Cheatography

Finance Cheat Sheet

by keersri05 via cheatography.com/217923/cs/48575/

Alternative Sources of Finance

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Alternative Sources of Finance: Basics

Meaning: **Funding** channels **beyond conventional bank lending** and public capital markets.

Alternative Sources of Finance: Basics (cont)

Why needed: Startup funding, growth, innovation, infrastructure and diversification.

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Alternative Sources of Finance: Basics (cont)

Equity: Angel investment, VC, PE.

Alternative Sources of Finance: Basics (cont)

Debt: Private credit.

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Alternative Sources of Finance: Basics (cont)

Platform-based: Crowdfunding.

Alternative Sources of Finance: Basics (cont)

Purpose-based: Infrastructure and social-impact financing.

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Alternative Sources of Finance: Basics (cont)

Startup funding: Umbrella covering multiple funding sources.

Alternative Sources of Finance: Basics (cont)

Indian ecosystem: SIDBI, Startup India, FFS, SEBI, NABARD, NIIF.

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Debt vs Equity Financing

Core concept: **Equity = ownership; Debt = borrowing**.

Debt vs Equity Financing (cont)

Equity: No compulsory repayment or fixed interest; dividends/capital gains for investors; ownership dilution.

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Debt vs Equity Financing (cont)

Debt: Principal repayment + interest; no ownership dilution; increases financial risk.

Debt vs Equity Financing (cont)

Major advantage: Equity reduces repayment pressure; debt preserves ownership.

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Debt vs Equity Financing (cont)

Major disadvantage: Equity dilutes control; debt creates fixed repayment obligations.

Debt vs Equity Financing (cont)

Key terms: **Leverage** = use of debt; **Gearing** = debt-equity relationship; **Collateral** = security for loan; **Dilution** = reduced ownership percentage.

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Debt vs Equity Financing (cont)

Interest is generally **tax-deductible** subject to tax rules; **dividends** are **not deductible business expenses**.

Venture Capital

Core concept: **Professionally managed funds** invest **pooled capital** in high-growth, high-risk startups.

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Venture Capital (cont)

Stage: Seed, **early-stage and growth-stage** businesses.

Venture Capital (cont)

Form: **Equity / equity-linked instruments**.

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Venture Capital (cont)

Returns: **Capital appreciation** through eventual exit.

Venture Capital (cont)

Process: **Pitch** → **Due diligence** → **Valuation** → **Term sheet** → **Investment** → **Monitoring** → **Exit**.

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Venture Capital (cont)

Due diligence: Detailed examination before investment.

Venture Capital (cont)

Valuation: Estimated worth of the startup.

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Venture Capital (cont)

Term sheet: Preliminary document outlining investment terms.

Venture Capital (cont)

Portfolio company: Company in which the fund invests.

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Venture Capital (cont)

Follow-on investment: Additional investment in an existing portfolio company.

Venture Capital (cont)

Dry powder: Committed but uninvested capital.

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Venture Capital (cont)

Unicorn: Privately held startup valued at **USD 1 billion or more**.

Venture Capital (cont)

Exit: Sale of investment to realise returns.

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Venture Capital (cont)

Funding rounds: **Series A** → **Series B** → **Series C** and subsequent rounds. - **Series A**: Scaling a business model with initial market traction. - **Series B**: Expanding operations and market reach. - **Series C** onwards: Larger expansion, acquisitions or preparation for an exit.

Stages of VC Financing

Stage Purpose

> **Seed** Develop idea, prototype and proof of concept

> **Startup** Product development and initial marketing

> **Early stage** Begin commercial production and sales

> **Growth stage** Expand operations, market share and capacity

> **Late stage** Scale operations before IPO or acquisition

Private Equity (PE)

Core concept: Investment in **privately held companies**, generally **established** businesses.

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Private Equity (PE) (cont)

Form: **Equity / equity-linked instruments**.

Private Equity (PE) (cont)

Objective: Improve company value and exit at a profit.

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Private Equity (PE) (cont)

Involvement: Management, governance, restructuring and strategic decisions.

Private Equity (PE) (cont)

Major types: **Buyout, LBO, Growth Capital, Distressed Investment, Minority Investment**.

Important keywords

- **Buyout**: Acquisition of a controlling stake.
- **LBO**: Leveraged Buyout, Acquisition financed substantially through borrowed funds.
- **Growth Capital**: Funding expansion of established businesses.
- **Turnaround**: Reviving a struggling business.
- **Value Creation**: Increasing business value through operational/strategic improvements.
- **Exit**: Sale, acquisition or IPO.

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Angel Investment

Core concept: **Wealthy individuals invest their personal money in early-stage startups**.

Angel Investment (cont)

Stage: Pre-seed, seed and early stage.

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Angel Investment (cont)

Form: **Equity or convertible instruments**.

Angel Investment (cont)

Returns: **Capital appreciation** through startup growth or exit.

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Angel Investment (cont)

Additional support: **Mentorship**, expertise and business networks.

Angel Investment (cont)

Pre-seed: Funding at the idea/concept stage.

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Angel Investment (cont)

Seed funding: Initial capital to develop a product or prototype.

Angel Investment (cont)

Exit: Investor realises returns through sale, acquisition or IPO.

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Angel Investment (cont)

Angel investors take **high risks** because startups have uncertain survival and returns.

Angel Investment (cont)

Key distinction: Angel = individual's own money; VC = professionally managed investment fund.

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Startup Funding

- Core concept: **Capital raised by startups to develop, launch, operate and expand**.

Startup Funding (cont)

- Funding lifecycle: **Bootstrapping / Pre-seed → Seed → Early stage → Growth → Late stage**.

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Startup Funding (cont)

- Sources: Own funds, Friends & Family, Angels, VC, Bank Loans, Government Grants, Crowdfunding, Incubators/Accelerators.

Startup Funding (cont)

Important keywords

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Startup Funding (cont)

- **Bootstrapping**: Using personal funds / internally generated revenue.

Startup Funding (cont)

- **Incubator**: Supports early-stage startups with mentoring and infrastructure.

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Startup Funding (cont)

- **Accelerator**: Fixed-duration programme to speed up startup growth.

Startup Funding (cont)

- **Burn Rate**: Rate of cash consumption.

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Startup Funding (cont)

- **Runway**: Time available before cash runs out.

Startup Funding (cont)

- **Product-Market Fit**: Product satisfies genuine market demand.

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Startup Funding (cont)

- **Bridge Financing**: Short-term funding until the next funding round or financing event.

Startup Funding (cont)

- **Valuation**: Estimated worth of the startup.

Formula: **Runway = Available Cash ÷ Net Monthly Burn Rate**.

Key distinction: **Incubator nurtures; accelerator speeds up growth**.

Recall trick: **Startup funding = Funding needs across the entire business lifecycle**.

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Crowdfunding

- Core concept: Raising funds through **small contributions** from a **large number of people**, usually via **online platforms**.

Crowdfunding (cont)

Four types

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Crowdfunding (cont)

- **Donation-based**: No financial return.

Crowdfunding (cont)

- **Reward-based**: Product / reward in return.

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Crowdfunding (cont)

- **Equity-based**: Shares / ownership.

Crowdfunding (cont)

- **Debt-based**: Loan repayment with interest.

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Crowdfunding (cont)

Advantages: Wider access to capital, market validation, publicity and reduced dependence on traditional finance.

Crowdfunding (cont)

Risks: Funding target may not be met, fraud, platform fees, IP exposure and regulatory concerns.

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Crowdfunding (cont)

Important keywords

Crowdfunding (cont)

- **All-or-nothing**: Funds released only if target is achieved.

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Crowdfunding (cont)

- **Keep-it-all**: Amount raised retained even if target is missed, subject to platform terms.

Crowdfunding (cont)

- **P2P Lending**: Direct lending through an online intermediary platform.

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Crowdfunding (cont)

- **Funding Target**: Amount campaign aims to raise.

Private Credit

Core concept: Loans provided by **non-bank lenders** / private funds directly to businesses.

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Private Credit (cont)

Returns: **Interest and fees**.

Private Credit (cont)

Features: Privately **negotiated terms**, flexible structures; secured or unsecured loans.

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Private Credit (cont)

Major types: Direct Lending, Mezzanine Financing, Distressed Debt, Venture Debt, Unitranche Financing.

Private Credit (cont)

Important keywords

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Private Credit (cont)

- **Covenants**: Conditions imposed on borrowers.

Private Credit (cont)

- **Collateral**: Assets pledged as loan security.

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Private Credit (cont)

- **Senior Debt**: Higher repayment priority.

Private Credit (cont)

- **Subordinated Debt**: Lower repayment priority than senior debt.

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Private Credit (cont)

- **Mezzanine Debt**: Hybrid debt with equity-like features.

Private Credit (cont)

- **Venture Debt**: Loans to startups, often VC-backed.

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Private Credit (cont)

- **Credit Spread**: Additional yield over a benchmark for credit risk.

Private Credit (cont)

- **Unitranche Financing**:Combines senior and junior debt into a single loan facility

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Infrastructure Financing

- Core concept: **Long-term financing** for **infrastructure projects** such as roads, railways, airports, power and ports.

Infrastructure Financing (cont)

- Financing methods: Project Finance, Government Funding, PPP, Infrastructure Bonds, Bank Loans, Infrastructure Funds, InvITs.

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Infrastructure Financing (cont)

PPP Models:

Infrastructure Financing (cont)

1. **BOT: Build → Operate → Transfer**. Private party operates during the concession period, often recovering costs through tolls.

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Infrastructure Financing (cont)

2. **BOOT: Build → Own → Operate → Transfer**. Private party also owns the project during the concession period.

Infrastructure Financing (cont)

3. **HAM: Hybrid Annuity Model**. Government and developer share costs (typically 40:60 in Indian highway projects); developer receives annuity payments.

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Infrastructure Financing (cont)

4. **EPC: Engineering, Procurement and Construction**. Contractor builds for an agreed price; generally no long-term operating or traffic risk.

Infrastructure Financing (cont)

MCQ traps: BOT vs BOOT = ownership; HAM = 40:60 + annuity; EPC = construction contract, not a concession-based operating model.

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Infrastructure Financing (cont)

- Important terms:

Infrastructure Financing (cont)

- **Project Finance** – Repayment primarily from project-generated cash flows.

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Infrastructure Financing (cont)

- **SPV (Special Purpose Vehicle)** – Separate legal entity for a specific project.

Infrastructure Financing (cont)

- **VGF (Viability Gap Funding)** – Government support for economically desirable but financially unviable projects.

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Infrastructure Financing (cont)

- **Greenfield** – New project; **Brownfield** – Expansion/redevelopment of an existing project.

Infrastructure Financing (cont)

- **Concession Period** – Period of permitted private operation/development.

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Infrastructure Financing (cont)

- **DSCR** – Measures ability to meet debt obligations.

Infrastructure Financing (cont)

- Important institutions: **IIFCL** – Long-term infrastructure finance;

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Infrastructure Financing (cont)

NaBFID – Infrastructure development finance institution;

Infrastructure Financing (cont)

NIIF – Infrastructure investments;

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Infrastructure Financing (cont)

NHAI – National highways;

Infrastructure Financing (cont)

NABARD – Rural infrastructure financing.

Formula: **DSCR (Debt-Service Coverage Ratio) = Cash Flow Available for Debt Service ÷ (Principal + Interest Due)**.

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Social-Impact Financing

Core concept: Financing projects that generate **measurable social/environmental benefits** alongside **financial sustainability**.

Social-Impact Financing (cont)

SIB: Social Impact Bond — investor returns linked to achievement of social outcomes.

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Social-Impact Financing (cont)

DIB: Development Impact Bond — outcome payments generally made by donors/development agencies.

Social-Impact Financing (cont)

Social Venture Capital: Investment in businesses pursuing social impact + financial returns.

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Social-Impact Financing (cont)

Blended Finance: Uses concessional/public funds to attract private investment.

Social-Impact Financing (cont)

CSR Funding: Corporate funding for eligible social-development activities.

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Social-Impact Financing (cont)

Important terms: Impact Investing – measurable impact + financial return; ESG – Environmental, Social and Governance; Outcome-based Financing – payments linked to results; Concessional Finance – funding on favourable terms.

Social-Impact Financing (cont)

Key distinction: Impact investing seeks both impact and financial returns; philanthropy primarily seeks social benefit.

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Social-Impact Financing (cont)

Concessional Finance: Funding provided on more favourable terms than market rates to support developmental objectives.

Alternative Investment Funds (AIFs)

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Meaning and structure of AIFs.

- AIF: Privately pooled investment vehicle collecting money from Indian or foreign investors under a defined investment policy.

Meaning and structure of AIFs. (cont)

- Legal structure: Trust, company, LLP or body corporate.

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Meaning and structure of AIFs. (cont)

- Participants: Sponsor (sets up fund), Manager (manages investments), Investors (contribute capital).

Meaning and structure of AIFs. (cont)

- Investment areas: Startups, private equity, debt, infrastructure, hedge strategies, etc.

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Meaning and structure of AIFs. (cont)

- Regulation: SEBI (Alternative Investment Funds) Regulations, 2012.

Meaning and structure of AIFs. (cont)

Important exclusions — Not treated as AIFs:

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Meaning and structure of AIFs. (cont)

1. Family trusts set up for relatives.

Meaning and structure of AIFs. (cont)

2. ESOP trusts.

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Meaning and structure of AIFs. (cont)

3. Employee welfare trusts and gratuity trusts.

Meaning and structure of AIFs. (cont)

4. Holding companies under the Companies Act, 2013.

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Meaning and structure of AIFs. (cont)

5. Securitisation trusts and other specifically excluded arrangements.

Meaning and structure of AIFs. (cont)

- Other investment structures: Mutual Funds are regulated under SEBI (Mutual Funds) Regulations, 1996; CIS is defined under Section 11AA of the SEBI Act and regulated under SEBI (Collective Investment Schemes) Regulations, 1999.

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Meaning and structure of AIFs. (cont)

- Key distinction: AIF ≠ Mutual Fund ≠ CIS.

AIF Categories

Category I: Startups, early-stage ventures, SMEs, social ventures and infrastructure; positive economic/social spillovers. Includes VCFs, Angel Funds, SME Funds, Social Impact Funds, Infrastructure Funds and Special Situation Funds.

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AIF Categories (cont)

Category II: PE Funds, Debt Funds and Fund of Funds; no leverage except permitted temporary operational borrowing.

AIF Categories (cont)

Category III: Hedge Funds; complex trading strategies, derivatives and permitted leverage.

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AIF Categories (cont)

Tenure: Category I & II – close-ended, minimum 3 years; Category III – open-ended or close-ended.

AIF Categories (cont)

Key trick: I = Development; II = Private Equity/Debt; III = Trading/Leverage.

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Venture Capital Funds

Meaning: Category I AIF investing primarily in unlisted securities of startups, emerging and early-stage businesses.

Venture Capital Funds (cont)

Focus: New products, services, technology, intellectual property and innovative business models.

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Venture Capital Funds (cont)

Investment form: Equity and equity-linked instruments.

Venture Capital Funds (cont)

Objective: High growth and capital appreciation through eventual exit.

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Venture Capital Funds (cont)

Investment requirement: At least 2/3 of investible funds in specified equity/equity-linked investments; remaining 1/3 in permitted investments.

Venture Capital Funds (cont)

VCU (Venture Capital Undertaking): Domestic company unlisted at the time of investment, subject to SEBI's definition.

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Venture Capital Funds (cont)

Leverage: Generally prohibited, subject to permitted temporary borrowing exceptions.

Venture Capital Funds (cont)

Key distinction: VCF is a specific Category I AIF sub-category; venture capital is the broader financing concept.

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Private Equity Funds

Meaning: AIF investing primarily in equity, equity-linked instruments or partnership interests of investee companies.

Private Equity Funds (cont)

Category: Generally Category II AIF.

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Private Equity Funds (cont)

Investment focus: Generally established businesses; often unlisted companies.

Private Equity Funds (cont)

Objective: Value creation and capital appreciation through eventual exit.

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Private Equity Funds (cont)

Strategies: Buyout, LBO (acquisition using borrowed funds), Growth Capital, Distressed Investment, Minority Investment.

Private Equity Funds (cont)

Involvement: Management participation, restructuring, governance and strategic improvements.

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Private Equity Funds (cont)

Leverage: Generally prohibited; permitted temporary borrowing subject to SEBI conditions.

Private Equity Funds (cont)

Investment limit: Generally 25% of investible funds in one investee company.

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Private Equity Funds (cont)

Key distinction: VC → startups/early-stage businesses; PE → generally established businesses.

Debt funds

Meaning: AIF investing primarily in debt securities of listed/unlisted companies or securitised debt instruments.

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Debt funds (cont)

Category: Generally Category II AIF.

Debt funds (cont)

Returns: Interest, coupon income and possible capital gains.

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Debt funds (cont)

Instruments: Corporate bonds, debentures, NCDs, CP and securitised debt.

Debt funds (cont)

Risks: Credit/default risk, interest-rate risk and liquidity risk.

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Debt funds (cont)

2025 regulatory update: Category II AIFs primarily invest in unlisted securities and/or listed debt securities rated A or below, including securitised debt instruments.

Debt funds (cont)

Leverage: Generally prohibited, except permitted temporary borrowing.

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Debt funds (cont)

Key distinction: Debt investor = creditor; equity investor = owner.

Hedge Funds

Meaning: Funds using diverse/complex trading strategies to generate returns.

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Hedge Funds (cont)

Category: Category III AIF.

Hedge Funds (cont)

Strategies: Long–Short Equity, Arbitrage, Global Macro, Event--Driven, Derivatives Trading.

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Hedge Funds (cont)

Instruments: Listed/unlisted securities, derivatives and structured products.

Hedge Funds (cont)

Leverage: Permitted subject to SEBI limits, investor consent and disclosure requirements.

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Hedge Funds (cont)

Structure: Can be open-ended or close-ended.

Hedge Funds (cont)

Risk: Market, liquidity and leverage risk.

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Basic SEBI Regulatory Framework for AIFs

Governing law: SEBI (Alternative Investment Funds) Regulations, 2012.

Basic SEBI Regulatory Framework for AIFs (cont)

Registration: Mandatory SEBI registration under the appropriate AIF category; fundraising through private placement.

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Basic SEBI Regulatory Framework for AIFs (cont)

General thresholds: Minimum scheme corpus ₹20 crore; minimum investor contribution ₹1 crore; employees/directors of AIF or manager ₹25 lakh; maximum 1,000 investors per scheme. Exceptions apply, including for accredited investors and specified subcategories.

Basic SEBI Regulatory Framework for AIFs (cont)

Sponsor/Manager continuing interest: Category I & II – 2.5% of corpus or ₹5 crore, whichever is lower; Category III – 5% or ₹10 crore, whichever is lower. Cannot be met through waiver of management fees.

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Basic SEBI Regulatory Framework for AIFs (cont)

Placement Memorandum: Discloses strategy, risks, fees, structure and other material information. Material strategy change generally requires consent of 2/3 investors by value.

Basic SEBI Regulatory Framework for AIFs (cont)

Investment limits: Category I & II – generally 25% of investible funds per investee company; Category III – generally 10%.

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Basic SEBI Regulatory Framework for AIFs (cont)

Associate investment: Generally requires 75% investor approval by value.

Basic SEBI Regulatory Framework for AIFs (cont)

Leverage: Category I & II generally prohibited except temporary borrowing; Category III permitted subject to SEBI conditions.

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Basic SEBI Regulatory Framework for AIFs (cont)

Tenure: Category I & II close-ended, minimum 3 years; Category III can be open-ended or close-ended.

Basic SEBI Regulatory Framework for AIFs (cont)

Compliance: Disclosure, valuation, audit, custodian, conflict-of-interest management, reporting and grievance redressal.

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Basic SEBI Regulatory Framework for AIFs (cont)

SEBI powers: Call for information, inspect AIFs and take enforcement action.

Basic SEBI Regulatory Framework for AIFs (cont)

2026 update: Third Amendment expanded accredited-investor recognition and introduced an investor dispute-resolution framework.

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Roles in an AIF

Sponsor: Sets up the AIF; responsible for establishing the fund.

Roles in an AIF (cont)

Fund Manager: Manages investments, makes investment decisions, monitors portfolio and handles day-to-day operations.

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Roles in an AIF (cont)

Trustee: Holds/oversees trust property and supervises compliance; applicable to trust structures.

Roles in an AIF (cont)

Investors: Contribute capital and receive returns; generally no day-to-day investment control.

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Roles in an AIF (cont)

Fiduciary duty: Sponsor and Manager must act in investors' interests and disclose conflicts of interest.

Roles in an AIF (cont)

Key regulatory point: Manager is responsible for investment decisions under Regulation 20(6); Investment Committee members may share responsibility.

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Roles in an AIF (cont)

Alternative structures: Board of Directors (company) or Designated Partners (LLP) perform the relevant oversight role.

Financial Management

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Meaning, Scope & Objectives

- Financial Management: Planning, raising, allocating and controlling financial resources.

Meaning, Scope & Objectives (cont)

- Primary objective: Wealth maximisation; increase shareholders' wealth.

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Meaning, Scope & Objectives (cont)

- Other objectives: Profitability, liquidity, solvency, financial stability, optimum fund utilisation and risk management.

Meaning, Scope & Objectives (cont)

Scope:

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Meaning, Scope & Objectives (cont)

- Financial planning: Estimate fund requirements.

Meaning, Scope & Objectives (cont)

- Investment: Decide where to invest funds.

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Meaning, Scope & Objectives (cont)

- Financing: Decide sources of funds (debt/equity).

Meaning, Scope & Objectives (cont)

- Dividend: Decide distribution vs retention of profits.

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Meaning, Scope & Objectives (cont)

- Working capital: Manage current assets and current liabilities.

Meaning, Scope & Objectives (cont)

- Financial control: Monitor costs, budgets and performance.

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Meaning, Scope & Objectives (cont)

Three core financial decisions:

Meaning, Scope & Objectives (cont)

1. Investment decision — Where to invest?

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Meaning, Scope & Objectives (cont)

2. Financing decision — How to raise funds?

Meaning, Scope & Objectives (cont)

3. Dividend decision — How much to distribute or retain?

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Meaning, Scope & Objectives (cont)

Important distinction:

Meaning, Scope & Objectives (cont)

- Liquidity = ability to meet short-term obligations.

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Meaning, Scope & Objectives (cont)

- Solvency = ability to meet long-term obligations.

Meaning, Scope & Objectives (cont)

- Profitability = ability to generate profits.

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Meaning, Scope & Objectives (cont)

- Wealth maximisation = maximising shareholders' overall value.

Profit vs Wealth Maximisation

- Profit maximisation: Highest possible accounting profit; traditional objective.

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Profit vs Wealth Maximisation (cont)

- Wealth maximisation: Maximise shareholders' wealth, generally reflected in market price of equity shares.

Profit vs Wealth Maximisation (cont)

- Wealth maximisation considers risk, timing and amount of expected returns.

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Profit vs Wealth Maximisation (cont)

- Profit maximisation may encourage short-term decisions and ignores the time value of money and risk if used alone.

Profit vs Wealth Maximisation (cont)

- Wealth maximisation focuses on future cash flows and their present value.

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Profit vs Wealth Maximisation (cont)

- EPS: Earnings Per Share; a profitability measure, not a complete measure of shareholder wealth.

Profit vs Wealth Maximisation (cont)

Exam traps:

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Profit vs Wealth Maximisation (cont)

- Higher accounting profit does not necessarily mean higher shareh-older wealth.

Profit vs Wealth Maximisation (cont)

- Wealth maximisation is the generally preferred modern objective.

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Profit vs Wealth Maximisation (cont)

- A project with higher returns may not be better if it carries disproportionately higher risk.

Profit vs Wealth Maximisation (cont)

- Wealth maximisation does not mean maximising the share price through manipulation; it means increasing fundamental shareholder value.

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Financial Decisions

1. Investment Decision

Financial Decisions (cont)

- Determines allocation of funds among assets/projects.

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Financial Decisions (cont)

- Capital budgeting = long-term investment in fixed assets/projects.

Financial Decisions (cont)

- Working capital management = short-term current assets and liabilities.

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Financial Decisions (cont)

- Techniques: NPV, IRR, Payback Period, ARR.

Financial Decisions (cont)

2. Financing Decision

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Financial Decisions (cont)

- Determines sources and mix of funds: debt, equity, preference capital and retained earnings.

Financial Decisions (cont)

- Capital structure = debt-equity composition.

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Financial Decisions (cont)

- Objective: Appropriate capital structure and lower overall cost of capital.

Financial Decisions (cont)

- Debt involves fixed interest and repayment obligations; equity dividends are not compulsory.

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Financial Decisions (cont)

3. Dividend Decision

Financial Decisions (cont)

- Determines distribution of profits vs retention.

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Financial Decisions (cont)

- Dividend = distribution to shareholders.

Financial Decisions (cont)

- Retained earnings = profits reinvested in business.

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Financial Decisions (cont)

- Influenced by profitability, liquidity, growth opportunities, legal restrictions, taxes and shareholder expectations.

Financial Decisions (cont)

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Financial Decisions (cont)

- Capital budgeting is a long-term investment decision.

Financial Decisions (cont)

- Working capital management is a short-term financial decision.

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Financial Decisions (cont)

- Interest on debt is generally tax-deductible; dividends are not.

Financial Decisions (cont)

- Retained earnings are an internal source of finance.

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Financial Decisions (cont)

- A profitable company may still have insufficient cash to pay dividends.

Risk–Return Relationship

- Return: Income + capital gain/loss relative to initial investment.

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Risk–Return Relationship (cont)

- Risk: Possibility of actual return differing from expected return.

Risk–Return Relationship (cont)

- Principle: Higher expected risk generally requires higher expected return; higher return is not guaranteed.

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Risk–Return Relationship (cont)

- Systematic risk: Market-wide; inflation, interest rates, recession; cannot be eliminated through diversification.

Risk–Return Relationship (cont)

- Unsystematic risk: Company/industry-specific; management failure, strikes, product failure; reducible through diversification.

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Risk–Return Relationship (cont)

- Variance: Average squared deviation from expected return.

Risk–Return Relationship (cont)

- Standard deviation: Square root of variance; measures total volatility.

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Risk–Return Relationship (cont)

- Beta: Measures systematic risk/market sensitivity.

Risk–Return Relationship (cont)

- β = 1: Market-level sensitivity.

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Risk–Return Relationship (cont)

- β > 1: More sensitive than market.

Risk–Return Relationship (cont)

- 0 < β < 1: Less sensitive than market.

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Risk–Return Relationship (cont)

- β < 0: Generally moves opposite to market.

Risk–Return Relationship (cont)

- CV = SD / Expected Return: Risk per unit of expected return.

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Risk–Return Relationship (cont)

- Diversification: Reduces unsystematic risk, not systematic risk.

Risk–Return Relationship (cont)

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Risk–Return Relationship (cont)

- Beta measures systematic risk, while standard deviation measures total risk.

Risk–Return Relationship (cont)

- A diversified portfolio still faces market risk.

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Risk–Return Relationship (cont)

- Higher risk means higher expected return, not assured return.

Risk–Return Relationship (cont)

- Lower CV is preferable when comparing investments with positive expected returns.

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Time Value of Money

- TVM: Money available today is worth more than the same amount received in the future.

Time Value of Money (cont)

- Reasons: Earning capacity, inflation, risk/uncertainty and liquidity preference.

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Time Value of Money (cont)

- Compounding: Converts present money into future value by adding interest.

Time Value of Money (cont)

- Discounting: Converts future money into present value using a discount rate.

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Time Value of Money (cont)

- Applications: Investment appraisal, NPV, bond valuation, loan/EMI calculation, retirement and pension planning.

Time Value of Money (cont)

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Time Value of Money (cont)

- Higher interest rate → Higher future value, for a given principal and period.

Time Value of Money (cont)

- Higher discount rate → Lower present value.

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Time Value of Money (cont)

- Longer time period → Higher future value under positive compounding; lower present value under positive discounting.

Present Value & Future Value

- PV: Current worth of a future amount; calculated through discounting.

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Present Value & Future Value (cont)

- FV: Future worth of present money; calculated through compounding.

Present Value & Future Value (cont)

- $FV = PV \times (1+r)^n$

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Present Value & Future Value (cont)

- $PV = FV \div (1+r)^n$

Present Value & Future Value (cont)

- r = Interest/discount rate per period; n = Number of periods.

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Present Value & Future Value (cont)

- Higher rate → Higher FV but lower PV.

Present Value & Future Value (cont)

- Longer period → Higher FV but lower PV (assuming positive rates).

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Present Value & Future Value (cont)

- Higher initial investment → Higher FV.

Present Value & Future Value (cont)

- Higher future cash flow → Higher PV.

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Present Value & Future Value (cont)

Exam traps:

Present Value & Future Value (cont)

- PV and FV are inversely related through the discounting/compounding process.

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Present Value & Future Value (cont)

- Use the rate and time period consistently: annual rate requires years; monthly rate requires months.

Present Value & Future Value (cont)

- Compounding earns interest on interest.

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Present Value & Future Value (cont)

- Discounting reverses compounding.

Compounding & Discounting

Compounding

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Compounding & Discounting (cont)

- Converts present value into future value.

Compounding & Discounting (cont)

- $FV = PV \times (1+r)^n$.

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Compounding & Discounting (cont)

- Compound interest = $P[(1+r)^n - 1]$.

Compounding & Discounting (cont)

- Multiple compounding: $FV = PV \times (1+r/m)^{mn}$.

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Compounding & Discounting (cont)

- m = Compounding periods per year.

Compounding & Discounting (cont)

- More frequent compounding → Higher FV for the same nominal annual rate.

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Compounding & Discounting (cont)

- Compound interest earns interest on accumulated interest.

Compounding & Discounting (cont)

Discounting

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Compounding & Discounting (cont)

- Converts future value into present value.

Compounding & Discounting (cont)

- PV = FV ÷ $(1+r)^n$.

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Compounding & Discounting (cont)

- Higher discount rate or longer period → Lower PV.

Compounding & Discounting (cont)

Simple vs Compound Interest

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Compounding & Discounting (cont)

- SI = P × r × n; interest only on original principal.

Compounding & Discounting (cont)

- CI = $P[(1+r)^n - 1]$; interest on principal plus accumulated interest.

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Compounding & Discounting (cont)

Effective Annual Rate

Compounding & Discounting (cont)

- EAR = $(1+r/m)^m - 1$.

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Compounding & Discounting (cont)

- Represents actual annual return after accounting for compounding frequency.

Compounding & Discounting (cont)

- EAR is generally higher than nominal annual rate when compounding occurs more than once a year and the rate is positive.

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Compounding & Discounting (cont)

Exam traps:

Compounding & Discounting (cont)

- Nominal rate and effective rate are not necessarily equal.

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Compounding & Discounting (cont)

- For quarterly compounding, divide annual rate by 4 and multiply years by 4.

Compounding & Discounting (cont)

- Simple interest grows linearly; compound interest grows exponentially.

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Compounding & Discounting (cont)

- Discounting is the reverse of compounding.

Capital Budgeting

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Payback period

- Meaning: Time required to recover initial investment from project cash inflows.

Payback period (cont)

- Equal inflows: PP = Initial Investment / Annual Cash Inflow.

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Payback period (cont)

- Unequal inflows: Full years before recovery + (Unrecovered investment / Cash inflow during recovery year).

Payback period (cont)

- Decision rule: Prefer the project with the shorter payback period, subject to the prescribed cutoff.

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Payback period (cont)

- Discounted Payback Period uses discounted cash inflows and considers TVM.

Payback period (cont)

- Advantages: Simple, liquidity-focused, useful under uncertainty.

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Payback period (cont)

- Limitations: Traditional PP ignores TVM, post-payback cash flows and overall profitability.

Payback period (cont)

- PP is expressed in years/months, not percentage.

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Payback period (cont)

Exam traps:

Payback period (cont)

- Traditional Payback Period does not discount cash flows.

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Payback period (cont)

- Discounted Payback Period does.

Payback period (cont)

- A project may recover its investment quickly but generate low total profits.

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Payback period (cont)

- Cash flows after payback are ignored in the traditional method.

Accounting Rate of Return (ARR)

Meaning: Average annual accounting profit as a percentage of investment.

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Accounting Rate of Return (ARR) (cont)

Formula: ARR = (Average Annual Accounting Profit / Average Investment) × 100.

Accounting Rate of Return (ARR) (cont)

Average annual profit: Total accounting profit over project life / Useful life.

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Accounting Rate of Return (ARR) (cont)

Average investment: (Initial Investment + Salvage Value) / 2, under the standard straight-line depreciation assumption.

Accounting Rate of Return (ARR) (cont)

Accounting profit: Cash inflows minus depreciation and other expenses; account for tax if the question specifies profit after tax.

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Accounting Rate of Return (ARR) (cont)

Decision: Accept if ARR exceeds the required rate; higher ARR is preferred.

Accounting Rate of Return (ARR) (cont)

Advantages: Simple, accounting-data based, considers full project life.

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Accounting Rate of Return (ARR) (cont)

Limitations: Ignores time value of money; uses profit rather than cash flow; affected by accounting policies.

Accounting Rate of Return (ARR) (cont)

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Accounting Rate of Return (ARR) (cont)

- ARR is expressed as a percentage, not years.

Accounting Rate of Return (ARR) (cont)

- Payback uses cash inflows; ARR uses accounting profits.

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Accounting Rate of Return (ARR) (cont)

- Depreciation reduces accounting profit but is a non-cash expense.

Accounting Rate of Return (ARR) (cont)

- Some questions use initial investment as the denominator instead of average investment. Follow the formula specified; otherwise use the standard average-investment method.

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Net Present Value (NPV)

Meaning: Difference between present value of future cash inflows and initial investment.

Net Present Value (NPV) (cont)

Formula: NPV = Total PV of cash inflows − Initial investment.

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Net Present Value (NPV) (cont)

Present value: PV=CF_t/(1+r)^t.

Net Present Value (NPV) (cont)

Discount rate: Required rate of return / cost of capital.

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Net Present Value (NPV) (cont)

Decision rule:

Net Present Value (NPV) (cont)

- NPV positive → Accept.

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Net Present Value (NPV) (cont)

- NPV zero → Indifferent.

Net Present Value (NPV) (cont)

- NPV negative → Reject.

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Net Present Value (NPV) (cont)

Mutually exclusive projects: Prefer the highest positive NPV.

Net Present Value (NPV) (cont)

Advantages: Considers TVM, entire project life and cash flows; measures wealth created.

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Net Present Value (NPV) (cont)

Limitations: Requires cash-flow forecasts and discount-rate estimation.

Net Present Value (NPV) (cont)

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Net Present Value (NPV) (cont)

- Higher discount rate → Lower present value, other things equal.

Net Present Value (NPV) (cont)

- Higher future cash inflow → Higher NPV, other things equal.

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Net Present Value (NPV) (cont)

- NPV is expressed in monetary units, not percentage or years.

Net Present Value (NPV) (cont)

- NPV = 0 does not mean the project earns zero profit; it earns exactly the required return.

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Net Present Value (NPV) (cont)

- NPV uses discounted cash flows; traditional Payback Period and ARR do not.

Internal Rate of Return (IRR)

- Meaning: Discount rate at which NPV = 0.

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Internal Rate of Return (IRR) (cont)

- Formula condition: PV of cash inflows = Initial investment.

Internal Rate of Return (IRR) (cont)

- Decision: IRR greater than required return → Accept; lower → Reject; equal → Indifferent.

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Internal Rate of Return (IRR) (cont)

- Interpolation formula:

Internal Rate of Return (IRR) (cont)

IRR=L+((NPV_L)/(NPV_L-NPV_H))*(H-L)

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Internal Rate of Return (IRR) (cont)

- (NPV_L): Positive NPV at lower rate.

Internal Rate of Return (IRR) (cont)

- (NPV_H): Negative NPV at higher rate.

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Internal Rate of Return (IRR) (cont)

- Advantages: Considers TVM and full project cash flows; percentage-based.

Internal Rate of Return (IRR) (cont)

- Limitations: Multiple IRRs possible; reinvestment assumption; conflicting rankings with NPV.

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Internal Rate of Return (IRR) (cont)

- Exam traps:

Internal Rate of Return (IRR) (cont)

- IRR is a percentage; NPV is a monetary amount.

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Internal Rate of Return (IRR) (cont)

- Higher discount rate generally reduces NPV.

Internal Rate of Return (IRR) (cont)

- IRR is the discount rate that makes NPV zero, not the rate that maximises NPV.

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Internal Rate of Return (IRR) (cont)

- For mutually exclusive projects with conflicting NPV and IRR rankings, generally prefer NPV.

Profitability Index (PI)

Meaning: Present value of future cash inflows per rupee of initial investment.

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Profitability Index (PI) (cont)

Formula: PI = PV of Cash Inflows / Initial Investment.

Profitability Index (PI) (cont)

Alternative: PI = (NPV + Initial Investment) / Initial Investment.

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Profitability Index (PI) (cont)

Decision:

Profitability Index (PI) (cont)

- PI > 1 → Accept.

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Profitability Index (PI) (cont)

- PI = 1 → Indifferent.

Profitability Index (PI) (cont)

- PI < 1 → Reject.

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Profitability Index (PI) (cont)

Relationship with NPV:

Profitability Index (PI) (cont)

- Positive NPV → PI > 1.

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Profitability Index (PI) (cont)

- Zero NPV → PI = 1.

Profitability Index (PI) (cont)

- Negative NPV → PI < 1.

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Profitability Index (PI) (cont)

Advantages: Considers TVM; useful under capital constraints; compares value per rupee invested.

Profitability Index (PI) (cont)

Limitations: Can misrank mutually exclusive projects; does not show absolute value created.

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Profitability Index (PI) (cont)

Exam traps:

Profitability Index (PI) (cont)

- PI is a ratio, not a percentage or monetary amount.

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Profitability Index (PI) (cont)

- PI = 1.2 means ₹1.20 of PV inflows per ₹1 invested.

Profitability Index (PI) (cont)

- Higher PI does not always mean higher total NPV.

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Profitability Index (PI) (cont)

- PI is particularly useful in capital rationing.

Project Selection & Capital Rationing

Project selection: Choosing investments to maximise shareholder wealth within available resources.

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Project Selection & Capital Rationing (cont)

Independent projects: Acceptance of one does not affect another; multiple projects can be accepted.

Project Selection & Capital Rationing (cont)

Mutually exclusive projects: Only one alternative can be selected; generally prefer higher NPV.

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Project Selection & Capital Rationing (cont)

Contingent projects: Acceptance of one depends on another project.

Project Selection & Capital Rationing (cont)

Capital rationing: Limited funds prevent undertaking all positive-NPV projects.

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Project Selection & Capital Rationing (cont)

Hard rationing: External restriction on funds (e.g. borrowing constr-aints).

Project Selection & Capital Rationing (cont)

Soft rationing: Internally imposed investment budget by manage-ment.

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Project Selection & Capital Rationing (cont)

PI: Useful for ranking projects under limited funds, especially divisible projects.

Project Selection & Capital Rationing (cont)

NPV: Select the feasible combination generating the highest total NPV.

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Project Selection & Capital Rationing (cont)

Linear programming: Optimises investment under multiple constr-aints.

Project Selection & Capital Rationing (cont)

Integer programming: Used when projects are indivisible.

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Project Selection & Capital Rationing (cont)

Exam traps:

Project Selection & Capital Rationing (cont)

- Capital rationing does not mean projects have negative NPV.

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Project Selection & Capital Rationing (cont)

- Positive-NPV projects may still be rejected because of budget constraints.

Project Selection & Capital Rationing (cont)

- PI measures value per rupee; NPV measures total value created.

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Project Selection & Capital Rationing (cont)

- Highest PI alone may not give the best project combination when projects are indivisible.

Capital Budgeting : For numericals

Payback: Time taken to recover initial investment.

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Capital Budgeting : For numericals (cont)

ARR: Accounting profitability as a percentage of average investment.

Capital Budgeting : For numericals (cont)

NPV: Absolute value created by a project.

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Capital Budgeting : For numericals (cont)

IRR: Project's implied discount rate.

Capital Budgeting : For numericals (cont)

PI: Present value generated per rupee invested.

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Capital Budgeting : For numericals (cont)

Capital rationing: Choosing the best feasible combination when funds are limited.

Capital Budgeting : For numericals (cont)

NPV is generally preferred for maximising shareholder wealth.

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Capital Budgeting : For numericals (cont)

PI is particularly useful for capital allocation under budget constraints.

Formula Bank

Method	Formula
Payback Period (equal inflows)	Initial Investment / Annual Cash Inflow
Payback Period (unequal inflows)	Full years + Unrecovered amount / Next year's inflow
ARR	Average Annual Profit / Average Investment × 100
NPV	Total PV of cash inflows − Initial Investment
IRR	Discount rate at which NPV = 0
PI	PV of Cash Inflows / Initial Investment

Cost of Capital and Capital Structure

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Cost of Equity

1. Meaning

Cost of Equity (cont)

Cost of Equity is the rate of return expected by equity shareholders for investing in a company's shares.

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Cost of Equity (cont)

From the company's perspective, it is the cost of raising funds through equity.

Cost of Equity (cont)

Equity shareholders take higher risk because:

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Cost of Equity (cont)

- Dividends are not guaranteed.

Cost of Equity (cont)

- They are paid after creditors and preference shareholders.

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Cost of Equity (cont)

- Their returns depend on the company's profitability and share-price performance.

Cost of Equity (cont)

Therefore, equity generally has a higher cost than debt.

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Cost of Equity (cont)

2. Methods of Calculating Cost of Equity

Cost of Equity (cont)

A. Dividend Growth Model (Gordon Growth Model)

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Cost of Equity (cont)

Used when dividends are expected to grow at a constant rate.

Cost of Equity (cont)

$K_e=(D_1 / P_0)+g$

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Cost of Equity (cont)

Where:

Cost of Equity (cont)

- K_e = Cost of equity.

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Cost of Equity (cont)

- D_1 = Expected dividend per share next year.

Cost of Equity (cont)

- P_0 = Current market price per share.

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Cost of Equity (cont)

- g = Constant dividend growth rate.

Cost of Equity (cont)

Since D_1=D_0(1+g), the formula can also be written as:

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Cost of Equity (cont)

K_e=D_0(1+g) / P_0+g

Cost of Equity (cont)

Example:

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Cost of Equity (cont)

Current share price = ₹100; expected next-year dividend = ₹8; growth rate = 5%.

Cost of Equity (cont)

K_e= (8/100)+0.05 =13%

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Cost of Equity (cont)

B. Capital Asset Pricing Model (CAPM)

Cost of Equity (cont)

Calculates expected return based on systematic risk.

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Cost of Equity (cont)

K_e=R_f+beta(R_m-R_f)

Cost of Equity (cont)

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Cost of Equity (cont)

- (R_f) = Risk-free rate.

Cost of Equity (cont)

- (beta) = Beta of the share.

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Cost of Equity (cont)

- (R_m) = Expected market return.

Cost of Equity (cont)

- (R_m-R_f) = Market risk premium.

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Cost of Equity (cont)

Example:

Cost of Equity (cont)

Risk-free rate = 6%; beta = 1.2; expected market return = 11%.

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Cost of Equity (cont)

K_e=6+1.2(11-6)

Cost of Equity (cont)

K_e=12%

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Cost of Equity (cont)

Interpretation: The share has a higher systematic risk than the market because its beta exceeds 1.

Cost of Equity (cont)

3. Important Concepts

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Cost of Equity (cont)

- Beta = 1: Same systematic risk as the market.

Cost of Equity (cont)

- Beta > 1: More sensitive to market movements; higher systematic risk.

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Cost of Equity (cont)

- Beta less than 1: Less sensitive to market movements.

Cost of Equity (cont)

- Beta = 0: No systematic market risk in the CAPM framework.

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Cost of Equity (cont)

- Negative beta: Tends to move opposite to the market.

Cost of Equity (cont)

- Risk-free rate: Theoretical return on an investment with negligible default risk.

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Cost of Equity (cont)

- Market risk premium: Additional return expected for investing in the market rather than a risk-free asset.

Cost of Equity (cont)

4. Limitations

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Cost of Equity (cont)

- Dividend Growth Model assumes constant dividend growth and is unsuitable for companies that do not pay dividends.

Cost of Equity (cont)

- CAPM depends on estimates of beta, market return and risk-free rate.

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Cost of Equity (cont)

- Both models rely on assumptions and estimates; actual returns may differ.

Cost of Debt

1. Meaning

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Cost of Debt (cont)

Cost of Debt is the effective cost incurred by a company for borrowing funds through loans, debentures, bonds and other debt instruments.

Cost of Debt (cont)

Interest is generally a tax-deductible expense. Therefore, we distinguish between:

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Cost of Debt (cont)

- Before-tax cost of debt: Interest cost before considering tax benefits.

Cost of Debt (cont)

- After-tax cost of debt: Effective cost after considering the tax deduction on interest.

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Cost of Debt (cont)

2. Before-Tax Cost of Debt

Cost of Debt (cont)

For irredeemable debt (debt with no fixed repayment date):

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Cost of Debt (cont)

K_d=(I / NP)*100

Cost of Debt (cont)

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Cost of Debt (cont)

- (I) = Annual interest.

Cost of Debt (cont)

- (NP) = Net proceeds from issuing debt.

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Cost of Debt (cont)

Example:

Cost of Debt (cont)

A company issues debentures of ₹1,000 at an annual interest rate of 10%.

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Cost of Debt (cont)

Annual interest = ₹100.

Cost of Debt (cont)

K_d=(100 / 1000)*100=10%

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Cost of Debt (cont)

3. After-Tax Cost of Debt

Cost of Debt (cont)

Since interest is tax-deductible, the effective cost is reduced by the tax shield.

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Cost of Debt (cont)

K_d=I(1-T)

Cost of Debt (cont)

When expressed as a percentage of debt value:

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Cost of Debt (cont)

K_d=R_d(1-T)

Cost of Debt (cont)

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Cost of Debt (cont)

- (R_d) = Before-tax interest rate.

Cost of Debt (cont)

- (T) = Corporate tax rate.

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Cost of Debt (cont)

Example:

Cost of Debt (cont)

Interest rate = 10%; corporate tax rate = 25%.

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Cost of Debt (cont)

K_d=10%(1-0.25)

Cost of Debt (cont)

K_d=7.5%

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Cost of Debt (cont)

Key concept

Cost of Debt (cont)

The company effectively bears a 7.5% cost because the interest expense reduces taxable profit, assuming the tax deduction can be fully utilised.

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Cost of Debt (cont)

4. Cost of Redeemable Debt

Cost of Debt (cont)

Redeemable debt is repaid after a specified period, often at a value different from its issue price.

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Cost of Debt (cont)

An approximate formula for before-tax cost of redeemable debt:

Cost of Debt (cont)

K_d=(I+((RV-NP)/n) / (RV+NP)/2)))*100

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Cost of Debt (cont)

Where:

Cost of Debt (cont)

- (I) = Annual interest.

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Cost of Debt (cont)

- (RV) = Redemption value.

Cost of Debt (cont)

- (NP) = Net proceeds.

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Cost of Debt (cont)

- (n) = Number of years to redemption.

Cost of Debt (cont)

After-tax approximation:

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Cost of Debt (cont)

K_d(after tax)=K_d(before tax)(1-T)

Cost of Debt (cont)

Example:

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Cost of Debt (cont)

- Net proceeds = ₹950

Cost of Debt (cont)

- Redemption value = ₹1,000

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Cost of Debt (cont)

- Annual interest = ₹100

Cost of Debt (cont)

- Period = 5 years

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Cost of Debt (cont)

K_d=(100+(1000-950/5)/(1000+950)/2)*100

Cost of Debt (cont)

=(110/975) *100

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Cost of Debt (cont)

=11.28%

Cost of Debt (cont)

After-tax cost at 25% tax:

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Cost of Debt (cont)

11.28% * 0.75= 8.46%

Cost of Debt (cont)

5. Important Concepts

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Cost of Debt (cont)

- Tax shield: Reduction in tax liability due to deductible interest expense.

Cost of Debt (cont)

- Secured debt: Backed by specified assets as collateral.

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Cost of Debt (cont)

- Unsecured debt: Not backed by specific collateral.

Cost of Debt (cont)

- Redeemable debt: Repaid on a specified future date.

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Cost of Debt (cont)

- Irredeemable debt: No specified maturity date.

Cost of Debt (cont)

- Effective cost: May include issue expenses, discount on issue and redemption premium, not merely the coupon rate.

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Weighted Average Cost of Capital (WACC)

1. Meaning

Weighted Average Cost of Capital (WACC) (cont)

Weighted Average Cost of Capital (WACC) is the average cost of all sources of finance used by a company, weighted according to their proportion in the capital structure.

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Weighted Average Cost of Capital (WACC) (cont)

A company may raise funds through:

Weighted Average Cost of Capital (WACC) (cont)

- Equity shares.

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Weighted Average Cost of Capital (WACC) (cont)

- Preference shares.

Weighted Average Cost of Capital (WACC) (cont)

- Debt (loans, bonds and debentures).

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Weighted Average Cost of Capital (WACC) (cont)

Each source has a different cost. WACC combines these costs into one overall rate.

Weighted Average Cost of Capital (WACC) (cont)

2. Formula

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Weighted Average Cost of Capital (WACC) (cont)

WACC=sum (W_i * K_i)

Weighted Average Cost of Capital (WACC) (cont)

For a company using equity and debt:

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Weighted Average Cost of Capital (WACC) (cont)

WACC=W_e*K_e+W_d*K_d

Weighted Average Cost of Capital (WACC) (cont)

Where:

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Weighted Average Cost of Capital (WACC) (cont)

- (W_e) = Weight of equity.

Weighted Average Cost of Capital (WACC) (cont)

- (W_d) = Weight of debt.

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Weighted Average Cost of Capital (WACC) (cont)

- (K_e) = Cost of equity.

Weighted Average Cost of Capital (WACC) (cont)

- (K_d) = After-tax cost of debt.

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Weighted Average Cost of Capital (WACC) (cont)

For three sources:

Weighted Average Cost of Capital (WACC) (cont)

WACC=W_e*K_e+W_p*K_p+W_d*K_d

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Weighted Average Cost of Capital (WACC) (cont)

Here (K_p) is the cost of preference share capital.

Weighted Average Cost of Capital (WACC) (cont)

Weights are calculated as:

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Weighted Average Cost of Capital (WACC) (cont)

W_e=Equity/ Total Capital

Weighted Average Cost of Capital (WACC) (cont)

W_d=Debt/ Total Capital

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Weighted Average Cost of Capital (WACC) (cont)

Include after-tax cost of debt when interest is tax-deductible.

Weighted Average Cost of Capital (WACC) (cont)

Weights: Proportion of each financing source in total capital.

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Weighted Average Cost of Capital (WACC) (cont)

Sources: Equity, preference shares and debt.

Weighted Average Cost of Capital (WACC) (cont)

Market value weights: Based on current market values; generally preferred for financial decisions over book value weights.

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Weighted Average Cost of Capital (WACC) (cont)

Application: Used as a discount rate for projects with risk similar to the company's existing operations.

Weighted Average Cost of Capital (WACC) (cont)

Interpretation: Project return above WACC generally creates value; below WACC generally destroys value.

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Weighted Average Cost of Capital (WACC) (cont)

Exam traps:

Weighted Average Cost of Capital (WACC) (cont)

- WACC is not a simple arithmetic average of individual costs.

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Weighted Average Cost of Capital (WACC) (cont)

- Debt cost is generally adjusted for tax.

Weighted Average Cost of Capital (WACC) (cont)

- Equity cost is not tax-adjusted.

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Weighted Average Cost of Capital (WACC) (cont)

- Higher debt may initially reduce WACC due to tax benefits, but excessive debt increases financial risk.

Weighted Average Cost of Capital (WACC) (cont)

- WACC is not necessarily the correct discount rate for every project.

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Capital Structure

Meaning: Mix of long-term debt, equity, preference shares and retained earnings used to finance a company.

Capital Structure (cont)

Equity: Ownership capital; dividends not compulsory; no fixed repayment.

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Capital Structure (cont)

Preference shares: Priority in dividends and repayment over equity; generally fixed dividend; no tax deduction for dividends.

Capital Structure (cont)

Debt: Loans, bonds and debentures; interest obligation; repayment obligation; interest generally tax-deductible.

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Capital Structure (cont)

Retained earnings: Profits reinvested in the business instead of distributed as dividends.

Capital Structure (cont)

Financial risk: Risk arising from fixed financial obligations, particularly debt.

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Capital Structure (cont)

Trading on equity: Using fixed-cost debt to potentially increase returns to equity shareholders.

Capital Structure (cont)

Optimal capital structure: Financing mix that minimises WACC and maximises firm value within the relevant framework.

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Capital Structure (cont)

Factors affecting capital structure: Cost, tax, business risk, cash-flow stability, control, flexibility, asset structure and market conditions.

Capital Structure (cont)

Exam traps:

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Capital Structure (cont)

- Debt does not dilute ownership but increases financial risk.

Capital Structure (cont)

- Equity dividends are not compulsory; debt interest is contractually payable.

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Capital Structure (cont)

- Retained earnings are an internal source of equity finance, but not free.

Capital Structure (cont)

- More debt does not always mean higher shareholder returns.

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Capital Structure (cont)

- Business risk exists even without debt; financial risk arises from financing obligations.

Operating and Financial Leverage

- Leverage: Use of fixed costs to magnify changes in earnings.

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Operating and Financial Leverage (cont)

- Operating leverage: Arises from fixed operating costs; measures EBIT sensitivity to sales.

Operating and Financial Leverage (cont)

DOL=Contribution / EBIT

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Operating and Financial Leverage (cont)

- Contribution = Sales − Variable Costs.

Operating and Financial Leverage (cont)

- EBIT = Contribution − Fixed Operating Costs.

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Operating and Financial Leverage (cont)

- Financial leverage: Arises from fixed financial costs; measures EPS sensitivity to EBIT.

Operating and Financial Leverage (cont)

DFL= EBIT / EBIT-Interest

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Operating and Financial Leverage (cont)

- With preference dividend:

Operating and Financial Leverage (cont)

DFL= EBIT / EBIT-I- (PD/(1-T))

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Operating and Financial Leverage (cont)

- Combined leverage:

Operating and Financial Leverage (cont)

DCL=DOL * DFL

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Operating and Financial Leverage (cont)

or

Operating and Financial Leverage (cont)

DCL= % Change in EPS / % Change in Sales

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Operating and Financial Leverage (cont)

- Interpretation: DOL = 2 means 10% sales change produces approximately 20% EBIT change; DFL = 1.5 means 10% EBIT change produces approximately 15% EPS change.

Operating and Financial Leverage (cont)

- Exam traps:

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Operating and Financial Leverage (cont)

- Operating leverage → Fixed operating costs.

Operating and Financial Leverage (cont)

- Financial leverage → Fixed financial costs.

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Operating and Financial Leverage (cont)

- DOL links sales to EBIT.

Operating and Financial Leverage (cont)

- DFL links EBIT to EPS.

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Operating and Financial Leverage (cont)

- DCL links sales to EPS.

Operating and Financial Leverage (cont)

- Higher leverage magnifies losses as well as gains.

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Capital Structure Theories

These theories explain whether the mix of debt and equity affects a company's overall cost of capital and total value.

Capital Structure Theories (cont)

1. Net Income (NI) Approach

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Capital Structure Theories (cont)

- Assumes that increasing debt in the capital structure reduces the overall cost of capital.

Capital Structure Theories (cont)

- Debt is cheaper than equity.

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Capital Structure Theories (cont)

- As debt increases, WACC decreases and firm value increases.

Capital Structure Theories (cont)

- Suggests that a company can increase its value by using more debt.

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Capital Structure Theories (cont)

Key idea: More debt → Lower WACC → Higher firm value.

Capital Structure Theories (cont)

2. Net Operating Income (NOI) Approach

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Capital Structure Theories (cont)

- Suggests that capital structure does not affect the total value of the firm.

Capital Structure Theories (cont)

- Overall cost of capital remains constant.

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Capital Structure Theories (cont)

- Increasing debt increases financial risk for equity shareholders.

Capital Structure Theories (cont)

- Consequently, cost of equity increases and offsets the benefit of cheaper debt.

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Capital Structure Theories (cont)

Key idea: Capital structure is irrelevant to firm value.

Capital Structure Theories (cont)

3. Traditional Approach

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Capital Structure Theories (cont)

- Suggests that an optimal capital structure exists.

Capital Structure Theories (cont)

- Moderate use of debt reduces WACC because debt is cheaper than equity.

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Capital Structure Theories (cont)

- Excessive debt increases financial risk and raises the cost of equity and debt.

Capital Structure Theories (cont)

- Initially WACC falls, reaches a minimum, and eventually rises.

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Capital Structure Theories (cont)

Key idea: There is an optimal debt-equity mix that minimises WACC and maximises firm value.

Capital Structure Theories (cont)

4. Modigliani–Miller (MM) Theory

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Capital Structure Theories (cont)

Developed by Franco Modigliani and Merton Miller.

Capital Structure Theories (cont)

A. Without Taxes

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Capital Structure Theories (cont)

- Capital structure is irrelevant to firm value under ideal market assumptions.

Capital Structure Theories (cont)

- Value of a levered firm = Value of an unlevered firm.

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Capital Structure Theories (cont)

- WACC remains constant.

Capital Structure Theories (cont)

- Investors can create personal leverage themselves by borrowing individually.

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Capital Structure Theories (cont)

B. With Corporate Taxes

Capital Structure Theories (cont)

- Interest on debt is tax-deductible.

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Capital Structure Theories (cont)

- Debt creates a tax shield.

Capital Structure Theories (cont)

- Increasing debt can increase firm value and reduce WACC.

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Capital Structure Theories (cont)

Simplified relationship:

Capital Structure Theories (cont)

$V_L = V_U + T_c * D$

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Capital Structure Theories (cont)

Where:

Capital Structure Theories (cont)

- (V_L) = Value of levered firm.

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Capital Structure Theories (cont)

- (V_U) = Value of unlevered firm.

Capital Structure Theories (cont)

- (T_c) = Corporate tax rate.

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Capital Structure Theories (cont)

- (D) = Value of debt.

Capital Structure Theories (cont)

This simplified model assumes perpetual debt and other idealised conditions.

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Capital Structure Theories (cont)

Key idea: Without taxes, capital structure is irrelevant; with corporate taxes, debt provides a tax advantage.

Capital Structure Theories (cont)

5.Important Concept: Trade-off Theory

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Capital Structure Theories (cont)

- Companies balance the tax benefits of debt against the costs of financial distress.

Capital Structure Theories (cont)

- Debt provides tax savings through interest deductibility.

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Capital Structure Theories (cont)

- Excessive debt increases bankruptcy risk, distress costs and agency costs.

Capital Structure Theories (cont)

- The optimal capital structure balances these benefits and costs.

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Capital Structure Theories (cont)

Key idea: Optimal debt is determined by balancing tax benefits against financial distress costs.

Dividend Decisions and Dividend Policy

1. Meaning of Dividend

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Dividend Decisions and Dividend Policy (cont)

A dividend is the portion of a company's profits distributed to its shareholders.

Dividend Decisions and Dividend Policy (cont)

A company can either:

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Dividend Decisions and Dividend Policy (cont)

- Distribute profits as dividends.

Dividend Decisions and Dividend Policy (cont)

- Retain profits for reinvestment and future growth.

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Dividend Decisions and Dividend Policy (cont)

The decision regarding how much profit to distribute and how much to retain is called the Dividend Decision.

Dividend Decisions and Dividend Policy (cont)

2. Types of Dividends

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Dividend Decisions and Dividend Policy (cont)

A. Cash Dividend

Dividend Decisions and Dividend Policy (cont)

- Paid to shareholders in cash.

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Dividend Decisions and Dividend Policy (cont)

- Most common form of dividend.

Dividend Decisions and Dividend Policy (cont)

B. Stock Dividend / Bonus Shares

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Dividend Decisions and Dividend Policy (cont)

- Additional shares issued to existing shareholders without receiving additional consideration.

Dividend Decisions and Dividend Policy (cont)

- Increases the number of shares held, but does not directly increase the company's total assets or shareholder wealth.

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Dividend Decisions and Dividend Policy (cont)

C. Interim Dividend

Dividend Decisions and Dividend Policy (cont)

- Declared by the Board of Directors during a financial year, before the final dividend.

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Dividend Decisions and Dividend Policy (cont)

D. Final Dividend

Dividend Decisions and Dividend Policy (cont)

- Recommended by the Board and declared by shareholders at the Annual General Meeting (AGM), subject to applicable law.

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Dividend Decisions and Dividend Policy (cont)

E. Special Dividend

Dividend Decisions and Dividend Policy (cont)

- One-time dividend arising from exceptional profits or surplus funds.

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Dividend Decisions and Dividend Policy (cont)

3. Important Dividend Ratios

Dividend Decisions and Dividend Policy (cont)

A. Dividend Payout Ratio

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Dividend Decisions and Dividend Policy (cont)

Percentage of earnings distributed as dividends.

Dividend Decisions and Dividend Policy (cont)

Dividend Payout Ratio= (Total Dividend / Net Profit after Tax)*100

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Dividend Decisions and Dividend Policy (cont)

Alternatively, per share:

Dividend Decisions and Dividend Policy (cont)

= (DPS / EPS)*100

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Dividend Decisions and Dividend Policy (cont)

B. Retention Ratio

Dividend Decisions and Dividend Policy (cont)

Percentage of earnings retained in the business.

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Dividend Decisions and Dividend Policy (cont)

Retention Ratio=1-Dividend / Payout Ratio

Dividend Decisions and Dividend Policy (cont)

Or:

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Dividend Decisions and Dividend Policy (cont)

= (Retained Earnings / Net Profit after Tax)*100

Dividend Decisions and Dividend Policy (cont)

C. Dividend Yield

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Dividend Decisions and Dividend Policy (cont)

Dividend income as a percentage of the current market price of a share.

Dividend Decisions and Dividend Policy (cont)

Dividend Yield= (DPS / Market Price per Share)*100

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Dividend Decisions and Dividend Policy (cont)

Where DPS = Dividend Per Share.

Dividend Decisions and Dividend Policy (cont)

D. Earnings Per Share (EPS)

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Dividend Decisions and Dividend Policy (cont)

EPS= Profit available to Equity Shareholders / Weighted Average Equity Shares

Dividend Decisions and Dividend Policy (cont)

4. Dividend Policy

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Dividend Decisions and Dividend Policy (cont)

Dividend policy refers to the approach adopted by a company for distributing profits between shareholders and reinvestment.

Dividend Decisions and Dividend Policy (cont)

Common approaches:

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Dividend Decisions and Dividend Policy (cont)

Policy Meaning

Dividend Decisions and Dividend Policy (cont)

Stable dividend policy Maintains relatively consistent dividends per share

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Dividend Decisions and Dividend Policy (cont)

Constant payout ratio Pays a fixed percentage of earnings as dividends

Dividend Decisions and Dividend Policy (cont)

Residual dividend policy Pays dividends after financing suitable investment opportunities

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Dividend Decisions and Dividend Policy (cont)

No/low dividend policy Retains most profits for business expansion

Dividend Decisions and Dividend Policy (cont)

Residual Dividend Policy:

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Dividend Decisions and Dividend Policy (cont)

- Identify profitable investment opportunities.

Dividend Decisions and Dividend Policy (cont)

- Determine the equity required to finance them.

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Dividend Decisions and Dividend Policy (cont)

- Retain the required profits.

Dividend Decisions and Dividend Policy (cont)

- Distribute the remaining earnings as dividends.

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Dividend Decisions and Dividend Policy (cont)

5.Factors Affecting Dividend Decisions

Dividend Decisions and Dividend Policy (cont)

- Profitability: Higher profits may support higher dividends.

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Dividend Decisions and Dividend Policy (cont)

- Liquidity: Dividends require cash; accounting profits alone are insufficient.

Dividend Decisions and Dividend Policy (cont)

- Growth opportunities: Companies with expansion plans may retain more earnings.

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Dividend Decisions and Dividend Policy (cont)

- Stability of earnings: Stable earnings support predictable dividends.

Dividend Decisions and Dividend Policy (cont)

- Debt obligations: Companies with high debt may prioritise repayment.

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Dividend Decisions and Dividend Policy (cont)

- Legal restrictions: Dividend distribution must comply with applicable company law.

Dividend Decisions and Dividend Policy (cont)

- Shareholder expectations: Investors may prefer regular dividend income.

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Dividend Decisions and Dividend Policy (cont)

- Tax considerations: Tax treatment can influence dividend decisions.

Dividend Decisions and Dividend Policy (cont)

- Access to capital markets: Companies with easier access to external funds may distribute more profits.

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Dividend Decisions and Dividend Policy (cont)

6. Dividend Theories

Dividend Decisions and Dividend Policy (cont)

A. Walter's Model

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Dividend Decisions and Dividend Policy (cont)

- Dividend policy affects the value of the firm.

Dividend Decisions and Dividend Policy (cont)

- The decision depends on the relationship between the company's return on investment (r) and cost of equity (Ke).

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Dividend Decisions and Dividend Policy (cont)

Relationship	Dividend implication

Dividend Decisions and Dividend Policy (cont)

r > Ke Retain earnings; reinvestment creates more value

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Dividend Decisions and Dividend Policy (cont)

r < Ke Distribute earnings; shareholders can earn better returns elsewhere

Dividend Decisions and Dividend Policy (cont)

r = Ke Dividend policy is irrelevant

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Dividend Decisions and Dividend Policy (cont)

B. Gordon's Dividend Growth Model

Dividend Decisions and Dividend Policy (cont)

- Investors value shares based on expected dividends and growth.

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Dividend Decisions and Dividend Policy (cont)

- Retained earnings can generate growth if reinvested profitably.

Dividend Decisions and Dividend Policy (cont)

- Dividend policy can affect share value.

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Dividend Decisions and Dividend Policy (cont)

P_0= D_1 / K_e-g}

Dividend Decisions and Dividend Policy (cont)

Where:

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Dividend Decisions and Dividend Policy (cont)

- (P_0) = Current share price.

Dividend Decisions and Dividend Policy (cont)

- (D_1) = Expected dividend next year.

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Dividend Decisions and Dividend Policy (cont)

- (K_e) = Cost of equity.

Dividend Decisions and Dividend Policy (cont)

- (g) = Constant dividend growth rate.

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Dividend Decisions and Dividend Policy (cont)

C. Modigliani–Miller (MM) Dividend Irrelevance Theory

Dividend Decisions and Dividend Policy (cont)

- Under ideal market assumptions, dividend policy does not affect the value of the firm.

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Dividend Decisions and Dividend Policy (cont)

- Firm value depends on investment decisions and earning capacity, not whether profits are distributed or retained.

Dividend Decisions and Dividend Policy (cont)

- Assumes perfect capital markets, no taxes and no transaction costs in the basic model.

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Dividend Decisions and Dividend Policy (cont)

Key distinction: Walter and Gordon suggest dividend policy can affect firm value; MM argues it is irrelevant under its idealised assumptions.

Dividend Decisions and Dividend Policy (cont)

7. Important Concepts and Traps

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Dividend Decisions and Dividend Policy (cont)

- High dividend payout means lower retention, other things equal.

Dividend Decisions and Dividend Policy (cont)

- High retention can support future growth if reinvested profitably.

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Dividend Decisions and Dividend Policy (cont)

- Dividend is not the same as interest: dividends are not compulsory contractual payments.

Dividend Decisions and Dividend Policy (cont)

- Bonus shares increase the number of shares but do not create additional company assets.

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Dividend Decisions and Dividend Policy (cont)

- A high dividend yield may reflect a falling share price rather than a rising dividend.

Dividend Decisions and Dividend Policy (cont)

- A company can report profits but lack sufficient cash to pay dividends.

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Working-Capital Management

Meaning and Components

- Working capital: Funds required for day-to-day business operations and short-term obligations.

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Meaning and Components (cont)

- Current assets: Cash, cash equivalents, inventory, trade receivables, bills receivable, short-term advances and prepaid expenses.

Meaning and Components (cont)

- Current liabilities: Trade payables, bills payable, short-term borrowings, outstanding expenses and current maturities of long-term debt.

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Meaning and Components (cont)

- Purpose: Maintain liquidity, meet short-term obligations and ensure uninterrupted operations.

Meaning and Components (cont)

- Too little working capital: Liquidity problems, delayed payments and possible disruption of operations.

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Meaning and Components (cont)

- Too much working capital: Idle funds, excess inventory and inefficient use of resources.

Meaning and Components (cont)

MCQ traps

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Meaning and Components (cont)

- Inventory includes raw materials, work-in-progress and finished goods.

Meaning and Components (cont)

- Trade receivables arise from credit sales; trade payables arise from credit purchases.

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Meaning and Components (cont)

- Prepaid expenses are current assets; outstanding expenses are current liabilities.

Meaning and Components (cont)

- Profitability and liquidity are different: a profitable business can still face a cash shortage

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Gross and Net Working Capital

- Gross Working Capital: Total investment in current assets.

Gross and Net Working Capital (cont)

GWC = Total Current Assets

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Gross and Net Working Capital (cont)

- Net Working Capital: Excess of current assets over current liabilities.

Gross and Net Working Capital (cont)

NWC = CA - CL

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Gross and Net Working Capital (cont)

- Positive NWC: CA > CL; generally better short-term liquidity.

Gross and Net Working Capital (cont)

- Zero NWC: CA = CL.

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Gross and Net Working Capital (cont)

- Negative NWC: CA < CL; may indicate liquidity pressure, but can be normal in certain fast-turnover businesses.

Gross and Net Working Capital (cont)

- Permanent working capital: Minimum current assets required continuously.

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Gross and Net Working Capital (cont)

- Temporary working capital: Additional current assets required due to seasonal or fluctuating demand.

Gross and Net Working Capital (cont)

MCQ traps

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Gross and Net Working Capital (cont)

- Gross working capital considers only current assets; net working capital considers both current assets and current liabilities.

Gross and Net Working Capital (cont)

- Permanent working capital does not mean fixed assets.

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Gross and Net Working Capital (cont)

- Negative NWC does not automatically mean insolvency.

Operating Cycle

- Operating Cycle: Time between acquisition of inventory and collection of cash from sales.

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Operating Cycle (cont)

- Stages: Raw material storage → WIP conversion → Finished goods storage → Receivables collection.

Operating Cycle (cont)

- Operating Cycle = RM Period + WIP Period + FG Period + Receivables Period.

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Operating Cycle (cont)

- Cash Conversion Cycle (CCC) = Operating Cycle − Payables Deferral Period.

Operating Cycle (cont)

- CCC measures the period for which funds remain tied up in operations after considering supplier credit.

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Operating Cycle (cont)

- Shorter CCC generally indicates better working-capital efficiency.

Operating Cycle (cont)

- CCC can be negative when a business collects cash from customers before paying suppliers.

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Operating Cycle (cont)

MCQ traps

Operating Cycle (cont)

- Payables period is subtracted, not added, when calculating CCC.

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Operating Cycle (cont)

- Operating cycle does not deduct the payables period.

Operating Cycle (cont)

- Faster inventory turnover and faster receivables collection generally reduce CCC.

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Operating Cycle (cont)

- Negative CCC is possible; it is not necessarily a sign of financial distress.

Cash Management

Concept

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Cash Management (cont)

Cash management refers to planning, monitoring and controlling cash inflows and outflows to ensure that a business has sufficient cash to meet its obligations while avoiding excessive idle cash.

Cash Management (cont)

The objective is to maintain liquidity without sacrificing profitability.

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Cash Management (cont)

A business needs cash for:

Cash Management (cont)

- Transaction motive: routine payments such as salaries, rent and suppliers.

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Cash Management (cont)

- Precautionary motive: unexpected expenses or emergencies.

Cash Management (cont)

- Speculative motive: taking advantage of unexpected investment opportunities.

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Cash Management (cont)

Key aspects of cash management

Cash Management (cont)

1. Cash Budgeting

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Cash Management (cont)

A cash budget estimates expected cash receipts and payments over a particular period.

