

### CBSE Test Paper -04 (Chapter- 10 Financial Markets)

1. At present only two depositories are registered with SEBI \_\_\_\_\_. (1)
  - a. NSDL and HDFC
  - b. NEFT and TDS
  - c. NSDL and ABSL
  - d. NSDL and CDSL
2. The National Stock Exchange of India was recognized stock exchange in the year: (1)
  - a. 1992
  - b. 1993
  - c. 1995
  - d. 1994
3. Instruments with a maturity period of less than one year are traded in \_\_\_\_\_. (1)
  - a. Capital Market
  - b. Money market
  - c. NSEI
  - d. Stock Exchange
4. A Treasury Bill is basically: (1)
  - a. An instrument to borrow short-term funds
  - b. An instrument of capital market
  - c. An instrument to borrow long-term funds
  - d. None of the above
5. State the essential function of primary market. (1)
6. Give the meaning of Secondary Market. (1)
7. **Money market is essentially a market for short-term funds.** In the light of this statement, state any three features of money market. (1)
8. State the essential function of 'Primary Market'. (1)
9. Pawan has 200 shares of Airtel Industries. Airtel comes out with a fresh issue of shares and Pawan received an offer to buy 1 more share of Airtel for every two shares held by him. Discuss the type of issue described. (3)
10. Ragunath Ahuja is one of the Promoter-Director of Vishwas Ltd. The company is engaged in the real estate sector, which has recently witnessed a steady fall in its revenue and the value of its assets due to a downward trend persisting in the market

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in specific and the economy in general. The periodical financial results of the company were to be declared in a fortnight time. Ragunath Ahuja, being an insider, had access to unpublished price sensitive information related to it. Consequently, he sells a major portion of his holdings in an anticipation of a fall in the market price of the shares of the Company subsequent to the announcement of periodical financial results of the company. Moreover, he doesn't inform The Securities and Exchange Commission (SEC) about the dealings.

On conducting a probe, Securities and Exchange Board Of India (SEBI) finds Ragunath Ahuja guilty of insider trading. As per law, company directors, officials or any individual with a stake of 10% or more in the company are considered to be insiders and they are required to report their insider transactions within two business days of the date the transaction occurred.

In the context of the above case:

- a. State the purpose of setting up SEBI.
- b. Identify the type of function performed by SEBI by quoting lines from the paragraph. **(3)**

11. State any two objectives of the NSE. **(4)**

12. Explain the working of a demat system? **(4)**

13. Madhav's is one of the India's most trusted brands in Indian sweets and snacks segment. The company has manufacturing plants in Kota, Kanpur, New Delhi, and Mumbai. Madhav's has its own retail chain stores and a range of restaurants in these cities. Now, the company plans to extend its business in 12 more cities in India. In order to raise the funds, its directors have decided to float a public issue through the prospectus. Besides, it intends to raise money to meet the floatation costs in terms of brokerage, underwriting commission, advertising etc.

In the context of the above case:

- a. What is the other name used for the funds required to meet floatation costs?
- b. Describe briefly the short term instrument popularly used by the companies to raise for the funds required to meet floatation costs. Who can issue them?
- c. Distinguish between the two types of financial markets that the company intends to approach to meet its financial needs. **(5)**

14. Explain the steps in the trading and settlement procedure? **(6)**

15. Explain the objectives and functions of SEBI. **(6)**

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**Answer**

1. d. NSDL and CDSL

**Explanation:**

One is the National Securities Depository Limited (NSDL) and the other is the Central Depository Service (India) Limited (CDSL). Every Depository Participant (DP) needs to be registered under this Depository before it begins its operation or trade in the market.

2. a. 1992

**Explanation:**

The National Stock Exchange of India was promoted by leading Financial institutions at the behest of the Government of India, and was incorporated in November 1992 as a tax-paying company. In April 1993, it was recognized as a stock exchange under the Securities Contracts (Regulation) Act, 1956.

3. b. Money market

**Explanation:**

As money became a commodity, the money market became a component of the financial markets for assets involved in short-term borrowing, lending, buying and selling with original maturities of one year or less.

4. a. An instrument to borrow short-term funds

**Explanation:**

A Treasury bill (T-Bill) is a short-term debt obligation backed by the Treasury Dept.

5. The key function of the primary market is to facilitate capital growth by enabling individuals to convert savings into investments. It facilitates companies to issue new stocks to raise money directly from households for business expansion or to meet financial obligations.
6. Secondary market refers to that market in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold.
7. A market can be described as a money market if it is comprised of highly liquid, short-

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term assets. The three features of money market are described below:

- a. It is a market for short term funds whose maturity period is upto one year.
  - b. The main participants are institutional investors.
  - c. Since the cost of securities may be high, investment in the money market requires huge capital outlay.
8. The money market is where financial instruments with high liquidity and very short maturities are traded. The main function of primary market is to facilitate the transfer of investible funds from the savers to entrepreneurs seeking to establish new enterprises.
9. Rights Offering (Issue): A rights offering (issue) is an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period.
10. a. The Securities and Exchange Board of India was officially appointed as the authority for regulating the financial markets in India on 12<sup>th</sup> April 1988. It was initially established as a non-statutory body, i.e. it had no control over anything but later in 1992, it was declared an autonomous body with statutory powers. SEBI has to be responsive to the needs of three groups, which constitute the market namely:
- i. The issuers of securities so as to provide them a platform for raising capital in an easy, effective and efficient manner.
  - ii. The investors so as to protect their interests in securities by keeping them abreast about the developments through true and appropriate information.
  - iii. The market intermediaries in order to provide them a framework so as to enable them to perform their functions effectively and efficiently.
- b. Regulatory function is being performed by SEBI: "On conducting a probe Securities and Exchange Board of India (SEBI) finds Ragimath Ahuja guilty of insider trading."
11. The two objectives of NSE are as under:
- i. To establish an appropriate communication network and to ensure that all investors get equal access across the country.
  - ii. National Stock Exchange provides and establish a nationwide trading facility for

all types of securities.

