Short Questions and Answers

Q1) What are Corporate Actions?
A1) It is a collective term used to describe the entitlements of a security holder.

Q2) What is Naked Dividend?
A2) When a dividend is declared from the profits of past years then such dividend is called as Naked Dividend.

Q3) What do you mean by Consolidation?
A3) When the face value of a security (usually shares) is increased in order to increase its market price, then such an action is called as Consolidation. It also refers to a corporate action whereby a company reorganizes its business in such a way that it keeps its core strengths and sells of unproductive businesses.

Q4) What is CUSIP?
A4) It is a security identifier which is used for securities issued and traded in US and Canada. CUSIP itself stands for Committee on Uniform Securities Identification Procedures.

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Q5) What is SEDOL?
A5) It is a security identifier which is used for securities issued and traded in UK and Ireland. SEDOL stands for Stock Exchange Daily Official List.

Q6) What is ISIN?
A6) It is a security identifier which is used all over the world. ISIN stands for International Securities Identification Number.

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Q7) What are Convertible Debentures?
A7) They are debentures which can be converted into ordinary (common) equity shares at a particular point of time in future at a predetermined conversion price given by the issuer.

Q8) What are redeemable preference shares?
A8) They are preference shares which can be redeemed into cash in future.

Q9) What are Share Warrants?
A9) They are financial instruments which are generally attached to a debenture issues. They allow its holder to convert them into the underlying shares (ordinary or preference shares) at a particular time in future at a predetermined conversion price fixed by the issuer. If the market price of the shares (ordinary or preference) at the time of conversion is more than the conversion price then the holder will convert, or else they would be worthless to the holder.

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Q10) What is Stock Borrowing?
A10) It is a mechanism through which one party (called the Borrower) borrows stock from another party (called the Lender) for a particular period of time for an agreed interest rate. Both the parties enter into an official agreement for such a transaction, which is called as Stock Lending and Borrowing Agreement. The transfer of stock happens by way of title transfer. The stock is returned by the borrower to the lender at the end of the borrowing period. Any benefits arising out of corporate actions during the borrowing period is transferred by the borrower to the lender.

Q11) What is Maintenance Margin?
A11) It is a level set by the exchange or the broker below which the balance in the margin account should not fall. If the balance in the margin account breaches this level then the party should replenish the margin account to the level of the initial margin.

Q12) What is Initial Margin?
A12) It is the margin that is paid by the parties to a contract to their respective brokers at the time of entering into a derivatives contract. The amount of margin is determined by the exchange and is the same for both the parties. This margin can either be given in cash or securities.

Q13) What is Variable Margin?
A13) It is the margin that is paid when the margin account depletes below the maintenance margin level. The amount of this margin is equal to the difference between the Initial margin and the balance in the margin account after it has fallen below the maintenance margin level.

Q14) What is Mark-to-Market?
A14) It is a method in which the derivatives contract is valued everyday at its closing price, and the daily losses are collected from the losing party and paid to the winning party. This procedure is followed till the expiry or termination of the contract. The purpose of this method is to minimize the counterparty credit risk to a single day's loss.

Q15) What is Reconciliation?
A15) It is a method in which data (transactions) from two sets of books maintained by two different parties are compared for the purpose of matching the key items. If all the key items are matched then it means that both the parties have recorded the transactions in a similar way. If the key items do not match then that means either of the parties have not recorded the transactions properly and hence investigation of the transactions is required.

Q16) What is Trade Guarantee?
A16) It is a guarantee of performance of contract provided by the Stock Exchange to the parties to a transaction, provided the parties honour their obligations. In other words, it is a guarantee provided by the stock exchange to every buyer that if he pays the money then he will get his securities, irrespective of whether the seller fulfills his obligations or not. Similarly, it is a guarantee provided by the stock exchange to every seller that if he delivers his securities then he will get his money. This guarantee is provided by the exchange in two ways - first, by becoming the counterparty to both the parties, and second, by imposing strict margin requirements on the brokers.

Q17) What is Novation?
A17) It refers to a process through which one party to a contract, with the permission of the other party, gives away his rights and obligations under the contract to a third party. The third party, by way of assuming the rights and obligations, becomes a party to the contract. The party who has given away his rights and obligations under the contract is called as "Outgoing party". The third party who assumed the rights and obligations is called as "Incoming party".

Q18) What is a Derivative?
A18) It is a financial instrument whose value is derived from that of an underlying asset. The primary purpose of derivatives is risk management.