Cash Management (cont)

Closing Cash = Opening Cash + Receipts - Payments

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Cash Management (cont)

It helps identify:

Cash Management (cont)

- Cash surplus: excess cash available for investment or debt repayment.

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Cash Management (cont)

- Cash deficit: additional financing required.

Cash Management (cont)

2. Managing Cash Inflows

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Cash Management (cont)

- Speed up collection from customers.

Cash Management (cont)

- Encourage timely payments through suitable credit policies.

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Cash Management (cont)

- Use efficient payment and collection systems.

Cash Management (cont)

3. Managing Cash Outflows

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Cash Management (cont)

- Schedule payments efficiently.

Cash Management (cont)

- Negotiate suitable credit periods with suppliers.

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Cash Management (cont)

- Avoid unnecessary early payments, while maintaining supplier relationships.

Cash Management (cont)

4. Maintaining Optimum Cash Balance

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Cash Management (cont)

Holding too much cash means lost investment opportunities; holding too little creates liquidity risk.

Cash Management (cont)

The objective is to maintain an optimum balance.

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Cash Management (cont)

Important Cash Management Models

Cash Management (cont)

A. Baumol Model

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Cash Management (cont)

- Determines the optimum cash balance by balancing cash conversion costs against the opportunity cost of holding cash.

Cash Management (cont)

- Assumes predictable and steady cash requirements.

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Cash Management (cont)

- Similar to the Economic Order Quantity (EOQ) model used in inventory management.

Cash Management (cont)

C^* = sqrt(2FT/i)

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Cash Management (cont)

Where:

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- F = Fixed cost per cash conversion.

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Cash Management (cont)

- T = Total cash requirement during the period.

Cash Management (cont)

- i = Opportunity cost/interest rate per period.

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Cash Management (cont)

Higher conversion costs increase optimum cash balance; higher opportunity cost reduces it.

Cash Management (cont)

B. Miller–Orr Model

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Cash Management (cont)

- Used when cash flows are uncertain and fluctuate randomly.

Cash Management (cont)

- Establishes a lower limit, an upper limit and a return point.

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Cash Management (cont)

- When cash reaches the upper limit, surplus is invested to bring cash back to the return point.

Cash Management (cont)

- When cash reaches the lower limit, investments are liquidated to restore cash to the return point.

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Cash Management (cont)

- Cash is allowed to fluctuate between the limits.

Receivables Management

Concept

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Receivables Management (cont)

Receivables management refers to managing the money owed by customers who have purchased goods or services on credit.

Receivables Management (cont)

When a business sells goods on credit, it records the amount due as trade receivables (debtors).

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Receivables Management (cont)

The objective is to increase sales through a suitable credit policy while minimising:

Receivables Management (cont)

- Delayed collections.

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Receivables Management (cont)

- Bad debts (amounts unlikely to be recovered).

Receivables Management (cont)

- Funds blocked in receivables.

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Receivables Management (cont)

- Collection and administrative costs.

Receivables Management (cont)

1. Credit Policy

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Receivables Management (cont)

A credit policy determines the conditions under which customers are allowed to purchase on credit.

Receivables Management (cont)

It includes:

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Receivables Management (cont)

- Credit standards: Criteria used to decide which customers qualify for credit.

Receivables Management (cont)

- Credit period: Time allowed to customers to make payment.

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Receivables Management (cont)

- Cash discount: Discount offered for early payment.

Receivables Management (cont)

- Collection policy: Procedures used to recover overdue amounts.

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Receivables Management (cont)

Example: Terms 2/10, net 30 mean:

Receivables Management (cont)

- 2% discount if payment is made within 10 days.

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Receivables Management (cont)

- Otherwise, the full amount is payable within 30 days.

Receivables Management (cont)

2. Factors Affecting Credit Policy

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Receivables Management (cont)

- Customer creditworthiness and payment history.

Receivables Management (cont)

- Industry practices and competition.

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Receivables Management (cont)

- Profitability of additional credit sales.

Receivables Management (cont)

- Cost of funds blocked in receivables.

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Receivables Management (cont)

- Risk of bad debts.

Receivables Management (cont)

- Administrative and collection costs.

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Receivables Management (cont)

A liberal credit policy may increase sales but also increase bad debts and investment in receivables.

Receivables Management (cont)

A restrictive credit policy may reduce bad debts but can also reduce sales.

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Receivables Management (cont)

3. Receivables Management Techniques

Receivables Management (cont)

A. Credit Analysis — 5 Cs of Credit

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Receivables Management (cont)

Factor Meaning

Receivables Management (cont)

Character Customer's willingness to repay

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Receivables Management (cont)

Capacity Ability to generate cash and repay

Receivables Management (cont)

Capital Financial strength/net worth

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Receivables Management (cont)

Collateral Assets offered as security

Receivables Management (cont)

Conditions Economic and industry conditions

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Receivables Management (cont)

B. Ageing Schedule

Receivables Management (cont)

Classifies receivables according to how long they have remained unpaid.

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Receivables Management (cont)

Example:

Receivables Management (cont)

- 0–30 days: ₹50,000

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Receivables Management (cont)

- 31–60 days: ₹20,000

Receivables Management (cont)

- 61–90 days: ₹10,000

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Receivables Management (cont)

- Above 90 days: ₹5,000

Receivables Management (cont)

Older outstanding balances may indicate higher collection risk.

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Receivables Management (cont)

C. Average Collection Period (ACP)

Receivables Management (cont)

Measures the average number of days taken to collect receivables.

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Receivables Management (cont)

ACP = (Average Receivables / CreditSales) * 365

Receivables Management (cont)

Alternatively:

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Receivables Management (cont)

ACP = 365 / Receivables Turnover Ratio

Receivables Management (cont)

D. Receivables Turnover Ratio

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Receivables Management (cont)

Measures how frequently receivables are collected during a year.

Receivables Management (cont)

Receivables Turnover = Net Credit Sales / Average Trade Receivables

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Receivables Management (cont)

Higher turnover generally indicates faster collection.

Receivables Management (cont)

4. Factoring

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Receivables Management (cont)

Factoring is an arrangement in which a business sells or assigns its receivables to a factor (a specialised financial institution) to obtain immediate funds.

Receivables Management (cont)

The factor may also provide collection and credit-management services.

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Receivables Management (cont)

Types:

Receivables Management (cont)

- Recourse factoring: Seller remains liable if the customer fails to pay.

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Receivables Management (cont)

- Non-recourse factoring: Factor generally bears the agreed credit-default risk, subject to contractual exclusions.

Receivables Management (cont)

- Disclosed factoring: Customer is informed that receivables have been assigned.

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Receivables Management (cont)

- Undisclosed factoring: Customer is not informed of the arrangement.

Receivables Management (cont)

Factoring improves liquidity and reduces collection-related work, but involves a fee or discount.

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Inventory Management

Concept

Inventory Management (cont)

Inventory management refers to planning, purchasing, storing and controlling the stock of materials and goods required by a business.

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Inventory Management (cont)

The objective is to maintain optimum inventory—enough stock to avoid production interruptions and lost sales, without locking excessive funds in inventory.

Inventory Management (cont)

1. Types of Inventory

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Inventory Management (cont)

- Raw Materials: Basic materials used in production.

Inventory Management (cont)

- Work-in-Progress (WIP): Partially completed goods.

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Inventory Management (cont)

- Finished Goods: Completed products ready for sale.

Inventory Management (cont)

- Stores and Spares: Consumables, maintenance materials and spare parts used in operations.

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Inventory Management (cont)

2. Costs Associated with Inventory

Inventory Management (cont)

A. Ordering Cost

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Inventory Management (cont)

- Cost of placing and receiving orders.

Inventory Management (cont)

- Includes purchase administration, transportation and inspection.

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Inventory Management (cont)

- Generally decreases when fewer, larger orders are placed.

Inventory Management (cont)

B. Carrying/Holding Cost

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Inventory Management (cont)

- Cost of storing inventory.

Inventory Management (cont)

- Includes warehouse rent, insurance, handling, deterioration, obsolescence and opportunity cost of capital.

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Inventory Management (cont)

- Generally increases with higher average inventory.

Inventory Management (cont)

C. Shortage/Stock-out Cost

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Inventory Management (cont)

- Cost arising when inventory is unavailable.

Inventory Management (cont)

- Includes lost sales, production stoppages, emergency purchases and customer dissatisfaction.

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Inventory Management (cont)

D. Purchase Cost

Inventory Management (cont)

- Cost of acquiring the inventory itself.

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Inventory Management (cont)

3. Economic Order Quantity (EOQ)

Inventory Management (cont)

EOQ is the order quantity that minimises the total of ordering and carrying costs.

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Inventory Management (cont)

EOQ = sqrt(2DS/H)

Inventory Management (cont)

Where:

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Inventory Management (cont)

- D = Annual demand (units).

Inventory Management (cont)

- S = Ordering cost per order.

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Inventory Management (cont)

- H = Annual holding cost per unit.

Inventory Management (cont)

Example:

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Inventory Management (cont)

- Annual demand = 1,000 units.

Inventory Management (cont)

- Ordering cost = ₹50 per order.

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Inventory Management (cont)

- Holding cost = ₹2 per unit per year.

Inventory Management (cont)

EOQ = sqrt{2(1000)(50)}{2}} = 224 units (approx.)

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Inventory Management (cont)

At EOQ, annual ordering cost equals annual carrying cost under the basic assumptions.

Inventory Management (cont)

Important effects:

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Inventory Management (cont)

- Higher annual demand → higher EOQ.

Inventory Management (cont)

- Higher ordering cost → higher EOQ.

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Inventory Management (cont)

- Higher holding cost → lower EOQ.

Inventory Management (cont)

4. Stock Levels

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Inventory Management (cont)

- Reorder Level: Inventory level at which a fresh order should be placed.

Inventory Management (cont)

- Minimum Level: Lowest desirable inventory level to avoid stock--outs.

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Inventory Management (cont)

- Maximum Level: Highest desirable inventory level to avoid excessive stock.

Inventory Management (cont)

- Safety Stock: Extra inventory maintained to handle unexpected demand or supply delays.

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Inventory Management (cont)

Common formulas:

Inventory Management (cont)

Reorder Level = Maximum Usage * Maximum Lead Time

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Inventory Management (cont)

Minimum Level = Reorder Level - (Normal Usage * Normal Lead Time)

Inventory Management (cont)

Maximum Level = Reorder Level + Reorder Quantity - (Minimum Usage * Minimum Lead Time)

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Inventory Management (cont)

Lead time = Time between placing an order and receiving the inventory.

Inventory Management (cont)

5. Inventory Control Techniques

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Inventory Management (cont)

A. ABC Analysis

Inventory Management (cont)

Classifies inventory based on annual consumption value.

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Inventory Management (cont)

Category Characteristics

Inventory Management (cont)

A Few items, very high annual consumption value; strict control

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Inventory Management (cont)

B Moderate number/value; moderate control

Inventory Management (cont)

C Many items, low annual consumption value; simpler control

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Inventory Management (cont)

Typical approximate pattern:

Inventory Management (cont)

- A: 10% items account for 70% value.

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Inventory Management (cont)

- B: 20% items account for 20% value.

Inventory Management (cont)

- C: 70% items account for 10% value.

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Inventory Management (cont)

These percentages are illustrative, not fixed rules.

Inventory Management (cont)

B. Just-in-Time (JIT)

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Inventory Management (cont)

- Inventory is received close to the time it is needed in production.

Inventory Management (cont)

- Reduces inventory holding costs and waste.

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Inventory Management (cont)

- Requires reliable suppliers, accurate scheduling and smooth logistics.

Inventory Management (cont)

- Supply disruptions can cause production stoppages because buffer inventory is low.

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Inventory Management (cont)

C. VED Analysis

Inventory Management (cont)

Classifies inventory according to criticality:

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Inventory Management (cont)

- Vital: Stock-out can seriously disrupt operations.

Inventory Management (cont)

- Essential: Important, but temporary shortage may be manageable.

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Inventory Management (cont)

- Desirable: Shortage has relatively limited impact.

Inventory Management (cont)

D. FSN Analysis

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Inventory Management (cont)

Based on the movement/usage of inventory:

Inventory Management (cont)

- Fast-moving.

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Inventory Management (cont)

- Slow-moving.

Inventory Management (cont)

- Non-moving.

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Inventory Management (cont)

E. Perpetual Inventory System

Inventory Management (cont)

- Continuous recording of inventory receipts, issues and balances.

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Inventory Management (cont)

- Helps monitor stock levels and identify discrepancies.

Inventory Management (cont)

6. Inventory Turnover Ratio

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Inventory Management (cont)

Measures how frequently average inventory is sold or consumed during a period.

Inventory Management (cont)

Inventory Turnover = Cost of Goods Sold / Average Inventory

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Inventory Management (cont)

Higher turnover generally indicates faster movement of inventory.

Inventory Management (cont)

However, excessively high turnover may indicate insufficient stock and risk of stock-outs.

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Working-Capital Financing

- Working-Capital Financing: Funding current assets and short-term operating requirements.

Working-Capital Financing (cont)

- Short-term sources: Trade credit, bank overdraft, cash credit, short-term loans, Commercial Paper and factoring.

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Working-Capital Financing (cont)

- Long-term sources: Equity, preference shares, retained earnings, long-term loans and debentures.

Working-Capital Financing (cont)

- Permanent working capital: Minimum current assets required continuously.

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Working-Capital Financing (cont)

- Temporary working capital: Additional funds required due to seasonal or fluctuating demand.

Working-Capital Financing (cont)

- Conservative Policy: Long-term funds finance fixed assets, permanent WC and part of temporary WC; lower liquidity risk, generally higher cost.

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Working-Capital Financing (cont)

- Aggressive Policy: Short-term funds finance temporary WC and part of permanent WC; lower cost, higher liquidity/refinancing risk.

Working-Capital Financing (cont)

- Matching Policy: Long-term funds finance fixed assets and permanent WC; short-term funds finance temporary WC.

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Working-Capital Financing (cont)

- Overdraft: Permits withdrawals beyond bank balance up to an approved limit.

Working-Capital Financing (cont)

- Cash Credit: Bank borrowing against security, generally inventory and receivables, for working-capital needs.

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Working-Capital Financing (cont)

- Commercial Paper: Unsecured short-term money-market instrument issued by eligible entities.

Working-Capital Financing (cont)

- Factoring: Receivables are sold/assigned to obtain immediate funds.

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Working-Capital Financing (cont)

MCQ traps

Working-Capital Financing (cont)

- Conservative = greater use of long-term funds.

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Working-Capital Financing (cont)

- Aggressive = greater use of short-term funds.

Working-Capital Financing (cont)

- Matching = maturity of finance matches asset requirement.

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Working-Capital Financing (cont)

- Aggressive financing generally has higher refinancing risk.

Working-Capital Financing (cont)

- Permanent working capital is not the same as fixed assets.

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Working-Capital Financing (cont)

- Trade credit is supplier financing; factoring is receivables financing.

Financial Risk Management

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Credit Risk

- Credit Risk: Risk of loss due to borrower/counterparty failing to meet contractual obligations.

Credit Risk (cont)

- Default Risk: Failure to repay principal or interest.

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Credit Risk (cont)

- Counterparty Risk: Other party fails to fulfil a financial contract.

Credit Risk (cont)

- Concentration Risk: Excessive exposure to one borrower, sector or geography.

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Credit Risk (cont)

- Settlement Risk: One party pays/delivers, but the other fails to fulfil its corresponding obligation.

Credit Risk (cont)

- NPA: Asset that ceases to generate income under applicable regulatory classification norms; for commercial-bank term loans, generally overdue for more than 90 days.

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Credit Risk (cont)

- PD: Probability of Default.

Credit Risk (cont)

- LGD: Loss Given Default; percentage of exposure lost after recoveries.

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Credit Risk (cont)

- EAD: Exposure at Default.

Credit Risk (cont)

- Expected Loss:

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Credit Risk (cont)

EL = PD x LGD x EAD

Credit Risk (cont)

- Management: Credit appraisal, scoring, collateral, exposure limits, diversification, monitoring, provisioning and recovery.

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Credit Risk (cont)

MCQ traps

Credit Risk (cont)

- PD = likelihood of default; LGD = loss severity; EAD = amount exposed.

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Credit Risk (cont)

- Expected loss is different from unexpected loss.

Credit Risk (cont)

- Collateral reduces potential loss but does not eliminate default risk.

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Credit Risk (cont)

- Diversification reduces concentration risk.

Credit Risk (cont)

- Provisioning is not the same as recovery of a loan.

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Market Risk

- Market Risk: Risk of financial loss due to adverse movements in market prices.

Market Risk (cont)

- Major types:

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Market Risk (cont)

- Equity price risk: Share-price fluctuations.

Market Risk (cont)

- Interest-rate risk: Changes in interest rates.

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Market Risk (cont)

- Foreign-exchange risk: Currency fluctuations.

Market Risk (cont)

- Commodity price risk: Changes in commodity prices.

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Market Risk (cont)

- VaR: Estimates potential portfolio loss over a specified time horizon at a specified confidence level.

Market Risk (cont)

- Stress Testing: Evaluates losses under extreme but plausible conditions.

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Market Risk (cont)

- Sensitivity Analysis: Measures impact of changes in one risk factor.

Market Risk (cont)

- Scenario Analysis: Evaluates impact of multiple market-factor changes.

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Market Risk (cont)

- Hedging: Offsets an existing risk exposure.

Market Risk (cont)

- Exposure Limits: Restrict risk-taking within approved boundaries.

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Market Risk (cont)

MCQ traps

Market Risk (cont)

- Market risk arises from price movements; credit risk arises from default.

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Market Risk (cont)

- Bond prices and interest rates generally move inversely.

Market Risk (cont)

- VaR is not the maximum possible loss.

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Market Risk (cont)

- A 99% one-day VaR of ₹10 lakh implies a 1% tail probability of exceeding that loss under model assumptions.

Market Risk (cont)

- Stress testing focuses on extreme scenarios, while VaR typically measures losses at a specified statistical confidence level.

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Liquidity Risk

- Liquidity Risk: Risk of inability to meet financial obligations when due without incurring unacceptable losses.

Liquidity Risk (cont)

- Funding Liquidity Risk: Inability to obtain sufficient cash to meet payment obligations.

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Liquidity Risk (cont)

- Market Liquidity Risk: Inability to sell assets quickly at fair market value.

Liquidity Risk (cont)

- Maturity Mismatch: Difference between the maturity of assets and liabilities. Financing long-term assets with short-term liabilities can create liquidity pressure.

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Liquidity Risk (cont)

- Asset-Liability Management (ALM): Coordinated management of assets and liabilities to control maturity, interest-rate and cash-flow mismatches.

Liquidity Risk (cont)

- Liquidity Coverage Ratio (LCR): Measures a bank's ability to withstand a 30-day liquidity stress scenario.

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Liquidity Risk (cont)

LCR = (High-Quality Liquid Assets / Total Net Cash Outflows over the next 30 calendar days) × 100

Liquidity Risk (cont)

- Net Stable Funding Ratio (NSFR): Measures stable funding available relative to stable funding required over a one-year horizon.

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Liquidity Risk (cont)

NSFR = (Available Stable Funding / Required Stable Funding) × 100

Liquidity Risk (cont)

- Basel III minimum requirements: LCR ≥ 100%; NSFR ≥ 100%.

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Liquidity Risk (cont)

MCQ traps

Liquidity Risk (cont)

- LCR = short-term, 30-day stress resilience.

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Liquidity Risk (cont)

- NSFR = longer-term, one-year stable funding.

Liquidity Risk (cont)

- HQLA = High-Quality Liquid Assets.

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Liquidity Risk (cont)

- A solvent institution can still face liquidity risk if it cannot access cash when required.

Liquidity Risk (cont)

- Market liquidity risk concerns selling assets; funding liquidity risk concerns obtaining funds.

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Operational Risk

- Operational Risk: Risk of loss due to inadequate or failed internal processes, people and systems, or external events.

Operational Risk (cont)

- People Risk: Fraud, negligence and human error.

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Operational Risk (cont)

- Process Risk: Weak controls, incorrect procedures and transacti-on-processing errors.

Operational Risk (cont)

- Systems Risk: IT failures, system outages and technology-related errors.

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Operational Risk (cont)

- External Event Risk: Natural disasters, external fraud and third-party disruptions.

Operational Risk (cont)

- Other important forms: Fraud risk, cyber risk, legal risk, compliance risk and business continuity risk.

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Operational Risk (cont)

- Internal Controls: Procedures designed to prevent and detect errors and fraud.

Operational Risk (cont)

- Segregation of Duties: Separating authorisation, execution and verification responsibilities.

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Operational Risk (cont)

- Business Continuity Planning (BCP): Ensures critical business functions continue during disruptions.

Operational Risk (cont)

- Disaster Recovery Planning (DRP): Restores IT systems, data and infrastructure after disruptions.

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Operational Risk (cont)

- Basel III: Introduced the Standardised Measurement Approach (SMA) for operational risk capital measurement.

Operational Risk (cont)

MCQ traps

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Operational Risk (cont)

- Operational risk includes people, processes, systems and external events.

Operational Risk (cont)

- Cyber risk is a component of operational risk.

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Operational Risk (cont)

- BCP focuses on continuity of business operations; DRP focuses on recovery of IT systems and infrastructure.

Operational Risk (cont)

- Segregation of duties reduces fraud and error risk.

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Operational Risk (cont)

- Operational risk can exist even when credit and market risks are absent.

Interest-Rate Risk

- Interest-Rate Risk: Risk of financial loss due to adverse changes in market interest rates.

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Interest-Rate Risk (cont)

- Repricing Risk: Assets and liabilities reset their interest rates at different times.

Interest-Rate Risk (cont)

- Yield Curve Risk: Risk due to changes in the shape/slope of the yield curve.

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Interest-Rate Risk (cont)

- Basis Risk: Different benchmark interest rates do not move by identical amounts.

Interest-Rate Risk (cont)

- Option Risk: Borrowers/investors exercise embedded options due to interest-rate changes, affecting expected cash flows.

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Interest-Rate Risk (cont)

- Yield Curve: Relationship between bond yields and their maturities.

Interest-Rate Risk (cont)

- Bond Price–Interest Rate Relationship: Inverse relationship; interest rates rise → bond prices fall, and vice versa.

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Interest-Rate Risk (cont)

- Macaulay Duration: Weighted average time to receive bond cash flows.

Interest-Rate Risk (cont)

- Modified Duration: Measures approximate bond-price sensitivity to yield changes.

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Interest-Rate Risk (cont)

- Approximate Bond Price Change (%) = −Modified Duration × Change in Yield (in decimal form) × 100.

Interest-Rate Risk (cont)

- Higher duration → greater interest-rate sensitivity.

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Interest-Rate Risk (cont)

- Management: ALM, duration matching, gap analysis, interest-rate swaps, futures and options.

Interest-Rate Risk (cont)

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Interest-Rate Risk (cont)

- Bond prices and yields move inversely.

Interest-Rate Risk (cont)

- Duration is not the same as maturity.

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Interest-Rate Risk (cont)

- Modified duration measures price sensitivity; Macaulay duration measures weighted average cash-flow timing.

Interest-Rate Risk (cont)

- A 1 percentage-point rise in yield means a change of 0.01 in decimal form.

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Interest-Rate Risk (cont)

- Basis risk arises from imperfect movement between different interest-rate benchmarks.

Foreign-Exchange Risk (Forex Risk)

- Forex Risk: Risk of financial loss due to exchange-rate fluctuations.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Transaction Risk: Exchange-rate changes between entering into a transaction and settling it.

Foreign-Exchange Risk (Forex Risk) (cont)

- Translation Risk: Change in reported value when foreign-currency financial statements/assets/liabilities are converted into reporting currency.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Economic Risk: Long-term impact of exchange-rate changes on competitiveness and future cash flows.

Foreign-Exchange Risk (Forex Risk) (cont)

- Rupee Depreciation: Imports become more expensive; exports become relatively cheaper for foreign buyers.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Rupee Appreciation: Imports become cheaper; exports become relatively more expensive for foreign buyers.

Foreign-Exchange Risk (Forex Risk) (cont)

- Forward Contract: Customised OTC agreement to buy/sell currency at a predetermined future rate.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Currency Futures: Standardised exchange-traded currency contracts; involve margin and mark-to-market.

Foreign-Exchange Risk (Forex Risk) (cont)

- Currency Options: Right but not obligation to buy/sell currency at a specified rate; buyer pays premium.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Currency Swaps: Exchange of principal and/or interest cash flows in different currencies.

Foreign-Exchange Risk (Forex Risk) (cont)

- Natural Hedging: Match foreign-currency receipts with foreign-currency payments.

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Foreign-Exchange Risk (Forex Risk) (cont)

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Foreign-Exchange Risk (Forex Risk) (cont)

- Transaction risk = actual contractual payment/receipt exposure.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Translation risk = accounting conversion of foreign-currency financial statements.

Foreign-Exchange Risk (Forex Risk) (cont)

- Economic risk = long-term competitive and cash-flow impact.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Depreciation generally benefits exporters and hurts importers, other things equal.

Foreign-Exchange Risk (Forex Risk) (cont)

- Forward = obligation for both parties; option buyer = right, not obligation.

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Foreign-Exchange Risk (Forex Risk) (cont)

- Futures are standardised and exchange-traded; forwards are generally customised OTC contracts.

Systemic Risk

- Systemic Risk: Risk that distress or failure of one institution or market component spreads and disrupts the financial system as a whole.

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Systemic Risk (cont)

- Causes: Interconnectedness, common exposures, excessive leverage, liquidity crisis, contagion and procyclicality.

Systemic Risk (cont)

- Interconnectedness: Financial institutions linked through lending, borrowing, derivatives and payment systems.

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Systemic Risk (cont)

- Contagion: Spread of financial distress from one institution or market to others.

Systemic Risk (cont)

- Systemic Risk: Threat to overall financial-system stability.

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Systemic Risk (cont)

- Systematic Risk: Broad market risk affecting securities; cannot be eliminated through diversification alone.

Systemic Risk (cont)

- Unsystematic Risk: Company/industry-specific risk; can generally be reduced through diversification.

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Systemic Risk (cont)

- Macroprudential Regulation: Protects stability of the financial system as a whole.

Systemic Risk (cont)

- Microprudential Supervision: Focuses on individual financial institutions.

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Systemic Risk (cont)

- SIFIs: Systemically Important Financial Institutions; their failure could significantly disrupt the financial system.

Systemic Risk (cont)

- Management: Capital and liquidity requirements, stress testing, exposure limits, macroprudential supervision and resolution frameworks.

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Systemic Risk (cont)

MCQ traps

Systemic Risk (cont)

- Systemic risk ≠ systematic risk.

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Systemic Risk (cont)

- Diversification reduces unsystematic risk, not systematic risk.

Systemic Risk (cont)

- Macroprudential = system-wide; microprudential = individual institution.

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Systemic Risk (cont)

- Contagion = transmission of financial distress.

Systemic Risk (cont)

- A systemically important institution is not necessarily the largest institution; interconnectedness and substitutability also matter.

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Diversification and Hedging

- Diversification: Spreading investments across assets, industries, securities or geographies to reduce concentration risk.

Diversification and Hedging (cont)

- Types: Asset-class, industry, geographical and security diversification.

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Diversification and Hedging (cont)

- Diversification reduces unsystematic risk but cannot eliminate systematic market risk.

Diversification and Hedging (cont)

- Hedging: Taking an offsetting position in another financial instrument to reduce an existing risk exposure.

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Diversification and Hedging (cont)

- Common instruments: Forwards, futures, options and swaps.

Diversification and Hedging (cont)

- Forward: Customised OTC contract.

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Diversification and Hedging (cont)

- Futures: Standardised exchange-traded contract.

Diversification and Hedging (cont)

- Options: Buyer has a right, not an obligation; pays premium.

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Diversification and Hedging (cont)

- Swaps: Exchange of cash flows between parties.

Diversification and Hedging (cont)

- Perfect Hedge: Completely offsets the relevant exposure.

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Diversification and Hedging (cont)

- Partial Hedge: Protects only part of the exposure.

Diversification and Hedging (cont)

- Basis Risk: Risk that the hedge instrument and underlying exposure do not move identically.

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Diversification and Hedging (cont)

- Hedge Ratio: Proportion of exposure hedged.

Diversification and Hedging (cont)

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Diversification and Hedging (cont)

- Diversification reduces unsystematic risk; it does not eliminate systematic risk.

Diversification and Hedging (cont)

- Hedging reduces exposure; speculation deliberately takes exposure to benefit from price movements.

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Diversification and Hedging (cont)

- A hedge can reduce potential losses but may also limit potential gains.

Diversification and Hedging (cont)

- Options provide asymmetric protection: buyer has a right, not an obligation.

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Diversification and Hedging (cont)

- Basis risk means the hedge may not perfectly offset the underlying exposure.

Risk Measurement and Management Basics

- Risk Measurement: Identifying and quantifying potential losses arising from uncertainty.

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Risk Measurement and Management Basics (cont)

- Risk Management Process: Identification → Assessment → Measurement → Mitigation → Monitoring and Reporting.

Risk Measurement and Management Basics (cont)

- VaR: Potential loss over a specified time horizon at a specified confidence level; does not indicate the severity of losses beyond the threshold.

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Risk Measurement and Management Basics (cont)

- Expected Shortfall (ES): Average loss in the worst outcomes beyond the VaR threshold; captures tail risk.

Risk Measurement and Management Basics (cont)

- Stress Testing: Evaluates resilience under extreme but plausible conditions.

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Risk Measurement and Management Basics (cont)

- Scenario Analysis: Measures impact of a combination of events or market movements.

Risk Measurement and Management Basics (cont)

- Sensitivity Analysis: Measures impact of change in one risk factor.

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Risk Measurement and Management Basics (cont)

- Standard Deviation: Measures dispersion of returns around the mean; indicates volatility.

Risk Measurement and Management Basics (cont)

- Beta: Measures sensitivity to overall market movements; $\beta = 1$ means broadly in line with market, $\beta > 1$ means more sensitive, $0 < \beta < 1$ means less sensitive.

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Risk Measurement and Management Basics (cont)

- Risk Appetite: Amount and type of risk an organisation is willing to accept.

Risk Measurement and Management Basics (cont)

- Risk Tolerance: Acceptable variation around risk objectives/limits.

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Risk Measurement and Management Basics (cont)

- Risk Exposure: Potential loss or amount exposed to risk.

Risk Measurement and Management Basics (cont)

- Risk Limit: Maximum permitted exposure.

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Risk Measurement and Management Basics (cont)

- Enterprise Risk Management (ERM): Integrated management of risks across the organisation.

Risk Measurement and Management Basics (cont)

- Risk Mitigation:

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Risk Measurement and Management Basics (cont)

- Avoidance = Do not undertake risky activity.

Risk Measurement and Management Basics (cont)

- Reduction = Lower likelihood or impact.

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Risk Measurement and Management Basics (cont)

- Transfer = Shift risk to another party.

Risk Measurement and Management Basics (cont)

- Acceptance = Retain and bear the risk.

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Risk Measurement and Management Basics (cont)

- Risk Premium = Expected Return − Risk-Free Rate.

Risk Measurement and Management Basics (cont)

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Risk Measurement and Management Basics (cont)

- VaR gives a loss threshold; ES estimates average losses beyond that threshold.

Risk Measurement and Management Basics (cont)

- Stress testing examines extreme scenarios; sensitivity analysis changes one risk factor.

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Risk Measurement and Management Basics (cont)

- Standard deviation measures total return volatility; beta measures systematic market sensitivity.

Risk Measurement and Management Basics (cont)

- Risk appetite is the broad willingness to take risk; risk limits impose operational boundaries.

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Risk Measurement and Management Basics (cont)

- Insurance transfers risk; diversification reduces concentration risk.

Risk Measurement and Management Basics (cont)

- Risk management aims to control risk, not necessarily eliminate it.

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Cheatography

Finance Cheat Sheet

by keersri05 via cheatography.com/217923/cs/48575/

Non-Banking Financial Companies (NBFCs)

Meaning, characteristics and functions of NBFCs

Meaning

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Meaning, characteristics and functions of NBFCs (cont)

- NBFC (Non-Banking Financial Company): A company engaged in financial activities such as lending, investment, asset financing and other specified financial services.

Meaning, characteristics and functions of NBFCs (cont)

- Provides financial intermediation and credit without performing the full range of banking functions

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Meaning, characteristics and functions of NBFCs (cont)

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Meaning, characteristics and functions of NBFCs (cont)

Characteristics

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Meaning, characteristics and functions of NBFCs (cont)

- Mobilises/raises funds and deploys them through lending and investments.

Meaning, characteristics and functions of NBFCs (cont)

- Provides credit to individuals, MSMEs, businesses and underserved sectors.

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Meaning, characteristics and functions of NBFCs (cont)

- Often specialises in vehicle finance, gold loans, housing finance, microfinance, leasing and infrastructure finance.

Meaning, characteristics and functions of NBFCs (cont)

- Regulated primarily by RBI (Reserve Bank of India) under RBI Act, 1934 and applicable directions.

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Meaning, characteristics and functions of NBFCs (cont)

- Cannot accept demand deposits (savings/current accounts).

Meaning, characteristics and functions of NBFCs (cont)

- Does not create demand-deposit money like banks.

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Meaning, characteristics and functions of NBFCs (cont)

- Funding sources include bank borrowings, debentures, commercial papers and equity.

Meaning, characteristics and functions of NBFCs (cont)

Major Functions

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Meaning, characteristics and functions of NBFCs (cont)

- Lending – Personal, business, vehicle and gold loans.

Meaning, characteristics and functions of NBFCs (cont)

- Asset Financing – Finance vehicles, machinery and equipment.

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Meaning, characteristics and functions of NBFCs (cont)

- Leasing – Right to use an asset against periodic payments.

Meaning, characteristics and functions of NBFCs (cont)

- Hire Purchase – Asset acquired through instalments; ownership generally transfers after final payment.

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Meaning, characteristics and functions of NBFCs (cont)

- Investment – Investment in permitted financial instruments.

Meaning, characteristics and functions of NBFCs (cont)

- Microfinance – Small loans to low-income households and micro--enterprises.

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Meaning, characteristics and functions of NBFCs (cont)

- Factoring – Purchase of business receivables/invoices for immediate funds.

Meaning, characteristics and functions of NBFCs (cont)

- Infrastructure Finance – Finance infrastructure projects.

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Banks vs NBFCs

Demand Deposits: Banks can accept savings/current deposits; NBFCs cannot.

Banks vs NBFCs (cont)

Public Deposits: Banks accept deposits; only specifically eligible NBFCs can accept public term deposits subject to RBI conditions.

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Banks vs NBFCs (cont)

Cheque Facility: Banks can issue cheques drawn on themselves; NBFCs cannot.

Banks vs NBFCs (cont)

Payment System: Banks have banking payment-system privileges; NBFCs do not have equivalent privileges.

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Banks vs NBFCs (cont)

Deposit Insurance: Eligible bank deposits are insured by DICGC (Deposit Insurance and Credit Guarantee Corporation) up to ₹5 lakh per depositor per bank; NBFC deposits are not insured by DICGC.

Banks vs NBFCs (cont)

Credit Creation: Banks create demand-deposit money through lending; NBFCs do not create demand-deposit money in the same manner.

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Banks vs NBFCs (cont)

Regulation: Banks – Banking Regulation Act, 1949 and RBI Act, 1934; NBFCs – primarily RBI Act, 1934 and applicable RBI directions.

Banks vs NBFCs (cont)

Commonality: Both provide credit, perform financial intermediation and serve individuals/businesses.

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Principal Business Criteria and the 50-50 test

Principal Business Criteria (PBC) / 50-50 Test

Principal Business Criteria and the 50-50 test (cont)

- RBI introduced the test through its press release dated 8 April 1999.

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Principal Business Criteria and the 50-50 test (cont)

- Used to determine whether a company's principal business is financial activity.

Principal Business Criteria and the 50-50 test (cont)

- Based on the asset and income pattern in the latest audited financial statements.

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Principal Business Criteria and the 50-50 test (cont)

Two Conditions — Both Mandatory

Principal Business Criteria and the 50-50 test (cont)

1. Financial Assets Test:

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Principal Business Criteria and the 50-50 test (cont)

Financial Assets / (Total Assets − Intangible Assets) × 100 > 50%

Principal Business Criteria and the 50-50 test (cont)

2. Financial Income Test:

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Principal Business Criteria and the 50-50 test (cont)

Financial Income / Gross Income × 100 > 50%

Principal Business Criteria and the 50-50 test (cont)

- Both ratios must be strictly greater than 50%.

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Principal Business Criteria and the 50-50 test (cont)

- Satisfying only one condition is insufficient.

Principal Business Criteria and the 50-50 test (cont)

- A company satisfying both criteria is generally required to register as an NBFC under Section 45-IA of the RBI Act, 1934, unless specifically exempted.

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Principal Business Criteria and the 50-50 test (cont)

MCQ Traps

Principal Business Criteria and the 50-50 test (cont)

- Exactly 50% does not satisfy the test; the requirement is more than 50%.

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Principal Business Criteria and the 50-50 test (cont)

- Both asset and income tests must be satisfied simultaneously.

Principal Business Criteria and the 50-50 test (cont)

- It is not sufficient to have more than 50% financial assets alone.

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Principal Business Criteria and the 50-50 test (cont)

- A manufacturing or trading company does not automatically become an NBFC because it undertakes some financial activity.

Principal Business Criteria and the 50-50 test (cont)

- The 50-50 test was introduced in 1999, not through the original RBI Act, 1934.

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Principal Business Criteria and the 50-50 test (cont)

Exam memory hook: More than 50% financial assets AND more than 50% financial income.

Net Owned Fund (NOF)

NOF — Net Owned Fund

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Net Owned Fund (NOF) (cont)

- Measures an NBFC's eligible own capital after specified deductions.

Net Owned Fund (NOF) (cont)

- Defined under Section 45-IA of the RBI Act, 1934.

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Net Owned Fund (NOF) (cont)

Calculation

Net Owned Fund (NOF) (cont)

- Owned Fund = Paid-up equity capital + Free reserves + Share premium + Eligible capital reserves − Accumulated losses − Deferred revenue expenditure − Intangible assets.

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Net Owned Fund (NOF) (cont)

- NOF = Owned Fund − Specified investments/deductions.

Net Owned Fund (NOF) (cont)

Specified Deductions

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Net Owned Fund (NOF) (cont)

- Investments in shares of subsidiaries and companies in the same group.

Net Owned Fund (NOF) (cont)

- Specified debentures, bonds, loans and advances to subsidiaries/group companies.

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Net Owned Fund (NOF) (cont)

- Such specified investments are deducted to the extent they exceed 10% of Owned Fund.

Net Owned Fund (NOF) (cont)

Importance

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Net Owned Fund (NOF) (cont)

- Minimum capital requirement for NBFC registration.

Net Owned Fund (NOF) (cont)

- Indicates financial strength and own-fund capacity.

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Net Owned Fund (NOF) (cont)

- Minimum NOF varies by NBFC category and applicable RBI directions.

Net Owned Fund (NOF) (cont)

Minimum NOF Requirement

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Net Owned Fund (NOF) (cont)

- The minimum NOF requirement depends on the category and activity of the NBFC.

Net Owned Fund (NOF) (cont)

- Under the scale-based regulatory framework, many NBFC categories have a minimum NOF requirement of ₹10 crore.

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Net Owned Fund (NOF) (cont)

- Certain specialised categories have different requirements.

Net Owned Fund (NOF) (cont)

- Important: ₹2 crore was the earlier general minimum requirement for many NBFCs; it should not be assumed to be the universal current threshold.

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Registration and Certificate of Registration

Registration of NBFCs

Registration and Certificate of Registration (cont)

- NBFCs generally require RBI registration under Section 45-IA of RBI Act, 1934.

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Registration and Certificate of Registration (cont)

- RBI grants a Certificate of Registration (CoR) authorising the company to commence or carry on NBFC business.

Registration and Certificate of Registration (cont)

- A company requiring registration cannot ordinarily commence NBFC business without CoR.

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Registration and Certificate of Registration (cont)

Key Conditions

Registration and Certificate of Registration (cont)

- Must be registered as a company under the Companies Act.

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Registration and Certificate of Registration (cont)

- Must maintain prescribed minimum Net Owned Fund (NOF).

Registration and Certificate of Registration (cont)

- Must satisfy RBI's fit-and-proper management requirements.

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Registration and Certificate of Registration (cont)

- Must have sound financial and management conditions.

Registration and Certificate of Registration (cont)

- Its operations must not be detrimental to public interest or depositors.

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Registration and Certificate of Registration (cont)

- Registration must be consistent with public interest and statutory requirements.

Registration and Certificate of Registration (cont)

Cancellation of CoR

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Registration and Certificate of Registration (cont)

- Failure to maintain prescribed NOF.

Registration and Certificate of Registration (cont)

- Non-compliance with statutory provisions or RBI directions.

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Registration and Certificate of Registration (cont)

- Violation of registration conditions.

Registration and Certificate of Registration (cont)

- Cessation of NBFC business.

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Registration and Certificate of Registration (cont)

- Other specified grounds under Section 45-IA.

Deposit-taking and non-deposit-taking NBFCs

A. Deposit-Taking NBFCs (NBFC-D)

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Deposit-taking and non-deposit-taking NBFCs (cont)

- NBFCs specifically authorised by RBI to accept public deposits.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Can accept public term deposits, but cannot accept demand deposits (savings/current accounts).

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Require a valid deposit-taking Certificate of Registration (CoR) and minimum investment-grade credit rating of BBB− from a SEBI-registered credit rating agency.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Public deposits can be accepted up to 1.5 times Net Owned Fund (NOF), subject to applicable prudential conditions.

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Must maintain liquid assets equal to at least 15% of outstanding public deposits.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Deposit maturity: minimum 12 months, maximum 60 months (5 years).

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Maximum interest rate: 12.5% per annum.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Minimum lock-in period: 3 months.

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Cannot accept deposits repayable on demand.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Deposits are not covered by DICGC (Deposit Insurance and Credit Guarantee Corporation).

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Deposit-taking and non-deposit-taking NBFCs (cont)

Important policy point: RBI has not issued fresh Certificates of Registration to new NBFCs for accepting public deposits since 1997. Existing eligible deposit-taking NBFCs may continue subject to applicable conditions.

Deposit-taking and non-deposit-taking NBFCs (cont)

B. Non-Deposit-Taking NBFCs (NBFC-ND)

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Do not accept public deposits.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Raise funds through bank borrowings, institutional finance, debentures, bonds, commercial papers and equity.

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Can undertake permitted lending, investment and other financial activities.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Remain subject to RBI regulation even without accepting public deposits.

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Deposit-taking and non-deposit-taking NBFCs (cont)

C. Scale-Based Regulatory Classification

Deposit-taking and non-deposit-taking NBFCs (cont)

- RBI classifies NBFCs into four layers:

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Base Layer (NBFC-BL): Generally includes non-deposit-taking NBFCs with assets below ₹1,000 crore, along with specified categories.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Middle Layer (NBFC-ML): All deposit-taking NBFCs, irrespective of asset size; non-deposit-taking NBFCs with assets of ₹1,000 crore or more; and certain specified categories.

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Deposit-taking and non-deposit-taking NBFCs (cont)

- Upper Layer (NBFC-UL): NBFCs specifically identified by RBI for enhanced regulation.

Deposit-taking and non-deposit-taking NBFCs (cont)

- Top Layer (NBFC-TL): Ideally remains empty; may be populated if systemic risk increases substantially.

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Deposit-taking and non-deposit-taking NBFCs (cont)

- The older ₹500 crore threshold for NBFC-ND-SI has been replaced by the current scale-based framework's ₹1,000 crore threshold for general NBFC-ML classification, subject to specified exceptions.

Systemically Important NBFCs

Systemically Important NBFCs

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Systemically Important NBFCs (cont)

- NBFCs whose size, interconnectedness and activities can create risks for the wider financial system.

Systemically Important NBFCs (cont)

- Failure of a large NBFC may cause contagion and financial instability.

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Systemically Important NBFCs (cont)

- RBI imposes enhanced regulation to reduce systemic risk.

Systemically Important NBFCs (cont)

Historical Classification

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Systemically Important NBFCs (cont)

- NBFC-ND-SI = Non-Deposit-Taking Systemically Important NBFC.

Systemically Important NBFCs (cont)

- Earlier threshold: asset size of ₹500 crore or more.

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Systemically Important NBFCs (cont)

- This historical classification has been replaced by the Scale-Based Regulatory (SBR) framework effective 1 October 2022.

Systemically Important NBFCs (cont)

Current Scale-Based Regulation (SBR): Four Layers

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Systemically Important NBFCs (cont)

1. Base Layer (NBFC-BL)

Systemically Important NBFCs (cont)

- Generally, non-deposit-taking NBFCs with assets below ₹1,000 crore.

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Systemically Important NBFCs (cont)

- Includes specified NBFC-P2P, NBFC-AA and other categories.

Systemically Important NBFCs (cont)

2. Middle Layer (NBFC-ML)

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Systemically Important NBFCs (cont)

- All deposit-taking NBFCs, irrespective of asset size.

Systemically Important NBFCs (cont)

- Non-deposit-taking NBFCs with assets of ₹1,000 crore or more.

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Systemically Important NBFCs (cont)

- Includes specified categories such as HFCs, CICs and NBFC-IFCs.

Systemically Important NBFCs (cont)

3. Upper Layer (NBFC-UL)

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Systemically Important NBFCs (cont)

- Under revised 2026 criteria, NBFCs with assets of ₹1,00,000 crore (₹1 lakh crore) or more, based on latest audited financial statements.

Systemically Important NBFCs (cont)

- Subject to enhanced regulatory requirements.

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Systemically Important NBFCs (cont)

- Threshold reviewed every 3 years.

Systemically Important NBFCs (cont)

4. Top Layer (NBFC-TL)

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Systemically Important NBFCs (cont)

- Ideally remains empty.

Systemically Important NBFCs (cont)

- Populated if RBI considers systemic risk from specific Upper Layer NBFCs to have increased substantially.

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Systemically Important NBFCs (cont)

Important Dates and Numbers

Systemically Important NBFCs (cont)

- Historical NBFC-ND-SI threshold: ₹500 crore.

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Systemically Important NBFCs (cont)

- SBR effective: 1 October 2022.

Systemically Important NBFCs (cont)

- Base/Middle Layer asset threshold: ₹1,000 crore.

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Systemically Important NBFCs (cont)

- Revised Upper Layer asset threshold: ₹1,00,000 crore.

Systemically Important NBFCs (cont)

- Upper Layer threshold review: Every 3 years.

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Systemically Important NBFCs (cont)

- RBI's 2026–27 Upper Layer list released: 6 August 2026, based on financials as at 31 March 2026.

RBI's regulatory jurisdiction

RBI's Regulatory Jurisdiction over NBFCs

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RBI's regulatory jurisdiction (cont)

1. Legal Framework

RBI's regulatory jurisdiction (cont)

- Primary legislation: Reserve Bank of India Act, 1934 — Chapter III-B.

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RBI's regulatory jurisdiction (cont)

- RBI is the principal regulator of NBFCs.

RBI's regulatory jurisdiction (cont)

- Issues registration requirements, prudential norms, directions, reporting requirements and supervisory instructions.

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RBI's regulatory jurisdiction (cont)

2. Important Sections of RBI Act, 1934

RBI's regulatory jurisdiction (cont)

- 45-IA: Registration and minimum Net Owned Fund (NOF).

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RBI's regulatory jurisdiction (cont)

- 45-IB: Maintenance of prescribed percentage of assets in unencumbered approved securities.

RBI's regulatory jurisdiction (cont)

- 45-IC: Creation of reserve fund.

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RBI's regulatory jurisdiction (cont)

- 45-ID: RBI's power to remove directors.

RBI's regulatory jurisdiction (cont)

- 45-IE: Supersession of Board of Directors.

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RBI's regulatory jurisdiction (cont)

- 45J: Regulation/prohibition of prospectus or advertisements soliciting deposits.

RBI's regulatory jurisdiction (cont)

- 45JA: Power to determine policy and issue directions.

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RBI's regulatory jurisdiction (cont)

- 45K: Collection of deposit-related information and power to issue directions.

RBI's regulatory jurisdiction (cont)

- 45L: Power to call for information from financial institutions and issue directions.

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RBI's regulatory jurisdiction (cont)

- 45M: Duty to furnish statements and information.

RBI's regulatory jurisdiction (cont)

- 45MA: Powers and duties of auditors.

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RBI's regulatory jurisdiction (cont)

- 45MAA: Action against auditors.

RBI's regulatory jurisdiction (cont)

- 45MB: Prohibition of deposit acceptance and alienation of assets.

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RBI's regulatory jurisdiction (cont)

- 45MBA: Resolution of NBFC.

RBI's regulatory jurisdiction (cont)

- 45MC: Power to file winding-up petition.

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RBI's regulatory jurisdiction (cont)

- 45N: Inspection.

RBI's regulatory jurisdiction (cont)

- 45NC: Power to grant exemptions.

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RBI's regulatory jurisdiction (cont)

- 45Q: Chapter III-B overrides other laws.

RBI's regulatory jurisdiction (cont)

3. Important Regulatory Numbers

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RBI's regulatory jurisdiction (cont)

- General minimum NOF: ₹10 crore.

RBI's regulatory jurisdiction (cont)

- IFC and IDF-NBFC NOF: ₹300 crore.

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RBI's regulatory jurisdiction (cont)

- HFC NOF: ₹20 crore.

RBI's regulatory jurisdiction (cont)

- MGC NOF: ₹100 crore.

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RBI's regulatory jurisdiction (cont)

- NBFC-AA and NBFC-P2P NOF: ₹2 crore.

RBI's regulatory jurisdiction (cont)

- Section 45-IB: Statutory minimum 5%, RBI can prescribe up to 25% of outstanding deposits in unencumbered approved securities.

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RBI's regulatory jurisdiction (cont)

- Section 45-IB penal interest: 3% above Bank Rate initially; 5% above Bank Rate for continued default in subsequent quarters.

RBI's regulatory jurisdiction (cont)

- Section 45-IB payment of penal interest: Within 14 days of demand notice.

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RBI's regulatory jurisdiction (cont)

- Section 45-IC reserve fund: At least 20% of annual net profit, before dividend declaration.

RBI's regulatory jurisdiction (cont)

- Section 45-IC withdrawal reporting: Within 21 days.

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RBI's regulatory jurisdiction (cont)

4. RBI's Supervisory and Enforcement Powers

RBI's regulatory jurisdiction (cont)

- Registration and cancellation of Certificate of Registration (CoR).

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RBI's regulatory jurisdiction (cont)

- Inspection of books, accounts and records.

RBI's regulatory jurisdiction (cont)

- Collection of returns and financial information.

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RBI's regulatory jurisdiction (cont)

- Prescribing capital adequacy, provisioning, asset classification and liquidity requirements.

RBI's regulatory jurisdiction (cont)

- Restricting deposit acceptance and disposal of assets.

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RBI's regulatory jurisdiction (cont)

- Removing directors and superseding boards under statutory conditions.

RBI's regulatory jurisdiction (cont)

- Initiating resolution and winding-up proceedings.

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RBI's regulatory jurisdiction (cont)

- Imposing penalties and corrective restrictions.

RBI's regulatory jurisdiction (cont)

5. Scale-Based Regulation (SBR)

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RBI's regulatory jurisdiction (cont)

- Effective: 1 October 2022.

RBI's regulatory jurisdiction (cont)

- Four layers: Base, Middle, Upper and Top.

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RBI's regulatory jurisdiction (cont)

- Base Layer: Generally non-deposit-taking NBFCs below ₹1,000 crore.

RBI's regulatory jurisdiction (cont)

- Middle Layer: All deposit-taking NBFCs; non-deposit-taking NBFCs with assets of ₹1,000 crore or more; specified categories.

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RBI's regulatory jurisdiction (cont)

- Upper Layer: Specifically identified NBFCs; current asset threshold ₹1,00,000 crore or more.

RBI's regulatory jurisdiction (cont)

- Top Layer: Ideally empty; used if systemic risk increases substantially.

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RBI's regulatory jurisdiction (cont)

- Upper Layer threshold review: Every 3 years.

RBI's regulatory jurisdiction (cont)

6. Important 2026 Exemption

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RBI's regulatory jurisdiction (cont)

- Effective 1 July 2026.

RBI's regulatory jurisdiction (cont)

- NBFCs with no public funds, no customer interface and assets below ₹1,000 crore are exempt from Sections 45-IA and 45-IC, subject to conditions.

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RBI's regulatory jurisdiction (cont)

- Eligible existing entities can apply for deregistration by 31 December 2026.

RBI's regulatory jurisdiction (cont)

7. Other Regulators

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RBI's regulatory jurisdiction (cont)

- RBI – NBFCs and banking.

RBI's regulatory jurisdiction (cont)

- SEBI – Securities markets and mutual funds.

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RBI's regulatory jurisdiction (cont)

- IRDAI – Insurance.

RBI's regulatory jurisdiction (cont)

- PFRDA – Pension sector.

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RBI's regulatory jurisdiction (cont)

- NHB – Housing finance development and refinance; RBI regulates HFCs.

RBI's regulatory jurisdiction (cont)

MCQ Traps

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RBI's regulatory jurisdiction (cont)

- Section 45-IA = Registration; Section 45-IB = Asset maintenance; Section 45-IC = Reserve Fund.

RBI's regulatory jurisdiction (cont)

- 20% of net profit goes to the reserve fund, not 20% of total assets.

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RBI's regulatory jurisdiction (cont)

- Section 45-N = Inspection, not registration.

RBI's regulatory jurisdiction (cont)

- Section 45-MC = Winding-up petition; Section 45-MB = Restriction on deposits and asset alienation.

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RBI's regulatory jurisdiction (cont)

- RBI is the principal NBFC regulator, but specified entities may have separate sectoral regulators or exemptions.

RBI's regulatory jurisdiction (cont)

- ₹500 crore was the historical NBFC-ND-SI threshold; do not confuse it with current SBR classification.

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RBI's regulatory jurisdiction (cont)

- The 2026 exemption applies only when all three conditions are met: no public funds, no customer interface and assets below ₹1,000 crore.

NBFC Classification

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Investment and Credit Companies (NBFC-ICC)

- Meaning: NBFC carrying on as its principal business:

Investment and Credit Companies (NBFC-ICC) (cont)

- Asset finance.

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Investment and Credit Companies (NBFC-ICC) (cont)

- Providing finance through loans, advances or otherwise for activities other than its own.

Investment and Credit Companies (NBFC-ICC) (cont)

- Acquisition of securities.

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Investment and Credit Companies (NBFC-ICC) (cont)

- Residual category: Does not qualify under another specialised NBFC category prescribed by RBI.

Investment and Credit Companies (NBFC-ICC) (cont)

- Principal Business Criteria (PBC): Both conditions must be satisfied:

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Investment and Credit Companies (NBFC-ICC) (cont)

- Financial assets / (Total assets − Intangible assets) > 50%.

Investment and Credit Companies (NBFC-ICC) (cont)

- Financial income / Gross income > 50%.

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Investment and Credit Companies (NBFC-ICC) (cont)

- Both must exceed 50%; exactly 50% is insufficient.

Investment and Credit Companies (NBFC-ICC) (cont)

- Type-wise classification:

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Investment and Credit Companies (NBFC-ICC) (cont)

- Type I NBFC-ICC: Does not accept/intend to accept public funds and does not have/intend to have customer interface.

Investment and Credit Companies (NBFC-ICC) (cont)

- Type II NBFC-ICC: Accepts/intends to accept public funds and/or has/intends to have customer interface.

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Investment and Credit Companies (NBFC-ICC) (cont)

- Minimum Net Owned Fund (NOF), as per RBI's published classification framework:

Investment and Credit Companies (NBFC-ICC) (cont)

- Type I: ₹2 crore.

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Investment and Credit Companies (NBFC-ICC) (cont)

- Type II: ₹10 crore.

Investment and Credit Companies (NBFC-ICC) (cont)

- Examples of activities: Vehicle finance, equipment loans, consumer loans, business loans and investment in securities.

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Investment and Credit Companies (NBFC-ICC) (cont)

- Regulator: Reserve Bank of India (RBI).

Investment and Credit Companies (NBFC-ICC) (cont)

MCQ traps

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Investment and Credit Companies (NBFC-ICC) (cont)

- ICC is not limited to investment in shares; lending and asset finance are also included.

Investment and Credit Companies (NBFC-ICC) (cont)

- A company primarily financing its own activities does not satisfy the definition's lending limb.

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Investment and Credit Companies (NBFC-ICC) (cont)

- ICC is a broad category; specialised NBFCs such as MFIs and Infrastructure Finance Companies are classified separately.

Investment and Credit Companies (NBFC-ICC) (cont)

- Type I vs Type II depends on public funds and customer interface, not merely the company's asset size.

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Microfinance Institutions (NBFC-MFIs)

Full form: Non-Banking Financial Company – Microfinance Institution.

Microfinance Institutions (NBFC-MFIs) (cont)

Meaning: A non-deposit-taking NBFC primarily engaged in providing microfinance loans to low-income households.

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Microfinance Institutions (NBFC-MFIs) (cont)

Minimum qualifying assets: 60% of total assets (net of intangible assets) must comprise qualifying microfinance loans.

Microfinance Institutions (NBFC-MFIs) (cont)

- RBI circular dated 6 June 2025 reduced the earlier threshold from 75% to 60%.

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Microfinance Institutions (NBFC-MFIs) (cont)

- If the NBFC-MFI fails to meet this requirement for 4 consecutive quarters, it must approach RBI with a remediation plan.

Microfinance Institutions (NBFC-MFIs) (cont)

Minimum Net Owned Fund (NOF): ₹10 crore.

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Microfinance Institutions (NBFC-MFIs) (cont)

Microfinance loan definition: Collateral-free loan to a household with annual income up to ₹3 lakh.

Microfinance Institutions (NBFC-MFIs) (cont)

Household definition: Husband + wife + unmarried children.

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Microfinance Institutions (NBFC-MFIs) (cont)

Repayment cap: Total monthly loan repayments (principal + interest across all loans) ≤ 50% of monthly household income.

Microfinance Institutions (NBFC-MFIs) (cont)

Loan purpose: Income generation or consumption; no restriction on end use.

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Microfinance Institutions (NBFC-MFIs) (cont)

Pricing: No uniform RBI interest-rate cap; Board-approved pricing policy and transparent disclosure required.

Microfinance Institutions (NBFC-MFIs) (cont)

Regulator: Reserve Bank of India (RBI).

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Housing Finance Companies (HFCs)

- Meaning: Specialised NBFC primarily engaged in financing purchase, construction, reconstruction, renovation and repairs of residential dwelling units.

Housing Finance Companies (HFCs) (cont)

- Principal Business Criteria:

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Housing Finance Companies (HFCs) (cont)

- Housing finance ≥ 60% of total assets (net of intangible assets).

Housing Finance Companies (HFCs) (cont)

- Housing finance to individuals ≥ 50% of total assets (net of intangible assets).

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Housing Finance Companies (HFCs) (cont)

- General NBFC test: financial assets >50% of adjusted total assets AND financial income >50% of gross income.

Housing Finance Companies (HFCs) (cont)

- Minimum NOF: ₹20 crore.

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Housing Finance Companies (HFCs) (cont)

- Capital adequacy:

Housing Finance Companies (HFCs) (cont)

- Total Capital Ratio ≥ 15%.

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Housing Finance Companies (HFCs) (cont)

- Tier 1 Capital ≥ 10%.

Housing Finance Companies (HFCs) (cont)

- Tier 2 Capital ≤ 100% of Tier 1 Capital.

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Housing Finance Companies (HFCs) (cont)

- LTV limits for individual housing loans:

Housing Finance Companies (HFCs) (cont)

- Up to ₹30 lakh → 90%.

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Housing Finance Companies (HFCs) (cont)

- Above ₹30 lakh to ₹75 lakh → 80%.

Housing Finance Companies (HFCs) (cont)

- Above ₹75 lakh → 75%.

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Housing Finance Companies (HFCs) (cont)

- LTV formula:

Housing Finance Companies (HFCs) (cont)

LTV Ratio = (Total Outstanding Loan Amount / Realisable Value of Mortgaged Property) × 100

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Housing Finance Companies (HFCs) (cont)

- Commercial component in integrated housing projects: Permitted up to 10% of total Floor Space Index (FSI) for the project to qualify as residential housing.

Housing Finance Companies (HFCs) (cont)

- Regulatory history:

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Housing Finance Companies (HFCs) (cont)

- Earlier regulator: National Housing Bank (NHB).

Housing Finance Companies (HFCs) (cont)

- Since 2019: RBI regulates HFCs.

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Housing Finance Companies (HFCs) (cont)

- NHB continues developmental and refinance functions.

Housing Finance Companies (HFCs) (cont)

- Current framework: RBI (Housing Finance Companies) Directions, 2025.

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Housing Finance Companies (HFCs) (cont)

- Relevant laws: National Housing Bank Act, 1987 and RBI Act, 1934.

Infrastructure Finance Companies (IFCs)

Full form: Non-Banking Financial Company – Infrastructure Finance Company.

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Infrastructure Finance Companies (IFCs) (cont)

Meaning: Specialised non-deposit-taking NBFC primarily financing infrastructure projects.

Infrastructure Finance Companies (IFCs) (cont)

Qualifying condition: Minimum 75% of total assets must be deployed towards infrastructure lending.

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Infrastructure Finance Companies (IFCs) (cont)

Minimum NOF: ₹300 crore.

Infrastructure Finance Companies (IFCs) (cont)

Capital adequacy:

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Infrastructure Finance Companies (IFCs) (cont)

- CRAR ≥ 15%.

Infrastructure Finance Companies (IFCs) (cont)

- Tier 1 capital ≥ 10%.

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Infrastructure Finance Companies (IFCs) (cont)

Infrastructure lending includes:

Infrastructure Finance Companies (IFCs) (cont)

- Term loans and project loans.

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Infrastructure Finance Companies (IFCs) (cont)

- Subscription to bonds, debentures, preference shares or equity shares of project companies as part of a project-finance package, where the investment is in the nature of an advance.

Infrastructure Finance Companies (IFCs) (cont)

- Other long-term funded facilities for eligible infrastructure sub-sectors notified by the Department of Economic Affairs (DEA), Ministry of Finance.

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Infrastructure Finance Companies (IFCs) (cont)

SBR classification: Middle Layer or Upper Layer; not Base Layer.

Infrastructure Finance Companies (IFCs) (cont)

Exposure limits:

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Infrastructure Finance Companies (IFCs) (cont)

- ML: Single borrower 30%; single group 50% of Tier 1 capital.

Infrastructure Finance Companies (IFCs) (cont)

- UL: Single borrower 25% (+5% with Board approval); single group 35% of eligible capital base.

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Infrastructure Finance Companies (IFCs) (cont)

Risk weight: 50% for qualifying Public-Private Partnership (PPP) and post-Commercial Operations Date (COD) infrastructure project assets that have completed over one year of commercial operations.

Infrastructure Finance Companies (IFCs) (cont)

Regulator: Reserve Bank of India (RBI).

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Infrastructure Debt Funds

Meaning: Non-deposit-taking NBFC that facilitates long-term debt financing of infrastructure projects, particularly operational projects.

Infrastructure Debt Funds (cont)

Two forms of IDF:

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Infrastructure Debt Funds (cont)

- IDF-MF → Trust; regulated by SEBI.

Infrastructure Debt Funds (cont)

- IDF-NBFC → Company; regulated by RBI.

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Infrastructure Debt Funds (cont)

Permitted activities:

Infrastructure Debt Funds (cont)

- Refinance infrastructure projects after at least 1 year of satisfactory commercial operations post-COD.

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Infrastructure Debt Funds (cont)

- Direct lending to Toll-Operate-Transfer (TOT) projects.

Infrastructure Debt Funds (cont)

Minimum NOF: ₹300 crore.

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Infrastructure Debt Funds (cont)

Fund-raising:

Infrastructure Debt Funds (cont)

- Rupee or US dollar-denominated bonds: minimum 5-year maturity.

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Infrastructure Debt Funds (cont)

- Shorter-tenor domestic bonds and CPs: maximum 10% of total outstanding borrowings.

Infrastructure Debt Funds (cont)

- External Commercial Borrowings (ECBs): minimum 5-year tenor.

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Infrastructure Debt Funds (cont)

Exposure limits:

Infrastructure Debt Funds (cont)

- Single borrower/party: 30% of Tier 1 capital.

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Infrastructure Debt Funds (cont)

- Single group of borrowers/parties: 50% of Tier 1 capital.

Infrastructure Debt Funds (cont)

Risk weights: Same as NBFC-ICCs.

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Infrastructure Debt Funds (cont)

Sponsorship: Mandatory bank/IFC sponsorship requirement withdrawn by RBI on 18 August 2023.

Infrastructure Debt Funds (cont)

Regulator: RBI for IDF-NBFC; SEBI for IDF-MF.

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Core Investment Companies (CICs)

Full form: Core Investment Company.

Core Investment Companies (CICs) (cont)

Meaning: Specialised NBFC primarily holding investments in group companies; functions as a holding/parent investment company.

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Core Investment Companies (CICs) (cont)

Investment criteria:

Core Investment Companies (CICs) (cont)

- ≥ 90% of net assets in investments (equity, preference shares, bonds, debentures, debt or loans) in group companies.

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Core Investment Companies (CICs) (cont)

- ≥ 60% of net assets in equity shares of group companies and permitted sponsor investments in InvITs.

Core Investment Companies (CICs) (cont)

Group company relationships: Parent–subsidiary, joint venture, associate, promoter–promotee, related party, common brand, or ≥20% equity investment.

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Core Investment Companies (CICs) (cont)

Registration threshold: Total assets ≥ ₹100 crore and access to public funds → RBI registration generally required.

Core Investment Companies (CICs) (cont)

Unregistered CIC: Assets below ₹100 crore, or assets ≥₹100 crore without access to public funds, subject to applicable exemption conditions.

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Core Investment Companies (CICs) (cont)

Capital adequacy: Adjusted Net Worth ≥ 30% of aggregate risk-weighted assets.

Core Investment Companies (CICs) (cont)

Leverage: Outside liabilities ≤ 2.5 times Adjusted Net Worth.

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Core Investment Companies (CICs) (cont)

Permitted activities: Investments in group companies, loans and guarantees to group companies, and specified treasury investments.

Core Investment Companies (CICs) (cont)

Investment restrictions: No ordinary trading in group-company investments; block sale for dilution/disinvestment permitted.

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Core Investment Companies (CICs) (cont)

Regulator: Reserve Bank of India (RBI).

Core Investment Companies (CICs) (cont)

Current framework: RBI (Core Investment Companies) Directions, 2025, amended in March 2026.

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Account Aggregators (NBFC-AAs)

Meaning: NBFC facilitating retrieval, consolidation, organisation and presentation of customers' financial information to customers or authorised Financial Information Users (FIUs), based on explicit consent.

Account Aggregators (NBFC-AAs) (cont)

Regulator: Reserve Bank of India (RBI).

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Account Aggregators (NBFC-AAs) (cont)

Current regulation: RBI (NBFC – Account Aggregator) Directions, 2025, dated 28 November 2025.

Account Aggregators (NBFC-AAs) (cont)

Legal basis: Section 45-I(f)(iii) and Section 45JA of RBI Act, 1934.

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Account Aggregators (NBFC-AAs) (cont)

Minimum NOF: ₹2 crore.

Account Aggregators (NBFC-AAs) (cont)

Maximum leverage ratio: 7 times.

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Account Aggregators (NBFC-AAs) (cont)

In-principle approval validity: 12 months.

Account Aggregators (NBFC-AAs) (cont)

SBR classification: Always Base Layer.

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Account Aggregators (NBFC-AAs) (cont)

FIP: Financial Information Provider — holds customer data (banks, NBFCs, insurers, AMCs, depositories, pension-related entities, GST Network, etc.).

Account Aggregators (NBFC-AAs) (cont)

FIU: Financial Information User — regulated entity receiving data for an authorised purpose.

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Account Aggregators (NBFC-AAs) (cont)

Consent: Explicit, purpose-specific, standardised consent artefact; revocable, including partially.

Account Aggregators (NBFC-AAs) (cont)

Data security: No customer credentials; customer financial information must not reside with AA.

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Account Aggregators (NBFC-AAs) (cont)

Business restriction: No lending, transaction execution or unrelated business; no outsourcing of core account aggregation activity.

Account Aggregators (NBFC-AAs) (cont)

Customer grievance redressal: Maximum 1 month.

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Account Aggregators (NBFC-AAs) (cont)

Information System Audit: At least once every 2 years; report to RBI within 1 month of auditor submission.

Account Aggregators (NBFC-AAs) (cont)

Examples of information: Bank deposits, securities, mutual funds, insurance, NPS, AIF, InvIT, REIT and GST returns.

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Peer-to-Peer Lending Platforms

- Full form: Non-Banking Financial Company – Peer-to-Peer Lending Platform.

Peer-to-Peer Lending Platforms (cont)

- Meaning: Online intermediary connecting individual lenders and borrowers; does not lend its own funds.

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Peer-to-Peer Lending Platforms (cont)

- Current framework: RBI (NBFC – Peer to Peer Lending Platform) Directions, 2025, dated 28 November 2025.

Peer-to-Peer Lending Platforms (cont)

- Legal basis: RBI Act, 1934 — Sections 45-IA, 45JA, 45L and 45M.

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Peer-to-Peer Lending Platforms (cont)

- Minimum NOF: ₹2 crore.

Peer-to-Peer Lending Platforms (cont)

- Registration: RBI CoR compulsory; only companies can operate.

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Peer-to-Peer Lending Platforms (cont)

- In-principle approval validity: 12 months.

Peer-to-Peer Lending Platforms (cont)

- SBR classification: Always Base Layer.

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Peer-to-Peer Lending Platforms (cont)

- Maximum leverage ratio: 2 times (Outside Liabilities / Owned Funds).

Peer-to-Peer Lending Platforms (cont)

Exposure limits — across all P2P platforms:

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Peer-to-Peer Lending Platforms (cont)

- One lender → all borrowers: ₹50 lakh.

Peer-to-Peer Lending Platforms (cont)

- Lender exposure >₹10 lakh → Chartered Accountant certificate confirming minimum net worth of ₹50 lakh.

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Peer-to-Peer Lending Platforms (cont)

- One borrower → all lenders: ₹10 lakh.

Peer-to-Peer Lending Platforms (cont)

- One lender → one borrower: ₹50,000.

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Peer-to-Peer Lending Platforms (cont)

- Maximum loan maturity: 36 months.

Peer-to-Peer Lending Platforms (cont)

Activities and restrictions:

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Peer-to-Peer Lending Platforms (cont)

- Cannot accept deposits or lend on its own.

Peer-to-Peer Lending Platforms (cont)

- Cannot provide credit guarantee or credit enhancement.

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Peer-to-Peer Lending Platforms (cont)

- Only unsecured loans permitted.

Peer-to-Peer Lending Platforms (cont)

- Lender bears entire credit/default risk.

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Peer-to-Peer Lending Platforms (cont)

- Cannot guarantee returns.

Peer-to-Peer Lending Platforms (cont)

- Cannot permit international fund flows.

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Peer-to-Peer Lending Platforms (cont)

- Cannot use one lender's money to replace another lender's funds.

Peer-to-Peer Lending Platforms (cont)

- Cannot hold customer funds on its balance sheet.

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Peer-to-Peer Lending Platforms (cont)

Escrow and fund transfer:

Peer-to-Peer Lending Platforms (cont)

- At least 2 escrow accounts: Lenders' and Borrowers'.

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Peer-to-Peer Lending Platforms (cont)

- Operated by bank-promoted trustee.

Peer-to-Peer Lending Platforms (cont)

- Fund transfer only through bank accounts; no cash.

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Peer-to-Peer Lending Platforms (cont)

- Escrow retention limit: T+1 bank working day.

Peer-to-Peer Lending Platforms (cont)

Pricing: Fees disclosed upfront; fixed amount or fixed proportion of principal; cannot depend on repayment.

