UpperCrust
THE WEALTH COMPANY

NISM CERTIFICATION · COMPLETE STUDY GUIDE

NISM Series VIII

Equity Derivatives

Futures and options on shares and indices: contracts, pricing, payoffs, strategies, clearing, margins and the rules.

100 QUESTIONS · 120 MINUTES · PASS 60% · 10 UNITS

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ABOUT THIS GUIDE

Everything you need, in one place.

NISM Series VIII is the mandatory certification for professionals dealing in equity derivatives on Indian exchanges, such as dealers, sales staff, advisers and compliance officers. Half the marks come from futures and options mechanics, which this guide treats with worked numbers.

100	120 min	60%	25% of marks
QUESTIONS	DURATION	TO PASS	NEGATIVE MARKING

Who should take this exam

Dealers, sales traders, relationship managers, advisers, back-office and compliance staff in broking and banks, and active traders who want a rigorous grounding in futures and options.

How this guide works

1. Read the unit overview
2. Study each concept card
3. Say the example aloud
4. Check the watch-outs
5. Take the unit mock

Each unit opens with its exam weight, so you know where marks are. Each concept card gives the idea, a worked example, and the mistake the exam wants you to make. The same ideas power the five mock tests on the UpperCrust Academy app, which get harder one by one.

Keep this in mind

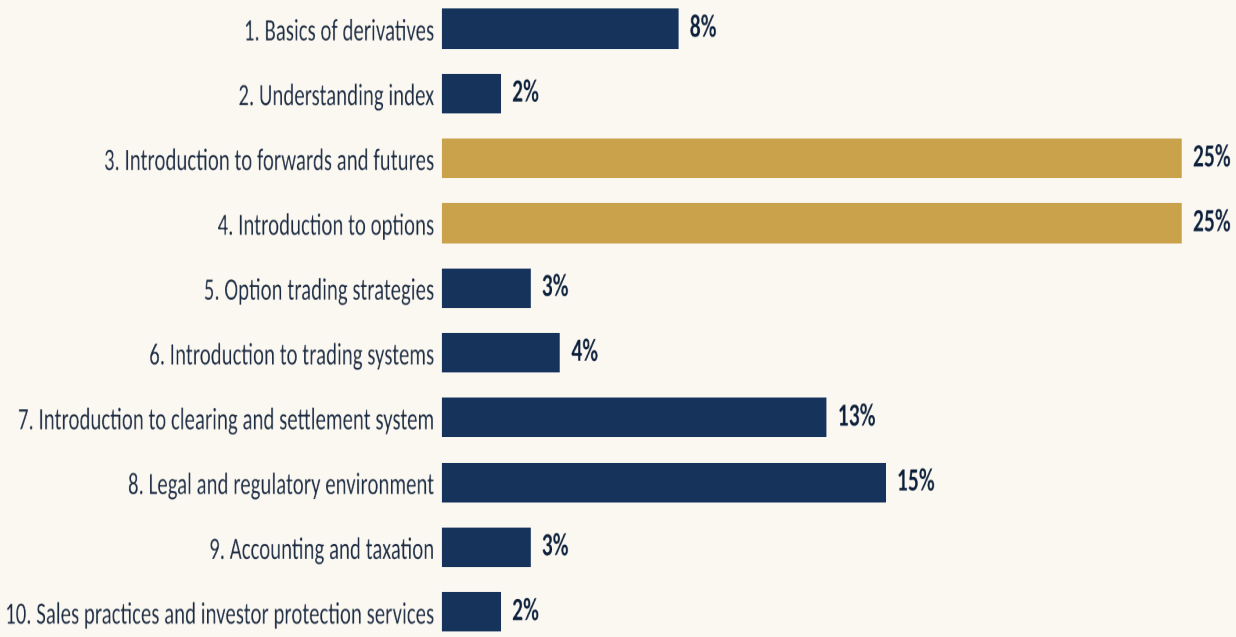
NISM revises its syllabus and workbook from time to time, and rules change by SEBI circular. This guide follows the official unit structure and weightage. Check the latest NISM workbook for any changes before your exam date.

EXAM AT A GLANCE

Structure and marks.

Item	Detail
Format	Computer-based, multiple-choice questions
Questions and marks	100 questions, 1 mark each, 100 marks
Duration	2 hours
Passing score	60 marks (60%)
Negative marking	25% of a question's marks, so 0.25 per wrong answer
Certificate validity	Three years; renew through NISM
Where it leads	Required to deal in equity derivatives as a registered professional

Where the marks are



Read the chart like an examiner

Units above 10% decide most results. Master them first, then use the small units for easy marks. A unit worth 3% still supplies three marks at no extra effort once you have the concepts.

YOUR STUDY PLAN

Time follows marks.

The bar shows how the exam is split across units. Spend your hours in the same proportion.



Unit	Marks	Share of study time	Suggested days
1. Basics of derivatives	8	8%	2
2. Understanding index	2	2%	1
3. Introduction to forwards and futures	25	25%	5
4. Introduction to options	25	25%	5
5. Option trading strategies	3	3%	1
6. Introduction to trading systems	4	4%	1
7. Introduction to clearing and settlement system	13	13%	3
8. Legal and regulatory environment	15	15%	3
9. Accounting and taxation	3	3%	1
10. Sales practices and investor protection services	2	2%	1
Revision and five mocks			7

The mock ladder

1 Mock 1 Foundation ▶ 2 Mock 2 Core ▶ 3 Mock 3 Applied ▶ 4 Mock 4 Exam level ▶ 5 Mock 5 Beyond exam

Take Mock 1 after your first pass through the guide. Move to the next mock only when you score 15 marks above the pass mark. Review every wrong answer in the app; each one links back to its unit.

UNIT 1 · 8% OF THE EXAM

Basics of derivatives

A derivative gets its value from something else: a share, an index, a currency or a commodity. This unit teaches the language, the purposes of derivatives and the differences between types.

What the exam looks for

- Forwards versus futures.
- Hedgers, speculators and arbitrageurs.
- Exchange-traded versus over-the-counter.

Forward versus futures

	Forward	Futures
Trading	Over the counter	Exchange
Terms	Customised	Standardised
Counterparty risk	Yes	Guaranteed by clearing corporation
Settlement	At maturity	Daily mark-to-market

Concept cards

01

Derivative

A derivative is a financial contract whose value depends on, or is derived from, an underlying asset or reference rate such as a share, index, currency or commodity.

EXAMPLE A contract's value moves with the price of a stock index.

WATCH OUT Not true: a derivative is a share issued by a company.

02

Underlying

The underlying is the asset or index on which a derivative contract is based.

EXAMPLE A futures contract is based on the Nifty 50, which is its reference.

WATCH OUT Not true: the underlying is the premium paid on an option.

03

Forward contract

A forward contract is a private agreement to buy or sell an asset at a fixed price on a future date. It is customised and traded over the counter, with counterparty risk.

EXAMPLE Two parties agree privately to exchange an asset at a fixed price in three months.

WATCH OUT Not true: a forward contract is standardised and traded on exchanges.

04

Futures contract

A futures contract is a standardised agreement traded on an exchange to buy or sell an underlying at a fixed price on a future date, with the clearing corporation guaranteeing performance.

EXAMPLE An exchange-traded contract in which both parties must settle at expiry.

WATCH OUT Not true: a futures contract carries no obligation for either party.

05

Hedger

A hedger uses derivatives to reduce an existing price risk rather than to profit from price moves.

EXAMPLE A fund manager takes an opposite position to protect a stock portfolio from a fall.

WATCH OUT Not true: a hedger aims to maximise profit from price moves.

06

Speculator

A speculator takes positions in derivatives to profit from expected price changes and accepts the risk.

EXAMPLE A trader buys index futures expecting a sharp rise.

WATCH OUT Not true: a speculator has no exposure to the price risk.

07

Arbitrageur

An arbitrageur exploits price differences between related markets to earn a low-risk profit.

EXAMPLE A trader buys in the cash market and sells in the futures market to lock in a price gap.

WATCH OUT Not true: an arbitrageur needs to predict the market's direction.

08

Exchange-traded derivative

Exchange-traded derivatives have standardised terms, are cleared by a clearing corporation and carry lower counterparty risk.

