
UNIT 7 MONEY MARKET IN INDIA

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7.0 OBJECTIVES

This unit deals with the money market in India—its participants and instruments. After going through this Unit, you will be able to -

- Explain the meaning and significance of the money market,
- Describe nature and mechanism of various instruments used in the money market, and
- Discuss role of the regulator—Reserve Bank of India, over the money market.

7.1 INTRODUCTION

We have learned in the previous Units that the financial market plays a very important role in the economy of a country. These markets are broadly classified into two categories namely, Money Market and Capital Market, primarily based on the duration for which dealing in funds are transacted. In this Unit, we will discuss the money market in India. The Capital Market will be taken up in the next Unit. Money Market is the market for short-term funds, generally ranging from overnight to a year. It helps in meeting the short-term and very short-term requirements of banks, financial institutions, firms, companies and also the Government. On the other hand, the surplus funds for short periods, with the individuals and other savers, are mobilised through the market and made available to the

aforesaid entities for utilisation by them. Thus, the money market provides a mechanism for evening out short-term liquidity imbalances within an economy. The development of the money market is, thus, a prerequisite for the growth and development of the economy of a country.

7.2 PARTICIPANTS IN MONEY MARKET

The major participants who supply the funds and demand the same in the money market are as follows:

- i) **Reserve Bank of India:** Reserve Bank of India is the regulator over the money market in India. As the Central Bank, it injects liquidity in the banking system, when it is deficient and contracts the same in opposite situation.
- ii) **Banks:** Commercial Banks and the Co-operative Banks are the major participants in the Indian money market. They mobilise the savings of the people through acceptance of deposits and lend it to business houses for their short-term working capital requirements. While a portion of these deposits is invested in medium and long-term Government securities and corporate shares and bonds, they provide short-term funds to the Government by investing in the Treasury Bills. They employ the short-term surpluses in various money market instruments.
- iii) **Discount and Finance House of India Ltd. (DFHI):** DFHI deals both ways in the money market instruments. Hence, it has helped in the growth of secondary market, as well as those of the money market instruments.
- iv) **Financial and Investment Institutions:** These institutions (eg. LIC, UTI, GIC, Development Banks, etc.) have been allowed to participate in the call money market as lenders only.
- v) **Corporates:** Companies create demand for funds from the banking system. They raise short-term funds directly from the money market by issuing commercial paper. Moreover, they accept public deposits and also indulge in inter-corporate deposits and investments.
- vi) **Mutual Funds:** Mutual funds also invest their surplus funds in various money market instruments for short periods. They are also permitted to participate in the Call Money Market. Money Market Mutual Funds have been set up specifically for the purpose of mobilisation of short-term funds for investment in money market instruments.

7.3 RESERVE BANK OF INDIA

As the Central Bank of the country, the Reserve Bank of

India plays a very significant role in the Indian Money Market. The various tasks being performed by the Reserve Bank have been explained in Unit 6. Let us recall that Reserve Bank is the banker to the banks and Central and State Governments. It manages the liquidity in the money market by granting refinance facilities to the banks and by stipulating the reserve requirements. **Cash Reserve Ratio (CRR)** and **Statutory Liquidity Requirements (SLR)** are the principal tools to affect the liquidity with the banks. When the banking system has excess liquidity, Reserve Bank of India raises the **Cash Reserve Ratio (CRR)** and thus, impounds the surplus liquidity and vice-versa. Statutory Liquidity requirement is raised to divert bank funds mainly to Government and other approved securities and thereby reducing liquidity with banks.

Reserve Bank of India has been providing in the past refinance facilities to the banks through different schemes, which were in operation from time to time. The **Narsimham Committee on Banking Sector Reforms, 1998** recommended that the Reserve Bank of India should provide support to the market through a Liquidity Adjustment Facility (LAF). Reserve Bank of India accordingly introduced LAF effective from June 5, 2000, which was preceded by interim liquidity facility, w.e.f. April, 1997.

