PERIYAR UNIVERSITY

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CENTRE FOR DISTANCE AND ONLINE EDUCATION

(CDOE)

BACHELOR OF COMMERCE

SEMESTER - III

SKILL ENHANCEMENT COURSE: CAPITAL MARKET

(Candidates admitted from 2024 onwards)

Prepared by:

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UNIT I

CAPITAL MARKET

Self –Learning Material Development –Stage -1

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Unit Modules Structuring

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- Type of Capital Market
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1.1 INDIAN CAPITAL MARKET

1.1.1 MEANING OF CAPITAL MARKET

Capital market is a place where buyers and sellers indulge in trade (buying/selling) of financial securities like bonds, stocks, etc. The trading is undertaken by participants such as individuals and institutions.

Capital Market refers to that part of the broader financial market which provides a market for borrowing and lending of **medium and long-term funds, above 1 year.** Thus, it caters to the borrowing needs for **medium to long term projects and investments.** Because of the long maturity period, the Capital Market facilitates the mobilization and allocation of long-term funds.

1.1.2 DEFINITION OF CAPITAL MARKET:

Capital Market are defined as “market in which money is provided for period longer than a year.

Financial Market is a broad term, referring to any center or arrangement where buyers and sellers participate in the trade of financial claims such as equities, bonds, currencies, and derivatives. The Financial Market is classified into **two categories.**

A. Money Market - Market for trading **short-term financial assets with a maturity of up to 1 year.**

B. **Capital Market** – Market for borrowing and lending of **medium and long-term funds, above 1 year.**

1.1.3 STRUCTURE OF CAPITAL MARKET

The capital market is a complex system, formed by various components. Various components and structure of capital market can be classified into the following **3 categories.**

1. Capital Market Participants

Capital Market participants include the individuals and institutions that interact within the market. These participants can be, broadly, categorized into **2 groups:**

Investors or Suppliers of Capital: These are entities with surplus funds and are looking to invest. They include individuals, pension funds, insurance companies, and commercial banks.

Borrowers or Issuers of Securities: These are entities that raise funds by issuing various types of securities. They include businesses looking to expand, governments financing projects, and individuals seeking loans.

2. Capital Market instruments

Capital Market Instruments or the Instruments of Capital Market refer to various types of financial tools used within the market. They include financial securities and derivatives that serve as mediums and facilitate the flow of money among the participants of the capital market.Various capital market instruments can be, broadly, classified into the **following types:**

- Share or Stock
- Debt Instruments
- Derivatives
- Mutual Funds
- Exchange Traded Funds (ETFs)
- Instruments of Foreign Investments

Each type of capital market instruments has been discussed in details in our articles of instruments of capital market.

3. Capital Market Infrastructure

Capital Market Infrastructure refers to the institutions that facilitate the smooth operation of the market. These institutions play a crucial role in connecting various participants and ensuring their regulated interactions for trading through instruments available in the market.

Major types of institutions forming part of the capital market infrastructure are as follows:

Stock Exchanges: Stock exchanges are essentially marketplaces for buying and selling financial instruments. They act as a central platform where investors and companies connect.Various concepts regarding Stock Exchanges have been dealt with in detail below.

Regulatory Bodies: These organizations ensure fair and transparent practices within the market. Major regulators involved in regulation of Capital Market in India are:

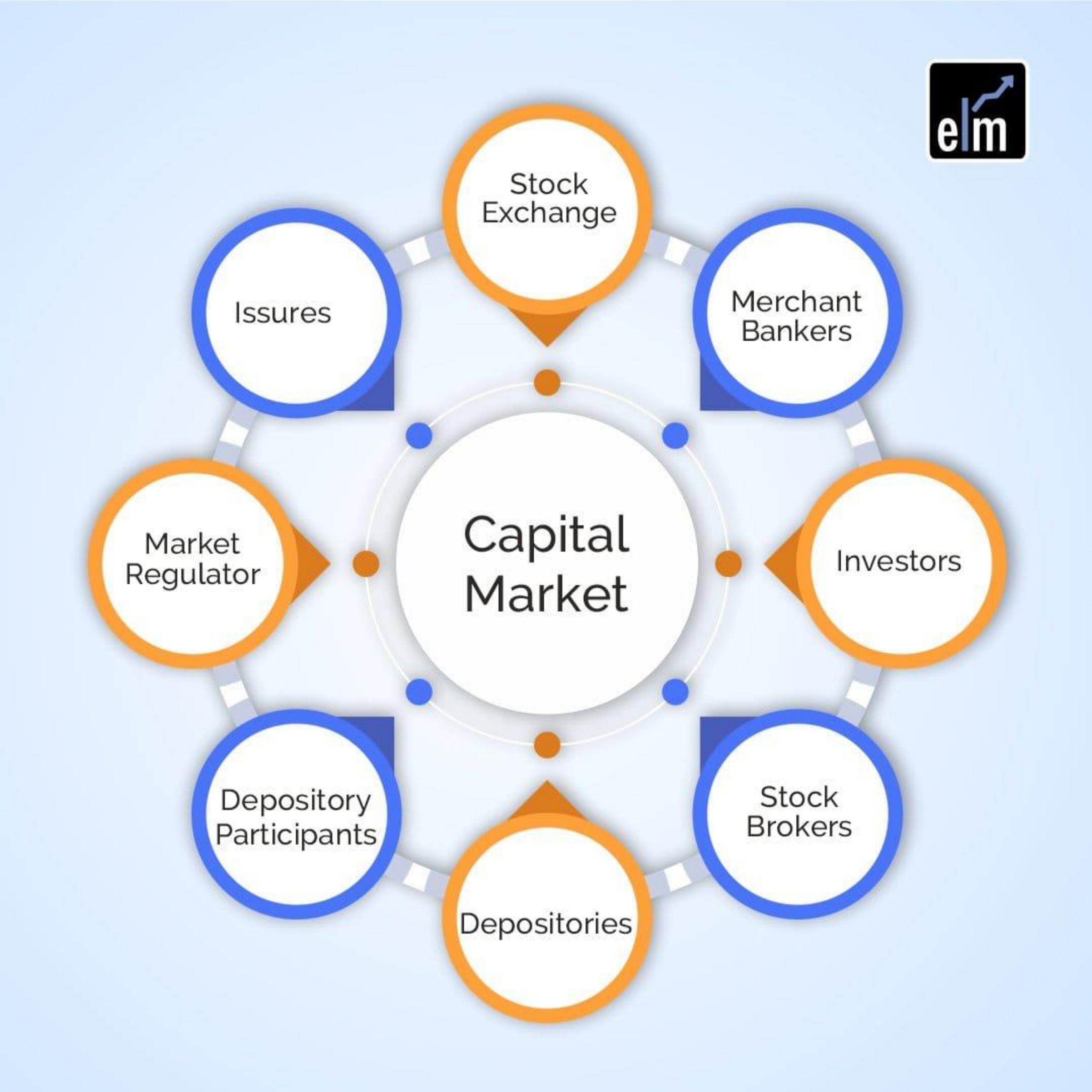
- Securities and Exchange Board of India (SEBI)
- Reserve Bank of India (RBI)
- Union Ministry of Corporate Affairs, and
- Department of Economic Affairs, Union Ministry of Finance.

Financial Intermediaries: These institutions connect investors with those seeking capital.

Brokers, investment banks, and underwriters are some examples.

1.1.4 TYPES OF CAPITAL MARKET

Based on the type of securities traded, the Capital Market is of **2 types:**



1. Primary Market or New Issue Market

The Primary Market is the type of Capital Market where **new securities** are **issued for the first time.** Thus, it is also called the New Issue Market. The primary market provides the channel for the sale of new securities. The issuer of securities sells the securities in the primary market to raise funds for investment and/or to discharge.

In other words, the market wherein resources are mobilized by companies through the issue of new securities is called the primary market.

2. Secondary Market or Old Issued Market

The Secondary Market refers to a market where **those types of securities are traded,** which have **already been issued** and offered to the public in the Primary Market and/or listed on the Stock Exchange.Thus, it is also called the Old Issue Market.The secondary market enables securities holders to adjust their holdings in response to changes in their assessment of risk and return or to buy/sell their securities as per their liquidity needs.

1.1.5 Different Between Primary Market and Secondary Market

PRIMARY MARKET	SECONDARY MARKET
New market securities are sold.	Only existing securities are traded.
Investors have the option of only buying the securities.	Investors can both buy and sell securities.
The price of securities is mostly decided by the management of the issuing company.	The price of securities is determined by the demand and supply of the market.
Primary Markets have no fixed geographical location.	Secondary Markets are located at specified places, known as Stock Exchange.
Major intermediaries – Merchant Banks, Underwriters, Debenture Trustees, Portfolio Managers, etc.	Major intermediaries – Brokers, Jobbers, etc.

1.1.6 PRIMARY MARKET OR NEW ISSUE MARKET CONCEPT

Type of issue in primary market

The issue of new securities in the Primary Market occurs through various methods as discussed below.

Public issue or Public Offering

Public Issue or Public Offering refers to the process of a company **offering its securities** (usually stocks or bonds) **for sale to the general public** for the first time or subsequently.It is the usual way through which companies raise capital from a broad range of investors.There are **2 main types of public issues:**

1. Initial public offering (IPO)

Initial Public Offering (IPO) refers to the process when a **private or unlisted company sells its shares to the public for the very first time.**This process transforms the company from being privately owned to a public company.This is why an IPO is also referred to as "**going public**".It is generally used by new and medium-sized firms that are looking for funds to grow and expand their business.After IPO, the company's shares are traded in an open market.Those shares can be further sold by investors through secondary market trading.

2. Follow on Public Offering (FPO)

Already issued shares and is listed on a stock exchange, **issues shares again** Follow on Public Offering (FPO) refers to the process when a **company, that has to raise additional fund.** Public companies have to sell at least 25% of their shares to the public to be traded on a stock exchange. Usually, it is this requirement that makes companies go for FPOs.

Bonus Issue or Scrip Issue or Capitalization Issue

It refers to offer of share to the existing shareholders against their distributable profit.Thus, under this, shareholders' share in profit is converted as share.

Rights Issue

Rights Issue is an **invitation to existing shareholders to purchase additional new shares** in the company. This type of issue **gives existing shareholders rights** to purchase new shares at a discount to the market price on a stated future date. It is called Rights Issue.

Private Placement

When an issuer makes an issue of securities to a limited group of pre-selected investors, and which is neither a rights issue nor a public issue, it is called a private placement. Private placement can be classified into **Two types:**

1. Preferential Allotment

When a listed issuer issues shares or convertible securities **to a select group of persons**, it is called a Preferential Allotment.

2 .Qualified Institutional Placement (QIP)

When a listed issuer issues shares or convertible securities **to a select group of Qualified Institutional Buyers (QIBs),** it is called a Qualified Institutional Placement (QIP).

Key Terminologies Related to Primary Market

Declared Price Issue

Its a method of pricing new issues wherein the issuer offers securities at a pre-fixed price.

Book Building Issue

Its is another method of pricing new issues wherein the price is not announced beforehand. Rather, the issuer, first, offers the shares and gets application from public and then based on the demand fixes the price.

Authorized Capital

It is the maximum amount authorized by Memorandum of Association of a company that can be raised by the company. The issuer can issue securities upto worth this amount only.

Issued Capital

It is the actual amount issued by the issuer. It may be equal to or lesser than the Authorized Capital.

Subscribed Capital

After the company issues shares, the public starts subscribing to those shares. The subscription can be oversubscribed (demand of shares more than the issued number of shares) or undersubscribed (demand of shares less than the issued number of shares). The actual amount subscribed is called Subscribed Capital.

Merchant Bankers

A “merchant banker” means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management.

Underwriting

Underwriting means an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.

Underwriter

The financial intermediary which agrees to purchase the under subscribed portion of issued capital is called Underwriter.

Called Up Capital

The company usually collects the subscribed capital in installments. The portion of money demanded from subscriber is known as Called Up Capital.

Paid Up Capital

The amount actually paid by subscribers, when the money is demanded by the issuer, is known as Paid Up Capital.

Reserve Capital

Usually, the issuer does not demand the whole amount from the subscriber. A small portion of money is left un-demanded, which is called Reserve Capital.

Capital Markets In India

The capital market provides the support to the system of capitalism of the country. The Securities and Exchange Board of India (SEBI), along with the Reserve Bank of India are the two regulatory authority for Indian securities market, to protect investors and improve the microstructure of capital markets in India. With the increased application of information technology, the trading platforms of stock exchanges are accessible from anywhere in the country through their trading terminals.

India has a fair share of the world economy and hence the capital markets or the share markets of India form a considerable portion of the world economy. The capital market is vital to the financial system.

The capital Markets are of two main types. The Primary markets and the secondary markets. In a primary market, companies, governments or public sector institutions can raise funds through bond issues. Alos, Corporations can sell new stock through an initial public offering (IPO) and raise money through that. Thus in the primary market, the party directly buys shares of a company. The process of selling new shares to investors is called underwriting.

In the Secondary Markets, the stocks, shares, and bonds etc. are bought and sold by the customers. Examples of the secondary capital markets include the stock exchanges like NSE, BSE etc. In these markets, using the technology of the current time, the shares, and bonds etc. are sold and purchased by parties or people.

Broad Constituents in the Indian Capital Markets

Fund Raisers

Fund Raisers are companies that raise funds from domestic and foreign sources, both public and private. The following sources help companies raise funds.Fund Providers

Fund Providers are the entities that invest in the capital markets. These can be categorized as domestic and foreign investors, institutional and retail investors. The list includes subscribers to primary market issues, investors who buy in the secondary market, traders, speculators, FIIs/ sub-accounts, mutual funds, venture capital funds, NRIs, ADR/GDR investors, etc.

Intermediaries

Intermediaries are service providers in the market, including stock brokers, sub-brokers, financiers, merchant bankers, underwriters, depository participants, registrar and transfer agents, FIIs/ sub-accounts, mutual Funds, venture capital funds, portfolio managers, custodians, etc.

Organizations

Organizations include various entities such as MCX-SX, BSE, NSE, other regional stock exchanges, and the two depositories National Securities Depository Limited (NSDL) and Central Securities Depository Limited (CSDL).

Role And Importance Of Capital Market In India

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

Mobilization Of Savings And Acceleration Of Capital Formation:

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

Raising Long-Term Capital

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

Promotion Of Industrial Growth

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

Ready and Continuous Market

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

Technical Assistance

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

Reliable Guide To Performance

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

Proper Channelization Of Funds

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

Provision Of Variety Of Services:

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

Development Of Backward Areas

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

Foreign Capital

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

Easy Liquidity

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

1.1.7 SECONDARY MARKET OR OLD ISSUE MARKET:

Components of Secondary Market

Based on the type of trading, the secondary market has **Two components:**

1. Over-The-Counter (OTC) Market

Over-The-Counter Markets or OTC Markets are essentially informal markets for trading securities.It is a decentralized marketplace where securities are traded directly between two parties, bypassing a central exchange.OTC markets are generally subject to less stringent regulations than exchanges.

2. Stock Exchange Market

It refers to markets for trading of securities through a centralized exchange, usually called Stock Exchange.

Key Terminologies Related to Secondary Market

Listed Securities: Listed Securities refer to those securities that are accepted to be traded in stock exchanges.

Cash Trading: It's a type of trading in the Secondary Market wherein the sale and purchase of securities takes place at the prevailing price on the day of trading.

Forward Trading : It's another type of trading in the Secondary Market wherein both buyer and seller agree to buy and sell respectively at a future date at a pre-agreed price, irrespective of the price that prevails on the day of trade.

Third Market: Third Market refers to the trading of exchange-listed securities in the over-the-counter (OTC) market.It allows institutional investors to trade blocks of securities directly, rather than through an exchange, providing liquidity and anonymity to buyers**.**

Fourth Market: Fourth Market refers to institution-to-institution trading directly, without using the service of broker-dealers, thus avoiding both commissions, and the bid–ask spread.

1.1.8 STOCK EXCHANGE

A Stock Exchange is a regulated marketplace where investors can buy and sell shares of publicly traded companies. It acts as a central hub for facilitating stock trading in a secure and efficient manner.In India, a Stock Exchange can operate only if it is recognized by the Government under the Securities Contracts (Regulation) Act, 1956.

Stock Exchanges of India

1. **Bombay Stock Exchange (BSE)**

The Bombay Stock Exchange (BSE) is India's largest and earliest securities market.It is also Asia's first stock exchange.BSE On-Line Trading (BOLT) is a screen-based automated trading platform of BSE.The BSE also offers depository services through one of its arms called the Central Depository Services Limited (CDSL)

2. National Stock Exchange of India Ltd. (NSE)

The National Stock Exchange of India Ltd. (NSE) is India's largest financial market.It ranks fourth in the world by equity trading volume.NSE is the first exchange in India to provide modern, fully automated electronic trading.

Stock Market Index

A Stock Market Index is a statistical measure that reflects the overall performance of a specific segment of the stock market, or the entire market itself.Each index is composed of a weighted values of specific group of stocks chosen based on certain criteria such as Market Capitalization, Representation of various sectors, etc.From each sector, top companies are selected on the basis of total value of all shares that are traded in the stock exchange. These companies are called **Blue Chip Companies.**It acts as an indicator of rise or fall in the prices of shares or other securities.Investors use Stock Market Indices as a benchmark to track market movements and compare the performance of their investments.

Important Stock Market Indices in India

BSE Sensex or Sensitive Index: It is an index of BSE, which measures the price movement of top 30 companies' shares.

Nifty or National Index for Fifty: It is an index of NSE, which measures price movement of top 50 companies.

Nifty Junior: It is an index of NSE, which measures the price movement of the next top 50 companies.

1.1.9ROLES AND IMPORTANCE OF CAPITAL MARKET

The Capital Market, as the major channel for mobilization of funds, plays very crucial role in an economy. Some of the its major roles and importance can be seen as follows:

Mobilization of Savings: It mobilizes idle savings or funds from people for further investments in the productive channels of an economy.

Capital Formation: Through mobilization of ideal resources it helps in formation of capital.

Investment Avenues: It enables to raise resources for longer periods of time. Thus it provides an investment avenue for people who wish to park their resources for a long period of time and earn reasonable return.

Economic Growth and Development: As it makes funds available for long period of time, the financial requirements of business houses are met by the capital market. This, in turn, helps them grow.

Optimal Allocation of Fund: By enabling price discovery as per the demand and supply, it helps in optimal allocation of financial resources.

Service Provision: As an important financial set up, capital market provides various types of services. It includes long term and medium term liquidity to industry, underwriting services, consultancy services, export finance, investor education by widening ownership base.

Barometer of Economic Health: The performance of the Secondary Market acts as the barometer of economic health. The investors use the level of stock exchange indices as a benchmark to track market movements and compare the performance of their investments.

REGULATION OF CAPITAL MARKET IN INDIA

Securities Contracts (Regulations) Act, 1956: It gives Central Government regulatory jurisdiction overStock exchanges – through a process of recognition and continued supervision.contracts in securities, andListing of securities on stock exchanges.

Companies Act, 2013: It regulates incorporation of a company, lays down responsibilities of a company, directors, dissolution of a company.The Companies Act is mainly **administered by the Union Ministry of Corporate Affairs.**

SEBI Act, 1992: It has established the Securities and Exchange Board of India (SEBI) as the primary regulator of securities markets in India.

Depositories Act, 1996: It provides a legal framework for establishment of depositories to facilitates holding of securities in physical/dematerialized form and to effect the transfer of securities through book entry only.

RBI's Provisions for NBFCs: Of late, the RBI has proposed a significant shift in its regulatory approach towards the NBFCs.The Capital Market serves as a vital channel for mobilizing savings into investments, and hence driving economic growth and prosperity. As India aims to grow faster in the time times to come, the role of the Capital Market is going to become even more important. Efforts should be taken to ensure its efficient functioning by focusing on transparency, fairness, and regulatory oversight to maintain investor confidence and market integrity.

SECTION 1.2 INTRODUCTION OF CAPITAL MARKETING

Check Your Progress – Quiz – 1

Q1. The capital market in India is controlled by?

