



Module-D Unit-2

JAIIB PAPER-1

**Indian Economy and Indian
Financial System (IE & IFS)**



JAIIB Paper 1 IE & IFS Module D Unit 2: Money Markets

Introduction

It is a market for short-term funds, with maturity ranging from overnight to one year and includes financial instruments that are deemed to be close substitutes to money.

The money market performs three broad functions.

- It provides an equilibrating mechanism for demand and supply of short-term funds.
- It enables borrowers and lenders of short-term funds to fulfill their borrowing and investment requirements, at an efficient market clearing price, and
- It provides an avenue for central bank intervention in influencing both quantum and cost of liquidity in the financial system, thereby transmitting monetary policy impulses to the real economy.

Call Money, Notice Money and Term Money

- The call/notice/term money market is a market for trading **very short-term liquid financial assets** that are readily convertible into cash at low cost.
- The money market primarily facilitates lending and borrowing of funds between banks and entities like Primary Dealers.
- The interest rate on such funds depends on the surplus funds available with lenders and the demand for the same, which remains volatile.



Participants in the Market

- **Supervision:** By the Reserve Bank of India, which issues guidelines for the various participants in the call/notice money market.
- **Participants:** Banks, Primary Dealers, development finance institutions, insurance companies and select mutual funds.

- **Operate both as borrowers and lenders in the market: Banks and PDs**
- **operate as lenders Only:** Non-bank institutions, which have been given specific permission to operate in call/notice money markets

Prudential Lending Limits

- Prudential limits in respect of outstanding lending transactions in the Call, Notice and Term Money Markets shall be decided by the participants with the approval of their Board within the regulatory framework of the exposure norms prescribed **by the Department of Regulation of the Reserve Bank for the eligible participant concerned.**

Prudential Borrowing Limits

Sr. No.	Participant Category	Prudential Limit
1	Scheduled Commercial Banks (including Small Finance Banks)	Call and Notice Money: (i) 100% of capital funds, on a daily average basis in a reporting fortnight, and (ii) 125% of capital funds on any given day. Term Money: (i) Internal board approved limit within the prudential limits for inter-bank liabilities.
2	Payment Banks, and Regional Rural Banks	Call, Notice and Term Money: (i) 100% of capital funds, on a daily average basis in a reporting fortnight, and (ii) 125% of capital funds on any given day.
3	Co-operative Banks	Call, Notice and Term Money: (i) 2.0% of aggregate deposits as at the end of the previous financial year.
4	Primary Dealers	Call and Notice Money: (i) 225% of Net Owned Fund (NOF) as at the end of the previous financial year on a daily average basis in a reporting fortnight. Term Money: (i) 225% of Net Owned Fund (NOF) as at the end of previous financial year.

Treasury Bills

- **Treasury bills (T Bills) are money market instruments, offered for the purpose of financing short-term debt obligation of the Government of India.**
- **Three types of T bills are issued, through a competitive or non-competitive bidding process of auction.**



- The investment in the Bills may be made by any person resident in India, including **Non-Resident Indians, Overseas Citizens of India and Foreign**

Portfolio Investors are eligible to invest, subject to the approval of the Government and provisions of **Foreign Exchange Management Act, 1999**

Non-Competitive Bidding

- State Governments, Union Territories with legislature, eligible Provident Funds in India, designated Foreign Central Banks (**Nepal Rashtra Bank, Royal Monetary Authority of Bhutan, Vnesheconom Bank (only in 91 Day T Bills)**), can participate on non-competitive basis, the allocation for which may be within or outside the notified amount, in consultation with the central Government.

Certificates Of Deposit

- A negotiable money market instrument issued in dematerialised form,
- CDs are discounted instruments and are issued at a discounted price and redeemed at par value.

Tenor: from 7 days to 1 year,

- Most CDs are issued by banks for **3, 6 and 12-months' tenors**
- NRI are also permitted to subscribe to CDs. However, they are mainly subscribed to by banks, mutual funds, provident and pension funds and insurance companies.
- The minimum amount:** Rs. 5 lakh and are accepted in multiples of Rs. 5 lakh thereafter.
- Banks are not allowed to grant loans against CDs, unless specifically permitted by the Reserve Bank.
- Buyback of CDs at prevailing market price can be made only **7 days after the date of issue of the CD.**

Issued By :

- Scheduled commercial banks (including Regional Rural Banks (RRBs)
- Small Finance Banks (SFBs)); select all-India Financial Institutions

Issued To: Individuals (other than minors),

- Corporations,
- Companies,
- Trusts,
- Funds,
- Associations, etc.

Commercial Paper

- **1990:** RBI introduced Commercial Papers (to enabling highly rated corporate borrowers).
- **An unsecured money market instrument issued in the form of a promissory note.**

Subject to the condition that:

(a) Any fund-based facility availed of from bank(s) and/or financial institutions is classified as a standard asset by all financing banks/institutions at the time of issue.

(b) Net worth of Rupees 100 crore or higher.

