Chapter 8

Money Market & Stock Market

Money

Barter system	Barter system means exchange of one kind of goods and services for another kind of goods and services. There was **no involvement of money** in barter system. e.g. exchange of Milk with Rice. In ancient days people used to exchange goods for goods. There were many problems of barter system such as absence of a common measure of value, lack of double coincidence of wants (for example, a person wants cloth and he has rice with him to offer in return. If the person who has cloth does not want rice, then exchange of rice for cloth will never take place and both the individuals cannot satisfy their wants), lack of space to store goods to exchange them for other goods, Lack of division of goods etc. This prompted human society to discover money.
Money	It acts as a **medium of exchange**. This means that people can buy or sell goods and services with the help of money. Money also acts as a **convenient unit of account**. The value of all goods and services can be expressed in monetary units. Money is **not perishable** and its storage costs are also considerably lower. It is also acceptable to anyone at any point of time. Thus money can act as a store of value for individuals. Wealth can be stored in the form of money for future use. However, to perform this function well, the value of money must be sufficiently stable. Money has **time value** as a Rupee today will have greater purchasing power than after a year. A rising price level may erode the purchasing power of money. It may be noted that any asset other than money can also act as a store of value, e.g. gold, property,. However, they may not be easily convertible to other commodities and do not have universal acceptability.
Demand deposits is also considered money	Apart from currency notes and coins, the balance in savings or current account (i.e. Demand deposits) is also considered money since cheques drawn on these accounts are used to settle transactions. Such deposits are called demand deposits as they are payable by the bank on demand from the accountholder. Other deposits, e.g. fixed deposits, have a fixed period to maturity and are referred to as time deposits.
Promise from the Governor of RBI	Every currency note bears on its face a promise from the Governor of RBI that if someone produces the note to RBI, or any other commercial bank, RBI will be responsible for giving the person purchasing power equal to the value printed on the note. The same is also true of coins.
Fiat money and Legal tenders	Currency notes and coins are called **fiat** money. They do not have intrinsic value like a gold or silver coin. They are also called **legal tenders** as they cannot be refused by any citizen of the country for settlement of any kind of transaction. Cheques drawn on savings or current accounts, however, can be refused by anyone as a mode of payment. Hence, demand deposits are not legal tenders.

Q.1 SCRA-2013
Which one among the following best explains 'Money'?
(a) It is a medium for producing capital goods (b) It is a means for redistributing wealth among people
(c) It is a common denominator for measuring value (d) It is a mechanism for resource allocation

Q.2 Prelims 2018
Which one of the following statements correctly describes the meaning of legal tender money ?
a) The money which is tended in courts of law to defray the fee of legal cases
b) The money which a creditor is under compulsion to accept in settlement of his claims
c) The bank money in the form of cheques drafts, bills of exchange, etc.
d) The metallic money in circulation in a country

Q.3 CDS 2021
Which one of the following is not a function of money?
(a) Acts as an intermediate in the exchange process (b) Acts as a store of value
(c) Used as the unit of account (d) Used for regulating consumption

Q.4 CAPF 2021
For anything to be recognized as money, it needs to have which of the following characteristics?
1. Act as an intermediate in exchange process the
2. Standard unit for quoting prices
3. Must be easily divisible
4. Have higher value in alternative uses
Select the correct answer using the code given below.
(a) 1, 2 and 4 (b) 2 and 3 only (c) 1, 2 and 3 (d) 1, 3 and 4

Demand for Money

Money is the most liquid of all assets in the sense that it is universally acceptable and hence can be exchanged for other commodities very easily. On the other hand, it has an **opportunity cost**. If, instead of holding on to a certain cash balance, you put the money in a fixed deposits in some bank you can earn interest on that money.

While deciding on how much money to hold at a certain point of time one has to consider the trade off between the advantage of liquidity and the disadvantage of the foregone interest. Demand for money balance is thus often referred to as liquidity preference.

People desire to hold money balance broadly from two motives.

1. The **transaction motive** i.e. to carry out transactions of day to day needs. The value of transactions determine the money, people want to keep. Larger is the quantum of transactions, larger is the quantity of money demanded. Since the quantum of transactions depends on income, hence a rise in income will lead to rise in demand for money. An increase in nominal GDP implies an increase in the total value of transactions and hence a greater transaction demand for money.

