Stock and Commodity Markets
Unit: 1-An overview on capital and commodity markets

SECTION - A

1. What is Indian financial system?/ Define Indian financial system.

   Financial system is a system where it transfers resources from one part of economy to another part of economy or resources are transferred from surplus to deficit units of the economy is called financial system.

2. What are the Components of Indian financial systems?
   - Financial institution
   - Financial assets/instruments/securities.
   - Financial services.
   - Financial markets

3. What do you mean by Financial institutions?

   These are institutions which are dealing in the financial market. They mobilize and transfer the savings or funds from surplus units to deficit units. Some important financial institution in India are: commercial banks, development banks, RBI, IDBI, IFCI, LIC, ICICI, IFCI, UTI and GIC etc.,.

4. What do you mean by financial instruments?

   The commodities that are traded or dealt in a financial market are financial assets/ instruments/securities. There are various types of securities which are traded in the financial market as the requirements of lenders and borrowers are varied. Financial assets represent a claim on the repayment of principal at a future date and/ or payment of a periodic or terminal sum in the form of interest or dividend. Some of the financial instruments are: equity shares, preference shares, debentures, bonds, bills etc.

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5. What do you mean by financial services?

   Financial services include the services offered by financial institutions. They include the leasing companies, bill discounting houses and acceptance houses. The various financial services provided includes, leasing, credit cards, factoring, banking, insurance.

6. What do you mean by financial markets?

   Financial markets can be referred to as those markets which transfers resources from one part of economy to another part of economy.

7. What do you mean by Money market?

   . It is a market for the lending and borrowing of short-term funds. Eg: commercial paper, treasury bills, certificates of deposits, treasury bonds..

8. What do you mean by Capital market:

   Capital market is a market for borrowing and lending of long term funds. Eg shares, debentures, bonds and securities.

9. What do you mean by Primary market?

Primary market is a market for new issues or fresh issue. Hence, it is also called new issue market. The primary market deals with those securities which are issued to the public for the first time.

10. What do you mean by Secondary market?

Securities which have already existed or already issued. Such securities are quoted in the stock exchange and it provides a continuous and regular market for buying and selling of securities.

11. What do you mean by Depositories?

A depository is an organization which holds securities (like shares, debentures, government securities, mutual fund units etc.,) of investors in electronic form at the request of the investors through a registered depository participant.
Eg: NSDL – National Security depositories ltd

12. What do you mean by Private placement?

It involves allotment of shares/securities by a company to few selected sophisticated investors like mutual funds, insurance companies, bankers etc.

In this method, the issue is placed with a small number of issuing house or brokers (i.e. financial institutions, corporate bodies and high net worth individuals). Financial intermediaries purchase the shares and sell them to investors at a later date at suitable price.

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13. Give the meaning of Dematerialization.

Dematerialization is the process of converting the securities held in physical form(certificates) to an equivalent number of securities in electronic form. For this purpose the investor must first open a Demat account with the depository participant.

14. Give the meaning of buyback of shares?

The repurchase of outstanding shares by a company in order to reduce the number of shares on the market or shares repurchase/buyback of shares is reacquisition of its own stake by a company.

15. Define Commodity.

Indian Forward Contract (Regulation) Act (FCRA) Define “Goods” as “every kind of movable property other than actionable claims, money and securities.

16. Give the meaning of commodity market?

Commodity market means markets that are trade in primary product rather than manufactured products. It is a physical or virtual marketplace for buying, selling and trading raw or primary products.

17. What do you mean by book building?

Book building is a process wherein the issue price of a security is determined by the demand and supply forces in the capital market. In case of book building, the issue price depends upon responses of the investors.

18. What is public issue?

Public issue is a very common method and it involves direct sale of securities to the public for fixed price. The company issues an advertisement inviting the public to subscribe for shares. No intermediaries are involved and this method is very costly.

19. What do you mean by bonus shares?

Bonus shares are those shares which are issued by the company to its existing shareholders at free of cost out of accumulated reserves and distributed past profits. Sometimes, the large amount of reserves and past profits are accumulated with company, and the company likes to distribute these accumulated profits. In such cases the company may issue the shares for this amount to its existing shareholders. The shares so issued are called as Bonus shares or stock dividend.

20. What do you mean by listing of securities?

Listing of securities means permission to quote shares and debentures officially on the trading floor of the stock exchange.

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SECTION – B

1. What are the features of Primary market?

It is also called as new issue market. Hence, it is also called new issue market. The primary market deals with those securities which are issued to the public for the first time.

Features of primary markets:

a) The primary market is the market where the **securities are sold for the first time**.
b) In a primary market, the securities are **issued by the company directly to investors.**
c) The company receives the money and issues new securities certificate to the investors.
d) Primary issues are issued by the companies for the **purpose of setting up new business or the expanding or modernizing the existing business.**
e) The primary market performs the crucial functions of **facilitating capital formation** in the economy.
f) It is also called as ‘**New Issue Market’**.

2. What are the features of Secondary market?

Securities which have already existed or already issued. Such securities are quoted in the stock exchange and it provides a continuous and regular market for buying and selling of securities.

Features of secondary market:

1. It is a place where existing long term securities are purchased and sold.
2. A stock exchange is an association of persons, whether incorporated or not.
3. The trading in a stock exchange is strictly regulated and rules and regulation prescribed for various transactions.
4. Both genuine investors and speculators buy and sell securities.
5. The securities of corporations, trusts, government, Municipal Corporation etc. are allowed to be dealt at stock exchange.

3. Difference between money market capital markets:

Money market	**Capital market**
It is a market for short-term loanable funds for a period not exceeding one year.	It is a market for long- term funds exceeding a period one year.
This market supplies funds for financing current business operations, working capital requirements of industries and short period requiremen of the government.	This market supplies funds for financing the fixed cap requirement of trade and commerce as well as the long – term requirement of t government
The instruments that are dealt in a money market are bills of exchange, treasury bills, commerci papers, certificate of deposit, etc.	This market deals in instruments like shares, debentur government bonds, etc.
Each single money market instrument is of large amount.	Each single capital market instruments is of small amount.
The central bank and commercial banks are the major institutions in the money market.	Development banks and insurance companies play a dominant role in the capital market.
Money market instruments generally do not have secondary markets.	Capital market instruments generally have secondary markets.
Transaction mostly takes place over-the-phone and there is no formal place	Transactions mostly take place at a formal place, i.e, stock exchange.
Transactions have to be conducted without the help of brokers	Transactions have to be conducted only through authorised dealers.

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(Or)

Capital market	**Money market**

It deals in long-term and medium funds	It deals in short-term funds
It provides funds for fixed capital	It provides funds for working capital
It acts as links between investors and industrial and commercial enterprises	It creates a link between the depositors and borrowers
It arranges large amount of funds	It arranges small amount of funds
Rate of interest is generally low	Rate of interest is generally high.

4. What are the Role/ functions of financial system?

1. It serves as **link between savers and investors**.
2. It channelizes **flow of savings into productive investments**.
3. It helps in utilizing the **mobilized savings** of the scattered savers in more efficient and effective manner.
4. Financial system helps in **liquidating one's saving whenever required**.
5. It also creates an environment for one to invest their funds which involves **good return on investment.**
6. It acts as a regulatory body and monitors the action performed by financial institutions and financial markets.
7. It has **increased the savings habits** of the household investments.
8. It promotes the process of **capital formation** by bringing together the supply of savings and the demand for investible funds.
9. It promotes **self-employment and improves employment level**.
10. **Mobilize huge financial resources** for the economy.
11. **Ensures allocation of resources** to different investment channels.
12. It plays the **role of transferor of resources from one part of economy to another.**
13. It a**ccelerates the rate of economic development.**
14. It helps in **passing on financial information**.
15. It helps in the **development of economy.**
16. Provide mechanism to **control risk and uncertainity**.

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5. Difference between primary market and secondary market

Primary market	Secondary market
It deals only with new or fresh issues made by companies for the first time.	**Deals in existing securities, which are already issued by companies**
No fixed geographical location for primary market	**Need fixed place for trading.**

• For the first time securities are created in stock exchange	• Securities are transferred from one person to another person
• All companies can enter primary market	• Only those companies which have issued securities in primary market can enter
• No definite administration setup is available	• definite administration setup is available.
• Regulatory body SEBI, stock exchange, companies act	• Subject to regulation both from within and outside the company.

6. What are the advantages and disadvantages of buyback shares?

The repurchase of outstanding shares by a company in order to reduce the number of shares on the market or shares repurchase/buyback of shares is reacquisition of its own stake by a company.

Company wills buy back shares either to increase the value of shares still available or to eliminate any threats by shareholders who may be looking for a controlling stake. Buyback offer can be binding or optional to the investors.

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Advantages of buyback of shares:

1. The buyback facility **enables the companies to manage their cash efficiently**. Many companies are faced with a problem of surplus cash without having any idea of where to invest them.
2. It would be better for them to return surplus cash to shareholders rather than to go in spending simply for want to alternatives
3. Companies having large amount of free reserves are free in use funds to acquire shares and other specified securities under the buyback process.
4. Buyback shares in helpful company to **reduce its share capital.**
5. It is helpful to **improvement in the values of shares**.
6. It avoids high **financial risk and ensures maximum return to the shareholders.**
7. It helps the promoters to formulation an effective defense strategy against hostile takeover bids.

Disadvantages of buyback of shares:

1. High buyback of share may lead to **artificial manipulation of stock prices** in the stock exchange.
2. All the **control of buyback of shares in the hands of promoters**, so results of in which the position of minority shareholders in weak.

7. What are the SEBI guidelines on buyback of shares?

1. A company is required to make public announcement in at least one national daily all with wide circulation where registered office of the company is situated.
2. Public announcement among other things specify the following:
   a) Specified date i.e. the date of the dispatch of the offer letter shall not be less than/ earlier than 30 days but not later than 42 days.
   b) SEBI shall be informed by the company within the seven working days from the date of public announcement.
   c) The offer for buyback shall remain open to the member for a period of not less than 15 days but not exceeds 30 days. However the opening date for the offer shall not be earlier than 7 days or later than 30 days from the specified date.
   d) The company shall complete the verification of offer within 15 days from the date closure and shares lodged shall be deemed to have been accepted unless communication of rejection is made within 15 days from the date of closure.

Restrictions on buyback of shares by Indian companies:

1. The buyback must be authorized by its articles.
2. A special resolution shall be passed in general meeting of the company authorizing buyback.
3. Buyback should not exceed 25% of the total paid –up capital and free reserves.
4. A declaration of solvency has to be filed with SEBI and registrar of companies.
5. The shares bought back should be extinguished and physically destroyed.
6. The buyback of listed securities is in accordance with SEBI regulations.
7. The buyback of unlisted securities is in accordance with guidelines prescribed by central government.
8. The company should not make any further issue of securities within 2 years, except bonus, conversion of warrants, etc.

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SECTION – C

1. Discuss various Issue mechanism of shares? (kinds of issues of equity shares in primary market)

Most companies are usually started privately by their promoter(s). However, the promoters' capital and the borrowing from banks and financial institutions may not be sufficient for setting up or running the business over a long term. So companies invite the public to contribute towards the equity and issue shares to individual investors.

Objective of capital issue:

1. To promote a new company.
2. To expand an existing company
3. To diversify the production
4. To meet the regular working capital requirements.
5. To capitalization of reserves.

Kinds of issues

1. Public issue
   a) Initial public Offering (by unlisted companies)
      i) Fresh issue
      ii) Offer for sale (bought out deals)
   b) Further public offering (by listed companies}
      i) Fresh issue
      ii) Offer for sale (Bought out deals)
2. Rights issues
3. Private placements
   I) Preferential issues
   II) Qualified institutional placements
4. Bonus issue.
   Public issues and right issues involve a detailed procedure, private placements are relatively simpler.

