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NISM XI - SECURITIES MARKET

FOUNDATION EXAM

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TEST DETAILS – The NISM SECURITIES MARKET FOUNDATION CERTIFICATION EXAM is a 100 mark exam with 60% as passing marks. In all 100 questions will be asked with 0.25 negative marking for Wrong Answers. The time duration is 2 hours.

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PRACTICE TEST - 1

- Question 1 Which of the following is ranked last both in terms of profit sharing and receiving liquidation proceeds?
- (a) Government Creditors
 - (b) Lenders
 - (c) Employees
 - (d) Equity Shareholders

Correct Answer Equity Shareholders

Answer Explanation If a business were to fail, the proceeds from liquidation of assets are first paid to other claimants such as government, lenders and employees, and any residual amount, if at all, is paid to equity shareholders, after paying out preference shareholders, if any.

- Question 2 Market capitalization of a stock is impacted by_____.
- (a) Changes in price of the stock
 - (b) Liquidity in the market
 - (c) Level of trading volumes
 - (d) Changes in market index

Correct Answer Changes in price of the stock

Answer Explanation Market capitalization = The market value of a company, calculated by multiplying the number of shares issued and outstanding by their current market price.

The number of shares issued is constant, the market price of the shares changes on a daily basis which affects the Market capitalization.

Question 3 The net asset value of a mutual fund primarily reflects which one of the following?

- (a) The income of the fund's constituents
- (b) The current market value of the fund's portfolio
- (c) The expenses of the AMC
- (d) The dividends and interest payable to investors

Correct Answer The current market value of the fund's portfolio

Answer Explanation The Net Asset Value (NAV) is the current value of a mutual fund unit.

It is the current market value of the securities held in the portfolio of the fund and any income earned such as dividend and interest. From this value, the costs and expenses charged for managing the fund are deducted. The value remaining is called the net assets of the fund.

Question 4 Which of the following categories of shares have to be mandatorily listed on a stock exchange?

- (a) All shares depending upon the terms of the issue
- (b) All shares issued in a public issue
- (c) All shares issued to non-promoters
- (d) All shares issued by a company

Correct Answer All shares issued in a public issue

Answer Explanation Primary market issue (public issue) distributes the securities to a large number of investors and it is mandatory to list a public issue of securities in the stock exchange.

Question 5 _____ is the process of identifying what is owed to the buyer and seller in a trading transaction on a secondary market.

- (a) Clearing
- (b) Settlement
- (c) Hedging
- (d) Trading

Correct Answer Clearing

Answer Explanation Secondary market transactions have three distinct phases: trading, clearing and settlement. To trade in shares is to buy and sell them through the stock exchanges. Clearing is the process of identifying what is owed to the buyer and seller in a trading transaction; and settlement is the mechanism of settling the obligations of counter parties in a trade.

Question 6 Which of the following is a financial goal?

- (a) Fund child's education in 10 years with Rs. 10 lakh
- (b) Create a corpus of Rs. 1 crore to fund the future needs
- (c) Invest in equity for long term wealth of Rs. 5 crore
- (d) Build enough assets to last life time of 30 years

Correct Answer Fund child's education in 10 years with Rs. 10 lakh

Answer Explanation Financial goal is the term used to describe the future needs of an individual that require funding. It specifies the sum of money required to meet the need when it is required.

Goals described in terms of the money required to meet it at a point of time in future, is called a financial goal. In the above question, only the option - 'Fund child's education in 10 years with Rs. 10 lakh clearly states the purpose and the amount required for that purpose.

Question 7 _____ the open interest as a percentage of traded volume, the greater is the liquidity in the market

- (a) Larger
- (b) Lower

Correct Answer Larger

Answer Explanation Open interest is compared with the volume of trading in the derivatives market. The larger the open interest as a percentage of traded volume, the greater is the liquidity in the market. An increase in open interest is seen as an indicator of liquidity as it means fresh money is flowing into those contracts.

Question 8 The Net Asset Value (NAV) of a mutual fund scheme is Rs. 18 and the exit load is 2%. What will be the redemption price per unit ?

- (a) Rs. 17.64
- (b) Rs. 18.36
- (c) Rs. 18
- (d) Rs. 19.12

Correct Answer Rs. 17.64

Answer Explanation Mutual funds may impose a charge on the investors at the time of exiting from a fund called the exit load. It is calculated as a percentage of the NAV and reduced from the NAV to arrive at the price that the investor will get on exiting from the investment.

Redemption Price = NAV less Exit load

In the above question, NAV is Rs. 18 and the exit load is 2%.

2% of Rs. 18 is 0.36

So the Redemption Price is $18 - 0.36 = \text{Rs. } 17.64$

Question 9 How can you calculate the coupon of a bond if the market price of the bond and its yield are known?