Q19) What is Trade Affirmation?
A19) It is a process in which one party sends the details of a trade to another party for the purpose of receiving consent or approval. The consent or approval is sought in order to process the trade further. Trade Affirmation is one of the methods of Trade Confirmation. Without the affirmation or confirmation, there is no legality to the trade. Usually, this process is used in trades where one party is a broker or dealer while the other party is an Institutional Client, such as an Investment Manager.

Q20) What is Trade Matching?
A20) In dealer-to-dealer trades, both the parties (dealers) will send the details of the trade to each other and try to match the records of their trades with the records received from the opposite party. This process of matching the own records of a dealer with that of the records of the opposite (counter) party is called as "Trade Matching". The purpose of trade matching is Trade Confirmation. If the records are not matched

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then the trades cannot be processed further. Once the trades are matched, the trades become legally enforceable.

Q21) What is Trade Booking?
A21) It is the task of recording the essential details of a trade in the official records of the company. Trade Booking should be done as soon as possible after Trade Execution. Usually, this process is automated through STP (Straight Through Processing).

Q22) What is a Security Identifier?
A22) It is a unique identification given to a security for the purpose of distinguishing it from other securities. The unique identification helps in avoiding confusion when two or more securities have similar names. It also helps in faster identification and processing of trades.

Q23) What is Static Data?
A23) It refers to the data that is more or less permanent in nature and does not change with every trade. Usually, the data relating to bank account details, depository details, counterparty address, the authorised signatory and other such non-trade related details are referred to as Static Data.

Q24) What is Trade Data?
A24) It refers to the essential data pertaining to a trade such as Security, Quantity, Price, Counterparty reference, Market, Currency, etc. These details change from trade and trade and are trade specific.

Q25) What is a Financial Asset?
A25) A financial asset is a asset whose value depends on the contractual relationship between the parties. Unlike a physical asset, there is no intrinsic value of the asset. There exists only value due to the terms and conditions of the contract. The examples of such assets are Shares, Debentures, Bank Deposits, etc.

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Q26) What is a Stock Exchange?
A26) It is an organised market place where buying and selling of securities takes place between various participants.

Q27) Who are Venture Capitalists?
A27) Venture Capitalists are companies or an association of persons who invest their money in new business ideas or in unlisted privately held companies which have a potential to flourish into successful businesses. Usually, the venture capital firms take a substantial (generally, controlling) stake in the businesses they invest into. They also take up directorship positions, particularly financial decision making control, in order to ensure the safety and prudent utilization of their investments. The investment they do is generally into equity capital of the company.

Q28) Who is a Investment Banker?
A28) A Investment Banker is a consultant and a broker who, for a fee, provides specialized services to companies such as raising capital from the public or private placement of securities, helping in mergers and acquisitions, raising syndicate loans, trading, research and consulting services, and any other services that might be required by companies from time to time.

Q29) What are Junk Bonds?
A29) They are bonds which are issued by companies that have a very poor credit rating. There is a high probability of default in such bonds. Due to the high risk involved in the bonds, they carry high interest rates. Investors who wish to take the risk may purchase these bonds with the expectation that the default will not occur and that they will get a substantially higher return compared to other bonds where the probability of default is lower.

Q30) What is EPS?
A30) It means Earnings per Share. It is ratio of the Net Profit to the Number of outstanding shares. The net profit here denotes the profit after interest, depreciation and taxes. In other words, it is that profit which

can be distributed to ordinary shareholders. It is a good indicator of the profitability of any company. It can be used to compare the profitability of a company over a period of time, and it can also be used to compare the profitability of the company with that of its peer groups. The period of earnings is usually an year but it can even be half-yearly or quarterly, depending upon the need and the availability of information.

Q31) What is PE Ratio?

A31) PE (Price Earnings) Ratio is a ratio of the Market price of a security to that of its Earnings. It is generally used in comparison with peer groups for making investment decisions. If the PE of a security is too high then it denotes that the security is expensive to buy. Similarly, if the PE of a security is too low then it denotes that it is cheaper to buy. However, it is quite possible that the PE is higher because the market expects a significant increase in earnings in future. Similarly, if the PE is too low then it is possible that the market expects a significant reduction in earnings in future.

Q32) What is Dividend?

A32) It means distribution of profits in cash by a company to its shareholders. A company can give dividend only if it has profits. The profits need not be from the current year; past profits (accumulated profits) can also be used in giving dividends. There should be sufficient cash to give dividends. The dividend can be declared as a percentage of the face value or as amount per share. The dividend can be paid either at the end of the year and/or at any time during the year.

