

NISM-Series-III-A — Securities Intermediaries Compliance (Non-Fund)

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CH-1

Introduction to the Financial System

Topic 1 — Meaning and Functions of the Financial System

A **financial system** is the network of institutions, markets, instruments, services and rules that moves money from savers to users.

- **Savers** — Households are the main surplus sector; they save part of their income.
- **Users** — Companies and government are deficit sectors; they need funds for investment and spending.
- **Link** — The system pools small savings and channels them to productive uses.
- **Outcome** — Better allocation of capital raises investment, output and employment.

Functions

Function	What it means
Mobilisation of savings	Pools small, idle savings into large sums for investment
Allocation of capital	Prices risk and return so funds go to the most productive users
Liquidity	Lets investors convert assets into cash quickly at a fair price
Risk transfer	Spreads risk through diversification, insurance and derivatives
Payments and settlement	Provides safe channels to pay for goods, services and securities
Price discovery	Markets reveal the fair price of securities through supply and demand
Information	Disclosures and ratings reduce information gaps between issuers and investors
Governance	Markets and lenders monitor managements and discipline poor performers

Remember this

- A sound financial system performs three core jobs: it **mobilises savings, allocates capital and manages risk.**

Topic 2 — Components of the Financial System

Component	Meaning	Indian examples
Financial institutions	Entities that accept, lend or invest funds	Banks, NBFCs, insurers, mutual funds, pension funds
Financial markets	Places or systems where financial assets are traded	Money, equity, debt, derivatives, commodity and currency markets
Financial instruments	Claims on future cash flows	Shares, bonds, T-bills, units, futures, options
Financial services	Specialised services that support transactions	Broking, depository, merchant banking, rating, custody
Regulators	Bodies that frame rules and supervise	SEBI, RBI, IRDAI, PFRDA, IFSCA

- **Organised sector** — Regulated institutions and markets that follow disclosure and conduct rules.
- **Unorganised sector** — Moneylenders, indigenous bankers and chit operators outside full regulation.
- **Formal shift** — Financial inclusion and digital payments have moved many users to the organised sector.
- **Direct finance** — Savers buy securities issued by users, for example shares bought in an IPO.

- **Indirect finance** — Savers deposit with an intermediary, such as a bank, which then lends.
- **Securities market role** — The securities market is the main channel of direct finance.

Topic 3 — Money Market

The **money market** deals in short-term funds and instruments with an original maturity of **up to one year**.

- **Regulator** — RBI regulates the money market and its instruments.
- **Purpose** — It meets short-term liquidity needs of banks, companies and government.
- **Policy link** — RBI's policy rate signals pass through the money market first.

Instrument	Tenor	Issuer / feature
Call money	Overnight	Unsecured inter-bank borrowing and lending
Notice money	2 to 14 days	Unsecured; borrowed with notice
Term money	15 days to 1 year	Unsecured inter-bank term funds
Treasury bills	91, 182 and 364 days	Central Government; issued at a discount
Commercial paper	7 days to 1 year	Companies, NBFCs and AIFIs; unsecured
Certificate of deposit	7 days to 1 year (banks)	Banks; AIFIs may issue for 1 to 3 years
Repo and TREPS	Mostly overnight	Collateralised borrowing against government securities

Remember this

- Money market = maturity **up to 1 year**. T-bills: 91, 182, 364 days. Call: overnight; notice: 2–14 days; term: 15 days–1 year.

Topic 4 — Capital Market: Primary and Secondary

The **capital market** deals in long-term funds through equity and debt securities with maturity above one year.

Primary market (new issue market)

- **Meaning** — Securities are issued for the first time and money flows to the issuer.
- **Routes** — IPO, follow-on public offer, rights issue, private placement, QIP and preferential issue.
- **Offer for sale** — Existing holders sell shares; the money goes to them, not to the company.
- **Process** — Applications are made through **ASBA**; individuals may block funds through UPI.
- **Listing** — Shares in a public issue list on **T+3**, three working days after the issue closes.