(a) RBI
(b) NABARD
(c) SEBI
(d) IRDA

Answer: c

Q2. SEBI was established in which year?

(a) 1990
(b) 1989
(c) 1992
(d) 1988

Answer: d

Q.3 How many companies are included in the BSE Sensex?

(a) 25
(b) 30
(c) 50
(d) 111

Answer: b

Q4. Which among the following does not belong to the stock exchange?

(a) KPO
(b) IPO
(c) NSE
(d) NAV

Answer: a

Q5. Which among the following is not an objective of SEBI?

(a) To regulate securities market
(b) To protect interests of inventors
(c) To promote individual businesses
(d) To promote the development of the market

Answer: c

Q.6. Which of the following are responsible for the fluctuations in the Sensex?

(a) Monetary policy
(b) Political instability
(c) Rain
(d) None of the above

Answer: a

Q.7 Nifty was established in which year?

(a) 1952
(b) 1965
(c) 1996
(d) None of these

Answer: c

Q.8 Which of the following is a global stock market index?

(a) Sensex

(b) FTSE100

(c) OTCEI index

(d) Nifty

Answer: b

Q.9 The money market where debt and stocks are traded and maturity period is more than a year is known as

(a) Long-term market

(b) Counter market

(c) Capital market

(d) Shorter term market

Answer: c

Q10.The regulatory body for the securities market in India is

(a) Stock exchanges

(b) IRDA

(c) RBI

(d) SEBI

Answer: d

1.3 UNIT SUMMARY

Capital markets are financial markets that bring buyers and sellers together to trade stocks, bonds, currencies, and other financial assets. Capital markets include the stock market and the bond market. They help people with ideas become entrepreneurs and help small businesses grow into big companies.

For a more detailed overview, check out our online module, Capital Markets. Content includes an understanding of capital markets, financial assets such as stocks and bonds, primary and secondary markets, financial capital and risk. After completing this module, viewers will understand the role of capital markets in the economy and will be able to explain why savers, businesses, governments and entrepreneurs participate in capital markets

1.4 GLOSSARY

Derivative	The term derivative refers to a type of financial contract whose value is dependent on an underlying asset, group of assets, or benchmark. A derivative is set between two or more parties that can trade on an exchange or over-the-counter (OTC).
Liquidity	Liquidity refers to the efficiency or ease with which an asset or security can be converted into ready cash without affecting its market price.
Bid ask spread	Bid-ask spread is the amount by which the ask price exceeds the bid price for an asset in the market. The bid-ask spread is essentially the difference between the highest price that a buyer is willing to pay for an asset and the lowest price that a

	seller is willing to accept.
Margin	Margin is the money borrowed from a broker to purchase an investment and is the difference between the total value of an investment and the loan amount.
Market index	A market index is a hypothetical portfolio of investment holdings that represents a segment of the financial market.
Value stock	Value stock refers to a company's stock trading at a lower price than its intrinsic or true value based on various financial metrics and fundamentals

1.5 SELF ASSESSMENT

Easy Type Questions

1. Who controls the Capital Market in India?
2. Who regulates the Capital Market in India?
3. Why do we need Capital Market?
4. What is difference between primary market and secondary market?
5. What is secondary market with example?
6. What is an example of a secondary transaction?
7. What is the role of secondary market?
8. How is price decided in a secondary market?
9. What is the main function of secondary markets?

1.6 CASE STUDY

An aspiring Manager, who wanted to set up his own business, examined the different ways to start his own business.The solution he original favored was a managed account structure, as he needed a solution with a fast time-to-market as well as low costs. Since he wanted to set up his asset management business from scratch.

At second glance, however, he found a lot of disadvantages: on the one hand, this account structure was only suitable for a very small number of clients. On the other hand, on boarding was very complicated as he would always need a proxy. MIFID 2 and the new reporting requirement posed another problem because it would create a potential administrative nightmare for the manager and could be very time consuming. Worse yet, with a managed account structure, he would not have been able to produce a proven track record over time.

When he approached us to learn more about the alternative structure we offered – the ETI Solution – he was quickly convinced of the benefits. The ETI is a publicly traded security and can be purchased by the client's broker via DVP or on the stockexchange. This setup is suitable for many new customers and the ETIs can be offered publicly with a minimum investment of € 1,000 or through private placement.

Upon request, we will prepare the yearly PRIIPS required for distribution to private customers. This means that the manager is deprived of the entire administrative nightmare. Since the ETI is a certified structure, the manager can build up a proven track record. Now, with iMaps ETIs, the manager has a very competitive and cost-effective solution and can focus on managing and selling his product.

1.7 TASK

Discuss the following points:

- Capital markets are used primarily to sell financial products such as equities and debt securities.
- A career in the capital market involves helping companies raise funding by selling stock to investors

1.8 E- CONTENT

S.No	Topic	E- Content Link
1	Meaning and definition of capital market	https://youtu.be/W2fljyHQa7M?si
2.	Role and importance of capital market	https://youtu.be/bvUwfnYWjbk?si=_K8NOg4M1LRI9Voz
3.	Stock exchange	https://youtu.be/GT_auP0fh90?si=cS1n3cFJtXY15Oxd
4.	E- Book	https://www.drnishikantjha.com/booksCollection/Ch%205%20The%20Capital%20Market.pdf

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UNIT II

MUTUAL FUND

Self –Learning Material Development –Stage -1

Introduction to Mutual Fund
Mutual Fund- Meaning – How Do Mutual Fund Work, Ways/Mode Of Mutual Funds Investment – How To Investment In Mutual Funds ET-Money- Future And Benefits – Function– Objective – Scope – Type Of Mutual Funds – Disadvantage Of Mutual Funds

Unit Modules Structuring

- Mutual Fund- Meaning
- How Do Mutual Fund Work
- Ways/Mode of Mutual Funds Investment
- How To Investment In Mutual Funds ET-Money?
- Future And Benefits of mutual funds
- Function and Benefits of mutual funds
- Objective of mutual funds
- Scope of mutual fund
- Type Of Mutual Funds
- Disadvantage Of Mutual Funds

2.1.1 MEANING OF MUTUAL FUNDS

A mutual fund functions as an entity that gathers funds from numerous investors and allocates them into various securities like stocks, bonds, and short-term debt instruments. The collective assets held by the mutual fund are referred to as its portfolio.

How Do Mutual Funds Work?

To understand how mutual funds work, let us first understand the concept of NAV (Net Asset Value). NAV per unit is the price at which investors can buy or redeem their mutual fund investments. Investors in mutual funds are allotted units proportional to their investments and this is calculated based on the NAV. For example, if you invest Rs 500 in a mutual fund with an NAV of Rs 10, you will get (500/10), 50 units of the mutual fund.

Now, the NAV of the mutual fund changes every day based on the performance of the assets in which the mutual fund is invested in. If a mutual fund invests in a particular stock whose price goes up tomorrow, the same will reflect in the NAV of the mutual fund and vice versa. So, in the above example, if the NAV of the mutual fund goes up to Rs 20, then your 50 units that amounted to Rs 500 earlier will now amount to Rs 1000 (500 units x Rs 20). Hence, the mutual fund's performance is driven by its underlying assets, which generate its returns to investors.

So, if you redeem your mutual fund units, you shall receive Rs 1000 against the Rs 500 you originally paid. This gain of Rs 500 is known as a capital gain. The market value of the mutual fund portfolio is not fixed but varies every day; consequently, NAV also tends to change daily, based on the valuation of the fund portfolio. Hence, this gain of Rs 500 can be a loss also, depending on how the NAV moves and the underlying assets perform. Since mutual fund investments are market-linked, the returns are not guaranteed and are also, dynamic in nature.

Mutual fund returns (capital gains) are subject to tax, known as capital gains tax. Capital gains tax will impact when you choose to redeem your investment; like in the example above you will be liable to pay a tax on the Rs 500 you have earned. Bear in mind two things though:

The capital gains tax is applicable only if you redeem the investment and not if you stay invested.

The extent of capital gains tax will depend on the types of mutual funds and your investment holding.

Mutual funds are subject to short-term capital gains tax (STCG) and long-term capital gains tax (LTCG). The periods of short-term and long-term capital gains tax are defined differently for mutual funds.

Mutual Funds – Concept And Role In India

Mutual Funds have become a major investment vehicle for Indian investors today. With an AUM of Rs.26,00,000 crore and an equity AUM of nearly 1/3rd of the total corpus, mutual funds have surely come a long way. What exactly is a mutual fund and how do they fit into the investment structure in India?

A mutual fund is a vehicle to mobilize money from investors. The money so collected is invested in equities, bonds, short term liquid instruments, gold etc to give the investors the benefit of growth, wealth creation, stability, regular income, liquidity or a mix of all. Every mutual fund scheme has an objective and its core purpose is to adhere to this objective. The objective in defined clearly in the memorandum of the fund and the trustee ensures that the fund adheres to the core principles laid out in the memorandum. By investing in a mutual fund, an investor can get access to markets that may otherwise be unavailable to them and avail of the professional fund management services offered by an asset management company. The concept of mutual fund is based on the twin ideas of diversification of risk and professional management. Direct equity investing is limited by the size of your corpus and by collating funds from thousands of individuals, the mutual fund overcomes that problem.

Important Role Played By Mutual Funds In The Indian Capital Markets

- Mutual funds perform different roles for the different constituents that participate in it. Here are some of the important roles played by them.
- Primary role of the mutual fund is to assist investors in earning an income or building their wealth
- Mutual funds are flexible and can structure a scheme for different kinds of investment objectives. It can target needs like wealth creation, regular income, liquidity, tax efficiency, macro defence etc.
- The money raised from investors helps the markets to get quality inflows, the investors to earn wealth and the market overall benefit by the surge in the equity cult among the investors.
- Mutual funds also help companies raise funds through debt by investing in their debt instruments. This facilitates capital allocation and ensures that productive projects are able to get funds.
- Mutual funds are in a better position to keep a check on the operations of the investee company, compared to individual investors due to their networks, size and market intelligence.
- Mutual funds with their large corpus can play the role of stabilizing the volatility in the markets by bringing in the required stability. This is useful at times when there is panic in the market resulting in bouts of volatility.
- But the most important role that mutual funds play is to create wealth for the investors and allows them to build a reasonable corpus over a period of time.

Structure of A Mutual Fund.

Mutual funds are designed as a trust to raise monies through the sale of units to the public for the purpose of investing in securities including money market instruments or gold, in line with a well defined objective. There are some clearly demarcated units in a mutual fund like the sponsor, the AMC, the trustee etc. Let us look at the demarcation below:

- Mutual funds are constituted as Trusts and are governed by the Indian Trusts Act, 1882. For example HDFC Mutual Fund is a trust.
- The mutual fund trust is created by one or more Sponsors, who bring in the initial capital for the mutual fund business. HDFC is the sponsor of HDFC Mutual Fund.
- The beneficiaries of the mutual fund trust are the investors who invest in various schemes of the mutual fund. They collectively become the beneficiaries.
- The operations of the fund are governed by a Trust Deed executed between the sponsors and the trustees.
- The role of protecting the interests of the beneficiaries (investors) is that of the Trustees and is governed by the Trust Deed. The role of trusteeship is performed through a duly constituted board of trustees.
- Regular management of the schemes is handled by an Asset Management Company (AMC). The AMC is appointed by the sponsor or the Trustees e.g. HDFC AMC. The AMC acts within the power vested on it by the trustees.
- Custody of the assets of the scheme (equity, bonds, structures, gold etc rest with the duly appointed Custodian. The custodians are also appointed by the Trustees.
- The back-end record of investors and their unit-holding is given by the AMC to the Registrar & Transfer Agent (RTA), which also processes any corporate actions.

WAYS/MODES OF MUTUAL FUND INVESTMENT

An investor can invest in mutual funds in the following ways:

Lumpsum: When you want to invest a significant amount in a mutual fund in one go. For example, if you had a sum of Rs 1 lakh to invest then you could go in for lumpsum investment and invest the entire amount of Rs 1.0 lakh at one go in a mutual fund of your choice. The units allotted to you will depend on the NAV of that fund on that particular day. If the NAV is Rs 1000, you will end up getting 100 units of the mutual fund.

SIP: You also have the option to invest small amounts periodically. In the above example, say, you don't have Rs 1 Lakh but can commit to an investment of Rs 10,000 per month for 10 months, and you can align your investments with your cash flows. This way of investing is known as a Systematic Investment Plan (SIP). SIP encourages regular investment of fixed amounts bi-monthly, monthly, quarterly and so on, depending on your need and the options available with the mutual fund.This method of investing inculcates a discipline of investment and also eliminates any need to look for the right time to invest. Many investors try to time the market which generally requires considerable time and expertise. What a SIP does instead is to average out your costs and the investor doesn't need to time the market. When the NAV is low, it gets you higher units and vice versa. SIPs, when done regularly over the long term, can help you build a more considerable mutual fund investment corpus.The minimum amount for a lump sum and SIP investments are defined by mutual fund companies and can vary but can start at as low as Rs 100.

HOW TO INVEST IN MUTUAL FUNDS?

Broadly there are three ways to invest in mutual fund schemes:

- Through a Mutual Fund company's website
- Through a Mutual Fund distributor
- Through the ET Money

If you want to invest through a mutual fund company's website, you will need to sign up and create an account. Then follow the ensuing steps. However, there's a major challenge with this route.

Most likely, you will find schemes of different fund houses attractive. To invest in them, you have to sign up with each fund house. And that could be a huge hassle. It would also be challenging to track your investments and analyze them.

The second option is to invest via a mutual fund distributor. But this isn't a cost-effective way. You will pay a higher expense ratio, and, as a result, your returns will be lower.

A much simpler, more efficient, and effective way of investing in mutual fund schemes is the third option – through the ET Money platform.

All you need to do is sign up once and start investing in schemes from different AMCs. You can choose from various schemes of various Mutual Fund companies. More importantly, you will be able to do it at a lower expense ratio because ET Money is a direct investment platform.

You can also track your existing portfolio on ET Money. You can view all your old and new investments in one place, making it much simpler to track them and make better-informed decisions.

The ET Money investment platform also offers valuable details like the fund's past performance, returns consistency, downside protection, fund history, expense ratio, exit load, and other essential information.

How to Invest In Mutual Funds Via ET Money?

- Sign up using email and OTP.
- Select fund. Enter the investment amount. Choose the investment type: one-time (lump sum) or SIP.
- Enter PAN, and full name, and verify mobile number.
- Enter bank account details and select the payment mode. In the case of SIP, set up a mandate.
- Follow the KYC process, which includes a selfie and a live video. Provide essential details and eSign.
- The transaction is processed on verification of KYC documents.

What Are The Documents Required To Invest In Mutual Funds?

The documents for KYC (Know Your Client) include proof of address and proof of identity. Here is a list of officially valid documents (OVD) admissible.

PROOF OF IDENTITY:

- PAN Card (Mandatory)
- Voter ID Card
- Driving License

- Passport
- Aadhaar Card

Any other valid identity card issued by the Central or State Government

PROOF OF ADDRESS

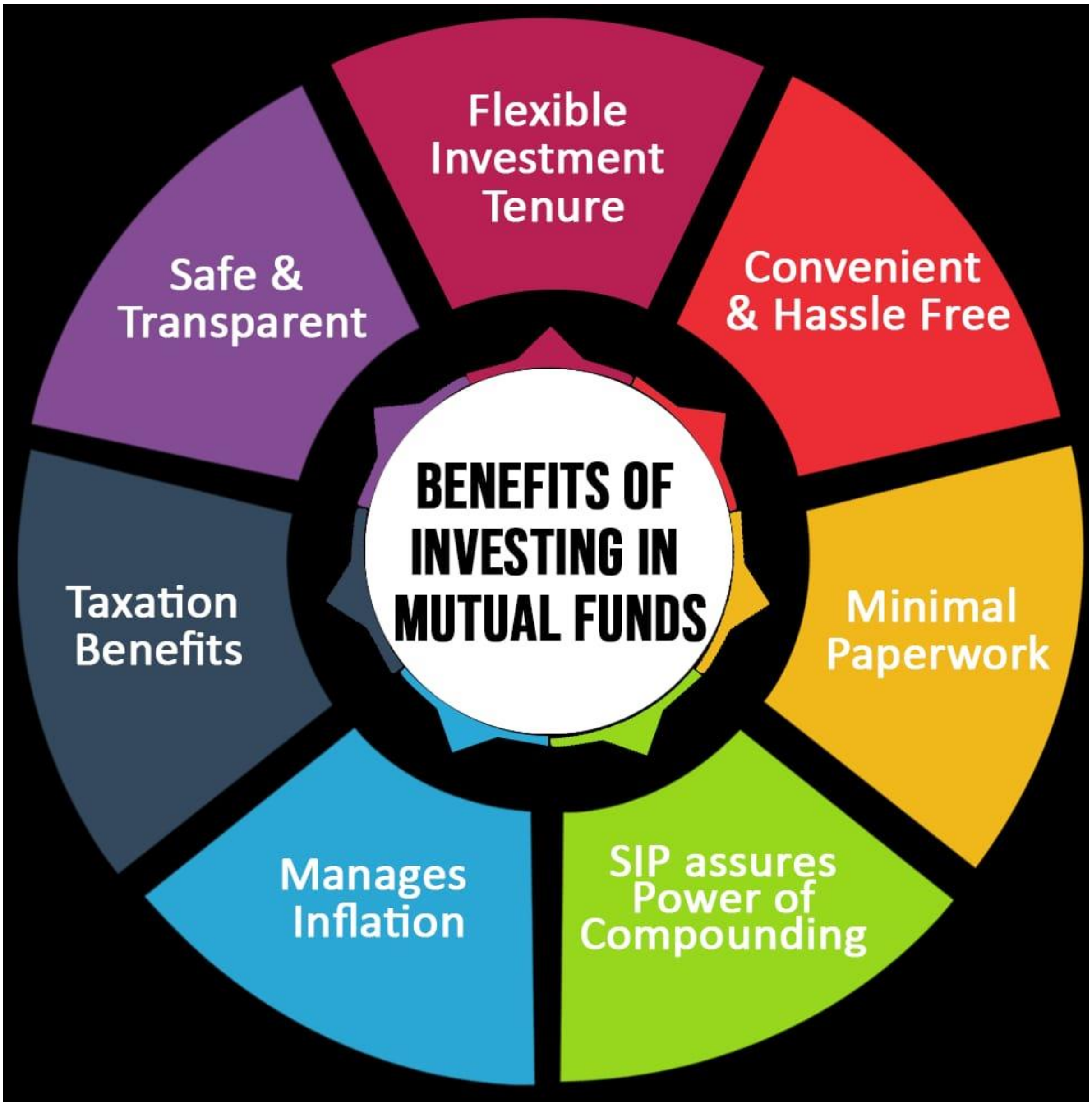
- Voter ID Card
- Driving License
- Passport
- Ration Card
- Aadhaar Card
- Bank account statement or bank passbook
- Utility bills like electricity or gas bills

While these are some of the standard documents, submitting all of these documents is a tedious process and can procrastinate your plan of investment. This is where ET Money offers you a paperless and fast solution.

You can submit your KYC in under two minutes by uploading photos of your identity and address proof. This includes PAN and any one of your Aadhaar, Voter ID, Driving License, and passport along with your signature, a selfie, and a live video authenticating your identity. ET Money's quick KYC application makes investing easy and hassle-free.

It takes about 3–5 working days to get your KYC verified as the verification is done by government-certified agencies.

2.1.2 FEATURES & BENEFITS OF MUTUAL FUNDS



Now that we know what mutual funds are and how they work along with their types, let us look at the advantages of investing in mutual funds.

Diversification: The saying ‘do not put all your eggs in one basket’ perfectly fits mutual funds as spreading investment across multiple securities and asset categories lowers risk. For example, compared to direct equity investing, where your funds are deployed in individual company stocks, equity mutual funds invest in a basket of stocks across sectors, thereby reducing risk.

