assets under management annually, while performance fees generally are 20% of gross profits returned by the fund, subject to certain constraints. The performance fee is the defining characteristic of a hedge fund: it motivates the hedge fund manager to generate superior returns, and it is intended to align the interests of the manager and investors more than the flat fees typically associated with long-only fund managers. To put it simply, hedge fund managers get rich if it generates superior returns, thereby making their clients rich.

Hedge funds vs. Mutual funds

Similar to hedge funds, mutual funds are pools of investment capital. However, there are many differences between the two, including the following:

- Hedge fund investors must be accredited (meaning they must have a certain amount of liquid assets and a certain degree of investing sophistication).
- Mutual fund strategies are long-only, meaning they cannot sell securities short.
- Mutual funds generally do not have a performance fee; they generally charge only a management fee.

Hedge Fund Structure

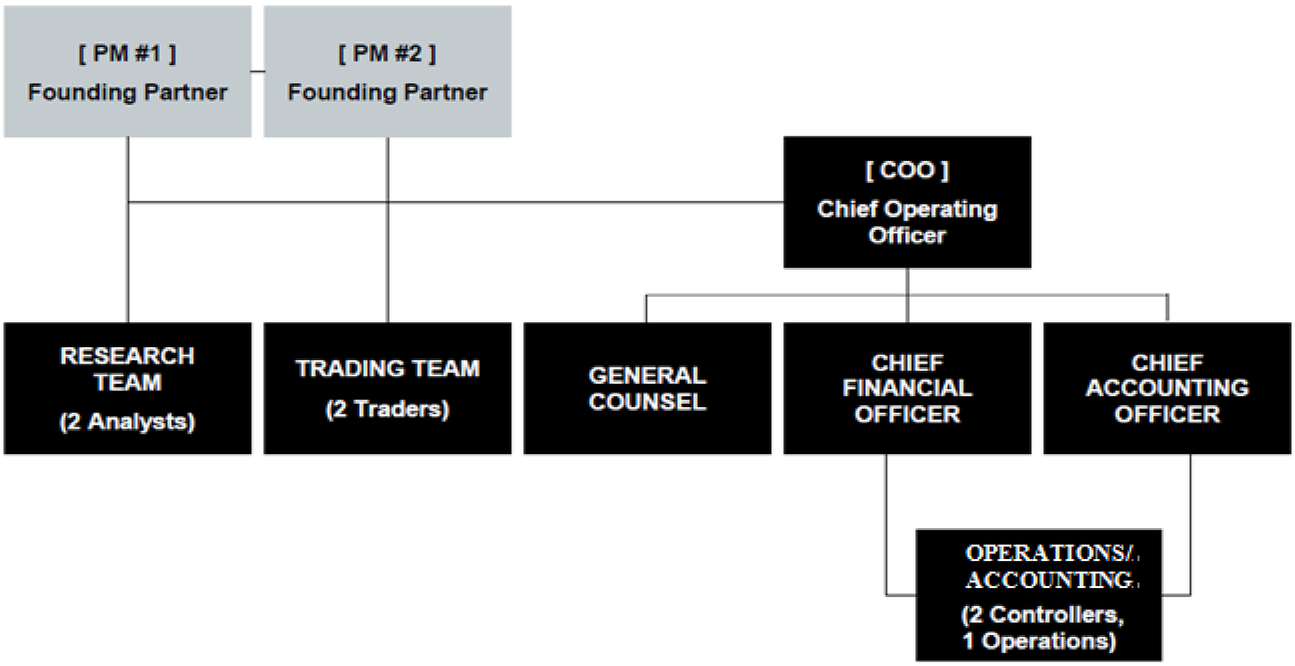
Hedge funds are generally very lean organizations: they can manage a high level of assets with relatively few employees. This makes breaking into a hedge fund much more difficult than traditional investment banks and asset management, because there are generally fewer jobs to go around. Such jobs are also much more competitive, due to the prestige associated with them, and the potential for superior compensation.

Hedge fund career paths generally consist of the following roles:

- Research Analyst
- Trader
- Portfolio Manager
- Risk Manager
- Marketing or Investor Relations
- Chief Financial Officer (CFO) & Chief Accounting Officer (CAO)

Below is a snapshot of a typical hedge fund structure. As the fund grows its assets under management (AUM), it will typically look to hire additional analysts to perform fund research while leveraging other employees at the firm.

STRUCTURE OF A HEDGE FUND


[PM #1]
Founding Partner
[PM #2]
Founding Partner
[COO]
Chief Operating Officer
RESEARCH TEAM
(2 Analysts)
TRADING TEAM
(2 Traders)
GENERAL COUNSEL
CHIEF FINANCIAL OFFICER
CHIEF ACCOUNTING OFFICER
OPERATIONS/ ACCOUNTING
(2 Controllers, 1 Operations)

Key Characteristics of Hedge Funds

1. **They're only open to "accredited" or qualified investors:** Hedge funds are only allowed to take money from "qualified" investors—individuals with an annual income that exceeds $200,000 for the past two years or a net worth exceeding $1 million, excluding their primary residence. As such, the Securities and Exchange Commission deems qualified investors suitable enough to handle the potential risks that come from a wider investment mandate.

2. **They offer wider investment latitude than other funds:** A hedge fund's investment universe is only limited by its mandate. A hedge fund can basically invest in anything—land, real estate, stocks, derivatives, and currencies. Mutual funds, by contrast, have to basically stick to stocks or bonds, and are usually long-only.

3. **They often employ leverage:** Hedge funds will often use borrowed money to amplify their returns. As we saw during the financial crisis of 2008, leverage can also wipe out hedge funds.

4. **Fee structure:** Instead of charging an expense ratio only, hedge funds charge both an expense ratio and a performance fee. This fee structure is known as "Two and Twenty"—a 2% asset management fee and then a 20% cut of any gains generated.

There are more specific characteristics that define a hedge fund, but basically, because they are private investment vehicles that only allow wealthy individuals to invest, hedge funds can pretty much do what they want as long as they disclose the strategy upfront to investors. This wide latitude may sound very risky, and at times it can be. Some of the most spectacular financial blow-ups have involved hedge funds. That said, this flexibility afforded to hedge funds has led to some of the most talented money managers producing some amazing long-term returns.

It is important to note that "hedging" is actually the practice of attempting to reduce risk, but the goal of most hedge funds is to maximize return on investment. The name is mostly historical, as the first hedge funds tried to hedge against the downside risk of a bear market by shorting the market. (Mutual funds generally don't enter into short positions as one of their primary goals). Nowadays, hedge funds use dozens of different strategies, so it isn't accurate to say that hedge funds just "hedge risk." In fact, because hedge fund managers make speculative investments, these funds can carry more risk than the overall market.

Below are some of the risks of hedge funds:

1. Concentrated investment strategy exposes hedge funds to potentially huge losses.
2. Hedge funds typically require investors to lock up money for a period of years.
3. Use of leverage, or borrowed money, can turn what would have been a minor loss into a significant loss.

Hedge Fund Strategies

Hedge fund strategies encompass a broad range of risk tolerance and investment philosophies within a wide array of investments, including debt and equity securities, commodities, currencies, derivatives, real estate and other investment vehicles. The horizon of hedge fund investment strategies has seen unprecedented expansion in recent years. Below is a description of some of the more common hedge fund strategies. Note that hedge fund investment terms are driven in large part by the fund’s strategy and its level of liquidity. See our article: Brief Survey of Common Hedge Fund Terms.

Long/Short Equity

One of the most commonly used strategies for start up hedge funds is the long/short equity strategy. As the name suggests, the long/short equity strategy involves taking long and short positions in equity and equity derivative securities. Funds using a long/short strategy employ a wide range of fundamental and quantitative techniques to make investment decisions. Long/short funds tend to invest primarily in publicly traded equity and their derivatives, and tend to be long biased. Long/short funds also tend to have fairly straightforward investment fund terms. Accordingly, lock-ups, gates and other withdrawal terms in long-short funds are usually on the more permissive side because of the ease of liquidating positions when needed to facilitate investor withdrawals.

Credit Funds

Credit funds make debt investments based on lending inefficiencies. Credit funds tend to follow cyclical patterns, and are most active following economic downturns and restrictions in the credit market. Credit funds include distressed debt strategies, fixed income strategies, direct lending and others.

Distressed Debt

Distressed debt involves investment in corporate bonds, bank debt, and occasionally common and preferred stock of companies in distress. When a company is unable to meet its financial obligations, or is in a liquidity crisis, its debt is devalued. Distressed debt funds use fundamental analysis to identify undervalued investments. Hedge funds that invest in distressed debt need to employ more stringent lock-up and withdrawal terms, including side pockets, (accounts to separate illiquid assets). A fund sponsor looking to form a distressed debt fund should speak with experienced legal counsel to determine whether a private equity fund would be more appropriate. Unlike hedge funds, that allow regular withdrawals, private equity funds are usually closed-ended and have a finite duration, typically between five and ten years.

Fixed Income

Fixed income funds invest in long-term government, bank and corporate bonds, debentures, convertible notes, capital notes, and their derivatives, which pay a fixed rate of interest. Many fixed income funds have lower risk tolerances than distressed debt funds and place capital preservation as a higher priority, leading to more diversification and volatility-reducing strategies. A common fixed income hedge fund strategy is fixed income arbitrage, discussed below.

Arbitrage

Arbitrage strategies seek to exploit observable price differences between closely-related investments by simultaneously purchasing and selling investments. When properly used, arbitrage strategies produce consistent returns with low risk. However, because price inefficiencies between investments tend to be slight, arbitrage funds must rely heavily on leverage to obtain significant returns. Due to heavy use of leverage, some arbitrage firms have suffered monumental losses when pricing differences unexpectedly shifted (including Long Term Capital Management, the infamous fixed income arbitrage fund from the 1990s that suffered catastrophic losses and had to be bailed out by a government-brokered consortium of Wall Street banks).

Fixed Income Arbitrage

Fixed income arbitrage seeks to exploit pricing differences in fixed income securities, most commonly by taking various opposing positions in inefficiently priced bonds or their derivatives, with the expectation that prices will revert to their true value over time. Common fixed income arbitrage strategies include swap-spread arbitrage, yield curve arbitrage and capital structure arbitrage.

Convertible Arbitrage

Convertible arbitrage seeks to profit from price inefficiencies of a company's convertible securities relative to its company's stock. At its most basic level, convertible arbitrage involves taking long positions in a company's convertible securities while simultaneously taking a short position in a company's common stock. Although simple in theory, proper execution of convertible arbitrage strategies requires careful timing to avoid losses. Furthermore, the increasing popularity of convertible arbitrage has had the effect of diminishing available price inefficiencies, making it difficult to achieve significant returns without using extensive leverage.

Relative Value Arbitrage

Relative value arbitrage, or "pairs trading" involves taking advantage of perceived price discrepancies between highly correlated investments, including stocks, options, commodities, and currencies. A pure relative value arbitrage strategy involves high risk and requires extensive expertise.

Merger Arbitrage

Merger Arbitrage involves taking opposing positions in two merging companies to take advantage of the price inefficiencies that occur before and after a merger. Upon the announcement of a merger, the stock price of the target company typically rises and the stock price of the acquiring company typically falls. Merger arbitrage is a form of event-driven hedge fund strategy, discussed below.

Event Driven

Event-driven strategies are closely related to arbitrage strategies, seeking to exploit pricing inflation and deflation that occurs in response to specific corporate events, including mergers and takeovers, reorganizations, restructuring, asset sales, spin-offs, liquidations, bankruptcy and other events creating inefficient stock pricing. Event-driven strategies require expertise in fundamental modelling and analysis of corporate events. Examples of event-driven strategies include: merger arbitrage, risk arbitrage, distressed debt, and event-based capital structure arbitrage.

Quantitative (Black Box)

Quantitative hedge fund strategies rely on quantitative analysis to make investment decisions. Such hedge fund strategies typically utilize technology-based algorithmic modelling to achieve desired investment objectives. Quantitative strategies are often referred to as “black box” funds, since investors usually have limited access to investment strategy specifics. Funds that rely on quantitative technologies take extensive precautions to protect proprietary programs.

Global Macro

Global macro refers to the general investment strategy making investment decisions based on broad political and economic outlooks of various countries. Global macro strategy involves both directional analysis, which seeks to predict the rise or decline of a country’s economy, as well as relative analysis, evaluating economic trends relative to each other.