Secondary market (stock market)

- **Meaning** — Existing securities are bought and sold among investors on stock exchanges.
- **No new capital** — The issuer receives no money from secondary trades.
- **Role** — It gives liquidity and continuous price discovery, which supports the primary market.
- **Mechanism** — Anonymous, screen-based order matching with a clearing corporation as counterparty.

Basis	Primary market	Secondary market
Securities	New securities	Already issued securities
Money flow	Investor to issuer	Investor to investor
Price	Fixed or set by book building	Set by market forces

Basis	Primary market	Secondary market
Main intermediaries	Merchant bankers, RTAs, bankers to an issue	Stock brokers, exchanges, clearing corporations, DPs
Purpose	Capital formation	Liquidity and valuation

Example: Sunrise Agro Ltd raises ₹600 crore through an IPO: ₹400 crore fresh issue and ₹200 crore offer for sale. Only ₹400 crore reaches the company. After listing, the shares trade on the exchange and the company receives nothing from those trades.

Topic 5 — Debt, Derivatives, Commodity and Currency Segments

Segment	What trades	Regulation
Government securities	Central and State Government bonds and T-bills; NDS-OM platform	RBI
Corporate debt	Bonds, debentures and commercial paper of companies	SEBI (listing and trading); RBI for some instruments
Equity derivatives	Index and stock futures and options	SEBI; traded on stock exchanges
Commodity derivatives	Futures and options on bullion, metals, energy and farm goods	SEBI (since the FMC merger in Sep 2015)
Currency derivatives	Exchange-traded futures and options on currency pairs	RBI and SEBI jointly
Interest rate derivatives	Exchange-traded interest rate futures	RBI and SEBI jointly

- **Derivative** — A contract whose value depends on an underlying asset, index, rate or price.
- **Uses** — Hedging, price discovery and speculation, with low initial outlay through margins.
- **Debt market** — It is mainly wholesale; banks, insurers and mutual funds are the big players.
- **Retail access** — Individuals may buy government securities directly through RBI Retail Direct.

Remember this

- Commodity derivatives moved from the Forward Markets Commission to SEBI on **28 September 2015**. Currency and interest rate derivatives on exchanges are under joint RBI–SEBI rules.

Topic 6 — Market Infrastructure Institutions (MIIs)

Market Infrastructure Institutions are stock exchanges, clearing corporations and depositories. They are systemically important and run the market's core plumbing.

MII	Core role	Indian examples
Stock exchange	Provides the trading platform, lists securities and supervises members	BSE, NSE, Metropolitan Stock Exchange; MCX and NCDEX for commodities
Clearing corporation	Clears and settles trades and acts as central counterparty	NSE Clearing, Indian Clearing Corporation, MCX Clearing Corporation
Depository	Holds securities in electronic form and records transfers	NSDL and CDSL

- **Public interest** — MIIs must run in the public interest, not only for profit.
- **Governance** — Their boards include public interest directors, and key staff face fit and proper tests.

- **Regulation** — Exchanges and clearing corporations follow the SEBI (SECC) Regulations, 2018; depositories follow the Depositories Act, 1996 and SEBI (D&P) Regulations, 2018.
- **Front-line role** — MIIs inspect and discipline members, so they act as first-level regulators.
- **Novation** — The clearing corporation becomes buyer to every seller and seller to every buyer.
- **Guarantee** — A Settlement Guarantee Fund protects settlement if a member defaults.
- **Risk tools** — Upfront margins, exposure limits and mark-to-market collection.

Remember this

- MIIs = **stock exchanges + clearing corporations + depositories**. India has two depositories: NSDL and CDSL.

Topic 7 — Financial Intermediaries and Their Role

Securities market intermediaries are entities registered with SEBI under section 12 of the SEBI Act that serve issuers and investors.