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Factors

Meaning: Financial institution purchasing or financing accounts receivable/invoices to provide immediate working capital to businesses.

Factors (cont)

Legislation: Factoring Regulation Act, 2011, amended in 2021.

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Factors (cont)

Regulator: RBI.

Factors (cont)

Registration: CoR under Section 3 of Factoring Regulation Act, 2011.

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Factors (cont)

Minimum NOF:

Factors (cont)

- New NBFC-Factor: ₹10 crore.

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Factors (cont)

- Existing NBFC-Factor glide path: ₹5 crore initially → ₹7 crore by 31 March 2025 → ₹10 crore by 31 March 2027.

Factors (cont)

NBFC-ICC eligibility for factoring: Non-deposit-taking; total assets ≥ ₹1,000 crore; prescribed NOF and regulatory compliance.

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Factors (cont)

Commencement: Factoring business must start within 6 months of CoR.

Factors (cont)

Principal Business Criteria:

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Factors (cont)

- Factoring financial assets ≥ 50% of total assets.

Factors (cont)

- Factoring income ≥ 50% of gross income.

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Factors (cont)

Recourse factoring: Seller (assignor) bears the agreed risk of buyer default; exposure reckoned on assignor.

Factors (cont)

Non-recourse factoring: Factor bears the agreed credit risk; exposure reckoned on debtor.

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Factors (cont)

NPA norms: More than 180 days for NBFC-Factors below ₹500 crore under the stated category-specific norm; more than 90 days for NBFC-Factors ≥₹500 crore and eligible NBFC-ICCs, subject to the RBI glide path.

Factors (cont)

Risk management: Genuine trade invoices, debtor credit appraisal, Board-approved underwriting limits and information sharing to prevent double financing.

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Factors (cont)

Section 5 exemptions: Banks, specified statutory corporations and Government companies.

Mortgage Guarantee Companies

- Full form: Mortgage Guarantee Company.

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Mortgage Guarantee Companies (cont)

- Meaning: Specialised company providing guarantees to creditor institutions against default on housing loans.

Mortgage Guarantee Companies (cont)

- Creditor institution: Bank or Housing Finance Company (HFC).

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Mortgage Guarantee Companies (cont)

- Regulator: Reserve Bank of India (RBI).

Mortgage Guarantee Companies (cont)

- Current framework: RBI (Mortgage Guarantee Companies) Directions, 2025, updated 10 March 2026.

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Mortgage Guarantee Companies (cont)

- Legal basis: Section 45JA, RBI Act, 1934.

Mortgage Guarantee Companies (cont)

- Contract of guarantee: Section 126, Indian Contract Act, 1872.

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Mortgage Guarantee Companies (cont)

Registration and business conditions

Mortgage Guarantee Companies (cont)

- RBI CoR compulsory.

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Mortgage Guarantee Companies (cont)

- Minimum NOF: ₹100 crore.

Mortgage Guarantee Companies (cont)

- Mortgage guarantee business ≥ 90% of business turnover OR 90% of gross income.

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Mortgage Guarantee Companies (cont)

- Other activities: maximum 10% of total assets.

Mortgage Guarantee Companies (cont)

- Cannot accept public deposits or raise ECBs.

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Mortgage Guarantee Companies (cont)

- Cannot undertake insurance business.

Mortgage Guarantee Companies (cont)

- Can be placed in any SBR layer depending on applicable scale--based criteria.

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Mortgage Guarantee Companies (cont)

Mortgage guarantee contract

Mortgage Guarantee Companies (cont)

- Tripartite: Borrower + Creditor Institution + MGC.

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Mortgage Guarantee Companies (cont)

- Unconditional and irrevocable.

Mortgage Guarantee Companies (cont)

- Covers outstanding principal and interest up to guaranteed amount.

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Mortgage Guarantee Companies (cont)

- Payment on invocation without first adjusting against realisable mortgage-property value.

Mortgage Guarantee Companies (cont)

Capital adequacy

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Mortgage Guarantee Companies (cont)

- Total Capital Adequacy Ratio ≥ 10%.

Mortgage Guarantee Companies (cont)

- Tier 1 Capital ≥ 6%.

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Mortgage Guarantee Companies (cont)

- Tier 2 Capital ≤ 100% of Tier 1 Capital.

Mortgage Guarantee Companies (cont)

- Single guarantee ≤ 10% of Tier 1 + Tier 2 capital.

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Mortgage Guarantee Companies (cont)

Exposure limits (not applicable to Upper Layer MGCs)

Mortgage Guarantee Companies (cont)

- Single borrower ≤ 15% of Tier 1 capital.

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Mortgage Guarantee Companies (cont)

- Single group ≤ 25% of Tier 1 capital.

Mortgage Guarantee Companies (cont)

Contingency Reserve

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Mortgage Guarantee Companies (cont)

- Annual appropriation: higher of 40% of premium/fee earned or 25% of profit after provisions and tax.

Mortgage Guarantee Companies (cont)

- Special minimum appropriation: 24% of premium/fee if claim-loss provisions exceed 35% of premium/fee earned.

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Mortgage Guarantee Companies (cont)

- Required reserve balance: at least 5% of outstanding mortgage guarantee commitments.

Asset Reconstruction Companies

- Full form: Asset Reconstruction Company.

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Asset Reconstruction Companies (cont)

- Meaning: Acquires stressed financial assets from banks/FIs and undertakes recovery, restructuring or resolution.

Asset Reconstruction Companies (cont)

- Main legislation: SARFAESI Act, 2002.

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Asset Reconstruction Companies (cont)

- Regulator: RBI.

Asset Reconstruction Companies (cont)

- Current framework: RBI (Asset Reconstruction Companies) Directions, 2025, updated 10 March 2026.

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Asset Reconstruction Companies (cont)

- Registration: RBI CoR under Section 3, SARFAESI Act.

Asset Reconstruction Companies (cont)

- Minimum NOF: ₹300 crore.

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Asset Reconstruction Companies (cont)

- Existing ARCs as on 11 October 2022: deadline 31 March 2026.

Asset Reconstruction Companies (cont)

- Minimum Capital Adequacy Ratio: 15% of risk-weighted assets.

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Asset Reconstruction Companies (cont)

- Commencement of business: Within 6 months of CoR; RBI may extend up to 12 months.

Asset Reconstruction Companies (cont)

- Deposits: Cannot accept public deposits.

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Asset Reconstruction Companies (cont)

Asset reconstruction and recovery

Asset Reconstruction Companies (cont)

- Change/takeover of management.

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Asset Reconstruction Companies (cont)

- Rescheduling of debt.

Asset Reconstruction Companies (cont)

- Enforcement of security interest.

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Asset Reconstruction Companies (cont)

- Settlement of dues.

Asset Reconstruction Companies (cont)

- Conversion of debt into equity.

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Asset Reconstruction Companies (cont)

- Planning period: maximum 6 months.

Asset Reconstruction Companies (cont)

- Normal realisation period: 5 years; Board-approved extension up to 8 years.

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Asset Reconstruction Companies (cont)

Security Receipts

Asset Reconstruction Companies (cont)

- Issued through trusts established for securitisation.

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Asset Reconstruction Companies (cont)

- Issued only to Qualified Buyers (QBs); transferable only to QBs.

Asset Reconstruction Companies (cont)

- ARC's minimum investment in each class of SRs: higher of:

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Asset Reconstruction Companies (cont)

- 15% of transferors' investment, or

Asset Reconstruction Companies (cont)

- 2.5% of total SRs issued.

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Asset Reconstruction Companies (cont)

- Initial rating by SEBI-registered CRA within 6 months of asset acquisition.

Asset Reconstruction Companies (cont)

- Rating review: 30 June and 31 December every year.

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Asset Reconstruction Companies (cont)

IBC-related permission

Asset Reconstruction Companies (cont)

- Minimum NOF ₹1,000 crore for additional Resolution Applicant activities not specifically permitted under SARFAESI.

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Asset Reconstruction Companies (cont)

- No significant influence/control over corporate debtor after 5 years from resolution-plan approval.

Asset Reconstruction Companies (cont)

Important statutory thresholds

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Asset Reconstruction Companies (cont)

- Secured creditor consent for enforcement: 60% of amount outstanding.

Asset Reconstruction Companies (cont)

- Management takeover: ARC dues ≥ 25% of borrower's total assets.

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Asset Reconstruction Companies (cont)

- Multiple secured creditors: at least 60% of outstanding SRs must agree to takeover.

Asset Reconstruction Companies (cont)

- ARC's NPA recognition: generally 180 days overdue.

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Standalone Primary Dealers

- Meaning: Specialised intermediaries in the Government Securities (G-Sec) market; support Government borrowing through underwriting and support secondary-market liquidity through market making.

Standalone Primary Dealers (cont)

- Types:

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Standalone Primary Dealers (cont)

- Standalone PD (SPD): Separate entity; PD business is its principal activity.

Standalone Primary Dealers (cont)

- Bank PD: Bank conducts PD business departmentally.

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Standalone Primary Dealers (cont)

- Regulator: Reserve Bank of India (RBI).

Standalone Primary Dealers (cont)

- Legal framework: RBI (Standalone Primary Dealers) Directions, 2025; issued 28 November 2025, updated 10 March 2026.

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Standalone Primary Dealers (cont)

- Regulatory status: SPDs are registered as Non-Banking Financial Companies (NBFCs) and always fall in the Middle Layer under Scale Based Regulation (SBR).

Standalone Primary Dealers (cont)

Capital and prudential requirements

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Standalone Primary Dealers (cont)

- Minimum Net Owned Fund (NOF): ₹150 crore (core activities only); ₹250 crore (core + non-core activities).

Standalone Primary Dealers (cont)

- Minimum Capital to Risk-Weighted Assets Ratio (CRAR): 15%.

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Standalone Primary Dealers (cont)

- Tier 1 capital: at least 50% of the capital requirement for credit risk.

Standalone Primary Dealers (cont)

- Total Tier 2 capital: maximum 100% of Tier 1; subordinated debt within Tier 2: maximum 50% of Tier 1.

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Standalone Primary Dealers (cont)

- At least 50% of total financial investments must be in G-Secs at all times.

Standalone Primary Dealers (cont)

- Market-risk capital charge for specified non-core activities: maximum 20% of NOF.

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Standalone Primary Dealers (cont)

Funding limits

Standalone Primary Dealers (cont)

- Call/notice money borrowing: average fortnightly limit 225% of NOF.

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Standalone Primary Dealers (cont)

- Call/notice money lending: average fortnightly limit 25% of NOF.

Standalone Primary Dealers (cont)

- Inter-Corporate Deposit (ICD) borrowing: maximum 150% of NOF; minimum maturity 1 week.

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Standalone Primary Dealers (cont)

- Foreign Currency Non-Resident (Bank) [FCNR(B)] loans: maximum 25% of NOF; at least 50% of foreign-exchange exposure must be hedged.

Standalone Primary Dealers (cont)

- External Commercial Borrowings (ECBs): prohibited.

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Standalone Primary Dealers (cont)

- Non-Convertible Debentures (NCDs): may issue with maturity up to 1 year.

Standalone Primary Dealers (cont)

Permitted activities

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Standalone Primary Dealers (cont)

- Core: G-Sec dealing/underwriting, interest-rate derivatives, G-Sec broking, corporate/PSU/financial-institution bonds, repo lending, Commercial Papers (CPs), Certificates of Deposit (CDs), debt mutual funds and Credit Default Swaps (CDS).

Standalone Primary Dealers (cont)

- Non-core: equity investments/trading, equity mutual funds, equity underwriting, currency futures, foreign-exchange market making and specified advisory/distribution services.

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Standalone Primary Dealers (cont)

- Not permitted: equity broking, commodity trading/broking and gold trading.

Standalone Primary Dealers (cont)

- CDS market making requires minimum NOF ₹500 crore, CRAR 15%, robust risk management and RBI approval.

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Standalone Primary Dealers (cont)

Key distinctions / MCQ traps

Standalone Primary Dealers (cont)

- SPD is an NBFC, but its specialised regulatory framework is the SPD Directions.

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Standalone Primary Dealers (cont)

- Bank PDs do not have a separate capital adequacy requirement for PD business; the bank's normal capital requirements apply.

Standalone Primary Dealers (cont)

- Bank PDs do not receive separate access to RBI's Liquidity Adjustment Facility (LAF) or call money market facilities because they already have access as banks.

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Standalone Primary Dealers (cont)

- SPDs are eligible for RBI liquidity support, subject to applicable conditions.

Standalone Primary Dealers (cont)

- Underwriting means taking responsibility for the unsubscribed portion; it is not the same as merely acting as a broker.

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Standalone Primary Dealers (cont)

- Primary market = issuance/underwriting; secondary market = trading/liquidity/market making.

NBFC Regulatory Framework

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Scale-Based Regulation

SBR: Introduced through RBI circular dated 22 October 2021; framework came into effect from 1 October 2022. Current consolidated framework: RBI (Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation) Directions, 2025, updated 1 July 2026.

Scale-Based Regulation (cont)

Objective: Proportionate regulation based on size, activity, complexity and perceived systemic risk.

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Scale-Based Regulation (cont)

Four layers:

Scale-Based Regulation (cont)

- Base Layer (BL): Non-deposit-taking NBFCs below ₹1,000 crore; P2P, AA, NOFHC and Type I NBFCs.

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Scale-Based Regulation (cont)

- Middle Layer (ML): All deposit-taking NBFCs; non-deposit-taking NBFCs ≥₹1,000 crore; SPD, IDF-NBFC, CIC, HFC and IFC.

Scale-Based Regulation (cont)

- Upper Layer (UL): NBFCs with assets ≥₹1,00,000 crore under current Directions.

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Scale-Based Regulation (cont)

- Top Layer (TL): Ideally empty; RBI moves an UL NBFC here if systemic risk rises substantially.

Scale-Based Regulation (cont)

Activity-specific placement: P2P, AA, NOFHC and Type I → always BL; SPD and IDF-NBFC → always ML; CIC, HFC, IFC and NBFC-D → ML/UL.

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Scale-Based Regulation (cont)

Group classification: Consolidated assets of relevant NBFCs in a common group ≥₹1,000 crore → relevant ICCs, MFIs, Factors and MGCs classified in ML.

Scale-Based Regulation (cont)

Regulatory principle: Higher layers inherit lower-layer regulations, unless specified otherwise.

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Scale-Based Regulation (cont)

UL transition: Minimum 5-year stay; implementation plan within 3 months; full compliance within a maximum 24 months.

Scale-Based Regulation (cont)

Public funds: Includes public deposits, inter-corporate deposits, bank finance, Commercial Papers (CPs), debentures and other external funding. Excludes specified compulsorily convertible equity instruments issued with conversion within 5 years.

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Scale-Based Regulation (cont)

MCQ traps: ₹1,000 crore = BL/ML dividing threshold; ₹1 lakh crore = current UL threshold; Top Layer is not a routine category; P2P and AA remain BL even if large; SPD and IDF-NBFC remain ML.

Base, Middle, Upper and Top Layers

- Base Layer (BL):

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Base, Middle, Upper and Top Layers (cont)

- Non-deposit-taking NBFCs with assets below ₹1,000 crore.

Base, Middle, Upper and Top Layers (cont)

- Always BL: NBFC-P2P (Peer-to-Peer Lending Platform), NBFC-AA (Account Aggregator), NOFHC (Non-Operative Financial Holding Company) and Type I NBFC.

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Base, Middle, Upper and Top Layers (cont)

- Subject to the basic SBR regulatory requirements.

Base, Middle, Upper and Top Layers (cont)

- Middle Layer (ML):

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Base, Middle, Upper and Top Layers (cont)

- All deposit-taking NBFCs, irrespective of asset size.

Base, Middle, Upper and Top Layers (cont)

- Non-deposit-taking NBFCs with assets ₹1,000 crore and above.

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Base, Middle, Upper and Top Layers (cont)

- Always ML: Standalone Primary Dealers (SPDs) and Infrastructure Debt Fund-NBFCs (IDF-NBFCs).

Base, Middle, Upper and Top Layers (cont)

- CICs (Core Investment Companies), HFCs (Housing Finance Companies) and IFCs (Infrastructure Finance Companies) are placed in ML or UL, not BL.

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Base, Middle, Upper and Top Layers (cont)

- Upper Layer (UL):

Base, Middle, Upper and Top Layers (cont)

- NBFCs specifically identified annually by RBI as warranting enhanced regulation.

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Base, Middle, Upper and Top Layers (cont)

- Current identification criterion under the 2025 Directions: asset size ₹1,00,000 crore and above, based on the latest audited balance sheet.

Base, Middle, Upper and Top Layers (cont)

- RBI's revised 2026 framework provides for annual identification; do not treat asset size alone as an automatic classification.

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Base, Middle, Upper and Top Layers (cont)

- Top Layer (TL):

Base, Middle, Upper and Top Layers (cont)

- Ideally remains empty.

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Base, Middle, Upper and Top Layers (cont)

- RBI can move an NBFC from UL to TL if its potential systemic risk increases substantially.

Base, Middle, Upper and Top Layers (cont)

- Subject to higher capital requirements and intensive supervisory oversight; additional requirements are communicated by RBI.

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Base, Middle, Upper and Top Layers (cont)

Group-level classification

Base, Middle, Upper and Top Layers (cont)

- NBFCs under a common group or common promoters are not always assessed independently.

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Base, Middle, Upper and Top Layers (cont)

- Consolidate assets of all RBI-registered NBFCs in the group, including entities otherwise placed in BL.

Base, Middle, Upper and Top Layers (cont)

- If consolidated assets are ₹1,000 crore or above, each NBFC-ICC (Investment and Credit Company), NBFC-MFI (Microfinance Institution), NBFC-Factor and MGC (Mortgage Guarantee Company) in that group moves to ML.

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Base, Middle, Upper and Top Layers (cont)

- This group aggregation rule does not apply to UL classification.

Base, Middle, Upper and Top Layers (cont)

- Statutory auditors must certify group NBFC asset size as on 31 March every year and submit the certificate to RBI.

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Base, Middle, Upper and Top Layers (cont)

Transition and regulatory applicability

Base, Middle, Upper and Top Layers (cont)

- ML entry: Once an NBFC reaches ₹1,000 crore, ML regulations apply immediately, irrespective of when it reaches that threshold.

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Base, Middle, Upper and Top Layers (cont)

- If assets subsequently fall below ₹1,000 crore, it continues to follow ML requirements until its next audited balance sheet is submitted to RBI and RBI grants specific dispensation.

Base, Middle, Upper and Top Layers (cont)

- UL transition:

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Base, Middle, Upper and Top Layers (cont)

- Board-approved implementation policy and plan within 3 months of RBI's advice.

Base, Middle, Upper and Top Layers (cont)

- Full compliance with UL requirements within 24 months of RBI's advice.

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Base, Middle, Upper and Top Layers (cont)

- Minimum stay in UL: 5 years.

Base, Middle, Upper and Top Layers (cont)

- Can exit after failing UL identification criteria for 5 consecutive years.

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Base, Middle, Upper and Top Layers (cont)

- Earlier exit may be permitted for voluntary strategic restructuring under a Board-approved policy, not merely due to deteriorating financial condition.

Base, Middle, Upper and Top Layers (cont)

- UL asset-size threshold reviewed every 3 years.

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Base, Middle, Upper and Top Layers (cont)

- Layer inheritance: BL regulations apply to ML; BL and ML regulations apply to UL, unless specifically stated otherwise.

Base, Middle, Upper and Top Layers (cont)

- Top Layer: Higher capital charge and enhanced supervisory engagement.

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Base, Middle, Upper and Top Layers (cont)

MCQ traps

Base, Middle, Upper and Top Layers (cont)

- ₹1,000 crore = BL/ML threshold; ₹1 lakh crore = UL identification threshold under the current framework.

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Base, Middle, Upper and Top Layers (cont)

- All deposit-taking NBFCs are ML or higher, regardless of size.

Base, Middle, Upper and Top Layers (cont)

- P2P and AA remain BL; SPD and IDF-NBFC remain ML.

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Base, Middle, Upper and Top Layers (cont)

- Reaching ₹1,000 crore triggers ML requirements immediately.

Base, Middle, Upper and Top Layers (cont)

- UL is an annual RBI identification, not simply an automatic asset-size category.

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Capital adequacy and leverage

- Capital Adequacy Ratio (CRAR):

Capital adequacy and leverage (cont)

- Measures an NBFC's capital relative to its risk-weighted assets (RWAs).

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Capital adequacy and leverage (cont)

- Formula:

Capital adequacy and leverage (cont)

CRAR = (Tier 1 Capital + Tier 2 Capital) / Risk-Weighted Assets × 100

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Capital adequacy and leverage (cont)

- NBFC-Middle Layer (ML) and above:

Capital adequacy and leverage (cont)

- Minimum CRAR: 15%.

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Capital adequacy and leverage (cont)

- Minimum Tier 1 capital: 10% of RWAs.

Capital adequacy and leverage (cont)

- Tier 2 capital cannot exceed 100% of Tier 1 capital.

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Capital adequacy and leverage (cont)

- NBFC-Upper Layer (UL): Additional minimum Common Equity Tier 1 (CET1) capital of 9% of RWAs.

Capital adequacy and leverage (cont)

- NBFC-Top Layer (TL): Higher capital requirements as specifically communicated by RBI.

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Capital adequacy and leverage (cont)

- NBFCs primarily engaged in lending against gold jewellery: Minimum Tier 1 capital 12% and CRAR 15%; Tier 2 ≤100% of Tier 1.

Capital adequacy and leverage (cont)

- NBFC-MFIs are exempt from the specific minimum capital requirements under these provisions.

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Capital adequacy and leverage (cont)

- Components of regulatory capital:

Capital adequacy and leverage (cont)

- Tier 1 Capital: Core capital available to absorb losses while the NBFC continues operations.

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Capital adequacy and leverage (cont)

- Includes owned funds and eligible instruments.

Capital adequacy and leverage (cont)

- CET1: Paid-up equity capital, share premium, statutory reserves, eligible free reserves and retained earnings, after regulatory deductions.

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Capital adequacy and leverage (cont)

- Goodwill, intangible assets, accumulated losses and specified deferred tax assets are deducted.

Capital adequacy and leverage (cont)

- Tier 2 Capital: Supplementary capital available to absorb losses, particularly during winding up.

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Capital adequacy and leverage (cont)

- Includes eligible subordinated debt, non-convertible preference shares, discounted revaluation reserves, hybrid debt and general provisions/loss reserves.

Capital adequacy and leverage (cont)

- General provisions and loss reserves eligible for Tier 2 are capped at 1.25% of RWAs.

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Capital adequacy and leverage (cont)

- Subordinated debt is progressively discounted as maturity approaches:

Capital adequacy and leverage (cont)

- Up to 1 year: 100% discount.

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Capital adequacy and leverage (cont)

- 1–2 years: 80%.

Capital adequacy and leverage (cont)

- 2–3 years: 60%.

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Capital adequacy and leverage (cont)

- 3–4 years: 40%.

Capital adequacy and leverage (cont)

- 4–5 years: 20%.

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Capital adequacy and leverage (cont)

- Eligible subordinated debt in Tier 2 is subject to a limit of 50% of Tier 1 capital.

Capital adequacy and leverage (cont)

- Perpetual Debt Instruments (PDIs):

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Capital adequacy and leverage (cont)

- Issued by eligible non-deposit-taking NBFCs.

Capital adequacy and leverage (cont)

- Can qualify as Tier 1 capital up to 15% of aggregate Tier 1 capital (based on previous 31 March).

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Capital adequacy and leverage (cont)

- Perpetual in nature; issued in Indian rupees.

Capital adequacy and leverage (cont)

- Minimum investment per investor per issue/tranche: ₹5 lakh.

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Capital adequacy and leverage (cont)

- Call option only after 10 years, with prior RBI approval.

Capital adequacy and leverage (cont)

- Step-up in interest rate: maximum 100 basis points, exercisable only once after 10 years.

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Capital adequacy and leverage (cont)

- NBFC-Base Layer cannot include PDI in Tier 1 or Tier 2 capital.

Capital adequacy and leverage (cont)

- Leverage Ratio:

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Capital adequacy and leverage (cont)

- Measures the extent to which an NBFC relies on outside liabilities relative to its own funds.

Capital adequacy and leverage (cont)

- Formula:

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Capital adequacy and leverage (cont)

Leverage Ratio = Total Outside Liabilities / Owned Fund

Capital adequacy and leverage (cont)

- For NBFC-Base Layer (BL), leverage ratio must not exceed 7 times at any point.

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Capital adequacy and leverage (cont)

- This is a separate constraint from CRAR: CRAR is risk-weighted; leverage ratio is not risk-weighted.

Capital adequacy and leverage (cont)

- Internal Capital Adequacy Assessment Process (ICAAP):

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Capital adequacy and leverage (cont)

- Applicable to NBFC-Middle Layer and above.

Capital adequacy and leverage (cont)

- Internal assessment of capital required against all material risks, including risks not fully captured by minimum regulatory capital.

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Capital adequacy and leverage (cont)

- Board oversees the process; capital planning and risk management must be aligned.

Capital adequacy and leverage (cont)

- Risk-Weighted Assets (RWAs):

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Capital adequacy and leverage (cont)

- Assets are assigned risk weights based on credit risk.

Capital adequacy and leverage (cont)

- Higher risk weight → higher capital requirement.

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Capital adequacy and leverage (cont)

- Illustrative risk weights under the NBFC capital framework:

Capital adequacy and leverage (cont)

- Cash and bank balances: 0%.

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Capital adequacy and leverage (cont)

- Approved securities: 0%.

Capital adequacy and leverage (cont)

- Public-sector bank bonds: 20%.

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Capital adequacy and leverage (cont)

- Most corporate loans, shares and debentures: 100%.

Capital adequacy and leverage (cont)

- Specified consumer credit and credit-card receivables: 125%.

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Capital adequacy and leverage (cont)

- RWA = Σ (Exposure × Applicable Risk Weight)

Capital adequacy and leverage (cont)

MCQ traps

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Capital adequacy and leverage (cont)

- CRAR = Tier 1 + Tier 2 divided by RWAs; leverage = outside liabilities divided by owned funds.

Capital adequacy and leverage (cont)

- 15% CRAR and 10% Tier 1 are separate minimum requirements for ML and above.

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Capital adequacy and leverage (cont)

- UL has an additional 9% CET1 requirement.

Capital adequacy and leverage (cont)

- Tier 2 cannot exceed Tier 1 for ML and above.

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Capital adequacy and leverage (cont)

- Tier 2 general provisions cap = 1.25% of RWAs.

Capital adequacy and leverage (cont)

- PDI Tier 1 eligibility cap = 15% of Tier 1; call option after 10 years with RBI approval.

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Capital adequacy and leverage (cont)

- BL leverage ceiling = 7 times.

Capital adequacy and leverage (cont)

- ICAAP applies to ML and above.

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Asset classification and provisionin

- Non-Performing Asset (NPA):

Asset classification and provisionin (cont)

- A loan or advance becomes an NPA when interest or principal remains overdue for more than 90 days.

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Asset classification and provisionin (cont)

- For instalment-based loans, an instalment overdue for more than 90 days generally results in NPA classification.

Asset classification and provisionin (cont)

- Interest on NPAs is recognised only on actual realisation, not on an accrual basis.

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Asset classification and provisionin (cont)

- Three asset categories:

Asset classification and provisionin (cont)

- Substandard Asset: Remains NPA for a period of up to 12 months.

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Asset classification and provisionin (cont)

- Doubtful Asset: Remains in the substandard category for 12 months.

Asset classification and provisionin (cont)

- Loss Asset: Identified as uncollectible by the NBFC, its auditors or RBI, but not yet fully written off.

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Asset classification and provisionin (cont)

- NPA classification by layer:

Asset classification and provisionin (cont)

- Base Layer (BL): The earlier 180-day norm was progressively reduced:

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Asset classification and provisionin (cont)

- More than 150 days overdue by 31 March 2024.

Asset classification and provisionin (cont)

- More than 120 days overdue by 31 March 2025.

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Asset classification and provisionin (cont)

- More than 90 days overdue by 31 March 2026.

Asset classification and provisionin (cont)

- Therefore, the applicable BL norm is now more than 90 days.

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Asset classification and provisionin (cont)

- Middle Layer (ML) and Upper Layer (UL): More than 90 days overdue.

Asset classification and provisionin (cont)

- Applies to overdue interest, term-loan instalments, demand/call loans, bills, lease rentals and hire-purchase instalments.

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Asset classification and provisionin (cont)

- Important: The earlier 180-day norm is historical, not the current BL requirement.

Asset classification and provisionin (cont)

- Substandard and Doubtful classification:

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Asset classification and provisionin (cont)

- BL:

Asset classification and provisionin (cont)

- Substandard: NPA for up to 18 months.

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Asset classification and provisionin (cont)

- Doubtful: Remains substandard for more than 18 months.

Asset classification and provisionin (cont)

- ML and UL:

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Asset classification and provisionin (cont)

- Substandard: NPA for up to 12 months.

Asset classification and provisionin (cont)

- Doubtful: Remains substandard for more than 12 months.

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Asset classification and provisionin (cont)

- Loss Asset: Identified as uncollectible or adversely affected by serious erosion in security value, fraud or non-availability of security.

Asset classification and provisionin (cont)

- Special Mention Accounts (SMA):

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Asset classification and provisionin (cont)

- SMA-0: Overdue up to 30 days.

Asset classification and provisionin (cont)

- SMA-1: Overdue more than 30 days and up to 60 days.

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Asset classification and provisionin (cont)

- SMA-2: Overdue more than 60 days and up to 90 days.

Asset classification and provisionin (cont)

- NPA: More than 90 days overdue.

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Asset classification and provisionin (cont)

- Classification is carried out through the day-end process on the relevant calendar date.

Asset classification and provisionin (cont)

- Borrower-wise classification:

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Asset classification and provisionin (cont)

- Asset classification is borrower-wise, not facility-wise.

Asset classification and provisionin (cont)

- If one credit facility becomes NPA, all credit facilities of that borrower with the NBFC are classified as NPA.

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Asset classification and provisionin (cont)

- Upgradation to standard requires payment of the entire arrears of principal and interest across all credit facilities.

Asset classification and provisionin (cont)

- Merely rescheduling or restructuring a loan does not automatically upgrade it.

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Asset classification and provisionin (cont)

Provisioning requirements

Asset classification and provisionin (cont)

- Standard assets — general provisions:

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Asset classification and provisionin (cont)

- BL: 0.25% of outstanding.

Asset classification and provisionin (cont)

- ML: 0.40% of outstanding.

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Asset classification and provisionin (cont)

- UL:

Asset classification and provisionin (cont)

- Individual housing loans and loans to Small and Micro Enterprises: 0.25%.

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Asset classification and provisionin (cont)

- Housing loans at teaser rates: 2%, reduced to 0.40% after one year from rate reset, if still standard.

Asset classification and provisionin (cont)

- Commercial Real Estate–Residential Housing (CRE-RH): 0.75%.

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Asset classification and provisionin (cont)

- Commercial Real Estate (CRE), excluding CRE-RH: 1%.

Asset classification and provisionin (cont)

- All other loans, including loans to Medium Enterprises: 0.40%.

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Asset classification and provisionin (cont)

- Standard-asset provisions are shown separately as contingent provisions and are not netted from gross advances.

Asset classification and provisionin (cont)

- Substandard assets:

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Asset classification and provisionin (cont)

- General provision: 10% of total outstanding.

Asset classification and provisionin (cont)

- Doubtful assets — BL:

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Asset classification and provisionin (cont)

- Unsecured portion: 100% provision.

Asset classification and provisionin (cont)

- Secured portion, based on time spent in doubtful category:

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Asset classification and provisionin (cont)

- Up to 1 year: 20%.

Asset classification and provisionin (cont)

- 1–3 years: 30%.

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Asset classification and provisionin (cont)

- More than 3 years: 50%.

Asset classification and provisionin (cont)

- Loss assets:

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Asset classification and provisionin (cont)

- Entire asset should be written off.

Asset classification and provisionin (cont)

- If retained in the books, 100% provision is required.

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Asset classification and provisionin (cont)

- Hire-purchase and leased assets — additional provision based on overdue period:

Asset classification and provisionin (cont)

- Up to 12 months: Nil.

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Asset classification and provisionin (cont)

- More than 12–24 months: 10% of Net Book Value (NBV).

Asset classification and provisionin (cont)

- More than 24–36 months: 40%.

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Asset classification and provisionin (cont)

- More than 36–48 months: 70%.

Asset classification and provisionin (cont)

- More than 48 months: 100%.

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Asset classification and provisionin (cont)

- Entire NBV must be provided for once 12 months have elapsed after the due date of the last instalment.

Asset classification and provisionin (cont)

Income recognition and special rules

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Asset classification and provisionin (cont)

- Interest, discount, lease rental and other income on an NPA are recognised only when actually realised.

Asset classification and provisionin (cont)

- Unrealised income previously recognised must be reversed when the asset becomes NPA.

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Asset classification and provisionin (cont)

- For standard loans with a permitted interest moratorium, income may be recognised on accrual basis.

Asset classification and provisionin (cont)

- NBFCs following Indian Accounting Standards (Ind AS) must maintain the Ind AS 109 Expected Credit Loss (ECL) allowance and the RBI prudential provisioning floor. Any shortfall must be transferred to a separate Impairment Reserve, which is not eligible as regulatory capital.

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Asset classification and provisionin (cont)

- Microfinance loans: Excluded from the general NPA classification provisions; NBFC-MFIs follow their specific provisioning framework. However, the ML standard-asset provision of 0.40% also applies to microfinance loans.

Asset classification and provisionin (cont)

- Project finance provisions for new projects (from 1 October 2025):

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Asset classification and provisionin (cont)

- Construction phase: CRE 1.25%; CRE-RH 1%; all other projects 1%.

Asset classification and provisionin (cont)

- Operational phase after commencement of repayment: CRE 1%; CRE-RH 0.75%; all other projects 0.40%.

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Asset classification and provisionin (cont)

- Projects achieving financial closure by 1 October 2025 generally continue under earlier provisioning rules unless a fresh credit event or material contractual change occurs.

Asset classification and provisionin (cont)

MCQ traps

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Asset classification and provisionin (cont)

- BL NPA norm is now 90 days, not 180 days.

Asset classification and provisionin (cont)

- BL substandard period = 18 months; ML/UL = 12 months.

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Asset classification and provisionin (cont)

- NPA classification is borrower-wise, not facility-wise.

Asset classification and provisionin (cont)

- Standard-asset provisioning: BL 0.25%, ML 0.40%; UL has differentiated rates.

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Asset classification and provisionin (cont)

- Substandard provision = 10%; loss asset = 100%.

Asset classification and provisionin (cont)

- Doubtful unsecured portion = 100%.

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Asset classification and provisionin (cont)

- NPA income recognition = cash basis, not accrual basis.

Asset classification and provisionin (cont)

- SMA classification and NPA classification are based on the day-end process.

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Liquidity requirements

Asset Liability Management (ALM):

Liquidity requirements (cont)

- Framework for managing mismatches between assets and liabilities, ensuring the NBFC can meet obligations when due.

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Liquidity requirements (cont)

- Covers liquidity risk, interest-rate risk, foreign-exchange risk and off-balance-sheet exposures.

Liquidity requirements (cont)

- Applicability: RBI ALM framework generally applies to NBFCs with assets ₹100 crore or above; smaller NBFCs are encouraged to adopt it voluntarily.

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Liquidity requirements (cont)

- Board has overall responsibility and must establish an Asset Liability Management Committee (ALCO) headed by the CEO, Managing Director or Executive Director.

Liquidity requirements (cont)

- Applies to relevant NBFCs across layers, including NBFC-ICCs, NBFC-MFIs, NBFC-Factors, IFCs, IDF-NBFCs, HFCs and deposit-t-aking NBFCs.

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Liquidity requirements (cont)

- CICs are covered by the ALM framework except the Liquidity Coverage Ratio (LCR) chapter.

Liquidity requirements (cont)

- Exempt categories include P2P, AA, SPD, MGC, NOFHC and Type I NBFCs.

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Liquidity requirements (cont)

- Liquidity mismatch management:

Liquidity requirements (cont)

- NBFCs prepare a Structural Liquidity Statement (SLS) using maturity buckets to compare expected cash inflows and outflows.

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Liquidity requirements (cont)

- Negative mismatch = outflows exceed inflows; positive mismatch = inflows exceed outflows.

Liquidity requirements (cont)

- Maximum permitted cumulative negative mismatches:

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Liquidity requirements (cont)

- 1–7 days: 10% of cumulative cash outflows.

Liquidity requirements (cont)

- 8–14 days: 10%.

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Liquidity requirements (cont)

- 15–30/31 days: 20%.

Liquidity requirements (cont)

- For other maturity buckets up to one year, internal prudential limits must be approved by the Board.

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Liquidity requirements (cont)

- Standard maturity buckets:

Liquidity requirements (cont)

- 1–7 days; 8–14 days; 15–30/31 days.

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Liquidity requirements (cont)

- Over 1–2 months; over 2–3 months.

Liquidity requirements (cont)

- Over 3–6 months; over 6 months–1 year.

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Liquidity requirements (cont)

- Over 1–3 years; over 3–5 years; over 5 years.

Liquidity requirements (cont)

- Liquidity Coverage Ratio (LCR):

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Liquidity requirements (cont)

- Measures the ability to withstand a severe liquidity stress scenario over 30 calendar days.

Liquidity requirements (cont)

- Applicable to:

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Liquidity requirements (cont)

- All deposit-taking NBFCs, irrespective of asset size.

Liquidity requirements (cont)

- Non-deposit-taking NBFCs with asset size ₹5,000 crore or above.

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Liquidity requirements (cont)

- Minimum LCR: 100%, maintained on an ongoing basis.

Liquidity requirements (cont)

- Formula:

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Liquidity requirements (cont)

LCR = (Stock of High Quality Liquid Assets / Total Net Cash Outflows over next 30 calendar days) × 100

Liquidity requirements (cont)

- High Quality Liquid Assets (HQLA): Unencumbered assets that can be readily converted into cash with little or no loss of value.

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Liquidity requirements (cont)

- HQLA examples and minimum haircuts:

Liquidity requirements (cont)

- Cash, demand deposits with Scheduled Commercial Banks and Government Securities: 0% haircut.

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Liquidity requirements (cont)

- Eligible sovereign/PSE securities with 20% risk weight, AA- or above corporate bonds and eligible Commercial Papers: 15% haircut.

Liquidity requirements (cont)

- Eligible securities with higher sovereign risk weights, Nifty/Sensex equity shares and qualifying A+ to BBB- corporate debt: 50% haircut.

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Liquidity requirements (cont)

- During financial stress, NBFCs may use HQLA and allow LCR to fall below 100%, but must immediately report this to RBI's Department of Supervision (DoS), with reasons and corrective measures.

Liquidity requirements (cont)

- Liquidity risk management requirements:

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Liquidity requirements (cont)

- Board-approved liquidity risk management policy, risk tolerance and prudential limits.

Liquidity requirements (cont)

- Diversification of funding sources and maturity profiles; avoid excessive dependence on one lender, instrument or market.

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Liquidity requirements (cont)

- Regular liquidity stress testing under entity-specific and market-wide scenarios.

Liquidity requirements (cont)

- Contingency Funding Plan (CFP): Identifies alternative funding sources and actions during severe liquidity disruptions.

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Liquidity requirements (cont)

- Monitor encumbered and unencumbered assets and collateral availability.

Liquidity requirements (cont)

- Manage intra-group liquidity transfers, contingent liabilities and off-balance-sheet exposures.

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Liquidity requirements (cont)

- Maintain a stock-based approach using internally defined liquidity ratios.

Liquidity requirements (cont)

- Regulatory reporting:

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Liquidity requirements (cont)

- DNBS04A – Short-Term Dynamic Liquidity (STDL) Return: Quarterly.

Liquidity requirements (cont)

- DNBS04B – Structural Liquidity and Interest Rate Sensitivity Return: Monthly.

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Liquidity requirements (cont)

- Public disclosure of specified liquidity-risk information: quarterly on the NBFC's website and in annual financial statements.

Liquidity requirements (cont)

- Interest-rate risk linkages:

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Liquidity requirements (cont)

- Traditional Gap Approach (TGA): Measures the immediate impact of interest-rate changes on earnings/Net Interest Income (NII).

Liquidity requirements (cont)

- Duration Gap Approach (DGA): Measures the impact on the economic value of assets, liabilities and net worth.

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Liquidity requirements (cont)

- Positive gap: Rate-sensitive assets (RSA) exceed rate-sensitive liabilities (RSL).

Liquidity requirements (cont)

- Negative gap: Rate-sensitive liabilities exceed rate-sensitive assets.

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Liquidity requirements (cont)

MCQ traps

Liquidity requirements (cont)

- ALM framework threshold: ₹100 crore; LCR threshold: ₹5,000 crore for non-deposit-taking NBFCs.

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Liquidity requirements (cont)

- Deposit-taking NBFCs must maintain LCR irrespective of asset size.

Liquidity requirements (cont)

- LCR = 100%, not 30%; 30 days is the stress horizon.

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Liquidity requirements (cont)

- First three liquidity mismatch limits: 10%, 10%, 20%.

Liquidity requirements (cont)

- Government Securities and cash: zero haircut; eligible AA- corporate bonds: minimum 15%; qualifying lower-rated assets/equities: minimum 50%.

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Liquidity requirements (cont)

- ALCO is headed by CEO/MD/ED; Board retains overall responsibility.

Liquidity requirements (cont)

- LCR can fall below 100% during genuine financial stress, subject to immediate RBI reporting.

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Concentration Norms

Concentration Norms

Concentration Norms (cont)

- Meaning: Regulatory limits on the amount of credit and investment exposure an NBFC can have towards a single borrower, a group of connected borrowers or particular sectors.

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Concentration Norms (cont)

- Objective: Prevent excessive dependence on a single borrower, corporate group, industry or market segment.

Concentration Norms (cont)

- Exposure includes: Both credit exposure (loans and advances) and investment exposure (shares, debentures, bonds etc.).

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Concentration Norms (cont)

- Applicable framework: RBI (Non-Banking Financial Companies – Concentration Risk Management) Directions, 2025, updated 25 August 2026.

Concentration Norms (cont)

Base Layer (BL)

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Concentration Norms (cont)

- No uniform numerical single-borrower or group exposure ceiling under the general BL framework.

Concentration Norms (cont)

- NBFC must have a comprehensive Board-approved concentration risk policy covering:

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Concentration Norms (cont)

- Single borrower/party and single group exposure limits.

Concentration Norms (cont)

- Consumer-credit sub-segments, particularly unsecured consumer credit.

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Concentration Norms (cont)

- Sectoral exposure limits.

Concentration Norms (cont)

- Risk Management Committee must monitor adherence to limits.

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Concentration Norms (cont)

- IPO financing: Maximum ₹1 crore per borrower for financing subscription to an Initial Public Offer (IPO); NBFC may prescribe a lower limit.

Concentration Norms (cont)

- Top-up loans against inherently depreciating movable assets (e.g. vehicles) are treated as unsecured loans for credit appraisal, prudential limits and exposure purposes.

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Concentration Norms (cont)

Middle Layer (ML)

Concentration Norms (cont)

General NBFCs (other than Infrastructure Finance Companies):

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Concentration Norms (cont)

- Single borrower/party: maximum 25% of Tier 1 capital.

Concentration Norms (cont)

- Single group of borrowers/parties: maximum 40% of Tier 1 capital.

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Concentration Norms (cont)

- Additional infrastructure exposure permitted:

Concentration Norms (cont)

- Single party: additional 5 percentage points → maximum 30%.

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Concentration Norms (cont)

- Single group: additional 10 percentage points → maximum 50%.

Concentration Norms (cont)

Infrastructure Finance Companies (IFCs):

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Concentration Norms (cont)

- Single party: maximum 30% of Tier 1 capital.

Concentration Norms (cont)

- Single group: maximum 50% of Tier 1 capital.

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Concentration Norms (cont)

- These are the standard IFC limits; do not apply the general NBFC limits to IFCs.

Concentration Norms (cont)

Important exemptions and conditions:

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Concentration Norms (cont)

- Exposure norms do not apply to NBFCs that neither access public funds in India (directly or indirectly) nor issue guarantees.

Concentration Norms (cont)

- Certain exposures to subsidiaries/group companies are exempt where the relevant investment has already been deducted from Owned Funds for calculating Net Owned Fund (NOF).

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Concentration Norms (cont)

- Eligible Government of India exposures and fully Government-guaranteed exposures receive specified exemptions.

Concentration Norms (cont)

- Tier 1 capital is calculated using the latest available financial statements (audited or subject to limited review).

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Concentration Norms (cont)

Upper Layer (UL) — Large Exposure Framework (LEF)

Concentration Norms (cont)

- Applies to NBFCs in the Upper Layer at both:

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Concentration Norms (cont)

- Solo level (individual NBFC).

Concentration Norms (cont)

- Consolidated level (NBFC group).

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Concentration Norms (cont)

- Covers both on-balance-sheet and off-balance-sheet exposures.

Concentration Norms (cont)

- Exposure is measured against the eligible capital base, not simply Tier 1 capital.

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Concentration Norms (cont)

Single counterparty:

Concentration Norms (cont)

- Standard limit: 20% of eligible capital base.

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Concentration Norms (cont)

- Board may permit an additional 5 percentage points for exceptional reasons, subject to a Board-approved policy and written justification.

Concentration Norms (cont)

- Infrastructure lending/investment may qualify for additional exposure.

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Concentration Norms (cont)

- General NBFC single-counterparty ceiling: 25%.

Concentration Norms (cont)

- IFC single-counterparty ceiling: 30%.

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Concentration Norms (cont)

Group of connected counterparties:

Concentration Norms (cont)

- General limit: 25% of eligible capital base.

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Concentration Norms (cont)

- Additional 10 percentage points permitted for infrastructure lending/investment.

Concentration Norms (cont)

- IFC limit: 45% of eligible capital base.

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Concentration Norms (cont)

Connected counterparties: Entities may be treated as a group when they are connected through:

Concentration Norms (cont)

- Control: one entity controls another.

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Concentration Norms (cont)

- Economic interdependence: financial difficulty or default of one is likely to affect the other.

Concentration Norms (cont)

Board responsibilities:

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Concentration Norms (cont)

- Define how connected counterparties are identified.

Concentration Norms (cont)

- Establish internal limits for sensitive sectors and other important sectors.

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Concentration Norms (cont)

- Set limits for exposure to the NBFC sector.

Concentration Norms (cont)

- Specify circumstances in which exposures above the standard single-counterparty threshold may be considered.

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Concentration Norms (cont)

Sensitive Sector Exposure (SSE)

Concentration Norms (cont)

- Sensitive sectors:

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Concentration Norms (cont)

- Capital Market Exposure (CME).

Concentration Norms (cont)

- Commercial Real Estate (CRE).

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Concentration Norms (cont)

- ML and UL NBFCs must have Board-approved internal limits for these exposures.

Concentration Norms (cont)

- ML: Internal limits for capital-market and commercial-real-estate exposure must be separately prescribed.

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Concentration Norms (cont)

- UL: Board must prescribe internal SSE limits and appropriate sub-limits.

Concentration Norms (cont)

- These are internal prudential limits; do not confuse them with the single-borrower/group exposure percentages.

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Concentration Norms (cont)

Quick numerical retention

Concentration Norms (cont)

Category Single party Single group

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Concentration Norms (cont)

ML — General NBFC 25% 40%

Concentration Norms (cont)

ML — General NBFC with infrastructure exposure 30% 50%

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Concentration Norms (cont)

ML — IFC 30% 50%

Concentration Norms (cont)

UL — General NBFC 20%, extendable to 25% 25%, extendable to 35% for infrastructure

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Concentration Norms (cont)

UL — IFC 25%, extendable to 30% 45%

Concentration Norms (cont)

- IPO financing: ₹1 crore per borrower.

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Concentration Norms (cont)

- BL: Internal Board-approved exposure limits; no general fixed numerical single/group ceiling.

Concentration Norms (cont)

- UL: Large Exposure Framework applies at solo and consolidated levels.

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Concentration Norms (cont)

- MCQ trap: ML limits are based on Tier 1 capital; UL limits are based on eligible capital base.

Corporate Governance

Applicability under Scale-Based Regulation (SBR):

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Corporate Governance (cont)

- Base Layer (BL): Chapter III governance requirements.

Corporate Governance (cont)

- Middle Layer (ML): Chapters II, III and IV.

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Corporate Governance (cont)

- Upper Layer (UL): Chapters II, III, IV and V.

Corporate Governance (cont)

- Government-owned NBFCs are exempt from the specified compensation-policy requirements.

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Corporate Governance (cont)

Board composition and experience:

Corporate Governance (cont)

- At least one director must have relevant experience of working in a bank or NBFC.

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Corporate Governance (cont)

- ML and UL: Board-approved policy for assessing directors' fit and proper status at appointment and on a continuing basis.

Corporate Governance (cont)

- Criteria include qualifications, technical expertise, track record and integrity.

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Corporate Governance (cont)

- Directors must submit annual declarations as on 31 March.

Corporate Governance (cont)

- Quarterly statement of changes in directors and Managing Director/Chief Executive Officer (MD/CEO) certification to RBI within 15 days of quarter-end.

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Corporate Governance (cont)

- March-quarter statement must be auditor-certified.

Corporate Governance (cont)

Risk Management Committee (RMC):

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Corporate Governance (cont)

- Mandatory for all NBFCs, at Board or executive level.

Corporate Governance (cont)

- Evaluates overall risks, including liquidity risk.

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Corporate Governance (cont)

- Reports to the Board.

Corporate Governance (cont)

Change in management:

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Corporate Governance (cont)

- Prior written RBI approval required if a management change results in a change of more than 30% of directors, excluding independent directors.

Corporate Governance (cont)

- Re-election of directors retiring by rotation is exempt from this prior approval requirement.

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Corporate Governance (cont)

- Other director/management changes must still be reported to RBI (National Housing Bank (NHB) for Housing Finance Companies).

Corporate Governance (cont)

Board committees — ML and UL

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Corporate Governance (cont)

Audit Committee:

Corporate Governance (cont)

- Minimum 3 Board members.

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Corporate Governance (cont)

- Same powers, functions and duties as Section 177 of Companies Act, 2013.

Corporate Governance (cont)

- Oversees financial reporting, internal controls and audit.

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Corporate Governance (cont)

- Ensures Information System Audit (IS Audit) as prescribed under RBI outsourcing directions.

Corporate Governance (cont)

Nomination and Remuneration Committee (NRC):

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Corporate Governance (cont)

- Constitution and functions as per Section 178 of Companies Act, 2013.

Corporate Governance (cont)

- Oversees director appointments, fit-and-proper assessments and compensation policy.

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Corporate Governance (cont)

- Government-owned NBFCs may constitute a Nomination Committee instead.

Corporate Governance (cont)

Key managerial and risk-management positions

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Corporate Governance (cont)

Chief Risk Officer (CRO):

Corporate Governance (cont)

- Mandatory for NBFCs with asset size above ₹5,000 crore.

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Corporate Governance (cont)

- Must function independently and report directly to MD/CEO or Board Risk Management Committee.

Corporate Governance (cont)

- Cannot have business targets or report to business verticals; no dual responsibilities.

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Corporate Governance (cont)

- Fixed tenure; premature removal/transfer requires Board approval and RBI reporting.

Corporate Governance (cont)

- Vets all retail and wholesale credit products from a risk perspective.

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Corporate Governance (cont)

Chief Compliance Officer (CCO):

Corporate Governance (cont)

- ML and UL must appoint a sufficiently senior CCO.

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Corporate Governance (cont)

- Independent compliance function and Board-approved policy defining the CCO's role and responsibilities.

Corporate Governance (cont)

Key Managerial Personnel (KMP):

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Corporate Governance (cont)

- Cannot hold office, including directorship, in another ML or UL NBFC.

Corporate Governance (cont)

- Exception: directorship in a subsidiary.

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Corporate Governance (cont)

- May hold directorship in BL NBFCs.

Corporate Governance (cont)

-Independent Directors:

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Corporate Governance (cont)

- An independent director cannot serve on the Boards of more than 3 ML/UL NBFCs simultaneously, subject to Companies Act limits.

Corporate Governance (cont)

- BL directorships are excluded from this RBI restriction.

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Corporate Governance (cont)

- Conflict of interest must be avoided.

Corporate Governance (cont)

Compensation governance — ML and UL

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Corporate Governance (cont)

- Board-approved compensation policy must address excessive risk-taking due to misaligned incentives.

Corporate Governance (cont)

- Must cover:

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Corporate Governance (cont)

- Fixed and variable pay.

Corporate Governance (cont)

- Risk alignment of remuneration.

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Corporate Governance (cont)

- Malus: Reduction/cancellation of deferred, unvested remuneration.

Corporate Governance (cont)

- Clawback: Recovery of remuneration already paid or vested, under specified circumstances.

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Corporate Governance (cont)

- Variable pay should reflect individual, business-unit and company-wide performance and may be reduced to zero.

Corporate Governance (cont)

- Deferral period is decided by the Board, considering the risk horizon.

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Corporate Governance (cont)

- Financial control, risk management, compliance and internal audit personnel should be compensated independently of the business units they oversee.

Corporate Governance (cont)

- Guaranteed bonuses are generally prohibited; joining/sign-on bonuses for new hires are permitted and are neither fixed nor variable pay.

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Corporate Governance (cont)

Additional Upper Layer requirements

Corporate Governance (cont)

- Board must have an appropriate mix of educational qualifications, experience and business-specific expertise.

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Corporate Governance (cont)

- Removal/resignation of an independent director before completion of normal tenure must be reported to supervisors.

Corporate Governance (cont)

- UL NBFCs must be mandatorily listed within 3 years of identification by RBI.

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Corporate Governance (cont)

- Listed-company-equivalent disclosure requirements apply even before actual listing.

Corporate Governance (cont)

- Exception: NBFC-UL fully owned and controlled by Government.

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Corporate Governance (cont)

Other governance requirements

Corporate Governance (cont)

- Whistle-blower mechanism: Mandatory for directors and employees to report genuine concerns.

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Corporate Governance (cont)

- Subsidiary governance: Parent NBFC's Board must ensure good corporate governance practices in subsidiaries.

Corporate Governance (cont)

- Internal Corporate Governance Guidelines: ML and UL NBFCs must frame Board-approved guidelines and publish them on their websites, if available.

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Corporate Governance (cont)

- Board must periodically review risk-management progress and compliance with governance standards.

Corporate Governance (cont)

MCQ traps

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Corporate Governance (cont)

- One director with bank/NBFC experience and RMC: all layers.

Corporate Governance (cont)

- Audit Committee and NRC: ML and UL.

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Corporate Governance (cont)

- CRO threshold: above ₹5,000 crore, not ₹5,000 crore and above.

Corporate Governance (cont)

- Prior RBI approval: change of more than 30% of directors, excluding independent directors.

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Corporate Governance (cont)

- Independent director limit: 3 ML/UL NBFC Boards.

Corporate Governance (cont)

- Quarterly director-change statement: within 15 days of quarter-end.

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Corporate Governance (cont)

- UL mandatory listing: within 3 years.

Corporate Governance (cont)

- Malus = cancellation/reduction of deferred pay; clawback = recovery of paid/vested pay.

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Public Deposits and Restrictions

- Public Deposit: Deposit received by an NBFC from the public, subject to the exclusions specified under RBI regulations.

Public Deposits and Restrictions (cont)

- Deposit-taking NBFC (NBFC-D): An NBFC specifically authorised by RBI to accept or hold public deposits.

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Public Deposits and Restrictions (cont)

- Important: RBI registration alone does not authorise an NBFC to accept public deposits. A specific deposit-taking authorisation is required.

Public Deposits and Restrictions (cont)

- Only existing authorised deposit-taking NBFCs can accept public deposits; RBI has not generally issued fresh deposit-taking registrations to NBFCs since 1997.

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Public Deposits and Restrictions (cont)

- All deposit-taking NBFCs fall under the Middle Layer or above under Scale-Based Regulation (SBR).

Public Deposits and Restrictions (cont)

Eligibility and limits

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Public Deposits and Restrictions (cont)

- Must possess:

Public Deposits and Restrictions (cont)

- RBI Certificate of Registration (CoR) with specific permission to accept public deposits.

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Public Deposits and Restrictions (cont)

- Minimum investment-grade credit rating of BBB− from a Securities and Exchange Board of India (SEBI)-registered credit rating agency.

Public Deposits and Restrictions (cont)

- Maximum public deposits: 1.5 times Net Owned Fund (NOF).

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Public Deposits and Restrictions (cont)

- Maximum interest rate: 12.5% per annum.

Public Deposits and Restrictions (cont)

- Minimum deposit maturity: 12 months.

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Public Deposits and Restrictions (cont)

- Maximum deposit maturity: 60 months.

Public Deposits and Restrictions (cont)

- Cannot accept deposits repayable on demand.

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Public Deposits and Restrictions (cont)

- Interest cannot be paid or compounded at intervals shorter than monthly rests.

Public Deposits and Restrictions (cont)

- Deposits are unsecured; no Deposit Insurance and Credit Guarantee Corporation (DICGC) protection is available.

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Public Deposits and Restrictions (cont)

Liquid asset requirement

Public Deposits and Restrictions (cont)

- Every deposit-taking NBFC must maintain unencumbered liquid assets equal to at least 15% of outstanding public deposits.

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Public Deposits and Restrictions (cont)

- Valuation is based on the public deposits outstanding on the last working day of the second preceding quarter.

Public Deposits and Restrictions (cont)

- Minimum 10% must be maintained in unencumbered approved securities.

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Public Deposits and Restrictions (cont)

- Remaining 5% or more may be maintained in:

Public Deposits and Restrictions (cont)

- Term deposits with Scheduled Commercial Banks, Small Industries Development Bank of India (SIDBI) or National Bank for Agriculture and Rural Development (NABARD).

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Public Deposits and Restrictions (cont)

- Bonds issued by SIDBI or NABARD.

Public Deposits and Restrictions (cont)

- Total eligible liquid assets must always be at least 15%.

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Public Deposits and Restrictions (cont)

- Securities must be valued at no more than their current market price.

Public Deposits and Restrictions (cont)

Reserve Bank of India

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Public Deposits and Restrictions (cont)

Restrictions and depositor protection

Public Deposits and Restrictions (cont)

- Credit-rating downgrade below BBB−:

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Public Deposits and Restrictions (cont)

- Immediately stop accepting fresh deposits and renewing existing deposits.

Public Deposits and Restrictions (cont)

- Existing deposits run off until maturity.

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Public Deposits and Restrictions (cont)

- Report the position to RBI within 15 working days.

Public Deposits and Restrictions (cont)

- Brokerage limits:

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Public Deposits and Restrictions (cont)

- Brokerage/commission/incentive: maximum 2% of deposits collected.

Public Deposits and Restrictions (cont)

- Reimbursement of expenses against bills/vouchers: maximum 0.5%.

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Public Deposits and Restrictions (cont)

- Maturity notification: Inform depositors at least 14 days before maturity.

Public Deposits and Restrictions (cont)

- Premature withdrawal:

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Public Deposits and Restrictions (cont)

- Lock-in period: 3 months from deposit acceptance.

Public Deposits and Restrictions (cont)

- After 3 months, premature repayment is at the NBFC's discretion, subject to the deposit terms.

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Public Deposits and Restrictions (cont)

- In the event of depositor's death, premature repayment is permitted even during the lock-in period to the eligible survivor, nominee or legal heirs.

Public Deposits and Restrictions (cont)

- Loan against deposit:

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Public Deposits and Restrictions (cont)

- After 3 months, an eligible non-problem NBFC may grant a loan up to 75% of the deposit amount.

Public Deposits and Restrictions (cont)

- Interest rate must be at least 2 percentage points above the interest rate payable on the deposit.

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Public Deposits and Restrictions (cont)

- Repayment default: An NBFC is treated as a problem NBFC if it fails to meet a lawful demand for repayment of matured public deposits within 5 working days, among other specified circumstances.

Public Deposits and Restrictions (cont)

What is NOT a public deposit?

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Public Deposits and Restrictions (cont)

Important exclusions under RBI's definition include:

Public Deposits and Restrictions (cont)

- Amounts received from Central/State Governments or guaranteed by them.

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Public Deposits and Restrictions (cont)

- Amounts received from other companies.

Public Deposits and Restrictions (cont)

- Share application money and advances towards securities, within Companies Act conditions and prescribed timelines.

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Public Deposits and Restrictions (cont)

- Amounts received from directors, subject to prescribed declarations.

Public Deposits and Restrictions (cont)

- Secured bonds/debentures, subject to the prescribed security and valuation conditions.

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Public Deposits and Restrictions (cont)

- Commercial Paper (CP).

Public Deposits and Restrictions (cont)

- Hybrid debt and subordinated debt with minimum maturity of 60 months, without an issuer recall option during that period.

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Public Deposits and Restrictions (cont)

- Perpetual Debt Instruments (PDIs) issued by eligible ML and above NBFCs, excluding deposit-taking NBFCs.

Public Deposits and Restrictions (cont)

Important restrictions on NBFCs generally

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Public Deposits and Restrictions (cont)

- Cannot accept demand deposits.

Public Deposits and Restrictions (cont)

- Cannot issue cheques drawn on themselves.

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Public Deposits and Restrictions (cont)

- Do not form part of the payment and settlement system.

Public Deposits and Restrictions (cont)

- Cannot claim DICGC deposit insurance for their depositors.

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Public Deposits and Restrictions (cont)

- RBI registration or supervision does not mean RBI guarantees repayment or the financial soundness of an NBFC.

Public Deposits and Restrictions (cont)

- Unincorporated bodies (individuals, partnership firms and associations of individuals) cannot accept public deposits as their principal business.

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Public Deposits and Restrictions (cont)

MCQ traps

Public Deposits and Restrictions (cont)

- Deposit-taking permission is separate from ordinary NBFC registration.

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Public Deposits and Restrictions (cont)

- Maximum deposits = 1.5 × NOF.

Public Deposits and Restrictions (cont)

- Minimum credit rating = BBB−.

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Public Deposits and Restrictions (cont)

- Interest ceiling = 12.5% p.a.

Public Deposits and Restrictions (cont)

- Deposit maturity = 12–60 months.

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Public Deposits and Restrictions (cont)

- Liquid assets = 15% (minimum 10% approved securities).

Public Deposits and Restrictions (cont)

- Lock-in = 3 months; loan against deposit = maximum 75% after lock-in.

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Public Deposits and Restrictions (cont)

- Brokerage = 2%; expense reimbursement = 0.5%.

Public Deposits and Restrictions (cont)

- Maturity notice = 14 days.

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Public Deposits and Restrictions (cont)

- Rating downgrade below BBB− → stop fresh deposits and renewals.

Public Deposits and Restrictions (cont)

- NBFC deposits are unsecured and not covered by DICGC insurance.

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Fair Practices Code (FPC)

- Meaning: RBI-prescribed code ensuring fair, transparent and non-discriminatory treatment of borrowers by NBFCs.

Fair Practices Code (FPC) (cont)

- Applicability: NBFCs having customer interface.

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Fair Practices Code (FPC) (cont)

- Objective: Transparency in lending, fair interest-rate practices, responsible recovery and grievance redressal.

Fair Practices Code (FPC) (cont)

- Board responsibility:

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Fair Practices Code (FPC) (cont)

- Board-approved Fair Practices Code.

Fair Practices Code (FPC) (cont)

- Board-approved grievance redressal mechanism.

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Fair Practices Code (FPC) (cont)

- Policies for determining interest rates, processing fees, penal charges and other charges.

Fair Practices Code (FPC) (cont)

- Periodic review of FPC compliance and grievance redressal.

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Fair Practices Code (FPC) (cont)

Loan application and sanction

Fair Practices Code (FPC) (cont)

- All borrower communications should be in the vernacular language or a language understood by the borrower.

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Fair Practices Code (FPC) (cont)

- Loan application forms must disclose:

Fair Practices Code (FPC) (cont)

- Necessary information affecting the borrower's interest.

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Fair Practices Code (FPC) (cont)

- Documents required.

Fair Practices Code (FPC) (cont)

- Fees and charges.

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Fair Practices Code (FPC) (cont)

- Information enabling comparison between lenders.

Fair Practices Code (FPC) (cont)

- Acknowledgement must be provided for every loan application; preferably specify the disposal timeline.

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Fair Practices Code (FPC) (cont)

- Loan sanction must be communicated through a sanction letter or otherwise, specifying:

Fair Practices Code (FPC) (cont)

- Loan amount.

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Fair Practices Code (FPC) (cont)

- Terms and conditions.

Fair Practices Code (FPC) (cont)

- Annualised interest rate and method of application.

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Fair Practices Code (FPC) (cont)

- Penal charges for delayed repayment (shown in bold in the loan agreement).

Fair Practices Code (FPC) (cont)

- Borrower's acceptance of loan terms must be retained on record.

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Fair Practices Code (FPC) (cont)

- Copy of the loan agreement and all enclosures must be provided at sanction/disbursement.

Fair Practices Code (FPC) (cont)

Interest rates and charges

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Fair Practices Code (FPC) (cont)

- Interest-rate policy must consider:

Fair Practices Code (FPC) (cont)

- Cost of funds.

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Fair Practices Code (FPC) (cont)

- Operating costs.

Fair Practices Code (FPC) (cont)

- Margin.

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Fair Practices Code (FPC) (cont)

- Risk premium and borrower risk profile.

Fair Practices Code (FPC) (cont)

- Interest rates and risk-gradation approach must be published on the NBFC's website or through other prescribed means.

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Fair Practices Code (FPC) (cont)

- Changes in interest rates, service charges and other terms must be communicated to borrowers.

Fair Practices Code (FPC) (cont)

- Changes must operate prospectively, not retrospectively.

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Fair Practices Code (FPC) (cont)

- Penal charges:

Fair Practices Code (FPC) (cont)

- Must be reasonable and Board-approved.

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Fair Practices Code (FPC) (cont)

- Must be disclosed upfront in the loan agreement and Key Facts Statement (KFS).

Fair Practices Code (FPC) (cont)

- Cannot be levied as penal interest.

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Fair Practices Code (FPC) (cont)

- Cannot be capitalised (no further interest on penal charges).

Fair Practices Code (FPC) (cont)

- Must not be used to increase the contracted rate of interest.

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Fair Practices Code (FPC) (cont)

- Must be applied consistently and without discrimination.

Fair Practices Code (FPC) (cont)

Key Facts Statement (KFS)

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Fair Practices Code (FPC) (cont)

- Applicable to all retail and Micro, Small and Medium Enterprise (MSME) term loans sanctioned by regulated entities, including NBFCs.

Fair Practices Code (FPC) (cont)

- KFS must disclose:

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Fair Practices Code (FPC) (cont)

- Annual Percentage Rate (APR).

Fair Practices Code (FPC) (cont)

- Loan amount and tenure.

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Fair Practices Code (FPC) (cont)

- Repayment schedule.

Fair Practices Code (FPC) (cont)

- Interest rate and method of calculation.

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Fair Practices Code (FPC) (cont)

- Processing fees and other charges.

Fair Practices Code (FPC) (cont)

- Penal charges and third-party charges.

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Fair Practices Code (FPC) (cont)

- APR includes interest and associated charges, including third-party charges recovered through the NBFC.

Fair Practices Code (FPC) (cont)

- Any fee or charge not mentioned in the KFS cannot be charged without the borrower's explicit consent.

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Fair Practices Code (FPC) (cont)

- KFS must form part of the loan agreement as a summary box.

Fair Practices Code (FPC) (cont)

- KFS validity for loans with tenure:

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Fair Practices Code (FPC) (cont)

- 7 days or more: Minimum validity of 3 working days.

Fair Practices Code (FPC) (cont)

- Less than 7 days: Minimum validity of 1 working day.

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Fair Practices Code (FPC) (cont)

Digital lending and recovery conduct

Fair Practices Code (FPC) (cont)

- NBFC remains responsible for acts of its Digital Lending Partners (DLPs), Direct Sales Agents (DSAs), Direct Marketing Agents (DMAs) and recovery agents.

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Fair Practices Code (FPC) (cont)

- Borrower must be informed about the recovery agency assigned.

Fair Practices Code (FPC) (cont)

- Recovery agents must not:

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Fair Practices Code (FPC) (cont)

- Use threatening or abusive language.

Fair Practices Code (FPC) (cont)

- Harass borrowers, relatives, friends or co-workers.

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Fair Practices Code (FPC) (cont)

- Publicly disclose borrowers' details.

Fair Practices Code (FPC) (cont)

- Make persistent recovery calls.

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Fair Practices Code (FPC) (cont)

- Call before 8:00 a.m. or after 7:00 p.m. under the revised recovery framework effective 1 January 2027.

Fair Practices Code (FPC) (cont)

- Recovery must be conducted with dignity and without intimidation.

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Fair Practices Code (FPC) (cont)

- Dedicated grievance-redressal mechanism for recovery-related complaints.

Fair Practices Code (FPC) (cont)

Pre-payment charges — important current rules

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Fair Practices Code (FPC) (cont)

- Floating-rate loans for non-business purposes to individuals: No pre-payment charges.

Fair Practices Code (FPC) (cont)

- For loans sanctioned or renewed on/after 1 January 2026:

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Fair Practices Code (FPC) (cont)

- Floating-rate business loans to individuals and Micro and Small Enterprises (MSEs): No pre-payment charges for Upper Layer NBFCs.

Fair Practices Code (FPC) (cont)

- Middle Layer NBFCs: No pre-payment charges where sanctioned amount/limit is up to ₹50 lakh.

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Fair Practices Code (FPC) (cont)

- Applies to full or partial pre-payment, irrespective of source of funds and without a minimum lock-in period.

Fair Practices Code (FPC) (cont)

- Dual/special-rate loans are assessed according to whether the loan is floating-rate at the time of pre-payment.

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Fair Practices Code (FPC) (cont)

Grievance redressal

Fair Practices Code (FPC) (cont)

- NBFC must appoint a Grievance Redressal Officer (GRO).

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Fair Practices Code (FPC) (cont)

- Borrower must be informed how to approach the GRO.

Fair Practices Code (FPC) (cont)

- Complaints unresolved within 30 days may be escalated to the RBI Ombudsman mechanism, where applicable.

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Fair Practices Code (FPC) (cont)

- NBFC must display the GRO's contact details and the procedure for complaint escalation.

Fair Practices Code (FPC) (cont)

MCQ traps

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Fair Practices Code (FPC) (cont)

- FPC must preferably be in the borrower's understood language.

Fair Practices Code (FPC) (cont)

- Penal charges ≠ penal interest; no capitalisation of penal charges.

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Fair Practices Code (FPC) (cont)

- KFS applies to retail and MSME term loans.

Fair Practices Code (FPC) (cont)

- APR includes applicable third-party charges.

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Fair Practices Code (FPC) (cont)

- Unmentioned KFS charges require explicit borrower consent.

Fair Practices Code (FPC) (cont)

- Changes to loan terms must be prospective.

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Fair Practices Code (FPC) (cont)

- Floating-rate non-business individual loans: no pre-payment charges.

Fair Practices Code (FPC) (cont)

- Revised recovery-agent calling window of 8 a.m.–7 p.m. takes effect 1 January 2027, not currently.

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Important RBI Directions and Circulars

A. Core prudential and regulatory directions

Important RBI Directions and Circulars (cont)

- Scale-Based Regulation (SBR) Directions, 2025: Four layers — Base, Middle, Upper and Top; determines regulatory requirements based on size, complexity and systemic risk.

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Important RBI Directions and Circulars (cont)

- Prudential Norms on Capital Adequacy Directions, 2025: Capital adequacy, Tier 1/Tier 2 capital, risk-weighted assets and leverage.

Important RBI Directions and Circulars (cont)

- Income Recognition, Asset Classification and Provisioning (IRACP) Directions, 2025: NPA recognition, asset classification, provisioning and income recognition.