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1. **Public issue:** the way to invite share capital from the public is called a "Public Issue". it can be further classified into –
   a) Initial public Offering (by unlisted companies)
      i) Fresh issue
      ii) Offer for sale (bought out deals)
   b) Further public offering (by listed companies}
      i) Fresh issue
      ii) Offer for sale (Bought out deals)

a) **Initial public offering (IPO)**: When an unlisted company makes either a fresh issue of securities or some of its existing shareholders make an offer for sale of part of their shareholding, or both, for the first time to the public through an offer document is called 'Initial Public Offering'.
   This pays the way for the listing and trading of the issuer's securities.
   i) **Fresh issue: Issue of new or fresh securities by a company is called fresh issue of shares. Fresh issue is made by a company when it requires money for growth-expansion or diversification or acquisitions or meets its increasing working capital requirements**. Companies also go in for IPOs mainly for the purpose of obtaining valuations for their companies, as market-validated valuations convert shares into a currency, which can also be used, for examples for pledging or for acquisitions. In a fresh securities sale, the proceeds of the share sales go to the issuing company.
   ii) Offer for sale: **Sale of securities held by the existing shareholders/ venture capital/private equity funds/ promoters either through the IPO or in the stock market once the shares are listed is called offer for sale.**

An IPO, where an offer for sale is being made by the existing shareholders, is typically made either because some existing shareholders/ venture capital/ equity funds, want an exit route where they can either sell their shares through the IPO or liquidate these in the stock market once the shares are listed, or in some cases, where the promoters themselves want to convert some of their shares into cash. Other objective could be to obtain valuation for their companies, which can also be used for, for example: for pledging or for acquisitions. In an offer for sale, the proceeds of the share sales go to the selling shareholders and not to issuing company.

b) **Further public offering (FPO)<u>: An already listed company makes either a fresh issue of securities to the public or the existing promoters makes offers for sale to the public through an offer document is called further public offer/ subsequent issue / follow on public offer.</u>**
   i) **Fresh issue**: Issue of new or fresh securities by a company is called fresh issue of shares. Fresh issue is made by a company when it requires money for growth-expansion or diversification or acquisitions or meets its increasing working capital requirements. An FPO is also the preferred route (over a right issue) when the company wants to bring the new investors- both institutional as well as retail.
   ii) **Offer for sale**: An FPO, where an offer for sale is being made by the existing shareholders, is typically made to comply with the listing guidelines which require a minimum level of public shareholding. It may be pointed out that the FPO route is also being utilized extremely by the Government for the PSUs for the purpose of disinvestment of government's holdings and use the proceeds for the social/other purposes.
   SEBI regulations also allow both unlisted and listed companies to make public issue of bonds.

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2. **Rights issue: <u>Right issue involves selling equity/ securities in the company to existing shareholders.</u>** This can be done after meeting some requirements specified by SEBI. According to section 81 of the Companies Act 1956, if a public company wants to increase its subscribed capital by allotment of further shares after two years from the date of its formation or one year from the date of its first allotment, whichever is earlier should offer share at first to the existing shareholders in proportion to the shares held by them at the time of offer. The shareholders have no legal binding to accept the offer and they have the right to renounce the offer in favour of any person.
3. **Private placement**: **<u>It involves allotment of shares/securities by a company to few selected sophisticated investors like mutual funds, insurance companies, bankers etc.</u>** In this method, the issue is placed with a small number of issuing house or brokers (i.e. financial institutions, corporate bodies and high net worth individuals). Financial intermediaries purchase the shares and sell them to investors at a later date at suitable price. The special feature of the private placement is that the issues are negotiated between the issuing company and the purchasing intermediaries. Listed public Ltd. company as well as closely held private Ltd., company can access the public through the private placement method. The major participants are UTI, MFs, insurance companies, and merchant banking

subsidiaries of commercial banks. In this method companies are issue equity shares, preference shares, cumulative convertible preference shares, debentures and bonds.

Advantage of private issues:

1) **Less expensive**: It is cost effective method of raising funds. In a public issue, underwriting, brokerage, printing, mailing and promotion account for 8 to 10% of the Issue cost. In the case of the private placement several statutory and non-statutory expenses avoided.
2) **Less time: T**he time required for completing the legal formalities and other formalities is less, mostly 2 or 3 months but it takes 6 months or more in public issue.
3) **Flexible:** In case of private placement to make the issue more attractive the company can provide discount to underwriters and incase of debenture the interest ceiling can be reduced but it is not possible in public issue. So it is flexible to suit the entrepreneurs and financial intermediaries.
4) **Easy access**: In case of private placement both listed and unlisted public company can mobilize capital and size of issue may be small or large. But in case of public issue, only listed companies can issue, and size of the issue cannot fall below a certain minimum size.

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Types of Private placements: They are divided into following two types:

a) **Preferential allotment**: it is an issue of equity by a listed company to selected investors at a price which may or may not be related to prevailing market price. It is not a public issue of shares. This kind of preferential allotment is made mainly to promoter or their friends and relative.
b) **Qualified institutional placement (QIP)**: It is a private placement of securities only to the qualified institutional buyers. The issuing company is required to follow on elaborate set of guidelines prescribed under the SEBI regulations on issue pricing, disclosures etc. QIP's are typically made to raise funds required by the company and also for meeting the listing requirements on minimum public holding.

4. **Bonus issue**: <u>**Bonus shares are those shares which are issued by the company to its existing shareholders at free of cost out of accumulated reserves and distributed past profits**</u>. Sometimes, the large amount of reserves and past profits are accumulated with company, and the company likes to distribute these accumulated profits. In such cases the company may issue the shares for this amount to its existing shareholders. The shares so issued are called as Bonus shares or stock dividend. Bonus issues are typically seen as a reward to the shareholder.

5. **Book building:** It is a process wherein the issue price of a security is determined by the demand and supply forces in the capital market. In case of book building, the issue price depends upon responses of the investors.

2. Explain the meaning, functions and differences between primary and secondary?
Already mentioned above…..

Unit – 2: Stock Exchange
SECTION - A

1. What is a Stock exchange?

According to Husband and Dockerary "stock exchanges are privately organized markets which are used to facilitate trading in securities."

So stock exchange means a market place where investors can buy and sell stock i.e. securities.

2. Mention the Functions of stock exchange?
   - Continuous and ready market for securities.
   - Provides safety and security in dealings.
   - Encourage capital formation.
   - Pricing of securities.

3. Expand the following:
   - Over the Counter Exchange of India - OTCEI
   - Madras stock exchange introduced Automated Network Trading System - MANTRA.
   - Bombay Online Trading System - BOLT
   - Securities and exchange board of India - SEBI
   - Department of economic affairs - DEA
   - Ministry of corporate affairs - MCA
   - Online trading/ Screen Based Trading System - SBTS
   - Central trading engine - CTE
   - Bombay Stock Exchange - BSE
   - National Stock Exchange - NSE
   - Securities contract Regulation Act-1956 – SCR.

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4. Give the meaning of derivatives?

A derivative is a financial contract whose value is derived from the value of something else such as stock price, commodity price, an exchange rate, an interest rate etc.

A very simple example of derivatives is curd, which is derivates of milk. The price of curd depends upon the price of milk which in turn depends upon the demand and supply of milk.

5. Mention the underlying securities for derivatives?

The underlying securities for derivatives

a) Commodities (castor seeds, grains, coffee, beans, pepper, potatoes)
b) Precious metals (gold, silver)

c) Short term debt securities (treasury bills)
d) Interest rate
e) Common shares or stock.
f) Stock index value.

6. What do you mean by forward contract?

A forward contract is an agreement between two parties obligating each to exchange a particular financial instrument at a set price on a future date. The contract is usually between either two financial institutions or a financial institution and one of its corporate clients. It is an over- the –counter agreement and has standardized market features. It is not traded on a stock exchange.

7. What do you mean by future contract?

A future contract is a standardized agreement between two parties to buy or sell an financial asset at certain price at certain time in future. A futures contract is a legally binding agreement. Futures are traded on an organized stock exchange.

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8. What do you mean by option?

Option is an agreement that gives the owner the right, but not the obligation, to buy or sell a specified asset at a specified price for a set period of time.

9. What is a Call option?

A call option is an option granting the right to the buyer of the option to buy the underlying assets on a specific day at an agreed upon prices, but not the obligation to do so.

Since the buyer of the call option has the right to buy the underlying assets. He will exercise his right to buy the underlying assets if and only if the price of the underlying assets in the market is more than the strike price on or before the expiry date of the contract.

10. What is a Put option?

A put option is an option granting the right to the buyer of the option to sell the underlying assets on or before a specific day at an agreed upon prices, but not the obligation to do so.

Since the buyer as the call option has the right to sell the underlying assets. He will exercise his right to sell the underlying assets if and only if the price of the underlying assets in the market is less than the strike price on or before the expiry date of the

11. What do you mean by SWAPS?

Swap means “exchange.” Swaps as contractual agreements to exchange or swap a series of cash flows. So a swap is any **agreement to a future exchange of one asset for another, one liability for another or more specifically** one stream of cash flow for another.

12. What are the types of Swaps?

Interest rate swaps: if the agreement is for one party to swap its fixed interest rate payment for the floating interest rates payment of another, it is termed as interest rate swaps.

Currency swaps: currency swaps involved exchanging principal and fixed interest payment on a loan in one currency for principal and fixed rate interest payments on an approximately equivalent loan in another currency.

SECTION - B

1. **What are the objectives of Securities contract (Regulation) Act-1956**:

Objectives of Securities contract (Regulation) Act-1956:

The Act empowers the SEBI to regulate the dealings in stock exchanges.

1. To empower the Central Government to **regulate dealing** and control the functions of the stock exchanges in India.
2. To promote **healthy and orderly** development of stock exchanges in the country.
3. To ensure reasonable uniformity regarding **rules and byelaws** of different stock exchanges in the country.
4. To prevent **unhealthy speculation** ant other undesirable practices in the stock exchanges.
5. To **protect the interest of the investors**.

2. **Mention few recognized stock exchanges in India**?

There are 23 recognized stock exchanges in India. They are:

1. Bombay stock exchange
2. National stock exchange
3. Ahmadabad stock exchange
4. Bangalore stock exchange
5. Bhubaneswar stock exchange
6. Calcutta stock exchange
7. Cochin stock exchange
8. Coimbatore stock exchange
9. Delhi stock exchange
10. Guwahati stock exchange
11. Hyderabad stock exchange
12. Jaipur stock exchange
13. Ludhiana stock exchange
14. Madhya Pradesh stock exchange
15. Madras stock exchange
16. Magadha stock exchange
17. Mangalore stock exchange
18. Meerut stock exchange
19. Over the counter exchange of India.

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20. Pune stock exchange
21. Saurashtra stock exchange
22. Uttar Pradesh stock exchange
23. Vadodadar stock exchange

3. **Write a short notes on Bombay Stock Exchange (BSE)**?

Bombay Stock Exchange (BSE):

BSE is the leading and the oldest stock exchange in India as well as in Asia. It was established in 1875 with the formation of "the native share and stock brokers association". BSE is a very active stock exchange with highest number of listed securities in India. It attained a permanent authorization from the Indian government in 1956 under Securities Contracts (Regulation) Act-1956. At present (since 1980) BSE is located at the "PhirozeJeejeebhoy Tower (28 storey building) located at Dalal Street, Fort, Mumbai.

In 2005, BSE was given the status of a full-fledged public limited company along with a new name as "Bombay stock exchange Limited". The BSE has computerized its trading system by introducing BOLT in March 1995. BSE is operating BOLT at 225 cities with 5 lakh trader a day. Average daily turnover of BSE is near Rs. 200 crores.

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BSE is the first exchange in India and second in the world to obtain an ISO-9001:2000 certification. It is also the first exchange in the country and second in the world to receive information security management system standard BS 7799-2-2002 certification for its BSE online trading system (BOLT).

BSE has set up an investor protection fund since 1987 to help the members against defaulting member. The fund is managed by the trustee appointed by the stock exchange. The members contribute to it. The stock exchange contributes 2.5% of the listing fees collected by it. The stock market also credits the interest on securities deposit kept by it with companies making a public issue. The exchange also released 5% of its surplus to this fund. The maximum amount payable to an investor from this fund in the case of default by a member is Rs. 10 lakh.

BSE has been giving a lot of attention to investor education and training. It provides financial assistance up to Rs. 1 crore to recognized investors associations for their development expenditure towards investor protection measures. It has set up investors association centre in many cities. It brings out many publications providing information to the investors. It arranges seminars and lectures for creating awareness among investors.

4. Write a short notes on National Stock Exchange?

National Stock Exchange (NSE): In November 1992 on the recommendation of the high powered study group on establishment of new stock exchanges repot to the government of India paved the way for the promotion of National Stock Exchange by leading financial institutions to

provide access to investors from across the country. It was established in 1992. In April 1993, the NSE was recognized under the SCR Act 1956

The NSE will have two types members viz., participating trading members, who can only trade on their behalf and intermediary trading members (dealers) who can deal on behalf of their clients. Trading members will have computer terminals connecting to the other trading members and to the central computer system at the NSE.