Intermediary	Main role
Stock broker	Trading member of an exchange who executes client orders; may also be a clearing member
Authorised person	Agent of a broker who brings clients; the earlier sub-broker category was merged into it
Depository participant (DP)	Agent of a depository who opens and services demat accounts
Merchant banker	Manages public issues, open offers, buy-backs and delisting offers
Registrar and share transfer agent (RTA)	Keeps holder records, processes applications and corporate actions
Custodian	Safekeeps securities of institutions, settles their trades and handles corporate actions
Credit rating agency (CRA)	Rates the credit risk of debt instruments
Debenture trustee	Protects the interests of debenture holders
Investment adviser (IA)	Gives investment advice for a fee
Research analyst (RA)	Publishes research reports and recommendations on securities
Portfolio manager (PMS)	Manages individual portfolios; minimum investment ₹50 lakh

- **Bridge** — Intermediaries reduce search, information and transaction costs for investors.
- **Gatekeepers** — Merchant bankers, CRAs, trustees and auditors check what issuers disclose.
- **Accountability** — Each must meet net worth, fit and proper, conduct and reporting rules.
- **Compliance** — Most must appoint a compliance officer, as this book explains later.

Topic 8 — Types of Financial Securities: Equity and Preference Shares

Equity shares

- **Ownership** — Equity shareholders own the company and bear the residual risk.
- **Rights** — They vote, receive dividends when declared and share surplus on winding up.
- **Return** — Return is dividend plus capital appreciation; neither is guaranteed.
- **Variants** — Shares with differential voting rights, sweat equity and bonus shares are forms of equity.

Preference shares



- **Priority** — They get a fixed dividend before equity holders and repayment before them on winding up.
- **Voting** — Holders vote only on matters that directly affect their rights, or when dividends remain unpaid for two years or more.
- **Redemption** — Under the Companies Act, 2013 they must be redeemed within **20 years**; infrastructure companies may issue them for up to **30 years**.
- **Types** — Cumulative or non-cumulative, convertible or non-convertible, participating or non-participating.

Feature	Equity share	Preference share
Dividend	Variable; paid if declared	Fixed rate; paid before equity
Voting	Full voting rights	Limited voting rights
Capital on winding up	Paid last	Paid before equity, after creditors
Risk and return	Highest risk, highest potential return	Lower risk, limited return
Redemption	Not redeemable (only buy-back)	Redeemable within 20 years (30 for infrastructure)

Topic 9 — Debt Instruments, Derivatives and Pooled Investment Units

Debt instruments

- **Nature** — Debt instruments are loans to the issuer that pay interest and return principal.
- **Examples** — Government securities, T-bills, corporate bonds, debentures, commercial paper and certificates of deposit.
- **Debenture types** — Secured or unsecured, convertible or non-convertible, zero-coupon or coupon-bearing.
- **Key risks** — Credit risk, interest rate risk and liquidity risk.

Derivatives

- **Futures** — An obligation to buy or sell an underlying at a fixed price on a future date.
- **Options** — A right, but not an obligation, to buy (call) or sell (put); the buyer pays a premium.
- **Exchange trade** — Exchange contracts are standardised and guaranteed by the clearing corporation.

Pooled investment units

Instrument	Structure	Key features
Mutual fund units	Trust managed by an AMC under the SEBI (Mutual Funds) Regulations, 2026	Diversified, professionally managed; priced at NAV
Exchange-traded fund (ETF)	Mutual fund scheme listed on an exchange	Tracks an index or commodity; trades at market price during the day
REIT units	Trust owning income-producing real estate	At least 80% in completed, rent-generating assets; at least 90% of net distributable cash flow paid out
InvIT units	Trust owning infrastructure assets such as roads and power lines	Most value in completed, revenue-generating projects; at least 90% of net distributable cash flow paid out

Remember this

- REITs and InvITs distribute at least **90%** of net distributable cash flows. Listed REIT and InvIT units trade in a lot of **one unit**.

