MONEY MARKET AND ITS INSTRUMENT

INTRODUCTION

- Financial markets in every economy have two separate segments, one catering to short term funds and other catering to long term funds. The short-term financial market is known as money market and the long term financial market is known as the capital market. Short-term funds are for a period of 364 days and long term funds are for above 364 days. Chakravarthy committee (1985) for first time underlined the need of an organized money market and Vahul Committee (1987) laid the blueprint for that.

MONEY MARKET

- The money market is a market for short - term funds, which deals in financial assets whose period of maturity is up to one year. It should be noted that money market does not deal in cash or money as such but simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money. These instruments help the business units, other organizations and the Government to borrow the funds to meet their short-term requirement.
- The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialized financial institutions. The Reserve Bank of India is the leader of the money market in India. Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate etc. also operate in the Indian money market.
- It is one part of financial market where instruments like securities ,bonds having short term maturities usually less than one year are traded is known as Money market
- Organization or Financial institutions having short term money requirement less than one year to meet immediate needs like buying inventories, raw material ,paying loans come to Money Market. It involves lending and borrowing of short term funds. Money market instruments like treasury bills, certificate of deposit and bills of exchange are traded their having maturity less than one year .Investment in money market is safe but it gives low rate of return.
- Money Market is regulated by R.B.I in India and instrument having maturity less than one year usually traded in money markets

MAJOR PLAYERS IN MONEY MARKET:-

- RBI
- Central Government
- State Governments
- Banks
- Financial Institutions

- Micro Finance Institutions
- Foreign Institutional Investors (FII)
- Mutual Funds

MONEY MARKET INSTRUMENTS

- Treasury Bills
- Commercial Papers
- Certificate of Deposit
- Bankers Acceptance
- Repurchase Agreement
- Call Money
- Trade Bill
- Cash Management Bills (CMBs)
- Commercial Bills (CBs)
- Inter Corporate Deposit Market
- LIBOR
- MIBOR

TREASURY BILLS

- Treasury Bills are also known as T-Bills. This is one of safest instrument to invest .T-bills are issued by RBI backed by government security. RBI issue treasury bills on the behalf of central government to meet the short term liquidity needs of central government bills are issued at a discount to face value, on maturity face value is paid to holder.
- At present, the Government of India issues three types of treasury bills through auctions, for 91-day, 182-day and 364-day. Treasury bills are available for a minimum amount of Rs. 25,000 and in multiples of Rs. 25,000.
- Treasury bills are also issued under the Market Stabilization Scheme (MSS).In this if RBI want to absorb excess liquidity it can issue T-bills.

COMMERCIAL PAPER

- Commercial paper (CP) is a popular instruments for financing working capital requirements of companies. The CP is an unsecured instruments issued in the form of promissory note. This instrument was introduced in 1990 to enable the corporate borrowers to raise short-term funds. It can be issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery. The highly reputed companies (Blue Chip companies) are the major player of commercial paper market.
    - These are unsecured **promissory*** notes issued by large corporates, primary dealers, satellite dealers and all India FIs.
    - Maturity period is between **7 days up to 1 year** from date of issue.

- Minimum amount to be invested is **Rs 5 lacs** or multiples of that.
- The net worth for a corporate to be able to issue it is **4 crore**.
- CPs need to have a **credit rating** from a credit rating agency.

CERTIFICATE OF DEPOSITS: ALL YOU NEED TO KNOW

INTRODUCTION

- Certificate of Deposit (CD) is a money market instrument issued in dematerialized form or as a Promissory Note against funds deposited at a bank or other eligible financial institution for a specified time period. It is offered by few banks and financial institutions which provides investors to enjoy the highest interest rate in comparison of any other saving accounts. It's a promissory note issued by the bank against funds deposited by an investor. It is a negotiable money market instrument and can't get less than 5 months and can't get exceed more than 5 year. You need to deposit fund for very short period other than any saving accounts and within this short period of time you will enjoy the highest interest rates. However there are few guidelines which apply for CDs and these guidelines are issued by the Reserve Bank of India amending from time to time. Your investment made on CDs is secure as they get insured by the bank with which you make your investment and further are insured by the Federal Deposit Insurance Corporation which makes it completely safe

INSTITUTIONS INVOLVED

- In India CDs cannot be issued by everyone. They are specifically issued by:
  - Commercial Banks in India
  - Financial institutions like IFCI
- A Certificate of Deposit in India are issued by all scheduled commercial banks excluding (Regional Rural Banks and Local Area Banks) and all India Financial Institutions permitted by RBI. A commercial bank can issue Certificate of Deposit as per their requirements. A financial institution can issue Certificate of Deposit within a limit prescribed by RBI. A thumb rule for FI is that CD together with other instruments like term money, term deposits, commercial papers and inter-corporate deposits should not exceed 100 per cent of its net owned funds. It can be issued to individuals, corporations, companies, trusts, funds, associations etc. The nonresident Indians are also eligible for CDs provided they don't repatriate the funds.

GUIDE LINES FOR CD

- CDs can't get issued by every bank and authority has confined itself to very few banks of India under Commercial Banks of India and few financial institutions like IFCI.

