# MONEY MARKET

## MONEY MARKET

- Money Market is a financial market where **short-term debt financial instruments** having liquidity of **one year or less are traded**.
- Instruments traded in money market are **call money, certificates of deposit, Treasury bills, commercial paper etc**.
- RBI is the **regulator** of the Money Market.

## FUNCTIONS OF MONEY MARKET

- It enables borrowers and lenders of short-term funds to fulfill their **borrowing and investment requirements**.
- It **promotes economic growth** by ensuring the availability of funds to various sectors of the economy such as industry, agriculture, and service sector, among others.
- The money market allows the Reserve Bank of India (RBI) to **implement monetary policy.**
- It provides an **equilibrating mechanism** for demand and supply of short-term funds.
- Money market provides efficient facilities for **adjustment of liquidity positions of commercial banks**, non-bank financial institutions, business firms and other investors.

## PARTICIPANTS IN THE MONEY MARKET

### CENTRAL GOVERNMENT

- The Central Government is an issuer of **Government of India Securities (G-Secs) and Treasury Bills (T-bills).**
- These instruments are issued to **finance the Government** as well as for managing the Government's cash flow.
- These **securities are issued by the RBI**, on behalf of the Government, so as to finance the latter's budget requirements, deficits and public sector development programmes.

**Treasury Bills**

- Treasury bills (T Bills) are money market instruments issued by **Government of India**.
- Three types of T bills are issued, namely **91-day, 182-day and 364-day.**
- Treasury bills are issued at a **discounted price and redeemed at par value.**

**Cash Management Bills**

- Cash Management Bill (CMB) is a short-term financial instrument issued to meet the **temporary mismatch in the cash flow** of the government.

- CMBs were **first issued in 2010** and They are issued for **less than 91 days**.

**PUBLIC SECTOR UNDERTAKINGS**

- Public Sector Undertakings (PSUs) **issue bonds which are medium to long-term coupon** (interest) bearing debt securities.
- PSU Bonds can be of **two types: taxable and tax-free bonds**. These bonds are issued to finance the working capital requirements and long-term projects of public sector undertakings.
- PSUs can also **issue Commercial Paper** to finance their working capital requirements.

- PSUs **generate large cash surpluses**. Such PSUs are active investors in instruments like Fixed Deposits, Certificates of Deposits and Treasury Bills.

## SCHEDULED COMMERCIAL BANKS

### Call Money

Call Money is the borrowing or lending of **funds for 1 day by Banks.**

### Notice Money

Notice Money is the borrowing or lending of funds for period between **2 days and 14 days Banks.**

### Term Money

Term money refers to borrowing/lending of funds for a period **exceeding 14 days and up to one year by banks**.

### Certificates Of Deposit

- Certificate of deposit is a **negotiable money market** instrument issued in **dematerialised form**.

- It issued by scheduled commercial banks, Regional Rural Banks Small Finance Banks and all-India Financial Institutions that have been permitted by RBI.
- CDs are issued at a **discounted price and redeemed at par value**.
- **Tenor** of issue can range from **7 days to 1 year.**
- Banks **invest in Government securities** to maintain their Statutory Liquidity Ratio (SLR), as well as to invest their surplus funds.

**PRIVATE SECTOR COMPANIES**

**Commercial Paper**

- It was introduced in India in 1990
- Commercial Paper (CP) is an **unsecured money market** instrument
- It usually has a maturity period **15 days to one year**.
- It is issued at a **discounted price and redeemed at par value.**

**Eligibility for Issue of CP**

- Anybody corporate with a minimum **net worth of 100 crore** or higher.
- **Co-operative societies/unions and limited liability partnerships** with a minimum net worth of 100 crore or higher.
- Any other entity specifically **permitted by the Reserve Bank**

**PROVIDENT/PENSION FUNDS**

Provident/Pension funds have **short term and long term surplus funds**. They invest their funds in debt instruments according to their internal guidelines and as per the prescriptions by the regulators.

**The instruments that these funds generally invest in are:**

**Government Securities & Related Investments**: G-Secs, government-guaranteed securities, and SEBI-regulated mutual funds focused on G-Secs.

**Debt Instruments**: Listed debt securities, Basel III Tier-I bonds issued by Scheduled Commercial Banks, Rupee Bonds from international financial institutions, term deposits from commercial banks, debt mutual fund units.

