

NISM Series X-A: Investment Adviser Level 1

Debt Management and Loans

LEARNING OBJECTIVES: Debt Need & DTI • Leverage & Cost • Loan Types • EMI Calc • Restructuring • Debt Strategies

1 Overview of Debt — Why We Borrow

Asset Acquisition
Buy appreciating assets like property

Education
Fund skills that raise future income

Vehicle / Goods
Finance depreciating but essential assets

Emergency Bridge
Short-term cash-flow mismatch cover

Leverage Returns
Amplify investment gains (M&M theorem)

Business Growth
Working capital for ongoing operations

■ Debt is a Tool — Not Inherently Bad

Think of debt like a knife: useful when handled correctly, dangerous when misused. A home loan lets a 30-year-old own property two decades earlier than pure savings would allow. Revolving credit-card debt at 42% p.a. can destroy the same financial plan. The key question is always: What is the cost, and does the asset/return justify it?

2 Debt Impact on Cash Flow — Debt-to-Income Ratio

The **Debt-to-Income (DTI) Ratio** is the single most important indicator of debt health. It measures what portion of gross monthly income goes toward servicing all debts.

$$DTI = \frac{\text{Total Monthly Debt Payments}}{\text{Gross Monthly Income}} \times 100$$

General guideline: DTI below 35% is healthy; above 50% signals financial stress.

■ REAL-WORLD EXAMPLE — Arjun the Software Engineer

Arjun earns ₹80,000/month. He has a home loan EMI of ₹20,000, a car loan of ₹8,000, and a personal loan of ₹6,000. $DTI = \frac{(20,000 + 8,000 + 6,000)}{80,000} = 42.5\%$. This is manageable but leaves little room for emergencies. An adviser would recommend eliminating the personal loan (highest rate) first, bringing DTI to 35% — a much healthier level.

4.2.1 Consumption vs. Investment Expenditure

Type	Definition	Examples	Adviser Action
Consumption	Spent, no future asset created	Dining, salon, vacations, gadget upgrades	Limit to available surplus

Investment	Creates future income-generating asset	Mutual fund SIP, property purchase, bonds	Prioritise before discretionary
Blended	Looks like expense; has future value	Children's education, upskilling courses	Treat as priority investment

The Income Formula: **Income – Savings = Expenses** (not Income – Expenses = Savings). Pay yourself first via auto-SIP before spending on discretionary items.

3 Leverage, Debt Cost & Responsible Borrowing

DEBT COST PYRAMID — Cheapest to Most Expensive



Factor	Key Insight	Practical Tip
Purpose	Borrow for appreciating assets only	Never borrow for vacations or gadgets
Cost	Secured < Unsecured. Credit card: ~42% p.a.	Always compare effective annual rate (EAR)
Tenure	Shorter tenure → higher EMI but less total interest	Match tenure to asset life and income horizon
Rescheduling	Rank by cost; pay costliest first	Refinancing at lower rate saves real money
Credit Score	CIBIL 300–900; above 750 = prime borrower	Check free report annually from CIBIL/Experian

■ Revolving Credit Card Debt: 3% per month compounds to $(1.03)^{12} - 1 = 42.6\%$ annually. If Priya carries ■50,000 as revolving balance for a year, she pays ■21,300 in interest alone — on money already spent. Always pay the full statement amount by due date.

4 Types of Borrowings & Key Loan Terms

Secured vs Unsecured Loans

Loan Type	Security	Typical Rate	Key Feature
Home Loan	Mortgage (property)	8–10% p.a.	Up to 30–35 yrs; tax benefit u/s 80C, 24(b)
Education Loan	Co-obligant/collateral	9–12% p.a.	Moratorium till course end + 6 months

Vehicle Loan	Hypothecation (car)	9–14% p.a.	3–7 yrs; depreciating asset — keep short
Loan Against Gold	Pledge (gold jewellery)	8–12% p.a.	Quick disbursement; gold stays with lender
Loan Against Property	Mortgage (property)	9–13% p.a.	Higher amount; multipurpose use of equity
Personal Loan	None (unsecured)	14–24% p.a.	No end-use restriction; quick approval
Credit Card	None (unsecured)	36–44% p.a.	Interest-free if paid by due date in full
P2P Lending	None (unsecured)	18–36% p.a.	RBI-regulated platforms; high default risk
Overdraft	FD / Securities	8–14% p.a.	Pay interest only for days used; flexible

Key Loan Terminology at a Glance

■ Amortisation

Repaying principal + interest in equal EMIs over loan life. Interest component is high early, falls over time.

■ Refinancing

Taking a new (cheaper) loan to repay an existing costlier one. Best when rate difference is $\geq 0.5\%$.

■ Prepayment

Paying extra capital before schedule. Reduces outstanding principal and shortens remaining tenure.

■ Pre-EMI Interest

Interest-only payment when loan is disbursed in tranches (e.g., under-construction property).

■ Moratorium

Temporary pause in EMI payments (e.g., Covid relief). Interest still accrues — meter is never off!

■ Hypothecation

Charge on movable asset (car) that stays with borrower; lender repossesses on default.

■ Pledge

Movable asset (gold) held physically by lender until loan repaid.

■ Mortgage

Charge on immovable asset (property). Lender holds title documents.

