

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