

# **Study Notes for NISM Series VIII : Equity Derivatives Certification Examination ( EDCE ) Version – June 2018**

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### NISM SERIES VIII : Equity Derivatives Certification Examination Details

<b>Total Questions</b>	<b>100 X 1 Marks</b>
<b>Type</b>	<b>Multiple Choice</b>
<b>Pass Score</b>	<b>60%</b>
<b>Duration</b>	<b>2 Hours</b>
<b>Negative marks</b>	<b>-0.25</b>

### Chapterwise Weightages

<b>Unit 1: Basics of Derivatives</b>	<b>8 marks</b>
<b>Unit 2: Understanding Index</b>	<b>2 marks</b>
<b>Unit 3: Introduction to Forwards and Futures</b>	<b>25 marks</b>
<b>Unit 4: Introduction to Options</b>	<b>25 marks</b>
<b>Unit 5: Option Trading Strategies</b>	<b>3 marks</b>
<b>Unit 6: Introduction to Trading Systems</b>	<b>4 marks</b>
<b>Unit 7: Introduction to Clearing and Settlement System</b>	<b>13 marks</b>
<b>Unit 8: Legal and Regulatory Environment</b>	<b>15 marks</b>
<b>Unit 9: Accounting and Taxation</b>	<b>3 marks</b>
<b>Unit 10: Sales Practices and Investor Protection Services</b>	<b>2 marks</b>



**Youtube Video Links for Individual Topics are given below**

[Who Should pass NISM Equity Derivatives exam ?](#)

[Should one attend or leave the unknown questions in NISM exam ?](#)

[NISM Equity Derivatives Chapterwise Weightages](#)

[Property Market & Derivatives Markets - A Comparison](#)

[Types of Derivatives | Forwards, Futures, Options & Swaps](#)

[How is a Stock Market Index Calculated ? - Types of Indices](#)

[Index Applications in Mutual Funds, Derivatives, Stock Markets](#)

[NISM ED - Bid Offer Spread / Bid Ask Spread](#)

[How to Measure the Liquidity of a Stock ? - Impact Cost](#)

[Positions in Derivatives | Open Position | Calendar Spread | Long & Short Positions](#)

[Definition of Futures Contract Explained with Example](#)

[How is a Futures contract Closed ? | Squared-off & Exercise](#)

[Long and Short Positions in Futures](#)

[Derivatives Terminology - FUTSTK, FUTIDX, OPTSTK, OPTIDX](#)

[What are the Features / Specifications of Future Contracts ?](#)

[Payoff for Futures](#)

[Meaning of a Call Option](#)

[Meaning of a Put Option](#)

[American & European Style Options](#)

[Option Formula](#)

[Option Calculation Table](#)

[Futures & Options Settlement](#)

[How are Futures Contracts settled on daily basis ? MTM](#)

[Hedging, Arbitraging & Speculation](#)

[Hedging](#)

[What is Basis in futures ? What is Tick Size ?](#)

[What is Cost of Carry in Futures / Equity Derivatives / Commodity markets?](#)

[What is Convenience Yield ?](#)

[What is Open Interest & Volume in Derivatives Market ?](#)

[Price Risk and its Types - Explained](#)

[How does Beta measure a Stock's Market Risk ?](#)

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[Eligibility Criteria for Stocks](#)

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[Eligibility Criteria for Indices](#)

[Corporate Actions](#)

[Adjustment Factor](#)

[Settlement of Futures & Options](#)



[Client Level Position Limit](#)

[Market Wide Position Limit](#)

[Limit Violations in Derivatives](#)

[Cash Components](#)

[Non Cash Components](#)

[How to do Accounting for Equity Derivatives trading ?](#)

[Securities Transaction Tax](#)

[How to Pass NISM Equity Derivatives Exam ?](#)

## **Chapter 1: Basics of Derivatives**

Derivative is a contract or a product whose value is derived from value of some other asset known as underlying. Derivatives are based on wide range of underlying assets. These include:

- Metals such as Gold, Silver, Aluminium, Copper, Zinc, Nickel, Tin, Lead
- Energy resources such as Oil and Gas, Coal, Electricity
- Agri commodities such as wheat, Sugar, Coffee, Cotton, Pulses and
- Financial assets such as Shares, Bonds and Foreign Exchange.

Some of the factors driving the growth of financial derivatives are:

- Increased fluctuations in underlying asset prices in financial markets.
- Integration of financial markets globally.
- Use of latest technology in communications has helped in reduction of transaction costs.
- Enhanced understanding of market participants on sophisticated risk management tools to manage risk.
- Frequent innovations in derivatives market and newer applications of products.

### **Types of Derivatives**

#### **Forwards**

It is a contractual agreement between two parties to buy/sell an underlying asset at a certain future date for a particular price that is pre-decided on the date of contract. Both the contracting parties are committed and are obliged to honour the transaction irrespective of price of the underlying asset at the time of delivery. Since forwards are negotiated between two parties, the terms and conditions of contracts are customized. These are OTC contracts.

#### **Futures**

A futures contract is similar to a forward, except that the deal is made through an organized and regulated exchange rather than being negotiated directly between two parties. Indeed, we may say futures are exchange traded forward contracts.

#### **Options**

An Option is a contract that gives the right, but not an obligation, to buy or sell the underlying on or before a stated date and at a stated price. While buyer of option pays the premium and buys the right, writer/seller of option receives the premium with obligation to sell/ buy the underlying asset, if the buyer exercises his right.



## Swaps

A swap is an agreement made between two parties to exchange cash flows in the future according to a prearranged formula. Swaps are series of forward contracts. Swaps help market participants manage risk associated with volatile interest rates, currency exchange rates and commodity prices.

Market Participants are of three types in the derivatives market - hedgers, traders (also called speculators) and arbitrageurs

## Types of Derivatives Markets

### OTC Derivatives Market

The OTC derivatives markets have following features compared to exchange traded derivatives:

- Contracts are tailor made to fit in the specific requirements of dealing counterparties.
- The management of counter-party (credit) risk is decentralized and located within individual institutions.
- There are no formal centralized limits on individual positions, leverage, or margining.
- There are no formal rules or mechanisms for risk management to ensure market stability and integrity, and for safeguarding the collective interest of market participants.
- Transactions are private with little or no disclosure to the entire market.

### Exchange Traded Derivatives Market

Exchange-traded contracts are standardized, traded on organized exchanges with prices determined by the interaction of buyers and sellers through anonymous auction platform. A clearing house/ clearing corporation, guarantees contract performance (settlement of transactions).

### Significance of Derivatives Market

- Derivatives market helps in improving price discovery based on actual valuations and expectations.
- Derivatives market helps in transfer of various risks from those who are exposed to risk but have low risk appetite to participants with high risk appetite. For example hedgers want to give away the risk where as traders are willing to take risk.
- Derivatives market helps shift of speculative trades from unorganized market to organized market. Risk management mechanism and surveillance of activities of various participants in organized space provide stability to the financial system

Market participants, who trade in derivatives are advised to carefully read the **Model Risk Disclosure Document**, given by the broker to his clients at the time of signing agreement.