7.3.1 Interim Liquidity Adjustment Facility (ILAF)

Under the ILAF facility, liquidity was managed through a combination of:

- i) Repos
- ii) Export credit refinance
- iii) Collateralised lending facilities
- iv) Open market operations at set rate of interest

Repo is a method of borrowing against certain securities for a short period. The borrower undertakes a commitment to purchase back (or to take back) the same securities after the specified period at a pre-determined price. The difference between the two prices is treated as interest on the amount borrowed.

Reserve Repo is the opposite practice wherein the lender lends against the securities with the commitment to take back the securities from the borrower against payment at a specified price. Thus by reverse repos the Reserve Bank contracts liquidity from the system.

Collateralised Lending Facility: Under this facility, banks

were provided funds upto 0.25% of their fortnightly average outstanding aggregate deposits in 1997-98. This facility was available for two weeks at the Bank rate. An **Additional Collateralised Lending Facility (ACLF)** for an equivalent amount at the Bank rate plus 2% was also made available to banks. These funds could be utilised beyond two weeks at a penal rate of 2.0%. Similarly, Primary Dealers were provided Level I Liquidity Support (equal to CLF for banks) against **collateral of Government securities** for period upto 90 days. They were also provided Additional Level II Liquidity Support (equal to ACLK) at Bank rate plus 2% for a period up to two weeks at a time. Thus, the Reserve Bank managed liquidity under the Interim Liquidity Adjustment Facility which was later on converted into full-fledged Liquidity Adjustment Facility.

7.3.2 Liquidity Adjustment Facility (LAF)

This facility was introduced with effect from June 5, 2000 and will be completed in three phases as follows:

- 1) The ACLK for banks and Level II liquidity support to Primary Dealers, as stated above, have been replaced by variable reverse repo auctions. The fixed rate repo has been replaced by variable rate repo auctions.
- 2) In the second stage, CLF for banks and Level I support to Primary Dealers will be replaced by variable rate reverse repo auctions.
- 3) In the third stage the LAF will be operated at different timings of the same day, if necessary.

Thus, after the second stage, repos and reverse repos, together with open market operations, will become the main instruments of affecting liquidity in the system.

At present repo/reverse repo auctions are conducted on a daily basis except Saturdays with a tenor of one day except on Fridays and days preceding the holidays. Bids are invited by Reserve Bank of India which are accepted either wholly or partially.

Interest rates in respect of both repos and reverse repos are decided through cut off rates emerging from auctions on uniform price basis. In August 2000, repo auctions of tenor between 3 to 7 days were also introduced.

When market liquidity happens to be easy, there are heavy bids at the Reserve Bank's repos auctions. Repo rate is an overnight rate. In the beginning of March 2002, Reserve Bank of India reduced the cut off rate for one-day repo auctions from 6.5% to 6%. Thus, repo rate is considered as the floor rate for the call rates. It was further reduced to 5.75% w.e.f. 27th June, 2002.

Reserve Bank of India infuses liquidity by accepting bids at the Reverse Repo auctions. The chief advantage of the system of LAF is the quantum of adjustment and also the rates of interest would be flexible depending upon the needs of the system. Moreover, funds lent by Reserve Bank of India under this facility are intended to meet primarily the day-to-day liquidity mis-match in the system and will not be permitted to be used for meeting the normal financing requirements of the banks and other institutions.

Check Your Progress 1

- 1) What do you understand by Money Market? Who are the major participants in this Market?

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- 2) What are the salient features and significance of the Liquidity Adjustments Facility implemented by the Reserve Bank of India?