Global macro funds are not confined to any specific investment vehicle or asset class, and can include investment in equity, debt, commodities, futures, currencies, real estate and other assets in various countries. Currency traders rely heavily on global macro strategies to forecast relative currency values. Likewise, interest rate portfolio managers, which trade instruments that are keyed into sovereign debt interest rates, are heavily involved with global macro fundamental analysis.

Multi-Strategy

Multi-strategy funds are not confided to a single investment strategy or objective, but use a variety of investment strategies to achieve positive returns regardless of overall market performance. Multi-strategy funds tend to have a low risk tolerance and maintain a high priority on capital preservation. Even though multi-strategy funds have the discretion to use a variety of strategies, we have found that fund managers tend to focus primarily on one or more core investment strategies.

Possible Questions

Part – A (Online Examination)

Part – B (2 Marks)

1. What is mutual fund?
2. Define Hedge funds.
3. List out any four mutual fund operators.
4. State any four mutual intimidators' service.
5. What fund expenses?
6. What do you mean by transfer agency?
7. List any for understanding modes to hedge funds.
8. State important hedge fund strategies.
9. List out various stages in trade life cycle.
10. Who are trustees of mutual funds?

Part – C (6 Marks)

1. Explain the various entities involved in mutual funds.
2. Elaborate the key characteristics of hedge funds.
3. Discuss the various classifications of mutual funds.
4. Explain the key characteristics of Hedge funds.
5. What are mutual funds? Explain the different types of mutual funds that operates in India.
6. Discuss the major types of Hedge fund operates in India.
7. Explain the merits and demerits of investing in Mutual Funds.
8. Differentiate between Mutual Fund and Hedge Funds.
9. Differentiate between open ended Mutual fund and closed ended Mutual fund
10. Discuss the merits and demerits of investing in Hedge Funds.

UNIT: III MUTUAL FUNDS AND HEDGE FUNDS

S.NO.	QUESTION	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
1	A closed-end fund is a mutual fund in which shares issue just when fund is	organized	unorganized	copied	random behaviour showing	organized
2	The largest single institutional owner of common stocks is	Mutual funds.	Insurance companies	Pension funds	Commercial banks.	Mutual funds.
3	The most popular type of investment company is a:	Unit investment trust.	Mutual fund.	Closed-end investment company	Real estate investment trust	Unit investment trust.
4	A group of mutual funds with a common management are known as:	Fund syndicates.	Fund conglomerates	Fund families.	Fund complexes	Fund families.
5	A computerized trading network that matches buy and sell orders electronically entered by customers is a	National Markets System	Electronic Communications Networks	Internet Investment Service	Global Investment Network	Electronic Communications Networks
6	_________ is the most important investment decision because it determines the Risk-return characteristics of the portfolio	Hedging	Market timing	Performance measurement	Asset allocation	Hedging
7	Which of the following is a reason for selecting a mutual fund?	Its historic return.	High tax efficiency	Charging 12b-1 fees instead of load fees.	Often realizing portfolio gains.	Often realizing portfolio gains.

8	______ are the dominant form of investing in securities markets for most individuals but ______ have enjoyed a far greater growth rate in the last decade.	Hedge funds; hedge funds	Mutual funds; hedge funds	Hedge funds; mutual funds	Mutual funds; mutual funds	Mutual funds; hedge funds
9	Like mutual funds, hedge funds	allow private investors to pool assets to be managed by a fund manager.	are commonly organized as private partnerships	are subject to extensive SEC regulations	are typically only open to wealthy or institutional investors	allow private investors to pool assets to be managed by a fund manager.

10	Unlike mutual funds, hedge funds	are commonly organized as private partnerships	are subject to extensive SEC regulations	are typically only open to wealthy or institutional investors	are commonly organized as private partnerships and are typically only open to wealthy or institutional investors	are commonly organized as private partnerships and are typically only open to wealthy or institutional investors
11	Alpha seeking hedge funds typically ______ relative mispricing of specific securities	bet on	hedge	investment	security	bet on
12	Hedge funds ______ engage in market timing	but	can	should	must	can
13	The risk profile of hedge funds ______, making performance evaluation ______.	can shift rapidly and substantially; challenging	can shift rapidly and substantially; straightforward	is stable; challenging	is stable; straightforward	can shift rapidly and substantially; challenging
14	Shares in hedge funds are priced	Face value	par value	at NAV	interest	at NAV

15	Hedge funds are typically set up as ______	minimal	limited liability partnerships	investment trusts	banker	limited liability partnerships
16	Hedge funds provide ______ information about portfolio composition and strategy to their investors.	maximum	average	low	minimal	minimal
17	Hedge funds are ______ transparent than mutual funds	less	more	zero	nil	less
18	______ must periodically provide the public with information on portfolio composition.	Hedge funds	Mutual funds	ADRs	Hedge funds and ADRs	Mutual funds
19	______ are subject to the Securities act of 1933 and the Investment Company Act of 1940 to protect unsophisticated investors.	Hedge funds	Mutual funds	ADRs	Hedge funds and ADRs	Mutual funds
20	Hedge funds traditionally have ______ than 100 investors	less	more	equal	equal and more	less
21	The minimum investment in some new hedge funds is as low as $______, compared to a traditional minimum of $______.	50,000; 500,000 to 1 million	25,000; 250,000 to 1 million	175,000; 400,000 to 1 million	10,000; 750,000	25,000; 250,000 to 1 million

22	Hedge funds differ from mutual funds in terms of ______.	transparency	investors	investment strategy	transparency, investors, investment strategy, and liquidity.	transparency, investors, investment strategy, and liquidity.
23	Hedge funds may invest or engage in	distressed firms	convertible bonds	distressed firms, convertible bonds, currency speculation, and merger arbitrage.	currency speculation	distressed firms, convertible bonds, currency speculation, and merger arbitrage.
24	Hedge funds often have ------------ provisions as long as several years	crackdown	lock-up	down ward	up ward	lock-up
25	Hedge fund strategies can be classified as ______.	directional and nondirectional	stock or bond	arbitrage or speculation	equity or share	directional and nondirectional
26	A hedge fund attempting to profit from a change in the spread between mortgages and Treasuries is using a ______	market neutral	directional	relative value	divergence	relative value

	strategy.					
27	Hedge funds exhibit a pattern known as a	. January effect	Santa effect	size effect	. book-to-market	Santa effect
28	Hedge fund performance may reflect significant compensation for ________ risk	liquidity	systematic	unsystematic	default	liquidity
29	Hedge fund incentive fees are essentially	call option	put option	sell option	buy option	call option
30	AMC directors are appointed with the permission of	company	board	Trustees.	agent	Trustees.
31	Mutual fund schemes pay tax on capital gains at	10%	15%	30%	Tax is not applicable	Tax is not applicable
32	The distributor can charge a fee from the investor.	investor.	company	board	Trustees.	investor.
33	Day to day operations of the mutual fund are handled by	RTA	ISCs	Board of Trustees	AMC	AMC
34	STT is applicable on	Equity transactions	Debt transactions	Gold transactions	Mutual fund transactions	Equity transactions
35	Open-ended schemes generally not offer exit option to investors through a stock exchange	AMC	stock exchange	Trustees.	Agent	stock exchange

36	A close-ended mutual fund has a fixed	NAV	fund size	rate of return	number of distr ibutors	fund size
37	The amount required to buy 100 units of a scheme having an entry load of 1.5% and NAV of Rs.20 is	Rs.2000	Rs.2015	Rs.1985	Rs.2030	Rs.2030
38	A gilt fund is a special type of fund that invests :	in very high qua lity equity only	in instruments issued by companies with a sound track record	in short-term securities	in government securities onl	in government sec urities onl
39	Of the following fund types, the highest risk is associated with	Balanced Funds	Gilt Funds	Equity Growt h Funds	Debt Funds	Equity Growth Fu nds
40	The NAV of a mutual fund :	is always consta nt	keeps going up at a steady rate	fluctuates wit h market price movements	cannot go dow n at all	fluctuates with mar ket price movemen ts
41	An open-ended mutual fund is one that has	an option to invest in any kind of security	units available for sale and repurchase at all times	an upper limit on its NAV	a fixed fund siz e	units available for sale and repurchase at a ll times

42	An investor in a close-ended mutual fund can get his/her money back by selling his/her units:	back to the fund	to a special tru st at NAV	on a stock exchange where the fund is listed	to the agent through which he/she subscribed to the units of the fund	on a stock exchange where the fund is listed
43	The "load" charged to an investor in a mutual fund is	entry fee	cost of the paper on which the unit certificates are printed	the fee the agent charges to the investor	the expenses incurred by fund managers for marketing a mutual fundscheme	the expenses incurred by fund managers for marketing a mutual fundscheme
44	A mutual fund is owned by	the Govt. of Ind ia	SEBI	all its investor s	AMFI	all its investors
45	Units from an open-ended mutual fund are bought	on a stock exch ange	from the fund i tself	from AMF	from a stock br oker	from the fund itsel f

46	A mutual fund is not	owned jointly by all investors	a company that manages investment portfolios of high networth individuals	a pool of funds used to purchase securities on behalf of investors	a collective investment vehicle	a company that manages investment portfolios of high networth individuals
47	The most important advantage of a money market mutual fund is	quick capital appreciation	high regular income	safety of principal	no loads	safety of principal
48	Some close-ended funds are quoted at a discount to their NAV because	of high expense ratios	investors do not expect the current NAV to be sustained in future	the repurchase price fixed by the fund in lower than the NAV	of the inherent risk involved in investing in such type of funds	investors do not expect the current NAV to be sustained in future
49	The NAV of each scheme should be updated on AMFI's website	every quarter	every month	every hour	every day	every day
50	Debt funds target	low risk and stable income	protection of principal	high growth with risk	long term capital appreciation	protection of principal

51	In which of the following do debt funds not invest	government debt instruments	corporate paper	financial instit utions' bonds	equity of privat e companies	equity of private c ompanies
52	Which of the following risks do not affect a debt fund	default by issue r on payment of interest or pri ncipal	price fluctuations of the debt sec urities	share price movements	interest volatili t	share price movements
53	Assured return or guaranteed monthly income plans are essentially	Hybrid funds	Growth Funds	Debt/Income funds	Sector funds	Debt/Income funds
54	A Fixed Term Plan Series is	an open-ended fund	a close-ended fund	a fixed term b ank deposit	a fixed term co rporate bond	a close-ended fund
55	The greatest potential for growth in capital is offered by	debt funds	gilt funds	growth funds	balanced funds	growth funds
56	A better performance than the return on index is given by	passive fund ma nager	an active fund manager	all fund mana gers	non fund mana ger	an active fund man ager
57	An AMC cannot explain adverse variations between expense estimates for thescheme on offer and actual expenses for past schemes in	financial newsp apers	business chann els on TV	the offer docu ment	AMFI newslett er	the offer document
58	The financial assets are -------------	shares	silver	real estate	gold	shares
59	The physical assets are -------------	debentures	shares	other securities	gold	gold

60	Asset mix means the ----------------	proportion of stock	proportion current asset	proportion of liability	proportion of profits	proportion of stock

Unit IV

Private Equity: Private equity – Understanding Private Equity Operations - Fund Accounting & NAV Calculations - Performance reporting – Reconciliations in Asset Management.

Private Equity

Private equity typically refers to investment funds organized as limited partnerships that are not publicly traded and whose investors are typically large institutional investors, university endowments, or wealthy individuals. Private equity firms are known for their extensive use of debt financing to purchase companies, which they restructure and attempt to resell for a higher value. Debt financing reduces corporate taxation burdens and is one of the principal ways in which private equity firms make business more profitable for investors. Private equity might also create value by overcoming agency costs and better aligning the incentives of corporate managers with those of their shareholders.

P.E. is, strictly speaking, a type of equity and one of the asset classes consisting of equity securities and debt in operating companies that are not publicly traded on a stock exchange. However the term has come to be used to describe the business of taking a company into private ownership in order to reform it before selling it again at a hoped-for profit.

A private equity investment will generally be made by a private equity firm, a venture capital firm or an angel investor. Each of these categories of investors has its own set of goals, preferences and investment strategies; however, all provide working capital to a target company to nurture expansion, new-product development, or restructuring of the company's operations, management, or ownership.