**Model Risk Disclosure Document** is issued by the members of Exchanges and contains important information on trading in Equities and F&O Segments of exchanges. All prospective participants should read this document before trading on Capital Market/Cash Segment or F&O segment of the Exchanges.

## Chapter 2: Understanding Index

1. Index is a statistical indicator that measures changes in the economy in general or in particular areas.
2. An index is a portfolio of securities that represent a particular market or a portion of a market.
3. Each Index has its own calculation methodology and usually is expressed in terms of a change from a base value. the percentage change is more important than the actual numeric value.

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4. Financial indices are created to measure price movement of stocks, bonds, T-bills and other type of financial securities.
  5. A stock index is created to provide market participants with the information regarding average share price movement in the market. Broad indices are expected to capture the overall behaviour of equity market and need to represent the return obtained by typical portfolios in the country

### Significance of Index

- A stock index is an indicator of the performance of overall market or a particular sector.
- It serves as a benchmark for portfolio performance - Managed portfolios, belonging either to individuals or mutual funds; use the stock index as a measure for evaluation of their performance.
- It is used as an underlying for financial application of derivatives – Various products in OTC and exchange traded markets are based on indices as underlying asset.

### Types of Stock Market Indices

#### Market capitalization weighted index

In this method of calculation, each stock is given weight according to its market capitalization. So higher the market capitalization of a constituent, higher is its weight in the index.

#### Free-Float Market Capitalization Index

if we compute the index based on weights of each security based on free float market cap, it is called free float market capitalization index. Indeed, both Sensex and Nifty, over a period of time, have moved to free float basis

#### Price-Weighted Index

A stock index in which each stock influences the index in proportion to its price. Stocks with a higher price will be given more weight and therefore, will have a greater influence over the performance of the index. Dow Jones Industrial Average and Nikkei 225 are popular price-weighted indices.

#### Equal Weighted Index

An equally-weighted index makes no distinction between large and small companies, both of which are given equal weighting. The value of the index is generated by adding the prices of each stock in the index and dividing that by the total number of stocks

The difference between the best buy and the best sell orders is called **bid-ask spread**. The “bid-ask spread” therefore conveys transaction cost for small trade

**Percentage degradation** ( From an Ideal Price ) that occurs when shares are bought or sold, is called **impact cost**. Impact cost varies with transaction size. Also, it would be different for buy side and sell side.

All NSE indices are managed by a separate company called India Index Services and Products Ltd. (IISL) .

A good index is a trade-off between diversification and liquidity. A well diversified index reflects the behaviour of the overall market/ economy

### Index Funds

These types of funds invest in a specific index with an objective to generate returns equivalent to the return on index. These funds invest in index stocks in the proportions in which these stocks exist in the index. For instance, Sensex index fund would get the similar returns as that of Sensex index.

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### **Exchange Traded Funds**

Exchange Traded Funds (ETFs) is basket of securities that trade like individual stock, on an exchange. They have number of advantages over other mutual funds as they can be bought and sold on the exchange. Since, ETFs are traded on exchanges intraday transaction is possible. The first ETF in Indian Securities Market was the Nifty BeES, introduced by the Benchmark Mutual Fund in December 2001. Prudential ICICI Mutual Fund introduced SPICe in January 2003, which was the first ETF on Sensex.

### **Index Derivatives**

- Index Derivatives are derivative contracts which have the index as the underlying asset.
- Index Options and Index Futures are the most popular derivative contracts worldwide.
- Index derivatives are useful as a tool to hedge against the market risk.

### **Exchange Traded Funds**

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- Further, ETFs can be used as basket trading in terms of the smaller denomination and low transaction cost.
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## **Chapter 3: Introduction to Forwards and Futures**

Essential features of a forward are:

- It is a contract between two parties (Bilateral contract).
- All terms of the contract like price, quantity and quality of underlying, delivery terms like place, settlement procedure etc. are fixed on the day of entering into the contract

Forwards are bilateral over the counter (OTC) transactions where the terms of the contract, such as price, quantity, quality, time and place are negotiated between two parties to the contract. Any alteration in the terms of the contract is possible if both parties agree to it. Corporations, traders and investing institutions extensively use OTC transactions to meet their specific requirements.

### **Major limitations of forwards**

#### **Liquidity Risk**

Liquidity is nothing but the ability of the market participants to buy or sell the desired quantity of an underlying asset

#### **Counterparty risk**

Counterparty risk is the risk of an economic loss from the failure of counterparty to fulfil its contractual obligation. In addition to the illiquidity and counterparty risks, there are several issues like lack of transparency, settlement complications as it is to be done directly between the contracting parties

### **Future Contract Specifications**

#### **Tick Size**



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It is minimum move allowed in the price quotations. Exchanges decide the tick sizes on traded contracts as part of contract specification. Tick size for Nifty futures is 5 paise. Bid price is the price buyer is willing to pay and ask price is the price seller is willing to sell.

### **Contract Size and contract value**

Futures contracts are traded in lots and to arrive at the contract value we have to multiply the price with contract multiplier or lot size or contract size.

### **Basis**

The difference between the spot price and the futures price is called basis. If the futures price is greater than spot price, basis for the asset is negative. Similarly, if the spot price is greater than futures price, basis for the asset is positive. During the life of the contract, the basis may become negative or positive, as there is a movement in the futures price and spot price. Further, whatever the basis is, positive or negative, it turns to zero at maturity of the futures contract i.e. there should not be any difference between futures price and spot price at the time of maturity/ expiry of contract

### **Cost of Carry**

Cost of Carry is the relationship between futures prices and spot prices. It measures the storage cost (in commodity markets) plus the interest that is paid to finance or 'carry' the asset till delivery less the income earned on the asset during the holding period. For equity derivatives, carrying cost is the interest paid to finance the purchase less (minus) dividend earned.

### **Margin Account**

As exchange guarantees the settlement of all the trades, to protect itself against default by either counterparty, it charges various margins from brokers. Brokers in turn charge margins from their customers

### **Initial Margin**

The amount one needs to deposit in the margin account at the time entering a futures contract is known as the initial margin

### **Marking to Market (MTM)**

In futures market, while contracts have maturity of several months, profits and losses are settled on day-to-day basis – called mark to market (MTM) settlement. The exchange collects these margins (MTM margins) from the loss making participants and pays to the gainers on day-to-day basis.

### **Open Interest and Volumes Traded**

An open interest is the total number of contracts outstanding (yet to be settled) for an underlying asset. The level of open interest indicates depth in the market.