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- 3) Distinguish between:

- (i) Money Market and Capital Market
- (ii) Repos and Reverse Repos

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7.4 MONEY AT CALL AND SHORT NOTICE

Market at call and short notice is an important constituent of the money market. It deals with short-term funds repayable at call or at a short notice. Initially the commercial banks used to be the participants in this market. Hence, this market was called the Inter Bank Call Money Market. The necessity for such inter-bank borrowings arise because some banks feel the need for short-term liquidity at a certain time, while other banks have surplus liquidity at that time which they can spare for a short period, e.g. a day or a few days, and thereby, they intend to earn income.

During the last two decades, the Reserve Bank of India has permitted other financial institutions also to participate in the Call Money Market, but only as lenders. Such institutions include the Life Insurance Corporation of India, the Unit

Trust of India, the General Insurance Corporation of India, the Industrial Development Bank of India, the National Bank for Agriculture and Rural Development, and Mutual Funds. Further, the Reserve Bank of India also permitted all such entities which have bulk lendable resources and not having outstanding borrowings from banks, to lend in the Call Money Market through Primary Dealers. The Discount and Finance House of India plays a very significant role in the Call Money Market and participates both as a lender and a borrower. Its leading role in this market may be gauged only by the fact that its aggregate lending in the Call, Notice and Term Money Market amounted to Rs. 6,57,094 crore during 2000-01 and Rs. 6,77,922 crore during the previous year. It offers two rates—Bid Rate and Offer Rate with a small difference between the two. For example as on 29th November, 2001 its bid rate was 6.70%, while the offer rate was 6.40%.

Till May 1984 the Call rates were administered by Indian Banks' Association by imposing a ceiling rate. Since then, it is now determined by the demand for and supply of bankable funds in the market. The Call rates are very volatile in behaviour—they shoot up when there is dearth of liquidity and ease with abundant supply of funds. This is the case with the Call lending rates announced by the Discount and Finance House of India Ltd also. For example, during the year 2000-01 the minimum rate touched the level of 0.50% during the fortnight ended on 20th April 2000 and the maximum rate went up to 35% during the fortnight ended 29th June, 2000.

7.4.1 Move Towards Pure Inter-Bank Call Money Market

As we have already noted above, several non-bank entities such as financial institutions and corporates (which lend in the call money market through Primary Dealers) were permitted to lend in the call/notice money market. Accepting the recommendation of the Narasimham Committee II, Reserve Bank of India has decided to move towards a pure inter-bank (including Primary Dealers) call/notice money market. In its credit policy of April 2001, Reserve Bank of India announced the steps to gradually phase out these institutions. Permission to corporates to route their call transactions through Primary Dealers was given upto June 30, 2001. Non-bank institutions are required to gradually reduce their participation in call market in four stages. With effect from May 5, 2001 non-banks have been allowed to lend upto 85% of their average daily lending in call market during 2000-01. Their participation will be reduced to 70%, 40%, 10% and 0% of their average daily lending during 2000-01 with effect from the dates to be fixed by Reserve Bank. The exclusion of the non-banks from the call

money market is expected to reduce the volatility in the market. Instead, it is intended to develop the repo-market so that the non-banks can park their excess funds there.

In its credit policy announced on April 29, 2002, Reserve Bank of India decided to reduce banks' reliance on call/notice money market. For this purpose, the following limits have proposed:

- i) **Scheduled Commercial Banks' daily lending** in the Call/notice money market will be restricted to 25% of their owned funds as at the end of March of the previous financial year.
- ii) Their daily borrowings in the call/notice money market will be restricted to 100% of their owned funds or 2% of their aggregate deposits at the end of March of the previous financial year, whichever is higher. This will be implemented by August, 2002.

7.5 TREASURY BILLS

A Treasury Bill is an instrument for short-term borrowing by the Government of India. It is issued by the Reserve Bank of India on behalf of the Government of India in the form of a promissory note. The necessity for issuing treasury bills arises because of the periodic nature of receipts of Government while the Government expenditure is on a continuing basis. Taxes are payable to the Government after quarterly intervals or so, but Government has to meet its expenditure on daily or monthly basis. Thus, to bridge this mis-match between the timings of Government receipts and expenditure, Government borrows money on short-term basis by issuing Treasury Bills.