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Important RBI Directions and Circulars (cont)

- Asset Liability Management (ALM) Directions, 2025: Liquidity mismatches, maturity buckets, Liquidity Coverage Ratio (LCR) and interest-rate risk.

Important RBI Directions and Circulars (cont)

- Concentration Risk Management Directions, 2025: Single borrower, group exposure and sensitive-sector limits.

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Important RBI Directions and Circulars (cont)

- Credit Risk Management Directions, 2025: Board-approved credit policies, borrower assessment, risk monitoring and credit controls.

Important RBI Directions and Circulars (cont)

- Resolution of Stressed Assets Directions, 2025: Early identification and resolution of stressed accounts, restructuring and lender coordination.

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Important RBI Directions and Circulars (cont)

- Treatment of Wilful Defaulters and Large Defaulters Directions, 2025: Identification, reporting, lender action and restrictions relating to wilful and large defaulters.

Important RBI Directions and Circulars (cont)

- Transfer and Distribution of Credit Risk Directions, 2025: Loan participation and transfer of credit risk through assignment, novation and related mechanisms.

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Important RBI Directions and Circulars (cont)

- Securitisation Transactions Directions, 2025: Pooling of financial assets, issuance of securities, minimum holding and minimum retention requirements.

Important RBI Directions and Circulars (cont)

- Classification, Valuation and Operation of Investment Portfolio Directions, 2025: Classification and valuation of investments, including accounting for depreciation and appreciation.

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Important RBI Directions and Circulars (cont)

B. Conduct, customer protection and operational directions

Important RBI Directions and Circulars (cont)

- Responsible Business Conduct Directions, 2025:

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Important RBI Directions and Circulars (cont)

- Fair Practices Code.

Important RBI Directions and Circulars (cont)

- Penal charges and interest-rate transparency.

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Important RBI Directions and Circulars (cont)

- Key Facts Statement (KFS).

Important RBI Directions and Circulars (cont)

- Recovery-agent conduct.

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Important RBI Directions and Circulars (cont)

- Pre-payment charges and customer grievance redressal.

Important RBI Directions and Circulars (cont)

- Digital Lending Directions, 2025:

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Important RBI Directions and Circulars (cont)

- Regulated Entity (RE) remains responsible for Lending Service Provider (LSP) conduct.

Important RBI Directions and Circulars (cont)

- Loan disbursement generally directly to the borrower's bank account; repayment directly to the RE.

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Important RBI Directions and Circulars (cont)

- No pass-through or pool account controlled by an LSP, subject to specified exceptions.

Important RBI Directions and Circulars (cont)

- Explicit borrower consent for data collection; need-based data collection.

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Important RBI Directions and Circulars (cont)

- No access to contact lists, call logs or telephony functions.

Important RBI Directions and Circulars (cont)

- Cooling-off period: at least 1 day for digital loans with tenor of 7 days or more; at least 1 day for loans with tenor below 7 days.

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Important RBI Directions and Circulars (cont)

- Digital Lending Apps (DLAs) must be reported to RBI through the prescribed process.

Important RBI Directions and Circulars (cont)

- Know Your Customer (KYC) Directions, 2025:

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Important RBI Directions and Circulars (cont)

- Customer Due Diligence (CDD), identity verification and beneficial ownership identification.

Important RBI Directions and Circulars (cont)

- Central Know Your Customer Records Registry (CKYCR).

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Important RBI Directions and Circulars (cont)

- Periodic KYC updation and risk categorisation.

Important RBI Directions and Circulars (cont)

- Prevention of money laundering and terrorist financing.

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Important RBI Directions and Circulars (cont)

- Managing Risks in Outsourcing Directions, 2025:

Important RBI Directions and Circulars (cont)

- NBFC remains responsible for outsourced activities.

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Important RBI Directions and Circulars (cont)

- Board-approved outsourcing policy.

Important RBI Directions and Circulars (cont)

- Due diligence and continuous monitoring of service providers.

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Important RBI Directions and Circulars (cont)

- Confidentiality, audit rights, business continuity and exit arrangements.

Important RBI Directions and Circulars (cont)

- Core management and decision-making responsibilities cannot simply be transferred to service providers.

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Important RBI Directions and Circulars (cont)

- Credit Information Reporting Directions, 2025:

Important RBI Directions and Circulars (cont)

- Reporting of borrower credit information to Credit Information Companies (CICs).

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Important RBI Directions and Circulars (cont)

- Accuracy, timely updating and correction of credit records.

Important RBI Directions and Circulars (cont)

- Borrower compensation for delayed correction of credit information: ₹100 per calendar day, subject to the applicable framework.

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Important RBI Directions and Circulars (cont)

- Credit Cards: Issuance and Conduct Directions, 2025: Credit-card issuance, consent, billing, charges, recovery and grievance redressal by eligible NBFCs.

Important RBI Directions and Circulars (cont)

C. Newer 2026 directions — important to recognise

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Important RBI Directions and Circulars (cont)

- Fraud Risk Management Directions, 2026: Board-approved fraud risk framework, early-warning signals, fraud classification, reporting, investigation and accountability.

Important RBI Directions and Circulars (cont)

- Cybersecurity, Technology: Risk, Resilience and Assurance Framework Directions, 2026:

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Important RBI Directions and Circulars (cont)

- Technology and cybersecurity governance.

Important RBI Directions and Circulars (cont)

- Information security and cybersecurity controls.

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Important RBI Directions and Circulars (cont)

- Information Systems (IS) audits.

Important RBI Directions and Circulars (cont)

- Business Continuity Planning (BCP) and Disaster Recovery (DR).

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Important RBI Directions and Circulars (cont)

- Requirements differentiated by NBFC layer and size.

Important RBI Directions and Circulars (cont)

- Compliance Function Directions, 2026: Independent compliance function, Chief Compliance Officer (CCO), compliance-risk identification and reporting.

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Important RBI Directions and Circulars (cont)

- Internal Audit Function Directions, 2026: Risk-based internal audit, independence of internal audit and Audit Committee oversight.

Important RBI Directions and Circulars (cont)

- Digital Payment Security Controls Directions, 2026: Security controls for digital payment channels, authentication, transaction monitoring and protection against payment fraud.

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Important RBI Directions and Circulars (cont)

- Climate Finance and Management of Climate Change Risks Directions, 2025: Climate-related financial risks, governance, risk assessment and disclosures.

Important RBI Directions and Circulars (cont)

D. Other important NBFC-specific directions

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Important RBI Directions and Circulars (cont)

- Acceptance of Public Deposits Directions, 2025: Deposit-taking eligibility, rating, deposit limits, maturity and liquid assets.

Important RBI Directions and Circulars (cont)

- Governance Directions, 2025: Board composition, committees, fit-and-proper criteria, compensation and risk governance.

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Important RBI Directions and Circulars (cont)

- Microfinance Institution Directions, 2025: Household income ceiling, repayment obligations and microfinance lending framework.

Important RBI Directions and Circulars (cont)

- Account Aggregator Directions, 2025: Consent-based financial information sharing.

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Important RBI Directions and Circulars (cont)

- Peer-to-Peer Lending Platform Directions, 2025: Lender/borrower exposure caps, escrow and platform restrictions.

Important RBI Directions and Circulars (cont)

- Housing Finance Companies Directions, 2025: HFC-specific registration, capital and housing-finance requirements.

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Important RBI Directions and Circulars (cont)

- Asset Reconstruction Companies Directions, 2025: Asset acquisition, securitisation, Security Receipts (SRs) and resolution of stressed assets.

Important RBI Directions and Circulars (cont)

- Standalone Primary Dealers Directions, 2025: Government securities market-making, underwriting and primary-market obligations.

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Important RBI Directions and Circulars (cont)

- Core Investment Companies Directions, 2025: Group investment and capital requirements.

Important RBI Directions and Circulars (cont)

- Mortgage Guarantee Companies Directions, 2025: Mortgage guarantee business, capital and exposure norms.

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Important RBI Directions and Circulars (cont)

E. Important RBI circulars and regulatory milestones

Important RBI Directions and Circulars (cont)

- 22 October 2021 — Scale-Based Regulation: Introduced the four-layer NBFC regulatory structure; implementation from 1 October 2022.

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Important RBI Directions and Circulars (cont)

- 10 November 2023 — Default Loss Guarantee (DLG): RBI framework for DLG arrangements in digital lending; prescribed conditions and a maximum DLG cover of 5% of the loan portfolio.

Important RBI Directions and Circulars (cont)

- 15 March 2024 — Key Facts Statement: Extended standardised KFS requirements to retail and MSME term loans by regulated entities.

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Important RBI Directions and Circulars (cont)

- 8 August 2024 — Credit Information Reporting: Compensation framework for delayed updation/rectification of credit information, including ₹100 per calendar day.

Important RBI Directions and Circulars (cont)

- 8 May 2025 — Pre-payment Charges: RBI revised directions on pre-payment charges for loans; applicability depends on lender category, borrower and loan purpose.

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Important RBI Directions and Circulars (cont)

- 28 November 2025 — Consolidation: RBI issued a comprehensive series of NBFC Master Directions, 2025, replacing many earlier standalone directions and circular-based frameworks.

Important RBI Directions and Circulars (cont)

- 31 July 2026 — Technology and cybersecurity: New NBFC cybersecurity and technology-risk framework issued, alongside new fraud--risk, internal-audit, compliance and digital-payment-security directions.

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Important RBI Directions and Circulars (cont)

MCQ traps / high-priority recall

Important RBI Directions and Circulars (cont)

- RBI's 2025 Master Directions consolidate many earlier NBFC regulatory instructions; remember the subject-wise titles.

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Important RBI Directions and Circulars (cont)

- DLG cap = 5% of the loan portfolio.

Important RBI Directions and Circulars (cont)

- Delayed credit-information correction compensation = ₹100 per calendar day.

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Important RBI Directions and Circulars (cont)

- Digital lending: RE remains responsible for LSP conduct.

Important RBI Directions and Circulars (cont)

- Outsourcing does not transfer regulatory accountability from the NBFC.

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Important RBI Directions and Circulars (cont)

- KYC = customer identification, beneficial ownership, ongoing due diligence and AML/CFT.

Important RBI Directions and Circulars (cont)

- Fraud, cybersecurity, compliance and internal audit each have dedicated 2026 directions.

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Important RBI Directions and Circulars (cont)

- RBI regulates NBFCs; NHB retains a developmental/refinance role in housing finance.

Important RBI Directions and Circulars (cont)

- Do not confuse an RBI Master Direction with an RBI circular: a Master Direction consolidates subject-specific regulatory instructions, while circulars may amend, clarify or supplement them.

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Finance Cheat Sheet

by keersri05 via cheatography.com/217923/cs/48575/

Financial Services

Leasing

Meaning

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Leasing (cont)

- Leasing is a financial arrangement in which the lessor (owner) gives the lessee (user) the right to use an asset for a specified period in return for periodic lease rentals.

Leasing (cont)

- Ownership generally remains with the lessor; the lessee obtains the right to use the asset.

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Leasing (cont)

- Common assets: machinery, vehicles, equipment, buildings and aircraft.

Leasing (cont)

Parties

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Leasing (cont)

- Lessor: Owns the asset and grants the right to use it.

Leasing (cont)

- Lessee: Uses the asset and pays lease rentals.

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Leasing (cont)

- Lease Rentals: Periodic payments made by the lessee.

Leasing (cont)

Types of Leasing

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Leasing (cont)

1. Finance Lease

Leasing (cont)

- Long-term arrangement in which substantially all risks and rewards incidental to ownership are transferred to the lessee.

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Leasing (cont)

- Generally non-cancellable during the primary lease period, subject to contractual terms.

Leasing (cont)

- Lease period usually covers a substantial part of the asset's useful economic life.

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Leasing (cont)

- Lessee effectively bears major costs such as maintenance, insurance and obsolescence, depending on the agreement.

Leasing (cont)

- Economically similar to financing the acquisition of an asset.

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Leasing (cont)

2. Operating Lease

Leasing (cont)

- Lease that does not transfer substantially all risks and rewards incidental to ownership.

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Leasing (cont)

- Generally shorter-term or more flexible.

Leasing (cont)

- Lessor typically retains significant ownership-related risks and responsibilities.

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Leasing (cont)

- Asset may be leased to multiple users over its useful life.

Leasing (cont)

Other Types

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Leasing (cont)

- Sale and Leaseback: Owner sells an asset to a lessor and leases it back to continue using it.

Leasing (cont)

- Direct Leasing: Lessor purchases an asset and leases it directly to the lessee.

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Leasing (cont)

- Leveraged Lease: Lessor finances a significant part of the asset purchase through borrowing.

Leasing (cont)

Advantages

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Leasing (cont)

- Allows asset use without immediate full purchase expenditure.

Leasing (cont)

- Preserves working capital and liquidity.

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Leasing (cont)

- Provides flexibility in asset acquisition and replacement.

Leasing (cont)

- Can provide access to expensive equipment and technology.

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Leasing (cont)

Risks / Limitations

Leasing (cont)

- Total lease rentals may exceed the cost of purchasing the asset.

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Leasing (cont)

- Lessee does not generally obtain ownership under an ordinary lease.

Leasing (cont)

- Long-term contractual payment obligations.

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Leasing (cont)

- Risk of technological obsolescence and asset-value changes, depending on lease type.

Leasing (cont)

Accounting and Regulatory Concepts

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Leasing (cont)

- Ind AS 116 – Leases: Prescribes lease accounting for entities applying Indian Accounting Standards.

Leasing (cont)

- For lessees, Ind AS 116 generally requires recognition of a Right--of-Use (ROU) Asset and a corresponding lease liability, subject to exemptions.

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Leasing (cont)

- Short-term lease exemption: lease term of 12 months or less, with no purchase option.

Leasing (cont)

- Low-value asset exemption is also available under prescribed conditions.

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Leasing (cont)

- Lease classification into finance and operating leases remains particularly relevant for lessor accounting.

Leasing (cont)

Important MCQ Traps

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Leasing (cont)

- Lessor = owner; lessee = user.

Leasing (cont)

- Leasing provides the right to use an asset, not necessarily ownership.

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Leasing (cont)

- Finance lease transfers substantially all risks and rewards; operating lease does not.

Leasing (cont)

- Sale and leaseback releases capital while allowing continued asset use.

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Leasing (cont)

- Leasing is a form of asset-based financing, unlike a conventional unsecured loan.

Hire Purchase

Meaning

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Hire Purchase (cont)

- Hire purchase is a financing arrangement in which an asset is acquired by making an initial payment (down payment) followed by periodic instalments.

Hire Purchase (cont)

- The hirer obtains possession and use of the asset immediately, but ownership transfers only after payment of all instalments and fulfilment of the agreement's conditions.

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Hire Purchase (cont)

- The financier/vendor retains ownership until the final payment.

Hire Purchase (cont)

Parties

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Hire Purchase (cont)

- Hirer: Person who obtains and uses the asset and pays instalments.

Hire Purchase (cont)

- Hire Vendor / Financier: Provides the asset and retains ownership until completion of the agreement.

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Hire Purchase (cont)

- Hire Purchase Instalments: Periodic payments comprising principal and finance charges.

Hire Purchase (cont)

Key Features

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Hire Purchase (cont)

- Usually involves a down payment followed by instalments.

Hire Purchase (cont)

- Hirer gets possession immediately.

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Hire Purchase (cont)

- Legal ownership remains with the hire vendor until the purchase option/contractual conditions are fulfilled.

Hire Purchase (cont)

- Hirer generally bears maintenance, insurance and operating expenses, as agreed.

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Hire Purchase (cont)

- If the hirer defaults, the vendor may repossess the asset subject to contractual and legal requirements.

Hire Purchase (cont)

Hire Purchase vs Leasing

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Hire Purchase (cont)

- Hire purchase is primarily a method of financing asset acquisition; leasing provides the right to use an asset.

Hire Purchase (cont)

- In hire purchase, ownership transfers after completion of payments and contractual conditions.

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Hire Purchase (cont)

- In a normal lease, ownership generally remains with the lessor.

Hire Purchase (cont)

- Hire purchase commonly includes an option or obligation to purchase; leasing does not necessarily result in ownership transfer.

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Hire Purchase (cont)

- Hire purchase instalments contribute towards acquiring the asset; lease rentals are payments for its use.

Hire Purchase (cont)

Hire Purchase vs Instalment Sale

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Hire Purchase (cont)

- In hire purchase, ownership generally remains with the vendor until the final payment and fulfilment of contractual conditions.

Hire Purchase (cont)

- In an instalment sale, ownership generally transfers to the buyer at the time of sale, although payment is made in instalments.

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Hire Purchase (cont)

Advantages

Hire Purchase (cont)

- Enables acquisition of expensive assets without paying the entire cost upfront.

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Hire Purchase (cont)

- Spreads the purchase cost over time.

Hire Purchase (cont)

- Asset can be used immediately.

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Hire Purchase (cont)

- Useful for financing vehicles, machinery and commercial equipment.

Hire Purchase (cont)

Limitations

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Hire Purchase (cont)

- Total cost may be higher due to interest/finance charges.

Hire Purchase (cont)

- Default may result in repossession.

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Hire Purchase (cont)

- Hirer does not have full ownership rights until completion.

Hire Purchase (cont)

- Instalment obligations can create financial pressure.

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Hire Purchase (cont)

Accounting and Regulatory Concepts

Hire Purchase (cont)

- Hire purchase involves both an asset acquisition and a financing arrangement.

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Hire Purchase (cont)

- Accounting treatment depends on the applicable accounting framework and substance of the arrangement.

Hire Purchase (cont)

- Under Ind AS 116, arrangements conveying the right to use an identified asset for consideration may fall within lease accounting depending on their substance; the contractual label alone is not decisive.

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Hire Purchase (cont)

- Hire-purchase transactions may also attract applicable provisions of the Sale of Goods Act, 1930 and other relevant laws.

Hire Purchase (cont)

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Hire Purchase (cont)

- Hirer = user and prospective owner; hire vendor = owner until contractual completion.

Hire Purchase (cont)

- Possession and ownership are different.

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Hire Purchase (cont)

- Final instalment and fulfilment of agreement conditions generally result in transfer of ownership.

Hire Purchase (cont)

- Leasing does not automatically lead to ownership transfer.

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Hire Purchase (cont)

- In an instalment sale, ownership generally passes at the time of sale, unlike hire purchase.

Factoring

Meaning

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Factoring (cont)

- Factoring is a financial service in which a business sells or assigns its accounts receivable (trade debts/invoices) to a factor in exchange for immediate funds.

Factoring (cont)

- The factor collects payment from the business's customers (debtors).

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Factoring (cont)

- Helps businesses convert credit sales into immediate liquidity.

Factoring (cont)

Parties

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Factoring (cont)

- Client: Business that sells goods/services on credit and assigns receivables.

Factoring (cont)

- Factor: Financial institution that purchases or finances the receivables.

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Factoring (cont)

- Debtor: Customer who owes money to the client.

Factoring (cont)

Key Functions

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Factoring (cont)

- Provides immediate finance against invoices.

Factoring (cont)

- Collects payments from debtors.

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Factoring (cont)

- Maintains sales ledger and receivables records.

Factoring (cont)

- Provides credit assessment of customers.

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Factoring (cont)

- May provide protection against debtor default, depending on the factoring arrangement.

Factoring (cont)

Types of Factoring

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Factoring (cont)

1. Recourse Factoring

Factoring (cont)

- Factor can recover the amount from the client if the debtor fails to pay.

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Factoring (cont)

- Client retains the ultimate risk of debtor default.

Factoring (cont)

- Usually involves lower factoring charges.

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Factoring (cont)

2. Non-Recourse Factoring

Factoring (cont)

- Factor assumes the agreed credit risk of debtor insolvency/default.

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Factoring (cont)

- Client is protected against covered debtor credit losses.

Factoring (cont)

- Generally more expensive.

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Factoring (cont)

- Protection does not necessarily cover commercial disputes, defective goods or other contractual exclusions.

Factoring (cont)

3. Disclosed Factoring

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Factoring (cont)

- Debtor is informed that the receivable has been assigned to the factor.

Factoring (cont)

- Payment is made directly to the factor.

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Factoring (cont)

4. Undisclosed Factoring

Factoring (cont)

- Debtor may not be informed of the factoring arrangement.

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Factoring (cont)

- Collection arrangements are structured accordingly.

Factoring (cont)

5. Domestic and International Factoring

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Factoring (cont)

- Domestic: Client and debtor are in the same country.

Factoring (cont)

- International: Involves cross-border receivables; may involve export and import factors.

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Factoring (cont)

Process

Factoring (cont)

- Business sells goods/services on credit and raises an invoice.

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Factoring (cont)

- Business assigns the receivable to the factor.

Factoring (cont)

- Factor advances an agreed percentage of the invoice value.

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Factoring (cont)

- Debtor pays the factor on the due date.

Factoring (cont)

- Factor releases the remaining amount after deducting fees and applicable charges.

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Factoring (cont)

Advantages

Factoring (cont)

- Improves working capital and cash flow.

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Factoring (cont)

- Reduces the time spent waiting for customer payments.

Factoring (cont)

- Can outsource receivables collection and administration.

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Factoring (cont)

- Non-recourse factoring can transfer specified debtor credit risk.

Factoring (cont)

- Particularly useful for Micro, Small and Medium Enterprises (MSMEs).

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Factoring (cont)

Limitations

Factoring (cont)

- Factoring fees reduce the net amount received.

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Factoring (cont)

- Customer relationships may be affected by collection practices.

Factoring (cont)

- Not all receivables are eligible.

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Factoring (cont)

- Recourse factoring does not transfer ultimate debtor default risk.

Factoring (cont)

Regulatory Framework in India

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Factoring (cont)

- Factoring Regulation Act, 2011, amended in 2021.

Factoring (cont)

- RBI regulates factoring business conducted by eligible financial entities under its regulatory framework.

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Factoring (cont)

- Banks and eligible Non-Banking Financial Companies (NBFCs) can undertake factoring subject to applicable conditions.

Factoring (cont)

- Trade Receivables Discounting System (TReDS): RBI-regulated electronic platform that facilitates financing/discounting of MSME trade receivables through multiple financiers.

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Factoring (cont)

- TReDS transactions are generally without recourse to the MSME seller.

Factoring (cont)

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Factoring (cont)

- Factoring involves the sale/assignment of receivables; it is not simply a conventional loan.

Factoring (cont)

- Factor = purchaser/financier of receivables.

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Factoring (cont)

- Client = seller/assignor of receivables.

Factoring (cont)

- Debtor = customer liable to pay the invoice.

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Factoring (cont)

- Recourse = credit risk remains with client; non-recourse = agreed credit risk transferred to factor.

Factoring (cont)

- Factoring may include financing, collection and credit-risk protection.

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Factoring (cont)

- TReDS facilitates financing of MSME trade receivables; it is not itself a conventional lender.

Forfaiting

Meaning

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Forfaiting (cont)

- Forfaiting is a form of trade finance in which an exporter sells its medium- or long-term export receivables to a forfaiter at a discount.

Forfaiting (cont)

- The forfaiter purchases the receivables, generally without recourse to the exporter.

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Forfaiting (cont)

- Enables exporters to receive immediate cash instead of waiting for payment from foreign buyers.

Forfaiting (cont)

Parties

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Forfaiting (cont)

- Exporter: Sells goods and receives payment through export receivables.

Forfaiting (cont)

- Importer: Purchases goods and owes payment to the exporter.

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Forfaiting (cont)

- Forfaiter: Financial institution that purchases export receivables.

Forfaiting (cont)

- Guaranteeing Bank: May provide a guarantee or aval (bank guarantee on a bill of exchange or promissory note).

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Forfaiting (cont)

Key Features

Forfaiting (cont)

- Usually used for international trade transactions.

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Forfaiting (cont)

- Generally involves medium- or long-term receivables.

Forfaiting (cont)

- Typically covers 100% of the eligible receivable value, less discount and charges.

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Forfaiting (cont)

- Usually without recourse: forfaiter bears the agreed payment/default risk.

Forfaiting (cont)

- Receivables are commonly represented by bills of exchange or promissory notes.

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Forfaiting (cont)

- Bank guarantees or avals may improve creditworthiness.

Forfaiting (cont)

Process

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Forfaiting (cont)

- Exporter sells goods to an overseas importer on deferred-payment terms.

Forfaiting (cont)

- Importer issues bills of exchange/promissory notes or provides other eligible payment obligations.

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Forfaiting (cont)

- Exporter sells these receivables to the forfaiter at a discount.

Forfaiting (cont)

- Exporter receives immediate payment.

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Forfaiting (cont)

- Forfaiter collects the amount from the importer or guaranteeing bank at maturity.

Forfaiting (cont)

Risks Assumed by Forfaiter

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Forfaiting (cont)

- Importer's credit/default risk.

Forfaiting (cont)

- Political and transfer risks in cross-border transactions.

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Forfaiting (cont)

- Country risk and currency-related risks, depending on the transaction.

Forfaiting (cont)

- Bank/guarantor risk where a guarantee is involved.

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Forfaiting (cont)

Forfaiting vs Factoring

Forfaiting (cont)

- Forfaiting: Primarily export-related, generally medium/long-term receivables.

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Forfaiting (cont)

- Factoring: Primarily domestic or international trade receivables, generally short-term invoices.

Forfaiting (cont)

- Forfaiting: Usually without recourse.

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Forfaiting (cont)

- Factoring: Can be with recourse or without recourse.

Forfaiting (cont)

- Forfaiting: Often involves bills of exchange, promissory notes and bank guarantees.

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Forfaiting (cont)

- Factoring: Usually involves accounts receivable and invoice-based financing.

Forfaiting (cont)

Advantages

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Forfaiting (cont)

- Provides immediate liquidity to exporters.

Forfaiting (cont)

- Eliminates agreed receivable collection and credit risks.

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Forfaiting (cont)

- Enables exporters to offer deferred payment terms to foreign buyers.

Forfaiting (cont)

- Reduces balance-sheet receivables and improves cash flow.

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Forfaiting (cont)

- Helps exporters avoid prolonged international collection procedures.

Forfaiting (cont)

Important MCQ Traps

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Forfaiting (cont)

- Forfaiting = purchase of export receivables at a discount.

Forfaiting (cont)

- Forfaiter = purchaser of receivables.

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Forfaiting (cont)

- Exporter receives immediate funds; importer pays at maturity.

Forfaiting (cont)

- Generally without recourse.

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Forfaiting (cont)

- Factoring is usually short-term; forfaiting is generally medium/long--term.

Forfaiting (cont)

- Discount represents the cost of financing and risks assumed by the forfaiter.

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Bill Discounting

Meaning

Bill Discounting (cont)

- Bill discounting is a short-term financing arrangement in which a seller obtains immediate funds by selling a bill of exchange to a bank or financial institution before its maturity, at a discount.

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Bill Discounting (cont)

- The bank pays the seller the bill amount minus discount charges and collects the full amount from the buyer (drawee) on maturity.

Bill Discounting (cont)

- Converts credit sales into immediate working capital.

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Bill Discounting (cont)

Parties

Bill Discounting (cont)

- Drawer: Seller who draws the bill.

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Bill Discounting (cont)

- Drawee: Buyer on whom the bill is drawn.

Bill Discounting (cont)

- Acceptor: Drawee who accepts the bill and promises to pay at maturity.

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Bill Discounting (cont)

- Payee: Person entitled to receive payment.

Bill Discounting (cont)

- Discounting Bank: Financial institution that purchases/discounts the bill.

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Bill Discounting (cont)

Process

Bill Discounting (cont)

- Seller supplies goods to buyer on credit.

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Bill Discounting (cont)

- Seller draws a bill of exchange on the buyer.

Bill Discounting (cont)

- Buyer accepts the bill, acknowledging the payment obligation.

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Bill Discounting (cont)

- Seller submits the accepted bill to a bank for discounting.

Bill Discounting (cont)

- Bank pays the seller the face value less discount and charges.

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Bill Discounting (cont)

- On maturity, the bank collects the full amount from the buyer.

Bill Discounting (cont)

Formula

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Bill Discounting (cont)

Discount = Face Value x Discount Rate x (Unexpired Period / 365)

Bill Discounting (cont)

Net Proceeds= Face Value - Discount

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Bill Discounting (cont)

- Actual day-count conventions and charges depend on the transaction.

Bill Discounting (cont)

Types

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Bill Discounting (cont)

- Trade Bill Discounting: Based on genuine underlying trade transactions.

Bill Discounting (cont)

- Accommodation Bill: Drawn without a genuine underlying trade transaction, generally to provide financial accommodation; subject to legal and regulatory restrictions.

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Bill Discounting (cont)

- With Recourse: Bank can recover the amount from the seller if the drawee defaults.

Bill Discounting (cont)

- Without Recourse: Bank bears the agreed credit risk, subject to contractual exclusions.

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Bill Discounting (cont)

Advantages

Bill Discounting (cont)

- Provides immediate liquidity to sellers.

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Bill Discounting (cont)

- Improves working capital management.

Bill Discounting (cont)

- Reduces the waiting period for trade receivables.

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Bill Discounting (cont)

- Enables banks to finance genuine trade transactions.

Bill Discounting (cont)

- Supports credit sales between businesses.

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Bill Discounting (cont)

Limitations

Bill Discounting (cont)

- Discounting charges increase financing costs.

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Bill Discounting (cont)

- Bank assesses the creditworthiness of the drawee and authenticity of the bill.

Bill Discounting (cont)

- Seller may remain liable in recourse arrangements.

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Bill Discounting (cont)

- Fraudulent or accommodation bills create credit and legal risks.

Bill Discounting (cont)

Regulatory and Institutional Framework

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Bill Discounting (cont)

- Negotiable Instruments Act, 1881: Governs bills of exchange and other negotiable instruments.

Bill Discounting (cont)

- RBI regulates banks and applicable financial institutions undertaking bill discounting.

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Bill Discounting (cont)

- Trade Receivables Discounting System (TReDS): Enables electronic financing of MSME trade receivables through invoice/bill discounting by financiers.

Bill Discounting (cont)

- Commercial bills are generally short-term instruments arising from genuine trade transactions.

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Bill Discounting (cont)

Important MCQ Traps

Bill Discounting (cont)

- Bill discounting = financing against an accepted bill before maturity.

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Bill Discounting (cont)

- Seller receives discounted value; bank receives face value at maturity.

Bill Discounting (cont)

- Drawer = seller; drawee = buyer; acceptor = drawee after acceptance.

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Bill Discounting (cont)

- Bill discounting is generally short-term trade finance.

Bill Discounting (cont)

- Factoring involves assignment/purchase of receivables; bill discounting specifically involves discounting a bill of exchange.

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Bill Discounting (cont)

- Discount is the difference between face value and the amount paid upfront.

Securitisation

Meaning

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Securitisation (cont)

- Securitisation = process of converting a pool of illiquid financial assets (e.g. home loans, vehicle loans, credit-card receivables) into marketable securities.

Securitisation (cont)

- Originator transfers a pool of receivables to a separate entity called a Special Purpose Entity (SPE)/Special Purpose Vehicle (SPV).

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Securitisation (cont)

- SPV issues securities to investors backed by cash flows from the underlying assets.

Securitisation (cont)

- Enables originators to obtain immediate funds and transfer agreed credit risks.

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Securitisation (cont)

Process

Securitisation (cont)

- Bank/NBFC originates loans → pools similar loans → transfers pool to SPV → SPV issues securities to investors → borrowers repay EMIs → collections are used to pay investors.

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Securitisation (cont)

- A trustee/servicer may administer the pool and collect repayments.

Securitisation (cont)

- Investors receive principal and interest from the underlying asset cash flows, after applicable expenses.

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Securitisation (cont)

Key Participants

Securitisation (cont)

- Originator: Bank/NBFC that originally created the loans and transfers them.

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Securitisation (cont)

- SPV/SPE: Separate entity that holds the assets and issues securities.

Securitisation (cont)

- Investors: Purchase securities issued by the SPV.

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Securitisation (cont)

- Servicer: Collects repayments from borrowers and manages loan accounts.

Securitisation (cont)

- Trustee: Protects investors' interests and oversees the transaction, where applicable.

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Securitisation (cont)

- Credit Rating Agency (CRA): Assesses credit risk of the securities.

Securitisation (cont)

Types of Securitisation

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Securitisation (cont)

- Mortgage-Backed Securities (MBS): Backed by mortgage/home-loan receivables.

Securitisation (cont)

- Residential Mortgage-Backed Securities (RMBS): Backed specifically by residential mortgages.

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Securitisation (cont)

- Commercial Mortgage-Backed Securities (CMBS): Backed by commercial-property mortgages.

Securitisation (cont)

- Asset-Backed Securities (ABS): Backed by non-mortgage assets such as vehicle loans, personal loans and credit-card receivables.

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Securitisation (cont)

- Collateralised Loan Obligations (CLOs): Backed by a pool of loans, often corporate loans.

Securitisation (cont)

Tranching and Credit Enhancement

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Securitisation (cont)

- Securities may be divided into tranches with different risk-return profiles:

Securitisation (cont)

- Senior tranche: First priority in receiving payments; generally lower risk and return.

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Securitisation (cont)

- Mezzanine tranche: Intermediate priority and risk.

Securitisation (cont)

- Equity/first-loss tranche: Absorbs losses first; highest risk and potentially higher return.

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Securitisation (cont)

- Credit enhancement: Mechanisms to improve the credit quality of securities.

Securitisation (cont)

- Internal: Subordination, over-collateralisation, excess spread, cash collateral.

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Securitisation (cont)

- External: Guarantees or other third-party credit support.

Securitisation (cont)

- Waterfall mechanism: Defines the priority in which collections are distributed among expenses and investor tranches.

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Securitisation (cont)

Benefits and Risks

Securitisation (cont)

- Originator: Raises liquidity, improves balance-sheet management and may transfer credit risk.

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Securitisation (cont)

- Investors: Access to diversified pools of receivables and different risk-return profiles.

Securitisation (cont)

- Risks: Borrower defaults, prepayment risk, interest-rate risk, servicing failure, model/valuation risk and complexity.

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Securitisation (cont)

- Prepayment risk: Borrowers repay early, changing expected cash flows and potentially reducing investor returns.

Securitisation (cont)

Regulatory Framework in India

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Securitisation (cont)

- RBI's Securitisation of Standard Assets Directions, 2021 govern securitisation transactions undertaken by regulated entities, subject to applicability and amendments.

Securitisation (cont)

- Securitisation must involve a genuine transfer of assets and comply with prescribed conditions on asset eligibility, transfer, risk retention and disclosure.

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Securitisation (cont)

- Minimum Holding Period (MHP): Originator must hold the underlying loans for the prescribed minimum period before securitisation.

Securitisation (cont)

- Minimum Retention Requirement (MRR): Originator must retain a prescribed portion of the securitised exposure to ensure continuing economic interest.

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Securitisation (cont)

- RBI's 2021 framework generally prescribes MHP based on original maturity:

Securitisation (cont)

- Original maturity up to 24 months: 3 months.

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Securitisation (cont)

- Original maturity above 24 months: 6 months.

Securitisation (cont)

- MRR depends on asset type and maturity; do not treat it as one universal percentage.

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Securitisation (cont)

- SEBI regulates listed securitised debt instruments under its applicable securities-market framework.

Securitisation (cont)

Securitisation vs Assignment

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Securitisation (cont)

- Securitisation: Assets are transferred to an SPV, which issues securities backed by their cash flows.

Securitisation (cont)

- Direct assignment: Originator directly transfers loan receivables to a buyer; no SPV-issued securities are necessarily involved.

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Securitisation (cont)

MCQ Traps

Securitisation (cont)

- Securitisation converts illiquid receivables into marketable securities.

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Securitisation (cont)

- SPV issues securities; originator originally creates the loans.

Securitisation (cont)

- MBS is a type of ABS, but not every ABS is mortgage-backed.

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Securitisation (cont)

- Senior tranche has payment priority; equity tranche absorbs first losses.

Securitisation (cont)

- Securitisation does not automatically eliminate all risk for the originator.

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Securitisation (cont)

- MRR ensures the originator retains exposure; credit enhancement improves protection for investors.

Asset Reconstruction

Meaning

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Asset Reconstruction (cont)

- Asset reconstruction = acquisition of Non-Performing Assets (NPAs) from banks/financial institutions and resolution of stressed assets to recover dues.

Asset Reconstruction (cont)

- Specialised entities called Asset Reconstruction Companies (ARCs) acquire distressed financial assets and attempt recovery through restructuring, enforcement or sale.

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Asset Reconstruction (cont)

- Objective: improve recovery, clean up bank balance sheets and release capital for fresh lending.

Asset Reconstruction (cont)

Key Participants

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Asset Reconstruction (cont)

- Bank/Financial Institution: Original lender that sells the stressed loan.

Asset Reconstruction (cont)

- ARC: Acquires the financial asset and manages recovery.

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Asset Reconstruction (cont)

- Borrower: Entity/person who owes the outstanding loan.

Asset Reconstruction (cont)

- Security Receipts (SRs): Instruments issued by an ARC to eligible investors representing their investment in the acquired assets.

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Asset Reconstruction (cont)

- Qualified Buyers (QBs): Institutional investors eligible to invest in SRs under the SARFAESI framework.

Asset Reconstruction (cont)

Process

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Asset Reconstruction (cont)

- Bank identifies an NPA → transfers/sells the financial asset to ARC → ARC pays consideration (cash and/or SRs, as permitted) → ARC takes recovery measures → proceeds are distributed according to the applicable structure.

Asset Reconstruction (cont)

- ARC may use restructuring, settlement, change in management, enforcement of security or sale of assets.

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Asset Reconstruction (cont)

- ARC may appoint a manager or agency to manage acquired assets.

Asset Reconstruction (cont)

Asset Reconstruction Company (ARC)

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Asset Reconstruction (cont)

- ARC is a specialised financial institution registered with the Reserve Bank of India (RBI) under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest

Asset Reconstruction (cont)

(SARFAESI) Act, 2002.

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Asset Reconstruction (cont)

- ARC acquires financial assets from banks/FIs and undertakes asset reconstruction or securitisation.

Asset Reconstruction (cont)

- It may issue Security Receipts to Qualified Buyers.

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Asset Reconstruction (cont)

- ARC is subject to RBI registration, capital, governance, reporting and prudential requirements.

Asset Reconstruction (cont)

Important Regulatory Conditions

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Asset Reconstruction (cont)

- RBI registration is mandatory for carrying on the business of securitisation or asset reconstruction under SARFAESI.

Asset Reconstruction (cont)

- Minimum Net Owned Fund (NOF) for an ARC: ₹300 crore under the current RBI framework; existing ARCs were required to meet the enhanced requirement within the prescribed transition period.

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Asset Reconstruction (cont)

- ARC must maintain a minimum 15% investment in each scheme of Security Receipts, or 2.5% of the total SRs issued under the scheme, whichever is higher.

Asset Reconstruction (cont)

- The remaining investment may be held by eligible Qualified Buyers.

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Asset Reconstruction (cont)

- ARC must follow RBI's prudential norms, including capital adequacy, asset classification, provisioning and fair-practice requirements.

Asset Reconstruction (cont)

SARFAESI Act, 2002

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Asset Reconstruction (cont)

- Provides the legal framework for securitisation, asset reconstruction and enforcement of security interest.

Asset Reconstruction (cont)

- Enables secured creditors to enforce security interests without initially approaching a court/tribunal, subject to statutory conditions and remedies.

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Asset Reconstruction (cont)

- Section 13(2): Secured creditor issues a 60-day demand notice to the borrower after default and classification as NPA, where applicable.

Asset Reconstruction (cont)

- Section 13(4): If the borrower fails to comply, secured creditor may take specified enforcement measures, such as taking possession of secured assets or taking over management in permitted cases.

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Asset Reconstruction (cont)

- Borrower can make a representation/objection under Section 13(3A); creditor must communicate reasons for rejection within the prescribed period.

Asset Reconstruction (cont)

- Borrower can approach the Debt Recovery Tribunal (DRT) under Section 17 after a measure under Section 13(4).

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Asset Reconstruction (cont)

Methods of Asset Reconstruction

Asset Reconstruction (cont)

- Restructuring of borrower debt.

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Asset Reconstruction (cont)

- Enforcement of security interest.

Asset Reconstruction (cont)

- Settlement or compromise with borrower.

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Asset Reconstruction (cont)

- Change or takeover of management, where legally permitted.

Asset Reconstruction (cont)

- Sale or lease of the business/assets.

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Asset Reconstruction (cont)

- Conversion of debt into equity or other securities, subject to applicable law.

Asset Reconstruction (cont)

ARC vs Bank

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Asset Reconstruction (cont)

- Bank primarily originates loans and provides credit.

Asset Reconstruction (cont)

- ARC primarily acquires stressed financial assets and focuses on recovery/resolution.

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Asset Reconstruction (cont)

- ARC may acquire NPAs from multiple banks and specialise in managing distressed assets.

Asset Reconstruction (cont)

MCQ Traps

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Asset Reconstruction (cont)

- ARC registration is with RBI under SARFAESI Act, 2002.

Asset Reconstruction (cont)

- ARC is not a bank and does not primarily undertake ordinary deposit-taking and lending.

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Asset Reconstruction (cont)

- Security Receipts represent investment in a scheme backed by acquired financial assets; they are not ordinary bank deposits.

Asset Reconstruction (cont)

- SARFAESI enforcement applies to secured assets and is subject to statutory exclusions and conditions.

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Asset Reconstruction (cont)

- 60 days is the demand-notice period under Section 13(2), not the general recovery period.

Asset Reconstruction (cont)

- ARC acquisition of an NPA does not automatically mean the borrower's liability is extinguished.

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Credit Rating

Meaning

Credit Rating (cont)

- Credit rating = an independent assessment of the creditworthiness of an issuer or a debt instrument and its ability to meet financial obligations on time.

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Credit Rating (cont)

- Indicates the relative likelihood of default; it is an opinion, not a guarantee of repayment.

Credit Rating (cont)

- Helps investors assess credit risk and make informed investment decisions.

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Credit Rating (cont)

Types of Credit Rating

Credit Rating (cont)

- Issuer rating: Assesses the overall creditworthiness of an entity.

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Credit Rating (cont)

- Instrument rating: Assesses repayment risk of a specific debt instrument.

Credit Rating (cont)

- Short-term rating: For instruments such as Commercial Paper (CP) and short-term debt.

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Credit Rating (cont)

- Long-term rating: For bonds, debentures and other long-term debt.

Credit Rating (cont)

- Sovereign rating: Assesses a country's ability and willingness to service its debt.

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Credit Rating (cont)

- Structured finance rating: Assesses securities backed by pools of financial assets.

Credit Rating (cont)

Credit Rating Agencies (CRAs) in India

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Credit Rating (cont)

- CRISIL: Credit Rating Information Services of India Limited.

Credit Rating (cont)

- ICRA: Investment Information and Credit Rating Agency of India Limited.

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Credit Rating (cont)

- CARE Ratings: Credit Analysis and Research Limited.

Credit Rating (cont)

- India Ratings: India Ratings and Research Private Limited.

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Credit Rating (cont)

- Brickwork Ratings: Brickwork Ratings India Private Limited.

Credit Rating (cont)

- Acuite Ratings: Acuité Ratings & Research Limited.

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Credit Rating (cont)

- These agencies are registered with and regulated by SEBI under the SEBI (Credit Rating Agencies) Regulations, 1999.

Credit Rating (cont)

Rating Scale

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Credit Rating (cont)

- Long-term ratings commonly use:

Credit Rating (cont)

- AAA: Highest degree of safety regarding timely servicing.

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Credit Rating (cont)

- AA: High degree of safety.

Credit Rating (cont)

- A: Adequate degree of safety.

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Credit Rating (cont)

- BBB: Moderate degree of safety.

Credit Rating (cont)

- BB: Substantial credit risk.

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Credit Rating (cont)

- B: High credit risk.

Credit Rating (cont)

- C: Very high credit risk.

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Credit Rating (cont)

- D: Default or expected default.

Credit Rating (cont)

- A plus (+) or minus (−) modifier indicates relative standing within a rating category, generally from AA to C.

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Credit Rating (cont)

- Investment grade: BBB− and above.

Credit Rating (cont)

- Speculative grade: Below BBB−.

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Credit Rating (cont)

- Short-term ratings use separate scales such as A1, A2, A3, A4 and D.

Credit Rating (cont)

Rating Outlook and Watch

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Credit Rating (cont)

- Positive outlook: Rating may be upgraded.

Credit Rating (cont)

- Negative outlook: Rating may be downgraded.

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Credit Rating (cont)

- Stable outlook: Rating is expected to remain unchanged.

Credit Rating (cont)

- Rating watch: Indicates the possibility of a rating change due to a specific event or developing situation.

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Credit Rating (cont)

- Outlook is not itself a rating; a watch generally signals a more immediate review.

Credit Rating (cont)

Factors Considered in Rating

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Credit Rating (cont)

- Financial strength: Debt levels, profitability, cash flows and interest coverage.

Credit Rating (cont)

- Business risk: Industry conditions, competition and operating stability.

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Credit Rating (cont)

- Management quality and corporate governance.

Credit Rating (cont)

- Liquidity and ability to meet near-term obligations.

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Credit Rating (cont)

- Economic, regulatory and sector-specific risks.

Credit Rating (cont)

- Security/collateral and guarantees, where applicable.

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Credit Rating (cont)

Regulatory Framework

Credit Rating (cont)

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Credit Rating (cont)

- CRA registration with SEBI is mandatory for regulated credit-rating activities.

Credit Rating (cont)

- CRAs must follow prescribed eligibility, net-worth, governance, disclosure, surveillance and conflict-of-interest requirements.

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Credit Rating (cont)

- Ratings must be monitored and reviewed during the life of the rated instrument, subject to applicable requirements.

Credit Rating (cont)

- CRAs must disclose rating rationale and material factors underlying rating decisions.

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Credit Rating (cont)

- SEBI can inspect, investigate and take enforcement action against CRAs.

Credit Rating (cont)

Limitations

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Credit Rating (cont)

- Rating is an opinion, not a recommendation to buy, sell or hold.

Credit Rating (cont)

- Ratings can change when financial or economic conditions change.

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Credit Rating (cont)

- Rating agencies may face conflicts because issuers often pay for ratings.

Credit Rating (cont)

- Ratings may not capture sudden market shocks or fraud.

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Credit Rating (cont)

- Investors must conduct their own due diligence.

Credit Rating (cont)

MCQ Traps

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Credit Rating (cont)

- Credit rating assesses credit/default risk, not the expected market return or share-price performance.

Credit Rating (cont)

- AAA is the highest conventional long-term rating; D indicates default.

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Credit Rating (cont)

- BBB− is the lowest investment-grade rating on the commonly used long-term scale.

Credit Rating (cont)

- A downgrade means deterioration in assessed creditworthiness; it does not necessarily mean immediate default.

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Credit Rating (cont)

- Credit rating and credit score are different: rating generally assesses issuers/instruments, while credit scores commonly assess individual borrowers.

Credit Rating (cont)

- SEBI, not RBI, regulates registered CRAs for securities-market credit-rating activities.

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Underwriting

Meaning

Underwriting (cont)

- Underwriting = an arrangement in which an underwriter agrees to subscribe to securities that are not subscribed to by the public, subject to the underwriting agreement.

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Underwriting (cont)

- Provides assurance to the issuing company that the issue will raise the required funds, even if public subscription is insufficient.

Underwriting (cont)

- Underwriters earn an underwriting commission/fee for assuming this risk.

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Underwriting (cont)

Key Participants

Underwriting (cont)

- Issuer: Company raising capital through securities.

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Underwriting (cont)

- Underwriter: Intermediary or financial institution undertaking the subscription obligation.

Underwriting (cont)

- Investors: Public or institutional investors subscribing to the issue.

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Underwriting (cont)

- Lead Manager: Coordinates issue management and may also act as an underwriter.

Underwriting (cont)

Process

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Underwriting (cont)

- Company plans a securities issue → appoints underwriters → issue is offered to investors → public subscriptions are received → underwriter subscribes to the agreed unsubscribed portion (devolvement) → issuer receives the funds.

Underwriting (cont)

- The underwriter's obligation is governed by the underwriting agreement and applicable regulations.

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Underwriting (cont)

Types of Underwriting

Underwriting (cont)

- Full underwriting: Entire issue is underwritten.

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Underwriting (cont)

- Partial underwriting: Only a specified portion is underwritten.

Underwriting (cont)

- Firm underwriting: Underwriter agrees to subscribe to a specified number of securities irrespective of public subscription, subject to the agreement.

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Underwriting (cont)

- Sub-underwriting: Main underwriter transfers part of its underwriting risk to another underwriter.

Underwriting (cont)

- Syndicate underwriting: Multiple underwriters jointly undertake an issue.

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Underwriting (cont)

- Standby underwriting: Underwriter agrees to subscribe to securities not taken up by existing shareholders, commonly in rights issues.

Underwriting (cont)

Types Based on Commitment

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Underwriting (cont)

- Hard underwriting: Underwriter commits to purchase securities irrespective of the final public subscription.

Underwriting (cont)

- Soft underwriting: Commitment depends on the final subscription outcome and contractual conditions.

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Underwriting (cont)

Underwriting Commission

Underwriting (cont)

- Compensation paid to underwriters for assuming the risk of unsubscribed securities.

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Underwriting (cont)

- Commission is governed by the Companies Act, applicable SEBI regulations and issue-specific requirements.

Underwriting (cont)

- It is distinct from brokerage paid for arranging subscriptions.

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Underwriting (cont)

Regulatory Framework in India

Underwriting (cont)

- SEBI regulates underwriting in the securities market.

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Underwriting (cont)

- SEBI (Underwriters) Regulations, 1993 provide the registration framework for underwriters.

Underwriting (cont)

- Merchant bankers, brokers and other eligible intermediaries may undertake underwriting subject to applicable registration and regulatory conditions.

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Underwriting (cont)

- Underwriting arrangements in public issues must comply with the applicable SEBI issue regulations, including the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Underwriting (cont)

- Underwriting does not remove the issuer's responsibility for accurate disclosures or regulatory compliance.

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Underwriting (cont)

Underwriting vs Subscribing

Underwriting (cont)

- Underwriting: Conditional contractual commitment to subscribe to the agreed unsubscribed portion.

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Underwriting (cont)

- Direct subscription: Investor purchases securities as an investment without necessarily assuming an underwriting obligation.

Underwriting (cont)

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Underwriting (cont)

- Devolvement: Unsubscribed securities become the underwriter's responsibility under the agreement.

Underwriting (cont)

- Underwriting reduces the issuer's risk of an undersubscribed issue; it does not eliminate market or business risk.

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Underwriting (cont)

- Full underwriting covers the entire issue; partial underwriting covers only a specified portion.

Underwriting (cont)

- Firm underwriting is an independent commitment, subject to contractual terms.

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Underwriting (cont)

- Underwriting commission is compensation for assuming subscr-iption risk, not ordinary brokerage.

Merchant Banking

Meaning

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Merchant Banking (cont)

- Merchant banking = specialised financial service involving assistance to companies in raising capital, managing securities issues and undertaking corporate financial advisory.

Merchant Banking (cont)

- Merchant bankers act as intermediaries between companies raising funds and investors.

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Merchant Banking (cont)

- In India, merchant bankers are regulated by the Securities and Exchange Board of India (SEBI) under the SEBI (Merchant Bankers) Regulations, 1992.

Merchant Banking (cont)

Core Functions

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Merchant Banking (cont)

- Issue management: Managing Initial Public Offerings (IPOs), Follow-on Public Offers (FPOs), rights issues and debt issues.

Merchant Banking (cont)

- Underwriting: Agreeing to subscribe to securities not taken up by the public, subject to the underwriting agreement.

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Merchant Banking (cont)

- Corporate advisory: Advising on mergers, acquisitions, restructuring and takeover transactions.

Merchant Banking (cont)

- Private placement: Helping companies raise funds from selected investors.

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Merchant Banking (cont)

- Due diligence: Examining financial statements, legal compliance, business risks and disclosures before an issue.

Merchant Banking (cont)

- Valuation and pricing: Assisting with valuation and issue pricing, subject to applicable regulations.

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Merchant Banking (cont)

- Placement and distribution: Marketing securities and coordinating with investors and intermediaries.

Merchant Banking (cont)

Role in an IPO

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Merchant Banking (cont)

- Advises the issuer on issue structure and timing.

Merchant Banking (cont)

- Conducts due diligence and helps prepare the offer document.

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Merchant Banking (cont)

- Coordinates with SEBI, stock exchanges, registrars, bankers to the issue and other intermediaries.

Merchant Banking (cont)

- Helps determine price band/book-building process and marketing strategy.

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Merchant Banking (cont)

- Monitors issue-related activities and ensures regulatory compliance.

Merchant Banking (cont)

- A merchant banker acting as Book Running Lead Manager (BRLM) manages the book-building process.

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Merchant Banking (cont)

Regulatory Framework

Merchant Banking (cont)

- SEBI (Merchant Bankers) Regulations, 1992.

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Merchant Banking (cont)

- Merchant bankers must obtain SEBI registration before undertaking regulated merchant banking activities.

Merchant Banking (cont)

- Net Worth: Minimum ₹5 crore for a Category I merchant banker under the current framework.

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Merchant Banking (cont)

- Registration categories were rationalised; Category I is the operative registration category.

Merchant Banking (cont)

- Merchant bankers must comply with capital adequacy, code of conduct, due diligence, disclosure, conflict-of-interest and record-maintenance requirements.

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Merchant Banking (cont)

- A merchant banker must maintain an arm's-length relationship between its merchant banking activities and other activities, as prescribed.

Merchant Banking (cont)

Important Distinctions

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Merchant Banking (cont)

- Merchant banker vs Investment banker: Broadly similar functions internationally; in India, merchant banker is the specific SEBI-regulated intermediary category.

Merchant Banking (cont)

- Merchant banker vs Commercial bank: Merchant banker provides issue management and corporate financial services; commercial bank primarily accepts deposits and provides loans/payment services.

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Merchant Banking (cont)

- Merchant banker vs Underwriter: Merchant banker may manage the entire issue; underwriter undertakes to subscribe to securities not subscribed by investors.

Merchant Banking (cont)

- Merchant banker vs Investment adviser: Merchant banker advises issuers on capital raising and corporate transactions; investment adviser provides investment advice to clients under SEBI regulations.

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Merchant Banking (cont)

MCQ Traps

Merchant Banking (cont)

- Merchant bankers are regulated by SEBI, not RBI, for merchant banking activities.

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Merchant Banking (cont)

- SEBI (Merchant Bankers) Regulations were issued in 1992.

Merchant Banking (cont)

- Category I is the relevant registration category.

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Merchant Banking (cont)

- Lead managers play a central role in IPO/FPO issue management and due diligence.

Merchant Banking (cont)

- Merchant banking is broader than underwriting; underwriting is only one possible function.

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Merchant Banking (cont)

- Merchant bankers primarily assist issuers; they are not simply brokers executing investors' buy/sell orders.

Financial Advisory and Distribution Services

Meaning

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Financial Advisory and Distribution Services (cont)

- Financial advisory = providing guidance on financial planning, investments, capital raising, risk management and financial decisions.

Financial Advisory and Distribution Services (cont)

- Financial distribution = facilitating the sale or placement of financial products to investors.

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Financial Advisory and Distribution Services (cont)

- Advisory focuses on recommendations; distribution focuses on connecting financial products with customers.

Financial Advisory and Distribution Services (cont)

Financial Advisory Services

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Financial Advisory and Distribution Services (cont)

- Investment advice: Recommendations on securities and investment products based on client needs and risk profile.

Financial Advisory and Distribution Services (cont)

- Financial planning: Goal-based planning for savings, investments, retirement and wealth creation.

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Financial Advisory and Distribution Services (cont)

- Corporate financial advisory: Advice on capital structure, fundraising, mergers, acquisitions and restructuring.

Financial Advisory and Distribution Services (cont)

- Portfolio advisory: Guidance on asset allocation, diversification and portfolio management.

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Financial Advisory and Distribution Services (cont)

- Risk management advisory: Identifying and managing financial and investment risks.

Financial Advisory and Distribution Services (cont)

- Retirement planning: Planning accumulation and deployment of retirement savings.

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Financial Advisory and Distribution Services (cont)

Financial Distribution Services

Financial Advisory and Distribution Services (cont)

- Mutual fund distribution: Selling mutual fund schemes to investors.

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Financial Advisory and Distribution Services (cont)

- Insurance distribution: Distributing life, health and general insurance products.

Financial Advisory and Distribution Services (cont)

- Pension product distribution: Facilitating access to National Pension System (NPS) and other eligible pension products.

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Financial Advisory and Distribution Services (cont)

- Securities distribution: Facilitating investment in shares, bonds, debentures and other securities.

Financial Advisory and Distribution Services (cont)

- Loan distribution: Connecting borrowers with banks/NBFCs for credit products.

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Financial Advisory and Distribution Services (cont)

- Depository and investment account services: Facilitating access to financial-market infrastructure and investment accounts.

Financial Advisory and Distribution Services (cont)

Important Intermediaries

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Financial Advisory and Distribution Services (cont)

- SEBI-registered Investment Advisers (IAs): Provide investment advice for consideration under SEBI regulations.

Financial Advisory and Distribution Services (cont)

- Research Analysts (RAs): Publish research reports and provide research-based recommendations under SEBI regulations.

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Financial Advisory and Distribution Services (cont)

- Mutual Fund Distributors (MFDs): Distribute mutual fund schemes; regulated through applicable SEBI/Association of Mutual Funds in India (AMFI) requirements.

Financial Advisory and Distribution Services (cont)

- AMFI-registered distributors: Obtain the required National Institute of Securities Markets (NISM) certification and AMFI registration/ARN, as applicable.

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Financial Advisory and Distribution Services (cont)

- Insurance brokers and agents: Distribute insurance products under Insurance Regulatory and Development Authority of India (IRDAI) regulations.

Financial Advisory and Distribution Services (cont)

- Pension agents/Points of Presence (PoPs): Facilitate NPS onboarding and related services under the PFRDA framework.

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Financial Advisory and Distribution Services (cont)

- Stockbrokers: Facilitate securities transactions through recognised stock exchanges.

Financial Advisory and Distribution Services (cont)

Important Regulatory Distinctions

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Financial Advisory and Distribution Services (cont)

- SEBI: Regulates investment advisers, research analysts, mutual funds and securities-market intermediaries.

Financial Advisory and Distribution Services (cont)

- RBI: Regulates banks and relevant NBFCs involved in lending and financial services.

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Financial Advisory and Distribution Services (cont)

- IRDAI: Regulates insurance intermediaries and insurance distribution.

Financial Advisory and Distribution Services (cont)

- PFRDA: Regulates NPS intermediaries and pension-related distribution infrastructure.

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Financial Advisory and Distribution Services (cont)

- IFSCA: Regulates financial services and intermediaries operating in International Financial Services Centres (IFSCs).

Financial Advisory and Distribution Services (cont)

Investment Adviser vs Distributor

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Financial Advisory and Distribution Services (cont)

- Investment adviser provides advice based on the client's needs and risk profile and is subject to fiduciary and conflict-management obligations.

Financial Advisory and Distribution Services (cont)

- Distributor facilitates product sales and may earn commission from product manufacturers.

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Financial Advisory and Distribution Services (cont)

- Under SEBI's framework, investment advisers and distributors must comply with applicable segregation and conflict-of-interest requirements.

Financial Advisory and Distribution Services (cont)

- Investors should understand whether advice is independent/fee-based or linked to product distribution.

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Financial Advisory and Distribution Services (cont)

Importance

Financial Advisory and Distribution Services (cont)

- Improves financial awareness and access to formal financial products.

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Financial Advisory and Distribution Services (cont)

- Helps investors match investments with goals, time horizons and risk tolerance.

Financial Advisory and Distribution Services (cont)

- Supports capital formation by connecting savers with financial markets.

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Financial Advisory and Distribution Services (cont)

- Enables wider distribution of mutual funds, insurance and pension products.

Financial Advisory and Distribution Services (cont)

- Promotes financial inclusion and household financial planning.

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Financial Advisory and Distribution Services (cont)

MCQ Traps

Financial Advisory and Distribution Services (cont)

- Advisory = recommendation; distribution = sale/facilitation of financial products.

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Financial Advisory and Distribution Services (cont)

- SEBI regulates investment advisers; IRDAI regulates insurance intermediaries; PFRDA regulates pension intermediaries.

Financial Advisory and Distribution Services (cont)

- Mutual fund distributors are not the same as SEBI-registered investment advisers.

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Financial Advisory and Distribution Services (cont)

- Research analysts provide research-based recommendations; investment advisers provide client-oriented investment advice.

Financial Advisory and Distribution Services (cont)

- A distributor may earn commissions; an investment adviser operates under a separate regulatory framework with specific fee and conflict rules.

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Other Investment Products

Portfolio Management Services

Core concepts and types

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Portfolio Management Services (cont)

- PMS (Portfolio Management Services): Individual portfolio management service offered by a SEBI-registered portfolio manager.

Portfolio Management Services (cont)

- Discretionary PMS: Portfolio manager independently makes investment decisions within the client's agreed mandate.

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Portfolio Management Services (cont)

- Non-discretionary PMS: Manager executes investment decisions according to client instructions.

Portfolio Management Services (cont)

- Advisory PMS: Manager provides investment advice; client makes the final investment decisions.

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Portfolio Management Services (cont)

- Ownership: Client securities are maintained in separate accounts; PMS is not a pooled investment scheme.

Portfolio Management Services (cont)

Regulatory framework and important numbers

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Portfolio Management Services (cont)

- Governing regulations: SEBI (Portfolio Managers) Regulations, 2020; amended regulations notified in 2026 become effective from 1 April 2027.

Portfolio Management Services (cont)

- Minimum investment: ₹50 lakh per client under the current general PMS framework.

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Portfolio Management Services (cont)

- Portfolio manager net worth: Minimum ₹5 crore.

Portfolio Management Services (cont)

- Operating expenses: Maximum 0.50% p.a. of average daily AUM, excluding brokerage and over and above PMS fees.

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Portfolio Management Services (cont)

- Upfront fees: Prohibited.

Portfolio Management Services (cont)

- High Water Mark: Performance fees are charged only on gains above the previous highest portfolio value.

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Portfolio Management Services (cont)

- Grievance redressal: Within 21 calendar days.

Portfolio Management Services (cont)

- PRIM (Portfolio Management Services for Retail Investors): New framework effective 1 April 2027; ₹25 lakh minimum investment and ₹2 crore minimum net worth.

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REITs

Core concepts and structure

REITs (cont)

- REIT (Real Estate Investment Trust): Pools investors' money to invest primarily in income-generating real estate assets.

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REITs (cont)

- Typical Assets: Commercial offices, shopping malls, warehouses and other eligible properties.

REITs (cont)

- Sponsor: Establishes the REIT and fulfils sponsor-related obligations.

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REITs (cont)

- Trustee: Holds assets in trust and oversees the manager in the interest of unitholders.

REITs (cont)

- Manager: Manages investments, properties and operations.

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REITs (cont)

- Unitholders: Investors who purchase REIT units and receive distributions.

REITs (cont)

- SPV (Special Purpose Vehicle): Separate entity through which a REIT may hold real estate assets.

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REITs (cont)

Investment and regulatory requirements

REITs (cont)

- Regulator: SEBI; governing law is SEBI (Real Estate Investment Trusts) Regulations, 2014, last amended on 18 April 2026.

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REITs (cont)

- Minimum asset value for initial offer: ₹500 crore.

REITs (cont)

- Minimum initial offer size: ₹250 crore.

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REITs (cont)

- Minimum public unitholders: 200, excluding sponsors and related parties.

REITs (cont)

- Maximum subscription by one non-sponsor investor: 25% of total unit capital.

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REITs (cont)

- Completed and revenue-generating properties: Generally at least 80% of asset value.

REITs (cont)

- Distribution: Minimum 90% of NDCF (Net Distributable Cash Flows) to unitholders, at least half-yearly.

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REITs (cont)

- Borrowing limit: 49% of REIT asset value; above 25%, credit rating and unitholder approval are required.

REITs (cont)

- Valuation: Full valuation annually and half-yearly updates.

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REITs (cont)

- Listing: Mandatory listing of units on a recognised stock exchange.

REITs (cont)

Returns and risks

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REITs (cont)

- Returns: Rental income distributions and potential appreciation in unit prices.

REITs (cont)

- Major Risks: Vacancy, tenant default, interest rates, property valuation, liquidity and concentration.

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REITs (cont)

- Taxation: Pass-through treatment for specified income streams; actual tax depends on the nature of distribution and applicable tax provisions.

InvITs

Core concepts and structure

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InvITs (cont)

- InvIT (Infrastructure Investment Trust): Pools investors' money to invest in infrastructure assets such as roads, power transmission, pipelines and renewable energy projects.

InvITs (cont)

- Sponsor: Establishes the InvIT and fulfils sponsor-related obligations.

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InvITs (cont)

- Trustee: Holds assets in trust and oversees the investment manager.

InvITs (cont)

- Investment Manager: Manages investments, portfolio and regulatory compliance.

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InvITs (cont)

- Project Manager: Operates and manages infrastructure projects.

InvITs (cont)

- SPV (Special Purpose Vehicle): Separate entity created to own or operate a particular infrastructure project.

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InvITs (cont)

- Types: Publicly offered InvIT and privately placed InvIT; both are regulated by SEBI and units are listed.

InvITs (cont)

Investment and regulatory requirements

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InvITs (cont)

- Governing law: SEBI (Infrastructure Investment Trusts) Regulations, 2014; latest consolidated version amended on 17 April 2026.

InvITs (cont)

- Minimum asset value for initial offer: ₹500 crore.

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InvITs (cont)

- Minimum initial offer size: ₹250 crore.

InvITs (cont)

- Minimum private-placement investment: ₹25 lakh.

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InvITs (cont)

- Private-placement investors: 5–1,000.

InvITs (cont)

- Public unitholders after listing: Minimum 20.

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InvITs (cont)

- Public InvIT: At least 80% in completed and revenue-generating infrastructure projects.

InvITs (cont)

- Under-construction projects: Maximum 10% of asset value for public InvITs.

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InvITs (cont)

- Distribution: At least 90% of NDCF to unitholders; at least half-y-early.

InvITs (cont)

- Leverage: Higher borrowing beyond 25% requires additional safeguards; the overall ceiling can extend to 70%, subject to stricter conditions.

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InvITs (cont)

Returns and risks

InvITs (cont)

- Returns: Project operating cash flows, distributions and potential appreciation in unit prices.

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InvITs (cont)

- Major risks: Traffic, construction, regulatory, interest-rate, counte-rparty, liquidity and concentration risks.

ETFs

Core concepts and classification

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ETFs (cont)

- ETF (Exchange-Traded Fund): Investment fund whose units are listed and traded on stock exchanges like shares.

ETFs (cont)

- Passive ETF: Attempts to replicate an underlying index or asset rather than actively selecting investments.

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ETFs (cont)

- Types: Equity, debt, gold, silver, international, sectoral, thematic and hybrid ETFs.

ETFs (cont)

- Creation: Authorised Participant (AP) delivers underlying securities/cash to the ETF and receives ETF units.

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ETFs (cont)

- Redemption: AP returns ETF units and receives underlying securities/cash.

ETFs (cont)

- Market Maker: Provides buy/sell quotes to support exchange liquidity.

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ETFs (cont)

- Creation Unit: Fixed block of ETF units used for direct creation/redemption with the AMC.

ETFs (cont)

Pricing and performance

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ETFs (cont)

- NAV (Net Asset Value): Per-unit value of the fund's net assets.

ETFs (cont)

- Market Price: Exchange-traded price determined by demand and supply.

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ETFs (cont)

- Premium: Market price above NAV; Discount: Market price below NAV.

ETFs (cont)

- iNAV (Indicative Net Asset Value): Intraday estimate of ETF value based on current portfolio prices.

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ETFs (cont)

- Tracking Error: Annualised standard deviation of the difference between daily ETF and benchmark returns.

ETFs (cont)

- Tracking Difference: Actual annualised return difference between ETF and benchmark over a specified period.

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ETFs (cont)

- Tracking Error: Generally capped at 2% for equity ETFs/index funds, subject to exceptions; disclosed daily.

ETFs (cont)

- Debt ETFs/index funds: Annualised tracking difference averaged over one year should not exceed 1.25%.

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ETFs (cont)

- Tracking Difference Disclosure: Monthly for 1, 3, 5, 10 years and since inception.

ETFs (cont)

Regulatory requirements

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ETFs (cont)

- Market Makers: AMC must appoint at least two for ETFs.

ETFs (cont)

- Equity ETF iNAV: Updated within a maximum 15-second lag from the underlying market.

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ETFs (cont)

- Debt and Hybrid ETF iNAV: At least four times daily, with minimum 90-minute gaps between intervening disclosures.

ETFs (cont)

- Gold/Silver ETF iNAV: Based on latest available underlying prices.

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ETFs (cont)

- Regulator: SEBI; ETFs operate under the SEBI (Mutual Funds) Regulations, 2026 and applicable master circulars.

Index Funds

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Index Funds (cont)

- Index Fund: Passively managed mutual fund that aims to replicate the performance of a specified market index.

Index Funds (cont)

- Examples: Nifty 50 Index Fund, Sensex Index Fund and Nifty Next 50 Index Fund.

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Index Funds (cont)

- Passive Management: Fund follows the index rather than actively selecting securities to outperform it.

Index Funds (cont)

- Full Replication: Invests in all index constituents in their respective weights.

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Index Funds (cont)

- Sampling: Invests in a representative sample of index securities.

Index Funds (cont)

- Market-Cap Weighted Index: Weights securities according to market capitalisation.

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Index Funds (cont)

- Free-Float Market-Cap Weighted Index: Weights securities according to shares available for public trading; Nifty 50 follows this method.

Index Funds (cont)

- Equal-Weighted Index: Gives equal initial weight to every constituent.

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Index Funds (cont)

Performance and regulatory requirements

Index Funds (cont)

- Tracking Error: Annualised standard deviation of the difference between daily fund and benchmark returns.

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Index Funds (cont)

- Tracking Difference: Actual annualised return difference between the fund and benchmark.

Index Funds (cont)

- Non-debt Index Funds: Tracking error generally capped at 2%, subject to prescribed exceptions.

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Index Funds (cont)

- Debt Index Funds: One-year average annualised tracking difference should not exceed 1.25%.

Index Funds (cont)

- Disclosure: Tracking error daily; tracking difference monthly for 1, 3, 5, 10 years and since inception.

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Index Funds (cont)

- Underlying Index Concentration Norms: Minimum 10 stocks; maximum individual stock weight 25% for ordinary indices and 35% for sectoral/thematic indices; top three stocks together cannot exceed 65%.

Index Funds (cont)

- Trading Frequency: At least 80%; average impact cost maximum 1% over the previous six months.

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Index Funds (cont)

- Scheme Allocation: Many index-fund schemes invest at least 95% of net assets in underlying index securities.

Index Funds (cont)

Advantages and risks

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Index Funds (cont)

- Advantages: Diversification, transparency, passive management and generally lower costs.

Index Funds (cont)

- Risks: Market risk, concentration risk, tracking error, tracking difference and liquidity risk.

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Index Funds (cont)

- Limitation: An index fund follows its benchmark even when some constituent securities are performing poorly; it does not actively avoid declining stocks.

Structured Investment Products

Core concepts and classification

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Structured Investment Products (cont)

- Structured Investment Product: Financial product combining traditional instruments, such as bonds, with derivatives to create market-linked returns.

Structured Investment Products (cont)

- Underlying: Asset or benchmark on which returns depend, such as equity indices, shares, interest rates or commodities.

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Structured Investment Products (cont)

- Principal-Protected Product: Designed to repay original principal at maturity, subject to issuer solvency.

Structured Investment Products (cont)

- Non-Principal-Protected Product: Does not promise full principal repayment and may result in capital loss.

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Structured Investment Products (cont)

- MLD (Market-Linked Debenture): Debt instrument whose returns are linked to an underlying market variable rather than only a fixed coupon.

Structured Investment Products (cont)

- PP-MLD (Principal-Protected Market-Linked Debenture): MLD designed to repay principal at maturity, subject to issuer creditworthiness.