Professional management: Mutual funds are managed by full-time, professional fund managers who have the expertise, experience, and resources to actively buy, sell, and manage investments. A fund manager continuously monitors investments and rebalances the portfolio accordingly to meet the scheme's objectives.

Transparency: Every mutual fund has a Scheme Information Document readily available on the fund house's website that can give you all the details about its holdings, fund manager, etc. In addition, the portfolio investment value (NAV) is published daily on the AMC site, and AMFI site for investors to track the portfolio of the mutual fund.

Liquidity: You can redeem your investments on any business/working day at the NAV of the day of your redemption. So, depending on the type of mutual fund you have invested in, you will receive your invested funds in your bank account in 1-3 days.
However, close-ended funds allow redemption only at the time of the maturity of the mutual fund. Similarly, ELSS mutual funds have a lock-in period of three years.

Tax Savings: Investment of up to Rs. 1,50,000 in ELSS mutual funds qualifies for tax benefit under section 80C of the Income Tax Act, 1961. Mutual fund investments, when held for a longer term, are tax-efficient.

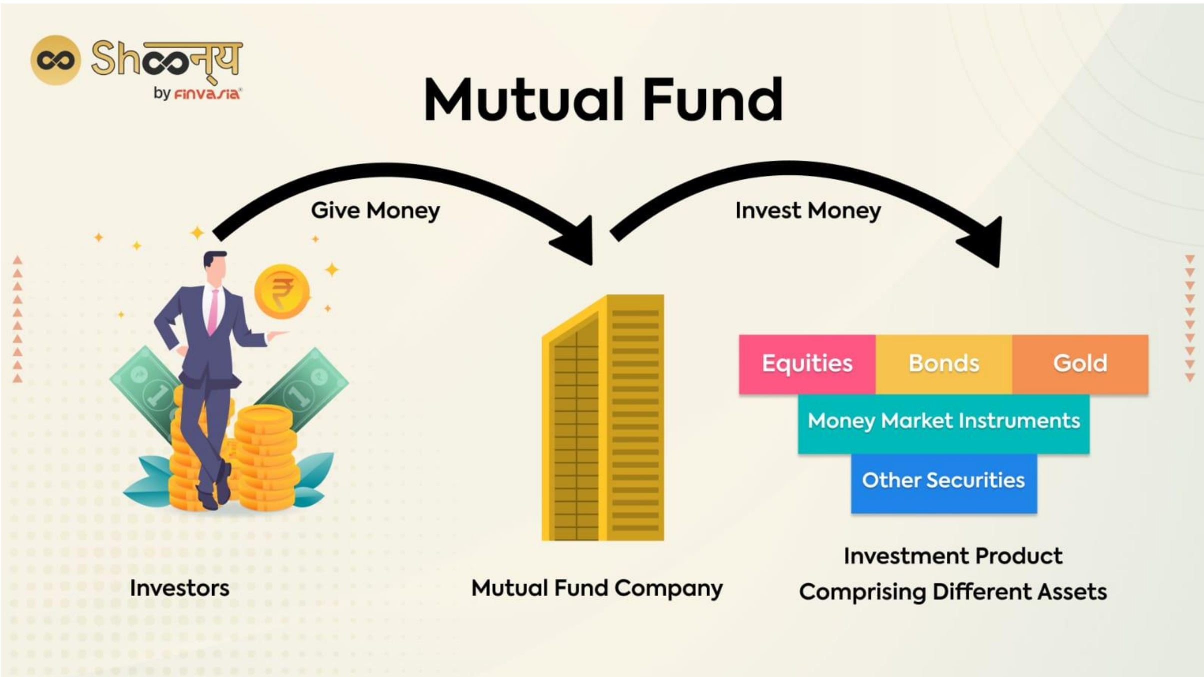
Choice: There are many options to invest in mutual funds to meet your different needs. To name a few- Liquid funds, are for investors looking to benefit from the safety of debt and low-interest rate risk, flexi-cap funds if you are looking for stock diversification, and solution-oriented mutual funds if you are looking to invest for a particular goal like retirement or children's education, etc.

Cost-effective: Mutual funds are a low-cost investment vehicle. The pooled investments from several investors in a mutual fund enable the fund to invest in a basket of stocks and debt securities which otherwise may be out of reach for the ordinary investor or require a higher investment amount. Thus, these pooled investments provide advantages of economies of scale. In return, lower costs to investors, such as brokerage, etc., are addressed in the minor form of fund expenses. This is why investing in direct mutual funds through ET Money makes sense because that helps you decrease the cost further.

Returns: Mutual fund returns are not assured by mutual funds and are subject to market risks. But over the long term, equity mutual funds have the potential to deliver double-digit returns annually. Debt funds can also offer higher returns as compared to bank deposits. You can also calculate your potential returns, using a mutual fund calculator.

Well Regulated: In India, the mutual fund industry is regulated by the capital market regulator Securities and Exchange Board of India (SEBI). Therefore, mutual funds must follow stringent rules and regulations, ensuring investor protection, risk mitigation, liquidity, and fair valuation.

2.1.3 CHARACTERISTICS OF MUTUAL FUNDS



A diversified portfolio of high-performing mutual funds can provide an investor with an excellent vehicle for accumulating wealth. However, with thousands of possibilities to choose from, selecting the proper funds to invest in can be an overwhelming task. Fortunately, there are certain characteristics that the best-performing funds seem to share.

Using a list of basic characteristics as a way of filtering, or paring down, the massive list of all possible funds available for consideration can greatly simplify the task of fund selection, as well as increase the probability that an investor's choices become profitable.

1. Low Fees or Expenses

Mutual funds with relatively low expense ratios are generally always desirable, and low expenses do not mean low performance. In fact, it is very often the case that the best-performing funds in a given category are among those that offer expense ratios below the category average.

There are some funds that charge substantially higher-than-average fees and justify the higher fees by pointing to the fund's performance. But the truth is there is very little genuine justification for any mutual fund having an expense ratio much over 1%.

Mutual fund investors sometimes fail to understand how big a difference even a relatively small percentage increase in fund expenses can make in the investor's bottom-line profitability. A fund with a 1% expense ratio charges an investor with $10,000 invested in the fund $100 annually. If the fund generates a 4% profit for the year, then that $100 charge takes away a full 25% of the investor's profits. If the expense ratio is 2%, it takes half of the profits. But an expense ratio of 0.25% only takes 6% of the investor's total profit. In short, expenses are of critical importance for mutual fund investors, who should be diligent in seeking out funds with low expense ratios.

In addition to the basic operating expenses charged by all funds, some funds charge a "load," or a sales fee that can run as high as 6% to 8%, and some charge 12b-1 fees used to cover advertising and promotional expenses for the fund. There is no need for mutual fund investors to ever have to pay these additional fees, since there are plenty of perfectly good funds to choose from that are "no-load" funds and do not charge any 12b-1 fees.

2. Consistently Good Performance

Most investors utilize investing in mutual funds as part of their retirement planning. Therefore, investors should select a fund based on its long-term performance, not on the fact that it had one really great year. Consistent performance by the fund's manager, or managers, over a long period of time indicates the fund will likely pay off well for an investor in the long-run.

A fund's average return on investment (ROI) over a period of 20 years is more important than its one-year or three-year performance. The best funds may not produce the highest returns in any one year but consistently produce good, solid returns over time. It helps if a fund has been around long enough for investors to see how well it manages during bear market cycles. The best funds are able to minimize losses during difficult economic periods or cyclical industry downturns.

A large part of consistently good performance is having a good fund manager. Investors should review a fund manager's background, previous experience, and performance as part of their overall evaluation of the fund. Good investment managers do not usually suddenly go bad, nor do poor investment managers tend to suddenly become overachievers.

3. Sticking to a Solid Strategy

The best-performing funds perform well because they are directed by a good investment strategy. Investors should be clearly aware of the fund's investment objective and the strategy the fund manager uses to achieve that objective.

Be wary of what is commonly called "portfolio drift." This occurs when the fund manager drifts off course from the fund's stated investment goals and strategy in such a way that the composition of the fund's portfolio changes significantly from its original goals. For example, it may shift from being a fund that invests in large-cap stocks that pay above-average dividends to being a fund mainly invested in small-cap stocks that offer little or no dividends at all. If a fund's investing strategy changes, the change and the reason for it should be clearly explained to fund shareholders by the fund manager.

4. Trustworthy, With Solid Reputations

The best funds are perennially developed by well-established, trustworthy names in the mutual fund business, such as Fidelity, T. Rowe Price, and the Vanguard Group. With all the unfortunate investing scandals over the past 20 years, investors are well-advised to do business only with firms in which they have the utmost confidence in, in regard to honesty and fiscal responsibility. The best mutual funds are invariably offered by companies that are transparent and upfront about their fees and operations, and they do not try to hide information from potential investors or in any way mislead them.

5. Plenty of Assets, but Not Too Much Money

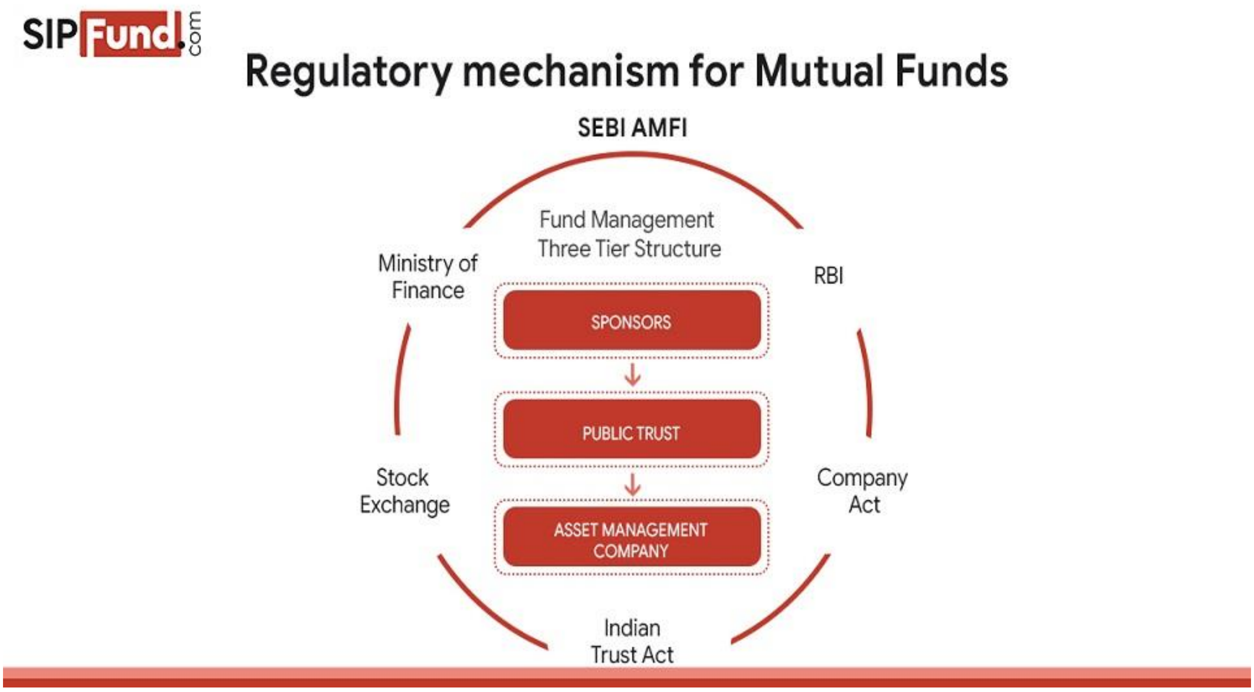
The best-performing funds tend to be those that are widely invested in but fall short of being the funds with the very highest amount of total assets. When funds perform well, they attract additional investors and are able to expand their investment asset base. However, there comes a point at which a fund's total assets under management (AUM) become so large as to be unwieldy and cumbersome to manage.

When investing billions, it becomes increasingly difficult for a fund manager to buy and sell stocks without the size of their transaction shifting the market price, so it costs more than they would ideally wish to pay to acquire a large amount of a specific stock. This can be particularly true for funds that seek undervalued, less-popular stocks. If a fund suddenly looks to buy $50 million worth of a stock that is ordinarily not very heavily traded, then the demand pressure injected into the market by the fund's buying could drive the stock's price substantially higher. This would make the stock less of a bargain than it appeared when the fund manager evaluated it prior to deciding to add it to the portfolio.

The same problem can occur when the fund seeks to liquidate a position in a stock. The fund may hold so many shares of the stock that when it attempts to sell them, the oversupply may put substantial downward pressure on the stock price so that, although the fund manager intended to sell the shares at $50 a share, by the time he is able to fully liquidate the fund's holdings of the stock, the average realized sale price is only $47 a share.

Investors may wish to look for mutual funds that are well-capitalized, indicating the fund has successfully drawn the attention of other individual investors and institutions but has not grown to the point where the size of the fund's total assets makes it difficult for the fund to be managed adroitly and efficiently. Problems in managing the fund's assets may arise as the fund's total assets grow beyond the $1 billion level.

2.1.4 REGULATORY MECHANISM OF MUTUAL FUNDS



Mutual funds are considered as the best avenue for multiplying the wealth by diversifying the risk amongst different asset classes. In this article, we will read about the regulatory mechanism of Mutual funds in India. To understand the regulatory mechanism, let us first have a look on the history of mutual funds in India.

The concept of mutual fund was introduced in the year 1963 when Unit Trust of India established its Mutual Fund in association with the Government and RBI. As people become aware of the investment in mutual funds, State Bank of India came up with its own mutual fund in 1987. It has been observed that mutual fund markets were largely dominated by the Government sector. Private companies showed interest to open their mutual funds and in 1993 many private players entered the mutual fund market. The Securities and Exchange Board of India (SEBI) started its operation as the regulator of capital market in 1996 but SEBI Act was passed in 1992. SEBI made it mandatory to get the certificates from Association of Mutual funds in India which was established in 1995. Mutual funds companies have grown exponentially in India.

As per the SEBI regulation 1996, Mutual Funds in India have a three-tier structure as mentioned below:

SPONSOR

The sponsor is simply the promoter of the mutual fund. The sponsor is entrusted with the responsibility of bringing in capital and make a mutual fund trust by setting up the AMC. The sponsor seeks approval from SEBI by making the application to register as a mutual fund. A sponsor is liable to contribute at least 40% of the net worth of the AMC. In simple words, a sponsor is the first pillar in formation of Mutual fund company. It is required that a sponsor should also have a 5-year experience in the financial services business and should be profitable for at least 3 out of the 5 years. A Bank, a corporate or a financial institution can be the sponsors for a Mutual fund company.

PUBLIC TRUST

Sponsor creates a public trust after getting registered with SEBI. The Public trust is made as per the Indian Trust Act 1882. However, it should get registered with SEBI first. Public trust, alone, has no legal identity in India as it is barred from entering into any contract by itself. Public trust has trustees who act on behalf of the trust. The sponsor and trustees sign a trust deed as per the Indian Regulation Act. The trust works like an internal regulator of the mutual fund and keeps a check on objectives mentioned in the deed.

ASSET MANAGEMENT COMPANY

Asset Management Company is the third pillar in the structure of a mutual fund. The trustees appoint Asset Management Company which pools money from investors and then manages it with the help of in house appointed mutual fund experts. The boards of directors of AMC works as per the rules laid down by SEBI and directions given by Trustees. An AMC floats variety of mutual fund schemes as per the requirement of markets. The AMC works as an investment manager for the trust. AMC charges small fees from its investors for managing their portfolio. It coordinates with brokers, auditors, bankers, registrars, lawyers, etc. by getting into an agreement with them.

SCOPE OF MUTUAL FUNDS

The scope of mutual funds has grown tremendously over the years. With the emergence of new AMC (Asset Management Companies) and the development of innovative mutual fund products, investors now have a wide range of mutual fund schemes to choose from.

Mutual funds play an important role for those without time to research the stock market and track their investments regularly.

Investors can choose from various types of mutual funds that offer different investment objectives and levels of risk. For example, Equity or stock funds invest in publicly traded stocks, while bond funds invest in government and corporate bonds. Money market funds invest in short-term, low-risk securities, while balanced funds invest in a mix of stocks and bonds. You can choose based on your needs.

Some specialized mutual funds invest in specific sectors such as healthcare, IT, FMCG, Green energy, or gold. For example, if you are optimistic about the IT sector and believe it will grow in the coming years, you can invest in an IT thematic mutual fund.

Nowadays, one can invest in a global mutual fund from India. Global mutual funds like S&P 500 and NASDAQ allow you to invest in international companies.

With the vast array of options available, investors must carefully evaluate before selecting a mutual fund. Proper research and consultation with a financial advisor can help investors make informed decisions and maximize their returns.

2.1.5 BENEFITS MUTUAL FUND

To understand mutual funds, let’s see how they function.

New fund offer (NFO) release: An AMC can start a mutual fund scheme by launching its NFO. It creates and shares the strategy of the scheme before its launch. Investors can then decide whether and how much they should invest. NFO units are often priced at a low ticket, such as Rs 10.

Pooling money: After the NFO, fund houses receive funds from interested investors to purchase shares in stocks, bonds, and other assets. Investors who didn’t participate in the NFO can still buy the units of the fund after it gets operational.

Investments in securities: The scheme’s strategy determines how the fund manager will invest the funds. The fund manager does extensive research on the economy, industries, and companies before making an investment decision. He then buys the most appropriate securities that will generate optimum returns for unitholders.

Return of funds: As mutual funds generate returns, the gains can be distributed among investors or retained in the scheme for further growth. Investors receive payouts if they choose the IDCW option (income distribution cum capital withdrawal). If they choose the growth option, the gains are retained in the scheme and allowed to grow further.

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OBJECTIVE OF MUTUAL FUND

Mutual funds seek to fulfill the following objectives for their unitholders:

Diversification: It is usually advised not to put all your eggs in one basket. Doing so can disproportionately increase your risk. Mutual funds are inherently diversified. They diversify across securities, assets, and even geographies. Hence, they help lower the risk.

Capital protection: Some mutual funds, such as money-market funds and liquid funds, aim to protect your capital. However, while they are relatively safer, they also have lower returns.

Capital growth: Certain mutual funds, such as equity funds, focus on growth to protect your investment against inflation. These funds invest in stocks and have higher returns but also come with higher risks.

Saving tax: A certain class of mutual funds, called equity-linked savings schemes (ELSS) or tax-saving funds, also provide income-tax deductions up to Rs 1.5 lakh in a financial year in the old income-tax regime.

DISADVANTAGE OF MUTUAL FUNDS

Now, let us have a look at the cons of investing in mutual funds.

Exit Load: Mutual funds generally levy an exit load (fee) for redeeming investments within a specified period, for example, one year from the date of investment. This is done to refrain the investor from exiting the scheme too early, as it impacts both the fund’s performance and the investor’s goal achievement. When investing directly in stocks, say, you do not face any exit load and in comparison, this may seem like an added expense. However, this has been introduced in the investors' interest.

High cost: SEBI has defined the maximum limit of expense ratios that mutual fund houses can charge and they depend on the mutual fund's size. As the size grows, the expense tends to come down. The maximum expense ratio that is chargeable for an equity-oriented mutual fund is 2.25%. And you have to bear this charge irrespective of the performance of the fund. When compared to another mode of investment, say, direct stocks, you may find the expense ratio to be higher than the brokerage you pay. But then it is being paid for the convenience and expertise, so, it is a balance that you need to achieve.

Over-diversification: In the quest to diversify your investments, you may invest in mutual funds, which invest in a vast number of stocks, leading to over-diversification. Not all the stocks of a portfolio would deliver high returns all the time. You may end up investing in two mutual funds holding similar portfolios which may then lead to over-diversification. It is advisable to study the mutual fund portfolio before you invest.

Risk: Investments in mutual funds are subject to market risk. The risk of losses faced by all types of securities in the financial markets cannot be reduced by diversification. Market risks may occur due to many macro and microeconomic factors. For example, equity mutual funds are subject to volatility risk owing to fluctuations in the stock market whereas debt mutual funds are subject to interest rate risk which is caused by fluctuations in the interest rates and so on.