2. The **Speculative Motive**- i.e. demand for money to take advantage of an investment opportunity. Speculative demand for money is inversely related to the rate of interest. In economics, an investor can hold money or bonds.

When interest rate is lower and If it is felt that the interest rate is going to rise (that means the price of bonds will fall), the investor will hold money until the fall in the price of bonds is realized or they will convert their bonds into money. Thus, high speculative demand for money.

When interest rate is very high and everyone expects it to fall in future (that means the price of bonds will rise), hence people will convert their money into bonds. Thus, low speculative demand for money.

Liquidity trap

Interest rate can be thought of as an opportunity cost or 'price' of holding money balance.

If supply of money in the economy increases and people purchase bonds with this extra money, demand for bonds will go up, bond prices will rise and rate of interest will decline.

However, if the market rate of interest is already low enough so that everybody expects it to rise in future (that means the price of bonds will fall), nobody will wish to hold bonds. Everyone in the economy will hold their wealth in money balance.

If additional money is injected within the economy it will be used up to satisfy people's craving for money balances without increasing the demand for bonds and without further lowering the rate of interest below the floor. Such a situation is called a **liquidity trap**.

Liquidity trap is a situation in which **conventional monetary policies become impotent**, because nominal interest rates are at or near zero to avoid a recession. Central banks lowers the interest rates to encourage borrowing, spending, and investment. Since the nominal interest rate is close or equal to zero hence monetary authority (Central bank) is unable to stimulate the economy through reduction in interest rates.

In this case, Governments should use fiscal policy tools like tax cuts or boosts to public spending to combat a future recession.

Negative Interest Rates

if growth or inflation is too low, then central bank may lower interest rates.

When interest rates are low – or even negative – financial firms are more likely to charge lower interest rates on loans to customers. Customers will then spend this money on goods and services, which helps boost growth in the economy and inflation.

Lower interest rates also tend to lead to depreciation of currency by making it a less attractive investment than that of other currencies. A weaker currency gives a country's export a competitive advantage and boosts inflation by pushing up import costs.

Under a negative rate policy, financial institutions are required to pay interest for parking excess reserves with the central bank. That way, central banks penalise financial institutions for holding on to cash in hope of prompting them to boost lending.

Reserve Money/Base Money/High Powered Money (M0)

Reserve money (M0), also called central bank money, base money or high-powered money, is the highly liquid component of money stock in the economy. It broadly reflects the total monetary liabilities of the Reserve Bank.

It consists of Currency in Circulation + Bankers' Deposits with RBI + Other Deposits with RBI

Currency in Circulation includes notes in circulation, rupee coins and small coins.

Bankers' Deposits with the RBI represent balances maintained by banks in the current account with the Reserve Bank mainly for maintaining Cash Reserve Ratio (CRR) and as working funds for clearing adjustments.

Other Deposits with the Reserve Bank for the purpose of monetary compilation includes deposits from foreign central banks, multilateral institutions, financial institutions and sundry deposits net of IMF Account.

Money supply

Money supply, like money demand, is a stock variable. The total stock of money in circulation among the public at a particular point of time is called money supply. RBI publishes figures for four alternative measures of money supply,viz. M1, M2, M3 and M4.

M_1

Currency with the Public + Demand Deposits with Banks + Other Deposits with RBI

Currency with the **Public** = Currency in Circulation minus Cash in hand with Banks.

M_2

M_1 + Post Office saving bank deposits

M_3

M3 = M1 + Net Time Deposits with Banks

M_4

M4 = M3 + Total Post Office deposits (excluding National Savings Certificates)

M1 and M2 are known as narrow money. M3 and M4 are known as broad money.

'Net' implies that only deposits of the public held by the banks are to be included in money supply. The interbank deposits, which a commercial bank holds in other commercial banks, are not to be regarded as part of money supply.

M1 is most liquid and easiest for transactions whereas M4 is least liquid of all. M3 is the most commonly used measure of money supply. It is also known as aggregate monetary resources.