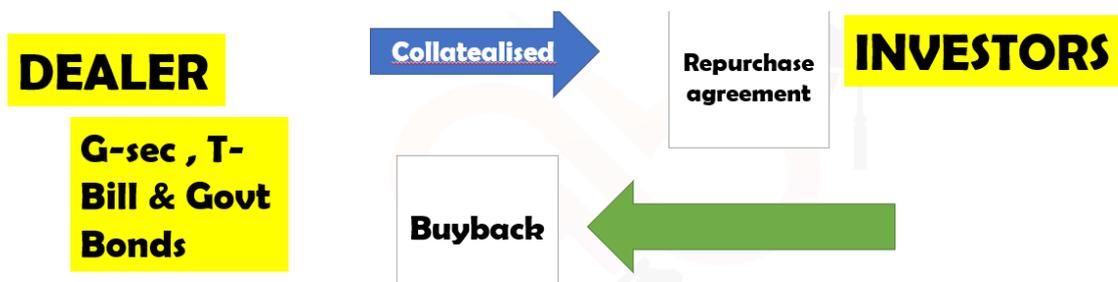
(c) Any other entity specifically permitted by **the Reserve Bank of India (RBI).**

- However, no person can invest in CPs **issued by related parties either in the primary or secondary market.**
- Eligible participants/issuers shall obtain credit rating for issuance of CP from any one **of the SEBI registered Credit Rating Agencies (CRAs).**
- **Minimum credit rating:** 'A3' as per rating symbol and definition prescribed by SEBI.
- **Total CP issuance during a calendar year is Rupees 1000 crore or more,** shall obtain credit rating from at least two CRAs registered with SEBI and should adopt the lower of the two ratings.
- Where both ratings are the same, the issuance shall be for the lower of the two amounts for which ratings are obtained.
- **Maturities:** Minimum of 7 days and maximum up to 1
- CPs can be issued **on a "stand alone" basis.**
- An FI can issue CPs, within the overall umbrella limit fixed by the RBI, i.e., the quantum for which the CPs can be issued together with other instruments, viz., term money borrowings, term deposits, certificates of deposit and inter-corporate deposits should **not exceed 100% of the Company's net owned funds, as per the latest audited balance sheet.**
- CPs may be issued to and held by individuals, banking companies, other corporate bodies registered or incorporated in India and unincorporated bodies, **Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs).**
- However, investment by FIIs should be within the **limits set for their investments by SEBI.**
- **Mutual Funds, Banks, Insurance companies, etc., are the dominant investors in the CP market.**

- **Secondary market trading takes** place through the inter-bank broking market between institutional participants.
- CPs are issued at a discount to their face value, as may be determined mutually by the issuer and the investor.
- The buyback offer can be made at the prevailing market price only not **before 30 days from the date of issue**.

Repo

- **Repo is a repurchase agreement, entered into between eligible** counterparties for borrowing and lending of funds, on a collateralised basis.



- A repo involves selling of a security, with an agreement to repurchase the same, at a future date, at a predetermined price.
- The seller of the security receives funds, while the buyer of the security receives collateral for the funds that has been lent.
- The rate at which the security will be repurchased in the 2nd leg of the repo, is derived from the rate of interest payable on the funds lent and is known as repo rate.
- Repo transactions are permitted between counterparties and in instruments permitted by **the Reserve Bank of India**.
- The rate at which the security will be repurchased in the 2nd leg of the repo, is derived from the rate of interest payable on the **funds lent and is known as repo rate**.
- **Repo transactions are permitted between counterparties and in instruments permitted by the Reserve Bank of India.**

Eligible securities:

- Government securities issued by the Central Government or a State Government,
- listed corporate bonds and debentures (subject to the condition that no participant shall borrow against the collateral of its own securities, or securities issued by a related entity),
- Commercial Papers (CPs),
- Certificate of Deposits (CDs),
- Units of Debt Exchange Traded Funds (ETFs).

Eligible participants :

- Any regulated entity,
- Any listed corporate,
- Any unlisted company, which has been issued special securities by the Government of India (using only such special securities as collateral), and
- Any All-India Financial Institution (FIs), viz., Exim Bank, NABARD, NHB and Small Industries Development Bank of India (SIDBI). Besides,
- Any other entity approved by the Reserve Bank from time to time for this purpose, can participate in repo transaction.

1st leg : The buying of securities and lending of short-term surplus in

2nd leg : selling the security at a predetermined rate

- Automatically, therefore, a repo transaction for one counterparty becomes a reverse repo transaction for the other counterparty.
- Repo transactions facilitate banks to invest their surplus cash for adjusting CRR positions and also for adjusting SLR positions.
- To facilitate equitable access to all market participants for trading, tri-party agents are **authorised by RBI/ SEBI to provide trading platform**.
- A repo contract - where a third entity (apart from the borrower and lender), known as a Tri-Party Agent, acts as an intermediary between the two parties to the repo, to facilitate services like collateral selection, payment and settlement, custody and management during the life of the transaction - **is called Tri-party Repo**.