The Treasury Bills are issued for different maturity periods. Till May 14, 2001, the maturity periods were 14 days, 91 days, 182 days and 365 days. But with effect from May 14, 2001 auctions of 14 days and 182 days Treasury Bills have been discontinued. The Treasury Bills are sold through auctions. While auctions of 91 days Treasury Bills take place on a weekly basis, the auctions for 364 days Treasury Bills are held on a fortnightly basis. The Reserve Bank of India also notifies the amounts in respect of the Treasury Bill auctions. The notified amounts for 14 days, 91 days Treasury Bills auctions are Rs. 100 crores each. The notified amount for 364 day Treasury Bills was raised from Rs. 500 crores to Rs. 750 crores during 2000-01 and has been further raised to Rs. 1000 crores for auctions to be held during 2002-03.

Out of the bids received by it, the Reserve Bank of India accepts bids upto the notified amount after determining its cut-off rate. The bids may be accepted for a lower amount also. In such cases, the rest of the amount (i.e. unsubscribe

amount) devolves on the Reserve Bank of India. On the basis of the cut-off price, a yield on the Treasury bill is calculated. For example, in the auction for 14 day Treasury Bills held on 26th Dec., 2000, 18 bids were received but only 5 were accepted for Rs. 30 crore at the cut-off price of Rs. 99.68 giving a yield of 8.37% which was equal to the yield in previous auction. Thus, Rs. 70 crores were devolved on the Reserve Bank of India. The yield on Treasury Bills depends upon the price at the cut off level. There has been significant drop in the yield on Treasury Bills in the Financial Year 2001-02 as shown in the Table below:

Table: 7.1
Yield on Treasury Bills

Month	364 days Bill		91 days Bill	
	2000-01	2001-02	2000-01	2001-02
April	9.27	8.83	8.05	8.06
May	9.15	8.33	8.46	7.65
June	9.24	7.83	8.91	7.26
July	9.77	7.37	8.86	7.07
August	10.81	7.22	10.29	6.91
September	10.85	7.21	10.17	7.01
October	10.46	7.05	9.67	6.86
November	10.15	6.75	9.08	6.71
December	10.02	7.13	8.90	6.89

Source: Economic Survey 2001-02

7.5.1 Discount and Finance House of India and Treasury Bills

Discount and Finance House of India (DFHI) was set-up by the Reserve Bank of India jointly with public sector banks and All-India Financial Institutions. It was incorporated on March 8, 1988 under the Companies Act, 1956 and commenced its business operations from April 25, 1988. The main objective of establishing DFHI was *"to facilitate the smoothening of the short-term liquidity imbalances by developing an active money market, and integrating the various segments of the money market."* DFHI has a share capital of Rs. 200 crores which has been subscribed by Reserve Bank of India, public sector banks and Financial Institutions.

The activities of DFHI include the following:

- a) **Dealing in Treasury Bill:** Treasury Bills are issued by the Reserve Bank of India on behalf of the Government of India. DFHI regularly participates in the auctions through which

these Treasury bills are sold. DFHI provides a ready market for these Treasury Bills by offering buy/sell quotes.

- b) **Re-discounting short-term commercial bills:** DFHI aims to impart liquidity to commercial bills, which have already been discounted by commercial banks or Financial Institutions. For this purpose, it announces its bid and re-discount rates on a fortnightly basis.
- c) **Participating in the Inter-Bank call money, notice money and term deposit market:** DFHI has been permitted by the Reserve Bank of India to operate in the inter-bank call money market both as a lender and borrower of funds ranging from overnight money to money for 14 days.
- d) **Dealing in Commercial Papers, Certificates of Deposits and Government Securities:** DFHI offers its bid rates in respect of Commercial Papers and Certificates of Deposit. The Bid rate is the discount rate at which DFHI is ready to buy CDs/CPs from the market. DFHI also participates in auctions of Government dated securities.