**GENERAL INSURANCE COMPANIES**

- General insurance companies (GICs) have to **maintain certain funds which have to be invested in approved investments.**
- They participate in **the G-Sec, Bond and short term money market** as lenders.
- It is seen that generally **they do not access funds** from these markets.

**LIFE INSURANCE COMPANIES**

- Life Insurance Companies (LICs) invest their funds in G**-Sec, Bond or short term money markets.**
- They have certain **predetermined thresholds** as to how much they can invest in each category of instruments.

## MUTUAL FUNDS

Mutual funds invest in **money market and debt instruments** based on the approved investment pattern of each scheme. The proportion allocated to each instrument varies according to the scheme's guidelines.

## NON-BANKING FINANCE COMPANIES

- Non-banking Finance Companies (NBCs) **invest their funds in debt instruments** to fulfill certain regulatory mandates as well as to park their surplus funds.
- NBCs are **required to invest 15% of their net worth** in bonds which fulfill the SLR requirement.

## PRIMARY DEALERS (PDS)

- It **participate as principals in Government of India** issues through bidding in auctions.

- It provide **underwriting services** and help develop underwriting and market-making capabilities for government securities outside RBI.
- It offer firm **buy - sell/bid ask quotes for T-Bills & dated securities** and to improve secondary market trading system.
- It strengthens the **infrastructure in the government securities market** in order to make it vibrant, liquid and broad based.

## 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.**
- A major portion of the transactions in the **call market are for an overnight tenor** i.e. the borrower repays principal and interest on the next day of the transaction.
- This market is used by participants to manage their **daily funding mismatches and to comply with CRR stipulations.**

- 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.
- 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.
- The placement of money/lending in the call/ notice money **market is unsecured.**

**TERM MONEY**

- Term Money refers to those borrowing/lending transactions between the participants which have tenors **greater than 14 days and upto 1 year.**
- The reasons for the transactions and **other aspects are the same as those for the call/notice money transactions.**
- However, there is **no regulatory limit** on the amount a participant can lend and borrow.

**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).**
- 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.
- 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.

## CERTIFICATE OF DEPOSITS (CDs)

- Certificate of Deposit (CD) is a negotiable money market instrument and **issued in dematerialised form**.
- **Banks have the freedom** to issue CDs depending on their requirements. An FI may issue CDs within the overall 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.
- 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.

**Other Features**

- CDs can be issued to **individuals, corporations, companies** (including banks and PDs), trusts, funds, associations, etc. .
- Non-Resident Indians (NRIs) may also subscribe to CDs, but only on non-repatriable basis which should be clearly stated

on the Receipt/Certificate. Such **CDs cannot be endorsed to another NRI in the secondary market.**

- **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.** However, according to the Depositories Act, 1996, investors have the option to seek certificate in physical form.
- **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.
- The **instrument is to be stamped** according to the rates prescribed by the Indian Stamp Act.
- Banks/FIs **cannot grant loans against CDs**. Furthermore, they cannot buy-back their own CDs before maturity.

- **All OTC trades in CDs shall be reported within 15 minutes** of the trade on the reporting platform of Clearcorp Dealing Systems (India) Ltd. (CDSIL).

## COMMERCIAL PAPER (CP)

- 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.
- 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.
- 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.
- All eligible participants shall obtain the **credit rating for issuance of Commercial Paper** from any one of the SEBI registered Credit Rating Agencies.

- The **minimum credit rating shall be 'A3'** as per rating symbol and definition prescribed by SEBI. The issuers shall ensure at the time of issuance of CP that the rating so obtained is current.

**Other Features**

- CP 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).
- Foreign Institutional Investors (FIIs) shall be eligible to invest in CPs subject to such conditions as may be set for them by Securities & Exchange Board of India (SEBI) and compliance with the provisions of the Foreign Exchange Management Act, 1999, the Foreign Exchange (Deposit) Regulations, 2000 and the Foreign Exchange Management (Trans-fer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

- CP can be issued either in the form of a **promissory note (Schedule I**) or in a **dematerialised form** through any of the depositories approved by and registered with SEBI.
- It is provided that all **RBI regulated entities can deal in and hold CP only in dematerialised form** through such depositories.
- CP shall be issued in d**enominations of Rs. 5 lakh and multiples thereof.** The amount invested by a single investor should not be less than Rs. 5 lakh (face value).
- **Options (call/put) are not permitted on CP.**
- Every issuer must **appoint an IPA [Issue and Pay Agent] for issuance of CP.** The issuer should disclose to the potential investors, its latest financial position as per the standard market practice.
- Only a **scheduled bank can act as an IPA for issuance of CP**. All scheduled banks, acting as IPAs, shall report the details of issuance of CP on the **Online Returns Filing System (ORFS) module of the RBI** within two days from the date of issuance of the CP.