Tri-Party Repo

- **A Tri-party repo is a type of repo contract, where a third entity (apart from the borrower and lender) called a Tri-Party Agent, acts as an intermediary between the two parties to the repo to facilitate services like collateral selection, payment and settlement, custody and management during the life of the transaction.**
- **Introduced by RBI in August 2017.**
- The job of the triparty agent is to administer the transaction **between the lender and the borrower**.
- Here, the agent does post-trade processing, such as collateral selection, payment and settlement, custody and management of the collaterals during the life of the transaction, etc.
- Once a lender or borrower notifies about transactions, the agent matches the transaction and, if successful, processes it.


BORROWER
SECURITIES**AGENT****LENDER****SURPLUS
MONEY**

Eligibility criteria of tri-party agents

- Prior authorisation from the Reserve Bank, to act in that capacity.
- Eligible under the Payment and Settlement Systems Act: Scheduled commercial banks, recognised stock exchanges and clearing corporations of stock exchanges or clearing corporations
- **Minimum paid-up equity share capital: Rs. 25 crores.**
- **Past experience :** at least 5 years in the financial sector, in India or abroad, preferably in custody, clearing or settlement services.
- **Tri-party agents should put in place, adequate system infrastructure to carry out their functions.**

Advantages of tri-party repo

- Introduced in order to provide depth and liquidity in the corporate bond market.
- To alleviate the burden of collateral management on one or both of the parties, by delegating the collateral management to the tri-party agent.

Bill Rediscounting Scheme (BRDS)

- **BRDS is the rediscounting of trade bills**, which have already been purchased by/discounted with the bank by the customers.
- Banks, in their normal course of business discount genuine bills of exchange. This forms part of the loans and advances or credit portfolio of the bank.
- To provide liquidity and to promote the bills culture in the economy, the RBI formulated a scheme, whereby, a bank may raise funds by issue of Derivative Usance Promissory Notes (DUPN) in convenient lots and maturities on the strength of genuine trade bills discounted by it.
- This scheme is known as the **Bills Rediscounting Scheme**.
- **Banks and permitted financial entities may invest by way of rediscounting trade bills of other eligible banks against a Derivative Usance Promissory Note issued by such bank.**
- **Tenor:** Minimum 15 days and the maximum tenor is 90 days.

- The bank borrowing under the BRDS scheme issues a Derivative Usance Promissory Note to the lender as well as a certificate that the bank holds eligible bills, equal to the amount of the transaction on its books.
- The discounting bank will hold and continue to hold such unencumbered usance bills till the date of maturity of the Derivative Usance Promissory Note.
- In case any of the bills mature during the currency of the derivative UPN, such bills should be replaced by fresh eligible bills discounted by the bank issuing such **derivative UPN**.

Long Term Repo Operations (LTRO)

Introduced by RBI in February 2020, with the following dual objectives:

- To encourage banks to undertake maturity transformation smoothly and seamlessly, so as to augment credit flows to productive sectors, and,
- To assure banks about the availability of durable liquidity, at reasonable cost, relative to prevailing market conditions.

Accordingly, it has been decided that, from the fortnight beginning on February 15, 2020, the RBI would conduct term repos of 1-year and 3-year tenors of appropriate sizes for up to a total amount of Rs 1,00,000 crores at the policy repo rate.

- The first two LTROs were conducted on February 17th and 24th, 2020 for Rs 25,000 crores each, for tenors of 3 years and 1 year, respectively. –
- The total amount of liquidity injected through these operations would be up to Rs 1,00,000 crores.
- LTROs are conducted on e-Kuber platform and the operations are conducted at a fixed rate.
- Banks are required to place their requests for the amount sought under LTRO during the window timing, at the prevailing policy repo rate.
- In case of over-subscription of the notified amount, the allotment is done, on pro-rata basis.
- The bid amount should be for a minimum of Rs 1 crore and multiples thereof.
- **Targeted Long-Term Repo Operations are Long-term repo operations (LTROs) conducted by the RBI, to ensure adequate liquidity at the longer period for specific sectors.**
- **Under LTROs, the RBI auction funds to banks for making investments in prescribed corporate and other instruments.**
- **In the initial phase, the RBI instructed banks to invest funds availed from TLTRO to invest in investment-grade corporate debt.**

- **Purpose:** To ensure that there is enough liquidity in markets like corporate bond market and their yield do not go up in the context of the COVID setback.
- **Exempted:** From regulatory requirement of the CRR for the equivalent of incremental credit disbursed by banks as loans.
- **Interest rate:** Floating rates linked to the policy repo rate.

Why TLTRO?

- Corporate were finding it difficult to mobilise funds as there were large sell offs in the corporate bonds, in the context of the COVID-19 pandemic and the accompanying economic risks.
- Therefore, providing liquidity to the corporate bond market was the **prime objective of the TLTROs**.
- On March 27, 2020, the RBI launched the first TLTRO to provide liquidity in the corporate bond market through banks.
- Four tranches were completed on April 17, 2020.
- In a similar step, the RBI also conducted a TLTRO 2.0 for supporting fund injections to NBFCs through banks.

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