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Structured Investment Products (cont)

Regulatory framework and important numbers

Structured Investment Products (cont)

- Governing framework: SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, and applicable operational circulars.

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Structured Investment Products (cont)

- Issuer net worth: Minimum ₹100 crore at the time of issue for structured/market-linked debt securities under the prescribed framework.

Structured Investment Products (cont)

- Credit-rating prefix: PP-MLD for principal-protected market-linked debentures.

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Structured Investment Products (cont)

- Mandatory disclosures: Scenario analysis, model risk, issuer credit risk, valuation information, distributor commissions and premature redemption conditions.

Structured Investment Products (cont)

- Principal non-protected instruments: Not eligible for issue and listing as debt securities under the SEBI NCS framework.

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Mutual Funds vs PMS vs AIF

Core distinctions

Mutual Funds vs PMS vs AIF (cont)

- Mutual Fund: Pools money from multiple investors into a common scheme; investors hold units.

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Mutual Funds vs PMS vs AIF (cont)

- PMS (Portfolio Management Services): Manages an individual client's portfolio; client owns the underlying securities.

Mutual Funds vs PMS vs AIF (cont)

- AIF (Alternative Investment Fund): Privately pools money from eligible investors under a defined alternative investment strategy.

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Mutual Funds vs PMS vs AIF (cont)

- SIF (Specialized Investment Fund): SEBI-regulated mutual fund category offering more sophisticated investment strategies; positioned between conventional MFs and PMS/AIFs.

Mutual Funds vs PMS vs AIF (cont)

Important numbers

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Mutual Funds vs PMS vs AIF (cont)

- Mutual Funds: No universal minimum investment; scheme-specific minimums apply.

Mutual Funds vs PMS vs AIF (cont)

- SIF: ₹10 lakh minimum investment per strategy, subject to conditions.

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Mutual Funds vs PMS vs AIF (cont)

- PMS: ₹50 lakh minimum investment per client under the current general framework.

Mutual Funds vs PMS vs AIF (cont)

- AIF: Generally ₹1 crore minimum investment per investor.

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Mutual Funds vs PMS vs AIF (cont)

- AIF employee/director exception: ₹25 lakh, subject to conditions.

Mutual Funds vs PMS vs AIF (cont)

- AIF minimum corpus: ₹20 crore.

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Mutual Funds

Core concepts and classification

Mutual Fund: Pools money from multiple investors and invests in securities through professional management.

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Core concepts and classification (cont)

Objectives: Diversification, professional management, liquidity, affordability and wealth creation.

Core concepts and classification (cont)

Structure: Open-ended (ongoing purchase/redemption); Close--ended (fixed maturity); Interval (transactions during specified periods).

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Core concepts and classification (cont)

Equity Funds: Invest primarily in shares; aim at capital appreciation; generally carry higher market risk.

Core concepts and classification (cont)

Debt Funds: Invest in bonds, government securities and money--market instruments; carry credit and interest-rate risks.

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Core concepts and classification (cont)

Hybrid Funds: Invest in a combination of equity and debt.

Core concepts and classification (cont)

Index Fund: Passively managed fund that aims to replicate a specified market index; units purchased/redeemed through the fund.

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Core concepts and classification (cont)

ETF (Exchange Traded Fund): Fund whose units are traded on stock exchanges like shares.

Core concepts and classification (cont)

FoF (Fund of Funds): Mutual fund that invests in units of other mutual funds or investment funds.

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Participants and calculations

AMC (Asset Management Company): Manages mutual fund investments and scheme operations.

Participants and calculations (cont)

Trustee: Oversees the AMC and safeguards unitholders' interests.

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Participants and calculations (cont)

Custodian: Safeguards securities and assets held by the mutual fund.

Participants and calculations (cont)

RTA (Registrar and Transfer Agent): Maintains investor records and processes purchases, redemptions and other transactions.

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Participants and calculations (cont)

NAV (Net Asset Value): Per-unit value of a scheme's net assets. Formula = (Total Assets − Liabilities) ÷ Units Outstanding.

Participants and calculations (cont)

Expense Ratio: Annual scheme operating expenses expressed as a percentage of average net assets; expenses reduce investor returns.

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Participants and calculations (cont)

Direct Plan: Investment without a distributor; generally has a lower expense ratio.

Participants and calculations (cont)

Regular Plan: Investment through a distributor; includes applicable distribution expenses and generally has a higher expense ratio.

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Participants and calculations (cont)

Growth Option: Earnings remain invested in the scheme and are reflected in NAV.

Participants and calculations (cont)

IDCW (Income Distribution cum Capital Withdrawal): Scheme option under which distributions may be made to investors; not guaranteed and may include capital withdrawal.

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Transaction facilities and risks

SIP (Systematic Investment Plan): Invests a fixed amount at regular intervals; helps rupee-cost averaging.

Transaction facilities and risks (cont)

SWP (Systematic Withdrawal Plan): Withdraws a specified amount at regular intervals by redeeming units.

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Transaction facilities and risks (cont)

STP (Systematic Transfer Plan): Periodically transfers money from one mutual fund scheme to another.

Transaction facilities and risks (cont)

Rupee-Cost Averaging: Fixed periodic investment purchases more units at lower NAV and fewer units at higher NAV; does not guarantee profit.

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Transaction facilities and risks (cont)

Tracking Error: Difference between index fund/ETF returns and benchmark index returns.

Transaction facilities and risks (cont)

Major Risks: Market (price fluctuations); Credit (issuer default); Interest Rate (bond-price changes); Liquidity (difficulty selling); Concentration (excessive exposure); Inflation (loss of purchasing power); Currency (exchange-rate movements); Reinvestment (reinvesting proceeds at lower rates).

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Transaction facilities and risks (cont)

Riskometer: SEBI-prescribed scheme risk indicator: Low → Low to Moderate → Moderate → Moderately High → High → Very High.

Mutual funds: Regulatory framework

Regulator: SEBI (Securities and Exchange Board of India); regulates mutual funds to protect investors and ensure transparency.

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Mutual funds: Regulatory framework (cont)

Governing law: SEBI (Mutual Funds) Regulations, 2026; effective 1 April 2026, replacing the 1996 Regulations.

Mutual funds: Regulatory framework (cont)

Sponsor eligibility: Route 1 – 5 years' financial-services track record, net profit in each of the preceding 5 years and average annual net profit of at least ₹10 crore. Route 2 – key personnel with combined experience of at least 30 years.

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Mutual funds: Regulatory framework (cont)

AMC (Asset Management Company) net worth: Route 1 – minimum ₹50 crore; Route 2 – ₹150 crore initially and ₹100 crore continuously (may reduce to ₹50 crore after 5 consecutive profitable years).

Mutual funds: Regulatory framework (cont)

Sponsor contribution: Minimum 40% of AMC's net worth.

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Mutual funds: Regulatory framework (cont)

Governance: At least 2/3 independent directors on a trustee company board; at least 50% of AMC directors must be non-associates of the sponsor, subsidiaries or trustees.

Mutual funds: Regulatory framework (cont)

Equity-oriented scheme: Minimum 65% of net assets in equity and equity-related instruments (subject to regulatory definition).

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Mutual funds: Regulatory framework (cont)

Debt concentration limits: Single issuer exposure generally 10% for AAA, 8% for AA and 6% for A and below; additional 2% may be permitted with prescribed approvals, subject to 12% overall.

Mutual funds: Regulatory framework (cont)

BER (Base Expense Ratio): Base recurring expenses charged by a scheme, subject to SEBI ceilings. Generally, permitted BER decreases as AUM (Assets Under Management) increases.

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Mutual funds: Regulatory framework (cont)

TER (Total Expense Ratio): Overall scheme expenses, including BER and separately identified applicable brokerage, transaction costs and statutory levies.

Mutual funds: Regulatory framework (cont)

Brokerage ceilings: Cash-market transactions – 6 basis points (0.06%); derivatives – 2 basis points (0.02%).

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Mutual funds: Regulatory framework (cont)

Other expense-ratio changes: Earlier additional 5 bps allowance for schemes with exit loads removed; statutory levies are separately identified.

Mutual funds: Regulatory framework (cont)

Broad-based fund: Minimum 20 investors; no single investor can hold more than 25% of corpus.

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Mutual funds: Regulatory framework (cont)

AMC termination: At least 75% of unitholders can pass a resolution to terminate the AMC's appointment.

Mutual funds: Regulatory framework (cont)

Scheme disclosures: SID (Scheme Information Document) = detailed scheme information; KIM (Key Information Memorandum) = concise summary; NFO (New Fund Offer) = initial subscription offer of a new scheme.

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Mutual funds: Regulatory framework (cont)

Important distinction: SEBI = statutory regulator; AMFI (Association of Mutual Funds in India) = mutual fund industry association, not the regulator.

Derivatives

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Meaning, features and uses of derivatives.

Core concepts and features

Meaning, features and uses of derivatives. (cont)

- Derivative: Financial contract whose value is derived from an underlying asset, benchmark or variable.

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Meaning, features and uses of derivatives. (cont)

- Underlying Assets: Shares, indices, commodities, currencies, interest rates and bonds.

Meaning, features and uses of derivatives. (cont)

- Leverage: Small initial investment/margin creates exposure to a larger underlying position.

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Meaning, features and uses of derivatives. (cont)

- Standardisation: Exchange-traded derivatives generally have standardised terms; OTC derivatives can be customised.

Meaning, features and uses of derivatives. (cont)

- Settlement: Derivatives may involve physical delivery or cash settlement.

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Meaning, features and uses of derivatives. (cont)

Uses of derivatives

Meaning, features and uses of derivatives. (cont)

- Hedging: Reducing or managing risk arising from adverse price movements.

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Meaning, features and uses of derivatives. (cont)

- Speculation: Taking positions to profit from expected price movements; involves risk.

Meaning, features and uses of derivatives. (cont)

- Arbitrage: Exploiting price differences between identical or related assets across markets.

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Meaning, features and uses of derivatives. (cont)

- Price Discovery: Futures prices provide information about market expectations.

Meaning, features and uses of derivatives. (cont)

- Portfolio Management: Adjusting market exposure without directly transacting in all underlying assets.

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Forwards

Meaning and features

Forwards (cont)

- Forward Contract: OTC agreement to buy/sell an asset at a predetermined price on a future date.

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Forwards (cont)

- Customised: Contract size, price, maturity and settlement are mutually agreed.

Forwards (cont)

- Bilateral: Direct agreement between two parties.

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Forwards (cont)

- Obligation: Both parties must fulfil the contract.

Forwards (cont)

- Counterparty Risk: Risk that the other party defaults.

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Forwards (cont)

- Settlement: Physical delivery or cash settlement.

Forwards (cont)

Positions and payoff

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Forwards (cont)

- Long Forward: Buyer; payoff = (S_T-K).

Forwards (cont)

- Short Forward: Seller; payoff = (K-S_T).

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Forwards (cont)

- (S_T): Spot/market price at maturity; (K): Agreed forward price.

Futures

Meaning and features

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Futures (cont)

- Futures Contract: Standardised agreement to buy/sell an underlying asset at a predetermined price on a future date.

Futures (cont)

- Exchange-traded: Traded on recognised exchanges.

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Futures (cont)

- Standardised: Contract size, expiry and specifications determined by exchange.

Futures (cont)

- Clearing Corporation: Central counterparty that reduces counterparty risk.

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Futures (cont)

- Margin: Deposit required to maintain a futures position; not the full contract value.

Futures (cont)

- Leverage: Controls a large exposure using a smaller margin.

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Futures (cont)

- MTM (Mark-to-Market): Periodic settlement of gains and losses based on price movements.

Futures (cont)

Margin concepts

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Futures (cont)

- Initial Margin: Deposit required to open a position.

Futures (cont)

- Maintenance Margin: Minimum balance to be maintained.

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Futures (cont)

- Variation Margin: Payment/receipt arising from price changes.

Futures (cont)

- Margin Call: Demand for additional funds when margin falls below the required level.

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Futures (cont)

Positions and payoff

Futures (cont)

- Long Futures: Buyer; gains when price rises.

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Futures (cont)

- Short Futures: Seller; gains when price falls.

Futures (cont)

- Long payoff = (S_T-K).

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Futures (cont)

- Short payoff = (K-S_T).

Futures (cont)

- Futures and spot prices generally converge at expiry.

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Options

Core concepts

Options (cont)

- Option: Contract giving buyer the right, but not obligation, to buy or sell an underlying asset.

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Options (cont)

- Call Option: Right to buy; buyer generally expects prices to rise.

Options (cont)

- Put Option: Right to sell; buyer generally expects prices to fall.

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Options (cont)

- Option Buyer: Pays premium and receives a right.

Options (cont)

- Option Writer: Receives premium and assumes an obligation.

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Options (cont)

- Strike Price: Predetermined exercise price.

Options (cont)

- Premium: Price paid by option buyer.

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Options (cont)

- Expiry: Date on which the option contract ends.

Options (cont)

Payoff and profit

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Options (cont)

- Call buyer payoff = max((S_T-K), 0).

Options (cont)

- Put buyer payoff = max((K-S_T), 0).

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Options (cont)

- Call buyer profit = Payoff − Premium.

Options (cont)

- Put buyer profit = Payoff − Premium.

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Options (cont)

- Option buyer's maximum loss = Premium paid.

Options (cont)

- Option writer's maximum gain = Premium received.

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Options (cont)

Moneyness

Options (cont)

- Call ITM: Spot price greater than strike price.

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Options (cont)

- Put ITM: Spot price lower than strike price.

Options (cont)

- ATM: Spot approximately equals strike.

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Options (cont)

- OTM: Call spot below strike; put spot above strike.

Options (cont)

Exercise styles

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Options (cont)

- European: Exercise only on expiry.

Options (cont)

- American: Exercise any time up to expiry.

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Swaps

Meaning and features

Swaps (cont)

- Swap: Derivative contract involving exchange of cash flows or financial obligations between two parties.

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Swaps (cont)

- Notional Principal: Reference amount used to calculate payments; generally not exchanged in an interest rate swap.

Swaps (cont)

- OTC: Swaps are commonly customised bilateral contracts.

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Swaps (cont)

- Net Settlement: Parties may exchange only the net difference between payment obligations.

Swaps (cont)

Types of swaps

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Swaps (cont)

- Interest Rate Swap: Exchange fixed-rate interest payments for floating-rate interest payments, or vice versa.

Swaps (cont)

- Currency Swap: Exchange principal and interest payments in two different currencies; principal is generally exchanged at the beginning and maturity.

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Swaps (cont)

- Commodity Swap: Exchange fixed commodity price payments for floating market-linked payments.

Swaps (cont)

- Equity Swap: Exchange equity/index returns for fixed or floating returns.

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Swaps (cont)

Uses and risks

Swaps (cont)

- Uses: Hedging interest rate, currency, commodity and equity risks; asset-liability management; financing flexibility; speculation.

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Swaps (cont)

- Risks: Counterparty, market, liquidity, basis and settlement risks.

Hedging, Speculation and Arbitrage

Core concepts and objectives

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Hedging, Speculation and Arbitrage (cont)

- Hedging: Taking an offsetting derivative position to reduce risk from adverse price movements in an existing exposure.

Hedging, Speculation and Arbitrage (cont)

- Speculation: Taking a position to profit from expected price movements, without necessarily having an existing exposure.

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Hedging, Speculation and Arbitrage (cont)

- Arbitrage: Exploiting price differences in the same or related assets across markets by buying cheap and selling dear.

Hedging, Speculation and Arbitrage (cont)

- Risk Transfer: Shifting risk from hedgers to participants willing to assume it.

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Hedging, Speculation and Arbitrage (cont)

- Price Discovery: Derivative prices reflect market expectations about future prices.

Hedging, Speculation and Arbitrage (cont)

- Market Efficiency: Arbitrage helps correct mispricing and align related asset prices.

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Hedging, Speculation and Arbitrage (cont)

Strategies and examples

Hedging, Speculation and Arbitrage (cont)

- Long Hedge: Buy futures to protect against a future price rise; e.g. importer or airline.

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Hedging, Speculation and Arbitrage (cont)

- Short Hedge: Sell futures to protect against a future price fall; e.g. farmer hedging crop sale.

Hedging, Speculation and Arbitrage (cont)

- Currency Hedge: Importer buys foreign currency forward; exporter sells foreign currency forward.

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Hedging, Speculation and Arbitrage (cont)

- Protective Put: Buy a put option on an existing shareholding to limit losses from a price fall; premium is the protection cost.

Hedging, Speculation and Arbitrage (cont)

- Cash-and-Carry Arbitrage: Buy spot asset + sell overpriced futures.

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Hedging, Speculation and Arbitrage (cont)

- Reverse Cash-and-Carry: Sell/short spot asset + buy underpriced futures.

Hedging, Speculation and Arbitrage (cont)

- Spatial Arbitrage: Exploit price differences across exchanges or locations.

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Hedging, Speculation and Arbitrage (cont)

- Statistical Arbitrage: Use quantitative models to exploit temporary pricing relationships.

Hedging, Speculation and Arbitrage (cont)

Important distinctions and exam traps

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Hedging, Speculation and Arbitrage (cont)

- Hedging reduces existing risk; speculation assumes risk; arbitrage exploits price discrepancies.

Hedging, Speculation and Arbitrage (cont)

- Hedging may limit potential gains and does not eliminate all risk.

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Hedging, Speculation and Arbitrage (cont)

- Perfect Hedge: Derivative gain/loss exactly offsets the underlying exposure.

Hedging, Speculation and Arbitrage (cont)

- Basis Risk: Risk that derivative and underlying exposure prices do not move exactly together.

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Hedging, Speculation and Arbitrage (cont)

- Speculators provide liquidity and take the opposite side of hedgers' trades.

Hedging, Speculation and Arbitrage (cont)

- Arbitrage promotes price alignment, but transaction costs, liquidity and execution risks can eliminate apparent profits.

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Hedging, Speculation and Arbitrage (cont)

- Long Hedge = protection against price rise; Short Hedge = protection against price fall.

Exchange-Traded vs OTC Derivatives

Core concepts and structure

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Exchange-Traded vs OTC Derivatives (cont)

- ETD (Exchange-Traded Derivative): Standardised derivative contract traded on a recognised exchange.

Exchange-Traded vs OTC Derivatives (cont)

- OTC (Over-the-Counter Derivative): Privately negotiated derivative contract between two parties.

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Exchange-Traded vs OTC Derivatives (cont)

- ETDs: Standardised contract size, expiry and terms; generally more transparent and liquid.

Exchange-Traded vs OTC Derivatives (cont)

- OTC: Customised amount, maturity and settlement; generally less transparent and less liquid.

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Exchange-Traded vs OTC Derivatives (cont)

Clearing and risk management

Exchange-Traded vs OTC Derivatives (cont)

- CCP (Central Counterparty): Interposes itself between buyer and seller, reducing bilateral counterparty risk.

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Exchange-Traded vs OTC Derivatives (cont)

- Novation: Clearing corporation replaces the original buyer-seller contract with two contracts.

Exchange-Traded vs OTC Derivatives (cont)

- Margin: Security deposit to cover potential losses.

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Exchange-Traded vs OTC Derivatives (cont)

- Netting: Offsetting payment obligations to determine the net amount payable.

Exchange-Traded vs OTC Derivatives (cont)

- OTC derivatives can also be centrally cleared; OTC does not automatically mean uncleared.

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Exchange-Traded vs OTC Derivatives (cont)

Examples and exam traps

Exchange-Traded vs OTC Derivatives (cont)

- ETD: Nifty futures/options, stock derivatives, exchange-traded currency and commodity futures.

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Exchange-Traded vs OTC Derivatives (cont)

- OTC: Forward contracts, interest rate swaps, currency swaps and customised derivatives.

Exchange-Traded vs OTC Derivatives (cont)

- ETD = Standardisation + Exchange + Central clearing (typically).

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Exchange-Traded vs OTC Derivatives (cont)

- OTC = Customisation + Bilateral negotiation (typically).

Exchange-Traded vs OTC Derivatives (cont)

- Counterparty risk is generally higher in bilateral, uncleared OTC contracts.

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Exchange-Traded vs OTC Derivatives (cont)

- OTC offers flexibility; ETDs generally offer greater transparency and easier trading.

Exchange-Traded vs OTC Derivatives (cont)

- Both ETD and OTC derivatives can be used for hedging, speculation and arbitrage.

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Finance Cheat Sheet

by keersri05 via cheatography.com/217923/cs/48575/

Derivative Mechanics

Call and put options

Options and contract terminology

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Call and put options (cont)

- Call: Right to buy; buyer bullish.

Call and put options (cont)

- Put: Right to sell; buyer bearish.

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Call and put options (cont)

- Long: Buyer of a contract; Short: Seller/writer.

Call and put options (cont)

- Strike Price: Predetermined exercise price.

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Call and put options (cont)

- Premium: Price paid by option buyer; maximum buyer loss and maximum writer gain.

Call and put options (cont)

- Expiry: Date on which option validity ends.

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Call and put options (cont)

- Exercise: Use of the option right.

Call and put options (cont)

- Settlement: Final fulfilment through cash or delivery.

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Call and put options (cont)

Intrinsic value and time value

Call and put options (cont)

- Option Premium = Intrinsic Value + Time Value.

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Call and put options (cont)

- Call intrinsic value = Max (S − K, 0).

Call and put options (cont)

- Put intrinsic value = Max (K − S, 0).

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Call and put options (cont)

- Time value = Premium − Intrinsic Value.

Call and put options (cont)

- OTM options have zero intrinsic value; at expiry, time value becomes zero.

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Call and put options (cont)

- Time decay: Time value generally falls as expiry approaches.

Call and put options (cont)

- Higher volatility and longer time to expiry generally increase option premium, all else equal.

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Call and put options (cont)

Payoff, profit/loss and breakeven

Call and put options (cont)

- Call buyer payoff = Max (S − K, 0); profit = payoff − premium.

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Call and put options (cont)

- Put buyer payoff = Max (K − S, 0); profit = payoff − premium.

Call and put options (cont)

- Call seller profit = Premium − call buyer payoff.

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Call and put options (cont)

- Put seller profit = Premium − put buyer payoff.

Call and put options (cont)

- Long Call breakeven = K + Premium.

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Call and put options (cont)

- Long Put breakeven = K − Premium.

Call and put options (cont)

- Long Call: Unlimited profit potential; maximum loss = premium.

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Call and put options (cont)

- Long Put: Maximum profit = K − premium (assuming underlying cannot fall below zero); maximum loss = premium.

Call and put options (cont)

- Short Call: Maximum gain = premium; theoretically unlimited loss.

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Call and put options (cont)

- Short Put: Maximum gain = premium; maximum loss = K − premium (assuming zero minimum underlying price).

Call and put options (cont)

Futures margins and settlement

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Call and put options (cont)

- Initial Margin: Deposit required to open position.

Call and put options (cont)

- Maintenance Margin: Minimum balance to maintain position.

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Call and put options (cont)

- Margin Call: Additional funds required when margin falls below required level.

Call and put options (cont)

- Variation Margin: Payment/receipt arising from price changes.

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Call and put options (cont)

- MTM (Mark-to-Market): Daily settlement of futures gains/losses.

Call and put options (cont)

- SPAN: Risk-based margin calculation system.

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Call and put options (cont)

- Contract Value = Futures Price × Lot Size.

Call and put options (cont)

- Initial Margin = Contract Value × Margin %.

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Call and put options (cont)

- Cash Settlement: Net monetary difference settled.

Call and put options (cont)

- Physical Settlement: Actual delivery of underlying asset.

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Call and put options (cont)

- Offsetting: Closing a position through an opposite trade.

Call and put options (cont)

Exam traps

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Call and put options (cont)

- Payoff excludes premium; profit/loss includes premium.

Call and put options (cont)

- Option buyer has a right; futures buyer has an obligation.

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Call and put options (cont)

- Long futures benefits from rising prices; short futures benefits from falling prices.

Call and put options (cont)

- Premium is paid upfront; futures margin is security deposit, not purchase price.

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Call and put options (cont)

- At expiry, time value is zero.

Call and put options (cont)

- Leverage magnifies both gains and losses.

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Long and short positions

Long position: Buy-side exposure; gains when underlying price rises.

Long and short positions (cont)

Short position: Sell-side exposure; gains when underlying price falls.

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Long and short positions (cont)

Long futures: Profit = (Final price − Entry price) × Lot size.

Long and short positions (cont)

Short futures: Profit = (Entry price − Final price) × Lot size.

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Long and short positions (cont)

Long call: Right to buy; bullish; maximum loss = premium.

Long and short positions (cont)

Long put: Right to sell; bearish; maximum loss = premium.

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Long and short positions (cont)

Short call: Writer receives premium; theoretically unlimited loss.

Long and short positions (cont)

Short put: Writer receives premium; maximum loss = Strike price − Premium (assuming underlying cannot fall below zero).

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Strike, Premium & Expiry

Strike price (K): Predetermined exercise price in an option contract.

Strike, Premium & Expiry (cont)

Call: Right to buy at strike price.

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Strike, Premium & Expiry (cont)

Put: Right to sell at strike price.

Strike, Premium & Expiry (cont)

Premium: Price paid by buyer and received by writer.

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Strike, Premium & Expiry (cont)

Buyer: Has a right, not an obligation; maximum loss = premium.

Strike, Premium & Expiry (cont)

Writer: Has an obligation if exercised; maximum gain = premium.

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Strike, Premium & Expiry (cont)

Expiry: Date on which option validity ends; time value becomes zero.

Strike, Premium & Expiry (cont)

Spot price: Current market price of underlying.

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Strike, Premium & Expiry (cont)

Exercise: Buyer uses the option right.

Strike, Premium & Expiry (cont)

Settlement: Contract is fulfilled through cash payment or delivery, as applicable.

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Intrinsic & Time Value

- Premium = Intrinsic Value + Time Value.

Intrinsic & Time Value (cont)

- Call intrinsic = max (Spot − Strike, 0).

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Intrinsic & Time Value (cont)

- Put intrinsic = max (Strike − Spot, 0).

Intrinsic & Time Value (cont)

- Time value = Premium − Intrinsic Value.

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Intrinsic & Time Value (cont)

- Intrinsic value = immediate exercise benefit; never negative.

Intrinsic & Time Value (cont)

- ITM: Positive intrinsic value.

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Intrinsic & Time Value (cont)

- ATM: Spot approximately equals strike.

Intrinsic & Time Value (cont)

- OTM: Zero intrinsic value.

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Intrinsic & Time Value (cont)

- More time to expiry → generally higher time value.

Intrinsic & Time Value (cont)

- Higher volatility → generally higher option premium.

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Intrinsic & Time Value (cont)

- Time decay: Time value falls as expiry approaches; becomes zero at expiry.

Intrinsic & Time Value (cont)

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Intrinsic & Time Value (cont)

- An OTM option can still have a premium because of time value.

Intrinsic & Time Value (cont)

- An ITM option's premium can exceed its intrinsic value.

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Intrinsic & Time Value (cont)

- At expiry, premium equals intrinsic value (before considering transaction costs).

Option Payoff and Profit/Loss

Position Profit/Loss Breakeven

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Option Payoff and Profit/Loss (cont)

Long Call max(S−K, 0) − P K + P

Option Payoff and Profit/Loss (cont)

Short Call P − max(S−K, 0) K + P

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Option Payoff and Profit/Loss (cont)

Long Put max(K−S, 0) − P K − P

Option Payoff and Profit/Loss (cont)

Short Put P − max(K−S, 0) K − P

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Option Payoff and Profit/Loss (cont)

Maximum gain/loss:

Option Payoff and Profit/Loss (cont)

- Long Call: Unlimited gain; loss limited to premium.

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Option Payoff and Profit/Loss (cont)

- Short Call: Gain limited to premium; theoretically unlimited loss.

Option Payoff and Profit/Loss (cont)

- Long Put: Gain limited to K − P; loss limited to premium.

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Option Payoff and Profit/Loss (cont)

- Short Put: Gain limited to premium; loss limited to K − P.

Option Payoff and Profit/Loss (cont)

Exam traps:

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Option Payoff and Profit/Loss (cont)

- Payoff does not include premium; profit/loss does.

Option Payoff and Profit/Loss (cont)

- Breakeven is where net profit/loss = zero.

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Option Payoff and Profit/Loss (cont)

- Call buyer benefits from rising prices; put buyer benefits from falling prices.

Option Payoff and Profit/Loss (cont)

- Option buyer's maximum loss is always the premium paid.

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Futures Settlement and Margin

Initial margin: Deposit required to open a futures position.

Futures Settlement and Margin (cont)

Maintenance margin: Minimum balance required to keep the position open.

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Futures Settlement and Margin (cont)

Margin call: Additional funds demanded when balance falls below maintenance margin.

Futures Settlement and Margin (cont)

Variation margin: Funds transferred to cover daily MTM gains/-losses.

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Futures Settlement and Margin (cont)

SPAN margin: Risk-based initial margin system.

Futures Settlement and Margin (cont)

Exposure margin: Additional margin for extreme potential losses.

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Futures Settlement and Margin (cont)

MTM: Daily settlement of futures gains and losses.

Futures Settlement and Margin (cont)

Contract value = Futures price × Lot size.

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Futures Settlement and Margin (cont)

Initial margin = Contract value × Margin percentage.

Futures Settlement and Margin (cont)

Long futures P/L = (Final price − Entry price) × Lot size.

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Futures Settlement and Margin (cont)

Short futures P/L = (Entry price − Final price) × Lot size.

Futures Settlement and Margin (cont)

Settlement: Cash or physical, depending on contract; position may also be closed by taking an opposite trade.

Exam traps:
- Margin is a security deposit, not the price of the contract.
- Futures have daily MTM; ordinary option buyers pay a premium upfront.
- Long futures gain when prices rise; short futures gain when prices fall.
- Leverage magnifies both gains and losses.

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Financial Inclusion and Technology

Financial Inclusion

- Financial Inclusion: Affordable, appropriate and timely access to formal financial services for all sections of society, especially underserved groups.

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Financial Inclusion (cont)

- Scope: Banking, savings, credit, insurance, pensions and digital payments.

Financial Inclusion (cont)

- Four dimensions:

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Financial Inclusion (cont)

- Access = Availability of services.

Financial Inclusion (cont)

- Usage = Actual utilisation.

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Financial Inclusion (cont)

- Quality = Affordability, suitability and reliability.

Financial Inclusion (cont)

- Financial capability = Ability to make informed financial decisions.

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Financial Inclusion (cont)

- Importance: Poverty reduction, savings mobilisation, economic growth, women empowerment, rural development, MSME financing, reduced dependence on informal lenders and efficient welfare delivery.

Financial Inclusion (cont)

- Financial exclusion: Lack of access to or inability to use appropriate formal financial services.

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Financial Inclusion (cont)

- Common challenges: Poor infrastructure, low financial/digital literacy, connectivity issues, documentation barriers, inactive accounts, gender inequality and cyber fraud.

Financial Inclusion (cont)

MCQ traps

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Financial Inclusion (cont)

- Financial inclusion is broader than merely opening bank accounts.

Financial Inclusion (cont)

- Access does not necessarily mean actual usage.

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Financial Inclusion (cont)

- Financial inclusion covers credit, insurance and pensions—not just deposits.

Financial Inclusion (cont)

- Quality and affordability are important dimensions.

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Financial Inclusion (cont)

- Financial literacy supports financial inclusion but is not identical to it.

Pradhan Mantri Jan Dhan Yojana (PMJDY)

- Launch: 28 August 2014.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Launched by: Government of India.

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Objective: Financial inclusion through universal access to basic banking services.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Account: Basic Savings Bank Deposit Account (BSBDA).

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Minimum balance: Zero; no minimum balance requirement.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Interest: Earned on deposits as per applicable bank rates.

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Debit card: RuPay debit card.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Overdraft: Up to ₹10,000 for eligible account holders, subject to conditions.

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- DBT: Enables direct transfer of government benefits and subsidies.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Insurance: RuPay-linked accident insurance cover, subject to scheme eligibility and conditions.

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Banking access: Bank branches and Business Correspondents.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Associated schemes:

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- PMJJBY – life insurance.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- PMSBY – accident insurance.

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- APY – pension.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

MCQ traps

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- PMJDY is a financial inclusion mission, not an insurance scheme.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Zero balance does not mean zero interest.

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- RuPay is operated by NPCI.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Overdraft is a credit facility, not a grant or subsidy.

Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- PMJDY accounts facilitate DBT but DBT is not limited to PMJDY accounts.

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Pradhan Mantri Jan Dhan Yojana (PMJDY) (cont)

- Accident insurance cover depends on applicable eligibility and usage conditions.

Aadhaar and Direct Benefit Transfer (DBT)

- Aadhaar: 12-digit unique identity number issued by UIDAI to residents of India.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- UIDAI: Unique Identification Authority of India; responsible for Aadhaar enrolment and authentication ecosystem.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- Biometrics: Fingerprints and iris scans.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- Authentication: Verification through permitted demographic, biometric or OTP-based methods.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- Aadhaar is proof of identity, not proof of citizenship.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- DBT: Direct transfer of government benefits, subsidies and payments into beneficiaries' bank accounts.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- DBT launch: 1 January 2013.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- Objectives: Reduce leakages, eliminate duplicate beneficiaries, improve transparency and ensure timely benefit delivery.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- JAM Trinity:

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- J = Jan Dhan bank accounts.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- A = Aadhaar identity.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- M = Mobile connectivity.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- APBS: Aadhaar Payment Bridge System; routes DBT payments to Aadhaar-seeded bank accounts.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- AePS: Aadhaar Enabled Payment System; facilitates basic banking transactions using Aadhaar authentication.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- AePS services: Cash withdrawal, cash deposit, balance enquiry and mini statement.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- NPCI: Operates APBS and AePS infrastructure.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

MCQ traps

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- Aadhaar is not proof of citizenship.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- UIDAI issues Aadhaar; NPCI operates payment systems such as APBS and AePS.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- APBS is primarily for routing DBT payments; AePS enables customer-initiated banking transactions.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- JAM = Jan Dhan + Aadhaar + Mobile.

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Aadhaar and Direct Benefit Transfer (DBT) (cont)

- Aadhaar authentication and Aadhaar-based payment routing are different functions.

Aadhaar and Direct Benefit Transfer (DBT) (cont)

- Aadhaar linkage is subject to applicable legal and scheme requirements; Aadhaar is not universally mandatory for every financial service.

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UPI and Digital Payments

- UPI: Unified Payments Interface; instant, real-time, 24×7 payment system launched in 2016 by NPCI.

UPI and Digital Payments (cont)

- VPA: Virtual Payment Address; identifier used to make and receive payments without sharing bank account details.

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UPI and Digital Payments (cont)

- P2P: Person-to-Person payments.

UPI and Digital Payments (cont)

- P2M: Person-to-Merchant payments.

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UPI and Digital Payments (cont)

- UPI PIN: Used to authorise transactions; must never be shared.

UPI and Digital Payments (cont)

- RuPay: Domestic card payment network developed by NPCI.

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UPI and Digital Payments (cont)

- IMPS: Immediate Payment Service; instant 24×7 interbank fund transfer system operated by NPCI.

UPI and Digital Payments (cont)

- NEFT: RBI-operated, batch-based electronic fund transfer system; available 24×7.

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UPI and Digital Payments (cont)

- RTGS: RBI-operated real-time gross settlement system; minimum transaction amount ₹2 lakh, with no RBI-prescribed upper ceiling.

UPI and Digital Payments (cont)

- BHIM: Bharat Interface for Money; UPI-based payment application developed by NPCI.

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UPI and Digital Payments (cont)

- BBPS: Bharat Bill Payment System; interoperable bill payment platform.

UPI and Digital Payments (cont)

- NACH: National Automated Clearing House; bulk and repetitive payments such as salaries, pensions and loan EMIs.

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UPI and Digital Payments (cont)

- *USSD (99#): Mobile banking without internet access.

UPI and Digital Payments (cont)

- FASTag: RFID-based electronic toll collection.

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UPI and Digital Payments (cont)

- NCMC: National Common Mobility Card; interoperable payments across participating transport systems.

UPI and Digital Payments (cont)

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UPI and Digital Payments (cont)

- UPI, IMPS, RuPay and BHIM are associated with NPCI.

UPI and Digital Payments (cont)

- NEFT and RTGS are operated by RBI.

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UPI and Digital Payments (cont)

- NEFT is batch-based; RTGS is real-time and gross.

UPI and Digital Payments (cont)

- RTGS minimum amount = ₹2 lakh.

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UPI and Digital Payments (cont)

- UPI is a payment interface; BHIM is an application using UPI.

UPI and Digital Payments (cont)

- RuPay is a card network, whereas UPI is an instant payment system.

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UPI and Digital Payments (cont)

- BBPS = bill payments; NACH = bulk/repetitive payments.

UPI and Digital Payments (cont)

- Digital payments improve convenience and financial inclusion but create cybersecurity, fraud and consumer-protection risks.

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Payment Banks and Small Finance Banks

- Payment Banks: Specialised banks focused on small savings, payments and remittances.

Payment Banks and Small Finance Banks (cont)

- Introduced: RBI guidelines issued in 2014.

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Payment Banks and Small Finance Banks (cont)

- Payment Bank deposit limit: ₹2 lakh per individual customer.

Payment Banks and Small Finance Banks (cont)

- Can do: Accept demand deposits, issue debit/ATM cards, provide remittances and payment services, distribute permitted third-party financial products.

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Payment Banks and Small Finance Banks (cont)

- Cannot do: Lending, issue credit cards or accept fixed and recurring deposits.

Payment Banks and Small Finance Banks (cont)

- Investment requirement: Prescribed portion of demand deposits must be invested in eligible government securities and balances maintained with scheduled commercial banks.

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Payment Banks and Small Finance Banks (cont)

- Examples: India Post Payments Bank, Airtel Payments Bank, Fino Payments Bank, Jio Payments Bank.

Payment Banks and Small Finance Banks (cont)

- Small Finance Banks (SFBs): Specialised banks providing deposits and credit to underserved sections.

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Payment Banks and Small Finance Banks (cont)

- Target customers: Small and marginal farmers, micro and small businesses, low-income households and unorganised sector entities.

Payment Banks and Small Finance Banks (cont)

- Can do: Accept savings/current/fixed/recurring deposits, provide loans, issue debit and credit cards subject to regulations.

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Payment Banks and Small Finance Banks (cont)

- PSL target: 75% of ANBC or CEOBSE, whichever is higher.

Payment Banks and Small Finance Banks (cont)

- Examples: AU, Ujjivan, Equitas, Jana, ESAF and Suryoday Small Finance Banks.

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Payment Banks and Small Finance Banks (cont)

- Regulator: RBI.

Payment Banks and Small Finance Banks (cont)

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Payment Banks and Small Finance Banks (cont)

- Payment Banks can accept deposits but cannot lend.

Payment Banks and Small Finance Banks (cont)

- Payment Banks' individual customer deposit limit = ₹2 lakh.

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Payment Banks and Small Finance Banks (cont)

- Payment Banks cannot issue credit cards.

Payment Banks and Small Finance Banks (cont)

- SFBs can both accept deposits and provide loans.

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Payment Banks and Small Finance Banks (cont)

- SFBs have a higher PSL target (75%) than the general domestic commercial bank target (40%).

Payment Banks and Small Finance Banks (cont)

- Payment Banks and SFBs are different differentiated banking models, not separate regulators.

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Payment Banks and Small Finance Banks (cont)

- Payment Banks cannot accept fixed deposits; SFBs can.

Fintech and Digital Lending

- Fintech: Application of technology to financial services.

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Fintech and Digital Lending (cont)

- Applications:

Fintech and Digital Lending (cont)

- Payments = UPI, wallets, QR codes.

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Fintech and Digital Lending (cont)

- Lending = Digital loan processing.

Fintech and Digital Lending (cont)

- Insurtech = Technology-based insurance.

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Fintech and Digital Lending (cont)

- Wealthtech = Digital investment and wealth management.

Fintech and Digital Lending (cont)

- Regtech = Technology for regulatory compliance.

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Fintech and Digital Lending (cont)

- AI/ML = Fraud detection, credit scoring and risk assessment.

Fintech and Digital Lending (cont)

- Blockchain = Distributed ledger technology.

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Fintech and Digital Lending (cont)

- Benefits: Faster services, lower costs, automation, improved access and financial inclusion.

Fintech and Digital Lending (cont)

- Risks: Cyber fraud, data breaches, privacy concerns, algorithmic bias, mis-selling and over-indebtedness.

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Fintech and Digital Lending (cont)

- Digital Lending: Electronic delivery of loans, including application, verification, assessment, disbursal and repayment.

Fintech and Digital Lending (cont)

- RE: Regulated Entity, such as a bank or NBFC.

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Fintech and Digital Lending (cont)

- LSP: Lending Service Provider; acts as an agent of a regulated lender.

Fintech and Digital Lending (cont)

- DLA: Digital Lending App through which customers access digital lending services.

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Fintech and Digital Lending (cont)

- APR: Annual Percentage Rate; annualised cost of borrowing, including interest and applicable charges.

Fintech and Digital Lending (cont)

- KFS: Key Fact Statement; discloses key loan terms and costs.

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Fintech and Digital Lending (cont)

- BNPL: Buy Now, Pay Later; short-term credit for purchases.

Fintech and Digital Lending (cont)

- P2P Lending: Online platform connecting borrowers and lenders; platforms in India are regulated as NBFC-P2Ps by RBI.

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Fintech and Digital Lending (cont)

- Co-lending: Two regulated lenders jointly finance loans under an agreed arrangement.

Fintech and Digital Lending (cont)

- DLG/FLDG: Default Loss Guarantee / First Loss Default Guarantee; arrangement to compensate a lender for specified loan defaults, subject to RBI requirements.

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Fintech and Digital Lending (cont)

- RBI Digital Lending Directions, 2025: Issued 8 May 2025; consolidated earlier instructions and introduced additional safeguards.

Fintech and Digital Lending (cont)

- Cooling-off period: Minimum one day; borrower can exit by paying principal and proportionate APR without penalty.

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Fintech and Digital Lending (cont)

- Public DLA directory: Helps customers check reported associations between digital lending apps and regulated entities.

Fintech and Digital Lending (cont)

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Fintech and Digital Lending (cont)

- LSP is not necessarily the lender; the regulated entity remains responsible.

Fintech and Digital Lending (cont)

- Digital lending is not unregulated merely because a fintech app provides the interface.

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Fintech and Digital Lending (cont)

- KFS provides loan-cost transparency.

Fintech and Digital Lending (cont)

- APR is broader than the stated interest rate.

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Fintech and Digital Lending (cont)

- P2P lending platforms are regulated as NBFC-P2Ps.

Fintech and Digital Lending (cont)

- Fintech is broader than digital payments; it also covers lending, insurance, investments and compliance.

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Financial Literacy and Consumer Protection

A. Financial Literacy

Financial Literacy and Consumer Protection (cont)

Financial literacy means having the knowledge, skills, attitude and behaviour required to make informed financial decisions and manage money effectively.

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Financial Literacy and Consumer Protection (cont)

It enables individuals to understand financial products, assess risks and use financial services responsibly.

Financial Literacy and Consumer Protection (cont)

Key Components

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Financial Literacy and Consumer Protection (cont)

1. Financial awareness: Understanding banking, savings, credit, insurance, pensions and investments.

Financial Literacy and Consumer Protection (cont)

2. Financial knowledge: Understanding interest rates, inflation, compounding, risk and returns.

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Financial Literacy and Consumer Protection (cont)

3. Financial skills: Budgeting, saving, borrowing responsibly and managing debt.

Financial Literacy and Consumer Protection (cont)

4. Financial behaviour: Making informed decisions, avoiding impulsive borrowing and planning for future needs.

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Financial Literacy and Consumer Protection (cont)

5. Financial attitude: Developing a responsible approach towards savings, spending and long-term financial planning.

Financial Literacy and Consumer Protection (cont)

Importance of Financial Literacy

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Financial Literacy and Consumer Protection (cont)

- Encourages savings and responsible investment.

Financial Literacy and Consumer Protection (cont)

- Helps individuals compare financial products and understand their costs.

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Financial Literacy and Consumer Protection (cont)

- Prevents excessive borrowing and over-indebtedness.

Financial Literacy and Consumer Protection (cont)

- Helps people identify fraudulent schemes and financial scams.

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Financial Literacy and Consumer Protection (cont)

- Improves retirement and insurance planning.

Financial Literacy and Consumer Protection (cont)

- Promotes informed use of digital financial services.

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Financial Literacy and Consumer Protection (cont)

- Strengthens financial inclusion by ensuring that access translates into effective usage.

Financial Literacy and Consumer Protection (cont)

Important Concepts

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Financial Literacy and Consumer Protection (cont)

- Compounding: Interest earned on both principal and previously accumulated interest.

Financial Literacy and Consumer Protection (cont)

- Inflation: General rise in prices, reducing the purchasing power of money.

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Financial Literacy and Consumer Protection (cont)

- Diversification: Spreading investments across different assets to reduce concentration risk.

Financial Literacy and Consumer Protection (cont)

- Risk-return trade-off: Higher expected returns generally involve higher risk.

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Financial Literacy and Consumer Protection (cont)

- Credit score: A numerical indicator of an individual's credit history and creditworthiness.

Financial Literacy and Consumer Protection (cont)

B. Financial Consumer Protection

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Financial Literacy and Consumer Protection (cont)

Financial consumer protection means safeguarding customers from unfair practices, fraud, misleading information and exploitation by financial institutions and service providers.

Financial Literacy and Consumer Protection (cont)

It ensures that financial products are sold and delivered fairly, transparently and responsibly.

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Financial Literacy and Consumer Protection (cont)

Important Consumer Rights and Principles

Financial Literacy and Consumer Protection (cont)

1. Fair treatment: Customers should not face discrimination or unfair practices.

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Financial Literacy and Consumer Protection (cont)

2. Transparency: Financial institutions must clearly disclose interest rates, charges, risks and terms.

Financial Literacy and Consumer Protection (cont)

3. Right to information: Customers should receive accurate and understandable information before purchasing a financial product.

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Financial Literacy and Consumer Protection (cont)

4. Data privacy: Personal and financial information must be protected.

Financial Literacy and Consumer Protection (cont)

5. Responsible lending: Lenders should assess repayment capacity and avoid irresponsible lending.

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Financial Literacy and Consumer Protection (cont)

6. Grievance redressal: Customers should have access to an effective complaint-resolution mechanism.

Financial Literacy and Consumer Protection (cont)

7. Protection against fraud: Institutions should have safeguards against unauthorised transactions and financial scams.

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Financial Literacy and Consumer Protection (cont)

C. Important Consumer Protection and Grievance Redressal Mechanisms

Financial Literacy and Consumer Protection (cont)

1. RBI – Integrated Ombudsman Scheme, 2026

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Financial Literacy and Consumer Protection (cont)

Important 2026 update

Financial Literacy and Consumer Protection (cont)

- The Reserve Bank – Integrated Ombudsman Scheme, 2026 (RB-IOS 2026) came into effect on 1 July 2026, replacing the 2021 scheme.

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Financial Literacy and Consumer Protection (cont)

- Provides cost-free, expeditious and non-adversarial resolution of complaints involving deficiency in services by covered RBI-regulated entities.

Financial Literacy and Consumer Protection (cont)

- Covers specified banks, certain NBFCs, non-bank Prepaid Payment Instrument issuers and Credit Information Companies.

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Financial Literacy and Consumer Protection (cont)

- Customer must first complain to the concerned regulated entity.

Financial Literacy and Consumer Protection (cont)

- If no response is received within 30 days (or the applicable longer timeline), or the customer is dissatisfied with the response, the customer can approach the RBI Ombudsman.

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Financial Literacy and Consumer Protection (cont)

- Complaint portal: RBI Complaint Management System.

Financial Literacy and Consumer Protection (cont)

- RBI Contact Centre: 14448.

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Financial Literacy and Consumer Protection (cont)

Reserve Bank of India

Financial Literacy and Consumer Protection (cont)

2. SEBI – SCORES 2.0

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Financial Literacy and Consumer Protection (cont)

- SCORES = SEBI Complaint Redress System.

Financial Literacy and Consumer Protection (cont)

- Online platform for investors to lodge and track complaints against SEBI-regulated entities.

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Financial Literacy and Consumer Protection (cont)

- Upgraded version launched in April 2024.

Financial Literacy and Consumer Protection (cont)

- Complaints are automatically routed to the concerned entity.

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Financial Literacy and Consumer Protection (cont)

- Entity generally has 21 calendar days to submit its Action Taken Report (ATR).

Financial Literacy and Consumer Protection (cont)

- Provides a two-level review mechanism.

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Financial Literacy and Consumer Protection (cont)

- Portal: SEBI SCORES.

Financial Literacy and Consumer Protection (cont)

3. IRDAI – Bima Bharosa

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Financial Literacy and Consumer Protection (cont)

- Grievance redressal platform for insurance policyholders.

Financial Literacy and Consumer Protection (cont)

- Enables registration and tracking of insurance-related complaints.

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Financial Literacy and Consumer Protection (cont)

- Supports transparency and monitoring of complaint resolution.

Financial Literacy and Consumer Protection (cont)

- Complaints can also be escalated through the Insurance Ombudsman mechanism, subject to applicable conditions.

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Financial Literacy and Consumer Protection (cont)

4. PFRDA – Grievance Redressal Mechanism

Financial Literacy and Consumer Protection (cont)

- Protects the interests of subscribers under the pension system.

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Financial Literacy and Consumer Protection (cont)

- NPS CGMS: Centralised Grievance Management System for NPS-related complaints.

Financial Literacy and Consumer Protection (cont)

- Subscribers can raise grievances against intermediaries and other entities involved in the pension ecosystem.

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Financial Literacy and Consumer Protection (cont)

- Escalation mechanisms are available under the applicable PFRDA framework.

Financial Literacy and Consumer Protection (cont)

D. Important Financial Literacy Initiatives

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Financial Literacy and Consumer Protection (cont)

- RBI Financial Literacy Centres (FLCs): Established through banks to provide financial education and awareness.

Financial Literacy and Consumer Protection (cont)

- Centre for Financial Literacy (CFL): Community-oriented initiative to improve financial awareness, particularly in rural areas.

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Financial Literacy and Consumer Protection (cont)

- National Strategy for Financial Education (NSFE): Provides a coordinated approach to financial education in India.

Financial Literacy and Consumer Protection (cont)

- Investor Education and Protection Fund (IEPF): Promotes investor awareness and protects eligible investors' interests, including facilitating refunds of unclaimed dividends and shares under applicable provisions.

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Digital Public Infrastructure

- DPI: Shared, interoperable digital infrastructure enabling delivery of services at population scale.

Digital Public Infrastructure (cont)

- India Stack: Collection of open APIs and digital public goods forming foundational digital infrastructure in India.

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Digital Public Infrastructure (cont)

- Three major DPI layers:

Digital Public Infrastructure (cont)

- Identity = Aadhaar.

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Digital Public Infrastructure (cont)

- Payments = UPI.

Digital Public Infrastructure (cont)

- Data exchange = Account Aggregator.

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Digital Public Infrastructure (cont)

- Aadhaar: Digital identity and authentication.

Digital Public Infrastructure (cont)

- UPI: Instant interoperable digital payments.

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Digital Public Infrastructure (cont)

- Account Aggregator: Consent-based financial data sharing.

Digital Public Infrastructure (cont)

- DigiLocker: Digital document storage, access and verification.

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Digital Public Infrastructure (cont)

- e-Sign: Electronic signing of documents.

Digital Public Infrastructure (cont)

- e-KYC: Electronic customer identity verification.

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Digital Public Infrastructure (cont)

- GSTN: Digital infrastructure for GST administration.

Digital Public Infrastructure (cont)

- Open API: Interface enabling different applications and systems to communicate.

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Digital Public Infrastructure (cont)

- Interoperability: Ability of different systems to work together.

Digital Public Infrastructure (cont)

- Importance: Financial inclusion, lower costs, faster services, digital payments, DBT, formal credit access and innovation.

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Digital Public Infrastructure (cont)

- Challenges: Digital divide, cybersecurity, privacy, authentication failures and digital illiteracy.

Digital Public Infrastructure (cont)

MCQ traps

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Digital Public Infrastructure (cont)

- Aadhaar = identity layer; UPI = payment layer; AA = data-exchange layer.

Digital Public Infrastructure (cont)

- DigiLocker is for digital documents, not financial data aggregation.

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Digital Public Infrastructure (cont)

- Account Aggregator enables consent-based sharing; it does not itself provide loans.

Digital Public Infrastructure (cont)

- DPI is infrastructure, not one single application.

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Digital Public Infrastructure (cont)

- India Stack includes both government-backed digital infrastructure and interoperable systems used by public and private participants.

Digital Public Infrastructure (cont)

- Interoperability is a key feature of DPI.

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Account Aggregator (AA) Framework

- Account Aggregator (AA): RBI-regulated NBFC that facilitates secure, consent-based sharing of customers' financial information between financial institutions.

Account Aggregator (AA) Framework (cont)

- Objective: Enable individuals to share their financial data securely, reduce paperwork and improve access to formal credit and other financial services.

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Account Aggregator (AA) Framework (cont)

- Regulator: Reserve Bank of India (RBI).

Account Aggregator (AA) Framework (cont)

- Original framework: RBI Master Direction – NBFC Account Aggregator, September 2016.

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Account Aggregator (AA) Framework (cont)

- FIP (Financial Information Provider): Institution that holds the customer's financial information and provides it upon valid consent. Examples: Banks, NBFCs, insurance companies, mutual funds, depositories and pension-related entities.

Account Aggregator (AA) Framework (cont)

- FIU (Financial Information User): Institution that receives financial information for an authorised purpose. Example: Bank using bank statements to assess loan eligibility.

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Account Aggregator (AA) Framework (cont)

- AA (Account Aggregator): Intermediary that facilitates consent management and secure transfer of financial information between FIP and FIU.

Account Aggregator (AA) Framework (cont)

- Working mechanism: Customer requests a financial service → FIU requests data → Customer gives consent through AA → FIP shares requested information → AA facilitates secure transfer to FIU → FIU uses it for the specified purpose.

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Account Aggregator (AA) Framework (cont)

- Consent Artefact: Electronic record specifying customer identity, information requested, purpose, recipient, duration and expiry of consent.

Account Aggregator (AA) Framework (cont)

- Consent requirements: Explicit, informed, purpose-specific and time-bound; customer can revoke consent.

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Account Aggregator (AA) Framework (cont)

- Customer rights: View consent records, know which FIUs received information and withdraw consent.

Account Aggregator (AA) Framework (cont)

- Data protection: AA cannot store the financial information it accesses, access FIP account passwords/PINs or use information for unrelated purposes.

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Account Aggregator (AA) Framework (cont)

- Restrictions: AA cannot undertake lending, support financial transactions on behalf of customers or conduct unrelated financial business.

Account Aggregator (AA) Framework (cont)

- Benefits: Faster loan processing, reduced documentation, improved credit assessment, lower information asymmetry and greater financial inclusion.

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Account Aggregator (AA) Framework (cont)

- Applications: Credit assessment, digital lending, financial planning and improved access to formal financial services.

Account Aggregator (AA) Framework (cont)

- Regulatory developments: Original RBI framework issued in September 2016; consolidated RBI NBFC-AA Directions issued in November 2025; RBI introduced an SRO framework for the AA ecosystem in March 2025.

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Account Aggregator (AA) Framework (cont)

- SRO-AA: Self-Regulatory Organisation for the Account Aggregator ecosystem; promotes industry standards and orderly functioning.

Account Aggregator (AA) Framework (cont)

MCQ traps

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Account Aggregator (AA) Framework (cont)

- FIP holds data; FIU uses data; AA facilitates transfer.

Account Aggregator (AA) Framework (cont)

- AA is an NBFC, but it is not a lender or a loan marketplace.

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Account Aggregator (AA) Framework (cont)

- AA does not own or store the financial information it accesses.

Account Aggregator (AA) Framework (cont)

- Customer consent is mandatory and revocable.

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Account Aggregator (AA) Framework (cont)

- AA cannot access customers' bank passwords or PINs.

Account Aggregator (AA) Framework (cont)

- Financial data sharing is different from payment authorisation or fund transfer.

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Account Aggregator (AA) Framework (cont)

- The main purpose of AA is consent-based financial data sharing, not account opening or loan disbursement.

Relevant Financial-Inclusion Schemes and Portals

A. Social security: insurance and pension

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Relevant Financial-Inclusion Schemes and Portals (cont)

1. Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY)

Relevant Financial-Inclusion Schemes and Portals (cont)

- Launched: 2015.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Purpose: Affordable life insurance.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Eligibility: Savings bank/post-office account holders aged 18–50 years at entry.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Cover: ₹2 lakh on death due to any cause.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Premium: ₹436 per year.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Renewable annually; premium is generally auto-debited from the account.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Implemented through banks/post offices in collaboration with life insurance companies.

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Relevant Financial-Inclusion Schemes and Portals (cont)

2. Pradhan Mantri Suraksha Bima Yojana (PMSBY)

Relevant Financial-Inclusion Schemes and Portals (cont)

- Launched: 2015.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Purpose: Affordable accident insurance.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Eligibility: Account holders aged 18–70 years.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Cover:

Relevant Financial-Inclusion Schemes and Portals (cont)

- ₹2 lakh: accidental death or permanent total disability.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- ₹1 lakh: permanent partial disability.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Premium: ₹20 per year.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Renewable annually; premium is auto-debited with consent.

Relevant Financial-Inclusion Schemes and Portals (cont)

3. Atal Pension Yojana (APY)

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Launched: 2015.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Purpose: Old-age income security, particularly for workers in the unorganised sector.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Eligibility: Indian citizens aged 18–40 years, with a savings bank or post-office savings account.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Provides a guaranteed minimum monthly pension of ₹1,000–₹5,000 after attaining 60 years, depending on the subscriber's contribution.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Contributions depend on age at joining and the chosen pension amount.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Spouse is entitled to receive the same pension after the subscriber's death; the accumulated pension wealth is payable to the nominee after the death of both.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Since October 2022, a person who is or has been an income-tax payer cannot newly join APY.

Relevant Financial-Inclusion Schemes and Portals (cont)

Remember the distinction: PMJJBY = life insurance; PMSBY = accident insurance; APY = pension.

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Relevant Financial-Inclusion Schemes and Portals (cont)

B. Credit and entrepreneurship schemes

Relevant Financial-Inclusion Schemes and Portals (cont)

4. Pradhan Mantri MUDRA Yojana (PMMY)

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Launched: 8 April 2015.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Purpose: Collateral-free institutional credit to micro and small non-corporate, non-farm enterprises.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Loans are provided through banks, Small Finance Banks, Regional Rural Banks, NBFCs and Microfinance Institutions.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Four categories:

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Shishu: Up to ₹50,000.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Kishor: Above ₹50,000 and up to ₹5 lakh.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Tarun: Above ₹5 lakh and up to ₹10 lakh.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Tarun Plus: Above ₹10 lakh and up to ₹20 lakh; available to entrepreneurs who have successfully repaid a previous Tarun loan.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Covers manufacturing, trading, services and activities allied to agriculture, such as dairy and poultry.

Relevant Financial-Inclusion Schemes and Portals (cont)

- MUDRA is the refinancing/development institution associated with the scheme; it is not necessarily the direct lender to every borrower.

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Relevant Financial-Inclusion Schemes and Portals (cont)

5. Stand-Up India Scheme

Relevant Financial-Inclusion Schemes and Portals (cont)

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Purpose: Promote entrepreneurship among women and Scheduled Caste (SC)/Scheduled Tribe (ST) entrepreneurs.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Facilitates bank loans of ₹10 lakh to ₹1 crore.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- For setting up a greenfield enterprise (a first-time venture in the relevant sector).

Relevant Financial-Inclusion Schemes and Portals (cont)

- Covers manufacturing, services, trading and activities allied to agriculture.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- At least one SC/ST borrower and at least one woman borrower per bank branch are intended to be supported.

Relevant Financial-Inclusion Schemes and Portals (cont)

- For non-individual enterprises, at least 51% of shareholding and controlling stake should be held by an SC/ST or woman entrepreneur.

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Relevant Financial-Inclusion Schemes and Portals (cont)

6. PM SVANidhi

Relevant Financial-Inclusion Schemes and Portals (cont)

- Launched: 2020.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Purpose: Provide working-capital support to eligible street vendors.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Provides collateral-free working-capital loans to help vendors restart or expand their businesses.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Important features include timely repayment incentives and incentives for digital transactions.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Implemented by the Ministry of Housing and Urban Affairs.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Portal: pmsvanidhi.mohua.gov.in.

Relevant Financial-Inclusion Schemes and Portals (cont)

7. Kisan Credit Card (KCC)

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Purpose: Timely and flexible credit to farmers for cultivation and other eligible agricultural needs.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Covers crop-related expenses, post-harvest expenses, working-capital requirements and eligible allied activities.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Available through banks and other eligible lending institutions.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Designed to reduce farmers' dependence on informal moneyl-enders.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- KCC is a credit facility, not an insurance or subsidy scheme.

Relevant Financial-Inclusion Schemes and Portals (cont)

The Government's Department of Financial Services identifies PMJDY, PMJJBY, PMSBY, APY, PMMY and Stand-Up India among its flagship financial-inclusion schemes.

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Relevant Financial-Inclusion Schemes and Portals (cont)

C. Important portals and platforms

Relevant Financial-Inclusion Schemes and Portals (cont)

8. JanSamarth Portal

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Launched: 6 June 2022.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Ministry: Ministry of Finance, Department of Financial Services.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- A National Portal for Credit-Linked Government Schemes.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Helps beneficiaries discover eligible government schemes, check eligibility and apply for loans through participating lenders.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Integrates applicants, banks, government departments and nodal agencies.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Schemes include PMMY, Kisan Credit Card, PM SVANidhi, PMEGP and Agriculture Infrastructure Fund.

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Relevant Financial-Inclusion Schemes and Portals (cont)

9. DBT Bharat Portal

Relevant Financial-Inclusion Schemes and Portals (cont)

- Official Direct Benefit Transfer portal of the Government of India.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Provides information on DBT schemes, fund transfers, transaction statistics and implementation progress.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Helps monitor transfers from government to beneficiaries and improve transparency.

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Relevant Financial-Inclusion Schemes and Portals (cont)

10. Jan Suraksha Portal

Relevant Financial-Inclusion Schemes and Portals (cont)

- Provides information and enrolment-related access for the three social-security schemes:

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Relevant Financial-Inclusion Schemes and Portals (cont)

- PMJJBY – life insurance.

Relevant Financial-Inclusion Schemes and Portals (cont)

- PMSBY – accident insurance.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- APY – pension.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Important for remembering the common social-security framework.

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Relevant Financial-Inclusion Schemes and Portals (cont)

11. RBI Sachet Portal

Relevant Financial-Inclusion Schemes and Portals (cont)

- Launched by RBI in 2016.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Helps the public report and obtain information about unauthorised deposit-taking activities and suspicious financial schemes.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Enables complaints and sharing of information about entities or schemes suspected of illegally collecting public deposits.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Also provides links to financial regulators and information about regulated entities.

Relevant Financial-Inclusion Schemes and Portals (cont)

12. RBI Complaint Management System (CMS)

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Portal for lodging and tracking complaints under the RBI Ombudsman framework.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Used for complaints relating to deficiency in service by covered RBI-regulated entities, after first approaching the concerned entity and satisfying the applicable conditions.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Complaints under the current RB-IOS 2026 framework can be lodged through CMS.

Relevant Financial-Inclusion Schemes and Portals (cont)

13. Other important portals to recognise

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Relevant Financial-Inclusion Schemes and Portals (cont)

- Udyam Registration: Official MSME registration portal; provides formal recognition to eligible micro, small and medium enterprises. Udyam Registration.

Relevant Financial-Inclusion Schemes and Portals (cont)

- Udyam Assist Platform: Helps bring informal micro enterprises into the formal MSME ecosystem.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- PMJDY Portal: Information and progress relating to Jan Dhan accounts. PMJDY.

Relevant Financial-Inclusion Schemes and Portals (cont)

- PFRDA NPS/APY portals: Information and subscriber services relating to pension schemes. PFRDA.

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Relevant Financial-Inclusion Schemes and Portals (cont)

- SEBI SCORES: Investor grievance redressal platform. SCORES.

Relevant Financial-Inclusion Schemes and Portals (cont)

- IRDAI Bima Bharosa: Insurance policyholder grievance platform. Bima Bharosa

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Public, Infrastructure and International Finance

Government borrowing and public debt

- Government borrowing: Funds raised by the government to finance expenditure when receipts are insufficient.

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Government borrowing and public debt (cont)

- Public Debt: Total outstanding borrowing liabilities of the government.

Government borrowing and public debt (cont)

- Fiscal Deficit: Total Expenditure − (Revenue Receipts + Non-debt Capital Receipts).

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Government borrowing and public debt (cont)

- Revenue Deficit: Revenue Expenditure − Revenue Receipts.

Government borrowing and public debt (cont)

- Primary Deficit: Fiscal Deficit − Interest Payments.

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Government borrowing and public debt (cont)

- Internal Debt: Borrowing from domestic sources.

Government borrowing and public debt (cont)

- External Debt: Borrowing from foreign governments, international institutions and overseas sources.

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Government borrowing and public debt (cont)

- Central Government Debt: Debt liabilities of the Union Government.

Government borrowing and public debt (cont)

- General Government Debt: Combined debt of Central and State Governments, avoiding double counting.

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Government borrowing and public debt (cont)

- Treasury Bills: Short-term government securities of 91, 182 and 364 days; issued at a discount and redeemed at face value.

Government borrowing and public debt (cont)

- Dated G-Secs: Long-term Central Government securities carrying fixed or floating interest.

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Government borrowing and public debt (cont)

- SDLs: State Development Loans; securities issued by State Governments.

Government borrowing and public debt (cont)

- Cash Management Bills: Short-term instruments for temporary cash-flow mismatches.

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Government borrowing and public debt (cont)

- Ways and Means Advances: Temporary RBI advances to Central and State Governments to manage short-term cash mismatches.

Government borrowing and public debt (cont)

- Crowding Out: Increased government borrowing may raise interest rates and reduce private-sector borrowing and investment.

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Government borrowing and public debt (cont)

- Debt-to-GDP Ratio: (Outstanding Public Debt / GDP) × 100; measures debt relative to the size of the economy.

Government borrowing and public debt (cont)

- Debt Sustainability: Ability of the government to service and repay debt over time without default or unrealistic fiscal adjustment.

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Government borrowing and public debt (cont)

- FRBM Act, 2003: Framework for fiscal discipline, deficit management, transparency and debt sustainability.

Government borrowing and public debt (cont)

Important distinctions

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Government borrowing and public debt (cont)

- Fiscal deficit measures the government's borrowing requirement; public debt is the accumulated outstanding liability.

Government borrowing and public debt (cont)

- Revenue deficit concerns revenue expenditure; fiscal deficit covers the overall fiscal gap.

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Government borrowing and public debt (cont)

- Primary deficit excludes interest payments.

Government borrowing and public debt (cont)

- T-Bills are short-term; dated G-Secs are generally long-term.

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Government borrowing and public debt (cont)

- Government securities are debt instruments, not equity.

Government borrowing and public debt (cont)

- Borrowing is not inherently harmful; its sustainability and productive use matter.

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Infrastructure finance

- Infrastructure Finance: Funding for the development, operation, maintenance and upgradation of physical and social infrastructure.

Infrastructure finance (cont)

- Characteristics: High initial investment, long gestation period, long repayment period and significant capital requirements.

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Infrastructure finance (cont)

- Examples: Roads, highways, railways, airports, ports, power, renewable energy, telecom, water supply and sanitation.

Infrastructure finance (cont)

- Sources of Finance: Government budgetary support, bank loans, corporate bonds, equity, InvITs, DFIs, multilateral institutions and foreign investment.

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Infrastructure finance (cont)

- NaBFID: National Bank for Financing Infrastructure and Development; established under the NaBFID Act, 2021; provides long-term infrastructure financing and supports infrastructure finance markets.

Infrastructure finance (cont)

- IIFCL: India Infrastructure Finance Company Limited; established in 2006; provides long-term financial assistance to viable infrastructure projects.

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Infrastructure finance (cont)

- NIIF: National Investment and Infrastructure Fund; established in 2015; mobilises domestic and international institutional investment for infrastructure and strategic sectors.

Infrastructure finance (cont)

- NIP: National Infrastructure Pipeline; announced in 2019; creates a pipeline of infrastructure investment projects.

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Infrastructure finance (cont)

- NMP: National Monetisation Pipeline; launched in 2021; monetises operational public assets to unlock funds for further investment.

Infrastructure finance (cont)

- PM Gati Shakti: Launched in 2021; GIS-based National Master Plan integrating multi-modal infrastructure planning across ministries.

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Infrastructure finance (cont)

- Infrastructure Bonds: Long-term debt instruments used to raise funds for infrastructure projects.

Infrastructure finance (cont)

- InvITs: Infrastructure Investment Trusts; pool investor funds and invest in infrastructure assets; investors receive income generated by these assets.

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Infrastructure finance (cont)

- IDFs: Infrastructure Debt Funds; provide long-term debt financing, particularly to operational infrastructure projects.

Infrastructure finance (cont)

- REITs: Real Estate Investment Trusts; invest in income-generating real estate assets.

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Infrastructure finance (cont)

- ECBs: External Commercial Borrowings; loans raised by eligible Indian entities from recognised non-resident lenders under RBI regulations.

Infrastructure finance (cont)

- Asset Monetisation: Unlocking the value of existing assets through leasing, concessions or other arrangements; does not necessarily involve outright sale.

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Infrastructure finance (cont)

- Securitisation: Converting pooled financial assets and their cash flows into marketable securities.

Infrastructure finance (cont)

- VGF: Viability Gap Funding; financial support, generally from government, to make economically desirable but financially less viable infrastructure projects commercially viable.

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Infrastructure finance (cont)

- Major Challenges: High capital costs, long gestation, land acquisition, regulatory delays, cost overruns, demand uncertainty, financing constraints and stressed assets.

Infrastructure finance (cont)

Important distinctions

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Infrastructure finance (cont)

- NaBFID = Development Finance Institution; NIIF = investment fund.

Infrastructure finance (cont)

- NIP = infrastructure project pipeline; NMP = monetisation of existing operational assets.

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Infrastructure finance (cont)

- InvITs invest in infrastructure assets; REITs invest in income-generating real estate.

Infrastructure finance (cont)

- Greenfield projects involve creating new infrastructure; brownfield projects involve existing infrastructure or expansion/upgradation.

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Infrastructure finance (cont)

- Asset monetisation does not automatically mean transfer of ownership.

Infrastructure finance (cont)

- VGF bridges the financial viability gap; it is not the same as a regular project loan.

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Public-Private Partnerships

- PPP: Contractual arrangement between government/public authority and private-sector entity for providing public infrastructure or services.

Public-Private Partnerships (cont)

- Purpose: Mobilise private investment, utilise private expertise, improve efficiency and share project risks.

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Public-Private Partnerships (cont)

- BOT: Private partner builds and operates the asset for a concession period, recovers investment and transfers it to the government.

Public-Private Partnerships (cont)

- BOT (Toll): Private partner earns toll revenue and generally bears traffic/demand risk.

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Public-Private Partnerships (cont)

- BOT (Annuity): Private partner receives periodic annuity payments; demand risk is generally borne by the public authority.

Public-Private Partnerships (cont)

- BOOT: Private partner builds, owns and operates the asset during the concession period and transfers ownership at the end.

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Public-Private Partnerships (cont)

- BOO: Private partner builds, owns and operates the asset; no mandatory transfer to government.

Public-Private Partnerships (cont)

- DBFOT: Private partner designs, builds, finances and operates the asset before transferring it.

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Public-Private Partnerships (cont)

- HAM: Hybrid Annuity Model; combines government funding and private investment. In Indian highways, government pays a portion during construction and the developer finances the balance; subsequent annuity payments reduce traffic-risk exposure.

