MONEY MARKET

The money market is a financial market where short-term financial instruments are traded, typically with maturities of one year or less. The purpose of the money **market is to provide short-term liquidity to borrowers and investors, allowing them to meet their immediate cash needs.**

Some common types of financial instruments traded in the money market include:

1. Treasury bills
2. Certificates of deposit (CDs)
3. Commercial paper:
4. Repurchase agreements (repos)
5. Money market funds: Mutual funds that invest in a variety of money market instruments, providing investors with a low-risk, low-return investment option.

NEED FOR THE MARKET

1. **Meeting short-term funding needs:** The money market provides a platform for borrowers to raise short-term funds to meet their immediate cash needs. **This includes banks and other financial institutions, corporations, and governments**.
2. **Efficient allocation of funds**: The money market enables investors to efficiently **allocate their funds to short-term investment opportunities that suit their risk profile and return expectations.**
3. **Low-risk investment options:** Money market instruments are typically considered to be low-risk investments, as they are backed by strong issuers and have short maturities. This makes them an attractive option for **investors looking to preserve capital and generate income.**
4. **Money market funds:** Money market funds are mutual funds that invest in a range of money market instruments, providing investors with a **diversified portfolio of short-term, low-risk investments.**

5. **Supporting monetary policy**: The money market also plays a crucial role in supporting the implementation of monetary policy by central banks. For example, central banks can use open market **operations in the money market to adjust the supply of money and credit in the economy.**

PARTICIPANTS IN THE MONEY MARKET

There are a variety of participants in the money market, including:

1. **Banks and Financial Institutions:** Banks and other financial institutions are the primary borrowers and lenders in the money market. They use the **market to manage their short-term liquidity needs and to fund their lending activities.**
2. **Governments**: Governments also participate in the money market by issuing short-term securities, such as Treasury bills, to fund their operations. Central **banks use the money market to implement monetary policy and manage the supply of money and credit in the economy.**
3. **Corporations:** Corporations may issue commercial paper in the money market to raise **funds for their short-term needs, such as paying suppliers or financing inventory**.
4. **Money Market Funds:** Money market funds are mutual funds that invest in a variety of money market instruments. They allow individual investors to **gain exposure to the money market and earn a return on their cash holdings.**
5. **Institutional Investors**: Institutional investors, such as pension funds and insurance companies**, may also participate in the money market by investing in money market funds or directly in money market instruments.**
6. **Broker-Dealers**: Broker-dealers are intermediaries that help facilitate transactions in the **money market by connecting buyers and sellers. They may also participate in the market by borrowing and lending securities on behalf of their clients.**

7. **Primary dealers (PDs)** are financial institutions that have a direct relationship with a central bank for conducting monetary policy operations, such **as open market operations, on behalf of the central**

bank. In the United States, primary dealers are appointed by the Federal Reserve Bank of New York.

MONEY MARKET - INSTRUMENTS

CALL MONEY/NOTICE MONEY

- Call money or call deposits are those funds which the borrower has to repay when called upon to do so by the lender. On the other hand, "Notice Money" refers to those funds where the lender has to give a certain number of **days' notice, which has been agreed on at the time of the contract, to the borrower to repay the funds.**
- However in the Indian money market, Call/Notice money refers to that transaction wherein the money is lent/borrowed between participants, permitted to operate in the Call/Notice money market, **for tenors ranging from overnight to transactions upto a maximum of fourteen days.**
- The rate at which the funds will be deployed or borrowed will be driven by demand **and supply of funds and determined on the basis of the market conditions at a given point of time.**
- The document by which the call/notice money transactions are evidenced **is the call/notice money receipt issued by the borrower to the lender.**
- Call deposit earns interest at agreed rate per annum. The repayment of call borrowings **is along with interest for the days of use of money.**

TERM MONEY

Term Money refers to those borrowing/lending transactions between the participants which have tenors greater than 14 days. The reasons for the transactions and other aspects are the same as those for the

call/notice **money transactions. How-ever, there is no regulatory limit on the amount a participant can lend and borrow.**

The key difference is that term money loans have a fixed term, typically ranging from 1 **month to 1 year, whereas call money loans have a variable term and can be called back at any time by the lender.**

BANK FIXED DEPOSITS (FDs)

The banks accept term deposits for a period of 7 days and above. The rates of interest on such deposits vary from bank to bank. Deposits are collected by bank branches. The depositor gets a Fixed/Term Deposit Receipt (FDR) or an advice from the bank which accepts the deposit. These deposits are not transferable. However, the depositor has an option to **liquidate the deposit prior to its contracted maturity, subject to penalty, which varies from bank to bank.**

