UNIT-2

FEATURES
Following are the features of commercial papers:

Nature
These are unsecured debts of corporates. They are issued in the form of promissory notes. These are redeemable at par to the holder at maturity. The issuing company should have a minimum tangible net worth
to the extent of Rs 4 crores. Moreover, the working capital (fund-based) limit of the company should not be less than Rs. 4 crores and this allows corporates to issue CPs upto 100 per cent of their fund based working capital limits. CPs are issued at a discount to face value in multiples of Rs. 5 lakhs. CPs attract stamp duty. No prior approval of RBI is needed to issue CPs and no underwriting is mandatory. The issuing company has to bear all expenses (such as dealers fees, rating agency tee and charges for provision of stand-by facilities) relating to the issue ot CP The Issue of CPs serves the purpose of releasing the pressure on bank funds for
small and medium sized borrowers, besides allowing highly rated companies to borrow directly from the market.
Market
The market for the CPs comprises of issues made by public sector and private sector enterprises. CPs issued by top rated corporates are considered as sound investments. Conditions attached to the issue are less stringent than those applicable for raising CPs. Beginning trom September 1996, Primary Dealers (PDs) were also permitted by RBI to Issue CPs for augmenting their resources. This is one of the steps initiated by the RBI to make the CPs market popular.

Rating
AS per the guidelines of the RBI, CPs are required to be graded by the organization issuing them. Accordingly, a rated CP is considered to be a quality and sound instrument. with the liberalization of interest rate Structure, the rate of interest is market-determined. This causes wide variation in the prevailing rates of interest.

Interest Rates
The rate of interest applicable to CPs varies greatly.This variation is influenced by a large number of factors such as credit rating of the instrument, economic phase, the prevailing rate of interest in CPs market, call rates, the position in foreign exchange market etc. it is however to be noted that there is no benchmark for the interest rate.

Marketability
The marketability of the cps is influenced by the rates prevailing in the call money market and the foreign exchange market. Accordingly, where attractive interest rates prevail in these

markets, the demand for CPS will be affected. This is because investors will divert their investment into this market.

Maturity
The minimum maturity of CP has been brought down from 3 months to 30 days and was further reduced to 15 days with effect from may 25 1998. This was done with a view to encouraging issuance of CPS.

Cps in lieu of wc
The nature of credit policy announced by the RBI allows highly rated corporates to have the advantage of bank offerings and automatic Restoration of working capital limits on the repayment of CP. Accordingly, short-term working capital loans were substituted with cheaper Cps. This was done by the RBI to hasten the growth of the cp market.

<u>Commercial bill market</u>

The market for buying and selling of commercial bills of exchange is known as the commercial bill market.
Importance
Commercial bill market is important for trade and industry and also for the development of the money market in the following ways.

1. ***Ideal source of credit***
1. Bill financing is considered to be the most common method of meeting the short term credit needs of trade and industry. It is quite possible for even banks to read discount tables in their position. In this manner banks are able to meet their short-term liquidity requirement.

2. ***High Liquidity***
   The level of liquidity of commercial bills is very high. This advantage emanates from their self-liquidating
   character. Such bills have a fixed and short tenure of maturity. They can be easily discounted.

3. ***Financial Discipline***
   As the payment must be made on the due date of the bill, the use of commercial bills as an instrument of credit,
   imposes financial discipline on the borrowers.

4. ***Ideal Parking of Funds***
   Discounting of bills offers an excellent avenue for short-term investments of the funds of banks. The existence of a bill market enables banks and other financial institutions to park their surplus funds profitably by selecting
   appropriate maturities.
5. ***Flexibility***

An important function of an efficient bill market is that it imparts flexibility to the money market by functionng as its effective constituent. The bill market helps ease out liquidity crunch in the banking system.

DEVELOPED BILL MARKET

Features

A bill market is considered a developed bill market if it possess the following characteristics:

1. **Genuine trade bills**

An important requisite for a developed bill market is that there should be a large trade and commercial transactions. Moreover, Benune trade bills should support these transactions.

