- Financial Institutions

and

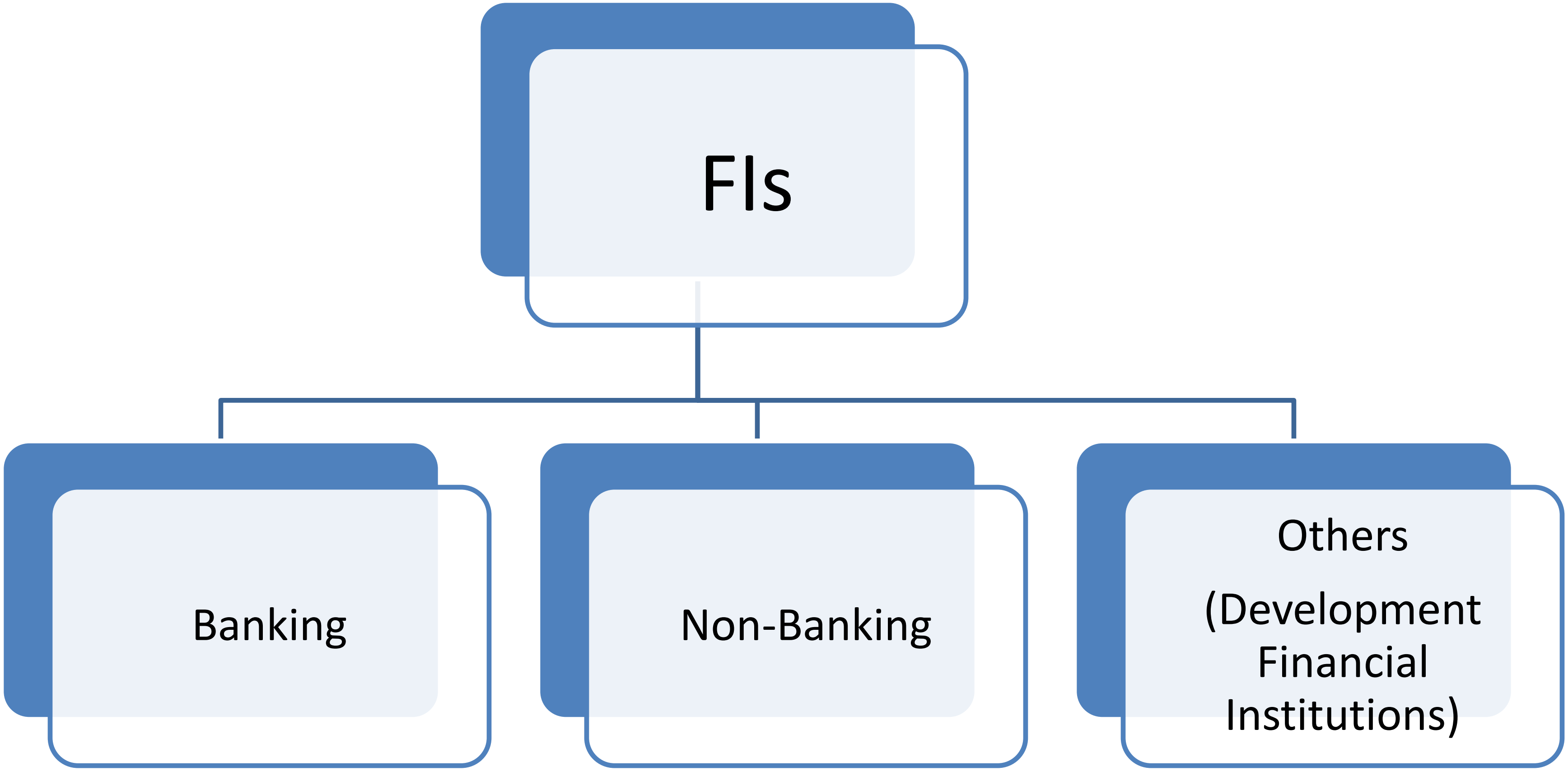
- Money Market

Financial Institutions

Financial Institutions	

• Types of FIs
• Banking – Types of Banks
• Reserve Bank of India
• Banking Business
• Types of lending
• Working Capital Financing
• Licencing of Banks
• Banking Acts and Regulations
• NPA
• Types of NPA
• NPA management
• Risks in Banks
	• NBFCs
	  • Types
	  • Functions
	• Other Financial Institutions
	  • NABRAD
	  • SIDBI
	  • EXIM Bank
	  • SFCs

Financial Institutions (FIs)



Financial Institutions

- They are business organizations dealing in financial resources.
- They collect resources by accepting deposits from individuals and institutions and lend them to trade, industry and others.
- This means financial institutions mobilize the savings of savers and give credit or finance to the investors.

Banking Institutions

- Banking financial institutions:
  - Banking institutions mobilize the savings of the people.
  - They provide a mechanism for the smooth exchange of goods and services.
  - They extend credit while lending money.
  - They not only supply credit but also create credit.

Banking Business (Sec 5(b) of Banking Regulation Act, 1949

As per Section 5(b) of the Banking Regulation Act,1949 are as follows:

- Acceptance of deposits from the public
- For the purpose of lending or investment
- Repayable on demand or otherwise
- Withdrawable by means of any instrument whether a cheque or otherwise

Indian Financial System–Share by Asset Size (2017)

Segment Market	Share of Financial Assets (Percentage)
Banks	51
Financial Institutions, Insurance companies and Housing finance companies	15
Non-banking Financial Institutions	12
Mutual Funds	13
Provident and Pension Funds	9
Total	100
Source: Source: RBI, Financial Stability Report, 2017	

Reserve Bank of India

- The RBI is the central bank of India. It was established in 1935 under a special act of the parliament.
- The RBI is the main authority for the monetary policy of the country. The main functions of the RBI are to maintain financial stability and the required level of liquidity in the economy.

RBI: Functions

- The RBI prints currency notes except one rupee note and its subsidiary coins in India.
- The RBI operates as a banker to the banks.
- The RBI oversees the operations of other banks in India.
- The RBI provides loans to other banks in India for certain reasons such as client lending. It serves as a final resort for all banks in financial difficulties.