Bloomberg Business week has called **private equity** a rebranding of leveraged-buyout firms after the 1980s. Common investment strategies in private equity include leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital. In a typical leveraged-buyout transaction, a private-equity firm buys majority control of an existing or mature firm. This is distinct from a venture-capital or growth-capital investment, in which the investors (typically venture-capital firms or angel investors) invest in young, growing or emerging companies, and rarely obtain majority control.

Private equity is also often grouped into a broader category called private capital, generally used to describe capital supporting any long-term, illiquid investment strategy.

Strategies

Leveraged buyout

Leveraged buyout, LBO or Buyout refers to a strategy of making equity investments as part of a transaction in which a company, business unit or business assets is acquired from the current shareholders typically with the use of financial leverage. The companies involved in these transactions are typically mature and generate operating cash flows.

Private equity firms view target companies as either Platform companies which have sufficient scale and a successful business model to act as a stand-alone entity, or as add-on or tuck-in acquisitions, which would include companies with insufficient scale or other deficits.

Leveraged buyouts involve a financial sponsor agreeing to an acquisition without itself committing all the capital required for the acquisition. To do this, the financial sponsor will raise acquisition debt which ultimately looks to the cash flows of the acquisition target to make interest and principal payments. Acquisition debt in an LBO is often non-recourse to the financial sponsor and has no claim on other investments managed by the financial sponsor. Therefore, an LBO transaction's financial structure is particularly attractive to a fund's limited partners, allowing them the benefits of leverage but greatly limiting the degree of recourse of that leverage. This kind of financing structure leverage benefits an LBO's financial sponsor in two ways: (1) the investor itself only needs to provide a fraction of the capital for the acquisition, and (2) the returns to the investor will be enhanced (as long as the return on assets exceeds the cost of the debt).

As a percentage of the purchase price for a leverage buyout target, the amount of debt used to finance a transaction varies according to the financial condition and history of the acquisition target, market conditions, the willingness of lenders to extend credit (both to the LBO's financial sponsors and the company to be acquired) as well as the interest costs and the ability of the company to cover those costs. Historically the debt portion of a LBO will range from 60%–90% of the purchase price. Between 2000–2005 debt averaged between 59.4% and 67.9% of total purchase price for LBOs in the United States.

A private equity fund say for example, ABC Capital II, borrows $9bn from a bank (or other lender). To this it adds $2bn of equity – money from its own partners and from limited partners (pension funds, rich individuals, etc.). With this $11bn it buys all the shares of an underperforming company, XYZ Industrial (after due diligence, i.e. checking the books). It replaces the senior management in XYZ Industrial, and they set out to streamline it. The workforce is reduced, some assets are sold off, etc. The objective is to increase the value of the company for an early sale.

The stock market is experiencing a bull market, and XYZ Industrial is sold two years after the buy-out for $13bn, yielding a profit of $2bn. The original loan can now be paid off with interest of, say, $0.5bn. The remaining profit of $1.5bn is shared among the partners. Taxation of such gains is at capital gains rates.

Note that part of that profit results from turning the company around, and part results from the general increase in share prices in a buoyant stock market, the latter often being the greater component.

- The lenders (the people who put up the $9bn in the example) can insure against default by syndicating the loan to spread the risk, or by buying credit default swaps (CDSs) or selling collateralized debt obligations (CDOs) from/to other institutions (although this is no business of the private equity firm).
- Often the loan/equity ($11bn above) is not paid off after sale but left on the books of the company (XYZ Industrial) for it to pay off over time. This can be advantageous since the interest is typically off settable against the profits of the company, thus reducing, or even eliminating, tax.
- Most buyout deals are much smaller; the global average purchase in 2013 was $89m, for example.

- The target company (XYZ Industrials here) does not have to be floated on the stock market; indeed most buyout exits are not IPOs.[citation needed]
- Buy-out operations can go wrong and in such cases the loss is increased by leverage, just as the profit is if all goes well.

Growth capital

Growth Capital refers to equity investments, most often minority investments, in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business.

Companies that seek growth capital will often do so in order to finance a transformational event in their life cycle. These companies are likely to be more mature than venture capital funded companies, able to generate revenue and operating profits but unable to generate sufficient cash to fund major expansions, acquisitions or other investments. Because of this lack of scale these companies generally can find few alternative conduits to secure capital for growth, so access to growth equity can be critical to pursue necessary facility expansion, sales and marketing initiatives, equipment purchases, and new product development.

The primary owner of the company may not be willing to take the financial risk alone. By selling part of the company to private equity, the owner can take out some value and share the risk of growth with partners. Capital can also be used to effect a restructuring of a company's balance sheet, particularly to reduce the amount of leverage (or debt) the company has on its balance sheet.

A Private investment in public equity, or PIPEs, refer to a form of growth capital investment made into a publicly traded company. PIPE investments are typically made in the form of a convertible or preferred security that is unregistered for a certain period of time. The Registered Direct, or RD, is another common financing vehicle used for growth capital. A registered directs is similar to a PIPE but is instead sold as a registered security.

Mezzanine capital

Mezzanine capital refers to subordinated debt or preferred equity securities that often represent the most junior portion of a company's capital structure that is senior to the company's common equity. This form of financing is often used by private equity investors to reduce the amount of equity capital required to finance a leveraged buyout or major expansion. Mezzanine capital, which is often used by smaller companies that are unable to access the high yield market, allows such companies to borrow additional capital beyond the levels that traditional lenders are willing to provide through bank loans. In compensation for the increased risk, mezzanine debt holders require a higher return for their investment than secured or other more senior lenders. Mezzanine securities are often structured with a current income coupon.

Venture capital

Venture capital or VC is a broad subcategory of private equity that refers to equity investments made, typically in less mature companies, for the launch of a seed or start-up company, early stage development, or expansion of a business. Venture investment is most often found in the application of new technology, new marketing concepts and new products that do not have a proven track record or stable revenue streams.

Venture capital is often sub-divided by the stage of development of the company ranging from early stage capital used for the launch of start-up companies to late stage and growth capital that is often used to fund expansion of existing business that are generating revenue but may not yet be profitable or generating cash flow to fund future growth.

Entrepreneurs often develop products and ideas that require substantial capital during the formative stages of their companies' life cycles. Many entrepreneurs do not have sufficient funds to finance projects themselves, and they must therefore seek outside financing. The venture capitalist's need to deliver high returns to compensate for the risk of these investments makes venture funding an expensive capital source for companies. Being able to secure financing is critical to any business, whether it is a start-up seeking venture capital or a mid-sized firm that needs more cash to grow. Venture capital is most suitable for businesses with large up-front capital requirements which cannot be financed by cheaper alternatives such as debt. Although venture capital is often most closely associated with fast-growing technology, healthcare and biotechnology fields, venture funding has been used for other more traditional businesses.

Investors generally commit to venture capital funds as part of a wider diversified private equity portfolio, but also to pursue the larger returns the strategy has the potential to offer. However, venture capital funds have produced lower returns for investors over recent years compared to other private equity fund types, particularly buyout.

Distressed and special situations

Distressed or **Special Situations** is a broad category referring to investments in equity or debt securities of financially stressed companies. The "distressed" category encompasses two broad sub-strategies including:

- "Distressed-to-Control" or "Loan-to-Own" strategies where the investor acquires debt securities in the hopes of emerging from a corporate restructuring in control of the company's equity;
- "Special Situations" or "Turnaround" strategies where an investor will provide debt and equity investments, often "rescue financing" to companies undergoing operational or financial challenges.

In addition to these private equity strategies, hedge funds employ a variety of distressed investment strategies including the active trading of loans and bonds issued by distressed companies.

Secondary

Secondary investments refer to investments made in existing private equity assets. These transactions can involve the sale of private equity fund interests or portfolios of direct investments in privately held companies through the purchase of these investments from existing institutional investors. By its nature, the private equity asset class is illiquid, intended to be a long-term investment for buy and hold investors. Secondary investments provide institutional investors with the ability to improve vintage diversification, particularly for investors that are new to the asset class. Secondaries also typically experience a different cash flow profile, diminishing the j-curve effect of investing in new private equity funds. Often investments in secondaries are made through third party fund vehicle, structured similar to a fund of funds although many large institutional investors have purchased private equity fund interests through secondary transactions. Sellers of private equity fund investments sell not only the investments in the fund but also their remaining unfunded commitments to the funds.

Other strategies

Other strategies that can be considered private equity or a close adjacent market include:

- Real estate: in the context of private equity this will typically refer to the riskier end of the investment spectrum including "value added" and opportunity funds where the investments often more closely resemble leveraged buyouts than traditional real estate investments. Certain investors in private equity consider real estate to be a separate asset class.
- Infrastructure: investments in various public works (e.g., bridges, tunnels, toll roads, airports, public transportation and other public works) that are made typically as part of a privatization initiative on the part of a government entity.
- Energy and Power: investments in a wide variety of companies (rather than assets) engaged in the production and sale of energy, including fuel extraction, manufacturing, refining and distribution (Energy) or companies engaged in the production or transmission of electrical power (Power).
- Merchant banking: negotiated private equity investment by financial institutions in the unregistered securities of either privately or publicly held companies.
- Fund of funds: investments made in a fund whose primary activity is investing in other private equity funds. The fund of funds model is used by investors looking for:
    - Diversification but have insufficient capital to diversify their portfolio by themselves
    - Access to top performing funds that are otherwise oversubscribed
    - Experience in a particular fund type or strategy before investing directly in funds in that niche
    - Exposure to difficult-to-reach and/or emerging markets
    - Superior fund selection by high-talent fund of fund managers/teams
- Royalty fund: an investment that purchases a consistent revenue stream deriving from the payment of royalties. One growing subset of this category is the healthcare royalty fund, in which a private equity fund manager purchases a royalty stream paid by a

pharmaceutical company to a drug patent holder. The drug patent holder can be another company, an individual inventor, or some sort of institution, such as a research university.

Investments in Private Equity

Although the capital for private equity originally came from individual investors or corporations, in the 1970s, private equity became an asset class in which various institutional investors allocated capital in the hopes of achieving risk adjusted returns that exceed those possible in the public equity markets. In the 1980s, insurers were major private equity investors. Later, public pension funds and university and other endowments became more significant sources of capital. For most institutional investors, private equity investments are made as part of a broad asset allocation that includes traditional assets (e.g., public equity and bonds) and other alternative assets (e.g., hedge funds, real estate, commodities).

Investor categories

US, Canadian and European public and private pension schemes have invested in the asset class since the early 1980s to diversify away from their core holdings (public equity and fixed income). Today equity accounts for more than a third of all monies allocated to the asset class, ahead of other institutional investors such as insurance companies, endowments, and sovereign wealth funds.

Direct vs. indirect investment

Most institutional investors do not invest directly in privately held companies, lacking the expertise and resources necessary to structure and monitor the investment. Instead, institutional investors will invest indirectly through a private equity fund. Certain institutional investors have the scale necessary to develop a diversified portfolio of private equity funds themselves, while others will invest through a fund of funds to allow a portfolio more diversified than one a single investor could construct.

Investment timescales

Returns on private equity investments are created through one or a combination of three factors that include: debt repayment or cash accumulation through cash flows from operations, operational improvements that increase earnings over the life of the investment and multiple expansions, selling the business for a higher price than was originally paid. A key component of private equity as an asset class for institutional investors is that investments are typically realized after some period of time, which will vary depending on the investment strategy. Private equity investments are typically realized through one of the following avenues:

- an *initial public offering* (*IPO*) – shares of the company are offered to the public, typically providing a partial immediate realization to the financial sponsor as well as a public market into which it can later sell additional shares;
- a *merger* or *acquisition* – the company is sold for either cash or shares in another company;
- a *recapitalization* – cash is distributed to the shareholders (in this case the financial sponsor) and its funds either from cash flow generated by the company or through raising debt or other securities to fund the distribution.

Large institutional asset owners such as pension funds (with typically long-dated liabilities), insurance companies, sovereign wealth and national reserve funds have a generally low likelihood of facing liquidity shocks in the medium term, and thus can afford the required long holding periods characteristic of private equity investment.

The median horizon for a LBO transaction is 8 years.