CERTIFICATE OF DEPOSITS (CDs)

- Certificate of Deposit (CD) is a negotiable money market instrument and issued in dematerialised form or as a Usance Promissory Note, for **funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently issued by the Reserve Bank of India.**
- Accordingly, CDs can be issued by (i) scheduled commercial banks excluding Regional **Rural Banks (RRBs) and Local Area Banks (LABs**); and (ii) select all-India Term Lending and Refinancing Financial Institutions (EXIM **Bank, NABARD, NHB and SIDBI) that have been permitted by RBI to raise resources within the umbrella limit fixed by RBI.**
- The maturity period of CDs issued by banks should be not less than 7 days and not more than one year from the date of issue. **The FIs**

can issue CDs for a period of not less than 1 year and not exceeding 3 years from the date of issue.

- CDs may be issued at a discount on face value. Banks/FIs are also allowed to issue CDs on **floating rate basis provided the methodology of compiling the floating rate is objective, transparent and market-based.**

COMMERCIAL PAPER (CP)

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. CP, as a privately placed instrument, was introduced in India in 1990 with a view to enabling highly rated corporate borrowers **to diversify their sources of short-term borrowings and to provide an additional instrument to investors.**

Subsequently, primary dealers and all-India financial institutions were also permitted to issue CP to enable them to meet their short-term funding requirements for their **operations. Guidelines for issue of CP are issued by the Reserve Bank of India, and amended from time** to time.

BILL REDISCOUNTING SCHEME (BRDS)

- The Bill Rediscounting Scheme (BRDS) is a facility provided by central banks to banks and **financial institutions for meeting their short-term liquidity needs. Under this scheme, banks and financial institutions can discount their bills of exchange with the central bank to raise funds.**

- A bill of exchange is a financial instrument that is used for short-term borrowing and lending. It is a written order by one party to another party to pay a specified amount of money on a specified date. Banks and **financial institutions hold bills of exchange as assets on their balance sheet. When they need funds, they can**

discount their bills of exchange with the central bank under the BRDS.

- When a bank or financial institution discounts a bill of exchange with the central bank, the central bank provides them with funds equivalent to the value of the bill, less a discount rate. The discount rate is the interest **rate charged by the central bank for the use of its funds. The bank or financial institution can then use these funds for its lending activities or to meet its liquidity requirements.**

INTER-BANK PARTICIPATION CERTIFICATES (IBPCs)

IBPC is yet another short-term money market instrument whereby the banks can raise money/ deploy short-term surplus. In the case of IBPC the borrowing **bank (Issuing Bank) passes on/sells the loans and credit that it has in its book, for a temporary period, to the lending bank (Participating Bank). IBPCs are of two types. They are:**

(i) With risk sharing (ii) Without risk sharing

Scheduled Commercial Banks can issue and purchase/participate in IBPCs. The scheme was also extended to the Regional Rural Banks (RRBs) in 2009 **whereby they were allowed to issue IBPCs to scheduled commercial banks in respect of their priority sector advances in excess of the minimum stipulated requirement.**

The various features of this instrument are given below:

- The minimum period shall be 91 days and maximum period 180 days in the case of IBPCs **on risk sharing basis and in the case of IBPCs under non-risk sharing basis the total period is limited to 90 days.**

- The maximum participation in loan/cash credit under IBPC would be 40% of the **amount outstanding or the limit sanctioned,**

whichever is lower the participation, however, should be in "standard asset" only.

- Interest rates are **determined between issuing bank and the participating bank.**
- The issuing bank and the participating bank have to enter into participation contracts in the format prescribed.
- IBPCs are **not transferable.**
- IBPCs **cannot be redeemed before due date.**
- On the date of maturity, the issuing Bank makes payment of the IBPC along with agreed rate of interest to the participating bank except in the case where risk has materialised.