RBI: Functions

- The RBI serves as a banker to the government. The Reserve Bank of India serves as the banker to the Union of India's national and state governments.
- The RBI controls the economy's credit and money supply. It raises interest rates to reduce the amount of loans and lowers interest rates to boost the volume of loans.

Instruments of monetary policy of RBI

- Open Market Operations
- Cash Reserve Ratio (CRR)
- Statutory Liquidity Ratio (SLR)
- Bank Rate Policy
- Repo Rate
- Reverse Repo Rate
- Credit Ceiling

Cash Reserve Ratio (CRR)

- The Cash Reserve Ratio (CRR) of the Reserve Bank of India (RBI) is 4.50% as of October 16, 2024.
- This means that banks must keep 4.50% of their net demand and time liabilities (NDTL) with the RBI as liquid cash reserves.

NDTL (Net Demand and Time Liabilities)

- "Demand liabilities" means liabilities which must be met on demand, and
- "Time liabilities" means liabilities which are not demand liabilities;
- This includes the sum of demand and time deposits held by the bank. Demand deposits are those that can be withdrawn anytime, whereas time deposits have a fixed maturity date.

Statutory Liquidity Ratio (SLR)

- The SLR is the minimum percentage of deposits that banks must keep in cash, gold, and other liquid assets.
- The RBI can change the SLR limit as needed, and the maximum limit is 40%.
- As of January 29, 2024, the Statutory Liquidity Ratio (SLR) of the Reserve Bank of India (RBI) is 18%. This means that for every ₹100 of deposits a bank holds, it must keep at least ₹18 in liquid assets.

SLR Requirement

- The following lending institutions are liable to maintain an SLR, per the Banking Regulation Act 1949:
  - Scheduled Commercial Banks
  - Local Area Banks
  - Primary (Urban) Co-operative Banks
  - State Co-operative Banks
  - Central Co-operative Banks

Calculation of SLR

- SLR = (Liquid assets held by the bank) / (Net demand and time liabilities (NDTL)) x 100
- Liquid assets such as cash, gold, and government securities. The total of these liquid assets

Bank Rate

- The Bank Rate is the interest rate at which the Reserve Bank of India (RBI) lends money to domestic banks for long-term loans like home loan.
- It is a fundamental tool used to control the supply of money in the economy and manage inflation.
- Changes in the Bank Rate can influence the rates that commercial banks charge their customers, impacting borrowing and spending patterns.

What is REPO Rate?

- The Repo Rate, or Repurchase Rate, is the rate at which the RBI lends short-term money to commercial banks against securities.
- In essence, it is a repurchase agreement where banks sell government securities to the RBI with an agreement to repurchase them at a future date at a predetermined price.
- The Repo Rate is a critical tool for managing short-term liquidity in the banking system.
- **Repo Rate : 6.50%.**

Bank Rate vs Repo Rate

- **Term of Loan:**
  - **Bank Rate**: Used for long-term loans.
  - **Repo Rate**: Used for short-term borrowing.
- **Mechanism:**
- **Bank Rate**: The RBI directly lends money to commercial banks without any collateral.
- **Repo Rate**: The RBI lends money to commercial banks against the collateral of government securities.
- **Objective:**
- **Bank Rate**: Aims to control long-term inflation and stabilise the economy.
- **Repo Rate**: Focuses on managing short-term liquidity and ensuring stability in the financial system.

Bank Rate vs Repo Rate

- **Frequency of Change:**
- **Bank Rate**: Tends to be changed less frequently as it impacts long-term economic trends.
- **Repo Rate**: Can be adjusted more frequently to address immediate liquidity needs.
- **Impact on Economy:**
- **Bank Rate**: Influences long-term interest rates and overall economic growth.
- **Repo Rate**: Has a more immediate impact on short-term interest rates and banking liquidity.

Bank Rate and Repo Rate: Impact

- An increase in these rates means higher borrowing costs for banks, which they often pass on to consumers in the form of higher interest rates on loans and mortgages.
- A lower Repo Rate means cheaper short-term borrowing, which can help banks manage their day-to-day operations more efficiently.

For Consumers

- **Loan and Mortgage Rates**: When the Bank Rate or Repo Rate increases, consumers can expect higher interest rates on loans and mortgages. This makes borrowing more expensive and can reduce spending and investment.
- **Savings and Investments**: Higher interest rates can benefit savers by providing better returns on deposits and fixed-income investments. Conversely, lower rates may reduce the returns on savings, encouraging consumers to spend or invest in higher-risk assets.
- **Overall Spending**: Changes in these rates can influence consumer confidence and spending. Higher rates may lead to reduced spending as borrowing costs rise, while lower rates can stimulate spending by making credit more affordable.

Impact of Repo Rate

- A slight change in repo rate it can directly impact EMIs and rates of interest on various types of loans like Personal Loans, Car Loans, Business Loans, Home Loans, etc.
- It is also likely to have a crucial impact on other finance-centric elements such as fixed deposits, mutual funds, savings accounts, etc.