Q.5 SCRA-2012
Following are some components of money supply in India :
1. Currency with the public 2. Aggregate demand deposits with 'banks
3. Aggregate time deposits with banks 4. 'Other' deposits with the Reserve Bank of India
Which of the aforesaid items are components of narrow money (M1) in India?
(a) I , 2 and 3 (b) 2 and 4 only (c) 1, 2 and 4 (d) 1 and 4 only

Q.6 Prelims 2002
Consider the following:
1. Currency with the public 2. Demand deposits with banks 3. Time deposits with banks
Which of these are included in Broad Money (M3) in India?
(a) 1 and 2 (b) 1 and 3 (c) 2 and 3 (d) 1, 2 and 3

Q.7 Prelims 1997
The sum of which of the following constitutes Broad Money in India ?
I. Currency with the Public II. Demand deposits with banks III. Time deposits with banks IV. Other deposits with RBI
Choose the correct answer using the codes given below :
(a) I and II (b) I, II and III (c) I, II, III and IV (d) I, II and IV

Q.8 CAPF 2018
The Reserve Bank of India defines narrow money as
(a) CU (currency notes + coins) + DD (net demand deposits held by commercial banks)
(b) CU + DD + saving deposits with post office savings banks
(c) CU + DD + net time deposits of commercial banks
(d) CU + DD + net time deposits of commercial banks + total deposits of post offices

Q.9 Prelims 2020
If you withdraw Rs. 1,00,000 in cash from your Demand Deposit Account at your bank, the immediate effect on aggregate money supply in the economy will be
(a) to reduce it by Rs. 1,00,000 (b) to increase it by Rs. 1,00,000
(c) to increase it by more than Rs. 1,00,000 (d) to leave it unchanged

Money Multiplier

Money multiplier explains the process through which the "base money" created by a central bank multiplies in the banking system to the stock of broad money (M3).

Money multiplier could be derived as broad money (M3) divided by base money (M0).

Total amount of **money stock** in the economy is much greater than the volume of high powered money. Commercial banks create this extra amount of money by giving out a part of their deposits as loans or investment credits.

The value of the money multiplier depends on two variables:

1. Currency-deposit ratio (cdr)- Ratio of money held by the public in currency to that they hold in bank deposits. Currency demand depends on the behaviour of the public (cdr increases during the festive season as people convert deposits to cash balance for meeting extra expenditure during such periods). High cdr means lower deposits in Banking system hence lower money creation.

2. Reserves-deposit ratio- RBI decides a certain percentage of deposits which every bank must keep as reserves. This is done to ensure that no bank is 'over lending'. This is called 'Required Reserve Ratio' or 'Reserve Ratio' or 'Cash Reserve Ratio' (CRR).

Cash Reserve Ratio (CRR) = Percentage of deposits which a bank must keep as cash reserves with the RBI.

Apart from the CRR, banks are also required to keep some reserves in liquid form in the short term. This ratio is called Statutory Liquidity Ratio or SLR.

The higher the reserve requirement, the tighter the money supply, which results in a lower multiplier effect for every rupee deposited. In contrast, the lower the reserve requirement, the larger the money supply, which means more money is being created for every rupee deposited.

Example of money creation: Suppose Bank has deposit of Rs. 1,00,000 and RBI CRR is 20% then Bank will provide loan for Rs. 80000. Now borrowers will spend that money on houses, cars, machinery etc and seller who receive the loaned money will deposit his revenue in banks. Bank will again loan out another 80% of that Rs. 80,000 and the cycle will start over again.

Lender of last resort

If all the account-holders of all commercial banks in the country want their deposits back at the same time, the banks will not have enough means to satisfy the need of every accountholder and there will be bank failures.

The Reserve Bank of India plays a crucial role here. In case of a crisis like the above it stands by the commercial banks as a guarantor and extends loans to ensure the solvency of the latter. This system of guarantee assures individual account-holders that their banks will be able to pay their money back in case of a crisis and there is no need to panic thus avoiding bank runs (a situation where everybody wants to take money out of one's bank account before the bank runs out of reserves). This role of the monetary authority is known as the **lender of last resort**.

Computation of Money Multiplier- Example:

Suppose Total Deposits is Rs. 1000, Currency is Rs. 400 and Cash Reserve Ratio (CRR) is 10%

Then Currency Deposit Ratio will be 400/1000 = 0.4 and Bank Cash Reserves with RBI will be 1000x10% = 100

Reserve Money (M0) = Currency plus Reserves i.e. 400+100 = 500

M3 or Broad money = Currency plus Deposits i.e. 400+1000 = 1400

Money multiplier could be derived as broad money (M3) divided by base money or reserve money (M0).

Money multiplier will be 1400/500 = 2.8

Or Money multiplier = (1+c)/(c+r) = (1+0.4) / (0.4+0.1) = 1.4/0.5 = 2.8, where 'c' is the currency-deposit ratio and 'r' is the reserves-deposit ratio.