EXAMPLE A contract with a fixed lot size, expiry and daily settlement.

WATCH OUT Not true: exchange-traded derivatives are customised for each buyer.

09

Over-the-counter derivative

OTC derivatives are privately negotiated and tailor-made but carry higher counterparty and liquidity risk.

EXAMPLE Two institutions agree bespoke terms without an exchange.

WATCH OUT Not true: oTC derivatives are guaranteed by a clearing corporation.

10

Swap

A swap is an agreement to exchange cash flows over a period, such as fixed for floating interest payments.

EXAMPLE Two parties agree to exchange a fixed rate payment for a floating one.

WATCH OUT Not true: a swap is an exchange-traded futures contract.

11

Leverage

Leverage in derivatives means controlling a large exposure with a small margin, magnifying both gains and losses.

EXAMPLE A trader controls a ₹10 lakh position with ₹1.5 lakh margin.

WATCH OUT Not true: leverage reduces the risk of losses.

12

Price discovery

Derivatives markets help in price discovery by reflecting market expectations about future prices of the underlying.

EXAMPLE Futures prices show where the market expects the index to be next month.

WATCH OUT Not true: derivatives play no role in price discovery.

Unit recap · one line each

Derivative · Underlying · Forward contract · Futures contract · Hedger · Speculator · Arbitrageur · Exchange-traded derivative · Over-the-counter derivative · Swap · Leverage · Price discovery

UNIT 2 · 2% OF THE EXAM

Understanding index

Index derivatives are based on stock indices. A short unit on how an index is built.

What the exam looks for

- Market capitalisation weighting and free float.
- Sensex and Nifty 50.

Concept cards

01

Stock index

A stock index is a number measuring the combined price performance of a basket of stocks, used as a market barometer and as the underlying of index derivatives.

EXAMPLE A single number tracks how 50 large companies are performing together.

WATCH OUT Not true: an index measures the price of only one stock.

02

Free-float weighting

Free-float market capitalisation weighting weights each stock by the value of shares available for public trading, so promoter holdings are excluded.

EXAMPLE A company with a large promoter holding gets a smaller weight in the index.

WATCH OUT Not true: free-float weighting counts all issued shares.

03

Base value

An index starts at a base value on a base date; the Nifty 50 base is 1000 and the Sensex base is 100, and later values are relative to them.

EXAMPLE An index set at 1000 on its base date rises to 2000, doubling in value.

WATCH OUT Not true: every index starts at zero.

04

Index rebalancing

Index constituents are reviewed periodically and stocks replaced when they no longer meet criteria on market cap, liquidity and free float.

EXAMPLE An exchange replaces a stock that no longer qualifies for the index.

WATCH OUT Not true: index constituents never change.

05

Beta of a portfolio

Beta measures the sensitivity of a portfolio to market moves; a beta of 1.2 means it is expected to move 20% more than the index.

EXAMPLE A portfolio typically rises 12% when the index rises 10%.

WATCH OUT Not true: beta measures the dividend of a stock.

Unit recap · one line each

Stock index · Free-float weighting · Base value · Index rebalancing · Beta of a portfolio

UNIT 3 · 25% OF THE EXAM

Introduction to forwards and futures

The heaviest unit in the exam. Contract specifications, pricing, payoffs, basis, margins and hedging with index futures.

What the exam looks for

- Payoffs of long and short futures.
- Cost of carry pricing.
- Basis, contango and backwardation.
- Hedging with index futures.

FORMULA · Cost of carry

Futures price = Spot price × (1 + r)^T, adjusted for dividends: F = S × e^((r − d) × T)

FORMULA · Hedge ratio

Number of contracts = Beta × Portfolio value ÷ (Futures price × lot size)

Futures payoff per unit

Position	Profit or loss
Long futures	Spot at expiry − entry price
Short futures	Entry price − spot at expiry

Concept cards

01

Long futures position

A long futures position buys the contract and gains when the price rises above the entry price and loses when it falls.

EXAMPLE A trader buys an index future at 24,000 and it moves to 24,100.

WATCH OUT Not true: a long futures position gains when the price falls.

02

Short futures position

A short position sells the contract and gains when the price falls below the entry price and loses when it rises.

EXAMPLE A trader sells a future at 24,000 and it closes at 23,900.

WATCH OUT Not true: a short futures position loses when the price falls.

03

Contract specification

An exchange fixes the underlying, lot size, tick size, expiry cycle and settlement method for each derivatives contract.

EXAMPLE The exchange standardises everything except the price.

WATCH OUT Not true: traders choose the lot size and expiry date themselves.

04

Tick size

The tick size is the minimum price movement allowed for a contract, such as ₹0.05 for futures on equity.

EXAMPLE A price can change only in steps of five paise.

WATCH OUT Not true: tick size is the lot size of the contract.

05

Contract value

Contract value equals futures price multiplied by the lot size and shows the exposure in rupees.

EXAMPLE A future at ₹2,000 with a lot of 500 has an exposure of ₹10 lakh.

WATCH OUT Not true: contract value equals the margin.

06

Expiry cycle

Index and stock futures have near-month, next-month and far-month contracts, and a contract expires on the day set by the exchange; on expiry it is cash settled.

EXAMPLE Three monthly contracts are available at any time.

WATCH OUT Not true: futures contracts have a ten-year expiry cycle.

07

Open interest

Open interest is the total number of outstanding contracts not yet squared off or settled, showing how many positions remain open.

EXAMPLE A count of all contracts still open at the end of the day.

WATCH OUT Not true: open interest is the number of contracts traded in a day.

08

Cost of carry

The cost of carry is the cost of holding the underlying until expiry, mainly financing cost less any income such as dividends, and drives futures pricing.

EXAMPLE A futures price is higher than spot by an amount reflecting interest costs.

WATCH OUT Not true: futures price is unrelated to spot price.

09

Contango

Contango is a market in which futures prices are higher than the spot price, normally due to carrying costs.

EXAMPLE The one-month future trades above spot.

WATCH OUT Not true: contango means futures trade below spot.

10

Backwardation

Backwardation is a market in which futures prices are lower than the spot price.

EXAMPLE A future trades at a discount to the spot price.

WATCH OUT Not true: backwardation means futures trade above spot.

11

Basis

Basis is the difference between the spot price and the futures price. It narrows to zero at expiry as the two prices converge.

EXAMPLE Spot is 24,000 and the future is 24,060; the gap shrinks as expiry nears.

WATCH OUT Not true: basis widens to its maximum at expiry.

12

Convergence

On the expiry date the futures price converges to the spot price of the underlying.

EXAMPLE On the last day the future and spot are nearly equal.

WATCH OUT Not true: futures and spot are unrelated at expiry.

13

Mark-to-market

In futures, profit or loss is settled daily against the day's settlement price, and the amounts are debited or credited to the member accounts.

EXAMPLE A trader's account is debited at the end of the day when prices fall.

WATCH OUT Not true: futures profits or losses are settled only at expiry.

14

Initial margin

Initial margin is the upfront deposit collected to cover the potential loss on a futures position over a short period. It is risk-based, using the SPAN system.

EXAMPLE A trader deposits a percentage of the contract value before taking the position.

WATCH OUT Not true: initial margin is refunded as profit after the first day.

15

Exposure margin

Exposure margin is an additional margin over and above SPAN margin, collected to cover risk beyond that measured.

EXAMPLE A buffer on top of the SPAN margin for extra safety.

WATCH OUT Not true: exposure margin replaces SPAN margin entirely.

16

SPAN

SPAN is a risk-based margining system that estimates the largest likely one-day loss across a portfolio under many scenarios.

EXAMPLE A margin system that assesses the worst-case scenario for the entire portfolio.

WATCH OUT Not true: sPAN charges a fixed 5% on every contract.

17

Square off

Squaring off means closing an open position by taking an equal and opposite position in the same contract before expiry.

EXAMPLE A trader who bought a future sells the same contract to close the position.

WATCH OUT Not true: squaring off means doubling a position.

18

Rollover

Rolling over means closing a near-month position and opening a similar position in the next month to maintain exposure.

EXAMPLE A trader sells the expiring contract and buys the next month's contract.

WATCH OUT Not true: rollover means taking physical delivery.

19

Hedging with index futures

A portfolio owner can sell index futures to protect against a fall in the market; the number of contracts depends on portfolio value and beta.