- (a) Coupon Rate = Market Price of the bond / Current Yield
- (b) Coupon Rate = Current Yield / Face Value of the bond
- (c) Coupon Rate = Current Yield / Market Price of the bond
- (d) Coupon Rate = Face Value / Market Price of the bond

Correct Answer Coupon Rate = Current Yield / Market Price of the bond

Answer Explanation Current yield = Coupon rate/ Market price of the bond
So if market price and the current yield are known, one can compute the Coupon rate as : Current Yield / Market Price of the bond.

Question 10 The reserves of a company rightfully belong to_____.

- (a) Promoters
- (b) Institutional lenders
- (c) Employees
- (d) Equity Shareholders

Correct Answer Equity Shareholders

Answer Explanation The share of profits that is not distributed to shareholders is known as retained profits ie. the company's reserve funds. Reserves belong to the shareholders, though it remains with the company until it is distributed as dividend.
Reserves represent retained profits that have not been distributed to the rightful owners of the same, namely the equity investors.

Question 11 In case of a Book Built issue, the offer will be open for a period between 3 to 7 days extendable by ____ days in case of a revision in price band.

- (a) 3
- (b) 5
- (c) 7
- (d) 10

Correct Answer 3

Answer Explanation A Fixed Price public issue will be open for a minimum of three working days and a maximum of 10 working day.
For book built issues, the offer will be open for a period between 3 to 7 days extendable by 3 days in case of a revision in price band.

Question 12 A bond is issued at a face value of Rs. 100 and a coupon of 10% p.a. The interest rates in the market have increased subsequently. This bond is likely to quote _____.

- (a) At the face value
- (b) At a price above face value
- (c) At a price below face value
- (d) At a price that reflects its credit risk

Correct Answer At a price below face value

Answer Explanation The higher the discount rate or yield, the lower the present value. Assume that a bond pays 10% interest for the next 10 years, and the market yield for a comparable bond has moved up to 12%. The future cash flows of this bond will now be discounted at 12% and the bond will be worth much lesser.

(Alternatively, if the same cash flows are discounted at 8%, the value of the bond will be higher)

- Question 13 Calculate the current yield of a bond whose face value is Rs. 100 and it pays 9% coupon. The current market price is Rs. 114.
- (a) 6.80%
 - (b) 7.80%
 - (c) 8.80%
 - (d) 9.80%

Correct Answer **7.80%**

Answer Explanation Current yield simply compares the coupon of a bond with its market price.

Current yield = Coupon rate/ Market price

As per the given data -

$$\begin{aligned}\text{Current yield} &= 9 / 114 \\ &= 0.078 (\times 100) = 7.8 \%\end{aligned}$$

- Question 14 The issue of debt securities is regulated by the provisions of the SEBI (Issuance of Capital and Disclosures Requirements) Regulation, 2009 - State True or False ?
- (a) TRUE
 - (b) FALSE

Correct Answer **FALSE**

Answer Explanation The issue of debt securities is regulated by the provisions of the Companies Act and SEBI's Issue and Listing of Debt Securities Regulations, 2008.

Question 15 The larger the open interest as a percentage of traded volume, the greater is the liquidity in the market - State True or False ?

- (a) TRUE
- (b) FALSE

Correct Answer TRUE

Answer Explanation Open interest is compared with the volume of trading in the derivatives market. The larger the open interest as a percentage of traded volume, the greater is the liquidity in the market. An increase in open interest is seen as an indicator of liquidity as it means fresh money is flowing into those contracts.

Question 16 Circuit limits for individual stocks cannot be fixed by the stock exchanges - State True or False ?

- (a) TRUE
- (b) FALSE

Correct Answer FALSE

Answer Explanation If there is an abnormal percentage change in the price of a stock, the exchange can suspend trading in that particular scrip. Such heavy movement in price is called "hitting the circuit breaker." Stock exchanges fix price bands (circuit limits) for individual stocks.

- Question 17 Individual investors are categorized as retail investors who invest not more than _____ in a public issue
- (a) Rs.1 lakh
 - (b) Rs.2 lakhs
 - (c) Rs. 50,000
 - (d) Rs. 5 lakhs

Correct Answer Rs.2 lakhs

Answer Explanation Individual investors are categorized as retail investors who invest not more than Rs.2 lakhs in a public issue and Non-Institutional buyers who invest more than Rs.2 lakhs.

- Question 18 State True or False - One type of investment cannot meet all requirements like liquidity, growth, regular income etc.
- (a) TRUE
 - (b) FALSE

Correct Answer TRUE

Answer Explanation A single type of investment cannot meet all the needs. For eg. For growth purpose one should invest in equity, for regular returns one should invest in debt etc.