COLLATERALISED BORROWING AND LENDING OBLIGATION (CBLO)

- Collateralised Borrowing and Lending Obligation (CBLO) is a money market instrument introduced by the Reserve Bank of India (RBI) in **2003. It is a short-term borrowing and lending instrument that allows market participants to borrow and lend funds for a period of one day to 365 days.**
- CBLO is a collateralised instrument, which means that the borrowing and lending transactions are backed by collateral in the form of government **securities. The borrower pledges government securities as collateral to the lender, and the lender in turn lends funds to the borrower against this collateral.**
- CBLO transactions are settled through the Clearing Corporation of India (CCIL), which acts as a central counterparty and guarantees the settlement of all **transactions. The interest rate on CBLO is market determined and is based on the demand and supply of funds in the market.**

- CBLO is a popular instrument among banks, mutual funds, and other financial **institutions for managing their short-term liquidity requirements. It provides a safe and efficient way to borrow and lend funds in the money market, and helps to maintain stability in the financial system.**

Eligibility:

Membership (including Associate Membership) of CBLO segment is extended to banks, financial institutions, insurance companies, mutual funds, **primary dealers, NBFCs, non-Government Provident Funds, Corporates etc.**

The Members are required to open Constituent SGL (CSGL) Account with CCIL for depositing securities which are offered as collateral/margin for **borrowing and lending of funds.**
Besides, Associate Members are required to open a current account with a Settlement Bank designated by CCIL for settlement of funds.

TREASURY BILLS (T-BILLS)

Treasury bill is a short-term money market instrument issued by the Government of India (GOI) through the RBI. The GOI issue T-Bills for tenures of 14 days, 28 days, 91 days, 182 days and 364 days.

The T-Bill issuance calendar is announced for each half-year. The T-Bill is a discounted **instrument i.e it is issued at a discount to its face value which is usually Rs.100.**

The T-Bills are issued in the primary market by the Reserve Bank of India periodically. Normally there are T-Bill auctions every week. The market participants have to bid for a discounted price in the auction.

The cut-off price for the auction is determined by the RBI at a level where the **notified amount of the auction is fully bid for.** Thus, the **cut-off is, under normal circumstances, determined by the market forces.**

REPURCHASE AGREEMENTS (REPOS)

Unlike call deposits and T-Bills, repo is not an instrument in the market. It is a **process wherein a number of instruments such as G-Sec, PSU Bond and other securities can be used as underlying securities to borrow and lend in the money market.**

Under a repo transaction, a holder of securities sells them to an investor with an **agreement to repurchase back the same securities for the same amount at a predetermined date.**

It is essentially a lending and borrowing transaction at an agreed rate of interest known as repo rate.
In the **money market, a repo transaction is nothing but collateralised lending as the terms of the transaction is structured to compensate for the funds lent and the cost of the transaction is the repo rate.**

Types of Repos

Broadly, there are four types of repos available in the international market when classified with regard to maturity of underlying securities, pricing, term of repo etc. They comprise buy-sell back repo, classic repo, bond borrowing and lending and tripartite repos.

Under a buy-sell repo (normal repo as described above) transaction, the lender actually takes possession of the collateral. Here, a security is sold outright and bought back simultaneously for settlement on a later date. In a buy-sell repo, **the ownership is passed on to the buyer and hence he retains any coupon interest due on the bonds.**

Classic repo In, a classic repo, the seller of the security, also known as the borrower, provides the security as collateral for the cash received from the buyer, also known as the lender. The cash received by the borrower is typically less than the market value of the security, with the difference representing the interest rate or repo rate for the use of the cash.

At the maturity of the repo, the borrower repurchases the security from the lender at the agreed-upon price, known as the repurchase price or reverse repo rate. The difference between the repurchase price and the sale price **represents the interest earned by the lender for the use of the security as collateral.**

Under a 'hold in custody' repo A "hold in custody" repo, also known as a "hold in safekeeping" repo or "hold-in-custody-and-return" repo, is a type of repurchase **agreement transaction in which the buyer of the security agrees to hold the security in custody for the seller, rather than selling the security outright.**

In a hold in custody repo, the seller of the security, also known as the borrower, transfers the ownership of the security to the buyer, also known as the lender, but retains the right to receive any interest or dividends **paid on the security during the term of the repo. The buyer holds the security in custody for the seller and returns it to the seller at the maturity of the repo.**

Under a Tripartite repo A tripartite repo, also known as a tri-party repo, is a type of repurchase **agreement transaction that involves three parties: the borrower, the lender, and a third-party custodian. The custodian acts as an intermediary and provides services to facilitate the repo transaction.**

In a tripartite repo, the borrower sells a security to the lender for cash, with an agreement to repurchase the same security at a future date

at a slightly higher price. **The custodian plays a crucial role in the transaction by holding the security as collateral on behalf of the borrower and ensuring its safekeeping.**