DIFFERENT TYPES OF MUTUAL FUNDS:

MUTUAL FUND TYPES BASED ON ASSET CLASS, STRUCTURE, RISK & BENEFITS

Introduction:

Mutual funds are one of the most popular forms of investments available in the market today. Mutual funds operate at the behest of asset management companies (or AMCs) that pool together investments from multiple individuals along with institutional investors that each have similar investment objectives. Fund managers are responsible for keeping an eye out for and managing these pooled investments. Mutual funds serve as the perfect tool with which individual investors get exposed to portfolios managed by experts. Read on to understand the varied forms of mutual funds that exist in the country.

2.1.6 TYPES OF MUTUAL FUNDS

Diversify your investment portfolio with various Mutual Funds. There's a diverse range of options out there, each tailored to specific investment goals, risk levels, asset classes and structures. Whether you're aiming for growth, income or specialised investments, Mutual Funds provide versatile avenues to building wealth.

Types of Mutual Funds based on asset class

An asset class refers to a category of financial assets with similar characteristics and behaviors, such as stocks, bonds, real estate or cash equivalents. Discover diverse Mutual Funds categorized by an asset class.

Equity Funds: Equity Funds (Stocks): Equity Funds invest in shares of companies. For example, large-cap Equity Funds target well-established, large companies, while small-cap funds focus on smaller, high-growth businesses.

Debt Funds: Debt Funds (Bonds): Debt Funds invest in bonds, providing a steady income. They include categories like Government Bond Funds and Corporate Bond Funds.

Money Market Funds: Money Market Funds (Short-term securities): Money Market Funds invest in low-risk, short-term securities, such as Treasury bills and commercial paper.

Hybrid Funds: Hybrid Funds (Mix of assets): Hybrid Funds blend both stocks and bonds, like balanced funds that aim for growth and stability in a single package.

Types of Mutual Funds based on Investment goals:

These funds cater to specific financial objectives, offering diverse options to match the investors' unique goals.

Growth Funds: Growth Funds focus on capital appreciation by primarily investing in stocks of companies with high growth potential. They are suited for long-term investors seeking substantial returns.

Income Funds: Income Funds emphasis regular income generation by investing in bonds, fixed-income securities or dividend-yielding stocks. They suit investors looking for a steady income stream.

Liquid Funds: Liquid Funds priorities liquidity and safety, investing in short-term debt instruments. They are ideal for investors seeking quick access to funds with minimal risk.

Tax Saving Funds: Tax-saving funds, also known as ELSS, offer tax benefits under Section 80C. They invest primarily in equities and serve as a tax-efficient investment option.

Aggressive Growth Funds: Aggressive Growth Funds target substantial capital appreciation and are willing to accept higher market risks. They suit investors with a long-term horizon and a risk-taking approach.

Capital Protection Funds: Capital Protection Funds focus on safeguarding the principal amount while generating modest returns. They are ideal for risk-averse investors looking to protect their investments.

Fixed Maturity Funds: Fixed Maturity Funds have a predetermined maturity date, providing investors with a clear investment horizon. They are suited for those looking for fixed returns and minimal interest rate risk.

Pension Funds: Pension Funds aim to create a corpus for retirement by investing in a mix of assets. They cater to individuals planning for a secure post-retirement financial future.

Types of Mutual Funds based on structure

Mutual Funds are categorized by structure, influencing how investors buy and sell units. These structures include open-ended, closed-ended and interval funds.

Open-ended Funds: Open-ended Funds allow investors to buy and sell units continuously, providing liquidity. These funds are suitable for investors looking for flexibility in terms of entry and exit points and they are commonly used for long-term wealth creation.

Closed-ended Funds: Closed-ended Funds have a fixed maturity period and a limited number of units. Investors can buy units only during the initial offer period and they can trade these units on stock exchanges. These funds are ideal for those seeking long-term investments with potential tax benefits.

Interval Funds: Interval Funds combine features of open and closed-ended funds. They allow periodic redemption requests, typically at predetermined intervals. This structure suits investors looking for a balance between liquidity and long-term investments.

Types of Mutual Funds based on risk

Different Mutual Funds come with their own level of risk, from very low to high, offering choices for diverse investor profiles.

Very low Risk Funds: Very low Risk Funds, like Money Market Funds, primarily invest in low-risk securities. These are ideal for conservative investors seeking capital preservation and minimal fluctuations in the investment's value.

Low Risk Funds: Low Risk Funds, such as Government Bond Funds, aim for income generation with a slightly higher risk than very low risk options. They are suitable for investors with a slightly higher risk tolerance

Medium Risk Funds: Medium Risk Funds, like balanced funds, offer a balance between risk and reward by combining equity and debt investments. These suit investors seeking moderate growth with a manageable level of risk.

High Risk Funds: High Risk Funds, such as sector-specific Equity Funds, focus on capital appreciation with increased risk. These are for investors willing to accept higher volatility in pursuit of potentially higher returns.

Specialized Mutual Funds: Explore unique investment options to diversify and meet specific financial objectives with Specialized Mutual Funds

Sector Funds: Sector Funds focus on specific industries or sectors, allowing investors to target areas they believe will perform well.

Index Funds: Index Funds replicate a market index's performance, providing low-cost exposure to the overall market or specific segments.

Funds of Funds: Funds of Funds invest in other Mutual Funds, offering a diversified portfolio through a single investment.

Emerging Market Funds: Emerging Market Funds invest in developing economies, offering growth opportunities with a higher risk.

International/ Foreign Funds: International or Foreign Funds invest outside the investor's home country, diversifying risk and potentially boosting returns.

Global Funds: Global Funds combine domestic and foreign investments, offering a broad geographic diversification.

Real Estate Funds: Real Estate Funds invest in properties, providing exposure to the Real Estate market without buying physical assets.

Commodity-focused Stock Funds: Commodity-focused Stock Funds invest in companies related to commodities, allowing indirect exposure to the commodity market.

Market Neutral Funds: Market Neutral Funds aim to generate returns while reducing market risks by balancing long and short positions.

Inverse/Leveraged Funds: Inverse/Leveraged Funds aim to provide returns inversely related to an index's performance or amplify returns.

Asset Allocation Funds: Asset Allocation Funds automatically adjust the portfolio's allocation to maintain a specific risk-return profile.

Gift Funds: Gift Funds are designed for charitable giving, offering tax advantages to donors while supporting causes.

Exchange-Traded Funds: Exchange-Traded Funds (ETFs) combine elements of Mutual Funds and Stocks, providing liquidity and a diversified exposure.

Section 2.2MUTUAL FUNDS

Check Your Progress - QUIZ

1 .Which type of Fund is required to be listed on Stock Exchange?

a) Debit Fund
b) Liquid Fund
c) Close Ended Funds

2 .Funds which combined the features of an Open-Ended and Close-Ended funds are known as which of the following?

a) Interval funds
b) Balance funds
c) Specialty funds
d) None of the Above

3.Which of the following banks launched the first mutual fund in India?

a. State Bank of India
b. Canara Bank
c. Indian Bank
d. Bank of India

4.Which of the following organizations is the Mutual Fund market regulator in India?

a) SEBI
b) RBI
c) ICICI
d) CIBIL

5.What is the full form of NAV?

a) Net Assessment Value
b) National Asset Value
c) Net Asset Value
d) National Asset Value

2.3 UNIT SUMMARY

A mutual fund is an investment fund that pools money from many investors to purchase securities. The term is typically used in the United States, Canada, and India, while similar structures across the globe include the SICAV in Europe ('investment company with variable capital'), and the open-ended investment company (OEIC) in the UK.Mutual funds are often classified by their principal investments: money market funds, bond or fixed income funds, stock or equity funds, or hybrid funds.[1] Funds may also be categorized as index funds, which are passively managed funds that track the performance of an index, such as a stock market index or bond market index, or actively managed funds, which seek to outperform stock market indices but generally charge higher fees. The primary structures of mutual funds are open-end funds, closed-end funds, and unit investment trusts. Over long duration passively managed funds consistently overperform actively managed funds.[2][3][4]Open-end funds are purchased from or sold to the issuer at the net asset value of each share as of the close of the trading day in which the order was placed, as long as the order was placed within a specified period before the close of trading. They can be traded directly with the issuer.[5]Mutual funds have advantages and disadvantages compared to direct investing in individual securities. The advantages of mutual funds include economies of scale, diversification, liquidity, and professional management.[6] As with other types of investment, investing in mutual funds involves various fees and expenses.Mutual funds are regulated by governmental bodies and are required to publish information including performance, comparisons of performance to benchmarks, fees charged, and securities held. A single mutual fund may have several share classes, for which larger investors pay lower fees.Hedge funds and exchange-traded funds are not typically referred to as mutual funds, and each is targeted at different investors, with hedge funds being available only to high-net-worth individuals.

2.4 GLOSSARY

Mutual Fund	A mechanism through which like-minded investors come in to invest money, to make a very large sum. This large sum is then invested in diverse investments such as Equities, Debt or a combination of both. The Fund's objective and plan is mentioned in the Offer Document.
Trustee	Internal regulators in a mutual fund whose job is to ensure that the fund house is safeguarding the interests of the unit holders.
Unit holder	A person or entity who holds units in a scheme
Volatility	The relative rate at which the price of a security moves up and down.\
Yield	The dividends or interest paid by a security (stock, bond, fund, etc.) expressed as a percentage of the current price. It is calculated by taking the dividend amount and dividing it into the current price of the security.
Yield Curve	A curve that shows the relationship between yields and maturity dates for a set of similar bonds, usually Treasuries, at a given point.
Yield to Maturity	The yield of a bond to maturity takes into account the price discount from, or premium over, the face amount. It is greater than the current yield when the

	bond is selling at a discount and less than the current yield when the bond is selling at a premium

2.5 SELF-ASSESMENT

1. What Are The Five Categories Of Mutual Funds?
2. What Are The Functions Of Mutual Funds?
3. What Are The Three Objectives Of Mutual Funds?
4. What Is The Main Function Of Fund Managers?
5. What Are 3 Characteristics Of Mutual Funds?
6. What is a mutual fund portfolio?
7. How does an investor buy and sell mutual funds?
8. When can I start investing in mutual funds?
9. Does an individual need a PAN card to invest in mutual funds?
10. Is the NAV of a mutual fund?

2.6 Case Study

A Journey Towards Long-Term Financial Goals Imagine a young professional named Aisha who aimed to build a substantial corpus for her retirement, a distant yet crucial goal. Aisha wisely chose to invest in a diversified equity mutual fund that aligned with her risk appetite and long-term perspective. Over the years, through market fluctuations and economic cycles, Aisha held firm to her investment strategy. As she approached her retirement years, she found herself with a robust portfolio that not only beat inflation but also secured her financial future. Aisha's journey underscores the power of consistency and strategic thinking in achieving long-term goals.

2: Capitalizing on Sectoral Opportunities Rahul, a technology enthusiast, recognized the burgeoning potential of the technology sector. He decided to invest in a sectoral mutual fund focused exclusively on technology companies. His research and belief in the sector's growth prospects paid off handsomely. Over time, Rahul's investment witnessed substantial appreciation, and he realized impressive gains as the technology sector flourished. Rahul's success underscores the significance of aligning investments with personal insights and capitalizing on emerging opportunities.

2.7 TASK

Discuss the following points:

- The primary function of a mutual fund is to pool money from multiple investors and invest it in a diversified portfolio of securities, aiming to generate returns and spread risk across various assets
- A mutual fund is a company that pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt.

2.8 E-CONTENT

S.NO	TOPICS	E- CONTENT LINK
1	Mutual funds	https://youtu.be/PbldLCsspgE?si=pwa-FxMi3FqP9zDR
2	Characteristics of mutual funds	https://youtu.be/1d2m9yYxas0?si=RdLigfgjHJtkJKJT
3	Mechanism of mutual fund operation	https://youtu.be/gttQpFAloKM?si=4hxelr0PcS6wBBs_
4	Various schemes of mutual funds	https://youtu.be/AD4GcFfLnTA?si=NgEhIffpzFaPe4Kf

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UNIT III

DEPOSITERY SYSTEM

Self –Learning Material Development –Stage -1

Introduction to Depositary System
Depositary System- Meaning – Objective – Process – Feature- Roles – Function – Dematerialization – Meaning - Process – Benefit- scope-Advantages-disadvantages-types-process of Depositary

Unit Modules Structuring

- Depositary System meaning
- Objective of Depositary System
- Process of Depositary System
- Feature of Depositary System
- Roles in Depositary System
- Function of Depositary System
- Dematerialization Meaning
- Process of Dematerialization
- Benefit of Dematerialization

3.1 DEPOSITORY SYSTEM

3.1.1 DEMATERILIATION

MEANING:

The dematerialisation process is as given below: Dematerialisation of certificates begins with the opening of a Demat account. The shareholder can open a Demat account with a Depository Participant (DP) of his choice. The certificate holder must take a Dematerialization Request Form (DRF) from the DP and submit it..

The depository is nothing but **an organization where securities of the shareholders are kept.** It is kept there in the form of electronic. It is just like a bank but useful only for securities. Thus, whenever an investor wishes to avail the service, he/she can opt for the service by opening an account.

KEY TAKEAWAYS

A depository can be a facility or institution, such as a building, office, or warehouse, where something is deposited for storage or safeguarding.

Depositories also may be organizations, banks, or institutions that hold currency or securities and assist in the trading of securities.

They provide security, liquidity, and a means of transferring funds.

3.1.2 What is a Depository?

A Depository refers to a place or entity that holds financial securities in a dematerialized form. A bank, organization, or any institution holding and assisting in security trading is referred to as a depository. Depository accounts hold securities in the same way that bank accounts hold funds.

A depository can also be a place where something is held for safekeeping or storage. Hence, a depository can be an institution, a building, or a warehouse, that enables individuals and businesses to deposit any valuable asset for safeguarding. The money deposited in a depository is used for investing in some other securities and lending to other people or businesses; thus, providing liquidity in the exchange market.

OBJECTIVES OF THE DEPOSITORY SYSTEM

- It removes the occurrences of forgery, duplicate share certificates, and bad deliveries.
- This can increase the liquidity of securities by making a way for easy transfer
- Also, it can avoid the delay caused in the transfer of securities.
- Furthermore, it reduces the cost of a transaction for the investors.
- It enables withdrawal and surrender from the securities with great ease.
- It also maintains a perfect record of the holdings for an investor. This is because all the details are stored in electronic form.
- This also provides infrastructure for services in capital markets.
- By complying to global standards, it does attract foreign investors.

Functions of a Depository

1. Serves as a link between public companies and investors/shareholders

A depository functions as a connecting link between the public companies that issue financial securities, and the investors or shareholders. The securities are issued by agents associated with depositories, who are known as depository participants. The agents are responsible for transferring the securities from the depositories to the investors. A depository participant can be a bank, an institution, or a brokerage.

2. Eliminates risk related to owning physical financial securities

A depository allows traders and investors to hold securities in dematerialized form; thus, eliminating the risk related to holding physical financial securities. The buyers and sellers now do not need to check whether the securities have been transferred successfully without any loss or theft. The depository system reduces such risks by allowing the securities to be held and transferred in electronic form.

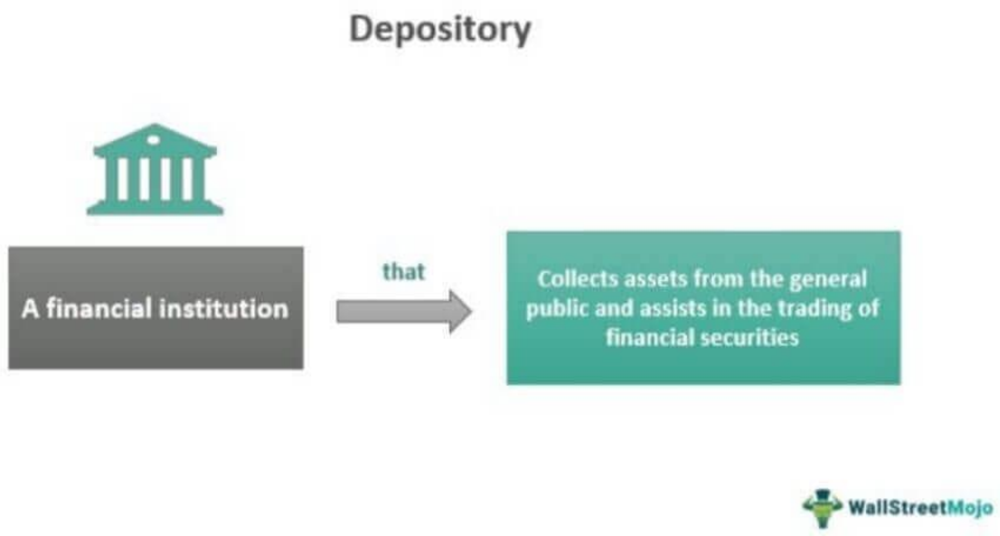
3. Allows the provision of loans of mortgages to interested parties

A depository holds the securities of customers and gives them back when the customers want. The customers receive interest on the deposits, while the depository earns even more interest by lending the deposits to other people or businesses in the form of loans or mortgages.

4. Reduced paperwork and accelerates the process of transferring securities

When a trade occurs, a depository transfers the ownership of securities from the account of one investor to another. It helps in reducing the paperwork associated with the finalization of a trade and accelerates the process of transfer of securities.

Types of Depository Institutions



1. Commercial Banks

Commercial banks are for-profit organizations and generally owned by private investors. The range of services offered by commercial banks depends on the size of the banks. For example, the services offered by the smaller banks are limited to consumer banking, small mortgages and loans, simple deposits, banking for small-business, and other services. The market range is also limited in the case of smaller banks.

On the contrary, larger banks and global banks offer a wide range of services such as foreign exchange-related services, money management, and investment banking. Some larger and global banks may also offer services for other banks and large organizations. The services offered by the large banks is the most diverse among all depository institutions.

2. Credit Unions

Credit unions are financial cooperatives implying that these depository institutions are owned by members of a particular group. The profits earned are either paid to the members as dividends or reinvested into the organization. The members of the credit unions are the ones that own accounts in the institution; hence, the depositors are also partial owners and receive dividends.

Since credit unions are non-profit institutions, they pay no federal or state tax. Hence, the interest rate charged by credit unions on loans is lower, and they pay a higher interest rate on deposits.

3. Savings Institutions

The banks serving a local community and loan institutions are called savings institutions. The local residents deposit money in the banks, and their money is offered back in the form of mortgages, consumer loans, credit cards, and loans for small businesses.

Savings institutions can sometimes be set up as corporations or as financial cooperatives allowing the depositors to get an ownership share in the organization.

DEMATERIALISATION OF SECURITIES:

Dematerialization is relatively a new concept introduced in the securities market. It is basically a process by which the physical certificates of an investor are taken/surrendered-by/to the company/registrar and actually destroyed and an equivalent number of securities are credited in the depository account of the investor on request of the investor. To overcome the problems associated with settlement of physical share certificates and to provide electronic depository facilities for securities traded in the equity and the debt markets, the process of dematerialization of shares was evolved.

DEFINITION:

Dematerialization is a process by which a client can get physical certificates converted into electronic balances maintained in its account with the depository participants. Securities held in dematerialization form are fungible Le they do not bear any distinguishable features.

The securities held in dematerialization form are fungible. They do not bear any distinguishable features like number, folio number or certificate number.

There are five main parties involved in the process of dematerialization as follows:

1) The Investor He is one who wishes to convert his physical holdings into electronic form.

2) Depository Participant It is a representative in the depository system and it maintains the client's securities account balance.

3) Depository Depository is an organization where securities of shareholders are held in electronic form at the request of the shareholder through the medium of the depository participant.

4) Registrar and Share Transfer Agents They provide the facility of dematerialization of shares of the company held by the shareholder. They enter into the tripartite agreement with NSDL and the company whose shares are to be dematerialized.

TO THE COMPANY:

- Less paper work.
- Reduced cost.
- Better and faster facility for share transfer.
- No legal consequences for non compliance of rules and regulations.