**Long position** Outstanding/ unsettled buy position in a contract is called "Long Position".

**Short Position** Outstanding/ unsettled sell position in a contract is called "Short Position".

**Open position** Outstanding/ unsettled either long (buy) or short (sell) position in various derivative contracts is called "Open Position"

### **Naked and calendar spread positions**

Naked position in futures market simply means a long or short position in any futures contract without having any position in the underlying asset.



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Calendar spread position is a combination of two positions in futures on the same underlying - long on one maturity contract and short on a different maturity contract. For instance, a short position in near month contract coupled with a long position in far month contract is a calendar spread position.

Calendar spread position is computed with respect to the near month series and becomes an open position once the near month contract expires or either of the offsetting positions is closed. A calendar spread is always defined with regard to the relevant months i.e. spread between August contract and September contract, August contract and October contract and September contract and October contract etc.

### **Cash and Carry Model for Futures Pricing**

Cash and Carry model is also known as **non-arbitrage model**. This model assumes that in an efficient market, arbitrage opportunities cannot exist. In other words, the moment there is an opportunity to make money in the market due to mispricing in the asset price and its replicas, arbitrageurs will start trading to profit from these mispricing and thereby eliminating these opportunities. This trading continues until the prices are aligned across the products/ markets for replicating assets.

When an underlying asset is not storable i.e. the asset is not easy to hold/maintain, then one cannot carry the asset to the future. The cash and carry model is not applicable to these types of underlying assets.

in case of natural disaster like flood in a particular region, people start storing essential commodities like grains, vegetables and energy products (heating oil) etc. As a human tendency we store more than what is required for our real consumption during a crisis. If every person behaves in similar way then suddenly a demand is created for an underlying asset in the cash market. This indirectly increases the price of underlying assets. In such situations people are deriving convenience, just by holding the asset. This is termed as **convenience return or convenience yield**.

if futures price is higher than spot price of an underlying asset, market participants may expect the spot price to go up in near future. This expectedly rising market is called “Contango market”. Similarly, if futures price are lower than spot price of an asset, market participants may expect the spot price to come down in future. This expectedly falling market is called “**Backwardation market**”.

**Price risk** is nothing but change in the price movement of asset, held by a market participant, in an unfavourable direction. This risk broadly divided into two components - specific risk or unsystematic risk and market risk or systematic risk.

### **Unsystematic Risk**

Specific risk or unsystematic risk is the component of price risk that is unique to particular events of the company and/or industry. This risk is inseparable from investing in the securities. This risk could be reduced to a certain extent by diversifying the portfolio.

### **Systematic Risk**

An investor can diversify his portfolio and eliminate major part of price risk i.e. the diversifiable/unsystematic risk but what is left is the non-diversifiable portion or the market risk-called systematic risk. Variability in a security’s total returns that are directly associated with overall movements in the general market or economy is called systematic risk



## Beta

A measure of systematic risk of a security that cannot be avoided through diversification. It measures the sensitivity of a scrip/ portfolio vis-a-vis index movement over a period of time, on the basis of historical prices. Suppose a stock has a beta equal to 2. This means that historically a security has moved 20% when the index moved 10%, indicating that the stock is more volatile than the index. Scrips/ portfolios having beta more than 1 are called aggressive and having beta less than 1 are called conservative scrips/ portfolios.

To find the number of contracts for perfect hedge 'hedge ratio' is used. Hedge ratio is calculated as:

Number of contracts for perfect hedge =  $V_p * \beta_p / V_i$

$V_p$  – Value of the portfolio  $\beta_p$  – Beta of the portfolio  $V_i$  – Value of index futures contract Value of index futures contract or contract size = futures index level \* contract multiplier. Readers may note that for simplification purpose, beta of futures index vis-a-vis cash index is taken as one.

## Long hedge

Long hedge is the transaction when we hedge our position in cash market by going long in futures market.

## Short hedge

Short Hedge is a transaction when the hedge is accomplished by going short in futures market

## Cross hedge

When futures contract on an asset is not available, market participants look forward to an asset that is closely associated with their underlying and trades in the futures market of that closely associated asset, for hedging purpose. They may trade in futures in this asset to protect the value of their asset in cash market. This is called cross hedge.

## Hedge contract month

Hedge contract month is the maturity month of the contract through which we hedge our position

## Arbitrage opportunities in futures market

Arbitrage is simultaneous purchase and sale of an asset or replicating asset in the market in an attempt to profit from discrepancies in their prices. Arbitrage involves activity on one or several instruments/assets in one or different markets, simultaneously. Important point to understand is that in an efficient market, arbitrage opportunities may exist only for shorter period or none at all. The moment an arbitrager spots an arbitrage opportunity, he would initiate the arbitrage to eliminate the arbitrage opportunity. Arbitrage occupies a prominent position in the futures world as a mechanism that keeps the prices of futures contracts aligned properly with prices of the underlying assets.

The objective of arbitragers is to make profits without taking risk, but the complexity of activity is such that it may result in losses as well

Arbitrage in the futures market can typically be of three types:

- **Cash and carry arbitrage:** Cash and carry arbitrage refers to a long position in the cash or underlying market and a short position in futures market.
- **Reverse cash and carry arbitrage:** Reverse cash and carry arbitrage refers to long position in futures market and short position in the underlying or cash market.
- **Inter-Exchange arbitrage:** This arbitrage entails two positions on the same contract in two different markets/ exchanges.

**Inter-market arbitrage** This arbitrage opportunity arises because of some price differences existing in same underlying at two different exchanges. If August futures on stock Z are trading at Rs. 101 at NSE and Rs. 100 at BSE, the trader can buy a contract at BSE and sell at NSE. The positions could be

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reversed over a period of time when difference between futures prices squeeze. This would be profitable to an arbitrageur.

## **Chapter 4: Introduction to Options**

Options may be categorized into two main types:-

- Call Options
- Put Options

Option, which gives buyer a right to buy the underlying asset, is called Call option and the option which gives buyer a right to sell the underlying asset, is called Put option

### **Writer of an option**

The writer of an option is one who receives the option premium and is thereby obliged to sell/buy the asset if the buyer of option exercises his right.

### **American option**

The owner of such option can exercise his right at any time on or before the expiry date/day of the contract.

### **European option**

The owner of such option can exercise his right only on the expiry date/day of the contract. In India, Index options are European

### **Strike price or Exercise price**

Strike price is the price per share for which the underlying security may be purchased or sold by the option holder

### **In the money (ITM) option**

This option would give holder a positive cash flow, if it were exercised immediately. A call option is said to be ITM, when spot price is higher than strike price. And, a put option is said to be ITM when spot price is lower than strike price. In our examples, call option is in the money.

### **At the money (ATM) option**

At the money option would lead to zero cash flow if it were exercised immediately. Therefore, for both call and put ATM options, strike price is equal to spot price.