- Question 19 People seek the services of financial planner for various reasons. Which one of the below is NOT a reason for it?
- (a) Plenty of investments and insurance products available
 - (b) There is lack of social security in India and life span has also increased
 - (c) Its a regulatory requirement
 - (d) The investment products are complex and difficult to understand

Correct Answer Its a regulatory requirement

Answer Explanation Financial planning is not a regulatory requirement. Its not required by law.

Financial planning is done because there is need for retirement planning, difficult to understand investment products etc.

- Question 20 Unexecuted limit orders are carried forward to the next trading day on Indian Stock Exchanges - State True or False ?
- (a) TRUE
 - (b) FALSE

Correct Answer FALSE

Answer Explanation Limit orders are the most common type of orders placed in the market. The buyer or seller specifies the price. A limit order is placed when an investor wants a trade to get executed only if the desired price becomes available in the market.

Unexecuted limit orders lapse and get cancelled at the end of the day.

Question 21 The amount that the clearing corporation collects from its members to ensure that trades settle without default is known as_____.

- (a) Premium
- (b) Margin
- (c) Membership fees
- (d) Special fees

Correct Answer Margin

Answer Explanation A margin is the amount of funds that one has to deposit with the clearing corporation in order to cover the risk of non-payment of dues or non-delivery of securities. In order to minimise this default risk, both buyers and sellers of equity are required to pay a percentage of their dues upfront at the time of placing their order. This payment is known as margin.

Question 22 When the key market indices are rising, this means that the economy is_____.

- (a) Weakening
- (b) Stagnating
- (c) Growing
- (d) Decoupling

Correct Answer Growing

Answer Explanation A sustained rise in key market indices indicate healthy revenues, profitability, capital investment and expansion in large listed companies, which in turn implies that the economy is growing strongly.

A continuous decline or poor returns on indices is a signal of weakening economic activity.

Question 23 Investors in debt do not enjoy a fixed rate of return on their investments - State whether True or False ?

- (a) TRUE
- (b) FALSE

Correct Answer FALSE

Answer Explanation Equity investors do not enjoy any fixed return or return of principal invested; debt investors earn a fixed rate of interest and return of principal at maturity.

Question 24 Tax-free bonds are mainly issued by PSUs in the _____.

- (a) Service sector
- (b) Infrastructure sector
- (c) Banking sector
- (d) All of the above

Correct Answer Infrastructure sector

Answer Explanation PSU (Public sector units) bonds can be categorized as taxable and tax-free bonds. Tax-free bonds are mainly issued by PSUs in the infrastructure sector. The government may authorize specific PSUs to issue tax-free bonds. Interest income earned from tax-free bonds is not taxable for the investor.

- Question 25 Large institutional investors such as venture capitalists may subscribe to equity in early stages and become_____.
- (a) Special investors
 - (b) Inside investors
 - (c) Outside investors
 - (d) IPO investors

Correct Answer Inside investors

Answer Explanation Equity capital can be provided by two types of shareholders. The first are the inside shareholders or promoters who start the company with their funds and entrepreneurial skills.

Large institutional investors such as venture capitalists may subscribe to equity in early stages and become inside investors. The second set of owners are outside-shareholders, or members of the public, who invest in the company's equity shares at a later stage in order to fund its subsequent expansions and operations.

- Question 26 What is a special characteristics of a growth option in a mutual fund scheme?
- (a) When dividend is declared, the NAV goes down accordingly
 - (b) The dividend declared is again invested in the fund
 - (c) Dividend is declared when there is a profit but its not distributed to the unit holders
 - (d) No dividend is declared

Correct Answer No dividend is declared

Answer Explanation In the growth option, the gains made in the portfolio are not distributed in the form of dividend but retained in the fund. Dividends are never declared. The gains are reflected in the rising NAV.

Investors can realise the gains by selling the units.

Question 27 Fill the blanks - Debt securities are _____ while Equity securities are _____.

- (a) income oriented, growth oriented
- (b) growth oriented, income oriented
- (c) risk free securities, risky securities
- (d) short term , long term

Correct Answer income oriented, growth oriented

Answer Explanation Equity represents a risky, long-term, growth oriented investment that can show a high volatility in performance, depending on how the underlying business is performing.
Debt represents a relatively lower risk, steady, short-term, income-oriented investment.

Question 28 Investments in _____ provide returns in form of capital appreciation and dividend.

- (a) Gold
- (b) Arts and Antiques
- (c) Equity shares
- (d) Debt securities

Correct Answer Equity shares

Answer Explanation The return from equity shares will be in the form of dividend and capital appreciation. There is however no assurance on these returns.

Question 29 The option buyer has the obligation and therefore must exercise the option - State whether True or False ?

- (a) TRUE
- (b) FALSE

Correct Answer FALSE

Answer Explanation The option buyer has the right but no obligation with regards to buying or selling the underlying asset, while the option writer (seller) has the obligation in the contract. Therefore, option buyer will exercise his option only when the situation is favourable to him, but, when he decides to exercise, option writer would be legally bound to honour the contract.

