

The Best CA Final SFM

Theory Short Notes

Strictly As Per New Syllabus Covering 30 Marks

By

CA Aaditya Jain

Undisputed Name For MAFA/SFM

Visiting Faculty Of ICAI

SIT LIKE A ROCK...WORK LIKE A CLOCK

MAKE YOUR NOW.....WOW

I will act now. I will act now. I will act now. Henceforth, I will repeat these words each hour, each day, everyday, until the words become as much a habit as my breathing, and the action which follows becomes as instinctive as the blinking of my eyelids. With these words I can condition my mind to perform every action necessary for my success. I will act now. I will repeat these words again and again and again. I will walk where failures fear to walk. I will work when failures seek rest. I will act now for now is all I have. Tomorrow is the day reserved for the labor of the lazy. I am not lazy. Tomorrow is the day when the failure will succeed. I am not a failure. I will act now. Success will not wait. If I delay, success will become wed to another and lost to me forever. This is the time. This is the place. I am the person.

Even if you are on the right track, you will get run over if you just sit there.

GET UP N KEEP GOING

IT'S TIME TO BE BUSY BECAUSE TOMORROW WILL BE YESTERDAY VERY SOON

*He who asks is a fool for five minutes, but he who does not ask remains a fool forever
It is easy to be brave from a safe distance. Nothing is particularly hard if you divide it into small jobs.*

**The Given Book Is The
BEST SHORT NOTES ON
THEORY
COVERING
30 MARKS
FOR LAST MOMENT REVISION**

**FOR DETAILED AND COMPREHENSIVE STUDY ON THEORY PLEASE
REFER DETAILED THEORY BOOK BY AADITYA JAIN AVAILABLE ON LEADING
BOOK STORES**

**FORMULA BOOKLET
OF SFM ALSO AVAILABLE
WHERE STUDENTS CAN GET**

**ALL THE FORMULA IN ONE PLACE
For Receiving Soft Copy Of FORMULA Booklet
OF SFM Please Mail Or SMS Your Detail To Us**

At :

By E-Mail: cafinalmafa@yahoo.com

By SMS: Delhi :9911442626 ; Kolkata:9339238834

[We Need Your Following Detail :Name,Mobile No.,E-mail Address,Exam Due,City]

Don't waste life in doubts and fears; spend yourself on the work before you, well assured that the right performance of this hour's duties will be the best preparation for the hours and ages that will follow it.

From the desk of CA Aaditya Jain

The Importance Of Patience In CA Career



Sometimes in life there are situations which makes you to loose your patience. The best way to react at these situation is not to react at all. These situations are meant just to distract you from your goal. Believe it or not a one minute involvement in such situation will take away your 2-5 hours of precious time or sometimes even more. When ever you encounter such situation just keep your head cool and try to get out of the atmosphere if possible and afterwards just relax your mind by cracking a joke or by taking 14-15 long breathes in a single stroke.

Believe me it'll work. So be ready to face such situations

Murphy's Law " If anything can go wrong,it will "Everything for the first time looks tough.

REMEMBERA, B , C , Dwas also tough for you one day

Practice makes a man perfect.....Follow the proper approach you will definitely succeed

Ending in this high note said by late Dhiru Bhai Ambani

" For Those Who Dare n Dream There is A Whole world to win "

Jinke honslo mein udaan hoti hai wo aasmaan ki uchayion se nahi darte

" I Welcome You as a Bright Future CA in This Amazing World of Finance "

**"In Every Man There is Something of Which I May Also
Learn, and in All That He is My Teacher"**

**I Wish All My Students to Always Aim High in Life.You have to grow
From Inside Out.None Can Teach You, None Can Make You
Spiritual. There is no Other Teacher But Your Own Soul.**

"Life is not measured by the number of breaths we take,
but by the moments that take our breath away."

Wishing You All The Best

*Remember You Can Do Wonders , Nobody Can Stop You From Achieving Success Except You
Get Up and Keep Going , World Is Waiting For You*

- Aaditya Jain

Now You Can Also Dream Of Scoring Good Marks In MAFA/SFM

"Targetting 90+ In Mafa/SFM"

"All your life you are told the things you cannot do. All your life they will say you're not good enough or strong enough or talented enough; they will say you're the wrong height or the wrong weight or the wrong type to play this or be this or achieve this. THEY WILL TELL YOU NO, a thousand times no, until all the no's become meaningless. All your life they will tell you no, quite firmly and very quickly.

AND YOU WILL TELL THEM YES."

The only thing that will stop you from fulfilling your dreams is you

Winning isn't everything, neither is losing, but the only thing is doing your best."

A superior man is modest in his speech, but exceeds in his actions.

LIST OF ALL PAST YEARS NEW COURSE QUESTION PAPER*[All questions are incorporated in this book]***SFM-Nov 2008 Theory Questions****QUESTION NO. 1** What are the drawbacks of investments in Mutual Funds ?**QUESTION NO. 2** Write short notes on any four of the following :

- (a) Financial restructuring
- (b) Cross border leasing
- (c) Embedded derivatives
- (d) Arbitrage operations
- (e) Rolling settlement.

SFM-Nov 2009 Theory Questions**QUESTION NO. 1** What are the limitations of Credit Rating?**QUESTION NO. 2** What is the impact of GDRs on Indian Capital Market?**SFM-May 2010 Theory Questions****QUESTION NO. 1** List and briefly explain the main functions of an investment bank.**QUESTION NO. 2** How is a stock market index calculated? Indicate any two important market indices.**QUESTION NO. 3** Write a short note on Debt Securitisation.**QUESTION NO. 4** Write a short note on Exchange Traded Funds (ETFs)**QUESTION NO. 5** Explain briefly, how financial policy is linked to Strategic Management.**SFM-Nov 2010 Theory Questions****QUESTION NO. 1** (a) (i) What is the meaning of NBFC?

(ii) What are the different categories of NBFCs?

(iii) Explain briefly the regulation of NBFCs under RBI Act.

QUESTION NO. 2 Explain the concept 'Zero date of a Project' in project management.**QUESTION NO. 3** Give the meaning of 'Caps, Floors and Collars' options.**QUESTION NO. 4** Distinguish between Open-ended and Close-ended Schemes.**QUESTION NO. 5** Explain CAMEL model in credit rating.

All the Theory Question Asked In The Past Exam Were Already Covered In Aaditya Jain Theory Book. So We Can Confidently Say That In Future Exams Also This Trend Is Expected To Continue & Students Can Be Sure Of Getting 100% Theory Question From This Book. However For Detailed & Comprehensive Study Of Full Theory students are advised to Refer Theory Book By Aaditya Jain Available In Leading Book Stores. The Given Theory Book is only a short notes applicable for Only Last Time Revision.

If I Believe I cannot do something, it makes me incapable of doing it. But when I believe I can, then I acquire the ability to do it even if I didn't have it in the beginning. -Mahatma Gandhi

CA RESULT ANALYSIS:-May 2010

Pass % of CPT - 27.55%

Pass % of PCC - 13.57%

Pass % of FINAL - 6.56%

If 1000 student get regd. for CA then

276 (1000*27.55%) will pass CPT out of this,

37 (276*13.57%) will pass PCC out of this,

2 (37*6.56%) will pass CA Final.

So, Final Analysis is that if 1000 student get registered in ICAI then only 2 student will finally become Chartered accountant(i.e, only 0.2%)

Such a big task..**CA FINAL EXAM RESULT-Last 15 Attempt**

Exam	S No.	Group I			Group II			Both Group		
MM/YYYY		Appeared	Passed	Pass %	Appeared	Passed	Pass %	Appeared	Passed	Pass %
Nov-09	1	25224	5011	19.87	30641	3099	10.11	18502	1454	7.86
Jun-09	2	25848	8379	32.42	27840	4185	15.03	18625	2579	13.85
Nov-08	3	21176	5892	27.82	23856	5762	24.15	14614	2926	20.27
May-08	4	17552	6444	36.71	18685	5290	28.31	10580	2645	25.00
Nov-07	5	16137	6353	39.37	16493	5005	30.35	8654	2446	28.26
May-07	6	15083	2289	15.18	15874	2777	17.49	7467	1023	13.70
Nov-06	7	14587	5505	37.74	16947	6555	38.68	68301	830	26.79
May-06	8	15355	5832	37.98	17952	5718	31.85	7053	1608	22.80
Nov-05	9	15902	5039	31.68	20085	5772	28.74	7620	1348	17.69
May-05	10	18211	5748	31.56	20513	3520	17.16	8650	1243	14.37
Nov-04	11	16645	4089	24.57	20448	4484	21.93	7666	939	12.25
May-04	12	20724	7011	33.83	21364	3354	15.70	9770	1490	15.25
Nov-03	13	19501	4450	22.82	20377	4381	21.50	8597	1076	12.52
May-03	14	20290	4469	22.03	18692	2203	11.79	7943	802	10.10
May-10[Old]		20049	2897	14.45	26517	2552	9.62	13242	458	3.46
May-10[New]		8840	1166	13.19	8670	683	7.88	7424	487	6.56

**FOR ANY CLASS RELATED ENQUIRY PLEASE CONTACT US AT
DELHI-9911442626;KOLKATA-9339238834**

Now All India Satellite Classes Also Available For IPCC-FM & CA Final SFM(MAFA)
By CA Aaditya Jain Across India.For More Detail For Satellite Classes Contact :

011-47665555 www.brightprofessionals.com

NOW YOU CAN ALSO JOIN SIR'S COMMUNITY ON FACEBOOK-

NAME OF COMMUNITY: CAADITYA JAIN SFM 90+ TARGET

For Getting Last Time Important Suggestions

Please mail or SMS your following details at :

By E-Mail:cafinaalmafa@yahoo.com [Name,Mobile No.,E-mail Address,Exam Due,City]

By SMS:Delhi :9911442626 ; Kolkata:9339238834

Happiness always looks small if you hold in your hands.But learn to share it,you will realize how big and precious it is .Do not confuse motion and progress. A rocking horse keeps moving but does not make any progress.

SPECIAL ATTRACTIONS OF UPCOMING BATCH

- ➔ 15 MINUTES OF OUR CLASS WILL BE SPECIALLY DEDICATED TO STOCK MARKET PRACTICAL (ON SPECIAL DEMAND OF STUDENTS)
- ➔ 600 CONCEPTS TOPICS WILL BE COVERED
- ➔ 600 PRACTICAL QUESTION WILL BE COVERED
- ➔ 100% THEORY AS PER NEW SYLLABUS WILL BE COVERED
- ➔ SPECIAL BOOKLET COVERING ENTIRE SFM-FORMULA & THEORY BEST FOR LAST TIME REVISION WILL BE ISSUED

SFM Classes Conducted By Aaditya Sir Is

A Rare Combination Of

Concept+Practical Problem+Theory

100 % COVERAGE OF CA FINAL SFM PAPER OF NOV 2010

FROM AADITYA JAIN SIR'S ASSIGNMENT-ITS TIME TO THINK

BEYOND 90 +

**Its Time To Think Beyond 90+ In MAFA/SFM
Limited Seats.....First Come First Serve Basis**

Stop Memorizing Without Understanding The Concept

.....Its Time To Learn Finance Conceptually



Congratulating Surbhi Agarwal For Securing All India Rank 1 In CA Final -Nov 2008 Exam

A Student Of Aaditya Jain Sir

From the Desk Of Surbhi Agarwal-All India Rank 1

I am excited and feeling great today...I must say that hard work and dedication is the path to success.. I take this opportunity to thank my family, friends and of course my Teachers whose guidance and support has always been with me. "I suggest the students to study the subjects not with the intention to mug up things but to gain knowledge. Given that we have eight subjects you cannot cram all of them so the best way out is to understand, comprehend and revise it again and again so that it settles deep into your sub-conscious mind." I will further like to thank Aaditya Sir to make my MAFA conceptually clear. Finally Delhi has got a good MAFA teacher. His notes are really excellent and updated .

-Surbhi Aggarwal, Rank Holder in PE-1, PE-2 and Final

For Fees & Other Detail Please Contact

Delhi:9911442626;Kolkata:9339238834

MAFA /SFM is no more a Nightmare for Students

"I found that the men and women who got to the top were those who did the jobs they had in hand, with everything they had of energy and enthusiasm and hard work."

Positive Feedback About The Theory Books And Classes

[mafabycaaadityajain] hello friends

Friday, 10 April, 2009 5:46 PM

From: "Sweta Kothari" <swetakothari@ymail.com>

To: mafabycaaadityajain@yahooogroups.com

I stay in Kolkata..I am appearing my CA finals in this June.. I have previously taken tutitions for MAFA from a teacher..

Though he was good but i was always scared of MAFA..By taking classes by Aditya Jain Sir, now i am feeling very good & comfortable in MAFA even though i am not his regular student..He makes us understand the concepts in a very easy manner.. I just want to thank sir for removing my fear for MAFA..Before taking classes from sir i just used to target 45-50 in MAFA.. But now i am targeting much more..

Thank you sir.. Thank you so much.. Regards.. Sweta Kothari Kolkata

THANKSFOR YOUR THEORY BOOK

Wednesday, 25 February, 2009 8:49 PM

From: "Priyanka Agarwal" <priyans26186@gmail.com>

To: ca_kumaraaditya@yahoo.co.in

This is Priyanka Agarwal from Kolkata.I have purchased ur theory book from Jayesh Sir and is extremely benefitted by it.Now I regret that

why havenot I joined u.Actually when I did my MAFA classes I even didnt know your name. Your theory book is just marvellous.No doubt I am getting immense knowledge from it but one more thing is there which I got from your book.The Confidence,most important thing for gaining courage and facing the exams.I would definitely ask all my friends to join your classes.I have heard that your classes are really awesome.I would like to request you that please give some of your valuable suggestions to me for passing the exams in all the subjects. A very heartfelt thanks to you for publishing such a nice book.

Monday, 8 June, 2009 3:28 PM

From: "Rajeev Nagpal" <rajeev@investbank.ae>

To: ca_kumaraaditya@yahoo.co.in

Hello Aditya Sir,

I came across your book and I must complement you on writing an excellent book. I have never seen such a simple and excellent presentation of any subject by any one. I am badly stuck up in Group-I of C.A. (Final). I wish I could get your complete notes. I am sure it will prove to be extremely helpful.

Regards,Rajeev Nagpal,Assistant Financial Controller,Head Office Finance Control Department,Invest Bank,Sharjah,U.A.E.

Tel : 06- 5694440 Ext. 350;Mob : 050-4996818;Fax :06-5681174

Wednesday, June 3, 2009 12:20 PM

From: "Ashish Singla" <ashishsinglaca@gmail.com>

To: cafinalmafa@yahoo.com

Dear Mr. Aditya Jain,

I owe it to you, that today, I can heave a sigh of relief after my MAFA Exam. I happened to read only your Suggested Compilation for June 2009 exam during my revision time. And, Im not regretting it one bit. I dont know how you did it, but so many questions came from your compilation (Which was obviously advantageous to me). Thanks a lot for putting in such a diligent effort to compile the same.

Regards, Ashish

P.S - I think there is not much chance that this mail shall come before your eyes because Im sending to a general id of yours BUT I believe youve made me one of your die hard word of mouth advertisers.

Abhishek Jakhetiya

CA Final-Roll No. 26804 MAFA Marks-74

CS Inter-Roll No.17926 Securities Market Paper-70 Marks

DOB: 12th September 1985

Email: ca.abhishejkj@yahoo.com

Addres: H.N 1391, Sector-4, Gurgaon-122001

Exam Completion in CA : May 2008

Comments on your Classes: Finally Delhi has got some good MAFA classes as well. Aaditya Jain Sir has not only made us fearless but also made us think of MAFA as a high scoring paper just as Accounts or Indirect Taxes.Your Study material is fantastic . Thankyou

Never blame a day in your life.Good days give you " Happiness ".Bad days give you Experience .Both are essential in life. Start everyday with a smile.Never look down on anybody unless you're helping him up.

QUESTION NO. 1 Explain the Interface of Strategic Management and Financial Policy ? or Explain briefly, how financial policy is linked to strategic Management. (Nov 2009)(May2010)

➔ The inter face of strategic management and financial policy will be clearly understood if we appreciate the fact that the starting point of an organization is money and the end point of that organization is also money again. Offer of the organization is only a vehicle that links up the starting point and the end point. No organization can run the existing business and promote a new expansion project without a suitable internally mobilized financial base or both internally and externally mobilized financial base.

➔ The success of any business is measured in financial terms. Maximising value to the shareholders is the ultimate objective. For this to happen, at every stage of its operations including policy-making, the firm should be taking strategic steps with value-maximization objective. This is the basis of financial policy being linked to strategic management.

➔ The linkage can be clearly seen in respect of many business decisions. For example :

(i) Manner of raising capital as source of finance and capital structure are the most important dimensions of strategic plan.

(ii) Cut-off rate (opportunity cost of capital) for acceptance of investment decisions.

(iii) Investment and fund allocation is another important dimension of interface of strategic management and financial policy.

(iv) Foreign Exchange exposure and risk management.

(v) Liquidity management

(vi) A dividend policy decision deals with the extent of earnings to be distributed and a close interface is needed to frame the policy so that the policy should be beneficial for all.

(vii) Issue of bonus share is another dimension involving the strategic decision.

Thus from above discussions it can be said that financial policy of a company cannot be worked out in isolation to other functional policies. It has a wider appeal and closer link with the overall organizational performance and direction of growth.

QUESTION NO.2 Write a short note on Project Feasibility ?

Project Feasibility is a test by which an investment is evaluated. There are three types of feasibilities evaluated for a project viz. (1) Market Feasibility

(2) Technical Feasibility and

(3) Financial Feasibility.

For projects evaluated by government, economic and social feasibility is also considered.

Market Feasibility :

➔ The market feasibility study for a product already selling in the market consists of :

(a) **Economic Indicators:**

(b) **Demand Estimation:**

(c) **End-user profile:**

(d) **Influencing Factors –**

(e) **Market Potential –**

(f) **Infrastructure Facility –**

(g) **Demand Forecasting –**

(h) **Supply Estimation:**

(i) **Identification of Critical Success Factors:**

(j) **Estimation of the Demand-Supply Gap –**

Technical Feasibility : The factors considered are :

When God takes away something from your hands , dont think that he is punishing you . He is just leaving you empty handed to receive something better. Think of it.

- (i) Availability of commercially viable technology and its alternatives.
- (ii) Suitability of the technology to local environment and its usefulness is to be assessed by the quality of material, power, skilled labour, environmental conditions, water supply etc.
- (iii) Technological innovation rate of the product.
- (iv) Production processes.
- (v) Capacity utilization rate and its justification.
- (vi) Availability of raw material and other resources e.g. power, gas, water, compressed air, labour etc.
- (vii) Plant and equipment with fabrication facilities.
- (viii) Feasible product mix with possibilities of joint and by-products.
- (ix) Facilities for affluent disposal.

Financial Feasibility: Financial feasibility study requires detailed financial analysis based on certain assumptions, workings and calculations such as:

- (1) Projections for prices of products, cost of various resources for manufacturing goods, capacity utilization. The actual data of comparable projects are included in the estimates.
- (2) Period of estimation is determined on the basis of product life cycle, business cycle; period of debt funds etc. and the value of the project at the terminal period of estimation are forecasted.
- (3) Financing alternatives are considered and a choice of financing mix made with regard to cost of funds and repayment schedules.
- (4) Basic workings in different schedules like Interest and repayment schedule, working capital schedule, working capital loan, interest and repayment schedule, depreciation schedule for income tax purposes, depreciation schedule for the purpose of reporting under Companies Act, 1956 (if policy is different from income tax rules).
- (5) Financial statements prepared in the project feasibility report viz. profit and loss account, balance sheet and cash flow statements for the proposed project.
- (6) Financial indicators calculated from data available in various financial statements. Basic financial parameters used for judging the viability of the project are Debt Service Coverage Ratio (DSCR), Net Present Value (NPV) or Internal Rate of Return (IRR), Payback Period, Interest Coverage Ratio.

Interest coverage ratio indicates the safety and timely payment of interest to lenders of money. Interest Coverage Ratio =

$$\frac{\text{PAT} + \text{Interest} + \text{Depreciation}}{\text{Interest}}$$
 .However, it is not an important indicator of project viability. Debt-service coverage ratio (DSCR) uses the same numerator as the interest coverage ratio, but it is compared with the interest payment and principal sum repayment in a year .This ratio is better than Interest Coverage Ratio since it shows the cash flows available for the interest as well as for principal repayment.

$$\text{DSCR (Debt Service Coverage Ratio)} = \frac{\text{PAT} + \text{Interest} + \text{Depreciation}}{\text{Interest} + \text{Principal Loan Repayment}}$$
 .An average DSCR of 1.5 is considered good. It is the safety indicator for lenders of money.

QUESTION NO.3 What are the Contents Of a Project Report ?

The following aspects need to be taken into account for a Project Report -

- 1. **Promoters:**
- 2. **Industry Analysis:**
- 3. **Economic Analysis:**
- 4. **Cost of Project:**
- 5. **Inputs:**

Dream is not what you see in sleep. A dream is the thing which doesn't let you sleep , makes you persevere till it comes out true before your eyes. The journey is the reward.

6. Technical Analysis:

7. Financial Analysis:

8. Social Cost Benefit Analysis(SCBA):

9. SWOT Analysis:(Strengths, Weaknesses, Opportunities, and Threats Analysis)

10. Project Implementation Schedule:

QUESTION NO. 4 What are NBFCs"? What are the different forms of NBFCs ? or Write a short note on "Regulation of NBFCs"? (May 2005)(8 Marks)(Nov 2010 SFM)

(i) Meaning of NBFC (Non Banking Financial Companies) :

NBFC stands for Non-Banking financial institutions, and these are regulated by the Reserve Bank of India under RBI Act, 1934. NBFC's principal business is receiving of deposits under any scheme or arrangement or in any other manner or lending on any other manner. They normally provide supplementary finance to the corporate sector.

(ii) Different categories of NBFC are :

1. Loan companies 2. Investment Companies. 3. Hire Purchase Finance Companies. 4. Equipment Leasing Companies. 5. Mutual Benefit Finance Companies. 6. Housing Finance Companies 7. Miscellaneous Finance Companies

(iii) Regulation of NBFCs-

RBI Act RBI regulates the NBFC through the following measures:

(a) Mandatory Registration.(b) Minimum owned funds. (c) Only RBI authorized NBFCs can accept public deposits.(d) RBI prescribes the ceiling of interest rate. (e) RBI prescribes the period of deposit. (f) RBI prescribes the prudential norms regarding utilization of funds. (g) RBI directs their investment policies. (h) RBI inspectors conduct inspections of such companies. (i) RBI prescribes the points which should be examined and reported by the auditors of such companies. (j) RBI prescribes the norms for preparation of Accounts particularly provisioning of possible losses. (k) If any of interest or principal or both is/ are due from any customer for more than 6 months, the amount is receivable (interest or principal or both) is termed as non-performing asset.

QUESTION NO. 5 How is a stock market index calculated? Indicate any two important market indices.(May 2010)[Also Refer your Class Register for its practical part]

Stock Market Index is representative of the entire stock market. Movements of the index represent the average returns obtained by investors in the stock market.A market Index acts as a barometer for market behavior.

How is the index calculated :

- 1.A base year is set alongwith a basket of base shares.
- 2.The changes in the market price of these shares is calculated on a daily basis.
- 3.The shares included in the index are those shares which are traded regularly in high volume.
- 4.In case the trading in any share stops or comes down then it gets excluded and another company's shares replace it.
- 5.Following steps are involved in calculation of index on a particular date:
 - Calculate market capitalization of each individual company comprising the index.
 - Calculate the total market capitalization by adding the individual market capitalization of all companies in the index.
 - Computing index of next day requires the index value and the total market capitalization of the previous day and is computed as follows:

$$\text{Index Value} = \frac{\text{Today's Market Capitalisation}}{\text{Yesterday's Market Capitalisation}} \times \text{Yesterday's Index Point}$$

Happiness always looks small if you hold in your hands.But learn to share it,you will realize how big & precious it is . "If opportunity does'nt knock ,build a door"

Example : If the market capitalization of 10 securities (considered to be the index) as at the beginning of 01.04.2008 amount to Rs. 5 crores is taken as base and equated to 100 and at day end market capitalization amounts to Rs. 5.50 crores, then the index at the end of 01.04.2008 will be 110 .

$$\text{i.e. Opening Index} \times \frac{\text{Closing Market Capitalization}}{\text{Opening Market Capitalization}} = 100 \times \frac{5.50}{5.00} = 110$$

If at the end 02.04.2008 , the market capitalization is Rs. 6.30 crores , then the index value would be 126.

$$\text{Opening Index} \times \frac{\text{Closing Market Capitalization}}{\text{Opening Market Capitalization}} = 110 \times \frac{6.30}{5.50} = 126$$

Two important market indices : Sensex and Nifty are two important share indices in India.

Sensex is an index number that measures the relative average change in prices of 30 shares listed in the Bombay Stock Exchange Ltd (BSE). . The base year of SENSEX is 1978-79 and the base value is 100.. It is calculated on a free-float market capitalization methodology.

Nifty tracks the performance of equity share of 50 important companies listed on NSE. The base of the index is the close of prices on November 3, 1995. The base value of the index has been set at 1000.. It is also calculated on a free-float market capitalization methodology.

QUESTION NO. 6 How project appraisal is done under inflationary conditions? (May 1998, Nov 2003)

➔ It is needless to mention that Inflation is a universal phenomena. In a developing country like India, it has become a part of life.

➔ It is a well known fact that during inflationary conditions, project cost is bound to increase on all heads viz. labour, raw material, fixed assets such as equipments, plant & machinery, building material, remuneration of technicians & managerial personnel etc.

➔ Under such circumstances, project appraisal has to be done generally keeping in view the following guidelines which are usually followed by Government agencies, banks and financial institutions:

(i) It is always advisable to make provisions for **cost escalation** on all heads of cost, keeping in view the rate of inflation during likely period of delay in project implementation.

(ii) The various **sources of finance** should be carefully scrutinised with reference to probable revision in the rate of interest by the lenders and the revision which could be effected in the interest bearing securities to be issued. All these factors will push up the cost of funds for the organisation.

(iii) Adjustments should be made in **profitability and cash flow projections** to take care of the inflationary pressures affecting future projections.

(iv) It is also advisable to examine the **financial viability of the project** at the revised rates and assess the same with reference to economic justification of the project. The rate of return should be acceptable which also accommodates the rate of inflation p.a

(v) In an inflationary situation, projects having early **payback periods** should be preferred because projects with longer payback period are more risky.

➔ It must be noted that measurement of inflation has no standard approach nor is easy. This makes the job of appraisal a difficult one under such conditions.

QUESTION NO.7 Write a short note on Social Cost Benefits Analysis? Is it relevant for private enterprises also ? (CA Final)

➔ **Meaning :** Social Cost Benefit Analysis is a systematic evaluation of an organisation's social performance as distinguished from its economic performance. Social Cost Benefits Analysis is an approach for evaluation of projects. It

A man daily sent a rose to his wife. One day he died, but his wife still received roses. She asked the floweriest. He said, your husband paid advance for your whole life. MORAL: Love someone forever.

assesses gains/losses to society as a whole.

→ **Techniques Of Social Cost Benefits Analysis:** Estimation of shadow prices form the core of social cost benefit methodology. Economic resources have been categorised into goods, services, labour, foreign exchange, shadow price of investment vis-à-vis consumption, shadow price of future consumption vis-à-vis present consumption, social rate of discount.

→ **Advantages of such an analysis may be the following –**

(a) It helps the Corporate Sector to keep track of its record as a Social Citizen. Being a good Social Citizen can be a marketing advantage. However, more importantly it can be pursued as an end in itself.

(b) Social benefits arising out of a project can be leveraged with the governments while negotiating for tax concessions and such other incentives for the project.

→ **Limitations:**

(i) Successful application depends upon reasonable accuracy and dependability of the underlying forecasts as well as assessment of intangibles.

(ii) Technique does not indicate whether given project evaluated on socio-economic considerations is best choice to reach national goals or whether same resources if employed in another project would yield better results.

(iii) Cost of evaluation by such technique could be enormous for smaller projects.

(iv) Social Cost Benefit Analysis takes into consideration those aspects of social costs and benefits which can not be quantified.

