

**Annexure - II** (w.e.f September 29, 2020)

**Test Objectives for NISM Series XIV: Internal Auditors for Stock Brokers Certification  
Examination**

**PART A: Regulatory Framework**

**Chapter 1: Introduction to Internal Audit**

- 1.1 Learn about the Scope of Internal Audit
- 1.2 Understand the Objectives of Internal Audit
- 1.3 Know who can conduct Internal Audit
- 1.4 Know about the Submission of Internal Audit Reports

**Chapter 2: Understand the financial system and the regulatory framework**

- 2.1 Describe the Financial System & Explain the role of Financial Markets in an economy.
- 2.2 Know about the Securities Market Intermediaries and the role played by each of them
  - 2.2.1 Stock Exchanges
  - 2.2.2 Clearing Corporation
  - 2.2.3 Depositories
  - 2.2.4 Depository Participant
  - 2.2.5 Stock Broker
  - 2.2.6 Clearing Member
  - 2.2.7 Custodians
  - 2.2.8 Registrars & Transfer Agents
  - 2.2.9 Merchant Bankers
  - 2.2.10 Investment Advisers
  - 2.2.11 Research Analysts
  - 2.2.12 Bankers to an Issue
  - 2.2.13 Mutual Funds
  - 2.2.14 Portfolio Managers
- 2.3 Understand types of Financial Securities and the definition of Security as per the SC(R)A, 1956
  - 2.3.1 Equity Shares
  - 2.3.2 Preference Shares
  - 2.3.3 Debentures
  - 2.3.4 Derivatives
  - 2.3.5 Warrants
  - 2.3.6 ADR/GDR
  - 2.3.7 IDR
  - 2.3.8 Masala Bonds
  - 2.3.9 Exchange Traded Fund
  - 2.3.10 Currency Derivatives
  - 2.3.11 Interest Rate Derivatives
- 2.4 Understand the Regulatory System in India
- 2.5 Know the role of the Financial Market Regulators
  - 2.5.1 Securities and Exchange Board of India

- 2.5.2 Reserve Bank of India
- 2.5.3 Insurance Regulatory & Development Authority of India
- 2.5.4 Pension Fund Regulatory & Development Authority of India
- 2.6 Understand the Role of Other Regulators in the Financial Market
  - 2.6.1 Registrar of Companies
  - 2.6.2 Economic Offences Wing
  - 2.6.3 Financial Intelligence Unit – India
- 2.7 Know the role of Securities Appellate Authority

### **Chapter 3: SEBI Act, SCRA and SCRR**

- 3.1 Understand the SEBI Act, 1992
  - 3.1.1 Salient Features of SEBI Act, 1992
  - 3.1.2 Powers and Functions of SEBI
  - 3.1.3 Penalties and Adjudication process
  - 3.1.4 Appellate Tribunal
  - 3.1.5 Registration of Intermediaries
  - 3.1.6 Prohibition of Manipulative and Deceptive Devices, Insider Trading
- 3.2 Understand the SC(R)A, 1956
  - 3.2.1 Call for Periodical Returns
  - 3.2.2 Contracts and Options in Securities
  - 3.2.3 Penalties and Procedures
- 3.3 Understand the following Rules of the SC(R)R 1957
  - 3.3.1 Eligibility criteria for membership of a recognized stock exchange
  - 3.3.2 Contracts between members
  - 3.3.3 Audit of accounts of members
  - 3.3.4 Books of account

### **Chapter 4: SEBI (Prohibition of Insider Trading) Regulations**

- 4.1 Understand the Definitions in SEBI (Prohibition of Insider Trading) Regulations, 2015 related to
  - 4.1.1 Compliance Officer
  - 4.1.2 Connected Person
  - 4.1.3 Immediate Relative
  - 4.1.4 Generally Available Information
  - 4.1.5 Insider
  - 4.1.6 Trading
  - 4.1.7 Unpublished Price Sensitive Information
  - 4.1.8 Promoter
  - 4.1.9 Proposed to be listed
- 4.2 Know the Restriction on Communication and Trading by Insiders
  - 4.2.1 Communication or procurement of unpublished price sensitive information
  - 4.2.2 Trading when in possession of unpublished price sensitive information
  - 4.2.3 Trading Plans
- 4.3 Learn about the Disclosure of trading by insiders
  - 4.3.1 Disclosure by certain persons