2. **Borrowing practice**
   the practice of borrowing against commercial bills should be well established and widely prevalent. For, such a practice would nurture the growth of an efficient bill market.
3. **Supply of bills**
   For a bill market to flourish and grow, there must be available a continuous and sulicien supply of a large quantity or commercial bills in the money market
4. **Financial discipline**
   Discipline among the parties to a bill of exchange is an essential requirement for a developed bill market. it is important that both borrowers and lenders subject themselves to strict financial discipline
5. **Ideal security**
   Commercial banks should use bill of exchange as an ideal avenue for providing credit to their customers. Such a practice will encourage more and more people in the trade and industry to increasingly make use of bill financing
6. **Facilities for rediscounting**
   In order that banks are encouraged to accept bills as a viable mode o
   lending. it is imperative that abundant facilities for rediscounting the bills are available in the ill market instance, the central bank should be ready to rediscount bills throughout the year. In other words, the market
   should have a well-developed secondary market for commercial bills.

7.**Velocity of bills**

There must be a wide spread use of bills as a source of financing. This requires that there should be high velocity of circulation of bills, i.e. they should be discounted and rediscounted greater number of times.

8.**Existence of intermediaries**

There should be available adequate number of intermediaries such as commercial banks, other financial institutions, or an acceptance house facility for 'acceptance of bills at low cost. This will considerably reduce the risk of default. The intermediaries are expected to ensure smooth functioning of bill market

9. Credit information

Adequate information must be available to judge the creditworthiness of different parties. Credit investigating agencies play an important role in investigating and obtaining vital and credible information about the parties involved in the bill market.

SHORTCOMINGS OF INDIAN BILL MARKET

There are many reasons as to why the Indian bill market remains in a state of underdevelopment. They are briefly explained below:

Lack of Bill Culture

The trade and industry, and government departments are reluctant to move towards the bill culture, which requires observance of strict financial discipline, particularly on the part of borrowers. This hinders the growth of the Indian bill market.

Stamp Duty

In respect of transaction in Boulder in making of bills of Exchange, that isn't necessity of affixing stamp on each bill. Many a time, stamp papers of required denomination are not available. Besides, the amount of stamp duty is also high.

Inadequate Credit Rating

Credit rating in India is of recent origin. Services of specialized and expert credit investigating agencies or not adequately available so as to facilitate valid judgement about the credibility of the parties concerned. Further, credit rating has also become expensive.

Absence of active secondary market

Secondary market for bills is an important requirement for the development of an efficient bill market. Facilities such as rediscounting, etc are available only with the apex level financial institutions, thus curtailing the size of the bill market. Further, the bill acceptance service in the commercial bill market has been very much restricted. Similarly, the rediscounting facility is available only at Mumbai, Kolkata, Delhi, Chennai, Ahmedabad, Bangalore,Hyderabad, Nagpur, Kanpur, and Patna.

Administrative Problems

There are many administrative problems, which are faced by players in the bill market. These include physical
scrutiny of invoices accompanying bills to ensure that they are trade related, physical presentation of bills for repayment and requirement of physical endorsement and re-endorsement of bills at the time of rediscount.

Limited Forelign Trade

Whereas a bill market is required to be constituted for the purpose of financing foreign trade, it is unfortunate
that the developments in the volume of international trade transactions in India is relatively small and restricted
For example, in India, foreign trade as a percentage of national income has always remained small which has contributed to the small size of the bill market.

Lukewarm Government Support
There has been a lukewarm support from the government in encouraging the practice of bill financing. A large
part of the trading activity at the government level in India is carried on through public sector units like STC
MMTC, FCI, etc. Unfortunately, the government does not prefer financing its activities through commercial bills.