→ **Features**

(1) It includes many economic activities having indirect effects on which there is no possibility of putting a market value.

(2) If savings are inadequate; money going into investment is regarded more valuable than money going into current consumption.

(3) Society values given quantum of additional consumption going to different sections of the population differently. So distributional considerations are important.

(4) For society, taxes are transferred from the project in hand to government and does not involve real cost.

(5) Relative valuation placed on future consumption compared to current consumption is different for the society. Also effect of perceived uncertainties may be different.

(6) Society may want to discourage consumption of certain goods and promote that of others.

(7) External effects exist on consumption side e.g. person getting inoculation against infectious disease will be conferring some benefit to society by preventing the spreading over of the disease.

(8) Output from large projects has significant impact on the market for the good/services and neither pre project market price nor expected post project market price would be correct indicators of the social value of project output. Market prices are not true indicators of social gains/losses but can be suitably adjusted to reflect social valuations.

→ **Relevance of Social Cost Benefit Analysis for Private Enterprises :**

(a) Social Cost Benefit Analysis is important for private corporations also which have a moral responsibility to undertake socially desirable projects.

(b) If the private sector includes social cost benefit analysis in its project evaluation techniques, it will ensure that it is not ignoring its own long-term interest, since in the long run only projects that are socially beneficial and acceptable, will survive.

(c) Financial Institutions e.g. IDBI, IFCI, etc. even insist on social cost benefit analysis of a private sector project before sanctioning any loan.

(d) Private enterprise cannot afford to lose sight of social aspects of a projects.

→ **Few indicators of Social Desirability of a Project :**

(a) Employment Potential Criterion; (b) Capital Output Ratio – that is the output per unit of capital; (c) Value Added Per Unit of capital; (d) Foreign Exchange Benefit Ratio. (e) Cost Benefit Ratio Criterion ;

→ **Indian Scenario:** The introduction of CNG in certain vehicles and switching of some portion of the transport demand to

What's greater then mom's love? Which pillow is better then Mom's lap?

Which company's better then friends? There are some things in life with no substitutes. Love them forever.

the metro rail have resulted in a significant reduction of atmospheric pollution in Delhi. The Delhi Metro provides multiple benefits: reduction in air pollution, time saving to passengers, reduction in accidents, reduction in traffic congestion and fuel savings. There are incremental benefits and costs to a number of economic agents: government, private transporters, passengers, general public and unskilled labour.

QUESTION NO.8 Write a short note on Real Option In Capital Budgeting ?

➡ The traditional measure of investment decision criterion i.e NPV, does not take into account the value of options inherent in capital budgeting.

➡ Three of the most common real call options in capital budgeting include:

- (1) option to delay until key variables change favorably,
- (2) option to expand if a project turns out to be more promising and
- (3) option to abandon if worse case occurs.

➡ Two models are normally used in determining the Real Option In Capital Budgeting

- (a) The Binomial Model of Option Pricing :
- (b) The Black-Scholes Model

QUESTION NO.9 Short note on Lease?

➡ **Meaning** : Lease can be defined as a right to use an equipment or capital goods on payment of periodical amount.

➡ **Parties to a Lease Agreement** : There are two principal parties to any lease agreement (i) **Lessor** (ii) **Lessee** :

➡ **Type of Leasing** : The different leasing options may however, be grouped in by two broad categories as under:

Operating Lease : Features of Operating Lease (CA Final)

- (i) It is a short-term arrangement.
- (ii) It can be cancelled by the lessee prior to its expiration date.
- (iii) The lease rental is generally not sufficient to fully amortize the cost of the asset.
- (iv) The cost of maintenance, taxes, insurance are the responsibility of the lessor.
- (v) The lessee is protected against the risk of obsolescence.
- (vi) The lessor has the option to recover the cost of the asset from another party on cancellation of the lease by leasing out the asset.
- (vii) The lease term is significantly less than the economic life of the equipment.

These Agreements may generally be preferred by the lessee in the following circumstances:

- (a) When the long-term suitability of asset is uncertain.
- (b) When the asset is subject to rapid obsolescence
- (c) When the asset is required for immediate use to tide over a temporary problem.

Computers & other office equipments are very common assets which form subject matter of many operating lease agreements.

Financial Lease : Features of Financial Lease (CA Final)

- (i) It is a long-term arrangement.
- (ii) During the primary lease period, the lease cannot be cancelled.
- (iii) The lease is more or less fully amortized during the primary lease period.
- (iv) The cost of maintenance, taxes, insurance etc., are to be incurred by the lessee unless the contract provides otherwise.

*Don't run through life so fast that you forget not only where you've been, but also where you are going.
"Build upon strengths, and weaknesses will gradually take care of themselves."*

- (v) The lessee is required to take the risk of obsolescence.
- (vi) The lessor is only the Financier and is not interested in the asset.
- (vii) The lease term generally covers the full economic life of the equipment.

➔ **Advantages of Leasing**

- (i) **Flexibility** :
- (ii) **100% Financing** :
- (iii) **Timely & Easy Availability of Finance** :
- (iv) **Simple Documentation** :
- (v) **Safeguarded Against the Risk of Obsolescence** :
- (vi) **Does not affect the Borrowing Capacity** :
- (vii) **Off the Balance Sheet Financing** :
- (viii) **Sale and Lease Back' Arrangement** :
- (ix) **Piecemeal Financing**
- (x) **Tax Benefits**

➔ **Disadvantages of Leasing** :

- (i) The lease rentals become payable soon after the acquisition of assets and no moratorium period is permissible as in case of term loans from financial institutions.
- (ii) The seller's warranties for satisfactory operation of the leased assets may sometimes not be available to lessee.
- (iii) Default in payment by the lessor may sometimes result in seizure of assets by banks causing loss to the lessee.
- (iv) Lease financing has a very high cost of interest as compared to interest charged on term loans by financial institutions/
- (v) **Restriction on Use** : The Lessor generally imposes certain restrictions on the leased assets. The Lessee may not be permitted to make addition on alterations to suit his needs.

QUESTION NO. 10 Write a short note on Cross Border Leasing ?

(CA Final)(SFM Nov 2008)

➔ **Meaning** : In case of cross-border or international lease, the lessor and the lessee are situated in two different countries. Because the lease transaction takes place between parties of two or more countries, it is called cross-border lease.

➔ **Basic Prerequisites Of Cross Border Leasing** : The basic prerequisites are relatively high tax rates in the lessor's country, liberal depreciation rules and either very flexible or very formalistic rules governing tax ownership.

➔ **Objective Of Cross Border Leasing** : A major objective of cross-border leases is to reduce the overall cost of financing through utilization of tax depreciation allowances to reduce its taxable income. Other important objectives of cross border leasing include the following :

- (i) The lessor is often able to utilize nonrecourse debt to finance a substantial portion of the equipment cost.
- (ii) Also, depending on the structure, in some countries the lessor can utilize very favourable "leveraged lease" financial accounting treatment for the overall transaction.
- (iii) In some countries, it is easier for a lessor to repossess the leased equipment following a lessee default.
- (iv) Leasing provides the lessee with 100% financing.

➔ **Principal Players Of Cross Border Lease** : The principal players are (i) one or more equity investors; (ii) a special purpose vehicle formed to acquire and own the equipment and act as the lessor; (iii) one or more lenders, and (iv) the lessee.

➔ **Benefits Of Cross Border Leasing** : Cross border lease benefits are more or less the same as are available in domestic lease viz. 100% funding off-balance sheets financing, the usual tax benefits on leasing, etc. In addition to these benefits, the following are the more crucial aspects which are required to be looked into:

Though no one can go back and make a brand new start, anyone can start from now and make brand new ending. Don't use time or words carelessly. Neither can be retrieved.

- (i) appropriate currency requirements can be met easily to match the specific cash flow needs of the lessee;
- (ii) funding for long period and at fixed rate which may not be available in the lessee home market may be obtained internationally;
- (iii) maximum tax benefits in one or more regions could be gained by structuring the lease in a convenient fashion;
- (iv) tax benefits can be shared by the lessee or lessor accordingly by pricing the lease in the most beneficial way to the parties;
- (v) choice of assets for cross border lease is different than domestic lease because those assets may find here attractive bargain which are internationally mobile, have adequate residual value and enjoy undisputed title.

QUESTION NO. 11 Explain the factors/determinants for determining Dividend Policy?

(CA Final)(May 99, Nov 01, Nov 02, May 06)

The factors that affect the dividend policy of a company are as follows :

- (i) **Legal Considerations** : The provisions of the Companies Act, 1956 must be kept in mind since they provide a major dimension to the dividend decision. Section 205 of the Companies Act prescribes the quantum of distributable profits. Further the provisions of the Income-tax Act specially as they relate to closely held companies may also be seen. All these provisions provide the legal framework within which the dividend policy has to be formulated. Under no circumstances, it is possible to declare a dividend higher than the amount legally permissible.
- (ii) **Stability of Earnings** : A firm having stable income can afford to have higher dividend pay-out ratio as compared to a firm which does not have such stability in its earnings conditions.
- (iii) **Opportunities for Reinvestment and Growth** : A company which sees a high growth potential for itself and, therefore, requires a large amount of funds for financing growth will declare lower dividends to conserve resources and maintain its debt equity ratio at a proper level. If, however, a company does not have immediate requirement for funds, it may decide to declare high dividends.
- (iv) **Cashflow** : From the point of view of financial prudence, a company must consider its cash requirements before declaring a dividend. In case it has a strained liquidity position, it may declare a lower dividend.
- (v) **Level of Inflation in the Economy** : The dividend decision is also linked up with the level of inflation in the economy.
- (vi) **Effect on Market Prices** : Dividend decision is one of the major factors which affect the market price of shares. As per traditional approach the Market Price of the share is considered to be the Present Value of the future dividend.
- (vii) **Tax Considerations** : The tax status of the major shareholders also affects the dividend decision sometimes.
- (viii) **Other Factors** : There are many other factors such as dividend policy of other firms in the same industry; attitude of management on dilution of existing control; fear of being branded inefficient or conservative etc. which also affect the dividend policy of a company.

QUESTION NO. 12 Write a Short note on Indian Capital Market?

INDIAN CAPITAL MARKET & ITS CLASSIFICATION

➡ The capital markets are the markets for relatively for long term (greater than one year maturity) financial instruments .e.g. bonds, debentures and equity share.

➡ The capital market is divided into two parts, namely, primary and secondary stock market.

A primary market (Also known as IPO Market) refers to the set up which helps the industry to raise funds by issuing different types of securities. The secondary market is market for subsequent sale/purchase and trading in the securities.

➡ Difference between Primary and Secondary Market

<u>Basis</u>	<u>Primary Markets</u>	<u>Secondary Markets</u>
(a) Meaning	A primary market refers to the set up which helps the industry to raise funds	The secondary market is market for subsequent sale/purchase and trading in the securities.

“There are some people who live in a dream world, and there are some who face reality; and then there are those who turn Dream Into Reality” .We cannot learn without pain.

	by issuing different types of securities.	
(b) Nature of Securities	It deals with new securities, i.e. securities which were not previously available, and are offered for the first time to the investors.	It is a market for old securities which have been issued already.
(c) Sale/Purchase	Securities are acquired from issuing Companies themselves.	Securities are purchased and sold by the investors without any involvement of the companies.
(d) Nature of Financing	It provides funds to new enterprises & also for expansion and diversification of the existing one.	It does not supply additional funds to company since the company is not involved in transaction
(e) Liquidity	It does not lend any liquidity to the securities	The secondary market provides facilities for the continuous purchase and sale of securities, thus lending liquidity & marketability to the securities
(f) Organisational Difference	It is not rooted in any particular spot and has no geographical existence. It has neither any tangible form nor any administrative organisational set up.	Secondary market has physical existence in the form of stock exchange and are located in a particular geographical area having an administrative organisation set up.

➡ Similarities between Primary and Secondary Market

- (a) Listing :
- (b) Control :
- (c) Mutual Interdependence :

QUESTION NO. 13 Name leading stock exchange of India & Stock Exchanges Abroad ?

Two Leading Stock Exchange of India: (a) Bombay Stock Exchange (BSE) (b) National Stock Exchange (NSE)
Stock Exchanges Abroad (a) New York Stock Exchange (NYSE) (b) Nasdaq (c) London Stock Exchange

QUESTION NO. 14 What are the functions of the Stock Exchanges? (RTP Nov 10)

- (a) Liquidity and Marketability of Securities:
- (b) Fair Price Determination:
- (c) Source for Long term Funds:
- (d) Helps in Capital Formation:
- (e) Reflects the General State of Economy:

QUESTION NO. 15 Write a short note on Clearing House ?

➡ Meaning: Clearing house is an exchange-associated body charged with the function of ensuring (guaranteeing) the financial integrity of each trade. Orders are cleared by means of the clearinghouse acting as the buyer to all sellers and the seller to all buyers. Clearing houses provide a range of services related to the guarantee of contracts, clearance and settlement of trades, and management of risk for their members and associated exchanges.

➡ Role:

- (i) It ensures adherence to the system and procedures for smooth trading.
- (ii) It minimises credit risks by being a counter party to all trades.
- (iii) It involves daily accounting of all gains or losses.
- (iv) It ensures delivery of payment for assets on the maturity dates for all outstanding contracts.

"Sometimes you cannot believe what you see. You have to believe what you feel."

"Courage is about doing what you're afraid to do. There can be no courage unless you're scared."

(v) It monitors the maintenance of speculation margins.

➔ The credit risk of the clearing house is then minimised by employing some deposits as collaterals by both, buyers and sellers. These deposits, known as Margins, which normally are in form of cash or T-bills, can be categorised into the following types: -

(i) Initial Margins on Securities (ii) Initial Margins on Derivatives (iii) Maintenance Margins (iv) Variation Margin

QUESTION NO.16 Write a short note on Rolling Settlement ?

(CA Final)(SFM Nov 2008)

➔ **Meaning** : A rolling settlement is that settlement cycle of the stock exchange, where all trades outstanding at end of the day have to be settled, which means that the buyer has to make payments for securities purchased and seller has to deliver the securities sold.

➔ **Example** : Suppose if we have T+2 settlement cycle it means that a transaction entered into on Day 1 has to be settled on the Day 1+2 working days. For example

Jan 1	Jan 2	Jan 3	Jan 4	Jan 5	Jan 6	Jan 7	Jan 8
Mon	Tue	Wed	Thu	Fri	Sat	Sun	Mon

Stocks purchased/sold on Jan 1 should be settled on Jan 3. Stocks purchased/sold on Jan 4 should be settled on Jan 8 (Note that Sat & Sun, being holidays are again excluded for the T+2 count).

➔ **Benefits of Rolling Settlement** : (a) In rolling settlements, payments are quicker than in weekly settlements. Thus, investors benefit from increased liquidity. (b) It keeps cash and forward markets separate. (c) Rolling settlements provide for a higher degree of safety. (d) From an investor's perspective, rolling settlement reduces delays. This also reduces the tendency for price trends to get exaggerated. Hence, investors not only get a better price but can also act at their leisure

QUESTION NO.17 Write a short note on GREEN SHOE OPTION (GSO) ? (CA Final)

➔ Green Shoe Option (GSO) means an option available to the company issuing securities to the public to allocate shares in excess of the public issue and operating a post-listing price stabilising mechanism through a stabilising agent.

➔ This option acts as a safety net for the investors and is a standard global practice.

➔ The name comes from the fact that Green Shoe Company was the first entity to use this option.

➔ In April, 2004 the ICICI bank Ltd. became the first Indian company to offer GSO.

➔ The GSO is available to a company which is issuing equity shares through book-building mechanism for stabilising the post-listing price of the shares. The following is the mechanism process of GSO :

1. The Company shall appoint one of the leading book runners as the Stabilising Agent (SA), who will be responsible for the price stabilising process.

2. 'The promoters of the company will enter into an agreement with SA to lend some of their shares to the latter, not exceeding 15% of the total issue size.

3. The borrowed shares shall be in the dematerialised form. These shares will be kept in a separate GSO Demat A/c.

4. In case of over subscription, the allocation of these share shall be on pro-rata basis to all applicants.

5. The money received from allotment of these shares shall also be kept in a 'GSO Bank A/c', distinct from the issue account, and the amount will be used for buying shares from the market during the stabilization period.

6. The shares bought from the market by SA for stabilization shall be credited to GSO Demat Account.

7. These shares shall be returned to the promoters within 2 days of closure of stabilisation process.

8. In order to stabilise post-listing prices, the SA shall determine the timing and quantity of shares to be bought.

9. If at the expiry of the stabilisation period, the SA does not purchase shares to the extent of over-allocated shares, then shares to the extent of shortfall will be allotted by the company to the GSO Demat A/c multiplied by the issue price. Amount left in the GSO Bank A/c (after meeting expenses of SA), shall be transferred to the Investors Protection Fund.

➔ In the Indian context, green shoe option has a limited connotation. SEBI guidelines governing public issues contain

"Be who you are and say what you feel because those who mind don't matter and those who matter don't mind." "For every person who doubts you, tell you that you will fail, try twice as hard to prove them wrong."

appropriate provisions for accepting over-subscriptions, subject to a ceiling, say 15% of the offer made to public. In certain situations, the green-shoe option can even be more than 15%.

QUESTION NO. 18 Write a short note on Book Building ?

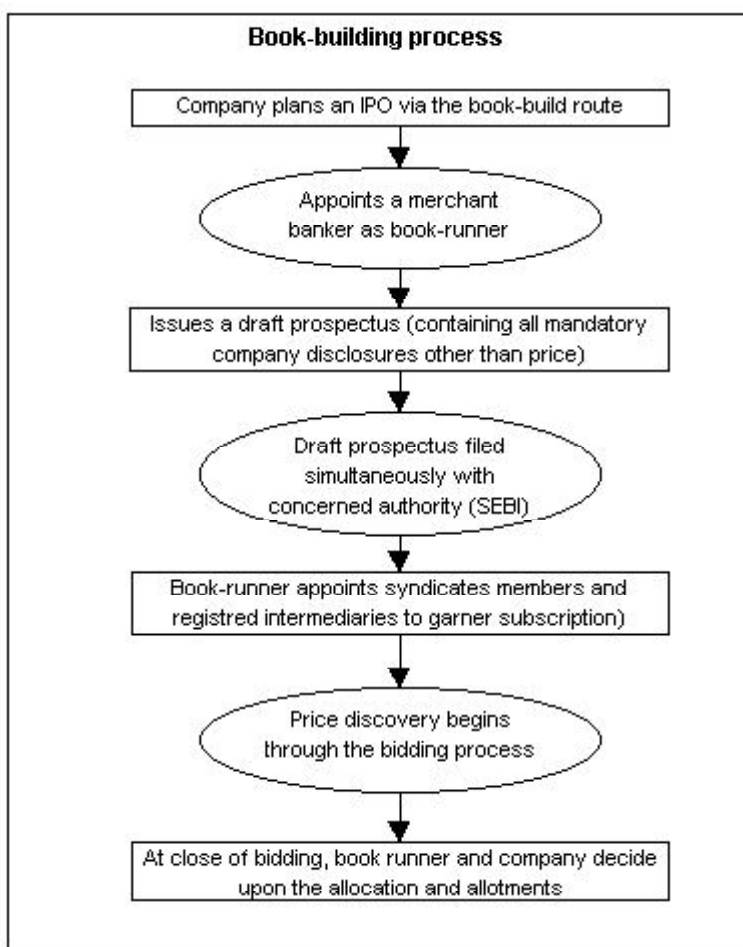
(CA Final)

➔ Book Building is a price discovery mechanism and is becoming increasingly popular as a method of issuing capital. The idea behind this process is to find a better price for the issue.

➔ The issue price is not determined in advance. Book Building is a process wherein the issue price of a security is determined by the demand and supply forces in the capital market.

➔ An issuer company may make an issue of securities to the public through a prospectus in the following manner

- 100% of the net offer to the public through the book building process or
- 75% of the net offer to the public through the book building process and 25% at the price determined through the book building.



➔ Advantage

(i) The book building process helps in discovery of price & demand.

(ii) The costs of the public issue are much reduced.

(iii) The time taken for the completion of the entire process is much less than that in the normal public issue.

(iv) In book building, the demand for the share is known before the issue closes. Infact, if there is not much demand, the issue may be deferred.

(v) It inspires investors confidence leading to a large investor universe.

(vi) Issuers can choose investors by quality.

“Don’t only help yourself in life, but try to help those truly in need, because you’ll never know when you’ll need the same support.” “If you must trust anyone in life, let it be yourself.”

(vii) The issue price is market determined.

➔ **Disadvantage**

(i) There is a possibility of price rigging on listing as promoters may try to bail out syndicate members.

(ii) The book building system works very effeciently in matured market conditions. But, such conditions are not commonly found in practice.

(iii) It is appropriate for the mega issues only.

(iv) The company should be fundamentally strong & well known to the investors without it book building process will be unsuccessful.

➔ **Recent Example :** Recent example of a book buliding process in Indian context is the IPO of Reliance Power. The issue was made through 100 % book building process .The price band for the the book buliding pocesss was between Rs 405 and Rs 450 with Rs 20 discount for retail investors .

QUESTION NO. 19 Write a short note on ‘bond indenture’ or ‘deed of trust’?

A Bond or Debenture is a long term security. The agreement between issuer and investor (or creditor and lender) is called the bond indenture or deed of trust. It contains all the information which is normally seen in any loan agreement, including the following

1. **Amount of the loan :**

2. **Rate of interest :**

3. **Schedule or form of interest payments :**

4. **Terms :**

5. **Call feature (if any) :**

6. **Refunding :**

QUESTION NO. 20 Write a short note on Derivatives ? What are different types of Derivative Risk ?

➔ A derivative is a financial instrument which derives its value from some other financial price. This ‘other financial price’ is called the underlying.

➔ **User & Purpose :** Derivative serve as a method to hedge and reduce risks .

Users

(i) Corporation

(ii) Individual Investors

(iii) Institutional Investor

(iv) Dealers

Purpose

To hedge currency risk and inventory risk

For speculation, hedging and yield enhancement.

For hedging asset allocation, yield enhancement and to avail arbitrage opportunities.

For hedging position taking, exploiting inefficiencies and earning dealer spreads.

➔ **Example :** The most important derivatives are Futures, Options, Forward, Swaps

➔ **Types of Derivative Market :** (a) Exchange Traded Derivatives (b) OTC (Over the Counter) Derivatives

Exchange-traded derivatives : Derivatives which trade on an exchange are called ‘**Exchange-traded derivatives**’.

Trades on an exchange generally take place with anonymity. Trades at an exchange generally go through the clearing corporation. **Example :** Interest rate futures, Interest rate options, Currency futures, Currency options.

OTC derivative : A derivative contract which is privately negotiated is called an **OTC derivative**. OTC trades have no anonymity, and they generally do not go through a clearing corporation. **Example :** Interest rate swaps, Currency swaps, Caps, collars, floors, forward.

➔ The different types of derivatives risks are:

(a) **Credit risk:** Credit risk in derivative products comes in two forms:

(i) **Pre-Settlement Risk:**

(ii) **Settlement risk:**

What is not started today is never finished tomorrow. The will must be stronger than the skill. For every minutes you are angry you lose 60 seconds of happiness.

- (b) **Market risk:**
- (c) **Liquidity risk:**
- (i) **Market liquidity risk:** (ii) **Funding liquidity risk:**
- (d) **Operational risk:**
- (e) **Legal risk:**
- (f) **Regulatory risk:**
- (g) **Reputation risk:**

QUESTION NO. 21 What are the major advantages & disadvantages of Futures Trading as compared to Stock Trading ?

The Major Advantages of Futures Trading Vs. Stock Trading: Compared to directly trading stocks, stock futures provide several major advantages:

- (i) **Leverage:** Compared to buying stock on margin, investing in futures is less costly. An investor can use leverage to control more stock with a smaller cash outlay.
- (ii) **Ease of Shorting:** Taking a short position in futures is simpler, less costly and may be executed at any time - there is no requirement for an uptick.
- (iii) **Flexibility:** Future investors can use the instruments to speculate, hedge, spread or for use in a large array of sophisticated strategies.

Stock Futures also have disadvantages. These include:

- (i) **Risk:** In a stock future contract, there is the risk of losing significantly more than the initial investment (margin deposit).
- (ii) **No Stockholder Privileges:** The future owner has no voting rights and no rights to dividends.
- (iii) **Required Vigilance:** Stock Futures are investments that require investors to monitor their positions more closely than many would like to do. Because future accounts are marked to the market every business day, there is the possibility that the brokerage firm might issue a margin call, requiring the investor to decide whether to quickly deposit additional funds or liquidate the position.

QUESTION NO. 22 What are the reasons for stock index futures becoming more popular financial derivatives over stock futures segment in India ?
(CA Final)(May 2010 6 Marks)

➔ Trading in stock index futures contracts was introduced by the Kansas City Board of Trade on February 24, 1982. In April 1982, the Chicago Mercantile Exchange (CME) began trading in futures contract based on the Standard and Poor's Index of 500 common stocks. The introduction of both contracts was successful, especially the S&P 500 futures contract, adopted by most institutional investors.

➔ In India, both the NSE and the BSE have introduced index futures in the S&P CNX Nifty and the BSE Sensex.

➔ **Uses of Stock Index Futures:** Investors can use stock index futures to perform myriad tasks. Some common uses are:

- (i) to speculate on changes in specific markets;
- (ii) to change the weightings of portfolios;
- (iii) to separate market timing from market selection decisions; and
- (iv) to take part in index arbitrage, whereby the investors seek to gain profits whenever a futures contract is trading out of line with the fair price of the securities underlying it.
- (v) Using Indexes to Hedge Portfolio Risk: Aside from the above uses of indexes, investors often use stock index futures to hedge the value of their portfolios.

➔ **Main reasons to trade stock index futures are:**

Stock index futures is most popular financial derivatives over stock futures due to following reasons:

Life is Finite, While Knowledge is Infinte. When anger rises, think of the consequences. The future depends on what we do in the present. - Mahatma Gandhi

1. It adds flexibility to one's investment portfolio. The stock systems do not provide this flexibility and hedging.
 2. It creates the possibility of speculative gains using leverage. Speculative gains in stock futures are limited but liabilities are greater.
 3. Stock index futures are the most cost efficient hedging device whereas hedging through individual stock futures is costlier.
 4. Stock index futures cannot be easily manipulated whereas individual stock price can be exploited more easily.
 5. Since, stock index futures consists of many securities, so being an average stock, is much less volatile than individual stock price.
- Further, it implies much lower capital adequacy and margin requirements in comparison of individual stock futures. Risk diversification is possible under stock index future than in stock futures.
6. One can sell contracts as readily as one buys them and the amount of margin required is the same.
 7. In case of individual stocks the outstanding positions are settled normally against physical delivery of shares. In case of stock index futures they are settled in cash all over the world on the premise that index value is safely accepted as the settlement price.
 8. It is also seen that regulatory complexity is much less in the case of stock index futures in comparison to stock futures.
 9. It provides hedging or insurance protection for a stock portfolio in a falling market.

QUESTION NO. 23 Write a short note on EMBEDDED DERIVATIVES ? (CA Final)(SFM Nov 2008)

➡ **Meaning :** An embedded derivative is a derivative instrument that is embedded in another contract - the host contract. The host contract might be a debt or equity instrument, a lease, an insurance contract or a sale or purchase contract.

➡ **Illustration :** A coal purchase contract may include a clause that links the price of the coal to a pricing formula based on the prevailing electricity price or a related index at the date of delivery. The coal purchase contract, which qualifies for the executory contract exemption, is described as the host contract, and the pricing formula is the embedded derivative.

➡ **When must embedded derivatives be accounted for?** An embedded derivative is split from the host contract and accounted for separately if:

- (i) Its economics are not 'closely related' to those of the host contract;
- (ii) A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- (iii) The entire contract is not carried at fair value through profit or loss.

QUESTION NO. 24 Write a short note on SIDEWAYS MARKET ?

➡ A situation where stock prices change little over a specific period of time.

➡ Consequently, traders who follow trends when making their investment decisions will tend to perform poorly during a sideways market.

QUESTION NO. 25 Write a short note on Commodity Derivatives ? or Write a short note on total set of customer needs concerning commodity derivatives ?