Characteristics of NSE:

1. **Completely automated** system in terms of both trading and settlement procedures to be provided through the securities facilities support corporation.
2. **Compulsory market makers**/ jobbers to provide liquidity and ready market.
3. The members are **large corporate** and institutional members and professionals drawn from various parts of the country.
4. **Only large and medium size companies** and Public sector undertakings are listed on the NSE.
5. The NSE would have a separate trading facilities and time allotted for debt instruments in order to have the beneficial effect of creating an active secondary market in debt instruments particularly of government debt.

Objectives of NSE:

1) Establishing a **nationwide** trading facility for all types of securities.
2) Ensuring **equal access** to investors all over the country through an appropriate communication network.
3) Providing for a **fair, efficient and transparent** securities market using electronic trading system.
4) Enable **shorter settlement cycle**.
5) Meeting up with **international benchmarks and standards**.

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6. Who are traders in derivative market?

Traders in derivative market

1. **Hedgers:** hedgers are those traders who wish to eliminate price risk associated with underlined security being traded.
   The objective of this kind of traders is to safeguard their existence position by reducing the risk. They are not in derivatives market to make profit.
2. **Arbitrageurs**: arbitrageurs are those traders who simultaneously purchase security or derivatives in one market at lower price and sale them in another market at relatively higher prices to make profit.
   Arbitrageurs make profit from price difference in existing market by simultaneously operating in two different markets, thus riskless profit making is the prime goal of arbitrageurs.
3. **Speculators**: speculators are those investors who willingly take price risk to make profit from price changes in underling assets.

Speculators are people, who analyze and forecast future price movement, trading with the hope of making profit.

7. **What are the types of derivatives instruments?**

Types of derivatives instruments are:

- A forwards contract is contract between two parties who agreed to buy or sell a specified quantity of financial instruments or commodity at certain price at a certain date in future.

  A forward contract amounts to setting price today for a trade that will occur in the future. Forward is a non standardized contract between two parties to buy or sell assets at specified time at an agreed price.

- A future contract is a standardized agreement between two parties to buy or sell an financial asset at certain price at certain time in future. A futures contract is a legally binding agreement. Futures are traded on an organized stock exchange.

- Option is an agreement that gives the owner the right, but not the obligation, to buy or sell a specified asset at a specified price for a set period of time.

- Swap means "exchange." Swaps as contractual agreements to exchange or swap a series of cash flows. So a swap is any agreement to a future exchange of one asset for another, one liability for another or more specifically one stream of cash flow for another.

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8. **State the features, advantages and disadvantages of FORWARDS**?

A forwards contract is contract between two parties who agreed to buy or sell a specified quantity of financial instruments or commodity at certain price at a certain date in future.

A forward contract amounts to setting price today for a trade that will occur in the future. Forward is a non standardized contract between two parties to buy or sell assets at specified time at an agreed price.

Features of forward contracts:

1. *Counter party risk:* Parties is to contract bear counter party risk or default risk i.e. if increasing in price in future specified date buyer will get profit, seller will suffers loss. In case seller refuses to sell at specified price the buyer is exposed to counter party risk.
2. *Underlying assets:* The underlying assets could be stock, bonds foreign exchange, commodities.
3. *Flexibility:* Forward contract offers flexibility to parties to design the contract in terms of price quantity, quality and delivery time and place.

4. *Settlement;* a contract has to be settle in delivery of underlying assets or cash settlement on expiry date.
5. *Contract price:* The contract price is generally is not available in public domain it is fixed till the date of maturity.

Advantages of forward contract

1. *Hedge risk:* forward can be used to hedge or lock in the price of purchase or sale of commodity or financial assets in future commitment date.
2. *No margin required:* forward contract does not require any margin(collateral/ security deposit)
3. *No initial cost :* In forward contracts generally margins are not paid. So it does not involve initial cost.
4. *Negotiability:* the terms and conditions of the forward contracts are negotiable.

Disadvantages of forward contracts;

1. *Counter party risk:* counter party risk is very much present in a forward contract since there is no performance guarantee.
2. *Not traded in stock exchange:* since forward contract are not traded in stock exchange they have no ready liquidity.
3. *No transparency of prices:* The contract price generally not available in public domain thereby, there is no transparency in prices. It requires tying up capital. There are no intermediate cash flows before settlement.

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9. **State the features, advantages and disadvantages of FUTURES**?

A future contract is an agreement between two parties in which the buyer agrees to buy an underlying asset from the seller at a future date at a price that is agreed upon today.

Characteristics of Future Contract.

1. *Highly standardized*: futures are highly standardized contract that provide for performance of contract through either deferred delivery of assets or final cash settlement.
2. *Future exchanges*: these contracts trade on organized future exchanges with clearing association that acts as middle man between contracting parties.
3. *Margin*: Contract seller is called “short” and purchaser is called “long”. Both parties pay margin to clearing corporations. This is used as performance bond by contracting parties.
4. *Fluctuations in price*: prices of the future contract changes every day.
5. *Mark to market*: Margins paid are generally marked to market price every day.
6. *No counter parties risk*: there is no questions of counter party risk as it is guaranteed by clearing corporation
7. *Transaction cost*: it includes brokerage fees for buying and selling orders.
8. *Fixed number of transactions*: Number of contracts in a year is fixed.

Advantages of Future Contracts

1. Helps in risk management
2. Guarantees performance of the contract as there is requirement of margin amount
3. Emits on price fluctuating prevents speculation
4. There is no counter party risk.

Disadvantages of Future Contracts

1. Leverages can make trading in future contracts highly risky for a particular strategy.
2. Future contract is standardized product and written for fixed amounts and terms
3. Lower commission cost can encourage a trader to take additional trades and lend to ever trading
4. It offers only a partial hedge.

10. Difference between forwards and futures

Forwards	Futures
1. Forwards contracts are over the counter contracts	1. Futures are traded to recognized future exchanges.
2. Prices remains fixed till maturity	2. Prices fluctuates every day
3. There is a counter party risk	3. There is no question of counter party risk
4. There can be any number of contracts in a year	4. Number of contracts in a year is fixed
5. No collateral is required in case of forwards	5. Margin is required in case of futures
6. 90% of forward contracts are settled by actual delivery	6. Most of the contracts are cash settlement
7. Mark to market is not done	7. Mark to market is done
8. It is non-standardized contract.	8. It is standardized contract

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11. State the features, advantages and disadvantages of OPTION?

Option is an agreement that gives the owner the right, but not the obligation, to buy or sell a specified asset at a specified price for a set period of time.

Features of options

1. The buyer has the right to buy or sell the assets
2. To acquire the right of an option, the buyer of the option must pay a price to the seller; this is called the option price or the premium.
3. It is the fixed price at which the holder of the call or put can buy or sell the underlying assets
4. Within expiry date the option holder has to exercise his or her right to buy or sell the underlying assets

5. Defaults on options work the same way as they do with forward contracts. Defaults in over the counter options transaction are based on counter parties, while exchange traded options use a clearing house.

Advantages of options

1. An investor can gain leverage in a stock without committing to a trade
2. Option premium are significantly cheaper on a per share basis than the full price of the underlying stock.
3. Risk is limited to the option premium (except when writing options for a security that is not already owned).
4. Options allow investor to protect their position against price fluctuations

Disadvantages of options

1. The cost of trading option is significantly higher on a percentage basis then trading the underlying stock and these cost can reduce profit
2. Options are very complex and required a great deal of observation and maintenance
3. Making money by trading options is extremely difficult and the average investor will fail

12. **Write a short notes on Online trading/ Screen Based Trading System (SBTS).**

Online trading/ Screen Based Trading System (SBTS)

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Before the NSE was set up trading on the stock exchange in India used to take place through open outcry without use of information technology for immediate matching or recording of trades. This was time consuming and inefficient. The practice of physical trading imposed limits on trading volumes as well as the speed.

To overcome from the above problems, the NSE introduced Screen Based Trading System (SBTS) where a member can punch into the computer the quantities of shares and the price at which he wants to transact. The transaction is executed as soon as the quote punched by a trading member find a matching sale or buying quote from counter party. SBTS electronically matches the buyers and sellers in an order- driven system or finds the customers the best price available in a quote- driven system, and hence cuts down on time, cost and risk of error as well as on the chances of fraud. SBTS enables distant participants to trade with each other, improving the liquidity of the markets. The high speed, with which traders are executed and the large numbers of participants, who can trade simultaneously; allow faster incorporation of price sensitive information into prevailing prices. This increases the informational efficiency of markets. With SBTS, it becomes possible for market participants to see the full market, which helps to make the market more transparent, leading to increased investors confidence.

On line trading mechanism:

Bombay stock exchange's trading system is popularly known as BOLT (BSE's online trading system). The BSE has two tier architecture, the trader workstations are connected directly to the backend server, which acts as a communication server and a central trading engine (CTE).

Other services like information provided by the system access to market related information through the trader workstation is essential for the market participants to act on real time basis and take immediate decision. BOLT has been interface with various information venders like Bloomberg, Bridge, and Reuters. Market information is fed to news agencies I real time. It makes the trade efficient, transparent and time saving.

SECTION - C

1. What are stock exchange? Explain its functions.

Stock exchange:

According to Husband and Dockerary "stock exchanges are privately organized markets which are used to facilitate trading in securities."

So stock exchange means a market place where investors can buy and sell stock i.e. securities.

Functions of stock exchange:

1. Continuous and ready market for securities: Stock exchanges provide ready and continuous market for purchase and sale of securities. Various types of securities are traded here on regular basis.
2. Provides safety and security in dealings: Stock exchange provides safety, securities and equity (justices) in dealings as transactions are conducted as per well defined rules and regulations. The managing body of the exchange keeps control on the members. Fraudulent practices are also checked efficiently. Due to various rules and regulations, stock exchange functions as the custodian of funds of genuine investors.
3. Encourage capital formation: Stock exchanges accelerate the process of capital formation. It creates the habit of savings, investing and risk taking among the investing class and coverts their savings into profitable investment. It also acts as a channel for right investment (safe and profitable).
4. Pricing of securities: The force of demand and supply works freely in the stock market. In this way, prices of securities are determined.
5. Facilitates public borrowings: it enable the Government to raise public debt easily and quickly.
6. Regulates company management: Listed companies have to comply with rules and regulations of concerned stock exchange and work under the vigilance (supervision) of stock exchange authorities.
7. Serves as economic barometer: Stock exchange indicates the state of health of companies and the national economy. It acts as a barometer of the economic situation/ condition.
8. Provides clearing house facilities: Stock exchange provides a clearing house facility to members. It settles the transactions among the members quickly and with ease. The members have to pay or receive only the net dues because of the clearing house facility.
9. Facilitates healthy speculation: Healthy speculation keeps the exchange active. But excessive speculation is undesirable as it is dangerous to investors and the growth of corporate sector.

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10. Facilitates bank lending: Banks easily know the prices of quoted securities. They offer loans to customers against corporate securities. This gives convenience to the owner of securities.

2. Briefly explain the role and functions of SEBI.

Securities and Exchange Board of India (SEBI)

SEBI is an apex body for overall development and regulation of the securities market. It was set up in April 12, 1944. To start with, SEBI was set up as a Non- statutory body. Later on it becomes a statutory body under the Securities and Exchange Board on India Act 1992. The Act entrusted SEBI with comprehensive power over practically all the aspect of capital; operations.

Role and functions of SEBI:

1. To **protect the interests of investors** through proper education and guidance as regards their investment in securities. For this, SEBI has made rules and regulation to be followed by the financial intermediaries such as brokers etc.
2. To **regulate and control** the business on stock exchange and other securities markets. For this, SEBI made registration of brokers and sub-brokers compulsory and they are expected to follow certain rules and regulations.
3. To **make registration** and to regulate the functioning of intermediaries such as stock brokers, sub-brokers, share transfer agents, merchant brokers and other intermediaries operating on the securities market. In addition, to provide suitable training to intermediaries.
4. To **register and regulate** the working of mutual funds including UTI. The purpose is to maintain effective supervision on their operations and avoid their unfair and anti-investor activities.
5. To **promote self-regulation organization** of intermediaries to form their professional association and control undesirable activities of their members.
6. To **regulate mergers, takeovers and acquisitions of companies** in order to protect the interest of investors.
7. To issue **guidelines to companies** regarding capital issue.
8. To **conduct inspection, enquiries and audits of stock exchanges**, intermediaries and self-regulating organization and to take suitable remedial measures whenever necessary.
9. SEBI **looks after the complaints** received from investors for fair settlement. It also issue booklets for the guidance and protection of small investors.
10. To **restrict insider trading** activity through suitable measures. This function is useful for avoiding undesirable activities of brokers and securities scams.