Topic 10 — Trading, Clearing and Settlement Cycle in the Indian Market

- **1. Trading** — The client places an order; the broker routes it to the exchange, where it is matched on price-time priority.
- **2. Contract note** — The broker issues a contract note to the client within 24 hours of the trade.
- **3. Clearing** — The clearing corporation confirms trades, nets them and works out each member's obligations.
- **4. Pay-in** — Members deliver funds and securities to the clearing corporation on the settlement day.
- **5. Pay-out** — The clearing corporation releases funds and securities to the receiving members and clients.
- **T+1** — Equity trades settle on the next working day; India completed the move to T+1 for all listed shares on **27 January 2023**.
- **Optional T+0** — A same-day cycle started on 28 March 2024 for 25 scrips and was widened in phases from 31 January 2025 to the top 500 scrips by market capitalisation.
- **T+0 window** — Trades executed up to 1:30 pm in the T+0 session settle the same day.
- **Direct payout** — Since 11 November 2024 (SEBI circular of 5 June 2024) the clearing corporation credits bought securities directly to the client's demat account.

Stage	Who acts	Key control
Order and trade	Client, broker, exchange	Upfront margin and order-level risk checks
Clearing	Clearing corporation, clearing member	Novation, netting and margins
Settlement	Clearing corporation, clearing banks, depositories	Delivery versus payment
Default handling	Clearing corporation	Auction or close-out and Settlement Guarantee Fund

N1. [Numerical] A client of Pragati Securities buys 800 shares of Delta Ltd at ₹1,240 and sells 300 shares of the same company at ₹1,255 on the same day in the T+1 segment. Find the client's net securities and funds obligation (ignore charges).

Item	Value
Bought	800 shares at ₹1,240
Sold	300 shares at ₹1,255
Cycle	T+1

Solution:

Formula:

$$\text{Net funds} = Q_b P_b - Q_s P_s$$

Value of purchase = $800 \times 1,240 = ₹9,92,000$.

Value of sale = $300 \times 1,255 = ₹3,76,500$.

Net quantity to receive = $800 - 300 = 500$ shares.

$$9,92,000 - 3,76,500 = ₹6,15,500$$

Answer: The client receives 500 shares and pays ₹6,15,500 on T+1; the 300 shares bought and sold the same day net off.

Remember this

- Equity settlement: **T+1** rolling (fully from 27 Jan 2023); optional **T+0** for the top 500 scrips. IPO listing: **T+3**.



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**NISM-Series-III-A | Module A | CH-1 | MCQs**

Q1. Which of the following is/are correct about the functions of a financial system?

- I. It channels surplus funds of households to deficit sectors.
 II. It provides price discovery and liquidity.
 III. It eliminates investment risk for savers. [Ref: Topic 1, p. 2]

- (a) I and III only (b) I and II only
 (c) II and III only (d) I, II and III

Q2. Rakesh deposits ₹5 lakh in a bank, which lends it to a manufacturer. Meena buys ₹5 lakh of the same manufacturer's bonds in a public issue. Which statement is correct? [Ref: Topic 2, p. 2]

- (a) Rakesh uses indirect finance and Meena uses direct finance
 (b) Both use direct finance because the money reaches the same manufacturer
 (c) Rakesh uses direct finance and Meena uses indirect finance
 (d) Both use indirect finance because a merchant banker manages the bond issue

Q3. A bank needs funds for 10 days in the inter-bank market without giving collateral. Which instrument fits? [Ref: Topic 3, p. 2]

- (a) Notice money (b) Call money
 (c) Term money (d) Treasury bill

Q4. Which of the following is NOT a money market instrument? [Ref: Topic 3, p. 2]

- (a) A 182-day Treasury bill
 (b) A 90-day commercial paper
 (c) A six-month certificate of deposit issued by a bank
 (d) A five-year non-convertible debenture

Q5. In an IPO of ₹900 crore, ₹500 crore is a fresh issue and the rest is an offer for sale by promoters. How much money does the company receive (ignore expenses)? [Ref: Topic 4, p. 2]

- (a) ₹900 crore
 (b) ₹400 crore
 (c) ₹500 crore
 (d) Nothing, because listed shares raise no capital

Q6. Which statement about the secondary market is correct? [Ref: Topic 4, p. 2]