BILL MARKET SCHEME, 1952

Features
Under this scheme, introduced in the year 1952, RB1 grants advances under section 17(4)(c) of the Reserve Bank of india Act, to eligible scheduled banks against the security of usance promissory notes. The advances under the Scheme take the form of demand loans made by the Reserve Bank. The scheme was discontinued in November 1971. The salient features of the scheme were as follows:

1.Bill refinancing
The scheme, which was announced under section 17(4) (C) of RBI Act, enables the RBI to make retinancing advances to scheduled banks and other approved financial institutions against the security
of Assurance of promissory notes or bills drawn on and payable in India. For this purpose, the bills must be arising out of bona fide commercial or trade transactions bearing two or more good signatures, one of which should be that of a scheduled bank and maturing within 90 days from the date of advances.
2. Split of bank advances
To be able to avail refinance under the scheme, scheduled commercial banks
were required to convert a portion ot the loans/overdrafts and cash credits granted by them into usance
promissory notes, maturing within 90 days. Accordingly, the existing loan, cash credit, or overdraft accounts were, theretore, required to be split up into two: one constituting the advances covered by the demand promissory notes, and the other being converted into usance promissory notes with the RBI for advances as
eligible security for borrowing so as to replenish their loanable funds.

3.Quantum of refinance
The quantum of advance to be provided by the RBI shall not be more than the
amount lent by the scheduled banks to the respective borrowers.

4. Genuineness
The bills which are eligible for financial accommodation must have the certification that they have arisen out of bona fide commercial transactions and that the parties were creditworthy. To further establish the genuineness of the bills, RBI could also make such appropriate enquiries as it deems fit.

5.Concession
Refinance advance was made to banks under the scheme in the initial stages at a concessional rate of interest. As a further inducement to banks, the RBI agreed to bear halt the cost of the stamp duty
Incurred in converting demand bills into time bills.

6.Quantum of advance
Minimum limit of an advance, which could be availed, from the RBIat any time was RS. 25 lakhs. The minimum limit of individual bills tendered for that purpose was fixed at Rs. 1 lakh. the minimum limits were subsequently reduced from Rs. 25 lakhs to Rs. 10 lakhs (reduced further to 5 lak In February 1967), and from Rs. 1 lakh to Rs. 50,000. The scheme, which was initially restricted to licensed scheduled commercial banks having deposits (including deposits outside India)of RS.10 crore or more, was later on extended to all licensed scheduled commercial banks, irrespective of the size of their deposits.

BILL MARKET SCHEME, 1970

Features

Under this scheme, RBI may rediscount the bills of scheduled commercial banks under section 17(2) (a) of the Reserve Bank of India Act. Under this section, the Reserve Bank made available loans to the bank for the unexpired period of the bill concerned. RBI introduced the scheme with effect from November 1, 1970, keeping in view the recommendations of the "Study Group". Under this scheme, the eligible bank could rediscount the bills discounted by them, with the Reserve Bank of India. However, in November 1981, the Reserve Bank stopped rediscounting the bills under the scheme and permitted the banks to rediscount the bills with one another or with approved financial institutions.

The salient features of the modified scheme are as under:

1. Eligible institutions
Besides all scheduled commercial banks, selected urban cooperative banks, there were 21 other institutions such as the Export Import Bank of india, LIC Mutual Fund, Small Industries Development
Banks etc which became eligible to rediscount bills under the scheme.
2. RBI permission
Every eligible bank should obtain permission, for sanctioning limits, from the Reserve Bank. This was with regard to limits for rediscounting under the scheme for a period of 12 months ending
31st October each year.
3. Ineligible bills
The bills that are not eligible for rediscounting are:
a. Bills for sale and despatch of goods under the directives of selective credit control.
b. Bills arising out of sale of services or goods on hire purchase basis.

C.Usance promissory notes executed by buyers in favor of sellers.
d. Bills drawn on mercantile agents for goods sent on consignment basis.
e. Bills under rediscounting scheme of IDBI.

4. Banker's certificate

The bank wishing to avail of the rediscounting facility will have to certify that:
a. Bills are on account of genuine trade transactions.
b. The drawers of the bills are financially sound and creditworthy, and that their signatures are genuine.
c. The bank has clear title to the bil1.
d. The signatures of the accepting bank are genuine.