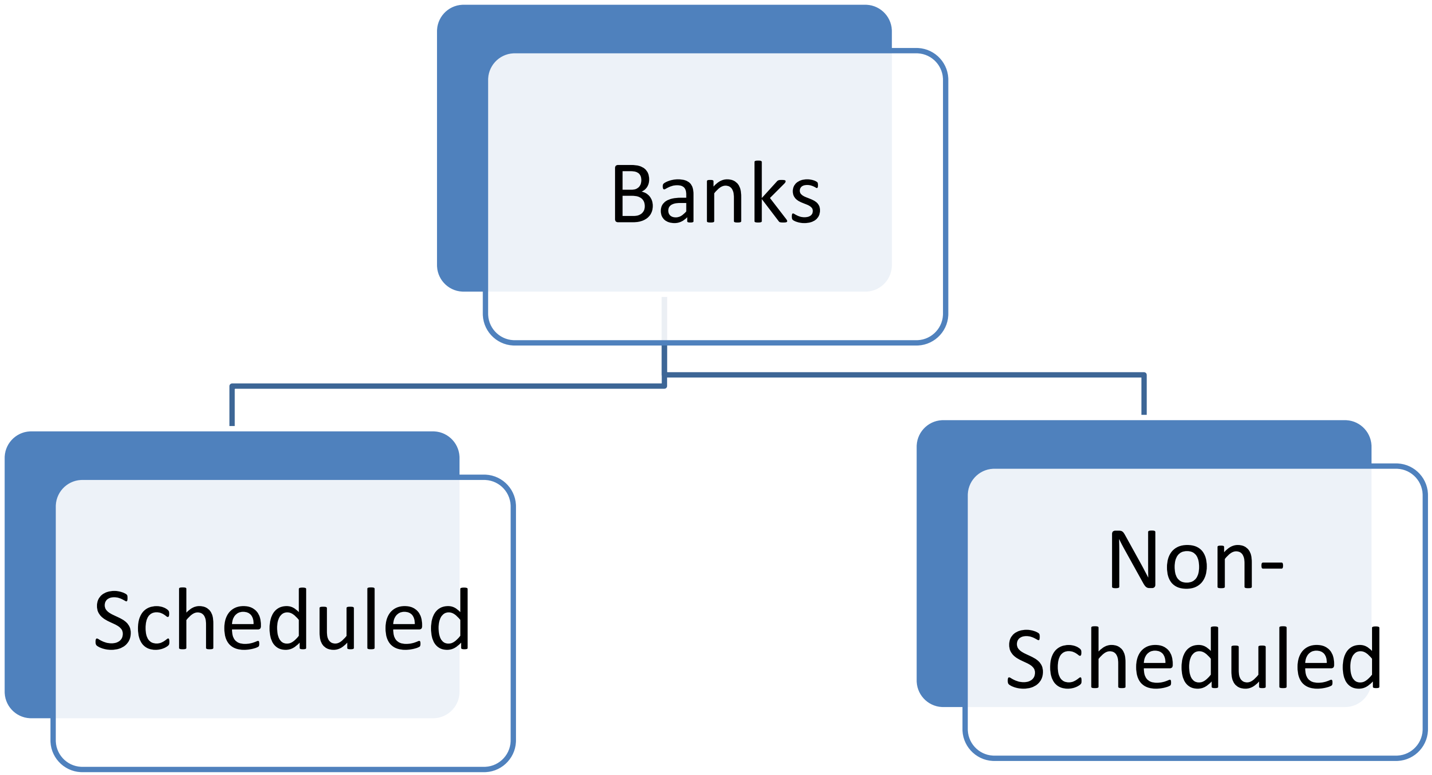
What is Reverse Repo Rate?

- As the name implies, reverse repo is the inverse contract to the repo rate. The reverse repo rate is the rate at which the RBI borrows funds from the country's commercial banks.
- It is the rate where the commercial banks in India park excess funds with the Reserve Bank of India, typically for a short period of time.

Schedule Banks

- Those banks which are included in 2nd Schedule of RBI Act 1934.
- The bank should fulfil two conditions:
  1. Paid up capital and collected funds should not be less than rupees 5 lakhs
  2. Any activity of the bank should not be determined or adversely affect the interest of the customers
- Every schedule bank enjoys two principal facilities:
  1. It becomes eligible for a loan from RBI at bank rate
  2. It automatically acquires the membership of clearing house

Commercial Banks



Scheduled Commercial Banks

As per the RBI

Commercial Banks refer to both scheduled and non-scheduled commercial banks which are regulated under Banking Regulation Act, 1949.

Scheduled Commercial Banks are grouped under following categories:

- **Scheduled Public Sector Banks**
- **Scheduled Private Sector Banks**
- **Scheduled Small Finance Banks**
- **Scheduled Payments Banks**
- **Scheduled Regional Rural Banks**
- **Scheduled Foreign Banks in India**

Scheduled Commercial Banks

- Scheduled banks are those banks that are listed under Schedule II of the Reserve Bank of India Act, 1934.
- The bank's paid-up capital and raised funds must be at least Rs. 5 lakh to qualify as a scheduled bank. These banks are liable for low interest loans from the RBI.

Non-Scheduled Commercial Banks

- Non-scheduled banks by definition are those which are not listed in the 2nd schedule of the RBI act, 1934.
- They don't conform to all the criteria under clause 42, but dully follow specific guidelines as laid down by RBI. Banks with a reserve capital of less than 5 lakh rupees qualify as non-scheduled banks.
- **Examples: Cooperative Banks**

‘Scheduled Commercial Banks

- ‘Scheduled Commercial Banks’ are banks included in second schedule of the RBI Act. It comprises of Public Sector Banks, Regional Rural Banks, Private Sector Banks, Small Finance Banks (SFBs), Scheduled Payments Banks and Foreign Banks.
- Public Sector banks’ comprises of State Bank of India (including erstwhile associate banks and Bharatiya Mahila Bank of period prior to April 1, 2017) and Nationalized banks.
- IDBI Bank Limited which was classified as ”Public Sector Banks” before January 21, 2019, is now classified as “Private Sector Banks”.

As on 31st March 2024

Type of Bank	No. of Banks with branches
Public Sector Banks	12
Private Sector Banks	21
Regional Rural Banks	43
Foreign Banks	46
State cooperative banks	33
District Central cooperative banks	352

Presently, 12 Small Finance Banks (SFBs) and 4 Scheduled Payments Banks are operating in India.

New Private Sector Banks

- Axis Bank Ltd
- Development Credit Bank Ltd
- HDFC Bank Ltd
- ICICI Bank Ltd
- IndusInd Bank Ltd
- Kotak Mahindra Ltd
- Yes Bank Ltd
- IDFC Bank
- Bandhan Bank Ltd.

Old Private sector Banks

- City Union Bank Ltd.
- Dhanlaxmi Bank Ltd.
- Karnataka Bank Ltd.
- Nainital bank Ltd.
- South Indian Bank Ltd.
- Catholic Syrian bank Ltd.
- Federal Bank Ltd
- Jammu & Kashmir Bank Ltd
- Karur Vysya Bank Ltd
- Lakshmi Vilas Bank Ltd
- RBL Bank Ltd.
- Tamilnad Mercantile Bank Ltd.