EXAMPLE A fund manager sells index futures to offset a possible fall in her holdings.

WATCH OUT Not true: hedging requires buying index futures.

20

Pair trade

A pair trade buys one related security and sells another, profiting from relative price movement rather than market direction.

EXAMPLE A trader buys a bank stock future and sells another bank's future.

WATCH OUT Not true: a pair trade is a single long position.

21

Cash settlement

In cash settlement, no underlying is delivered; the difference between the contract price and the settlement price is paid in cash.

EXAMPLE An index future ends with a rupee payment, not with shares.

WATCH OUT Not true: index futures settle with delivery of all 50 stocks.

22

Physical settlement

In physical settlement, the underlying shares are actually delivered on expiry; stock derivatives in India are physically settled.

EXAMPLE A stock future held to expiry results in delivery of shares.

WATCH OUT Not true: stock futures are always cash settled.

23

Single-stock futures

Single stock futures are futures on individual shares, available for eligible stocks with liquidity and market-cap criteria.

EXAMPLE A contract on a single company's share, with a fixed lot size.

WATCH OUT Not true: single-stock futures are available for any listed company.

24

Index futures

Index futures are contracts on stock indices such as the Nifty 50, are cash settled, and are widely used to hedge and speculate on the overall market.

EXAMPLE A trader takes a view on the market as a whole with one contract.

WATCH OUT Not true: index futures are delivered in shares.

25

Long hedge versus short hedge

A short hedge sells futures to protect against price falls; a long hedge buys futures to protect against price rises.

EXAMPLE A person expecting to buy shares next month buys futures to lock in prices.

WATCH OUT Not true: a short hedge buys futures contracts.

26

Fair value of futures

The fair price of a futures contract is the spot price plus the net cost of carry; deviations create arbitrage opportunities.

EXAMPLE A future priced well above spot plus carry attracts arbitrage sellers.

WATCH OUT Not true: futures can trade at any price without arbitrage.

27

Cash-and-carry arbitrage

Cash-and-carry arbitrage buys the underlying in the cash market and sells the future when the future is expensive relative to fair value.

EXAMPLE A trader buys shares and sells the future, locking in a gap.

WATCH OUT Not true: cash-and-carry arbitrage buys futures and sells shares.

28

Reverse cash-and-carry

Reverse cash-and-carry sells the underlying and buys the future when the future is cheap relative to fair value.

EXAMPLE A trader sells shares and buys a cheap future to lock in a gain.

WATCH OUT Not true: reverse cash-and-carry buys the underlying and sells futures.

29

Futures versus forwards risk

Exchange-traded futures remove counterparty risk through the clearing corporation, while forwards leave it with the counterparty.

EXAMPLE A clearing corporation guarantees that the futures trade will be honoured.

WATCH OUT Not true: forward contracts are guaranteed by the exchange.

30

Futures margin and leverage

Because only margin is paid upfront, futures offer leverage: a small price change can produce a large percentage gain or loss on margin.

EXAMPLE A 2% price move creates a 15% change in the trader's margin capital.

WATCH OUT Not true: futures margin limits the loss to the margin amount.

Unit recap · one line each

Long futures position · Short futures position · Contract specification · Tick size · Contract value · Expiry cycle · Open interest · Cost of carry · Contango · Backwardation · Basis · Convergence · Mark-to-market · Initial margin · Exposure margin · SPAN · Square off · Rollover · Hedging with index futures · Pair trade · Cash settlement · Physical settlement · Single-stock futures · Index futures · Long hedge versus short hedge · Fair value of futures · Cash-and-carry arbitrage · Reverse cash-and-carry · Futures versus forwards risk · Futures margin and leverage

UNIT 4 · 25% OF THE EXAM

Introduction to options

Options are the second heavy unit. Calls, puts, moneyness, premium, Greeks, put-call parity and the payoff of each position.

What the exam looks for

- Payoffs and break-even of calls and puts.
- Intrinsic value and time value.
- The Greeks.
- Settlement and exercise.

FORMULA · Premium

Option premium = Intrinsic value + Time value

FORMULA · Put-call parity (European)

Call price − Put price = Spot − Strike ÷ (1 + r)^T

Concept cards

01

Call option buyer

The buyer of a call pays a premium and has the right to buy the underlying at the strike. Maximum loss is the premium and the potential profit is unlimited.

EXAMPLE A trader pays ₹20 for the right to buy at ₹500 and expects a rise.

WATCH OUT Not true: a call buyer has unlimited loss.

02

Call option seller

The call seller (writer) receives the premium and must sell the underlying at the strike if exercised. The maximum profit is the premium and the loss is potentially unlimited.

EXAMPLE A trader receives ₹20 and must sell if the price rises sharply.

WATCH OUT Not true: a call writer has unlimited profit and limited loss.

03

Put option buyer

The buyer of a put pays a premium and has the right to sell at the strike. Maximum loss is the premium; profit rises as the price falls to zero.

EXAMPLE A trader pays ₹15 for the right to sell at ₹500 and expects a fall.

WATCH OUT Not true: a put buyer benefits when the price rises.

04

Put option seller

The put seller receives the premium and must buy the underlying at the strike if exercised. Maximum profit is the premium; loss can be large if prices fall.

EXAMPLE A trader receives ₹15 and must buy at ₹500 if the price collapses.

WATCH OUT Not true: a put writer has unlimited profit.

05

In-the-money

A call is in the money when spot is above the strike; a put is in the money when spot is below the strike. It has positive intrinsic value.

EXAMPLE A call with strike 500 when spot is 550.

WATCH OUT Not true: a call is in the money when spot is below the strike.

06

At-the-money

An option is at the money when the strike equals the spot price. Its intrinsic value is zero.

EXAMPLE A call with strike 500 when spot is 500.

WATCH OUT Not true: an at-the-money option has high intrinsic value.

07

Out-of-the-money

A call is out of the money when spot is below the strike; a put when spot is above the strike. It has no intrinsic value, only time value.

EXAMPLE A put with strike 500 when spot is 550.

WATCH OUT Not true: an out-of-the-money option has the highest intrinsic value.

08

Intrinsic value

Intrinsic value is the amount by which an option is in the money, and is never negative. For a call it is the greater of (spot − strike) and zero.

EXAMPLE A call with strike 500 and spot 560 has a value of ₹60 on exercise.

WATCH OUT Not true: intrinsic value of an option can be negative.

09

Time value

Time value is the part of the premium above intrinsic value, reflecting the chance of further favourable moves; it falls to zero at expiry.

EXAMPLE An option with intrinsic value ₹60 and premium ₹75 has ₹15 of this.

WATCH OUT Not true: time value rises as expiry approaches.

10

Option premium determinants

The premium depends on spot, strike, time to expiry, volatility, interest rates and dividends; higher volatility and longer time raise it.

EXAMPLE An option on a very volatile stock costs more than one on a stable stock.

WATCH OUT Not true: volatility has no effect on option premium.

11

Implied volatility

Implied volatility is the volatility the market's option prices imply for the underlying, derived from the option price.

EXAMPLE Option prices suggest the market expects larger swings.

WATCH OUT Not true: implied volatility is the volatility in the past year.

12 **Delta**

Delta measures the change in an option's price for a ₹1 change in the underlying. Calls have delta between 0 and 1; puts between −1 and 0.

EXAMPLE A call with delta 0.5 gains about ₹0.50 if the underlying rises ₹1.

WATCH OUT Not true: delta measures the effect of time decay.

13 **Gamma**

Gamma measures how much delta changes for a ₹1 move in the underlying. It is highest for at-the-money options near expiry.

EXAMPLE The sensitivity of delta is greatest for options near the strike.

WATCH OUT Not true: gamma is the change in price for time decay.

14 **Theta**

Theta measures the loss in option value as one day passes, other things equal. It hurts option buyers and helps sellers.

EXAMPLE An option loses a little value each day as expiry nears.

WATCH OUT Not true: theta helps option buyers.

15 **Vega**

Vega measures the change in an option's price for a 1% change in volatility. Higher volatility raises both call and put prices.

EXAMPLE An option's price rises when volatility increases.

WATCH OUT Not true: vega measures the effect of interest rate changes.

16 **Rho**

Rho measures the change in an option's price for a 1% change in the interest rate.