ELIGIBILITY

- CDs can be issued by Scheduled Commercial Banks and All-India Financial Institutions (FIs) that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.

MINIMUM AMOUNT:

- The first criteria is that you need to make your deposit the minimum amount of 1,00,000 and that too by a single issuer. Under the issuer anyone can make their investment on companies, firms, trusts, banks and even NRIs but there are very strict guidelines that have been made in the context of NRIs. Once you are ready to make your investment by accepting the guidelines of the bank you will receive a written declaration for your investment and in this declaration everything will be mentioned like your date of making your investment, date of maturity and other information too.

MATURITY PERIOD:

- The maturity period of CDs that are issued by banks should not be less than 7 days and not more than 1 year from the date of issue.
- The FIs can issue CDs for a period not less than 1 year and not more than 3 years from the date of issue.

SECURITY ASPECT:

- If CD has been issued in physical form they can be freely transferred. So they have been released in Demat form so that they can be transferred as per the procedure applicable to other demat securities. Other information is there is no lock-in period for certificates of deposit Banks/FIs cannot grant loans for CDs. They cannot buy their own CDs before maturity. Bank needs to maintain cash reserve ratio (CRR) and statutory liquidity ratio (SLR), on the issue price of the CDs.

DUPLICATE CERTIFICATES:

- In case of loss of physical certificates duplicate certificates can be issued after completing following conditions
  - Notice must be given in at least one local newspaper.
  - Lapse of a reasonable period (say 15 days) from the date of the notice in the newspaper.
  - Execution of an indemnity bond by the investor for the satisfaction of the issuer of CDs.
- The duplicate certificate can be issued only in physical form. No fresh stamping is required as the duplicate certificate is issued for the original lost CD. The duplicate CD should clearly mention that the CD is a Duplicate one stating the original value date, due date, and the date of issue.

CONCLUSION

- Certificate of deposits cannot be issued by all. There are a stipulated set of institutions that can issue the same. Interest rates on these CDs are pretty competitive to interest rates that we get on government securities. It could be marginally higher than depending on the credibility and the market movement of interest rates. Since these forms are issued by banks and institutions the credibility and repayment would not matter too much. These CDs are generally applied for by the institutions in the country. These are the brief about certificate of deposits.

BANKERS ACCEPTANCE

- Bankers Acceptance is also a money market instrument to meet short term liquidity requirement .In this company provides bank guarantee to seller to pay amount of good purchased at agreed future date . In case buyer failed to pay on agreed date , seller can invoke bank guarantee . It is usually used to finance export and import.

REPURCHASE AGREEMENT

- Repurchase agreement is also known as Repo .It is money market instrument .In this one party sell his asset usually government securities to other party and agreed to buy this asset on future agreed date . The seller pays an interest rate, called the repo rate, when buying back the securities. This is like a short term loan given by buyer of security to seller of security to meet immediate financial needs.

CALL MONEY

- Call money is mainly used by the banks to meet their temporary requirement of cash. They borrow and lend money from each other normally on a daily basis. It is repayable on demand and its maturity period varies in between one day to a fortnight. The rate of interest paid on call money loan is known as call rate.
- Interbank market where funds are borrowed and lent for **1 day or less.**
- **If >1 day and up to 14 days**, it is called notice money.
- Mutual funds, scheduled commercial & cooperative banks act as both borrowers and lenders.
- LIC, GIC, NABARD, IDBI act only as lenders.

TRADE BILL

- Normally the traders buy goods credit. Th3e sellers get payment after the end of the credit period. But if any seller does not want to wait or in immediate need of money he/she can draw a bill of exchange in favour of the buyer. When buyer accepts the bill it becomes a negotiable instrument and is termed as bill of exchange o trade bill. This trade bill can now be discounted with a bank before its maturity. On maturity the bank gets the payment from the drawee i.e., the buyer of goods. When trade bills are accepted by Commercial Banks it is known as Commercial Bills, So trade bill is as instrument, which enables the drawer of the bill to get funds for short period to meet the working capital needs.

CASH MANAGEMENT BILLS (CMBS)

- It's a comparatively new short-term instrument issued by RBI on behalf of Govt.
- Issued to meet **temporary mismatches in cash flow** of Govt.
- They resemble T-bills in character but are issued for **less than 91 days only.**

COMMERCIAL BILLS

- Negotiable instruments which are issued by all India FIs, NBFCs, SCBs, Merchant banks & Mutual funds.
- Drawn by seller on the buyer (buyer gives seller), hence also called **trade bills.**

INTER CORPORATE DEPOSIT MARKET

- This is a market where corporates extend the unsecured loan to each other.
- Majorly used by low rated corporates for managing their funds.

LIBOR:

- LIBOR stands for London Inter-Bank Offered Rate. LIBOR is the benchmark/reference for average interest rates – used by the A-Grade banks as "Offer" for lending their funds to the A-Grade banks as unsecured loans in marketable lot in London based interbank transactions.