- The **rate of interest** is determined by parties to the transaction
- The **instrument is to be stamped** according to the rates prescribed by the Indian Stamp Act.

**Eligibility for Issue of CP**

- Anybody corporate with a minimum **net worth of 100 crore** or higher.
- **Co-operative societies/unions and limited liability partnerships** with a minimum net worth of 100 crore or higher.
- Any other entity specifically **permitted by the Reserve Bank**

**BILL REDISCOUNTING SCHEME (BRDS)**

- The Bills Rediscounting Scheme (BRDS) is an **initiative introduced by the Reserve Bank of India (RBI).**

- The scheme is designed to provide a **mechanism for banks and financial institution**s to rediscount bills of exchange and promissory notes with the eligible entities.
- The bank borrowing under BRDS issues a **Derivative Usance Promissory Note a**nd certifies its possession of eligible bills equal to the transaction amount.
- BRDS transactions have a **minimum tenor of 15 days and a maximum of 90 days.**

**ELIGIBILITY CRITERIA FOR REDISCOUNTING BILLS**

- Bills eligible for rediscounting must originate from **legitimate trade transactions.** Bills from house transactions and finance companies are excluded from BRDS coverage.
- The bill of exchange must **not be encumbered or tied to any obligations** and The bill's remaining term should not exceed 90 days.
- The advances of a bank borrowing under **the BRDS get reduced to the extent of the borrowing**, while it is shown as an advance on the lender's books.

## 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 with risk sharing and 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.

## FEATURES OF INTER-BANK PARTICIPATION CERTIFICATES (IBPCS)

- 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 rate**s are determined between issuing bank and the participating bank.
- **IBPCs are not transferable** and IBPCs cannot be redeemed before due date.
- In case the balance in the **cash credit/loan account on which IBPCs have been issued comes down,** at any point of time, the issuing bank has to repay the portion of the IBPCs issued to the participating bank so that the participation is not more than **40**% of the balance outstanding in the said accounts

**Q: 1 Which of these statements is correct regarding money market?**

I. It involves low market risk.

II. SEBI is the regulator of the Money Market

III. Deals in short-term debt instruments.

IV. The instruments traded are highly liquid

a) I, III, IV

b) II, III, IV

c) I, II, IV

d) I, II, III,

**Q: 2 Money Market allows the Reserve Bank of India (RBI) to implement ____________.**

a) Long-term infrastructure projects

b) Monetary policy

c) Foreign exchange policy

d) Capital market policy

**Q: 3 Certificates of Deposit are issued at a discounted price and redeemed at par value. Certificates of Deposit is issued by ___________.**

I. Scheduled commercial banks

II. Regional Rural Banks

III. Small Finance Banks

IV. All-India Financial Institutions that have been permitted by RBI

a) I, III, IV

b) II, III, IV

c) I, II, IV

d) I, II, III, IV

**Q: 4 T-Bills, which are short-term securities sold at a discount and redeemed at face value, help the government cover immediate expenses and manage cash flow efficiently. T-bills are issued by __________.**

a) The Central Government

b) The State Government

c) The Local Government

d) All of the above

**Q: 5 Cash Management Bills (CMBs) are a type of short-term debt instrument issued by the government to address what kind of financial situation?**

a) Long-term investment needs

b) Temporary cash flow mismatches

c) Funding large infrastructure projects

d) Paying off long-term debts

**Q: 6 What is the typical maturity period for commercial paper?**

a) More than 5 years

b) Over 10 years

c) Between 15 days to one year.

d) None of the above

**Q: 7 Which of the following entities is NOT eligible to issue commercial paper in India?**

a) Any corporate entity possessing a net worth of at least 100 crore or more.

b) Any additional organization explicitly authorized by the Reserve Bank.

c) Cooperative societies, unions, and limited liability partnerships with a net worth of a minimum 100 crore or higher.