EXAMPLE An option's sensitivity to the interest rate.

WATCH OUT Not true: rho measures the effect of volatility on price.

17 **European option**

A European option can be exercised only on the expiry date. All options on Indian exchanges are European style.

EXAMPLE A holder can exercise an option only on the last day.

WATCH OUT Not true: a European option can be exercised any time before expiry.

18 **American option**

An American option can be exercised at any time up to and including expiry.

EXAMPLE A holder can exercise whenever she chooses before expiry.

WATCH OUT Not true: an American option can be exercised only at expiry.

19

Exercise and assignment

When a buyer exercises, a seller is assigned at random or by rule and must perform the obligation under the contract.

EXAMPLE A call buyer exercises and a writer is called to deliver.

WATCH OUT Not true: the option buyer is always obliged to exercise.

20

Settlement of index options

Index options are cash settled at expiry on the closing index value; in-the-money options are exercised automatically.

EXAMPLE An in-the-money index option ends with a cash credit.

WATCH OUT Not true: index options are settled by delivering all index shares.

21

Settlement of stock options

Stock options are physically settled; in-the-money stock options at expiry result in delivery of shares.

EXAMPLE A call buyer who is in the money at expiry gets shares delivered.

WATCH OUT Not true: stock options are always cash settled.

22

Put-call parity

For European options, the call price minus the put price equals the present value relationship of spot and strike; deviations offer arbitrage.

EXAMPLE A call and put with the same strike and expiry are linked by spot and strike.

WATCH OUT Not true: calls and puts are priced independently.

23

Long call payoff

A long call's profit at expiry = max(spot − strike, 0) − premium; break-even = strike + premium.

EXAMPLE A call with strike 500 bought at ₹20 breaks even at 520.

WATCH OUT Not true: a long call's break-even is strike minus premium.

24

Long put payoff

A long put's profit at expiry = max(strike − spot, 0) − premium; break-even = strike − premium.

EXAMPLE A put with strike 500 bought at ₹15 breaks even at 485.

WATCH OUT Not true: a long put's break-even is strike plus premium.

25

Short call payoff

A short call's profit at expiry = premium − max(spot − strike, 0); break-even = strike + premium.

EXAMPLE A writer who sold a 500 call at ₹20 starts losing above 520.

WATCH OUT Not true: a short call is profitable at any rise in price.

26

Short put payoff

A short put's profit at expiry = premium − max(strike − spot, 0); break-even = strike − premium.

EXAMPLE A writer who sold a 500 put at ₹15 loses below 485.

WATCH OUT Not true: a short put is profitable at any fall in price.

27

Option writer margin

Option sellers must deposit margin because of their potential large losses; option buyers pay only the premium and need no margin.

EXAMPLE A seller deposits margin while the buyer only pays the premium.

WATCH OUT Not true: option buyers must deposit margin like sellers.

28

Premium settlement

Premium is paid by the buyer and received by the seller on the next working day after the trade.

EXAMPLE The premium for an option traded today is settled the following business day.

WATCH OUT Not true: premium is paid only at expiry.

29

Option chain

An option chain lists the available strikes and premiums of calls and puts for a given underlying and expiry.

EXAMPLE A table showing calls on one side and puts on the other by strike price.

WATCH OUT Not true: an option chain shows only futures prices.

30

Weekly options

Exchanges list options with weekly expiries on selected indices, subject to regulatory limits on the number of contracts.

EXAMPLE Some index options expire every week.

WATCH OUT Not true: all stock options expire weekly.

31

Early exercise of European options

Because European options cannot be exercised early, holders who want to exit before expiry sell the option in the market.

EXAMPLE A holder sells the option in the market a week before expiry.

WATCH OUT Not true: a European option holder may exercise any day.

Unit recap · one line each

Call option buyer · Call option seller · Put option buyer · Put option seller · In-the-money · At-the-money · Out-of-the-money · Intrinsic value · Time value · Option premium determinants · Implied volatility · Delta · Gamma · Theta · Vega · Rho · European option · American option · Exercise and assignment · Settlement of index options · Settlement of stock options · Put-call parity · Long call payoff · Long put payoff · Short call payoff · Short put payoff · Option writer margin · Premium settlement · Option chain · Weekly options · Early exercise of European options

UNIT 5 · 3% OF THE EXAM

Option trading strategies

Combining options and underlying positions shapes the risk and reward. A short unit worth three marks.

What the exam looks for

- Covered call, protective put, spreads, straddle, strangle.

Strategies at a glance

Strategy	View	Construction
Covered call	Neutral to mildly bullish	Hold shares, sell a call
Protective put	Bullish with protection	Hold shares, buy a put
Bull call spread	Moderately bullish	Buy lower-strike call, sell higher-strike call
Long straddle	Big move either way	Buy call and put at same strike
Long strangle	Big move either way, cheaper	Buy OTM call and OTM put

Concept cards

01

Covered call

A covered call holds the underlying and sells a call against it, earning the premium but capping the upside.

EXAMPLE An investor holding shares sells a call to earn income.

WATCH OUT Not true: a covered call has unlimited upside.

02

Protective put

A protective put buys a put against a held position, setting a floor under the loss at the cost of the premium.

EXAMPLE An investor buys a put to insure shares she owns.

WATCH OUT Not true: a protective put adds to the loss when prices fall.

03

Bull call spread

A bull call spread buys a lower-strike call and sells a higher-strike call, limiting both the cost and the profit.

EXAMPLE A trader buys a 500 call and sells a 520 call.

WATCH OUT Not true: a bull call spread has unlimited profit.

04

Long straddle

A long straddle buys a call and a put at the same strike and expiry, profiting from a large move in either direction.

EXAMPLE A trader expects a big move after results but not its direction.

WATCH OUT Not true: a long straddle profits if the price stays still.

05

Long strangle

A long strangle buys an out-of-the-money call and an out-of-the-money put, costing less than a straddle but needing a bigger move.

EXAMPLE A trader buys a 520 call and a 480 put.

WATCH OUT Not true: a long strangle uses the same strike for both options.

06

Collar

A collar holds the underlying, buys a put and sells a call, limiting both downside and upside, often at a low net cost.

EXAMPLE An investor protects shares with a put financed by selling a call.

WATCH OUT Not true: a collar leaves both ends of risk unlimited.

07

Bear put spread

A bear put spread buys a higher-strike put and sells a lower-strike put, profiting from a moderate fall with limited risk.

EXAMPLE A trader buys a 500 put and sells a 480 put.

WATCH OUT Not true: a bear put spread profits from a rise.

08

Butterfly spread

A butterfly spread uses three strikes to profit if the price stays near the middle strike, with limited risk and limited reward.

EXAMPLE A trader expects little movement and uses three strikes.

WATCH OUT Not true: a butterfly spread profits from a large move.

Unit recap · one line each

Covered call · Protective put · Bull call spread · Long straddle · Long strangle · Collar · Bear put spread · Butterfly spread

UNIT 6 · 4% OF THE EXAM

Introduction to trading systems

How orders are placed and matched in the exchange's electronic system.

What the exam looks for

- Order types and priority.
- Trading hours.
- Position limits and bans.

Concept cards

01

Order matching

Orders on the exchange are matched on price-time priority: the best price first, and among equal prices the earliest order.

EXAMPLE Two buyers bid the same price and the earlier order is filled first.

WATCH OUT Not true: orders are matched on the largest size first.

02

Order types

Common order types are limit, market, stop loss and IOC (immediate or cancel); each controls price and timing differently.

EXAMPLE A trader uses an order that executes immediately or is cancelled.

WATCH OUT Not true: only limit orders exist in the derivatives segment.

03

Market maker

A market maker quotes continuous two-way prices to provide liquidity in a contract.

EXAMPLE An entity always quotes both buy and sell prices to keep the market liquid.

WATCH OUT Not true: a market maker only buys, never sells.

04

Market-wide position limit

The MWPL caps the total open positions across all traders in a stock's derivatives; when it reaches 95% the stock enters a ban period.

EXAMPLE A stock's derivative position exceeds 95% of the limit and is banned for fresh positions.

WATCH OUT Not true: mWPL applies only to index derivatives.

05

Ban period

In the ban period, traders can only reduce their open positions in the stock; fresh positions are not allowed.