Q33) What is Margin?

A33) It is a deposit paid by parties to a contract to their brokers at the time of taking position in the market. It is not an advance and hence it cannot be adjusted to the contract value. It is fixed by the exchange on which the contract is traded. In case of OTC contracts, the margin is determined by both the parties.

Q34) What is Netting provision in OTC Derivatives?

A34) It is a provision agreed by the parties to a OTC derivatives contract whereby in the event of bankruptcy of one of the parties, the other party can net the outstanding payables between them under the contract and remit or receive the same. This provision helps the solvent party in reducing or eliminating its payables or receivables to the other party in the event of bankruptcy. It may also help the solvent party to avoid being a part of the liquidation proceedings of the insolvent party.

Q35) What is Rights Issue?

A35) It is a right given by the company to its existing shareholders to subscribe to new shares of the company. The existing shareholders can either subscribe to the rights, renounce the rights, or sell the rights in the open market. Usually, the rights issue is a cheaper form of financing the company's needs compared to an IPO or FPO. Hence, the rights issue is priced lesser than the current market price. The right to subscribe to new shares of the company are issued as a ratio to the existing shares held by the shareholders. For example, a 3-for-5 rights issue means that a shareholder having 5 shares will get the right to subscribe to 3 additional shares in the company.

Q36) What is the purpose of margin?

A36) The purpose of margin is to mitigate counterparty credit risk.

Q37) What is the main function of a Depository?

A37) There are three main functions of a depository namely, 1) Safekeeping of securities, 2) Transfer of securities between parties upon instructions, and 3) Asset Servicing.

Q38) What is Clearing?

A38) It is a process of calculating the obligations of the participants for settlement. It usually involves applying netting to both securities and cash position among all the participants involved in clearing.

Q39) What is Settlement?

A39) It is a process of transferring securities from the seller to the buyer, and cash from the buyer to the seller. In a bilateral OTC transaction, this is done between the parties. In a cleared OTC transaction, this is done through a Central Clearing Counterparty. In an exchange, this is done by the Clearing Corporation through the involvement of Clearing Brokers.

Q40) What is DvP?

A40) It means Delivery versus Payment. It refers to a process in which the brokers will have to first deliver the securities and cash to the clearing corporation as determined by the Pay-In obligations under the clearing process and only then will the clearing corporation will pay the securities and cash to the brokers as per the Pay-Out obligations under the clearing process.

Q41) What are Breaks in Reconciliation?

A41) During a reconciliation process, it is possible that some transactions do not match; such transactions are referred to as Break Items or simply Breaks. These items will have to be investigated and reconciled again.

Q42) What does Position mean?

A42) It means exposure to market risk. Whenever a person buys a contract in the expectation that the price will rise in future, he is said to have taken a "Long Position". When the person sells a contract in the expectation that the price will fall in future, he is said to have taken a "Short Position". Both the positions expose the person to market risk. If a person takes a Long Position in a particular security and subsequently takes a Short Position in that security, then the position is said to be "Square", which means that he has no further exposure to market risk. It is very important to keep track of positions in various securities as it represents the risk that the individual or firm is taking.

Q43) What is Gap?

A43) It refers to Liquidity risk. Whenever a position is taken in the market, a Gap arises. When a Long position is taken, there is a need to pay money at the time of settlement. The firm has to track these flows of money (receivables and payables) on various settlement dates in order to ensure successful settlement and management of cash.

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Q44) What is Premium in an Option?

A44) It is the amount paid by the buyer of the option to its seller at the time of entering into an options contract. It is also referred to as the Price of the Option.

Q45) What is an SRO?

A45) It means Self Regulating Organisations. It refers to organisations or trade bodies which have the power to make rules and regulations governing its members. The rules and regulations laid down by it are enforceable on all its members. The power of such organisations to make rules and regulations are recognised by law.

Q46) What are Treasury Bills?

A46) They are short term instruments issued by the Government. They represent short term borrowings. They are usually issued at a discount to the face value and redeemed at the face value.

Q47) What are Treasury Bonds?

A47) They are long term instruments issued by the Government. They represent long term borrowings. The interest on these instruments are usually paid semi-annually.

Q48) What is Commercial Paper?

A48) It is a short term unsecured instrument issued by the Corporates.

Q49) What is Trade Enrichment?

A49) It is a process of adding Static Data to Trade Data for processing a Trade for clearing and settlement.

Q50) What is PvP?

A50) It refers to Payment versus Payment. It is used in foreign exchange settlement.