Q.10 Prelims 2019, 2021
The money multiplier in an economy increases with which one of the following?
(a) Increase in the cash reserve ratio (b) Increase in the banking habit of the population
(c) Increase in the statutory liquidity ratio (d) Increase in the population of the country

Q.11 Prelims 2021
In India, the central bank's function as the ''lender of last resort'' usually refers to which of the following?
1. Lending to trade and industry bodies when they fail to borrow from other sources
2. Providing liquidity to the banks having a temporary crisis
3. Lending to governments to finance budgetary deficits
Select the correct answer using the code given below
a) 1 and 2 b) 2 only c) 2 and 3 d) 3 only

Money in circulation

Coins in circulation	50 paise, 1, 2, 5, 10 and 20 rupee
Notes in circulation	2, 5, 10, 20, 50, 100, 200, 500 and 2000. Bank notes are legal tender at any place in India for payment without limit. RBI has announced the withdrawal of ₹2000 banknotes from circulation w.e.f. October 1, 2023.
Issuing authority	Upto Re. 1 note and coins are issued by Govt of India (Ministry of finance). Rest are issued by RBI
Indian coinage act	(a) Rupee coin 1 and above can be used to pay any sum not exceeding Rs. 1000; (b) a half-rupee (50 paisa) coin, for any sum not exceeding 10 rupees; (c) any other coin, for any sum not exceeding one rupee:

Q.12 CDS-2011
Consider-the following statements:
1. In India the minimum denomination coin acceptable for transaction is 50 paise.
2. Coins below 50 paise is not a legal tender for payment.
Which of the statements given above is/ are correct? I
(a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

Bitcoin

About bitcoin	Bitcoin is a web based crypto-currency. **Blockchain technology** is behind crypto currencies like **Bitcoin**. A blockchain is a digitized, decentralized, public ledger of all cryptocurrency transactions.
Peer-to-peer payment network	It is the first decentralized peer-to-peer payment network that is powered by its users with no central authority or middlemen.
Digital money	Bitcoin is pretty much like cash for the Internet i.e. a completely digital money
24*7 use	It is possible to send and receive bitcoins anywhere in the world at any time. No bank holidays. No borders. No bureaucracy
Legality in India	India has not recognized the bitcoin as a legal tender.
Legality in world	El Salvador became the first country in the world to adopt bitcoin as legal tender (09-06-2021)

Q.13 ES-2014
The term 'bitcoin', frequently in the news, is mentioned in the context of:
(a) hologram stickers (b) technology for improving the security features of paper currency
(c) peer to peer digital currency (d) Near Field Communication Technology

Q.14 Prelims 2016
With reference to ‘Bitcoins’, sometimes seen in the news, which of the following statements is/are correct?
1. Bitcoins are tracked by the Central Banks of the countries.
2. Anyone with a Bitcoin address can send and receive Bitcoins from anyone else with a Bitcoin address.
3. Online payments can be sent without either side knowing the identity of the other.
Select the correct answer using the code given below.
(a) 1 and 2 only (b) 2 and 3 only (c) 3 only (d) 1, 2 and 3

Q.15 CDS 2017
Which of the following statements about Bitcoin is / are correct?
1. It is a decentralized virtual currency.
2 . It is generated through complex computer software systems.
3. The Reserve Bank of India recognized it as a legal tender in January 201 6.
Select the correct answer using the code given below. (a) 1 only (b) 1 and 2 only (c) 2 and 3 only (d) 1, 2 and 3

Q.16 Geo Scientist 2022
Recently which one of the following countries became the first in the world to adopt the cryptocurrency 'Bitcoin' as legal tender?
(a) Argentina (b) Bolivia (c) El Salvador (d) Peru

Non-Fungible Tokens (NFTs)

NFTs, are blockchain-based digital certificate of ownership that represents a digital or physical asset.

NFTs are unique cryptographic tokens that exist on a blockchain and cannot be replicated.

Most common NFT assets are digital art, digital content, event tickets etc.

Unlike cryptocurrencies, NFTs cannot be traded or exchanged at equivalency. They cannot be used as a medium for commercial transactions.