Liquidity in Private Equity Market

The private equity secondary market (also often called private equity secondary) refers to the buying and selling of pre-existing investor commitments to private equity and other alternative investment funds. Sellers of private equity investments sell not only the investments in the fund but also their remaining unfunded commitments to the funds. By its nature, the private equity asset class is illiquid, intended to be a long-term investment for buy-and-hold investors. For the vast majority of private equity investments, there is no listed public market;

however, there is a robust and maturing secondary market available for sellers of private equity assets.

Increasingly, secondaries are considered a distinct asset class with a cash flow profile that is not correlated with other private equity investments. As a result, investors are allocating capital to secondary investments to diversify their private equity programs. Driven by strong demand for private equity exposure, a significant amount of capital has been committed to secondary investments from investors looking to increase and diversify their private equity exposure.

Investors seeking access to private equity have been restricted to investments with structural impediments such as long lock-up periods, lack of transparency, unlimited leverage, concentrated holdings of illiquid securities and high investment minimums.

Secondary transactions can be generally split into two basic categories:

- **Sale of Limited Partnership Interests** – The most common secondary transaction, this category includes the sale of an investor's interest in a private equity fund or portfolio of interests in various funds through the transfer of the investor's limited partnership interest in the fund(s). Nearly all types of private equity funds (e.g., including buyout, growth equity, venture capital, mezzanine, distressed and real estate) can be sold in the secondary market. The transfer of the limited partnership interest typically will allow the investor to receive some liquidity for the funded investments as well as a release from any remaining unfunded obligations to the fund.
- **Sale of Direct Interests** – Secondary Directs or Synthetic secondaries, this category refers to the sale of portfolios of direct investments in operating companies, rather than limited partnership interests in investment funds. These portfolios historically have originated from either corporate development programs or large financial institutions.

Largest private equity firms in the world are:

1. The Blackstone Group
2. Kohlberg Kravis Roberts
3. The Carlyle Group
4. TPG Capital
5. Warburg Pincus
6. Advent International Corporation
7. Apollo Global Management
8. EnCap Investments
9. Neuberger Berman
10. CVC Capital Partners

Private equity fund accounting and NAV Calculations

Private equity fund accounting is unlike that of other investment vehicles because private equity funds are not like other types of investments. They are one part hedge fund, one part venture capital firm and one part something all their own, and it is evident in their accounting. The same accounting rules you see in other companies still apply, but they often have to be modified to accommodate privately held companies.

Private equity funds are akin to hedge funds in that they have similar payment structures. Investors pay management fees and a percentage of the profits earned. Both types of funds maintain portfolios of different investments, but they have very different focuses. Private equity has a longer game, and this affects its accounting. While hedge funds invest in anything and everything, most of these positions are highly liquid. They can be sold in seconds if the fund manager chooses. In contrast, private equity funds tend to be very illiquid.

In this way, they are like venture capital firms in that private equity funds invest directly in private companies and, depending on the investment, may not be able to touch their investments for years. In some cases, they may also intervene in a private company's operations and coach the management into making the business profitable. This could end in an initial public offering (IPO) or culminate in the company merging with another. In either case, there is a period of years during which a precise value of the private equity fund's investments is not objectively defined.

Fund Structure

Private equity funds tend to be structured as limited partnership agreements (LPAs) with several classes of partners. There is often a founder partner (FP) class, as well as a general partner (GP) class and a limited partner (LP) class. Fund expenses and distributions have to be allocated across these partner classes. The rules for this are to be stipulated in the LPA, and there can be wide variance between firms. The exact structure impacts how the accounting information for each investment and that of the company as a whole are recorded. The level of analysis the private equity fund uses may also be affected by the structure.

The country of jurisdiction also makes a big difference in both private equity fund structures and accounting. Most U.S. private equity funds are in Delaware, but private equity funds may also go offshore, as in a Cayman Limited Partnership, or they may be based in another country. For instance, in Europe, an English Limited Partnership is very common, even for funds not based in the United Kingdom. (For more, see: *Understanding a Private Equity Fund's Structure*).

Private Equity Investments

Also, keep in mind that many private equity funds create complex investment structures to limit the tax burdens of their investments, which vary depending on the state or country of jurisdiction, and that complicates the accounting. Controls may be put in place, or need to be put in place, to reduce tax risk, and some structures may need to be adjusted as time goes on depending on changing legislation or the accepted interpretation of tax legislation.

Further, the agreements that private equity funds have with the companies in which they invest also make a difference. For example, some private equity funds invest in a business through both equity and debt, actually financing a sort of loan for the business. If so, interest payments have to be reconciled. In other cases, the company may have an agreement to pay dividends to the private equity fund, and the distribution of those profits has to be handled.

Accounting Standards

For the most part, accounting standards were not written with private equity in mind, so the format for private equity fund accounting has to be modified to illustrate clearly the operations and financial situation of the private equity fund. There is also variance in the terms the private equity fund has with each company in which it invests, the purpose of the private equity fund's activities and the needs of its investors as far as financial statements are concerned.

Private equity fund accounting may also be affected by the amount of control the fund has over an entity. For instance, under U.K. generally accepted accounting principles (GAAP), equity accounting is necessary if the investment gives the fund an influential minority (20 to 50%) stake in the company and is not held as part of a larger portfolio, while U.S. GAAP does not require equity accounting for influential minority positions. In contrast, International Financial Reporting Standards (IFRS) requires equity accounting for influential minority positions when they are not valued fairly through a profit and loss.

The accounting standard a private equity fund adopts also affects how partner capital is treated. Under U.S. GAAP, partner capital is treated as equity unless the partners have an agreement that allows them to redeem their investment at a particular time. In contrast, the U.K. GAAP and IFRS treat partner capital as debt that has a finite life.

Valuation Methodologies

When looking at private equity accounting, valuation is a critical element. The choice of accounting standards impacts how investments are valued. While all accounting standards require investments to be listed at fair value, the definition of fair value differs considerably between standards. In certain cases, a private equity fund may be able to discount the value of an investment by claiming there is a contractual or regulatory restriction that affects the market price. In other cases, investments are listed at what the fund paid for them minus any provisions or are valued at the sale price of the investment if it were put on the market.

Financial Statements

The financial statements prepared for investors also vary depending on the accounting standard. Private equity funds under U.S. GAAP follow the framework outlined in the American

Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide. This includes a cash flow statement, a statement of assets and liabilities, a schedule of investments, a statement of operations, notes to the financial statements and a separate listing of financial highlights. In contrast, the IFRS requires an income statement, balance sheet and cash flow statements, as well as applicable notes and an account of any changes in the net assets attributable to the fund partners. U.K. GAAP asks for a profit and loss statement, a balance sheet, a cash flow statement, a statement of the gains and losses the fund recognizes, as well as any notes.

Net Asset Value

The Net Asset Value (NAV) of a mutual fund is the price at which units of a mutual fund are bought or sold. It is the market value of the fund after deducting its liabilities. The value of all units of a mutual fund portfolio are calculated on a daily basis, from this all expenses are then subtracted. The result is then divided by the total number of units the resultant value is the NAV. NAV is also sometimes referred to as Net Book Value or book Value. Let's discuss its calculation in a bit more detail.

NAV indicates the market value of the units in a fund. So, it helps an investor keep track of the performance about the mutual fund. An investor can calculate the actual increase in the value of their investment by determining the percentage increase in the mutual fund NAV. NAV, therefore, gives accurate information about the performance about the mutual fund.

Calculation of NAV

Mutual fund assets usually fall under two categories – securities & cash. Securities, here, include both bonds and stocks. Therefore, the total asset value of a fund will include its stocks, cash and bonds at market value. Dividends and interest accrued and liquid assets are also included in total assets.

Also, liabilities like money owed to creditors, and other expenses accrued are also included. Now the formula is:

Net Asset Value (NAV) = (Assets – Debts) / (Number of Outstanding units)

Here:

Assets = Market value of mutual fund investments + Receivables + Accrued Income

Debts = Liabilities + Expenses (accrued)

The market value of the stocks & debentures is usually the closing price on the stock exchange where these are listed.

NAV cycle

- Cash is invested into a fund
- The fund issues shares to an investor.
- The fund then makes investments in various financial instruments, earns income and incurs expenses
- The net asset valuation is calculated.
- The NAV per share is the basis upon which subsequent investments and withdrawals are processed.
- So the NAV per share determines the number of shares issued to investors and the amount of cash paid to investors

Performance Reporting

Investment performance is the return on an investment portfolio. The investment portfolio can contain a single asset or multiple assets. The investment performance is measured over a specific period of time and in a specific currency. Investors often distinguish different types of return. One is the distinction between the total return and the price return, where the former takes into account income (interest and dividends), whereas the latter only takes into account capital appreciation.

Another distinction is between net and gross return. The 'pure' net return to the investor is the return net of all fees, expenses, and taxes, whereas the 'pure' gross return is the return before all fees, expenses, and taxes. Various variations between these two extremes exist. Which return one looks at depends on what one is trying to measure. For example, if one wishes to measure the ability of an investment manager to add value, then the return net of transaction expenses, but gross of all other fees, expenses, and taxes is an appropriate measure to look at since fees, expenses, and taxes other than transaction expenses are often outside the control of the investment manager.

Another important distinction is between the money-weighted return and the time-weighted return. The former is appropriate if the manager determines the timing of inflows in or outflows from the portfolio. The latter is appropriate when the manager is not responsible for the timing of cash inflows into and cash outflows from the portfolio.

Reconciliation in Asset Management

Reconciliation is an accounting process that uses two sets of records to ensure figures are correct and in agreement. It confirms whether the money leaving an account matches the amount that's been spent, and making sure the two are balanced at the end of the recording period. The purpose of reconciliation is to provide consistency and accuracy in financial accounts.

Reconciliation is particularly useful for explaining the difference between two financial records or account balances. Some differences may be acceptable due to the timing of payments and deposits. Unexplained or mysterious discrepancies may be signs of theft or cooking the books.

There is no standard method of accounting reconciliation, but Generally Accepted Accounting Principles (GAAP) consider double-entry accounting and account conversion to be the main procedures. Businesses and individuals may reconcile their records daily, monthly or annually using either of these methods.

Difference Between Double-Entry Reconciliation and Account Conversion

In double-entry accounting, commonly used by companies, every financial transaction is posted in two columns of a balance sheet.

For example, if a business takes out a long-term loan for $10,000, the accountant credits the long-term debt column with that amount and debits the cash column with the same amount. When these amounts are added together, the account reconciles or balances at zero. Similarly, imagine that a business incurs an invoice for carpet-cleaning services. It credits the amount of the invoice in its accounts payable column, and it debits a column devoted to expenses for the same amount. When the company pays the bill, it debits accounts payable and credits the cash column. Again, the two columns should agree, balancing out at zero.

Under the account conversion method, records such as receipts or cancelled checks are simply compared with the entries in a ledger.

Reconciliation in Personal Accounting

At the end of every month, many individuals reconcile their check books and credit card accounts by comparing their cancelled checks, debit card receipts, and credit card receipts with their bank and credit card statements. This type of account reconciliation makes it possible to determine whether money is being fraudulently withdrawn. It also makes sure financial institutions have not made any errors with individuals' accounts, and it gives consumers an overall picture of their spending.

When an account is reconciled, the statement's transactions and ending balance should match the account holder's records. For a checking account, it is also important to know how any pending deposits or outstanding checks affect the statement balance.

Reconciliation in Business Accounting

Account reconciliation is also important for businesses. Companies must reconcile their accounts to prevent balance sheet errors, check for fraud, and avoid penalty from auditors.

Some reconciliations are necessary to ensure all cash inflows and outflows matchup on the income statement and the cash flow statement. Other reconciliations turn non-GAAP measures, such as earnings before interest, taxes, depreciation and amortization (EBITDA), into their GAAP-approved counterparts.

Possible Questions

Part – A (Online Examination)

Part – B (2 Marks)

1. What is private equity?
2. How private funds are operating?
3. Define fund accounting.
4. How NAV is calculates?
5. What is mean by performance reporting?
6. What is mean by reconciliation?
7. Define Asset management.

Part – C (6 Marks)

1. Explain the various types of private equities.
2. Define reconciliation and explain the different types of reconciliation.
3. Discuss the components of private equity investment.
4. Elaborate NAV Calculation methods.
5. Discuss the growth and developments of venture capital in India.
6. Define performance reporting and explain its process.
7. What is private equity? Explain the private equity investment strategies.
8. Explain the various modes of reconciliation.
9. Write a short note on
   i. Leveraged buyout ii. Growth Capital iii. Venture Capital
10. Explain the private equity operations in India.