Discount and Finance House of India Ltd. provides liquidity in the money market by dealing in the money market instruments, including Treasury Bills. It deals in Treasury Bills in the primary market and secondary market as well. The following table shows the figure of its turnover of such bills during the financial year 2000-01:

Table: 7.2 : DFHI's Turnover in Treasury Bills

	Rs. crore
(A) Primary Market Turnover	2410.98
(i) Purchase at auctions (including developments)	2186.43
(ii) Maturities	224.55
(B) Secondary Market Turnover	22082.08
(i) Outright	3946.52
(ii) Repos	18135.56
Total Turnover (A + B)	24493.06

DFHI participates in all auctions of treasury bills and a minimum bidding commitment for each treasury bills auction is prescribed. During 2000-01 the extent of minimum commitment was fixed at 18% as against 15% for the previous year. During 2000-01 DFHI achieved a success rate of 42.11% much above the prescribed minimum. DFHI also earned underwrite fee on Treasury Bills during the year. But with effect from June 2000, Reserve Bank of India has discontinued the practise of payment of this fee.

DFHI's turnover (i.e. purchase and sale) in Treasury Bills in the Secondary Market comprises both on outright basis and on repo basis. The Repos imply sale/purchase of Treasury Bills on the condition that the buyers/sellers will sell or buy the Treasury bills from the Discount House on a pre-determined price in the coming days. Discount House of India provides two-way quotes for this purpose—one for bids and the other for offer. These rates were 6.9% and 6.85% respectively as on 30th November, 2001 indicating a very small difference between the two.

Check Your Progress 2

- 1) What do you understand by Call Money Market?

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- 2) Why are Treasury Bills issued and by whom?

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- 3) Discuss the role of Discount and Finance House of India in developing a Secondary Market for Treasury Bills.

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7.5.2 Commercial Bills of Exchange

Commercial Bills of Exchange arise out of genuine trade transactions and are drawn by the seller of the goods on the buyers (i.e. debtors), where goods are sold on credit. They are called 'Demand Bills', when payable on demand or on presentment before the buyer, who is called the 'drawee' of the bill. Alternatively, the bills may be payable after a specified period of time, e.g. 30, 60 or 90 days. Such bills are called 'Usance Bills' and need acceptance by the drawee. By accepting the bills, the drawee gives his consent to make payment of the bills on the due date. Thus, payment of the bills is assured on the dates of maturity. These bills are, therefore, called self-liquidating in nature.

The drawee of the bill (i.e. the seller of the goods) generally discounts the bill with a commercial bank. By discounting is meant that the bill is endorsed in favour of the banker, who makes payment of the amount of the bill less discount (i.e. interest on the amount for the period of the bill) to the drawee. Thus, the drawee gets payment of the bill (less discount) immediately. The discounting banker, however,

recovers the money from the acceptor of the bill on the due date of the bill. The bill is thereafter extinguished.

Commercial Bill of Exchange is a negotiable instrument i.e. it may be negotiated (or endorsed/transferred) any number of times till its maturity. When the discounting bank falls short of liquidity, it may negotiate the bill in favour of any other bank/financial institution or the Reserve Bank of India and may receive payment of the bill less re-discounting charges (i.e. interest for the unexpired period of the bill). This process is called re-discounting of Commercial Bills and may be undertaken several times, till the date of maturity of the bill.

The Reserve Bank of India introduced a Bills Re-discounting Scheme in 1970. Under this scheme bills are re-discounted by Reserve Bank of India or by any scheduled bank/financial institution/investment institution/mutual fund. But important pre-conditions are that the bill should arise out of a genuine trade transaction, must be accepted by the buyer's banker either singly or jointly with him and the period of maturity should not exceed 90 days.