#### 4.4 Learn about the Code of Disclosure and Conduct

##### 4.4.1 Code of Fair Disclosure

##### 4.4.2 Code of Conduct

##### 4.4.3 Institutional Mechanism for Prevention of Insider trading

### **Chapter 5: SEBI (Fraudulent and Unfair Trade Practices) Regulations**

#### 5.1 Understand the (Fraudulent and Unfair Trade Practices) Regulations

##### 5.1.1 Know the definition of Fraud and Fraudulent

##### 5.1.2 Learn about Prohibition of Fraudulent and Unfair Trade Practices

##### 5.1.3 Power of SEBI to order investigation

##### 5.1.4 Submission of report and enforcement

##### 5.1.5 Suspension or cancellation of registration

### **Chapter 6: The Prevention of Money Laundering Act, 2002 (PMLA)**

#### 6.1 Define Money Laundering

#### 6.2 Know the Prevention of Money Laundering provisions

##### 6.2.1 Obligations of Banking companies, financial Institutions and Intermediaries

##### 6.2.2 Maintenance of Records

##### 6.2.3 Procedure for maintaining and furnishing records

##### 6.2.4 Verification of the records of the identity of clients

##### 6.2.5 Maintenance of records of the identity of clients

#### 6.3 Know the Offences of money-laundering

##### 6.3.1 Procedures relating to money – laundering

##### 6.3.2 Attachment of property

##### 6.3.3 Power of survey

##### 6.3.4 Search and seizure

#### 6.4 Learn about the Adjudicating Authorities, their composition and powers

##### 6.4.1 Adjudication

##### 6.4.2 Power of the Adjudicating Authority

##### 6.4.3 Appellate Tribunal

##### 6.4.4 Appeal to High Court

#### 6.5 Learn about the Agreement with foreign countries

#### 6.6 Describe the SEBI Procedures related to

##### 6.6.1 Policies and Procedures to Combat Money Laundering and Terrorist Financing

##### 6.6.2 Written Anti Money Laundering Procedures

##### 6.6.3 Record Keeping

##### 6.6.4 Information to be maintained

##### 6.6.5 Retention of Records

##### 6.6.6 Monitoring of transactions

##### 6.6.7 Suspicious Transaction Monitoring & Reporting

##### 6.6.8 List of Designated Individuals/Entities

##### 6.6.9 Procedure for freezing of funds, financial assets or economic resources or related services

##### 6.6.10 Reporting to Financial Intelligence Unit-India

- 6.6.11 Designation of an officer for reporting of suspicious transactions
- 6.6.12 Furnishing of Information to the Director
- 6.6.13 Employees' Hiring/Employee's Training
- 6.6.14 Investors Education

## **Chapter 7: SEBI Stock Brokers Regulations**

### **7.1 Understand the SEBI (Stock Broker) Regulations related to**

- 7.1.1 Registration of Stock Brokers
- 7.1.2 General Obligations and Responsibilities
- 7.1.3 Procedure for Inspection
- 7.1.4 Action in case of Default
- 7.1.5 Code of conduct
- 7.1.6 Fees payable by Stock Brokers
- 7.1.7 Regulation of transactions between clients and brokers
- 7.1.8 Direct Market Access
- 7.1.9 Algorithmic Trading

## **PART B: Operations**

### **Chapter 8: Introduction to Stock Broking Operations**

#### **8.1 Understand the Securities Trade Life Cycle**

#### **8.2 Describe the activities of Front Office Operations**

##### **8.2.1 Client On-Boarding process**

- Account Opening Process
- Know Your Client (KYC) and In Person Verification (IPV)
- KRA Agency and the Guidelines as per SEBI (KRA) Regulation
- Central KYC Records Registry
- Rights and Obligations (Member-Client Agreement)
- Unique Client Code
- Risk Disclosure Document

##### **8.2.2 Order Management**

- Internet Based Trading (IBT) and Securities Trading using Wireless Technology (STWT)
- Order Placement and Trade Matching

#### **8.3 Understand the Middle Office Operations**

- Risk Management Procedures
- Different Risks in the stock market

#### **8.4 Describe the Back Office Operations with regards to**

##### **8.4.1 Trade activities**

- Trade Enrichment
- Trade Allocation

##### **8.4.2 Brokerage**

##### **8.4.3 Contract Note**

- Electronic Contract Note

##### **8.4.4 Straight Through Processing**

#### 8.4.5 The Settlement Process

- Procedure for receipt/payment of funds and securities from / to clients
- Settlement of Funds & accounts – Running Account
- Handling of client securities by Trading members / Clearing members
- Margin obligations to be given by way of Pledge/ Re-pledge in the Depository System
- Statement of Accounts for funds and securities
- Banking and Demat account operations