Local Area Banks

- These banks are set up in private sector to cater to the credit needs of the local people and to provide efficient and competitive financial intermediation services in their area of operation.
  - Coastal Local Area Bank Ltd. in Andhra Pradesh,
  - Krishna Bhima Samruddhi Local Area Bank Ltd. which operates in Mahbubnagardistrict of Andhra Pradesh, Gulbarga
  - Raichur districts in Karnatakaand Subhadra Local Area Bank Ltd. in Kolhapur.

Small Finance Banks

- On 27 November 2014, the Reserve Bank of India issued the required guidelines that have to be followed for licensing of small finance banks in the private sector.
- The small finance bank shall primarily undertake basic banking activities of acceptance of deposits and lending to the unserved and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganized sector entities.

List of Small Finance Banks (2015)

- 1. Au Financiers (India) Ltd., Jaipur
- 2. Capital Local Area Bank Ltd., Jalandhar
- 3. Disha Microfin Private Ltd., Ahmedabad
- 4. Equitas Holdings Private Limited, Chennai
- 5. ESAF Microfinance and Investments Private Ltd., Chennai
- 6. Janalakshmi Financial Services Private Limited, Bengaluru
- 7. RGVN (North East) Microfinance Limited, Guwahati
- 8. Suryoday Micro Finance Private Ltd., Navi Mumbai
- 9. Ujjivan Financial Services Private Ltd., Bengaluru
- 10. Utkarsh Micro Finance Private Ltd., Varanasi

Payments Banks

- The Reserve Bank of India issued the guidelines for licensing of payments banks on27 November 2014.
- The objectives of setting up of payment banks will be to process further the financial inclusion by providing (i) small savings accounts and (ii) payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganized sector entities and other users.

List of Payment Banks

- 1. Aditya Birla Nuvo Limited
- 2. Airtel M Commerce Services Limited
- 3. Cholamandalam Distribution Services Limited
- 4. Department of Posts
- 5. Fino PayTech Limited
- 6. National Securities Depository Limited
- 7. Reliance Industries Limited
- 8. Shri Dilip Shantilal Shanghvi
- 9. Shri Vijay Shekhar Sharma
- 10. Tech Mahindra Limited
- 11. Vodafone m-pesa Limited
- 12. Tech Mahindra,
- 13.Cholamandalam Investment and Finance Company
- 14. IDFC Bank and Telenor Financial Services

Banking Business

- (i) Term-lending business particularly in the infrastructure sector.
- (ii) Capital market directly/indirectly.
- (iii) Retail finance such as housing finance, consumer finance and so on.

Lending of Funds

- Lending or the extension of credit is the major activity of a commercial bank.
- Prior to the early 1990s, the lending by banks was directed according to plan priorities.
- In the post-reforms period, bank lending is determined by both supply and demand factors.
- Banks now strive to earn highest return on their portfolio with minimum risk.

Bank Portfolio

- Bank portfolio consists of four categories of assets.
  - Cash in hand and balances with the central bank;
  - Assets with the banking system;
  - Investments in Government and other approved securities; and
  - Loans and advances.

Lending of Funds by Banks

- Lending to Agriculture
- Lending to Priority Sector
- Lending to industry
- Infrastructure financing
- Lending to household sector
- Lending to sensitive sectors
- Financing of NBFCs
- Financing to factoring companies

Corporate lending

- **Term Loans**
- Term Loans to support capital expenditures for setting up/starting industrial unit and new business as well as for expansion, revocation etc.
- Investment Decision (capital)

Project Finance & Infrastructure Finance

- Bank provides fund based and non fund base credit facilities for New Project as well as expansion, diversification and modernisation of existing projects in Infrastructure and Non- Infrastructure Sector.

Infrastructure financing

- For funding large infrastructure projects, banks also syndicate loans-in which different banks come forward to share the loan amount.
- Banks extend credit facility by way of working capital finance, term loan, project loan, subscription to bonds and debentures/ preference shares/equity shares acquired as a part of the project finance package which is treated as 'deemed advance' and any other form of funded or non-funded finance facility.

Export Finance

- Export Finance at pre-shipment and post shipment stage to exporters in various types of fund based and non fund based credit facility.

Bill Financing

- Advances against Inland Bills in the form of limit for purchase of bills, discount of bills or advance against bills sent for collection to borrowers for their genuine trade transactions.
- Bills facilities are also allowed to the borrowers against bills accompanied by Railway Receipts (RRs), Motor Transport Receipts (MTRs), Govt. Supply Bills, third party DDs and cheques etc.

Others

- Rooftop PV Solar Power Projects
- Loan Against Future Lease Rentals
- Working Capital Financing (Short-term)

Lending to agriculture

- Farm credit (which will include short-term crop loans and medium/long-term credit to farmers) [e.g.Crop loans to farmers)
- (ii) Agriculture infrastructure and
- (iii) Ancillary activities.

Lending to Priority Sector

- The broad sectors under the revised norms include agriculture (both direct and indirect), small enterprises (direct and indirect), retail trade in essential commodities and consumer cooperatives stores, micro credit, education loans, and housing loans.
- **Adjusted Net Bank Credit (ANBC):** ANBC is the net banking credit after taking into account bill discounting, non-SLR securities and other exemption via long-term bonds.

Priority Sector Lending

Categories	Domestic scheduled commercial banks and foreign banks with 20 branches and above	Foreign banks with less than 20 branches
Total Priority Sector	40 per cent of Adjusted Net Bank Credit or credit equivalent amount of off-balance sheet exposure, whichever is higher.	40 per cent of Adjusted Net Bank Credit or credit equivalent amount of off-balance sheet exposure, whichever is higher;
Agriculture	18 per cent of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher	Not applicable
Micro Enterprises	7.5 per cent of ANBC or credit equivalent amount of off-balance sheet exposure.	Not applicable
Advances to Weaker Sections	10 per cent of ANBC or credit equivalent amount of off-balance sheet exposure, whichever is higher.	Not applicable

Lending to industry

- Banks finance both short-term working capital and long-term requirements of industry.
- Banks lend to both large and small enterprises.
- Banks also finance infrastructure projects by way of term loans, bonds and guarantees.

NBFCs

- The non-banking financial institutions also mobilize financial resources directly or indirectly from the people.
- They lend funds but do not create credit. Companies like LIC, GIC,UTI, Development Financial Institutions.
- Non-banking financial institutions can be categorized as investment companies, housing companies, leasing companies, hire purchase companies, specialized financial institutions.

