MONEY MARKET INSTRUMENTS

By convention, the term "Money Market" refers to the market for short-term requirement and deployment of funds. Money market instruments are those instruments, which have a maturity period of less than one year. The most active part of the money market is the market for overnight call and term money between banks and institutions and repo transactions. Call Money/Repo are very short-term Money Market products. The below mentioned instruments are normally termed as money market instruments:

1. GOVERNMENT SECURITIES(G- Secs)

   Government Securities are securities issued by the Government for raising a public loan or as notified in the official Gazette. G-secs are sovereign securities mostly interest bearing dated securities which are issued by RBI on behalf of Govt. of India(GOI). GOI uses these borrowed funds to meet its fiscal deficit, while temporary cash mismatches are met through treasury bills of 91 days.

   G-secs consist of Government Promissory Notes, Bearer Bonds, Stocks or Bonds, Treasury Bills or Dated Government Securities. Government bonds are theoretically risk free bonds, because governments can, up to a point, raise taxes, reduce spending, and take various measures to redeem the bond at maturity.

   Features of Government Securities

- Usually Issued and redeemed at face value
- No default risk as the securities carry sovereign guarantee.
- Ample liquidity as the investor can sell the security in the secondary market
- Interest payment on a half yearly basis on face value
- No tax deducted at source
- Can be held in D-mat form
- Rate of interest and tenor of the security is fixed at the time of issuance and is not subject to change (unless intrinsic to the security like FRBs).
- Redeemed at face value on maturity
- Maturity ranges from of 2-30 years.

- Securities qualify as SLR investments (unless otherwise stated).

Types of Government Securities:

Dated Securities	**Zero Coupon Bonds**	**Partly Paid Stock**	**Floating Rate Bonds**	**Bonds with Call/Put Option**	**Capital Indexed Bonds**
A stock that has fixed redemption date.	Also called a discount bond or deep discount bond is bought at a price lower than its face value, with the face value repaid at the time of maturity.	Payment of the principal amount of investment is made in installments over a given time frame	A bond with a variable interest rate. The adjustments to the interest rate are tied to a certain money-market index plus a spread. There maybe a cap n floor rate attached to interest rate.	Bond option is a financial instrument that facilitates an option to buy or sell a particular bond at a certain date for a particular price. Similar to stock option, however underlying asset is bond.	Inflation linked returns on both the coupons and principal repayments at maturity. The principal repayment at maturity would be the inflation-adjusted principal amount or its original par value, whichever is greater.
Half yearly fixed Coupons on face value	No coupons; Return=Face Value less Discounted Issue price	Half yearly Coupons on face value	Half yearly Coupons on face value; coupon rate fixed as a % over a predefined benchmark	Half yearly Coupons; Coupon rate for the bonds would be specified in real terms, to be applied to the inflation-adjusted principal to calculate the periodic semi-annual coupon payments	
Government paper with tenor beyond one year is known as dated security. At present, there are Central Government dated securities with a tenor up to 30 years in the market.	Zero coupon bonds may be long(maturity dates typically start at 10-15 yrs) or short term(maturities of less than one year) investments. The bonds can be held until maturity or sold on secondary bond markets.	Meets the needs of the investor with regular flow of funds & with the need of government when it does not need the fund immediately	Protect investors against a rise in interest rates		The inflation protection for the coupons and the principal repayment on the bond is provided with respect to the Wholesale Price Index (WPI) for All Commodities (1993-94=100), the leading measure of inflation in India.

2. MONEY MARKET AT CALL AND SHORT NOTICE

Next in liquidity after cash, money at call is a loan that is repayable on demand, and money at short notice is repayable within 14 days of serving a notice. The participants are banks & all other Indian Financial Institutions as permitted by RBI.

The market is over the telephone market, non bank participants act as lender only. Banks borrow for a variety of reasons to maintain their CRR, to meet their heavy payments, to adjust their maturity mismatch etc.

3. MONEY MARKET MUTUAL FUNDS(MMMFs)

A money market fund is a mutual fund that invests solely in money market instruments. Money market instruments are forms of debt that mature in less than one year and are very liquid. Treasury bills make up the bulk of the money market instruments. Securities in the money market are relatively risk-free. Money market funds are generally the safest and most secure of mutual fund investments. The goal of a money-market fund is to preserve principal while yielding a modest return by investing in safe and stable instruments issued by governments, banks and corporations etc.

4. TREASURY BILLS

Treasury Bills are short term (up to one year) borrowing instruments of the Government of India which enable investors to park their short term surplus funds while reducing their market risk. These are discounted securities and thus are issued at a discount to face value. The return to the investor is the difference between the maturity value and issue price.