d) None of the above

## MONEY MARKET

## MONEY MARKET – INSTRUMENTS

## COLLATERALISED BORROWING AND LENDING OBLIGATION (CBLO)

- CBLO is a money market instrument approved by RBI. This is a product developed by **Clearing Corporation of India Ltd. (CCIL)**.
- It enables entities to **borrow or lend funds against collateral** in a secured and efficient manner and borrowers must **pledge eligible securities to CCIL,** which acts as a central counterparty.
- It is designed primarily catering to **entities that do not have direct access to the interbank call money market** or have been given restricted participation in terms of ceiling on call borrowing and lending transactions
- Maturity period ranging from one day to ninety days (can be made available up to one year as per RBI guidelines).
- In order to enable the market participants to borrow and lend funds, **CCIL provides the Dealing System through Indian Financial Network (INFINET).**

- 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 **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.
- T-Bills have a **moderately active secondary market**. The secondary market trades in T-Bills on a yield basis.

**REPURCHASE AGREEMENTS (REPOS)**

- It is a **repurchase agreement** 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.

- **REPO is also undertaken by RBI** for controlling liquidity in the market as also to help banks in need of liquidity. The banks can borrow funds from RBI by doing a REPO.
- **Repo rate is the annualized interest rate** for the funds lent by the buyer of the securities (lender) to the seller of the securities (borrower).
- Generally, the **repo rate is lower than that offered on unsecured (or clean) inter-bank loan** for the reason that it is a collateralised transaction.

**Ready Forward Transaction**

A repo is sometimes called a ready forward transaction as it is a means of funding by **selling a security held on a spot (ready) basis** and repurchasing the same on a forward basis.

**Double Ready Forward Transaction.**

When an entity sells a security to another entity on repurchase agreement basis and simultaneously purchases s**ome other security from the same entity on resell basis** it is called a double ready forward transaction.

## Repo Pricing

- The price adjustment depends on the relationship between the **net coupon and the repo amount** worked out on the basis of the repo interest agreed upon the total funds transferred.
- When **repo rate is higher than current yield**, repurchase price will be adjusted upward signifying a capital loss for seller.
- If the **repo rate is lower than the current yield**, then the repurchase price will be adjusted downward signifying a capital gain for seller.
- If the **repo rate and coupon are equal**, then the repurchase price will be equal to the sale price of security since no price adjustment at the repurchase stage will be required.

## Eligible Instruments

Different instruments can be considered as collateral security for undertaking the ready forward deals and they include

Government dated securities, Treasury Bills, corporate bonds, money market securities and equity.

## 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.

**Buy-Sell Repo**

- Under a buy-sell repo 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.
- The **forward price of the bond is set in advance** at a level which is different from the spot clean price by actually adjusting the difference between repo interest and coupon earned on the security.

## Classic Repo

- In the case of this type of repo, the **start and end prices of the securities are the same** and a separate payment of "interest" is made.
- Classic repo makes it explicit that the **securities are only collateral for cash loan.** Here, the coupon income will accrue to the seller of the security.

## Hold in custody repo

Under a 'hold in custody' repo, the counterparties enter into an agreement whereby the **securities sold are held in custody by the seller for the buyer** until maturity of the repo thus eliminating the settlement requirements.

## Tripartite repo

- In this repo securities are sold by the borrower to the lender, but they are held by a **third-party custodian during the term of the repo agreement.**

- The custodian ensures that the securities remain in **safekeeping and cannot be sold or pledged again during the repo period**.
- Under a Tripartite repo, a **common custodian/ clearing agency arranges for custody**, clearing and settlement of repo transactions.

**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.** Though these are terminated as per agreement, it is possible for either party to terminate the repo at **any time by giving one- or two-days' notice.**
- In an open repo, there is no such fixed maturity period, and the interest rate would change from day to day depending on the money market conditions.
- Under **flexible repos the lender places funds,** but they are withdrawn by the borrower as per his requirements over an agreed period.

**Risks**

- Repos are collateralized transactions, the parties to repo are exposed to **counterparty risk and the issuer risk** associated with the collateral.
- **Counterparty risk is minimized** because the lender can liquidate the securities received as collateral to offset any potential loss.
- **Lenders in repos may face interest rate** risk because rising interest rates can lower the market value of the securities used as collateral.
- If the **borrower defaults or becomes bankrupt** and fails to repurchase the securities, the lender might be left holding securities worth less than the loan amount.
- **Borrowers in repos are also at risk** if interest rates fall, as the market value of the securities sold increases, leading to a loss of opportunity.
- If the **lender defaults**, the borrower may need to repurchase the securities at a higher market price, incurring a loss.