Credit Creation of Banks

- CRR (Cash Reserve Ratio) : 4.50%
- SLR (Statutory Liquidity Reserve): 18.00%
- Rs.100
- Cannot lend Rs.100 to public
- Why?
- Is it mandatory or not?
- Yes?

NBFC

Fund-based activities	Fee-based activities
• Equipment leasing, hire purchasing • Consumer finance • Bill discounting • Factoring • House Finance	• New Issue Management • Portfolio management • Corporate counselling • Loan syndication • Advising on M&A

Other Financial Institutions

- “Other development financial institution" means a development financial institution licensed under Section 29 of the National Bank for Financing Infrastructure and Development Act, 2021
- NABARD
- SIDBI
- SFCs
- EXIM Bank

Other Institutions

- “Exim Bank” means the Export-Import Bank of India established under section 3 of the Export-Import Bank of India Act, 1981 (28 of 1981);]
- “National Housing Bank” means the National Housing Bank established under section 3 of the National Housing Bank Act, 1987;]

NABARD

- National Bank" means the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agriculture and Rural Development Act, 1981;]
- "Regional rural bank" means a regional rural bank established under section 3 of the Regional Rural Banks Act, 1976 (21 of 1976);]

SIDBI

- Small Industries Bank” means the Small Industries Development Bank of India established under section 3 of the Small Industries Development Bank of India Act, 1989;]

Banking Regulator

- Reserve Bank of India Act, 1934
- Banking Regulation Act, 1949
- Foreign Exchange Management Act, 1999
- Payment and Settlement Systems Act, 2007
- Deposit Insurance and Credit Guarantee Corporation Act, 1961

Licencing of Banks

- The Reserve Bank of India (RBI) issues licences to entities to carry on the business of banking and other businesses in which banking companies may engage, as defined and described in Sections 5 (b) and 6 (1) (a) to (o) of the Banking Regulation Act, 1949, respectively.
- The payments bank will be registered as a public limited company under the Companies Act, 2013, and licensed under Section 22 of the Banking Regulation Act, 1949, with specific licensing conditions.

Non-performing Assets (NPA)

- NPA is defined as a credit facility/advance whose:
- (i) Interest and/or instalment of principal remain overdue (i.e. an amount due has not been paid on the due date fixed by the bank) for more than 90 days (one quarter) in respect of a term-loan,
- (ii) Account remains ‘out of order’ for more than 90 days in respect of an overdraft (OD)/cash credit (CC).
- (iii) Bill remains overdue for more than 90 days in case of bills purchased/discounted.
- (iv) Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half-years in case of advances granted for agricultural purposes, and
- (v) Amount to be viewed remains overdue for more than 90 days in respect of other accounts.

Types of NPA

- (a) Sub-standard assets,
- (b) Doubtful assets, and
- (c) Loss assets

Sub-standard asset

- A sub-standard asset is one which is classified as NPA for a period not exceeding 12 months.
- In such cases, the current net worth of the borrower/guarantor or the current market value of the security charged is not enough to ensure full recovery of bank dues.

Doubtful assets

- A doubtful asset is one which has remained NPA for a period exceeding 12 months.
- A loan classified as doubtful has all the weaknesses inherent in sub-standard assets, with the added characteristic that the weakness make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss assets

- A loss asset is one where loss has been identified by the bank or its internal or external auditors, or by the RBI inspection, though the amount has not been written off wholly.
- In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

NPA Management

- The mechanism comprises:
- (1) DRTs, (2) Recovery officers and (3) Debt Recovery Appellate Tribunals (DRATs).
- Corporate debt restructuring (CRD) system
- Securitization and reconstruction of Financial assets and enforcement of security Interest (SRFASESI Act 2002)
- IBC Code 2016

Banking risks

- Banking risks can be categorized into:
- (i) Business-related risks and
- (ii) Control-related risks

Business-related risks

- They fall into six categories:
  - (a) Credit risk
  - (b) Market risk comprising of
    - interest rate risk, foreign exchange risk, equity price risk; commodity price risk and liquidity risk;
  - (c) Country risk;
  - (d) Business environment risk;
  - (e) Operational risk; and
  - (f) Group risk.

Control-related risks.

- Control related risks arise out of an absence/lack of control and supervisory systems
- (Basel III Framework)
- Interest Rate Risk

Credit Risk Management

- Risk Planning
  - Defining/ procedures/policies
  - Designing of Credit process
- Risk management and Monitoring
  - Credit rating
  - Review of credit proposals
  - Asset review
  - Sector review
- Risk Analytics
  - Credit risk and pricing models
  - Portfolio analysis and reporting

Money Market

- Concept and Definition
- Importance
- Money market organisation
- Types
- Call Money
- Treasury Bills Market
- Certificate of Deposits
- Commercial Papers
- Commercial Bills

Sources of Finance: Based on Time Period

- Short-term [Current Assets][Upto 1 year]
  - Working Capital
- Long-term [Fixed Assets]
- Medium term [Adv Campaign]

Sources of Finance: Based on Ownership

- Owners Capital (Share capital)
  - Equity Shares and Preference Shares
  - 9% Convertible Preference Shares
- Borrowed Capital

Sources of Finance: Based on Generation

- Internal Sources: Retained Earnings, Depreciation Funds
- External Sources:

Global Financial System

- The global financial system is the worldwide framework of legal agreements, institutions, and both formal and informal economic action that together facilitate international flows of financial capital for purposes of investment and trade financing.


The Global Financial System
GOVERNMENT TREASURIES
SUPERVISORY AUTHORITIES
CENTRAL BANKS
ACCOUNTING STANDARD BODIES
CURRENCIES
INTERNATIONAL FINANCIAL INSTITUTIONS
EXCHANGE RATES
COMMERCIAL BANKS
MULTINATIONAL ENTERPRICES (MCE)
FINANCIAL MARKETS
INVESTMENT BANKS
INSTITUTIONAL INVESTORS
SOVEREIGN FUNDS
RATING AGENCIES

Stakeholders in Financial Markets

- Primary Stakeholders
  - Shareholders
  - Lenders
  - Companies
  - Mutual Fund Organisations/holders/fund managers

Service Providers

- Merchant Bankers
- Brokers
- Underwriters
- Depositors
- Custodians

Merchant Banker

- Merchant banker means any person who is engaged in the business of issue management, either by making arrangements regarding selling, buying, or subscribing to securities or acting as a manager, consultant, or adviser, or rendering corporate advisory services in relation to such issue management.
- It is mandatory to appoint a merchant banker in case of a public issue.

