

## UNIT TITLE: DERIVATIVES

Attainment Level	Learning Outcome	Indicative Content
<b>Demonstrate an understanding of:</b>	The derivatives market structure, features, regulatory and trading environment	<ul style="list-style-type: none"> <li>• Role, structure and regulation of global derivatives markets <ul style="list-style-type: none"> <li>– Role of regulators, other supervisory bodies and trade associations</li> </ul> </li> <li>• Range of derivative instruments and typical risks <ul style="list-style-type: none"> <li>– Financial derivatives</li> <li>– Commodity derivatives</li> <li>– Property derivatives</li> <li>– Exotic derivatives</li> </ul> </li> <li>• Market terminology</li> <li>• Key market participants and roles</li> <li>• Exchange trading and over-the-counter (OTC) trading – main differences <ul style="list-style-type: none"> <li>– Standard and bespoke</li> <li>– Maturity, expiry, margin, collateral, liquidity</li> <li>– Clearing and settlement</li> <li>– Transparency and confidentiality</li> <li>– Trading mechanisms</li> <li>– Counterparties</li> <li>– Documentation</li> </ul> </li> <li>• Central counterparty (CCP) clearing of OTC transactions</li> </ul>
<b>Demonstrate an understanding of:</b>	The principles, components, characteristics and risks of derivatives relative to the underlying	<ul style="list-style-type: none"> <li>• Relationships to underlying</li> <li>• Physically settled versus cash settled</li> <li>• General pricing principles – futures, options</li> </ul>

<b>Demonstrate an understanding of:</b>	The market environment, product types and characteristics of Exchange Traded derivatives	<ul style="list-style-type: none"> <li>• Main products <ul style="list-style-type: none"> <li>– Futures</li> <li>– Options</li> </ul> </li> <li>• Main UK and international exchanges</li> <li>• Trading platforms <ul style="list-style-type: none"> <li>– Mechanisms and procedures</li> </ul> </li> <li>• Wholesale trading facilities <ul style="list-style-type: none"> <li>– Significance and uses</li> </ul> </li> <li>• Clearing mechanisms and processes</li> </ul>
<b>Demonstrate an understanding of:</b>	The pricing, trading and market practice of Exchange Traded derivatives	<ul style="list-style-type: none"> <li>• Calculation of profit/loss on delivery or expiry – futures and options</li> <li>• Mechanisms for futures pricing <ul style="list-style-type: none"> <li>– Factors influencing pricing</li> <li>– Bases for calculation</li> </ul> </li> <li>• Mechanisms of options pricing <ul style="list-style-type: none"> <li>– Factors influencing pricing and premiums</li> <li>– Bases for calculation</li> </ul> </li> <li>• Price discovery for commodities</li> <li>• Market transparency, reporting and monitoring</li> <li>• Order/instruction flow and order type</li> <li>• Input and matching, trade registration processes</li> </ul>

<b>Demonstrate an understanding of:</b>	The main types and characteristics of OTC traded derivatives	<ul style="list-style-type: none"> <li>• Forwards and forward rate agreements (FRAs)</li> <li>• OTC option products</li> <li>• Contracts for difference</li> <li>• Swaps <ul style="list-style-type: none"> <li>– Interest rate swaps</li> </ul> </li> <li>• Credit derivatives <ul style="list-style-type: none"> <li>– Credit default swaps</li> </ul> </li> <li>• Structured products</li> <li>• OTC trade capture, confirmation and clearing mechanisms</li> </ul>
<b>Demonstrate an understanding of:</b>	Clearing, margin, settlement, exercise and delivery of both Exchange Traded and OTC derivatives	<ul style="list-style-type: none"> <li>• Definition and purpose of clearing <ul style="list-style-type: none"> <li>– Roles and relationships</li> <li>– Risks and guarantees</li> <li>– Central counterparty clearing</li> </ul> </li> <li>• Purpose, types and application of margin <ul style="list-style-type: none"> <li>– Parties involved</li> <li>– Processing, collection and payment</li> <li>– Pricing factors and calculation</li> </ul> </li> <li>• Purpose, types and application of collateral</li> <li>• Delivery and settlement</li> <li>• Exercise of options, assignment of obligations, abandonment and expiry</li> </ul>

<b>Demonstrate an ability to evaluate:</b>	<p>The purpose, merits, limitations and risks of the main derivatives strategies for trading, hedging and investment relevant to client investment activity</p>	<ul style="list-style-type: none"> <li>• Trading and Speculation</li> <li>• Hedging <ul style="list-style-type: none"> <li>– Options strategies</li> <li>– Futures strategies</li> </ul> </li> <li>• Investment and derivatives, including use of synthetics <ul style="list-style-type: none"> <li>– Portfolio hedging</li> <li>– Portfolio yield enhancement</li> <li>– Structured funds and ETFs</li> </ul> </li> </ul>
<b>Demonstrate an ability to apply:</b>	<p>The relevant factors and considerations to decide and implement investment recommendations</p>	<p><i>These standards include the requirement to COMBINE and APPLY the learning content from all units of the Appropriate Exam</i></p> <ul style="list-style-type: none"> <li>• Obtain the range of client information and subjective factors to understand their needs, wants, values and risk profile essential to planning</li> <li>• Synthesise client and relevant market information to provide the basis for assumptions and decisions</li> <li>• Analyse the advantages and disadvantages of the appropriate strategies</li> <li>• Select, recommend, explain and justify, and transact <ul style="list-style-type: none"> <li>– Sources and use of research and other information</li> </ul> </li> <li>• Holding derivatives within an investment portfolio: <ul style="list-style-type: none"> <li>– Direct holdings, indirect holdings and combinations</li> <li>– Rationale, advantages and disadvantages</li> <li>– Impact on overall client objectives and priorities</li> <li>– Main factors to consider when holding both securities and derivatives within the portfolio</li> <li>– Asset allocation factors and relationship to overall portfolio</li> <li>– Matching to client risk appetite and trade-offs</li> </ul> </li> </ul>

		<ul style="list-style-type: none"><li>• Take account of relevant tax, accounting and costs considerations</li><li>• Comply with advice and dealing regulations specific to derivatives - COBS</li><li>• Client reporting requirements</li><li>• Communication, monitoring, review and maintenance of the portfolio to achieve the client's objectives, deal with change and respond to setbacks</li></ul>
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