Public-Private Partnerships (cont)

- O&M Contract: Government retains ownership; private partner operates and maintains the asset for an agreed fee.

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Public-Private Partnerships (cont)

- VGF: Viability Gap Funding; government financial assistance to make economically desirable but commercially less viable PPP projects financially viable.

Public-Private Partnerships (cont)

- IIPDF: India Infrastructure Project Development Fund; supports PPP project-development expenses of public authorities.

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Public-Private Partnerships (cont)

- PPPAC: Public-Private Partnership Appraisal Committee; appraises specified Central-sector PPP projects.

Public-Private Partnerships (cont)

- DEA: Department of Economic Affairs, Ministry of Finance; plays a role in PPP policy and appraisal frameworks.

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Public-Private Partnerships (cont)

- Construction Risk: Risk of delays, cost overruns and technical problems.

Public-Private Partnerships (cont)

- Demand Risk: Risk of actual usage or revenue being lower than projected.

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Public-Private Partnerships (cont)

- Force Majeure: Extraordinary events such as natural disasters or war that affect contractual performance.

Public-Private Partnerships (cont)

- Contingent Liability: Potential government financial obligation arising from guarantees or contractual commitments.

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Public-Private Partnerships (cont)

Important distinctions

Public-Private Partnerships (cont)

- PPP is not the same as complete privatisation; public authority retains contractual oversight.

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Public-Private Partnerships (cont)

- BOT (Toll) = private partner collects toll; BOT (Annuity) = periodic payments.

Public-Private Partnerships (cont)

- BOOT involves temporary private ownership; BOO does not require eventual transfer.

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Public-Private Partnerships (cont)

- HAM shares project funding between government and private developer.

Public-Private Partnerships (cont)

- VGF supports project viability; it is not the same as a loan.

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Public-Private Partnerships (cont)

- In PPPs, risks should be allocated to the party best able to manage them.

Project finance

- Project Finance: Long-term financing where repayment primarily depends on cash flows generated by the project itself.

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Project finance (cont)

- SPV: Special Purpose Vehicle; separate legal entity created to develop, finance and operate a specific project.

Project finance (cont)

- Project Sponsors: Investors who initiate the project and contribute equity.

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Project finance (cont)

- Lenders: Banks and financial institutions that provide project debt.

Project finance (cont)

- Off-taker: Buyer of the project's output or services; provides revenue through contractual payments.

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Project finance (cont)

- Debt: Borrowed capital repayable with interest.

Project finance (cont)

- Equity: Capital contributed by sponsors/investors; bears residual risk.

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Project finance (cont)

- Debt-to-Equity Ratio: Total Debt / Total Equity; measures dependence on borrowing.

Project finance (cont)

- Limited Recourse Financing: Lenders primarily rely on project cash flows and assets, with limited claims against sponsors.

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Project finance (cont)

- Non-Recourse Financing: Lenders generally have no claim against sponsors' other assets for project debt; repayment depends on project cash flows and security.

Project finance (cont)

- Escrow Account: Designated account into which project revenues are deposited and distributed according to an agreed payment priority.

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Project finance (cont)

- DSCR: Cash Flow Available for Debt Service / (Principal Repayment + Interest Payment); measures ability to meet debt obligations.

Project finance (cont)

- DSCR greater than 1: Cash flow exceeds debt-service requirement.

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Project finance (cont)

- DSCR equal to 1: Cash flow exactly covers debt servicing.

Project finance (cont)

- DSCR less than 1: Cash flow is insufficient to meet debt servicing.

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Project finance (cont)

- LLCR: Present Value of Cash Flows Available for Debt Service during remaining loan life / Outstanding Debt.

Project finance (cont)

- PLCR: Present Value of Cash Flows Available for Debt Service over remaining project life / Outstanding Debt.

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Project finance (cont)

- Construction Risk: Risk of delays, cost overruns and technical problems.

Project finance (cont)

- Demand Risk: Risk of lower-than-expected project usage or revenue.

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Project finance (cont)

- Foreign-Exchange Risk: Risk arising from currency fluctuations affecting foreign-currency borrowing or repayment.

Project finance (cont)

- Project Finance: Primarily project-specific repayment and risk assessment.

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Project finance (cont)

- Corporate Finance: Repayment based on the overall financial strength and cash flows of the company.

Project finance (cont)

Important distinctions

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Project finance (cont)

- Project finance repayment depends primarily on project cash flows; corporate finance repayment depends on the company's overall financial position.

Project finance (cont)

- SPV is a separate legal entity, not merely a project department.

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Project finance (cont)

- Limited recourse does not mean zero sponsor liability.

Project finance (cont)

- Non-recourse does not mean lenders have no security; they can have security over project assets and rights.

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Project finance (cont)

- DSCR measures the ability to meet debt servicing; a value below 1 indicates a shortfall.

Project finance (cont)

- LLCR covers the remaining loan period; PLCR covers the remaining project life.

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Social cost-benefit analysis

- SCBA: Social Cost-Benefit Analysis; evaluates a project based on its overall costs and benefits to society rather than only its financial profitability.

Social cost-benefit analysis (cont)

- Objective: Determine whether a project improves overall social welfare.

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Social cost-benefit analysis (cont)

- Financial Analysis: Evaluates profitability from the perspective of the project owner/investor.

Social cost-benefit analysis (cont)

- SCBA: Evaluates social and economic benefits and costs from society's perspective.

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Social cost-benefit analysis (cont)

- Social Costs: Direct expenditure, environmental damage, displacement, loss of livelihood, opportunity costs and negative externalities.

Social cost-benefit analysis (cont)

- Social Benefits: Employment, improved connectivity, productivity, regional development, time savings and positive externalities.

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Social cost-benefit analysis (cont)

- Externalities: Costs or benefits affecting third parties that are not fully reflected in market prices.

Social cost-benefit analysis (cont)

- Negative Externality: Pollution affecting nearby residents.

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Social cost-benefit analysis (cont)

- Positive Externality: Vaccination reducing disease transmission.

Social cost-benefit analysis (cont)

- Shadow Prices: Prices reflecting the true social or economic value of resources when market prices are distorted.

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Social cost-benefit analysis (cont)

- Opportunity Cost: Value of the next-best alternative sacrificed.

Social cost-benefit analysis (cont)

- Social Discount Rate: Rate used to convert future social costs and benefits into present values.

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Social cost-benefit analysis (cont)

- Social NPV: Present Value of Social Benefits − Present Value of Social Costs.

Social cost-benefit analysis (cont)

- BCR [Benefit-Cost Ratio] : Present Value of Social Benefits / Present Value of Social Costs.

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Social cost-benefit analysis (cont)

- BCR greater than 1: Social benefits exceed social costs.

Social cost-benefit analysis (cont)

- BCR equal to 1: Social benefits equal social costs.

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Social cost-benefit analysis (cont)

- BCR less than 1: Social costs exceed social benefits.

Social cost-benefit analysis (cont)

- Social IRR: Discount rate at which Social NPV becomes zero.

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Social cost-benefit analysis (cont)

- Project Evaluation: A positive social NPV indicates net social benefits, but distributional, environmental and other considerations must also be assessed.

Social cost-benefit analysis (cont)

Important distinctions

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Social cost-benefit analysis (cont)

- Financial profitability and social desirability are not the same.

Social cost-benefit analysis (cont)

- Market prices and shadow prices may differ.

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Social cost-benefit analysis (cont)

- Opportunity cost is the value of the next-best alternative, not necessarily the actual expenditure.

Social cost-benefit analysis (cont)

- Externalities affect third parties.

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Social cost-benefit analysis (cont)

- A project may have negative financial returns but positive social NPV.

Social cost-benefit analysis (cont)

- A higher social discount rate reduces the present value of future benefits.

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International financial institutions

International Financial Institutions (IFIs): Institutions established through international cooperation to promote economic development, financial stability and international monetary cooperation.

International financial institutions (cont)

IMF: International Monetary Fund; established in 1944, began operations in 1945; headquarters Washington, D.C.; promotes monetary cooperation and financial stability and provides BoP assistance.

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International financial institutions (cont)

IMF Quota: Determines member contributions, voting power and general access to IMF financing.

International financial institutions (cont)

SDR: Special Drawing Right; IMF-created international reserve asset, not a currency.

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International financial institutions (cont)

SDR Basket: US dollar, euro, Chinese renminbi, Japanese yen and British pound.

International financial institutions (cont)

Article IV Consultation: IMF's regular assessment of a member country's economic and financial policies.

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International financial institutions (cont)

World Bank Group: Development institution comprising five organisations: IBRD, IDA, IFC, MIGA and ICSID.

International financial institutions (cont)

IBRD: International Bank for Reconstruction and Development; lends mainly to middle-income and creditworthy low-income countries.

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International financial institutions (cont)

IDA: International Development Association; provides concessional financing and grants to the poorest countries.

International financial institutions (cont)

IFC: International Finance Corporation; supports private-sector development through loans, equity investments and advisory services.

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International financial institutions (cont)

MIGA: Multilateral Investment Guarantee Agency; provides political-risk insurance and guarantees to encourage foreign investment.

International financial institutions (cont)

ICSID: International Centre for Settlement of Investment Disputes; facilitates conciliation and arbitration of investment disputes between investors and states.

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International financial institutions (cont)

ADB: Asian Development Bank; established in 1966; headquarters Manila; promotes economic and social development in Asia-Pacific.

International financial institutions (cont)

NDB: New Development Bank; established by BRICS in 2014; headquarters Shanghai; finances infrastructure and sustainable development.

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International financial institutions (cont)

AIIB: Asian Infrastructure Investment Bank; established in 2015; headquarters Beijing; finances sustainable infrastructure.

International financial institutions (cont)

BIS: Bank for International Settlements; established in 1930; headquarters Basel; known as the bank for central banks.

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International financial institutions (cont)

BCBS: Basel Committee on Banking Supervision; develops international banking regulatory standards, including Basel norms; operates under the BIS framework.

International financial institutions (cont)

FSB: Financial Stability Board; established in 2009; coordinates international financial authorities and promotes global financial stability.

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International financial institutions (cont)

OECD: Organisation for Economic Co-operation and Development; established in 1961; promotes economic growth and better public policies.

International financial institutions (cont)

UNCTAD: United Nations Conference on Trade and Development; established in 1964; promotes trade, investment and development; publishes the World Investment Report.

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International financial institutions (cont)

WTO: World Trade Organization; established in 1995; regulates international trade and provides a platform for trade negotiations and dispute settlement.

International financial institutions (cont)

IFAD: International Fund for Agricultural Development; established in 1977; supports rural development and agricultural financing.

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Foreign exchange market and exchange-rate basics

- Foreign Exchange Market: Global market for buying and selling currencies; facilitates international trade, investment, payments and hedging.

Foreign exchange market and exchange-rate basics (cont)

- Exchange Rate: Price of one currency expressed in terms of another currency.

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Foreign exchange market and exchange-rate basics (cont)

- USD/INR = ₹85: One US dollar costs ₹85.

Foreign exchange market and exchange-rate basics (cont)

- Rupee Appreciation: Rupee gains value; USD/INR generally falls.

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Foreign exchange market and exchange-rate basics (cont)

- Rupee Depreciation: Rupee loses value; USD/INR generally rises.

Foreign exchange market and exchange-rate basics (cont)

- Fixed Exchange Rate: Currency maintained at a predetermined value against another currency or basket.

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Foreign exchange market and exchange-rate basics (cont)

- Floating Exchange Rate: Currency value determined primarily by market demand and supply.

Foreign exchange market and exchange-rate basics (cont)

- Managed Float: Market-determined exchange rate with central bank intervention when required; India follows this system.

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Foreign exchange market and exchange-rate basics (cont)

- Demand for Foreign Currency: Increases due to imports, overseas investment, foreign travel and external debt repayments.

Foreign exchange market and exchange-rate basics (cont)

- Supply of Foreign Currency: Increases due to exports, foreign investment inflows, remittances and foreign tourist spending.

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Foreign exchange market and exchange-rate basics (cont)

- Higher Demand for Foreign Currency: Other things unchanged, causes foreign currency appreciation and domestic currency depreciation.

Foreign exchange market and exchange-rate basics (cont)

- Higher Supply of Foreign Currency: Other things unchanged, causes foreign currency depreciation and domestic currency appreciation.

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Foreign exchange market and exchange-rate basics (cont)

- Spot Market: Currency transactions at the prevailing spot rate; settlement generally follows the applicable market convention.

Foreign exchange market and exchange-rate basics (cont)

- Forward Contract: OTC agreement to exchange currencies at a predetermined rate on a future date.

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Foreign exchange market and exchange-rate basics (cont)

- Currency Futures: Standardised, exchange-traded contracts to exchange currencies at a specified future date and price.

Foreign exchange market and exchange-rate basics (cont)

- Currency Options: Give the buyer the right, but not the obligation, to buy or sell currency at a specified exchange rate.

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Foreign exchange market and exchange-rate basics (cont)

- Currency Swaps: Agreements to exchange principal and/or interest payments in different currencies.

Foreign exchange market and exchange-rate basics (cont)

- Nominal Exchange Rate: Bilateral exchange rate without adjustment for price-level differences.

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Foreign exchange market and exchange-rate basics (cont)

- Real Exchange Rate: Nominal exchange rate adjusted for relative price levels.

Foreign exchange market and exchange-rate basics (cont)

- NEER: Nominal Effective Exchange Rate; weighted average of bilateral exchange rates against a basket of currencies.

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Foreign exchange market and exchange-rate basics (cont)

- REER: Real Effective Exchange Rate; NEER adjusted for relative inflation or price levels.

Foreign exchange market and exchange-rate basics (cont)

- Current Account Convertibility: Conversion of currency for current international transactions such as trade, travel and remittances.

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Foreign exchange market and exchange-rate basics (cont)

- Capital Account Convertibility: Conversion for capital transactions such as foreign investment and borrowing.

Foreign exchange market and exchange-rate basics (cont)

- Devaluation: Official reduction in currency value under a fixed or pegged exchange-rate system.

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Foreign exchange market and exchange-rate basics (cont)

- Depreciation: Market-driven decline in currency value.

Foreign exchange market and exchange-rate basics (cont)

- Revaluation: Official increase in currency value under a fixed exchange-rate system.

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Foreign exchange market and exchange-rate basics (cont)

- Appreciation: Market-driven increase in currency value.

Foreign exchange market and exchange-rate basics (cont)

- Currency Hedging: Use of financial instruments to reduce foreign-exchange risk.

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Foreign exchange market and exchange-rate basics (cont)

Important distinctions

Foreign exchange market and exchange-rate basics (cont)

- Rupee depreciation → imports become costlier and exports may become more competitive, other things unchanged.

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Foreign exchange market and exchange-rate basics (cont)

- Rupee appreciation → imports become cheaper and exports may become less competitive, other things unchanged.

Foreign exchange market and exchange-rate basics (cont)

- Forward = customised OTC contract; futures = standardised exchange-traded contract.

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Foreign exchange market and exchange-rate basics (cont)

- Options provide a right, not an obligation; forwards and futures create contractual obligations.

Foreign exchange market and exchange-rate basics (cont)

- Devaluation/revaluation are official changes; depreciation/appreciation are market-driven changes.

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Foreign exchange market and exchange-rate basics (cont)

- NEER is nominal; REER accounts for relative price levels.

Foreign exchange market and exchange-rate basics (cont)

- Current account convertibility does not mean full capital account convertibility.

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Balance of Payments

1. Meaning and Accounting

Balance of Payments (cont)

- BoP: Systematic record of all economic transactions between residents and non-residents during a period.

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Balance of Payments (cont)

- Prepared using the double-entry accounting system.

Balance of Payments (cont)

- Every transaction has corresponding credit and debit entries.

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Balance of Payments (cont)

- BoP always balances as an accounting identity after including all accounts, reserve transactions and net errors and omissions.

Balance of Payments (cont)

Credit (+): Exports, services receipts, remittances received, FDI/FPI inflows.

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Balance of Payments (cont)

Debit (−): Imports, overseas investment, remittances sent, income payments abroad.

Balance of Payments (cont)

2. Components of BoP

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Balance of Payments (cont)

A. Current Account

Balance of Payments (cont)

1. Goods: Merchandise exports and imports.

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Balance of Payments (cont)

2. Services: IT, tourism, transport, financial services, etc.

Balance of Payments (cont)

3. Primary Income: Wages, interest, dividends and investment income.

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Balance of Payments (cont)

4. Secondary Income: Transfers without direct economic return, e.g. remittances, gifts and donations.

Balance of Payments (cont)

B. Capital Account — Formal IMF Definition

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Balance of Payments (cont)

- Capital transfers, including debt forgiveness and certain investment grants.

Balance of Payments (cont)

- Acquisition/disposal of non-produced, non-financial assets.

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Balance of Payments (cont)

C. Financial Account

Balance of Payments (cont)

- FDI (Foreign Direct Investment).

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Balance of Payments (cont)

- FPI (Foreign Portfolio Investment).

Balance of Payments (cont)

- Financial derivatives.

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Balance of Payments (cont)

- Other investment: loans, deposits, trade credit.

Balance of Payments (cont)

- Reserve assets: foreign currency assets, monetary gold, etc.

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Balance of Payments (cont)

MCQ distinction: In formal IMF terminology, the Capital Account and Financial Account are separate. Indian economic discussions sometimes use capital account broadly to include financial flows.

Balance of Payments (cont)

3. Current Account Deficit (CAD)

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Balance of Payments (cont)

- CAD = Current Account Credits − Current Account Debits, when negative.

Balance of Payments (cont)

- Occurs when current-account payments exceed receipts.

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Balance of Payments (cont)

- Includes goods, services, primary income and secondary income.

Balance of Payments (cont)

Trade Deficit vs CAD

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Balance of Payments (cont)

- Trade Deficit = Goods Imports − Goods Exports.

Balance of Payments (cont)

- CAD includes goods + services + primary income + secondary income.

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Balance of Payments (cont)

- A services surplus or remittance inflows can offset a merchandise trade deficit.

Balance of Payments (cont)

4. BoP Surplus and Deficit

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Balance of Payments (cont)

- BoP Surplus: Autonomous receipts exceed autonomous payments.

Balance of Payments (cont)

- BoP Deficit: Autonomous payments exceed autonomous receipts.

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Balance of Payments (cont)

- BoP deficit can be financed through reserve drawdown, external borrowing or additional capital inflows.

Balance of Payments (cont)

- Accounting identity always balances after financing entries are included.

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Balance of Payments (cont)

Autonomous transactions: Undertaken for commercial/economic reasons.

Balance of Payments (cont)

Accommodating transactions: Undertaken to finance an overall BoP imbalance.

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Balance of Payments (cont)

5. Net Errors and Omissions (NEO)

Balance of Payments (cont)

- Statistical balancing item for discrepancies in recorded international transactions.

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Balance of Payments (cont)

- Arises from differences in timing, reporting, valuation and data collection.

Balance of Payments (cont)

- Not a separate economic transaction.

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Balance of Payments (cont)

6. Formula and Concept Recall

Balance of Payments (cont)

Current Account Balance:

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Balance of Payments (cont)

CAB = Net Goods + Net Services + Net Primary Income + Net Secondary Income

Balance of Payments (cont)

Current Account Deficit:

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Balance of Payments (cont)

CAD = -(Current Account Balance), when CAB < 0

Balance of Payments (cont)

BoP accounting identity (conceptual):

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Balance of Payments (cont)

Current Account + Capital Account + Financial Account + NEO =0

Balance of Payments (cont)

Sign conventions for the financial account and reserve assets vary across presentations; focus on the accounting principle that total recorded entries balance.

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Foreign Investment and Capital Flows

1. Meaning

Foreign Investment and Capital Flows (cont)

- Foreign investment = Investment by non-residents in another country's businesses, securities or assets.

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Foreign Investment and Capital Flows (cont)

- Supplements domestic savings; supports capital formation, infrastructure, employment, technology transfer and productivity.

Foreign Investment and Capital Flows (cont)

- Helps finance CAD, but volatile inflows can create external-sector vulnerability.

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Foreign Investment and Capital Flows (cont)

2. Foreign Direct Investment (FDI)

Foreign Investment and Capital Flows (cont)

- Investment involving lasting interest and significant influence/control in an enterprise in another country.

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Foreign Investment and Capital Flows (cont)

- Generally long-term, less liquid and relatively stable; brings capital, technology and managerial expertise.

Foreign Investment and Capital Flows (cont)

- Greenfield: Establishment of a new business/facility.

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Foreign Investment and Capital Flows (cont)

- Brownfield: Investment in/acquisition of an existing business/facility.

Foreign Investment and Capital Flows (cont)

- Joint Venture: Foreign and domestic investors jointly establish/operate a business.

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Foreign Investment and Capital Flows (cont)

- Wholly Owned Subsidiary: Entire subsidiary owned by foreign parent, where permitted.

Foreign Investment and Capital Flows (cont)

3. Foreign Portfolio Investment (FPI)

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Foreign Investment and Capital Flows (cont)

- Investment in financial securities without seeking management control.

Foreign Investment and Capital Flows (cont)

- Instruments: Equity shares, government securities, corporate bonds and other permitted securities.

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Foreign Investment and Capital Flows (cont)

- Generally more liquid and volatile than FDI; influenced by interest rates, global liquidity, risk appetite and market sentiment.

Foreign Investment and Capital Flows (cont)

- Sudden FPI outflows can cause currency depreciation and financial-market volatility.

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Foreign Investment and Capital Flows (cont)

FDI vs FPI: FDI = lasting business interest and influence; FPI = securities investment without management control. FDI is generally more stable, but neither is risk-free.

Foreign Investment and Capital Flows (cont)

4. FDI Routes and Regulation in India

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Foreign Investment and Capital Flows (cont)

- Automatic Route: No prior government approval; sectoral caps, entry conditions, FEMA and reporting requirements still apply.

Foreign Investment and Capital Flows (cont)

- Government Route: Prior government approval required.

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Foreign Investment and Capital Flows (cont)

- Sectoral Cap: Maximum permitted foreign investment percentage in a sector.

Foreign Investment and Capital Flows (cont)

- 100% FDI does not necessarily mean automatic-route permission.

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Foreign Investment and Capital Flows (cont)

Institutions:

Foreign Investment and Capital Flows (cont)

- DPIIT: FDI policy.

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Foreign Investment and Capital Flows (cont)

- RBI: FEMA and foreign exchange framework.

Foreign Investment and Capital Flows (cont)

- SEBI: FPI regulation under SEBI (Foreign Portfolio Investors) Regulations, 2019.

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Foreign Investment and Capital Flows (cont)

- FII: Older terminology; FPI is the current regulatory framework.

Foreign Investment and Capital Flows (cont)

5. Other Forms of Foreign Capital

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Foreign Investment and Capital Flows (cont)

- ECB (External Commercial Borrowing): Commercial borrowing by eligible Indian entities from recognised non-resident lenders; governed by RBI's ECB framework under FEMA. Creates principal and interest obligations.

Foreign Investment and Capital Flows (cont)

- FVCI: Foreign Venture Capital Investment in specified Indian venture capital undertakings/funds; supports start-ups and emerging businesses.

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Foreign Investment and Capital Flows (cont)

- ADR: American Depository Receipt; represents shares of a foreign company and trades in US markets.

Foreign Investment and Capital Flows (cont)

- GDR: Global Depository Receipt; represents shares and trades in international markets.

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Foreign Investment and Capital Flows (cont)

- NRI Investment: Investment by eligible NRIs/non-residents in permitted Indian assets.

Foreign Investment and Capital Flows (cont)

- External Assistance: Grants and loans from foreign governments and multilateral institutions; may be concessional or non-concessional.

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Foreign Investment and Capital Flows (cont)

6. Capital Inflows and Outflows

Foreign Investment and Capital Flows (cont)

- Inflows: FDI/FPI into India, ECBs, eligible non-resident deposits.

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Foreign Investment and Capital Flows (cont)

- Outflows: Indian investment abroad, acquisition of foreign assets, foreign investors withdrawing/repatriating investments and external loan repayments.

Foreign Investment and Capital Flows (cont)

- Inflows generally increase foreign exchange supply; outflows increase foreign exchange demand, other things being equal.

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Foreign Investment and Capital Flows (cont)

7. BoP Linkages

Foreign Investment and Capital Flows (cont)

- Under formal IMF classification, FDI, FPI and ECBs are recorded in the Financial Account.

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Foreign Investment and Capital Flows (cont)

- Capital inflows can finance CAD but do not eliminate the underlying current-account imbalance.

Foreign Investment and Capital Flows (cont)

- Interest and dividends paid abroad → Current Account debit (Primary Income).

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Foreign Investment and Capital Flows (cont)

- Principal repayment of external borrowing → Financial Account transaction.

Foreign Investment and Capital Flows (cont)

- Foreign borrowing brings funds today but creates future repayment obligations.

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Indian Financial System

Meaning, structure and components

Financial system: Network of institutions, markets, instruments and services facilitating transfer of funds from savers to borrowers/investors.

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Meaning, structure and components (cont)

Four core components: Financial institutions, financial markets, financial instruments and financial services.

Meaning, structure and components (cont)

Supporting framework: Regulators, laws, payment systems, clearing, settlement and depositories.

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Meaning, structure and components (cont)

Financial institutions: Banks, NBFCs, DFIs, insurance companies, mutual funds and pension funds.

Meaning, structure and components (cont)

Financial markets: Money market, capital market, G-Sec, forex and derivatives markets.

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Meaning, structure and components (cont)

Financial instruments: Debt, equity, money market instruments and derivatives.

Meaning, structure and components (cont)

Financial services: Banking, lending, payments, insurance, investment management, underwriting and advisory.

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Meaning, structure and components (cont)

Major regulators: RBI – banking/monetary/financial markets; SEBI – securities; IRDAI – insurance; PFRDA – pensions; IFSCA – IFSCs.

Meaning, structure and components (cont)

Key distinction: Institution = organisation; market = platform; instrument = financial claim/contract; service = activity.

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Meaning, structure and components (cont)

Remember: Financial market infrastructure enables safe and efficient payment, clearing and settlement; it is not the same as a financial instrument.

Functions and importance

Functions of the Financial System

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Functions and importance (cont)

- Mobilises savings from households and institutions.

Functions and importance (cont)

- Promotes capital formation by channelising savings into productive investment.

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Functions and importance (cont)

- Allocates funds among competing sectors and borrowers.

Functions and importance (cont)

- Provides financial intermediation and reduces transaction/search costs.

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Functions and importance (cont)

- Provides liquidity through financial markets and instruments.

Functions and importance (cont)

- Facilitates risk management through insurance, diversification and derivatives.

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Functions and importance (cont)

- Enables payments, remittances, clearing and settlement.

Functions and importance (cont)

- Supports price discovery of securities, currencies and interest rates.

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Functions and importance (cont)

- Facilitates bank credit creation, subject to regulatory constraints.

Functions and importance (cont)

- Reduces information asymmetry through credit appraisal, rating and monitoring.

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Functions and importance (cont)

Direct vs Indirect Finance

Functions and importance (cont)

- Direct finance: Borrower raises funds directly from investors through securities, e.g. issue of shares/bonds.

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Functions and importance (cont)

- Indirect finance: Funds pass through an intermediary, e.g. bank deposits converted into loans.

Functions and importance (cont)

Information Problems

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Functions and importance (cont)

- Information asymmetry: Unequal information between parties.

Functions and importance (cont)

- Adverse selection: Before transaction; hidden information may attract riskier borrowers.

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Functions and importance (cont)

- Moral hazard: After transaction; borrower may take excessive risks because the lender bears part of the loss.

Functions and importance (cont)

Importance

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Functions and importance (cont)

- Encourages savings and investment.

Functions and importance (cont)

- Supports economic growth, employment and infrastructure development.

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Functions and importance (cont)

- Improves efficiency of capital allocation.

Functions and importance (cont)

- Promotes financial inclusion and access to credit.

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Functions and importance (cont)

- Strengthens monetary-policy transmission.

Functions and importance (cont)

- Supports financial stability and resilience when properly regulated.

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Functions and importance (cont)

MCQ traps

Functions and importance (cont)

- Liquidity = ease of conversion into cash, not profitability.

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Functions and importance (cont)

- Adverse selection = before transaction; moral hazard = after transaction.

Functions and importance (cont)

- Direct finance does not mean absence of regulation or intermediaries such as underwriters.

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Functions and importance (cont)

- Banks are important intermediaries and also create deposits through lending.

Functions and importance (cont)

- Financial development supports growth, but weak regulation can create systemic risk.

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Financial markets,institutions,instruments

1. Financial Markets

Financial markets,institutions,instruments (cont)

- Money Market: Short-term funds (generally up to one year); liquidity and working-capital needs.

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Financial markets,institutions,instruments (cont)

- Call Money: Overnight.

Financial markets,institutions,instruments (cont)

- Notice Money: 2–14 days.

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Financial markets,institutions,instruments (cont)

- Term Money: Beyond 14 days, generally up to one year.

Financial markets,institutions,instruments (cont)

- T-Bills: 91, 182, 364 days; short-term government securities.

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Financial markets,institutions,instruments (cont)

- CP: Unsecured short-term instrument issued by eligible corporates/permitted entities.

Financial markets,institutions,instruments (cont)

- CD: Negotiable short-term instrument issued by eligible banks/FIs.

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Financial markets,institutions,instruments (cont)

- Repo: Borrowing against securities with agreement to repurchase.

Financial markets,institutions,instruments (cont)

- Capital Market: Medium/long-term funds.

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Financial markets,institutions,instruments (cont)

- Primary Market: New issue; funds go to issuer.

Financial markets,institutions,instruments (cont)

- Secondary Market: Existing securities traded; provides liquidity and price discovery.

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Financial markets,institutions,instruments (cont)

- Other markets: Government Securities, Forex, Derivatives and Commodity markets.

Financial markets,institutions,instruments (cont)

2. Financial Institutions

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Financial markets,institutions,instruments (cont)

- Commercial banks: Deposits, loans, payments and credit creation.

Financial markets,institutions,instruments (cont)

- Cooperative banks: Member-based banking and credit.

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Financial markets,institutions,instruments (cont)

- RRBs: Rural and agricultural credit.

Financial markets,institutions,instruments (cont)

- Small Finance Banks: Financial inclusion and lending to underserved segments.

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Financial markets,institutions,instruments (cont)

- Payments Banks: Permitted deposits, payments and remittances; cannot lend.

Financial markets,institutions,instruments (cont)

- NBFCs: Credit and financial services; generally cannot accept demand deposits like banks.

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Financial markets,institutions,instruments (cont)

- DFIs: Specialised/long-term finance (NABARD, SIDBI, EXIM Bank, NaBFID).

Financial markets,institutions,instruments (cont)

- Insurance companies: Risk protection.

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Financial markets,institutions,instruments (cont)

- Mutual funds: Pool and invest money in securities.

Financial markets,institutions,instruments (cont)

- Pension funds: Manage retirement savings.

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Financial markets,institutions,instruments (cont)

3. Financial Instruments

Financial markets,institutions,instruments (cont)

- Debt: Borrowing; repayment obligation (bonds, debentures, T-Bills, CP).

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Financial markets,institutions,instruments (cont)

- Equity: Ownership; dividends not guaranteed; voting rights may apply.

Financial markets,institutions,instruments (cont)

- Hybrid: Combines debt/equity features (convertible debentures, preference shares).

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Financial markets,institutions,instruments (cont)

- Derivatives: Value derived from underlying asset/rate/index (forwards, futures, options, swaps).

Financial markets,institutions,instruments (cont)

- Deposits, insurance and pension products: Savings, protection and retirement.

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Financial markets,institutions,instruments (cont)

4. Financial Services

Financial markets,institutions,instruments (cont)

- Merchant banking: Issue management, underwriting, advisory.

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Financial markets,institutions,instruments (cont)

- Stock broking: Securities trading for clients.

Financial markets,institutions,instruments (cont)

- Underwriting: Takes up agreed unsubscribed securities.

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Financial markets,institutions,instruments (cont)

- Credit rating: Creditworthiness/default-risk assessment.

Financial markets,institutions,instruments (cont)

- Asset management: Investment management.

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Financial markets,institutions,instruments (cont)

- Leasing: Use of asset against periodic payments.

Financial markets,institutions,instruments (cont)

- Factoring: Receivables financing/collection.

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Financial markets,institutions,instruments (cont)

- Depository: Electronic holding and transfer of securities.

Financial markets,institutions,instruments (cont)

- Payment services: Fund transfers and settlement.

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Financial markets,institutions,instruments (cont)

Important distinctions

Financial markets,institutions,instruments (cont)

- Money market = short-term; capital market = medium/long-term.

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Financial markets,institutions,instruments (cont)

- Primary market = issuer raises funds; secondary market = investors trade existing securities.

Financial markets,institutions,instruments (cont)

- Debt = creditor relationship; equity = ownership.

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Financial markets,institutions,instruments (cont)

- Payments Bank cannot lend; Small Finance Bank can lend.

Financial markets,institutions,instruments (cont)

- Mutual fund = investment pool; pension fund = retirement-savings manager.

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Financial markets,institutions,instruments (cont)

- Underwriting = subscription guarantee; credit rating = credit-risk assessment.

Role in Economic Development

- Capital formation: Mobilises savings and channels them into productive investment.

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Role in Economic Development (cont)

- Economic growth: Finances industry, infrastructure, technology, innovation and business expansion.

Role in Economic Development (cont)

- Productivity: Improves allocation of capital towards efficient and productive uses.

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Role in Economic Development (cont)

- Employment: Supports industries, MSMEs, entrepreneurship and self-employment.

Role in Economic Development (cont)

- Financial inclusion: Expands access to banking, credit, insurance, pensions and digital payments.

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Role in Economic Development (cont)

- Infrastructure: Mobilises long-term finance for roads, power, transport and telecommunications.

Role in Economic Development (cont)

- Monetary policy transmission: RBI policy-rate changes influence bank lending/deposit rates, credit and aggregate demand through financial institutions and markets.

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Role in Economic Development (cont)

- Risk management: Insurance, diversification and derivatives help manage financial risks.

Role in Economic Development (cont)

- Wealth creation: Provides savings, investment, insurance and retirement products.

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Role in Economic Development (cont)

- Government finance: Facilitates public borrowing through T-Bills and dated G-Secs.

Role in Economic Development (cont)

- Balanced development: Rural finance, microfinance and priority--sector lending support underserved sectors and regions.

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Role in Economic Development (cont)

Key linkage: Savings mobilisation → Financial intermediation → Investment → Capital formation → Productivity → Economic growth.

Role in Economic Development (cont)

MCQ traps

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Role in Economic Development (cont)

- Financial inclusion means access to a range of formal financial services, not merely opening bank accounts.

Role in Economic Development (cont)

- Financial development supports growth, but uncontrolled credit expansion can create systemic risk.

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Role in Economic Development (cont)

- Monetary policy transmission operates through banks and financial markets.

Role in Economic Development (cont)

- Financial system contributes to both economic growth (higher output) and economic development (broader improvement in living standards).

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Finance Cheat Sheet

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Formal and informal financial systems

Formal Financial System

Formal and informal financial systems (cont)

- Operates within established legal and regulatory frameworks.

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Formal and informal financial systems (cont)

- Includes banks, regulated NBFCs, mutual funds, insurance companies, pension funds, stock exchanges and recognised intermediaries.

Formal and informal financial systems (cont)

- Features: prescribed documentation, transparency, reporting, supervision and grievance redress.

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Formal and informal financial systems (cont)

- Advantages: consumer protection, organised savings, regulated credit and access to formal financial products.

Formal and informal financial systems (cont)

- Limitations: eligibility requirements, documentation and procedural delays.

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Formal and informal financial systems (cont)

Informal Financial System

Formal and informal financial systems (cont)

- Financial arrangements outside or largely outside the formal regulatory framework.

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Formal and informal financial systems (cont)

- Examples: moneylenders, friends/relatives, local lending networks and informal rotating savings/credit arrangements.

Formal and informal financial systems (cont)

- Features: relationship-based, flexible, often minimal documentation and limited regulatory oversight.

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Formal and informal financial systems (cont)

- Advantages: quick access, flexibility and local availability.

Formal and informal financial systems (cont)

- Limitations: high borrowing costs, exploitation risks, lack of transparency and limited formal grievance redress.

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Formal and informal financial systems (cont)

Formalisation of Finance in India

Formal and informal financial systems (cont)

- PM Jan Dhan Yojana: Expands access to basic banking.

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Formal and informal financial systems (cont)

- Aadhaar + DBT: Facilitates direct transfer of government benefits.

Formal and informal financial systems (cont)

- UPI/digital payments: Supports formal and traceable transactions.

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Formal and informal financial systems (cont)

- Microfinance: Expands small-ticket credit to underserved segments.

Formal and informal financial systems (cont)

- Financial literacy: Improves informed use of financial products and consumer protection.

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Formal and informal financial systems (cont)

MCQ traps

Formal and informal financial systems (cont)

- Informal finance is not necessarily illegal; it is generally outside the formal regulated institutional framework.

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Formal and informal financial systems (cont)

- Formal finance is not always cheaper or instantly accessible.

Formal and informal financial systems (cont)

- Financial inclusion is broader than bank-account ownership.

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Formal and informal financial systems (cont)

- UPI facilitates payments; it is not itself a lending institution.

Formal and informal financial systems (cont)

- Microfinance is not synonymous with informal lending; regulated institutions also provide microfinance.

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Financial Institutions

Commercial banks

Commercial Banks

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Commercial banks (cont)

- Accept deposits from the public and provide loans/advances; act as financial intermediaries.

Commercial banks (cont)

- Major functions: deposit mobilisation, lending, credit creation, payment/remittance services and agency services.

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Commercial banks (cont)

Types of Deposits

Commercial banks (cont)

- Savings: Individual savings; interest-bearing, with liquidity.

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Commercial banks (cont)

- Current: Mainly business transactions; frequent withdrawals, generally no interest.

Commercial banks (cont)

- Fixed/Term: Deposit for specified tenure at agreed interest rate.

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Commercial banks (cont)

- Recurring: Fixed amount deposited periodically for a specified tenure.

Commercial banks (cont)

Types of Advances

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Commercial banks (cont)

- Term Loan: Repaid over a specified period.

Commercial banks (cont)

- Cash Credit: Borrowing up to a sanctioned limit, generally for working capital.

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Commercial banks (cont)

- Overdraft: Withdrawal beyond account balance up to approved limit.

Commercial banks (cont)

- Bill Discounting: Purchase of bill before maturity after deducting discount.

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Commercial banks (cont)

Other Important Concepts

Commercial banks (cont)

- Credit Creation: Banks create deposit money through lending; constrained by CRR, capital adequacy, liquidity, credit demand and regulation.

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Commercial banks (cont)

- CASA: Current Account + Savings Account deposits; higher CASA generally lowers cost of deposits.

Commercial banks (cont)

- NPA: Loan/advance overdue for more than 90 days, subject to RBI classification norms and exceptions.

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Commercial banks (cont)

- CRR: Percentage of NDTL maintained as cash balance with RBI.

Commercial banks (cont)

- SLR: Percentage of NDTL maintained in prescribed liquid assets, including cash, gold and eligible securities.

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Commercial banks (cont)

- DICGC: Deposit insurance cover up to ₹5 lakh per depositor per bank, including principal and interest, subject to rules.

Commercial banks (cont)

MCQ traps

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Commercial banks (cont)

- CRR is maintained with RBI; SLR is maintained by banks in prescribed liquid assets.

Commercial banks (cont)

- Current accounts generally do not earn interest; savings accounts do.

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Commercial banks (cont)

- Cash Credit and Overdraft are not the same as term loans.

Commercial banks (cont)

- Credit creation is constrained; banks cannot lend without limit.

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Commercial banks (cont)

- Deposit insurance is provided by DICGC, not RBI directly.

Public-sector and private-sector banks

- Public-Sector Banks: Government of India holds majority ownership (>50%); includes SBI and nationalised banks.

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Public-sector and private-sector banks (cont)

- Private-Sector Banks: Majority ownership with private shareholders; regulated by RBI.

Public-sector and private-sector banks (cont)

- Nationalisation: 14 major banks in 1969; 6 more in 1980.

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Public-sector and private-sector banks (cont)

- SBI: Established in 1955, following transformation of Imperial Bank of India; not one of the 14 banks nationalised in 1969.

Public-sector and private-sector banks (cont)

- Private banks: Old private-sector banks and new private-sector banks (licensed under post-1991 RBI guidelines).

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Public-sector and private-sector banks (cont)

- Examples of PSBs: SBI, PNB, Bank of Baroda, Canara Bank, Union Bank of India.

Public-sector and private-sector banks (cont)

- Examples of private banks: HDFC Bank, ICICI Bank, Axis Bank, Kotak Mahindra Bank, Federal Bank.

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Public-sector and private-sector banks (cont)

- Both types accept deposits, lend, create credit and are regulated by RBI.

Public-sector and private-sector banks (cont)

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Public-sector and private-sector banks (cont)

- Public-sector bank = Government majority ownership, not necessarily 100% government ownership.

Public-sector and private-sector banks (cont)

- Private-sector banks are also subject to RBI regulation.

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Public-sector and private-sector banks (cont)

- SBI's establishment in 1955 is distinct from the 1969 bank nationalisation.

Public-sector and private-sector banks (cont)

- PSBs are not exempt from commercial or prudential banking requirements.

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Cooperative Banks

Meaning and Characteristics

Cooperative Banks (cont)

- Member-owned, member-oriented institutions based on cooperation and democratic governance.

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Cooperative Banks (cont)

- Serve agriculture, rural communities, small businesses and local borrowers.

Cooperative Banks (cont)

1. Rural Short-Term Cooperative Credit Structure

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Cooperative Banks (cont)

- StCB (State Cooperative Bank): State-level apex institution.

Cooperative Banks (cont)

- DCCB (District Central Cooperative Bank): District-level institution; links State Cooperative Banks with Primary Agricultural Credit Societies.

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Cooperative Banks (cont)

- PACS (Primary Agricultural Credit Society): Village-level grassroots society; provides short-term agricultural credit directly to members.

Cooperative Banks (cont)

- Structure: StCB → DCCB → PACS.

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Cooperative Banks (cont)

2. Urban Cooperative Banks (UCBs)

Cooperative Banks (cont)

- Serve urban/semi-urban individuals, traders and small businesses.

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Cooperative Banks (cont)

- Classified as scheduled and non-scheduled Urban Cooperative Banks.

Cooperative Banks (cont)

3. Regulation

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Cooperative Banks (cont)

- RBI (Reserve Bank of India): Banking regulation and supervision under the Banking Regulation Act, 1949.

Cooperative Banks (cont)

- NABARD (National Bank for Agriculture and Rural Development): Supervisory role for State Cooperative Banks and District Central Cooperative Banks; supports rural cooperative credit.

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Cooperative Banks (cont)

- RCS (Registrar of Cooperative Societies): Handles cooperative--society registration, governance and administrative matters.

Cooperative Banks (cont)

- Multi-State Cooperative Societies Act, 2002: Governs cooperative societies operating across multiple states.

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Cooperative Banks (cont)

4. Important MCQ Traps

Cooperative Banks (cont)

- Primary Agricultural Credit Societies are grassroots credit societies, not equivalent to licensed commercial banks.

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Cooperative Banks (cont)

- RBI regulates banking functions; cooperative-society matters also involve the Registrar.

Cooperative Banks (cont)

- NABARD is not the primary banking regulator; RBI has banking regulatory powers.

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Cooperative Banks (cont)

- Urban Cooperative Banks serve urban/semi-urban areas; rural cooperative structure serves agricultural and rural credit.

Cooperative Banks (cont)

- Cooperative banks are member-owned, unlike ordinary shareholder-owned commercial banks.

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Regional Rural Banks (RRBs)

Regional Rural Banks (RRBs)

Regional Rural Banks (RRBs) (cont)

- Established under the Regional Rural Banks Act, 1976; first RRB, Prathama Bank, established on 2 October 1975 in Moradabad, Uttar Pradesh.

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Regional Rural Banks (RRBs) (cont)

- Objective: Provide banking and credit to small/marginal farmers, agricultural labourers, artisans and rural entrepreneurs.

Regional Rural Banks (RRBs) (cont)

- Combine local rural orientation with commercial banking practices.

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Regional Rural Banks (RRBs) (cont)

Ownership

Regional Rural Banks (RRBs) (cont)

- Central Government: 50%

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Regional Rural Banks (RRBs) (cont)

- State Government: 15%

Regional Rural Banks (RRBs) (cont)

- Sponsor Bank: 35%

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Regional Rural Banks (RRBs) (cont)

- Sponsor Bank provides managerial, technical and operational support.

Regional Rural Banks (RRBs) (cont)

Functions

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Regional Rural Banks (RRBs) (cont)

- Accept deposits and provide rural/agricultural credit.

Regional Rural Banks (RRBs) (cont)

- Finance farmers, rural artisans, labourers and entrepreneurs.

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Regional Rural Banks (RRBs) (cont)

- Support Micro, Small and Medium Enterprises (MSMEs), financial inclusion, Direct Benefit Transfer (DBT) and pension payments.

Regional Rural Banks (RRBs) (cont)

Regulation and Supervision

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Regional Rural Banks (RRBs) (cont)

- RBI (Reserve Bank of India): Banking regulator under the Banking Regulation Act, 1949.

Regional Rural Banks (RRBs) (cont)

- NABARD (National Bank for Agriculture and Rural Development): Supervisory/inspection role and developmental support.

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Regional Rural Banks (RRBs) (cont)

- Sponsor Bank: Operational and managerial assistance.

Regional Rural Banks (RRBs) (cont)

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Regional Rural Banks (RRBs) (cont)

- RRBs are commercial banks, not cooperative banks.

Regional Rural Banks (RRBs) (cont)

- Ownership: 50:15:35 (Central Government : State Government : Sponsor Bank).

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Regional Rural Banks (RRBs) (cont)

- RRB Act = 1976; first RRB established in 1975.

Regional Rural Banks (RRBs) (cont)

- RRBs operate in specified regions, unlike nationwide commercial banks.

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Regional Rural Banks (RRBs) (cont)

- NABARD supervises/supports RRBs; RBI remains the banking regulator.

Small Finance Banks (SFBs)

Small Finance Banks (SFBs)

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Small Finance Banks (SFBs) (cont)

- Objective: Financial inclusion through savings and credit for small/-marginal farmers, Micro and Small Enterprises (MSEs), low-income households and underserved sections.

Small Finance Banks (SFBs) (cont)

- Can accept deposits and undertake lending; unlike Payments Banks.

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Small Finance Banks (SFBs) (cont)

- Offer savings/current/term deposits, loans, debit cards and payment services.

Small Finance Banks (SFBs) (cont)

- Can distribute permitted mutual fund, insurance and pension products subject to applicable rules.

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Small Finance Banks (SFBs) (cont)

Important RBI Licensing Norms

Small Finance Banks (SFBs) (cont)

- Minimum paid-up voting equity capital: ₹200 crore, subject to applicable guidelines/exceptions.

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Small Finance Banks (SFBs) (cont)

- Promoter's initial minimum contribution: 40%, subject to lock-in and dilution conditions.

Small Finance Banks (SFBs) (cont)

- Priority Sector Lending (PSL) target: 75% of Adjusted Net Bank Credit (ANBC) or Credit Equivalent of Off-Balance Sheet Exposures (CEOBE), whichever is higher, subject to applicable directions.

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Small Finance Banks (SFBs) (cont)

- At least 50% of loan portfolio should consist of loans up to ₹25 lakh, under the licensing framework.

Small Finance Banks (SFBs) (cont)

Examples: AU, Ujjivan, Equitas, Jana, ESAF, Suryoday, Utkarsh Small Finance Banks.

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Small Finance Banks (SFBs) (cont)

SFB vs Payments Bank

Small Finance Banks (SFBs) (cont)

- SFB: Accepts deposits and lends.

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Small Finance Banks (SFBs) (cont)

- Payments Bank: Accepts permitted deposits and provides payments/remittance services but cannot lend.

Payments Banks

Payments Banks

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Payments Banks (cont)

- Introduced by RBI to promote financial inclusion through small savings, payments and remittances.

Payments Banks (cont)

- Target: Migrant workers, low-income households, small businesses and underserved customers.

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Payments Banks (cont)

- Can accept demand deposits (savings/current accounts); maximum end-of-day balance ₹2 lakh per individual customer.

Payments Banks (cont)

- Cannot lend, issue credit cards or accept NRI deposits.

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Payments Banks (cont)

- Can issue debit/ATM cards and provide domestic remittance/payment services.

Payments Banks (cont)

- Can distribute permitted third-party products (insurance, mutual funds and pension products), subject to rules.

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Payments Banks (cont)

Deposit Deployment

Payments Banks (cont)

- At least 75% of demand deposit balances invested in Government Securities/Treasury Bills with maturity up to one year.

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Payments Banks (cont)

- Remaining maximum 25% may be placed in deposits with other scheduled commercial banks, subject to RBI conditions.

Payments Banks (cont)

- Deposits cannot be deployed for lending.

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Payments Banks (cont)

Capital and Regulation

Payments Banks (cont)

- Minimum paid-up equity capital: ₹100 crore.

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Payments Banks (cont)

- Promoter's initial minimum contribution: 40%, subject to lock-in/dilution conditions.

Payments Banks (cont)

- Licensed and regulated by RBI (Reserve Bank of India).

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Payments Banks (cont)

Examples: India Post Payments Bank (IPPB), Airtel Payments Bank, Fino Payments Bank, NSDL Payments Bank.

Payments Banks (cont)

Payments Bank vs Small Finance Bank

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Payments Banks (cont)

- Payments Bank = Deposits + payments/remittances; no lending.

Payments Banks (cont)

- Small Finance Bank = Deposits + lending.

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Payments Banks (cont)

MCQ Traps

Payments Banks (cont)

- Payments Banks cannot lend or issue credit cards.

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Payments Banks (cont)

- ₹2 lakh = maximum end-of-day balance per individual customer.

Payments Banks (cont)

- Minimum capital: Payments Bank ₹100 crore; Small Finance Bank ₹200 crore under the respective licensing frameworks.

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Payments Banks (cont)

- Payments Banks are banks, not ordinary payment-system operators or NBFCs.

Development Financial Institutions (DFIs)

Development Financial Institutions (DFIs)

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Development Financial Institutions (DFIs) (cont)

- Specialised institutions established to provide finance for sectors requiring long-term investment or facing financing gaps.

Development Financial Institutions (DFIs) (cont)

- Major sectors: Infrastructure, industry, agriculture, rural development, Micro, Small and Medium Enterprises (MSMEs), exports and housing.

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Development Financial Institutions (DFIs) (cont)

- Focus on developmental objectives and long-term/sector-specific finance rather than ordinary commercial banking alone.

Development Financial Institutions (DFIs) (cont)

Key Characteristics

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Development Financial Institutions (DFIs) (cont)

- Provide long-term and specialised finance for projects with large capital requirements and long gestation periods.

Development Financial Institutions (DFIs) (cont)

- May provide loans, refinancing, guarantees, equity investment and advisory support.

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Development Financial Institutions (DFIs) (cont)

- May be statutory or established through specific institutional arrangements.

Development Financial Institutions (DFIs) (cont)

- Not all DFIs accept public deposits.

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Development Financial Institutions (DFIs) (cont)

Types of Development Finance

Development Financial Institutions (DFIs) (cont)

- Direct Finance: Loans directly to eligible borrowers/projects.

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Development Financial Institutions (DFIs) (cont)

- Refinance: Funds provided to lending institutions against eligible loans already extended by them.

Development Financial Institutions (DFIs) (cont)

- Project Finance: Finance based primarily on the project's expected cash flows and viability.

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Development Financial Institutions (DFIs) (cont)

- Guarantees: Credit support that reduces lenders' risk.

Development Financial Institutions (DFIs) (cont)

- Equity Support: Investment in eligible companies, funds or projects.

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Development Financial Institutions (DFIs) (cont)

DFI vs Commercial Bank

Development Financial Institutions (DFIs) (cont)

- Commercial banks: Broad-based deposit mobilisation, lending and payment services.

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Development Financial Institutions (DFIs) (cont)

- DFIs: Sector-specific/developmental mandate and often longer-term finance.

Development Financial Institutions (DFIs) (cont)

- DFIs are not necessarily deposit-taking institutions; some may also perform banking-related functions.

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Specialised institutions

1. NABARD — National Bank for Agriculture and Rural Development

Specialised institutions (cont)

- Established: 12 July 1982; Act: NABARD Act, 1981; Headquarters: Mumbai.

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Specialised institutions (cont)

- Apex development financial institution for agriculture and rural development.

Specialised institutions (cont)

- Provides refinance to eligible institutions for agricultural and rural credit.

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Specialised institutions (cont)

- Manages Rural Infrastructure Development Fund (RIDF).

Specialised institutions (cont)

- Supports rural cooperatives and Regional Rural Banks (RRBs); supervises State Cooperative Banks and District Central Cooperative Banks under the applicable framework.

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Specialised institutions (cont)

2. SIDBI — Small Industries Development Bank of India

Specialised institutions (cont)

- Established: 2 April 1990; Act: SIDBI Act, 1989; Headquarters: Lucknow.

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Specialised institutions (cont)

- Principal financial institution for Micro, Small and Medium Enterprises (MSMEs).

Specialised institutions (cont)

- Provides direct finance, indirect finance and refinance.

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Specialised institutions (cont)

- Supports MSME modernisation, expansion, entrepreneurship and start-ups.

Specialised institutions (cont)

3. EXIM Bank — Export-Import Bank of India

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Specialised institutions (cont)

- Established: 1982; Act: Export-Import Bank of India Act, 1981; Headquarters: Mumbai.

Specialised institutions (cont)

- Promotes India's international trade.

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Specialised institutions (cont)

- Provides pre-shipment and post-shipment export finance, import finance and overseas investment finance.

Specialised institutions (cont)

- Extends Lines of Credit (LoCs) to overseas governments and institutions to support Indian exports.

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Specialised institutions (cont)

4. NHB — National Housing Bank

Specialised institutions (cont)

- Established: 9 July 1988; Act: National Housing Bank Act, 1987; Headquarters: New Delhi.

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Specialised institutions (cont)

- Principal institution for development of housing finance.

Specialised institutions (cont)

- Provides refinance to eligible housing finance institutions and promotes affordable housing.

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Specialised institutions (cont)

- RBI became the regulator of Housing Finance Companies (HFCs) in 2019; NHB continues developmental and refinance functions.

Specialised institutions (cont)

5. Other Specialised Institutions

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Specialised institutions (cont)

- NaBFID (National Bank for Financing Infrastructure and Development): Established under NaBFID Act, 2021; infrastructure-focused DFI; long-term infrastructure finance; RBI-regulated AIFI.

Specialised institutions (cont)

- IIFCL (India Infrastructure Finance Company Limited): Established 2006; long-term finance for viable infrastructure projects.

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Specialised institutions (cont)

- IFCI (Industrial Finance Corporation of India): Established 1948 under IFCI Act, 1948; among India's earliest DFIs; industrial and infrastructure finance.

Specialised institutions (cont)

- PFC (Power Finance Corporation): Established 1986; financing for power generation, transmission and distribution.

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Specialised institutions (cont)

- REC (Rural Electrification Corporation, now REC Limited): Established 1969; rural electrification and power-sector finance.

Specialised institutions (cont)

Five All India Financial Institutions (AIFIs) regulated by RBI

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Specialised institutions (cont)

- NABARD – Agriculture and rural development.

Specialised institutions (cont)

- SIDBI – MSMEs.

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Specialised institutions (cont)

- EXIM Bank – International trade.

Specialised institutions (cont)

- NHB – Housing finance.

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Specialised institutions (cont)

- NaBFID – Infrastructure finance.

Differences between financial institutions

Banks

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Differences between financial institutions (cont)

- Accept demand deposits (savings/current accounts), provide loans and payment services.

Differences between financial institutions (cont)

- Can issue cheques drawn on themselves and participate in the payment and settlement system.

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Differences between financial institutions (cont)

- Create deposit money through the credit creation process.

Differences between financial institutions (cont)

- Regulated by RBI under Banking Regulation Act, 1949 and RBI Act, 1934.

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Differences between financial institutions (cont)

NBFIs — Non-Bank Financial Institutions

Differences between financial institutions (cont)

- Provide specialised financial services without performing the full range of banking functions.

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Differences between financial institutions (cont)

- Include NBFCs, insurance companies, mutual funds, pension funds and DFIs.

Differences between financial institutions (cont)

- NBFCs are one category of NBFIs; not all NBFIs are NBFCs.

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Differences between financial institutions (cont)

NBFCs — Non-Banking Financial Companies

Differences between financial institutions (cont)

- Provide loans, advances, investments, asset finance, leasing, hire purchase, factoring, microfinance and infrastructure finance.

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Differences between financial institutions (cont)

- Cannot accept demand deposits or offer savings/current accounts.

Differences between financial institutions (cont)

- Cannot issue cheques drawn on themselves.

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Differences between financial institutions (cont)

- Do not create demand-deposit money like banks.

Differences between financial institutions (cont)

- Most cannot accept public deposits; eligible deposit-taking NBFCs require RBI permission and must follow prescribed conditions.

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Differences between financial institutions (cont)

- Regulated primarily by RBI under RBI Act, 1934 and applicable directions.

Differences between financial institutions (cont)

Deposit Insurance

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Differences between financial institutions (cont)

- DICGC (Deposit Insurance and Credit Guarantee Corporation) covers eligible deposits in insured banks up to ₹5 lakh per depositor per bank, including principal and interest.

Differences between financial institutions (cont)

- NBFC deposits are not covered by DICGC.

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Differences between financial institutions (cont)

Regulators — Quick Recall

Differences between financial institutions (cont)

- Banks and NBFCs – RBI (Reserve Bank of India).

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Differences between financial institutions (cont)

- Insurance companies – IRDAI (Insurance Regulatory and Development Authority of India).

Differences between financial institutions (cont)

- Mutual funds – SEBI (Securities and Exchange Board of India).

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Differences between financial institutions (cont)

- Pension funds – PFRDA (Pension Fund Regulatory and Development Authority).

Financial Markets

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Money market and capital market

1. Money Market and Capital Market

Money market and capital market (cont)

- Financial Market: A market where financial instruments are issued and traded, facilitating the transfer of funds from savers to borrowers/investors.

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Money market and capital market (cont)

- Money Market:

Money market and capital market (cont)

- Market for short-term funds and financial instruments with original maturity up to 1 year.

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Money market and capital market (cont)

- Meets short-term liquidity and working-capital requirements.

Money market and capital market (cont)

- Instruments: Treasury Bills (T-Bills), Commercial Paper (CP), Certificates of Deposit (CD), Call Money, Notice Money, Term Money and Repurchase Agreements (Repo).

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Money market and capital market (cont)

- Major participants: RBI, banks, Primary Dealers (PDs), financial institutions, NBFCs, mutual funds and corporates (subject to instrument-specific eligibility).

Money market and capital market (cont)

- Regulator: RBI.

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Money market and capital market (cont)

- Capital Market:

Money market and capital market (cont)

- Market for medium- and long-term funds, generally with original maturity exceeding 1 year, as well as equity instruments without a maturity date.

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Money market and capital market (cont)

- Facilitates long-term investment and capital formation.

Money market and capital market (cont)

- Instruments:

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Money market and capital market (cont)

- Equity shares.

Money market and capital market (cont)

- Preference shares.

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Money market and capital market (cont)

- Corporate bonds and debentures.

Money market and capital market (cont)

- Government securities (G-Secs) with longer maturities.

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Money market and capital market (cont)

- Convertible securities.

Money market and capital market (cont)

- Major participants: Companies, Government, investors, mutual funds, insurance companies, pension funds and Foreign Portfolio Investors (FPIs).

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Money market and capital market (cont)

- Regulator: Securities and Exchange Board of India (SEBI) for securities markets; RBI regulates Government securities and related money-market segments.

Money market and capital market (cont)

Market structure - Financial Market

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Money market and capital market (cont)

a.) Money Market

Money market and capital market (cont)

≤ 1 year

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Money market and capital market (cont)

Short-term funds

Money market and capital market (cont)

- T-Bills

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Money market and capital market (cont)

- CP and CD

Money market and capital market (cont)

- Call Money

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Money market and capital market (cont)

- Repo

Money market and capital market (cont)

b.) Capital Market

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Money market and capital market (cont)

Long-term

Money market and capital market (cont)

Long-term capital

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Money market and capital market (cont)

- Equity

Money market and capital market (cont)

- Bonds

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Money market and capital market (cont)

- Debentures

Money market and capital market (cont)

- Preference shares

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Money market and capital market (cont)

MCQ traps

Money market and capital market (cont)

- Classification depends on original maturity, not remaining maturity.

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Money market and capital market (cont)

- Equity is part of the capital market despite having no maturity.

Money market and capital market (cont)

- Treasury Bills are money-market instruments; long-term Government Securities are capital-market instruments.

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Money market and capital market (cont)

- Money market = liquidity management; capital market = long-term capital formation.

Money market and capital market (cont)

- RBI regulates the money market; SEBI regulates the securities market, with jurisdictional overlap in certain instruments and activities.

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Difference Between Money Market and Capital Market

Meaning:

Difference Between Money Market and Capital Market (cont)

- Money Market: Market for short-term funds.

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Difference Between Money Market and Capital Market (cont)

- Capital Market: Market for medium- and long-term funds.

Difference Between Money Market and Capital Market (cont)

Maturity:

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Difference Between Money Market and Capital Market (cont)

- Money Market: Original maturity up to 1 year.

Difference Between Money Market and Capital Market (cont)

- Capital Market: Generally original maturity more than 1 year; equity has no maturity.

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Difference Between Money Market and Capital Market (cont)

Purpose:

Difference Between Money Market and Capital Market (cont)

- Money Market: Working capital and short-term liquidity management.

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Difference Between Money Market and Capital Market (cont)

- Capital Market: Long-term investment, business expansion and capital formation.

Difference Between Money Market and Capital Market (cont)

Instruments:

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Difference Between Money Market and Capital Market (cont)

- Money Market: Treasury Bills (T-Bills), Commercial Paper (CP), Certificates of Deposit (CD), Call Money, Notice Money, Term Money and Repo.

Difference Between Money Market and Capital Market (cont)

- Capital Market: Equity shares, preference shares, corporate bonds, debentures and long-term Government Securities.

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Difference Between Money Market and Capital Market (cont)

Risk and Returns:

Difference Between Money Market and Capital Market (cont)

- Money Market: Generally lower risk and lower returns, but depends on issuer and instrument.

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Difference Between Money Market and Capital Market (cont)

- Capital Market: Generally higher risk and potentially higher returns, particularly equity.

Difference Between Money Market and Capital Market (cont)

Liquidity:

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Difference Between Money Market and Capital Market (cont)

- Money Market: Generally high liquidity in actively traded instruments.

Difference Between Money Market and Capital Market (cont)

- Capital Market: Varies depending on the security and trading activity.

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Difference Between Money Market and Capital Market (cont)

Participants:

Difference Between Money Market and Capital Market (cont)

- Money Market: RBI, banks, Primary Dealers, financial institutions, NBFCs, corporates and Mutual Funds.

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Difference Between Money Market and Capital Market (cont)

- Capital Market: Companies, governments, retail investors, Mutual Funds, insurance companies, pension funds and Foreign Portfolio Investors (FPIs).

Difference Between Money Market and Capital Market (cont)

Regulation:

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Difference Between Money Market and Capital Market (cont)

- Money Market: Primarily regulated by the Reserve Bank of India (RBI).

Difference Between Money Market and Capital Market (cont)

- Capital Market: Securities market primarily regulated by the Securities and Exchange Board of India (SEBI); RBI regulates Government Securities and relevant segments.

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Difference Between Money Market and Capital Market (cont)

Important MCQ Traps:

Difference Between Money Market and Capital Market (cont)

- Classification is based on original maturity, not remaining maturity.

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Difference Between Money Market and Capital Market (cont)

- Treasury Bills are money-market instruments even though issued by the Government.

Difference Between Money Market and Capital Market (cont)

- Long-term Government Securities belong to the capital-market segment.

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Difference Between Money Market and Capital Market (cont)

- Equity shares are capital-market instruments despite having no maturity.

Difference Between Money Market and Capital Market (cont)

- Money Market = short-term liquidity; Capital Market = long-term financing.

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Difference Between Money Market and Capital Market (cont)

- RBI is the primary regulator of the money market; SEBI regulates the securities market.

Market Participants and Intermediaries

Issuers / Borrowers:

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Market Participants and Intermediaries (cont)

- Entities raising funds by issuing securities.

Market Participants and Intermediaries (cont)

- Examples: Central and State Governments, companies, financial institutions.

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Market Participants and Intermediaries (cont)

- Raise funds through equity, bonds, debentures and money-market instruments.

Market Participants and Intermediaries (cont)

Investors / Fund Providers:

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Market Participants and Intermediaries (cont)

- Supply funds in return for income, capital appreciation or portfolio diversification.

Market Participants and Intermediaries (cont)

- Examples: Retail investors, banks, Mutual Funds (MFs), insurance companies, pension funds, Foreign Portfolio Investors (FPIs).

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Market Participants and Intermediaries (cont)

Financial Intermediaries:

Market Participants and Intermediaries (cont)

- Connect issuers and investors and facilitate transactions.

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Market Participants and Intermediaries (cont)

- Stockbrokers: Execute buy/sell orders on stock exchanges.

Market Participants and Intermediaries (cont)

- Merchant Bankers: Manage public issues, underwriting and issue--related compliance.

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Market Participants and Intermediaries (cont)

- Underwriters: Agree to subscribe to securities not purchased by the public, subject to the underwriting agreement.

Market Participants and Intermediaries (cont)

- Depositories: Hold securities electronically — NSDL (National Securities Depository Limited) and CDSL (Central Depository Services (India) Limited).

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Market Participants and Intermediaries (cont)

- Depository Participants (DPs): Provide investors access to depository services.

Market Participants and Intermediaries (cont)

- Clearing Corporations: Determine obligations, manage counterparty risk and facilitate settlement.

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Market Participants and Intermediaries (cont)

- Registrars and Transfer Agents (RTAs): Maintain investor records and process allotments, transfers and related services.

Market Participants and Intermediaries (cont)

- Credit Rating Agencies (CRAs): Assess creditworthiness and assign ratings to debt instruments; ratings indicate credit risk, not guaranteed repayment.

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Market Participants and Intermediaries (cont)

- Investment Bankers: Advise issuers on fundraising, structuring and capital-market transactions.

Market Participants and Intermediaries (cont)

Regulators and Supporting Institutions:

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Market Participants and Intermediaries (cont)

- SEBI (Securities and Exchange Board of India): Regulates securities markets and intermediaries; protects investors.

Market Participants and Intermediaries (cont)

- RBI (Reserve Bank of India): Regulates money markets, government securities market and banking-related participants.

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Market Participants and Intermediaries (cont)

- IRDAI (Insurance Regulatory and Development Authority of India): Regulates insurance companies.

Market Participants and Intermediaries (cont)

- PFRDA (Pension Fund Regulatory and Development Authority): Regulates the pension sector, including the National Pension System (NPS).

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Market Participants and Intermediaries (cont)

- IFSCA (International Financial Services Centres Authority): Regulates financial products, services and institutions in International Financial Services Centres (IFSCs).

Market Participants and Intermediaries (cont)

MCQ traps:

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Market Participants and Intermediaries (cont)

- Broker = executes trades; merchant banker = manages securities issues.

Market Participants and Intermediaries (cont)

- Underwriter = assumes subscription risk; does not guarantee investment returns.

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Market Participants and Intermediaries (cont)

- Depository = holds securities electronically; DP = provides the investor-facing access.

Market Participants and Intermediaries (cont)

- Clearing corporation = clearing and settlement risk management; stock exchange = trading platform.

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Market Participants and Intermediaries (cont)

- Credit rating indicates relative credit risk, not a recommendation to buy or sell and not a guarantee of repayment.

Functions of Financial Markets

- Mobilisation of Savings: Channel household and institutional savings into productive investments.

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Functions of Financial Markets (cont)

- Capital Formation: Facilitate funding for businesses, infrastructure and government expenditure.

Functions of Financial Markets (cont)

- Efficient Allocation of Resources: Direct funds towards borrowers and projects offering better risk-adjusted returns.

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Functions of Financial Markets (cont)

- Liquidity: Allow investors to convert financial assets into cash, particularly through secondary markets.

Functions of Financial Markets (cont)

- Price Discovery: Determine prices and yields through demand and supply.

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Functions of Financial Markets (cont)

- Risk Management: Enable transfer and management of financial risks through derivatives, insurance-linked instruments and diversification.

Functions of Financial Markets (cont)

- Maturity Transformation: Help channel short-term savings into longer-term financing through financial intermediaries.

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Functions of Financial Markets (cont)

- Payment and Settlement: Facilitate transfer of funds and securities between market participants.

Functions of Financial Markets (cont)

- Information Dissemination: Market prices, interest rates and yields communicate information about economic conditions and expectations.

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Functions of Financial Markets (cont)

- Monetary Policy Transmission: Changes in RBI policy rates influence money-market rates, bond yields, borrowing costs and investment decisions.

Functions of Financial Markets (cont)

Important distinctions / MCQ traps:

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Functions of Financial Markets (cont)

- Liquidity = ease of converting an asset into cash without significant loss in value.

Functions of Financial Markets (cont)

- Price discovery = determination of fair market prices through trading.

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Functions of Financial Markets (cont)

- Capital formation = conversion of savings into productive investment.

Functions of Financial Markets (cont)

- Risk transfer does not eliminate risk; it shifts risk to another party willing to bear it.

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Functions of Financial Markets (cont)

- Primary markets mainly facilitate fresh capital mobilisation; secondary markets mainly provide liquidity and price discovery.

Functions of Financial Markets (cont)

- Financial markets support monetary policy transmission, but RBI determines monetary policy in India.

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Organised and Unorganised Financial Markets

Organised (Formal) Financial Market:

Organised and Unorganised Financial Markets (cont)

- Operates within a defined legal and regulatory framework.

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Organised and Unorganised Financial Markets (cont)

- Transactions take place through recognised institutions, authorised intermediaries and regulated platforms.

Organised and Unorganised Financial Markets (cont)

- Subject to rules on disclosure, transparency, reporting, investor protection and settlement.

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Organised and Unorganised Financial Markets (cont)

- Examples:

Organised and Unorganised Financial Markets (cont)

- Stock exchanges — NSE, BSE.

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Organised and Unorganised Financial Markets (cont)

- Government securities market — RBI's NDS-OM platform.

Organised and Unorganised Financial Markets (cont)

- Regulated money-market segments — Treasury Bills, Commercial Paper and Certificates of Deposit.

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Organised and Unorganised Financial Markets (cont)

- Regulators include SEBI (Securities and Exchange Board of India) and RBI (Reserve Bank of India), depending on the market segment.

Organised and Unorganised Financial Markets (cont)

Unorganised (Informal) Financial Market:

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Organised and Unorganised Financial Markets (cont)

- Operates outside, or largely outside, the formal institutional regulatory framework.

Organised and Unorganised Financial Markets (cont)

- Transactions may be based on personal relationships, local practices and bilateral agreements.

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Organised and Unorganised Financial Markets (cont)

- Often lacks standardised documentation, transparency and formal dispute-resolution mechanisms.

Organised and Unorganised Financial Markets (cont)

- Examples:

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Organised and Unorganised Financial Markets (cont)

- Moneylenders.

Organised and Unorganised Financial Markets (cont)

- Indigenous bankers.

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Organised and Unorganised Financial Markets (cont)

- Informal lending between individuals.

Organised and Unorganised Financial Markets (cont)

- Local chit arrangements operating outside applicable regulation.

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Organised and Unorganised Financial Markets (cont)

Key Distinctions:

Organised and Unorganised Financial Markets (cont)

- Organised market: formal institutions, standardised contracts, regulatory oversight and greater transparency.

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Organised and Unorganised Financial Markets (cont)

- Unorganised market: informal arrangements, limited transparency and weaker formal safeguards.

Organised and Unorganised Financial Markets (cont)

- Organised markets generally provide better investor protection and price discovery.