Merchant Bankers

IPO league table	Rank#	Volume (₹ cr)	No of IPOs	Mkt share (%)	Deals*
Kotak	1(4)	1,589	7	11.64	InterGlobe, Coffee Day, Dr Lal
Axis Bank	2 (2)	1,468	7	10.76	Alkem, Syngene, Coffee Day
Citi	3 (NA)	1,312	4	9.61	InterGlobe, Coffee Day, Dr Lal
ICICI	4 (8)	1,001	6	7.34	Teamlease, Quick Heal, VRL
JPMorgan	5 (NA)	988	3	7.24	InterGlobe, Alkem, Quick Heal

ECM** league table	Rank#	Volume (₹ cr)	No of issues	Mkt share (%)	Deals*
Goldman Sachs	1(5)	22,262	3	25.67	Sun Pharma, Axis, IndusInd
Citi	2 (4)	12,377	16	14.27	Kotak Bank, Eicher, Infosys
JM Financial	3 (6)	6,105	9	7.04	Indian Oil, REC, GMR Infra
Axis Bank	4 (8)	4,955	16	5.71	Indiabulls Housing, PFC, GMR Infra
Kotak	5 (2)	4,915	12	5.67	Indian Oil, Tata Motors, InterGlobe

**ECM is equity capital market, which includes IPO (initial public offering); #Rank is for FY16 and figures in brackets show FY15 rank; FY16 data till Tuesday; *List is not exhaustive; compiled by Samie Modak; source: Bloomberg;

Regulators

- Securities and Exchange Board of India (SEBI)
- Reserve Bank of India (RBI)
- IRDA
- Pension Fund Regulatory and Development Authority

Administrators to facilitate

- Association of Mutual Funds of India (AMFI)
- Foreign Exchange Dealers Association of India
- Fixed Income Money Market and Derivative Association of India
- Association of Investment Bankers of India

Credit Policy of RBI

- Maintenance of Price stability
- Achieving economic growth
- Exchange rate stability
- External balance of payment equilibrium
- Moderate structure of interest rates
-

Instruments of Credit Policy

- CRR
- SLR
- Liquidity Adjustment Faculty (Commercial can borrow from RBI through discount window against the collateral of securities)
  - REPO and Reverse Repo
- Margin Standing Facility
- Open Market Operations

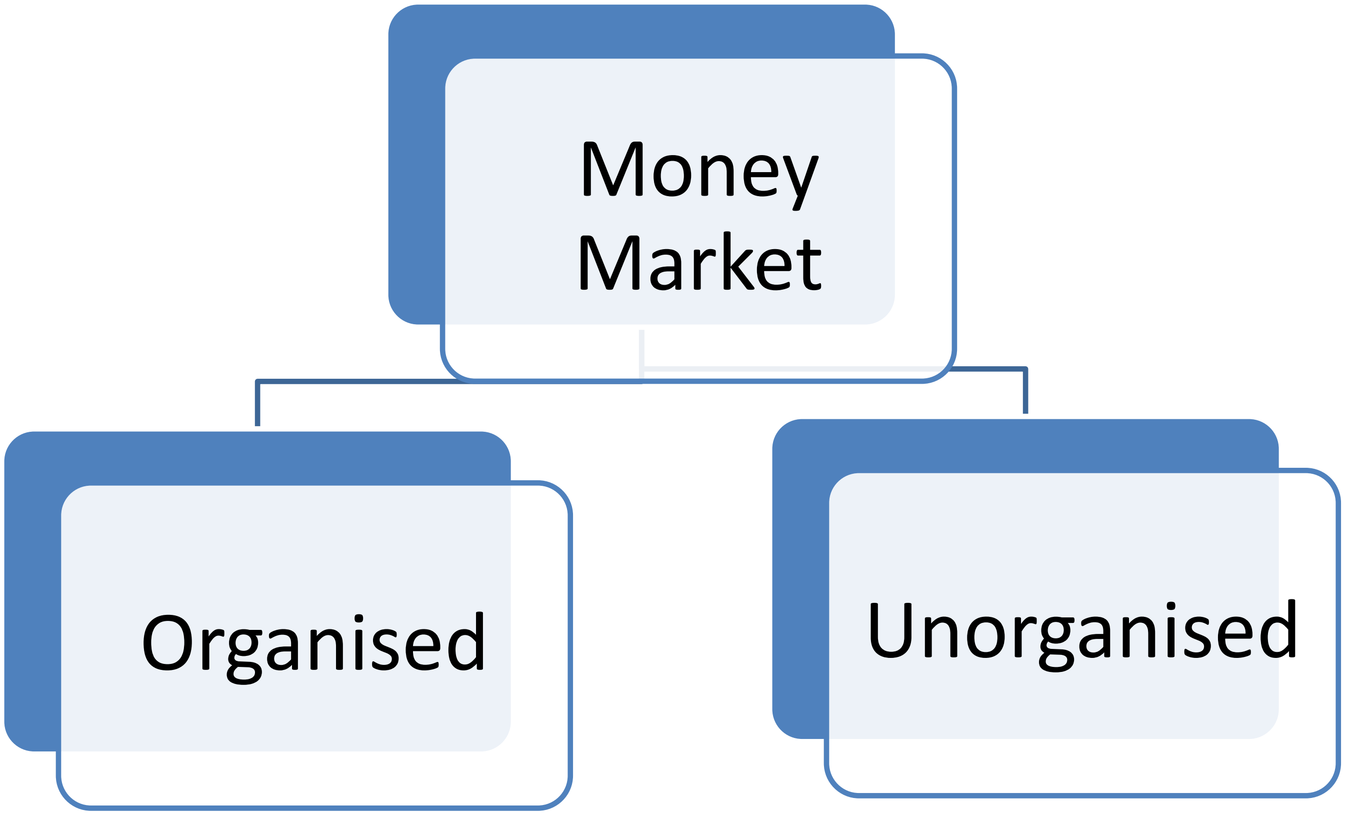
Others

- FED (Federal Reserve System) Policy
- Cost of Inflation Index (For computation of Long Term Capital Gains)
- Consumer Price Index
- Wholesale Price Index