5. Depositing of bills

The banks seeking rediscounting facility were authorized to keep with them, on behalf of their Discounting Institutions, individual bills upto Rs. 10 lakhs. This was to avoid undue delay. For this purpose, the banks will have to submit a return in the prescribed form to the Discounting Institution giving all details of such bills.

6. Redelivery of bills

The banks can take delivery of bills lodged with the Discounting Institution 3 days before the date of maturity, by payment to the Discounting Institution. Where the bank desires, it can make payment earlier than the date of maturity and get a refund of the proportionate discount charged. In case of bills
lodged with the banks themselves, they should make payment to the Discounting Institution and re-endorse to themselves such bills, 3 days before their date of maturity.

Procedure for Rediscounting

Following are the steps involved in the bills rediscounting by the RBI.

1 Making an application to RBI in the prescribed form giving the estimated requirements for the 12 months ending October of each year.

2 Loading bills with the RBI for the purpose of rediscounting; however the actual lodgment of bills of face value of Rs, 2 lakhs and below was dispensed with and the banks were authorized to hold such bills with themselves. This limit was increased to Rs.10 lakhs in November 1973.

3. Sanctioning of limits by the RBI for a period of one year running from 1st November to 3 1st October of
the following year and taking delivery of bills by the rediscounting banker.

4. Presentment by the RBI

for payment of bills of exchange that are rediscounted by it.

Failure of Bill Market Scheme, 1970

Despite sincere efforts made by the RBI, the new bill market scheme did not take off well. Following are the reasons for the same:

1. Reluctance

There was reluctance among the Indian businessmen in accepting and appreciating financial discipline implicit in the new scheme. Moreover, the firm commitment for payment on maturity date, was not well appreciated by the parties concerned. Many big businessmen, particularly monopolists, considered the act of accepting a bill' as something against their prestige.

2. Limited coverage

The scheme suffered a setback because of its limited coverage. In fact, barring textiles,It excluded sensitive commodities covered by the selective credit controls by the RBI. Similarly, supplies to government departments were not initially covered, although the coverage was extended to them in July 1971. Further, due to operational difficulties, application of the scheme, for all practical purposes, was confined to the rediscounting centers alone

3. Poor response

Public sector undertakings, which occupied commanding heights of the economy, did not respond enthusiastically by allowing bill financing to take place in a liberal manner.

4.Restricted period

As against be normal credit period of six months to 9months in the case of the certain trades such as wholesale textile business, the scheme allowed only a credit limit upto 90 days. This restricted
the scope of the scheme.

5. Banker blues

Commercial banks, instead of approaching other banks for rediscounting bills, approached the RBI whenever there was an urgent need of funds making bill-rediscounting cheaper than call loans. Thus,RBI acted more as the lender of the first resort than as lender of the last resort. Moreover, small businessmen found it difficult to get bills accepted by banks, which is an essential requirement under the new scheme. The continued insistence of the banks to treat bills only as a security and the availability of alternate, less cumbersome and cheaper means of finance, have also restricted the growth of the bill market.

6. Lack of credit rating

When the new bill market scheme was launched in the seventies, there were no agencies to provide information about the credibility of firms or issues. In fact, credit rating agencies were non-existent before the setting up of CRISIL and ICRA.

IDBI BILL REDISCOUNTING SCHEME

The Industrial Development Bank of India introduced the Bill Rediscounting scheme in April l965.the features of the scheme are as follows:

Maximization of Sales

The scheme allows for the manufacturers of indigenous machinery/capital equipment to push up the sales of their products by offering to the prospective purchaser, the deferred payment facility. Moreover, the manufacturer obtains the value of the machinery within a few days of the delivery by discounting with his banker, the bill a exchange/promissory notes arising out of the sales of the machinery.

Use of Fixed Assets
The mechanism of bill rediscounting helps the purchaser of the machinery to utilize the machinery acquired and repay the amount over a number of years.

Industrial Development
The scheme facilitates the sale of machinery thus contributing to the industrial progress of the country.