■ **EXAMPLE — Home Loan EMI Calculation (Pradeep buys a flat in Pune)**

Pradeep takes a ₹40 lakh home loan at 9% p.a. for 20 years (240 months). $EMI = PMT(9\%/12, 240, -4000000) = ₹35,989/month$. In Month 1: Interest = $₹40,00,000 \times 9\%/12 = ₹30,000$; Principal repaid = ₹5,989. By Month 120 (halfway): outstanding $\approx ₹27$ lakh; interest share has dropped but is still majority. Total interest paid over 20 years $\approx ₹46.4$ lakh — more than the loan itself!

EMI Components — PPMT and IPMT Functions

Excel Formula	What it Calculates	Example (₹10L, 9%, 10yr, Month 1)
=PMT(rate/12, nper, -PV)	Full monthly EMI	₹12,667/month
=PPMT(rate/12, 1, nper, -PV)	Principal portion in Month 1	₹5,167
=IPMT(rate/12, 1, nper, -PV)	Interest portion in Month 1	₹7,500
=NPER(rate/12, -EMI, PV)	Months to pay off given EMI	Varies by inputs

■ **RESTRUCTURING EXAMPLE — Riya loses her job**

Riya has ₹3 lakh outstanding at 7% for 3 years remaining. Original EMI = ₹9,263. After restructuring, tenure extended to 5 years: New EMI = ₹5,940. If lender also gives a haircut to ₹2 lakh outstanding: EMI drops to ₹3,960. **Key check:** Always compute PV of all restructured payments to verify you are not paying more in present value terms.

6 Floating Rate Decisions & Invest vs. Repay

Scenario	Change EMI	Change Tenure
Rates rise sharply	EMI goes up — strain on cash flow	Tenure extends — EMI stays same ✓ preferred
Rates fall significantly	Reduce EMI for immediate relief ✓	Keep EMI, shorten tenure — saves interest ✓
Near retirement	Increase EMI to clear debt faster ✓	Avoid extending beyond income years

■ **Invest the Windfall or Repay the Loan?**

Received a ₹5 lakh Diwali bonus? Decision framework: (1) If high-cost debt (credit card/personal loan) exists → repay it first — guaranteed return = interest rate saved. (2) If only home loan (8%) remains → compare with expected investment return. Equity historically earns 12-14% over long term → invest. But equity has risk; loan repayment is risk-free savings. (3) Hybrid: split 50-50 — partial prepayment + SIP investment.

7 Strategies to Get Rid of Debt Faster

■ **AVALANCHE**

Highest Interest Rate First

- Pay minimums on all loans
- Extra → highest rate loan
- Mathematically optimal
- Saves most interest ■■■

■ **SNOWBALL**

Smallest Balance First

- Pay minimums on all loans
- Extra → smallest balance
- Psychological wins first
- Builds momentum & habit

■ ■ ■ BLIZZARD EXAMPLE — Karan's Debt Portfolio

Karan owes: Credit Card ■40,000 @ 42%, Personal Loan ■1.5L @ 21%, Car Loan ■1.2L @ 12%, Home Loan ■18L @ 8.5%. **Blizzard Strategy:** Step 1 (Snowball motivation): Eliminate Credit Card first — smallest balance. Step 2 (Avalanche efficiency): Redirect freed ■ to Personal Loan (highest remaining rate). Then Car Loan. Then Home Loan. This hybrid approach gives psychological wins early and mathematical efficiency thereafter.

■ CHAPTER 4 — QUICK REVISION: DEBT MANAGEMENT

DTI Ratio	Total monthly debt payments ÷ Gross income. Below 35% = healthy; above 50% = stress.
Cost Hierarchy	Home loan (cheapest) → Vehicle → Personal loan → Credit card (most expensive).
Amortisation	EMI = fixed. Interest component falls each month; principal component rises.
Credit Score	CIBIL 300–900. Above 750 gets best loan terms. Free report annually from all 4 CICs.
Restructuring	Compare PV of all future payments before agreeing. Haircut = lender forgives some principal.
Avalanche	Pay highest interest rate debt first. Saves most total interest — mathematically optimal.
Snowball	Pay smallest balance first. Psychological wins build momentum. Less optimal mathematically.
Blizzard	Start with smallest (snowball), then switch to highest rate (avalanche). Best of both.
Invest vs Repay	If loan rate < expected investment return (long-term) → invest. High-cost debt → repay first.
Responsible Debt	Borrow for appreciating assets. Never carry revolving credit card balance. Match tenure to income.

MCQ PRACTICE — Chapter 4 — Debt Management

0 Questions | Answers at end

1

Vikram earns ■60,000/month and pays ■18,000 in total EMIs. What is his DTI ratio and how should it be assessed?

- | | |
|--------------------------------------|--------------------------------------|
| a) 10% — very healthy | b) 20% — healthy room to borrow more |
| c) 30% — manageable, monitor closely | d) 50% — financial stress zone |

✓ **Answer: c) 30% — manageable, monitor closely**

DTI = $18,000 \div 60,000 = 30\%$. This is the upper end of manageable. An adviser would suggest no new loans and a plan to reduce.

2 Meena carries **₹30,000** on her credit card at 3% per month. What is her effective annual interest cost?

- | | |
|---------------|---------------|
| a) 36% p.a. | b) 38.5% p.a. |
| c) 42.6% p.a. | d) 24% p.a. |

✓ **Answer: c) 42.6% p.a.**

$(1 + 0.03)^{12} - 1 = 42.6\%$ p.a. This is compound interest, making revolving credit card debt extremely costly.

3 A car loan is an example of which type of security arrangement?

- | | |
|------------------|--------------|
| a) Mortgage | b) Pledge |
| c) Hypothecation | d) Unsecured |

✓ **Answer: c) Hypothecation**

In hypothecation, the borrower retains possession of the asset (car) while the lender has a charge on it. On default, the lender repossesses it.