Financial Markets

- Financial Markets
  - Money Market (Short Period Less than one year)
  - Capital Market (Long Period More than one Year)

Money Market



Organised Segment

- Commercial and other banks
- NBFCs
- Cooperative banks
- Financial and Investment institutions
- Corporates
- Mutual Funds
- Discount and Finance House of India
- Government

Unorganised Segment

- Money lenders
- Indigenous Bankers
- Nidhis (Mutual Fund Association)
- Chit Funds

Money Market

- Money market is the market for financial asset that close substitutes for money.
- It is the market for instruments ranging from one day deployment for example call money market to a few months but up to or less than one year.
- Duration: From 1 day to 1 year

Concept and Definition

The money market is a market for financial assets that are close substitutes for money. It is a market for overnight to short-term funds and instruments having a maturity period of one or less than one year.

It is not a physical location (like the stock market), but an activity that is conducted over the telephone. The money market constitutes a very important segment of the Indian financial system.

- It is not a single market but a collection of markets for several instruments.
- It is a wholesale market of short-term debt instruments.
- Its principal feature is honour where the creditworthiness of the participants is important.
- It is a need-based market wherein the demand and supply of money shape the market.

Main Participants of Money Market

- Reserve Bank of India (RBI)
- Discount and Finance House of India (DFHI)
- Mutual funds, Insurance companies
- Banks, Corporate investors
- Non-banking finance companies (NBFCs)
- State governments, Provident funds
- Primary dealers
- Securities Trading Corporation of India (STCI)
- Public sector undertakings (PSUs)
- Non-resident Indians.

Importance

- Provides a stable source of funds to banks
- Encourages development of non-bank entities
- Facilitates government market borrowing
- Makes effective monetary policy actions
- Helps in pricing different floating

Role of RBI

- To ensure that liquidity and short-term interest rates are maintained at levels consistent with the monetary policy objectives of maintaining price stability;
- To ensure an adequate flow of credit to the productive sectors of the economy; and
- To bring about order in the foreign exchange market.

Money Market Instruments

- 1. Treasury Bills (T-bills)
- 2. Call/notice money market—Call (overnight) and short notice (up to 14 days)
- 3. Commercial Papers (CPs);
- 4. Certificates of Deposits (CDs);
- 5. Commercial Bills (CBs)
- 6. Collateralised Borrowing and Lending Obligation (CBLO)

Treasury Bills

- Who will issue?
- Why?
- 60 Days TB (auction basis)
  - Face Value Rs.100
  - Issue Price?
  - Rs.98
- 182 Days
- 365 Days

Call Money, Notice Money and Term Money

- This is the short-term borrowing and lending operations between banks and sometimes with and between primary dealers.
- Call money is for overnight deployment i.e. for one day.
- Notice money is 2 to 14 days
- Term Money is for a tenure 15 days and longer

Location: Call Money

- Inter-bank money market
- Centrally- Mumbai
- Sub-markets Delhi, Kolkata, Chennai and Ahmedabad

Call Money

- Call money is required mostly by banks. Commercial banks borrow money without collateral from other banks to maintain a minimum cash balance known as the cash reserve requirement (CRR).
- This inter-bank borrowing has led to the development of the call money market.

Call Rate

- The interest rate paid on call loans is known as the ‘call rate.’ It is a highly volatile rate.
- It varies from day-to-day, hour-to-hour, and sometimes even minute-to-minute.
- It is very sensitive to changes in the demand for and supply of call loans. Within one fortnight, rates are known to have moved from 1–2 per cent to over 140 per cent per annum.

MIBOR

- The National Stock Exchange (NSE) developed and launched the NSE Mumbai Inter-bank Bid Rate (MIBID) and the NSE Mumbai Inter-bank Offer Rate (MIBOR) for overnight money markets on June 15, 1998.

- NSE MIBID/MIBOR are based on rates pooled by the NSE from a representative panel of 31 banks/institutions/ primary dealers. Currently, quotes are pooled and processed daily by the exchange at 9:40 (1ST), for the overnight rate and at 11.30 (IST) for the 14 day, 1 month, and 24 month rates. The rates pooled are then processed using the boost trap method to arrive at an efficient estimate of the reference rates. This rate is used as a benchmark rate for majority of the deals struck for floating rate debentures and term deposits.
- The benchmark is the rate at which money is raised in the financial markets. These rates are used in hedging strategies and as reference points in forwards and swaps.

Government Treasury Bills

- T-Bills are short-term instruments used by the government to raise short-term funds.
- Issued by the Reserve Bank on behalf of the government to tide over short-term liquidity shortfalls.

TBs

- Negotiable securities.
- Highly liquid.
- Absence of default risk.
- Assured yield, low transaction cost, and are eligible for inclusion in the securities for SLR purposes.
- Purchases and sales are effected through the Subsidiary General Ledger (SGL) account.

Types of TBs

- At present, there are 91-day, 182-day, and 364-day T-bills.
- The 91-day T-bills are auctioned by the RBI every Friday and the 364-day T-bills every alternate Wednesday, i.e., the Wednesday preceding the reporting Friday.
- Treasury bills are available for a minimum amount of Rs. 25,000 and in multiples thereof.

Participants in the T-Bills Market

- The Reserve Bank of India, banks, mutual funds, financial institutions, primary dealers, provident funds, corporates, foreign banks, and foreign institutional investors are all participants in the T-bills market.
- The state governments can invest their surplus funds as non-competitive bidders in T-bills of all maturities.

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Types of Auctions

- **(i) Multiple-price Auction**
  - Each winning bidder pays the price it bid
- **(ii) Uniform-price Auction**
  - Each winning bidder pays the uniform price decided by the Reserve Bank.