### **Out of the money (OTM) option**

Out of the money option is one with strike price worse than the spot price for the holder of option. In other words, this option would give the holder a negative cash flow if it were exercised immediately. A call option is said to be OTM, when spot price is lower than strike price. And a put option is said to be OTM when spot price is higher than strike price. In our examples, put option is out of the money.

### **Time value**

It is the difference between premium and intrinsic value, if any, of an option. ATM and OTM options will have only time value because the intrinsic value of such options is zero.



### Open Interest

As discussed in futures section, open interest is the total number of option contracts outstanding for an underlying asset.

**Leverage** An option buyer pays a relatively small premium for market exposure in relation to the contract value. This is known as leverage

Leverage also has downside implications. If the underlying price does not rise/fall as anticipated during the lifetime of the option, leverage can magnify the investment's percentage loss. Options offer their owners a predetermined, set risk

	<b>Risk / Loss</b>	<b>Return / Profit</b>
Long	Premium paid	Unlimited
Short	Unlimited	Premium received

There are five fundamental parameters on which the option price depends:

- 1) Spot price of the underlying asset
- 2) Strike price of the option
- 3) Volatility of the underlying asset's price
- 4) Time to expiration
- 5) Interest rates

### Spot price of the underlying asset

If price of the underlying asset goes up the value of the call option increases while the value of the put option decreases. Similarly if the price of the underlying asset falls, the value of the call option decreases while the value of the put option increases.

### Strike Price

If all the other factors remain constant but the strike price of option increases, intrinsic value of the call option will decrease and hence its value will also decrease. On the other hand, with all the other factors remain constant, increase in strike price of option increases the intrinsic value of the put option which in turn increases its option value.

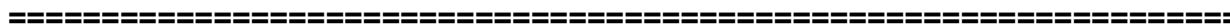
### Volatility

It is the magnitude of movement in the underlying asset's price, either up or down. It affects both call and put options in the same way. Higher the volatility of the underlying stock, higher the premium because there is a greater possibility that the option will move in-the-money during the life of the contract.

Higher volatility = Higher premium, Lower volatility = Lower premium (for both call and put options).

### Time to expiration

The effect of time to expiration on both call and put options is similar to that of volatility on option premiums. Generally, longer the maturity of the option greater is the uncertainty and hence the higher premiums. If all other factors affecting an option's price remain same, the time value portion of an option's premium will decrease with the passage of time. This is also known as **time decay**. Options are known as 'wasting assets', due to this property where the time value gradually falls to zero. high interest rates will result in an increase in the value of a call option and a decrease in the value of a put option.



## Options Pricing Models

### The Binomial Pricing Model

This is a very accurate model as it is iterative, but also very lengthy and time consuming

### The Black & Scholes Model

It is one of the most popular, relative simple and fast modes of calculation. Unlike the binomial model, it does not rely on calculation by iteration.

## Option Greeks

### Delta ( $\delta$ or $\Delta$ )

The most important of the 'Greeks' is the option's "Delta". This measures the sensitivity of the option value to a given small change in the price of the underlying asset. It may also be seen as the speed with which an option moves with respect to price of the underlying asset.  $\text{Delta} = \text{Change in option premium} / \text{Unit change in price of the underlying asset}$ .

Delta for call option buyer is positive

Delta for put option buyer is negative

### Gamma ( $\gamma$ )

It measures change in delta with respect to change in price of the underlying asset. This is called a second derivative option with regard to price of the underlying asset. It is calculated as the ratio of change in delta for a unit change in market price of the underlying asset.  $\text{Gamma} = \text{Change in an option delta} / \text{Unit change in price of underlying asset}$

### Theta ( $\theta$ )

It is a measure of an option's sensitivity to time decay. Theta is the change in option price given a one-day decrease in time to expiration. It is a measure of time decay. Theta is generally used to gain an idea of how time decay is affecting your option positions.  $\text{Theta} = \text{Change in an option premium} / \text{Change in time to expiry}$

### Vega ( $v$ )

This is a measure of the sensitivity of an option price to changes in market volatility. It is the change of an option premium for a given change (typically 1%) in the underlying volatility.  $\text{Vega} = \text{Change in an option premium} / \text{Change in volatility}$

### Rho ( $\rho$ )

Rho is the change in option price given a one percentage point change in the risk-free interest rate. Rho measures the change in an option's price per unit increase in the cost of funding the underlying.  $\text{Rho} = \text{Change in an option premium} / \text{Change in cost of funding the underlying}$

## Chapter 5: Option Trading Strategies

### Option Spreads

Spreads involve combining options on the same underlying and of same type (call/ put) but with different strikes and maturities. These are limited profit and limited loss positions. They are primarily categorized into three sections as:



- Vertical Spreads
- Horizontal Spreads
- Diagonal Spreads

### **Vertical Spreads**

Vertical spreads are created by using options having same expiry but different strike prices. Further, these can be created either using calls as combination or puts as combination. These can be further classified as:

- Bullish Vertical Spread
  - o Using Calls
  - o Using Puts
- Bearish Vertical Spread
  - o Using Calls
  - o Using Puts

### **Horizontal Spread**

Horizontal spread involves same strike, same type but different expiry options. This is also known as time spread or calendar spread.

### **Diagonal spread**

Diagonal spread involves combination of options having same underlying but different expiries as well as different strikes. Again, as the two legs in a spread are in different maturities, it is not possible to draw payoffs here as well.

### **Straddle**

This strategy involves two options of same strike prices and same maturity. A long straddle position is created by buying a call and a put option of same strike and same expiry whereas a short straddle is created by shorting a call and a put option of same strike and same expiry.

### **Strangle**

This strategy is similar to straddle in outlook but different in implementation, aggression and cost.

### **Long Strangle**

As in case of straddle, the outlook here (for the long strangle position) is that the market will move substantially in either direction, but while in straddle, both options have same strike price, in case of a strangle, the strikes are different. Also, both the options (call and put) in this case are out-of-the-money and hence the premium paid is low.

### **Short Strangle**

This is exactly opposite to the long strangle with two out-of-the-money options (call and put) shorted. Outlook, like short straddle, is that market will remain stable over the life of options

### **Covered Call**

This strategy is used to generate extra income from existing holdings in the cash market. If an investor has bought shares and intends to hold them for some time, then he would like to earn some income on that asset, without selling it, thereby reducing his cost of acquisition.



### **Protective Put**

Any investor, long in the cash market, always runs the risk of a fall in prices and thereby reduction of portfolio value and MTM losses. A protective put payoff is similar to that of long call. This is called synthetic long call position. Its like buying insurance to protect your portfolio against market falls.