Q.17 Prelims 2022
With reference to Non-Fungible Tokens (NFTs), consider the following statements :
1. They enable the digital representation of physical assets.
2. They are unique cryptographic tokens that exist on a blockchain.
3. They can be traded or exchanged at equivalency and therefore can be used as a medium of commercial transactions.
Which of the statements given above are correct?
(a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

Money laundering

Converting the black money into white money

HAWALA

Hawala is an illegal method of remittance of money. Hawala does not involve physical movement of cash.

Q.18 Prelims 1996
Hawala transactions relate to payments
(a) received in rupees against overseas currencies and vice versa without going through the official channels
(b) received for sale/transfer of shares without going through the established stock exchanges
(c) received as commission for services rendered to overseas investors/buyers/ sellers in assisting them to get over the red tape and/or in getting preferential treatment
(d) made to political parties or to individuals for meeting election expenses

Round-tripping

Round tripping refers to money that leaves the country though various channels and makes its way back into the country often as foreign investment. This mostly involves black money and is allegedly often used for stock price manipulation.

Round tripping is used for tax evasion and money laundering.

Money market v/s Capital market

Financial markets can broadly be divided into money and capital market.

Money Market	Capital Market
• Controlled by RBI. • Money market is a market for short term debt securities usually less than one year . • Money market instruments include call money, Repos, T- Bills, Commercial Paper, Certificate of Deposit and Collateralized Borrowing and Lending Obligations (CBLO).	• Controlled by SEBI. • Capital market is a market for long-term debt and equity shares • Capital market can be further divided into primary and secondary markets.

Q.19 Prelims 2020
With reference to the Indian economy, consider the following statements :
1. “Commercial Paper” is a short-term unsecured promissory note.
2. “Certificate of Deposit” is a long-term instrument issued by the RBI to a corporation.
3. “Call Money” is a short-term finance used for interbank transactions.
4. "Zero-Coupon Bonds” are the interest bearing short-term bonds issued by the Scheduled Commercial Banks to corporations.
Which of the statements given above is/are correct?
(a) 1 and 2 only (b) 4 only (c) 1 and 3 only (d) 2, 3 and 4 only

Q.19A Prelims 2023
Consider the following markets
1. Government Bond Market 2. Call Money Market 3. Treasury Bill Market 4. Stock Market
How many of the above are included in capital markets?
(a) Only one (b) Only two (c) Only three (d) All four

Primary market v/s Secondary market

Primary market	Secondary market
• In the primary market, securities are offered to public for subscription for the purpose of raising capital or fund. • Since securities are new hence they create capital formation	• Secondary Market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. • Secondary market comprises of equity markets and the debt markets.

	• Secondary market could be either auction or dealer market. While stock exchange is the part of an auction market, Over-the-Counter (OTC) is a part of the dealer market. • There is no profit for company. When price of securities is increased, market capitalization of company increased.

Call money market

Call money market is a market for uncollateralized lending and borrowing of funds. This market is predominantly overnight and is open for participation only to scheduled commercial banks and the primary dealers.

Collateralised Borrowing and Lending Obligation (CBLO)

The Clearing Corporation of India Ltd. (CCIL) has developed and introduced with effect from January 20, 2003 a money market instrument called Collateralised Borrowing and Lending Obligation (CBLO).

The CBLO is designed to meet the borrowing and lending needs of banks and financial institutions, MFs, NBFCs and corporates. The borrowing and lending of Collateralised Borrowing & Lending Obligations are collateralized which means they are secured using G-Sec or T-Bills. For added transparency, trades are screen based with CCIL, which is a central counter party.

Commercial Paper (CP)

Commercial Paper' (CP) is an unsecured money market instrument issued in the form of a promissory note. The original tenor of a CP shall be between seven days to one year.

CP can be issued in denominations of Rs.5 lakh or multiples thereof. Amount invested by a single investor should not be less than Rs.5 lakh (face value).

CP, as a privately placed instrument, was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors

Companies, including Non-Banking Finance Companies (NBFCs) and All India Financial Institutions (AIFIs), are eligible to issue CPs.

Certificate of Deposit

Certificate of Deposit" or "CD" is a negotiable, unsecured money market instrument issued by a bank as a Usance Promissory Note against funds deposited at the bank for a maturity period upto one year;

With a view to further widening the range of money market instruments and giving investors greater flexibility in deployment of their short-term surplus funds, Certificates of Deposit (CDs) were introduced in India in 1989.

Certificate of Deposits (CDs) may be issued by: (i) Scheduled Commercial Banks; (ii) Regional Rural Banks; and (iii) Small Finance Banks.