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Organised and Unorganised Financial Markets (cont)

- Unorganised markets may serve borrowers excluded from formal finance but can involve higher borrowing costs and exploitation risks.

Organised and Unorganised Financial Markets (cont)

MCQ traps:

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Organised and Unorganised Financial Markets (cont)

- Organised vs unorganised is based on the degree of institutionalisation and regulatory oversight, not the maturity of instruments.

Organised and Unorganised Financial Markets (cont)

- Money market and capital market can both have organised segments.

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Organised and Unorganised Financial Markets (cont)

- Informal lending is not automatically illegal; legality depends on the applicable law and licensing requirements.

Organised and Unorganised Financial Markets (cont)

- A market being electronic does not, by itself, make it organised; regulatory recognition and institutional framework matter.

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Primary and Secondary Markets

Primary Market (New Issue Market):

Primary and Secondary Markets (cont)

- Market where new securities are issued for the first time by companies or governments to raise fresh capital.

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Primary and Secondary Markets (cont)

- Funds flow from investors to the issuer.

Primary and Secondary Markets (cont)

- Methods:

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Primary and Secondary Markets (cont)

- IPO (Initial Public Offering): First public issue of shares by an unlisted company.

Primary and Secondary Markets (cont)

- FPO (Follow-on Public Offer): Further public issue by an already listed company.

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Primary and Secondary Markets (cont)

- Rights Issue: Shares offered to existing shareholders, generally in proportion to their holdings.

Primary and Secondary Markets (cont)

- Private Placement: Securities offered to a select group of investors rather than the public.

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Primary and Secondary Markets (cont)

- Preferential Allotment: Issue of securities to selected persons on a preferential basis.

Primary and Secondary Markets (cont)

- QIP (Qualified Institutions Placement): Listed company raises funds from Qualified Institutional Buyers (QIBs).

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Primary and Secondary Markets (cont)

- OFS (Offer for Sale): Existing shareholders sell shares to the public; proceeds go to selling shareholders, not the company.

Primary and Secondary Markets (cont)

- Book Building: Price discovery through investor bids within a price band.

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Primary and Secondary Markets (cont)

- Fixed Price Issue: Issue price is determined in advance.

Primary and Secondary Markets (cont)

Secondary Market (Stock Market):

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Primary and Secondary Markets (cont)

- Market where already-issued securities are bought and sold among investors.

Primary and Secondary Markets (cont)

- Funds flow between investors; the issuing company generally receives no money from these trades.

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Primary and Secondary Markets (cont)

- Provides liquidity, continuous price discovery and an exit route for investors.

Primary and Secondary Markets (cont)

- Examples: Recognised stock exchanges such as NSE and BSE.

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Primary and Secondary Markets (cont)

- Trading generally takes place through stockbrokers and electronic trading platforms.

Primary and Secondary Markets (cont)

Key Market Infrastructure:

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Primary and Secondary Markets (cont)

- Stock Exchange: Provides a platform for trading securities.

Primary and Secondary Markets (cont)

- Depositories: Hold securities in electronic (dematerialised/demat) form.

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Primary and Secondary Markets (cont)

- Depository Participants (DPs): Act as agents between investors and depositories.

Primary and Secondary Markets (cont)

- Clearing Corporations: Calculate obligations, manage settlement risk and facilitate settlement.

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Primary and Secondary Markets (cont)

- Settlement: Exchange of securities and funds after a trade; Indian equity cash-market settlement is generally T+1 (trade date + 1 working day), with optional T+0 for eligible securities.

Primary and Secondary Markets (cont)

Regulatory Framework:

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Primary and Secondary Markets (cont)

- SEBI (Securities and Exchange Board of India): Regulates securities markets, exchanges, intermediaries and investor protection.

Primary and Secondary Markets (cont)

- Companies Act, 2013: Governs corporate issuance and related requirements.

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Primary and Secondary Markets (cont)

- SCRA (Securities Contracts (Regulation) Act), 1956: Provides the framework for securities contracts and recognised stock exchanges.

Primary and Secondary Markets (cont)

- Depositories Act, 1996: Governs depositories and dematerialisation.

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Primary and Secondary Markets (cont)

MCQ distinctions:

Primary and Secondary Markets (cont)

- Primary market = issue of new securities; secondary market = trading of existing securities.

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Primary and Secondary Markets (cont)

- IPO is a primary-market transaction; subsequent exchange trading is secondary-market activity.

Primary and Secondary Markets (cont)

- OFS is a primary-market offer to investors, but proceeds go to the selling shareholder.

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Primary and Secondary Markets (cont)

- A stock exchange facilitates secondary-market trading; it is not itself the issuer.

Primary and Secondary Markets (cont)

- SEBI regulates both markets, while stock exchanges provide the trading platform.

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Finance Cheat Sheet

by keersri05 via cheatography.com/217923/cs/48575/

Money-Market Instruments

Call Money and Notice Money

Call Money:

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Call Money and Notice Money (cont)

- Unsecured short-term borrowing and lending for 1 day (overnight).

Call Money and Notice Money (cont)

- Used by banks and eligible financial institutions to manage temporary liquidity mismatches.

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Call Money and Notice Money (cont)

- No collateral is involved.

Call Money and Notice Money (cont)

Notice Money:

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Call Money and Notice Money (cont)

- Unsecured short-term borrowing and lending for 2–14 days.

Call Money and Notice Money (cont)

- Borrowing is repayable after the agreed notice period.

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Call Money and Notice Money (cont)

Term Money:

Call Money and Notice Money (cont)

- Unsecured borrowing and lending for more than 14 days and up to 1 year.

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Call Money and Notice Money (cont)

Market Participants:

Call Money and Notice Money (cont)

- Banks, Primary Dealers (PDs) and other eligible participants under RBI regulations.

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Call Money and Notice Money (cont)

- Banks use this market to meet short-term liquidity requirements and manage reserve positions.

Call Money and Notice Money (cont)

Key Characteristics:

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Call Money and Notice Money (cont)

- Unsecured instruments: no collateral backing.

Call Money and Notice Money (cont)

- Interest rate is determined by demand and supply of short-term funds.

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Call Money and Notice Money (cont)

- Call money rate reflects immediate liquidity conditions in the banking system.

Call Money and Notice Money (cont)

- RBI's Liquidity Adjustment Facility (LAF) influences short-term money-market rates.

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Call Money and Notice Money (cont)

MCQ Traps:

Call Money and Notice Money (cont)

- Call = 1 day; Notice = 2–14 days; Term = more than 14 days.

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Call Money and Notice Money (cont)

- These are unsecured, unlike repo transactions.

Call Money and Notice Money (cont)

- They are instruments of the money market, not capital market.

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Call Money and Notice Money (cont)

- Call money is not the same as a call option or callable bond.

Treasury Bills (T-Bills)

Meaning

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Treasury Bills (T-Bills) (cont)

- Short-term money-market instruments issued by the Government of India to meet short-term borrowing requirements.

Treasury Bills (T-Bills) (cont)

- Issued by the RBI on behalf of the Central Government.

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Treasury Bills (T-Bills) (cont)

- They are zero-coupon instruments: issued at a discount and redeemed at face value.

Treasury Bills (T-Bills) (cont)

- No periodic interest is paid.

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Treasury Bills (T-Bills) (cont)

Maturities

Treasury Bills (T-Bills) (cont)

- 91-day T-Bills.

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Treasury Bills (T-Bills) (cont)

- 182-day T-Bills.

Treasury Bills (T-Bills) (cont)

- 364-day T-Bills.

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Treasury Bills (T-Bills) (cont)

How They Work

Treasury Bills (T-Bills) (cont)

- Investors purchase T-Bills below their face value.

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Treasury Bills (T-Bills) (cont)

- At maturity, they receive the full face value.

Treasury Bills (T-Bills) (cont)

- Return = Difference between face value and issue/purchase price.

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Treasury Bills (T-Bills) (cont)

- Example: Buy a ₹100 T-Bill for ₹98; receive ₹100 at maturity; return = ₹2.

Treasury Bills (T-Bills) (cont)

Market Participants

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Treasury Bills (T-Bills) (cont)

- RBI conducts auctions on behalf of the Government.

Treasury Bills (T-Bills) (cont)

- Banks, Primary Dealers, financial institutions, Mutual Funds and eligible retail investors participate.

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Treasury Bills (T-Bills) (cont)

- T-Bills are actively used by banks for liquidity management and by institutions for short-term investment.

Treasury Bills (T-Bills) (cont)

Important Characteristics

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Treasury Bills (T-Bills) (cont)

- Sovereign-backed; carry negligible credit/default risk.

Treasury Bills (T-Bills) (cont)

- Highly liquid and marketable.

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Treasury Bills (T-Bills) (cont)

- Issued through competitive and non-competitive bidding.

Treasury Bills (T-Bills) (cont)

- Traded in the secondary market.

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Treasury Bills (T-Bills) (cont)

- Used as eligible High-Quality Liquid Assets (HQLA) for Liquidity Coverage Ratio (LCR), subject to applicable conditions.

Treasury Bills (T-Bills) (cont)

MCQ Traps

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Treasury Bills (T-Bills) (cont)

- T-Bills are issued by the Central Government, not RBI on its own account.

Treasury Bills (T-Bills) (cont)

- T-Bills are discount instruments, not coupon-bearing instruments.

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Treasury Bills (T-Bills) (cont)

- Maximum standard maturity is 364 days; they are money-market instruments.

Treasury Bills (T-Bills) (cont)

- State Governments issue State Development Loans (SDLs), not Treasury Bills.

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Commercial Paper (CP)

Meaning

Commercial Paper (CP) (cont)

- Unsecured, short-term money-market instrument issued by eligible corporates and other permitted entities to raise funds.

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Commercial Paper (CP) (cont)

- Issued in the form of a promissory note.

Commercial Paper (CP) (cont)

- Used mainly to meet working-capital and short-term financing requirements.

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Commercial Paper (CP) (cont)

Maturity

Commercial Paper (CP) (cont)

- Minimum maturity: 7 days.

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Commercial Paper (CP) (cont)

- Maximum maturity: 1 year.

Commercial Paper (CP) (cont)

- Maturity must not exceed the issuer's validity of credit rating or sanctioned credit limit, as applicable.

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Commercial Paper (CP) (cont)

Denomination

Commercial Paper (CP) (cont)

- Minimum denomination: ₹5 lakh.

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Commercial Paper (CP) (cont)

- Multiples of ₹5 lakh thereafter.

Commercial Paper (CP) (cont)

Issuers

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Commercial Paper (CP) (cont)

- Companies.

Commercial Paper (CP) (cont)

- Other eligible entities permitted under RBI directions, including certain NBFCs and financial institutions.

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Commercial Paper (CP) (cont)

- Issuer must satisfy prescribed eligibility and credit-rating requirements.

Commercial Paper (CP) (cont)

Investors

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Commercial Paper (CP) (cont)

- Individuals.

Commercial Paper (CP) (cont)

- Banks and financial institutions.

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Commercial Paper (CP) (cont)

- Mutual Funds.

Commercial Paper (CP) (cont)

- Other eligible institutional investors.

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Commercial Paper (CP) (cont)

Important Characteristics

Commercial Paper (CP) (cont)

- Unsecured: no specific collateral backs the instrument.

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Commercial Paper (CP) (cont)

- Generally issued at a discount and redeemed at face value.

Commercial Paper (CP) (cont)

- Can also be issued in interest-bearing form, subject to applicable rules.

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Commercial Paper (CP) (cont)

- Credit rating is required from a SEBI-registered Credit Rating Agency (CRA).

Commercial Paper (CP) (cont)

- Transferable and tradable, subject to applicable regulations.

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Commercial Paper (CP) (cont)

MCQ Traps

Commercial Paper (CP) (cont)

- CP = unsecured instrument; it is not backed by specific collateral.

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Commercial Paper (CP) (cont)

- CP is generally used by creditworthy borrowers for short-term funding.

Commercial Paper (CP) (cont)

- Unlike Treasury Bills, CP carries issuer credit risk.

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Commercial Paper (CP) (cont)

- CP is regulated by RBI, not SEBI, although credit rating agencies are regulated by SEBI.

Commercial Paper (CP) (cont)

- CP is different from a Commercial Bill: CP is issued by an eligible borrower, whereas a commercial bill arises from a genuine trade transaction.

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Certificate of Deposit (CD)

Meaning

Certificate of Deposit (CD) (cont)

- Negotiable, unsecured money-market instrument issued by banks and eligible financial institutions to raise short-term funds.

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Certificate of Deposit (CD) (cont)

- Represents a deposit with a bank or financial institution for a specified maturity.

Certificate of Deposit (CD) (cont)

- Generally issued at a discount or on a floating-rate basis.

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Certificate of Deposit (CD) (cont)

Issuers

Certificate of Deposit (CD) (cont)

- Scheduled Commercial Banks (SCBs).

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Certificate of Deposit (CD) (cont)

- Select All India Financial Institutions (AIFIs) permitted by RBI.

Certificate of Deposit (CD) (cont)

Maturity

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Certificate of Deposit (CD) (cont)

- Banks: Minimum 7 days, maximum 1 year.

Certificate of Deposit (CD) (cont)

- Eligible AIFIs: Minimum 1 year, maximum 3 years.

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Certificate of Deposit (CD) (cont)

Denomination

Certificate of Deposit (CD) (cont)

- Minimum: ₹5 lakh.

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Certificate of Deposit (CD) (cont)

- Multiples of ₹5 lakh thereafter.

Certificate of Deposit (CD) (cont)

Investors

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Certificate of Deposit (CD) (cont)

- Individuals.

Certificate of Deposit (CD) (cont)

- Corporates.

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Certificate of Deposit (CD) (cont)

- Banks and financial institutions.

Certificate of Deposit (CD) (cont)

- Mutual Funds and other eligible institutional investors.

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Certificate of Deposit (CD) (cont)

Important Characteristics

Certificate of Deposit (CD) (cont)

- Unsecured: no specific collateral backing.

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Certificate of Deposit (CD) (cont)

- Negotiable and transferable, allowing secondary-market trading.

Certificate of Deposit (CD) (cont)

- Issued in dematerialised form or as a Usance Promissory Note, as permitted.

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Certificate of Deposit (CD) (cont)

- Generally offers a return higher than ordinary bank deposits, depending on market conditions and issuer creditworthiness.

Certificate of Deposit (CD) (cont)

- Carries issuer credit risk; unlike a bank deposit, a CD is a tradable money-market instrument.

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Certificate of Deposit (CD) (cont)

MCQ Traps

Certificate of Deposit (CD) (cont)

- CD = bank/FI-issued; CP = eligible corporate-issued.

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Certificate of Deposit (CD) (cont)

- Both CP and CD are generally unsecured money-market instruments.

Certificate of Deposit (CD) (cont)

- CDs are regulated by RBI.

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Certificate of Deposit (CD) (cont)

- CD is different from a Certificate of Deposit issued under a retail bank deposit scheme; here it refers to a negotiable wholesale money-market instrument.

Certificate of Deposit (CD) (cont)

- CD maturity for banks is up to 1 year; eligible AIFIs can issue CDs up to 3 years.

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Repo and Reverse Repo

Repo (Repurchase Agreement)

Repo and Reverse Repo (cont)

- A short-term, collateralised borrowing transaction in which one party sells securities and agrees to repurchase them at a predetermined price on a future date.

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Repo and Reverse Repo (cont)

- The seller of securities is effectively the borrower; the buyer provides funds.

Repo and Reverse Repo (cont)

- Securities serve as collateral.

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Repo and Reverse Repo (cont)

- Used by banks and financial institutions to meet short-term liquidity requirements.

Repo and Reverse Repo (cont)

- RBI injects liquidity into the banking system through repo operations.

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Repo and Reverse Repo (cont)

Reverse Repo

Repo and Reverse Repo (cont)

- A transaction in which one party purchases securities and agrees to sell them back later.

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Repo and Reverse Repo (cont)

- From the RBI's perspective, reverse repo operations absorb surplus liquidity from the banking system.

Repo and Reverse Repo (cont)

- Banks and eligible participants park surplus funds with RBI against securities.

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Repo and Reverse Repo (cont)

How Repo Works

Repo and Reverse Repo (cont)

- Bank receives funds from RBI by providing eligible securities as collateral.

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Repo and Reverse Repo (cont)

- On the agreed date, the bank repurchases the securities at a higher price.

Repo and Reverse Repo (cont)

- Difference between sale and repurchase prices represents the repo interest.

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Repo and Reverse Repo (cont)

Important Characteristics

Repo and Reverse Repo (cont)

- Repo is a collateralised money-market transaction.

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Repo and Reverse Repo (cont)

- Government securities are commonly used as collateral.

Repo and Reverse Repo (cont)

- Can be overnight or for a specified term.

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Repo and Reverse Repo (cont)

- Repo rate is an important monetary-policy transmission rate.

Repo and Reverse Repo (cont)

- RBI conducts repo and reverse repo operations under its Liquidity Adjustment Facility (LAF).

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Repo and Reverse Repo (cont)

Repo vs Reverse Repo — RBI's Perspective

Repo and Reverse Repo (cont)

- Repo: RBI lends funds to banks → liquidity injected.

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Repo and Reverse Repo (cont)

- Reverse Repo: RBI borrows funds from banks → liquidity absorbed.

Repo and Reverse Repo (cont)

MCQ Traps

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Repo and Reverse Repo (cont)

- Repo = liquidity injection; reverse repo = liquidity absorption (from RBI's perspective).

Repo and Reverse Repo (cont)

- Repo is secured; Call Money and Notice Money are unsecured.

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Repo and Reverse Repo (cont)

- Repo interest is embedded in the difference between the initial and repurchase prices.

Repo and Reverse Repo (cont)

- The Standing Deposit Facility (SDF) is now the floor of the LAF corridor; it allows RBI to absorb liquidity without providing collateral.

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Repo and Reverse Repo (cont)

- The policy repo rate is the rate at which RBI lends to banks under the relevant repo facility.

TREPS (Treasury Bills Repurchase Agreement)

Meaning

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- TREPS is a collateralised money-market borrowing and lending mechanism.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- It facilitates short-term borrowing and lending against eligible collateral, primarily Government Securities.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- It replaced the earlier CBLO (Collateralised Borrowing and Lending Obligation) mechanism from November 2018.

TREPS (Treasury Bills Repurchase Agreement) (cont)

How It Works

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- A borrower obtains funds by providing eligible securities as collateral.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- A lender provides funds against the collateral.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- The transaction is reversed on the agreed repayment date.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- The difference between borrowing and repayment amounts represents the interest cost.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

Market Infrastructure

TREPS (Treasury Bills Repurchase Agreement) (cont)

- Operated through the Clearing Corporation of India Limited (CCIL).

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- CCIL acts as the central counterparty and provides clearing and settlement services.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- Transactions are conducted through an electronic platform.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

Participants

TREPS (Treasury Bills Repurchase Agreement) (cont)

- Banks.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- Mutual Funds.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- Insurance companies.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- Primary Dealers.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- Financial institutions and other eligible entities.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

Important Characteristics

TREPS (Treasury Bills Repurchase Agreement) (cont)

- Secured short-term borrowing and lending.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- Provides an avenue for institutions to manage temporary liquidity surpluses and deficits.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- Commonly used by Mutual Funds for short-term deployment of surplus funds.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- Helps improve liquidity and efficiency in the money market.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- TREPS rates reflect short-term demand and supply of funds.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

MCQ Traps

TREPS (Treasury Bills Repurchase Agreement) (cont)

- TREPS is a money-market instrument/mechanism, not a capital-market instrument.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- TREPS is collateralised, unlike Call Money and Notice Money.

TREPS (Treasury Bills Repurchase Agreement) (cont)

- CCIL operates the platform and acts as central counterparty; RBI is the regulator.

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TREPS (Treasury Bills Repurchase Agreement) (cont)

- TREPS replaced CBLO; do not treat them as two currently separate equivalent platforms.

Commercial Bills

Meaning

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Commercial Bills (cont)

- Short-term, negotiable money-market instruments arising from genuine credit-based trade transactions.

Commercial Bills (cont)

- Used to finance the credit sales of goods and services.

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Commercial Bills (cont)

- A seller draws a bill of exchange on the buyer, who accepts it and promises to pay on a specified future date.

Commercial Bills (cont)

How They Work

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Commercial Bills (cont)

- Seller supplies goods to buyer on credit.

Commercial Bills (cont)

- Seller draws a bill of exchange for the amount due.

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Commercial Bills (cont)

- Buyer accepts the bill, acknowledging the payment obligation.

Commercial Bills (cont)

- Seller can hold the bill until maturity or discount it with a bank to receive funds immediately.

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Commercial Bills (cont)

- Bank collects the amount from the buyer on maturity.

Commercial Bills (cont)

Parties Involved

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Commercial Bills (cont)

- Drawer: Seller who draws the bill.

Commercial Bills (cont)

- Drawee: Buyer on whom the bill is drawn.

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Commercial Bills (cont)

- Acceptor: Buyer after accepting the bill.

Commercial Bills (cont)

- Payee: Person entitled to receive payment.

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Commercial Bills (cont)

- Endorsee: Person to whom the bill is transferred through endorsement.

Commercial Bills (cont)

Important Characteristics

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Commercial Bills (cont)

- Arises from an underlying genuine trade transaction.

Commercial Bills (cont)

- Generally short-term and self-liquidating.

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Commercial Bills (cont)

- Negotiable and transferable.

Commercial Bills (cont)

- Can be discounted with banks to obtain immediate liquidity.

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Commercial Bills (cont)

- Provides working-capital finance to sellers.

Commercial Bills (cont)

- Carries the buyer's credit risk; bank discounting does not automatically eliminate that risk.

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Commercial Bills (cont)

Bill Discounting

Commercial Bills (cont)

- Bank purchases the bill before maturity at a discount.

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Commercial Bills (cont)

- Amount received by seller = Face Value − Discount.

Commercial Bills (cont)

- Discount represents the bank's return for providing funds before maturity.

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Commercial Bills (cont)

MCQ Traps

Commercial Bills (cont)

- Commercial Bill = arises from a trade transaction; Commercial Paper = issued by an eligible entity to raise funds.

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Commercial Bills (cont)

- Commercial Bills are generally trade-backed; Commercial Paper is unsecured corporate borrowing.

Commercial Bills (cont)

- Discounting converts a future receivable into immediate funds.

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Commercial Bills (cont)

- A bill of exchange is governed by the Negotiable Instruments Act, 1881.

Participants and Instruments

Major Participants

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Participants and Instruments (cont)

- RBI (Reserve Bank of India): Regulates the money market, manages systemic liquidity and conducts monetary-policy operations.

Participants and Instruments (cont)

- Banks: Major borrowers, lenders and investors; manage short-term liquidity and reserve requirements.

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Participants and Instruments (cont)

- Primary Dealers (PDs): Participate in Government Securities auctions and market-making; support liquidity in Government Securities.

Participants and Instruments (cont)

- NBFCs (Non-Banking Financial Companies): Eligible entities can issue Commercial Paper and participate in permitted money-market segments.

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Participants and Instruments (cont)

- Mutual Funds: Invest in T-Bills, CPs, CDs and TREPS; Liquid Funds and Overnight Funds are important money-market investors.

Participants and Instruments (cont)

- Insurance Companies and Pension Funds: Invest in eligible short-term debt instruments.

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Participants and Instruments (cont)

- Corporates: Raise short-term funds through Commercial Paper and manage surplus funds.

Participants and Instruments (cont)

- CCIL (Clearing Corporation of India Limited): Provides clearing, settlement and central-counterparty services for specified money--market transactions.

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Participants and Instruments (cont)

Instrument Characteristics — Quick Retention

Participants and Instruments (cont)

- Call Money: Unsecured; overnight; used for immediate liquidity management.

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Participants and Instruments (cont)

- Notice Money: Unsecured; 2–14 days.

Participants and Instruments (cont)

- Term Money: Unsecured; more than 14 days and up to 1 year.

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Participants and Instruments (cont)

- Treasury Bills: Government-issued; 91, 182 and 364 days; zero-coupon; issued at discount and redeemed at face value.

Participants and Instruments (cont)

- Commercial Paper (CP): Unsecured; issued by eligible corporates/entities; 7 days to 1 year; generally used for working capital.

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Participants and Instruments (cont)

- Certificate of Deposit (CD): Negotiable, unsecured deposit instrument; issued by eligible banks and financial institutions.

Participants and Instruments (cont)

- Repo: Collateralised borrowing against securities; liquidity injection from RBI's perspective.

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Participants and Instruments (cont)

- Reverse Repo: Liquidity absorption from RBI's perspective.

Participants and Instruments (cont)

- TREPS: Collateralised short-term borrowing and lending mechanism; operated through CCIL.

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Participants and Instruments (cont)

- Commercial Bills: Trade-backed bills of exchange; can be discounted with banks before maturity.

Participants and Instruments (cont)

Important Distinctions

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Participants and Instruments (cont)

- Secured instruments/transactions: Repo, TREPS.

Participants and Instruments (cont)

- Unsecured instruments: Call Money, Notice Money, Term Money, CP and CD.

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Participants and Instruments (cont)

- Government-issued: Treasury Bills.

Participants and Instruments (cont)

- Corporate-issued: Commercial Paper.

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Participants and Instruments (cont)

- Bank/FI-issued: Certificate of Deposit.

Participants and Instruments (cont)

- Trade transaction-based: Commercial Bills.

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Participants and Instruments (cont)

- Zero-coupon discount instrument: Treasury Bills; CPs and CDs may also be issued at a discount.

Participants and Instruments (cont)

- Liquidity injection: Repo.

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Participants and Instruments (cont)

- Liquidity absorption: Reverse Repo and Standing Deposit Facility (SDF), from RBI's perspective.

Participants and Instruments (cont)

MCQ Traps

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Participants and Instruments (cont)

- Money-market instruments generally have original maturity up to 1 year.

Participants and Instruments (cont)

- T-Bills are sovereign instruments; CPs and CDs carry issuer credit risk.

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Participants and Instruments (cont)

- Repo and TREPS are collateralised; CP and CD are unsecured.

Participants and Instruments (cont)

- Commercial Bills arise from genuine trade transactions, unlike CP.

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Participants and Instruments (cont)

- RBI regulates the money market; SEBI regulates Mutual Funds and Credit Rating Agencies.

Capital-Market Instruments

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Equity Shares

Meaning

Equity Shares (cont)

- Equity shares represent ownership capital in a company.

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Equity Shares (cont)

- Equity shareholders are the owners of the company and bear the residual business risk.

Equity Shares (cont)

- They are entitled to voting rights and dividends, subject to applicable law and share-class rights.

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Equity Shares (cont)

- Equity shares generally have no fixed maturity or guaranteed return.

Equity Shares (cont)

Key Characteristics

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Equity Shares (cont)

- Ownership: Shareholders own a proportionate interest in the company.

Equity Shares (cont)

- Voting Rights: Generally one vote per share held, subject to the Companies Act and applicable share-class provisions.

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Equity Shares (cont)

- Dividend: Not fixed or guaranteed; declared out of distributable profits in accordance with law.

Equity Shares (cont)

- Capital Appreciation: Investors may earn returns through an increase in market price.

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Equity Shares (cont)

- Residual Claim: Equity shareholders are paid after creditors and preference shareholders during liquidation.

Equity Shares (cont)

- Limited Liability: Shareholders' liability is generally limited to the unpaid amount on their shares.

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Equity Shares (cont)

- Transferability: Listed equity shares can be traded on recognised stock exchanges.

Equity Shares (cont)

Types of Equity Shares

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Equity Shares (cont)

- Ordinary Equity Shares: Carry voting rights and residual ownership claims.

Equity Shares (cont)

- Equity Shares with Differential Rights: May carry differential voting, dividend or other rights, subject to Companies Act requirements.

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Equity Shares (cont)

- Bonus Shares: Additional shares issued to existing shareholders by capitalising eligible reserves; no fresh funds are raised.

Equity Shares (cont)

- Rights Shares: New shares offered to existing shareholders, generally in proportion to their holdings.

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Equity Shares (cont)

Returns to Equity Shareholders

Equity Shares (cont)

- Dividend income, if declared.

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Equity Shares (cont)

- Capital gains from an increase in share price.

Equity Shares (cont)

- Capital loss if the market price falls.

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Equity Shares (cont)

Important Regulatory Points

Equity Shares (cont)

- Governed primarily by the Companies Act, 2013 and SEBI regulations for listed companies.

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Equity Shares (cont)

- Face value is the nominal value assigned to a share; market price is determined by market demand and supply.

Equity Shares (cont)

- Equity shares can be issued at a premium, subject to applicable law.

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Equity Shares (cont)

MCQ Traps

Equity Shares (cont)

- Equity shareholders are owners, whereas debenture holders and bondholders are creditors.

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Equity Shares (cont)

- Dividend is not a compulsory fixed payment.

Equity Shares (cont)

- Equity shareholders have residual claims, not priority claims.

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Equity Shares (cont)

- Bonus issue increases the number of shares but does not bring fresh capital into the company.

Equity Shares (cont)

- Rights issue raises fresh capital and gives existing shareholders an opportunity to maintain their ownership proportion.

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Equity Shares (cont)

- Equity shares are capital-market instruments even though they have no maturity.

Primary Issuance and Secondary Trading

A. Primary Issuance

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Primary Issuance and Secondary Trading (cont)

- Primary market is where securities are issued for the first time to raise capital.

Primary Issuance and Secondary Trading (cont)

- Funds flow from investors to the issuer, except in secondary-sale components such as an Offer for Sale (OFS).

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Primary Issuance and Secondary Trading (cont)

Methods of Issuance

Primary Issuance and Secondary Trading (cont)

- Initial Public Offering (IPO): First public issue of shares by an unlisted company.

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Primary Issuance and Secondary Trading (cont)

- Follow-on Public Offer (FPO): Further public issue by an already listed company.

Primary Issuance and Secondary Trading (cont)

- Rights Issue: Shares offered to existing shareholders, generally in proportion to their existing holdings.

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Primary Issuance and Secondary Trading (cont)

- Private Placement: Securities offered to a select group of investors rather than the public.

Primary Issuance and Secondary Trading (cont)

- Preferential Allotment: Issue of securities to selected persons on a preferential basis.

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Primary Issuance and Secondary Trading (cont)

- Qualified Institutions Placement (QIP): Listed company raises funds through an issue to Qualified Institutional Buyers (QIBs).

Primary Issuance and Secondary Trading (cont)

- Public Issue of Bonds/Debentures: Company raises debt capital from the public.

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Primary Issuance and Secondary Trading (cont)

- Private Placement of Debt: Corporate debt securities issued to selected investors.

Primary Issuance and Secondary Trading (cont)

Price Discovery

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Primary Issuance and Secondary Trading (cont)

- Book Building: Investors bid within a specified price band; issue price is determined based on demand.

Primary Issuance and Secondary Trading (cont)

- Fixed Price Issue: Issue price is determined in advance and disclosed to investors.

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Primary Issuance and Secondary Trading (cont)

- Face Value: Nominal value assigned to a security.

Primary Issuance and Secondary Trading (cont)

- Issue Price: Price at which the security is offered to investors.

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Primary Issuance and Secondary Trading (cont)

B. Secondary Trading

Primary Issuance and Secondary Trading (cont)

- Secondary market is where already-issued securities are bought and sold between investors.

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Primary Issuance and Secondary Trading (cont)

- The issuing company generally does not receive funds from these transactions.

Primary Issuance and Secondary Trading (cont)

- Provides liquidity, price discovery and an exit opportunity to investors.

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Primary Issuance and Secondary Trading (cont)

Trading Infrastructure

Primary Issuance and Secondary Trading (cont)

- Stock Exchanges: NSE (National Stock Exchange) and BSE (BSE Limited) provide platforms for securities trading.

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Primary Issuance and Secondary Trading (cont)

- Stockbrokers: Execute investors' buy and sell orders.

Primary Issuance and Secondary Trading (cont)

- Depositories: NSDL (National Securities Depository Limited) and CDSL (Central Depository Services (India) Limited) hold securities electronically.

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Primary Issuance and Secondary Trading (cont)

- Depository Participants (DPs): Provide investors access to depository services.

Primary Issuance and Secondary Trading (cont)

- Clearing Corporations: Calculate obligations, manage counterparty risk and facilitate settlement.

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Primary Issuance and Secondary Trading (cont)

- Settlement: Exchange of securities and funds after a trade.

Primary Issuance and Secondary Trading (cont)

Settlement Cycle in India

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Primary Issuance and Secondary Trading (cont)

- T+1: Standard rolling settlement cycle for the equity cash market — settlement generally takes place one business day after the trade.

Primary Issuance and Secondary Trading (cont)

- T+0: Optional same-day settlement for eligible securities under the applicable framework.

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Primary Issuance and Secondary Trading (cont)

- T = Trade date; holidays and non-business days affect the actual settlement calendar.

Primary Issuance and Secondary Trading (cont)

Important Regulatory Framework

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Primary Issuance and Secondary Trading (cont)

- SEBI (Securities and Exchange Board of India): Regulates securities issuance, intermediaries, exchanges and investor protection.

Primary Issuance and Secondary Trading (cont)

- Companies Act, 2013: Governs corporate share and debenture issuance.

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Primary Issuance and Secondary Trading (cont)

- SEBI ICDR Regulations: Issue of Capital and Disclosure Requirements — regulate public issues, rights issues and preferential issues.

Primary Issuance and Secondary Trading (cont)

- SEBI NCS Regulations: Issue and Listing of Non-Convertible Securities.

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Primary Issuance and Secondary Trading (cont)

- SCRA, 1956: Securities Contracts (Regulation) Act — regulates securities contracts and recognised stock exchanges.

Primary Issuance and Secondary Trading (cont)

- Depositories Act, 1996: Governs depositories and dematerialisation.

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Primary Issuance and Secondary Trading (cont)

C. Important Distinctions and MCQ Traps

Primary Issuance and Secondary Trading (cont)

- IPO = first public issue; FPO = further public issue by an already-listed company.

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Primary Issuance and Secondary Trading (cont)

- Fresh Issue = new securities issued; proceeds go to the company.

Primary Issuance and Secondary Trading (cont)

- OFS = existing shareholders sell their holdings; proceeds go to selling shareholders.

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Primary Issuance and Secondary Trading (cont)

- Primary market = capital mobilisation; secondary market = liquidity and price discovery.

Primary Issuance and Secondary Trading (cont)

- Book Building = price discovered through bids; Fixed Price = price decided in advance.

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Primary Issuance and Secondary Trading (cont)

- Depository holds securities; DP acts as the investor-facing intermediary.

Primary Issuance and Secondary Trading (cont)

- Clearing Corporation manages clearing and settlement risk; stock exchange provides the trading platform.

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Primary Issuance and Secondary Trading (cont)

- Listing does not mean a security is guaranteed to be liquid or risk-free.

Convertible and Non-Convertible Securities

A. Convertible Securities

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Convertible and Non-Convertible Securities (cont)

- Financial instruments that can be converted into another class of security, generally equity shares, according to predetermined terms.

Convertible and Non-Convertible Securities (cont)

- Conversion may be compulsory or optional, depending on the instrument.

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Convertible and Non-Convertible Securities (cont)

- Commonly used by companies to raise funds while offering investors the possibility of future equity participation.

Convertible and Non-Convertible Securities (cont)

Types

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Convertible and Non-Convertible Securities (cont)

- Fully Convertible Debentures (FCDs): Entire principal amount converts into equity shares.

Convertible and Non-Convertible Securities (cont)

- Partly Convertible Debentures (PCDs): A specified portion converts into equity; the remaining portion continues as debt.

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Convertible and Non-Convertible Securities (cont)

- Optionally Convertible Debentures (OCDs): Conversion takes place at the investor's option, according to issue terms.

Convertible and Non-Convertible Securities (cont)

- Convertible Preference Shares: Preference shares that can be converted into equity shares.

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Convertible and Non-Convertible Securities (cont)

- Convertible Bonds: Debt securities carrying an option or obligation to convert into equity.

Convertible and Non-Convertible Securities (cont)

Key Characteristics

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Convertible and Non-Convertible Securities (cont)

- Initially provide debt-like or preference-share characteristics.

Convertible and Non-Convertible Securities (cont)

- Conversion gives investors ownership participation in the company.

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Convertible and Non-Convertible Securities (cont)

- Conversion ratio determines the number of equity shares received.

Convertible and Non-Convertible Securities (cont)

- Investors may benefit from equity-price appreciation after conversion.

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Convertible and Non-Convertible Securities (cont)

- Conversion may dilute the ownership percentage of existing shareholders.

Convertible and Non-Convertible Securities (cont)

B. Non-Convertible Securities

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Convertible and Non-Convertible Securities (cont)

- Securities that cannot be converted into equity shares.

Convertible and Non-Convertible Securities (cont)

- They retain their original character until redemption or maturity.

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Convertible and Non-Convertible Securities (cont)

- Examples include:

Convertible and Non-Convertible Securities (cont)

- Non-Convertible Debentures (NCDs).

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Convertible and Non-Convertible Securities (cont)

- Non-convertible corporate bonds.

Convertible and Non-Convertible Securities (cont)

- Non-convertible preference shares.

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Convertible and Non-Convertible Securities (cont)

Key Characteristics

Convertible and Non-Convertible Securities (cont)

- Debt instruments generally provide contractual interest payments and principal repayment.

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Convertible and Non-Convertible Securities (cont)

- Non-convertible preference shares provide preferential dividend and capital-repayment rights but remain preference share capital.

Convertible and Non-Convertible Securities (cont)

- No conversion-related equity dilution occurs.

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Convertible and Non-Convertible Securities (cont)

- Investors do not acquire equity ownership merely by holding these instruments.

Convertible and Non-Convertible Securities (cont)

C. Important Distinctions

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Convertible and Non-Convertible Securities (cont)

- Convertible debenture = debt initially, with conversion into equity as per terms.

Convertible and Non-Convertible Securities (cont)

- Non-convertible debenture = remains debt until repayment.

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Convertible and Non-Convertible Securities (cont)

- Fully convertible = entire principal converts.

Convertible and Non-Convertible Securities (cont)

- Partly convertible = only a portion converts.

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Convertible and Non-Convertible Securities (cont)

- Optionally convertible = conversion depends on the specified option.

Convertible and Non-Convertible Securities (cont)

- Convertible preference share = preference share capital that converts into equity.

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Convertible and Non-Convertible Securities (cont)

- NCD = debt security that does not convert into equity.

Convertible and Non-Convertible Securities (cont)

MCQ Traps

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Convertible and Non-Convertible Securities (cont)

- Convertible does not automatically mean conversion is optional; it may be compulsory.

Convertible and Non-Convertible Securities (cont)

- Conversion ratio determines the number of equity shares received.

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Convertible and Non-Convertible Securities (cont)

- Conversion of debt into equity reduces the company's debt burden but may dilute existing shareholders.

Convertible and Non-Convertible Securities (cont)

- NCD holders remain creditors; conversion into equity changes the investor's status to shareholder.

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Convertible and Non-Convertible Securities (cont)

- Non-convertible does not mean non-redeemable: NCDs are generally redeemable at maturity.

Convertible and Non-Convertible Securities (cont)

- Convertible and non-convertible are classifications based on conversion rights, not whether a security is listed or unlisted.

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SGBs and Other Government-Issued Instruments

A. Sovereign Gold Bonds (SGBs)

SGBs and Other Government-Issued Instruments (cont)

- Government securities denominated in grams of gold, issued by the Government of India on behalf of the Government through RBI.

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SGBs and Other Government-Issued Instruments (cont)

- Provide investors exposure to gold prices without requiring physical possession of gold.

SGBs and Other Government-Issued Instruments (cont)

- Represent a government borrowing instrument; they are not backed by physical gold allocated to each investor.

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SGBs and Other Government-Issued Instruments (cont)

Key Characteristics

SGBs and Other Government-Issued Instruments (cont)

- Denomination: 1 gram of gold and multiples thereof.

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SGBs and Other Government-Issued Instruments (cont)

- Tenure: 8 years.

SGBs and Other Government-Issued Instruments (cont)

- Premature redemption: Permitted after the 5th year, on interest--payment dates.

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SGBs and Other Government-Issued Instruments (cont)

- Interest: 2.5% per annum, payable semi-annually, on the initial investment amount.

SGBs and Other Government-Issued Instruments (cont)

- Redemption: In Indian rupees, based on the prevailing gold price as specified under the scheme.

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SGBs and Other Government-Issued Instruments (cont)

- Maximum subscription:

SGBs and Other Government-Issued Instruments (cont)

- Individuals and HUFs: 4 kg per financial year.

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SGBs and Other Government-Issued Instruments (cont)

- Trusts and similar entities: 20 kg per financial year.

SGBs and Other Government-Issued Instruments (cont)

- Minimum investment: 1 gram.

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SGBs and Other Government-Issued Instruments (cont)

- Tradability: Can be traded on recognised stock exchanges, subject to applicable conditions.

SGBs and Other Government-Issued Instruments (cont)

- Collateral: Can be used as collateral for loans, subject to lender requirements.

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SGBs and Other Government-Issued Instruments (cont)

Tax Treatment

SGBs and Other Government-Issued Instruments (cont)

- Interest is taxable according to the investor's applicable tax slab.

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SGBs and Other Government-Issued Instruments (cont)

- Capital gains on redemption by an individual are exempt from income tax under the applicable SGB tax provisions.

SGBs and Other Government-Issued Instruments (cont)

- Capital gains arising from secondary-market sale are subject to applicable capital-gains provisions.

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SGBs and Other Government-Issued Instruments (cont)

Important Tax Update — Effective 1 April 2026

SGBs and Other Government-Issued Instruments (cont)

- Capital-gains exemption on SGB redemption is now restricted to an individual who subscribed at the original issue and held the bond continuously until its 8-year maturity.

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SGBs and Other Government-Issued Instruments (cont)

- No exemption for secondary-market purchases, even if held until maturity.

SGBs and Other Government-Issued Instruments (cont)

- No exemption for premature redemption, even after the 5-year lock-in.

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SGBs and Other Government-Issued Instruments (cont)

- Interest remains taxable according to the applicable income-tax provisions.

SGBs and Other Government-Issued Instruments (cont)

- This is an important recent change; older SGB notes may state that all individual redemptions are capital-gains exempt.

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SGBs and Other Government-Issued Instruments (cont)

MCQ Traps

SGBs and Other Government-Issued Instruments (cont)

- SGBs are government securities linked to gold prices, not physical gold deposits.

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SGBs and Other Government-Issued Instruments (cont)

- The 2.5% interest is calculated on the initial investment amount, not the prevailing gold value.

SGBs and Other Government-Issued Instruments (cont)

- Gold-price appreciation or depreciation affects the redemption value.

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SGBs and Other Government-Issued Instruments (cont)

- Premature redemption through RBI is allowed after 5 years on interest-payment dates; exchange trading is a separate exit route.

SGBs and Other Government-Issued Instruments (cont)

- The 8-year maturity and 5-year premature-redemption eligibility are different concepts.

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SGBs and Other Government-Issued Instruments (cont)

Reserve Bank of India+1

SGBs and Other Government-Issued Instruments (cont)

B. Other Relevant Government-Issued Instruments

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SGBs and Other Government-Issued Instruments (cont)

- Sovereign Green Bonds (SGrBs):

SGBs and Other Government-Issued Instruments (cont)

- Government securities issued to finance eligible environmentally sustainable public projects.

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SGBs and Other Government-Issued Instruments (cont)

- Proceeds are earmarked for green expenditure, such as renewable energy, clean transportation and climate adaptation.

SGBs and Other Government-Issued Instruments (cont)

- Carry sovereign backing and are generally similar to conventional G-Secs in structure.

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SGBs and Other Government-Issued Instruments (cont)

- The distinguishing feature is the use of proceeds, not a separate ownership or repayment structure.

SGBs and Other Government-Issued Instruments (cont)

- Inflation-Indexed Bonds (IIBs):

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SGBs and Other Government-Issued Instruments (cont)

- Government securities designed to protect investors against inflation.

SGBs and Other Government-Issued Instruments (cont)

- Principal and/or interest payments are linked to an inflation index, depending on the bond structure.

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SGBs and Other Government-Issued Instruments (cont)

- Help preserve the real value of investments.

SGBs and Other Government-Issued Instruments (cont)

- India introduced Inflation-Indexed Bonds in 2013.

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SGBs and Other Government-Issued Instruments (cont)

- State Development Loans (SDLs):

SGBs and Other Government-Issued Instruments (cont)

- Debt securities issued by State Governments to finance their borrowing requirements.

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SGBs and Other Government-Issued Instruments (cont)

- Generally carry fixed coupons and are issued through RBI auctions.

SGBs and Other Government-Issued Instruments (cont)

- Carry State Government repayment obligations.

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SGBs and Other Government-Issued Instruments (cont)

- Usually offer higher yields than comparable Central Government securities.

SGBs and Other Government-Issued Instruments (cont)

- Cash Management Bills (CMBs):

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SGBs and Other Government-Issued Instruments (cont)

- Short-term instruments issued by the Central Government to meet temporary cash-flow mismatches.

SGBs and Other Government-Issued Instruments (cont)

- Maturity is less than 91 days.

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SGBs and Other Government-Issued Instruments (cont)

- Similar to Treasury Bills but issued for temporary cash-management requirements.

SGBs and Other Government-Issued Instruments (cont)

- Floating Rate Savings Bonds, 2020 (Taxable):

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SGBs and Other Government-Issued Instruments (cont)

- Government-issued savings bonds with floating interest rates.

SGBs and Other Government-Issued Instruments (cont)

- Interest rate is reset periodically and linked to the National Savings Certificate (NSC) rate with an additional spread.

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SGBs and Other Government-Issued Instruments (cont)

- Interest is taxable.

SGBs and Other Government-Issued Instruments (cont)

- These are savings instruments, rather than ordinary exchange--traded corporate debt securities.

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SGBs and Other Government-Issued Instruments (cont)

- National Savings Certificate (NSC) and Kisan Vikas Patra (KVP):

SGBs and Other Government-Issued Instruments (cont)

- Government-backed small-savings instruments.

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SGBs and Other Government-Issued Instruments (cont)

- NSC has a fixed prescribed maturity and interest structure.

SGBs and Other Government-Issued Instruments (cont)

- KVP is designed to double the invested amount over a prescribed period.

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SGBs and Other Government-Issued Instruments (cont)

- Primarily retail savings instruments, not conventional market-traded capital-market securities.

SGBs and Other Government-Issued Instruments (cont)

C. Important Distinctions

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SGBs and Other Government-Issued Instruments (cont)

- SGB = exposure to gold prices + fixed interest.

SGBs and Other Government-Issued Instruments (cont)

- SGrB = government borrowing for eligible green expenditure.

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SGBs and Other Government-Issued Instruments (cont)

- IIB = protection against inflation through index-linked payments.

SGBs and Other Government-Issued Instruments (cont)

- SDL = borrowing by State Governments.

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SGBs and Other Government-Issued Instruments (cont)

- CMB = short-term government cash-management borrowing.

SGBs and Other Government-Issued Instruments (cont)

- NSC/KVP = small-savings instruments, not conventional tradable G-Secs.

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SGBs and Other Government-Issued Instruments (cont)

MCQ Traps

SGBs and Other Government-Issued Instruments (cont)

- SGBs are denominated in grams of gold; they do not represent ownership of physical gold.

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SGBs and Other Government-Issued Instruments (cont)

- Sovereign Green Bonds are classified by the use of proceeds.

SGBs and Other Government-Issued Instruments (cont)

- SDLs are issued by State Governments, whereas G-Secs are issued by the Central Government.

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SGBs and Other Government-Issued Instruments (cont)

- CMB maturity is less than 91 days; standard T-Bill maturities are 91, 182 and 364 days.

SGBs and Other Government-Issued Instruments (cont)

- Not every government-backed savings instrument is a marketable security.

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Government Securities (G-Secs)

Meaning

Government Securities (G-Secs) (cont)

- Government Securities (G-Secs) are debt instruments issued by the Central Government and State Governments to borrow funds.

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Government Securities (G-Secs) (cont)

- They represent a borrowing obligation of the government.

Government Securities (G-Secs) (cont)

- Central Government securities carry sovereign credit backing, making them virtually free from domestic credit/default risk.

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Government Securities (G-Secs) (cont)

- Issued and managed through the Reserve Bank of India (RBI).

Government Securities (G-Secs) (cont)

Types of Government Securities

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Government Securities (G-Secs) (cont)

- Dated Government Securities: Medium- and long-term securities issued by the Central Government, generally with maturity above 1 year.

Government Securities (G-Secs) (cont)

- Treasury Bills (T-Bills): Short-term securities with maturities of 91, 182 and 364 days; issued at a discount and redeemed at face value.

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Government Securities (G-Secs) (cont)

- Cash Management Bills (CMBs): Short-term instruments issued by the Central Government to meet temporary cash-flow mismatches; maturity is less than 91 days.

Government Securities (G-Secs) (cont)

- State Development Loans (SDLs): Securities issued by State Governments to finance their borrowing requirements.

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Government Securities (G-Secs) (cont)

- Special Securities: Issued for specific purposes, including certain government obligations and recapitalisation requirements.

Government Securities (G-Secs) (cont)

Types Based on Interest Structure

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Government Securities (G-Secs) (cont)

- Fixed-Rate Bonds: Carry a fixed coupon throughout the tenure.

Government Securities (G-Secs) (cont)

- Floating-Rate Bonds (FRBs): Coupon changes periodically based on a specified benchmark.

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Government Securities (G-Secs) (cont)

- Zero-Coupon Bonds: Issued at a discount and redeemed at face value; no periodic interest.

Government Securities (G-Secs) (cont)

- Inflation-Indexed Bonds (IIBs): Designed to protect investors against inflation by linking specified payments to an inflation index.

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Government Securities (G-Secs) (cont)

- Sovereign Green Bonds (SGrBs): Government securities whose proceeds finance eligible green projects.

Government Securities (G-Secs) (cont)

- STRIPS (Separate Trading of Registered Interest and Principal of Securities): Coupon and principal cash flows of eligible securities are separated and traded as individual zero-coupon instruments.

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Government Securities (G-Secs) (cont)

Important Characteristics

Government Securities (G-Secs) (cont)

- Issuer: Central Government or State Government.

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Government Securities (G-Secs) (cont)

- Regulator and Manager: RBI manages government borrowing and conducts issuance operations.

Government Securities (G-Secs) (cont)

- Coupon: Interest paid periodically on coupon-bearing securities.

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Government Securities (G-Secs) (cont)

- Maturity: T-Bills are short-term; dated G-Secs generally have longer maturities.

Government Securities (G-Secs) (cont)

- Tradability: G-Secs can be traded in the secondary market.

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Government Securities (G-Secs) (cont)

- Sovereign Backing: Central Government securities carry sovereign backing; SDLs are obligations of respective State Governments.

Government Securities (G-Secs) (cont)

- SLR Eligibility: Eligible G-Secs and specified securities can be held by banks towards Statutory Liquidity Ratio (SLR) requirements.

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Government Securities (G-Secs) (cont)

Market Infrastructure

Government Securities (G-Secs) (cont)

- RBI: Conducts auctions and manages government securities issuance.

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Government Securities (G-Secs) (cont)

- Primary Dealers (PDs): Underwrite government securities issuances and support market-making.

Government Securities (G-Secs) (cont)

- NDS-OM (Negotiated Dealing System–Order Matching): Electronic anonymous order-matching platform for secondary-market trading in G-Secs.

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Government Securities (G-Secs) (cont)

- CCIL (Clearing Corporation of India Limited): Provides clearing and settlement services for government securities transactions.

Government Securities (G-Secs) (cont)

- SGL (Subsidiary General Ledger) Account: RBI-maintained securities account used by eligible institutions to hold G-Secs electronically.

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Government Securities (G-Secs) (cont)

- Retail Direct: RBI platform allowing individual retail investors to participate directly in the government securities market.

Government Securities (G-Secs) (cont)

Risks Associated with G-Secs

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Government Securities (G-Secs) (cont)

- Interest Rate Risk: Bond prices fall when market interest rates rise.

Government Securities (G-Secs) (cont)

- Inflation Risk: Inflation reduces the real purchasing power of fixed coupon payments.

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Government Securities (G-Secs) (cont)

- Reinvestment Risk: Coupon payments may have to be reinvested at lower interest rates.

Government Securities (G-Secs) (cont)

- Liquidity Risk: Some securities may have limited secondary-market trading.

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Government Securities (G-Secs) (cont)

- Credit Risk: Central Government G-Secs have negligible domestic sovereign default risk; SDLs carry State Government obligations.

Government Securities (G-Secs) (cont)

MCQ Traps

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Government Securities (G-Secs) (cont)

- T-Bills are also Government Securities, but are money-market instruments.

Government Securities (G-Secs) (cont)

- Dated G-Secs are generally capital-market instruments.

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Government Securities (G-Secs) (cont)

- State Governments issue SDLs, not Treasury Bills.

Government Securities (G-Secs) (cont)

- RBI manages issuance and trading infrastructure; the Government is the borrower/issuer.

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Government Securities (G-Secs) (cont)

- G-Secs are not necessarily risk-free in terms of market value: they carry interest-rate and inflation risk.

Government Securities (G-Secs) (cont)

- Yield and bond price move inversely.

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Government Securities (G-Secs) (cont)

- Sovereign Green Bonds are government debt instruments with earmarked use of proceeds; they are not equity investments.

Corporate Bonds

Meaning

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Corporate Bonds (cont)

- Corporate bonds are debt securities issued by companies to raise medium- and long-term funds.

Corporate Bonds (cont)

- Investors lend money to the issuing company and receive interest (coupon) and repayment of principal according to the bond terms.

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Corporate Bonds (cont)

- Bondholders are creditors, not owners of the company.

Corporate Bonds (cont)

Key Characteristics

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Corporate Bonds (cont)

- Face Value (Par Value): Principal amount payable at maturity.

Corporate Bonds (cont)

- Coupon Rate: Interest rate specified on the bond's face value.

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Corporate Bonds (cont)

- Maturity: Date on which principal is due for repayment.

Corporate Bonds (cont)

- Yield: Actual return earned by an investor based on purchase price and cash flows.

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Corporate Bonds (cont)

- Credit Risk: Risk that the issuer may default on interest or principal repayment.

Corporate Bonds (cont)

- Interest Rate Risk: Bond prices generally fall when market interest rates rise, and vice versa.

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Corporate Bonds (cont)

- Liquidity: Depends on issue size, credit quality and secondary-market activity.

Corporate Bonds (cont)

Types of Corporate Bonds

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Corporate Bonds (cont)

- Fixed-Rate Bonds: Pay a predetermined coupon throughout the tenure.

Corporate Bonds (cont)

- Floating-Rate Bonds: Coupon changes with a benchmark interest rate.

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Corporate Bonds (cont)

- Zero-Coupon Bonds: Issued at a discount and redeemed at face value; no periodic coupon.

Corporate Bonds (cont)

- Secured Bonds: Backed by specified assets or security.

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Corporate Bonds (cont)

- Unsecured Bonds: Not backed by specific collateral.

Corporate Bonds (cont)

- Convertible Bonds: Can be converted into equity shares under specified terms.

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Corporate Bonds (cont)

- Non-Convertible Bonds: Remain debt until repayment.

Corporate Bonds (cont)

- Perpetual Bonds: Have no fixed maturity date, subject to their terms.

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Corporate Bonds (cont)

- Green Bonds: Proceeds are earmarked for eligible environmental or climate-related projects.

Corporate Bonds (cont)

- Infrastructure Bonds: Proceeds are used to finance infrastructure--related activities.

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Corporate Bonds (cont)

Bond Pricing and Yield

Corporate Bonds (cont)

- Bond price and market interest rates generally move in opposite directions.

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Corporate Bonds (cont)

- When market interest rates rise, existing fixed-coupon bonds become less attractive, so their prices fall.

Corporate Bonds (cont)

- When market interest rates fall, existing fixed-coupon bonds become more attractive, so their prices rise.

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Corporate Bonds (cont)

Important Formulas

Corporate Bonds (cont)

- Current Yield = (Annual Coupon Payment / Current Market Price) × 100

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Corporate Bonds (cont)

- Coupon Rate = (Annual Coupon Payment / Face Value) × 100

Corporate Bonds (cont)

- Bond Value = Present Value of (Future Coupon Payments) + Present Value of (Principal Repayment)

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Corporate Bonds (cont)

Credit Rating

Corporate Bonds (cont)

- Credit Rating Agencies (CRAs) assess the issuer's ability to repay debt.

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Corporate Bonds (cont)

- Higher ratings indicate relatively lower credit risk; lower ratings indicate higher credit risk.

Corporate Bonds (cont)

- Investment Grade: Generally BBB− or higher under the commonly used rating scale.

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Corporate Bonds (cont)

- Below Investment Grade: Ratings below BBB−.

Corporate Bonds (cont)

- Credit ratings are opinions on credit risk, not guarantees of repayment.

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Corporate Bonds (cont)

Indian Corporate Bond Market

Corporate Bonds (cont)

- Regulated primarily by SEBI for listed corporate debt securities.

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Corporate Bonds (cont)

- Corporate bonds may be issued through public issues or private placements.

Corporate Bonds (cont)

- Stock exchanges facilitate secondary-market trading.

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Corporate Bonds (cont)

- Electronic Book Provider (EBP) platforms facilitate electronic bidding for specified debt-security issues.

Corporate Bonds (cont)

MCQ Traps

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Corporate Bonds (cont)

- Corporate bondholders are creditors, not shareholders.

Corporate Bonds (cont)

- Coupon rate is based on face value; current yield is based on market price.

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Corporate Bonds (cont)

- Bond prices and market yields generally move inversely.

Corporate Bonds (cont)

- A higher coupon does not necessarily mean a higher yield.

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Corporate Bonds (cont)

- Corporate bonds carry credit risk; Government of India securities carry sovereign credit backing.

Corporate Bonds (cont)

- Green bonds are classified by the use of proceeds, not necessarily by the issuer's ownership or credit rating.

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Debentures

Meaning

Debentures (cont)

- A debenture is a debt instrument issued by a company to borrow money.

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Debentures (cont)

- Debenture holders are creditors of the company, not owners.

Debentures (cont)

- The company undertakes to repay the principal and pay interest according to the issue terms.

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Debentures (cont)

- Governed primarily by the Companies Act, 2013 and applicable SEBI regulations for listed debentures.

Debentures (cont)

Key Characteristics

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Debentures (cont)

- Fixed Interest: Generally carries a specified coupon/interest rate, payable according to agreed terms.

Debentures (cont)

- Creditor Status: Debenture holders do not ordinarily enjoy ownership or voting rights in the company.

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Debentures (cont)

- Maturity: Usually issued for a specified period, after which principal is repaid.

Debentures (cont)

- Security: May be secured against company assets or unsecured.

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Debentures (cont)

- Priority: Debenture holders rank ahead of shareholders during liquidation, subject to the applicable security and insolvency framework.

Debentures (cont)

- Transferability: Listed debentures can be traded in the secondary market.

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Debentures (cont)

Types of Debentures

Debentures (cont)

- Secured Debentures: Backed by a charge on company assets.

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Debentures (cont)

- Unsecured Debentures: Not backed by specific collateral.

Debentures (cont)

- Convertible Debentures: Can be converted into equity shares, either fully or partly, according to issue terms.

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Debentures (cont)

- Non-Convertible Debentures (NCDs): Cannot be converted into equity shares.

Debentures (cont)

- Fully Convertible Debentures: Entire principal converts into equity.

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Debentures (cont)

- Partly Convertible Debentures: Part converts into equity; remaining portion continues as debt.

Debentures (cont)

- Redeemable Debentures: Repaid after a specified period.

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Debentures (cont)

- Perpetual Debentures: No fixed maturity; subject to applicable legal and regulatory requirements.

Debentures (cont)

Important Regulatory Provisions — Companies Act, 2013

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Debentures (cont)

- Section 71: Governs the issue of debentures.

Debentures (cont)

- A company cannot issue debentures carrying voting rights.

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Debentures (cont)

- Secured debentures are subject to prescribed conditions, including security creation and applicable maturity requirements.

Debentures (cont)

- A company issuing debentures to the public or to its members exceeding 500 must appoint one or more Debenture Trustees before issuing the prospectus or letter of offer.

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Debentures (cont)

- Debenture Redemption Reserve (DRR) requirements apply to prescribed classes of companies, subject to exemptions and applicable rules.

Debentures (cont)

- Listed debt securities are also subject to SEBI's Issue and Listing of Non-Convertible Securities Regulations.

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Debentures (cont)

Debenture Trustee

Debentures (cont)

- Represents and protects the interests of debenture holders.

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Debentures (cont)

- Monitors compliance with issue terms and security-related obligations.

Debentures (cont)

- Acts in accordance with the Companies Act and SEBI requirements.

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Debentures (cont)

MCQ Traps

Debentures (cont)

- Debenture holder = creditor; equity/preference shareholder = owner.

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Debentures (cont)

- Debentures do not carry voting rights.

Debentures (cont)

- Secured debenture = backed by a charge on assets.

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Debentures (cont)

- Convertible debenture = debt that may become equity.

Debentures (cont)

- Interest on debentures is a contractual obligation, unlike equity dividends.

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Debentures (cont)

- Debenture holders generally rank ahead of preference and equity shareholders during liquidation.

Preference Shares

Meaning

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Preference Shares (cont)

- Preference shares are shares carrying preferential rights over equity shares regarding:

Preference Shares (cont)

- Payment of dividends.

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Preference Shares (cont)

- Repayment of capital during winding up.

Preference Shares (cont)

- Preference shareholders are owners of the company but generally have limited voting rights.

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Preference Shares (cont)

- Dividend is usually specified as a fixed rate, but payment is subject to applicable law and availability of distributable profits.

Preference Shares (cont)

Key Characteristics

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Preference Shares (cont)

- Dividend Preference: Preference shareholders receive dividends before equity shareholders.

Preference Shares (cont)

- Capital Repayment Preference: Have priority over equity shareholders during liquidation, but rank behind creditors.

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Preference Shares (cont)

- Voting Rights: Generally restricted to matters directly affecting their rights and specified statutory circumstances.

Preference Shares (cont)

- Fixed Dividend Rate: Usually expressed as a percentage of face value.

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Preference Shares (cont)

- Hybrid Nature: Combines features of equity ownership and fixed--income-like returns.

Preference Shares (cont)

- No Automatic Guarantee: A stated dividend rate does not mean the dividend is guaranteed in all circumstances.

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Preference Shares (cont)

Types of Preference Shares

Preference Shares (cont)

- Cumulative Preference Shares: Unpaid dividends accumulate and are carried forward; must generally be paid before equity dividends.

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Preference Shares (cont)

- Non-Cumulative Preference Shares: Unpaid dividends do not accumulate; entitlement for that year lapses.

Preference Shares (cont)

- Participating Preference Shares: May receive additional participation in profits or surplus assets beyond the fixed preferential entitlement.

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Preference Shares (cont)

- Non-Participating Preference Shares: Receive only the specified preferential entitlement.

Preference Shares (cont)

- Convertible Preference Shares: Can be converted into equity shares according to predetermined terms.

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Preference Shares (cont)

- Non-Convertible Preference Shares: Cannot be converted into equity shares.

Preference Shares (cont)

- Redeemable Preference Shares: Repaid after a specified period or on specified terms.

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Preference Shares (cont)

Important Regulatory Provisions — Companies Act, 2013

Preference Shares (cont)

- Section 43: Recognises equity share capital and preference share capital.

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Preference Shares (cont)

- Section 55: Companies cannot issue irredeemable preference shares.

Preference Shares (cont)

- Maximum redemption period: 20 years from the date of issue, subject to the infrastructure-project exception.

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Preference Shares (cont)

- Infrastructure companies may issue preference shares for a period exceeding 20 years, subject to redemption of at least 10% per year from the 21st year onwards, or earlier, at the option of preference shareholders.

Preference Shares (cont)

- Preference shares can generally be issued only when authorised by the Articles of Association and approved through the required shareholder resolution.

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Preference Shares (cont)

- Redemption is permitted only out of profits available for dividends or proceeds of a fresh issue made for redemption.

Preference Shares (cont)

- Preference shares must be fully paid before redemption.

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Preference Shares (cont)

MCQ Traps

Preference Shares (cont)

- Preference shareholders are owners, not creditors.

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Preference Shares (cont)

- Preference dividend has priority over equity dividend.

Preference Shares (cont)

- Creditors rank ahead of preference shareholders during liquidation.

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Preference Shares (cont)

- Cumulative = unpaid dividend accumulates; non-cumulative = it does not.

Preference Shares (cont)

- Irredeemable preference shares are prohibited under the Companies Act.

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Preference Shares (cont)

- Preference shares are different from debentures: preference shares represent share capital, while debentures represent debt.

Financial Market Intermediaries

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Stock Exchanges

Meaning

Stock Exchanges (cont)

- A stock exchange is a recognised platform where securities are bought and sold.

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Stock Exchanges (cont)

- Provides an organised marketplace for trading securities such as equity shares, bonds, debentures and eligible derivatives.

Stock Exchanges (cont)

- In India, stock exchanges operate under the regulatory framework of SEBI and the Securities Contracts (Regulation) Act, 1956.

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Stock Exchanges (cont)

Major Stock Exchanges in India

Stock Exchanges (cont)

- NSE (National Stock Exchange): Established in 1992; commenced operations in 1994. Major index: NIFTY 50.

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Stock Exchanges (cont)

- BSE (BSE Limited): Established in 1875; one of Asia's oldest stock exchanges. Major index: S&P BSE SENSEX.

Stock Exchanges (cont)

- Both are recognised stock exchanges regulated by SEBI.

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Stock Exchanges (cont)

Functions of Stock Exchanges

Stock Exchanges (cont)

- Trading Platform: Provides an electronic platform for buying and selling securities.

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Stock Exchanges (cont)

- Price Discovery: Determines security prices through demand and supply.

Stock Exchanges (cont)

- Liquidity: Enables investors to buy and sell securities.

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Stock Exchanges (cont)

- Transparency: Provides information on prices, volumes and trading activity.

Stock Exchanges (cont)

- Investor Protection: Enforces exchange rules, surveillance and risk-management mechanisms under SEBI oversight.

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Stock Exchanges (cont)

- Capital Formation: Supports the primary market ecosystem by facilitating listing and subsequent trading.

Stock Exchanges (cont)

- Settlement Facilitation: Works with clearing corporations and depositories to complete transactions.

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Stock Exchanges (cont)

Important Concepts

Stock Exchanges (cont)

- Listing: Admission of a company's securities to trading on a recognised stock exchange.

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Stock Exchanges (cont)

- Trading: Buying and selling of listed securities.

Stock Exchanges (cont)

- Order Matching: Electronic matching of buy and sell orders based on price-time priority, subject to exchange rules.

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Stock Exchanges (cont)

- Circuit Limits: Price movement limits intended to manage excessive volatility.

Stock Exchanges (cont)

- Market Surveillance: Monitoring trading activity to detect manipulation, abnormal price movements and unfair practices.

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Stock Exchanges (cont)

- Indices: Represent the performance of a selected group of securities.

Stock Exchanges (cont)

- NIFTY 50 — NSE.

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Stock Exchanges (cont)

- SENSEX — BSE.

Stock Exchanges (cont)

Regulatory Framework

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Stock Exchanges (cont)

- SEBI: Regulates stock exchanges and securities-market intermediaries.

Stock Exchanges (cont)

- SCRA, 1956: Provides the legal framework for recognised stock exchanges and securities contracts.

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Stock Exchanges (cont)

- SEBI Stock Exchanges and Clearing Corporations Regulations, 2018: Prescribes governance, ownership and operational requirements for exchanges and clearing corporations.

Stock Exchanges (cont)

MCQ Traps

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Stock Exchanges (cont)

- Stock exchange = trading platform; it is not the depository or clearing corporation.

Stock Exchanges (cont)

- NSE was established in 1992 and commenced operations in 1994.

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Stock Exchanges (cont)

- BSE was established in 1875.

Stock Exchanges (cont)

- NIFTY 50 is associated with NSE; SENSEX is associated with BSE.

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Stock Exchanges (cont)

- SEBI regulates stock exchanges; RBI does not regulate the equity stock-exchange segment.

Stock Exchanges (cont)

- Stock exchanges facilitate secondary-market trading; they do not themselves become the buyer or seller in every transaction.

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Brokers and Sub-Brokers

A. Stockbrokers

Brokers and Sub-Brokers (cont)

- A stockbroker is a SEBI-registered intermediary who buys and sells securities on behalf of clients through a recognised stock exchange.

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Brokers and Sub-Brokers (cont)

- Acts as an intermediary between investors and the stock exchange.

Brokers and Sub-Brokers (cont)

- Earns brokerage or commission for executing transactions.

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Brokers and Sub-Brokers (cont)

Functions

Brokers and Sub-Brokers (cont)

- Execute buy and sell orders placed by investors.

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Brokers and Sub-Brokers (cont)

- Provide trading platforms and access to stock exchanges.

Brokers and Sub-Brokers (cont)

- Facilitate delivery of securities and settlement of funds.

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Brokers and Sub-Brokers (cont)

- Provide contract notes and transaction records.

Brokers and Sub-Brokers (cont)

- Follow Know Your Customer (KYC), client-fund segregation and other compliance requirements.

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Brokers and Sub-Brokers (cont)

- Maintain records and comply with exchange and SEBI regulations.

Brokers and Sub-Brokers (cont)

B. Sub-Brokers

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Brokers and Sub-Brokers (cont)

- Historically, sub-brokers acted as agents of stockbrokers and assisted investors in accessing stock-market services.

Brokers and Sub-Brokers (cont)

- They were required to obtain registration from SEBI under the earlier regulatory framework.

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Brokers and Sub-Brokers (cont)

- SEBI discontinued the sub-broker registration category with effect from 3 September 2018.

Brokers and Sub-Brokers (cont)

- Existing sub-brokers were required to transition into authorised persons or other permitted arrangements.

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Brokers and Sub-Brokers (cont)

C. Authorised Persons (APs)

Brokers and Sub-Brokers (cont)

- Persons appointed by stockbrokers to provide access to trading platforms as agents of the broker.

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Brokers and Sub-Brokers (cont)

- Act as an extension of the stockbroker, subject to exchange rules.

Brokers and Sub-Brokers (cont)

- Can assist clients with order placement and trading-related services.

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Brokers and Sub-Brokers (cont)

- The stockbroker remains responsible for the acts and omissions of its authorised persons within the scope of their activities.

Brokers and Sub-Brokers (cont)

Important Regulatory Framework

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Brokers and Sub-Brokers (cont)

- SEBI (Stock Brokers) Regulations, 1992: Earlier principal regulatory framework; replaced by the SEBI (Stock Brokers) Regulations, 2026.

Brokers and Sub-Brokers (cont)

- Stockbrokers must obtain registration and comply with applicable SEBI and recognised stock-exchange requirements.

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Brokers and Sub-Brokers (cont)

- Stockbrokers must maintain proper client accounts and comply with rules relating to client funds and securities.

Brokers and Sub-Brokers (cont)

- Stock exchanges supervise their trading members, while SEBI exercises overall regulatory oversight.

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Brokers and Sub-Brokers (cont)

MCQ Traps

Brokers and Sub-Brokers (cont)

- Stockbroker = registered intermediary; authorised person = appointed agent of a stockbroker.

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Brokers and Sub-Brokers (cont)

- Sub-broker is a discontinued SEBI registration category, not the current equivalent of an authorised person.

Brokers and Sub-Brokers (cont)

- The stockbroker remains responsible for its authorised persons.

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Brokers and Sub-Brokers (cont)

- Brokers execute trades; depositories hold securities electronically; clearing corporations manage clearing and settlement.

Brokers and Sub-Brokers (cont)

- Brokerage is the intermediary's fee, not the exchange's settlement charge.

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Depositories and Depository Participants (DPs)

Meaning

Depositories and Depository Participants (DPs) (cont)

- A Depository holds securities in electronic form (dematerialised or demat form) and facilitates transfer and settlement of securities.

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Depositories and Depository Participants (DPs) (cont)

- Depository Participant (DP) acts as the intermediary between the investor and the depository.