➡ **Introduction:** Trading in derivatives first started to protect farmers from the risk of the value of their crop going below the cost price of their produce. Derivative contracts were offered on various agricultural products like cotton, rice, coffee, wheat, pepper and and so on.

➡ **Necessary Conditions To Introduce Commodity Derivatives:** The following attributes are considered crucial for qualifying for the derivatives trade:

- (1) a commodity should be durable and it should be possible to store it;
- (2) units must be homogeneous;

Memories play a very confusing role...They make you laugh when you remember the time you cried. But make you cry when you remember the time you laughed. "It may be that those who do most, dream most."

- (3) the commodity must be subject to frequent price fluctuations with wide amplitude; supply and demand must be large;
 (4) supply must flow naturally to market.

Total set of customer needs concerning commodity derivatives

➡ The total set of customer needs concerning commodity derivatives is differentiated into instrumental needs and convenience needs .

➡ Instrumental needs are the hedgers' needs for price risk reduction.

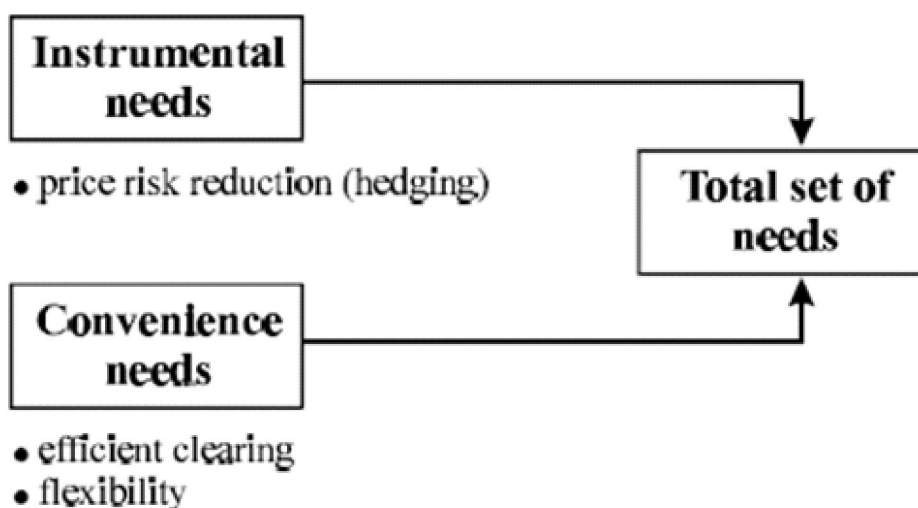
➡ Not only do hedgers wish to reduce price risk, they also desire flexibility in doing business, easy access to the market, and an efficient clearing system. These needs are called convenience needs.

➡ Some of the advantages of commodity markets are:

(i) Most money managers prefer derivatives to tangible commodities;

(ii) Less hassle (delivery, etc);

(iii) Allows indirect investment in real assets that could provide an additional hedge against inflation risk.



➡ **Special characteristics of Commodity derivatives trading are:** (i) To complement investment in companies that use commodities; (ii) To invest in a country's consumption and production; (iii) No dividends, only returns from price increases

➡ Four popular national commodity exchanges of India are : National Multi-Commodity Exchange of India (NMCE), National Board of Trade (NBOT), National Commodity and Derivatives Exchange (NCDEX) and Multi Commodity Exchange (MCX).

➡ National Commodity and Derivatives Exchange (NCDEX) is the largest commodity derivatives exchange with a turnover of around Rs 3,000 crore (Rs 30 billion) every fortnight.

QUESTION NO. 26 Write a short note on Commodity Futures ?

➡ Commodities futures, or futures contracts, are an agreement to buy or sell a commodity at a specific date in the future at a specific price.

➡ Just like the price of bananas at the grocery store, the prices of commodities can change on a weekly or even daily basis. If the price goes up, the buyer of the futures contract makes money, because he gets the product at the lower, agreed-upon price and can now sell it at the higher, market price. If the price goes down, the seller makes money, because he can buy the commodity at the lower market price, and sell it to the buyer at the higher, agreed-upon price.

➡ **Advantages Of Commodity Futures :** 1 Easiest and cheapest way to invest in commodities 2. Can either buy (go long) or sell (go short) 3. Can trade with a small amount of capital 4. Volatility offers potential for quick profits

Be Optimistic Always. See Height Of Optimism:

Solider-Sir We Are Surrounded! ArMy Major-Excellent We Can Attack In Any Direction...

➔ **Disadvantage Of Commodity Futures :** 1. Principal/Initial Investment is not guaranteed 2. High risk due to use of leverage 3. High price volatility could lead to margin calls

➔ **Major Categories of Commodity Futures Are:** 1. Agricultural products (soft commodities) –fibers, grains, food, livestock 2. Energy – crude oil, heating oil, natural gas 3. Metals – copper, aluminum, gold, silver, platinum

QUESTION NO. 27 Write a short note on Commodity Swaps ?

➔ **Meaning:** A swap where exchanged cash flows are dependent on the price of an underlying commodity. This is usually used to hedge against the price of a commodity. The vast majority of commodity swaps involve oil. Commodity swaps are used to lock-in the price of a commodity. Commodity swaps are becoming increasingly common in the energy and agricultural industries, where demand and supply are both subject to considerable uncertainty. It is a swap in which at least one set of payments is based on the price of a commodity, such as oil.

➔ **Types Of Commodity Swaps :** There are two types of commodity swaps: fixed-floating or commodity-for-interest.

(a) **Fixed-Floating Swaps:**

(b) **Commodity-for-Interest Swaps:**

➔ Commodity swaps are characterized by some distinctive peculiarities, though. These include the following factors for which we must account (at a minimum):

(i) The cost of hedging (ii) The institutional structure of the particular commodity market in question (iii) The liquidity of the underlying commodity market (iv) Seasonality and its effects on the underlying commodity market (v) The variability of the futures bid/offer spread (vi) Brokerage fees (vii) Credit risk, capital costs and administrative costs.

QUESTION NO. 28 What is Fundamental Analysis ? What are the key variables that an investor must monitor in order to carry out his fundamental analysis?

➔ **Fundamental Analysis** is based on the premise that the price of a share is based on the benefits the holders of the share is expected to receive in the future in the form of dividends. The present value of future dividends, computed at an appropriate discount rate to reflect the riskiness of the share, is called the intrinsic or fundamental value of the share.

➔ **Computation :**

Constant Dividend Approach: $P_0 = \frac{DPS}{K_e}$

Dividend Growth Approach: $P_0 = \frac{DPS_1}{K_e - g}$ or $\frac{DPS_0(1+g)}{K_e - g}$

The fundamental analysts use the above models or some of their variations, for estimating the fundamental or intrinsic price or the fundamental price-earnings multiple of a security.

➔ **Decision To Be Taken By Fundamental Analysts :**

If the prevailing price or the P/E multiple of a security is higher than the estimated fundamental value, the security is overpriced, the decision in such case will be to sell such security

If the prevailing price or the P/E multiple of a security is lesser than the estimated fundamental value, the security is underpriced, the decision in such case will be to buy such security

➔ **Key Variables Of Fundamental Analysis :** The key variables that an investor must monitor in order to carrying out his fundamental analysis are : 1. Economy Analysis 2. Industry Analysis 3. Firm/Company Analysis

1. **Economy Analysis:**

Factors Affecting Economic Analysis (a) Growth Rates of National Income and Related Measure (b) Growth Rates of Industrial Sector (c) Inflation (d) Monsoon

"Don't Tell God How Big Your Problems Are, Learn to Tell Your Problems How Big Your God is!!"

"Live only for today, for tomorrow may never come."

Some of the techniques used for economic analysis are: (a) Anticipatory Surveys (b) Barometer/Indicator Approach (i) Leading Indicators (ii) Roughly Coincidental Indicators (iii) Lagging Indicators (c) Economic Model Building Approach

2. Industry Analysis:

Factors Affecting Industry Analysis (a) Product Life-Cycle (b) Demand Supply Gap (c) Barriers to Entry (d) Government Attitude (e) State of Competition in the Industry (f) Cost Conditions and Profitability (g) Technology and Research

Some of the techniques used for Industry Analysis are: (a) Regression Analysis (b) Input-Output Analysis

3. Firm/Company Analysis:

Factors Affecting Company Analysis (a) Net Worth & Book Value (b) Sources & Uses of funds (c) Cross-Sectional & Time Series Analysis (d) Size and Ranking, (e) Growth Record, (f) Financial Analysis, (g) Quality of Management, (h) Location and Labour-Management Relations, (i) Pattern of Existing Stock Holding, (j) Marketability of the Shares

Some of the techniques used for company analysis are: (a) Correlation & Regression Analysis (b) Trend Analysis (c) Decision Tree Analysis

QUESTION NO. 29 Explain briefly 'Technical Analysis' to Portfolio Management? or Write a short note on Evaluation of Technical Analysis ? or What are the charts used by Technical analysts ?

➡ **Meaning :** Technical Analysis is a method of share price movements based on a study of price graphs or charts on the assumption that share price trends are repetitive, that what is seen to have happened before is likely to be repeated. In other words Technical analysis is based on the proposition that the securities prices and volume in past suggest their future price behaviour.

➡ Technical analysts use three types of charts for analyzing data. They are:

(i) Bar Chart :

(ii) Line Chart:

(iii) Point and Figure Chart:

Note: For detailed Graph on each chart please refer comprehensive Theory Book By Aaditya Jain Available In Leading Book Stores.

QUESTION NO. 30 Explain General Principles And Methods Of Technical Analysis?

1. The Dow Theory:

2. Market Indicators

(i) Breadth Index:

(ii) Volume of Transactions:

(iii) Confidence Index:

(iv) Relative Strength Analysis:

(v) Odd - Lot Theory:

3. Support and Resistance Levels

4. Moving Averages

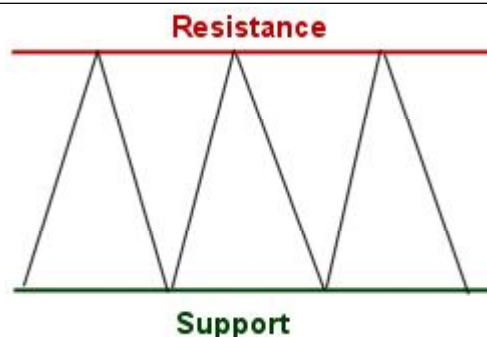
5. Bollinger Bands

QUESTION NO.31 Write a short note on SUPPORT AND RESISTANCE ?

➡ Support and resistance is one of the most widely used concepts in trading.

➡ When the index/price goes down from a peak, the peak becomes the resistance level. Resistance levels act like a ceiling for the price of a stock. As the price rises up to a resistance level, it tends to stop, turn around and move lower.

*There are no secrets to success. It is the result of preparation, hard work, learning from failure
The difficulties of life are intended to make us better, not bitter*



➔ When the index/price starts falling, the lowest value reached becomes the support level. Support levels act like a floor for the price of stock. As the price of a stock drops down to a support level it tends to stop at that point, turn around and move higher.

➔ The price is then expected to move between these two levels.

➔ Whenever the price approaches the resistance level, there is a selling pressure because all investors who failed to sell at the high would be keen to liquidate, while whenever the price approaches the support level, there is a buying pressure as all those investors who failed to buy at the lowest price would like to purchase the share.

➔ Support levels indicate the price where the most of investors believe that prices will move higher. Resistance levels indicate the price at which the most of investors feel prices will move lower.

QUESTION NO. 32 Name some price patterns documented by technical analysts ?

Interpreting Price Patterns: There are numerous price patterns documented by technical analysts. Some of which are as follows :

(a) **Channel:**

(b) **Wedge:**

(c) **Head and Shoulders:**

(i) **Head and Shoulder Top Pattern:**

(ii) **Inverse Head and Shoulder Pattern:**

(d) **Triangle or Coil Formation:**

(e) **Flags and Pennants Form:**

(f) **Double Top Form:**

(g) **Double Bottom Form:**

Note: For detailed Graph on each chart please refer comprehensive Theory Book By Aaditya Jain Available In Leading Book Stores.

QUESTION NO. 33 Write a short note on Moving Averages ?

➔ Moving Averages is one of the more popular methods of data analysis for decision making.

➔ Moving averages are frequently plotted with prices to make buy and sell decisions.

➔ The classic interpretation of a moving average is to use it in observing changes in prices. Investors typically buy when the price of an instrument rises above its moving average and sell when it falls below its moving average.

➔ The two types of moving averages used by chartists are :

(i) Arithmetic Moving Average (AMA) or Simple Moving Average (SMA) and (ii) the Exponential Moving Average (EMA).

SIMPLE MOVING AVERAGE (SMA)

" Always follow your dreams, and never let the flame in your heart burn out. The day you're born is the day you start to die, so make every day count. Every new day bring new light and hope."

➔ A “simple” moving average is calculated by adding the instrument prices for the most recent “n” time periods and then dividing by “n”.

EXPONENTIAL MOVING AVERAGE (EMA)

➔ The exponential moving average is a type of moving average that gives more weight to recent prices in an attempt to make it more responsive to new information.

➔ Formula: $EMA = EMA \text{ yesterday} + a \times [\text{Price Today} - EMA \text{ Yesterday}]$

➔ To identify trend, technical analysts use moving average analysis:

(i) A 200 day's moving average of daily prices or a 30 week moving of weekly price for identifying a long term trend.

(ii) A 60 day's moving average of daily price to discern an intermediate term trend.

(iii) A 10 day's moving average of daily price to detect a short term trend.

➔ Buy and Sell Signals Provided by Moving Average Analysis

Buy Signal

(a) Stock price line rise through the moving average line when graph of the moving average line is flattening out.

(b) Stock price line falls below moving average line which is rising.

(c) Stock price line which is above moving average line falls but begins to rise again before reaching the moving average line

Sell Signal

(a) Stock price line falls through moving average line when graph of the moving average line is flattening out.

(b) Stock price line rises above moving average line which is falling.

(c) Stock price line which is below moving average line rises but begins to fall again before reaching the moving average line.

QUESTION NO. 34 Write a short note on Bollinger Bands ?

➔ **Bollinger Bands** are a technical analysis tool invented by John Bollinger in the 1980s. Having evolved from the concept of trading bands, Bollinger Bands can be used to measure the highness or lowness of the price relative to previous trades.

➔ When stock prices continually touch the upper Bollinger band, the prices are thought to be overbought; conversely, when they continually touch the lower band, prices are thought to be oversold, triggering a buy signal. In other words The closer the prices move to the upper band, the more overbought the market, and the closer the prices move to the lower band, the more oversold the market.

➔ When the markets become more volatile, the bands widen (move further away from the average), and during less volatile periods, the bands contract (move closer to the average).



➔ The technician can be relatively certain that almost all of the price data needed will be found between the two bands.

*If you judge people, you have no time to love them. -- Mother Teresa
" For others to understand you, you must first understand yourself."*

➔ Bollinger Bands serve two primary functions:

- To identify periods of high and low volatility
- To identify periods when prices are at extreme, and possibly unsustainable, levels.

➔ Bollinger Bands consist of:

- a middle band · an upper band · a lower band

➔ Calculation:

Upper Band = SMA + (2 × Standard Deviation)

Middle Bollinger Band = Simple Moving Average (SMA)

Lower Band = SMA - (2 × Standard Deviation)

➔ There are two indicators derived from Bollinger Bands, %b pronounced 'percent b' and BandWidth.

Bandwidth = (Bollinger Upper Band - Bollinger Lower Band) / Bollinger Middle Band

%b = (last closing value - lowerBB) / (upperBB - lowerBB)

QUESTION NO. 35 Write a short note on Signals ?

Signals: Momentum is a basic application of oscillator analysis, designated to measure the rate of price change, not the actual price level. Three common signals are

(a) **Zero-line Crossings:**

(b) **Trend line Violations:**

(c) **Extreme Values:**

QUESTION NO. 36 Write some of the basic rules which should be remembered with regard to bonds ?

➔ Some basic rules which should be remembered with regard to bonds are:

- (a) When the required rate of return equals the coupon rate, the bond sells at par value. (b) When the required rate of return exceeds the coupon rate, the bond sells at a discount. The discount declines as maturity approaches. (c) When the required rate of return is less than the coupon rate, the bond sells at a premium. The premium declines as maturity approaches. (d) The longer the maturity of a bond, the greater is its price change with a given change in the required rate of return.

QUESTION NO. 37 Explain the Traditional Approach to Portfolio Management?

The traditional approach to portfolio management concerns itself with the

(a) **Investor; definition of portfolio objectives:**

(b) **Investment strategy :**

(c) **Diversification :**

(d) **Selection of individual investment :**

QUESTION NO. 38 Write a short note on DOW JONES THEORY ?

➔ The Dow Jones Theory is probably the most popular theory regarding the behaviour of stock market prices. The theory derives its name from Charles H. Dow, who formulated this theory.

➔ The Dow Theory is one of the oldest and most famous technical theories.

➔ The Dow Theory's purpose is to determine where the market is and where it is going.

➔ The Dow Jones theory classifies the movements of the prices on the share market into three major categories:

1. Primary Movements.
2. Secondary Movements.
3. Daily Fluctuations.

"Success is possible even working part-time using your computer in a homebased business as long as you are willing to work, learn & persevere." "Go the extra mile. It's never crowded."

1. **Primary Movements** : They reflect the trend of the stock market & last from one year to three years, or sometimes even more.

During a Bull phase, the primary trend is that of rise in prices.

During a Bear Phase, the primary trend is that of fall in prices.

2. **Secondary Movements** : These movements are opposite in direction to the primary movements and are shorter in duration. These movements normally last from three weeks to three months

Hence in Graph 1 above, Primary Trend is Rising and in Graph 2, Primary Trend is Falling

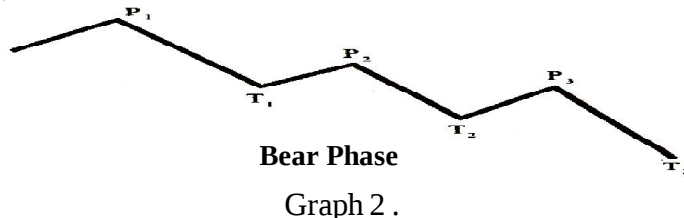
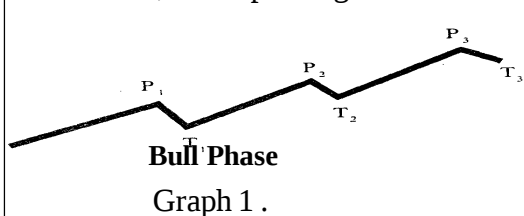
Hence in Graph 1 above, Secondary Trend is Falling and in Graph 2, Secondary Trend is Rising

3. **Daily Movements** : There are irregular fluctuations which occur every day in the market. These fluctuations are without any definite trend.

→ **Benefit Of Dow- Jones Theory** :

(a) **Timings of Investments** : Investor can choose the appropriate time for his investment / divestment .Investment should be made in shares when their prices have reached the lowest level, and sell them at a time when they reached the highest peak.

(b) **Identification of Trend** : Using Dow-Jones theory, the correct and appropriate movement in the Market Prices can be identified, and depending on the investors preference, decisions can be taken.



QUESTION NO. 39 Write a short note on Efficiency Market Theory ?

→ **Meaning**: Market Efficiency Theory is “the degree to which stock prices reflect all available, relevant information.” Furthermore, the Efficient Market Hypothesis claims “that a market cannot be outperformed because all available information is already built into all stock prices”.

→ **Misconception about Efficient Market Theory**:

(i) Though the Efficient Market Theory implies that market has perfect forecasting abilities, in fact, it merely signifies that prices impound all available information and as such does not mean that market possesses perfect forecasting abilities.

(ii) Although price tends to fluctuate they cannot reflect fair value.

(iii) Inability of institutional portfolio managers to achieve superior investment performance implies that they lack competence in an efficient market.

(iv) The random movement of stock prices suggests that stock market is irrational.

→ **Level of Market Efficiency** : There exist three levels of market efficiency:-

(i) **Weak Form Efficiency** – Price reflect all information found in the record of past prices and volumes.

(ii) **Semi – Strong Efficiency** – Price reflect not only all information found in the record of past prices and volumes but also all other publicly available information.

(iii) **Strong Form Efficiency** – Price reflect all available information public as well as private.

→ **Empirical Evidence on Weak Form Efficient Market Theory** :

(a) **Serial Correlation Test**:

(b) **Run Test**:

(c) **Filter Rules Test** :

→ **Empirical Evidence on Semi-strong Efficient Market Theory**:

Several studies support the Semi-Strong Form Efficient Market Theory. Fama, Fisher, Jensen and Roll in their adjustment

“Life should be enjoyable; too often we think it’s about achievement. The truth is that making life enjoyable is an achievement in itself.” “ Rejection is always better then regret.”

of stock prices to new information examined the effect of stock split on return of 940 stock splits in New York Stock Exchange during the period 1957-1959. They found that prior to the split, stock earns higher returns than predicted by any market model. Boll and Bound in an empirical evaluation of accounting income numbers, studied the effect of annual earnings announcements.

➔ **Empirical Evidence on Strong Form Efficient Market Theory:**

According to the Efficient Market Theory, all available information, public or private, is reflected in the stock prices. This represents an extreme hypothesis. To test this theory, the researcher analysed returns earned by certain groups viz. corporate insiders, specialists on stock exchanges, mutual fund managers who have access to internal information (not publicly available), or possess greater resource or ability to intensively analyse information in the public domain. They suggested that corporate insiders (having access to internal information) and stock exchange specialists (having monopolistic exposure) earn superior rate of return after adjustment of risk.

➔ **Challenges to the Efficient Market Theory :**

- (a) **Information Inadequacy** –
- (b) **Limited information processing capabilities** –
- (c) **Irrational Behaviour** –
- (d) **Monopolistic Influence** –

QUESTION NO. 40 What are the assumption of Markowitz Model Of Risk-Return Optimization OR the Modern Approach to Portfolio Management? ?

➔ Harry Markowitz is regarded as the father of modern portfolio theory. According to him, investors are mainly concerned with two properties of an asset: risk and return, but by diversification of portfolio it is possible to tradeoff between them.

➔ **Assumptions of the Model:** This model is based on the following assumptions. :

- (i) The return on an investment adequately summarises the outcome of the investment.
- (ii) The investors can visualise a probability distribution of rates of return.
- (iii) The investors' risk estimates are proportional to the variance of return they perceive for a security or portfolio.
- (iv) Investors base their investment decisions on two criteria i.e. expected return and variance of return.
- (v) All investors are risk averse.
- (vi) Investors are assumed to be rational in so far as they would prefer greater returns to lesser ones given equal or smaller risk and are risk averse.
- (vii) 'Return' could be any suitable measure of monetary inflows like NPV but yield has been the most commonly used measure of return, so that where the standard deviation of returns is referred it is meant the standard deviation of yield about its expected value.

QUESTION NO. 41 Explain the Random Walk Theory to Portfolio Management? (CA Final)

➔ The supporters of this theory put out a simple argument. It follows that:

- (a) Prices of shares in stock market can never be predicted.
- (b) The reason is that the price trends are not the result of any underlying factors, but that they represent a statistical expression of past data.
- (c) There may be periodical ups or downs in share prices, but no connection can be established between two successive peaks (high price of stocks) and troughs (low price of stocks).

This hypothesis is known as Random Walk hypothesis which states that the behaviour of stock market prices is unpredictable and that there is no relationship between the present prices of the shares and their future prices.

“Don't wait until people are dead to give them flowers.” “Don't let your pride or a lack of courage stand in the way of saying you're sorry to people you may have offended.”

QUESTION NO. 42 Write a short note on CAPM? OR Write a short note on Assumptions of CAPM?**(CA Final)**

→ The Capital Assets Pricing Model was developed by Sharpe, Mossin and Lintner in 1960. The model explains the relationship between the expected return, non-diversifiable risk and the valuation of security.

→ Under CAPM, the expected return from a Security can be expressed as :

Expected Return = Risk Free Rate + Beta of a Security (Market Return - Risk Free Rate)

→ CAPM only takes into account Systematic Risk. The CAPM is an economic model that describes how securities are priced in the market place.

→ **Assumption Of CAPM** : The CAPM is based on following eight assumptions :

(i) **Efficient Market** :

(ii) **Rational Investment Goals** :

(iii) **Risk aversion** in efficient market is adhered to although at times risk seeking behaviour is adopted for gains.

(iv) CAPM assumes that all assets are divisible and liquid assets.

(v) Investors are able to borrow freely at a risk less rate of interest i.e. borrowings can fetch equal return by investing in safe Government securities.

(vi) Securities can be exchanged without payment of brokerage, commissions or taxes and without any transaction cost.

(vii) Securities or capital assets face no bankruptcy or insolvency.

→ **Security Market Line** : A graphical representation of CAPM is the Security Market Line, (SML).

→ **Advantages of CAPM** : The advantages of CAPM can be listed as:

(i) **Risk Adjusted Return** : It provides a reasonable basis for estimating the required return on an investment which has risk built into it. Hence it can be used as Risk Adjusted Discount Rate in Capital Budgeting.

(ii) **No Dividend Company** : It is useful in computing the cost of equity of a company which does not declare dividend.

→ **Limitations of CAPM**

(a) **Reliability of Beta** : Statistically reliable Beta might not exist for shares of many firms. It may not be possible to determine the cost of equity of all firms using CAPM. All shortcomings that apply to Beta value apply to CAPM too.

(b) **Other Risks** : By emphasizing only on systematic risk it ignores unsystematic risks. Unsystematic Risks are also important to share holders who do not possess a diversified portfolio.

(c) **Information Available** : It is extremely difficult to obtain important information on risk free interest rate and expected return on market portfolio as there are multiple risk free rates for one while for another, markets being volatile it varies over time period.

QUESTION NO. 43 State the Objectives of Portfolio Management?**(CA Final)**

(i) **Security/Safety of Principal**

(ii) **Stability of Income**

(iii) **Capital Growth**

(iv) **Marketability**

(v) **Liquidity**

(vi) **Diversification** :

(vii) **Favourable Tax Status** :

QUESTION NO. 44 Mention the major activities involved in an efficient Portfolio Management?

The following three major activities are involved in an efficient portfolio management:

(i) Identification of assets or securities, allocation of investment and identifying asset classes.

"One of the few things that can't be recycled is wasted time."

The best way to make your dreams come true is to wake up. "God gives burdens, but also shoulders"

- (ii) Deciding about major weights/proportion of different assets/securities in the portfolio.
- (iii) Security selection within the asset classes as identified earlier.

QUESTION NO. 45 State two basic principles for effective Portfolio Management?

(CA Final)

Basic Principles of Portfolio Management : There are two basic principles for effective portfolio management.

Effective investment planning for the investment in securities by considering the following factors :

- (a) Fiscal, Financial and Monetary Policies of the Government of India and the Reserve Bank of India.
- (b) Industrial and economic environment and its impact on industry prospects in terms of prospective technological changes, competition in the market, capacity utilisation with industry and demand prospects etc.

(ii) Constant Review of Investment : Portfolio managers are required to review their investment in securities and continue selling and purchasing their investment in more profitable avenues. For this purpose they will have to carry the following analysis:

(a) Assessment of quality of management of the companies in which investment has already been made or is proposed to be made.

(b) Financial & trend analysis of companies balance sheet/profit&loss account to identify sound companies with optimum capital structure & better performance & to disinvest the holding of those companies whose performance is found to be slackening.

(c) The analysis of securities market and its trend is to be done on a continuous basis.

The above analysis will help the portfolio manager to arrive at a conclusion as to whether the securities already in possession should be disinvested and new securities be purchased. If so, the timing for investment or dis-investment is also revealed.

QUESTION NO. 46 Write short notes on : “Factor effecting investment decisions in Portfolio Management” ?

Factor effecting investment decisions in Portfolio Management are as follows :

(i) **Objectives of Investment Portfolio** :

(ii) **Selection of Investment** :

(iii) **Timing of Purchase** :

QUESTION NO. 47 Two broad choices are required for the formulation of an appropriate portfolio strategy ? What are they?

Two broad choices are required for the formulation of an appropriate portfolio strategy. They are active portfolio strategy and passive portfolio strategy.