EXAMPLE A trader can square off but cannot build new positions in a stock under restriction.

WATCH OUT Not true: during a ban period all trading is banned.

06

Client position limit

Position limits restrict the open positions a single client or member can hold, to prevent concentration and manipulation.

EXAMPLE A single client cannot hold unlimited open positions in one stock.

WATCH OUT Not true: there are no limits for a single client.

07

Trading hours of derivatives

The equity derivatives segment trades during regular market hours, 9:15 am to 3:30 pm, on business days.

EXAMPLE A trader places a futures order at 10 am on a working day.

WATCH OUT Not true: equity derivatives trade only in the pre-open session.

08

Price band in derivatives

Derivatives have operating ranges that stop orders far from the last price, to prevent erroneous trades.

EXAMPLE An order far away from the market price is rejected by the system.

WATCH OUT Not true: there is no price protection in derivatives.

Unit recap · one line each

Order matching · Order types · Market maker · Market-wide position limit · Ban period · Client position limit · Trading hours of derivatives · Price band in derivatives

UNIT 7 · 13% OF THE EXAM

Introduction to clearing and settlement system

After the trade comes the settlement. This unit covers clearing members, the clearing corporation, margins, daily MTM and final settlement.

What the exam looks for

- Roles of clearing corporation and clearing members.
- Margin types and collateral.
- Settlement of futures and options.

Settlement summary

Contract	Daily	At expiry
Index futures	MTM in cash	Final settlement in cash
Stock futures	MTM in cash	Physical delivery
Index options	Premium paid at trade	Cash settlement of ITM
Stock options	Premium paid at trade	Physical delivery of ITM

Concept cards

01

Clearing corporation

The clearing corporation becomes the counterparty to every trade through novation, guaranteeing settlement and managing risk.

EXAMPLE After a trade, the buyer's counterparty is the clearing entity, not the seller.

WATCH OUT Not true: the clearing corporation sets prices of contracts.

02

Novation

Novation replaces the original contract between buyer and seller with two contracts, each with the clearing corporation as counterparty.

EXAMPLE After matching, each side deals with the clearing corporation instead of the other party.

WATCH OUT Not true: novation cancels the trade.

03

Clearing member

A clearing member is authorised to clear and settle trades with the clearing corporation, for itself or for trading members.

EXAMPLE A firm that settles trades on behalf of other brokers with the clearing corporation.

WATCH OUT Not true: a clearing member only advises clients.

04

Professional clearing member

A professional clearing member clears trades for others without being a trading member itself.

EXAMPLE An institution clears trades for several brokers but does not trade itself.

WATCH OUT Not true: a professional clearing member is also a trading member always.

05

Self-clearing member

A self-clearing member is a trading member who also clears its own trades and its clients' trades.

EXAMPLE A broker that trades and clears by itself.

WATCH OUT Not true: a self-clearing member relies on others to settle its trades.

06

Daily settlement price

The daily settlement price of futures is generally the closing price (average of the last half hour), and positions are marked against it.

EXAMPLE The price used to compute each day's profit or loss on futures.

WATCH OUT Not true: the daily settlement price is the opening price.

07

Final settlement price

On expiry, the final settlement price of index futures is the closing value of the underlying index.

EXAMPLE Index futures are settled against the index close on the last day.

WATCH OUT Not true: the final settlement price is the previous month's average.

08

Settlement of premium

Option premium is settled in cash on T+1; the buyer pays and the seller receives.

EXAMPLE The premium moves between accounts the day after the trade.

WATCH OUT Not true: premium is settled after expiry.

09

Settlement guarantee fund

The clearing corporation maintains a fund to cover member defaults, built from contributions of members and the corporation.

EXAMPLE A pool of money used if a member fails to meet obligations.

WATCH OUT Not true: the fund is paid to investors as dividend.

10

Collateral for margin

Margin can be given in cash, bank guarantees, fixed deposit receipts or approved securities, subject to haircuts.

EXAMPLE A trader pledges approved shares instead of cash margin.

WATCH OUT Not true: only cash is accepted as margin.

11

Haircut

A haircut is a reduction applied to the value of collateral securities to protect against price falls.

EXAMPLE A pledged share valued at ₹100 is counted at ₹80 for margin.

WATCH OUT Not true: a haircut increases the collateral value.

12

Mark-to-market margin

MTM margin is collected from members for the day's losses on open positions, to ensure daily settlement.

EXAMPLE A trader whose position fell during the day pays the difference.

WATCH OUT Not true: mTM margin is collected only at expiry.

13

Peak margin

Peak margin rules require traders to maintain margin at the highest level of exposure during the day, not just at the end of the day.

EXAMPLE A trader must hold margin for the highest exposure taken at any time in the day.

WATCH OUT Not true: margin is checked only at the market close.

14

Extreme loss margin

Extreme loss margin covers losses beyond those captured by SPAN in highly adverse moves.

EXAMPLE A margin collected to cover extreme price moves.

WATCH OUT Not true: extreme loss margin is the same as premium.

15

Position squaring and exercise

A position can be closed by an opposite trade or held to expiry, when options are exercised or lapse and futures are settled.

EXAMPLE A trader ends an option position by selling it before expiry.

WATCH OUT Not true: positions cannot be closed before expiry.

16

Default handling

On a member's default, the clearing corporation uses the member's margins and deposits first, then other resources, to complete settlement.

EXAMPLE A defaulting member's deposits are used before other funds.

WATCH OUT Not true: the investors' funds are used first for member defaults.

Unit recap · one line each

Clearing corporation · Novation · Clearing member · Professional clearing member · Self-clearing member · Daily settlement price · Final settlement price · Settlement of premium · Settlement guarantee fund · Collateral for margin · Haircut · Mark-to-market margin · Peak margin · Extreme loss margin · Position squaring and exercise · Default handling

UNIT 8 · 15% OF THE EXAM

Legal and regulatory environment

Who permits derivatives, who regulates them, who is eligible to trade and what safeguards exist. Questions here test exact names and rules.

What the exam looks for

- SCRA, SEBI Act and committees.
- Eligibility of securities and members.
- Investor protection and risk disclosure.

Milestones

Event	Year
Derivatives permitted after the L.C. Gupta committee	1999 amendment of SCRA
Index futures launched	June 2000
Index options launched	June 2001
Stock options launched	July 2001
Stock futures launched	November 2001

Concept cards

01

SCRA

The Securities Contracts (Regulation) Act, 1956 regulates trading in securities and, after amendment, recognises derivatives as securities.

EXAMPLE The law that defines securities and allows derivatives trading on recognised exchanges.

WATCH OUT Not true: the SCRA bans all derivatives trading.

02

SEBI Act

The SEBI Act, 1992 gives SEBI the power to regulate the securities market, including derivatives, and protect investors.

EXAMPLE The statute that created the regulator and gave it powers.

WATCH OUT Not true: the SEBI Act regulates only banks.

03

L.C. Gupta Committee

The Dr. L. C. Gupta Committee (1998) recommended the introduction of derivatives trading in India and laid out the regulatory framework.

EXAMPLE A committee that paved the way for derivatives in India.

WATCH OUT Not true: the committee banned derivatives in 1998.

04

J.R. Varma Committee

The Prof. J. R. Varma Committee recommended risk containment measures, including margining systems, for derivatives trading.

EXAMPLE A committee whose report shaped margin and risk measures.

WATCH OUT Not true: the Varma committee recommended banning index futures.

05

Eligibility of stocks

Stocks are admitted to derivatives based on criteria such as market capitalisation, free float, trading frequency and volatility.

EXAMPLE A stock must meet liquidity and size tests to get derivatives contracts.

WATCH OUT Not true: any listed company can have derivatives.

06

Trading member

A trading member of the derivatives segment must be registered with SEBI, meet net-worth and certification norms, and have qualified dealers.

EXAMPLE A broker must hold the NISM certificate for its dealers.

WATCH OUT Not true: trading members need no certification.

07

Certification requirement

Dealers and persons who handle derivatives business must pass the NISM derivatives certification examination.

EXAMPLE A sales trader must hold the examination certificate to deal.

WATCH OUT Not true: anyone can deal in derivatives without certification.

