TREASURY INSTRUMENTS

OBJECTIVE

To provide detailed information on money market instruments like call money, notice money, term money, Bank fixed deposits, certificate of deposits, commercial papers, BRDS, IBPCs, CBLO, treasury bills, repos, etc.

MONEY MARKET – INSTRUMENTS

There are a number of players in the money market and in addition the market is also characterised by a number of instruments.

- **Call Money / Notice Money Call money -**those moneys which are lent where the borrower has to repay the funds when called on to do so by the lender.
- **Notice Money- refers to those moneys 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 a maximum of fourteen days.**
- **The participants, who have surplus, lend money to adjust the mismatch for the relative period. The participants who are short of funds, on the other hand, would borrow funds for the relative period.**

- 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**. When the market is highly liquid, funds would be easily available whereas funds will be difficult to obtain in tight money market conditions. The **rates will be low in easy money (liquid) market and the rates would be high in tight money market.**

The **document by which the call / notice money transactions are evidenced is the call / notice money receipt issued by the borrower to the lender.** The lender pays funds to the borrower by way of a Banker's Cheque, a cheque drawn on RBI or a RTGS credit.

Term Money- refers to those **borrowing / lending transactions between the inter-bank participants which have a fixed tenor of 15 days or more.** The reasons for the transactions and other aspects could be the same as those for the call / notice money transactions. However, there is no regulatory limit on the amount an inter-bank participant can lend and borrow.

Rates of interest on term money are negotiated between transacting parties. These rates are arrived from the deposit rates prevailing in the market. The interest rate is simple and calculated on a day count basis of actual/365.

- **Normally term money is not repayable before maturity.** However, premature cancellation after 14 days can be done by mutual consent on mutually agreed terms. No loan / overdraft can be granted against Term Money. **Term money cannot be traded. As such, it has limited use in the money market.**

Bank Fixed Deposits (FDs)- Scheduled Commercial Banks (SCBs) and Co-operative banks accept term deposits for a period of 7 days and above. **The rates of interest on such deposits vary from bank to bank**.

- 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, known as premature closure (embedded option), prior to its contracted maturity** subject to penalty as indicated by a bank which could vary from bank to bank.
- Anybody can invest funds in a fixed deposit. In a **strict sense a fixed deposit is not a money market instrument since it cannot be traded.** However, often banks and FIs make investment in FDs. This is appropriate when **funds are available for a specified period and rate in FD market is more favourable than other markets**

Certificates of Deposit (CD)

Certificate of Deposit (CD) is a. **negotiable money market instrument and issued in dematerialized form or as a 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

- scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and

- select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI. Banks have the freedom to issue CDs depending on their requirements.
- **The maturity period of CDs issued by banks should be not less than 7 days and not more than one year**. 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.** The issuing bank / FI is free to determine the discount / coupon rate.

Other features of CD are as follows:

- CDs can be issued to individuals, corporations, companies, trusts, funds, associations, etc. Non-Resident Indians (NRIs) may also subscribe to CDs.
- Physical CDs are freely transferable by endorsement and delivery. **Demat CDs can be transferred as per the procedure applicable to other demat securities.** Currently, as per RBI guidelines, Banks / FIs should issue CDs only in the demat form.
- There is no lock-in period for the CDs (**minimum period has to be in excess of 7 days).**
- Minimum amount of a CD should be Rs. 1 lakh.
- The rate of discount / coupon is determined by parties to the transaction. The market factors, demand and supply are taken into consideration while fixing the rates.

- Banks / FIs cannot grant loans against CDs. Furthermore, they cannot ordinarily buy-back their own CDs before maturity, **except with specific approval from RBI.**

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 enable highly rated corporate borrowers to diversify their sources of short-term borrowings and **to provide an additional instrument to investors**.
- Guidelines for issue of CP are issued by the **Reserve Bank of India, and amended from time to time.**
- Corporates and primary dealers (PDs), and the all-India financial institutions (FIs) that have been **permitted to raise short-term resources under the umbrella limit fixed by Reserve Bank of India, are eligible to issue CP.**
- A corporate would be eligible to issue CP if the tangible net worth of the company, as per the latest audited balance sheet, is not less than ₹4 crore;
- CP can be issued for maturities **between a minimum of 7 days and a maximum up to one year from the date of issue.**
- CP may be held by individuals, banking companies, other corporate bodies registered or incorporated in India
- CP can be issued either in the form of a promissory note (Schedule I) or in a dematerialized form through any of the depositories approved by and registered with SEBI.

- CP will be issued at a discount to face value as may be determined by the issuer.

Bill Rediscounting Scheme (BRDS)

BRDS is the rediscounting of trade bills, which have already been purchased by / discounted with the bank by the customers. These trade bills arise out of supply of goods / services.

Banks, in their normal course of business discount genuine bills of exchange. **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 (BRDS).

The minimum tenor **of a BRDS transaction is 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.

Derivative Usance Promissory Note (DUPN):

Usance Promissory note drawn by the discounting Bank against the underlying Bills. **While rediscounting the Bills, actual endorsement and delivery of these Bills are not necessary**. Instead this Promissory Note is delivered. Since this Note derives its value from the underlying Bills, this is called Derivative Usance Promissory Note.

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 / 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.
- 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.
- Interest rates are determined between issuing bank and the participating bank.
- IBPCs are not transferable.
- IBPCs cannot be redeemed before due date.

Collateralized Borrowing and Lending Obligation (CBLO)

- CBLO is a money market instrument approved by RBI. This is a product developed by CCIL for the benefit of the entities who have either **been phased out from inter-bank call money market or have been given restricted participation in terms of ceiling on** call borrowing and lending transactions and who do not have access to the call money market.
- CBLO is a discounted instrument available in electronic book entry form for the maturity period ranging from one day to ninety days (can be made available up to one year as per RBI guidelines).

Eligibility: Membership (including Associate Membership) of CBLO segment is extended to banks, financial institutions, insurance companies, mutual funds, primary dealers, NBFCs, non-government Provident / Pension 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.**

Eligible Securities: Eligible securities are Central Government securities including Treasury Bills.

Treasury Bills (T-bills)

- Treasury bill is a short-term instrument issued by the Government of India (GOI) and are presently **issued in three tenors, namely, 91 days, 182 days and 364 days.**
- The **T-Bills are issued in the primary market by the Reserve Bank of India. 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.

Cash Management Bills

In 2010, the Government of India, in consultation with the Reserve Bank of India, introduced a new short-term instrument, known as Cash

Management Bills, to meet the temporary cash flow mismatches of the Government.

- The Cash Management Bills are issued **for maturities less than 91 days**. The Cash Management Bills have the generic character of Treasury Bills.
- The Cash Management Bills are issued **at discount to the face value** through auctions, as in the case of the Treasury Bills.

Repurchase Agreements (Repos)

Under a repo transaction, a **holder of securities sells them to lender of funds with an agreement to repurchase the same securities for a 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 collateralized lending, as the terms of the transaction are structured to compensate for the funds lent and the cost of the transaction is the repo rate.

Repo Rate

It is the annualized interest rate for the funds lent by the buyer of the securities (lender) to the seller of the securities (borrower). Factors that may affect the repo rate include the creditworthiness of the borrower, liquidity of the collateral and comparable rates of other money market instruments.

Repo Period

Repo transaction can be undertaken for overnight to a longer-term period. Overnight repo lasts only one day. If more than one day period is fixed and agreed in advance, it is a term repo.

Documentation

Legal title to the collateral security which is used in repo transaction passes to the buyer during the repo period. As a result, in case the seller defaults in repayment of funds, the buyer need not separately establish right on the collateral security.