S.NO.	QUESTION	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
1	Which of the following is related to leveraged buyouts?	Shares in new company are distributed to parent company's stockholders.	A large fraction of the purchase price is debt-financed.	Shares in the new company are not given to existing shareholders; they are sold to the public.	Sale of a government-owned company to private investors.	A large fraction of the purchase price is debt-financed.
2	LBOs involve high debt, incentives, and the following	Public ownership	Operational efficiency	Private ownership	Equity debt	Private ownership
3	Who puts up almost all the money in a private equity investment fund?	General partner	General and limited partners equally	Limited partners	It varies too much to generalize	Limited partners
4	The first level regulator of AMC is	Board of Trustees	Company Law Board	SEBI	RBI	Board of Trustees
5	In case of merger of two AMC, 75% of the unit holders have to approve the merger in case of	Open ended funds	both open and close ended funds	Close ended funds	Limited open ended funds only	Close ended funds
6	An investor buys one unit of a fund at an NAV of Rs.20. He receives a dividend of Rs.3 when the NAV is Rs.21. The unit is redeemed at an NAV of Rs.22. Total return is	25.71%	27.51%	21.27%	21.75%	25.71%

7	For evaluating sector funds, the preferred benchmark would be the	BSE Sensex	S & P CNX Nifty	BSE 200	S & P CNX Sectoral Indices	S & P CNX Sectoral Indices
8	An actively managed equity fund expects to	Be able to beat the benchmarks	Earn the same returns as the benchmark	Have no benchmarks	Under-perform when compared with the benchmark	Be able to beat the benchmarks
9	A fund with stable positive earnings	Gives higher returns	Is less risky	Gives lower returns	Is more risky	Is less risky
10	Investors should be advised to avoid investing in a debt fund with a	Lower rated portfolio and higher expenses ratio	Higher rated portfolio and lower expense ratio	Lower rated portfolio and lower expense ratio	Higher rated portfolio and higher expense ratio	Lower rated portfolio and higher expenses ratio
11	The private sector was granted permission to enter the mutual fund industry in	1992	1993	1998	1995	1993
12	A close-ended scheme is quoted on the stock exchange at a discount to its NAV when	The markets are bearish	Investors perceive that the fund will be unable to maintain the NAV	The assets of the fund are undervalued	When the investor expects price of the shares to decrease	Investors perceive that the fund will be unable to maintain the NAV

13	For a closed-ended fund, the purchase price should not be lower than	NAV	95% of NAV	93% of NAV	97% of NAV	95% of NAV
14	Leveraged buyouts (LBOs) almost always involve:	AAA grade debt	Issuance of new shares of stock to many investors	The existing management team as new shareholders	Junk grade debt	Junk grade debt
15	In the case of spin-offs:	Shares of the new company are given to shareholders of the parent company	Shares of the new company are sold as a public offering	Shares of the new company are bought by borrowing or issuing junk bonds	Shares of the new company are given to shareholders of the subsidiary company	Shares of the new company are given to shareholders of the parent company
16	Which of the following statements regarding spin-offs and carve-outs is not true?	Spin-offs are not taxed if the shareholders of the parent company are given a majority of shares in the new company.	Spin-offs are not taxed if the shareholders of the parent company are given at least 80% of the shares in the new company.	Gains or losses from carve-outs are taxed at the corporate tax rate.	A carve out can reduce shareholder value if synergies are lost.	Spin-offs are not taxed if the shareholders of the parent company are given a majority of shares in the new company.

17	A leveraged restructuring is different from an LBO because	Debt is used	Company goes private	No change of control	Private assets are used	No change of control
18	A privatization is a:	Sale of a government-owned company to private investors	Sale of private companies to the government	Sale of a publicly traded company to private investors	Semi-Governmental Companies	Sale of a government-owned company to private investors
19	When a LBO is led by management, it is called	MBO	IPO	LBOM	CEO	MBO
20	In the case of carve-outs	Shares of the new company are given to the shareholders of the parent company	Shares of the new company are sold in a public offering	Shares of the new company are bought by borrowing or issuing junk bonds	Shares of the new company are given to the shareholders both of the parent and subsidiary company	Shares of the new company are sold in a public offering
21	Investors have shifted away from buying commodities that are heavily dependent on which country?	Australia	Brazil	China	Russia	China

22	Petco Animal Supplies and Emergency Medical Services offered to sell bonds that allowed them to pay interest in the form of what?	Stocks	Bonds	Dividends	Derivatives	Bonds
23	Which types of firms, like Blackstone, are investing heavily in foreclosed properties, which may strengthen the housing recovery?	Mutual funds	Hedge funds	Investment banks	Private-equity	Private-equity
24	A person who purchases common stock of a corporation is known as:	preferred stockholder	creditor	bond holder	common stockholder	common stockholder
25	A person who purchases preferred stock of a corporation is known as:	preferred owner	preferred creditor	preferred stockholder	preferred investor	preferred stockholder
26	Which of the following statements is not true about preferred stock?	The rate of dividend is usually fixed	Stockholders always have a voting right	Stockholders' usually have a preference as to assets upon liquidation of the corporation	Stockholders' usually have a preference as to dividends	Stockholders always have a voting right
27	Who is known as the real owner of the corporation?	creditor	preferred stockholder	common stockholder	director	common stockholder

28	The shares of common and preferred stock that have been issued and outstanding are reported in which section of balance sheet?	Fixes assets section	Stockholders' equity section	Current assets	Liabilities section	Stockholders' equity section
29	The following are examples of changes in corporate control except:	Mergers and acquisition	LBOs	Proxy fights	Spin-offs and carve-outs	Proxy fights
30	The following are important motives for privatization except	Economies of scale	Revenue for the government	Increased efficiency	Share ownership	Economies of scale
31	Which of the following is an advantage of private equity partnerships?	Does not carry interest gives the general partner plenty of upside	General partner has incentives to take risks	Separation of ownership and control	Person receives order from many superiors	General partner has incentives to take risks
32	Most investors are risk averse which means:	They will assume more risk only if they are compensated by higher expected return	They will always invest in the investment with the lowest possible risk.	They actively seek to minimize their risks.	They avoid the stock market due to the high degree of risk.	They will always invest in the investment with the lowest possible risk.

33	Which of the following has helped to eliminate the use of stock certificates by placing stock transactions on computers?	Demat account	Securities Exchange Commission	Depository Trust Company	Federal Depository Insurance Corporation	Demat account
34	This type of risk is avoidable through proper diversification.	portfolio risk	systematic risk	unsystematic risk	total risk	unsystematic risk
35	The first market index was introduced by charts in	1984	1985	1986	19987	1984
36	Which of the following would not be considered as capital market security?	A corporate bond	A common stock	A 6-month Treasury bill	A mutual fund share	A 6-month Treasury bill
37	Investors seeking to avoid actively managing their portfolios will prefer which of the following assets?	Common stock.	Commercial bank deposits	Financial futures	Real estate	Commercial bank deposits
38	A corporate bond is a corporation's write undertaking that it will refund a specific amount of money plus	premium	interest	security	save	interest
39	Ambiguity introduced by way by which organization finances its investments is	country risk	liquidity risk	financial risk	business risk	financial risk
40	Trustee is a self-governing organization that operates as bondholders	partner	guardian	broker	representative	representative

41	In primary markets, the first time issued shares to be publicly traded in stock markets is considered as	traded offering	public markets	issuance offering	initial public offering	initial public offering
42	The transaction cost of trading of financial instruments in centralized market is classified as	flexible costs	low transaction costs	high transaction costs	constant costs	low transaction costs
43	The stocks or shares that are sold to investors without transacting through financial institutions are classified as	direct transfer	indirect transfer	global transfer	pension transfer	direct transfer
44	The type of financial security which have linked payoff to another issued security is classified as	linked security	derivative security	payable security	non-issuing security	derivative security
45	In primary markets, the property of shares which made it easy to sell newly issued security is considered as	increased liquidity	decreased liquidity	money flow	large funds	increased liquidity
46	The money market where debt and stocks are traded and maturity period is more than a year is classified as	shorter term markets	capital markets	counter markets	long-term markets	capital markets

47	The example of derivative securities includes	swap contract	option contract	futures contract	Swap, Option and Futures	Swap, Option and Futures
48	The authority which intervenes directly or indirectly in foreign exchange markets by altering the interest rates is considered as	centralized instruments	centralized stocks	central government	central corporations	central government
49	The type of structured market through which the funds flow with the help of financial instruments such as bonds and stocks is classified as	financial markets	non-financial markets	funds market	flow market	financial markets
50	The legal document required by Securities Exchange Commission stating associated risks and detailed description of issues is classified as	prospectus	stated document	risk detailed document	exchange commission document	Prospectus
51	The process of selling and buying of stocks and bonds is classified as	s-trade	b-trade	e-trade	stock trade	e-trade
52	In capital markets, the major suppliers of trading instruments are	government and corporations	liquid corporations	instrumental corporations	manufacturing corporations	government and corporations

53	The transfer of financial instruments from suppliers of funds to users of funds without any intermediary in between is classified as	global transfer	pension transfer	direct transfer	indirect transfer	direct transfer
54	The type of financial markets in which the corporations issues new funds to raise funds is classified as	flow market	primary markets	secondary markets	funding markets	primary markets
55	The type of security backed by mortgage cash flows and are packed by financial instruments is classified as	cash mortgage	securitized mortgage	financial mortgage	instrumental mortgage	securitized mortgage
56	Market risk arises out of the changes in the pattern of	demand and supply	supply	demand	profit	demand and supply
57	Internal business risk is associated with the	external environment	internal environment	organization	management	internal environment
58	External Risk is associated with the	external environment	internal environment	organization	management	external environment
59	Risk is also arise due to changes in the	company policy	market rules	dividend policy	government policies	government policies
60	Principal amount and terminal value are known with certainty	Fixed principal investments	Variable investments	Indirect alternatives	Direct alternatives	Fixed principal investments

Unit V

Risk Management: Counterparty Credit Risk Management – Market Risk Management.

Risk and Types of Risk

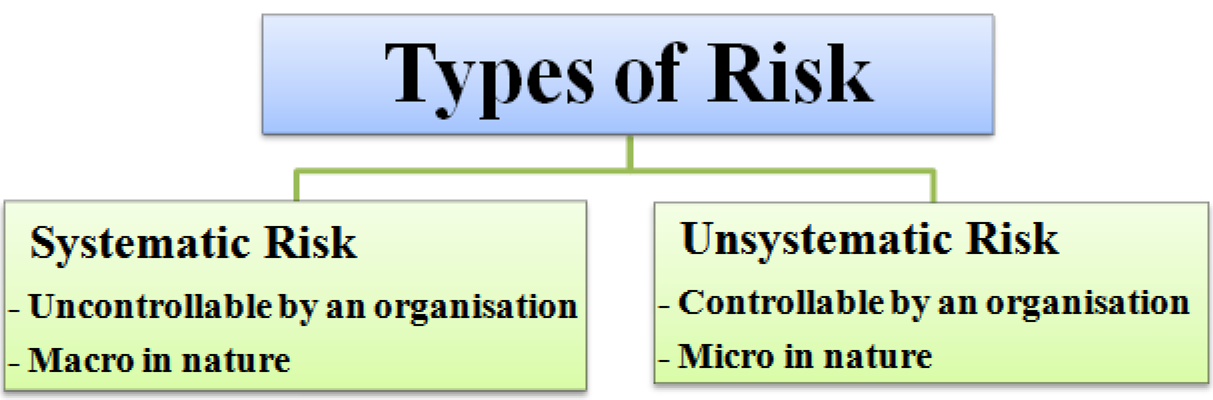
Risk is the possibility you'll lose money if an investment you make provides a disappointing return. All investments carry a certain level of risk, since investment return is not guaranteed.

According to modern investment theory, the greater the risk you take in making an investment, the greater your return has the potential to be if the investment succeeds.

For example, investing in a startup company carries substantial risk, since there is no guarantee that it will be profitable. But if it is, you're in a position to realize a greater gain than if you had invested a similar amount in an already established company.

As a rule of thumb, if you are unwilling to take at least some investment risk, you are likely to limit your investment return.