### **Collar**

A collar strategy is an extension of covered call strategy. In case of covered call, the downside risk remains for falling prices; i.e. if the stock price moves down, losses keep increasing (covered call is similar to short put). To put a floor to this downside, we long a put option, which essentially negates the downside of the short underlying/futures (or the synthetic short put)

### **Butterfly Spread**

As collar is an extension of covered call, butterfly spread is an extension of short straddle. Downside in short straddle is unlimited if market moves significantly in either direction. To put a limit to this downside, along with short straddle, trader buys one out of the money call and one out of the money put. Resultantly, a position is created with pictorial pay-off, which looks like a butterfly and so this strategy is called "Butterfly Spread". Butterfly spread can be created with only calls, only puts or combinations of both calls and puts.

## **Chapter 6: Introduction to Trading Systems**

All the exchanges in India (BSE, NSE and MCX-SX) provide a fully automated screen-based trading platform for index futures, index options, stock futures and stock options. These trading systems support an order driven market and simultaneously provide complete transparency of trading operations. Derivative trading is similar to that of trading of equities in the cash market segment

### **Entities in the trading system**

Broadly there are four entities in the trading system

- Trading Members
- Trading cum Clearing Members
- Self Clearing Member (SCM)
- Professional Clearing Members and
- Participants

### **Corporate Hierarchy**

In the Futures and options trading software, trading member will have a provision of defining the hierarchy amongst users of the system. This hierarchy comprises:

- Corporate Manager
- Branch Manager and
- Dealer

### **Order Types**

#### **Time conditions**

**Day order:** A Day order is an order which is valid for a single day on which it is entered. If the order is not executed during the day, the trading system cancels the order automatically at the end of the day.

**Immediate or cancel (IOC):** User is allowed to buy/sell a contract as soon as the order is released into



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the trading system. An unmatched order will be immediately cancelled. Partial order match is possible in this order, and the unmatched portion of the order is cancelled immediately.

### **Price condition**

**Limit order:** It is an order to buy or sell a contract at a specified price. The user has to specify this limit price while placing the order and the order gets executed only at this specified limit price or at a better price than that

**Market order:** A market order is an order to buy or sell a contract at the bid or offer price currently available in the market. Price is not specified at the time of placing this order.

### **Order Matching Rules**

In India, F&O platforms offer an order driven market, wherein orders match automatically on price time priority basis. Orders, as and when they are received, are first time stamped and then immediately processed for potential match. If a match is not found, then the orders are stored in different 'books'. Orders are stored in price-time priority in various books in the following sequence:

- Best Price
- Within Price, by time priority.

The best buy order will match with the best sell order. An order may match partially with another order resulting in multiple trades. For order matching, the best buy order is the one with highest price and the best sell order is the one with lowest price. This is because the computer views all buy orders available from the point of view of a seller and all sell orders from the point of view of the buyers in the market.

### **Price Band**

There are no price bands applicable in the derivatives segment. However, in order to prevent erroneous order entry, operating ranges and day minimum/maximum ranges are kept as below:

- For Index Futures: at 10% of the base price
- For Futures on Individual Securities: at 10% of the base price
- For Index and Stock Options: A contract specific price range based on its delta value is computed and updated on a daily basis.

### **Eligibility criteria of stocks**

- a) The stock shall be chosen from amongst the top 500 stock in terms of average daily market capitalization and average daily traded value in the previous six months on a rolling basis.
- b) The stock's median quarter-sigma order size (MQSOS) over the last six months shall be not less than Rs.10 Lakhs (Rupees Ten Lakhs). For this purpose, a stocks quarter-sigma order size shall mean the order size (in value terms) required to cause a change in the stock price equal to one-quarter of a standard deviation.
- c) The market wide position limit (MWPL) in the stock shall not be less than Rs.300 crores (Rupees Three Hundred crores). Since market wide position limit for a stock is computed at the end of every month, the Exchange shall ensure that stocks comply with this criterion before introduction of new contracts. Further, the market wide position limit (which is in number of shares) shall be valued taking the closing prices of stocks in the underlying cash market on the date of expiry of contract in the month.

### **Continued eligibility criteria for stocks in equity derivatives**

The criteria for retention of stock in equity derivatives segment are as under:

- a) The stock's median quarter-sigma order size over last six months shall not be less than Rs. 5 lakhs (Rupees Five Lakhs).

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- b) MWPL of the stock shall not be less than Rs. 200 crores (Rupees Two Hundred crores).
- c) The stock's average monthly turnover in derivatives segment over last three months shall not be less than Rs. 100 crores (Rupees Hundred crores).

If a stock fails to meet these retention criteria for 3 months consecutively, then no fresh month contract shall be issued on that stock. However, the existing unexpired contracts may be permitted to trade till expiry and new strikes may also be introduced in the existing contract months. Further, once the stock is excluded from the F&O list, it shall not be considered for re-inclusion for a period of one year.

### **Re-introduction of excluded stocks**

A stock which is excluded from derivatives trading may become eligible once again. In such instances, the stock is required to fulfil the eligibility criteria for 3 consecutive months to be re-introduced for derivatives trading

### **Recently approved changes - Inclusion and Exclusion of stocks for derivatives trading**

SEBI in its Board Meeting on March 28, 2018 took the following decisions in order to rationalize and strengthen the framework of the equity derivatives market in India:

- (i) To facilitate greater alignment of the cash and derivative market, physical settlement for all stock derivatives shall be carried out in a phased and calibrated manner.
- (ii) To update and strengthen the existing entry criteria for introduction of stocks into the derivative segment in line with the increase in market capitalization since the last revision of the criteria in 2012. Accordingly, existing criteria like market wide position limit and median quarter-sigma order size shall be revised upward from current level of INR 300 crore and INR 10 lakh respectively to INR 500 crore and INR 25 lakh respectively. An additional criterion, of average daily 'deliverable' value in the cash market of INR 10 Crore, has also been prescribed. The enhanced criteria are to be met for a continuous period of six months.
- (iii) To begin with, stocks which are currently in derivatives but fail to meet any of the enhanced criteria, would be physically settled. Such stocks would exit the derivative segment if they fail to meet any of the enhanced criteria within a period of one year from the specified date or fail to meet any of the current existing criteria for a continuous period of three months.
- (iv) Stocks which are currently in derivatives and meet the enhanced criteria shall be cash settled. Such stocks if they fail to meet any one of the enhanced criteria for a continuous period of three months shall move from cash settlement to physical settlement. After moving to physical settlement if such stock does not meet any of the current existing criteria for a continuous period of three months, then it would exit out of derivatives. After a period of one year from the specified date, only those stocks which meet the enhanced criteria would remain in derivatives.
- (v) To reflect global initiatives on product suitability, a framework has been approved. Individual investors may freely take exposure in the market (cash and derivatives) upto a computed exposure based on their disclosed income as per their Income Tax Return (ITR) over a period of time. For exposure beyond the computed exposure, the intermediary would be required to undertake rigorous due diligence and take appropriate documentation from the investor.