4 Raghav has multiple loans. Which debt repayment strategy saves the maximum total interest?

- | | |
|--------------------------------------|--------------------------------------------|
| a) Snowball — smallest balance first | b) Avalanche — highest interest rate first |
| c) Blizzard — mix of both | d) Random — pay whatever is convenient |

✓ **Answer: b) Avalanche — highest interest rate first**

The Avalanche method is mathematically optimal as it eliminates the highest-cost debt fastest, reducing the total interest paid over time.

5 Which of the following is NOT an effect of a moratorium on a loan?

- | | |
|----------------------------------------------|--------------------------------------------------|
| a) EMI payments are paused temporarily | b) Interest stops accruing during the moratorium |
| c) Credit score is not affected by the pause | d) Missed EMIs are pushed to end of loan tenure |

✓ **Answer: b) Interest stops accruing during the moratorium**

During a moratorium, the interest meter keeps running. This is a common misconception. Only EMI payments are paused; interest continues to compound.

6

Priya received a ₹3 lakh bonus. She has a home loan at 8.5% and is considering investing in an equity mutual fund. What is the most likely appropriate action?

- | | |
|-----------------------------------------------------------------------|----------------------------------------------------------------------|
| a) Prepay the home loan entirely as debt is always bad | b) Invest all in equity since returns are generally higher long-term |
| c) Split: prepay some principal and invest rest in diversified equity | d) Hold in savings account until market is certain |

✓ **Answer: c) Split: prepay some principal and invest rest in diversified equity**

A hybrid approach balances certain interest savings (8.5%) with potential long-term equity returns (~12%). It also manages risk better than going all-in on either option.

7

An education loan differs from most other loans because:

- | | |
|-------------------------------------------------------------------|-----------------------------------------------------|
| a) It is always secured with property | b) Repayment starts immediately after disbursement |
| c) There is a moratorium till course completion plus grace period | d) Interest rate is always subsidized by government |

✓ **Answer: c) There is a moratorium till course completion plus grace period**

Education loans typically have a moratorium period covering the course duration plus 6-12 months, allowing students to find employment before repaying.

8

What does "refinancing" a home loan mean?

- | | |
|-----------------------------------------------------|---------------------------------------------------------------|
| a) Getting a top-up on the same loan | b) Closing the old loan with proceeds from a new cheaper loan |
| c) Restructuring the existing loan with same lender | d) Converting floating rate to fixed rate |

✓ **Answer: b) Closing the old loan with proceeds from a new cheaper loan**

Refinancing involves taking a new loan at a lower interest rate to repay the existing costlier loan. It makes sense when rate difference is significant (typically $\geq 0.5\%$).

9

Which of the following credit information companies is NOT authorized to provide credit scores in India?

- | | |
|---------------------|--------------------|
| a) TransUnion CIBIL | b) CRIF High Mark |
| c) Experian India | d) Bloomberg India |

✓ **Answer: d) Bloomberg India**

India has four RBI-licensed Credit Information Companies (CICs): TransUnion CIBIL, Experian, Equifax, and CRIF High Mark. Bloomberg is a financial data company, not a CIC.

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In an amortised loan, which statement about the EMI components is correct?

- | | |
|---------------------------------------------------------------------|-------------------------------------------------------|
| a) Principal component stays constant throughout | b) Interest component rises as loan ages |
| c) Principal component rises and interest component falls over time | d) Both components remain equal throughout the tenure |

✓ **Answer: c) Principal component rises and interest component falls over time**

In amortisation, outstanding principal reduces each month, so interest (charged on reducing balance) also reduces. The "freed" interest portion then goes toward principal, which rises over time.

Sneha Rege

NISM Series X-A: Investment Adviser Level 1

Introduction to the Indian Financial Markets

LEARNING OBJECTIVES: Indian Economy • Financial Markets • Regulators • Market Structure • Participants

1 Overview — India's Financial Ecosystem

Banking System
RBI-regulated; credit & deposits

Securities Market
SEBI-regulated; equity & debt

Insurance
IRDAI-regulated; risk protection

Pension Funds
PFRDA-regulated; NPS & EPFO

Forex Market
Currency exchange; FBIL rates

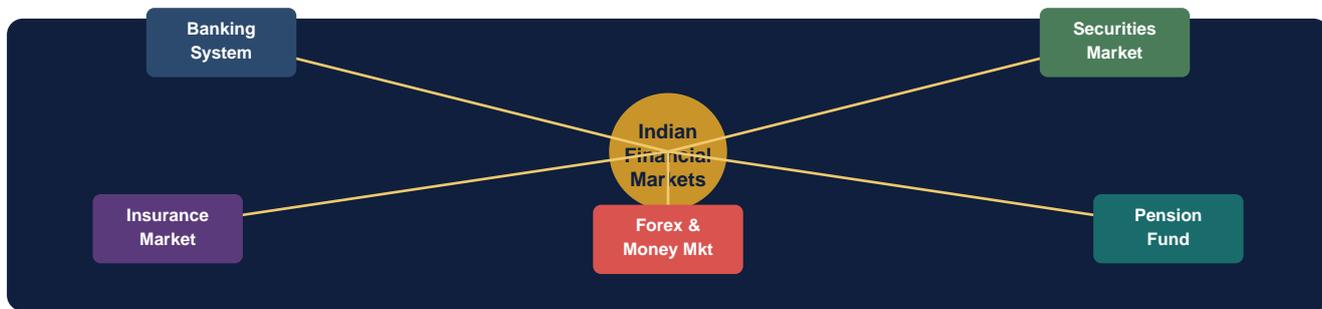
Commodity Market
Price discovery; hedge inflation

■ Why Financial Markets Matter

Financial markets are the circulatory system of an economy. They channel savings from those who have surplus funds (households, institutions) to those who need capital (businesses, government). India's market has grown from a predominantly agri-based economy to one where services contribute ~55% of GDP. Developed, well-regulated markets are essential for sustained 7%+ GDP growth.