Commercial bill of exchange, thus, is an instrument through which the banks/financial institutions/mutual funds may park their surplus funds for a shorter period as they can afford. Thus liquidity imbalances in the financial system are removed or minimised. Reserve Bank of India has taken several steps in the past, but the practice of drawing bills has not become very popular in India. The obvious reason is the strict discipline that it imposes on the acceptor of the bill to make payment of the bill on the due date. Bills purchased and discounted by Scheduled Commercial Banks in India as on March 31, 2001 constituted just 3.88% of their total assets (i.e. Rs. 50224 crores). But the outstanding amount of commercial bills re-discounted by them with various financial institutions was Rs. 1013 crores as on the same date. This shows that bills re-discounting with other financial institutions is to a limited extent only.

7.6 CERTIFICATES OF DEPOSITS

A Certificate of Deposit is a receipt for a deposit of money with a bank or a financial institution. It differs from a fixed Deposit Receipt in two respects. First, it is issued for a big amount and second, it is freely negotiable. The Reserve Bank of India announced the scheme of Certificates of Deposit in March 1989. The main features of the scheme are as follows:

- i) Certificate of Deposits can be issued by Scheduled Commercial Banks (excluding Regional Rural Banks) and the specified All-India Financial Institutions like Industrial

Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI), Small Industries Development Bank of India (SIDBI), Industrial Investment Bank of India (IDBI), and the Export Import Bank of India (Exim Bank).

- ii) Certificates of Deposits can be issued to Individuals, Associations, Companies and Trust Funds.
- iii) Certificates of Deposits are freely transferable by endorsement and delivery after an initial lock-in period of 15 days after which they may be sold to any of the above participants or to the Discount and Finance House of India (DFHI).
- iv) The maturity period of Certificate of Deposits issued by Banks may range from 3 months to 12 months while those issued by specified Financial Institutions may range from 1 to 3 years.
- v) Certificate of Deposits are to be issued at a discount to the face value.
- vi) Presently there is no limit on the amount which a Bank may raise through Certificate of Deposits. Initially, though, there was a limit linked to the fortnightly aggregate average deposits of the bank.
- vii) The minimum amount for which they may be issued is now pegged at Rs. 5 Lacs. (Reduced from Rs. 25 Lacs).
- viii) The minimum size of issue of Certificate of Deposits to a single investor is Rs. 5 Lacs, thereafter they can be issued in multiples of Rs. 1 Lac. (with effect from October 1997).
- ix) Banks and Financial Institutions are required to issue CDs only in dematerialised form with effect from June 30, 2002. The existing CDs are to be converted into demat forms by October 2002.

Certificate of Deposits are a popular avenue for companies to invest their short-term surpluses because Certificate of Deposits offer a risk-free investment opportunity at rates of interest higher than Treasury bills and term deposits, besides being fairly liquid. For the Issuing Banks, Certificate of Deposits provide another source of mobilizing funds in bulk.

The outstanding amount of Certificate of Deposits of scheduled commercial banks declined perceptibly to a level of Rs. 12,134 crores for the fortnight ended March 28, 1997 from Rs. 16,316 crores for the fortnight ended March 29, 1996. Due to lack of demand for funds and the general decline in the interest rates, the discount rates range on

Certificate of Deposits declined substantially from 12.00—22.25% for the fortnight ended March 29, 1996 to 7.00—15.75% for the fortnight ended March 28, 1997 and further to 7.30—12.50% for the fortnight ended September 12, 1997.

In subsequent years, the total amount of outstanding CDs has been continuously on the decline. The amount of such CDs declined from Rs. 14,584 crores during the fortnight ending May 5, 2000. Thereafter there has been a slight revival in the amount of outstanding CDs, when the figure touches Rs. 1,695 crores on October 20, 2000. The effective rate of interest on CDs has also witnessed sharp decline from 8.25 to 24% to 6.30% to 14.06% range during this period.