TBs: How to calculate yield

TBs are issued at discount and their yields can be calculated with the help of the following formula:

$$Y = \left[\frac{F-P}{P}\right] \times \frac{365}{M} \times 100$$

where Y = Yield,

F = Face Value,

P = Issue Price/Purchase Price,

M = Maturity.

Illustration 1

- The RBI offers 91-Day Treasury Bills to raise ₹15,000 crores. The following bids have been received. Face Value ₹100.

Bidder	Bid Rate	Amount (₹) Crore
A Ltd.	98.95	18,000
B Ltd.	98.93	7,000
C Ltd.	98.92	10,000

What is the Yield for each of the price at which the bid has been made?
Who are the winning bidders if it was a yield-based auction, and how much of the security will be allocated to each winning bidder?

Solution

$$Yield = \frac{Face\ Value - Issue\ Price}{Issue\ Price} \text{x} \frac{365}{Maturity\ Period} \text{ x } 100$$

$$A= \frac{100-98.95}{98.95} \text{x} \frac{365}{91} \text{ x } 100 = 4.26\%$$

$$B= \frac{100-98.93}{98.93} \text{x} \frac{365}{91} \text{ x } 100 = 4.34\%$$

$$C= \frac{100-98.92}{98.92} \text{x} \frac{365}{91} \text{ x } 100 = 4.38\%$$

As this a yield based auction, and since the entire amount of ₹15,000 crore can be sourced at the lowest yield of 4.26% itself, only A's Bid would be accepted for ₹15000 crore.

Commercial paper

- A commercial paper is an unsecured short-term promissory note, negotiable and transferable by endorsement and delivery with a fixed maturity period.
- It is generally issued at a discount by the leading creditworthy and highly rated corporates to meet their working capital requirements.
- Depending upon the issuing company, a commercial paper is also known as a finance paper, industrial paper, or corporate paper.

Investors in CP

- Individuals
- Banks
- Corporates
- Unincorporated bodies
- NRIs
- FIIs

Role of RBI

- Prior approval of RBI is required before issue
- RBI controls the broad timing of the issue to ensure orderly fund raising.
- Every issue of CP launched by a company including rollover will be treated as fresh issue.

Commercial Paper

- **Size of CP**: Rs. 5 Lakhs or multiple thereof
- **Maximum size** of CP issue hundred percent of the issuers working capital.
- **Minimum :** 7 days from the date of issue
- **Maximum:** One year from the date of issue

Certificate of Deposits

- Certificates of deposit (CDs) are unsecured, negotiable, short-term instruments in bearer form, issued by commercial banks and development financial institutions.
- CDs can be issued by (i) scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and (ii) select all-India Financial Institutions that have been permitted by the RBI to raise short-term resources within the umbrella limit fixed by the RBI.
- Minimum amount of a CD should be Rs. 1 lakh, i.e., the minimum deposit that could be accepted from a single subscriber should not be less than Rs. 1 lakh and in the multiples of Rs. 1 lakh thereafter.

Certificate of Deposits

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

Certificate of Deposits

- CDs may be issued at a discount on face value.
- Banks have to maintain the appropriate reserve requirements, i.e., cash reserve ratio (CRR) and statutory liquidity ratio (SLR), on the issue price of the CDs.

Commercial Bills

- Commercial bills are negotiable instruments drawn by the seller on the buyer which are, in turn, accepted and discounted by commercial banks.
- **Commercial bill is an important tool to finance credit sales.**
- Commercial bills were introduced in the money market in 1970.
- The RBI rediscounted genuine trade bills at the bank rate or at a rate specified by it. The development of the bills market enabled banks and financial institutions to invest their short-term surplus funds in bills of varying maturities.

Types of Commercial Bills

- Demand Bill: A demand bill is payable on demand, i.e., immediately at sight or on presentation to the drawee.
- Usance Bill: A usance bill is payable after a specified time. If the seller wishes to give some time for payment, the bill would be payable at a future date.
- Clean Bill: In a clean bill, documents are enclosed and delivered against acceptance by the drawee, after which it becomes clear.
- Documentary Bill: In the case of a documentary bills, documents are delivered against payment accepted by the drawee and documents of the file are held by bankers till the bill is paid.

Commercial Bills

- Inland Bill : Inland bills must (a) be drawn or made in India and must be payable in India; or (b) drawn upon any person resident in India.
- Foreign Bill: Foreign bills, on the other hand, are (a) drawn outside India and may be payable in and by a party outside India, or may be payable in India or drawn on a party in India; or (b) it may be drawn in India and made payable outside India.
- **Hundi:** The indigenous variety of bill of exchange for financing the movement of agricultural produce, called a 'hundi,' has a long tradition of use in India. It is in vogue among indigenous bankers for raising money or remitting funds or to finance inland trade.

Derivative Usance Promissory Note

- With a view to eliminating movement of papers and facilitating multiple rediscounting, the RBI introduced an innovative instrument known as ‘Derivative Usance Promissory Notes,’ backed by such eligible commercial bills for required amounts and usance period (up to 90 days).

Collateralised Borrowing and Lending Obligation (CBLO)

- The Clearing Corporation of India Limited (CCIL) launched a new product–Collateralised Borrowing and Lending Obligation (CBLO)—on January 20, 2003 to provide liquidity to non-bank entities hit by restrictions on access to the call money market.
- CBLO is a discounted instrument available in electronic book entry form for the maturity period ranging from 1 day to 19 days.
- Banks, Cooperative Banks, Financial institutions, Insurance Companies, Mutual Funds, and Primary Dealers who are members of negotiated dealing system (NDS) are allowed to participate in CBLO transactions.

Illustration 2

- X Ltd. issued Commercial Paper as per the following details:
- Date of issue : 17th January 2022
- Date of Maturity : 17th April 2022
- No of Days : 90 Days
- Face Value : ₹100
- Interest Rate: 11.25%
- What was the net amount received by the Company on issue of Commercial Paper?

Solution

$$\text{Interest} = \frac{Face\ Value - Net\ Amount\ Realised}{Net\ Amount\ Realised} \text{ x } \frac{365}{Maturity\ Period}$$

$$0.1125 = \frac{100 - Net\ Amount\ Realised}{Net\ Amount\ Realised} \text{ x } \frac{365}{90}$$

So, Net Amount Realised = ₹97.30

thank you

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