Active Portfolio Strategy (APS) : An APS is followed by most investment professionals and aggressive investors who strive to earn superior return after adjustment for risk. There are four principle vectors of active strategy. They are:

(a) **Market Timing** : Market timing is based on an explicit or implicit forecast of general market movement. A variety of tools are employed for market timing analysis namely business cycle analysis, moving average analysis, advance-decline analysis, Econometric models.

(b) **Sector Rotation** : Sector or group rotation may apply to both stock and bond component of the portfolio. It is used more compulsorily with respect to strategy. The components of the portfolio are used when it involves shifting. The weighting for various industry sectors is based on their asset outlook.

(c) **Security Selection** : Security selection involves a search for under price security. If one has to resort to active stock selection he may employ fundamental / technical analysis to identify stocks which seems to promise superior return and concentrate the stock components of portfolio on them. Such stock will be over weighted relative to their position in the

“As simple as it sounds, we all must try to be the best person we can: by making the best choices, by making the most of the talents we’ve been given.” It is a rough road that leads to the heights of greatness.

market portfolio. Like wise stock which are perceived to be unattractive will be under weighted relative to their position in the market portfolio. As far as bonds are concerned security selection calls for choosing bonds which offer the highest yields to maturity and at a given level of risk.

(d) Use of Specialised Investment Concept : To achieve superior return, one has to employ a specialised concept/philosophy particularly with respect to investment in stocks. The concept which have been exploited successfully are growth stock, neglected or out of favour stocks, asset stocks, technology stocks and cyclical stocks. The advantage of cultivating a specialized investment concept is that it helps to :

(i) Focus one's effort on a certain kind of investment that reflects one's ability and talent.

(ii) Avoid the distraction of perusing other alternatives.

(iii) Master an approach or style through sustained practice and continual self criticism.

The greatest disadvantage of focusing exclusively on a specialized concept is that it may become obsolete. The changes in the market risk may cast a shadow over the validity of the basic premise underlying the investor philosophy.

Passive Portfolio Strategy : Active strategy was based on the premise that the capital market is characterized by efficiency which can be exploited by resorting to market timing or sector rotation or security selection or use of special concept or some combination of these vectors. Passive strategy, on the other hand, rests on the tenet that the capital market is fairly efficient with respect to the available information. Hence they search for superior return. Basically, passive strategy involves adhering to two guidelines. They are :

(a) Create a well diversified portfolio at a predetermined level of risk.

(b) Hold the portfolio relatively unchanged overtime unless it became adequately diversified or inconsistent with the investor risk return preference.

QUESTION NO. 48 Write a short note on Portfolio Strategic Matrix ?

➔ Keth Ambachster has developed a matrix which pulls together the elements of timing and selectivity which can be a useful guide for developing one's portfolio strategy.

Ability to select		Ability to forecast overall market	
Good	Good	(a) Concentrate holding in selective undervalued securities rather than diversify broadly.	(b) Shift Beta above and below the desired long term average based on the market forecasts.
	Poor	(a) Hold a good broadly diversified list of securities.	(b) Shift Beta above and below the desired long term average based market forecast.
Good	Good	(a) Concentrate holding in selective undervalued security rather than diversify broadly.	(b) Keep Beta stable at the desired long term average.
	Poor	(a) Hold a good broadly diversified list of securities.	(b) Keep Beta stable at the desired long-term average.

QUESTION NO. 49 What are the criteria which must be kept in mind in Selection of Securities ?

Selection of Bonds : Bonds are fixed income avenues. The following factors have to be evaluated in selecting fixed income avenues:

(a) Yield to Maturity :

(b) Risk of Default :

(c) Tax Shield :

"We all have dreams. But in order to make dreams into reality, it takes an awful lot of determination, dedication, self-discipline, and effort." " We don't cross the river by just looking on the other side."

(d) Liquidity :

Selection of Stock (Equity Share) : Three approaches are applied for selection of equity shares-

- (a) Technical Analysis
- (b) Fundamental Analysis
- (c) Random Selection Analysis

QUESTION NO. 50 Security market is thronged by four types of players/transactors? Explain or What are the Key Players of Security Market ?

Security market is thronged by four types of players/transactors

- (a) **Value Based Transactor (V.B.T):**
- (b) **Information Based Transactor (I.B.T.):**
- (c) **Liquidity Based Transactor (L.B.T.):**
- (d) **Pseudo Information Based Transactor (P.I.B.T.):**
- (e) **Dealers:**

Summary of Trading Motivations, Time, Horizons and Time Vs Price Preferences

Transactors	Motivations	Time Horizons	Time vs. Price Preference
V.B.T.	Discrepancy between value and price	Weeks to Months	Price
I.B.T.	New information	Hours to days	Time
L.B.T.	Release or absorb cash	Hours to days	Time
P.I.B.T.	Apparently new information	Hours to days	Time
Dealers	Accommodation	Minutes to hour	Indifferent.

QUESTION NO. 51 What are guidelines which have to be borne in mind while executing security transaction?

Following guidelines have to be borne in mind while executing transaction :

- (a) Maintain a dialogue with the broker when trade is seriously contemplated. Check with the broker about the sensitivity of the stock to buying and selling pressure, the volume that can be traded without pushing the price out of the desirable range, the manipulative games played by operators and degree of market resilience.
- (b) Place an order which serves one's interest best. Different kinds of order can be placed with broker, the common one's are – market order, best effort order, market on open order, limit order.
- (i) Market order instructs the broker to execute the transaction promptly at the best available price. This order leaves very little discretion to the broker
- (ii) The best offer order gives the broker a certain measure of discretion to execute a transaction when he considers market condition more favorable.
- (iii) The market on open order instructs the broker to execute the transaction no sooner the market opens.
- (iv) The limit order instructs the broker to execute the transaction only within the price that is specified in the order, the timing of the order trade is left according to market conditions.
- (v) For IBT, the most appropriate order is market order or market open order, for VBT most appropriate order is the limit order, while for LBT and PIBT the most appropriate orders may be the best-effort order.

QUESTION NO. 52 Write a short note on Portfolio Rebalancing ?

→ **Meaning :** It means the value of portfolio as well as its composition. The relative proportion of bond and stocks may

Don't say you don't have enough time. You have exactly the same number of hours per day that were given to Helen Keller, Pasteur, Michaelangelo, Mother Teresa, Leonardo da Vinci, Thomas Jefferson, & Albert Einstein.

change as stock and bonds fluctuate in response to such changes. Portfolio rebalancing is necessary.

→ There are three policies of portfolio rebalancing- Buy and hold policy, Constant mix policy, and Constant proportion portfolio insurance policy (CPPI). These policies have different pay off under varying market conditions.

→ **Purpose of Rebalancing** (i) For increasing returns & (ii) Maintaining risk profile

→ **Benefits of Portfolio Rebalancing**

(i) **Disciplined investing**: Rebalancing is a vital part of investment policy - there can be no asset allocation target without the discipline to preserve that target.

(ii) **Reduces risk**: A plan may incur higher risk if no rebalancing policy exists.

(iii) **Buy low, sell high**: Rebalancing is a mechanism for sensible timing - the process naturally buys low and sells high. This strategy ensures that the portfolio returns are enhanced.

(iv) A clear rebalancing policy avoids the risks of ad-hoc and costly portfolio revisions.

(a) **Buy and Hold Policy**:

The initial mix that is bought is held. This is basically a 'do nothing' policy in respect of what happens to relative values of rebalancing if done.

(b) **Constant Mix Policy**: In this case Ratio of Equity & Debt is to be maintained every time portfolio is rebalanced.

(c) **Constant Proportion Portfolio Insurance Policy (CPPI)**:

Investment in stocks or equity is to be maintained in the following manner = $m(\text{Portfolio value} - \text{Floor value})$ where m stands for multiplier.

The performance feature of the three policies may be summed up as follows:

(a) **Buy and Hold Policy**

(i) Gives rise to a straight line pay off.

(ii) Provides a definite downside protection.

(iii) Performance between Constant mix policy and CPPI policy.

(b) **Constant Mix Policy**

(i) Gives rise to concave pay off drive.

(ii) Doesn't provide much downward protection and tends to do relatively poor in the up market.

(iii) Tends to do very well in flat but fluctuating market.

(c) **CPPI Policy**

(i) Gives rise to a convex pay off drive.

(ii) Provides good downside protection and performance well in up market.

(iii) Tends to do very poorly in flat but in fluctuating market.

QUESTION NO. 53 Write a short note on Asset Allocation Strategies ?

Many portfolios containing equities also contain other asset categories, so the management factors are not limited to equities. There are four asset allocation strategies:

(a) **Integrated Asset Allocation**: Under this strategy, capital market conditions and investor objectives and constraints are examined and the allocation that best serves the investor's needs while incorporating the capital market forecast is determined.

(b) **Strategic Asset Allocation**: Under this strategy, optimal portfolio mixes based on returns, risk, and co-variances is generated using historical information and adjusted periodically to restore target allocation within the context of the investor's objectives and constraints.

(c) **Tactical Asset Allocation**: Under this strategy, investor's risk tolerance is assumed constant and the asset allocation is changed based on expectations about capital market conditions.

(d) **Insured Asset Allocation**: Under this strategy, risk exposure for changing portfolio values (wealth) is adjusted; more

The difference between a successful person and others is not a lack of strength, not a lack of knowledge, but rather a lack in will. "The most important time in life is the present."

value means more ability to take risk.

QUESTION NO. 54 Write a short note on Hedge Funds ?

➔ Hedge Fund is an aggressively managed portfolio of investments that uses advanced investment strategies such as leverage, long, short and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark).

➔ **Benefits Of Hedge Funds** : There are many advantages of hedge funds. Some of the important advantages are:

(a) Many hedge fund strategies have the ability to generate positive returns in both rising and falling equity and bond markets.

(b) Inclusion of hedge funds in a balanced portfolio reduces overall portfolio risk and volatility and increases returns.

(c) Huge variety of hedge fund investment styles – many uncorrelated with each other – provides investors with a wide choice of hedge fund strategies to meet their investment objectives. Academic research proves hedge funds have higher returns and lower overall risk than traditional investment funds.

(d) Hedge funds provide an ideal long-term investment solution, eliminating the need to correctly time entry and exit from markets.

(e) Adding hedge funds to an investment portfolio provides diversification not otherwise available in traditional investing.

➔ **Main Features Of Hedge Funds** : The key characteristics of hedge funds can be stated as follows:

(a) Hedge funds utilize a variety of financial instruments to reduce risk, enhance returns and minimize the correlation with equity and bond markets. Many hedge funds are flexible in their investment options (can use short selling, leverage, derivatives such as puts, calls, options, futures, etc.).

(b) Hedge funds vary enormously in terms of investment returns, volatility and risk. Many, but not all, hedge fund strategies tend to hedge against downturns in the markets being traded.

(c) Many hedge funds have the ability to deliver non-market correlated returns.

(d) Many hedge funds have as an objective consistency of returns and capital preservation rather than magnitude of returns.

(e) Most hedge funds are managed by experienced investment professionals who are generally disciplined and diligent.

(f) Pension funds, endowments, insurance companies, private banks and high net worth individuals and families invest in hedge funds to minimize overall portfolio volatility and enhance returns.

(g) Most hedge fund managers are highly specialized and trade only within their area of expertise and competitive advantage.

(h) Hedge funds benefit by heavily linking hedge fund managers' remuneration towards performance incentives, thus attracting the best brains in the investment business. In addition, hedge fund managers usually have their own money invested in their fund.

➔ **Hedging Strategies**: Wide ranges of hedging strategies are available to hedge funds. For example:

(i) **Selling Short** :

(ii) **Using Arbitrage** :

(iii) **Trading Options or Derivatives** :

(iv) **Investing in Anticipation of a Specific Event** :

(v) **Investing in Deeply Discounted Securities** :

(vi) **Investing In Securities Which Are Non-Correlated to the direction of Equity Market**

Hedge Funds Industry Scenario Of The World : The hedge funds industry around the world is estimated to be \$300-\$400 billion and is growing at about 20% per year with between 4,000 and 5,000 active hedge funds.

Different Styles Of Hedge Funds :

(a) **Aggressive Growth**:

(b) **Distressed Securities**:

*"A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty."
You must motivate yourself EVERYDAY! "Always do what you are afraid to do."*

- (c) Emerging Markets:
- (d) Funds of Hedge Funds:
- (e) Income:
- (f) Macro:
- (g) Market Neutral: Arbitrage:
- (h) Market Neutral: Securities Hedging:
- (i) Market Timing:
- (j) Opportunistic:
- (k) Multi Strategy:
- (l) Short Selling:
- (m) Special Situations:
- (n) Value:

Broad Categories Of Hedge Fund : The three broad hedge fund categories are based on the types of strategies they use:

- (a) Arbitrage Strategies (Relative Value) :
- (b) Event-Driven Strategies:
- (c) Directional or Tactical Strategies:

Reasons For Investing In a Hedge Fund :

- (a) **Potential for Higher Returns, Especially in a Bear Market:**
- (b) **Diversification Benefits:**

Demerits Of Hedge Funds -

- (i) Hedge fund investors are exposed to multiple risks, and each strategy has its own unique risks.
- (ii) **Fat Tails Are The Problem:** The problem is that hedge fund returns do not follow the symmetrical return paths implied by traditional volatility. Instead, hedge fund returns tend to be skewed.

QUESTION NO. 55 What is the Difference Between Hedge Funds and Mutual Funds ?

➡ Hedge funds are like mutual funds in two respects:

- (i) they are pooled investment vehicles (i.e. several investors entrust their money to a manager) and
- (ii) they invest in publicly traded securities.

But there are important differences between a hedge fund and a mutual fund.

- (i) Investors give hedge funds the freedom to pursue absolute return strategies. While Mutual Funds Seek Relative Returns
- (ii) Unlike mutual funds, which are “long-only” (make only buy-sell decisions), a hedge fund engages in more aggressive strategies and positions, such as short selling, trading in derivative instruments like options and using leverage (borrowing) Leveraging and other higher-risk investment strategies are a hallmark of hedge fund management.
- (iii) Hedge funds are more popular in bear markets. In a bull market, hedge funds may not perform as well as mutual funds, but in a bear market - taken as a group or asset class - they should do better than mutual funds because they hold short positions and hedges.
- (iv) Hedge funds are “liberated” with respect to registration, investment positions, liquidity and fee structure. Hedge funds in general are not registered with the authorities like in USA with SEC. Mutual funds are heavily regulated by the SEC (Securities & Exchange Commission).
- (iv) Furthermore, hedge funds are prohibited from soliciting or advertising to a general audience. Hedge funds aren’t supposed to publicly market themselves. Mutual funds advertise heavily.
- (v) In hedge funds, liquidity is a key concern for investors. Liquidity provisions vary, but invested funds may be difficult to withdraw “at will”.

Let others lead small lives, but not you. Let others argue over small things, but not you. Let others cry over small hurts, but not you. Let others leave their future in someone else’s hands, but not you.

(vi) Hedge funds are more expensive than Mutual Funds.

(vii) Hedge funds are private investment pools that apply aggressive investment strategies and leverage. Mutual funds are public investment companies that typically invest in stocks, bonds and cash.

(viii) Typically hedge funds are used by wealthy individuals. The US government only allows high net worth individuals and institutional investors to invest in them. However anyone can invest in mutual funds.

(ix) Hedge Funds are not required to make periodic reports under the regulations. Mutual funds report their prices daily.

QUESTION NO. 56 Write a short note on Benefits of International Portfolio Management ?

(a) **Reduce Risk & Diversification Benefits:**

(b) **Raise Return through better Risk – Return Trade off :**

QUESTION NO. 61 List and briefly explain the main functions of an investment bank. (CA Final)(May 2010)

Main Functions of an Investment Bank : The following are, briefly, a summary of investment banking functions:

-Managing an IPO (Initial Public Offering):

-Issue of debt:

-Mergers and Acquisitions:

-Private Placement:

-Financial Restructuring:

QUESTION NO. 57 Write a note on "Credit Rating" in India?(CA Final)

➔ **Meaning** Credit Rating is an act of assigning values to credit instruments by assessing the solvency i.e. the ability of the borrower to repay debt. Thus Credit Rating is:

(1) An expression of opinion of a rating agency. (2) The opinion is in regard to a debt instrument. (3) The opinion is as on a specific date. (4) The opinion is dependent on risk evaluation. (5) The opinion depends on the probability of interest and principal obligations being met timely.

➔ **What Credit Rating do not indicate** It may be noted that credit rating is only an opinion and not the guarantee or protection against default. It is not a recommendation to buy, or sell, or hold a security. Thus Credit Rating does not in any way linked with

(1) Performance Evaluation of the rated entity unless called for. (2) Investment Recommendation by the rating agency to invest or not in the instrument to be rated. (3) Legal Compliance by the issuer-entity through audit. (4) Opinion on the holding company, subsidiaries or associates of the issuer entity.

➔ **Credit Rating in India** (i) CRISIL (Credit Rating & Information Services of India Ltd.) (ii) ICRA (Investment Information and Credit Rating Agency of India) (iii) CARE (Credit Analysis and Research Limited) (iv) Fitch Ratings India (P) Ltd. CRISIL was the first credit rating agency in India, incorporated in 1987 jointly by ICICI and the UTI. CRISIL has pioneered the concept of Credit Rating in India.

QUESTION NO. 58 Write a short note on Credit Rating Process ?

(1) **Request from issuer and analysis –**

(2) **Rating Committee –**

(3) **Communication to management and appeal –**

“None of us knows how much time we have left on this earth. So why not grab each day as it comes, make the most of it, explore it to the fullest, enjoy all its delights and treasures.”

- (4) Pronouncement of the rating –
- (5) Monitoring of the assigned rating –
- (6) Rating Watch –
- (7) Confidentiality of information –
- (8) Rating Credibility –
- (9) Rating Coverage –
- (10) Rating Scores –

QUESTION NO. 59 Write a short note on Uses Of Credit Rating ?

For users –

- (i) Aids in investment decisions.
- (ii) Helps in fulfilling regulatory obligations.
- (iii) Provides analysts in Mutual Funds to use credit ratings as one of the valuable inputs to their independent evaluation system.

For issuers –

- (i) Requirement of meeting regulatory obligations as per SEBI guidelines.
- (ii) Recognition given by prospective investors of providing value to the ratings which helps them to raise debt equity capital.

The rating process gives a viable market driven system which helps individuals to invest in financial instruments which are productive assets.

QUESTION NO. 60 Write a short note on CAMEL MODEL IN CREDIT RATING ? (CA Final May 2010)

CAMEL Stands for Capital, Assets, Management, Earnings and Liquidity. The CAMEL model adopted by the Rating Agencies deserves special attention, it focuses on the following aspects:

- (a) **Capital** – Composition of Retained Earnings and External Funds raised; Fixed dividend component for preference shares and fluctuating dividend component for equity shares and adequacy of long term funds adjusted to gearing levels; ability of issuer to raise further borrowings.
- (b) **Assets** – Revenue generating capacity of existing / proposed assets, fair values, technological / physical obsolescence, linkage of asset values to turnover, consistency, appropriation of methods of depreciation and adequacy of charge to revenues. Size, ageing and recoverability of monetary assets viz receivables and its linkage with turnover.
- (c) **Management** – Extent of involvement of management personnel, team-work, authority, timeliness, effectiveness and appropriateness of decision making along with directing management to achieve corporate goals.
- (d) **Earnings** – Absolute levels, trends, stability, adaptability to cyclical fluctuations ability of the entity to service existing and additional debts proposed.
- (e) **Liquidity** – Effectiveness of working capital management, corporate policies for stock and creditors, management and the ability of the corporate to meet their commitment in the short run.

These five aspects form the five core bases for estimating credit worthiness of an issuer which leads to the rating of an instrument.

QUESTION NO. 61 Write a short note on Limitations Of Credit Rating ? (CA Final)

- (1) Rating Changes –
- (2) Industry Specific rather than Company Specific –

If you want to accomplish anything in life, you can't just sit back & hope it will happen. You've got to make it happen. It is not because things are difficult that we do not dare, it is because we do not dare that things are difficult.

- (3) Cost Benefit Analysis –
 (4) Conflict of Interest –
 (5) Corporate Governance Issues –

QUESTION NO. 62 What is a depository ? Who are the major players of a depository system ? What advantage the depository system offer to the clearing member ? (CA Final)

→ The term 'Depository' means a place where something is deposited for safe keeping; Depository system is concerned with conversion of securities from physical to electronic form, settlement of trades in electronic segment, electronic transfer of ownership of shares and electronic custody of securities.

→ **Major players of a depository system:**

- | | | | |
|---------------|----------------------|---------------------------|--------------------|
| • Depository | • Issuers or Company | • Depository participants | • Clearing members |
| • Corporation | • Stock brokers | • Clearing Corporation | • Investors |
| | | | • Banks |

→ **Advantages to Clearing Member**

- Enhanced liquidity, safety, and turnover on stock market.
- Opportunity for development of retail brokerage business.
- Ability to arrange pledges without movement of physical scrip and further increase of trading activity, liquidity and profits.
- Improved protection of shareholder's rights resulting from more timely communications from the issuer.
- Reduced transaction costs.
- Elimination of forgery and counterfeit instruments with attendant reduction in settlement risk from bad deliveries.
- Provide automation to post-trading processing.
- Standardisation of procedures.

→ **Depositories In India** : 1. National Securities Depository Limited (NSDL) 2. Central Depository Service (India) Limited (CSDL) NSDL was registered by the SEBI on June 7, 1996 as India's first depository to facilitate trading and settlement of securities in the dematerialized form.

→ **Pros And Cons Of Depository Services:**

The major benefits accruing to investors & other market players are as follows :

1. Securities are held in a safe and convenient manner
2. Transfer of securities is effected immediately
3. Stamp duty for transfer is eliminated and transaction costs are reduced
4. Paper work is minimized
5. Bad deliveries, fake securities and delays in transfers are eliminated.
6. Routine changes viz. change in address of one person owning securities issued by different companies can be taken care of simultaneously for all securities with little delay.
7. Benefit accruing from issue of bonus shares, consolidation, split or merger is credited without much difficulty.
8. Payment of dividends and interest is expedited by the use of electronic clearing system.
9. Securities held in electronic form can be locked in and frozen from either a sale or purchase for any definite period.
10. Securities held in electronic form can also be pledged for any credit facility.

There are however risks as well

1. **Systemic failure** –
2. **Additional record keeping** –
3. **Cost of Depository Participant (DP)** –
4. **Human Fraud** –

"The first step toward change is acceptance. Once you accept yourself, you open the door to change. That's all you have to do. Change is not something you do, it's something you allow."

QUESTION NO. 63 Write a short note on Debit Cards ?

→ **Meaning :** Debit cards are also known as cheque cards. Debit cards look like credit cards or ATM (automated teller machine) cards, but operate like cash or a personal cheque. When one uses a debit card his money is quickly deducted from his savings account. Debit cards are accepted at many locations, including grocery stores, retail stores, gasoline stations, and restaurants. One can use his card anywhere. They offer an alternative to carrying a cheque book or cash.

→ **Difference Between Debit Cards and Credit Cards :** It's the difference between "debit" and "credit." Debit means "subtract." When one uses a debit card, one is subtracting his money from his own bank account. Debit cards allow him spend only what is in his bank account. Debit cards are different from credit cards. While a credit card is to "pay later," a debit card is to "pay now." Credit is money made available by a bank or other financial institution, like a loan.

→ **Benefits of Debit Cards :**

- (1) Obtaining a debit card is often easier than obtaining a credit card.
- (2) Using a debit card instead of writing cheques saves one from showing identification or giving his personal information at the time of the transaction.
- (3) Using a debit card frees him from carrying cash or a cheque book.
- (4) Using a debit card means he no longer has to stock up on traveller's cheques or cash when he travels
- (5) Debit cards may be more readily accepted by merchants than cheques, in other states or countries wherever the card brand is accepted.
- (6) The debit card is a quick, "pay now" product, giving one no grace period.
- (7) Returning goods or canceling services purchased with a debit card is treated as if the purchase were made with cash or a cheque.

→ **How To Use Debit Cards/Precaution to be taken while using Debit Cards :**

- (1) If the card is lost or stolen, report the loss immediately to the financial institution.
- (2) If one suspects his card is being fraudulently used, report it immediately to his financial institution.
- (3) Hold on to the receipts from debit card transactions. A thief may get name and debit card number from a receipt and order goods by mail or over the telephone. The card does not have to be missing in order for it to be misused.
- (4) If one has a PIN number, memorizing is required. Never keep PIN number with the card. Also, never choose a PIN number that a smart thief could figure out, such as phone number or birthday date.
- (5) Never give PIN number to anyone. Keep the PIN private.
- (6) Always know how much money you have in your account.
- (7) Keep your receipts in one place – for easy retrieval and better oversight of your bank account.

QUESTION NO. 64 What are the Advantages of Online Trading ?

1. Investors can have benefit of direct access to stock analysis.
2. They can put their trades as it gives the advantage of the real time live rates and real time transactions.
3. They can stream news and research, also get an advantage of viewing various charts and creating their own strategies.
4. It gives the investors a real access to the market.
5. Trade privacy is a key point which online trading offers. There is an increase in the trust and confidence of investors, both large and small which has resulted in increased online traders.
6. Since trading is totally internet based they get direct access to their trading platform from any place and any computer in the world.
7. Online trading has a great speed transparency at a very low cost.

QUESTION NO. 65 Write a short note on : EXCHANGE TRADED FUNDS (ETFs) ?

(CA Final)

"Risk more than others think is safe. Care more than others think is wise. Dream more than others think is practical. Expect more than others think is possible."

➔ **Meaning :** Exchange Traded Funds (ETFs) were introduced in US in 1993 and came to India around 2002. Exchange-Traded Funds (ETFs) are mutual fund schemes that are listed and traded on exchanges like any other stocks. An Exchange Traded Fund (ETF) is a hybrid product that combines the features of an index fund.

➔ ETFs invest in a basket of stocks and try to replicate a stock market index such as the S&P CNX Nifty or BSE Sensex

➔ **Advantage :**

1. By owning an ETF, you get the diversification of an index fund as well as the ability to sell short, buy on margin and purchase as little as one share.

2. Another advantage is that the expense ratios for most ETFs are lower than those of the average mutual fund. They have very low operating and transaction costs, since there are no loads required to purchase ETFs.

3. There is no paper work involved for investing in an ETF. These can be bought like any other stock by just placing an order with a broker.

4. A great reason to consider Exchange Traded Funds is that they simplify index and sector investing in a way that is easy to understand. If investors feel a turnaround is around the corner, they can go long. If, however, they think ominous clouds will be over the market for some time, they have the option of going short.

5. The combination of the instant diversification, low cost and the flexibility that Exchange Traded Funds offer makes these instruments one of the most useful innovations and attractive pieces of financial engineering to date.

QUESTION NO. 66 Write a short note on ADVANTAGES OF MUTUAL FUND ? (CA Final)

(1) **Professional Management:**

(2) **Diversification:**

(3) **Convenient Administration:**

(4) **Higher Returns:**

(5) **Low Cost of Management:**

(6) **Liquidity:**

(7) **Transparency:**

(8) **Highly Regulated:**

QUESTION NO. 67 Write a short note on KEY PLAYERS OF MUTUAL FUND ?

Mutual Fund is formed by a trust body.

(1) **Sponsor:** (2) **Asset Management Company:** (3) **Trustee:** (4) **Unit Holder:** (5) **Mutual Fund Organization**

(6) The three market intermediaries are: (1) **Custodian** (2) **Transfer Agents** (3) **Depository**

QUESTION NO. 68 Write a short note on classification of Mutual Funds ?

Classification of Mutual Funds: There are three different types of classification of mutual funds. (1) Functional (2) Portfolio and (3) Ownership. Each classification is mutually exclusive.

Functional Classification : Funds are divided into: Open Ended and Close Ended. (CA FINAL)

(i) **Number Of Units :** The number of units outstanding under the schemes of Open Ended Funds keeps on changing. A closed-end mutual fund is a publicly traded investment company with a limited number of units i.e number of units under Close Ended Funds is fixed.

(ii) **Maturity Period :** Open Ended schemes usually don't have a fixed maturity period whereas Close Ended Schemes have fixed maturity period.

(iii) **NAV / Market Price :** The price at which an investor buys or sell shares of a Close Ended Fund after the NFO (New Fund Offer) is the market price, as determined by the demand and supply market principles. In contrast, the price at which an investor buys or sells shares of a mutual fund is the NAV of the Mutual Fund at the close of a given business day.