In finance, different types of risk can be classified under two main groups, viz.,



1. Systematic risk.
2. Unsystematic risk.

The meaning of systematic and unsystematic risk in finance:

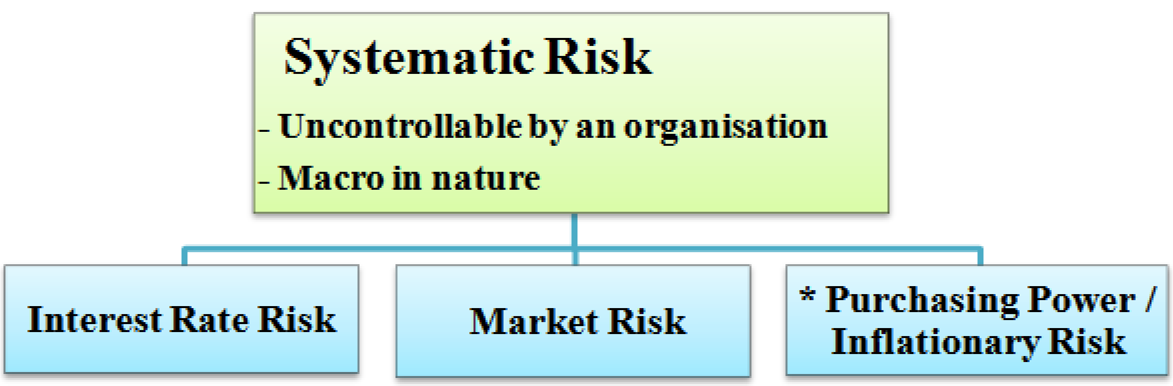
1. Systematic risk is uncontrollable by an organization and macro in nature.
2. Unsystematic risk is controllable by an organization and micro in nature.

A. Systematic Risk

Systematic risk is due to the influence of external factors on an organization. Such factors are normally uncontrollable from an organization's point of view.

It is a macro in nature as it affects a large number of organizations operating under a similar stream or same domain. It cannot be planned by the organization.

The types of systematic risk are depicted and listed below.



* Note: In context of types of risk in finance, purchasing power risk and inflationary risk are same.

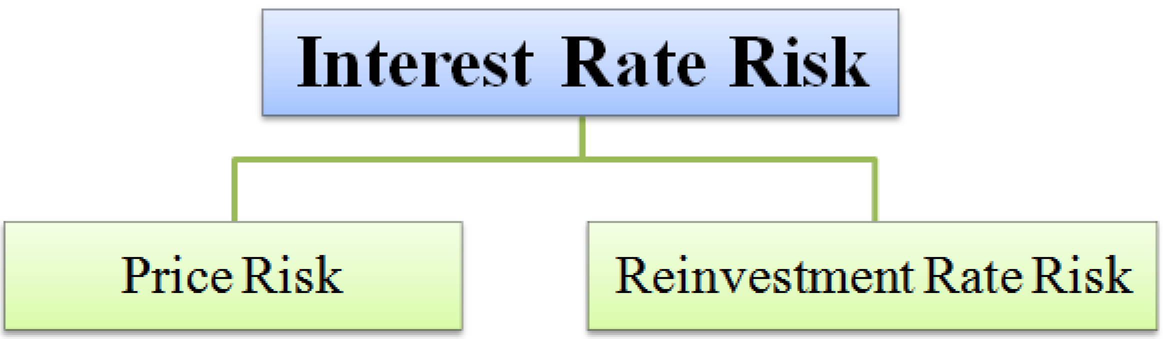
1. Interest rate risk,
2. Market risk and
3. Purchasing power or inflationary risk.

Now let's discuss each risk classified under this group.

1. Interest rate risk

Interest-rate risk arises due to variability in the interest rates from time to time. It particularly affects debt securities as they carry the fixed rate of interest.

The types of interest-rate risk are depicted and listed below.



1. Price risk and
2. Reinvestment rate risk.

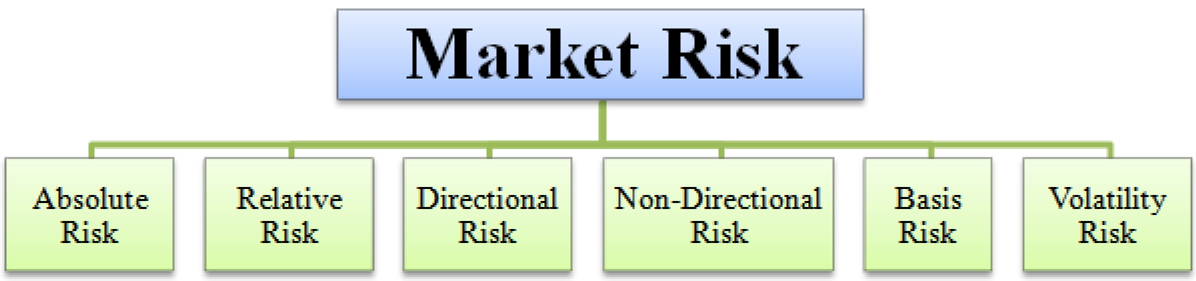
The meaning of price and reinvestment rate risk is as follows:

1. Price risk arises due to the possibility that the price of the shares, commodity, investment, etc. may decline or fall in the future.
2. Reinvestment rate risk results from fact that the interest or dividend earned from an investment can't be reinvested with the same rate of return as it was acquiring earlier.

2. Market risk

Market risk is associated with consistent fluctuations seen in the trading price of any particular shares or securities. That is, it arises due to rise or fall in the trading price of listed shares or securities in the stock market.

The types of market risk are depicted and listed below.



1. Absolute risk,
2. Relative risk,
3. Directional risk,
4. Non-directional risk,
5. Basis risk and
6. Volatility risk.

The meaning of different types of market risk is as follows:

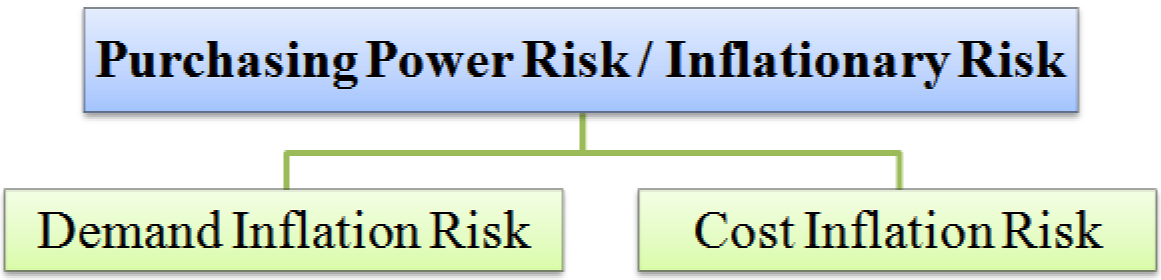
1. Absolute risk is without any content. For e.g., if a coin is tossed, there is fifty percentage chance of getting a head and vice-versa.

2. Relative risk is the assessment or evaluation of risk at different levels of business functions. For e.g. a relative-risk from a foreign exchange fluctuation may be higher if the maximum sales accounted by an organization are of export sales.
3. Directional risks are those risks where the loss arises from an exposure to the particular assets of a market. For e.g. an investor holding some shares experience a loss when the market price of those shares falls down.
4. Non-Directional risk arises where the method of trading is not consistently followed by the trader. For e.g. the dealer will buy and sell the share simultaneously to mitigate the risk
5. Basis risk is due to the possibility of loss arising from imperfectly matched risks. For e.g. the risks which are in offsetting positions in two related but non-identical markets.
6. Volatility risk is of a change in the price of securities as a result of changes in the volatility of a risk-factor. For e.g. it applies to the portfolios of derivative instruments, where the volatility of its underlying is a major influence of prices.

3. Purchasing power or inflationary risk

Purchasing power risk is also known as inflation risk. It is so, since it emanates (originates) from the fact that it affects a purchasing power adversely. It is not desirable to invest in securities during an inflationary period.

The types of power or inflationary risk are depicted and listed below.



1. Demand inflation risk and
2. Cost inflation risk.

The meaning of demand and cost inflation risk is as follows:

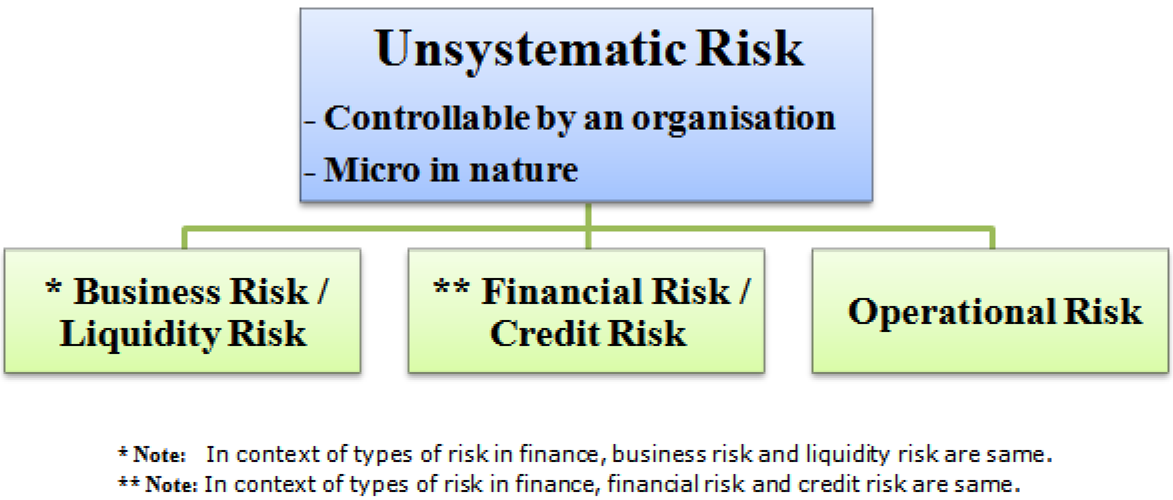
1. Demand inflation risk arises due to increase in price, which result from an excess of demand over supply. It occurs when supply fails to cope with the demand and hence cannot expand anymore. In other words, demand inflation occurs when production factors are under maximum utilization.
2. Cost inflation risk arises due to sustained increase in the prices of goods and services. It is actually caused by higher production cost. A high cost of production inflates the final price of finished goods consumed by people.

B. Unsystematic Risk

Unsystematic risk is due to the influence of internal factors prevailing within an organization. Such factors are normally controllable from an organization's point of view.

It is a micro in nature as it affects only a particular organization. It can be planned, so that necessary actions can be taken by the organization to mitigate (reduce the effect of) the risk.

The types of unsystematic risk are depicted and listed below.



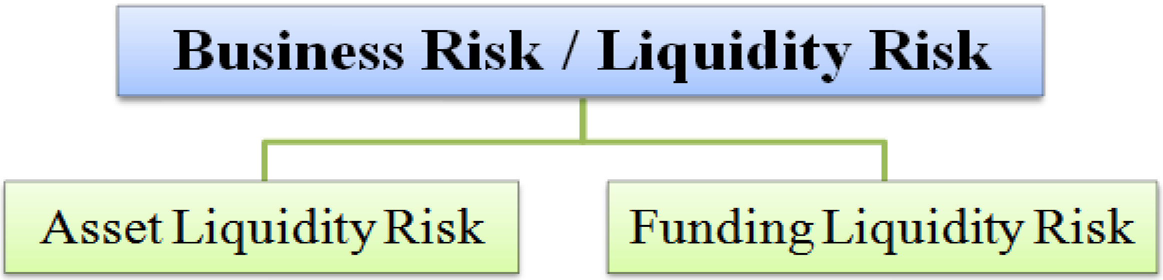
1. Business or liquidity risk,
2. Financial or credit risk and
3. Operational risk.

Now let's discuss each risk classified under this group.

1. Business or liquidity risk

Business risk is also known as liquidity risk. It is so, since it emanates (originates) from the sale and purchase of securities affected by business cycles, technological changes, etc.

The types of business or liquidity risk are depicted and listed below.