TO THE INVESTOR:

- Less paper work.
- No filing of transfer deeds and lodging.
- No bad delivery of shares.
- No loss of share certificates.
- No forgeries and frauds.
- Faster and easier trading of shares.
- Exemption of stamp duty.
- No courier/postal charges.

SECURITIES ELIGIBLE FOR DEMATERIALISATION:

The entire depository system in India is governed by the rules made by the market regulations SEBI. According to the SEBI (Depositories and Participants) regulations, 1996, the following securities are eligible for holding in dematerialized form.A list of securities available for demat in NSDL/CDSL depository is made known to all DP's by way of circulars sent through e-mails. The information is also put up on NSDL/CDSL website and in the monthly information bulletin.

HISTORY OF STOCK EXCHANGES:

The stock exchange operating in the 19th century were those of Bombay set up in 1875 and Ahmedabad set up in 1894. Those were organized as voluntary non-profit making association of brokers to regulate and protect their interests. Before the control on securities trading becomes a central subject under the constitution. in 1950, it was a state subject and Bombay securities contract (control) act of 1925 used to regulate trading in securities. Under this Act, the Bombay stock. exchange was reorganized in 1927 and Ahmedabad in 1937.

Constituents of Depository System:

1. Depository:

Depository functions like a securities bank, where the dematerialized physical securities are traded and held in custody. Tlus facilitates faster risk free and low cost settlement, Depository is much like a bank and performs many activities that are similar to a bank depository:Enables surrender and withdrawal of securities to and from the depository through the process of 'demat' and 'remat''.maintains investors' holdings in electronic form,Effects settlement of securities traded in depository mode on the stock exchanges, carries out settlement of trades not done on the stock exchanges (off market trades).

In India a depository has to be promoted as a corporate body under Companies Act, 1956.It is also to be registered as a depository with SEBI. It starts operations after obtaining a certificate of commencement of business from SEBI. It has to develop automatic data. processing systems to protect against unauthorised access. A network to link up with depository participants, issuers and issuer's agent has to be created.Depository, operating in India. shall have a net worth of rupees one hundred crore and instruments for which depository mode is open need not be a security as defined in the Securities Contract (Regulations) Act 1956. The depository, holding securities, shall maintain ownership records in the name of each participant. Despite the fact that legal ownership is with depository, it does not have any voting right against the securities held by it. Rights are intact with investors.

PROCESS OF DEPOSITORY SYSTEM:

Process of Depository: Companies which would like to issue the securities to the investor in the form of physical or through the depository. The company over here is called as an Issuer.

A depository helps in holding securities in the electronic form and also their transactions to be processed by book entry.

The process of physical transfer of certificates has many demerits. In absence of a depository system:

1. Every share transfer is required to be accomplished by physical movement of share certificates and registration with, the company concerned.

2. The process often involves long delays in settlements and a significant portion of transactions end up as 'bad delivery' due to faulty completion of paperwork.

3. Theft, forgery, mutilation of certificates and other irregularities.

4. The issuer has the right to refuse the transfer of a security. All this adds to costs and delays in settlement, restricted liquidity and made investor grievance redressal time consuming and, at times, intractable. Thus the limitations of having shares in physical form are:

5. High cost involved by way of postal charges, stamp duty, cost on paper work etc.

6. Depository system is a system wherein the securities of investors are held in the electronic form with the depository at the request of the investors and transfer of securities takes place by means of book entries on the ledger of the depository. The

system is also referred as the 'scripless trading system' as the system dispenses with the securities and its movement in the physical form

FEATURES OF THE DEPOSITORY SYSTEM

Securities in Dematerialized Form: Depository system provides for maintenance of ownership record of the securities of the investor in a book entry form.

The system immobilizes physical securities so that there is no physical certificate in existence.

Fungibility: In the depository system, the securities dematerialized are not identified by distinctive numbers or certificate numbers as in the physical environment. Thus all securities in the same class are identical and interchangeable.

Parties Involved: In a depository system, the parties involved are:

- The depository
- The depository participant (DP)
- The beneficial owner Chapter 35 Depository System 2

The issuer. The depository renders service connected with the recording of allotment of securities or transfer of ownership of securities in its record. A depository functions through depository participants who are the agent of the depository through whom the investors avail of the depository service. In the depository system, the ownership of securities dematerialized is bifurcated between Registered Owner and Beneficial Owner. For the securities dematerialized, depository is the Registered Owner in the books of the issuer (i.e. company).

Free Transferability of Shares: Transfer of shares held in dematerialized form takes place freely through electronic book-entry system. The system dispenses with the transfer deed and other procedural requirements with respect to transfer of securities.

No Stamp Duty: No stamp duty for transfer of securities in the electronic form is payable. In case of transfer of physical shares, stamp duty of 0.5 percent is payable on the market value of shares transferred.

No Risk: All risks associated with physical certificates such as delays, loss in transit, theft, bad deliveries, etc. eliminated in the depository system. Depositories curb the irregularities in the capital market and protect the interests of the investors and pave a way for an orderly conduct of the financial markets through the free transferability of securities with speed, accuracy, transparency etc. Functioning of Depository System The depository system functions as under:

The system envisages setting up of one or more depositories to hold securities of investors in the electronic form.

The depository functions through its agents, who are called Depository Participants (DP).

The investor, who wants to avail the services of the Depository, has to open a beneficiary account with the Depository through a DP. The account known as the "Demat" account can be opened with more than one DP.

After opening the demat account, the investor is required to dematerialize the securities held by him in the physical form. To dematerialize the securities, the investor has to fill the Dematerialization Request Form (DRF) and submit the same to the DP along with the security certificate. The DP through the Depository will intimate the company/issuer and surrender the security certificate. The process known as 'dematerialization takes about 30 days. 35. The issuer/company on receipt of the intimation shall cancel the security certificate and substitute the name of the Depository as the registered owner of the security.

The Depository on being intimated by the company/issuer, enters the name of the investor in its record as the beneficial owner of the security.

Whenever any rights, bonus or dividend is announced by a company for its particular security, the Depository would furnish all details of the investors having electronic holdings of that security on the record date. The disbursement of the rights, dividends etc. will be done by the company based the information provided. 8. In case of sale of the security under this mode, the investor/transferor (the client) has to intimate the DP through issuing a Delivery Instruction Slip (DIS) duly signed and containing the details of the security transaction. In case of purchase, the client will send the intimation to the DP giving details of the security purchased. The Depository on receiving the information through the DP will register the transfer of securities in the name of the transferee in its record.

DP will also make book entries in the account of the investor to record sale/purchase of securities.

DP is required to send statement of accounts to the clients at regular intervals, and update the account after each transaction.

The client/investor has to pay charges to the Depository and the DP for availing the services. Benefits of Depository System The following are the benefits for the investors:

Bad deliveries are almost eliminated.

The risks associated with physical certificates such as loss, theft, mutilation of certificate etc. are eliminated.

It eliminates handling of huge volumes of paper work.

There is immediate transfer and registration of the securities (at the end of every settlement cycle, which is 4 working days i.e. T+3) and you need not have to suffer delays on account of processing time.

It leads to faster settlement cycle and faster realization of sale proceeds so the fund of the investor is not tied up unnecessarily.

The system facilitates a faster disbursement of security holding benefits like rights shares, bonus shares etc.

The stamp duty on transfer of securities, which is 0.25% of the consideration on transfer of shares in physical form is not applicable.

Availability of periodical status report to investors on their holding and transactions is disseminated by the depository.

ROLE OF DEPOSITORIES

Depositories play a pivotal role in the Indian stock market by providing essential infrastructure and services that help in the efficient functioning of securities trading and settlement. Some of their key role includes:

Dematerialization: One of the primary functions of depositories is to convert physical securities (paper certificates) into electronic form, a process known as dematerialization. This process eliminates the risks and inefficiencies associated with physical certificates, such as theft, loss, forgery, and delays in transfer. Investors can hold their securities electronically in a demat account, which is similar to a bank account for securities.

Electronic Settlement: Depositories facilitate electronic trade settlement by enabling seamless securities transfer between buyers and sellers. When a trade occurs on a stock exchange, the depository ensures that the ownership of the securities is transferred from the seller's demat account to the buyer's demat account.

Centralized Record Keeping: Depositories maintain a centralized electronic record of all securities investors hold. This record includes details of the investor's holdings, transactions, and other relevant information. This centralization makes tracking and managing securities easier, reducing administrative complexities.

Transfer and Pledging of Securities: Investors can transfer securities held in their demat accounts to other accounts easily through depositories. Additionally, they can pledge their securities for obtaining loans by creating a pledge in favor of the lender. This process simplifies the collateral management system.

Corporate Actions: Depositories are crucial in facilitating corporate actions such as dividends, bonus issues, rights issues, and mergers. They ensure that investors receive the benefits and entitlements associated with their holdings promptly and accurately.

Reduction of Settlement Risks: By eliminating physical securities and streamlining the settlement process, depositories significantly reduce settlement risks, counterparty risks, and overall systemic risks in the stock market.

Interoperability: Depositories work closely with stock exchanges and clearing corporations to enable smooth settlement and interoperability between different market participants. This integration ensures that trades executed on one exchange can settle seamlessly through the depository, regardless of where the trading occurred.

IMPORTANCE OF A DEPOSITORY

1. Serves as a link between public companies and investors/shareholders

A depository functions as a connecting link between the public companies that issue financial securities, and the investors or shareholders. The securities are issued by agents associated with depositories, who are known as depository participants. The agents are responsible for transferring the securities from the depositories to the investors. A depository participant can be a bank, an institution, or a brokerage.

2. Eliminates risk related to owning physical financial securities

A depository allows traders and investors to hold securities in dematerialized form; thus, eliminating the risk related to holding physical financial securities. The buyers and sellers now do not need to check whether the securities have been transferred successfully without any loss or theft. The depository system reduces such risks by allowing the securities to be held and transferred in electronic form.

3. Allows the provision of loans of mortgages to interested parties

A depository holds the securities of customers and gives them back when the customers want. The customers receive interest on the deposits, while the depository earns even more interest by lending the deposits to other people or businesses in the form of loans or mortgages.

4. Reduced paperwork and accelerates the process of transferring securities

When a trade occurs, a depository transfers the ownership of securities from the account of one investor to another. It helps in reducing the paperwork associated with the finalization of a trade and accelerates the process of transfer of securities.

3.1.3.PROCESS OF DEMATERIALIZATION

The Dematerialization starts with **opening a Demat account**. So, let's first see how to create an account.

Select a depository participant (DP): Most financial institutions and brokerage service firms are referred to as Depository Participants.

Fill an account opening form:S You need to fill an account opening form to open a Demat account. This includes basic contact information.

Submit documents for verification: You need to submit a copy of your income proof, identity proof, address proof, active bank account proof and one passport-sized photograph for verification. All copies of documents need to be duly attested.

Sign a standardized agreement with the DP: A standardized agreement will contain the rules and regulations, charges you will incur and the terms and conditions of the agreement between you and the depository participant.

Verification of documents: A staff member from the DP will verify all the documents that you have submitted in your application.

Demat account number and ID are generated: Once all your documents have been verified, your Demat account number and ID will be generated. You can use this information to access your online Demat account.

BENEFITS OF DEMATERIALISATION

Easy and Convenient

A Demat account provides you the facility to carry out the transactions electronically. There is no need for you to be physically present at the broker's place to settle a transaction. Moreover, the investor can have access to the Demat account using a computer or smartphone. In addition, you can convert your physical holdings into electronic format to become the legal owner of your shares.

Fund Transfer

By linking your Demat account with the bank account you can easily transfer funds electronically. This saves you from the hassles of drawing a cheque or transferring the funds manually.

Safe and Secure

Demat account is the most secure and safest way to carry out transactions by electronic means. All the risks like theft, damage, loss of share certificates, etc. that were associated with holding shares in physical form are completely eliminated.

Nomination Facility

Demat account provides you the facility to grant the right to operate your Demat account to the nominee in your absence. With this facility, you can carry out transactions in your Demat account with the help of a nominee when you are not in a situation to do it yourself.

Paperless

One of the main benefits of using a Demat account is that it excludes the need for paper. Since the Demat account is about holding shares or securities in electronic form, the need for the paper is almost zero. In addition, the Demat account has also proved to be very useful for the companies in reducing their administrative costs and hassles. Furthermore, cutting down paper usage is also good for the environment.

Avail Loan Facility

The Demat account helps you in availing loans against the holdings in dematerialized form. The securities and shares held in Demat account can be kept as collateral and loan can be taken against them.

Easily Traceable

With the help of a Demat account, you can monitor your portfolio from your home, office or anywhere across the globe. The flexibility to be able to monitor the portfolio performance enhances the chances of you making more profits because of the increase in participation and interest.

Ease In Receiving Corporate Benefits

Demat account eases the process of receiving various corporate benefits like dividends, interest, refunds, etc. All the benefit amount gets directly credited into the Demat account. Moreover, other benefits like stock splits, bonus shares, rights shares, etc. get directly updated into the Demat account.

Multiple Purposes

In the Demat account, you can not only hold shares or equities but also debt instruments. You can even **purchase, hold and sell mutual fund** units through the Demat account. In fact, you can even purchase government bonds, exchange-traded funds, etc. in the Demat account.

3.1.4NSDC

Established in 2008, National Skills Development Corporation (Which is the NSDC full form) is a not-for-profit public limited company, incorporated under Section 25 of the Companies Act 1956. NSDC was set up by the Ministry of Finance, as an entity named 'Public-Private Partnership'. NSDC's primary focus is to promote skill development throughout the country. Funding provided by NSDC can be used for the working capital requirement for skill development activity and is not provided for buying or constructing any type of immovable property that includes land or building, etc.

Key Functions of NSDC

Provides funding to build accessible and profitable vocational training centers
Develop low-cost and high-quality business models
Enables a support system that emphasizes quality assurance and information systems
Directly training the trainer academies or via partnerships
Provides funding support to companies, enterprises, and organizations that promote and provide skill training and development
Develops suitable models to improve, support, and coordinate private sector initiatives

NSDC Courses

'Skill India Mission' was launched with the aim to train over 40 crore people by 2022. It is meant to provide various vocational and certificate courses for Indian youth for a better livelihood. There are many courses offered under various programs mentioned below:

- Industrial Training Institutes (ITI)
- NSDC Fee-based courses
- NAPS – Apprenticeship Training
- Pradhan Mantri Kaushal Kendra (PMKK)
- Technical Intern Training Program (TITP)
- Jan ShikshanSansthan.
- Introduction to Central Depository Services Ltd. (CDSL)

Central Depository Services Ltd., or CDSL as it is better known, is a central securities depository in India. It is a financial organization that serves as a godown for securities, shares and other tradable market instruments. The objective of the company is to provide a centralized space for all of its users: individual, institutional, financial companies, government, etc. that helps in making transactions, particularly electronic, much easier.

Understanding Central Depository Services Ltd.

CDSL maintains the book entry of all electronic transactions made to all depository participants (DP). DPs are agents of CDSL and they all hold their assets with the company for clearing, holding and settlement. The Beneficial Owner (BO), also called the investor, can open a dematerialization account (DEMAT) through the DPs to enable the transfer of the securities from the DP to the investor's account. CDSL as a depository service plays an essential role in everyday transactions. Where once physical certificates had to be issued to determine the ownership of a share, CDSL eliminates that need. CDSL also ensures that its DPs are accountable for the investors' data and dealings and provide detailed overviews to the BOs at intervals. On the other hand, at the time of issuing dividends, companies listed on BSE can consult CDSL on data about the shareholders and transfer the amount to them.

Highlights of Central Depository Services Ltd.

CDSL was promoted by the Bombay Stock Exchange as of December 2019, until BSE disinvested for CSDL to accept sponsors via leading banks of the country. CDSL holds shares listed on the BSE only, while its counterpart NSDL holds NSE's shares. CDSL was established in 1999. There are 600+ DPs registered with CDSL in comparison to 250+ on NSDL. This is likely because BSE is an older stock exchange and has significantly more companies listed on it for a longer time than NSE. The DEMAT number for CDSL is a simple 16-digit number, like an account number.

DEMATERIALIZATIN

3.2Check Your Progress - QUIZ

1. Appeal against the orders Securities and Exchange Board of India can be made to

_____.

(a) Central Government

(b) Securities Appellate Tribunal

(c) Registrar of Companies

(d) High Court

2. In case, a body corporate is applying for trading membership in the capital market segment of NSEIL,

(a) at least 5 directors should be graduates of whom one should be a professional.

(b) atleast two directors should be graduates and have minimum of 2 years experience of securities market.

(c) no prior experience is required.

(d) all the directors should be graduates.

3. What is the purpose of 'Trade Log' report on the NEAT system?

(a) There is no report as 'Trades Log' report.

(b) To show the trades that have only been cancelled or modified orders for the dealers belonging to a trading member for the current trading day.

(c) To show the details of the trade related activity by the trading member for a specific day.

(d) To show the trades that was done by the trading member for the last seven days.

4. In ASBA, the amount is blocked in

(a) Trading members account

(b) Investors own account

(c) Both A and B

(d) None of the above

5. The Capital Market Segment of NSE commenced operations in

(a) Sep-96

(b) Nov-94

(c) Aug-96

(d) Nov-96

6. _____ obligates the depositories to maintain ownership records of

securities and effect changes in such records electronically at the behest of the owner of the securities.

a) The Depositories Act, 1996

(b) The SEBI Act, 1992

(c) The Securities Contract (Regulation) Act, 1956

(d) The Companies Act, 1956

7. The first two characters in ISIN code for a security represents ___.

(a) issuer type

(b) security type

(c) country code

(d) company identity

8. Which of the following is true regarding the norms and procedures pertaining to surrender of membership ?

a) A trading member desirous of surrendering membership has to give its request in writing in a prescribed form

b) The original SEBI registration certificates for all trading segments have to be submitted by the trading member.

c) Sub-broker registration certificates have to be submitted

d) All leased lines and VSATs will not be dismantled for the surrendering trading member.

(a) a,b,c

(b) a,c

(c) a,d

(d) a,b,c,d

9. If the eighth and ninth character of the ISIN is mentioned as 04, what does it indicate

(a) security is security receipt

(b) security is non-convertible preference share

(c) security is a warrant

(d) security is equity share / mutual fund

3.2 UNIT SUMMARY

A depository allows traders and investors to hold securities in dematerialized form; thus, eliminating the risk related to holding physical financial securities. The buyers and sellers now do not need to check whether the securities have been transferred successfully without any loss or theft. A depository refers to a place or entity that holds financial securities in a dematerialized form, eliminating the risk related to holding physical financial securities .A depository functions as a connection between the public companies that issue financial securities and the investors or shareholders. A depository holds the securities of customers and gives them back when the customers want.

3.4 GLOSSARY

Allocation	Asset allocation means making changes in the formation of the investment portfolio either by adding new investments to meet the investor's objectives or by changing the portfolio's investments as the investor's objectives change or a change in the risk level or the time available
Diversification	Diversification is an investment strategy where an individual distributes his/her invested money on markets or industries or different securities. Diversification aims to protect the portfolio in case the returns of one of the sectors or securities are decreased.
Inflation	Inflation is the great and continuing rise of the prices of most goods and services. Inflation often accompanies periods of economic recovery
Volatility	Volatility refers to the extent and speed in which the stock prices, indices or the financial market indicators change within. When, for example, a share is volatile, it means that prices fall and rise sharply in short periods of time.
Share	A share is an investment that represents the ownership in a company and entitles the owner to earn a part of the

	company's profits and assets.

3.5 CASE STUTY

Indian capital markets played a major role in the mobilization of savings in the 1950s. Nevertheless, their importance diminished consider- ably during the period from 1960 to 1980. During the same period domestic savings as a proportion of national income increased substan- tially from 13.7 percent in 1960-61 to about 22 percent in the mid- 1980s. While funds raised from the capital market amounted to 13 percent of net domestic savings in the 1950s, they amounted to less than 1 percent in the late 1970s, 0.4 percent in the 1980s, and 4 percent in 1984 and 1985**.**

There were two major reasons why capital markets did not play a sig- nificant role in the financing of the industrial sector.