2 Key Features of Financial Markets

Feature	What It Does	Example
Resource Allocation	Channels surplus funds to productive uses	FD savings → corporate bond → factory
Liquidity	Easy entry/exit from investments	Sell 100 shares of Infosys in seconds on NSE
Price Discovery	Markets aggregate all information into price	RIL share price reflects all public info
Risk Transfer	Derivatives and insurance shift risk to those willing to bear it	Farmer sells wheat futures to hedge price risk
Information	Disseminates economic data to all participants	SEBI disclosures, quarterly results, credit ratings



3 Regulators of Financial Markets

<p>RBI Banks, NBFCs Forex, Credit</p>	<p>SEBI Securities Commodities</p>	<p>IRDAI Life & General Insurance</p>	<p>PFRDA Pension Funds NPS</p>
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Regulator	Established	Primary Jurisdiction	Key Functions
RBI	1935	Banks, NBFCs, Forex, Payments	Monetary policy, bank supervision, currency issue
SEBI	1992 (Act)	Securities & Commodity Markets	Investor protection, market regulation, intermediary oversight
IRDAI	1999 (Act)	Life & General Insurance	Licence insurers, regulate products, protect policyholders
PFRDA	2013 (Act)	Pension Sector, NPS	Regulate NPS, register fund managers, subscriber protection
MCA	Companies Act 2013	Corporate Sector	Regulate company formation, governance, ICAI/ICSI/ICAI oversight
FSDC	2010	Overall Financial Stability	Inter-regulatory coordination, systemic risk monitoring

Ministry of Finance coordinates all financial sector regulators. It has five departments: Economic Affairs (capital markets), Expenditure, Revenue (taxes), Financial Services (banks/insurance/pension), and Investment & Public Asset Management (PSU disinvestment).

4 Structure of Indian Financial Markets

4.1 Banking System

Type	Examples	Key Feature
Public Sector Banks	SBI, PNB, Bank of Baroda	Govt majority-owned; largest network
Private Sector Banks	HDFC, ICICI, Axis, Kotak	Tech-driven; high efficiency ratios

Foreign Banks	Citibank, HSBC, Standard Chartered	Limited branches; global client base
Small Finance Banks	AU SFB, Equitas, Ujjivan	Credit to micro/small; RBI-licensed
Payment Banks	Paytm, India Post, Airtel	Deposits up to ₹1 lakh; no lending
NBFCs	Bajaj Finance, HDFC Ltd, Muthoot	No demand deposits; fills credit gap
Housing Finance Cos	LIC HFL, Aavas, PNB HFL	Primary business = home loans; RBI regulated since 2019

4.2 Securities Market Participants

 Stock Exchanges NSE & BSE — anonymous electronic order matching	 Clearing Corps NSCCL, ICCL — guarantee settlement, novation	 Depositories NSDL & CDSL — electronic holding of securities	 Brokers Registered trading members; execute buy/sell orders
 Custodians Hold securities for institutions; manage benefits	 Mutual Funds Pool investor money; diversified portfolio management	 Rating Agencies CRISIL, ICRA — assess issuer creditworthiness	 KYC Agencies CKYC (individuals), KRA — central investor verification

4.3 Insurance & Pension Markets

Segment	Products	Distribution Channels
Life Insurance	Term, Endowment, ULIP, Whole Life	Agency, bancassurance, brokers, direct
General Insurance	Motor, Health, Travel, Fire, Marine	Agents, corporate agents, online direct
NPS (PFRDA)	Tier I (retirement), Tier II (voluntary savings)	POPs (banks), online, PRAN card
EPFO (PF+EPS)	PF (employee savings) + EPS (pension scheme)	Employer-mandatory for formal sector

5 Money Market, Forex & Credit Information

Instrument	Maturity	Issuer	Key Users
Treasury Bills (T-Bills)	91 / 182 / 364 days	Central Government via RBI	Banks, institutions — risk-free short-term
Commercial Paper (CP)	7 days to 1 year	Corporates, AIFIs	Companies fund working capital needs
Certificates of Deposit (CD)	7 days to 1 year	Scheduled Commercial Banks	Investors needing bank-backed liquid paper
Call/Notice Money	Overnight to 14 days	Banks, PDs	Banks manage daily reserve requirements

Repo/Reverse Repo	Overnight	RBI ↔ Banks	RBI manages liquidity and policy rate signalling
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■ FOREX EXAMPLE — Sunita's Import Business

Sunita runs a textile business importing fabric from China. She has a USD payment of \$50,000 due in 3 months. Spot USD/INR = 83.50. She worries the rupee will weaken (i.e., she'd pay more rupees). She buys a USD/INR forward contract at 84.10 for 3-month delivery, locking in her cost. FBIL publishes daily reference rates for USDINR, EURINR, GBPINR, JPYINR on Mumbai business days.

■ Account Aggregators (AA) — New Digital Lending Tool

AA are RBI-licensed entities that consolidate a customer's financial data (bank accounts, investments, insurance policies) and share it with lenders or advisers — but ONLY with the customer's explicit consent. The customer can revoke consent anytime. This dramatically reduces paperwork in loan approvals and brings more borrowers into the formal credit system. Think of AA as a "financial passport."