HISTORY:

- LIBOR rates used to be published since 1986 for the then three main currencies of the world, namely United States Dollar (USD), Great Britain Pound (GBP) and Japanese Yen (JPY) for four different maturity periods of one month, three months, six months and one year.
- After the merger of currencies of the European nations into Euro, on January 01, 1999, LIBOR rates started to be published for 10 major currencies of the world and for 15 different maturity periods ranging from overnight to 1 week, 2 weeks, and 12 different months. These 10 (Currencies) x 15 (Different Time Periods) = 150 rates used to be published daily at 11.30 A.M. London Time i.e. 5.00 P.M. (Indian Standard Time).
- The ten constituent currencies of LIBOR used to be USD, GBP, Euro, Swiss Franc, Canadian Dollar, JPY, Danish Krone, Swedish Krona, Australian Dollar and New Zealand Dollar. LIBOR used to be calculated and published by Thomas Reuters on behalf of British Bankers' Association.

CURRENT STATUS:

- The responsibility of LIBOR was handed over to Inter-Continental Exchange on February 01, 2014 administered by ICE Benchmark Administration (IBA). (This was done after detection of scandal in the calculations of LIBOR).
- Since then it is also called by the name of ICE-LIBOR. Currently it constitutes of five major currencies i.e. CHF (Swiss Franc), EUR (Euro), GBP (Pound Sterling), JPY (Japanese Yen), and USD (US Dollar).
- The rates are now quoted for overnight, one week, and 1, 2, 3, 6 and 12 months and thus 5 (Constituent Currencies) x 7 (Different Maturity Periods) = 35 ICE-LIBOR rates are published on every business day. Usually, the borrower bank has to pay four to five basis points above the LIBOR.

SIGNIFICANCE:

- LIBOR is used by different A-Grade banks either for interbank lending of the surplus funds or for interbank borrowing for meeting their short term liquidity requirements.
- LIBOR has been in use as a reference/benchmark rate by the financial institutions for deciding interest rates for the different financial instruments.
- The developed countries like Canada, U.K., U.S.A. and Switzerland rely on LIBOR as a reference/benchmark rate. LIBOR is also used by the well-known multinational commercial corporations.

CALCULATIONS:

- A survey is made of the interest rate quotations from 18 major London based global banks on the beginning of every business day in London – at which rate they are willing to "Offer" their funds as unsecured funding to other A-grade borrower banks.
- Out of the 18 responses, the four highest quoted rates and the four lowest quoted rates are deleted and an Arithmetical Mean is arrived of the remaining 10 responses.

MIBOR:

- MIBOR stands for Mumbai Inter Bank Offered Rate. Like LIBOR, MIBOR is the benchmark for overnight interest rates BUT ONLY for the Indian Rupee (INR) at which banks can lend or borrow funds, in marketable size, from other banks in the Indian interbank money market.

HISTORY:

- MIBOR was launched on June 15, 1998 as "Overnight" rate by Committee for the Development of the Debt Market. Later on, MIBOR started making "Offer" and dealing for 14-days maturity beginning from November 10, 1998.
- Further, one month and three months maturities were also added to MIBOR on December 1, 1998. In addition to these maturities, w.e.f. June 6, 2008, the offers for the three days' maturity rates were also commenced on every business Friday (i.e. from Friday to Monday) in collaboration with Fixed Income Money Market and Derivative Association of India (FIMMDA).

CALCULATIONS:

- MIBOR used to be calculated daily by the National Stock Exchange of India Limited (NSEIL) by the calculated average of the "Offer" of the lending rates with weighted calculations of the quantum of surplus funds available with the lender banks for lending to the first-class borrowers.
- Since June 22, 2015 FIMMDA joined the NSEIL for calculating the MIBOR and MIBOR was given the name of "FIMMDA-NSE MIBID/MIBOR". MIBID stands for Mumbai Inter-bank Bid Rate. "Offer" Rates are obtained on every business day from "30 Offer Makers" comprising of Public Sector Banks, Private Sector Banks, Foreign Banks and the Approved Money Market Dealers and calculated weighted average of the polled rates are displayed on the NSEIL website. It must be noted that MIBOR rates are the "Polled Rates" and not the actual dealing rates.

SIGNIFICANCE:

- MIBOR is used by different Indian banks either for interbank lending of the surplus funds or for interbank borrowing for meeting their short term liquidity requirements.
- MIBOR has been in use as a reference/benchmark rate by the financial institutions for deciding interest rates for the different financial instruments like Interest Rate Swaps, Forward Rate Agreements, Floating Rate Debentures and Term Deposits, Loans of different maturities and mortgages, etc. MIBOR is also the benchmark for the Call Money Market Rates. But the volumes of MIBOR are quite meagre as compared with the volumes of LIBOR.

REVIEW:

- Reserve Bank of India has started taking concrete initiative of making the “FIMMDA-NSE MIBID/MIBOR” rates more transparent so that NO LIBOR like scandal should occur in MIBID/MIBOR.
- **Note:** Average LIBOR rates closed at 1.70261% p.a. and average MIBOR rates closed at 7.21% on Monday, February 13, 2017.