Question 30 Requirement of Rs 3 lakhs after a year to pay for a family vacation is an example of ____.

- (a) Financial Planning
- (b) Financial Goal
- (c) Risk Management
- (d) Personal Finances

Correct Answer Financial Goal

Answer Explanation Financial goal is the term used to describe the future needs of an individual that require funding. It specifies the sum of money required to meet the need when it is required. Here 'vacation' is the future need, Rs 3 lakhs is the 'sum required' and '1 year' is the time period.

Question 31 Investors can buy and sell securities in the _____ market once they are issued by the issuer.

- (a) Tertiary
- (b) Secondary
- (c) Primary
- (d) Commodity

Correct Answer Secondary

Answer Explanation The secondary market (generally the stock exchange) is where securities once issued are bought and sold between investors.

Question 32 A Depository Receipt issued by a company represent a certain number of underlying shares of the company - State whether True or False ?

- (a) TRUE
- (b) FALSE

Correct Answer TRUE

Answer Explanation Depository receipts (DRs) are financial instruments that represent shares of a local company but are listed and traded on a stock exchange outside the country. DRs are issued in foreign currency, usually dollars.

To issue a DR, a specific quantity of underlying equity shares of a company are lodged with a custodian bank, which authorizes the issue of depository receipts against the shares.

Question 33 On the livestock market ticker, a ____ upward arrow shows that the price has moved up compared to previous day's closing

- (a) Red
- (b) Blue
- (c) Green
- (d) Purple

Correct Answer Green

Answer Explanation When the market is live, prices of traded stocks and updated value of indices run as a ticker tape.

A green upward arrow shows that the stock price has moved up compared to previous day's closing; a red downward arrow shows that the price has fallen compared to previous day's closing.

Question 34 The process of reducing the risk of concentration of investments in a particular asset or asset class is known as ____.

- (a) Diversification
- (b) Active investment strategy
- (c) Hedging
- (d) Passive investment strategy

Correct Answer Diversification

Answer Explanation Diversification means having a combination of investments in a portfolio in such a way that a fall in the value of one or few will be made up by other investments that are doing well. Allocating between different asset classes, such as equity, debt, gold, real estate, is the first level of diversification.

Question 35 _____ is attached with the Key Information Memorandum (KIM).

- (a) Scheme Information Document (SID)
- (b) Statement of Additional Information (SAI)
- (c) Application Form
- (d) Fund Fact Sheet

Correct Answer Application Form

Answer Explanation The application form for the NFO is available along with the Key Information Memorandum (KIM). KIM gives important information about the scheme and procedures for investing.

Question 36 The derivative contracts are settled in cash on _____ basis by computing the difference between the traded price and the daily settlement price.

- (a) T + 0
- (b) T + 1
- (c) T + 2
- (d) T + 3

Correct Answer T + 1

Answer Explanation All derivative contracts are settled in cash on t+1 basis by computing the difference between the traded price and the daily settlement price. The daily settlement price is announced by the exchange. It is the weighted average price of the last 30 minutes of trading.
T is the day trade
T+1 is the next working day

Question 37 The obligation(s) of an investor while dealing with trading members in secondary market includes _____.

- (a) Pay funds and securities for settlement on time
- (b) Verify bank account and DP account for funds and securities movement
- (c) Verify details of trades
- (d) All of the above

Correct Answer All of the above

Question 38 To calculate the Current Yield, one has to compare the coupon of a bond with its market price - State True or False?

- (a) TRUE
- (b) FALSE

Correct Answer TRUE

Answer Explanation Current yield simply compares the coupon of a bond with its market price.

Current yield = $\text{Coupon rate} / \text{Market price}$

If the market price is below the face value, then current yield is higher than the coupon. If market price is higher than the face value, then current yield is lower than the coupon.

Question 39 Which of these entities issue securities?

- (a) Private Companies
- (b) Government
- (c) Financial Institutions
- (d) All of the above

Correct Answer All of the above

Question 40 Who regulates the equity markets in India ?

- (a) Reserve Bank of India (RBI)
- (b) Ministry of Finance and Ministry of Corporate Affairs (MCA)
- (c) Department of Economic Affairs (DEA)
- (d) Securities and Exchange Board of India (SEBI)

Correct Answer Securities and Exchange Board of India (SEBI)

Answer Explanation The Securities and Exchange Board of India (SEBI), a statutory body appointed by an Act of Parliament (SEBI Act, 1992), is the chief regulator of securities markets in India. Secondary markets are regulated under the provisions of the Securities Contract Regulations Act, 1956 and SCR (Rules), 1957. SEBI is authorised by law to implement the provisions of this act and its rules.

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