12. The working of a demat system is as below: When you buy shares, the broker credits your demat account with the shares and these are reflected in your statement of holdings. If you are trading through an internet based platform, you can view your holdings online. Typically the broker credits the shares on T+2, that is trading day + 2 days after that. When you sell the shares, you need to give your broker a delivery instruction note, where in you fill the various details of the stock sold. Your account is debited with the shares and you are then paid the money for the shares sold. If you are trading through the internet, the account will automatically reflect a debit of the shares and amount credit to your account. There are two Depositories in India – the National Securities Depositories Limited (NSDL) and the Central Depository Services Limited (CDSL), through whom the shares are held by the various depository participants.
13. a. Flotation costs are incurred by a publicly traded company when it issues new securities, and includes expenses such as underwriting fees, legal fees and registration fees. Companies must consider the impact these fees will have on how much capital they can raise from a new issue. Flotation costs, expected return on equity, dividend payments and the percentage of earnings the business expects to retain are all part of the equation to calculate a company's cost of new equity. Bridge financing is the other name used for the funds required to meet floatation costs.
- b. Commercial paper is an unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts payable and inventories and meeting short-term liabilities. Maturities on commercial paper rarely range longer than 270 days. Commercial Papers issued by large and credit worthy companies. The instrument is in the form of an unsecured promissory note and is freely transferable by endorsement. It is sold at discount and redeemed at par. Its maturity period may range from a fortnight to a year. It is also used to meet the short term seasonal and working capital requirem
- c. Capital Market and Money Market.
- d. Differences between Primary Market and Secondary Market.

| S. No | Basis | Capital Market | Money Market |
|-------|-------|----------------|--------------|
|       |       |                |              |

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|----|-------------------|--|--|
| 1. | Duration          | It is a market for long term   | It is a market short term funds whose maturity period is up to one year.   |
| 2. | Participants      | The main participants in the capital market are banks, financial institutions, corporate bodies, foreign investors and retail investors. | The main participants are institutional investors.   |
| 3. | Investment outlay | Since the cost of securities may be low, investment can be made in the capital market can be with less capital.                          | Since the cost of securities may be high, investment in the money market requires huge capital outlay.                             |
| 4. | Liquidity         | The securities in the capital market enjoy good liquidity.   | The securities in the money market enjoy high liquidity as The Discount Finance house of India works as a compulsory market maker. |
| 5. | Risk and return   | The instruments in the capital market carry high risk as the expected return is high on them.  | The instruments in the money market carry low risk as the expected return is low on them.  |

14. **Trading procedure : Selection of a Broker:** The first step is to select a broker, who will buy/sell securities on behalf of the speculator/investor. This is necessary because trading of securities can only be done through SEBI registered brokers, who are members of the stock exchange. Brokers may be individuals, partnership firms and corporate bodies.

**Opening Demat Account with Depository:** The next step is to open a demat account. Demat (Dematerialised) account refers to an account which an Indian citizen must open with the depository participant (banks and stockbrokers) to trade in listed securities in "electronic form. The securities are held in the electronic form by a depository. 'Depository' is an institution/organization which holds securities (e.g. shares, debentures, bonds, mutual funds, etc) in electronic form, in which trading is

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done.

**Placing the Order:** The next step is to place the order with the broker. The order can be communicated to the broker either personally or through telephone, cell phone, e-mail, etc.

The instructions should specify the securities to be bought or sold and the price range within which the order is to be executed. Only the securities of listed companies can be traded on the stock exchange.

**Executing the Order:** According to the instructions of the investor, the broker buys or sells securities. The broker then issues a contract note. A copy of the contract note contains the name and the price of securities, names of the parties, brokerage charges, etc. It is duly signed by the broker.

**Settlement:** This is the last stage in the trading of securities done by the brokers on behalf of their clients. The mode of settlement depends upon the nature of the contract. Equity spot markets follow a T + 2 rolling settlement. This means that any trade taking place on Monday gets settled by Wednesday. Stock exchange operates from Monday to Friday between 9:55 am and 3:30 pm. Each exchange has its own clearing house, which assumes all settlement risk.

#### 15. Objectives of SEBI:

- i. To regulate the stock exchanges and securities industry to promote their orderly functioning.
- ii. To educate the investors and to protect their rights and interests.
- iii. To prevent fraudulent and malpractices by having balance between self regulation of business and its statutory regulations.
- iv. To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

#### Functions of SEBI:

##### 1. Protective Functions:

- i. To protect the capital market from manipulations, price rigging and misleading statements.
- ii. To control the insider trading and to impose penalties for such practices.
- iii. To protect the investors.
- iv. To promote fair and healthy practices and to maintain the code of conduct.

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## **2. Regulatory Functions:**

- i. To Register the brokers, sub-brokers and other players in the market.
- ii. To Register the Mutual funds and other investment schemes.
- iii. To Regulate the :
  - Stock brokers
  - Underwriters
  - Merchant bankers
  - Portfolio exchanges
  - Takeover bids by companies
- iv. To conduct the audit of stock exchanges and intermediaries.
- v. To charge fee and other charges.
- vi. To perform and exercise the power given by the Government of India under Securities Contracts (Regulation) Act 1956.

## **3. Development Functions**

- i. To provide the training to the intermediaries.
- ii. To conduct the research.
- iii. To Publish the useful information.
- iv. To develop the capital market by adapting a flexible approach.