08

Risk disclosure document

Brokers must give clients a risk disclosure document explaining the risks of derivatives, including leverage and the possibility of losing the entire margin.

EXAMPLE A client must read and acknowledge the risks before trading.

WATCH OUT Not true: a risk disclosure document is optional.

09

Client registration

Clients must complete KYC and sign a client-broker agreement before trading derivatives.

EXAMPLE A new client signs the standard forms before the first trade.

WATCH OUT Not true: a client can trade before completing KYC.

10

Contract note

A broker must issue a contract note for every trade, showing price, time, brokerage and charges, usually within 24 hours.

EXAMPLE A client receives a document confirming the details of her trade.

WATCH OUT Not true: a contract note is optional.

11

Segregation of client funds

Brokers must keep client funds and securities separate from their own and must not use them for proprietary trading.

EXAMPLE A broker holds client money in a separate account.

WATCH OUT Not true: brokers may use client funds for their own trades.

12

Minimum contract size

SEBI prescribes a minimum value for a derivatives contract at the time of its introduction, reviewed periodically, so that lot sizes are meaningful.

EXAMPLE A contract lot is set to meet the regulator's minimum value.

WATCH OUT Not true: the exchange can fix any tiny contract value.

13

Suitability

Intermediaries must ensure that derivatives trading is suitable for the client given experience, income and risk appetite.

EXAMPLE A broker checks that a retail client understands leverage before allowing trades.

WATCH OUT Not true: suitability is irrelevant to broking.

14

Prohibition of insider trading

Using unpublished price-sensitive information to trade stock derivatives is an offence under SEBI rules.

EXAMPLE An insider buys stock futures before the company announces a merger.

WATCH OUT Not true: insider trading rules apply only to shares and not to derivatives.

15

Investor Protection Fund

Exchanges maintain a fund to compensate clients of defaulting members within prescribed limits.

EXAMPLE A client of a failed broker receives compensation from the exchange fund.

WATCH OUT Not true: the fund compensates every market loss.

16

Grievance redressal and arbitration

Disputes between clients and brokers can be taken to the exchange's arbitration, investor service cells and SEBI's complaint system.

EXAMPLE A client files a complaint and seeks arbitration against a broker.

WATCH OUT Not true: clients have no recourse for disputes.

17

Surveillance

Exchanges and SEBI monitor derivatives markets for manipulation, with measures such as position limits and bans.

EXAMPLE A regulator flags unusually concentrated positions.

WATCH OUT Not true: surveillance covers only the cash market.

18

Proprietary versus client trades

Brokers must distinguish their own proprietary trades from client trades and ensure they are reported and handled separately.

EXAMPLE A broker's own account trades are tagged separately from client orders.

WATCH OUT Not true: proprietary and client trades are mixed together.

Unit recap · one line each

SCRA · SEBI Act · L.C. Gupta Committee · J.R. Varma Committee · Eligibility of stocks · Trading member · Certification requirement · Risk disclosure document · Client registration · Contract note · Segregation of client funds · Minimum contract size · Suitability · Prohibition of insider trading · Investor Protection Fund · Grievance redressal and arbitration · Surveillance · Proprietary versus client trades

UNIT 9 · 3% OF THE EXAM

Accounting and taxation

How profits and losses from derivatives are treated for accounts and tax.

What the exam looks for

- Income tax treatment of F&O.
- STT.

Concept cards

01

Non-speculative business income

Profits or losses from index and stock futures and options are generally treated as non-speculative business income under income tax law.

EXAMPLE A trader reports F&O profits as business income, not capital gains.

WATCH OUT Not true: f&O gains are always taxed as capital gains.

02

Securities transaction tax on derivatives

STT is charged on derivatives transactions, for example on the sale of options on the premium and on futures sale, at rates set by law.

EXAMPLE A small tax is deducted on the sell side of a futures trade.

WATCH OUT Not true: derivatives are exempt from all transaction taxes.

03

Tax audit

A person whose derivatives turnover or losses cross specified thresholds may need to get accounts audited under the tax law.

EXAMPLE A trader with large F&O turnover must have accounts audited.

WATCH OUT Not true: tax audit is never required for traders.

04

Mark-to-market accounting

Open futures positions are marked to market at year end for accounting, and unrealised losses may be recognised.

EXAMPLE Open positions are valued at the closing price on the balance sheet date.

WATCH OUT Not true: open positions are ignored at year end.

05

Carry forward of business losses

Non-speculative business losses from derivatives can be set off against other business income and carried forward for eight years if returns are filed on time.

EXAMPLE A trader's F&O loss is carried forward to future years.

WATCH OUT Not true: f&O losses can never be carried forward.

06

Turnover for derivatives

For tax audit purposes, turnover of futures and options is computed using specified methods, such as the absolute profit and loss and premium on sale of options.

EXAMPLE Turnover is computed by adding absolute profits and losses for futures.

WATCH OUT Not true: turnover for F&O is equal to the contract value.

Unit recap · one line each

Non-speculative business income · Securities transaction tax on derivatives · Tax audit · Mark-to-market accounting · Carry forward of business losses · Turnover for derivatives

UNIT 10 · 2% OF THE EXAM

Sales practices and investor protection services

Good conduct in selling derivatives, from advice to complaints.

What the exam looks for

- Suitability, disclosures and ethics.

Concept cards

01

Know your client

Intermediaries must know the client's identity, financial position and investment objectives before allowing derivative trades.

EXAMPLE A broker collects income and experience details from a new client.

WATCH OUT Not true: kYC is needed only for futures and not for options.

02

Code of conduct

A code of conduct for brokers requires honesty, fairness, due diligence and prohibits misleading statements and unfair practices.

EXAMPLE A broker must not promise assured profits.

WATCH OUT Not true: brokers can guarantee returns in derivatives.

03

Conflict of interest

A dealer must avoid or disclose conflicts, such as trading ahead of client orders (front running), which is prohibited.

EXAMPLE A dealer who trades for his own account before executing a large client order commits a violation.

WATCH OUT Not true: front running is permitted if the client is not aware.

04

Complaint handling

Intermediaries must have a grievance mechanism and resolve client complaints promptly, and escalate to the exchange or SEBI if not resolved.

EXAMPLE A client with an unresolved complaint writes to the exchange.

WATCH OUT Not true: clients can complain only after a year.

05

Appropriate advice

Dealers should explain leverage, margin calls and potential loss and avoid pushing high-risk strategies to unsuitable clients.

EXAMPLE A dealer explains that a short option can lose more than the premium collected.

WATCH OUT Not true: dealers should hide risk to encourage trades.

Unit recap · one line each

Know your client · Code of conduct · Conflict of interest · Complaint handling · Appropriate advice

QUICK REFERENCE

Numbers and formulas.

Option payoffs at expiry (per unit)

Position	Payoff	Break-even	Max loss	Max profit
Long call	max(S − K, 0) − premium	K + premium	Premium	Unlimited
Short call	premium − max(S − K, 0)	K + premium	Unlimited	Premium
Long put	max(K − S, 0) − premium	K − premium	Premium	K − premium
Short put	premium − max(K − S, 0)	K − premium	K − premium	Premium

Greeks in one line

Greek	Measures
Delta	Change in option price for a ₹1 move in the underlying
Gamma	Change in delta for a ₹1 move in the underlying
Theta	Loss of option value per day from time passing
Vega	Change in option price for a 1% move in volatility
Rho	Change in option price for a 1% move in the interest rate

GLOSSARY

Every term, A to Z.