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Unit-3 Trading in Stock Market

SECTION-A

1. Who are eligible to become brokers?

   Individuals

   Partnership firm registered under the Indian partnership Act 1932.

   Institutions including subsidiary of banks engaged in financial services.

   Body corporate including companies as defined in the companies Act 1956.

2. Who is a stock broker?

   According to SEBI (stock brokers and sub-brokers) Regulations 1992, a stock broker is a member of a stock exchange and requires to hold a certificate of registration from SEBI in order to buy, sell or deal in securities.

3. Who is a Speculator?

   Speculators are those investors who willingly take price risk to make profit from price changes in underling assets.

4. Who is a Bull?

   A bull is "a speculator who expects a rise in prices of securities". He purchases securities at a lower price in order to sell them in future at a higher price.

5. Who is a Bear?

   Bear: A bear also called Mandiwala. A bear is a speculator who is worried about fall in prices and hence sells securities so that he may buy them at cheap price in future.

6. Who is a Stag?

   In short, a stag is a speculator who applies for new shares with the main aim of selling them at a profit after the allotment of securities.

7. Who is a Lameduck?

   Lame duck: A lame-duck is nothing but a stressed bear. When a bear find it difficult to complete his promise he is labeled as a lame duck. Generally a bear agrees to dispose of certain shares on specified date. But sometime he fails to delivery due to non-availability of shares in the market. If the other party refuses to postpone the delivery then lame duck suffers heavy losses.

8. What do you mean by depository?

   A depository is an institution or a kind of organization which holds securities in electronic form (dematerialized form). A depository holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form.

9. What is meant by Dematerialization?

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Dematerialization is the process by which physical certificates of securities of an investor are converted to an equivalent number of securities in electronic form and credited in the investor's account with DP.

10. What is meant by Re-materialization?

Re-materialization is the term used for converting electronic holdings back into physical certificates. Your DP will forward request through depository system to the Registrar after verifying the necessary balance. The registrar will print the certificates and dispatch the same to Demat account holder.

SECTION-B

1. Explain the participants in process of clearing and settlement.

Trading and settlement in stock exchange:

The transactions in secondary market pass through three distinct phases, viz. trading, clearing and settlement. While stock exchanges provide the plat form for trading, the clearing corporation determines the funds and securities obligations of the trading members and ensures that the trade is settled through exchange of obligation.

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Participants in the process of clearing and settlement:

1. **Clearing Corporation**: The clearing corporation is responsible for post trade activities such as risk management and clearing and settlement of traders, executed in a stock exchange. The first clearing corporation to be established in the country and also the first clearing corporation in the country to introduce settlement guarantee is the National Security Clearing Corporation Ltd.(NSCCL), a wholly owned subsidiary of NSE. NSCCL was incorporated in August 1995.
   Objectives of clearing corporation:
   a) Bringing and sustaining confidence in clearing and settlement of securities
   b) Promoting and maintaining short and consistent settlement cycles.
   c) Providing counter party risk guarantee
   d) Operating a tight risk containment system.
2. **Clearing members**: Clearing members are responsible for settlement obligations as determined by the clearing corporation. They do so by making available funds and/ or securities on the designated accounts with clearing bank/depositories on the date of settlement.
3. **Custodians**: Custodians are clearing members but not trading members. They settle trades on behalf of trading members, when particular trade is assigned to them for settlement. The custodian is required to confirm whether he is going to settle that trade or not. If he confirms to settle that trade, then clearing corporation assigns that particular obligation to him.

4. **Clearing banks**: Clearing banks are a key link between the clearing members and clearing corporation to effect settlement of trade. Every clearing member is required to open a dedicated clearing account with one of the designated clearing bank. Based on the clearing member's obligation as designated through clearing, the clearing member makes funds available in the clearing account for the pay-in and receives funds in case of a payout.
5. **Depositories: Depository** holds securities in dematerialized form for the investors in their beneficiary accounts. Each clearing member is required to maintain a clearing pool A/c with depositories. He is required to make available, the required securities in designated account on settlement day. The depository runs an electronic file to transfer the securities from accounts of the custodian/ clearing member to that of clearing corporation and vice-versa as per the schedule of collection of securities.
6. **Professional clearing member**: Professional clearing members may clear and settle trades executed for their clients (individuals, institutions etc.), in such cases, the functions and responsibilities of the professional clearing members are similar to that of the custodians. PCMs also undertake clearing and settlement responsibilities of the trading members. The PCM in this case has no trading rights, but has clearing rights.

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2. What are the procedure involved in trading in stock exchange?

Trading in stock exchange: Buying and selling of securities/stocks in stock exchange is called stock trading. Buying is also called as demand or bid and selling is also called as supply or order.

Trading procedure on a stock exchange:

1. **Selection of a broker:** The buying and selling of securities can only be done through SEBI registered brokers who are members of the Stock Exchange. The broker can be an individual, partnership firms or corporate bodies. So the first step is to select a broker who will buy/sell securities on behalf of the investors or speculator.

2. **Opening Demat Account with Depository:** Demataccount refer to an account which an Indian citizen must open with the depository participant to trade in listed securities in electronic form. Second step in trading procedure is to open a Demat account.

   The securities are held in the electronic form by a depository. Depository is an institution or an organization which holds securities (eg. Shares, Debentures, Bonds, mutual funds, etc.). At present in India there are two depositories: NSDL, CSDL. There is no direct contact between depository and investor. Depository interacts with investors through depository participants only.

   Depository participant will maintain securities account balances of investor and intimate investor about the status of their holdings from time to time.

3. **Placing the Order:** After opening the Demat Account, the investor can place the order. The order can be placed to the broker either (DP) personally or through phone, email, etc.Investor must place the order very clearly specifying the range of price at which securities can be bought or sold. Eg. "Buy 100 equity shares of Reliance for not more than Rs.500 per share.
4. **Executing the Order:** As per the instruction of the investors, the broker executes the order i.e. he buys and sells the securities. Broker prepares a contract note for the order executed. The contract note contains the name and the price of securities, name of parties and brokerage charged by him. Contract note is signed by the broker.
5. **Settlement:** This means actual transfer of securities. This is the last stage in the trading of securities done by the broker on behalf of their clients. There are two types of settlement.
   a) **On the spot settlement:** It means settlement is done immediately and on spot settlement follows. T+2 rolling settlement. This means any trade taking place on Monday gets settled by Wednesday.
   b) **Forward settlement:** It means settlement will take place on some future date. It can be T+5 or T+7, etc. All trading in stock exchanges takes place between 9:55 am to 3:30 pm. Monday to Friday.

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3. Explain the types of trading and settlements.

Types / patterns of trading:

1. **Day trading**: Buying and selling of securities on daily basis is called Day Trading. This is also called as Intra Day Trading. Whatever you buy today you have to sell it today or whatever you sell today, you have to buy it today and very importantly during market hours that is 9.00 AM to 3.30 PM.(Indian time)
2. **Delivery trading**: In delivery trading, as the name says, you have to take delivery of stock and after getting those stocks in your Demat account you can sell them at any time. In delivery trading you need to have the amount required to buy stock in your account, once purchased, these stocks will get deposited in your Demat A/c. Then you can sell these stocks whenever you want. It should be noted that first you have to buy and sell.
3. **Investment in short term, mid-term and long term trading**:
   a) Short term trading: Stock trading done from one week to couple of months is called short term trading.
   b) Mid-term trading: Stock trading done from one month to couple of month say six to eight months is called mid-term trading.
   c) Long term trading: stock trading done from couple of months to couple of years is called long term trading. Companies whose fundamental are good and have good further plans then stocks of these companies are used for long term trading.

4. Who is a stock broker? Explain the types of brokers?

Stock broker

According to SEBI (stock brokers and sub-brokers) Regulations 1992, a stock broker is a member of a stock exchange and requires to hold a certificate of registration from SEBI in order to buy, sell or deal in securities.

Types of brokers:-

1) **Full service broker**: A full services broker is there to provide with advise, updates and everything and to manage the investment.
2) **Discount stock broker**: Discount stock broker offer stock broking services (buying & selling of securities) for lower fees than full service stock brokers. Discount brokers may also be called non-advisory brokers, no-frills brokers or low fee stock brokers.
   Many discount brokers, provide financial advice, market reports and even stock tips.
3) **Online brokers**: A online broker is broker who provides all brokering services through online i.e. using internet and computers

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5. What are the functions of stock brokers?

Duties/activities/ functions of stock brokers: stock brokers provide valuable connection for consumers and world's financial market alike. Following are the duties/activities which are performed by the stoke brokers.

1. **Recruit new customers**: Brokers use several tactics to attain new clients. They can hold free seminars where they offer advice on a financial topic such as planning for retirement. And they can offer free consultation to prospective clients. Brokers contact the people they know such as family members, friends and past co workers. They ask their current clients to refer their friends and family to them.
2. **Customer service**: A stock broker relies heavily on the relationship he has with his customers. Consumers need to feel secure with the individual investing on their behalf; therefore, it is
3. **Advice client:** A stock broker can advice his clients how to manage their portfolios, what stocks to buy and where to place their money based on the clients financial situations and goals. A broker only recommends investments based on the clients' risk tolerance to ensure minimal losses.
4. **Trade execution:** stock brokers will execute trades on behalf of their clients. This is done electronically, over the phone or the physical trading floor. Trades consist of buying or selling, depending on the best interests of the client's portfolio.
5. **Account management:** Management is a big part of a stock broker's duty. He must constantly review the clients' investment profiles, ensuring they meet market standards and adjustment where necessary to ensure that the portfolio continues to grow.
6. **Research:** Brokers research the markets and the performance of individual securities and newcomers to the marketplace for investment potential. This research can involve pulling

quarterly statements, investigating the company's current financial status and reviewing the management personnel within that company to ensure it is a valuable investment.

7. **Build relationship with clients:** A major attribute of good stock brokers is that they know how to build relationship with their clients. After a broker gets a new client he must learn about the client's financial position, tolerance for risk and goals. This helps him to give appropriate advice to his clients. Broker should build a trusting relationship with their clients so that they remain clients for a long term.
8. **Monitor clients portfolio: I**t is the broker's duty to keep an eye over his clients' investments. If market condition shift or client's financial situation changes, the broker must recommend appropriate course of action. As a result, it important for a broker to maintain a close communication with his clients.
9. **Warning:** If a broker does not act in his client's best interest at all times he can face disciplinary action by the Financial Industry Regulatory Authority (FINRA). FINRA is the organization that is mandated by the Securities and Exchange Commission to regulate the stock market and ensure that all stock brokers and financial advisors obey all rules and regulations.

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6. What do you mean by speculation? Mention the difference between investor and speculator.

Speculation: Speculation is the practice of engaging in risky financial transactions in an attempt to make profit from short or medium term fluctuations in the market value of tradable goods such as a financial instrument rather than attempting to profit from the underlying financial attributes embodied in the instrument such as capital gains, interests or dividends.

Difference between investment or investors and speculation or speculators:

Investment / investor	Speculation/speculator
1. Longer planning horizon.	1. Shorter planning horizon
2. Not willing to assume more than moderate risk.	2. Willing to assume high risk.
3. Modest rate of return	3. High rate of return
4. An investor generally uses his own funds eschews borrowings	4. A speculator normally uses borrowed fund.
5. Investments are carefully thought out decisions which involve calculated risk.	5. Speculation is based on rumors, hearsay, tips etc.

6. Who are speculators? Explain the types of speculation.

Speculators are those investors who willingly take price risk to make profit from price changes in underling assets.

Kinds of speculators/speculations are:

1. **Bull**: A bull also called as Tejiwala. A bull is an operator who is hopeful of price rise in the near future. In anticipation of price rise he makes purchases of shares and other securities with the intention of selling them at higher prices in future. He being a speculator has no intention of taking delivery of securities but deals only in differences of prices. Such a speculator is called as bull.

   In short a bull is "a speculator who expects a rise in prices of securities. He purchases securities at a lower price in order to sell them in future at a higher price.
2. **Bear**: A bear also called Mandiwala. A bear is a speculator who is worried about fall in prices and hence sells securities so that he may buy them at cheap price in future. A bear does not have securities at present but sells them at higher prices in anticipation that he will supply them, by purchasing at lower prices in the future. If the prices move down as per the expectation of the bear, he will earn profit.
3. **Stag:** A stag is that type of speculator who reads his path very carefully. He applies for shares in new companies and expects to sell them at a premium. If he gets an allotment. He select those companies whose shares are most in demand and are likely to carry a premium.