Any person in India including Individuals, Firms, Companies, Corporate bodies, Trusts and Institutions can purchase Treasury Bills.

At present, RBI issues T-Bills for three different maturities: 91 days, 182 days and 364 days. Treasury Bills are available for a minimum amount of Rs.25,000 and in multiples of Rs. 25,000 thereafter. They are available in both Primary and Secondary market. Treasury Bills are eligible securities for SLR purposes.

Treasury bills are an effective cash management product since short term surpluses or idle funds can be conveniently deployed in treasury bills depending upon the availability and requirement. Even funds in current accounts with Banks can be deployed for short term periods. One can purchase treasury bills of different maturities as per requirements so as to match the respective outflow of funds.

Advantages of investing in Treasury Bills:

- No Tax Deducted at Source (TDS)
- Zero default risk as these are the liabilities of GOI
- Liquid money Market Instrument
- Active secondary market thereby enabling holder to meet immediate fund requirement.

5. CERTIFICATES OF DEPOSITS

A CD is a time deposit, financial product commonly offered to consumers by banks. In case of CDs the banks issue a certificate for a deposit made, such certificate is transferable, i.e. holder of CD is holder of deposit. CDs are negotiable instrument issued either in physical form transferable by endorsement and delivery or in demat form or as a Usance Promissory Notes. CDs issued by banks should not have the maturity less than seven days and not more than one year. Financial Institutions are allowed to issue CDs for a period between 1 year and up to 3 years. They normally give a higher

return than Bank term deposit, and are rated by approved rating agencies (e.g. CARE, ICRA, CRISIL, and FITCH) which considerably enhance their tradability in the secondary market, depending upon demand. SBI DFHI is an active player in secondary market of CDs.

CDs can be issued to individuals, corporations, trusts, funds and associations. NRIs can also subscribe to CDs, but on non-repatriable basis only. In secondary market such CDs cannot be endorsed to another NRI. They are issued at a discount rate freely determined by the issuer and the market/investors. CDs are issued in denominations of Rs.1 Lac and in the multiples of Rs. 1 Lac thereafter. Loans cannot be granted against CDs and Banks/FIs cannot buy back their own CDs before maturity.

6. INTER CORPORATE DEPOSITS

An ICD is an unsecured loan extended by one corporate to another. This market allows corporates with surplus funds to lend to other corporates. Also the better-rated corporates can borrow from the banking system and lend in this market. As the cost of funds for a corporate is much higher than that for a bank, the rates in this market are higher than those in the other markets. Also, as ICDs are unsecured, the risk inherent is high and the risk premium is also built into the rates.

7. COMMERCIAL BILLS

Commercial bill is a short term, negotiable, and self-liquidating instrument with low risk. It enhances the liability to make payment within a fixed date when goods are bought on credit. Bills of exchange are negotiable instruments drawn by the seller (drawer) on the buyer (drawee) or the value of the goods delivered to him. Such bills are called trade bills. When trade bills are accepted by commercial banks, they are called commercial bills. The bank discount this bill by keeping a certain margin and credits the proceeds. Banks can also get such bills re-discounted by financial institutions such as LIC, UTI, GIC, ICICI and IRBI. The maturity period of the bills varies from 30 days, 60 days or 90 days, depending on the credit extended in the industry.

Commercial bill is an important tool finance credit sales. It may be a demand bill or a usance bill; clean bills or documentary bills.; inland bills or foreign bills.

8. COMMERCIAL PAPER

Commercial Paper is a money-market security issued (sold) by large banks and corporations to get money to meet short term debt obligations , and is only backed by an issuing bank or corporation's promise to pay the face amount on the maturity date specified on the note. Since it is not backed by collateral, only firms with excellent credit ratings from a recognized rating agency will be able to sell their commercial paper at a reasonable price. Commercial paper is usually sold at a discount from face value, and carries shorter repayment dates than bonds. The longer the maturity on a note, the higher the interest rate the issuing institution must pay. Interest rates fluctuate with market conditions, but are typically lower than banks' rates. Corporate Borrowers, especially the large and financially sound, can diversify their short term borrowing by the issue of Commercial Paper. Commercial Paper is especially attractive for companies with cyclical cash flows and for cash rich companies during periods of greater cash inflows than overdraft or cash credit since monitoring is more convenient.
Maturity: 7days -1 year

Preconditions for issue of Commercial paper:

- tangible net worth (paid-up capital plus free reserves) is not less than Rs 4 crores

- has been sanctioned working capital limit by banks or FIs
- Borrowal account of the company is classified as a Standard Asset by Banks/FIs
- Specified Credit Rating of P2 is obtained from CRISIL, A2 from ICRA and PR2 from CARE

Commercial Paper is issued in denominations of Rs. 5 lakhs. But the minimum lot or investment is Rs 25 lakhs (face value) per investor. The secondary market transactions can be for Rs. 5 lakhs or multiples thereof. Commercial Paper may be issued to any person, bank, company or other registered (in India) corporate body and incorporated body. Issue to NRI can only be on non-repatriable basis and is not transferable. The paper issued to NRI should state that it is non-repatriable and non-endorseable.