#### 8.4.6 Margins

- Client Margin – Cash Segment
- Client Margin – Derivatives Segment
- Margin Report to Clearing Corporation
- Margin report to Clients
- Collateral Management
- Enhanced Supervision of Stock Brokers

#### 8.4.7 Books of Accounts

- Register of Transactions
- Client Ledger
- General Ledger
- Security Ledger
- Journal
- Cash and Bank Book

#### 8.4.8 Types of Transactions

- Principal to Principal Transactions
- Negotiated Deals / Cross Deals
- Proprietary Trading regulations
- Pro-Account Trading Terminal

#### 8.4.9 Role of Information Technology

#### 8.4.10 Cyber Security & Cyber Resilience framework

### 8.5 Describe Margin Trading

#### 8.5.1 Securities Eligible

#### 8.5.2 Brokers eligible

#### 8.5.3 Funding for margin trading

#### 8.5.4 Leverage and Exposure Limits

#### 8.5.5 Margins Requirements

#### 8.5.6 Liquidation of securities by the broker in case of default by the client

#### 8.5.7 Maintenance of Records

#### 8.5.8 Disclosures Requirements

#### 8.5.9 Rights and Obligations of Margin Trading

#### 8.5.10 Other Conditions

### 8.6 Describe the Securities Lending & Borrowing Program (SLB) with respect to

#### 8.6.1 Client on boarding

#### 8.6.2 Transaction cycle and market timing

#### 8.6.3 Settlement

#### 8.6.4 Short delivery

#### 8.6.5 Risk Management

#### 8.6.6 Margins

- First Leg transaction

- Reverse Leg Transaction
- 8.6.7 Corporate action
- 8.6.8 Early recall / early repayment
- 8.6.9 Rollover Facility
- 8.6.10 Other Points
- 8.7 Learn about the use of Computer-assisted Audit Techniques (CAAT) for analyzing unusual transaction trends

## **Chapter 9: Risk Management**

### **9.1 Learn about the Risk Management Framework for Cash Segment with respect to**

#### **9.1.1 Margin**

- Value at Risk
- Mark to Market
- Extreme Loss
- Margin not to exceed the purchase value of a buy transaction

#### **9.1.2 Liquid Assets**

- Liquidity Categorisation of Securities
- Calculation of Mean Impact Cost
- Margining of Institutional Trades in Cash Market

#### **9.1.3 Shortfall of Margins / Pay-in of funds**

#### **9.1.4 Base Minimum Capital**

#### **9.1.5 Additional Margins**

#### **9.1.6 Margins from the Client**

#### **9.1.7 Provision of early pay-in**

#### **9.1.8 Pre-trade Risk Controls**

- Order Level Checks
- Dynamic Price Bands

#### **9.1.9 Risk Reduction Mode**

### **9.2 Learn about the Risk Management Framework for F&O Segment**

#### **9.2.1 Types of Margins**

- Initial Margin
- Exposure Margin
- Premium Margin
- Assignment Margin

#### **9.2.2 Initial margin requirement**

#### **9.2.3 Reporting and Disclosure**

#### **9.2.4 Liquid Net Worth and Exposure Limits of a Clearing Member related to**

- Liquid Assets

### **9.3 Risk Management Requirements for Commodity Derivatives**

#### **9.3.1 Liquid Assets**

#### **9.3.2 Commodity Futures**

#### **9.3.3 Options on Commodity Futures**

#### **9.3.4 Concentration Margins**

#### **9.3.5 Additional Ad-hoc Margins**

#### **9.3.6 Margin Provisions for Intra-day crystallized losses**

#### **9.3.7 Minimum Liquid Networth**

#### **9.3.8 Base Minimum Capital**

- 9.3.9 Risk Reduction Mode
- 9.3.10 Measures in case of repeated shortfall in margin/pay-in
- 9.4 Understand the Annual Compliance Requirements related to
  - 9.4.1 Insurance Cover
  - 9.4.2 Audit Report
  - 9.4.3 Appointment and change of compliance officer
  - 9.4.4 Trading through other trading members
  - 9.4.5 Internal Audit Report
  - 9.4.6 Networth Certificate
  - 9.4.7 Networth certificate for margin trading
  - 9.4.8 System Audit Report
- 9.5 Understand the Quarterly Compliance Requirements related to
  - 9.5.1 Disclosure by trading members of their holdings in listed companies
  - 9.5.2 Quarterly compliance certificate on order limits
  - 9.5.3 Client-wise funding report
  - 9.5.4 Guidelines for execution of Power Of Attorney
- 9.6 List the Other Compliances related to
  - 9.6.1 Operations at Branch and Authorised Persons
  - 9.6.2 Client Code Modification
  - 9.6.3 Monitoring of client funds lying with the Stock broker by the Exchanges