   In short, a stag is a speculator who applies for new shares with the main aim of selling them at a profit after the allotment of securities.
4. **Lame duck**: A lame-duck is nothing but a stressed bear. When a bear find it difficult to complete his promise he is labeled as a lame duck. Generally a bear agrees to dispose of certain shares on specified date. But sometime he fails to delivery due to non-availability of shares in the market. If the other party refuses to postpone the delivery then lame duck suffers heavy losses.

   In short a lame duck is bear speculator who has agreed to sell certain securities in a particular date on a specified price but finds it difficult to supply the securities on the settlement date.

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7. What is depository? Explain its features and objectives.

Meaning of Depository

A depository is an institution or a kind of organization which holds securities in electronic form (dematerialized form). A depository holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form. Besides holding securities, a depository also provides services related to transactions in securities. In India, there are two Depository-NSDL & CSDL.

Features of Depository

a) It holds securities in accounts
b) It transfers securities in accounts
c) It transfers without handling physical securities

d) It undertakes safeguarding of securities

Objectives of Depository

1) To eliminate forgery (duplicate) of certificate
2) To avoid tearing and mutilation (severe damage of certificate) of scripts due to reckless handling
3) To avoid loss of certificates by postal authorities/registrars/investors
4) To ensure liquidity
5) To liberate the Indian securities market from the paperwork grid
6) To reduce the paper handling cost in the capital market
7) To standardize the Indian settlement practice
8) To increase the growth potential of Indian capital market
9) To implement an achievable clearing, settlement, and depository solution which is not expensive to develop and maintain.

8. What do you mean by Depository Participants? Mention the benefits of depository system.

Meaning of Depository Participants:

Depository provides its services to investors through its agents called Depository Participants (DPs). These agents are appointed by NSDL with the approval of SEBI. According to SEBI regulations, amongst others, three categories of entities i.e. Banks, Financial Institutions and Members of Stock Exchanges (brokers) registered with SEBI can become DPs.

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Benefits of participation in a depository system

- Immediate transfer of securities
- No stamp duty on transfer of securities
- Elimination of risks associated with physical certificates such as bad delivery, fake securities etc.
- Reduction in paper work involved in transfer of securities
- Reduction in transaction cost
- Nomination facility
- Change in address/bank account details recorded with DP gets registered electronically with all companies in which investor holds securities eliminating the need to correspond with each of them separately
- Transmission of securities is done by DP eliminating correspondence with companies
- Holding investments in equity, debt instrument, government securities, mutual fund units etc. in single account
- Automatic credit of shares, mutual fund unit etc. arising out of split/merger etc. into the Demat account.

<u>Following are the problems faced by investors and corporate in handling large volume of paper:-</u>

- Bad deliveries
- Fake certificates
- Loss of certificates in transit
- Delays in transfer
- Long settlement cycles

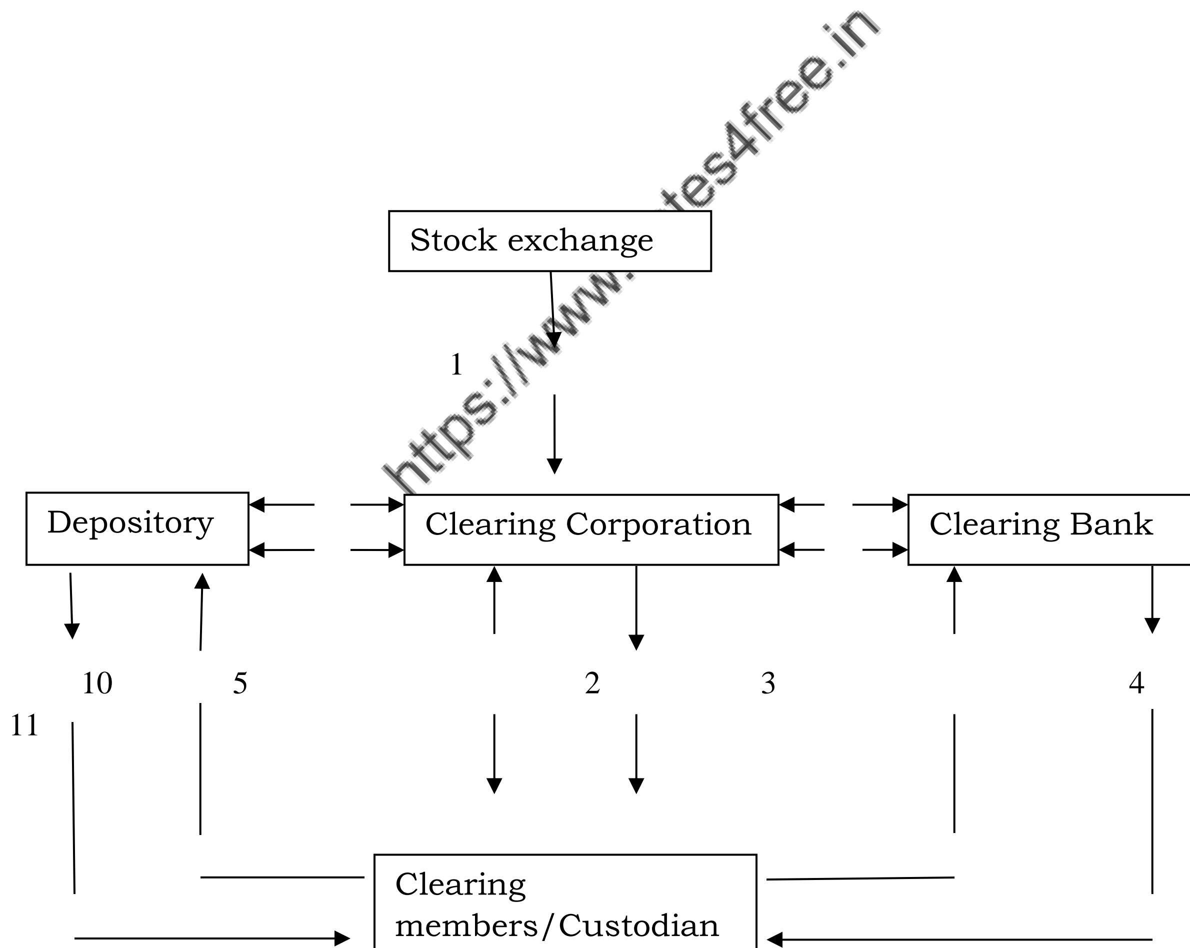
- Mismatch of signatures
- Mutilation (cuts or tearing off) of certificates
- Delay in refund and remission of dividend etc.

SECTION-C

1. Explain the process involved in clearing and settlement of stocks.

Clearing and settlement: The clearing process involves determination of what counter parties owe and which counter parties are due to receive on the settlement date, thereafter the obligation are discharged by settlement. The clearing and settlement process comprises of three main activities- clearing, settlement and risk management.

Clearing and Settlement process:



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The core processes involved in clearing and settlement:

1. **Trade recording**: The key details about the trades are recorded to provide the basis for settlement. These details are automatically recorded in the electronic trading system of the exchange.
2. **Trade confirmation**: Trades that are meant for settlement by the custodians are indicated with a custodian participant code, and the same is subject to confirmation by the respective custodian. The custodian is required to confirm the settlement of these trades on T+1 day by the cut off time of 1:00 pm.

   Note: T+1 means one working day after the trade day. T+ terms have similar meaning the actual movement of funds as well as securities on the prescribed pay-I and pay-out day.
3. **Determination of obligation:** The next step is the determination of what the counterparties owe, and what the counterparties are due to receive on the settlement date. The clearing corporation interposes itself as a central counterparty between the counterparties to trade and net the position so that a member has a securities wise net obligation to receive or deliver security, and has to either pay or receive funds.

   The settlement process begins as soon as the members' obligations are determined through the clearing process. The settlement process is carried out by the clearing corporation with the help of clearing bank and depositories. The clearing corporation provides link between

   a) Pay-in of funds and securities: This requires the members to bring in their funds/securities to the clearing corporation. The clearing members(CMs) make securities available in the designated account with the depositories. The depositories move the securities available in the pool account to the pool account of the clearing corporation. Likewise, the CMs with funds obligations make the funds available in the designated accounts with the clearing banks. The clearing corporation sends electronic instruction to the clearing banks to debit the designated CMs' account to the extent of the payment obligations. The banks process these instructions, debit the accounts of the CMs, and credit the accounts of the clearing corporation.

   b) Pay-out of funds and securities: After processing for shortages of funds/securities and arranging for the movement of funds from surplus banks to deficit banks through RBI clearing, the clearing corporation sends electronic instruction to the depositories/clearing banks to release the pay out of securities/ funds. Depositories and clearing banks debit the accounts of the clearing corporation and credit the accounts of CMs

2. Write a short notes on NSDL?

National Securities Depository Limited (NSDL)

Introduction: NSDL is a public limited company. NSDL is the first depository to be set up in India. It was incorporated on December 12.1995. It commenced its operations on November 8, 1996.

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Promoters of NSDL: IDBI, UTI, NSE, SBI, Global Trust Bank Limited, Citibank, Standard Chartered Bank, HDFC Bank Limited, Dena Bank, Canara Bank etc.

Benefits of NSDL

1) Elimination of bad deliveries: In the depository system, once holdings of an investor are dematerialized, the question of bad delivery does not arise. In the physical environment, buyer was required to take risk of transfer and face uncertainty of the quality of assets purchased.
2) Elimination of all risks associated with physical certificates: Dealing in physical securities leads to security risks of theft, mutilation of certificates and loss of certificates during movements through and from the registrars, thus exposing the investor to the cost of obtaining duplicate certificate etc. This problem does not arise in the depository environment.
3) Stamp duty: No stamp duty is required for transfer of any kind of securities in the depository.
4) Immediate transfer and registration of securities: In the depository environment, once the securities are credited to the investors account, he becomes the legal owner of the securities. There is no further need to send it to the company's registrar for registration. Having purchased securities in the physical environment, the investor has to send it to the company's registrar so that the change of ownership can be registered.
5) Faster settlement cycle: NSDL provides faster settlement of trade and more liquidity with the investor.
6) Faster disbursement of non-cash corporate benefits like dividend, bonus etc.: NSDL provides for direct credit of non-cash corporate entitlement to an investors account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.
7) Reduction in brokerage by many brokers for trading in dematerialized securities: Broker provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker.
8) Better control: Periodic status reports to investors on their holdings and transactions through SMS alert facility leads to better control.
9) Elimination of problems related to change of address of investor: In case of change of address, investor have to only inform their DP with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities.
10) Elimination of problems related to transmission of Demat shares: In case of dematerialized holdings, the process of transmission is more convenient as the transmission formalities for all securities held in a Demat account can be completed by submitting documents to the DP whereas, in case of physical securities, the surviving joint holder/legal heirs/nominee has to correspond independently with each company in which shares are held.
11) Elimination of problems related to selling securities on behalf of a minor: A natural guardian is not required to take court approval for selling Demat account on behalf of a minor.
12) Portfolio monitoring: It ensures ease in portfolio monitoring since statement of account gives a consolidated position of investments in all instruments.

Functions of NSDL

a) It enables the surrender and withdrawal of securities to and from the depository (dematerialization and re-materialization)
b) It maintains investor holdings in the electronic form

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c) Effects settlement of securities traded on the exchanges
d) Carries out settlement of trades not done on the stock exchange (off market trades)
e) Transfer of securities
f) Pledging of dematerialized securities
g) Electronic credit in public offerings of companies or corporate actions
h) Receipt of non-cash corporate benefits like bonus rights, etc. in electronic form

Facilities or services offered by NSDL

a) Dematerialization (converting physical certificates into electronic form) and re-materialization (conversion of securities held in Demat form into physical certificates)
b) Facilitating conversion/reconversion/repurchase/redemption of units of mutual funds
c) Electronic settlement of trades in stock exchanges connected to NSDL
d) Pledging/hypothecation of dematerialized securities against loan
e) Electronic credit of securities allotted in public issues
f) Receipt of non-cash corporate benefits such as bonus, in electronic form
g) Freezing/locking of Demat accounts, so that debits from the account are not permitted
h) Nomination facility for Demat account
i) SMS alert facility
j) Effecting transmission of securities etc.

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Fees structure of NSDL: NSDL charges the DPs and not the investors directly. These charges are fixed. The DPs in turn, are free to charge their clients, i.e., the investors for their services. Thus, there is a two tier fee structure.

Management of NSDL: NSDL is a public limited company management by a professional Board of Directors. The day-to-day operations are conducted by the Managing Director. To assist the MD in his functions, the Board appoints and Executive Committee of not more than 15 members.