CDs may be issued to all persons resident in India.

The tenor of a CD at issuance shall not be less than seven days and shall not exceed one year.

CDs shall be issued in minimum denomination of ₹5 lakh and in multiples of ₹5 lakh thereafter.

Bull and Bear Market

Bull market	A bull market is one where prices are rising
Investor Optimistic	A bull investor has a very optimistic view of the market. He aggressively buys and sells stocks quickly.
Bear market	A bear market is one where prices are falling.
Investor Pessimistic	A bear investor is pessimistic about the market and may make more conservative stock choices.

Q.20 PRELIMS 2010 & CDS-2012
In the parlance of financial investments, the term 'bear' denotes
(a.) An investor who feels that the price of a particular security is going to fall
(b.) An investor who expects the price of particular shares to rise
(c.) A shareholder or a bondholder who has' an interest in a company, financial or otherwise
(d.) Any lender, whether by making a loan or buying a bond

Major stock exchanges of world

Country	**Stock Exchange**	**Indices**
India	Bombay Stock Exchange.	SENSEX (30 companies)
India	National Stock Exchange of India.	NIFTY (50 companies)
Japan	Tokyo stock exchange	NIKKEI
US	New York Stock Exchange (NYSE)	NYSE Composite, Dow Zones, S&P 500
US	NASDAQ	NASDAQ Composite, Dow Zones, S&P 500
UK	London stock exchange	FTSE 100
China	Shanghai stock exchange	SSE Composite/SHCOMP
China	Hong Kong stock market	Hang Seng
China	Shenzhen stock exchange	SZSE component
Singapore	Singapore stock market	Straits Times STI
Pakistan	Karachi Stock Exchange	KSE 100
Brazil	Sao Paulo stock exchange	IBOVESPA
Korea	Korea Stock exchange	KOSPI
Germany	German stock exchange	DAX
France	French stock market	CAC 40
Russia	Moscow Stock Exchange	RTS and MICEX
South Africa	Johannesburg Stock Exchange	FTSE/JSE

Q.21 Prelims 2009
Which of the following pairs given is/are not correctly matched?

Country	Stock Exchange
a. Japan–	NIKKEI
b. Singapore–	SHCOMP
c. UK –	FTSE
d. USA –	NASDAQ

Q.22 CDS-2012
Which of the following statements is/ are correct?
1. NIFTY is based upon 50 firms in India.
2. NIFTY is governed and regulated by the Reserve Bank of India.
3. NIFTY does not trade in mutual funds.
Select the correct answer using the code given below
(a) 1 only (b) 2 (c) 3 only (d) 1 and 3

Q.23 CDS-2009
Which one of the following statements is not correct ?
(a) The National Association of Securities Dealers Automated Quotations known as NASDAQ, is an American stock exchange
(b) Nikkei is the stock market index for the Tokyo Stock Exchange
(c) S & P CNX Nifty is the index for 50 large companies on the Bombay Stock Exchange
(d) Hang Seng Indexes record daily changes of the largest companies of the Hong Kong stock market

Q.24 Prelims 1998
Which of the following pairs are correctly matched ?
I. Dow Jones : New York

II. Hang Seng : Seoul
III. FTSE 100 : London
Select the correct answer using the codes given below:
(a) I, II and III (b) II and III (c) I and II (d) I and III

Q.25 Prelims 2000
A rise in 'SENSEX' means
(a) a rise in prices of shares of all companies registered with Bombay Stock Exchang
(b) a rise in prices of shares of all companies registered with National Stock Exchange
(c) an overall rise in prices of shares of group of companies registered with Bombay Stock Exchange
(d) a rise in prices of shares of all companies belonging to a group of companies registered with Bombay Stock Exchange

Securities Transaction Tax (STT)

Securities Transaction Tax (STT) is a direct tax being levied on all transactions done on the stock exchanges at rates prescribed by the Central Government from time to time.

The Securities and Exchange Board of India (SEBI) or Market Watchdog

Establishment	SEBI was established as a statutory body on April 12, 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992.
Basic functions of the SEBI	- to protect the interests of investors in securities market - to promote the development of securities market and - to regulate the securities market
HQ	Mumbai.
Securities Appellate Tribunal (SAT)	SAT is a statutory body established under the provisions of the SEBI Act, 1992 to hear and dispose of appeals against orders passed by the SEBI. Consequent to Government Notification, SAT also hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) and Insurance Regulatory Development Authority of India (IRDAI) Against SAT order appeal may be filed in Supreme court.