- (a) It is where companies raise fresh capital through follow-on public offers and rights issues
 (b) It gives liquidity to securities already issued, but the issuer receives no money from trades
 (c) Prices are fixed by the merchant banker through the book-building process
 (d) Only qualified institutional buyers may trade in it through the stock exchanges

Q7. A jeweller wants to hedge gold price risk on an exchange in India. Which regulator governs that exchange-traded commodity derivative? [Ref: Topic 5, p. 3]

- (a) SEBI (b) RBI
 (c) Forward Markets Commission (d) IFSCA

Q8. Which of the following is correctly matched? [Ref: Topic 6, p. 3]

- (a) Clearing corporation — lists securities and admits trading members
 (b) Stock exchange — becomes central counterparty to every trade through novation
 (c) Depository participant — guarantees settlement through the Settlement Guarantee Fund
 (d) Depository — holds securities in electronic form and records their transfer

Q9. After a trade is matched, the clearing corporation becomes the buyer to every seller and the seller to every buyer. This is called: [Ref: Topic 6, p. 3]

- (a) Netting (b) Pay-out
 (c) Novation (d) Delivery versus payment

Q10. Arun wants an entity that will open a demat account for him and process his delivery instructions. Which intermediary should he approach? [Ref: Topic 7, p. 3]

- (a) A registrar and share transfer agent
 (b) A custodian
 (c) A depository participant
 (d) A debenture trustee

Q11. Which of the following is/are correct about preference shares under the Companies Act, 2013?

- I. They carry a preferential right to a fixed dividend.
 II. A manufacturing company may issue them for 25 years.
 III. An infrastructure company may issue them for up to 30 years. [Ref: Topic 8, p. 3]

- (a) I and II only (b) I and III only
 (c) II and III only (d) I, II and III

Q12. A REIT earns net distributable cash flow of ₹300 crore in a half-year. What is the minimum it must distribute to unitholders? [Ref: Topic 9, p. 4]

- (a) ₹240 crore (b) ₹300 crore (c) ₹150 crore (d) ₹270 crore

Q13. Which statement about an ETF is correct? [Ref: Topic 9, p. 4]

- (a) It is a mutual fund scheme listed on an exchange that trades at market price during the day
 (b) It is a trust that must distribute 90% of its cash flow every six months
 (c) It is bought and sold only with the AMC at the NAV declared at the end of the day
 (d) It is a derivative contract that gives the right to buy an index on expiry

Q14. An investor buys 400 shares at ₹500 and sells 150 of them at ₹520 on the same day in the T+1 segment. What is the net funds pay-in on T+1 (ignore charges)? [Ref: Topic 10, p. 4]

- (a) ₹2,00,000 (b) ₹78,000 (c) ₹1,25,000 (d) ₹1,22,000

Q15. Which of the following is correct about the settlement cycle in India today? [Ref: Topic 10, p. 4]

- (a) T+2 is the standard cycle, and T+1 is optional for the top 500 scrips by market capitalisation
 (b) T+0 is the standard cycle for all listed shares, and T+1 applies only to block deals
 (c) T+1 is the standard rolling cycle, and an optional T+0 cycle is available for the top 500 scrips
 (d) T+1 applies only to F&O contracts, while cash market shares still settle on T+2

Answer key

Q	Ans	Q	Ans	Q	Ans	Q	Ans	Q	Ans
1	b	4	d	7	a	10	c	13	a
2	a	5	c	8	d	11	b	14	d
3	a	6	b	9	c	12	d	15	c



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CH-2

Regulatory Framework – General View

Topic 1 — Need for Regulation of Financial Markets

Financial markets run on trust. Regulation protects that trust where markets alone would fail.