Working of the Scheme
The prospective purchaser of indigenous machinery approaches the manufacturer/seller for the supply of
machinery on deferred payment terms under the IDBI's Bills Rediscounting Scheme. The manufacturing cost of
machinery, excluding the advance payment, is subdivided into half-yearly/yearly installments. A separate
bill promissory note is drawn, made for each installment plus interest in respect of deferred payments. Machinery
is delivered and the bill/promissory note is accepted/guaranteed by/on behalf of the purchaser.

Eligible Industry
Firms engaged in all manufacturing activities in the country such as industries making automobiles and
agricultural machinery and equipments, etc both in the public and private sectors, are eligible to avail the
benefits under the scheme. However, sale of machinery for Vanaspati manufacturing, Brewery and Malt manufacturing industries require prior approval of the IDBI. The facilities that are required for industrial use
only are eligible. Prior approval of the IDBI would also be required where the machinery is not required for industrial use. Moreover, the assistance under the scheme is generally available only in respect of complete supply of machinery/capital equipment and is not available for purchase of machinery required for setting upnew projects except small-scale industrial units.

Period of Credit
The period of deferred payment for the sale of machinery to be covered under the scheme is counted from the date of despatch of machinery or from the date of execution of bills/promissory notes, whichever is earlier. It should range from 6 months to 5 years. The period may be extended upto 7 years in deserving cases with the prior permission of the IDBI.
Quantum of Assistance
The minimum amount or transaction covering a set of bills/promissory notes eligible for rediscounting has been fixed at Rs. 10,000. It is not necessary that this transaction should relate to the purchase of single machinery only. It may even cover more than one machine.

GENERAL REASONS FOR FAILURE OF BILL MARKET SCHEME

Despite a plethora of measures adopted by the RBI over the years, to revamp and rejuvenate an otherwise sick Indian bill market, it suffers from the following handicaps:

Weak Participants

Most of the customers in the bill market are SSI units. These are the weak customers who approached banks/NBFCs for discounting of bills. It is rather difficult to assess the credit worthiness of such enterprises.

Lack of Genuine Bills

In many occasions, kite bills or accommodation bills were used for the purpose of bill financing. This practice of drawing bills without any underlying movement of goods caused considerable damage to the bill market scheme. As the funds obtained through this practice were generally diverted to earn a very high return, this severely affected the genuine bill market. Moreover, such a practice also imparted a false liquidity to the system.

Supply Bills

Supply bills are those that are drawn by suppliers/contractors in Government departments. The Government did not accept these bills although contractors are able to get them discounted with nationalized banks. Whenever there was any default committed by the Government, the dues were simply debited to the 'Government A/c'. This practice very much affected the level of cash flow in the bill market.

Lack of Corporate Enthusiasm

There was lukewarm support from corporate houses and business groups. Such attitude never encouraged bill culture and bill financing.

Stamp Duty

The practice of not levying stamp duty in respect of bills upto 90 days contributed to the lopsided growth of the bill market. In most of the cases, it became a general practice to draw bills only upto 90 days. This affected the depth of the bill market.

REVITALIZING BILL MARKET

In the light of the past experience in the bill market scheme over several years and in order to revitalize it on basis of the recommendations made by several committees, the RBI initiated the following measures:

Interest Rate

The ceiling rate of interest on advances was lowered by the RBI from 17.5 percent to 16.5 percent and later 15.5 percent. RBI also fixed the interest rate on bills one percentage point below the new maximum lending rate. Similarly, with a view to attracting market players with surplus funds, such as UTI, LIC, etc to the bill market, the ceiling on rediscount rate was increased from 11.5 percent to 12.5 percent.

Restricting Receivables Advance
With effect from April 1, 1988, RBI advised the banks that only 75 percent of the receivables would be eligible for the drawing power on cash credit/overdraft facility. The remainder 25 percent is to be met through demand/usance bills.

Stamp Duty
With effect from July 23, 1988 and subject to certain conditions, stamp duty on the following usance bills of exchange was waived by the government:
1. On bills that are payable not more than 90 days after date or sight
2.On bills that are drawn on or made by or in favor of a commercial bank or a cooperative bank.
3.On bills that arise out of a genuine commercial or trade transaction.