Q.26 Prelims 1995
To prevent recurrence of scams in Indian Capital Market, the Government of India has assigned regulatory powers to
(a) SEBI (b) RBI (c) SBI (d) ICICI

Different kinds of issue of Shares

Issues made by an Indian company can be classified as Public (IPO and FPO), Rights, Bonus and Private Placement.

Initial public offer (IPO): When an **unlisted** company makes either a fresh issue of shares or offers its existing shares for the first time to the public, it is called an IPO. This paves way for listing and trading of the issuer's shares on the Stock Exchanges.

Further public offer (FPO) or Follow on offer: When an **already listed** company makes either a fresh issue of shares to the public or an offer for sale to the public, it is called a FPO.

Rights issue (RI): When an issue of shares is made to existing shareholders.

As per section 62 of Companies Act 2013, Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of **further** shares, such shares shall be offered-

-to persons who, at the date of the offer, are holders of equity shares of the company by sending a **letter of offer**;

-to any persons, if it is authorised by a special resolution.

Bonus issue: Shares issued by the companies to their existing shareholders **free of cost** by capitalization of accumulated reserves from the profits earned in the earlier years.

Private placement: When an issuer makes an issue of shares to **a select group of persons** and which is neither a rights issue nor a public issue.

Q.27 ES 2019
The cheapest method of marketing of securities with the only cost incurred being on sending 'letters of rights' to existing holders is
(a) Public issue through prospectus method (b) Offer for sale method
(c) Rights issue (d) Subscription by inside coterie method

Offer document

'Offer document' is a document which contains all the relevant information about the company, promoters, projects, financial details, objects of raising the money, terms of the issue, etc and is used for inviting subscription to the issue being made by the issuer.

'Offer Document' is called "Prospectus" in case of a public issue and "Letter of Offer" in case of a rights issue.

Draft offer document is an offer document filed with SEBI for specifying changes, if any, in it, before it is filed with the Registrar of companies (ROCs).

Red herring prospectus is an offer document used in case of a **book built public issue**. It contains all the relevant details except that of price or number of shares being offered. It is filed with RoC **before the issue opens**.

Prospectus is an offer document in case of a public issue, which has all relevant details including price and number of shares being offered. This document is registered with RoC before the issue opens in case of a fixed price issue and after the closure of the issue in case of a book built issue.

Abridged prospectus is an abridged version of offer document in public issue and is issued along with the **application form** of a public issue. It contains all the salient features from the prospectus.

Shelf prospectus is a prospectus which enables an issuer to make a series of issues within a period of 1 year without the need of filing a fresh prospectus every time. This facility is available to public sector banks, scheduled banks and Public Financial Institutions.

Letter of offer is an offer document in case of a Rights issue of shares and is filed with Stock exchanges before the issue opens.

Abridged letter of offer is an abridged version of the letter of offer. It is sent to all the shareholders along with the application form.

Placement document is an offer document for the purpose of Qualified Institutional Placement and contains all the relevant and material disclosures.

Pricing of securities in an issue

The issuer in consultation with the merchant banker on the basis of market demand decides the price. SEBI does not play any role in price fixation.

Fixed Price Issue: Issuer at the outset decides the issue price and mentions it in the Offer Document.

Book built Issue: Issuer discloses a price band. Price band is a range of price within which investors can bid. The spread between the floor and the cap of the price band shall not be more than 20%.

Price of an issue is discovered on the basis of demand received from the prospective investors at various price levels within the price band.

Green-shoe Option
Green Shoe Option is a price stabilizing mechanism in which shares are issued in excess of the issue size, i.e. a maximum of 15%. It is a mechanism to stabilize the issue price post listing.

Underwriting

Definition	An agreement wherein underwriter undertakes to subscribe to the securities offered by the company in case these are not fully subscribed by the public.

Who is underwriter	Underwriters may be individual, Banks or Financial institutions
Example	XYZ ltd issued a IPO of 2,00,000 shares. XYZ limited entered into underwriting agreement with SBI for underwriting of shares. Offer from public came for 1,50,000 shares, now SBI will have to purchase unsubscribed 50,000 shares.

Equity Shares

An equity share, commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holders of such shares are members of the company and have voting rights.