Reason	Market failure it addresses
Information gaps	Issuers and intermediaries know more than investors; mandatory disclosure narrows the gap
Investor protection	Small investors cannot verify claims or enforce contracts on their own
Market integrity	Insider trading, price rigging and fraud must be prevented and punished
Systemic stability	Failure of a large intermediary or MII can spread across the system
Conflicts of interest	Intermediaries may put their own interest above the client's
Fair competition	Uniform rules give a level playing field to all participants

- **Goals** — Investor protection, fair and efficient markets, and lower systemic risk.
- **Tools** — Registration, disclosure, conduct rules, capital norms, inspection, surveillance and penalties.
- **Balance** — Rules must protect investors without choking innovation and market development.

Topic 2 — The Regulatory System in India

India follows a **sector-wise model**: each financial segment has its own statutory regulator, with the Government framing policy and law.

Regulator	Law	Domain
SEBI	SEBI Act, 1992	Securities and commodity derivatives markets and their intermediaries
RBI	RBI Act, 1934; Banking Regulation Act, 1949	Banks, NBFCs, money, G-sec and forex markets, payment systems
IRDAI	IRDA Act, 1999	Insurance companies and insurance intermediaries
PFRDA	PFRDA Act, 2013	National Pension System, Atal Pension Yojana and pension intermediaries
IFSCA	IFSCA Act, 2019	All financial services inside International Financial Services Centres

- **Coordination** — The **Financial Stability and Development Council (FSDC)**, chaired by the Finance Minister, coordinates regulators.
- **Overlap areas** — Exchange-traded currency and interest rate derivatives fall under joint RBI–SEBI rules.
- **Self-regulation** — Stock exchanges, clearing corporations and depositories supervise their own members.

Remember this

- Five financial regulators: **SEBI, RBI, IRDAI, PFRDA and IFSCA**. FSDC coordinates them under the Finance Minister.

Topic 3 — Securities and Exchange Board of India (SEBI)

- **Origin** — SEBI was set up on **12 April 1988** as a non-statutory body.

- **Statutory status** — It got statutory powers on **30 January 1992**; the SEBI Act was passed in April 1992.
- **Mandate** — Protect investors' interests, promote development of the securities market and regulate it.
- **Board** — A Chairman, two members from the Ministry of Finance, one from RBI and five others, at least three of them whole-time.
- **Head office** — Mumbai, with regional and local offices.

Powers of SEBI

Type of power	Examples
Quasi-legislative	Frames regulations, issues circulars and master circulars
Quasi-judicial	Passes orders, imposes penalties through adjudicating officers, settles cases
Executive	Registers intermediaries, inspects, investigates, issues directions
Developmental	Investor education, market reforms, new products and platforms

- **Registration** — No intermediary may deal in securities without a SEBI certificate of registration (section 12).
- **Commodity markets** — The Forward Markets Commission merged into SEBI on 28 September 2015.
- **Pending reform** — The **Securities Markets Code Bill, 2025** (introduced 18 December 2025) would consolidate the SEBI Act, SCRA and Depositories Act; the Standing Committee on Finance tabled its report in July 2026, and the Bill is not yet law.

Topic 4 — RBI, IRDAI and PFRDA

Reserve Bank of India

- **Role** — Central bank, monetary authority and regulator of banks and NBFCs.
- **Markets** — It regulates the money, government securities and foreign exchange markets.
- **FEMA** — It administers foreign exchange rules with the Central Government, including FPI debt limits.
- **Debt manager** — It manages the borrowing programme of the Central and State Governments.

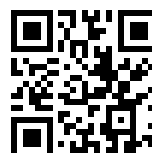
IRDAI

- **Role** — The Insurance Regulatory and Development Authority of India regulates insurers, brokers, agents and other insurance intermediaries.
- **Securities link** — Insurers are large investors in debt and equity; unit-linked plans invest in markets.

PFRDA

- **Role** — The Pension Fund Regulatory and Development Authority regulates NPS, its pension funds and intermediaries.
- **Status** — It became statutory under the PFRDA Act, 2013, effective 1 February 2014.

Example: A bank issuing bonds on the exchange deals with RBI as its prudential regulator and SEBI for listing and disclosure. An insurer's listed shares fall under SEBI, while its solvency and products stay with IRDAI.



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