Procedure for Issue:
Commercial Paper is issued only through the bankers who have sanctioned working capital limits to the company. It is counted as a part of working capital. Unlike public deposit, commercial paper really cannot augment working capital resources. There is no increase in the overall short term borrowing facilities.

Every company proposing to issue commercial paper should submit the proposal in the form prescribed by the RBI to the bank which provides working capital along with the credit rating of the company. The bank Scrutinizes the application and on being satisfied that eligibility criteria are met and conditions stipulated are met will has to be privately place the issue within two weeks by the company or through the good offices of a merchant banker. The initial investor pays the discounted value of the paper to the account of the issuing company with the bank in writing. The working capital limit is correspondingly reduced by the bank. the company must advise RBI, through the bank, of the amount of commercial paper issued within three days.

9. CALL MONEY MARKET AND SHORT TERM DEPOSIT MARKET

The borrowers are essentially the banks. DFHI plays a vital role in stabilizing the call and short term deposit rates through larger turnover and smaller spread. It ascertains the prospective lenders and borrowers, the money available and needed and exchanges a deal settlement advice with them indicating the negotiated interest rates applicable to them. When DFHI borrows, a call deposit receipt is issued to the lender against a cheque drawn on RBI for the amount lent. If DFHI lends it issues to the RBI a cheque representing the amount lent to the borrower against the call deposit receipt.

10. INTER BANK PARTICIPATION CERTIFICATES

With a view for providing an additional instrument for evening out short-term liquidity within the banking system, two types of Inter-Bank Participations (IBPs) were introduced, one on risk sharing basis and the other without risk sharing. These are strictly inter-bank instruments confined to scheduled commercial banks excluding regional rural banks. The IBP with risk sharing can be issued for 91-180 days. Under the uniform grading system introduced by Reserve Bank for application by banks to measure the health of bank advances portfolio, a borrower account considered satisfactory if the one in which the conduct of account is satisfactory, the safety of advance is not in doubt, all the terms and conditions are complied with, and all the accounts of the borrower are in order. The IBP risk sharing provides flexibility in the credit portfolio of banks. The rate of interest is left free to be determined between the issuing bank and the participating bank subject to a minimum 14.0 per cent per annum. The aggregate amount of such IBPs under any loan account at the time of issue is not to exceed 40 per cent of the outstanding in the account.

The IBP without risk sharing is a money market instrument with a tenure not exceeding 90 days and the interest rate on such IBPs is left to be determined by the two concerned banks without any ceiling on interest rate.

11. BILLS REDISCOUNTING

It is an important segment of money market and the bill as an instrument provides short term liquidity to the suppliers in need of funds. Bill financing seller drawing a bill of exchange & the buyer accepting it, thereafter the seller discounting it, say with a bank. Hundies, an indigenous form of bill of exchange, have been popular in India, but there has been a general reluctance on the part of the buyers to commit themselves to payments on maturity. Hence the Bills have been not so popular.

12. GILT EDGED GOVERNMENT SECURITIES

These are issued by governments such as Central Government, State Government, Semi Government authorities, City Corporations, Municipalities, Port trust, State Electricity Board, Housing boards etc.

The gilt-edged market refers to the market for Government and semi-government securities, backed by the Reserve Bank of India(RBI). Government securities are tradable debt instruments issued by the Government for meeting its financial requirements. The term gilt-edged means 'of the best quality'. This is because the Government securities do not suffer from risk of default and are highly liquid (as they can be easily sold in the market at their current price). The open market operations of the RBI are also conducted in such securities.

13. BANKER'S ACCEPTANCE

It is a short-term credit investment. It is guaranteed by a bank to make payments. The Banker's Acceptance is traded in the Secondary market. The banker's acceptance is mostly used to finance exports, imports and other transactions in goods. The banker's acceptance need not be held till the maturity date but the holder has the option to sell it off in the secondary market whenever he finds it suitable

14. REPOS

The Repo or the repurchase agreement is used by the government security holder when he sells the security to a lender and promises to repurchase from him at a specified time. Hence the Repos have terms raging from 1 night to 30 days. They are very safe due to government backing.

References:
www.wikipedia.org
www.investopedia.com
www.sbidfhi.com &
other internet websites