7.7 COMMERCIAL PAPER

Commercial Paper is a short-term usance promissory note with fixed maturity, issued by creditworthy and highly rated corporations. It is negotiable by endorsement and delivery. The Reserve Bank of India permitted its introduction in January 1990 as an additional source of short-term finance to corporates and also as an avenue for investment of funds by large investors.

Reserve Bank of India has issued guidelines for issuance of commercial paper. These guidelines, as amended in October, 2000 have the following features:

- i) **Eligibility:** Commercial Paper may be issued by Primary Dealers, Secondary Dealers and All India Financial Institutions, besides the corporates.

The eligibility conditions prescribed for the corporates are:

- a) Tangible net worth should be Rs. 4 crores,
 - b) It should have a sanctioned working Capital limit from a bank or financial institution, and
 - c) The borrowed account should be a standard asset.
- ii) **The Instrument of Commercial Paper should have:**
 - a) A minimum maturity period of 15 days and the maximum period upto one year.
 - b) A minimum amount of Rs. 5 lakhs and thereafter in its multiples.
 - c) Minimum credit rating of P₂ of CRISIL or equivalent rating by other approved credit rating agencies.
 - iii) **The Investors in Commercial Paper:** CPs can be held by individual banks, corporates, unincorporated bodies, Non-Resident Indians and foreign financial institutions.

iv) **Methods of Issuing Commercial Paper:** Only Scheduled Banks can act as issuing and paying agents. CPs can be issued as a promissory note or in a dematerialised form. With effect from June 30, 2001, it is mandatory that all fresh issuance and investments in CPs should be in dematerialised form. Existing CPs were also required to be converted into demat form by October 31, 2001. Underwrit is not permitted.

CPs are issued at a discount to face value. Discount rate is freely determined by the issuing company. CPs are freely transferable. The issuing company bears all expenses, e.g. dealers' fees, rating agency's fees and other charges.

CPs are required to be issued as a 'stand alone' product. It means that while the banks and financial institutions fix working capital limits for the Corporates issuing CPs, they will take into account all sources of finance available to the Company, including the CPs.

Commercial Paper in India

Issuance of Commercial Paper by the eligible corporates has now become an established practise because of its lower cost. Total outstanding amounts of CPs ranged between Rs. 5000 crores and Rs. 8000 crores during January 1999 and July 2001. The typical effective rates of discount ranged between 8% to 12% during this period and varied from time to time.

Scheduled Commercial Banks have been the predominant investors in CPs and their outstanding holding was Rs. 6,984 crores as on 23rd March, 2001 (as against the total outstanding amount of Rs. 6,991 crores as on 15.3.2001)

Check Your Progress 3

1) State the pre-condition for re-discounting a Commercial Bill by RBI under Re discounting Scheme, 1970.

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2) What are Certificates of Deposits? How do they differ from fixed deposits in banks?

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- 3) What do you understand by Commercial Paper? Give the salient features of the guidelines issued by Reserve Bank of India in this regard.

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7.8 LET US SUM UP

The financial markets play a significant role in the economy of a country. These markets are of two types: Money Market and Capital Market. Money Market deals in short-term funds upto the period of one-year. Commercial and Co-operative Banks, Discount and Finance House of India Ltd., financial and investment institutions, Reserve Bank of India, corporates and Mutual Funds participate in the money market. As a Central Bank, Reserve Bank of India performs various tasks including the effective regulation of financial institutions. It provides refinance facilities to the banks through the schemes like Interim Liquidity Adjustment Facility (ILAF) and Liquidity Adjustment Facility (LAF). Call Money Market and Short Notice Money Market are important constituents of the money market.

Earlier several non-bank entities such as financial institutions and selected corporates were permitted to lend directly in the call/notice money market. However, with a view to reduce the volatility in the market, RBI has taken steps to reduce the participation of non-bank institutions in the Call Money Market. Treasury Bills, Commercial Bills of Exchange, Certificates of Deposit, Commercial Paper are the important instruments for short-term borrowings in the money market.