3.6.TASK

Discuss the following points

- Dematerialization is the process of converting your physical shares and securities into digital or electronic form.
- The process of buying, selling, transferring and holding shares and also about making it cost-effective and foolproof

3.7. E-CONTENT

S.NO	TOPIC	E-CONTENT LINK
1	DEPOSITERY SYSTEM	https://youtu.be/Goxf5wko6UE?si=3ixlGDAvIspKDLj1

2	DEMATERIALIZATION	**https://youtu.be/pw0L2KXu2gA?si=szZR66yy8EpSlUoB**
3	PROCESS OF DEMATERIALIZATION	**https://youtu.be/knpnKGEdjQw?si=eicF2_6anbr0WLqU**

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UNIT IV

SECURITIES AND EXCHANGE BOARD OF INDIA

Self-Learning Material Development – STAGE – 1

INTRODUCTION OF SEBI
Meaning-Definition-Objectives-Function-Purpose-Structure-Importance-Role-Scope-Advantages-Disadvantages-Functions

Unit Module Structuring

- Meaning of SEBI
- Role of SEBI
- Objectives of SEBI
- Scope of SEBI
- Types of SEBI
- Functions of SEBI
- Meaning of an Investor
- The significance of protecting Investors
- Meaning of Investor Protection
- What is SEBI and how SEBI Protects Investor Right?
  Investor Protection Measures of SEBI
- Procedure for Resolving Investor Complaints
- Important Point of consideration for Investors
- Challenges faced by SEBI regarding Investor Protection Measures of SEBI

4.1.1 Meaning of SEBI

SEBI stands for Securities and Exchange Board of India. It is a statutory regulatory body that was established by the Government of India in 1992 for protecting the interests of investors investing in securities along with regulating the securities market. SEBI also regulates how the stock market and mutual funds function.

4.1.2 OBJECTIVES OF SEBI

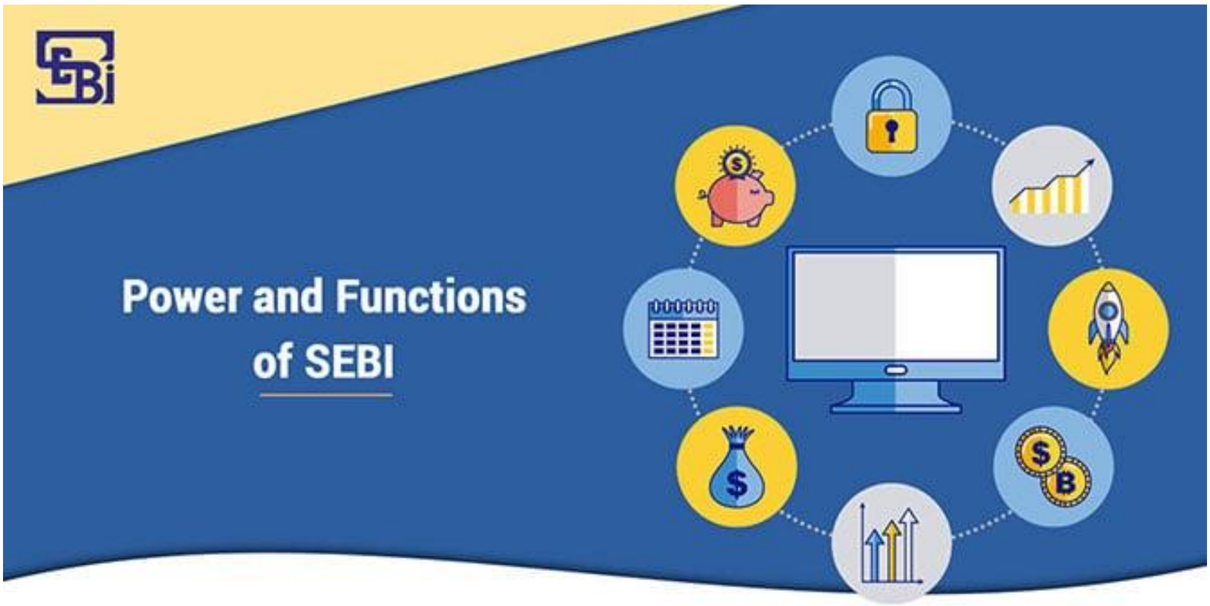
Investor Protection: This is one of the most important objectives of setting up SEBI. It involves protecting the interests of investors by providing guidance and ensuring that the investment done is safe.

Preventing the fraudulent practices and malpractices which are related to trading and regulation of the activities of the stock exchange

To develop a code of conduct for the financial intermediaries such as underwriters, brokers, etc.

To maintain a balance between statutory regulations and self regulation.

4.1.3 FUNCTIONS OF SEBI



SEBI has the following functions

1. Protective Function

2. Regulatory Function

3. Development Function

The following functions will be discussed in detail

Protective Function: The protective function implies the role that SEBI plays in protecting the investor interest and also that of other financial participants. The protective function includes the following activities.

Prohibits insider trading: Insider trading is the act of buying or selling of the securities by the insiders of a company, which includes the directors, employees and promoters. To prevent such trading SEBI has barred the companies to purchase their own shares from the secondary market.

Check price rigging: Price rigging is the act of causing unnatural fluctuations in the price of securities by either increasing or decreasing the market price of the stocks that leads to unexpected losses for the investors. SEBI maintains strict watch in order to prevent such malpractices.

Promoting fair practices: SEBI promotes fair trade practice and works towards prohibiting fraudulent activities related to trading of securities.

Financial education provider: SEBI educates the investors by conducting online and offline sessions that provide information related to market insights and also on money management.

Regulatory Function: Regulatory functions involve establishment of rules and regulations for the financial intermediaries along with corporates that helps in efficient management of the market.

The following are some of the regulatory functions.

- SEBI has defined the rules and regulations and formed guidelines and code of conduct that should be followed by the corporates as well as the financial intermediaries.
- Regulating the process of taking over of a company.
- Conducting inquiries and audit of stock exchanges.
- Regulates the working of stock brokers, merchant brokers.

Developmental Function: Developmental function refers to the steps taken by SEBI in order to provide the investors with a knowledge of the trading and market function. The following activities are included as part of developmental function.

- Training of intermediaries who are a part of the security market.
- Introduction of trading through electronic means or through the internet by the help of registered stock brokers.
- By making the underwriting an optional system in order to reduce cost of issue.

4.1.4 PURPOSE OF SEBI

The purpose for which SEBI was setup was to provide an environment that paves the way for mobilsation and allocation of resources. It provides practices, framework and infrastructure to meet the growing demand.

It meets the needs of the following groups:

Issuer: For issuers, SEBI provides a marketplace that can utilised for raising funds.

Investors: It provides protection and supply of accurate information that is maintained on a regular basis.

Intermediaries: It provides a competitive market for the intermediaries by arranging for proper infrastructure.

4.1.5 STRUCTURE OF SEBI

- SEBI board comprises nine members. The Board consists of the following members.
- One Chairman of the board who is appointed by the Central Government of India
- One Board member who is appointed by the Central Bank, that is, the RBI
- Two Board members who are hailing from the Union Ministry of Finance
- Five Board members who are elected by the Central Government of India

ADVANTAGES OF SEBI

SEBI regulates every player in Indian capital market to protect the interest of investors. One of the main objectives of SEBI is developing the Indian capital markets by enforcing rules and regulations.

The Securities and Exchange Board of India (SEBI) is a statutory body that regulates the commodity and financial market in India. The Ministry of Finance holds ownership of SEBI. SEBI drafts regulations according to its legislative capacity, and it conducts investigation and enforcement action in executive function. It passes the rulings and orders in its judicial capacity. SEBI is responsible for ensuring that the requirements of investors, market intermediaries and securities issuers are fulfilled. This apex body is crucial for the interest of those who are interested in investing.

The basic objectives of SEBI are described by the Preamble of the Securities and Exchange Board of India. As per this description, SEBI's function is as mentioned:

> To protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental there to

Along with that, the following are the objectives of SEBI:

Safeguarding the Interest of Investors: One of the main objectives of SEBI is to educate investors on the methods to take necessary precautions. Along with that, SEBI facilitates investors to make informed decisions related to investments. SEBI has adopted measures such as the dematerialization of securities, T+2 rolling settlement, screen-based trading system. It has also framed regulations for regulating intermediaries, corporate restructuring, as well as the issue and trade of securities.

Facilitating Redressal of Investor Grievances: SEBI has a comprehensive mechanism for the redressal of the grievances of investors against listed companies and intermediaries. In case a company or intermediary does not redress the grievances of investors, SEBI sends reminders and also holds meetings. Appropriate enforcement actions are taken as per the law.

There is a comprehensive arbitration mechanism in the stock exchange and depositories for the resolution of investors' disputes. The investor protection fund helps in compensating investors if a broker is declared to be a defaulter. The depository repays the investors for loss due to negligence of the depository.

3. **Regulating the Stock Market:** Another objective of SEBI is to regulate Indian Capital Markets. The Capital Markets Division of Department of Economic Affairs administers the rules made within the bounds of SEBI. It carries out the following functions within the tenets of SEBI regulations:

- Regulating Capital markets through preventive measures
- Encouraging the formation of self-regulatory organizations
- Regulating the functions of stock exchange and security markets
- Formulating rules to prevent malpractices within the system
- Managing and controlling complaints division
- Promoting learning opportunities for investors

Developing Code of Conduct for Intermediaries of Mutual Funds: SEBI prioritizes the interests of investors, and therefore it takes steps to safeguard their interests. For this purpose, SEBI issues Mutual Fund Regulations and guidelines to ensure safe distribution, selling, and advertising practices. It also mandates mutual funds to adhere to SEBI guidelines for preparing literature related to any scheme. These schemes must be up to date in the form of SID, addenda, performance report, fact sheets, SAI, portfolio disclosure, and brochure.

POWERS OF SEBI

SEBI possesses quasi-judicial powers, allowing it to adjudicate on matters related to securities law violations. It has the authority to conduct hearings, examine evidence, and pass orders, ensuring a fair and impartial resolution of disputes within the securities market

There are three main powers of SEBI, including the following:

Quasi-Judicial: In case there are any financial frauds committed in the security market, SEBI has the authority to rule out judgments. This is to ensure transparency, fairness, and accountability within the securities market.

Quasi-legislative: SEBI also holds the power to protect its investors by managing rules to prevent malpractices within the securities market. These rules are related to insider reading, essential disclosure requirements, and listing obligations.

Quasi-executive: SEBI holds the power to examine and gather critical financial documents as evidence against violations. Based on the investigation, SEBI can impose rules, take legal actions and pass judgment as and when required.

FUNCTIONS OF SECURITIES AND EXCHANGE BOARD OF INDIA

SEBI has primarily three functions, including Developmental, Protective and Regulatory functions. Let us take a look at each of them:

Developmental Functions: SEBI performs these functions for promoting and developing activities in the stock exchange. As a part of the developmental functions, SEBI does the following:

Promoting the training of intermediaries of securities market

Permitting IPO of the primary market through the stock market

Reducing the cost of the issue for which SEBI has made underwriting optional

Permitting internet trading through a registered stock broker

Protective Function: Another crucial function of SEBI is to protect the interests of investors and to provide them the safety of the investment. For this purpose, SEBI performs further functions:

Prohibiting price rigging since this malpractice involves the manipulation of security prices to inflate or deflate market prices of securities.

Insiders have access to sensitive information of the company to which they belong. They use the privilege of having internal information to impact the prices of securities. SEBI protects the interest of investors by prohibiting insider trading.

It does not allow companies to prepare any statement that may mislead investors and induce the purchase and sale of securities.

Educating investors to help them evaluate securities of different companies and maximize the output by choosing the most profitable security.

Regulatory Functions: These are performed to regulate business in stock exchange. These include the following:

Regulating intermediaries such as brokers and underwriters on the basis of a code of conduct and set of rules

Conducting inquiries and auditing of stock exchange

Registering and regulating mutual funds

Bringing intermediaries under the regulatory purview and making private placement more restrictive

Regulating takeover of companies

Registering and regulating the working of stock brokers, sharing merchant brokers, trustees, and professionals associated with the stock exchange.

A COMPREHENSIVE GUIDE ON INVESTOR PROTECTION MEASURES OF SEBI

The Primary and Secondary Financial Markets are based on investors. They put their money into the stock market in order to support economic growth and market expansion, which will result in higher profits. The basic goal of investor protection is to ensure that investors are properly informed about their purchases, transactions, and corporate activities. The investors control the degree of activity. The Securities and Exchange Board of India (SEBI) was founded with the primary goal of defending the interests of securities investors. Promoting the growth and regulation of the stock market is one of the SEBI's goals. We will dive into great detail about **Investor Protection Measures of SEBI** in this article.

Before we move on to discuss about the **Investor Protection Measures of SEBI**, let's first discuss about who is Investor? So that we could have better understanding of the measures provided by SEBI.

MEANING OF AN INVESTOR

An investor is someone who contributes money to a project or business but does not actively manage or participate in its day-to-day operations. They can be either an individual or a legal entity. He is a person who makes investments in securities like shares, mutual funds, debentures, etc. to make money.

The securities market depends heavily on investors. An investor is someone who invests money in the hope of making a profit. For the financial markets to develop well, there must be strong investor protection. It is crucial to safeguard investors' interests, and doing so has a big impact on how an economy's financial system is set up. Investor protection includes a variety of policies put in place to safeguard investors' interests from fraud in the stock market, mutual funds, and other areas.

MEANING OF INVESTOR PROTECTION

A sign of assurance is the investor insurance money. Investor protection, to put it simply, means that, up to a certain extent, you will get your money back if the dealer declares bankruptcy or bows to extortion. When opening a trading account or a record with an internet dealer, it is an important factor to take into account. You typically receive financial backing security when you open an exchange account with a brokerage.

"Investor Protection," as defined by the SEBI Act, 1992, includes "protecting the interest of the investors in securities and promoting the development of and regulating the securities market, as well as for matters connected therewith or incidental thereto."

WHAT IS SEBI AND HOW SEBI PROTECTS INVESTOR RIGHT?

On April 12, 1992, the Securities and Exchange Board of India was established as a legally binding administrative organization.

The primary goal of SEBI is to manage and control the Indian commodity and securities markets while developing policies and regulations. SEBI's headquarters are located at Mumbai's Bandra Kurla Complex. The corporate structure of SEBI consists of various divisions, each of which is headed by an office head.

There are more than twenty divisions. These offices include those for company accounts, financial and strategy investigations, obligation and mixture protections, authorization, human resources, executive rumor, product subsidiaries market guidance, legal concerns, etc.

The primary purpose of SEBI is to protect the financial backers' interests in the protections market are as follows:

It manages the business while advancing the market for protections.

Stockbrokers, sub-dealers, Portfolio managers, speculators, experts in the stock market, brokers, trader financiers, trustees of trust deeds, recorders, guarantors, and other connected people can apply for and manage work through SEBI.

It regulates the actions of safes, members, guardians of safeguards, unidentified portfolio financial backers, and FICO rating agencies.

It prevents internal trade securities, such as fraudulent and absurd business practices in the insurance industry.

It guards against internal exchanges that are fake or unjustified, as determined by the market.

It ensures that financial backers are informed about the protection's markets' intermediaries.

It monitors significant company acquisitions and takeovers.

In order to ensure that the protections market is continually competent, SEBI engages in new efforts.

A wide range of market participants are covered by SEBI's regulatory framework, including listed companies, stock exchanges, brokers, and investment advisers. In order to guarantee accountability, fairness, and openness in the securities market, SEBI has adopted a number of regulations. These rules address topics including insider trading, transparency obligations, and market manipulation, among others.

To enhance investor protection in India, SEBI has also implemented a number of initiatives. Enhancing disclosure requirements is one of these measures' most crucial components. Companies must promptly and completely educate investors about their financial performance, corporate governance policies, and other pertinent information. In order to guarantee that they carry out their responsibilities with integrity and professionally, SEBI has also implemented stiffer rules for auditors and credit rating organizations.

Along with these steps, SEBI has regulated mutual funds and portfolio managers to guarantee that investors have access to a variety of investment options and that these options are managed by qualified and professional organizations. Additionally, SEBI has launched a number of efforts to enlighten investors of their rights and obligations and to motivate them to make wise investment choices.

INVESTOR PROTECTION MEASURES OF SEBI

To periodically ensure investor protection, SEBI has issued a number of procedures and measures. It has issued numerous directives, led numerous investor awareness campaigns, and established the Investor Protection Fund (IPF) to provide investors with compensation. We shall examine the SEBI's efforts for protecting investors in detail.

Section 11(2) of the SEBI Act, 1992 outlines the options SEBI has to carry out the law's mandate for investor protection. It contains:

Preventing unfair and deceptive trade practices in the securities the market.

Regulating significant share acquisitions and corporate takeovers.

Fostering and policing self-governing organizations.

Governing activity on stock exchanges and other securities markets.

Encouraging the education of investors and the training of securities market

intermediaries.

Registering them and governing their operation, including that of mutual funds and collective investment plans.

Simplifying the process for Transferring and Allocating Shares: A committee headed by Shri R Chandrasekaran, Managing Director of the Stock Holding Corporation of India Limited, was appointed by SEBI to recommend a process for hastening and streamlining share transfer and issuance. The committee distributed its draught report to a number of market intermediaries for their feedback. The report will be finalized and the required steps will be made to put the recommendations into practice based on the feedback we've gotten. It is anticipated that putting the committee's suggestions into practice will greatly lessen the difficulties investors are currently experiencing as a result of excessive share transfer delays and subpar delivery.

Unique Order Code Number: Every stock exchange has to make sure that a system is in place where each transaction is given a special-order code number, which is communicated to the client by the broker. This number must be printed on the contract note following the execution of the order.

Time Stamping of Contracts: Stock brokers are expected to keep track of the time the customer made the order and include that information in the contract note along with the time the order was executed. This will make sure that the broker executes the client's order with proper consideration and charges the correct price to the client, not profiting from any intraday price fluctuations.

Function of Sub-brokers: In the past, brokers have operated through a network of sub-brokers that serve as an essential link between them and investors. Only 1,798 sub-brokers have registered with SEBI, despite the fact that the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 require sub-brokers to be registered. The following steps have been taken in an effort to protect investors' interests and put sub-brokers under the regulatory control of SEBI and the stock exchanges:

Under the regulations and bylaws of the stock exchanges, efforts have been undertaken to reestablish the institution of remisier. A remisier, who is registered with the stock exchange, acts as a broker's agent. He is not, however, authorized to issue a contract or confirmation letter to his investor; rather, the broker does so, and as a result, the broker is fully responsible for that transaction. In this manner, the investor's interests in relation to the remisier or broker are safeguarded.

For all transfer deeds dated June 1, 1997 and later, stock exchanges would treat as bad delivery any transfer deeds bearing rubber stamps on the reverse that are not those of clearing members of stock exchanges, clearing houses, clearing corporations, SEBI registered sub-brokers, and remisiers registered with the stock exchanges.

If a sub-broker is not registered with SEBI, a stock broker may not conduct business with him. If a client is not registered with SEBI as a sub-broker or is not accepted as a remisier by the stock market, the broker is responsible for making sure they are not functioning in that role.

Fund for Investor Protection: The amount of compensation available for a single investor claim stemming from a member broker's breach of duty has already been raised to Rs. 1 lakh for major stock exchanges, Rs. 25,000 for smaller stock exchanges, including Gauhati, Bhubaneshwar, Magadh, and Madhya Pradesh, and Rs. 50,000 for all other stock exchanges.

Programme for Investor Awareness: The Securities Market Awareness Campaign was introduced by SEBI in 2003. These programmes are now regularly organized by SEBI to inform and raise investor awareness. The training covers important topics such investor protection funds, mutual funds, tax laws, portfolio management, and the SEBI grievance redressal system. Additionally, it offers workshops on derivatives, Sensex trading, and stock exchanges. In more than 500 cities across the nation, SEBI has now held similar workshops using a variety of media channels, including radio, television, print, and the internet.