(iv) **Sale and Purchase :** The Units of Open Ended Funds are available for subscription and redemption on an ongoing basis. An investor is allowed to join or withdraw from the fund at any time by the mutual fund companies at NAV related prices. The Units of Close Ended Funds can be purchased or sold by the investor only from the secondary market i.e

Most of the important things in the world have been achieved by people who have kept on trying when there seemed to be no hope at all." "Education is the best friend. An educated person is respected everywhere.

stock market after the initial public offerings or there may be periodic repurchase at NAV related price by Mutual Fund itself.

(v) **Listing** : Open Ended Funds are not listed on any stock exchange . While listing of close ended funds are compulsory on any Stock Exchange .

(vi) **Example** : The Unit Scheme - 1964 (US- 64) was an open ended mutual fund scheme. Recently introduced Reliance Natural Resources Fund was also an Open Ended Mutual Fund . UTI has recently come up with new fund offer (NFO) with name "India Lifestyle Fund". This will be a three year close ended scheme .

Portfolio Classification : Funds are classified into Equity Funds, Debt Funds and Special Funds.

Equity Funds are invested in equity stocks. They are of the following types viz.

(a) **Growth Funds** :

(b) **Aggressive Funds** :

(c) **Income Funds** :

(d) **Balanced Funds** :

Debt Funds are of two types viz.

(a) **Bond Funds** :

(b) **Gilt Funds** :

Special Funds are of four types viz.

(a) **Index Funds** :

(b) **International Funds** :

(c) **Offshore Funds** :

(d) **Sector Funds** :

Ownership Classification : Funds are classified into Public Sector Mutual Funds, Private Sector Mutual Funds, Foreign Mutual Funds. **Public Sector Mutual Funds** are sponsored by a company of the public sector. **Private Sector Mutual Fund** are sponsored by a company of the private sector. **Foreign Mutual Funds** are sponsored by companies for raising funds in India, operate from India and invest in India.

QUESTION NO. 69 Write a short note on Asset Valuation Rule of Mutual Fund ?

Asset Values : Valuation Rule

Nature of Asset

Liquid Assets e.g. cash held
All listed and traded securities
(other than those held as not for sale)
Debentures and Bonds
Illiquid shares or debentures

Fixed Income Securities

Valuation Rule

As per books.
Closing Market Price

Closing traded price or yield
Last available price or book value whichever is lower.
Estimated Market Price approach to be adopted if suitable benchmark is available.
Current Yield.

QUESTION NO. 70 What are the limitations/drawbacks of investing in Mutual Fund? (RTP, Nov 2009)

(1) **No guarantee of Return** – There are three issues involved :

(a) All Mutual Funds cannot be winners. There may be some who may under perform the benchmark index i.e. it may not even perform well as a beginner who invests in the stocks constituting the index.

(b) A mutual fund may perform better than the stock market but this does not necessarily lead to a gain for the investor. The

*Always forgive your enemies - Nothing annoys them so much. Love your enemies. It will drive them crazy!
Life is 10% what happens to us and 90% how we react to it. "A man is great by deeds, not by birth."*

market may have risen and the mutual fund scheme increased in value but the investor would have got the same increase had he invested in risk free investments than in mutual fund.

(c) Investors may forgive if the return is not adequate. But they will not do so if the principal is eroded. Mutual Fund investment may depreciate in value.

(2) **Diversification** – Diversification may minimize risk but does not guarantee higher return.

(3) **Selection of Proper Fund** – It may be easier to select the right share rather than the right fund. For stocks, one can base his selection on the parameters of economic, industry and company analysis. In case of mutual funds, past performance is the only criteria to fall back upon. But past cannot predict the future.

(4) **Cost Factor/ High Management Fee** – Mutual Funds carry a price tag. Fund Managers are the highest paid executives. While investing, one has to pay for entry load and when leaving he has to pay for exit load. Such costs reduce the return from mutual fund. The fees paid to the Asset Management Company is in no way related to performance. The Management Fees charged by the Fund reduces the return available to the investors.

(5) **Unethical Practices** – Mutual Funds may not play a fair game. There may be unethical practices e.g. diversion of Mutual Fund amounts by Mutual Funds to their sister concerns for making gains for them.

(6) **Others-**

-Mutual Funds systems do not maintain the kind of transparency they should maintain

-Many MF scheme are, at times, subject to lock in period, therefore, deny the market drawn benefits

-At times, the investments are subject to different kind of hidden costs.

-Redressal of grievances, if any, is not easy

QUESTION NO. 71 Write short note on 'Factors Influencing the selection of Mutual Fund '?

(1) **Past Performance** –

(2) **Timing** –

(3) **Size of Fund** –

(4) **Age of Fund** –

(5) **Largest Holding** –

(6) **Fund Manager** –

(7) **Expense Ratio** –

(8) **PE Ratio** –

(9) **Portfolio Turnover** –

QUESTION NO.72 Write short note on 'Signals Highlighting The Exit Of The Investor From The Mutual Fund Scheme'

(1) When the mutual fund consistently under performs the broad based index, it is high time that it should get out of the scheme. It would be better to invest in the index itself either by investing in the constituents of the index or by buying into an index fund.

(2) When the mutual fund consistently under performs its peer group instead of it being at the top. In such a case, we should get out of the scheme and then invest in the winning schemes.

(3) When the mutual fund changes its objectives e.g. instead of providing a regular income to the investor, the composition of the portfolio has changed to a growth fund mode which is not in tune with the investor's risk preferences.

(4) When the investor changes his objective of investing in a mutual fund which no longer is beneficial to him.

(5) When the fund manager, handling the mutual fund schemes, has been replaced by a new entrant whose image is not known.

There is keen competition at the bottom but there is always vacancy at the top." Look failure in the eye, have faith, do not submit, stand tall, overcome, and live knowing that failing in life is the key to rising above."

QUESTION NO. 73 Write a short note on Money Market Operations ?

- ➔ The money market is a market for short term financial assets that are close substitutes for money.
- ➔ The important feature of money market instrument is that it is liquid.
- ➔ This is market for borrowing and lending Short-term funds.
- ➔ Money market instrument are those instruments which have a maturity period of less than one year .
- ➔ It is a collection of markets such as Treasury Bills, Certificate of Deposits, Commercial Paper, Repo etc.

QUESTION NO. 74 What is the difference between Capital Market and Money Market? (CA Final)**Basics****(i)**Tenure**Money Market**

It is a market for lending and borrowing of short term funds, upto one year .

(ii)Well defined place

It is a not a well-defined market where business is done .

(iii)Short Term /Long Term

It deals in short term financial assets e.x .interbank call money, treasury bills,commercial paper, etc.

(iv)Classification

There is no sub-division in money market .

(v)Volume of business

The total value of transaction in money market far exceeds the capital market .According to DFHI only in call money market daily lending is Rs. 6000 crores around

(vi)No. of instrument

The number of instruments dealt in money market are various, e.g.(a) Interbank call money (b) Notice money upto 14 days (c) Short term deposits upto 3 months (d) 91 days treasury bill (e) 182 days treasury bill (f) Commercial paper etc.

(vii)Participants

The participants in money market are Bankers, RBI and Government .

(viii)Liquidity

The important features of money market instrument is that it is liquid.

(viii)Regulator

It is regulated by the guidelines of RBI

(ix) End Use

Capital raised are used for Working Capital needs only

(x)Risk

Low Credit & Market Risk

Capital Market

Capital markets deals in long term securities for a period beyond one year.

It is a well defined market where business is done e.g. stock exchange.

It deals in medium & long term financial assets e.g equity shares, debentures etc.

Capital Market is classified between Primary Market and Secondary Market. Capital market lag behind the total value of transaction done in money market.

The number of instruments in capital market are shares and debentures.

The participants in capital market are general investors, brokers, merchant bankers,registrars to issue, underwriters,corporate investors,Flls & Bankers.

Whereas Capital market are not as liquid as money market instrument.

It is regulated by the guidelines of SEBI.

Capital raised being long term,are used for fixed & working capital High Credit & Market Risk

QUESTION NO. 75 What is the role of Financial Advisor in PSU? (CA FINAL)

The financial adviser occupies an important position in all public sector undertakings (PSU). He functions as the principal advisor to the chief executive of the enterprise on all financial matters. The committee on public sector undertakings has specified the following functions and responsibilities for a financial adviser:

- (i)** Determination of financial needs of the firm and the ways these needs are to be met.
- (ii)** Formulation of a programme to provide most effective cost-volume profit relationship.
- (iii)** Analysis of financial results of all operations and recommendations concerning future operations.

Our greatest weakness lies in giving up. The most certain way to succeed is always to try just one more time. "Put all your excuses aside and remember this: YOU are capable."

(iv) Examination of feasibility studies & detailed project reports from the point of view of overall economic viability of the project.

(v) Conduct of special studies with a view to reduce costs and improve efficiency and profitability.

QUESTION NO. 76 List out few rigidities in the Indian Money Market?

The money market is not free from certain rigidities which are hampering the growth of the market. The most important rigidities in the Indian money market are: (i) Markets not integrated, (ii) High volatility, (iii) Players restricted, (iv) Supply based-sources influence uses, (v) Not many instruments, (vi) Players do not alternate between borrowing and lending, (vii) Reserve requirements, (viii) Lack of transparency, and, (ix) Inefficient Payment Systems (x) Interest rates not properly aligned.

QUESTION NO. 77 Write a short note on :

A. Call/Notice Money

(CA Final)

→ The core of the Indian money market structure is the interbank call money market which is centralised primarily in Mumbai, but with sub-markets in Delhi, Calcutta, Chennai and Ahmedabad.

→ **Meaning :** Call money or inter-bank call money is the medium through which the scheduled commercial banks lend, borrow or call at short notice to manage the day-to-day surpluses and deficits in the cash flow. The money that is lent for one day in this market is known as 'call money' and if it exceeds one day (but less than 15 days), it is referred as 'notice money'.

→ **Participants :** The participants in the markets are commercial banks, cooperative banks and primary dealers who can borrow and lend funds. Large mutual funds promoted by nationalised banks, private sector mutual funds and all India financial institutions can participate in the market as lenders only. Brokers are not permitted in the market.

→ **Risk Involved :**

(a) Interest rate in the market is market driven and is highly sensitive to the forces of demand and supply. Hence, the participants in the markets are exposed to a high degree of interest rate risk.

(b) The activities in the money market are subjected to fluctuations due to seasonal factors, i.e. busy (November to April) and slack (May to October) seasons.

→ **Factor Affecting Call Rates :** There are different factors which affect & make the call rates to be volatile. Some of these factors are :

(a) **Liquidity Position :** Call rates depend on the liquidity position of the economy in general and of the banking system in particular

(b) **CRR Requirement :** A reduction in CRR results in lesser cash balance to be maintained by banks which dampens the demand in call market and thus reducing the call rate.

(c) **Volatility in the Foreign Exchange Market :** Volatility in the foreign exchange market affects fluctuations in call rates.

(d) **Capital Market Conditions :** The volatility in call rate is also affected by the capital market conditions.

(e) **Level of Competition in the Call Market :** The level of competition and the number of participants affect the volatility in the call money market.

→ **Security :** No collateral security is required to cover these transactions .

→ **Account with RBI :** In view of the short tenure of such transactions , both the Borrowers and the Lenders are required to have current accounts with the Reserve Bank of India .

→ **Indian Scenario :** The emergence of a purely inter bank call money market is shaping up. In a recent development, Corporates are now not allowed to route call money transactions through primary dealers

"Anything's possible. You can be told you have a 90% chance or a 50% chance or a 1% chance, but you have to believe, and you have to fight." "Confidence is half of victory."

→ **Benefits :**

(a) **Even out day to day deficits:** Call Market enables Banks and Financial institutions to even out their day-to-day deficits and surplus of money.

(b) **Cash Reserve Requirements:** Commercial Banks, Co-operative Banks and Primary Dealers are allowed to borrow and lend in this market for adjusting their cash reserve requirements.

(c) **Outlet for Deploying Funds:** It serves as an outlet for deploying funds on short-term basis to the lenders having steady inflow of funds..

B. INTER-BANK PARTICIPATION CERTIFICATE (IBPC) (CA Final)

→ **Meaning :** A IBPC is a deed of transfer through which a bank, sells or transfers to a third party (transferee) a part or all of a loan made to its clients (borrowers). In other words The Inter Bank Participation Certificates are short term instruments to even out the short term liquidity within the Banking system particularly when there are imbalances affecting the maturity mix of assets in Banking Book.

→ **Why it is called so ? :** It is called a participation certificate because through it, the PC holder participates in a bank loan, and so also in the interest, the security of the loan, and risk of default on a proportionate basis.

→ **Objective:** The primary objective is to provide some degree of flexibility in the credit portfolio of banks & to smoothen the consortium arrangements.

→ **Who can Issue & Subscribe:** The IBPC can be issued by scheduled commercial bank and can be subscribed by any commercial bank.

→ **Issued against underlying Advance :** The IBPC is issued against an underlying advance, classified standard during the currency of the participation.

→ **Types :** The participation can be issued in two types, viz. with and without risk to the lender.

While the participation without risk can be issued for a period not exceeding 90 days. Participation with risk can be issued for a period between 91 days and 180 days.

→ **Benefits :** The scheme is beneficial both to the issuing and participating banks. **The issuing bank** can secure funds against advances without actually diluting its asset-mix. A bank having the highest loans to total asset ratio and liquidity bind can square the situation by issuing IBPCs. **To the lender,** it provides an opportunity to deploy the short term surplus funds in a secured and profitable manner. The IBPC with risk can also be used for capital adequacy management.

→ **Interest Rate:** The interest rate on IBPC is freely determined in the market. The certificates are neither transferable nor prematurely redeemable by the issuing bank.

→ **Current Scenario :** Despite its advantages, the IBPC scheme has not become a popular money market instrument. One of the reason for this may be the prohibition against transferability as the participants are not allowed to transfer the certificates. Secondly due to the absence of a ceiling on the interest rate the borrower bank has to pay the issuing bank a rate higher than that agreed with the borrower.

C. TREASURY BILLS (TBs) (CA Final)

→ **Meaning :** T-Bills are short term instruments issued by RBI on behalf of the Government of India to tide over short term liquidity shortfalls.

→ **Periodicity :** The periodicity of the T-Bills is 14 days, 28 days, 91 days, 182 days & 364 days.

→ **Issue Price :** Treasury Bills are issued at a discount and redeemed at face value .

→ **SGL Account :** T-Bills transactions are routed through the Special General Ledger (SGL) Accounts.

→ **Yield / Return :** The return from T-Bills is in the form of Capital Profit i.e difference between issue price (which is at a discount) & redemption price (at par) . Their yields can be calculated with the help of the following formula :

"Always make a total effort, even when the odds are against you." "Just keep going. Everybody gets better if they keep at it" " Right now your opponent is working twice as hard to defeat you. Will you be ready?"

$$y = \left[\frac{F - P}{P} \right] \times \frac{365}{m} \times 100 \quad \text{Where } Y = \text{Yield, } F = \text{Face Value, } P = \text{Issue Price/Purchase Price, } M = \text{Maturity}$$

→ **Features** : (i) Government's contribution to the money market, (ii) Mop-up short-term funds in the money market (iii) Sold through auctions, (iv) Discount rate is market driven (v) Focal Point for monetary policy.

→ **Advantages to Investor** (i) Manage cash position with minimum balances, (ii) Increased liquidity, (iii) Very little risk, (iv) Market related yield, (v) Eligible for repos, (vi) SLR security, (vii) Two-way quotes by DFHI/Primary Dealers Bank (viii) No capital loss,

→ **Auction** : T-bills are issued by the RBI through the auction method. There are two types of auctions for T-Bills

(i) Multiple Price Based (ii) Uniform Price Based

In Multiple Price Based all bids equal to or above the cut off price is accepted however, the bidder has to obtain the T-bills at the price quoted by him.

In Uniform Price Based all the bids equal to or above the cut off price are accepted at the cut off level. However unlike the multiple price based model, the bidder obtains the T-Bills at the cut off price and not the price quoted by him.

91 days T-Bills are auctioned under uniform price auction method where as 364 days T- Bills are auctioned on the basis of multiple price auction method .

→ **RBI Role** : The amount to be accepted at the auctions and the cut-off price are decided by the Reserve Bank of India on the basis of its public debt management policy, the conditions in money market and its monetary policy .

→ **Participants** : TBs can be purchased by any person, firm, company, corporate body and institutions.

→ **Lots** : TBs are issued in lots of Rs. 25,000 (14 days and 91 days)/Rs. 1,00,000 (364 days)

→ **Importance** The treasury bills are extremely important among money market instruments, both for the issuer & investors. Through these instruments, Government can raise funds for short term to meet the temporary mismatches in cash flows & mop up excess liquidity in the system. Thus it have emerged as an effective instrument for dyanmic asset-liability management.

D. COMMERCIAL BILLS or Derivative Usance Promissory Notes (DUPNs) :

→ The commercial bill is a instrument drawn by a seller of goods on a buyer of goods.

→ RBI has pioneered its efforts in developing bill culture in India, keeping in mind the distinct advantages of commercial bills, like, self-liquidating in nature, recourse to two parties, knowing exact date of transactions, transparency of transactions etc.

→ Under the Scheme, commercial banks can discount with approved institutions (i.e. Commercial Banks, Insurance Companies, Development Financial Institutions, Mutual Funds, Primary Dealers, etc.) the bills which were originally discounted by them provided that the bills should have arisen out of genuine commercial trade transactions.

→ The need for physical transfer of commercial bills has been waived and the rediscounting institution can now raise Derivative Usance Promissory Notes (DUPNs).

→ **DUPN** is an innovative instrument issued by the RBI to eliminate movement of papers and facilitating easy rediscounting.

→ **Backing** : DUPN is backed by up to 90 Days Usance Commercial Bills

→ **Transfer** : DUPN is transferable by endorsement and delivery and hence liquid .

→ **Stamp Duty** : Government has exempted stamp duty on derivative usance promissory notes.

→ **Maturity** : These DUPNs are sold to investors in convenient lots and maturities (15 days to 90 days) on the basis of genuine trade bills, discounted by the discounting bank.

→ **Condition** : The discounting bank should, comply with the following conditions,

(i) Bank which originally discounts the bills only draw DUPN.

(ii) Continue to hold unencumbered usance bills till the date of maturity of DUPN.

(iii) Matured bills should be substituted by fresh eligible bills.

"If u want to know your past -look into ur present conditions.If you want to know your future - look into your present actions." .Doubters do not win and Winners do not doubt.

(iv) The transactions underlying the DUPN should be bonafide commercial or trade transactions.

(v) The usance of the bill should not exceed 120 days & the unmatured period of such bills for drawing DUPN should not exceed 90 days.

→ **Issue at a discount** : The DUPN is issued at a discount which is realised at front-end.

→ **Yield** : The yield to the investor can be calculated with the following formula:
$$Y = \left\{ \left(1 + \frac{D}{100 \times M} \right)^M - 1 \right\} \times 100$$

Where Y = Actual Yield, D = Discount Rate, M = Period of discount compounded for one year (12/Number of months or 365/number of days)

→ **Importance** : Commercial bills re-discounting is a safe and highly liquid instrument having advantage to both borrower and lender. It can be better used for management of temporary mismatches in cash flows and asset-liability management. Hence it can be said that it is a negotiable self-liquidity instrument with low degree of risk.

E. CERTIFICATE OF DEPOSITS (CDs)

→ **Meaning** : Certificate of Deposit (CD) is a front ended negotiable instrument, issued at a discount and the face value is payable at maturity by the issuing bank. In short CDs are money market instruments in the form of usance Promissory Notes issued at a discount & are negotiable in character. There is a lock-in-period of 15 days, after which they can be sold.

→ **History** : The CDs were introduced in June, 1989 with the primary objective of providing a wholesale resource base to banks at market related interest rates.

→ **Eligible Issuers Of CD** - CDs can be issued only by scheduled commercial banks excluding Regional Rural Banks (RRBs). Recently Financial Institution (FIs) has also been allowed to issue CDs.

→ **Subscribers/Investors to CDs** : CDs can be issued to individuals, corporations, companies, trusts, funds, association, etc. Non-Resident Indians (NRIs) may also subscribe to CDs, but only on non-repatriable basis which should be clearly stated on the Certificate. Such CDs cannot be endorsed to another NRI in the secondary market.

→ **Yield** : In the case of CDs effective rate/yield to the bank will be calculated on the basis of the following formula:

$$Y = \left\{ \left(1 + \frac{D}{100 \times M} \right)^M - 1 \right\} \times 100 ; \text{Where } Y = \text{Actual Yield, } D = \text{Discount Rate, } M = \text{Period of discount compounded for one}$$

year (12/Number of months or 365/number of days)

→ **Minimum size of issue** : CDs can be issued for minimum amount of Rs. 5 lakhs to a single investor. CDs above Rs. 5 lakhs should be in multiples of Rs. 1 lakh. There is however no limit on the total quantum of funds raised through CDs.

→ **Transferability** : CDs are freely transferable by endorsement and delivery but only 15 days after the date of issue.

→ **Stamp Duty** : CDs are eligible to stamp duty as per provisions of Indian Stamps Act.

→ **Reserve requirements** : Banks have to maintain CRR and SLR on the issue price of the CDs.

→ **Loans/buy backs** - Banks cannot grant loans against CDs. Further, they cannot buy-back their own CDs before maturity.

→ **Interest** : The rate of interest is determined by the parties to the transaction freely.

→ **Importance** : The instrument has emerged as effective asset-liability management.

F. COMMERCIAL PAPER (CP)

(CA Final)

→ **Meaning** : CP is an unsecured debt instrument in the form of a promissory note issued by highly rated borrowers for tenors ranging between 15 days to one year for meeting working capital requirement directly from the market instead of borrowing from banks.

→ **Origination** : The concept of CPs was originated in USA in early 19th century when commercial banks monopolised

"The tragedy of life doesn't lie in not reaching your goal. The tragedy lies in having no goals to reach." "The only place where success comes before work is in the dictionary."

and charged high rate of interest on loans and advances. In India, the CP was introduced in January 1990 on the recommendation of Vaghul Committee.

→ **Conditions under which the CPs can be issued are:**

(i) the issuer company should have a minimum net worth and fund-based working capital limit of not less than Rs. 4 crores each.

(ii) the company should obtain a minimum rating as required from CRISIL/ICRA/CARE etc. which should not be more than 2 months old at the time of issue of CPs.

(iii) CP should be issued for a minimum period of 7 days and a maximum of less than 1 year

(iv) minimum amount of CP issued for a single investor will be Rs. 25 Lakhs in the minimum denomination of Rs. 5 Lakhs,

(v) CPs can be issued to a maximum of 100% of the fund-based working capital limits of issuer company,

(vi) the banks can neither extend any stand-by or underwriting facility nor guarantee payment of the instrument on maturity.

(vii) the CPs are subject to stamp duty. Besides, the issuer has to incur rating agency fee, issuing and paying agents fee, etc.

→ **Mode of CP** CP has to be issued at a discount to face value. Discount rate has to be freely determined by the market.

→ **Negotiability of CP** CP (being usance promissory note) would be freely negotiable by endorsement and delivery.

→ **Stamp Duty** The issue of CP would be subject to payment of stamp duty.

→ **Benefits of CP to the Issuer**

(i) **Low interest expenses** : The interest cost associated with the issuance of CP is normally expected to be less than the cost of bank financing.

(ii) **Access to short term funding** : CP issuance provides a company with increased access to short term funding sources.

(iii) **Flexibility and liquidity** : CP affords the issuer increased flexibility and liquidity in matching the exact amount and maturity of its debt to its current working capital requirement.

(iv) **Investor recognition** : The issuance of CP provides the issuer with favourable exposure to major institutional investors as well as wider distribution of its debt.

(v) **Ease and low cost of establishment** : A CP programme can be established with ease at a low cost, once the basic criteria have been satisfied.

→ **Benefits of CP to the Investor**

(i) **Higher yield** : Higher yields are expected to be generally obtainable on CP than on other short term money market instruments like bank deposits.

(ii) **Portfolio diversification** : Commercial Paper provides an attractive avenue for short term portfolio diversification.

(iii) **Flexibility** : CPs can be issued for periods ranging from 15 days to less than one year, thereby affording an opportunity to precisely match cash flow requirements.

(iv) **Liquidity** : Liquidity in CP is generally provided by a dealer offering to buy it back from an investor prior to maturity, for which a market quote will be available. The investment in CP will therefore be quite liquid.

→ **Principal Parties to a Commercial Paper Transaction** :

(i) The Issuer (ii) The Head Bank (iii) The Issuing and Paying Agency (iv) The Investor

(v) The Dealer (vi) Credit Rating Agency, e.g., CRISIL, ICRA etc. (vii) RBI

→ **Governing Authority** : Issue of CP is governed by RBI guidelines as amended from time to time.

→ **Limitation of Commercial Paper** : CP as a source of financing has its own limitations :

(i) Only highly credit rating firms can use it. New and moderately rated firms generally are not in a position to issue CP

(ii) CP can neither be redeemed before maturity nor can be extended beyond maturity.

QUESTION NO. 78 Write a Short Note on Repo [Repurchase Option] Agreement ? Briefly state the difference between Repo & Reverse Repo? Or What is Repo and Reverse Repo .(CA Final)(RTP SFM May 2010)

→ **A Repurchase Agreement (or repo)** is an agreement of sale of a security with a commitment to repurchase or buy the

"If you want total security, go to prison. There you're fed, clothed, given medical care, and so on. The only thing lacking... is freedom." If you have 50 friends - It is not enough but If you have one enemy - It is too much.

security back at a specified price and on a specified date .

➔ **Reverse repo** is a term used to describe the opposite side of a repo transaction. Reverse Repo is a purchase of security with a commitment to sell at a pre-determined price and date .Accordingly, there are **two possible motives for entering into a reverse repo**: short-term investment of funds, or to obtain temporary use of a particular security.

➔ **Repos/Reverse Repos are used :**

(i) to meet shortfall in cash position (ii) augment returns on funds held (iii) to borrow securities to meet regulatory requirement (iv) An SLR surplus bank and a CRR deficit bank can use the Repo deals as a convenient way of adjusting CRR/SLR positions simultaneously (v) RBI uses Repo and Reverse Repo deals as a convenient way of adjusting liquidity in the system.

➔ **The securities eligible for trading under Repo/Reverse Repo are:** (i) GOI & State Govt. Securities (ii) Treasury Bills (iii) PSU bonds, (iv) FI bonds & Corporate bonds held in Dematerialised form

➔ **Issuer :** In India, only RBI, Banks and PDs are allowed to enter into Repos. Financial institutions and others specified can only do reverse Repos.

➔ **Coupon/Interest terms :**

(a) **Computation :** Interest for the period of Repo is the difference between Sale Price and Purchase Price .The amount of interest earned on funds invested in a Repo is determined as follows :

Interest earned = Funds Invested × Repo Rate × Number of Days/365

(b) **Recognition :** Interest should be recognized on a time -proportion basis , both in the books of the buyer and seller.

(c) **Time Period :** Interest to be payable on maturity and rounded-off to the nearest rupee. Interest to be calculated on an actual/365-day year basis.

➔ **Maturity :** Repos are normally done for a minimum maturity period of one day & a maximum maturity period of fourteen days.

➔ **Minimum denomination and transaction size :** Generally Repo transactions are done in market lots of Rs 5 crores.

➔ The essential feature of Repo transaction are :

(i) A financial institution places certain securities (presently restricted to Treasury bills) with the buyer and borrows a certain amount of money.

(ii) On a given date specified in advance (between 14 days to 1 year) the entire transaction is reversed.

(iii) The difference between the purchase and sale price is the interest or gain to the buyer. Sometimes the seller may also gain from a transaction. This is when the buyer is in need of securities and initiates the transaction.

Difference Between Repo & Reverse Repo :

➔ **Reverse repo** is a term used to describe the opposite side of a repo transaction.

➔ The term Repurchase Agreement (Repo) and Reverse Repurchase Agreement (Reverse Repo) refer to a type of transaction in which money market participant raises funds by selling securities and simultaneously agreeing to repurchase the same after a specified time generally at a specified price, which typically includes interest at an agreed upon rate.

