

## **Annexure II – Test Objectives**

### **NISM-Series-XVI: Commodity Derivatives Certification Examination**

#### **1. Introduction to Commodity Markets**

- 1.1. History of commodity trading
  - 1.1.1. Study the history of commodities trading both globally and in India
  - 1.1.2. Understand the evolution of commodity exchanges
- 1.2. Spot and derivatives trading in commodities
  - 1.2.1. Overview of the Electronic spot and Physical spot markets for commodities
  - 1.2.2. Know the key economic functions performed by derivatives markets
  - 1.2.3. Define the derivative instruments such as Forwards, Futures, Options and Swaps
- 1.3. List major commodities traded in derivatives exchanges in India
- 1.4. Know various participants of commodity derivatives markets
- 1.5. Discuss the commodities trading vis-à-vis trading in other financial assets
- 1.6. List the important entities in the commodity markets ecosystem
- 1.7. Explain the various factors that have an impact on the commodity prices
- 1.8. Know the commodity options and derivatives on commodity indices

#### **2. Commodity Indices**

- 2.1. Explain the term “Index” and its economic purpose
- 2.2. Know the important commodity market indices in Indian and International markets
- 2.3. Discuss the salient points of index construction and its constituents
- 2.4. Explain the trading in derivatives on commodity indices
- 2.5. Discuss the uses of derivatives on commodity indices

#### **3. Commodity Futures**

- 3.1. Understand the key characteristics of commodity futures
- 3.2. Know the differences between futures and forwards
- 3.3. Understand cost-of-carry model for pricing of futures
- 3.4. Understand the “convergence” of spot and futures prices
- 3.5. Calculate fair value of futures with various compounding frequencies
- 3.6. Understand the concept of “convenience yield” and its role in pricing of commodity futures
- 3.7. Understand the advantages of commodity futures over commodity forwards
- 3.8. Understand the linear pay-off profile of futures contracts
  - 3.8.1. Long position in futures
  - 3.8.2. Short position in futures
- 3.9. Understand tick size and compute Profit/loss per contract for a change of one tick
- 3.10. Describe the spot price polling mechanism

#### **4. Commodity Options**

- 4.1. Understand the key characteristics of commodity options

- 4.2. Know the key terminology of options: strike price, spot price, option premium, lot size, intrinsic value, time value, etc.
- 4.3. Understand the non-linear pay-off profile of options contracts
- 4.4. Determinants of option premium
  - 4.4.1. Understand the key determinants of option price and how these parameters influence the price of a call option and the price of a put option
  - 4.4.2. Outline the commonly used models for options pricing
  - 4.4.3. Discuss the option greeks: delta, gamma, theta, vega and rho with suitable examples
  - 4.4.4. Explain the concept of “moneyness” of an option and how it is determined by the market price and strike price of an option contract (ITM, ATM, CTM and OTM)
  - 4.4.5. Explain Put-call parity with the help of an example
- 4.5. Understand the commodity options with commodity futures as their underlying (Options on Futures)
- 4.6. Understand the commodity options with underlying commodity as their underlying (Options on Goods)

## **5. Strategies using Commodity Futures and Commodity Options**

- 5.1. Understand the term “Hedging” (Price Risk Management strategies)
- 5.2. Illustrate long hedge and short hedge strategies using commodity derivatives
- 5.3. Understand the term “Speculation” using long and short positions in commodity futures and options
- 5.4. Understand the term “Arbitrage”
- 5.5. Know the meaning of Spread Trading and illustrate various strategies such as buying a spread, selling a spread, Inter-commodity spread and intra-commodity spread with examples
- 5.6. Understand the concept of “Basis”, strengthening and weakening of basis, basis risk and the basis in contango and backwardation markets
- 5.7. Discuss various Option trading strategies
  - 5.7.1. Describe the covered option positions
  - 5.7.2. Know the spread trading strategies
  - 5.7.3. Explain the execution of straddle and strangle strategies
- 5.8. Understand how the derivatives on commodity indices can be used for hedging, trading and arbitrage purposes
- 5.9. Know the hedging strategies disclosure norms for listed companies

## **6. Trading Mechanism**

- 6.1. Understand Membership on commodity derivatives exchange
- 6.2. Explain Trading system in commodity derivatives exchanges
  - 6.2.1. Know the fully automated screen-based trading system (SBTS) of exchanges
  - 6.2.2. Briefly introduce the algorithmic trading
  - 6.2.3. Know the trading hours applicable for various types of commodities on Indian Exchanges
  - 6.2.4. Know the trading parameters across contracts and describe the delivery process