### **Eligibility criteria of Indices**

The Exchange may consider introducing derivative contracts on an index, if weightage of constituent stocks of the index, which are individually eligible for derivatives trading, is at least 80%. However, no single ineligible stock in the index shall have a weightage of more than 5% in the index

### Dividends

Dividends which are below 10% of the market value of the underlying stock would be deemed to be ordinary dividends and no adjustment in the Strike Price would be made for ordinary dividends. For extra-ordinary dividends, above 10% of the market value of the underlying stock, the Strike Price would be adjusted.

### Limits in Derivatives Market

	Index Options	Index Futures	Stock Options	Stock Futures
<b>Client level / FPI category III / MF Schemes</b>	Higher of --> 1% of the free float market cap OR 5% of the open interest in the derivative contracts on a particular underlying stock			
<b>Trading Member / FPI Cat I &amp; II / Mutual Fund</b>	Higher of Rs.500 crores OR 15% of the total open interest in the market in equity index option contracts	Higher of Rs.500 crores OR 15% of the total open interest in the market in equity index futures contracts	The position limits of Trading members / FPIs (Category I & II) / Mutual Funds in individual stocks is related to the market-wide position limit for the individual stocks. The combined futures and options position limit shall be 20% of the applicable Market Wide Position Limit (MWPL).	
<b>Market wide</b>	No MWPL for Index Options	No MWPL for Index Futures	At the end of each day the Exchange disseminates the aggregate open interest across all Exchanges in the futures and options on individual scrips along with the market wide position limit for that scrip and tests whether the aggregate open interest for any scrip exceeds 95% of the market wide position limit for that scrip. If yes, the Exchange takes note of open positions of all client/ TMs as at the end of that day in that scrip, and from next day onwards the client/ TMs should trade only to decrease their positions through offsetting positions till the normal trading in the scrip is resumed. The normal trading in the scrip is resumed only after the aggregate open interest across Exchanges comes down	

		to 80% or below of the market wide position limit.
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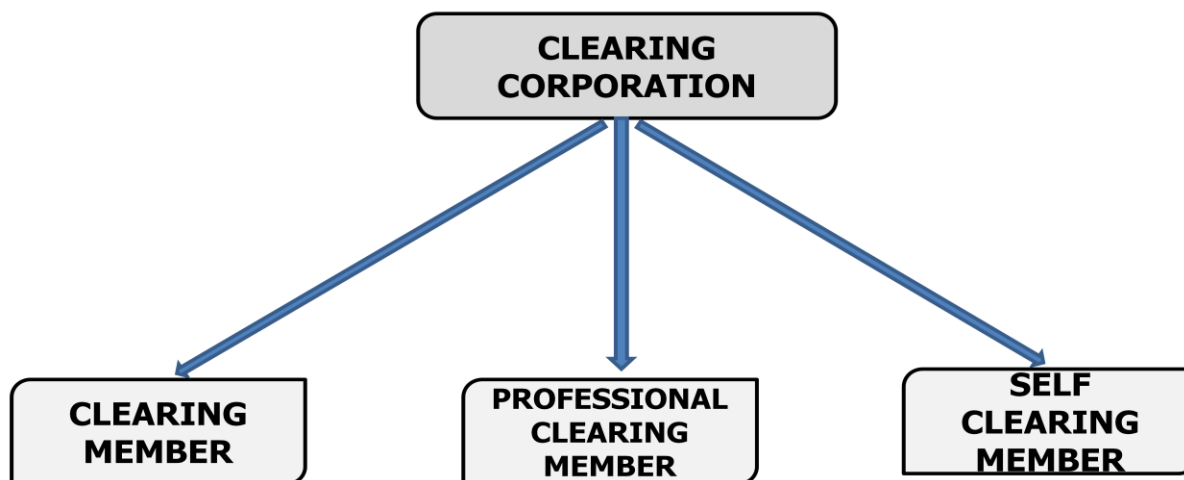
In addition to the above limits, in index futures and options, FPI Category (I &II)/MFs shall take exposure in equity index derivatives subject to the following limits:

- Short positions in index derivatives (short futures, short calls and long puts) not exceeding (in notional value) the FPI Category (I &II)/ MFs holding of stocks.
- Long positions in index derivatives (long futures, long calls and short puts) not exceeding (in notional value) the FPI Category (I &II)/MFs holding of cash, government securities, T-Bills, money market mutual funds and gilt funds and similar instruments.

In this regard, if the open position of an FPI Category (I &II)/ MF exceeds the limits as stated for Index Futures or Index Options, such surplus would be deemed to comprise of short and long positions in the same proportion of the total open positions individually. Such short and long positions in excess of the said limits shall be compared with the FPI Category (I &II) /MFs holding in stocks, cash etc. as stated above.

### Chapter 7: Introduction to Clearing and Settlement System

# CLEARING MEMBERSHIPS



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

### Clearing Member Eligibility Norms

- Net-worth of at least Rs.300 lakhs. The Net-worth requirement for a Clearing Member who clears and settles only deals executed by him is Rs. 100 lakhs.
- Deposit of Rs. 50 lakhs to clearing corporation which forms part of the security deposit of the Clearing Member.
- Additional incremental deposits of Rs.10 lakhs to clearing corporation for each additional TM, in case the Clearing Member undertakes to clear and settle deals for other TMs.

### Settlement Mechanism

In India, SEBI has given the stock exchanges the flexibility to offer:

- a) Cash settlement (settlement by payment of differences) for both stock options and stock futures; or
- b) Physical settlement (settlement by delivery of underlying stock) for both stock options and stock futures; or
- c) Cash settlement for stock options and physical settlement for stock futures; or
- d) Physical settlement for stock options and cash settlement for stock futures.

A Stock Exchange may introduce physical settlement in a phased manner. On introduction, however, physical settlement for all stock options and/or all stock futures, as the case may be, must be completed within six months.

### Settlement Schedule

The settlement of trades is on T+1 working day basis. Members with a funds pay-in obligation are required to have clear funds in their primary clearing account on or before 10.30 a.m. on the settlement day. The payout of funds is credited to the primary clearing account of the members thereafter.

### Settlement of Futures Contracts on Index or Individual Securities

In Futures contracts, both the parties to the contract have to deposit margin money which is called as initial margin. Futures contract have two types of settlements, the MTM settlement which happens on a continuous basis at the end of each day, and the final settlement which happens on the last trading day of the futures contract. Mark to Market (MTM) Settlement Mark to Market is a process by which margins are adjusted on the basis of daily price changes in the markets for underlying assets. The profits/ losses are computed as the difference between:

1. The trade price & the day's settlement price for contracts executed during the day but not squared up.
2. The previous day's settlement price & current day's settlement price for brought forward contracts.
3. The buy price and the sell price for contracts executed during the day and squared up.