Investor Education and Protection Fund (IEPF) : The Government of India established a fund called the Investor Education and Protection Fund (IEPF) under the Companies Act, 1956 as part of SEBI's investor safety initiatives. The act mandates that a corporation that has been in operation for seven years must transfer all unclaimed fund dividends, matured deposits and debt securities, share application funds, etc. to the government through IEPF.

Additional Measures: To protect the interests of investors in securities, SEBI has implemented a number of measures including a screen-based trading system, the dematerialization of securities, T+2 rolling settlement, and numerous regulations to control intermediaries' issuance and trading of securities, corporate restructuring, etc'.

PROCEDURE FOR RESOLVING INVESTOR COMPLAINTS

Investors' Services Cell (ISC) has been authorized by BSE to address investor complaints. By resolving investors' complaints against listed businesses or BSE members, the ISC has significantly contributed to increasing and preserving investors' trust and confidence.

Investors can file complaints in the Complaint specified format with the relevant Regional Arbitration Centre of BSE. The complaint process will be swiftly concluded if the appropriate complaint is filed at the relevant Regional Arbitration Centre.

Important Point of consideration for Investors

These are the following important point of Consideration for Investors:

Investors should only work with stock exchanges or intermediaries that have registered with SEBI.

All investment-related documents, including application forms, contract notes, and acknowledgment slips, should always be kept on file.

The copies of the documents that investors give to companies should always be kept on hand.

Important documents must be sent via registered mail or another trustworthy method to ensure delivery.

Before selling, they must confirm that they are in possession of securities.

They must make sure to provide trading members or agents with instructions that are clear and understandable.

They ought to use trading or investment methods that don't involve taking on much risk.

CHALLENGES FACED BY SEBI REGARDING INVESTOR PROTECTION MEASURES OF SEBI

There are still several issues that the Indian securities sector must address. The necessity to balance the interests of various stakeholders, including investors, issuers, and intermediaries, is one of the most pressing concerns.

SEBI must make sure that its policies and rules safeguard the interests of investors and other stakeholders while also fostering the growth of the securities market.

Another problem that SEBI faces is the necessity for greater cooperation among regulatory agencies.

SEBI needs to work closely with other regulatory authorities, including the Reserve Bank of India and the Ministry of Corporate Affairs, to ensure that its policies and rules are consistent with the country's broader regulatory structure.

SECURITIES AND EXCHANGE BOARD OF INDIA

4.2 Check Your Progress - QUIZ

1.The Chairman of Securities and Exchange Board of India is appointed by the ______.

a) Ministry of Finance
b) Reserve Bank of India (RBI)
c) Stock Exchanges
d) None of the above

Answer: a

2.The headquarters of the Securities and Exchange Board of India are in ______.

a) Mumbai
b) New Delhi

c) Kolkata
d) Chennai

Answer: a

3.Who is the Current Chairman of the Securities and Exchange Board of India?

a) C B Bhave
b) Ajay Tyagi
c) U K Sinha
d) None of the above

Answer: b

4.The Securities and Exchange Board of India meets the needs of ________.

a) Investors
b) Market intermediaries
c) Issuers of securities
d) All of the above

Answer: d

5.The total number of board members in the Securities and Exchange Board of India is __________.

a) 5
b) 7
c) 10
d) 9

Answer: d

6.The number of regional offices of the Securities and Exchange Board of India is ____________.

a) One
b) Three
c) Four

d) Two

Answer: c

7) The Chairman of the Securities and Exchange Board of India is appointed for a period of ______.

a) Four years
b) Three years
c) Five years
d) Two years

Answer: c

8.The Securities and Exchange Board of India was constituted on __________.

a) 10th July 1991
b) 11th October 1989
c) 12th April 1988
d) None of the above

Answer: c

9.Which of the following statements about the Securities and Exchange Board of India is correct?

a) One of the objectives of setting up SEBI was to protect the interests of investors.
b) SEBI was established under the Securities (Contract and Regulation) Act, 1956.
c) SEBI was formed from among the Directors of stock exchanges in India.
d) SEBI issued various rules and regulations to help bring monetary gains for investors.

Answer: a

10.The Securities and Exchange Board of India has a department for cases related to diversion of funds, resources and bank loans by promoters of a company. What is the name of that department?

a) Financial Corporation and Investigation Department
b) Corporation Finance Investigation Department
c) Funds and Stocks Investigation Department
d) Funds and Securities Investigation Department

Answer: a

11.Which of the following agencies conducts physical oversight of mutual funds and depositories?

a) Securities and Exchange Board of India (SEBI)
b) Non Banking Financial Company (NBFC)
c) Reserve Bank of India (RBI)
d) Association of Mutual Funds in India (AMFI)

Answer: a

12.Which of the following is not a public sector unit?

a) Reserve Bank of India (RBI)
b) Securities and Exchange Board of India (SEBI)
c) State Bank of India (SBI)
d) Industrial Development Bank of India (IDBI)

Answer: d

13.Which of the following is a function of the Securities and Exchange Board of India?

a) Promote fair practices and prohibit fraudulent activities related to securities trading.
b) Check price rigging of securities.
c) Prohibit insider trading by barring companies from buying their shares in the secondary market.
d) All of the above.

Answer: d

14.The Securities and Exchange Board of India has launched an online registration system for _____.

a) Participatory Notes
b) Infrastructure Investment Trust (InvIT)
c) Real Estate Investment Trust (REIT)
d) Both b and c

Answer: d

15.The Securities and Exchange Board of India has granted a unified license to ________ to operate in the commodity derivative and equity markets.

a) Non Banking Financial Company (NBFC)
b) Clearing members
c) Brokers
d) Both b and c

Answer: d

16.The Securities and Exchange Board of India has allowed celebrities to endorse __________.

a) Mutual Funds
b) Insurance
c) Stocks and shares
d) Dividends

Answer: a

17.The Securities and Exchange Board of India has announced regulations to tighten ________.

a) Investor trading
b) Algorithmic trading
c) Spot trading
d) None of the above

Answer: b

18.Which of the following is a function of the Securities and Exchange Board of India?

a) Conduct audits and inquiries of stock exchanges.
b) Supervise the process of taking over a company.
c) Control the working of merchant brokers and stockbrokers.
d) All of the above.

Answer: d

19.The Securities and Exchange Board of India Act was passed on _______.

a) 30th January 1982
b) 30th January 1987
c) 30th January 1992
d) 30th January 1990

Answer: c

20. The Chairman of the Securities and Exchange Board of India can be reappointed for a period of ______.

a) Two years
b) Three years
c) One year
d) None of the above

Answer: a

21.The Securities and Exchange Board of India Ombudsman was introduced in the year ________.

a) 2001
b) 2003
c) 2000
d) 2002

Answer: c

22.Which of the following is not an objective of the Securities and Exchange Board of India?

a) To become a platform that promotes businesses.
b) To regulate the securities market in India.
c) To encourage development of the securities market in India.
d) To protect investors from fraudulent activities.

Answer: a

23. Securities and Exchange Board of India had dropped the Ombudsman for the securities market in __________.

a) June 2021
b) May 2021
c) July 2021
d) None of the above

Answer: b

24.______________ has asked intermediaries and companies to make regulatory payments in digital mode.

a) Insurance Regulatory and Development Authority (IRDA)
b) Reserve Bank of India (RBI)
c) Securities and Exchange Board of India (SEBI)
d) None of the above

Answer: c

25.Which of the following is a function of the Securities and Exchange Board of India?

a) Making underwriting optional to reduce the cost of issue.
b) Training intermediaries who are part of the security market.
c) Introducing trading through electronic means with the help of registered stockbrokers.
d) All of the above.

Answer: d

4.4 Glossary

Protection	Protection is a way to protect traders/investors from adverse price movements in the market**.**
Bond	A negotiable certificate evidencing indebtedness - a debt security or IOU, issued by a company,municipality or government agency. A bond investor lends money to the issuer and, in exchange, theissuerpromises to repay the loan amount on a specified maturity date. The issuer usually pays thebondholder periodic interest payments over the life of the loan.:
Firm allotment	Allotment on a firm basis in public issues by an issuing company made to Indian and multilateral development financial institutions, Indian mutual funds, foreign institutional investors including non-resident Indians and overseas corporate bodies and permanent/regular employees of the issuer company
Financial crisis	Sharp, brief, ultracyclical deterioration of all or most of a group of financial indicators short term interest rates, asset (stock, real estate, land) prices, commercial insolvencies and failures of financial institutions

Demutualization	Process of transition from "mutually-owned" association to a company "owned by shareholders". In other words, transformation of the legal structure from a mutual form to a business corporation form. and privatisation of the corporations so constituted, is referred to as demutualization.
Depository	A system of organisation, which keeps records of securities, deposited by its depositors. The records may be physical or simply electronic records.
Credit rating agency	Credit rating agency means a body corporate which is engaged in, or proposes to be engaged in, the business of rating of securities offered by way of public or rights issue.
Credit Risk	The risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter. Credit risk includes pre-settlement risk (replacement cost risk) and settlement risk (Principal risk).
Chartist analysis	Using charts of financial asset price movements (often with the aid of additional descriptive statistics) to try to infer the likely course of future prices and

	thus construct forecasts and trading:
Bull Market	A rising market with abundance of buyers and relatively few sellers.

4.5 SELF ASSESMENT

1. Give a brief notes on SEBI.

2. What are the objective of SEBI?

3. Write a notes on function on SEBI.

4. What are the powers of SEBI? Explain.

5. Give a brief notes on SEBI guidelines for primary market & secondary market.

6. Brief explain the measures for investor protection.

4.6 Task

Discuss the following points

- Protecting the interests of Indian investors in the securities market. Promoting the development and efficient functioning of the securities market
- SEBI plays a crucial role in the Indian financial system by regulating the securities market, ensuring transparency, and protecting investors' interests

4.7 CASE STUDY

Referring to the allegation that Appellants made heavy net sales in the said scrips as compared to the total net sales at BSE/NSE during the period, learned Senior Counsel stated that the criterion of net sales as sought to be defined by the Respondent is flawed as the relevant criterion for determining the impact of the Appellants trading volumes on the price of a stock is to compute these trading volume as a percentage of the stocks daily traded volume at BSE/NSE, that the Respondent had deliberately chosen not to even explain or justify its concept of net sales and total net sales as a relevant touch stone/analysis method.

Shri Chinoy also rebutted the Appellants version that even the cumulative trading by the Appellants in all scrips of BSE showed a pattern of significant net selling during this period and the aggregate trading at BSE and NSE also showed substantial net sales on certain dates, citing factual position stated in para 5B.12 and 5B.13 of the appeal. Shri Chinoy referring to the Respondent�s finding that the Appellants� aggregate trading at BSE/NSE also showed substantial net sales on certain dates, stated that the Respondent has failed to consider the fact that the Appellant was a net buyer on other days in the same period. According to him out of the total 22 trading days in the period, the Appellant was a net buyer in 11 days; that the Respondent has deliberately and selectively relied on certain data to support a pattern, which it is fully aware does not exist. The observation that the cumulative trading by Appellant No. 3 showed a pattern of significant selling during this period, according to the learned Senior Counsel, is false as the Appellant had net sales and purchases on an equal number of days in this period of 11 days of net purchase and 11 days of net sales from 13.2.01 to 15.3.01, that even the size of the net purchases are high on certain days. He cited figures in support of this. He also submitted that there is no co-relation between the days when Appellant No.3 had the alleged significant net selling and the market movement on those days, that for example, 19.2.01 and 7.3.01 are mentioned in the impugned order as days on which the Appellants had substantial net sales but actually the market went up on those days. In this context the learned Senior Counsel referred to the statement on p.48 of the Memorandum of Appeal and pointed out the stock index movement to substantiate his point of view.

Shri Chinoy referred the statement of "daily combined BSE and NSE Turnover Position of the Appellants and the changes in the BSE sensex" furnished in the appeal and pointed out that there was no correlation in the index movement vis-à-vis the Appellants� trading.

Learned Senior Counsel submitted that reference/reliance by the Respondent of significant net sales made by the Appellants during arbitrarily selected time slots ranging from 8 to 18 minutes to show that the Appellants trading contributed to the fall in scrip prices is contrary to the factual position. He submitted that the Respondent had arbitrarily chosen the time slots in which it could fit its hypothesis , that the contention that the selection of time slots pertains to specific periods of substantial price fall in scrips is incorrect. By way of example he stated that the sale trade of Wipro in the time slot 10.09-10.13 on February 23 of 1699 shares (as against 5000 shares contented by the Respondent) saw the price of Wipro go up by Rs.6.35 during the period. Learned Counsel referred to the data relied on by the Respondent that the sale of 5000 shares of Wipro by the Appellants constituted 41.6% of the net sales in Wipro during the period 10:09-10:13 on February 23.

With reference to the charge that the Appellants created an artificial market by placing orders at prices beyond the prevalent traded prices and thereafter canceling the same, the learned Senior Counsel stated that orders were put in at prices different from the prevailing market prices, that limit orders always have to be put in a price different from the prevailing market price as that is the very definition of a limit order. A sell limit order is always placed at a price higher than the prevailing market price and a buy limit order at a price lower than the prevailing market price, that is what exactly the Appellants have done. He further stated that the fact that 90% of all the orders above 1000 shares transferred by the Appellants were through disclosed offers negates the charge of attempting to influence/depress the market prices by making large sale offers.

4.8 E – Content

S.NO	TOPIC	E-CONTENT LINK
1	SEBI	https://youtu.be/NhwWvzuh1NQ?si=hN5BUZNA1DRC1FOr
2	Purpose of SEBI	https://youtu.be/NhwWvzuh1NQ?si=hN5BUZNA1DRC1FOr
3	Investor	https://youtu.be/iQzftOrBPj0?si=AiTnQLnJ7F2HmKFh

4.9 Reference

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UNIT V

DERIVATIVES

Self-Learning Material Development – STAGE – 1

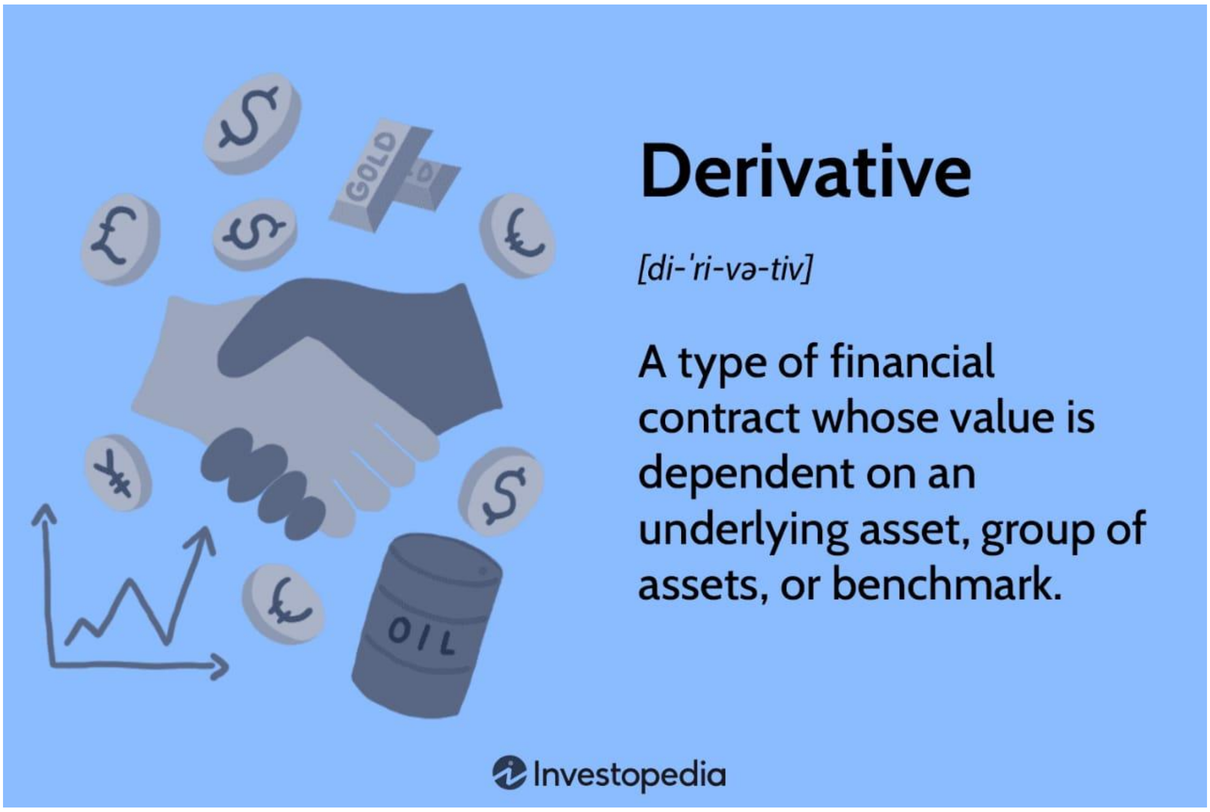
Introduction to Derivatives
Meaning of Derivatives-Objective – Process – Feature- Roles – Function – Characteristics for derivatives - Participant in derivatives market- Process – Benefit- scope- Futures of derivatives- Types of financial derivatives- Swaps of derivatives- Options of derivatives-Derivatives -Features of a Financial Derivative- Types of Financial Derivatives Basic Financial derivatives- History of Derivatives Markets -Uses of Derivatives - Critiques of Derivatives

5.1 DERIVATIVE

5.1.1 MEANING OF DERIVATIVE

Derivatives are contracts, and the value is determined by the underlying asset. These are frequently utilized to speculate and profit. Some people also utilized them to shift risk.

DEFINITION OF DERIVATIVES



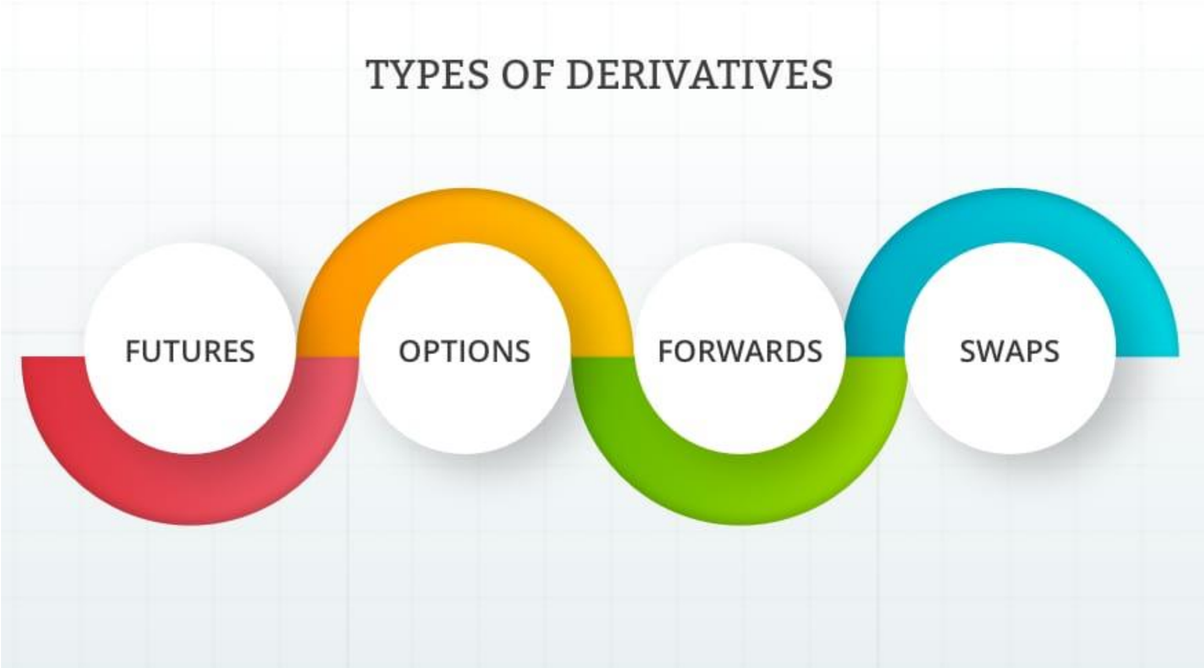
Derivatives are financial contracts, and their value is determined by the value of an underlying asset or set of assets. Stocks, bonds, currencies, commodities, and market indices are all common assets.