3. Write a short notes on CSDL?

Central Securities Depository Ltd(CSDL) Or Central Depository Service Ltd(CDSL)

Introduction: CDSL is the second depositary, has been promoted by Bombay Stock Exchange and Bank of India. It was formed in February 1999. CDSL is a Depository which facilitates holding of securities in the electronic form. All leading stock exchanges like the National Stock Exchange, Calcutta Stock Exchange, Delhi Stock Exchange, The Stock Exchange-Ahmadabad etc have established connectivity with CDSL.

Promoters/shareholders of CDSL: Bombay stock exchange ltd., Bank of India, Bank of Baroda, HDFC bank ltd., Standard Chartered bank, Canara bank, Union bank of India, Bank of Maharashtra, The Calcutta stock exchange etc

Benefits of CSDL: Choosing CSDL is significant because of facilities provided like Convenience, Dependability and Security.

Convenience

a) Network: A vast network of DPs has been established by CDSL and serving more than 1000 sites. The large network provides the feasibility of attracting an investor from all over the part of country even from remote area too.
b) On-line services of DP: Various DPs who are shouldering the responsibility to run the networks are directly connected with CDSL and thus providing a better chain of investors.
c) Flexibility of fee structure: The tariff plan and fee structure has been kept in affordable condition at CDSL so that an investor can enjoy the facilitates
d) Accessibility of the schemes: DPs are well supported with internet so that they may connect their investor with the CDSL at times
e) The number of various securities easily available: Various types of investment areas like bonds, shares etc. are easily available at CDSL. For investment in various schemes, all the transactions can be managed through one DEMAT account only.

Dependability

a) Online access for users: The structure of CSDL is based on a large data base which is capable enough to provide all the required depository facilities to the investors
b) Convenient for DPs: complete details of an investor are kept secured at CDSL. In case any issues arise it can be resolved at DPs and investors do not face any problems.
c) Requirements of user: The data base of CDSL is updated and thus many requirements of investor are satisfied
d) Continuous checks: Regular audit and inspections of data base of CDSL enable the investor to go further with CDSL
e) Support of Helpdesk: A helpline facility is available at CDSL from where required help can be rendered at all time irrespective of time schedule, both for investors and DPs.

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Security

a) Claims: In case of any claims at DP, the liquidation is managed by the CDSL at once, so that relationship between investor and CDSL is not affected
b) Cover: There is an insurance cover provided by CDSL to protect the investor from any unforeseen incident. This loss can be occurred due to a calamity or by the negligence of staff at CDSL either by DP or system
c) Safety: A recovery system of all the data base has been developed at CDSL and this system enable the DPs and investor to satisfy that his transaction history is safe at CDSL. The data is kept under strong encryption and there is no chance of loss of valuable data.

Role of NSDL and CDSL in the Capital Market

- They are promoted mainly by NSE and BSE respectively, provide depository service for electronic trading of securities both equity and debt
- These two depositories maintain details of shares and debt instruments in electronic format after dematerialization

- ❖ The basic activities of these two organizations may be compared to that of banks. Just as banks maintains cash deposits and provides all services relating to the electronic settlement of trading in shares and debt instrument
- ❖ Change of ownership of securities following buying and selling of these instrument in stock exchanges are reflected in the electronic database maintained by these two depositories
- ❖ The depositories also provide many services. Appropriate electronic crediting of securities to investors Demat accounts after a public issue, bonus issue or stock splits are also done through them. They also facilitate the purchase and sale of units of mutual funds.

Unit- 4
Commodities market
SECTION – A

1. What is Commodity?

Commodities are economic goods that have some physical and uniform attributes and are tradable through an established market.

2. Give the meaning of commodity market/ commodity exchange.

Commodity market means markets that are trade in primary product rather than manufactured products. It is a physical or virtual marketplace for buying, selling and trading raw or primary products.

3. Define commodity.

Indian Forward Contract (Regulation) Act (FCRA) Define “Goods” as “every kind of movable property other than actionable claims, money and securities.

4. Mention any 2 functions of forward market commission.

The functions of FMC are as follows:-

   a. To advise central government in respect of grant of recognition or withdrawal of recognition of any association.
   b. To keep forward markets under observation

5. What is forward markets commission (FMC)?

FMC is a statutory institution set up in 1953 under Forward Contract Regulation Act of 1952. Most of the powers are delegated to the FMC, which is the regulatory body for commodity futures/forward trade in India. It has headquarters in Mumbai.

6. Write any two qualities /eligibility of commodity exchange market.

The following entities are eligible for becoming members of the commodity exchanges:

- ➢ An individual or a proprietary firm
- ➢ A registered partnership firm
- ➢ A Hindu undivided family
- ➢ A private limited company

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- A public limited company
- Co-operative societies
- Stock brokers

7. Mention the two types of membership of commodity exchanges.
   a. Ordinary members.
   b. Designated Clearing Banks.
   c. Trading-Cum-Clearing Members.
   d. Institutional Clearing Members.
   e. Trading members.

8. Mention the different transactions in commodity market.
   The transactions of commodity market are:
   a. Spot market or physical market.
   b. Future market.
   c. Derivatives.
9. Mention the participants in commodity derivatives market.
   The participants in commodity derivatives market are:
   a. Hedgers.
   b. Speculators.
   c. Arbitrageurs.

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10. Who are hedgers?
   Hedgers are the people who are worried about the potential losses they could incur due to volatile prices of the commodities they could be physically holding with them. Some of the hedgers are exporters, importers, processors, farmers, merchandisers etc.

11. List out the hedgers.
   Exporters, importers, processors, farmers..

12. Who are speculations?
   Speculators are sophisticated leading players in commodities futures market. They are basically risk takers and are never associated with any commodity. They generally bet against the price movement in the hope of making profits. They do either by going long or going short positions.

13. Give the meaning of Arbitrage.
   Arbitrageurs are investors who earn from discrepancy in prices between the two exchanges or between different maturities of the same commodity. A simple example of arbitrager buys gold at lower price from one exchange and selling it on another exchange for higher price. So they make profit from price difference.

14. Mention any four risks involved in commodity derivatives market participants.
   The risks faced by participants in commodity derivatives market are Credit risk, market risk, liquidity risk, operational and hedge risk.

15. Mention National commodity exchanges in India.

National level commodity exchanges:

a. National Multi-Commodity Exchange (NMCE).
b. National Commodity and Derivatives Exchange Limited (NCDEX).
c. Multi Commodity Exchange (MCX).

16. Mention few Regional commodity exchanges.

Regional commodity exchanges:

a. Ahmadabad Commodity Exchange (ACE).
b. Bhatinda Commodity and Oil Exchange Ltd.
c. Bikaner Commodity Exchange Ltd. (Bikaner).
d. E-Commodities Ltd.
e. ESugar India Ltd. (Mumbai).
f. First Commodity Exchange of India (Kochi).

17. Mention any two recent developments in commodity markets.

The recent development of commodity markets is:

a) Speculation in forward markets.
b) Farmers are expected to face and sharp drop in crop prices as a result of bad rainfall.

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SECTION – B

1. Mention the different types of commodities of market.

Types of Commodity

Agricultural products	Industrial metals	Precious metals	Energy
Oil and oil seeds Spices Pulses Cereals Plantations Fibers Potato Sugar livestock	Copper Nickel Zinc Aluminum Palladium Lead Tin Steel Sponge iron	Gold Silver Platinum	Crude oil Natural gas Furnace oil Aviation turbine Fuel power

Commodities are split into two types, Hard commodities like natural resources that is mined or extracted (metals, oil, rubber etc.) and Soft commodities like agricultural products or live stock (corn, coffee, farm animals etc.).

2. Explain objectives/ features of commodity market.

Features of Commodity Exchange:

a) Commodity exchange is an entity, usually an incorporated non-profit association, that determines and enforces rules and procedures for trading of commodities
b) Speculators and investors also buy and sell the future contracts in attempt to make a profit and provide liquidity to the system
c) It is also refers to the physical center where trading tales place. It serves as a market place for buyers and sellers to engage in trading commodities directly
d) Commodity exchange usually trade futures contracts on commodities. This protects the farmer from price drops and buyer from price rises
e) The entire process is done electronically

3. Explain the history of commodities market.

History of Commodities Market

Commodity markets in India are still in their initial stages of development. Stringent regulatory restrictions, interventions by the government did not provide the scope for development of commodity market. Commodity markets have a huge potential in India because of the agricultural based economy. The history of commodity derivatives market begins with the establishment of the Bombay Cotton Trade Association in 1875, which was the first organized future market established to trade in cotton contracts. Following that cotton derivatives, trading started in oilseed in Bombay (1900), raw jute and jute goods in Calcutta (1913), and bullion in Bombay (1930). This was the beginning and slow development of the commodity market in India. Commodity market was considered to be high risk creating speculation and bring about losses. Therefore, 1952, option trading and cash settlement of commodities future was banned and the parliament passed the forward contract regulation Act, 1952, which regulated contracts in commodities in India.

After liberalization and globalization in 1990-91, the government set up a Kobra committee in 1993 to examine the role of future trading. The committee recommended to allow future trading in 17 commodity groups, & strengthen forward market commission, and certain amendments to forward contract (Regulation) Act-1952, particularly allowing option trading in goods and registration of brokers with Forward Market Commission.

The recommendations were accepted by the government and future trading was permitted in all recommended commodities. Commodity exchanges are now highly speculative.

Forward Market Commission, the governing body of commodity markets; serve as platforms for facilitating transparency in trading, trading in multiple commodities, electronic delivery and creating system, a world class environment for Indian traders. India has experienced phenomenal growth in the commodity markets since 2003, once the government lifted restriction on futures trading. Today, Indian participants are exploiting the potential opportunities in commodity market. This accounted for the indirect investments in commodity

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assets. But with the establishment of commodity exchanges, a shift in the investment patterns of individuals has occurred, as investors started recognizing commodity investments as an alternative investment avenue. Presently in India, there are 25 recognized future exchanges, of which there are 3 national level multi-commodity exchanges and remaining 22 are regional commodity exchanges.

4. Explain the different types of participants of commodity market.

Participants in Commodity derivative Markets

1) **Hedgers**: They use derivatives markets to reduce or eliminate the risk associated with price of a commodity. Majority of the participants in derivatives market belongs to this category. These are the people who are worried about the potential losses they could incur due to volatile prices of the commodities they could be physically holding with them. They trade in the futures market to transfer their risk of movement in prices of the commodity they are actually physically dealing. Some of the hedgers are exporters, importers, processors, farmers, merchandisers etc.

2) **Speculators**: Speculators are sophisticated leading players in commodities futures market. They are basically risk takers and are never associated with any commodity. They generally bet against the price movement in the hope of making profits. They undertake speculative position with a small margin and square off anytime during trading hours. They do either by going long or going short positions. Buying a futures contract in anticipation of price increase in known as 'going long'. Selling a futures contract in anticipation of a price decrease is known as 'going short'.

3) **Arbitrageurs**: Arbitrageurs are investors who earn from discrepancy in prices between the two exchanges or between different maturities of the same commodity. A simple example of arbitraging is simultaneously buying gold at lower price from one exchange and selling it on another exchange for higher price. So they make profit from price difference.

Speculators and arbitrageur give enormous liquidity to the contracts traded on the exchanges. This liquidity, in turn, result in better price discovery, lower transaction costs and less manipulation of the market.

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5. Explain the process of membership in commodity market.

Process of Membership

Step 1: Application Form with Documents: To become a member, they have to fill an application form with certain specific details. Along with filled application form they have provide required documents and have to pay necessary amount.

- Non-refundable admission fees
- Annual subscription charges
- The prescribed net worth of the applicant
- Additional based capital which is refundable only after a minimum lock-in period

- Contribution towards the 'Trade guarantee fund' also refundable only after a minimum locking period

Step 2: Processing of Application by the Exchange: The exchange processes the application and if it is satisfied it will call the applicant for an interview by the committee which will accept the application. At the interview, the financial soundness of the applicant is judged and several questions are asked by the Commodity Exchange. Once the application and processing is approved, the exchange sends a Letter of approval to become a member of the exchange.

Step 3: **Unique Membership Code:** Once the applicant receives the letter of approval from the exchange, he can apply for the unique membership code which allows him to have trading terminals that are connected through leased lines through the internet.

Step 4: Activating Membership of the Exchange: When the terminals are connected, the members can initiate trade in the commodities market. There are either 'broker members' or 'trader members'. Broker members conduct proprietary trading and brokerage business on behalf of their clients. Trader members can trade only on their own account.