Derivative Promissory Note
An innovative instrument called 'derivative usance promissory note was introduced by the RBI from September 1988. Under this mechanism, banks were permitted to issue derivative usance promissory note for a
period not exceeding 90 days under the strength of underlying bills.

DFHI
For the purpose of promoting and strengthening the secondary bill market, the government set up a premier money market institution, called the 'Discount Finance House of India Ltd.' in April 1988. This was considered an essential step towards ushering in a developed bill market. DFHI obtains refinance from RBI. With sound financial resources at its command; it is able to offer a rediscounting facility to its client-bankers. Further, DFHI offers two-way quotes for buying and selling rediscounted bills.

Certificate of Deposit (CD) Market
A market for the purchase and sale of certificates of deposit is called Certificate of Deposit (CD) market. It is an important constituent of the money market.

Meaning of CDs:
A marketable document of title to a time deposit for a specified period may be referred to as a 'Certificate of
Deposit' (CD). It takes the form of a receipt given by a bank or any other institution for funds deposited with it
by the depositor.

Features
Certificates of Deposit possess the following distinguishing characteristics:

1. Negotiable instruments

CDs are negotiable term-deposit certificates issued by commercial
banks/financial institutions at discount to face value at market rates. The Negotiable Instruments act.

2.Maturity

The maturity period of CDs range from 15 days to one year

3.Nature

CDs are in the form of usance promissory notes and hence easily negotiable by endorsement.

4. Ideal source

CD's Constitute a judicious source of investments as these certificates are the liabilities of commercial banks/financial institutions.

... banks/financial institutions

TIME DEPOSIT Vs. CERTIFICATE OF DEPOSIT

A Certificate of Deposit is different from a Conventional Time Deposit in the following manner:

Sl. No.	Feature	Conventional Time Deposit	Certificate of Deposit
1.	Negotiability	Not freely negotiable	Freely negotiable
2.	Stamp Duty	Not subject to stamp duty	Requires stamp duty, as it is in the nature of usance note
3.	Period	Can be for any period	Can be for 3 to 12 months when issued by banks and for 1 to 3 years when issued by specified all-India financial institutions
4.	Issue at discount	Cannot be issued at discount	Can be issued at discount
5.	Limits of deposit	No limit on the minimum and maximum amount	Minimum size of a single CD is Rs. 5 lakhs and the minimum size of an issue to a single investor is Rs. 25 lakhs

ROLE OF DFHI

The Discount and Finance House of India Ltd. functions as a market maker in the CDs market. It offers a bid rate, the rate of discount at which it is prepared to buy CDs, and an offer rate at which it would be willing to sell the CDs. The DFHI acts as an ideal conduit for disinvestments of CD holdings, which is done through their banker in Mumbai. DFHI also engages in buying CDs from the bank at its bid discount rate. Settlements are effected
through RBI cheque.

Treasury Bill market

A market for the purchase and sale of treasury bills is known as a Treasury Bills Market.

TREASURY BILLS (TBs)

A kind of finance bills, which are in the nature of promissory notes, issued by the government under discount for a fixed period, not exceeding one year, containing a promise to pay the amount stated therein to the bearer of the instrument, are known as 'treasury bills'.

GENERAL FEATURES

Treasury bills incorporate the following general features:

1.Issuer

TBs are issued by the government for raising short-term funds from institutions or the public for bridging temporary gaps between receipts (both revenue and capital) and expenditure

2. Finance bills

TBs are in the nature of finance bills because they do not arise due to any genuine

3.Liquidity

TBs are not self liquidating like genuine trade bills, although they enjoy higher degree of liquidity

4.Vital source

Treasury bills are an important source of raising short-term funds by the government

5.Monetary management

TB's device on important all of monetary management is the body central bank of the country to inches security into the economy.