7.9 KEY WORDS

- Additional Collateralised Facility** : This facility is in addition to the collateralised lending facility. It is granted at Bank rate plus 2% points.
- Call Money Market** : This is the market for short-term funds, generally for one-day or a few days. Banks lend their short-term surplus funds in this market to other banks. Other institutions also participate as lenders only.
- Certificates of Deposits** : It is a receipt for deposits made with a bank or financial institution. It is freely transferable instrument.

**Collateralised
Lending Facility**

: Under this facility, Reserve Bank of India provided funds to the Commercial Banks upto 0.25% of their fortnightly average outstanding deposits in 1997-98. Such facility was granted for two weeks at Bank rate.

Commercial Paper

: It is an unseamed short-term debt instrument issued by credit worthy corporates and financial institutions. Its maturity ranges between 15 days and one year. It is negotiable instrument.

**Liquidity Adjustment
Facility (LAF)**

: At present Reserve Bank of India manages liquidity in the economy through the repo and reverse repo auctions under the Liquidity Adjustment Facility. It absorbs liquidity from the system through repos and release funds through reverse repos.

**Money Market
Instruments**

: Instruments through which funds are transacted for short-term period in the money market are called money market instruments for example, certificates of deposits, commercial papers, bills of exchange.

Refinance Facilities

: The Reserve Bank of India, IDBI, SIDBI, NABARD and Exim Bank provides loans to banks against the loans granted by them. Such loans constitute refinancing.

Repo Auctions

: Repo is the right to repurchase the security. Under repo auctions the borrower retains the right to take back the security by repaying the borrowed amount. Under repo auctions Reserve Bank of India sells the securities and thus, contracts liquidity, wherever there is excess liquidity.

Treasury Bills

: These are instruments for short-term borrowings by Government of India and are issued on its behalf by Reserve Bank of India. At present they are issued by auction for 91 days and 365 days.

Variable Reverse Repo Auctions : Under the reverse repo auctions Reserve Bank of India releases funds in the system by buying securities in the auction.

7.10 SOME USEFUL BOOKS

L.M. Bhole (3rd Edition, 2002): Financial Institutions and Markets, Tata McGraw Hill, Delhi.

P.N. Varshney & D.K. Mittal (4th Edition, 2002): Financial System in India, Sultan Chand & Sons, Delhi.

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Report of the Committee on Banking Sector Reforms (Chairman: M. Narsimham), 1998

7.11 ANSWERS/HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

- 1) Money Market is the market which deals in short-term funds ranging from overnight to a year.

The major participants in the money market are: Commercial and Co-operative Banks, Discount and Finance House of India Ltd (DFHI), RBI, Financial and investment institutes like LIC, UTI, GIC etc.

- 2) See Section 7.32

- 3) i) Money Market is the market for short-term funds upto one-year duration whereas capital market deals in long-term funds.

- ii) Repo is a method of borrowing against certain securities for a short period whereas reverse repo is a method of lending against the securities with the commitment to take back the securities from the borrower against payment at a specified price.

Check Your Progress 2

- 1) Market for money at call and short notice is known as Call Money Market.
- 2) The Treasury Bills are issued to bridge the mismatch

between the timings of Government receipts and expenditure. Treasury Bills are issued by RBI.

3) See Sub-section 7.5.1

Check Your Progress 3

- 1)
 - i) The bill should arise out of a genuine trade transaction.
 - ii) It must be accepted by the buyer's banker either singly or jointly with him.
 - iii) Period of maturity should not exceed 90 days.
- 2) Certificate of Deposit can be defined as a receipt for a deposit of money with a bank or a financial institution. They differ from fixed deposits in two senses:
 - a) certificate of deposit is issued for a big amount,
 - b) it is freely negotiable.
- 3) See Section 7.7