6. Explain the function of forward market commission.

Functions of forward market commission: The functions of FMC are as follows:-

- To advise central government in respect of grant of recognition or withdrawal of recognition of any association
- To keep forward markets under observation
- To collect and publish information relating to trading conditions in respect of goods including information relating to demand, supply and prices
- To submit to the government periodical reports of forward markets in commodities
- To undertake inspection of books of accounts and other documents of recognized/registered associations
- To make recommendations for improving the organization and working of forward markets.

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7. Explain the types of members for trading in commodity exchanges.

Types of members: Members of Commodity Exchanges include the following**:**

1) Ordinary Members: They are the promoters who have the right to have own account transactions without having the right to execute transactions in the trading ring. They have to place orders with trading members or others who have the right to trade in the exchange.
2) Trading Members: These members execute buy and sell orders in the trading ring of the exchange on their own account or on account of ordinary members and other clients.
3) Trading-Cum-Clearing Members: They have the right to trade and also to participate in clearing and settlement in respect of transactions carried out on their account and on account of their clients.
4) Institutional Clearing Members: They have the right to participate in clearing and settlement on behalf of other members but do not have the trading rights.

5) Designated Clearing Banks: It provides banking facilities in respect of pay-in, pay-out and other monetary settlements.

8. Write a note on National Commodities and Derivatives Exchange(NCDEX).

National Commodities and Derivatives Exchange Ltd. (NCDEX):

NCDEX is an independent, demutualised co. incorporated on 23rd April 2003. NCDEX is a national level technology driven online commodity exchange with an independent Board of Directors and professionals. It has commenced its operations on 15th December 2003. It is regulated by FMC in respect to futures trading in commodities. It is located in Mumbai and offers facilities to its members across 1000 centers throughout India. NCDEX currently facilitates trading of 57 commodities. It has offices in Mumbai, Delhi, Ahmedabad, Indore, Hyderabad, Jaipur and Kolkata.

Key Shareholders of NCDEX

- ICICI Bank
- LIC
- NABARD
- National Stock Exchange
- Punjab National Bank
- Credit Rating Information Services of India Ltd. (CRISIL)
- Indian Farmers Fertilizer Cooperative Ltd. (IFFCO)
- Canara bank
- Goldman Sachs
- Inter Continental Exchange (ICE)

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9. Write a note on National Multi Commodity Exchange(NMCE).

National Multi-Commodity Exchange of India Ltd. (NMCE)

India's first demutualised, electronic, multi commodity exchange to be granted the National status on a permanent basis by the Government of India has been operational since 26th November 2002. It is based in Ahmedabad. Contracts traded on NMCE are based on commodities that include cash crops, food grains, plantations, spices, oil seeds, metals, bullion etc. NMCE is the only exchange in India to have such investment and technical support from the commodity relevant institutions. Exchange is managed by the experienced and qualified professional. It follows best international risk management practices. It was the exchange, which showed a way to introduce Warehouse Receipt System within existing legal and regulatory framework. This Warehouse Receipt System leads to guaranteed clearing and settlement and assumes counter party risk on settlement.

Key Shareholders (promoters) of NMCE

- Central Warehousing Corporation
- Gujarat Agro Industries Corporation Ltd.
- National Agricultural Cooperative Marketing Federation of India
- National Institution of Agricultural Marketing
- Neptune Overseas Ltd.
- Gujarat State Agricultural Marketing Board
- Punjab National Bank

10. Write a note on Multi Commodity Exchange(MCX).

Multi Commodity Exchange of India Ltd. (MCX):

MCX is an independent and demutualized exchange with permanent reorganization from Government of India, having head quarter in Mumbai. It is India's first listed exchange in commodities futures exchange that facilities online trading, clearing and settlement of commodity futures transactions there by providing a platform for risk management. MCX started to trade in November 2003. It deals with about 100 commodities. MCX is India's leading commodity future exchange with a market share of 87.3% in terms of the value of commodity future contracts traded in FY 2012-13 and third largest exchange in the world. During 2012, MCX was the world's largest exchange in silver and gold futures, second largest in copper and natural gas futures and the third largest in crude oil futures.

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Key shareholder of MCX

- Financial Technologies India Ltd.
- SBI
- Union Bank of India
- Corporation bank of India
- Bank of India
- Canara bank

11. Difference between forward contracts and future contracts.

Difference between forward contracts and future contracts

Forward contracts/ markets	Future contracts/ markets
9. Forwards contracts are over the counter contracts 10. Prices remains fixed till maturity 11. There is a counter party risk 12. There can be any number of contracts in a year 13. No collateral (margin) is required in case of forwards	9. Futures are traded in recognized future exchanges. 10. Prices fluctuates every day 11. There is no question of counter party risk 12. Number of contracts in a year is fixed 13. Margin is required in case of futures

14. 90% of forward contracts are settled by actual/ physical delivery	14. Most of the contracts are cash settlement
15. Mark to market is not done	15. Mark to market is done
16. It is non-standardized contract.	16. It is standardized contract

12. Difference between physical and future market.

Differences between Physical market and Futures market

Particulars	Physical Market	Future Market
Type	The Physical market deals with spot or cash contracts and is ready delivery	Future market deals with risk management or hedging for a future payment
Payment	The payment of the contract is made within 2 to3 days	It is settled by offsetting payments before the due date mutually
Delivery	Physical markets are party-to-party contracts and delivery is given of the product on spot	There are rarely any deliveries as speculators use futures contracts to receive profits from changes in prices
Prices	Physical market prices are determined by the supply and demand for the physical commodity	Futures prices are determined by the supply and demand of futures positions
Risk	There is no question of price risk	There is price risk due to fluctuations in future prices
Speculative	Are not speculative in nature	Are speculative in nature

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13. What are the types of transactions dealt in commodity market?

Types of transactions dealt in commodity market: a commodity market facilitates trading in various commodities. The commodity market may be a spot (physical) market or a derivative market.

Physical/ spot Market: A market in which goods are bought and sold for cash and delivered immediately is called the physical market.

Dealings in these markets are immediately effective. It is also known as Cash market or Spot market, because prices are settled in cash on the spot at current market prices. Since transactions take place directly between principals (like farmer, processor, wholesaler, dealers, mill owner etc.), there is a high degree of flexibility in these transaction.

Agricultural marketing is constitutionally a state subject. Each state has a State Agricultural Marketing Board (SAMD), which sets up Mandi Boards at the level of the district. Mandis, which are the local wholesale agricultural markets, can be set up only with the permission of the state government. Farmers sell their produce through these Mandis; these are the market places where prices of the commodity are set. The Mandi serves as the delivery point where farmers bring their produce directly or through village agents for sale to traders (licensed intermediaries). The commodity is sold through an open-outcry auction process and as every lot is auctioned, a new price is set, where the commodity is sold. There is little transparency related to the prices. If there is excess produce that does not get sold on the same day that the farmers brings it to the Mandi, traders have the facility to keep the goods at the Mandi yards overnight. But it does not provide long term storage at the Mandi.

Derivative market: A market in which various commodity derivatives (financial instruments based on the commodities) are traded is called derivative market.

Types of derivative market are:

1. Forward markets: Forward markets are agreements to buy or sell a commodity at a particular time for a certain price in future. A forward contract is a customized contract between two parties, where settlement takes place on a specific date in future, at a price agreed today.
2. Futures market: Futures market is a standardized contract to buy or sell a certain underlying asset at a certain date in the future at a specified price. It is traded on an exchange.
3. Options: In option contracts, the buyer or holder of the option has the right to buy or sell an underlying asset, at a predetermined strike price, on or by the maturity date. On the other hand, the seller or the writer of the option is under an obligation to perform the contract (buy or sell). The price at which parties have the right to buy or sell is called the strike price or the exercise price.

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SECTION – C

1. Briefly explain the role of commodity markets.

Importance and Role of Commodity Market

1) <u>Efficient portfolio diversification:-</u> Commodities actually offer immense potential to become a separate asset class for market. The operations of commodities are easy to understand as far as fundamentals of demand and supply are concerned.
2) <u>wide market diverse opportunities:-</u> The listed commodities in exchange include bullion, metals, energy and agricultural products. Trading in commodities provides a wide market opportunity for investors, hedgers, traders, speculators, manufacturers, exporters and importers.
3) <u>Exploitable fundamentals:-</u>Commodity trading operates on the simple principle that 'price is a function of demand and supply'. This makes things really easy to understand and exploit.
4) <u>Global opportunity:-</u> Gold when traded on commodity exchanges has international price benchmarking, which does not allow anyone to manipulate prices.
5) <u>Hedge against inflation:-</u> Trading in commodities is a hedge against inflation since the commodity market typically move opposite to that of stocks and shares.

6) Physical delivery of goods not a compulsion:-Physical delivery of goods is not compulsory unless participants in commodity trade intend to take delivery of goods.
7) Smooth flow of transaction: Commodity futures exchanges are gate way to the futures market. Because of high competition and complexity of traded products, commodity exchanges helps for smooth flow of transaction
8) Professional service: If the players do not have the knowledge of commodity markets, can hire a trained and qualified professionals with experience in trading commodity futures to do the trading in commodity exchanges

2. Explain the factors affecting / influencing on commodity market.

Factors affecting Commodity Market

1) Risk and return:- High return is followed by high risk. Commodity trading is not like trading shares at spot prices. It is futures trading process. The uncertainty and risk involved are part and parcel of the commodity market.
2) Trading, Clearing and Settlement:- Trading is when two or more parties negotiable to exchange goods with cash at a specific date and price. Exchanges clear the trade in sense that both the negotiating parities are capable of respecting the contract and the Settlement agency take care of the settlement of goods against cash.
3) Demand and supply:- Demand and supply are basic factors that affect the movement of any commodity prices. However demand and supply of all commodities vary during different time periods depending upon seasons, domestic and global conditions.
4) Global and domestic economy:- Demand and supply of any commodity has a direct relationship with economic condition in the state. Depending upon the nature of the commodity, global and domestic economic scenarios affect the commodity prices. For e.g.; steel prices highly depend on global economic factors as this is a globally and massively used commodity.
5) Economic growth:- Economic growth of the world as well as the domestic economy is an important fundamental that will affect the demand and supply positions in a country. If the country is growing at a fast rate the consumption level will also be at a higher rate. This will increase the demand for various commodities but supply may not increase at the same rate as it takes time to set up new industries and increase production.
6) Inflation: Commodities are considered as hedge against inflation. With increase in inflation the prices of major commodities tend to increase and it is true the other way as well. Due to hedging, the risk can be avoided through future contracts.
7) Geo-political factors: Political factors have a direct as well as indirect effect on commodity prices.
8) Extra-ordinary events:- There may be certain extra-ordinary factors that do not occur very frequently. For example wars, natural calamities, depression etc.

3. Explain the types of commodity derivatives.

Derivative market: A market in which various commodity derivatives (financial instruments based on the commodities) are traded is called derivative market.

Commodity Derivatives: A derivative is a financial contract whose value is derived from the value of something else such as stock price, commodity price, an exchange rate, an interest rate

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etc..A very simple example of derivatives is curd, which is derivates of milk. The price of curd depends upon the price of milk which in turn depends upon the demand and supply of milk. Thus the value of a derivative fluctuates as determined by the value of the underlying item.

Types of commodity derivatives: Generally there are four kinds of commodity derivatives:- Forward contracts, Future contracts, Options contracts and Swaps.

1. **Forward Markets:** Forward markets or forward contracts are agreements to buy or sell a commodity at a particular time for a certain price in the future. It is traded over-the-counter market. A forward contract is a customized contract between two parties, where settlement takes place on a specific date in future, at a price agreed today.
   In forward contracts, the buyer agrees to buy and pay for, and the seller agrees to sell and deliver a specified commodity at a specified date and at a specified price in the future. When that date arrives, the agreement is completed, with the seller delivering the specified commodity and the buyer paying the specified price for it.

Features of Forward Markets:

- ✓ They are bilateral contracts, and hence exposed to counter party risk
- ✓ Each contract is custom designed and hence is unique in terms of contract size, expiry date and the commodity type and quality
- ✓ The contract price is generally not available in the public domain
- ✓ The contract has to be settled by delivery of the asset on expiry date
- ✓ Forward contracts are mostly used for hedging and speculation

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2. **Futures Market:** Futures contracts are similar to forwards but are traded on a futures exchange (commodity exchange). A futures market is a standardized contract to buy or sell a certain underlying asset at a certain date in the future at a specified price. It is normally traded on an exchange. As the two parties do not necessarily know each other, the exchange provides a mechanism that gives the two parties a guarantee that the contract will be honoured.

