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B.Com Honours | Semester VI | Calicut University

FINANCIAL DERIVATIVES

Course Code: COM6EJ301 • Module 1 Notes

Module I: Introduction to Financial Derivatives

Covers derivative definition, features, Indian historical origin (LC Gupta Committee 1997), market participants, underlying assets, financial vs commodity contracts, basic instruments, and SEBI regulatory framework.

Unit 1: Derivatives Definition, Features, & History in India

Financial Derivative: Financial contract whose value is derived from performance of underlying asset (stocks, indices, bonds, currencies, commodities). History: Recommended by LC Gupta Committee (1997) & JR Varma Committee (1998); index futures launched on BSE/NSE in June 2000.

Unit 2: Participants in Derivatives Market & Underlying Assets

1. Hedgers: Reduce existing price risk in spot market.
2. Speculators: Take risk to profit from price movements.
3. Arbitrageurs: Exploit price misalignments between spot and futures markets to lock in riskless profit.

Unit 3: Financial vs Commodity Derivatives

Financial Derivatives (Underlying: Stocks, Indices, Currencies, Interest Rates) vs Commodity Derivatives (Underlying: Crude oil, Gold, Agricultural commodities).

Unit 4: Overview of Basic Contracts (Forwards, Futures, Options, Swaps)

Core Instruments: Over-the-counter (OTC) Forwards & Swaps vs Exchange-Traded Futures & Options.

Unit 5: Economic Functions of Derivatives

Economic Utility: Price discovery in forward markets, risk reallocation, market liquidity enhancement, & lower transaction costs.

Unit 6: Regulatory Framework of Derivatives in India

Regulations: SEBI governs equity & stock derivatives; RBI regulates currency & interest rate derivatives under SCRA Act 1956.

Practical Case Framework 1 (Derivatives Market Participants Structural Comparison Matrix): Compare participant role, market motivation, risk posture, and typical trading strategy.

Market Participants Typologies Table:

Participant Type	Primary Market Motivation	Risk Exposure Posture
Hedger	Neutralize existing price volatility in spot holding	Risk-Averse (Transfers risk to market)
Speculator	Generate abnormal profit from directional views	Risk-Seeking (Absorbs market risk)
Arbitrageur	Lock in risk-free profit from mispricing gaps	Risk-Neutral (Simultaneous buy/sell)

Practical Case Framework 2 (Financial vs Commodity Derivatives Architecture Matrix): Compare underlying asset nature, storage/delivery requirements, contract standardization, and regulator.

Financial vs Commodity Derivatives Table:

Dimension	Financial Derivatives	Commodity Derivatives
Underlying Assets	Stocks, Equity Indices, Currencies, Interest Rates	Gold, Silver, Crude Oil, Agri Produce
Settlement Mode	Cash Settlement predominant	Physical delivery at warehouses or cash
Storage / Carrying Cost	Negligible (Demat electronic form)	Significant warehousing & insurance cost