Depositories and Depository Participants (DPs) (cont)

- In India, the two depositories are:

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Depositories and Depository Participants (DPs) (cont)

- NSDL – National Securities Depository Limited.

Depositories and Depository Participants (DPs) (cont)

- CDSL – Central Depository Services (India) Limited.

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Depositories and Depository Participants (DPs) (cont)

Functions of Depositories

Depositories and Depository Participants (DPs) (cont)

- Hold shares, bonds, debentures, Government Securities and other eligible securities electronically.

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Depositories and Depository Participants (DPs) (cont)

- Enable dematerialisation (physical certificates → electronic holdings).

Depositories and Depository Participants (DPs) (cont)

- Enable rematerialisation (electronic holdings → physical certificates, where permitted).

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Depositories and Depository Participants (DPs) (cont)

- Facilitate transfer of securities without physical movement of certificates.

Depositories and Depository Participants (DPs) (cont)

- Enable settlement of securities trades through book entries.

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Depositories and Depository Participants (DPs) (cont)

- Facilitate pledge and hypothecation of securities.

Depositories and Depository Participants (DPs) (cont)

- Process corporate actions such as bonus issues, rights issues, stock splits and dividends.

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Depositories and Depository Participants (DPs) (cont)

- Maintain electronic records of beneficial ownership.

Depositories and Depository Participants (DPs) (cont)

Depository Participant (DP)

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Depositories and Depository Participants (DPs) (cont)

- Investor opens a Demat Account with a DP, not directly with the depository in the usual retail arrangement.

Depositories and Depository Participants (DPs) (cont)

- DPs provide account opening, KYC, demat/remat, transfer, pledge and account statement services.

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Depositories and Depository Participants (DPs) (cont)

- Banks, stockbrokers and financial institutions can act as DPs, subject to eligibility and registration.

Depositories and Depository Participants (DPs) (cont)

- DP is an agent of the depository and operates under its supervision.

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Depositories and Depository Participants (DPs) (cont)

- Investor is the Beneficial Owner (BO); the depository is the registered owner for the limited purpose of effecting transfers under the law.

Depositories and Depository Participants (DPs) (cont)

Dematerialisation Process

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Depositories and Depository Participants (DPs) (cont)

- Investor submits physical certificates and a Dematerialisation Request Form (DRF) to the DP.

Depositories and Depository Participants (DPs) (cont)

- DP forwards the request to the depository and issuer/RTA.

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Depositories and Depository Participants (DPs) (cont)

- After verification and confirmation, electronic securities are credited to the investor's demat account.

Depositories and Depository Participants (DPs) (cont)

- Rematerialisation reverses this process through a Rematerialisation Request Form (RRF).

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Depositories and Depository Participants (DPs) (cont)

Regulatory Framework

Depositories and Depository Participants (DPs) (cont)

- Governed by the Depositories Act, 1996.

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Depositories and Depository Participants (DPs) (cont)

- SEBI regulates depositories and DPs.

Depositories and Depository Participants (DPs) (cont)

- Key regulations: SEBI (Depositories and Participants) Regulations, 2018.

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Depositories and Depository Participants (DPs) (cont)

- Depositories must be registered with SEBI and comply with governance, risk management, inspection and investor-protection requirements.

Depositories and Depository Participants (DPs) (cont)

- ISIN (International Securities Identification Number) uniquely identifies a security; it is a 12-character alphanumeric code.

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Depositories and Depository Participants (DPs) (cont)

Important Distinctions / MCQ Traps

Depositories and Depository Participants (DPs) (cont)

- Depository = holds securities electronically; DP = provides investor-facing access.

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Depositories and Depository Participants (DPs) (cont)

- Demat account is opened with a DP.

Depositories and Depository Participants (DPs) (cont)

- NSDL and CDSL are India's two depositories.

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Depositories and Depository Participants (DPs) (cont)

- Depository is not a stock exchange; it does not execute buy/sell orders.

Depositories and Depository Participants (DPs) (cont)

- Depository is not a clearing corporation; it does not determine trading obligations.

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Depositories and Depository Participants (DPs) (cont)

- Securities are held in the investor's beneficial-owner account, not as physical certificates.

Depositories and Depository Participants (DPs) (cont)

- Fungibility: Securities of the same class are interchangeable in demat form; individual certificate numbers are eliminated.

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Clearing Corporations

Meaning

Clearing Corporations (cont)

- A Clearing Corporation (CC) is an institution that manages the clearing and settlement of trades executed on stock exchanges.

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Clearing Corporations (cont)

- It acts as a Central Counterparty (CCP), becoming the buyer to every seller and the seller to every buyer.

Clearing Corporations (cont)

- This reduces counterparty risk and ensures orderly settlement.

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Clearing Corporations (cont)

Key Functions

Clearing Corporations (cont)

- Clearing: Determines obligations of buyers and sellers after trades are executed.

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Clearing Corporations (cont)

- Settlement: Ensures securities are delivered to buyers and funds to sellers.

Clearing Corporations (cont)

- Novation: Interposes itself between the original buyer and seller, replacing their bilateral obligations with obligations to the CCP.

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Clearing Corporations (cont)

- Risk management: Collects margins, monitors exposures and manages defaults.

Clearing Corporations (cont)

- Netting: Offsets buy and sell obligations to determine net payable or receivable positions.

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Clearing Corporations (cont)

- Settlement guarantee: Guarantees settlement subject to its rules and risk-management framework.

Clearing Corporations (cont)

- Default management: Uses margins, default funds and other financial resources to manage member defaults.

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Clearing Corporations (cont)

Margin and Risk Management

Clearing Corporations (cont)

- Initial Margin: Collected to cover potential future losses during the period required to close out a defaulting member's positions.

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Clearing Corporations (cont)

- Mark-to-Market (MTM) Margin: Covers losses arising from daily or periodic changes in market prices.

Clearing Corporations (cont)

- Exposure Margin: Additional margin to cover potential risks beyond ordinary margin requirements.

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Clearing Corporations (cont)

- Settlement Guarantee Fund (SGF): Financial resources maintained to meet settlement obligations in case of member default.

Clearing Corporations (cont)

- Margins and collateral help protect the clearing corporation and other market participants from losses.

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Clearing Corporations (cont)

Settlement Process

Clearing Corporations (cont)

- Trade executed on stock exchange → trade details sent for clearing.

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Clearing Corporations (cont)

- Clearing corporation determines each member's net funds and securities obligations.

Clearing Corporations (cont)

- Clearing members arrange funds and securities.

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Clearing Corporations (cont)

- Clearing corporation coordinates settlement through clearing banks and depositories.

Clearing Corporations (cont)

- Securities and funds are transferred to complete settlement.

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Clearing Corporations (cont)

Indian Market Structure

Clearing Corporations (cont)

- NSE Clearing Limited (formerly National Securities Clearing Corporation Limited – NSCCL): Clearing corporation for the National Stock Exchange (NSE).

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Clearing Corporations (cont)

- Indian Clearing Corporation Limited (ICCL): Clearing corporation associated with BSE.

Clearing Corporations (cont)

- NSE Clearing and ICCL operate as central counterparties for their respective markets.

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Clearing Corporations (cont)

- CCIL (Clearing Corporation of India Limited): Provides clearing and settlement infrastructure for Government securities, money market and foreign exchange transactions.

Clearing Corporations (cont)

Regulatory Framework

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Clearing Corporations (cont)

- Regulated by the Securities and Exchange Board of India (SEBI).

Clearing Corporations (cont)

- Key framework: SEBI (Stock Exchanges and Clearing Corporations) Regulations, 2018.

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Clearing Corporations (cont)

- Clearing corporations are recognised as Market Infrastructure Institutions (MIIs).

Clearing Corporations (cont)

- Subject to requirements relating to governance, capital adequacy, risk management, default handling and settlement integrity.

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Clearing Corporations (cont)

Important Distinctions / MCQ Traps

Clearing Corporations (cont)

- Stock exchange = executes/facilitates trading; clearing corporation = clears and settles trades.

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Clearing Corporations (cont)

- Clearing corporation = CCP; novation is a defining feature.

Clearing Corporations (cont)

- Depository holds securities electronically; clearing corporation manages settlement obligations.

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Clearing Corporations (cont)

- Clearing member is responsible for meeting obligations to the clearing corporation.

Clearing Corporations (cont)

- Net settlement reduces gross obligations by offsetting buys and sells.

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Clearing Corporations (cont)

- Clearing and settlement are related but distinct: clearing determines obligations; settlement fulfils them.

Custodians

Meaning

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Custodians (cont)

- A Custodian is a SEBI-registered intermediary that safeguards and administers securities and other financial assets on behalf of clients.

Custodians (cont)

- Primarily serves institutional investors such as Foreign Portfolio Investors (FPIs), mutual funds, insurance companies and pension funds.

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Custodians (cont)

Key Functions

Custodians (cont)

- Safekeeping of securities and financial assets.

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Custodians (cont)

- Settlement of securities transactions by ensuring delivery of securities and payment of funds.

Custodians (cont)

- Collection of dividends, interest and other corporate benefits.

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Custodians (cont)

- Processing corporate actions such as bonus issues, rights issues and stock splits.

Custodians (cont)

- Maintaining records of holdings, transactions and asset movements.

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Custodians (cont)

- Reconciliation of securities and cash balances.

Custodians (cont)

- Reporting holdings and transactions to clients and regulators.

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Custodians (cont)

- Supporting institutional investors with regulatory and operational compliance.

Custodians (cont)

Custodian vs Depository vs DP

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Custodians (cont)

- Custodian: Safeguards and administers client assets; provides institutional custody services.

Custodians (cont)

- Depository: Holds securities in electronic form and maintains beneficial ownership records.

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Custodians (cont)

- Depository Participant (DP): Provides investors access to depository services through demat accounts.

Custodians (cont)

- A custodian may also be a registered DP, subject to applicable requirements.

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Custodians (cont)

Custodian for Foreign Portfolio Investors

Custodians (cont)

- Custodians play an important role in India's FPI framework.

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Custodians (cont)

- They provide custody, settlement, reporting and compliance-related services to FPIs.

Custodians (cont)

- They help ensure proper monitoring of FPI investments and transactions.

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Custodians (cont)

- FPI registration and regulatory framework are governed by SEBI (Foreign Portfolio Investors) Regulations, 2019.

Custodians (cont)

Regulatory Framework

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Custodians (cont)

- Governed by the SEBI (Custodian) Regulations, 1996.

Custodians (cont)

- Custodians must obtain registration from SEBI.

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Custodians (cont)

- Subject to requirements relating to eligibility, infrastructure, capital adequacy, internal controls, records, inspection and compliance.

Custodians (cont)

- Must maintain segregation and proper accounting of client assets.

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Custodians (cont)

Important Distinctions / MCQ Traps

Custodians (cont)

- Custodian = safekeeping and administration of assets; broker = execution of trades.

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Custodians (cont)

- Custodian does not operate as a stock exchange.

Custodians (cont)

- Custodian services are especially important for institutional investors and FPIs.

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Custodians (cont)

- Custody and depository services are related but not identical.

Custodians (cont)

- Custodians facilitate settlement but do not replace the clearing corporation's CCP function.

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Merchant Bankers

Meaning

Merchant Bankers (cont)

- A Merchant Banker is a SEBI-registered intermediary providing financial and advisory services, particularly in capital raising and securities issuance.

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Merchant Bankers (cont)

- Plays a major role in managing public issues, rights issues, takeovers and corporate restructuring.

Merchant Bankers (cont)

Key Functions

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Merchant Bankers (cont)

- Issue Management: Manages Initial Public Offerings (IPOs), Further Public Offers (FPOs) and rights issues.

Merchant Bankers (cont)

- Due Diligence: Examines the issuer's financial position, business, disclosures and regulatory compliance.

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Merchant Bankers (cont)

- Underwriting: May underwrite securities issues, subject to applicable regulations.

Merchant Bankers (cont)

- Corporate Advisory: Advises on mergers, acquisitions, restructuring and capital structure.

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Merchant Bankers (cont)

- Regulatory Compliance: Coordinates with SEBI, stock exchanges, registrars and other intermediaries.

Merchant Bankers (cont)

- Pricing and Marketing: Assists in issue pricing, book building and marketing securities to investors.

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Merchant Bankers (cont)

- Takeover Management: Acts as manager to open offers under takeover regulations.

Merchant Bankers (cont)

Role in an IPO

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Merchant Bankers (cont)

- Conducts due diligence on the issuer.

Merchant Bankers (cont)

- Coordinates preparation of the Draft Red Herring Prospectus (DRHP).

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Merchant Bankers (cont)

- Files the offer document with SEBI and relevant stock exchanges.

Merchant Bankers (cont)

- Coordinates with legal advisers, auditors, registrars and other intermediaries.

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Merchant Bankers (cont)

- Assists in determining the price band and managing the book-b-uilding process.

Merchant Bankers (cont)

- Ensures compliance with disclosure and allotment requirements.

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Merchant Bankers (cont)

- Coordinates post-issue activities and listing.

Merchant Bankers (cont)

Categories and Registration

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Merchant Bankers (cont)

- Regulated under the SEBI (Merchant Bankers) Regulations, 1992.

Merchant Bankers (cont)

- Merchant bankers require registration with SEBI.

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Merchant Bankers (cont)

- Earlier, registration was divided into four categories:

Merchant Bankers (cont)

- Category I: Issue management, underwriting, advisory and portfolio management.

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Merchant Bankers (cont)

- Categories II–IV: Had progressively restricted activities.

Merchant Bankers (cont)

- The category-based system was subsequently rationalised; do not treat the old four-category classification as the current registration structure.

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Merchant Bankers (cont)

- Current framework focuses on registration, eligibility, capital adequacy, conduct, due diligence and compliance.

Merchant Bankers (cont)

Important Distinctions / MCQ Traps

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Merchant Bankers (cont)

- Merchant banker = manages and advises on securities issues.

Merchant Bankers (cont)

- Underwriter = assumes responsibility for subscribing to the unsubscribed portion of an issue, subject to agreement.

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Merchant Bankers (cont)

- Registrar and Transfer Agent (RTA) = handles applications, allotment records and transfer-related services.

Merchant Bankers (cont)

- Broker = executes securities trades.

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Merchant Bankers (cont)

- Lead Manager is a merchant banker appointed to manage a public issue.

Merchant Bankers (cont)

- Merchant bankers are important gatekeepers for disclosure quality and investor protection.

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Registrars and Transfer Agents (RTAs)

Meaning

Registrars and Transfer Agents (RTAs) (cont)

- A Registrar to an Issue (R) manages the administrative process of a securities issue, including applications, allotment and refund-related activities.

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Registrars and Transfer Agents (RTAs) (cont)

- A Share Transfer Agent (STA) maintains security-holder records and handles transfer and related services.

Registrars and Transfer Agents (RTAs) (cont)

- Both functions are commonly performed by Registrars and Transfer Agents (RTAs).

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Registrars and Transfer Agents (RTAs) (cont)

Key Functions

Registrars and Transfer Agents (RTAs) (cont)

- Processing applications in IPOs, FPOs, rights issues and other securities offerings.

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Registrars and Transfer Agents (RTAs) (cont)

- Verifying application details and coordinating with stock exchanges and other intermediaries.

Registrars and Transfer Agents (RTAs) (cont)

- Processing basis of allotment in consultation with the issuer and stock exchange.

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Registrars and Transfer Agents (RTAs) (cont)

- Coordinating credit of allotted securities to investors' demat accounts.

Registrars and Transfer Agents (RTAs) (cont)

- Processing refunds and unblocking of funds under the applicable application mechanism.

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Registrars and Transfer Agents (RTAs) (cont)

- Maintaining records of shareholders and other security holders.

Registrars and Transfer Agents (RTAs) (cont)

- Processing transmission, transposition and other permitted changes in ownership records.

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Registrars and Transfer Agents (RTAs) (cont)

- Handling investor queries, complaints and corporate-action-related records.

Registrars and Transfer Agents (RTAs) (cont)

Two Main Roles

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Registrars and Transfer Agents (RTAs) (cont)

Registrar to an Issue

Registrars and Transfer Agents (RTAs) (cont)

- Handles the issue application process.

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Registrars and Transfer Agents (RTAs) (cont)

- Maintains application and investor data.

Registrars and Transfer Agents (RTAs) (cont)

- Assists in determining the basis of allotment.

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Registrars and Transfer Agents (RTAs) (cont)

- Coordinates refunds/unblocking and credit of securities.

Registrars and Transfer Agents (RTAs) (cont)

Share Transfer Agent

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Registrars and Transfer Agents (RTAs) (cont)

- Maintains records of security holders.

Registrars and Transfer Agents (RTAs) (cont)

- Processes permitted transfers and transmission requests.

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Registrars and Transfer Agents (RTAs) (cont)

- Updates ownership and contact details.

Registrars and Transfer Agents (RTAs) (cont)

- Facilitates corporate-action-related services.

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Registrars and Transfer Agents (RTAs) (cont)

Regulatory Framework

Registrars and Transfer Agents (RTAs) (cont)

- Governed by the SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993.

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Registrars and Transfer Agents (RTAs) (cont)

- RTAs require SEBI registration.

Registrars and Transfer Agents (RTAs) (cont)

- Registration categories:

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Registrars and Transfer Agents (RTAs) (cont)

- Category I: Can act as both Registrar to an Issue and Share Transfer Agent.

Registrars and Transfer Agents (RTAs) (cont)

- Category II: Can act as either Registrar to an Issue or Share Transfer Agent.

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Registrars and Transfer Agents (RTAs) (cont)

- Subject to requirements relating to eligibility, infrastructure, records, investor grievance redressal and compliance.

Registrars and Transfer Agents (RTAs) (cont)

Important Distinctions / MCQ Traps

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Registrars and Transfer Agents (RTAs) (cont)

- Merchant banker = manages the issue and conducts due diligence.

Registrars and Transfer Agents (RTAs) (cont)

- RTA = processes applications, allotment-related administration and investor records.

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Registrars and Transfer Agents (RTAs) (cont)

- Depository = holds securities electronically.

Registrars and Transfer Agents (RTAs) (cont)

- DP = provides access to depository services.

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Registrars and Transfer Agents (RTAs) (cont)

- Registrar to an Issue and Share Transfer Agent are distinct functions, even when performed by the same entity.

Registrars and Transfer Agents (RTAs) (cont)

- RTA does not decide the issue price or independently determine the issuer's capital-raising strategy.

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Underwriters

Meaning

Underwriters (cont)

- An Underwriter is a financial intermediary who agrees to subscribe to securities that remain unsubscribed in an issue, subject to the underwriting agreement.

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Underwriters (cont)

- Underwriting provides assurance to the issuer that the issue will receive the agreed level of subscription.

Underwriters (cont)

Key Functions

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Underwriters (cont)

- Provides subscription support for public issues and other securities offerings.

Underwriters (cont)

- Reduces the risk of an issue remaining undersubscribed.

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Underwriters (cont)

- Assesses the issuer's financial position and issue-related risks.

Underwriters (cont)

- Helps build investor confidence in the securities issue.

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Underwriters (cont)

- Supports capital mobilisation by providing subscription commitment.

Underwriters (cont)

Types of Underwriting

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Underwriters (cont)

- Firm Underwriting: Underwriter agrees to subscribe to a specified number/value of securities irrespective of public subscription, according to the agreement.

Underwriters (cont)

- Sub-underwriting: An underwriter transfers part of its underwriting commitment to another intermediary.

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Underwriters (cont)

- Full Underwriting: Entire issue is underwritten.

Underwriters (cont)

- Partial Underwriting: Only a specified portion of the issue is underwritten.

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Underwriters (cont)

How Underwriting Works

Underwriters (cont)

- Issuer appoints underwriters and enters into an underwriting agreement.

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Underwriters (cont)

- Underwriters agree to subscribe to a specified portion of the issue.

Underwriters (cont)

- Securities are offered to the public.

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Underwriters (cont)

- If the issue is undersubscribed, underwriters fulfil their contractual obligations for the shortfall.

Underwriters (cont)

- Underwriters receive an agreed underwriting commission.

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Underwriters (cont)

Regulatory Framework

Underwriters (cont)

- Governed by the SEBI (Underwriters) Regulations, 1993.

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Underwriters (cont)

- Underwriters must obtain SEBI registration, subject to applicable exemptions and conditions.

Underwriters (cont)

- Must comply with prescribed eligibility, capital adequacy, conduct and disclosure requirements.

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Underwriters (cont)

- Merchant bankers, stockbrokers and other eligible intermediaries may undertake underwriting subject to the relevant regulatory framework.

Underwriters (cont)

Important Distinctions / MCQ Traps

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Underwriters (cont)

- Underwriter = provides subscription commitment.

Underwriters (cont)

- Merchant banker = manages the issue; may also undertake underwriting if eligible.

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Underwriters (cont)

- Broker = executes buy/sell orders in the secondary market.

Underwriters (cont)

- Underwriting does not guarantee that investors will earn returns or that the security price will remain stable.

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Underwriters (cont)

- Underwriting commission is the fee paid for accepting underwriting risk.

Underwriters (cont)

- Underwriting risk: Risk that the underwriter may have to subscribe to securities not taken up by investors.

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Credit Rating Agencies (CRAs)

Meaning

Credit Rating Agencies (CRAs) (cont)

- A Credit Rating Agency (CRA) evaluates the creditworthiness of an issuer or a debt instrument and assigns a rating indicating the relative risk of default.

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Credit Rating Agencies (CRAs) (cont)

- Helps investors assess the issuer's ability and willingness to meet debt obligations.

Credit Rating Agencies (CRAs) (cont)

- A credit rating is an opinion, not a guarantee of repayment or investment return.

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Credit Rating Agencies (CRAs) (cont)

Key Functions

Credit Rating Agencies (CRAs) (cont)

- Assess credit risk of debt securities such as corporate bonds and debentures.

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Credit Rating Agencies (CRAs) (cont)

- Evaluate the issuer's financial position, cash flows, debt levels and repayment capacity.

Credit Rating Agencies (CRAs) (cont)

- Assign and periodically review credit ratings.

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Credit Rating Agencies (CRAs) (cont)

- Monitor rated instruments and communicate rating changes.

Credit Rating Agencies (CRAs) (cont)

- Provide investors with an independent assessment of relative credit risk.

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Credit Rating Agencies (CRAs) (cont)

Credit Rating Scale

Credit Rating Agencies (CRAs) (cont)

- AAA: Highest degree of safety regarding timely servicing of financial obligations.

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Credit Rating Agencies (CRAs) (cont)

- AA: High degree of safety.

Credit Rating Agencies (CRAs) (cont)

- A: Adequate degree of safety.

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Credit Rating Agencies (CRAs) (cont)

- BBB: Moderate degree of safety; moderate credit risk.

Credit Rating Agencies (CRAs) (cont)

- BB and below: Increasingly higher credit risk.

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Credit Rating Agencies (CRAs) (cont)

- D: Default or expected default, as defined under the applicable rating framework.

Credit Rating Agencies (CRAs) (cont)

- Ratings from AAA to BBB are generally considered investment grade; BB and below are speculative grade.

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Credit Rating Agencies (CRAs) (cont)

- A + or − modifier indicates relative standing within a rating category, where applicable.

Credit Rating Agencies (CRAs) (cont)

Factors Considered in Rating

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Credit Rating Agencies (CRAs) (cont)

- Financial performance, profitability and cash-flow generation.

Credit Rating Agencies (CRAs) (cont)

- Debt-equity ratio, leverage and interest coverage.

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Credit Rating Agencies (CRAs) (cont)

- Liquidity and repayment capacity.

Credit Rating Agencies (CRAs) (cont)

- Industry conditions and business risk.

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Credit Rating Agencies (CRAs) (cont)

- Management quality and corporate governance.

Credit Rating Agencies (CRAs) (cont)

- Macroeconomic conditions and regulatory environment.

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Credit Rating Agencies (CRAs) (cont)

- Security, guarantees and other credit enhancements.

Credit Rating Agencies (CRAs) (cont)

Types of Ratings

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Credit Rating Agencies (CRAs) (cont)

- Issuer Rating: Assesses overall creditworthiness of the issuer.

Credit Rating Agencies (CRAs) (cont)

- Instrument Rating: Assesses the credit risk of a particular debt instrument.

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Credit Rating Agencies (CRAs) (cont)

- Long-Term Rating: For instruments with longer maturities.

Credit Rating Agencies (CRAs) (cont)

- Short-Term Rating: For short-maturity obligations such as commercial paper.

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Credit Rating Agencies (CRAs) (cont)

- Structured Finance Rating: For securities backed by pools of financial assets.

Credit Rating Agencies (CRAs) (cont)

Major Credit Rating Agencies in India

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Credit Rating Agencies (CRAs) (cont)

- CRISIL – Credit Rating Information Services of India Limited.

Credit Rating Agencies (CRAs) (cont)

- ICRA – Investment Information and Credit Rating Agency of India Limited.

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Credit Rating Agencies (CRAs) (cont)

- CARE Ratings – Credit Analysis and Research.

Credit Rating Agencies (CRAs) (cont)

- India Ratings and Research.

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Credit Rating Agencies (CRAs) (cont)

- Acuité Ratings & Research.

Credit Rating Agencies (CRAs) (cont)

- Brickwork Ratings.

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Credit Rating Agencies (CRAs) (cont)

Regulatory Framework

Credit Rating Agencies (CRAs) (cont)

- Governed by the SEBI (Credit Rating Agencies) Regulations, 1999.

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Credit Rating Agencies (CRAs) (cont)

- CRAs require registration with SEBI.

Credit Rating Agencies (CRAs) (cont)

- Subject to requirements relating to eligibility, capital adequacy, rating process, disclosures, record maintenance and conflict-of-interest management.

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Credit Rating Agencies (CRAs) (cont)

- Must disclose rating rationale and monitor ratings during the life of rated securities.

Credit Rating Agencies (CRAs) (cont)

Important Distinctions / MCQ Traps

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Credit Rating Agencies (CRAs) (cont)

- Credit rating measures credit/default risk, not market-price volatility or overall investment suitability.

Credit Rating Agencies (CRAs) (cont)

- Higher rating generally indicates lower expected credit risk, not zero risk.

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Credit Rating Agencies (CRAs) (cont)

- Rating is an opinion, not a recommendation to buy, sell or hold.

Credit Rating Agencies (CRAs) (cont)

- Downgrade = deterioration in assessed creditworthiness; upgrade = improvement.

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Credit Rating Agencies (CRAs) (cont)

- Rating Watch: Indicates a possibility of rating change in the near term.

Credit Rating Agencies (CRAs) (cont)

- Rating Outlook: Indicates the likely direction of rating movement over a medium-term horizon.

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Credit Rating Agencies (CRAs) (cont)

- Credit rating agencies are different from credit bureaus: CRAs rate debt instruments/issuers, while credit bureaus maintain borrower credit histories and credit scores.

Investment Advisers and Research Analysts

Investment Advisers (IAs)

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Investment Advisers and Research Analysts (cont)

Meaning

Investment Advisers and Research Analysts (cont)

- An Investment Adviser (IA) provides investment advice to clients regarding securities and investment products.

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Investment Advisers and Research Analysts (cont)

- Advice may cover buying, selling or investing in securities and must be based on the client's financial circumstances, objectives and risk profile.

Investment Advisers and Research Analysts (cont)

- IAs are subject to fiduciary responsibilities and conflict-of-interest requirements.

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Investment Advisers and Research Analysts (cont)

Key Functions

Investment Advisers and Research Analysts (cont)

- Assess client's financial goals, investment horizon and risk appetite.

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Investment Advisers and Research Analysts (cont)

- Conduct risk profiling and suitability assessment.

Investment Advisers and Research Analysts (cont)

- Recommend suitable investment products and asset allocation.

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Investment Advisers and Research Analysts (cont)

- Provide investment planning and portfolio-related advice.

Investment Advisers and Research Analysts (cont)

- Disclose fees, risks and conflicts of interest.

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Investment Advisers and Research Analysts (cont)

- Maintain client records and comply with regulatory requirements.

Investment Advisers and Research Analysts (cont)

Research Analysts (RAs)

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Investment Advisers and Research Analysts (cont)

Meaning

Investment Advisers and Research Analysts (cont)

- A Research Analyst (RA) prepares and publishes research reports or provides analysis and recommendations concerning securities.

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Investment Advisers and Research Analysts (cont)

- Research may include recommendations to buy, sell or hold securities based on fundamental, technical or quantitative analysis.

Investment Advisers and Research Analysts (cont)

Key Functions

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Investment Advisers and Research Analysts (cont)

- Analyse companies, industries and securities.

Investment Advisers and Research Analysts (cont)

- Study financial statements, business models and market trends.

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Investment Advisers and Research Analysts (cont)

- Estimate financial performance and valuation.

Investment Advisers and Research Analysts (cont)

- Prepare research reports and investment recommendations.

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Investment Advisers and Research Analysts (cont)

- Disclose material interests and conflicts of interest.

Investment Advisers and Research Analysts (cont)

- Maintain supporting records and research documentation.

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Investment Advisers and Research Analysts (cont)

Investment Adviser vs Research Analyst

Investment Advisers and Research Analysts (cont)

- IA provides personalised investment advice based on an individual client's needs and risk profile.

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Investment Advisers and Research Analysts (cont)

- RA provides research-based analysis and recommendations concerning securities, generally to investors or the public.

Investment Advisers and Research Analysts (cont)

- IA focuses on suitability for the client; RA focuses on research and analysis of securities.

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Investment Advisers and Research Analysts (cont)

- Both must manage conflicts of interest and comply with disclosure requirements.

Investment Advisers and Research Analysts (cont)

Regulatory Framework

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Investment Advisers and Research Analysts (cont)

Investment Advisers

Investment Advisers and Research Analysts (cont)

- Governed by the SEBI (Investment Advisers) Regulations, 2013.

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Investment Advisers and Research Analysts (cont)

- Registration with SEBI is required unless specifically exempt.

Investment Advisers and Research Analysts (cont)

- Must undertake risk profiling and suitability assessment.

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Investment Advisers and Research Analysts (cont)

- Must disclose fees, conflicts of interest and relevant risks.

Investment Advisers and Research Analysts (cont)

- Must maintain appropriate records and comply with client-level segregation and fiduciary requirements.

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Investment Advisers and Research Analysts (cont)

Research Analysts

Investment Advisers and Research Analysts (cont)

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Investment Advisers and Research Analysts (cont)

- Registration with SEBI is required unless specifically exempt.

Investment Advisers and Research Analysts (cont)

- Must maintain independence and objectivity in research.

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Investment Advisers and Research Analysts (cont)

- Must disclose financial interests, material conflicts and compensation arrangements.

Investment Advisers and Research Analysts (cont)

- Must maintain records supporting research recommendations.

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Investment Advisers and Research Analysts (cont)

Important Distinctions / MCQ Traps

Investment Advisers and Research Analysts (cont)

- IA = personalised investment advice; RA = securities research and analysis.

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Investment Advisers and Research Analysts (cont)

- A stockbroker executes transactions; an IA advises; an RA researches.

Investment Advisers and Research Analysts (cont)

- Investment advice must consider suitability and the client's risk profile.

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Investment Advisers and Research Analysts (cont)

- Research recommendations are not guaranteed returns.

Investment Advisers and Research Analysts (cont)

- Both intermediaries must disclose conflicts of interest.

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Investment Advisers and Research Analysts (cont)

- Fiduciary duty: Obligation to act in the client's best interests while providing investment advice.

Financial Regulators

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Reserve Bank of India (RBI)

Meaning and Objectives

Reserve Bank of India (RBI) (cont)

- India's central bank, established on 1 April 1935 under the Reserve Bank of India Act, 1934.

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Reserve Bank of India (RBI) (cont)

- Nationalised in 1949.

Reserve Bank of India (RBI) (cont)

- Main objectives: monetary stability, price stability, financial stability, currency management and development of the financial system.

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Reserve Bank of India (RBI) (cont)

- Monetary policy objective under the amended RBI Act: maintain price stability while keeping in mind the objective of growth.

Reserve Bank of India (RBI) (cont)

Jurisdiction

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Reserve Bank of India (RBI) (cont)

- Regulates banks, specified financial institutions and Non-Banking Financial Companies (NBFCs).

Reserve Bank of India (RBI) (cont)

- Regulates and supervises payment systems.

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Reserve Bank of India (RBI) (cont)

- Manages currency, foreign exchange reserves and government banking operations.

Reserve Bank of India (RBI) (cont)

- Regulates money markets, Government securities markets and foreign exchange transactions within its statutory mandate.

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Reserve Bank of India (RBI) (cont)

Major Functions

Reserve Bank of India (RBI) (cont)

Monetary Policy

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Reserve Bank of India (RBI) (cont)

- Formulates and implements monetary policy.

Reserve Bank of India (RBI) (cont)

- Uses policy repo rate, Standing Deposit Facility (SDF), Marginal Standing Facility (MSF), Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) to influence liquidity and credit conditions.

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Reserve Bank of India (RBI) (cont)

- Inflation target under the flexible inflation-targeting framework: 4% Consumer Price Index (CPI) inflation, with a tolerance band of ±2 percentage points.

Reserve Bank of India (RBI) (cont)

- Monetary Policy Committee (MPC) has 6 members: 3 RBI members and 3 Central Government-appointed external members.

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Reserve Bank of India (RBI) (cont)

- MPC meets at least 4 times a year.

Reserve Bank of India (RBI) (cont)

Currency Management

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Reserve Bank of India (RBI) (cont)

- Issues banknotes except the ₹1 note, which is issued by the Government of India.

Reserve Bank of India (RBI) (cont)

- Manages currency circulation and withdrawal of unfit notes.

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Reserve Bank of India (RBI) (cont)

- Government of India issues coins; RBI distributes them.

Reserve Bank of India (RBI) (cont)

Banker to Government

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Reserve Bank of India (RBI) (cont)

- Acts as banker, agent and debt manager to Central and State Governments, subject to applicable arrangements.

Reserve Bank of India (RBI) (cont)

- Manages government receipts, payments and public debt operations.

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Reserve Bank of India (RBI) (cont)

Banker's Bank and Lender of Last Resort

Reserve Bank of India (RBI) (cont)

- Maintains banks' reserves and provides liquidity support.

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Reserve Bank of India (RBI) (cont)

- Acts as lender of last resort to eligible institutions under prescribed conditions.

Reserve Bank of India (RBI) (cont)

Financial Regulation and Supervision

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Reserve Bank of India (RBI) (cont)

- Regulates and supervises commercial banks, cooperative banks within its jurisdiction, NBFCs and specified financial institutions.

Reserve Bank of India (RBI) (cont)

- Promotes sound banking practices, depositor protection and financial stability.

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Reserve Bank of India (RBI) (cont)

- Regulates payment and settlement systems under the Payment and Settlement Systems Act, 2007.

Reserve Bank of India (RBI) (cont)

External Sector

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Reserve Bank of India (RBI) (cont)

- Manages India's foreign exchange reserves.

Reserve Bank of India (RBI) (cont)

- Administers foreign exchange framework under the Foreign Exchange Management Act (FEMA), 1999.

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Reserve Bank of India (RBI) (cont)

- Works to maintain orderly conditions in the foreign exchange market.

Reserve Bank of India (RBI) (cont)

Important Regulatory Framework

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Reserve Bank of India (RBI) (cont)

- Reserve Bank of India Act, 1934.

Reserve Bank of India (RBI) (cont)

- Banking Regulation Act, 1949.

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Reserve Bank of India (RBI) (cont)

- Foreign Exchange Management Act, 1999.

Reserve Bank of India (RBI) (cont)

- Payment and Settlement Systems Act, 2007.

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Reserve Bank of India (RBI) (cont)

- RBI Integrated Ombudsman Scheme, 2021.

Reserve Bank of India (RBI) (cont)

Important MCQ Traps

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Reserve Bank of India (RBI) (cont)

- RBI established in 1935; nationalised in 1949.

Reserve Bank of India (RBI) (cont)

- RBI is India's central bank, not the securities-market regulator.

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Reserve Bank of India (RBI) (cont)

- ₹1 note is issued by Government of India and bears the Finance Secretary's signature; other banknotes are issued by RBI and bear the RBI Governor's signature.

Reserve Bank of India (RBI) (cont)

- MPC determines the policy repo rate; RBI implements monetary policy.

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Reserve Bank of India (RBI) (cont)

- SEBI regulates securities markets; PFRDA regulates pension-sector activities; IRDAI regulates insurance.

Securities and Exchange Board of India (SEBI)

Meaning and Objectives

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Securities and Exchange Board of India (SEBI) (cont)

- Established in 1988 as a non-statutory body; granted statutory status through the SEBI Act, 1992.

Securities and Exchange Board of India (SEBI) (cont)

- Headquarters: Mumbai.

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Securities and Exchange Board of India (SEBI) (cont)

- Primary objective: protect investors, promote the development of the securities market and regulate the securities market.

Securities and Exchange Board of India (SEBI) (cont)

- These three objectives are expressly reflected in the SEBI Act.

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Securities and Exchange Board of India (SEBI) (cont)

Jurisdiction

Securities and Exchange Board of India (SEBI) (cont)

- Regulates India's securities and capital markets.

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Securities and Exchange Board of India (SEBI) (cont)

- Supervises stock exchanges, clearing corporations, depositories and market intermediaries.

Securities and Exchange Board of India (SEBI) (cont)

- Regulates public issues, listing, securities trading, takeovers and substantial acquisition of shares.

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Securities and Exchange Board of India (SEBI) (cont)

- Regulates mutual funds, Alternative Investment Funds (AIFs), Portfolio Managers, Investment Advisers and Research Analysts.

Securities and Exchange Board of India (SEBI) (cont)

- Regulates Foreign Portfolio Investors (FPIs) and other prescribed market participants.

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Securities and Exchange Board of India (SEBI) (cont)

Major Functions

Securities and Exchange Board of India (SEBI) (cont)

Investor Protection

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Securities and Exchange Board of India (SEBI) (cont)

- Prevents fraudulent and unfair trade practices.

Securities and Exchange Board of India (SEBI) (cont)

- Takes action against insider trading and market manipulation.

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Securities and Exchange Board of India (SEBI) (cont)

- Promotes investor education and awareness.

Securities and Exchange Board of India (SEBI) (cont)

- Provides mechanisms for investor grievance redressal.

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Securities and Exchange Board of India (SEBI) (cont)

- Regulates disclosures to ensure informed investment decisions.

Securities and Exchange Board of India (SEBI) (cont)

Market Development

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Securities and Exchange Board of India (SEBI) (cont)

- Promotes fair, transparent and efficient securities markets.

Securities and Exchange Board of India (SEBI) (cont)

- Encourages development of new financial products and market infrastructure.

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Securities and Exchange Board of India (SEBI) (cont)

- Facilitates technological improvements in trading and settlement.

Securities and Exchange Board of India (SEBI) (cont)

- Promotes institutional participation and market liquidity.

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Securities and Exchange Board of India (SEBI) (cont)

Market Regulation

Securities and Exchange Board of India (SEBI) (cont)

- Registers and regulates stock exchanges, brokers, depositories, merchant bankers, credit rating agencies and other intermediaries.

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Securities and Exchange Board of India (SEBI) (cont)

- Regulates IPOs, FPOs, rights issues and other securities offerings.

Securities and Exchange Board of India (SEBI) (cont)

- Supervises mutual funds and other collective investment schemes.

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Securities and Exchange Board of India (SEBI) (cont)

- Regulates takeovers and substantial acquisition of shares.

Securities and Exchange Board of India (SEBI) (cont)

- Prescribes disclosure, listing, governance and compliance requirements.

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Securities and Exchange Board of India (SEBI) (cont)

Enforcement Powers

Securities and Exchange Board of India (SEBI) (cont)

- Can inspect, investigate and conduct inquiries into market activities.

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Securities and Exchange Board of India (SEBI) (cont)

- Can issue directions to market participants.

Securities and Exchange Board of India (SEBI) (cont)

- Can suspend trading or restrain persons from accessing the securities market.

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Securities and Exchange Board of India (SEBI) (cont)

- Can impose monetary penalties under the SEBI Act.

Securities and Exchange Board of India (SEBI) (cont)

- Has powers to regulate, prohibit and investigate prohibited market practices.

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Securities and Exchange Board of India (SEBI) (cont)

Organisational Structure

Securities and Exchange Board of India (SEBI) (cont)

- Governed by a Board constituted under the SEBI Act.

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Securities and Exchange Board of India (SEBI) (cont)

- Board consists of:

Securities and Exchange Board of India (SEBI) (cont)

- Chairman.

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Securities and Exchange Board of India (SEBI) (cont)

- Two members from the Central Government's Ministry of Finance.

Securities and Exchange Board of India (SEBI) (cont)

- One member from the Reserve Bank of India.

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Securities and Exchange Board of India (SEBI) (cont)

- Five other members appointed by the Central Government, of whom at least three must be whole-time members.

Securities and Exchange Board of India (SEBI) (cont)

- SEBI is an autonomous statutory regulator, functioning within the framework of the SEBI Act.

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Securities and Exchange Board of India (SEBI) (cont)

Important Regulatory Framework

Securities and Exchange Board of India (SEBI) (cont)

- SEBI Act, 1992.

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Securities and Exchange Board of India (SEBI) (cont)

- Securities Contracts (Regulation) Act, 1956 (SCRA).

Securities and Exchange Board of India (SEBI) (cont)

- Depositories Act, 1996.

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Securities and Exchange Board of India (SEBI) (cont)

- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR).

Securities and Exchange Board of India (SEBI) (cont)

- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR).

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Securities and Exchange Board of India (SEBI) (cont)

- SEBI (Prohibition of Insider Trading) Regulations, 2015.

Securities and Exchange Board of India (SEBI) (cont)

- SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003 (PFUTP).

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Securities and Exchange Board of India (SEBI) (cont)

Important MCQ Traps

Securities and Exchange Board of India (SEBI) (cont)

- SEBI established in 1988; statutory status in 1992.

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Securities and Exchange Board of India (SEBI) (cont)

- SEBI's three core objectives: investor protection, market development and market regulation.

Securities and Exchange Board of India (SEBI) (cont)

- RBI regulates banking and monetary policy; SEBI regulates securities markets.

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Securities and Exchange Board of India (SEBI) (cont)

- SEBI regulates mutual funds, but does not regulate bank deposits as securities-market products.

Securities and Exchange Board of India (SEBI) (cont)

- SEBI is not a ministry; it is a statutory regulator.

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Securities and Exchange Board of India (SEBI) (cont)

- Stock exchanges and depositories are Market Infrastructure Institutions (MIIs) regulated by SEBI.

PFRDA

Pension Fund Regulatory and Development Authority (PFRDA)

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PFRDA (cont)

Meaning and Objectives

PFRDA (cont)

- Established in 2003 initially through an executive resolution of the Government of India.

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PFRDA (cont)

- Became a statutory regulator under the Pension Fund Regulatory and Development Authority Act, 2013.

PFRDA (cont)

- The Act came into force on 1 February 2014.

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PFRDA (cont)

- Primary objective: promote old-age income security by regulating and developing pension funds and protecting pension subscribers.

PFRDA (cont)

- Headquarters: New Delhi.

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PFRDA (cont)

Jurisdiction

PFRDA (cont)

- Regulates the National Pension System (NPS) and pension schemes administered by PFRDA.

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PFRDA (cont)

- Regulates the Atal Pension Yojana (APY).

PFRDA (cont)

- Supervises pension-sector intermediaries such as:

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PFRDA (cont)

- Pension Funds (PFs).

PFRDA (cont)

- Points of Presence (PoPs).

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PFRDA (cont)

- Central Recordkeeping Agencies (CRAs).

PFRDA (cont)

- Trustee Bank.

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PFRDA (cont)

- Custodian.

PFRDA (cont)

- Retirement Advisers.

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PFRDA (cont)

- Covers government-sector, corporate-sector and All Citizen Model NPS subscribers.

PFRDA (cont)

- Does not regulate the Employees' Provident Fund Organisation (EPFO) or the Employees' Pension Scheme (EPS).

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PFRDA (cont)

Major Functions

PFRDA (cont)

Regulation and Supervision

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PFRDA (cont)

- Registers and regulates pension funds and other pension intermediaries.

PFRDA (cont)

- Prescribes investment guidelines for pension funds.

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PFRDA (cont)

- Monitors fund performance, operations and compliance.

PFRDA (cont)

- Conducts inspection, inquiry and audit of regulated intermediaries.

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PFRDA (cont)

- Prescribes standards for subscriber servicing and grievance redressal.

PFRDA (cont)

Pension Fund Development

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PFRDA (cont)

- Promotes expansion of pension coverage, especially among the unorganised sector and self-employed individuals.

PFRDA (cont)

- Encourages participation in NPS and other regulated pension schemes.

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PFRDA (cont)

- Promotes competition and efficiency among pension fund managers.

PFRDA (cont)

- Develops pension-sector infrastructure and operational systems.

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PFRDA (cont)

Subscriber Protection

PFRDA (cont)

- Protects subscribers' interests and pension assets.

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PFRDA (cont)

- Prescribes disclosure, transparency and governance requirements.

PFRDA (cont)

- Establishes grievance redressal mechanisms.

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PFRDA (cont)

- Ensures proper management and administration of subscriber contributions.

PFRDA (cont)

NPS Architecture

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PFRDA (cont)

- PFRDA: Regulator of the pension system.

PFRDA (cont)

- NPS Trust: Holds assets of subscribers in trust for their benefit and oversees the functioning of pension funds and other entities.

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PFRDA (cont)

- Pension Funds: Invest subscriber contributions according to prescribed investment guidelines.

PFRDA (cont)

- CRA: Maintains records of subscribers and issues Permanent Retirement Account Numbers (PRANs).

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PFRDA (cont)

- PoPs: Act as points of interaction between subscribers and the NPS architecture.

PFRDA (cont)

- Trustee Bank: Facilitates fund transfers and banking operations.

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PFRDA (cont)

- Custodian: Safeguards securities and financial assets.

PFRDA (cont)

Important Features of NPS

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PFRDA (cont)

- Defined-contribution pension system: retirement benefits depend on contributions and investment performance.

PFRDA (cont)

- Market-linked returns; returns are not guaranteed by PFRDA.

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PFRDA (cont)

- Individual subscriber receives a Permanent Retirement Account Number (PRAN).

PFRDA (cont)

- Two account types:

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PFRDA (cont)

- Tier I: Primary retirement account with withdrawal restrictions and applicable tax benefits.

PFRDA (cont)

- Tier II: Voluntary investment account with greater withdrawal flexibility, subject to applicable rules.

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PFRDA (cont)

- Investment choices include Active Choice and Auto Choice, subject to scheme rules.

PFRDA (cont)

- NPS is portable across employment and locations.

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PFRDA (cont)

Important Regulatory Framework

PFRDA (cont)

- Pension Fund Regulatory and Development Authority Act, 2013.

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PFRDA (cont)

- PFRDA (National Pension System Trust) Regulations, 2015.

PFRDA (cont)

- PFRDA (Point of Presence) Regulations, 2018.

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PFRDA (cont)

- PFRDA (Pension Fund) Regulations, 2015.

PFRDA (cont)

- PFRDA (Central Recordkeeping Agency) Regulations, 2015.

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PFRDA (cont)

- PFRDA (Exit and Withdrawals under the NPS) Regulations, 2015, as amended.

PFRDA (cont)

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PFRDA (cont)

- PFRDA established in 2003; statutory status under the 2013 Act, effective 1 February 2014.

PFRDA (cont)

- PFRDA regulates pension funds; it does not regulate mutual funds (SEBI) or insurance companies (IRDAI).

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PFRDA (cont)

- NPS is a defined-contribution, market-linked system, not a defined-benefit guaranteed-pension scheme.

PFRDA (cont)

- PFRDA is the regulator; NPS Trust safeguards subscriber interests and assets.

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PFRDA (cont)

- CRA maintains subscriber records; Pension Funds manage investments.

PFRDA (cont)

- EPFO and EPS fall under the Ministry of Labour and Employment, not PFRDA.

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IRDAI

Insurance Regulatory and Development Authority of India (IRDAI)

IRDAI (cont)

Meaning and Objectives

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IRDAI (cont)

- Established in 1999 under the Insurance Regulatory and Development Authority Act, 1999.

IRDAI (cont)

- Became operational as the statutory insurance regulator in 2000.

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IRDAI (cont)

- Headquarters: Hyderabad.

IRDAI (cont)

- Primary objective: protect policyholders' interests and regulate, promote and ensure orderly growth of the insurance industry.

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IRDAI (cont)

Jurisdiction

IRDAI (cont)

- Regulates insurance companies operating in India:

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IRDAI (cont)

- Life insurers.

IRDAI (cont)

- General insurers.

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IRDAI (cont)

- Health insurers.

IRDAI (cont)

- Reinsurers.

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IRDAI (cont)

- Regulates insurance intermediaries:

IRDAI (cont)

- Insurance brokers.

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IRDAI (cont)

- Corporate agents.

IRDAI (cont)

- Insurance marketing firms.

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IRDAI (cont)

- Third-party administrators (TPAs).

IRDAI (cont)

- Surveyors and loss assessors.

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IRDAI (cont)

- Web aggregators and other prescribed intermediaries.

IRDAI (cont)

- Supervises insurance distribution, policy servicing, claims settlement and market conduct.

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IRDAI (cont)

Major Functions

IRDAI (cont)

Policyholder Protection

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IRDAI (cont)

- Prescribes standards for fair treatment of policyholders.

IRDAI (cont)

- Regulates policy disclosures, policy terms and conditions.

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IRDAI (cont)

- Monitors claim settlement practices.

IRDAI (cont)

- Prescribes grievance redressal and policyholder service standards.

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IRDAI (cont)

- Addresses unfair practices and mis-selling.

IRDAI (cont)

Insurance Regulation

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IRDAI (cont)

- Registers and supervises insurers and intermediaries.

IRDAI (cont)

- Prescribes solvency margin requirements to ensure insurers can meet liabilities.

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IRDAI (cont)

- Regulates investments of insurance funds.

IRDAI (cont)

- Prescribes accounting, reporting, actuarial valuation and disclosure requirements.

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IRDAI (cont)

- Conducts inspections, investigations and audits.

IRDAI (cont)

Insurance Development

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IRDAI (cont)

- Promotes insurance penetration and density.

IRDAI (cont)

- Encourages insurance coverage in rural and underserved areas.

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IRDAI (cont)

- Promotes competition and innovation.

IRDAI (cont)

- Supports development of health, life, general and reinsurance markets.

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IRDAI (cont)

- Encourages technology-enabled insurance distribution and servicing.

IRDAI (cont)

Solvency and Risk Management

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IRDAI (cont)

- Ensures insurers maintain adequate capital to meet policyholder obligations.

IRDAI (cont)

- Solvency Margin: excess of assets over liabilities, maintained in accordance with prescribed requirements.

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IRDAI (cont)

- The commonly applicable control-level solvency ratio is 150% of the Required Solvency Margin (RSM), subject to applicable regulatory provisions and directions.

IRDAI (cont)

- Monitors underwriting, investment and operational risks.

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IRDAI (cont)

Insurance Ombudsman and Grievance Redressal

IRDAI (cont)

- IRDAI supervises the insurance grievance redressal framework.

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IRDAI (cont)

- The Insurance Ombudsman provides an alternative dispute-resolution mechanism for eligible policyholder complaints.

IRDAI (cont)

- The Insurance Ombudsman framework is governed by the Insurance Ombudsman Rules, 2017, as amended.

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IRDAI (cont)

Important Regulatory Framework

IRDAI (cont)

- Insurance Act, 1938.

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IRDAI (cont)

- Insurance Regulatory and Development Authority Act, 1999.

IRDAI (cont)

- IRDAI (Protection of Policyholders' Interests, Operations and Allied Matters of Insurers) Regulations, 2024.

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IRDAI (cont)

- IRDAI (Registration, Capital Structure, Transfer of Shares and Amalgamation of Insurers) Regulations, 2024.

IRDAI (cont)

- IRDAI (Expenses of Management, including Commission, of Insurers) Regulations, 2024.

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IRDAI (cont)

- Insurance Ombudsman Rules, 2017.

IRDAI (cont)

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IRDAI (cont)

- IRDAI established under the 1999 Act; headquarters Hyderabad.

IRDAI (cont)

- IRDAI regulates insurers and insurance intermediaries; PFRDA regulates pension funds.

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IRDAI (cont)

- Life insurance covers life-related risks; general insurance covers non-life risks.

IRDAI (cont)

- Reinsurance = insurance purchased by an insurer to transfer part of its risk to another insurer/reinsurer.

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IRDAI (cont)

- Solvency requirements protect policyholders by ensuring financial capacity to meet claims.

IRDAI (cont)

- Insurance Ombudsman is a grievance-resolution mechanism, not the insurance regulator itself.

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IFSCA

Meaning and Objectives

IFSCA (cont)

- Established under the International Financial Services Centres Authority Act, 2019.

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IFSCA (cont)

- Became operational on 27 April 2020.

IFSCA (cont)

- Headquarters: GIFT City, Gandhinagar, Gujarat.

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IFSCA (cont)

- Functions as a unified regulator for financial products, financial services and financial institutions operating in India's International Financial Services Centres (IFSCs).

IFSCA (cont)

- Objective: develop IFSCs as international financial hubs and provide a globally competitive regulatory environment.

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IFSCA (cont)

Jurisdiction

IFSCA (cont)

- Regulates financial activities conducted within India's IFSCs.

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IFSCA (cont)

- Its jurisdiction covers activities relating to:

IFSCA (cont)

- Banking and financial institutions.

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IFSCA (cont)

- Capital markets and securities.

IFSCA (cont)

- Insurance and reinsurance.

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IFSCA (cont)

- Fund management and investment funds.

IFSCA (cont)

- Financial products and financial services.

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IFSCA (cont)

- Aircraft and ship leasing.

IFSCA (cont)

- Bullion exchanges and related activities.

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IFSCA (cont)

- FinTech and other permitted financial activities.

IFSCA (cont)

Major Functions

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IFSCA (cont)

Unified Financial Regulation

IFSCA (cont)

- Exercises regulatory powers in an IFSC that are otherwise performed by RBI, SEBI, IRDAI and PFRDA in the domestic financial system.

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IFSCA (cont)

- Regulates financial institutions, intermediaries and service providers operating in IFSCs.

IFSCA (cont)

- Grants registrations, licences and authorisations under its regulatory framework.

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IFSCA (cont)

- Prescribes prudential, governance, disclosure and compliance requirements.

IFSCA (cont)

Financial Market Development

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IFSCA (cont)

- Develops international financial markets in India.

IFSCA (cont)

- Facilitates international banking, capital raising and investment activities.

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IFSCA (cont)

- Promotes cross-border financial services.

IFSCA (cont)

- Encourages participation by foreign and domestic financial institutions.

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IFSCA (cont)

Fund Management and Capital Markets

IFSCA (cont)

- Regulates fund management entities and investment funds in IFSCs.

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IFSCA (cont)

- Facilitates international securities trading and listing.

IFSCA (cont)

- Develops markets for foreign currency-denominated financial products.

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IFSCA (cont)

- Supports global capital mobilisation through IFSC platforms.

IFSCA (cont)

Banking and Insurance

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IFSCA (cont)

- Regulates banking units operating in IFSCs.

IFSCA (cont)

- Regulates insurance offices, intermediaries and reinsurance activities within its jurisdiction.

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IFSCA (cont)

- Facilitates international banking and insurance transactions.

IFSCA (cont)

Innovation and New Financial Activities

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IFSCA (cont)

- Promotes FinTech and financial innovation.

IFSCA (cont)

- Supports aircraft and ship leasing activities.

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IFSCA (cont)

- Develops bullion trading and other permitted international financial services.

IFSCA (cont)

- Encourages sustainable finance and international financial market connectivity.

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IFSCA (cont)

GIFT City and IFSC

IFSCA (cont)

- GIFT City: Gujarat International Finance Tec-City, located in Gandhinagar, Gujarat.

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IFSCA (cont)

- IFSC: A specially designated jurisdiction within India for international financial services.

IFSCA (cont)

- GIFT IFSC is India's first operational IFSC.

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IFSCA (cont)

- Transactions and services in an IFSC may be conducted in permitted foreign currencies, subject to applicable regulations.

IFSCA (cont)

- IFSC entities are located within India but operate under a specialised regulatory and financial framework.

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IFSCA (cont)

Important Regulatory Framework

IFSCA (cont)

- International Financial Services Centres Authority Act, 2019.

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IFSCA (cont)

- IFSCA (Banking) Regulations, 2020.

IFSCA (cont)

- IFSCA (Capital Market Intermediaries) Regulations, 2021.

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IFSCA (cont)

- IFSCA (Fund Management) Regulations, 2025.

IFSCA (cont)

- IFSCA (Insurance Business) Regulations, 2021, as amended.

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IFSCA (cont)

- IFSCA (Finance Company) Regulations, 2021.

IFSCA (cont)

Important MCQ Traps

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IFSCA (cont)

- IFSCA established in 2020 under the 2019 Act.

IFSCA (cont)

- Headquarters: GIFT City, Gandhinagar.

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IFSCA (cont)

- IFSCA is a unified regulator, not merely a coordinator among domestic regulators.

IFSCA (cont)

- RBI, SEBI, IRDAI and PFRDA continue to regulate their respective domestic sectors; IFSCA regulates relevant financial activities within IFSCs.

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IFSCA (cont)

- GIFT City is not itself the regulator; IFSCA is the regulator.

IFSCA (cont)

- IFSC is located in India but serves international financial markets.

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IFSCA (cont)

- IFSCA's jurisdiction is geographically and functionally specific; it does not replace SEBI or RBI across India.

Ministry of Finance (MoF), Government of India

Meaning and Objectives

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Ministry of Finance (MoF), Government of India (cont)

- The Ministry of Finance (MoF) is the principal ministry responsible for managing India's public finances and formulating economic and financial policies.

Ministry of Finance (MoF), Government of India (cont)

- It is a part of the Central Government, not an independent statutory financial regulator.

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Ministry of Finance (MoF), Government of India (cont)

- Headed by the Union Finance Minister.

Ministry of Finance (MoF), Government of India (cont)

- Main objectives:

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Ministry of Finance (MoF), Government of India (cont)

- Maintain fiscal stability and sound public finances.

Ministry of Finance (MoF), Government of India (cont)

- Mobilise government revenue and manage expenditure.

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Ministry of Finance (MoF), Government of India (cont)

- Formulate taxation and financial-sector policies.

Ministry of Finance (MoF), Government of India (cont)

- Promote economic growth, investment and financial inclusion.

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Ministry of Finance (MoF), Government of India (cont)

- Coordinate financial-sector institutions and reforms.

Ministry of Finance (MoF), Government of India (cont)

Major Departments

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Ministry of Finance (MoF), Government of India (cont)

1. Department of Economic Affairs (DEA)

Ministry of Finance (MoF), Government of India (cont)

- Formulates economic policies and manages macroeconomic issues.

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Ministry of Finance (MoF), Government of India (cont)

- Prepares the Union Budget.

Ministry of Finance (MoF), Government of India (cont)

- Deals with government borrowing and public debt management.

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Ministry of Finance (MoF), Government of India (cont)

- Handles foreign investment policy and external financial assistance.

Ministry of Finance (MoF), Government of India (cont)

- Deals with capital markets and policy matters relating to financial institutions.

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Ministry of Finance (MoF), Government of India (cont)

- Coordinates with international financial institutions such as the World Bank, International Monetary Fund (IMF) and Asian Development Bank (ADB).

Ministry of Finance (MoF), Government of India (cont)

2. Department of Financial Services (DFS)

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Ministry of Finance (MoF), Government of India (cont)

- Deals with policy matters concerning:

Ministry of Finance (MoF), Government of India (cont)

- Public-sector banks and banking reforms.

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Ministry of Finance (MoF), Government of India (cont)

- Financial institutions and financial inclusion.

Ministry of Finance (MoF), Government of India (cont)

- Insurance-sector policy.

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Ministry of Finance (MoF), Government of India (cont)

- Pension-sector policy.

Ministry of Finance (MoF), Government of India (cont)

- Oversees government initiatives relating to banking access, credit delivery and financial inclusion.

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Ministry of Finance (MoF), Government of India (cont)

- Coordinates with financial regulators and public-sector financial institutions.

Ministry of Finance (MoF), Government of India (cont)

3. Department of Revenue

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Ministry of Finance (MoF), Government of India (cont)

- Formulates and administers direct and indirect taxation policies.

Ministry of Finance (MoF), Government of India (cont)

- Oversees:

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Ministry of Finance (MoF), Government of India (cont)

- Central Board of Direct Taxes (CBDT).

Ministry of Finance (MoF), Government of India (cont)

- Central Board of Indirect Taxes and Customs (CBIC).

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Ministry of Finance (MoF), Government of India (cont)

- Deals with income tax, customs duties, Goods and Services Tax (GST) policy and other revenue matters.

Ministry of Finance (MoF), Government of India (cont)

- Administers tax laws and enforcement through the respective tax authorities.

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Ministry of Finance (MoF), Government of India (cont)

4. Department of Expenditure

Ministry of Finance (MoF), Government of India (cont)

- Deals with government expenditure management.

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Ministry of Finance (MoF), Government of India (cont)

- Prescribes financial rules and expenditure-control procedures.

Ministry of Finance (MoF), Government of India (cont)

- Monitors government spending and fiscal discipline.

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Ministry of Finance (MoF), Government of India (cont)

- Deals with public procurement policy and expenditure reforms.

Ministry of Finance (MoF), Government of India (cont)

- Oversees implementation of financial management systems.

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Ministry of Finance (MoF), Government of India (cont)

5. Department of Investment and Public Asset Management (DIPAM)

Ministry of Finance (MoF), Government of India (cont)

- Handles government investments in Central Public Sector Enterprises (CPSEs).

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Ministry of Finance (MoF), Government of India (cont)

- Deals with disinvestment and strategic disinvestment.

Ministry of Finance (MoF), Government of India (cont)

- Manages the government's equity investments and related asset monetisation.

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Ministry of Finance (MoF), Government of India (cont)

- Formulates policies concerning management of government investments.

Ministry of Finance (MoF), Government of India (cont)

6. Department of Public Enterprises (DPE)

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Ministry of Finance (MoF), Government of India (cont)

- Formulates policies concerning Central Public Sector Enterprises.

Ministry of Finance (MoF), Government of India (cont)

- Deals with performance evaluation, governance and management of CPSEs.

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Ministry of Finance (MoF), Government of India (cont)

- Issues guidelines relating to CPSE autonomy, remuneration and corporate governance.

Ministry of Finance (MoF), Government of India (cont)

- Promotes efficiency and accountability in public enterprises.

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Ministry of Finance (MoF), Government of India (cont)

Role in the Financial System

Ministry of Finance (MoF), Government of India (cont)

- Frames the Union Budget and fiscal policy.

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Ministry of Finance (MoF), Government of India (cont)

- Determines taxation policy and government borrowing requirements.

Ministry of Finance (MoF), Government of India (cont)

- Coordinates financial-sector reforms.

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Ministry of Finance (MoF), Government of India (cont)

- Promotes financial inclusion through schemes such as:

Ministry of Finance (MoF), Government of India (cont)

- Pradhan Mantri Jan Dhan Yojana (PMJDY).

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Ministry of Finance (MoF), Government of India (cont)

- Pradhan Mantri Mudra Yojana (PMMY).

Ministry of Finance (MoF), Government of India (cont)

- Stand-Up India.

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Ministry of Finance (MoF), Government of India (cont)

- Atal Pension Yojana (APY), in coordination with PFRDA.

Ministry of Finance (MoF), Government of India (cont)

- Plays an important role in recapitalisation and policy support for public-sector banks.

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Ministry of Finance (MoF), Government of India (cont)

- Coordinates with RBI, SEBI, PFRDA, IRDAI and IFSCA on financial-sector matters.

Ministry of Finance (MoF), Government of India (cont)

Important Distinction: Ministry of Finance vs Financial Regulators

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Ministry of Finance (MoF), Government of India (cont)

- Ministry of Finance: Formulates government policies, administers public finances and oversees departments and institutions under its administrative framework.

Ministry of Finance (MoF), Government of India (cont)

- RBI: Statutory central bank; monetary policy, banking regulation and currency management.

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Ministry of Finance (MoF), Government of India (cont)

- SEBI: Statutory securities-market regulator.

Ministry of Finance (MoF), Government of India (cont)

- PFRDA: Statutory pension-sector regulator.

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Ministry of Finance (MoF), Government of India (cont)

- IRDAI: Statutory insurance-sector regulator.

Ministry of Finance (MoF), Government of India (cont)

- IFSCA: Unified statutory regulator for financial activities in IFSCs.

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Ministry of Finance (MoF), Government of India (cont)

- Financial regulators exercise statutory powers and are not merely departments of the Ministry of Finance.

Ministry of Finance (MoF), Government of India (cont)

Important MCQ Traps

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Ministry of Finance (MoF), Government of India (cont)

- Ministry of Finance is a government ministry, not a statutory financial regulator.

Ministry of Finance (MoF), Government of India (cont)

- DEA prepares the Union Budget and deals with economic policy and public debt.

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Ministry of Finance (MoF), Government of India (cont)

- DFS handles policy matters concerning banking, insurance and financial services.

Ministry of Finance (MoF), Government of India (cont)

- CBDT deals with direct taxes; CBIC deals with indirect taxes and customs.

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Ministry of Finance (MoF), Government of India (cont)

- DIPAM handles disinvestment and government investments in CPSEs.

Ministry of Finance (MoF), Government of India (cont)

- DPE deals with policy and governance matters relating to CPSEs.

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Ministry of Finance (MoF), Government of India (cont)

- RBI's monetary policy functions are distinct from the Ministry of Finance's fiscal policy functions.

Ministry of Finance (MoF), Government of India (cont)

- Fiscal policy = government taxation, expenditure and borrowing.

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Ministry of Finance (MoF), Government of India (cont)

- Monetary policy = management of money, liquidity and interest rates, primarily by RBI.

Coordination Between Financial Regulators

Need for Coordination

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Coordination Between Financial Regulators (cont)

- India's financial system is regulated by multiple specialised regulators.

Coordination Between Financial Regulators (cont)

- Financial products and institutions often operate across sectors, creating overlapping regulatory responsibilities.

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Coordination Between Financial Regulators (cont)

- Coordination ensures financial stability, prevents regulatory gaps and reduces regulatory arbitrage.

Coordination Between Financial Regulators (cont)

- Promotes consistent regulations, investor protection and orderly development of financial markets.

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Coordination Between Financial Regulators (cont)

Financial Stability and Development Council (FSDC)

Coordination Between Financial Regulators (cont)

- Established in December 2010 as a non-statutory apex coordination body.

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Coordination Between Financial Regulators (cont)

- Chaired by the Union Finance Minister.

Coordination Between Financial Regulators (cont)

- Members include heads of major financial regulators and relevant government departments.

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Coordination Between Financial Regulators (cont)

- Key functions:

Coordination Between Financial Regulators (cont)

- Strengthen financial stability and maintain financial-sector resilience.

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Coordination Between Financial Regulators (cont)

- Coordinate inter-regulatory issues.

Coordination Between Financial Regulators (cont)

- Promote financial-sector development and financial inclusion.

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Coordination Between Financial Regulators (cont)

- Improve coordination in financial literacy and consumer protection.

Coordination Between Financial Regulators (cont)

- Address systemic risks and interconnections across financial institutions.

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Coordination Between Financial Regulators (cont)

- FSDC does not replace or supersede the statutory powers of individual regulators.

Coordination Between Financial Regulators (cont)

FSDC Sub-Committee

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Coordination Between Financial Regulators (cont)

- Chaired by the RBI Governor.

Coordination Between Financial Regulators (cont)

- Focuses on operational coordination among financial-sector regulators.

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Coordination Between Financial Regulators (cont)

- Examines financial stability, systemic risks and inter-regulatory issues.

Coordination Between Financial Regulators (cont)

- Supports implementation of decisions and recommendations arising from FSDC discussions.

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Coordination Between Financial Regulators (cont)

Major Areas of Regulatory Overlap

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Coordination Between Financial Regulators (cont)

1. Banking and Securities Markets

Coordination Between Financial Regulators (cont)

- RBI regulates banks and their banking activities.

Coordination Between Financial Regulators (cont)

- SEBI regulates securities-market activities, including trading, listing and investment products.

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Coordination Between Financial Regulators (cont)

- Example: Banks participating in securities markets must comply with RBI requirements for banking activities and SEBI requirements applicable to their securities-market activities.

Coordination Between Financial Regulators (cont)

2. Insurance and Pension Products

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Coordination Between Financial Regulators (cont)

- IRDAI regulates insurance products and insurers.

Coordination Between Financial Regulators (cont)

- PFRDA regulates pension schemes and pension funds under its jurisdiction.

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Coordination Between Financial Regulators (cont)

- Certain retirement products may combine insurance and pension characteristics, requiring coordination and clear regulatory classification.

Coordination Between Financial Regulators (cont)

3. Mutual Funds and Pension Investments

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Coordination Between Financial Regulators (cont)

- SEBI regulates mutual funds and their asset management activities.

Coordination Between Financial Regulators (cont)

- PFRDA regulates pension funds and NPS investments.

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Coordination Between Financial Regulators (cont)

- Both oversee investment-related activities, but under separate statutory frameworks.

Coordination Between Financial Regulators (cont)

4. NBFCs and Financial Conglomerates

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Coordination Between Financial Regulators (cont)

- RBI regulates NBFCs and their financial activities.

Coordination Between Financial Regulators (cont)

- SEBI regulates their securities-market activities and listed securities.

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Coordination Between Financial Regulators (cont)

- IRDAI and PFRDA regulate insurance and pension activities respectively.

Coordination Between Financial Regulators (cont)

- Large financial groups may therefore fall under multiple regulators.

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Coordination Between Financial Regulators (cont)

5. International Financial Services Centres

Coordination Between Financial Regulators (cont)

- IFSCA regulates relevant financial activities within IFSCs.

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Coordination Between Financial Regulators (cont)

- It exercises regulatory powers that otherwise fall under RBI, SEBI, IRDAI and PFRDA in the domestic financial system.

Coordination Between Financial Regulators (cont)

- Coordination may be necessary for cross-border activities and entities operating both within and outside IFSCs.

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Coordination Between Financial Regulators (cont)

6. Government and Regulatory Coordination

Coordination Between Financial Regulators (cont)

- Ministry of Finance coordinates financial-sector policy and legislative initiatives.

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Coordination Between Financial Regulators (cont)

- Individual regulators exercise their statutory regulatory and supervisory powers.

Coordination Between Financial Regulators (cont)

- RBI and the Ministry of Finance coordinate on monetary, fiscal and public-debt-related matters while retaining distinct responsibilities.

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Coordination Between Financial Regulators (cont)

Regulatory Arbitrage

Coordination Between Financial Regulators (cont)

- Meaning: Taking advantage of differences or gaps in regulations applicable to similar financial activities or products.

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Coordination Between Financial Regulators (cont)

- Can result in entities choosing a less restrictive regulatory route.

Coordination Between Financial Regulators (cont)

- Inter-regulatory coordination and harmonisation help minimise regulatory arbitrage.

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Coordination Between Financial Regulators (cont)

Important MCQ Traps

Coordination Between Financial Regulators (cont)

- FSDC is chaired by the Union Finance Minister.

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Coordination Between Financial Regulators (cont)

- FSDC Sub-Committee is chaired by the RBI Governor.

Coordination Between Financial Regulators (cont)

- FSDC is a non-statutory coordination body, not a super-regulator.

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Coordination Between Financial Regulators (cont)

- Financial regulators retain their statutory autonomy and jurisdiction.

Coordination Between Financial Regulators (cont)

- Ministry of Finance handles government policy coordination; regulators enforce their respective regulatory frameworks.

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Coordination Between Financial Regulators (cont)

- IFSCA is a unified regulator within IFSCs, not a replacement for domestic regulators throughout India.

Coordination Between Financial Regulators (cont)

- Regulatory overlap does not necessarily mean duplication: different regulators may supervise different activities of the same institution.

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