**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 establish right on the collateral security.

**Agreement (OSLA) developed by the International Stock Lenders Association.**

- The Overnight Stock Lending Agreement (OSLA), developed by the International Securities Lending Association (ISLA), is a master agreement that **governs the relationship between parties in repo transactions.**
- It sets out terms for securities transfer, margin requirements, marking to market, and how income on securities is handled.
- It defines **events of default** and the actions parties can take in case of default, such as set-off of claims.
- The agreement also covers **collateral substitution and specifies the timing for coupon** and interest payments.

- In short, OSLA ensures clear terms for security, obligations, and risk management in repo transactions.

**Uses**

- An active repo market would lead to an **increase in turnover in the money market,** thereby improving liquidity and depth of the market;
- Repos would **increase the volumes in the debt market** as it is a tool for funding transactions. It enables dealers to deal in higher volumes.
- Repos provide an **inexpensive and most efficient way of improving liquidity** in the secondary markets for underlying instruments.
- **For institutions and corporate entities**, repos provide a source of inexpensive finance and offers investment opportunities of borrowed money at market rates thus earning a good spread.

- **Tripartite repos** will offer opportunities for suitable financial institutions to intermediate between the lender and the borrower;
- A large number of repo transactions with different durations create a **term interest rate structure**, particularly in the interbank market.
- Central banks can use repo as an integral part of their open market operations with the objective of **injecting/withdrawing liquidity into/ from the market** and also to reduce volatility in short term, in particular, in call money rates.
- **Bank reserves and call rates** are used in such instances as the operating instruments with a view to ultimately easing/ tightening the monetary conditions.

# CAPITAL MARKET

## CAPITAL MARKET

- Capital market is a financial market in which **long-term debt or equity-backed securities are bought and sold.**
- The main instruments traded in the capital market are – **equity shares, debentures, bonds, preference shares etc.**
- **SEBI is the regulator** of the Capital Market.

## FINANCIAL PRODUCTS DEALT IN CAPITAL MARKET

### EQUITY SHARES

- The holders of equity shares are the **real owners of the company**.
- Equity shareholder have a **control over the working of the company** and they have voting rights.

- The equity shares which are issued by the company **are permanent and are non-redeemable.**
- Equity shareholders are e**ntitled to dividends from distributable profits** at a rate decided by the Board.
- **Market price of shares** depends on factors such as earnings, dividends, liquidity, and economic conditions.
- Shares are **transferable and considered movable property**, with each share identified by a distinct number.
- **Share certificates** are issued to registered shareholders within **three months** of share allotment.
- Shares are **now issued and traded in dematerialized** form, eliminating physical certificates.
- **NSDL and CDSL are the two central depositories** managing electronic shares, with Depository Participants (DPs) handling them.

**PREFERENCE SHARES**

- Preference shares represent **ownership in a company**. They are **secondary owner** of business.
- Preference shareholders enjoy the preference over common shareholders in the **payment of dividend and capital.**
- Fixed rate of dividend is paid to the preference share holder.

## Types of Preference Shares

**Cumulative Preference Shares :** These shares accumulate unpaid dividends from previous years. If the company is unable to pay dividends in a particular year, the **unpaid dividends are carried forward and must be paid before any dividends** are distributed to equity shareholders.

**Non-Cumulative Preference Shares**: These shares do **not accumulate unpaid dividends.** If the company does not declare a dividend in a given year, the shareholder has no right to claim it in the future.

**Participating Preference Shares**: These shares provide shareholders with a fixed dividend, but also allow them to **participate in any additional profits of the company,** beyond the fixed dividend, after the equity shareholders have received their due share.

**Convertible Preference Shares:** These shares can be **converted into a certain number of equity shares** at a predetermined price, within a specified time frame.

**Redeemable Preference Shares**: These shares are issued on condition that the company **can buy them back (redeem) at a future date**, at a fixed price or according to a predetermined schedule.