### Settlement of Options Contracts on Index or Individual Securities

Options contracts have two types of settlements. These are as follows



- 1) Daily premium settlement,
- 2) Final settlement

### Settlement of Custodial Participant (CP) Deals

Clearing corporation provides a facility to entities like institutions to execute trades through any trading member, which may be cleared and settled by their own CM. Such entities are called Custodial Participants (CP). A CP is required to register with clearing corporation through this clearing member, which allots them a unique CP code. The CP and the CM are required to enter into an agreement. All trades executed by such CP through any TM are required to have the CP code in the relevant field on the F&O trading system at the time of order entry

**Settlement Price for derivatives is given in the following table:**

Product	Settlement	Price
Futures Contracts on Index OR Individual Security OR Global Index	Daily Settlement	Closing price of the futures contracts on the trading day (closing price for a futures = last half an hour weighted average price of such contract).
Un-expired illiquid futures contracts (including Global Indices)	Daily Settlement	Theoretical Price computed as per formula $F=S *e^{rt}$
Futures Contracts on Index or Individual Securities	Final Settlement	Closing price of the relevant underlying index / security in the Capital Market segment of NSE, on the last trading day of the futures contracts.
Futures Contracts on Global Indices	Final Settlement	The Special Opening Quotation (SOQ) of the Global Indices on the last trading day of the futures contracts
Options Contracts on Index and Individual Securities	Final Exercise Settlement	Closing price of such underlying security (or index) on the last trading day of the options contract.
Options Contracts on Global Indices	Final Exercise Settlement	The Special Opening Quotation (SOQ) of the Global Indices on the last trading day of the options contracts

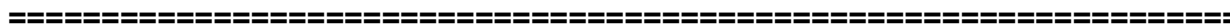
### Risk Management

The most critical component of risk containment mechanism for F&O segment is the margining system and on-line position monitoring. The actual position monitoring and margining is carried out on-line through Parallel Risk Management System (PRISM) using SPAN® (Standard Portfolio Analysis of Risk) system for the purpose of computation of on-line margins, based on the parameters defined by SEBI.

### Initial margin

Margins are computed by clearing corporation upto client level with the help of SPAN. Clearing corporation collects initial margin for all the open positions of a Clearing Member based on the margins computed. Margins are required to be paid up-front on gross basis at individual client level for client positions and on net basis for proprietary positions. A Clearing Member collects initial margin from TM whereas TM collects from his clients.





Initial margin requirements are based on 99% value at risk over a one day time horizon. However, in the case of futures contracts (on index or individual securities), where it may not be possible to collect mark to market settlement value, before the commencement of trading on the next day, the initial margin is computed over a two-day time horizon, applying the appropriate statistical formula

### **Premium Margin**

Along with Initial Margin, Premium Margin is also charged at client level. This margin is required to be paid by a buyer of an option till the premium settlement is complete.

### **Assignment Margin for Options on Securities**

It is required to be paid on assigned positions of Clearing Members towards final exercise settlement obligations for option contracts on individual securities, till such obligations are fulfilled. The margin is charged on the net exercise settlement value payable by a Clearing Member towards final exercise settlement.

### **Exposure Margins**

The exposure margins for options and futures contracts are as follows:

- For Index options and Index futures contracts: 3% of the notional value of a futures contract. In case of options it is charged only on short positions and is 3% of the notional value of open positions.
- For option contracts and Futures Contract on individual Securities: The higher of 5% or 1.5 standard deviation of the notional value of gross open position in futures on individual securities and gross short open positions in options on individual securities in a particular underlying. The standard deviation of daily logarithmic returns of prices in the underlying stock in the cash market in the last six months is computed on a rolling and monthly basis at the end of each month.

### **Client Margins**

Clearing corporation intimates all members of the margin liability of each of their client. Additionally members are also required to report details of margins collected from clients to clearing corporation, which holds in trust client margin monies to the extent reported by the member as having been collected from their respective clients.

### **Cross Margin**

Salient features of the cross margining available on exchanges are as follows:

1. Cross margining is available across Cash and Derivatives segment.
2. Cross margining is available to all categories of market participants.
3. When a Clearing Member clears for client/ entities in Cash and Derivatives segments, he is then required to intimate client details through a Collateral Interface for Members (CIM) to benefit from Cross margining.

### **Disclosure for Client Positions in Index based contracts**

Any person or persons acting in concert who together own 15% or more of the open interest on a particular underlying index is required to report this fact to the Exchange/ Clearing Corporation

**Penalties** A penal charge will be levied on the amount in default as per the byelaws relating to failure to meet obligations by any Clearing Member



Type of Default	Penalty Charge per day	Chargeable to
Overnight settlement shortage of value more than Rs.5 lakhs	0.07%	Clearing Member
Security Deposit Shortage	0.07%	Clearing Member
Shortage of Capital Cushion	0.07%	Clearing Member

Instances of Disablement	Penalty to be levied
1st instance	0.07% per day
2nd to 5th instance of disablement	0.07% per day + Rs.5,000/- per instance from 2nd to 5th instance
6th to 10th instance of disablement	0.07% per day + Rs.20,000/- ( for 2nd to 5th instance) + Rs.10000/- per instance from 6th to 10th instance
11th instance onwards	0.07% per day + Rs.70,000/- ( for 2nd to 10th instance) + Rs.10,000/- per instance from 11th instance onwards. Additionally, the member will be referred to the Disciplinary Action Committee for suitable action

### Market wide Position Limit violation

At the end of each day during which the ban on fresh positions is in force for any security, when any member or client has increased his existing positions or has created a new position in that security the client/trading members will be subject to a penalty 1% of the value of increased position subject to a minimum of Rs.5000 and maximum of Rs.100000.

## Chapter 8: Legal and Regulatory Environment

### Securities Contracts (Regulation) Act, 1956

The Act aims to prevent undesirable transactions in securities. It governs the trading of securities in India. The term “securities” has been defined in the Section 2(h) of SCRA.

According to the act “Derivatives” is defined as:-

- A security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security.
- A contract which derives its value from the prices, or index of prices, of underlying securities.
- Commodity derivatives, and Such other instruments as may be declared by the Central Government to be derivatives.
- Section 18A provides that notwithstanding anything contained in any other law for the time being in force, contracts in derivative shall be legal and valid if such contracts are:
  - Traded on a recognized stock exchange
  - Settled on the clearing house of the recognized stock exchange, in accordance with the rules and bye-laws of such stock exchanges.

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### Regulation in Trading

- The derivatives exchange/segment should have a separate governing council and representation of trading/clearing members shall be limited to maximum of 40% of the total members of the governing council.
- The Exchange should have a minimum of 50 members
- The minimum contract value shall not be less than Rs. 5 Lakhs
- The minimum networth for clearing members of the derivatives clearing corporation/house shall be Rs.300 Lakhs
- The minimum contract value shall not be less than Rs 5,00,000

Responsibilities of the Clearing Corporation include:

- Collection of Margins on timely basis
- Smooth operation of the Market
- Daily Clearing and Settlement
- To act as a legal counterparty for every contract
- To monitor positions in derivatives and cash segments
- Deciding Daily Settlement Prices
- Keep consistent record of margins at client level
- Take care not to appropriate client margins against brokers dues

The Clearing Corporation can transfer client positions from one broker member to another broker member in the event of a default by the first broker member.