Term	Meaning	Unit
American option	An American option can be exercised at any time up to and including expiry.	4
Appropriate advice	Dealers should explain leverage, margin calls and potential loss and avoid pushing high-risk strategies to unsuitable clients.	10
Arbitrageur	An arbitrageur exploits price differences between related markets to earn a low-risk profit.	1
At-the-money	An option is at the money when the strike equals the spot price. Its intrinsic value is zero.	4
Backwardation	Backwardation is a market in which futures prices are lower than the spot price.	3
Ban period	In the ban period, traders can only reduce their open positions in the stock; fresh positions are not allowed.	6
Base value	An index starts at a base value on a base date; the Nifty 50 base is 1000 and the Sensex base is 100, and later values are relative to them.	2
Basis	Basis is the difference between the spot price and the futures price. It narrows to zero at expiry as the two prices converge.	3
Bear put spread	A bear put spread buys a higher-strike put and sells a lower-strike put, profiting from a moderate fall with limited risk.	5
Beta of a portfolio	Beta measures the sensitivity of a portfolio to market moves; a beta of 1.2 means it is expected to move 20% more than the index.	2
Bull call spread	A bull call spread buys a lower-strike call and sells a higher-strike call, limiting both the cost and the profit.	5
Butterfly spread	A butterfly spread uses three strikes to profit if the price stays near the middle strike, with limited risk and limited reward.	5
Call option buyer	The buyer of a call pays a premium and has the right to buy the underlying at the strike. Maximum loss is the premium and the potential profit is unlimited.	4
Call option seller	The call seller (writer) receives the premium and must sell the underlying at the strike if exercised. The maximum profit is the premium and the loss is potentially unlimited.	4
Carry forward of business losses	Non-speculative business losses from derivatives can be set off against other business income and carried forward for eight years if returns are filed on time.	9
Cash settlement	In cash settlement, no underlying is delivered; the difference between the contract price and the settlement price is paid in cash.	3
Cash-and-carry arbitrage	Cash-and-carry arbitrage buys the underlying in the cash market and sells the future when the future is expensive relative to fair value.	3
Certification requirement	Dealers and persons who handle derivatives business must pass the NISM derivatives certification examination.	8
Clearing corporation	The clearing corporation becomes the counterparty to every trade through novation, guaranteeing settlement and managing risk.	7
Clearing member	A clearing member is authorised to clear and settle trades with the clearing corporation, for itself or for trading members.	7
Client position limit	Position limits restrict the open positions a single client or member can hold, to prevent concentration and manipulation.	6

Term	Meaning	Unit
Client registration	Clients must complete KYC and sign a client-broker agreement before trading derivatives.	8
Code of conduct	A code of conduct for brokers requires honesty, fairness, due diligence and prohibits misleading statements and unfair practices.	10
Collar	A collar holds the underlying, buys a put and sells a call, limiting both downside and upside, often at a low net cost.	5
Collateral for margin	Margin can be given in cash, bank guarantees, fixed deposit receipts or approved securities, subject to haircuts.	7
Complaint handling	Intermediaries must have a grievance mechanism and resolve client complaints promptly, and escalate to the exchange or SEBI if not resolved.	10
Conflict of interest	A dealer must avoid or disclose conflicts, such as trading ahead of client orders (front running), which is prohibited.	10
Contango	Contango is a market in which futures prices are higher than the spot price, normally due to carrying costs.	3
Contract note	A broker must issue a contract note for every trade, showing price, time, brokerage and charges, usually within 24 hours.	8
Contract specification	An exchange fixes the underlying, lot size, tick size, expiry cycle and settlement method for each derivatives contract.	3
Contract value	Contract value equals futures price multiplied by the lot size and shows the exposure in rupees.	3
Convergence	On the expiry date the futures price converges to the spot price of the underlying.	3
Cost of carry	The cost of carry is the cost of holding the underlying until expiry, mainly financing cost less any income such as dividends, and drives futures pricing.	3
Covered call	A covered call holds the underlying and sells a call against it, earning the premium but capping the upside.	5
Daily settlement price	The daily settlement price of futures is generally the closing price (average of the last half hour), and positions are marked against it.	7
Default handling	On a member's default, the clearing corporation uses the member's margins and deposits first, then other resources, to complete settlement.	7
Delta	Delta measures the change in an option's price for a ₹1 change in the underlying. Calls have delta between 0 and 1; puts between −1 and 0.	4
Derivative	A derivative is a financial contract whose value depends on, or is derived from, an underlying asset or reference rate such as a share, index, currency or commodity.	1
Early exercise of European options	Because European options cannot be exercised early, holders who want to exit before expiry sell the option in the market.	4
Eligibility of stocks	Stocks are admitted to derivatives based on criteria such as market capitalisation, free float, trading frequency and volatility.	8
European option	A European option can be exercised only on the expiry date. All options on Indian exchanges are European style.	4
Exchange-traded derivative	Exchange-traded derivatives have standardised terms, are cleared by a clearing corporation and carry lower counterparty risk.	1
Exercise and assignment	When a buyer exercises, a seller is assigned at random or by rule and must perform the obligation under the contract.	4

Term	Meaning	Unit
Expiry cycle	Index and stock futures have near-month, next-month and far-month contracts, and a contract expires on the day set by the exchange; on expiry it is cash settled.	3
Exposure margin	Exposure margin is an additional margin over and above SPAN margin, collected to cover risk beyond that measured.	3
Extreme loss margin	Extreme loss margin covers losses beyond those captured by SPAN in highly adverse moves.	7
Fair value of futures	The fair price of a futures contract is the spot price plus the net cost of carry; deviations create arbitrage opportunities.	3
Final settlement price	On expiry, the final settlement price of index futures is the closing value of the underlying index.	7
Forward contract	A forward contract is a private agreement to buy or sell an asset at a fixed price on a future date. It is customised and traded over the counter, with counterparty risk.	1
Free-float weighting	Free-float market capitalisation weighting weights each stock by the value of shares available for public trading, so promoter holdings are excluded.	2
Futures contract	A futures contract is a standardised agreement traded on an exchange to buy or sell an underlying at a fixed price on a future date, with the clearing corporation guaranteeing performance.	1
Futures margin and leverage	Because only margin is paid upfront, futures offer leverage: a small price change can produce a large percentage gain or loss on margin.	3
Futures versus forwards risk	Exchange-traded futures remove counterparty risk through the clearing corporation, while forwards leave it with the counterparty.	3
Gamma	Gamma measures how much delta changes for a ₹1 move in the underlying. It is highest for at-the-money options near expiry.	4
Grievance redressal and arbitration	Disputes between clients and brokers can be taken to the exchange's arbitration, investor service cells and SEBI's complaint system.	8
Haircut	A haircut is a reduction applied to the value of collateral securities to protect against price falls.	7
Hedger	A hedger uses derivatives to reduce an existing price risk rather than to profit from price moves.	1
Hedging with index futures	A portfolio owner can sell index futures to protect against a fall in the market; the number of contracts depends on portfolio value and beta.	3
Implied volatility	Implied volatility is the volatility the market's option prices imply for the underlying, derived from the option price.	4
In-the-money	A call is in the money when spot is above the strike; a put is in the money when spot is below the strike. It has positive intrinsic value.	4
Index futures	Index futures are contracts on stock indices such as the Nifty 50, are cash settled, and are widely used to hedge and speculate on the overall market.	3
Index rebalancing	Index constituents are reviewed periodically and stocks replaced when they no longer meet criteria on market cap, liquidity and free float.	2
Initial margin	Initial margin is the upfront deposit collected to cover the potential loss on a futures position over a short period. It is risk-based, using the SPAN system.	3
Intrinsic value	Intrinsic value is the amount by which an option is in the money, and is never negative. For a call it is the greater of (spot − strike) and zero.	4