➔ Such a transaction is called a Repo when viewed from the perspective of the seller of securities (the party acquiring funds) and Reverse Repo when described from the point of view of the supplier of funds.

➔ Thus, whether a given agreement is termed a Repo or a Reverse Repo depends largely on which party initiated the transaction.

India's Position: Indian Repo market is governed by Reserve Bank of India. At present Repo is permitted between 64 players against Central and State Government Securities (including T-Bills) at Mumbai.

QUESTION NO. 79 Write a short note on Costs & Benefits of Host & Home country associated with FDI ?

Costs Involve

Host Country

(i) Inflow of foreign investment improves balance of payments position while outflow due to imports, dividend payments,

Everyone is a house with four rooms, a physical, a mental, an emotional & a spiritual. Most of us tend to live in one room most of the time, but unless we go into every room, every day, we are not a complete person

technical service fees, royalty reduces balance of payments position.

(ii) Use of imported raw materials may be harmful to the interest of the domestic country whereas it may be useful to the interests of the foreign country.

(iii) Supply of technology to the host country makes it dependent on the home country resulting in the payment of higher price for acquisition.

(iv) The technology may not be suitable to the local environment causing substantial loss to the host country.

(v) MNCs are reluctant to hire and train local persons. Advanced technology being capital intensive does not ensure bigger job prospects.

(vi) Foreign investors do not care to follow pollution standards; nor do they stick to the optimal use of natural resources nor have any concern about location of industries while opting for a manufacturing process. Such violation affects host nations interest.

(vii) Domestic industries cannot withstand the financial power exercised by the foreign investors and thereby die a premature death.

(viii) Because of their oligopolistic position in the market, foreign companies charge higher prices for their products. Higher prices dampen the spirit of the buyers and at the same time lead to an inflationary pressure.

(ix) Foreign culture is infused by these foreign companies in industrial units as well as to the society at large. Governmental decisions fall prey to such measures as they become a dominant force to reckon with.

Home Country

(i) Any foreign investment causes a transfer of capital, skilled personal and managerial talent from the country resulting in the home country's interest being hampered.

(ii) MNCs have the primary objective of maximising their overall profit while operating in different countries. The standards followed by them in most cases are not beneficial to the host nation. Such an action leads to deterioration in bilateral relations between the host and home country.

FDI is a mixed bag of bright features and dark spots. So it requires careful handling by both sides.

Benefits Derived

Host Country

(a) Improves balance of payment position by crediting the inflow of investment to capital account. Also current account improves as FDI aids import substitution/export promotion.

(b) Exports get a boost through the expertise of foreign investors possessing export market intelligence and their mechanism. Updated technology of producing world standard goods at low cost are available to the host country.

(c) Export credits from the cheapest source in the international market can be availed of quite easily.

(d) Foreign firms foster forward and backward economic linkages. Demand for various inputs give rise to the development of the supplying industries which through employment of labour force raise their income and increase the demand for domestic industrial production. The living standard of the domestic consumers improves as quality products at competitive prices are available. Also a pool of trained personnel is created in this context.

(e) Foreign investors by investing in economic / social infrastructure, financial markets and marketing systems helps the host country to develop a support base essential for quick industrialisation. The presence of foreign investors creates a multiplier effect leading to the emergence of a sound support system.

(f) Foreign investors are a boon to government to revenue with regard to the generation of additional income tax. Also they pay tariff on their imports. It results in lessening the burden on national budget.

(g) FDI aids to maintain a proper balance amongst the factors of production by the supply of scarce resources thereby accelerating economic growth.

Home Country

(i) The home country gets the benefit of the supply of raw materials if FDI helps in its exploitation.

(ii) BOP (Balance Of Payment) improves due to the parent company getting dividend, royalty, technical service fees and

"We can teach from our experience, but we cannot teach experience." "Teachers open the door, but you must enter by yourself." "Tell Yourself everyday " I'll never give in, until I win!"

also from its increased exports to the subsidiary.

(iii) Also there is employment generation and the parent company enters into newer financial markets by its investment outside.

(iv) FDI helps to develop closer political relationship between the home and the host country which is advantageous to both.

QUESTION NO. 80 Write a short note on Foreign Institutional Investment (FIIs) ?

➔ **Meaning :** FII means an entity established or incorporated outside India which proposes to make investment in India. India is being described as magnet to FIIs investments.

➔ **Advantage of FII** invests in India : (a) Enhanced flow of equity capital, (b) Improving capital markets, (c) Better corporate governance, and (d) Foreign investors confidence in India attracting FDI.

➔ **Disadvantage of FII** investments in India : (a) Fear of management control, (b) Potential capital outflows—foreign capital is hot money, it may leave any time— and (c) Foreign portfolio investment is described as notoriously volatile.

QUESTION NO. 81 Write a short note on External Commercial Borrowings (ECB) ? (CA Final)

➔ The foreign currency borrowings raised by the Indian corporates from confirmed banking sources outside India are called “External Commercial Borrowings” (ECBs).

➔ These Foreign Currency borrowings can be raised within ECB Policy guidelines of Govt. of India/ Reserve Bank of India applicable from time to time.

➔ External Commercial Borrowings (ECB) are defined to include

1. commercial bank loans,
2. buyer’s credit,
3. supplier’s credit,
4. securitised instruments such as floating rate notes, fixed rate bonds etc.,
5. credit from official export credit agencies,
6. commercial borrowings from the private sector window of multilateral financial institutions such as IFC, ADB, AFIC, CDC etc. and
7. Investment by Foreign Institutional Investors (FIIs) in dedicated debt funds

➔ **Benefits :** The ECBs route is beneficial to the Indian corporates on account of following :-

1. It provides the foreign currency funds which may not be available in India.
2. The cost of funds at times works out to be cheaper as compared to the cost of rupee funds.
3. The availability of the funds from the International market is huge as compared to domestic market and corporates can raise large amount of funds depending on the risk perception of the International market.
4. ECBs provided an additional source of funds to the Indian companies, allowing them to supplement domestically available resources and to take advantage of lower international interest rates.
5. ECB encourage infrastructure/core and export sector financing which are crucial for overall growth of the economy.

QUESTION NO. 82 Write a short note on instruments of International Finance ?

The various financial instruments dealt with in the international market are briefly described below :

1 Euro Bonds :

2 Foreign Bonds:

3 Fully Hedged Bonds :

Do it now! can affect every phase of ur life. It can help u do the things you should do but don't feel like doing. It helps you seize those precious moments that, if lost, may never be retrieved

4 Floating Rate Notes :

5 Euro Commercial Papers :

6 Foreign Currency Options :

7 Foreign Currency Futures :

QUESTION NO. 83 Write a short note on the following topics :

A. FCCB (Foreign Currency Convertible Bonds)

➔ A type of convertible bond issued in a currency different than the issuer's domestic currency. In other words, the money being raised by the issuing company is in the form of a foreign currency. A convertible bond is a mix between a debt and equity instrument. It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholder the option to convert the bond into stock. These types of bonds are attractive to both investors and issuers. The investors receive the safety of guaranteed payments on the bond & are also able to take advantage of any large price appreciation in the company's stock.

➔ **Advantages of FCCBs**

1. The convertible bond gives the investor the flexibility to convert the bond into equity at a price or redeem the bond at the end of a specified period, normally three years if the price of the share has not met his expectations.
2. Companies prefer bonds as it defers the dilution of equity and earnings per share.
3. FCCBs are easily marketable as investors enjoy option of conversion into equity if resulting to capital appreciation. Further investor is assured of a minimum fixed interest earnings.

➔ **Disadvantages of FCCBs**

1. Exchange Risk is more in FCCBs as interest on bonds would be payable in foreign currency. Thus companies with low debt equity ratios, large forex earnings potential only opt for FCCBs.
2. FCCBs mean creation of more debt and a forex outgo in terms of interest which is in foreign exchange.
3. There is exchange risk on the interest payment as well as re-payment if the bonds are not converted into equity shares.

➔ **Recent Example :** In the first quarter of 2007 Reliance Communications company raised \$1 billion FCCB. It was one of the biggest FCCBs from India.

B. GDR (Global Depository Receipts) Or Impact of GDRs on Indian Capital Market

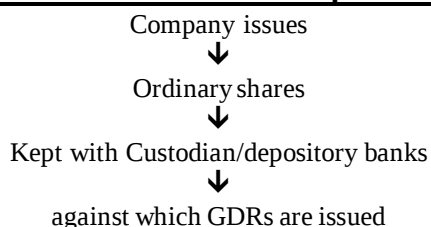
(SFM, Nov 2009)

➔ A Global Depository Receipt or Global Depository Receipt (GDR) is a certificate issued by a depository bank, which purchases shares of foreign companies and deposits it on the account. Global Depository Receipts facilitate trade of shares, and are commonly used to invest in companies from developing or emerging markets.

Several international banks issue GDRs, such as JPMorgan Chase, Citigroup, Deutsche Bank, Bank of New York. GDRs are often listed in the Frankfurt Stock Exchange, Luxembourg Stock Exchange and in the London Stock Exchange, where they are traded on the International Order Book (IOB).

➔ GDR are negotiable instruments issued to Overseas Depository Bank on behalf of an Indian Company to raise funds abroad.

➔ **The mechanics of a GDR issue may be described with the help of following diagram.**



Every adversity, every failure, every heartache carries with it the seed of an equal or greater benefit. "The biggest challenge you have is to challenge your own self-doubt & your laziness"



to Foreign investors

→ **Impact of GDRs on Indian Capital Market** Since the inception of GDRs a remarkable change in Indian capital market has been observed as follows.

- (i) Indian stock market to some extent is shifting from Bombay to Luxembourg.
- (ii) There is arbitrage possibility in GDR issues.
- (iii) Indian stock market is no longer independent from the rest of the world. This puts additional strain on the investors as they now need to keep updated with-world wide economic events.
- (iv) Indian retail investors are completely sidelined. By placement of GDRs to Foreign Institutional Investors' plus free pricing implies that retail investors can no longer expect to make easy money on heavily discounted rights/public issues. As a result of introduction of GDRs a considerable foreign investment has flown into India.

→ **Markets of GDR'S**

- (i) GDR's are sold primarily to institutional investors.
- (ii) Demand is likely to be dominated by emerging market funds.
- (iii) Switching by foreign institutional investors from ordinary shares into GDRs is likely.
- (iv) Major demand is also in UK, USA, South East Asia (Hong kong, Singapore), and to some extent continental Europe (principally France and Switzerland) .

→ **Profile of GDR investors** : The following parameters have been observed in regard to GDR investors.

- (i) Dedicated convertible investors
- (ii) Equity investors who wish to add holdings on reduced risk or who require income enhancement.
- (iii) Fixed income investors who wish to enhance returns.
- (iv) Retail investors: Retail investment money normally managed by continental European banks which on an aggregate basis provide a significant base for Euro-convertible issues.

→ **Characteristics**

- (i) Holders of GDRs participate in the economic benefits of being ordinary shareholders though they do not have voting rights.
- (ii) GDRs are settled through CEDEL & Euro-clear international book entry systems.
- (iii) GDRs are listed on the Luxembourg stock exchange.
- (iv) Trading takes place between professional market makers on an OTC (over the counter) basis.

→ **Advantages of GDRs :**

- (a) The issuer has the benefit of collecting the issue proceeds in foreign currency which may be utilized for meeting the foreign exchange component of the project cost, repayment of foreign currency / loan etc.
- (b) It has been perceived that a GDR issue has been able to fetch higher prices from international investors than those that a domestic public issue would have been able to extract from Indian investors.
- (c) GDR does not entitle the holder to any voting rights, so there is no fear of loss of management and control.
- (d) GDR does not involve any foreign exchange risk to the issuing company , as the shares represented by GDR are expressed in rupees.

→ **Current Scenario** : It has been perceived that a GDR issue has been able to fetch higher prices from international investors than those that a domestic public issue would have been able to extract from Indian investors.

→ **Indian Example** : Among the Indian companies, Reliance Industries Ltd. was the first company (1992) to raise funds through a GDR Issue. Recently Tata Motors on 9th Oct 2009 raised \$375 million through a GDR issue, becoming the third company from the Tata Empire, after Tata Steel and Tata Power.

C. **Euro Convertible Bonds**

(CA Final)

→ A convertible bond is a debt instrument which gives the holders of the bond an option to convert the bond into a

*One of the main reasons people are not rich is that they worry too much about things that might never happen.
" Once you set your mind with enthusiasm and persistence, nothing is impossible."*

predetermined number of equity shares of the company. Usually, the price of the equity shares at the time of conversion will have a premium element. The bonds carry a fixed rate of interest.

➔ If the issuer company desires, the issue of such bonds may carry two options viz. -

(i) Call Options: (Issuer's Option) - Where the terms of issue of the bonds contain a provision for call option, the issuer company has the option of calling (buying) the bonds for redemption before the date of maturity of the bonds. This call option forces the investors to convert the bonds into equity.

(ii) Put Options: (Holder's Option) - A provision of put option gives the holder of the bonds a right to put (sell) his bonds back to the issuer company at a pre-determined price and date.

➔ In case of Euro-convertible bonds, the payment of interest and the redemption of the bonds will be made by the issuer company in US dollars

➔ Indian companies which have opted ECBs issue are Jindal Strips, Reliance, Essar Gujarat, Sterlite etc. Indian companies are increasingly looking at Euro-Convertible bond in place of Global Depository Receipts because GDRs are falling into disfavour among international fund managers.

D. American Depository Receipts

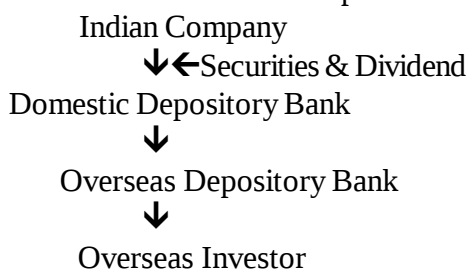
(CA Final)

➔ **Meaning :** An American Depository Receipt (abbreviated ADR) represents ownership in the shares of a non-U.S. company that trades in U.S. financial markets. The stock of many non-US companies trade on US stock exchanges through the use of ADRs. ADRs enable U.S. investors to buy shares in foreign companies without the hazards or inconveniences of cross-border & cross-currency transactions. ADRs carry prices in US dollars, pay dividends in US dollars, and can be traded like the shares of US-based companies.

➔ The first ADR was introduced by JPMorgan in 1927, for the British retailer Selfridges. Four major commercial banks that provide depository bank services - JPMorgan, Citibank, Deutsche Bank and the Bank of New York Mellon.

➔ **Statutory Compliance :** Such receipts have to be issued in accordance with the provisions stipulated by the Securities and Exchange Commission of USA (SEC) which are very stringent. Regulations include requirement such as minimum size of issue, reporting to SEC, adherence to US GAAP in reporting etc.

➔ **Mechanism for ADR issue :** An ADR is generally created by the deposit of the securities of a non-United States company with a custodian bank in the country of incorporation of the issuing company. The custodian bank informs the depository in the United States that the ADRs can be issued. ADRs are United States dollar denominated and are traded in the same way as are the securities of United States companies. The pictorial representation of the process is given below



➔ **Types of ADRs :** There are three types of ADRs:

Un-sponsored ADRs are issued without any formal agreement between the issuing company and the depository, although the issuing company must consent to the creation of the ADR facility. For the issuing company, they provide a relatively inexpensive method of accessing the United States capital markets (especially because they are also exempt from most of reporting requirements of the Securities and Exchange Commission).

Sponsored ADRs are created by a single depository which is appointed by the issuing company under rules provided in a deposit agreement. There are two broad types of sponsored ADRs

Restricted ADRs (RADRs) These are restricted with respect to the type of buyer which is allowed and are privately placed. They are allowed to be placed only among selected accredited investors and face restrictions on their resale. As

" God is always listening. Therefore be careful of what you ask, because you just might get it!"

" It's okay to change your dreams, as long as you never lower your standards."

these are not issued to the general public, they are exempt from reporting requirements of the Securities and Exchange Commission and are not even registered with it. Restricted ADR issues are sometimes issued by companies that seek to gain some visibility and perhaps experience in the United States capital markets before making an unrestricted issue.

Unrestricted ADRs (URADRs) are issued to and traded by the general investing public in United States capital markets. There are three classes of URADR, each increasingly demanding in terms of reporting requirements of the Securities and Exchange Commission, but also increasingly attractive in terms of degree of visibility provided. The three classes of Unrestricted ADRs are

(i) Level 1 URADRs, (ii) Level II URADRs and (iii) Level III URADRs

→ **Benefit of ADR for US investors** ADR is an attractive investment to US investors willing to invest in securities of non US issuers for following reasons

(a) ADRs provide a means to US investors to trade the non US company's shares in US dollars. The trading in ADR effectively means trading in underlying shares.

(b) ADRs facilitates share transfers. ADRs are negotiable and can be easily transferred among the investors like any other negotiable instrument. The transfer of ADRs automatically transfers the underlying share.

(c) The transfer of ADRs does not involve any stamp duty.

(d) The dividends are paid to the holders of ADRs in US dollars.

→ **Benefits of ADR Issue to Indian Company**

(a) Better corporate image both in India & abroad which is useful for strengthening the business operation in the overseas market.

(b) Exposure to international markets and hence stock prices in line with international trends.

(c) Means of raising capital abroad in foreign exchange.

(d) Use of foreign exchange proceeds for activities like overseas acquisitions, setting offices abroad & other capital expenditure.

(e) Increased recognition internationally by bankers, customers, suppliers etc.

(f) No risk of foreign exchange fluctuations as the company will be paying the interest and dividends in Indian rupees to the domestic depository bank.

→ **Documents used in ADRs** A public offering of ADRs by a non US private issuer will require, in general, the following documents: (a) Form F1 (b) Form F6 (c) Listing Application (d) Blue Sky Survey (e) Deposit Agreement (f) Custodian Agreement (g) Underwriting Agreement

→ **Example of Indian ADRs**: Only few Indian companies have gone for ADRs so far. Some of which are (1) Infosys, (2) Wipro, (3) MTNL, (4) VSNL, (5) Silverline, (6) Dr. Reddy. These are listed on two stock exchanges (i) NASDAQ (National Association of Securities Dealers Automatic Quotes) and (ii) New York Stock Exchange, both have their head offices at New York.

E. **Indian Depository Receipts (IDRs)**

→ IDR means any instrument in the form of depository receipt created by the domestic depository in India against the underlying equity shares of the issuing foreign company.

→ Companies incorporated outside the country can now raise resources from the Indian capital market through the issue of Indian Depository Receipts (IDRs).

→ An IDR is a financial instrument similar to a Global Depository Receipt (GDR) and American Depository Receipt (ADR), the objective of which is to provide a platform to foreign firms to directly raise capital in India. For Indian investors, IDRs would provide a route to invest in foreign firms.

→ In an IDR, foreign companies would issue shares, to an Indian Depository (say National Security Depository Limited – NSDL), which would in turn issue depository receipts to investors in India.

→ **Recent Example**: Standard Chartered Bank became the first foreign company to list IDR in India.

"A life spent in making mistakes is not only more honourable but more useful than a life spent doing nothing." Give to the world the best that you have and the best will come back to you.

The largest foreign bank in India, which reeled in a billion dollar of profit from domestic operations last year (India is its most profitable unit after Hong Kong), will sell 24 crore IDRs through a public issue.

➔ **Listing:** These IDRs would be listed on stock exchanges in India and would be freely transferable.

➔ **Benefits to Indian Investors:** IDR is an additional investment opportunity for Indian investors for overseas investment. Indian citizens will be able to easily improve their portfolio diversification as well as a chance to sample new companies that would otherwise not be available for investment.

QUESTION NO.84 What are the types of ORDERS in a future market?

(RTP Nov 2008)

Customers in futures and option markets are able to submit a complete range of dealing instructions to their brokers. This allows them to give precise instructions as to how their orders will be treated. Generally, following types of orders are issued:

(i) **Market Order** : When a trader places a buy or sell order at the price which prevails in the futures market at the time the order is given, it is called a market order.

(ii) **Limit Order** : If the trader specifies a particular price or the price limit within which the order should be executed, such an order is called a limit order.

(iii) **Market-if-touched (MIT) Order** : If an order is executed at the best available price after a trade occurs at a particular price or at a price more favourable than the specified price, it is called a Market-if-touched order.

(iv) **Stop Loss Order** : Stop loss orders are normally placed by specifying a range in which the order should be executed instead of giving a single price order.

(v) **Good Till Cancelled (GTC) Order** : In terms of National Stock Exchange (NSE) regulations, Good till cancelled orders shall be cancelled at the end of 7 calendar days from the date of entering the order.

Other type of orders include : (vi) Guaranteed Stop.(vii) Spread Order.(viii) Scale Order.(ix) Opening Order.(x) Closing Order.(xi) Limit or Market on Close Order.(xii) Stop Limit Order.(xiii) Public Limit Order.

QUESTION NO. 85 What are the methods of Venture Capital Financing? (CA FINAL)

➔ **Meaning** : The **Venture Capital Financing** refers to financing of new high risky ventures promoted by qualified entrepreneurs who lack experience & funds to give form to their ideas.

➔ **Methods of Venture Capital Financing :**

(i) **Equity Financing**

(ii) **Conditional Loan :**

(iii) **Income Note :**

(iv) **Participating Debenture :**

➔ The following are the **criteria** which may be applied to find out the eligibility of an undertaking for Venture Capital Financing (i) The venture must be a technically feasible proposition (ii) It should be commercially viable (iii) The entrepreneurs must be technically competent & having managerial skill (iv) The undertaking must have a long run competitive advantage over other units

➔ **Benefits Of Venture Capital Financing :**

(i) This is the only feasible source of funds available for new enterprising projects , since bank loan & public issues are quite difficult at start up stage .

(ii) There is flexibility in structuring the mode of finance i.e debt or equity.

(iii) Tax concessions available for VCF help in promoting and increasing the availability of venture capital .

➔ **Limitations Of Venture Capital Financing :**

(i) Availability of Venture Capital is limited in practice & it depends mostly on the personal contacts of the entrepreneurs.

*For any good relationship to last, there needs be three C's; Communication, Commitment, Compromise
Choose your Habits, Choose your Life.Keep your face to the sunshine and you cannot see the shadow.*

(ii) It is a very expensive source of finance and also dilutes managerial control of the entrepreneur.

➔ **Example of Indian Venture Capital Funds :** Infosys Technologies co-founder and chairman NR Narayana Murthy recently sold company shares worth around \$37 million to set up a VC fund for incubating Indian start-ups. A statement issued by Infosys said the VC fund would encourage & support young entrepreneurs having brilliant business ideas.

QUESTION NO. 86 Write a short note on "Zero Date Of Project Management" ? (Nov 2010)(CA FINAL)

➔ Zero Date of a Project means a date is fixed from which implementation of the project begins. It is a starting point of incurring cost. The project completion period is counted from the zero date. Pre-project activities should be completed before zero date. The pre-project activities should be completed before zero date.

➔ The pre-project activities are:

(a) Identification of project/product (b) Determination of plant capacity (c) Selection of technical help/collaboration (d) Selection of site. (e) Selection of survey of soil/plot etc. (f) Manpower planning and recruiting key personnel (g) Cost and finance scheduling.

QUESTION NO. 87 What are the complexities involved in International Capital Budgeting and International Working Capital?

Complexities Involved in International Capital Budgeting :

- (a) Cash flows from foreign projects have to be converted into the currency of the parent organization.
- (b) Parent cash flows are quite different from project cash flows
- (c) Profits remitted to the parent firm are subject to tax in the home country as well as the host country
- (d) Effect of foreign exchange risk on the parent firm's cash flow
- (e) Changes in rates of inflation causing a shift in the competitive environment and thereby affecting cash flows over a specific time period
- (f) Restrictions imposed on cash flow distribution generated from foreign projects by the host country
- (g) Initial investment in the host country to benefit from the release of blocked funds
- (h) Political risk in the form of changed political events reduce the possibility of expected cash flows
- (i) Concessions/benefits provided by the host country ensures the upsurge in the profitability position of the foreign project
- (j) Estimation of the terminal value in multinational capital budgeting is difficult since the buyers in the parent company have divergent views on acquisition of the project.

Complexities Involved in International Working Capital : The management of working capital in an international firm is very much complex as compared to a domestic one. The reasons for such complexity are:

- (1) A multinational firm has a wider option for financing its current assets. Host country funds can be used if needed. Funds flow from different units of the same firm. Approach is made from the international financial market. However, domestic firms find it difficult to avail such funds.
- (2) Interest and tax rates vary from one country to the other. A manager associated with a multinational firm has to consider the interest/ tax rate differentials while financing current assets. This is not the case for domestic firms.
- (3) A multinational firm is confronted with foreign exchange risk due to the value of inflow/outflow of funds as well as the value of import/export are influenced by exchange rate variations. Restrictions imposed by the home or host country government towards movement of cash and inventory on account of political considerations affect the growth of MNCs. Domestic firm limit their operations within the country and does not face such problems.
- (4) With limited knowledge of the politico-economic conditions prevailing in different host countries, a multinational manager often finds it difficult to manage working capital of different units of the firm operating in these countries. The pace of

There are as many nights as days, and the one is just as long as the other in the year's course. Even a happy life cannot be without a measure of darkness, and the word 'happy' would lose its meaning if it were not balanced by sadness.

development taking place in the communication system has to some extent eased this problem but it is still there very much. (5) Intra flow of funds is available with multinational firms as cash positioning and cash mobilization, an important aspect of international working capital management becomes easier to handle. This is not possible for domestic firms. A study of International Working Capital Management also requires knowledge of Multinational Cash Management, International Inventory Management and International Receivables Management.

QUESTION NO. 88 Write a short note on Leading And Lagging ?

➔ This technique is used by subsidiaries for optimizing cash flow movements by adjusting the timing of payments to determine expectations about future currency movements.

➔ MNCs accelerate (lead) or delay (lag) the timing of foreign currency payments through adjustment of the credit terms extended by one unit to another.

➔ The technique helps to reduce foreign exchange exposure or to increase available working capital.

➔ The advantages associated with Leading and Lagging are :

(1) No formal recognition of indebtedness is required and the credit terms can be altered by increase / decrease of the terms on the accounts.

(2) It helps in minimizing foreign exchange exposure and helps in transferring liquidity among affiliates by changing credit terms and is dependent on the opportunity cost of funds to both paying and receiving units.

(3) It is an aggressive technique aimed at taking advantage of expected revaluations and devaluations of currency movements.

QUESTION NO. 89 Write a short note on Netting ?

➔ **Meaning : Exposure Netting** refers to offsetting exposures in one currency with Exposures in the same or another currency, where exchange rates are expected to move in such a way that losses or gains on the first exposed position should be offset by gains or losses on the second currency exposure.

➔ **Objective :** The objective of the exercise is to offset the likely loss in one exposure by likely gain in another.

➔ It is a technique of optimising cash flow movements with the combined efforts of the subsidiaries thereby reducing administrative and transaction costs resulting from currency conversion.

➔ **Advantages derived from netting system includes :**

(1) Reduces the number of cross-border transactions between subsidiaries thereby decreasing the overall administrative costs of such cash transfers

(2) Reduces the need for foreign exchange conversion and hence decreases transaction costs associated with foreign exchange conversion.

(3) Improves cash flow forecasting since net cash transfers are made at the end of each period

(4) Gives an accurate report and settles accounts through co-ordinated efforts among all subsidiaries

➔ There are two types of Netting :

(1) **Bilateral Netting System** –

(2) **Multilateral Netting System** –

QUESTION NO. 90 Write a short note on Exchange Rate Forecasting ?

➔ **Meaning:** The foreign exchange market has changed dramatically over the past few years. The amounts traded each day in the foreign exchange market are now huge. In this increasingly challenging and competitive market, investors and traders need tools to select and analyze the right data from the vast amounts of data available to them to help them make good decisions. Corporates need to do the exchange rate forecasting for taking decisions regarding hedging, short-term

Winning Horse doesn't know why it runs in the race, it runs bcoz of hits & pain. Life is a race, God is ur rider. So, if u r in pain, God wants u to win the race.

financing, short-term investment, capital budgeting, earnings assessments and long-term financing.