■ CHAPTER 5 — QUICK REVISION: INDIAN FINANCIAL MARKETS

4 Regulators	RBI (banking), SEBI (securities), IRDAI (insurance), PFRDA (pension). FSDC coordinates all.
Money Market	Instruments < 1 year: T-Bills, CPs, CDs, Call Money. RBI uses repo/reverse repo for liquidity.
2 Depositories	NSDL and CDSL hold securities electronically. DPs are their agents (banks, brokers).
2 Exchanges	NSE and BSE — anonymous electronic order matching. NSCCL and ICCL clear/settle trades.
NBFCs	Cannot accept demand deposits. Cannot issue cheques. No DICGC cover. Fill credit gap where banks can't.
Credit Bureaus	CIBIL, Experian, Equifax, CRIF High Mark. RBI mandates free annual credit report for individuals.
Payment Banks	Deposits up to ■1 lakh. No lending. No credit cards. Paytm/Airtel examples.
Account Aggregator	RBI-licensed. Shares financial data with consent only. Enables paperless digital lending.
Clearing Corp	Acts as central counterparty (novation). Guarantees settlement even if member defaults.
KYC	CKYC Registry for individuals. KRAs (CAMS, CVL, NDML) for non-individuals. Once done, used across intermediaries.

1 Which regulator oversees both the securities market AND commodity derivatives in India?

- | | |
|----------|------------------------|
| a) RBI | b) SEBI |
| c) IRDAI | d) Ministry of Finance |

✓ **Answer: b) SEBI**

After the merger of FMC (Forward Markets Commission) with SEBI in 2015, SEBI regulates both securities markets and commodity derivatives.

2 An NBFC differs from a bank in which of the following ways?

- | | |
|----------------------------------------|---------------------------------------------------------|
| a) NBFCs cannot lend money | b) NBFCs cannot accept demand deposits or issue cheques |
| c) NBFCs are regulated by SEBI not RBI | d) NBFCs can only operate in rural areas |

✓ **Answer: b) NBFCs cannot accept demand deposits or issue cheques**

NBFCs are engaged in lending, leasing and hire purchase but cannot accept demand deposits, cannot issue cheques, and their deposits are not covered by DICGC insurance.

3 Which of the following accurately describes the role of a Depository Participant (DP)?

- | | |
|----------------------------------------------------|----------------------------------------------------------------------------------------|
| a) They hold securities on behalf of issuers | b) They are agents of depositories that open and maintain demat accounts for investors |
| c) They clear and settle trades on stock exchanges | d) They provide credit ratings to security issuers |

✓ **Answer: b) They are agents of depositories that open and maintain demat accounts for investors**

DPs (brokers, banks) open investor demat accounts. The actual securities are held by NSDL or CDSL (depositories). DPs act as the interface between investors and depositories.

4 Financial Benchmark India Pvt. Ltd. (FBIL) publishes reference rates for which currency pairs?

- | | |
|-----------------------------------|---------------------------|
| a) Only USDINR | b) USDINR and EURINR only |
| c) USDINR, EURINR, GBPINR, JPYINR | d) All G20 currency pairs |

✓ **Answer: c) USDINR, EURINR, GBPINR, JPYINR**

FBIL publishes daily reference rates for four major currency pairs against the Indian Rupee on Mumbai business days, providing a transparent benchmark for the forex market.

5 A Payment Bank can perform which of the following activities?

- | | |
|--------------------------------------------|--------------------------------------------------------------------------|
| a) Provide home loans up to ₹5 lakh | b) Accept savings deposits up to ₹1 lakh and provide remittance services |
| c) Issue credit cards to premium customers | d) Invest customer deposits in equity mutual funds |

✓ **Answer: b) Accept savings deposits up to ₹1 lakh and provide remittance services**

Payment Banks are restricted to: accepting deposits up to ₹1 lakh per customer, issuing ATM/debit cards (not credit cards), and providing payment/remittance services. They CANNOT lend.

6 The Account Aggregator framework is best described as:

- | | |
|-------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| a) A government database of all bank accounts | b) An RBI-licensed intermediary that shares financial data with third parties only with customer consent |
| c) A credit bureau that maintains credit scores | d) A KYC verification agency for the securities market |

✓ **Answer: b) An RBI-licensed intermediary that shares financial data with third parties only with customer consent**

Account Aggregators consolidate financial data across institutions and share it only with explicit, revocable customer consent. They do not store data — they just facilitate its flow to enable services like digital loans.

7 Which of the following is the central counterparty that guarantees settlement of trades on stock exchanges?

- | | |
|---------------------------------------|---------------------------|
| a) SEBI | b) Depository Participant |
| c) Clearing Corporation (e.g., NSCCL) | d) Stock Broker |

✓ **Answer: c) Clearing Corporation (e.g., NSCCL)**

The Clearing Corporation (NSCCL for NSE, ICCL for BSE) acts as the central counterparty through novation — it guarantees settlement of all trades even if a member defaults, using the Settlement Guarantee Fund.

8 Small Finance Banks were created primarily to:

- | | |
|---------------------------------------------------------|------------------------------------------------------------------------------|
| a) Compete with large private banks for corporate loans | b) Provide banking services to micro, small businesses and unbanked segments |
| c) Handle foreign exchange transactions for exporters | d) Manage government pension funds |

✓ **Answer: b) Provide banking services to micro, small businesses and unbanked segments**

RBI approved Small Finance Banks to extend formal banking — including savings vehicles and credit — to small businesses, marginal farmers, and the unorganized sector that larger banks underserve.