Main objectives of Trade Guarantee Fund (TGF):

- To guarantee settlement of bonafide transactions of the members of the exchange.
- To inculcate confidence in the minds of market participants.
- To protect the interest of the investors in securities.

All active members of the Exchange are required to make initial contribution towards Trade Guarantee Fund of the Exchange.

## **Chapter 9: Accounting and Taxation**

### **When forward contract is for hedging**

- The premium or discount (difference between the value at spot rate and forward rate) should be amortized over the life of contract.
- Exchange difference (difference between the value of settlement date/ reporting date and value at previous reporting date/ inception of the contract) is recognized in Profit & Loss statement of the year.
- Profit/ loss on cancellation/ renewal of forward contract are recognized in P&L of the year.

### **When forward contract is for trading/ speculation**

- No premium or discount is recognized.
- A gain or loss i.e. the difference between the forward rate as per contract/ previous year end valuation rate and the forward rate available at the yearend (reporting date) for remaining maturity period should be recognized in the P&L of the period.
- Profit/ loss on cancellation / renewal of forward contract are recognized in P&L of the year.

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### **Taxation of Profit/Loss on derivative transaction in securities**

Prior to Financial Year 2005–06, transaction in derivatives were considered as speculative transactions for the purpose of determination of tax liability under the Income-tax Act.

Finance Act, 2005 has amended section 43(5) so as to exclude transactions in derivatives carried out in a “recognized stock exchange” for this purpose. This implies that income or loss on derivative transactions which are carried out in a “recognized stock exchange” is not taxed as speculative income or loss. Thus, loss on derivative transactions can be set off against any other income during the year (except salary income). In case the same cannot be set off, it can be carried forward to subsequent assessment year and set off against any other non-speculative business income of the subsequent year. Such losses can be carried forward for a period of 8 assessment years.

### **Securities Transaction Tax (STT)**

Trading member has to pay securities transaction tax on the transaction executed on the exchange shall be as under:

#### **STT rates**

1. Sale of an option in securities → 0.05 per cent ( from 2016 )
2. Sale of an option in securities, where option is exercised → 0.125 per cent ( Paid by Purchaser)
3. Sale of futures in securities → 0.01 per cent

## **Chapter 10: Sales Practices and Investors Protection Services**

### **Churning**

“Churning” refers to when securities professionals making unnecessary and excessive trades in customer accounts for the sole purpose of generating commissions. Investors should be careful to review their monthly account statements and investigate any abnormally high trading activity.

### **Customer Due Diligence**

The customer due diligence (“CDD”) measures comprises the following:

- Obtaining sufficient information in order to identify persons who beneficially own or control securities account
- Verify the customer’s identity using reliable, independent source documents, data or information
- Conduct ongoing due diligence and scrutiny, i.e. perform ongoing scrutiny of the transactions and account throughout the course of the business relationship to ensure that the transactions being conducted are consistent with the registered intermediary’s knowledge of the customer, its business and risk profile, taking into account, where necessary, the customer’s source of funds

### **Clients of special categories (CSC)**

Such clients include the following:

- Non resident clients.
- High networth clients.
- Trust, Charities, NGOs and organizations receiving donations.
- Companies having close family shareholdings or beneficial ownership.
- Politically exposed persons (PEP) of foreign origin.
- Companies offering foreign exchange offerings.
- Clients in high risk countries
- Non face to face clients.

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- Clients with dubious reputation as per public information available.etc.

### **Investors Grievance Mechanism**

All exchanges have a dedicated department to handle grievances of investors against the Trading Members and Issuers. These include the Investor Service Committees (ISC) consisting of Exchange officials and independent experts whose nomination is approved by Securities and Exchange Board of India. SEBI also monitors exchange performance related to investor grievance redressal

### **Arbitration**

- Arbitration is a quasi judicial process of settlement of disputes between Trading Members, Investors, Sub-brokers & Clearing Members and between Investors and Issuers (Listed Companies).
- The parties to arbitration are required to select the arbitrator from the panel of arbitrators provided by the Exchange. The arbitrator conducts the arbitration proceeding and passes the award normally within a period of 4 months from the date of initial hearing.
- The arbitration award is binding on both the parties. However, the aggrieved party, within 15 days of the receipt of the award from the arbitrator, can file an appeal to the arbitration tribunal for re-hearing the whole case.
- On receipt of the appeal, the Exchange appoints an Appellate Bench consisting of 5 arbitrators who re-hear the case and then give the decision. The judgment of the Bench is by a 'majority' and is binding on both the parties. The final award of the Bench is enforceable as if it were the decree of the Court.
- Any party who is dissatisfied with the Appellate Bench Award may challenge the same in a Court of Law.

### **SEBI Complaints Redress System (SCORES) [<http://scores.gov.in>]**

SEBI has launched a centralized web based complaints redress system (SCORES).

SCORES is web enabled and provides online access 24 x 7. This has the following salient features:

- Complaints and reminders thereon are lodged online at anytime from anywhere
- An email is generated instantaneously acknowledging the receipt of the complaint and allotting a unique complaint registration number for future reference and tracking
- The complaint moves online to the entity (intermediary or listed company) concerned for its redressal
- The entity concerned uploads an Action Taken Report (ATR) on the complaint
- SEBI peruses the ATR and disposes of the complaint if it is satisfied that the complaint has been redressed adequately
- The concerned investor can view the status of the complaint online
- The entity concerned and the concerned investor can seek and provide clarification(s) online to each other
- The life cycle of a complaint has an audit trail and
- All the complaints are saved in a central database which would generate relevant MIS reports to enable SEBI to take appropriate policy decisions and or remedial actions.

Effective from August 01, 2018, following procedure shall be followed for filing and redressal of investor grievances using SCORES:

- =====
- Investors who wish to lodge a complaint on SCORES have to register themselves on [www.scores.gov.in](http://www.scores.gov.in).
  - While filing the registration form, details like Name of the investor, PAN, Contact details, Email id, Aadhaar card number (optional), CKYC ID(optional) etc. may be provided for effective communication and speedy redressal of the grievances.
  - Upon successful registration, a unique user id and a password will be communicated to the investor through an acknowledgement email / SMS. Using the login credentials, the investor can lodge his/her complaint on SCORES.
  - The complainant may use SCORES to submit the grievance directly to companies / intermediaries and the complaint shall be forwarded to the entity for resolution. The entity is required to redress the grievance within 30 days, failing which the complaint shall be registered in SCORES.

**IMPORTANT NOTE :**

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

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Email: [akshayatraining@gmail.com](mailto:akshayatraining@gmail.com)

WhatsApp only - 98949 49987