1. Asset liquidity risk and
2. Funding liquidity risk.

The meaning of asset and funding liquidity risk is as follows:

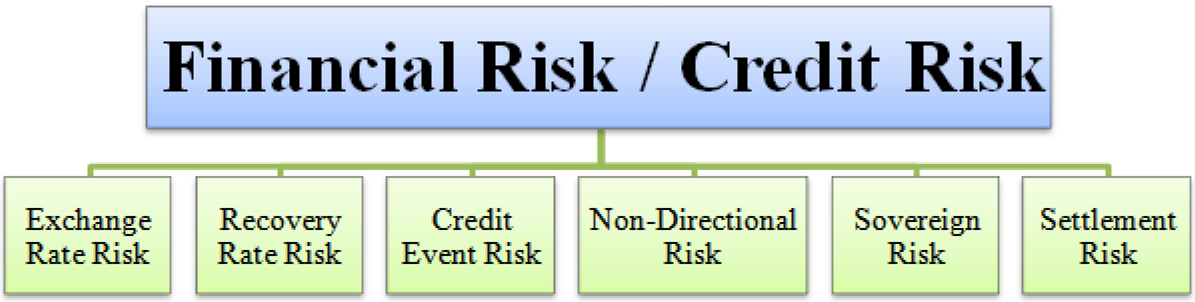
1. Asset liquidity risk is due to losses arising from an inability to sell or pledge assets at, or near, their carrying value when needed. For e.g. assets sold at a lesser value than their book value.
2. Funding liquidity risk exists for not having an access to the sufficient-funds to make a payment on time. For e.g. when commitments made to customers are not fulfilled as discussed in the SLA (service level agreements).

2. Financial or credit risk

Financial risk is also known as credit risk. It arises due to change in the capital structure of the organization. The capital structure mainly comprises of three ways by which funds are sourced for the projects. These are as follows:

1. Owned funds. For e.g. share capital.
2. Borrowed funds. For e.g. loan funds.
3. Retained earnings. For e.g. reserve and surplus.

The types of financial or credit risk are depicted and listed below.



1. Exchange rate risk,
2. Recovery rate risk,
3. Credit event risk,
4. Non-Directional risk,
5. Sovereign risk and
6. Settlement risk.

The meaning of types of financial or credit risk is as follows:

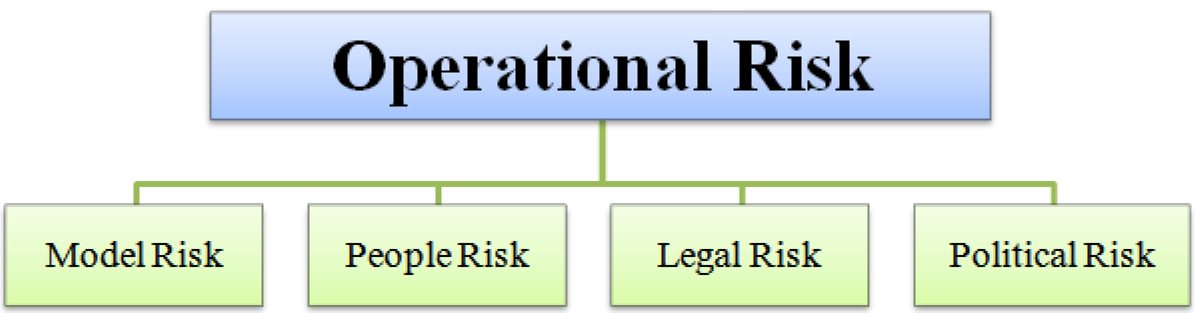
1. Exchange rate risk is also called as exposure rate risk. It is a form of financial risk that arises from a potential change seen in the exchange rate of one country's currency in relation to another country's currency and vice-versa. For e.g. investors or businesses face it either when they have assets or operations across national borders, or if they have loans or borrowings in a foreign currency.
2. Recovery rate risk is an often neglected aspect of a credit-risk analysis. The recovery rate is normally needed to be evaluated. For e.g. the expected recovery rate of the funds tendered (given) as a loan to the customers by banks, non-banking financial companies (NBFC), etc.

3. Sovereign risk is associated with the government. Here, a government is unable to meet its loan obligations, reneging (to break a promise) on loans it guarantees, etc.
4. Settlement risk exists when counterparty does not deliver a security or its value in cash as per the agreement of trade or business.

3. Operational risk

Operational risks are the business process risks failing due to human errors. This risk will change from industry to industry. It occurs due to breakdowns in the internal procedures, people, policies and systems.

The types of operational risk are depicted and listed below.



1. Model risk,
2. People risk,
3. Legal risk and
4. Political risk.

The meaning of types of operational risk is as follows:

1. Model risk is involved in using various models to value financial securities. It is due to probability of loss resulting from the weaknesses in the financial-model used in assessing and managing a risk.
2. People risk arises when people do not follow the organization's procedures, practices and/or rules. That is, they deviate from their expected behaviour.
3. Legal risk arises when parties are not lawfully competent to enter an agreement among them. Furthermore, this relates to the regulatory-risk, where a transaction could conflict with a government policy or particular legislation (law) might be amended in the future with retrospective effect.
4. Political risk occurs due to changes in government policies. Such changes may have an unfavourable impact on an investor. It is especially prevalent in the third-world countries.

Possible Questions

Part – A (Online Examination)

Part – B (2 Marks)

1. What is risk Management?
2. List out various type risk.
3. Define systematic risk.
4. What is mean by unsystematic risk?
5. What financial risk?
6. What do you meant by credit risk?
7. Define market risk.
8. Define interest rate risk.
9. Who are counterparties in risk management?
10. List out any four risk measuring tools.

Part – C (6 Marks)

1. 1. Differentiate between systematic risk and unsystematic risk.
2. Explain the steps involved in risk management functions.
3. Explain the various types of credit risks.
4. Discuss the operational risk involved in trade.
5. Explain the concepts of risk return profile and also explain the various types of risks involved in investment.
6. What is risk modeling? Explain the various risk predict techniques.
7. Wire a short note on
   i. Market Risk ii. Financial Risk iii. Credit Risk

   (OR)
8. Explain the various parameters used to compute the Credit Risk.
9. Explain the counterparty risk management Process.
10. Explain the various types of credit risks.

S.NO.	QUESTION	OPTION 1	OPTION 2	OPTION 3	OPTION 4	ANSWER
1	Political constancy is chief aspect concerning	exchange risk	systematic risk	non-systematic risk	country risk	country risk
2	Most favourable portfolio is proficient portfolio with the	lowest risk	highest risk	highest utility	least investment	highest utility
3	Ambiguity introduced by way by which organization finances its investments is	country risk	liquidity risk	financial risk	business risk	financial risk
4	Liquidity risk is:	is risk investments bankers face	is lower for small OTC	is risk associated with secondary market transactions	increases whenever interest rates increases	is risk associated with secondary market transactions
5	Standard deviation determine	systematic risk of a security	unsystematic risk of security	total risk of security	premium of security	total risk of security
6	Total portfolio hazard is	equal to systematic risk plus diversifiable risk	equal to systematic risk plus unavoidable risk	equal to avoidable risk plus diversifiable risk	equal to systematic risk plus no diversifiable risk	equal to systematic risk plus diversifiable risk
7	Non-systematic risk is furthermore identified as	no diversifiable	market risk	random risk	company specific risk	company specific risk

		risk				
8	Investors should be agreeing to invest in riskier investments merely	if return is short	if there are no safe alternatives except for holding cash	if expected return is adequate for risk level	if there are true speculators	if expected return is adequate for risk level
9	Asset allocation is procedure of scattering your assets between numerous different kinds of investments to	highest risk	moderate risk	lessen risk	no risk	lessen risk
10	Markowitz model presumed generally investors are	risk averse	risk natural	risk seekers	risk moderate	risk averse
11	Underlying all investments is the tradeoff between	Expected return and actual return	Low risk and high risk	Actual return and high risk	. Expected return and risk.	Expected return and actual return
12	Most investors are risk averse which means:	They will assume more risk only if they are compensated by higher expected return	They will always invest in the investment with the lowest possible risk.	They actively seek to minimize their risks	They avoid the stock market due to the high degree of risk	They will always invest in the investment with the lowest possible risk.

13	Which of the following would be considered a risk-free investment?	Gold	Equity in a house	High-grade corporate bonds	Treasury bills	Gold
14	This type of risk is avoidable through proper diversification.	portfolio risk	systematic risk	unsystematic risk	total risk	unsystematic risk
15	Financial risk is most associated with	the use of equity financing by corporations	the use of debt financing by corporations	Equity investments held by corporations	Debt investments held by corporations	. the use of debt financing by corporations
16	Liquidity risk	The risk that investment bankers normally face	Lower for small OTCEI stocks than for large NSE stocks	The risk associated with secondary market transactions	The risk increases whenever interest rates increase	The risk increases whenever interest rates increase
17	Which of the following is not related to overall market variability?	Financial risk. power risk.	Interest rate risk.	Purchasing	Market risk	Financial risk. power risk.
18	Financial disclosure regulations affecting the brokerage industry are a type of	Market risk	Financial risk.	Business risk.	Liquidity risk	Business risk.
19	If interest rates rose, you would expect ------------ to also rise	Business risk. .	Financial risk.	Liquidity risk.	Inflation risk	Liquidity risk.

20	Interest rate risk is a	systematic risk	unsystematic risk	internal risk	market risk	systematic risk
21	Non systematic risk is also known as	Non-diversifiable risk	Market risk	Random risk	company-specific risk	Non-diversifiable risk
22	___________risks are non-divertible bad arise out of the market, nature of the industry, state of the economy, etc	unsystematic risk	systematic risk	market risk	economic risk	systematic risk
23	__________ Risk is that portion of total risks that is unique, or peculiar to a firm or an industry	unsystematic risk	systematic risk	market risk	economic risk	unsystematic risk
24	______is arrived at by dividing the annual coupon price by purchase price	price earnings ratio	purchasing power	current yield	interest rate	current yield
25	__________is arrived at by dividing market price per share by earnings per share	price earnings ratio	current yield	interest rate	dividend	price earnings ratio
26	_______The risk affects the market as a whole	unsystematic risk	market risk	current yield	systematic	systematic

27	______risk is the variation in return caused by the changes in the market interest rate	interest rate	intrinsic value	dividend policy	mutual value	interest rate
28	_____________ Risk is caused by inflation	purchasing power	current yield	price earnings ratio	mutual value	purchasing power
29	_____Risk is unique to the particular industry or company	unsystematic risk	market risk	current yield	systematic	unsystematic risk
30	Which of the following risks emerges from the debt component of the capital structure	financial risk	business risk	purchasing power risk	market risk	financial risk
31	A ---------- is a pessimistic speculator	bull	bear	stag	lame duck	bear
32	Indentify the uncontrollable risk of a company	technological obsolescence	cut in subsidy	labour problem	increase in loan services charges	cut in subsidy
33	In the weak form of market stock prices reflect	the past prices and traded volumes	the demand for the scrip	the country economic conditions	the past price of the scrip	the past prices and traded volumes
34	Risk is influenced by the	internal or external risk	internal	external	market risk	internal or external risk

35	Risk is	certainty	uncertainty	appreciable	no appreciable	uncertainty
36	Unsystematic risk is	The risk associated with movements in security prices	Reduced through diversificati on	Higher when interest rates rise	The risk of loss of purchasing power	The risk associated with movements in security prices
37	Most investors are risk averse which means	They will assume more risk only if they are compensate d by higher expected return	They will always invest in the investment with the lowest possible risk	They actively seek to minimize their risks	They avoid the stock market due to the high degree of risk	. They will always invest in the investment with the lowest possible risk
38	Which of the following would be considered a risky investment?	Gold	Equity in a house	High-grade corporate bonds	Treasury bills	Equity in a house
39	Individuals define risk as	Deviation from some expected return	A cost of investing	A quantitative measure.	Losing money	A cost of investing
40	The statistical tool used to measure a company risk is	mean	mode	variable	covariance	covariance

41	Company specific risk is also known as	Market risk.	Systematic risk	Non-diversifiable risk.	Idiosyncratic risk	Non-diversifiable risk.
42	The optimal portfolio is the efficient portfolio with the	Lowest risk.	Highest risk	Highest utility	Least investment	Highest utility
43	Market risk is best measured by the	Alpha	Beta	Standard deviation	Coefficient of variation	Coefficient of variation
44	In modern investment analysis, the risk for a stock is related to its:	Leverage factor.	Standard deviation	Beta coefficient	Coefficient of variation	Leverage factor.
45	The first four categories of bond ratings are known as _______	Risk-free securities.	High-yield securities.	Investment grade securities	Top drawer securities	Risk-free securities.
46	The relevant risk for a well-diversified portfolio is	Interest rate risk.	Inflation risk.	Business risk.	Market risk	Market risk
47	Portfolio risk is best measured by the	Expected value	. Portfolio beta	Weighted average of individual risk.	Standard deviation.	Weighted average of individual risk.
48	rational investors will seek efficient portfolios because these portfolios are optimal based on	Expected return.	Risk.	Expected return and risk.	Transactions costs	Expected return and risk.