## **Chapter 10: Clearing and Settlement Process**

- 10.1 Understand the Clearing & Settlement Process for Cash Market
  - 10.1.1 Clearing Corporation
  - 10.1.2 Participants and their role
    - Clearing Member
    - Clearing Bank
    - Depository
    - Custodian
  - 10.1.3 Clearing Process
    - Obligation Determination
    - Institutional Confirmation
  - 10.1.4 Settlement Process
    - Settlement Schedule
    - Settlement of Funds
    - Settlement of Securities
    - Auction and Close out
  - 10.1.5 Broker internal netting and shortage
- 10.2 Understand the Clearing & Settlement Process for Futures & Options Market with respect to
  - 10.2.1 Participants and their role
  - 10.2.2 Clearing Process – obligation / open position determination
  - 10.2.3 Settlement Period
  - 10.2.4 Daily mark to market and final Settlement
  - 10.2.5 Premium settlement for options contract
  - 10.2.6 Exercise and assignment

- 10.2.7 Corporate Action Adjustments
- 10.3 Clearing & Settlement Process for Commodity Derivatives
- 10.4 Interoperability among Clearing Corporations (CCPs)
  - 10.4.1 SEBI Guidelines in Interoperability
  - 10.4.2 Operational Procedure common across Exchanges/Clearing Corporation
- 10.5 Discuss the Core Settlement Guarantee fund
  - 10.5.1 Corpus
  - 10.5.2 Contribution to Core SGF
  - 10.5.3 Default waterfall
  - 10.5.4 Stress testing and back testing
- 10.6 Discuss Investor Protection Fund (IPF)
  - 10.6.1 Guidelines for IPF / Customer Protection Fund (CPF) at Stock Exchanges
- 10.7 Discuss the SEBI Investor Protection and Education Fund
- 10.8 Know the Activities which are Outsourced by Brokers
  - 10.8.1 Activities not to be Outsourced
  - 10.8.2 Other Obligations
  - 10.8.3 Guidelines for outsourcing for intermediaries
    - Comprehensive Policy for Outsourcing
    - Outsourcing risk management program
    - Outsourcing arrangements with respect to obligations to customers and regulatory supervision
    - Selection and monitoring of third party
    - Outsourcing contract/ agreement
    - Contingency Plans
    - Protection of Confidential Information
    - Risks Arising from Concentration

## **Chapter 11: Investor Grievance Redressal**

- 11.1 Learn about the Measures undertaken for Investor Protection
- 11.2 Discuss the Investor Grievance Redressal Mechanism
  - 11.3.1 Investor Grievance mechanism at the Brokerage House / Listed Company
  - 11.3.2 Stock Exchange Investor Grievance redressal mechanism
  - 11.3.3 SEBI Investor Grievance Handling Mechanism
  - 11.3.4 SEBI Complaints Redress System (SCORES)
- 11.4 Describe the Arbitration Mechanism
  - 11.4.1 Panel of Arbitrators
  - 11.4.2 Empanelment of arbitrators and segregation of arbitration and appellate arbitration panel
  - 11.4.3 Public dissemination of profile of Arbitrators
  - 11.4.4 Code of Conduct for Arbitrators
  - 11.4.5 Arbitration Process
  - 11.4.6 Mechanism for implementation of award
  - 11.4.7 Record and Disclosures



## **Chapter 12: Forensic Audit**

### **12.1 Introduction to Forensic Audit**

#### **12.1.1 Benefits of Forensic Audit**

### **12.2 Frauds and its Definition**

### **12.3 Frauds in relation to financial markets**

### **12.4 Financial Audit Vs. Forensic Audit**

### **12.5 Forensic Auditing Procedure**

#### **12.5.1 Gathering Information**

#### **12.5.2 Data Analysis**

#### **12.5.3 Detection of fraud and substantiation**

#### **12.5.4 Report preparation**

#### **12.5.5 Digital Forensics**

### **12.6 Forensic Audit- Case Study**

## **ANNEXURES**

- Annexure 1: Certificate format for Internal Audit
- Annexure 2: Guidance for Verification in the respective areas
- Annexure 3: Operational Mechanism for Margin Pledge