- 6.3. Explain the selection criteria of commodities for trading on derivatives exchanges
- 6.4. Know the key terminology used in the Contract Specifications for Commodity Derivatives Contracts
- 6.5. Understand the Order types and conditions
  - 6.5.1. Know the price-related condition orders
  - 6.5.2. Know the time-related orders
  - 6.5.3. Know the modification and cancellation of orders
- 6.6. Know the tracking of commodity futures and options prices
- 6.7. Know various trading costs such as Brokerage, Exchange transaction charges, SEBI turnover fee, other costs like Stamp duty, GST, STT, etc.
- 6.8. Understand the type of participants permitted to trade in Commodity markets
- 6.9. Discuss disclosures by exchanges

## **7. Clearing, Settlement and Risk Management**

- 7.1. Understand the concept of clearing corporation
- 7.2. Explain the clearing and settlement Process
- 7.3. Understand the delivery process
  - 7.3.1. Know about Compulsory Delivery
  - 7.3.2. Know about Both option to deliver
- 7.4. Understand the entities involved in the clearing and settlement process: clearing corporation, clearing members, clearing banks, custodial services / repositories, warehouses and electronic-registry for warehouse receipts
- 7.5. Explain premium and discount
- 7.6. Know the penalties for delivery default by the seller
- 7.7. Understand the deliveries in case of physical delivery
- 7.8. Understand various risk management mechanisms implemented by the clearing corporations
  - 7.8.1. Describe counterparty risk
  - 7.8.2. Describe principal risk
  - 7.8.3. Describe market integrity and surveillance related risks
  - 7.8.4. Know about operational risk
  - 7.8.5. Know about legal Risk
  - 7.8.6. Know about systemic Risk
- 7.9. Understand the Position limits and computation of open position
- 7.10. Salient features of risk containment measures
  - 7.10.1. Know the importance of capital adequacy
  - 7.10.2. Know about online monitoring
  - 7.10.3. Know about offline surveillance activity
  - 7.10.4. Know the margin requirements
  - 7.10.5. Describe price bands / daily price limits (DPL) for broad/narrow/sensitive commodities and position limits
  - 7.10.6. Describe settlement guarantee fund (SGF)
  - 7.10.7. Describe Investor Protection Fund (IPF)

- 7.11. Explain Margining mechanism with the help of examples
  - 7.11.1. Know SPAN margin
  - 7.11.2. Know initial margin and extreme loss margin
  - 7.11.3. Know MTM margin
  - 7.11.4. Know additional / special margin and concentration margin
  - 7.11.5. Know tender period / delivery period margin
  - 7.11.6. Know devolvement margin for option on futures
  - 7.11.7. Lean-period margin
  - 7.11.8. Pre-expiry margin on commodities under Alternate Risk Management Framework
  - 7.11.9. Cross margin in Commodity Index futures and its underlying constituent futures or its variants
- 7.12. Understand Additional procedures for other market segments: index futures, options on futures and options on goods
- 7.13. Briefly discuss raising of bill for delivery

## **8. Legal and Regulatory Environment**

- 8.1. Explain the regulatory framework governing the commodity markets in India: Central Government, Securities and Exchange Board of India (SEBI) and the Exchanges
- 8.2. Know the Securities Contracts (Regulation) Act, 1956
- 8.3. Understand Securities and Exchange Board of India Act, 1992
- 8.4. Describe other regulatory norms to encourage commodity derivatives

## **9. Accounting and Taxation**

- 9.1. Understand Important accounting aspects related to trading in commodity derivatives
- 9.2. Know the key elements of the guidance note issued by ICAI on accounting treatment of derivatives transactions
  - 9.2.1. Describe presentation in the financial statements
  - 9.2.2. Understand types of hedge accounting
  - 9.2.3. Describe disclosures in financial statements
- 9.3. Explain accounting of options contracts
- 9.4. Understand important tax aspects related to trading in commodity derivatives
  - 9.4.1. Briefly introduce Commodity Transaction Tax (CTT)
  - 9.4.2. Know stamp duty
  - 9.4.3. Know SEBI turnover fees
  - 9.4.4. Briefly introduce Goods and Services Tax (GST)

## **10. Codes of Conduct and Investor Protection Measures**

- 10.1. Describe SEBI's code of conduct for brokers
- 10.2. Explain Risk disclosure to client and KYC
  - 10.2.1. Know the importance of risk disclosure at the time of client onboarding
  - 10.2.2. Describe the risks faced by investors trading in commodity derivatives markets
  - 10.2.3. Understand the importance of KYC process and KYC documents

- 10.2.4. Know the Suspicious Transaction Reporting (STR) to Financial Intelligence Unit (FIU)
- 10.3. Explain Investors Grievance Redressal Mechanism
- 10.4. Explain Rights and obligations of members and clients
- 10.5. Understand Additional Do's and Don'ts for Investors in Commodity Derivatives markets

\*\*\*