9 Which statement about Credit Rating Agencies is correct?

a) They rate equity shares based on expected growth	b) They assess the default risk of debt issuers and rate specific debt issues
c) They are regulated by RBI not SEBI	d) Ratings, once assigned, are permanent and never changed

✓ **Answer: b) They assess the default risk of debt issuers and rate specific debt issues**

Credit Rating Agencies (CRISIL, ICRA, CARE, India Ratings) assess creditworthiness of debt instruments and issuers. They are registered with and regulated by SEBI. Ratings are regularly reviewed and can be upgraded, downgraded, or placed on watch.

10 FSDC, the Financial Stability and Development Council, serves which primary purpose?

a) It is the apex appellate authority for market disputes	b) It directly regulates mutual funds in India
c) It monitors overall financial stability and coordinates between financial regulators	d) It manages India's foreign exchange reserves

✓ **Answer: c) It monitors overall financial stability and coordinates between financial regulators**

FSDC is a government-established body (chaired by Finance Minister) that enables macro-prudential oversight, inter-regulatory coordination between RBI, SEBI, IRDAI and PFRDA, and addresses systemic risks across the financial sector.

Sneha

NISM Series X-A: Investment Adviser Level 1

Securities Market Segments

LEARNING OBJECTIVES: Primary Market • Issue Types • IPO Process • Secondary Market • Risk Mgmt • Corporate Actions

1 Primary Market — Raising Capital for the First Time

Wider Access
Company reaches thousands of new investors

Transparent Price
Auction/book building determines fair value

Ownership Spread
Promoter holding diluted; governance improves

Better Disclosure
SEBI mandates detailed prospectus and results

Early Investor Exit
PE/VC investors get liquidity via IPO

Regulatory Cover
Every step supervised; investor rights protected

PRIMARY MARKET

"New Issue Market"

- Issuer → Investor directly
- IPO / FPO / Rights Issue
- Capital flows to company
- ASBA / UPI application

SECONDARY MARKET

"Stock Exchange Trading"

- Investor → Investor trades
- NSE / BSE / Exchanges
- No new capital to company
- Price discovery & liquidity

Types of Primary Market Issues

Issue Type	Who Can Participate	Example / Key Detail
IPO — Fresh Issue	General public, QIBs, HNIs, retail	New shares; increases paid-up capital. E.g., Zomato IPO 2021.
IPO — Offer for Sale (OFS)	General public — buying from existing holder	Promoter/PE sells; money goes to seller, not company. E.g., LIC IPO 2022.
FPO (Further Public Offer)	Public — company already listed	Follow-on capital raise; increase public float above regulatory minimum
Rights Issue	Existing shareholders only	Offered in ratio (e.g. 1:2); prevents dilution of existing shareholders
Bonus Issue	Existing shareholders (free)	From free reserves; 1:3 means 1 share per 3 held. No cash payment.
Preferential Issue	Select investors (private placement)	Listed company to specific investors; needs SEBI ICDR compliance

QIP	Qualified Institutional Buyers only	Fast route for listed companies; institutional appetite gauged
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IPO Pricing — Fixed Price vs Book Building

■ BOOK BUILDING EXAMPLE — TechNext India Ltd IPO

TechNext offers 5,000 shares with price band ■180–■216 (20% above floor). Bids received: ■216 → 900 shares; ■210 → 1,400; ■200 → 2,700; ■190 → 800; ■180 → 400. Running demand: ■216=900, ■210=2,300, ■200=5,000 ← fills here.

Cut-off price = ■200. All bidders at ■200 and above get shares. Those who bid ■190 or ■180 get refunds. Retail investors can bid at "cut-off" to guarantee allotment.

ASBA (Application Supported by Blocked Amount): Your bank account is debited only upon allotment — funds are merely blocked during the IPO period. UPI-based ASBA allows retail investors applying through brokers. Minimum application: ■10,000–■15,000 (SEBI mandated lot size range).

Types of Issuers in the Primary Market

Issuer	Instruments Issued	Example
Central Government	T-Bills (91/182/364d), G-Secs, Dated Securities	RBI auctions ■10,000 Cr of 10yr G-Sec at 7.1%
State Governments	State Development Loans (SDLs)	Maharashtra SDL at slight spread over G-Sec
PSU Companies	Equity (disinvestment), tax-free bonds	NHAI tax-free bonds; Coal India FPO
Private Companies	Equity, preference, NCDs, CPs	Infosys IPO 1993; HDFC NCD issue
Banks/FIs/NBFCs	Equity, bonds, CDs, CP, securitized paper	SBI Additional Tier 1 (AT1) bonds
Mutual Funds	Units via NFO (closed or open-ended)	Parag Parikh Flexi Cap NFO 2013
REITs / InvITs	Units via public offer or private placement	Embassy REIT (offices), IRB InvIT (roads)

2

Secondary Market — Trading, Liquidity & Price Discovery

Function	How It Works	Real Example
Liquidity	Buyers and sellers meet anonymously on exchange; quick exit	Sell Tata Motors shares in T+1 settlement; funds in 1 day
Price Discovery	Continuous order matching; price = equilibrium of all informed views	Sensex drops 3% on poor GDP data — market processes news instantly
Information Signalling	Price movements act as public scorecard of management performance	Company misses quarterly profit → share falls → management accountability
Economic Barometer	Sensex / Nifty indices reflect broad economic health	Bull run 2014–21 aligned with India's GDP growth trajectory