49	Financial assets permit all of the following except ____________.	consumption timing	allocation of risk	separation of ownership and control	elimination of risk	elimination of risk
50	Unsystematic risk is	The risk associated with movements in security prices	Reduced through diversification	Higher when interest rates rise.	The risk of loss of purchasing power	Reduced through diversification
51	In foreign financial markets, the growth is represented by the factors such as	savings in foreign countries	investment opportunities	accessible information	Savings, Investment and accessible information	Savings, Investment and accessible information
52	The risk arises when the technology system may got malfunction is classified as	system risk	technology risk	operational risk	support risk	operational risk
53	The risk stating the assets are sold at low prices because of sudden surge in withdrawals of liabilities is classified as	payment risk	liquidity risk	income risk	balance risk	liquidity risk

54	The risk which arises from insufficient capital available to balance the sudden decrease in assets value is classified as	insolvency risk	solvency risk	balanced risk	unbalanced risk	insolvency risk
55	What is risk?	Negative consequence that could occur	Negative consequence that will occur	Negative consequence that must occur	Negative consequence that shall occur	Negative consequence that could occur
56	In the process of the risk management w hat should be consider before talking the decision of risk?	Risk assessment	Risk identification	Risk retention	Risk transfer	Risk identification
57	The type of risk in which payments are interrupted by the intervention of foreign governments is considered as	channel risk	globalization risk	state risk	country risk	country risk
58	The risk arises from trading of assets because of change in asset prices and exchange rates is classified as	asset risk	trade risk	market risk	exchange risk	market risk

59	The risk faced by financial institutions in which advancement of technology does not produce savings in cost is classified as	savings risk	advance risk	cost risk	technology risk	technology risk
60	The risk which arises all the activities from contingent liabilities and assets is considered as	off balance sheet risk	income statement risk	balance of trade risk	balance of payment risk	off balance sheet risk

Register No.: ……….

[16BPU501A]

Karpagam Academy of Higher Education

(Deemed to be University)

(Established Under Section 3 of UGC Act 1956)

COIMBATORE – 641021

(For the candidates admitted from 2016 onwards)

FIRST INTERNAL EXAMINATION - JULY 2018

B.COM – BPS – FIFTH SEMESTER

BUSINESS PROCESS SERVICES IN CAPITAL MARKET

Time: 2 Hours

Date : **Maximum: 50 Marks**

PART – A (20 X 1 = 20 Marks)

CHOOSE THE CORRECT ANSWER

1. Investment in gold and silver is considered ------------- investment
   a. Real investment b. Risk free c. Risk d. Certain
2. The stock that higher rate of growth than the industrial growth rate in profitability are referred to as -----------
   a. Growth shares b. Equity shares c. Preference d. Debenture
3. Money market is a market for purely ---------
   a. Long term funds b. Medium term funds
   c. Short term funds d. Certain period
4. Which one of the following is not a fixed income bearing security?
   a. Debentures b. Bonds c. Fixed deposits d. Equity shares
5. ---------------- scheme helps in reducing tax liability
   a. Investment in real estate b. National saving certificate
   c. Equity shares d. Savings bank account
6. The ------------- refers to all the facilities and the institutional arrangements for the borrowing and the loaning of long term funds
   a. Money market b. Capital market c. Bullion market d. Securities market
7. OTCEI is a -----------------
   a. National stock exchange b. Regional stock exchange
   c. Primary market d. Government undertaking
8. The market where existing securities are bought and sold
   a. Secondary market b. Primary market
   c. Money market activity d. NIM
9. A ---------- means a document which either creates or acknowledge a debt
   a. Share b. Bond c. Debentures d. Debt
10. Government bond is a
    a. Long-term security b. short-term security
    c. medium-term securities d. neither long-term or short-term
11. Investing money in a private business is known as -------
    a. Financial investment b. Economic investment
    c. Business investment d. Social investment

12. LIC is primarily a

    a. broker   b. money market intermediary
    c. Secondary market intermediary   d. Lenders

13. Financial systems includes

    a. Financial market   b. Share market
    c. Financial and share market   d. Capital market

14. The differences between the sale price and the purchase price is called ----------------

    a. depreciation   b. capital appreciation
    c. investment   d. gambling

15. Money market is a market for purely

    a. long term funds   b. medium term funds
    c. short term funds   d. certain period

16. The financial system as it existed in India at

    a. 1988   b. 1947   c. 1926   d. 1977

17. The component of a capital market is

    a. treasury bill market   b. govt. securities market
    c. commercial bill market   d. RBI

18. Government securities are issued in the form

    a. pledge   b. new method   c. promissory note   d. prepaid

19. __________Includes call money market, treasury bills market, commercial bills, and short term loan market

    a. Insurance company   b. LIC
    c. RBI   d. the imperial bank of India

20. SEBI is

    a. an apex body   b. a security market   c. an intermediary   d. regulator

PART – B (3 X 2 = 6 Marks)
Answer All the Questions

21. What do you mean by hybrid security?
22. List out the features of BSE.
23. Define investment banking.

PART – C (3 X 8 = 24 Marks)
Answer All the Questions

24. a. Give an overview of the Indian financial system and the recent development in Indian capital market.

    (or)

    b. Describe the structure of global financial system.

25. a. Explain the important aspects of the regulatory framework for financial market.

    (or)

    b. Explain the various participants in capital market trade.

26. a. Discuss the advantages of OTCEI to investors and the companies

    (or)

    b. Explain the functions of investment banking.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed to be University)
(Established Under Section 3 of UGC Act 1956)
Coimbatore – 641 021.
DEPARTMENT OF COMMERCE

STAFF NAME: **Dr.V M SENTHIL KUMAR**
SUBJECT NAME: **BUSINESS PROCESS SERVICES IN CAPITAL MARKET**
SUB.CODE: **16BPU501A**
SEMESTER: **V** CLASS: **III B.Com - BPS**

LECTURE PLAN - UNIT – I

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1.	1	Introduction to BPS in Capital Market	T: a - 7
2.	1	Introduction to Securities	T: a - 7
3.	1	Type of Securities	T: a - 9
4.	1	Visit BSE website and Identify innovative investment products trading in BSE	W
5.	1	Equities	T: a – 10 - 11
6.	1	Fixed Income Security & Government Security	T: a - 12
7.	1	Derivatives	W
8.	1	Visit NSE website and Identify innovative investment products trading in NSE	W
9.	1	OTC Products	T: a - 12
10.	1	Participants in a Trade	W
11.	1	Global Financial Market	W
12.	1	Visit OTCEI website and Identify innovative investment products trading in OTCEI	W
13.	1	Financial Markets	W
14.	1	Stock Exchanges	W
15.	1	OTC Products and Financial Markets	W
16.	1	Investment Games - I	W
17.	1	Overview of Regulators	W
18.	1	Important regulations	W
19.	1	Recapitulation and discussion of important questions	19
		Total no. of hours planned for unit-1	**19 Hours**

UNIT-2

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1.	1	Investment Banking – Introduction	T: C - 6
2.	1	Visit any One Leading website of Indian capital market and observe the listing procedure in details	W
3.	1	Basics of Investment Banking	T: C - 6
4.	1	Trade Life Cycle	T: C -11
5.	1	Visit BSE website and observe SENSEX calculation methodology.	W
6.	1	Clearing	T: C - 8
7.	1	Settlement	T: C – 8 -9
8.	1	Security Lending	W
9.	1	Visit NSE website and observe Nifty calculation methodology.	W
10.	1	Prime Brokerage	W
11.	1	Collateral Management	W
12.	1	Corporate Actions	T: C - 12
13.	1	Case Study - I	W
14.	1	Mandatory Action	T: C - 12
15.	1	Voluntary Action	T: C - 12
16.	1	Corporate Action	T: C - 13
17.	1	Class Room discussion about worldwide Top 10 Stocks Exchanges and its features	W
18.	1	How Actions affect Securities	T: C – 14 -15
19.	1	Recapitulation and discussion of important questions	
		Total no. of hours planned for unit-2	**19 Hours**

UNIT-3

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1.	1	Introduction to Mutual Fund	T: b - 6
2.	1	Visit MCX India website and Identify innovative investment products trading in MCX India	W
3.	1	Characteristics of Mutual Funds	T: b - 6
4.	1	Growth of Mutual Fund Industry	T: b - 6
5.	1	Factors contributing for the Growth of Mutual Funds	T: b - 6
6.	1	Visit SEBI website and identify the recent announcements	W
7.	1	Transactions in Mutual Funds	T: b – 6 - 10
8.	1	Mutual Fund Expenses	T: b – 10 -12
9.	1	Transfer Agency	T: b – 6 - 12
10.	1	Investment Game - II	W
11.	1	Overview of Hedging	W
12.	1	Hedging Fund Vs Mutual Fund	T: b – 6 - 12
13.	1	Structure of a Hedge Fund	T: b – 6 -13
14.	1	Visit NSCCL Website and Observe its service	T: b – 6 - 13
15.	1	Understanding Hedging Fund	T: b - 14
16.	1	Categories of Hedge Funds	W
17.	1	Hedge Fund Strategies	W
18.	1	Case - II	W
19.	1	Recapitulation and discussion of important questions	
		Total no. of hours planned for unit-3	**19 Hours**

UNIT-4

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1.	1	An Overview of Private Equity	T: b - 14
2.	1	Private Equity Strategies	T: b - 14
3.	1	Reason to Invest in Private Equity	T: b - 14
4.	1	Visit ICCL Website and Observe its service	W
5.	1	Access of Private Equity	T: b - 15
6.	1	Understanding Private Equity Operations	T: b - 16
7.	1	Fund Accounting	T: b - 16
8.	1	Visit MCX – SX CCL Website and Observe its service	W
9.	1	Players in Private Equity	T: b - 17
10.	1	Global Scenario of Private Equity	W
11.	1	Regulatory Framework	W
12.	1	Identify the top 10 mutual funds in India – Discuss the performance of these.	W
13.	1	NAV Calculations - I	T: b - 11
14.	1	NAV Calculations - II	T: b - 11
15.	1	NAV Calculations - III	T: b - 11
16.	1	Identify the top 5 AMC in India and Observe its features	W
17.	1	Performance Reporting	W
18.	1	Reconciliations in Asset Management	W
19.	1	Recapitulation and discussion of important questions	
		Total no. of hours planned for unit-4	**19 Hours**

UNIT-5

S.No	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1.	1	Emergence of Risk Management.	T: d - 6
2.	1	Risk Assessment Consists	T: d - 6
3.	1	Benefits of Risk Management	T: d - 6
4.	1	Select any five mutual funds and calculate the NAV	W
5.	1	Holistic Risk Management	T: d - 7
6.	1	The Risk Management Process	T: d - 8
7.	1	Quantifying and Qualifying Risks	T: d - 8
8.	1	Select top 10 equity shares and evaluate the Risk Level Associate with that.	W
9.	1	Benefits of Risk Management	T: d - 9
10.	1	Credit Risk Management	T: d - 9
11.	1	Counterparty of Credit Risk Management	T: d - 9
12.	1	Select top 10 Mutual fund and evaluate the Risk Level Associate with that.	W
13.	1	Approach to Counterparty Credit Risk Management	T: d - 10
14.	1	Market Risk Management	T: d - 10
15.	1	Modelling market risk	T: d - 11
16.	1	Approach of Market risk Management	T: d - 12
17.	1	Recapitulation and discussion of important questions	
18.	1	**Revision :** Discussion of ESE question papers	
19.	1	Discussion of ESE question papers	
20.	1	Discussion of ESE question papers	
		Total no. of hours planned for unit-5 & Question Paper Discussion	**20 hours**

SUPPORT MATERIALS: TCS Material

Web Site: www.bseindia.com , www.nseindia.com, www.moneycontrol.com