➔ **Techniques Of Exchange Rate Forecasting :** There are numerous methods available for forecasting exchange rates. They can be categorized into four general groups-

(a) **Technical Forecasting:** It involves the use of historical data to predict future values. For example time series models. Speculators may find the models useful for predicting day-to-day movements. However, since the models typically focus on the near future and rarely provide point or range estimates, they are of limited use to MNCs.

(b) **Fundamental Forecasting:** It is based on the fundamental relationships between economic variables and exchange rates. For example subjective assessments, quantitative measurements based on regression models and sensitivity analyses. In general, fundamental forecasting is limited by:

- (i) the uncertain timing of the impact of the factors,
- (ii) the need to forecast factors that have an immediate impact on exchange rates,
- (iii) the omission of factors that are not easily quantifiable, and
- (iv) changes in the sensitivity of currency movements to each factor over time.

(c) **Market-Based Forecasting:** It uses market indicators to develop forecasts. The current spot/forward rates are often used, since speculators will ensure that the current rates reflect the market expectation of the future exchange rate.

(d) **Mixed Forecasting:** It refers to the use of a combination of forecasting techniques. The actual forecast is a weighted average of the various forecasts developed.

QUESTION NO. 91 Write a short note on Exchange Rate Theories ?

There are three theories of exchange rate determination-

- (a) **Interest Rate Parity (IRP)**
- (b) **Purchasing Power Parity (PPP) :**
- (c) **International Fisher Effect (IFE)**

QUESTION NO. 92 What are the various types of Foreign Exchange Risk ?

There are several types of risk that an investor should consider and pay careful attention to. Deciding the potential return while respecting risk is the age-old decision that investors must make.

- 1. **Financial Risk:**
- 2. **Business Risk:**
- 3. **Credit or Default Risk:**
- 4. **Country Risk:**
- 5. **Interest Rate Risk:**
- 6. **Political Risk:**
- 7. **Market Risk:**
- 8. **Foreign Exchange Fluctuation Risk:**

QUESTION NO. 93 Write a short note on Foreign Exchange Exposures ?

➔ “An Exposure can be defined as a Contracted, Projected or Contingent Cash Flow whose magnitude is not certain at the moment. The magnitude depends on the value of variables such as Foreign Exchange rates and Interest rates.”

➔ In other words, exposure refers to those parts of a company's business that would be affected if exchange rate changes. Foreign exchange exposures arise from many different activities.

➔ For example, travellers going to visit another country have the risk that if that country's currency appreciates against their

What do to when you face choices? Simple! Just toss a coin. It works. Not becoz it settles the confusion, but while the coin is in the air, u suddenly know what your heart hopes for.

own their trip will be more expensive. An exporter who sells his product in foreign currency has the risk that if the value of that foreign currency falls then the revenues in the exporter's home currency will be lower. An importer who buys goods priced in foreign currency has the risk that the foreign currency will appreciate thereby making the local currency cost greater than expected. Fund Managers and companies who own foreign assets are exposed to falls in the currencies where they own the assets. This is because if they were to sell those assets their exchange rate would have a negative effect on the home currency value.

➔ **Types of Exposure** : The foreign exchange exposure may be classified under three broad categories:

1. **Transaction Exposure**: It measures the effect of an exchange rate change on outstanding obligations that existed before exchange rates changed but were settled after the exchange rate changes. Thus, it deals with cash flows that result from existing contractual obligations.

2. **Translation Exposure**: Also known as accounting exposure, it refers to gains or losses caused by the translation of foreign currency assets and liabilities into the currency of the parent company for accounting purposes.

3. **Economic Exposure**: It refers to the extent to which the economic value of a company can decline due to changes in exchange rate. It is the overall impact of exchange rate changes on the value of the firm. The essence of economic exposure is that exchange rate changes significantly alter the cost of a firm's inputs and the prices of its outputs and thereby influence its competitive position substantially.

QUESTION NO. 94 Write a short note on Forwards-Based Derivatives ?

Forwards-Based Derivatives: There following divisions of forwards-based derivatives are

(a) Forward Contracts:

(b) Swaps:

Interest Rate Swaps: (CA Final)

➔ **Meaning** : An Interest Rate Swap is a transaction involving an exchange of one stream of interest obligations for another. In an interest rate swap, no exchange of principal takes place but interest payments are made on the notional principal amount.

➔ Interest payments can be exchanged between two parties to achieve changes in the calculation of interest on the principal, for example : (a) Floating to fixed; (b) Fixed to floating; (c) LIBOR to prime - based; (d) Prime to LIBOR;

➔ **Major Players** : The major players in the swap markets are banks (or other intermediaries on the one side) and medium and large size corporates on the other. Individual borrowers generally do not perform swap.

➔ **Features of Interest Rate Swap** :

(a) It is treated as an off - the balance sheet transaction.

(b) It is structured as a separate contract distinct from the underlying loan agreement.

(c) There is no exchange of principal repayment obligations.

(d) It effectively translates a floating rate borrowing into a fixed rate borrowing and vice versa.

(e) The motivation of interest rate swap is to save interest cost.

➔ **Types of Interest Rate Swaps** :

(a) **Liability Swap** - Where there is an exchange of interest obligation i.e., interest is to be paid, the swap is liability swap.

(b) **Asset Swap** - Where there is an exchange of interest receipts i.e., interest is to be received, the swap is asset swap.

➔ **Purpose**: Interest Rate Swap is intended to hedge against the interest rate fluctuations to some extent through careful planning with the help of swap dealer .

➔ **Provision of Interest Rate Swaps** : Some of the provisions of IRS are as follows :

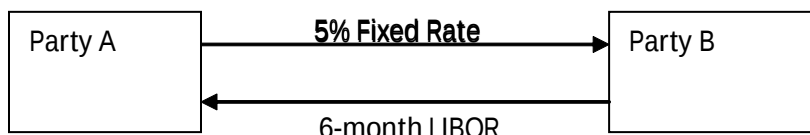
1. The notional principal value upon which the interest rate is to be applied.

2. The fixed interest rate to be exchanged for another rate.

3. Formula type of index used to determine the floating rate.

“Twenty years from now you will be more disappointed by the things you didn't do than by the ones you did do. So throw off the bowlines. Sail away from the safe harbor. Catch the trade winds in your sails.

4. Frequency of payments, such as quarterly or every six months is also agreed.
5. Life time of the swap.



Currency Swaps: (CA Final)

➔ These involve an exchange of liabilities between currencies. A currency swap can consist of three stages:

(a) A spot exchange of principal.

(b) Continuing exchange of interest payments during the term of the swap.

(c) Re-exchange of principal on maturity.

➔ A currency swap has the following benefits:

(a) Treasurers can hedge currency risk.

(b) It can provide considerable cost savings. So a strong borrower in the Deutschmark market may get a better US dollar rate by raising funds in the Deutschmark market and swapping them for US dollars.

(c) The swap market permits funds to be accessed in currencies, which may otherwise command a high premium.

(d) It offers diversification of borrowings.

(e) Cost cutting is the major motivation behind currency swap.

(f) It enables access to a sector of international capital market otherwise not available.

➔ In a currency swap the principal sum is usually exchanged: • At the start; • At the end; • At a combination of both; or • Neither.

Other Type Of Swaps :

Circus Swaps

Plain Vanilla Swaps

Basis Rate Swaps

Asset Swaps

Mortgage Swaps

Amortising Swaps

Forward Swaps

Swaptions

Callable Swaps

Canape' Swaps

(c) Futures Contracts.

(d) Options

QUESTION NO. 95 What is the difference between Futures and Forward Contracts ? (CA Final)

There major differences between the traditional forward contract and a futures contract. These are tabulated below:

<u>Feature</u>	<u>Forward Contract</u>	<u>Futures Contract</u>
Amount	Flexible.No Lot Size	Standard amount.Lot Size Requirement
Maturity	Any valid business date agreed to by the two parties	Standard date of maturity.
Currencies traded	All currencies	Majors
Cross rates	Available in one contract; Multiple contracts avoided	Usually requires two contracts
Market-place	Global network	Regular markets-futures market and exchanges

*"Yesterday is history. Tomorrow is mystery. Today is a gift. That's why it's called the present."
Three things to respect..Old Age, Religion and Law*

Price fluctuations	No daily limit in many currencies	Daily price limit set by exchange
Risk	Depends on counter party	Minimal due to margin requirements
Honouring of contract	By taking and giving delivery	Mostly by a reverse transaction
Cash flow	None until maturity date	Initial margin plus ongoing variation margin because of market to market rate and final payment on maturity date
Trading hours	24 hours a day	4 - 8 hours trading sessions
Regulation	RBI	SEBI

Other Distinction between forward and futures contracts are as follows:

- 1. Organised exchanges/Trading:** Forward contracts are traded in over the counter market. Futures contracts are traded on organised exchanges with a designated physical location for example : Stock Exchange .
- 2. Transaction costs:** Cost of forward contracts is based on bid-ask spread. Futures contracts entail brokerage fees for buy and sell orders.
- 3. Marking to Market:** Forward contracts are not subject to marking to market. Futures contracts are subject to marking to market in which the loss or profit is debited or credited in the margin account on daily basis due to change in price.
- 4. Margins:** Margins are not required in forward contract. In futures contracts every participant is subject to maintain margin as decided by the exchange authorities.
- 5. Liquidity :** Forward contracts is exposed to the problem of liquidity whereas in futures there is no liquidity problem as they are traded in stock exchange.
- 6. Disclosure :** In forward contracts, price are not publicly disclosed whereas in future contracts price is transparent.

QUESTION NO. 96 Write a short note on ARBITRAGE ?

(SFM Nov 2008)

➔ **Meaning :** Arbitrage by definition is a financial transaction that makes an immediate profit without involving any risk. Arbitrage is a strategy to take advantage of price differential of a product in different markets. An arbitrageur makes money by buying an asset at low price in a market and selling it in any other market at a relatively higher price.

➔ **For instance,** If one can buy an asset for \$5, sell it for \$20 and make a profit of \$15 that is arbitrage. The \$15 gain represents an arbitrage profit.

➔ Arbitrage profits are the result of

- (i) the difference in exchange rates at two different exchange centres,
- (ii) the difference. due to interest yield which can be earned at different exchanges.

➔ **Types of Arbitrage**

- (i) Geographical/Space Arbitrage -
- (ii) Cross - Rate Arbitrage -
- (iii) Time Arbitrage -

QUESTION NO. 97 Explain the various types of risks to which the Swap Dealer is exposed to ?

(RTP May 2010)

In the process of swap, the role of swap dealer is significant insofar as it brings together two counter-parties whose interests are complementary to each other. For this role, it takes a small part of the interest payment flow. Since the principal amount is large, even a small percentage of the interest payment adds considerably to its profit. But, on the other hand, the swap dealer has to face a variety of risks. These different forms of risks as follows:

- (a) Interest-rate Risk :
- (b) Exchange-rate Risk :
- (c) Credit Risk :

Love doesn't start in morning & end in evening. It starts when you don't need it & ends when you need it most. "If a=1%, b=2%, c= 3%, etc., what does 'attitude' add up to?" (Work it out - the answer is 100%).

- (d) **Mismatch Risk :**
- (e) **Sovereign Risk:**
- (f) **Delivery Risk:**

QUESTION NO. 98 Write a short note on Forward Rate Agreements ?

➔ **Meaning:** In finance, a **forward rate agreement (FRA)** is a forward contract in which one party pays a fixed interest rate, and receives a floating interest rate and vice versa. In other words, Agreement to borrow or lend at a specified future date at an interest rate that is fixed today.

➔ **How It Is Quoted :** FRAs are quoted in the format AxB, with (A) representing the number of months until the loan is set to begin, and (B) representing the number of months until the loan ends. To find the length of the loan, subtract A from B.

For Example :

➔ A 1 x 4 quote would mean a 3 month loan, set to begin 1 month in the future.

➔ A t1 X t2 FRA: The start date, is t1 months hence. The end of the forward period is t2 months hence. The loan period is t1-t2 months long.

➔ A 9 X 12 FRA has a contract period beginning nine months hence, ending 12 months hence.

Payoff formula : The netted payment made at the effective date is:

$$\frac{\text{Notional Amount Of Loan} \times (\text{Rate At Expiration or LIBOR or Reference Rate} - \text{FRA or Fixed Rate}) \times \frac{\text{Days in Underlying Rate or FRA Days}}{360}}{1 + \text{Rate At Expiration or LIBOR or Reference Rate} \times \frac{\text{Days in Underlying Rate or FRA Days}}{360}}$$

➔ If LIBOR > FR the seller owes the payment to the buyer, and if LIBOR < FR the buyer owes the seller the absolute value of the payment amount .

Under an FRA

-The buyer (borrower) is the party seeking to protect itself against a rise in interest rates.

-The seller (lender) is the party seeking to protect itself against a fall in interest rates.

➔ FRAs are commonly used to hedge against the risk of rising interest rates by a company with a borrowing. In general, FRA's are used by corporates for the following broad purposes:

To lock in the cost of borrowing on an existing floating-rate loan.

To guarantee the rate of interest a company has to pay on future draw downs.

To guarantee the interest rate earned on surplus funds for any period.

Users of FRAs :

1. FRAs are far more widely used than futures by corporates. Usually, this is because corporates, being less interest-rate sensitive on the whole than financial institutions, do not place such a high value on the facility futures offer of being in and out of the market in minutes. The forward rate agreement provides corporate treasurers with approximately the same hedging benefits of futures, but with none of the technical and administrative difficulties.

2. Banks are also heavy users of the FRA market. The most common use of FRAs by banks is to iron out mismatches in the short-term structure of their assets and liabilities.

Other Points

➔ FRAs are cash-settled forward contracts on interest rates traded among major international banks active in the Eurodollar market.

➔ An FRA can be viewed as the OTC equivalent of a Eurodollar futures contract.

➔ Most FRAs trade for maturities corresponding to standard Eurodollar time deposit maturities, although nonstandard maturities are sometimes traded.

➔ Trading in FRAs began in 1983 (Norfield 1992).

I think success has no rules, but you can learn a lot from failure." Don't be upset or disappointed about something that happened; just think, will it really matter 10 years from now?"

➔ A forward rate agreement (FRA) is an over-the-counter version of a short interest rate future. Primarily used as an inter-bank hedging instrument in the early 1980s, its use has since spread to a number of corporates as well. FRA is very popular method of hedging interest rate risk.

QUESTION NO. 99 Write a short note on SWAPTIONS ? (CA Final)

➔ A **swaption** is an option granting its owner the right but not the obligation to enter into an underlying swap. Although options can be traded on a variety of swaps, the term "swaption" typically refers to options on interest rate swaps.

➔ **There are two types of swaption contracts:**

A payer swaption gives the owner of the swaption the right to enter into a swap where they pay the fixed leg and receive the floating leg.

A receiver swaption gives the owner of the swaption the right to enter into a swap where they will receive the fixed leg, and pay the floating leg.

➔ **The buyer and seller of the swaption agree on:**

the premium (price) of the swaption

the strike rate (equal to the fixed rate of the underlying swap)

length of the option period (which usually ends two business days prior to the start date of the underlying swap),

the term of the underlying swap,

notional amount,

amortization, if any

frequency of settlement of payments on the underlying swap

➔ **Exercise Date :**

There are three different ways the right to exercise the option in a swaption contract can be scheduled

European – the owner of the contract can exercise his right to enter the swap at maturity

American – the owner of the contract can exercise his right to enter the swap at any date between the start and end dates of the option period agreed to

Bermudan – the owner of the contract can exercise his right to enter the swap at certain predetermined dates between the start and end dates of the option period.

➔ **Uses of swaptions:**

(a) Swaptions can be used as an effective tool to swap into or out of fixed rate or floating rate interest obligations, according to a treasurer's expectation on interest rates. Swaptions can also be used for protection if a particular view on the future direction of interest rates turned out to be incorrect.

(b) Swaptions can be applied in a variety of ways for both active traders as well as for corporate treasurers. Swap traders can use them for speculation purposes or to hedge a portion of their swap books. It is a valuable tool when a borrower has decided to do a swap but is not sure of the timing.

(c) Swaptions have become useful tools for hedging embedded option which is common in the natural course of many businesses.

(d) Swaptions are useful for borrowers targeting an acceptable borrowing rate. By paying an upfront premium, a holder of a payer's swaption can guarantee to pay a maximum fixed rate on a swap, thereby hedging his floating rate borrowings.

(e) Swaptions are also useful to those businesses tendering for contracts. A business, would certainly find it useful to bid on a project with full knowledge of the borrowing rate should the contract be won.

(f) Swaptions also provide protection on callable/puttable bond issues.

(g) Swap also provide arbitrage opportunity. The more innovative borrowers can use this arbitrage opportunity to their advantage in order to bring down their funding cost.

Every king was once a crying baby and every great building was once a blueprint. Its not where you are today but where you will reach tomorrow that counts.

QUESTION NO. 100 Write a short note on INTEREST RATE CAP/FLOOR/COLLAR ?(Nov 10)(CA FINAL)**INTEREST RATE CAP**

- ➔ An interest rate cap is a derivative in which the buyer receives payments at the end of each period in which the interest rate exceeds the agreed strike price.
- ➔ It is a type of European Call Option and for this buyer is required to pay premium.
- ➔ In other words A caplet is an interest rate call option that provides the purchaser an upper limit on interest rates.
- ➔ The payoff (Gross Profit) of a cap is given by the following formula:

$$(\text{Actual Interest Rate} - \text{Strike or Floating Rate}) \times (\text{Days to maturity} / 360) \times (\text{Nominal Loan Amount})$$

INTEREST RATE FLOOR

- ➔ An interest rate floor is a derivative in which buyer of the floor receives money if on the maturity, the interest rate is below the agreed strike price of the floor.
- ➔ It is a type of European Put Option and for this buyer is required to pay premium.
- ➔ A floorlet is an interest rate put option that provides the purchaser an lower limit on interest rates
- ➔ The payoff (Gross Profit) of a Floor is given by the following formula:

$$(\text{Strike or Floating Rate} - \text{Actual Interest Rate}) \times (\text{Days to maturity} / 360) \times (\text{Nominal Loan Amount})$$

INTEREST RATE COLLAR**Collar can be created in two manner :**

- ➔ Buy a collar (whereby you buy a cap and sell a floor both with the same expiry but different strike prices and notionals) Premium is received by Selling a Floor and Premium is paid by Buying a Cap.
- ➔ Sell a collar (whereby you sell a cap and buy a floor both with the same expiry but different strike prices and notionals) Premium is received by Buying a Floor and Premium is paid by Selling a Cap.
- ➔ When the premium of the floor exactly matches that of the cap this is known as a Zero Cost Collar.
- ➔ An Interest Rate Collar sets a maximum (cap) and minimum (floor) boundary on a given floating rate
- ➔ Interest rates quoted in cap/floor & Collar agreements follow money market day-count conventions, so that payment calculations assume a 360-day year.

QUESTION NO. 101 Write five principal steps in a successful M & A programme?

- ➔ There are five principal steps in a successful M & A programme :
 1. Manage the pre-acquisition phase.
 2. Screen candidates.
 3. Eliminate those who do not meet the criteria and value the rest.
 4. Negotiate.
 5. Post-merger integration.
- ➔ During the pre-acquisition phase, the acquirer should maintain secrecy about its intentions. Otherwise, the resulting price increase due to rumours may kill the deal.

QUESTION NO. 102 List out some problems for Merger & Acquisition in India?

- (i) Indian corporates are **largely promoter-controlled and managed**. It is difficult for either of the two promoters to voluntarily relinquish management control in favour of the other, as a merger between two companies implies .
- (ii) In some cases, the need for prior negotiations and concurrence of financial institutions and banks is an added rider, besides **SEBI's rules and regulations**.
- (iii) The **reluctance of financial institutions and banks** to fund acquisitions directly.

Every night before you go to sleep, look at the good you have accomplished during the day, measure your progress and make plans for taking advantage of whatever opportunity the mornings brings your way.

- (iv) The **BIFR route**, although tedious, is preferred for obtaining financial concessions.
- (v) **Lack of Exit Policy** for restructuring/downsizing.
- (vi) **Absence of efficient capital market system** makes the Market capitalisation not fair in some cases.
- (vii) Valuation is **still evolving** in India.

QUESTION NO. 103 Write a short note on the evolution of takeovers, principles and enforcement-Under the context of Indian Scenario ?

→ **Meaning** : Takeover is generally understood to mean acquisition of substantial shares, for the purpose of seeking management control of the Company. Takeover of companies is a well-accepted and established strategy for corporate growth.

→ **Modes of Takeover** : There are essentially two major modes of takeover which are prevalent in India. These are:

(i) **Takeover through direct negotiations** with Financial Institutions (FIIs) or Board for Industrial and Financial Reconstruction (BIFR), or with promoters

(ii) **Takeover by acquisition** of adequate shareholding

→ **Acquisition or Takeover may be by way of**

(i) Acquisition of Companies shares.

(ii) Acquisition of business assets (ABOs).

(iii) Acquisition of Brand

(iv) Acquisition of Companies by Friendly vs. Hostile takeover.

(v) Reverse acquisition

→ The two types of takeovers are:

(i) **Friendly takeover.**

(ii) **Hostile takeover.**

→ **Take Over Strategies** : Other than tender offer the acquiring company can also use the following techniques:

(i) **Street Sweep:**

(ii) **Bear Hug:**

(iii) **Strategic Alliance:**

(iv) **Brand Power:**

QUESTION NO. 104 What is a Takeover by Reverse Bid or Reverse Takeover? (CA Final)

→ **Meaning** : It is the act of a smaller company gaining control over a larger one. In ordinary case, the company taken over is the smaller company; in a 'Reverse Takeover', a smaller company gains control of a larger one.

→ **Tests For Identifying Takeover by Reverse Bid** :

The three tests in a takeover by reverse bid that are required to be satisfied are, namely,

(i) the assets of the transferor company are greater than the transferee company,

(ii) equity capital to be issued by the transferee company pursuant to the acquisition exceeds its original issued capital, and

(iii) the change of control in the transferee company through the introduction of a minority holder or group of holders.

Takeover by reverse bid could happen where already a significant percent of the shareholding is held by the transfer company, to exploit economies of scale, to enjoy better trading advantages and other similar reasons.

QUESTION NO. 105 How to Defend a company in a Takeover Bid ?

Defensive Tactics : A target company can adopt a number of tactics to defend itself from hostile takeover through a

The tragedy of life is not death , but what dies within you when you are alive.If you keep your attention focussed on your goal , you will never notice the obstacles and pitfalls along the way

tender offer. Some of which are as follows : (i) **Divestiture** : (ii) **Crown jewels** : (iii) **Poison pill** : (iv) **Poison Put** : (v) **Greenmail** : (vi) **White knight** : (vii) **White squire** : (viii) **Golden parachutes** : (iv) **Pac-man defence**:

QUESTION NO. 106 Highlight the importance of due diligence in M&A ?

➔ The concept of due diligence has many dimensions such as: Due diligence is research, its purpose in M&A is to support the valuation process, arm negotiators, test the accuracy of representations and warranties contained in the merger agreement, fulfill disclosure requirements to investors, and inform the planners of post-merger integration.

➔ It is the opposite of negligence. Weaknesses in the due diligence process may cause an M&A to fail.

➔ A due diligence process should focus at least on the following issues:

(i) **Legal issues**: (ii) **Financial and tax issues**: (iii) **Marketing issues**: (iv) **Cross-border issues**: (v) **Cultural and ethical issues**:

QUESTION NO. 107 What a short note on Reasons for demerger and different ways of demerger ?

➔ A corporate strategy to sell off subsidiaries or divisions of a company. The act of splitting off a part of an existing company to become a new company, which operates completely separate from the original company.

➔ **Reasons For Demerger**: There are various reasons for divestment or demerger viz.,

(i) To pay attention on core areas of business;

(ii) The Division's/business may not be sufficiently contributing to the revenues;

(iii) The size of the firm may be too big to handle;

(iv) The firm may be requiring cash urgently in view of other investment opportunities.

➔ **Different ways of demerger**: Different ways of divestment or demerger are as follows:

Sell off:

Spin-off:

Split-up:

Carve outs:

Sale of A Division:

➔ **Indian example**: The biggest example of demerger in recent times is the division of the **Reliance empire** where the oil and chemical business remained with Mr. Mukesh Ambani, while power, financial services and telecom were hived off to Mr. Anil Ambani.

QUESTION NO. 108 What a short note on LBO ? (CA Final)

➔ **Meaning**: A **Leveraged buy-out (LBO)** is an acquisition of a company in which the acquisition is substantially financed through debt. Typically in the LBO 90% or more of the purchase price is financed with debt.

➔ An **attractive candidate for acquisition through leveraged buyout** should possess three basic attributes :

(a) If firm have a good position in its industry with a solid profit history and reasonable expectations of growth.

(b) The firm should have a relatively low level of debt and a high level of bankable assets that can be used as loan collateral.

(c) It must have a stable and predictable cash flows that are adequate to meet interest and principle payment of the debt and provide adequate working capital.

➔ Typical **advantages** of the leveraged buy-out method include:

(a) **Low capital or cash requirement** for the acquiring entity

(b) **Synergy gains**, by expanding operations outside own industry or business,

(c) **Efficiency gains** by eliminating the value-destroying effects of excessive diversification,

The truth is, u choose ur destiny. U choose to be as good as u want to be & u choose to do as good as u want to do. Stop making excuses & just face reality, b'coz there will always be something that stands in ur way of success

(d) Improved Leadership and Management :

(e) Leveraging: as the debt ratio increases, the equity portion of the acquisition financing shrinks to a level at which a private equity firm can acquire a company by putting up anywhere from 20-40% of the total purchase price.

(f) Acquiring Company pay less taxes because interest payments on debt are tax-deductible

➔ **Recent example:** India has experienced a number of buyouts and leveraged buyouts . A successful example of LBO is the acquisition of Tetley brand, the biggest tea brand of Europe by TATA Tea of India at 271 million pounds. It was one of the biggest cross border acquisition by an Indian Company. Another recent example of a leveraged buyout is **Tata Steel** (India) acquiring **Corus** (United Kingdom) for \$11.3 billion .

QUESTION NO. 109 Write a short note on Financial Restructurings ?*(SFM Nov 2008)*

➔ When a company cannot pay its cash obligations - for example, when it cannot meet its bond payments or its payments to other creditors (such as vendors) - it goes bankrupt. In this situation, a company can, of course, choose to simply shut down operations and walk away. On the other hand, it can also restructure and remain in business.

➔ **What does it Mean to Restructure?** The process can be thought of as two-fold: financial restructuring and organizational restructuring.

➔ Restructuring from a **financial viewpoint** involves renegotiating payment terms on debt obligations, issuing new debt, and restructuring payables to vendors.

➔ From an **organizational viewpoint**, a restructuring can involve a change in management, strategy and focus.

➔ Restructuring can take many forms. Some typical approaches to financial restructuring include:

(i) Vertical Restructuring ; (ii) Horizontal Restructuring ; (iii) Corporate Restructuring

➔ The financial restructuring leads to significant changes in the financial obligations and capital structure of corporate firm, leading to a change in the financing pattern, ownership and control and payment of various financial changes.

➔ In nutshell it may be said that financial restructuring (also known as internal re-construction) is aimed at reducing the debt/payment burden of the corporate firm. This results into

(i) Reduction/Waiver in the claims from various stakeholders;

(ii) Real worth of various properties/assets by revaluing them timely;

(iii) utilizing profit accruing on account of appreciation of assets to write off accumulated losses and fictitious assets (such as preliminary expenses and cost of issue of shares and debentures) and creating provision for bad and doubtful debts.

QUESTION NO. 110 What are the reasons for Merger Failures ? How to make merger successful ?

➔ The reasons for merger failures can be numerous. Some of the key reasons are :

(i) Acquirers generally overpay;

(ii) The value of synergy is over-estimated;

(iii) Poor post-merger integration; and

(iv) Psychological barriers.

➔ To make a merger successful

(i) Decide what tasks need to be accomplished in the post-merger period;

(ii) Choose managers from both the companies (and from outside);

(iii) Establish performance yardstick and evaluate the managers on that yardstick; and

(iv) Motivate them.

QUESTION NO. 111 Write a short note on Cross-Border M&A ?