**Irredeemable Preference Shares**: These shares cannot be redeemed by the company, meaning they must **remain outstanding until the company is liquidated or dissolved.**

**EXTERNAL COMMERCIAL BORROWINGS (ECB)**

- An external commercial borrowing (ECB) is an instrument used in India to facilitate the access to foreign money by Indian corporations and **Public Sector Undertaking**.

- External Commercial Borrowings (ECB) are c**ommercial loans raised by eligible resident entitie**s from recognised non-resident entities.

**ECB Framework: Three Tracks for Raising Loans**

**Track I:** Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years.

**Track II:** Long term foreign currency denominated ECB with minimum average maturity of 10 years.

**Track III:** Indian Rupee (INR) denominated ECB with minimum average maturity of 3/5 years.

**Forms Of ECB**

The ECB Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms:

- Loans including bank loans
- Securitized instruments
- Buyers' credit

- Suppliers' credit
- Foreign Currency Convertible Bonds (FCCBs).
- Financial Lease
- Foreign Currency Exchangeable Bonds

**Available Routes For Raising ECB**

- Under the ECB framework, ECBs can be raised either under the **automatic route or under the approval route.**
- For the automatic route, the cases are examined by the Authorized Dealer Category-I (AD Category-I) banks.
- Under the **approval route**, the prospective borrowers are required to **send their requests to the RBI** through their ADs for examination.
- While the **regulatory provisions are mostly similar**, there are some differences in the form of amount of borrowing, eligibility of borrowers, permissible end-uses, etc. under the two routes.

- While the **first six forms of borrowing**, can be raised both under the **automatic and approval routes**, Foreign Currency Exchangeable Bonds can be issued only under the approval route.

**PARAMETERS FOR ECB**

**Track I:**

**Minimum Average Maturity Period**

- 3 years for ECB upto USD 50 million or its equivalent.
- 5 years for ECB beyond USD 50 million

**Eligible Borrowers**

- Companies in manufacturing and software development sectors.
- Shipping and airlines companies.
- Small Industries Development Bank of India (SIDBI).

- Units in Special Economic Zones (SEZs).
- Export Import Bank of India (Exim Bank) (only under the approval route).

**Recognised Lenders/Investors**

- International banks.
- International capital markets.
- Multilateral financial institutions
- Regional financial institutions
- Government owned financial institutions.
- Export credit agencies.
- Suppliers of equipment.
- Foreign equity holders.
- **Overseas long term investors such as:**

(a) Prudentially regulated financial entities;

(b) Pension funds;

(c) Insurance companies;

(d) Sovereign Wealth Funds;

(d) Financial institutions located in International

**All-in-Cost (AIC)**

The all-in-cost ceiling is prescribed through a **spread over the benchmark rate as under:**

- For ECB with minimum **average maturity period of 3 to 5 years** - 300 basis points per annum over 6-month LIBOR or applicable bench mark for the respective currency.
- For ECB with **average maturity period of more than 5 years** - 450 basis points per annum over 6-month LIBOR or applicable bench mark for the respective currency.
- **Penal interest, if any,** for default or breach of covenants **should not be more than 2 per cent** over and above the contracted rate of interest.

**End-use prescriptions**

- **ECB proceeds can be utilised for capital expenditure in the form of:**

a) **Import of capital goods** including payment towards import of services, technical know-how and license fees.
b) Local sourcing of capital goods.
c) New project;
d) Modernisation/expansion of existing units;
e) **Overseas direct investment** in Joint ventures (JV)/Wholly owned subsidiaries (WOS);
f) **Acquisition of shares of public sector undertakings** at any stage of disinvestment under the disinvestment programme of the Government of India.
g) **Refinancing of existing trade credit** raised for import of capital goods;
h) **Payment of capital goods** already shipped/imported but unpaid;
i) **Refinancing of existing ECB** provided the residual maturity is not reduced.

- **SIDBI can raise ECB** only for the purpose of on-lending to the borrowers in the Micro, Small and Medium Enterprises (MSME sector), where MSME sector is as defined under the

MSME Development Act, 2006, as amended from time to time.

- **Units of SEZs can raise ECB** only for their own requirements.
- **Shipping and airlines companies** can raise ECB only for import of vessels and aircrafts respectively. The respective conditions will be applicable for all the three tracks.
- ECBs for the following purposes will be **considered only under the approval route:**

a) Import of second hand goods as per the Director General of Foreign Trade (DGFT) guidelines;

b) On-lending by Exim Bank.