Term	Meaning	Unit
Investor Protection Fund	Exchanges maintain a fund to compensate clients of defaulting members within prescribed limits.	8
J.R. Varma Committee	The Prof. J. R. Varma Committee recommended risk containment measures, including margining systems, for derivatives trading.	8
Know your client	Intermediaries must know the client's identity, financial position and investment objectives before allowing derivative trades.	10
L.C. Gupta Committee	The Dr. L. C. Gupta Committee (1998) recommended the introduction of derivatives trading in India and laid out the regulatory framework.	8
Leverage	Leverage in derivatives means controlling a large exposure with a small margin, magnifying both gains and losses.	1
Long call payoff	A long call's profit at expiry = max(spot − strike, 0) − premium; break-even = strike + premium.	4
Long futures position	A long futures position buys the contract and gains when the price rises above the entry price and loses when it falls.	3
Long hedge versus short hedge	A short hedge sells futures to protect against price falls; a long hedge buys futures to protect against price rises.	3
Long put payoff	A long put's profit at expiry = max(strike − spot, 0) − premium; break-even = strike − premium.	4
Long straddle	A long straddle buys a call and a put at the same strike and expiry, profiting from a large move in either direction.	5
Long strangle	A long strangle buys an out-of-the-money call and an out-of-the-money put, costing less than a straddle but needing a bigger move.	5
Mark-to-market	In futures, profit or loss is settled daily against the day's settlement price, and the amounts are debited or credited to the member accounts.	3
Mark-to-market accounting	Open futures positions are marked to market at year end for accounting, and unrealised losses may be recognised.	9
Mark-to-market margin	MTM margin is collected from members for the day's losses on open positions, to ensure daily settlement.	7
Market maker	A market maker quotes continuous two-way prices to provide liquidity in a contract.	6
Market-wide position limit	The MWPL caps the total open positions across all traders in a stock's derivatives; when it reaches 95% the stock enters a ban period.	6
Minimum contract size	SEBI prescribes a minimum value for a derivatives contract at the time of its introduction, reviewed periodically, so that lot sizes are meaningful.	8
Non-speculative business income	Profits or losses from index and stock futures and options are generally treated as non-speculative business income under income tax law.	9
Novation	Novation replaces the original contract between buyer and seller with two contracts, each with the clearing corporation as counterparty.	7
Open interest	Open interest is the total number of outstanding contracts not yet squared off or settled, showing how many positions remain open.	3
Option chain	An option chain lists the available strikes and premiums of calls and puts for a given underlying and expiry.	4
Option premium determinants	The premium depends on spot, strike, time to expiry, volatility, interest rates and dividends; higher volatility and longer time raise it.	4

Term	Meaning	Unit
Option writer margin	Option sellers must deposit margin because of their potential large losses; option buyers pay only the premium and need no margin.	4
Order matching	Orders on the exchange are matched on price-time priority: the best price first, and among equal prices the earliest order.	6
Order types	Common order types are limit, market, stop loss and IOC (immediate or cancel); each controls price and timing differently.	6
Out-of-the-money	A call is out of the money when spot is below the strike; a put when spot is above the strike. It has no intrinsic value, only time value.	4
Over-the-counter derivative	OTC derivatives are privately negotiated and tailor-made but carry higher counterparty and liquidity risk.	1
Pair trade	A pair trade buys one related security and sells another, profiting from relative price movement rather than market direction.	3
Peak margin	Peak margin rules require traders to maintain margin at the highest level of exposure during the day, not just at the end of the day.	7
Physical settlement	In physical settlement, the underlying shares are actually delivered on expiry; stock derivatives in India are physically settled.	3
Position squaring and exercise	A position can be closed by an opposite trade or held to expiry, when options are exercised or lapse and futures are settled.	7
Premium settlement	Premium is paid by the buyer and received by the seller on the next working day after the trade.	4
Price band in derivatives	Derivatives have operating ranges that stop orders far from the last price, to prevent erroneous trades.	6
Price discovery	Derivatives markets help in price discovery by reflecting market expectations about future prices of the underlying.	1
Professional clearing member	A professional clearing member clears trades for others without being a trading member itself.	7
Prohibition of insider trading	Using unpublished price-sensitive information to trade stock derivatives is an offence under SEBI rules.	8
Proprietary versus client trades	Brokers must distinguish their own proprietary trades from client trades and ensure they are reported and handled separately.	8
Protective put	A protective put buys a put against a held position, setting a floor under the loss at the cost of the premium.	5
Put option buyer	The buyer of a put pays a premium and has the right to sell at the strike. Maximum loss is the premium; profit rises as the price falls to zero.	4
Put option seller	The put seller receives the premium and must buy the underlying at the strike if exercised. Maximum profit is the premium; loss can be large if prices fall.	4
Put-call parity	For European options, the call price minus the put price equals the present value relationship of spot and strike; deviations offer arbitrage.	4
Reverse cash-and-carry	Reverse cash-and-carry sells the underlying and buys the future when the future is cheap relative to fair value.	3
Rho	Rho measures the change in an option's price for a 1% change in the interest rate.	4
Risk disclosure document	Brokers must give clients a risk disclosure document explaining the risks of derivatives, including leverage and the possibility of losing the entire margin.	8

Term	Meaning	Unit
Rollover	Rolling over means closing a near-month position and opening a similar position in the next month to maintain exposure.	3
SCRA	The Securities Contracts (Regulation) Act, 1956 regulates trading in securities and, after amendment, recognises derivatives as securities.	8
SEBI Act	The SEBI Act, 1992 gives SEBI the power to regulate the securities market, including derivatives, and protect investors.	8
Securities transaction tax on derivatives	STT is charged on derivatives transactions, for example on the sale of options on the premium and on futures sale, at rates set by law.	9
Segregation of client funds	Brokers must keep client funds and securities separate from their own and must not use them for proprietary trading.	8
Self-clearing member	A self-clearing member is a trading member who also clears its own trades and its clients' trades.	7
Settlement guarantee fund	The clearing corporation maintains a fund to cover member defaults, built from contributions of members and the corporation.	7
Settlement of index options	Index options are cash settled at expiry on the closing index value; in-the-money options are exercised automatically.	4
Settlement of premium	Option premium is settled in cash on T+1; the buyer pays and the seller receives.	7
Settlement of stock options	Stock options are physically settled; in-the-money stock options at expiry result in delivery of shares.	4
Short call payoff	A short call's profit at expiry = premium − max(spot − strike, 0); break-even = strike + premium.	4
Short futures position	A short position sells the contract and gains when the price falls below the entry price and loses when it rises.	3
Short put payoff	A short put's profit at expiry = premium − max(strike − spot, 0); break-even = strike − premium.	4
Single-stock futures	Single stock futures are futures on individual shares, available for eligible stocks with liquidity and market-cap criteria.	3
SPAN	SPAN is a risk-based margining system that estimates the largest likely one-day loss across a portfolio under many scenarios.	3
Speculator	A speculator takes positions in derivatives to profit from expected price changes and accepts the risk.	1
Square off	Squaring off means closing an open position by taking an equal and opposite position in the same contract before expiry.	3
Stock index	A stock index is a number measuring the combined price performance of a basket of stocks, used as a market barometer and as the underlying of index derivatives.	2
Suitability	Intermediaries must ensure that derivatives trading is suitable for the client given experience, income and risk appetite.	8
Surveillance	Exchanges and SEBI monitor derivatives markets for manipulation, with measures such as position limits and bans.	8
Swap	A swap is an agreement to exchange cash flows over a period, such as fixed for floating interest payments.	1
Tax audit	A person whose derivatives turnover or losses cross specified thresholds may need to get accounts audited under the tax law.	9

Term	Meaning	Unit
Theta	Theta measures the loss in option value as one day passes, other things equal. It hurts option buyers and helps sellers.	4
Tick size	The tick size is the minimum price movement allowed for a contract, such as ₹0.05 for futures on equity.	3
Time value	Time value is the part of the premium above intrinsic value, reflecting the chance of further favourable moves; it falls to zero at expiry.	4
Trading hours of derivatives	The equity derivatives segment trades during regular market hours, 9:15 am to 3:30 pm, on business days.	6
Trading member	A trading member of the derivatives segment must be registered with SEBI, meet net-worth and certification norms, and have qualified dealers.	8
Turnover for derivatives	For tax audit purposes, turnover of futures and options is computed using specified methods, such as the absolute profit and loss and premium on sale of options.	9
Underlying	The underlying is the asset or index on which a derivative contract is based.	1
Vega	Vega measures the change in an option's price for a 1% change in volatility. Higher volatility raises both call and put prices.	4
Weekly options	Exchanges list options with weekly expiries on selected indices, subject to regulatory limits on the number of contracts.	4

FINAL STRETCH

The last seven days.

Revision checklist

- [ ] Redo every payoff calculation on paper: long and short futures, long and short call and put.
- [ ] Memorise break-even formulas and maximum profit and loss for each strategy.
- [ ] Revise delta, gamma, theta, vega and rho in one line each.
- [ ] Re-read units 3 and 4 (50% of marks).
- [ ] Take Mock 5 under timed conditions and apply negative marking.

Exam-day tips

- Negative marking is 0.25 per wrong answer. Skip a question only if you have no idea; guessing between two options is worth it.
- Do payoff questions with a quick diagram: it prevents sign errors.
- Read for 'long' or 'short' and 'buyer' or 'seller' before calculating.
- Never forget lot size when asked for a rupee amount.
- Regulatory questions are about exact terms; learn the names of the committees and acts.

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