Preference shares / Preferred Stock

Preference shares mean the shares which carry a fixed dividend rate and which have preferencial right over the equity share with respect to- Payment of Dividend and Repayment of Capital at the time of winding up of the company. Preference shares do not carry voting rights.

Debenture

Section 2(30) of the Companies Act, 2013 define “debenture" which includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Derivative

Derivative is a financial instrument whose value is derived from the value of an underlying asset, which can be securities, commodities, bullion, currency etc. Four most common examples of derivative instruments are Forwards, Futures, Options and Swaps. These are primarily used for hedging position and minimizing the price risk.

Futures contract is an agreement between two parties to buy or sell an underlying asset at a predetermined future date for a specific price. Futures are standardized contracts that trade on an exchange. On expiry, futures can be settled by delivery of the underlying asset or cash.

Forward contracts are similar to futures but they do not trade on an exchange. These contracts only trade **over-the-counter.**

Option contract is similar to a futures contract that **trade on an exchange**. The key difference is that, Option Contract gives the **buyer of the contract the right (but not the obligation)** to buy/sell the underlying asset. The buyer of the option purchases the right from the seller for a consideration which is called the **premium.** The **seller of an option is obligated** to settle the option as per the terms of the contract when the buyer exercises his right.

An Option to buy is called Call option and option to sell is called Put option.

Further, if an option that is exercisable on or before the expiry date is called American option and one that is exercisable only on expiry date, is called European option.

Swaps are used to exchange one kind of cash flow with another. Interest rate swaps are very popular. Interest rate swap helps companies manage their risks due to fluctuation in the interest rates. It involves an exchange of a floating interest rate for a fixed rate or vice versa. These contracts only trade **over-the-counter**.

Initial Coin Offerings (ICO)

ICO is a type of raising capital using cryptocurrencies. In an ICO, a company offers digital tokens to potential investors to fund a certain project or platform, and distributes the tokens (Coins) via a blockchain network.

Mutual Fund

Meaning	As per SEBI, "Mutual fund" means a fund established in the form of a trust to raise monies through the sale of units to the public for investing in securities like shares, debentures etc. A mutual fund **collects money from investors** and invests the money on their behalf. It charges a small fee for managing the money. Mutual funds are an ideal investment vehicle for regular investors who do not know much about investing. Investors of mutual funds are known as unitholders. Unit Trust of India was the first mutual fund set up in India in the year 1963.
Registration with SEBI	SEBI formulates policies, regulates and supervises mutual funds to protect the interest of the investors All mutual funds are required to be registered with SEBI before they launch any scheme.
Net Asset Value (NAV) of a scheme	The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV). The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. NAV is required to be disclosed by the mutual funds on a daily basis
Systematic Investment Plan (SIP)	A SIP allows an investor to invest regularly. One puts in a small amount every month that is invested in a mutual fund.
Exchange Traded Funds (ETFs)	ETFs are mutual fund units that investors can buy or sell at the stock exchange

Large Cap, Mid Cap and Small Cap company

As per SEBI, Large Cap: 1st -100th company in terms of full market capitalization

Mid Cap: 101st -250th company in terms of full market capitalization

Small Cap: 251st company onwards in terms of full market capitalization

International Financial Services Centres Authority (IFSCA)

IFSCA has been established on April 27, 2020 under the International Financial Services Centres Authority Act, 2019. (A statutory authority). It is headquartered at GIFT City, Gandhinagar in Gujarat.

The IFSCA is a **unified authority** for the development and regulation of financial products, financial services and financial institutions in the International Financial Services Centre (IFSC) in India.

At present, the GIFT SEZ IFSC is the maiden international financial services centre in India. RBI, SEBI, IRDAI issued regulations allowing Indian and foreign institutions to open their office in the IFSC. The Union Budget 2016 provided competitive tax regime for the International Financial Services Centre at GIFT SEZ. Company Law exemptions provided in January 2017. International Dispute Resolution Mechanism through Singapore International Arbitration Centre office at GIFT in August 2017.

IFSC centres deal with flows of finance, financial products and services across borders. London, New York and Singapore can be counted as global financial centres.

Miscellaneous

When the supply of money remain same, if demand of money increases then interest rate will increase.

Answers of MCQs

1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**16**	**17**	**18**
c	b	d	c	c	d	c	b	d	b	b	c	c	b	b	c	a	a
19	**20**	**21**	**22**	**23**	**24**	**25**	**26**	**27**	**19A**								
c	a	b	a	c	d	c	a	c	a								

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