Corporate Control	Underperforming firms trade at discount; become takeover targets	Hostile bids force boards to improve performance or accept acquisition
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Risk Management Systems in Secondary Markets

Mechanism	Purpose	How It Protects Investors
Capital Adequacy (BMC)	Minimum net worth for brokers	Ensures broker has skin in the game
Margins	Upfront deposit when placing order	17% example: buyer pays ₹1,700 on ₹10,000 trade
Circuit Breakers	Halt trading at 10/15/20% index move	Prevents panic spiral; gives market time to breathe
Price Bands	2/5/10/20% daily limit per stock	Restricts extreme intraday moves in individual securities
Core SGF	Settlement Guarantee Fund	Clears trades even if member defaults — novation principle
Online Monitoring	Real-time surveillance of member positions	Alerts on abnormal build-up; prevents systemic risk

■ CIRCUIT BREAKER EXAMPLE — Market Event

During COVID crash (March 23, 2020), the Nifty fell 13% at open. Circuit breaker triggered at 10% decline → 45-minute trading halt. This prevented a liquidity-driven panic spiral and gave institutional investors time to reassess. Sensex fell from 41,000 in Jan 2020 to 25,981 on Mar 23, 2020 — but without circuit breakers, the crash could have been even deeper.

Market Information — Cap, Turnover & Indices

Metric	Definition	India Context
Large Cap	Top 100 companies by market cap	Reliance, TCS, HDFC Bank — highly liquid
Mid Cap	101–250 ranked companies	Moderate liquidity; growth potential
Small Cap	251 and below	Low liquidity; higher risk/return
Sensex (BSE)	30-stock free-float weighted index; base 1979=100	Oldest and most cited India index
Nifty 50 (NSE)	50-stock free-float weighted; base Nov 1995=1000	F&O; benchmark; wider sector representation
Market Cap/GDP	Buffett Indicator — market relative to economy	India ~110% (2024); >100% = richly valued

3

Corporate Actions — What Companies Do to Their Shares

Action	What It Means	Investor Impact	Example
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Rights Issue	Existing shareholders offered new shares first	No dilution if exercised; can trade rights entitlement (RE)	Tata Motors rights 1:1 @ ₹170 (2021)
Bonus Issue	Free shares from free reserves; no cash needed	Share count ↑; price adjusts proportionally; no actual gain	HDFC 1:1 bonus; 100 → 200 shares
Dividend	Cash share of profits to shareholders	Taxable in investor hands; reduces cash with company	Infosys ₹21/share final dividend FY24
Stock Split	Face value reduced; share count rises	Price falls proportionally; liquidity improves	MRF 10:1 split 2023 — ₹90,000 → ₹9,000
Share Buyback	Company repurchases own shares and extinguishes them	EPS rises (fewer shares); signals undervaluation	TCS, Infosys regular buybacks via tender offer
Delisting	Shares removed from stock exchange	Exit via reverse book building (voluntary) or forced (regulatory)	Essar Steel delisted after insolvency resolution
Mergers & Acquisitions	Acquirer buys controlling stake; open offer triggered	Minority shareholders get mandatory exit window (SEBI)	HDFC-HDFC Bank merger 2023

■ STOCK SPLIT WORKED EXAMPLE — Understanding MRF-Style Split

Imagine you hold 10 shares of "Premier Tyres" at ₹50,000 each = ₹5,00,000 total value. Company announces 5:1 stock split (face value ₹10 → ₹2). Post-split: you now hold 50 shares. Market price adjusts to ₹10,000/share. Your total value = 50 × ₹10,000 = ₹5,00,000 — UNCHANGED. Benefit: More investors can now afford the stock; liquidity improves significantly.

Record Date / Book Closure: Companies fix a date to determine eligible shareholders for corporate actions. Only shareholders on record as of this date are entitled to rights, bonus, or dividend.

■ CHAPTER 6 — QUICK REVISION: SECURITIES MARKET SEGMENTS

Primary Market	New securities issued for the first time. Capital flows from investor to issuer.
Secondary Market	Existing securities traded between investors. No new capital to company.
IPO vs FPO	IPO = first-ever public listing. FPO = additional issue by already-listed company.
Book Building	Price band set; investors bid. Cut-off = price at which issue gets fully subscribed.
ASBA	Funds blocked in bank during IPO. Released only on allotment. Mandatory for all applications.
Circuit Breakers	10/15/20% index moves trigger market halt. Prevents panic cascade in extreme events.
Price Bands	2/5/10/20% daily limit on individual stocks. No bands on F&O; eligible stocks.
Bonus vs Split	Bonus: new shares from reserves (no face value change). Split: reduces face value, multiplies shares.

Buyback	Company buys and cancels own shares. Boosts EPS. Must not have defaulted on debt/dividends.
Rights Issue	Existing shareholders get first right to new shares. Rights Entitlement (RE) tradeable on exchange.

MCQ PRACTICE — Chapter 6 — Securities Market Segments

0 Questions | Answers at end

1

Ananya applies for an IPO through the ASBA mechanism. What happens to her bank balance during the subscription period?

- | | |
|-------------------------------------------------------|---------------------------------------------|
| a) The full application amount is immediately debited | b) Nothing happens until allotment |
| c) The application amount is blocked (not debited) | d) Interest is earned on the blocked amount |

✓ **Answer: c) The application amount is blocked (not debited)**

ASBA blocks the application amount in the investor's bank account. It is only actually debited on allotment. The investor continues earning interest on the blocked amount (since it remains in their account).