Life is like a coin. Pleasure and Pain are the two sides. Only one side is visible at a time. But remember other side is also waiting for it's turn. Success does not come to you.....You go to it

➔ Cross-border M&A is a popular route for global growth and overseas expansion. Crossborder M&A is also playing an important role in global M&A. This is especially true for developing countries such as India.

➔ Factors that motivate multinational companies to engage in cross-border M&A in Asia include the following:

- (i) Globalization of production and distribution of products and services.
- (ii) Integration of global economies.
- (iii) Expansion of trade and investment relationships on International level.
- (iv) Many countries are reforming their economic and legal systems, and providing generous investment and tax incentives to attract foreign investment.
- (v) Privatisation of state-owned enterprises and consolidation of the banking industry.

QUESTION NO. 112 Write a short note on :

A. Credit Cards As A Part Of Consumer Finance

(May 2008)

➔ **Meaning :** Credit Cards work on the philosophy of "Buy Now And Pay Later". A person who holds a credit card need not pay in cash at the time of every expenditure. Instead, he can use the credit card, to meet the expenditures. Credit Cards are a good substitute for cash and the resultant safety and convenience, the competition in this business has made credit cards a source of short-term finance also for individuals.

➔ **Parties Involved In Credit Card Transaction :** Every transaction on a credit card involves three parties : (1) The credit card issuer (2) The credit cardholder and (3) The party to whom the cardholder is supposed to pay, say the merchant outlet (MO). Examples of MO are : a departmental store, hotel, railways, airlines etc.

Advantages :

- (i) They allow you to make purchases on credit without carrying around a lot of cash. This allows you a lot of flexibility.
- (ii) They allow accurate record-keeping by consolidating purchases into a single statement.
- (iii) They allow convenient remote purchasing - ordering/shopping online or by phone. They allow you to pay for large purchases in small, monthly installments.
- (iv) Under certain circumstances, they allow you to withhold payment for merchandise which proves defective.
- (v) They are cheaper for short-term borrowing.
- (vi) Many cards offer additional benefits such as additional insurance cover on purchases, cash back and discounts on holidays.
- (vii) Beside this, the credit-card may also extend the benefit of roll over credit, supplementary cards and travel assistance.
- (viii) Credit cards enable a person to track and document all his expenses
- (ix) It is safer to carry Credit Cards rather than cash as it provides 100% safety of cash against theft

Disadvantages:

- (i) You may become an impulsive buyer and tend to overspend because of the ease of using credit cards. Cards can encourage the purchasing of goods and services you cannot really afford.
- (ii) Credit cards are a relatively expensive way of obtaining credit if you don't use them carefully, especially because of the high interest rates and other costs after the credit period expires.
- (iii) Lost or stolen cards may result in some unwanted expense and inconvenience.
- (iv) The use of a large number of credit cards can get you even further into debt.
- (v) Using a credit card, especially remotely, introduces an element of risk as the card details may fall into the wrong hands resulting in fraudulent purchases on the card. Fraudulent or unauthorized charges may take months to dispute, investigate, and resolve.

B. "Balance Transfer"(RTP)

Home loan repayments are huge commitments that most families face. Sometimes, there is a huge difference in interest rate

Living in the favourable and non favourable situation is " Part Of living " But surviving happily in all those situations is called "Art Of Living "

between what the borrower currently pays his bank and what another lender offers. In such a scenario, people consider either prepaying their loan or switching the lender. Switching to another lender offering better rates is called balance transfer.

Expenses involved : A balance transfer of the outstanding loan from one bank to another can result in savings of a few thousand rupees, month after month in your EMIs. Borrowers must exert due diligence before exploring the balance transfer option. The existing lender charges a penalty for prepayment and the new lender may seek processing fees. These expenses must be taken into account while weighing the benefits of a balance transfer. Some lenders may levy additional switching charges that must be taken into account as well.

When it works well for you : It makes sense to go ahead with a balance transfer if your net gain is more than one percent. This is after factoring in the prepayment penalty of two percent and loan processing charge of 0.5 to one percent. Since lower rates are applicable for a new borrower (rather than existing borrowers) shop for competitive rates and a good lender. After the switching exercise, you shouldn't get a rude jolt that the new lender has increased the rates. So find out if any rate hike is on the cards before switching.

C. 'Stack hedging' and 'Strip hedging' (RTP)

➔ For longer –term hedging programmes, such as a two-year loan with three-monthly rollover dates, more complicated strategies can be adopted, such as 'stack hedging' and 'strip hedging'.

➔ With a stack hedge, the total number of contract needed to hedge the loan are purchased for the month of the first rollover date. At that date, the remaining, number of contracts necessary are purchased for the next rollover date, and so on. Uses a single contract for all futures expiration over the hedging horizon

➔ A strip hedge, on the other hand, treats each three-month segment of the loan as separate entity, and futures contracts are purchased for each rollover date at the outset of the loan. Uses an equal number of contracts for each futures expiration over the hedging horizon

➔ The performance of a strip hedge is superior to the stack hedge because the interest rates adjust every quarter. Stack hedges may perform poorly if interest rates change in differing amounts

➔ Advantages of Stack Hedges

1. Works better when the cash position has a single horizon. 2. Requires trading a single contract.

➔ Advantage of Strip Hedges

1. Can provide a more aligned hedge and better results with a multiple-maturity cash position. 2. No rollover and curve risk

➔ **A good example of strip vs. stack hedge :** On March 1, an oil distributor agrees to deliver 1,000 bbl of crude oil in each of the next 8 quarters, at a fixed price. The firm faces the risk that crude oil prices will rise, and therefore will enter into a long hedge. On March 1, the firm can either:

- 1) Trade, 1 contract for delivery in each of the next 8 quarters (This process is known as a "strip hedge.") or
- 2) Trade, 8 June contracts. Then, in May, offset the June contracts and trade 7 Sept contracts. Then, in August, offset the Sept contracts and trade 6 Dec contracts, etc. (This process is known as a "stacked hedge.")

QUESTION NO. 113 Write a short note on Buy-Back of shares by companies? OR Briefly explain 'Buy Back of Securities' and give the management objectives of buying Back Securities? (CA FINAL)

➔ In India Buy back of Securities is governed by the Companies Act 1956. The Companies (Amendment) Act gives the power to the corporates to purchase its securities by virtue of Sections 77A .Section 77AA and 77B.

➔ **Meaning :** Buyback is reverse of issue of shares by a company , where it offers to take back its shares owned by the investors at a specified prices .

➔ **Objectives of Buyback :** The following are the management objectives of buying back securities :

- (i) To return excess cash to shareholders, in absence of appropriate investment opportunities.

"If you can dream it, you can do it." Do not think so much on others faults, that you forget your own faults. Be not afraid of growing slowly, be afraid only of standing still

(ii) To give a signal to the market that shares are undervalued.

(iii) To increase promoters holding, as a percentage of total outstanding shares, without additional investment. Thus, buy back is often used as a defence mechanism against potential takeover.

(iv) To change the capital structure.

(v) To Increase Earning per share

➔ **Resources of Buy Back** : A Company can purchase its own shares from

(i) free reserves; (ii) securities premium account; or (iii) proceeds of any shares or other specified securities.

➔ **Advantages of Buyback** : The Advantages of Buyback of securities to investors, companies and economy are :

(i) **Revival of the Capital Market** :

(ii) **Liquidity to Dormant Shares** :

(iii) **Odd Lots** :

(iv) **Restructuring of capital base by Companies with special reference to public sector units** :

(v) **Increasing the Earnings Per Share (EPS) and at the same time providing higher prices (P/E ratio) to Investors** :

(vi) **Proper Utilisation of Excess Funds** :

(vii) **For ensuring price stability in share prices**

(viii) **For exercising control over the company**

(ix) **For taking tax advantages**

(x) **For saving the company from hostile takeover**

➔ **Disadvantages of Buyback** : Some of the disadvantages of Buyback are as follows :

(i) Manipulation of share prices by its promoters (ii) speculation (iii) collusive trading

QUESTION NO. 114 Explain the term Insider Trading and why Insider Trading is punishable? (CA FINAL)

➔ **Meaning** : Insider trading refers to using the unpublished information about the performance or other matters of a company, in dealings with the securities of the company. or In other words Insider Trading

-is a buying or selling or dealing in securities of a listed company,

-by a director, member of management, an employee or any other person such as internal or statutory auditor, agent, advisor, analyst, consultant etc.

-who have knowledge of material 'inside' information not available to general public

➔ **The word insider has wide connotation**. An outsider may be held to be an insider by virtue of his engaging himself in this practice on the strength of inside information.

➔ **Why Insider Trading is punishable** : Insider trading is prohibited by the SEBI as (i) it results into unfair gains to insiders and harms the interest of other shareholders, (ii) it downgrades the image of the company, (iii) it drives away the investors from the market, and (iv) it causes unwarranted volatility in the prices of the shares of the company.

QUESTION NO. 115 What is a re-financing ? Briefly explain indicating at least two institutions which offer such re-financing ? (Nov2006)(May 2008)

Meaning : "Re-financing" is a process by which a large financial institution provides funds or reimburses funds to another institution to help development, relief or other similar causes identified as the purpose of the former. It can also, in another way, be described as a wholesale distribution of financial assistance to a retailing institution. Often, governmental support or subsidized funding is reached to the ultimate beneficiaries, through such channel. It is also termed as whole-sale financing.

Institutions which offer Re-financing :

National Bank for Agriculture and Rural Development (NABARD) is a governmental organization established with the

" Don't ever let anyone tell you what you can and cannot do with your life! Believe in yourself, work hard and you will be successful! You have a bright future in front of you ...DREAM BIG!!!"

primary objective of financing the farm sector; it is an arm through which government extends certain concessions/privileges to the farming community. NABARD does not deal with farmers directly but deals with many banks such as scheduled and nationalized banks providing re-financing for quite a few schemes intended for the benefit of the agricultural sector.

Small Industries Development Bank of India (SIOBI) is another governmental organization whose objective is to assist the development of small industries. It is another institution which is engaged in refinancing activities; it funds a few schemes intended for SSIs through scheduled/nationalized banks.

QUESTION NO. 116 Explain the terms ESOS and ESPS with reference to the SEBI guidelines for The Employees Stock Option Plans (ESOPs). (CA FINAL)(May 2005)

ESOS

1. **Meaning** : Employee Stock Option Scheme means a scheme under which the company grants options to employees

2. **Auditors Certificate** : Auditors Certificate to be placed at each AGM stating that the scheme has been implemented as per the guidelines and in accordance with the special resolution passed

3. **Transferability** : It is not transferable

4. **Consequences of failure** : The amount payable may be forfeited. If the option are not vested due to non-fulfillment of condition relating to vesting of option then the amount may be refunded to the employees

5. **Lock in period** : Minimum period of 1 year shall be there between the grant and vesting of options. Company is free to specify the lock in period for the shares issued pursuant to exercise of option

ESPS

Employee Stock Purchase Scheme means a scheme under which the company offers shares to employees as a part of public issue.

No such Certificate is required

It is transferable after lock in period

Not applicable

One year from the date of allotment. If the ESPS is part of public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees pursuant to ESPS shall not be subject to any lock in.

QUESTION NO. 117 What is the difference between Cash and the Derivative Market ? (RTP May 2010)

The basic differences between Cash and the Derivative market are as follows :

(a) In cash market tangible assets are traded whereas in derivative markets contracts based on tangible or intangibles assets like index or rates are traded.

(b) In cash market, we can purchase even one share whereas in Futures and Options minimum lots are fixed.

(c) Cash market is more risky than Futures and Options segment because in "Futures and Options" risk is often limited.

(d) Cash assets may be meant for consumption or investment. Derivative contracts are for hedging, arbitrage or speculation.

(e) The value of derivative contract is always based on and linked to the underlying security. Though this linkage may not be on point-to-point basis.

(f) In the cash market, a customer must open securities trading account with a securities depository whereas to trade futures a customer must open a future trading account with a derivative broker.

(g) Buying securities in cash market involves putting up all the money upfront whereas buying futures simply involves putting up the margin money.

(h) With the purchase of shares of the company in cash market, the holder becomes part owner of the company. While in future it does not happen.

QUESTION NO. 118 Write a short note on Debt Securitisation? or What are the advantages of Debt Securitisation? OR What is securitisation? What are its various instruments? OR Write a short note on Asset Securitisation. (CA FINAL)

➔ **Meaning** : Securitisation is a process of pooling and repackaging homogeneous illiquid financial assets into market-

Time is really the only capital that any human being has, and the only thing he can't afford to lose.

REMEMBER : Behind every successful man there's a lot of unsuccessful years -

able securities that can be sold to investors. Securitisation is the process by which financial assets are transformed into securities.

➔ Debt Securitisation will thus provide liquidity to the instrument.

➔ **Steps involved in a Securitisation Process :**

(i) **The Origination Function :**

(ii) **The Pooling Function :**

(iii) **The Securitisation Function :**

➔ **Parties involved in Securitisation Process :**

(i) **The Originator :**

(ii) **Special Purpose Vehicle (SPV) :**

(iii) **The Investor :**

(iv) **Other Parties :** Borrowers, Obligors, Rating Agencies, Administrator, Agent and Trustee.

➔ **Instruments of Securitisation :** Under this process securities issued by SPV are in the form of Pass Through Certificate (PTC), Pay Through Securities (PTS) and Stripped Securities. Securities may be Asset Backed Securities and Mortgage Backed Securities.

(i) **Asset Backed Securities:** These are securities backed by other assets like credit card receivable, trade receivables etc

(ii) **Mortgage Backed Securities:** These are the securities where the assets collateralised are mortgage loans i.e. loans secured by a mortgage of specified immovable property.

➔ **Benefits to the Originator :**

1. The assets are shifted off the balance sheet, thus giving the originator recourse to off balance sheet funding.

2. It converts illiquid assets to liquid portfolio.

3. It facilitates better balance sheet management as assets are transferred off balance sheet facilitating satisfaction of capital adequacy norms.

4. The originator's credit rating enhances.

➔ **Benefits to the Investor :**

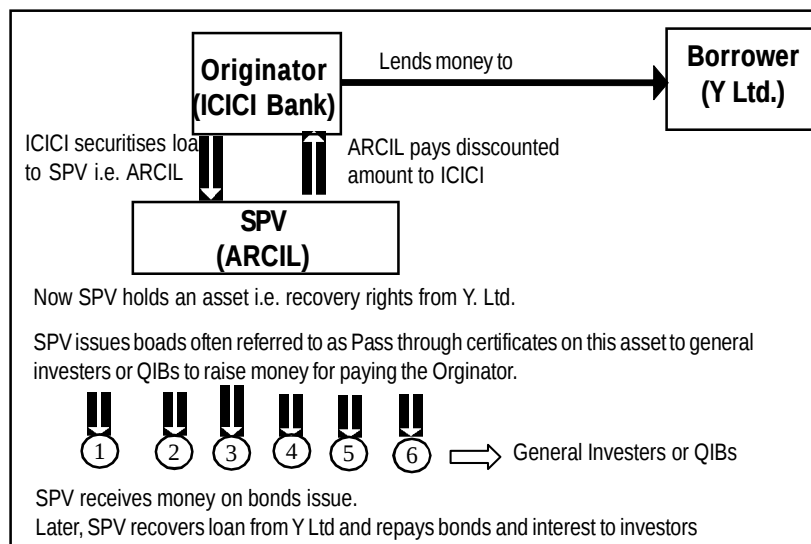
1. For the investor securitisation opens up new investment avenues.

2. Though the investor bears the credit risk, the securities are tied up to definite assets.

3. Securitisation helps to convert a stream of cash receivables into a source of long-term finance.

4. Securities are rated by Credit Rating Agencies and it becomes easier for an investor to compare risk return profile and make an informed choice.

The digrame bellow illustrates the process of Scuritisation in India



I have not failed. I've just found 10,000 ways that won't work. - Thomas Alva Edison
"If you want to feel rich, just count all of the things you have that money can't buy."

How The Poor Live

One day, a father of a very wealthy family took his son on a trip to the country with the firm purpose of showing his son how poor people live. They spent a couple of days and nights on the farm of what would be considered a very poor family. On their return from their trip, the father asked his son, "How was the trip?"

"It was great, Dad."

"Did you see how poor people live?" the father asked.

"Oh yeah," said the son.

"So, tell me, what did you learn from the trip?" asked the father.

The son answered, "I saw that we have one dog and they had four. We have a pool that reaches to the middle of our garden, and they have a creek that has no end. We have imported lanterns in our garden, and they have the stars at night. Our patio reaches to the front yard, and they have the whole horizon. We have a small piece of land to live on, and they have fields that go beyond our sight. We have servants who serve us, but they serve others. We buy our food, but they grow theirs. We have walls around our property to protect us; they have friends to protect them."

The boy's father was speechless.

Then his son added, "Thanks, Dad, for showing me how poor we are."

Abraham Lincoln never quits.

Born into poverty, Lincoln was faced with defeat throughout his life. He lost eight elections, twice failed in business and suffered a nervous breakdown.

He could have quit many times – but he didn't and because he didn't quit, he became one of the greatest presidents in the United States history.

Here is a sketch of Lincoln's road to the White House:

- 1816 His family was forced out of their home. He had to work to support them.
- 1818 His mother died.
- 1831 Failed in business.
- 1832 Ran for state legislature – lost.
- 1832 Also lost his job – wanted to go to law school but couldn't get in.
- 1833 Borrowed some money from a friend to begin a business and by the end of the year he was bankrupt. He spent the next 17 years of his life paying off this debt.
- 1834 Ran for state legislature again – won.
- 1835 Was engaged to be married, sweetheart died and his heart was broken.
- 1836 Had a total nervous breakdown and was in bed for six months.
- 1838 Sought to become speaker of the state legislature – defeated.
- 1840 Sought to become elector – defeated.
- 1843 Ran for Congress – lost.
- 1846 Ran for Congress again – this time he won – went to Washington and did a good job.
- 1848 Ran for re-election to Congress – lost.
- 1849 Sought the job of land officer in his home state – rejected.
- 1854 Ran for Senate of the United States – lost.
- 1856 Sought the Vice-Presidential nomination at his party's national convention – get less than 100 votes.
- 1858 Ran for U.S. Senate again – again he lost.
- 1860 Elected president of the United States.

If you want to build a positive attitude, learn the phrase, "do it now" and stop the habit of procrastination.

Never leave till tomorrow which you can do today

When you're right, no one remembers. When you're wrong, no one forgets..I don't measure a man's success by how high he climbs but how high he bounces when he hits bottom.

Yet Another Milestone Achieved By Aaditya Sir.Her Student

Archana Jhunjhunwala

cleared her CA After **15 years** of enrollment due to high score of
71 Marks In MAFA Roll No.40251

The Power Of Determination



From The Desk Of Archana Jhunjhunwala...

I finally cleared my CA in Nov 2009 Exam scoring 71 Marks in MAFA. For me MAFA was always a nightmare. My first CA Final Attempt was due in May 2000 which I was unable to clear due to MAFA. Then I got married but I always wanted to become CA. However MAFA was still a nightmare for me. I was unable to recover from that. My husband supported me a lot and arranged lots of Books and Notes relating to MAFA. But I was not confident. Finally I heard about Aaditya Sir and joined him in June 2009. After taking classes from Sir, the most important thing which I got is the Confidence to crack the paper. He made Mafa very simple with his unique Concept Question Approach. His main strength is his simplified notes, extensive coverage, giving proper balance to both Concept & question, examination oriented. By taking classes I developed a special interest in Finance. The subject which was once a nightmare for me became my strength. Now just because of MAFA I am a CA. This is like a Dream come true. I dedicated this success to my husband, my children and to one and only Aaditya Sir. Thank you sir from the bottom of my heart.

From The Desk Of Aaditya Sir

There will be many times when you will want to quit, give up, and go back to doing something else, but the one quality that will guarantee your success is the willingness to stick with it, to see it through to the end -- to refuse to settle for anything less than your dream. The longer you hang in there, the greater the chance that something will happen in your favor. No matter how hard it seems, the longer you persist, the more likely your success will be.

More than 4000 years ago in China, Confucius wrote: "Our greatest glory is not in never falling, but in rising every time we fall."

Always be solution-oriented in your thinking

"We all have dreams. But in order to make dreams come into reality, it takes an awful lot of determination, dedication, self-discipline, and effort."

--Aaditya Jain

I AM NOWHERE.....I AM NOWHERE.....I AM NOW HERE

MAFA IS NOT TOUGH, ITS JUST THE APPROACH THAT MATTERS

[mafabycaaadityajain] hello friends

Friday, 10 April, 2009 5:46 PM

From: "Sweta Kothari" <swetakothari@ymail.com>

To: mafabycaaadityajain@yahoogroups.com

I stay in Kolkata..I am appearing my CA finals in this June.. I have previously taken tutons for MAFA from a teacher..

Though he was good but i was always scared of MAFA..By taking classes by Aditya Jain Sir, now i am feeling very good & comfortable in MAFA even though i am not his regular student..He makes us understand the concepts in a very easy manner.. I just want to thank sir for removing my fear for MAFA..Before taking classes from sir i just used to target 45-50 in MAFA.. But now i am targeting much more.. Thank you sir.. Thank you so much.. Regards.. Sweta Kothari Kolkata

THANKS FOR YOUR THEORY BOOK

Wednesday, 25 February, 2009 8:49 PM

From: "Priyanka Agarwal" <priyans26186@gmail.com>

To: ca_kumaraaditya@yahoo.co.in

This is Priyanka Agarwal from Kolkata.I have purchased ur theory book and is extremely benefitted by it.Now I regret that why havenot I joined u.Actually when I did my MAFA classes I even didnt know your name.Your theory book is just marvellous.No doubt I am getting immense knowledge from it but one more thing is there which I got from your book.The Confidence,most important thing for gaining courage and facing the exams.I would definitely ask all my friends to join your classes.I have heard that your classes are really awesome.I would like to request you that please give some of your valuable suggestions to me for passing the exams in all the subjects. A very heartfelt thanks to you for publishing such a nice book.

Aaditya Jain Sir is the best teacher of MAFA.

-Manish Gupta [jesh01ster@gmail.com]

Aaditya jain Sir is "Lifeline Of MAFA/SFM"

-Piru [piru_hi@yahoo.co.in]

Sir i have attempted all the question and I am sure to achieve more than 90% marks in MAFA.Sir you are definitely the Best FM Faculty Of India.Abhishek Kapuria [Delhi Student]

Taking Class from Aaditya jain Sir was a wonderful experience as it is the first time I am solving practical problems after having clear concepts.The best part of sir is that he used to give equal importance to both Concepts & Practical Problems.Also he take Theory Classes in detail.-Ankit Jaiswal[jaiswal.ankit90@yahoo.com]

WE ARE THE BEST

Galib Auditorium, New Delhi, MAFA/SFM Batch

You may delay, but time will not.

"It's Time To Be Busy-~~BECAUSE~~ Today Will Be Yesterday Very Soon "

The woods are lovely, dark and deep,
But I have promises to keep,
And miles to go before I sleep,
And miles to go before I sleep

WISHING ALL MY STUDENTS To Always aim high in life and proceed in the direction of realising your goals with total determination "Firm determination and hard work is always rewarding."

Tips Of Increasing Concentration Power

1. If you want to develop the power of concentration, then here is an exercise you can try. First wash your face and eyes properly with cold water. Then make a black dot on the wall at eye level. Stand facing the dot, about ten inches away, and concentrate on it. Focus on one point and hold your attention there. The mind will waiver, you'll think a million thoughts, but each time you do, bring your mind back to the point of concentration.

2 Start taking deep breaths while staring and for a short time after you have finished staring at the dot..

3 You should now find an increase in your concentration power.



The power of concentration can be increased by focussing at the central dot in the Srichakra, which is located in the central triangle of the Srichakra. I was skeptical at first of this exercise but still decided to give it a try and I have to say that it has worked for me quite well. I guess the reason for this is that it is almost impossible to maintain focus on the dot during the first instance, due to the complex geometry of the yantra. At first it was quite difficult to maintain the focus as my eyes would keep moving away to other parts of the yantra. But with constant effort i have been able to progress further. This activity does not need much time as well. I have found that practising this technique 5 minutes a day has helped in improving my concentration. I hope u guys can reap the benefits of this technique as well.

There are other ways of increasing concentration such as meditation, yoga etc. but they can be quite time consuming.

The Srichakra is an ancient Indian symbol or design which consists of a concentric series of triangles cumulating in one singular triangle at the center. There are 43 triangles in all.

The Srichakra or the Sriyantra, as it is sometimes referred to, has a large number of fables and stories weaved around it. To each his Own, I guess. Well, some look at it from a religious perspective others from an artistic. But the fact remains that the Srichakra remains an integral part of Hindu Mythology. It is quite commonplace to find a Srichakra in many Hindu temples. The intricate and complex design of the Srichakra has also been explained in many different ways ranging from the religious to various other aspects. The concept of the Srichakra has been studied by various scholars and philosophers to understand the design, effects and the history behind the yantra.

Close your eyes. Deep breathe. Imagine that you are taking in light and energy with every in-breath and exhaling all your stress and anxiety with every out-breath. After a few minutes u will start feeling calm and relaxed

Its time to think again
Whether you want to be in these snaps as rankholders or not??

COSTING BY PARAG GUPTA

KISHKANDA GARG
(14th RANK)

TRAPTI VARSHNEY
(31st RANK)

ANUJ KATHURIA
(46th Rank-Final & 15th Rank -PEII)



For More Detail Please Contact :

Bright Professionals Pvt Ltd ,1st Floor,Lalita Park,Laxmi Nagar,Delhi-110092

Phone:47665555,9811136987,9811042458,9911442626

Every sunset gives us one day less to live!But every sunrise give us, one day more to hope! So, hope for the best.Good Day & Good Luck! "You are the lock and you are the key."



BRIGHT
professionals
Its all about Smart preparation ...

INDIA'S BEST TEAM TOGETHER
For Satellite Based CA Preparation



CPT - IPCC - FINAL
Its all about Smart preparation ...
Advanced Series Batches Critical Preparation Top Faculties of Delhi

Faculty	Subject	Stage
CA Praveen Jindal	Fin. Reporting / Accounts	Final / IPCC
CA Aaditya Jain	SFM / Fm	Final / IPCC
CA Munish Bhandari	Law	Final / IPCC
CA Surbhi Bansal	Audit	Final / IPCC
CA Parag Gupta	Costing & OR	Final
CA Jayesh Gupta	Direct Taxes	Final
CA Manoj Batra	Indirect Taxes	Final
CWA S K Monga	ISCA	Final
CWA Sumit Rastogi	Costing	IPCC
R M Jha (MCA)	IT & SM	IPCC
CA Ranjeet Kunwar	Income Tax	IPCC

Batches commencing from 15th Feb., 2011 at 100 centres Across India
Central Student Helpline : 011-47-66-55-55 (30 Lines)
info@brightprofessionals.com / brightpro@vsnl.net
For Registration go Online or at : www.brightprofessionals.com

**For Last Time
Important
Suggestion Of
CPT/IPCC/Final
Please mail or
SMS your
following details**

at :

**By E-Mail:
cafinaimafa@yahoo.com**

[Name, Mobile No.,

**E-mail Address,
Exam**

Due, City]

By SMS: Delhi :

9911442626 ;

Kolkata:

9339238834

More Than 100 Centres Across India. List Of Some Of Our All India Centres

Guwahati	-	Rohtak	-	Jaipur
Patna	9431014763	Sirsa	-	Sri Ganganagar
Raipur	-	Dhanbad		Agra
Delhi Karkardooma	8527606205	Jamshedpur		Aligarh
Delhi Naraina	9999133456	Ranchi		Ghaziabad
Delhi Kalkaji	9999476425	Nagpur	9028791529	Gorakhpur 9235669619/7275942490
Delhi Laxmi Nagar	-	Amritsar		Kanpur 9807789128/9336111729
Delhi Rohini	-	Bhatinda		Lucknow 9565556888
Ambala	-	Jalandhar		Meerut 9997000260
Chandigarh	-	Jalandhar		Moradabad
Faridabad	-	Ludhiana		Varanasi 9452290889
Gurgoan	-	Patiala		Kolkatta 9339238834
Hissar	-	Bikaner		Siliguri
Jind	-	Panipat		Panchkula 9832089292
Karnal	-			

FOR MORE DETAIL LOG ON TO: www.brightprofessionals.com

Central Student Helpline: 011-47665555