   The contracts have certain standardized specifications. Originally, forward and future contracts were used to: (1) hedge prices and therefore, the risk of holding the commodity and (2) the producer could sell today for a guaranteed price in the future.

The standardized items in any futures contracts are:

- ✓ Quantity of the underlying
- ✓ Quality of the underlying
- ✓ Date and month of delivery
- ✓ Units of price quotation and minimum charge in price
- ✓ Location of settlement

3. **Option Contracts:** In option contracts, the buyer or the holder of the option has the right (without an obligation) to buy or sell an underlying asset, at a predetermined strike price, on or by the maturity date. On the other hand, the seller or the writer of the option is under an obligation to perform the contract (buy or sell). The price at which parties have the right to buy or sell is called the strike price or the exercise price.

Depending upon the contract, the option can be an option to buy or an option to sell in options contracts. Unlike other types of derivatives, options do have an initial cost: the premium. The longer the coverage period (that is the time to maturity), or the greater the risk, the higher the premium will be. The value of the premium changes until the option expires or is exercised. The expiry date is the date and time after which an option may be no longer be exercised.

There are two types of options:

a. **Call option**: An option that gives the buyer the right to buy is called a Call option.
b. **Put option**: An option that gives the buyer the right to sell is called a Put option.

A Call option with lower strike price will command a higher premium than a call option with higher strike price. Similarly, a Put option with a higher strike price will command a higher premium than a put option with lower strike price. Features of options:

- ✓ Limited risk, unlimited profit- Call options
- ✓ Higher returns, higher risk- Put options
- ✓ Position in all market conditions

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Unit – 5
Trading in Commodity Markets
SECTION – A

1. What is commodity trading?

   Trading in commodities exchanges in India takes place only through its members. There are different types of membership at most exchanges- typically membership can be in the form of broker member or trader member.

2. Who is a broker member?

   Broker members conduct both proprietary trading and brokerage business on behalf of their clients

3. What do you mean by trader member?

   Trader members trade only on their own account.,

4. What is meant by commodity brokerage?

   A Commodity Broker is a firm or an individual who executes orders to buy or sell commodity contracts on behalf of clients and charges them a commission.

5. Mention the participants of commodity market.

The participants of commodity markets are Farmer, Exporters, Importers, Traders.

6. Mention two constituents of commodity market.

The two constituents commodity market are Spot market and Derivative Market.

7. Mention the different types of commodity market settlement?

   The different types of commodity market settlement are daily settlement and spot settlement.

8. Difference between daily settlement and final settlement.

Daily Settlement	Final Settlement
• Done at the end of each trading day • Based on the daily settlement price • Takes into account all trades, all open positions are mark-to-market	• Done on the day of contract expiry • Based on the final settlement price, or the due date rate • Takes into account only trades not closed till contract expiry

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9. Mention the steps for trading in commodity.

   The steps for trading in commodity are:
   a. Choose a broker.
   b. Fill a DEMAT account form.
   c. Depositing margin.
   d. Access to information and a trading plan.

SECTION – B

1. Explain the types of settlement.

   Settlement: Settlement is the act of completing the contract, and can be done in any one of the following two ways, as laid out in the specification of the futures contract i.e., Physical delivery and Cash settlement. Settlement of a commodity contract can be done as a daily settlement or on the expiry of the contract.

   Mode of settlement:
   Physical Delivery**:** A physical delivery means that the specific amounts of the underlying assets under the contract are delivered by the seller to the commodity exchange and by the exchange to the buyer of the contract. Physical delivery is common with commodities, though, in practice, it occurs only on a minority of contracts.
   Cash Settlement**:** A futures contract is settled through cash settlement. According to this mode of contract, the seller buys the cash value of the commodity that is traded according to the terms of the contract. The cash payment is made according to the spot price of the underlying

assets. A futures contract can also be sold according to the index based on trade in a spot market. The accounts of the parties in futures contracts are adjusted everyday and most of the transactions are settled in cash. If the trade is to be settled by delivery, the clearing house gives the buyer warehouse receipts received from the seller. Settlement is done at the end of each day based on the daily settlement price and it takes into account all trades, all market positions and mark margin to the market. The final settlement is done on the day of the contract's expiry date.

Types of Settlement:

a) **Daily settlement:** Under this method settlement done at the end of each trading day based on the daily settlement price.
b) **Final settlement:** Under this method settlement is done on maturity day of the contact on the basis of the final settlement price or the due date rate.

Difference between daily settlement and final settlement

Daily Settlement	Final Settlement
• Done at the end of each trading day • Based on the daily settlement price • Takes into account all trades, all open positions are mark-to-market	• Done on the day of contract expiry • Based on the final settlement price, or the due date rate • Takes into account only trades not closed till contract expiry

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Note: Spot price is the price of a commodity in the physical market, where goods are bought and sold 'on the spot', while futures price is the price of the same commodity at a future date.

2. Explain the steps for trading in commodity market.

Steps for trading in commodity market:

1. **Choose a broker:** The broker you choose should be a FMC{Forward Market Commission} recognized member of the commodity exchanges you wish to trade in, other than this one should keep the following factors in mind while choosing a broker:
   a) Competitive edge provided by the broker.
   b) Broker's knowledge of commodity markets.
   c) Credibility of the broker.
   d) Experience of the broker
   e) Net-worth of the broker
   f) Quality of broker trading platforms.
2. **Fill a DEMAT account form** with the brokerage house (this mandates PAN card, address proof and passport size photographs in India)
3. **Depositing margin**: Margin is the deposit money that needs to be paid to buy or sell each contract. In short, it means performance bond or good faith money. These margin requirements vary across commodities and exchange. The margin requirements for most future contracts range from 2% to 15% of the value of contract.

   Types of margin:

a) **Initial margin**: The amount that must be deposited by a customer at the time of entering into a contract is called initial margin. The margin is a mandatory requirement for parties who are entering into the contract.
b) **Maintenance margin:** It is a margin which is less than initial margin money. If the balance in the margin account falls below the maintenance margin, broker received a margin call and is required to deposit extra funds to bring it to the initial margin level within a very short period of time. If the balance in the margin account more than initial margin a trader can withdraw excess amount.
c) **Additional margin:** It is a margin money required to deposit by trader when balance in margin account falls below the maintenance margin due to sudden higher than expected volatility
d) **Mark-to-market margin (MTM):** The investor position is mark to market daily and any profit or loss is adjusted to his margin account.

4. **Access to information and a trading plan**: the investor should have access to the prevailing prices on the exchanges as well as market information that can help predict price movements. Brokers provide research and analysis to their clients. Other information sources are financial dailies, specialized magazines on commodities and the internet. Further, an investor requires a trading plan. Such a trading plan can be developed in consultation with the broker in order to maximize profit or to minimize losses.

Traders who intend to trade for actual delivery of the commodity additionally need to open a Depository Participant Account and obtain a Sales Tax Registration at the place where the delivery centre of the commodity traded is located.

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3. Explain the commodity market trade clearing mechanism/ types of members for trading.

Types of Members for Trading: There are three types of membership of Commodity exchange:

1) Trading-Cum-Clearing Member (TCM)
2) Institutional Trading-Cum-Clearing Member (ITCM)
3) Professional Clearing Member (PCM)

<u>Trading-Cum-Clearing Member</u>: A TCM is entitled to trade on his own account as well as on account of his clients and clear and settle the contract for himself. A person desired to register as TCM is required to submit an application as per the format prescribed under the business rules along with all enclosures, fee and other documents specified therein. He is required to go through interview by Membership Admission Committee and Committee is empowered to frame rules or criteria relating to selection or rejection of a member.

<u>Institutional Trading-Cum-Clearing Member</u>: Only an Institution/corporate can be admitted by the Exchange as a member and they have the right to trade and clear through the clearing house of exchange as an ITCM. The member may be allowed to make deals for himself as well as on behalf of his clients and clear and settle such deals. They can also appoint sub brokers, trading members and authorized persons who would be registered as trading members.

Professional Clearing Member: A corporate entity/institution only can apply for PCM. A PCM entitled to clear and settle trades executed by other members of the exchange. The member would be allowed to clear and settle trades of such members of the Exchange who choose to clear and settle their trades through such professional clearing members.

4. Explain the patterns of trading.

Patterns of Trading: Following are the different approaches to trade in commodities:

1) Self Directed or Independent
2) Full Services or Managed Account
3) Commodity Fund

Self Directed: As a trader, the most realistic choice is to trade independently and manage one's own account, without any help or guidance from a commodity broker. This involves maximum risk because it is the trader's responsibility to manage funds, place orders, maintain margins, conduct research etc., in relation to a given commodity. This requires time, knowledge and complete attention to the market.

Full Services: It is also known as Managed account. The trader and the broker will need to agree upon terms and conditions that will define the role of the appointed broker in managing the former's trading account. Then the broker will carry out trading on the investor's behalf, following the conditions agreed upon when the account was opened. This method can reduce both effort and risk for the trader, although the investor is still responsible for any losses incurred and margin calls.

Commodity Fund: A third way to enter the commodity market, and one that offers least risk, is to join a commodity fund. No one person has an individual account; funds are combined with others and traded as one. The profits and losses are directly proportionate to the amount of money invested into the fund. However, it is essential that the fund be managed by a skilled broker.

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Trading systems on Commodity Exchange: There are two ways that contracts can be traded on an exchange.

1) Floor Based Method of trading: It is also called as Open Outcry method. As the name suggests, this method involves the use of shouting and hand signals by traders on the exchange trading floor to transfer information about buy and sell orders. The part of the trading floor where this takes place is called the Pit (or Ring). The trading floor serves as a trading venue or a place where traders meet in order to buy and sell contract. This community uses a specific dialect, hand signals and clothing to communicate.

2) Electronic Trading: Electronic trading or e-trading is a screen based method of trading electronically. It uses information technology to bring together buyers and sellers through

electronic media to create a virtual market place. E-trading is widely believed to be more reliable than floor based method of trading.

In an electronic trading system, trading will proceed as follows:

- Orders are entered through Trader Terminals
- A credit-controlled module verifies credit-worthiness based on clearing-member predetermined parameters
- Orders are matched on price and time priority
- Matched orders are confirmed at each originating terminal
- The unmatched orders remain in the system until they are matched or withdrawal
- The trade is executed; all participants receive last sale price and quantity data, as well as updated information on best bid, offer and size of each order
- As each trade is confirmed, it is routed to the exchange clearing system for settlement
- Clearing member firms adjust buyers' and sellers' accounts for positions and margins.

5. Write a note on clearing house.

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Clearing: Clearing house undertake clearing of trades executed on the commodity exchanges. Only clearing members includes Professional Clearing Members (PCM) only are entitled to clear and settle contracts through the clearing house. Clearing members are responsible for risk management of its members. A clearing house is usually a limited liability company that has shareholders who are also members of the exchange.

Clearing house handles the back office work of commodity exchanges. In fact, it is a service for maintaining records of all the trades that take place in the commodity exchange have to report their purchases and sales to the clearing house. The clearing house makes the settlement from the buyers and sellers and guarantees all contracts by requiring the participants to maintain cash deposits called margin or margin money with it (clearing house).

A commodity exchange may have a clearing house as a separate department or separate legal identity within the commodity exchange. A single clearing house gives services to more than one commodity exchange. NCDEX gets its clearing house service from National Securities Depository Limited (NSDL).

Working of Clearing House: The Clearing House works in the following manner:

- An order is placed through a registered trading member/broker
- Orders are matched and presented to clearing house by clearing members
- The market contracts are registered and presented to the clearing house
- When the contract is registered two new contracts are started in place of one. These are identical open contracts

- The clearing house becomes a counterparty to all the open contracts and the clearing house now promises to undertake and perform the financial aspects of the contract (collects margins, effect pay-in/pay out and monitors delivery and settlements)
- The clearing house now matches the transactions and reconciles all sales and purchases and makes daily settlements.

6. Difference between Broker and Trader.

Particulars	Broker	Trader
Membership	A broker is a member of the commodities market	A trader is a member of the commodities market
Trading	Broker can trade on his own account for himself as well as for his clients	Trader can trade on his own account for himself only
Commission	Broker gets commission from his clients for conducting trade of buying and selling commodities	Trader trades for himself and therefore question of commission does not arise
Information	Broker has to give information to his clients and must find out details everyday	The trader has to be competent and get the information for himself so that he does not make a loss
Brokerage	Broker charges brokerage and transaction charges per contract. Brokerage charge is different for different commodities	Trader has to pay transaction charges

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