2

In a book-built IPO, what is the "cut-off price"?

- | | |
|----------------------------------------|---------------------------------------------------------------------------|
| a) The minimum price set by SEBI | b) The price at which the issue is exactly fully subscribed by valid bids |
| c) The maximum price in the price band | d) The price at which retail investors must apply |

✓ **Answer: b) The price at which the issue is exactly fully subscribed by valid bids**

The cut-off price is determined after the issue closes, based on bids received. It is the lowest price at which the issue gets fully subscribed. Bidders at or above this price receive allotment.

3

A company issues a 1:3 bonus share. Ramesh holds 600 shares. How many shares will he hold after the bonus?

- | | |
|---------------|-----------------|
| a) 200 shares | b) 600 shares |
| c) 800 shares | d) 1,800 shares |

✓ **Answer: c) 800 shares**

1:3 ratio means 1 bonus share for every 3 held. Ramesh gets $600 \div 3 = 200$ bonus shares. Total = $600 + 200 = 800$ shares. The share price adjusts proportionally, so total value is unchanged.

4 Which of the following statements about a stock split is INCORRECT?

- | | |
|---------------------------------------------------------------------|----------------------------------------------------------|
| a) Number of shares held by investor increases | b) Face value per share decreases proportionally |
| c) Total market value of investor's holding increases significantly | d) Liquidity in the stock tends to improve after a split |

✓ Answer: c) Total market value of investor's holding increases significantly

A stock split does NOT change the total market value of a holding. Price adjusts in inverse proportion to the split ratio. E.g., a 2:1 split doubles shares but halves price — net value stays the same.

5 What is the primary difference between a Rights Issue and a Public Issue (IPO/FPO)?

- | | |
|--------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| a) Rights issues are regulated by RBI, public issues by SEBI | b) Rights issues are offered only to existing shareholders; public issues are open to all eligible investors |
| c) Rights issues do not require SEBI filing | d) Only companies over 10 years old can make rights issues |

✓ Answer: b) Rights issues are offered only to existing shareholders; public issues are open to all eligible investors

Rights issues are made to protect existing shareholders from dilution — they get first right at a specific ratio and price. Public issues (IPO/FPO) are open to the general public, including new investors.

6 Why does a company conduct a share buyback?

- | | |
|--------------------------------------------------------------------------------------------|------------------------------------------------------------|
| a) To increase total number of shares outstanding | b) To raise fresh capital for expansion |
| c) To increase EPS by reducing shares outstanding, and return surplus cash to shareholders | d) To comply with SEBI's minimum public shareholding norms |

✓ Answer: c) To increase EPS by reducing shares outstanding, and return surplus cash to shareholders

Buybacks retire shares, reducing the denominator in EPS (Earnings Per Share), thus improving EPS. They also signal management confidence in undervaluation and are a tax-efficient way to return surplus cash.

7 The Nifty 50 index fell 18% in one trading session (hypothetical). At which point would trading be automatically halted for the rest of the day?

- | | |
|--------------------------------------------------------------|-----------------------------------------------------------------|
| a) At 10% decline only | b) At 15% decline only |
| c) At 20% decline for rest of day if it occurs after 3:30 PM | d) Trading cannot be halted for the full day under any scenario |

✓ Answer: c) At 20% decline for rest of day if it occurs after 3:30 PM

Circuit breakers operate in three stages: 10%, 15%, and 20%. A 20% move triggers a halt for the rest of the day regardless of the time. The 10% and 15% halts have different durations depending on time of trigger.

8

An investor holds shares in a company that announces it is being acquired. Under SEBI's takeover regulations, what right does the investor have?

- | | |
|----------------------------------------------------------------------------|---------------------------------------------------------|
| a) No special rights — must hold through the transaction | b) Must sell all shares back to the company immediately |
| c) Can participate in the mandatory open offer made to public shareholders | d) Gets automatic bonus shares as compensation |

✓ **Answer: c) Can participate in the mandatory open offer made to public shareholders**

When an acquirer crosses the trigger threshold (25%), SEBI's Takeover Code requires them to make an open offer to buy at least 26% from public shareholders. This gives minority investors an exit at a fair (often premium) price.

9

Which category of investors is exclusively targeted in a Qualified Institutional Placement (QIP)?

- | | |
|-------------------------------------------------|------------------------------------------------------------------------|
| a) Only retail investors applying in small lots | b) Qualified Institutional Buyers (QIBs) such as mutual funds and FPIs |
| c) Only domestic mutual funds regulated by SEBI | d) High Net Worth Individuals (HNIs) only |

✓ **Answer: b) Qualified Institutional Buyers (QIBs) such as mutual funds and FPIs**

QIP is a fast route for listed companies to raise equity capital from institutional investors (mutual funds, insurance companies, FPIs, banks etc.) without a public issue process. It's private placement to sophisticated institutions.

10

The definition of "Securities" under the Securities Contracts (Regulation) Act 1956 includes which of the following?

- | | |
|------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------|
| a) Only equity shares listed on BSE and NSE | b) Only government securities and treasury bills |
| c) A wide range including shares, debentures, derivatives, mutual fund units, government securities and rights in securities | d) Only instruments with maturity over 1 year |

✓ **Answer: c) A wide range including shares, debentures, derivatives, mutual fund units, government securities and rights in securities**

Section 2(h) of SCRA 1956 gives a broad definition covering shares/stocks/bonds, derivatives, CIS units, mutual fund units, government securities, securitised instruments, and rights/interests in securities.