FEATURES OF INDIAN TBs

History

It was in the year 1877, that Treasury Bills (TBs) came to be issued for the first time in the world. Later, it acquired wide popularity around the world both in developing and developed countries. TBs were first issued in India in October 1917. The issue aimed at raising resources for financing the First World War efforts of the
government and for mopping up excess liquidity in the economy due to heavy war expenditure.
TBs that were initially sold by the government had a maturity period of 3 months, 6 months, 9 months and
12 months. Later on, with the setting up of the RBI in 1935, the issue profile of TBs underwent a lot of changes. Accordingly, RBI came to issue two type of TBs such as Tap Bills that were issued at all times and Intermediate Bills that were sold between auctions, to nongovernment investors. However, in the year 1965, sale of TBs to
public through auction was suspended and issue took place on tap basis at a discount. Thus commercial banks
began to invest in them.

The Gilt edged securities Market

It is the market in government securities or the securities guaranteed (as to both principal and interest) by the government. The former includes securities of the government of India and of the state governments. The gilt-edged market may be divided into two parts – the treasury bills market and the government bond market. As far as the government bond market is concerned, on the borrower side, the RBI manages entirely the public debt operations of the central as well as that of the state governments.

GOVERNMENT SECURITIES-FEATURES

Following are the characteristics of a Government securities/market, which plays a significant role in the Indian
stock market:

Agencies
Government securities are issued by agencies such as Central Government, State Governments, semigovernment authorities like local Government authorities, e.g.city Governments and municipalities, autonomous institutions such as metropolitan authorities, port trusts, improvement or development trusts, state electricity boards, Public Sector Enterprises, and other Governmental agencies like IDBI, IFCI, SFCS, NABARD, LDBS, SIDCS, housing boards etc. These agencies supply government securities. The demand essentially emanates from banks, financial institutions and other investors.
RBI's Special Role
RBI takes a special and an active role in the purchase and sale of these securities as part of its monetary management exercise. There is no underwriting or guaranteeing required in the sale of Government securities,as RBI is policy-bound to buy a substantial portion of the loan unsubscribed by the public. Dealings in Government securities take place through the mechanism provided by the RBI. The brokers and dealers including banks approved by the RBI are eligible to deal in these securities.

Nature of Securities
Securities offer a safe avenue of investment through guaranteed payment of interest and repayment of principal by the Government. They offer relatively a lower fixed rate of interest compared to interest rates on other securities. They are issued in the denominations of Rs. 100 and Rs. 1000. They have a fixed maturity spanning a period of time. Interest is paid half-yearly. RBI services loans as these are the liabilities of Government of India and the State Governments. This makes the securities safe and risk-free. Further, these securities are eligible asSLR investments. These are also known as 'dated government securities' as the date of maturity is specified in the securities.

Liquidity Profile
The liquidity profile of gilt-edged securities varies. Accordingly liquidity profile of securities issued by Central Government is high. However, the securities issued by State Governments and local Government organizations have limited liquidity.

Tax Rebate
A striking feature of these securities is that they offer wide-ranging tax incentives to investors. This has made these securities are very popular. Rebates for investment in these securities are available under the Income Tax and other Acts.

Market

As each sale and purchase has to be negotiated separately, the gilt-edged market is an 'over-the-counter market. The Government securities market in India has two segments namely primary market and secondary market. The issuers such as the Central Government and State Governments constitute the primary market. The secondary market comprises banks, financial institutions, insurance companies, provident funds, trusts, individuals, primary dealers and Reserve Bank of India.

Forms

The securities of Central and State Government take such forms as inscribed stock or stock certificate, promissory note and bearer bond. The securities such as bearer bonds and stock certificates are not popular with Indian investors.

READY FORWARD CONTRACTS (REPOS)

Meaning

A transaction in which two parties agree to sell and repurchase the same security is known as 'ready forward contract' or 'Repos' or 'buyback deal'. This arrangement provides for the seller to sell specified securities with an agreement to repurchase the same at a mutually predetermined future date and price, and the buyer to purchase the securities with an agreement to resell the same to the seller at a predetermined future date and price.

Benefits/Features

1. Interest rate Being collateralized loans, repos help reduce counterparty risk and therefore, fetch a low interest rate.