The underlying assets' value fluctuates in response to market conditions. The main idea behind getting into derivative contracts is to benefit by betting on the future value of the underlying asset.

Consider the possibility that the market price of an equity share will rise or fall. A drop in the stock value may cause you to lose money.

You can enter a derivative contract, in this case, to generate gains by placing an appropriate bet. Alternatively, you might simply protect yourself from losses in the spot market where the stock is traded.

5.1.4 TYPE OF DERIVATIVE



Mentioned here are the types of derivatives in the market-

1) Forwards

It is a tailored agreement between two parties to buy or sell an asset, a product, or a commodity at a defined price at a future date.

Forwards are not traded on any central exchanges but rather over-the-counter, and they are not standardized to be controlled. As a result, even if it does not guarantee any gains, it is largely effective for hedging and reducing risk.

Over-the-counter Forwards are also subject to counterparty risk. Counterparty risk is a type of credit risk in which the buyer or seller may be unable to fulfil his or her obligations.

If a buyer or seller goes bankrupt and is unable to fulfil his or her obligations, the other party may be without remedy to salvage his or her position.

2) Options

Options are financial contracts in which the buyer or seller has the option to buy or sell a security or financial asset but not the obligation to do so. Options are quite similar to futures.

It is a contract or agreement between two parties to buy or sell any form of security at a certain price in the future.

The parties, on the other hand, are under no legal responsibility to keep their end of the contract, which means they can sell or buy the security at any time.

It is simply an option provided to lessen risk in the future if the market is volatile.

3) Futures

Futures are financial contracts that are basically identical to forwards, with the main distinction being that features can be exchanged on exchanges, resulting in standardization and regulation.

They're frequently utilized in commodity speculation.

4) Swaps

Swaps, as the name implies, are exactly what they sound like. Swaps are a type of financial derivative used to convert one type of cash flow into another.

Swaps are private agreements between parties that are primarily exchanged over the counter and are not traded on stock exchanges.

Currency swaps and interest rate swaps are the two most popular types of swaps. An interest rate swap, for example, can be used to convert a variable-interest loan to a fixed-interest loan or vice versa.

HOW TO TRADE DERIVATIVES?

Every financial market is influenced by a variety of elements, including economic, political, and social concerns. Any one of these influencing elements is sufficient to induce a large market shift.

It is prudent to educate oneself completely on current market circumstances and the variables that are likely to influence them. As a result - you must be aware of these developments and be prepared ahead of time.

Introduction

The past decade has witnessed the multiple growths in the volume of international trade and business due to the wave of globalization and liberalization all over the world. As a result, the demand for the international money and financial instruments increased significantly at the global level. In this respect, changes in the interest rates, exchange rates and stock market prices at the different financial markets have increased the financial risks to the corporate world. Adverse changes have even threatened the very survival of the business world. It is, therefore, to manage such risks; the new financial instruments have been developed in the financial markets, which are also popularly known as financial derivatives.

The basic purpose of these instruments is to provide commitments to prices for future dates for giving protection against adverse movements in future prices, in order to reduce the extent of financial risks. Not only this, they also provide opportunities to earn profit for those persons who are ready to go for higher risks. In other words, these instruments, indeed, facilitate to transfer the risk from those who wish to avoid it to those who are willing to accept the same.

Today, the financial derivatives have become increasingly popular and most commonly used in the world of finance. This has grown with so phenomenal speed all over the world that now it is called as the derivatives revolution. In an estimate, the present annual trading volume of derivative markets has crossed US $ 30,000 billion, representing more than 100 times gross domestic product of India.

Financial derivatives like futures, forwards options and swaps are important tools to manage assets, portfolios and financial risks. Thus, it is essential to know the terminology and conceptual framework of all these financial derivatives in order to analyze and manage the financial risks. The prices of these financial derivatives contracts depend upon the spot prices of the underlying assets, costs of carrying assets into the future and relationship with spot prices. For example, forward and futures contracts are similar in nature, but their prices in future may differ. Therefore, before using any financial derivative instruments for hedging, speculating, or arbitraging purpose, the trader or investor must carefully examine all the important aspects relating to them.

Definition of Financial Derivatives

Before explaining the term financial derivative, let us see the dictionary meaning of

'derivative. Webster's Ninth New Collegiate Dictionary (1987) states Derivatives as:

1. A word formed by derivation. It means, this word has been arisen by derivation.

2. Something derived, it means that some things have to be derived or arisen out of the underlying variables. For example, financial derivative is an instrument indeed derived from the financial market.

3. The limit of the ratio of the change is a function to the corresponding change in its independent variable. This explains that the value of financial derivative will change as per the change in the value of the underlying financial instrument.

4. A chemical substance related structurally to another substance, and theoretically derivable from it. In other words, derivatives are structurally related to other substances.

5. A substance that can be made from another substance in one or more steps. In case of financial derivatives, they are derived from a combination of cash market instruments or other derivative instruments.

For example, you have purchased gold futures on May 2003 for delivery in August 2003. The price of gold on May 2003 in the spot market is 4500 per 10 grams and for futures delivery in August 2003 is 4800 per 10 grams. Suppose in July 2003 the spot price of the gold changes and increased to 4800 per 10 grams. In the same line value of financial derivatives or gold futures will also change.

From the above, the term derivatives may be termed as follows:

The term "Derivative" indicates that it has no independent value, ie., its value is entirely derived from the value of the underlying asset. The underlying asset can besecurities, commodities, bullion, currency, livestock or anything else.

In other words, derivative means forward, futures, option or any other hybrid contract of predetermined fixed duration, linked for the purpose of contract fulfillment to the value of a specified real or financial asset or to an index of securities.

Features of a Financial Derivatives

As observed earlier, a financial derivative is a financial instrument whose value is derived from the value of an underlying asset; hence, the name 'derivative came into existence. There are a variety of such instruments which are extensively traded in the financial markets all over the world, such as forward contracts, futures contracts, call and put options, swaps, etc. A more detailed discussion of the properties of these contracts will be given later part of this lesson. Since each financial derivative has its own unique features, in this section, we will discuss some of the general features of simple financial derivative instrument.

HERE'S HOW YOU CAN MAKE MONEY TRADING DERIVATIVES

Step 1: Before you can start trading in various types of derivatives, you must first open an online trading account. If you're trading derivatives through a broker, you can take orders over the phone or even online.

Step 2: You must pay a margin amount when you begin trading derivatives and their types, which you cannot withdraw until the contract is completed and the trade is concluded. Suppose your margin goes below the minimum permissible amount while trading; you will receive a margin call to rebalance it.

Step 3: Make sure you know everything there is to know about the underlying asset. Keep your budget in mind and make sure it's sufficient for fulfilling the financial requirements of the margin for trading, cash on hand, and contract prices.

Step 4: You should keep your investment in the contract until the trade is resolved.

Advantages of Derivatives

There are Lower Transaction Costs

When compared to other securities, such as stocks or bonds, trading in the derivatives markets has a low transaction cost. As derivatives are primarily used to control risk, they ensure lower transaction costs.

Hedging Risks

Hedging risk is the process of reducing risk in one's investment by forming a new one, and derivatives are the best way to do it.

Derivatives are utilized as insurance policies to mitigate risk, and they are typically used with the goal of reducing market risk.

5.1.3 PARTICIPANTS OF DERIVATIVES MARKET

Many of us invest our hard-earned money in the stock market by taking risks and thinking of making good returns. But a lot of us don't know that investing in the stock market can turn out to be risky due to price fluctuations of securities like currency, commodities, equity, etc.

During these times, anyone may end up losing all their money, and this can wipe out their entire investments within a fraction of seconds. However, several instruments can protect you from the volatility of financial markets.

These instruments not only protect traders from risk but also deliver guarantees to them. These instruments are none other than derivatives.

With the help of this article, let's understand what derivatives are and who can participate in the derivatives market.

What is a Derivative?

Financial contracts that get their value from a group of assets or underlying assets are called derivatives. Based on the market conditions, the value of the derivatives keeps on changing.

The prime motive behind entering into derivative contracts is to make a large chunk of profits by contemplating the underlying asset's value in the future.

Let's assume that you have invested in an equity share, and that particular share is quite volatile. Moreover, you may suffer a loss if the market falls due to a stock value downfall. In this case, you may enter into derivative trading through a derivative contract, either to make a profit by placing a bet on the exact value or just to rest from the losses you have faced in the stock market where the stock is being traded.

Who are the Participants in Derivatives Market?

Participants in the derivatives market can be classified into 4 categories based on their trading motives.

Speculators:

Speculators bear the risk in the market. They embrace risk to earn a profit. They have an opposite point of view as compared to the hedgers. This opinion difference helps them make huge profits if the bets turn correct. Let's say that you bought a put option to secure yourself from a fall in stock prices. Your counterparty, i.e. the speculator, will have to bet that the stock price won't fall. If it is so, then you won't exercise your put option. Therefore, the speculator keeps the premium and makes a profit.

Hedger:

Hedgers are risk-averse traders in the stock markets. They aim at derivative markets to secure their investment portfolio against market risk and price fluctuations. They do this by assuming the exact opposite position in the derivatives market. In this manner, they transfer the risk to those ready to take it. However, they have to pay a premium to the risk-taker for the hedging available. Let's understand with an example.

Suppose you hold 100 shares of a company ABC, which are currently priced at Rs 120, and you aim to sell these shares post 3 months, but you don't want to incur losses during these 3 months due to the fall in the market price. Also, you don't want to lose the opportunity to make profits by selling them at a higher price in the future. In this case, you can buy a put option by paying a nominal premium that takes care of both the above conditions.

Margin Traders:

Margin means the minimum amount you need to deposit with the broker to participate in the derivative market. It is used to reflect losses and gains daily based on market movements. It gives leverage in the derivative market and maintains a large outstanding position.

Arbitrageurs:

These use low-risk market imperfections to gain profits. They usually buy low-priced securities simultaneously in one market and sell them at a higher price in another market. However, this can only happen when the same security is quoted at different prices in different markets.

Different Types of Derivative Contracts in India

There are primarily four types of derivative trading in India: forwards, futures, swaps, and options.

Forwards:

These are just like futures contracts, but in this, the holders are under the obligation to perform the contract. However, forwards are unstandardized and not traded on the exchanges. These are available over the counter and are not marked market-to-market. Moreover, these can be customized to suit the parties' requirements of the contract.

Futures:

These are standardized contracts allowing the holder to buy or sell the asset at an agreed price at the specified date. The parties under the future contract are under the obligation to perform the contract. Moreover, these contracts are traded on the stock exchange, and the value of the contracts is marked on the market every day.

Swaps:

In a swaps contract, two parties exchange their financial obligations. The cash flows depend on the notional principal amount agreed by both parties without the exchange of principal. This amount of cash flow is based on a rate of interest. One cash flow is fixed, but the other keeps changing based on the benchmark interest rate. Interest swaps are the most commonly used category and are not traded on stock exchanges.

Options:

These derivative contracts allow buyers to buy/sell the underlying assets at the specified price. However, the buyer is under no obligation to exercise the option. The option seller is known as the option writer, and the specified price is the strike price.

Derivative contracts like forward, futures, options, and swaps are the best options to earn profits. The traders can analyze and predict the future price movement of their equity shares and accumulate huge profits out of these contracts.

How can Choice India help you

Derivatives trading in the Indian Derivatives Markets is the medium to leverage on foreseen market movements that allow you to buy/sell a specific amount of underlying financial assets at a given time in the future.

At Choice India, the clients are allowed to perform Futures Trading and Options Trading for higher growth rates acting as a well-balanced and preferred tool to hedge their risks, speculate, and earn fair profits in the shortest duration.

Get access to the aptest Fundamental Research and Technical Research for Derivatives Trading in the Indian Derivatives Markets.

Derivatives Direction:

A daily report that provides derivatives strategy. In this report, we pick open-interest data and stock-specific data while sharing key highlights on NIFTY options and FII & DII Derivative Statistics.

Aaj Ka Trend derivatives:

This derivative report covers stock-specific strategies and index-specific strategies in the Derivatives market.

What distinguishes option contracts from future and format contracts?

Options contracts vary from future and format contracts in that there is no requirement to discharge the contract on a certain date.

What exactly are derivatives?

Derivatives are financial contracts that get their value from a group of assets.

What exactly are forward contracts?

Forward contracts are agreements between two parties to acquire and sell an underlying asset at a predetermined date and agreed-upon price in the future.

Why are swap contracts so complicated?

The agreement in swap contracts is made secretly between the two parties. Because the investment banker operates as a middleman between these contracts, the parties that enter into swap contracts agree to exchange their cash flow in the future according to a predetermined formula.

Are derivatives safe?

Derivatives are utilized for risk hedging on a variety of underlies. However, trading derivatives alone entails risks such as market volatility, counterparty risks, connectivity hazards, and liquidity risk

5.1.5Types of Financial Derivatives

In the past section, it is observed that financial derivatives are those assets whose values are determined by the value of some other assets, called as the underlying. Presently, there are complex varieties of derivatives already in existence, and the markets are innovating newer and newer ones continuously. For example, various types of financial derivatives based on their different properties like, plain, simple or straightforward, composite, joint or hybrid, synthetic, leveraged, mildly leveraged, customized or OTC traded, standardized or organized exchange traded, etc. are available in the market.

Due to complexity in nature, it is very difficult to classify the financial derivatives, so in the present context, the basic financial derivatives which are popular in the market have been described in brief. The details of their operations, mechanism and trading, will be discussed in the forthcoming respective chapters.

DEVRIVATIVES

5.2 CHECK YOUR PROGRESS -QIUZ

1) The payoffs for financial derivatives are linked to

(a) securities that will be issued in the future.

(b) the volatility of interest rates.

(c) previously issued securities.

(e) none of the above.

(d) government regulations specifying allowable rates of return.

Answer: C

2) Financial derivatives include

(a) stocks.

(b) bonds.

(c) futures.

(d) none of the above,

Answer: C

3) Financial derivatives include

(a) stocks.

(b) bonds.

(c) forward.contracts.

(d) both (a) and (b) are true.

Answer: C

4) Which of the following is not a financial derivative?

(a) Stock

(b) Futures

(c) Options

(d) Forward contracts

Answer: A

5) Hedging a portfolio, a bank manager

(a) reduces interest rate risk.

(b) increases reinvestment risk.

(c) increases exchange rate risk.

(d) increases the probability of gains.

Answer: A

6) Which of the following is a reason to hedge a portfolio?

(a) To increase the probability of gains.

(b) To limit exposure to risk.

(c) To profit from capital gains when interest rates fall.

(d) All of the above.

(e) Both (a) and (c) of the above.

Answer: B

7) Hedging risk for a long position is accomplished by

(a) Taking another long position.

(b) Taking a short position.

(c) Taking additional long and short positions in equal amounts.

(d) Taking a neutral position.

(e) None of the above.

Answer: B

8) Hedging risk for a short position is accomplished by

(a) Taking a long position.

(b) Taking another short position.

(c) Taking additional long and short positions in equal amounts.

(d) Taking a neutral position.

(e) None of the above.

Answer: A

9) A contract that requires the investor to buy securities on a future date is called a

(a) Short contract.

(b) Long contract.

(c) Hedge.

(d) Cross.

Answer: B

10) Long contract requires that the investor

(a) Sell securities in the future.

(b) Buy securities in the future.

(c) Hedge in the future.

(d) Close out his position in the future.

Answer: B

11) A person who agrees to buy an asset at a future date has gone

(a) Long.

(b) Short.

(c) Back.

(d) Ahead.

(e) Even.

Answer: A

12) A short contract requires that the investor

(a) Sell securities in the future.

(b) Buy securities in the future.

(c) Hedge in the future.

(d) Close out his position in the future.

Answer: A

13) A contract that requires the investor to sell securities on a future date is called a

(a) Short contract.

(b) Long contract.

(c) Hedge.

(d) Micro hedge.

Answer: A

14) If a bank manager chooses to hedge his portfolio of treasury securities by selling futures contracts, he

(a) Gives up the opportunity for gains.

(b) Removes the chance of loss.

(c) Increases the probability of a gain.

(d) Both (a) and (b) are true.

Answer: D

5.3 Unit summary

The derivative is the first of the two main tools of calculus (the second being the integral). The derivative is the instantaneous rate of change of a function at a point in its domain. This is the same thing as the slope of the tangent line to the graph of the function at that point. In order to give a rigorous definition for the derivative, we need the concept of limit introduced in the preceding section.

Given a function f, we can define a derivative function f' to take on the value of the derivative of f at each point in the domain. For example, if Otis drives in a straight line from his home to Grand Rapids, Michigan, and the function f (t) gives his distance from home at time t, then the function f'(t) gives his "instantaneous rate of change", or his velocity, at time.

Once we have taken the derivative of a function f once, we can take the derivative again. This is called the second derivative of the original function f, and equals the "instantaneous rate of change of the instantaneous rate of change" of f. In the example above, this corresponds to how quickly Otis is speeding up or slowing down, that is, his acceleration. We can continue in this manner as long as we like, taking successive derivatives.In this SparkNote, we define derivatives and seek to develop an intuitive understanding of their meaning. In the following chapters, we will see how to compute derivatives and will explore some of their many applications.

5.4 GLOSSERY

Call option	: It is the right to buy a particular stock or index at a future date—settlement date—at a pre-fixed price (strike price). The market price for call option is called premium.
Time decay	Since the option contract is for specific number of days, its value keeps on coming down every day and the same is called time decay
Market lot	You can’t buy one share in the Futures & Options segment, and the minimum number of shares you can buy is called market lot.
Put option	It is the right to sell a particular stock or index at a future settlement date at the pre-fixed strike price. The market price

	for the put option is also called premium.
Out of the money option	Put options where strike price is below the price of the underlying security or call options where strike price is above of the underlying security. Here the premiums will be lower.
In the money options	Put options where strike price is above the price of the underlying security or call options where strike price is below price of the underlying security. Here premiums will be higher.
Option writing	While the option buyer gets the right to buy or sell a security, there is no obligation on him to do so. The option writer, on the other hand, has an obligation to trade and his reward is only the premium. So, option writers take unlimited risk for limited reward.
Hedging	Mutual fund managers sometimes use this technique. While we often say that, equity or mutual fund investment should be for the long term, there is no denying volatility is stressful and it can often trigger off panic selling.

5.4 TASK

DISCUSS THE FOLLOWING POINTS

- The derivative market functions through the trading of derivative contracts between buyers and sellers.
- Derivative contracts specify details including the underlying asset, amount, expiration date, price and other terms.

5.6 CASE STUDY

The speed at which Amarnath's energy derivatives portfolio accumulated mark to market losses has been astounding. Unpredictable market events caused the funds natural gas spread positions to record heavy losses. The prices behaviour and illiquidity in the markets also did not provide any economically viable means of exiting those positions for the hedge fund. Additionally, a relatively uneventful hurricane season in the year 2006 caused the MArch/April spread narrowed from 2.05 points on 1 september 0.75 points on 18th september.

After starting in 2006 with a $7.5 billion asset value, the fund showed a comfortable position of $9.2 billion in assets in April and eventually collapsed to less than $3 billion by the end of june 2006. On 14 september alone, it lost $565 millions. It suffered close to a $6 billion loss in september 2006 after huge concentrated positions in the natural gas market went wrong. The losses have forced the firm to sell its energy portfolio to Chicago based hedge fund citadel and JP Morgan.

5.7 E-CONTENT

S.NO	TOPIC	E-CONTENT LINK
1	DERIVATIVES	https://youtu.be/tYkqwIllFX4?si=4sedlfYPQmq5LD9-
2	TYPES OF FINANCIAL DERIVATIVES	https://youtu.be/tYkqwIllFX4?si=4sedlfYPQmq5L23-
3	FUTURE,OPTIONS,SWAPS	https://youtu.be/tYkqwIllFX4?si=4sedlfYPQmq5L19-

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