2. Contract The repo contract provides the seller-bank to get money by parting with its security and the buyer-bank in turn to get the security by parting with its money. It becomes a Reverse Repo deal for the purchaser of the security. Securities are sold first to a buyer by a bank and simultaneously another contract is entered into with the buyer to repurchase them at a predetermined date and price in the future. The prices of sale and repurchase of securities is determined before entering into the deal.

3. Hedge tool As the purchaser of the repo acquires title to the securities for the term of the agreement, andas the repurchase price is locked-in at the time of sale itself, it is possible to use repos as an effective hedge tool to arrange another repo or to sell them outright or to deliver them to another party to fulfill a delivery commitment in respect of a forward or future contract or a short sale or a maturing reverse repo.

4. Safety Repo is an almost risk-free instrument used to even-out liquidity changes in the system. Repos
offer a safe short-term outlet for temporary excess cash at close to market interest rates.
5. Participants Securities dealers, commercial banks, DFHI, STCI, RBI and cooperative banks are allowed to
participate in the repos market. According to the recent RBI monetary policy, nonbank financial companies,
LIC, GIC, UTI, and the corporates are also allowed to participate in this market. This is with effect from March 3, 2003. The new entities will be able to enter the repo trade through their gilt accounts maintained with
the custodians under the Constituent Subsidiary General Ledger (CSGL) facility. Repo transactions could be
undertaken by the RBI-regulated entities only in securities held in excess of the prescribed SLR. Although banks can resort to repo transactions among themselves and with DFHI, RBI and STCI, major repo deals take place in practice, between banks and RBI, or between banks and DFHI or STCI rather than between banks. NSE can also be used for carrying out repo transactions. Repo transactions are arranged over-the-counter by telephone either by direct contact or through a group of market specialists and can be used in respect of CPs, CDs, TBs, government dated securities, etc.
6. Uses
As low-risk and flexible short-term instruments, repos are used to finance securities held in trading and investment accounts of security dealers, to establish short positions, to implement arbitrage activities besides meeting specific customer needs. They offer low-cost investment opportunities with combinations of yield and liquidity. It is possible to enhance the safety of repo transactions by marking the security price to the market and by providing a margin on the security value.

Government Bonds

A government bond is a debt instrument issued by the Central and State Governments of India. Issuance of such bonds occur when the issuing body (Central or State governments) faces a liquidity crisis and requires funds for the purpose of infrastructure development.

Types of Government Bonds in India?

The multiple variants of Government bonds are discussed below –

1.Fixed-rate bonds

Government bonds of this nature come with a fixed rate of interest which remains constant throughout the tenure of investment irrespective of fluctuating market rates.

2.Floating Rate Bonds (FRBs)

As the name suggests, FRBs are subject to periodic changes in rate of returns. The change in rates is undertaken at intervals which are declared beforehand during the issuance of such bonds. For instance, an FRB could have a pre-announced interval of 6 months; which means interest rates on it would be reset every six months throughout the tenure.

3.Sovereign Gold Bonds (SGBs)
The Central Government issues sovereign Gold Bonds, wherein entities can invest in gold for an extended period through such bonds, without the burden of investing in physical gold. The interest earned on such bonds is exempted from tax.

4.Inflation-Indexed Bonds
It is a unique financial instrument, wherein the principal, as well as the interest earned on such bond, is accorded with inflation. Mainly issued for retail investors, these bonds are indexed as per the Consumer Price Index (CPI) or Wholesale Price Index (WPI). Such IIBs ensure real returns accrued with such investments remain constant, thereby allowing investors to safeguard their portfolio against inflation rates.

5.Bonds with Call or Put Option
The distinguishing feature of this type of bonds is the issuer enjoys the right to buy-back such bonds (call option) or the investor can exercise its right to sell (put option) them to such issuer.

6.Zero-Coupon Bonds
As the name suggests, Zero-Coupon Bonds do not earn any interest. Earnings from Zero-Coupon Bonds arise from the difference in issuance price (at a discount) and redemption value (at par). This type of bonds are not issued through auction but rather created from existing securities.