

Financial Institutions and Markets
Prof. Jitendra Mahakud
Department of Humanities and Social Sciences
Indian Institute of Technology, Kharagpur

Lecture - 39
Miscellaneous Short-Term Money Market – I

In the previous class we discussed about the into two different important markets, particularly the Short Term Money Market which works in the Financial System that is your call money market and we have the Treasury Bills Market. Call Money Market is an interbank market and the Treasury Bill Market is basically a short term government securities market through which the Reserve Bank of India tries to control the money supply in the economy as a whole.

And there is an auction process which works for the pricing or the yield determination of the treasury bills. Apart from this treasury bills market and the call money market, we have other market which also work in this particular system. What are those markets? This markets include your commercial papers, it include certificate of deposits, commercial bills then, you have a discount market. So, there are different types of other market also work in this particular system and which are mostly related to short term securities.

So, keeping those things in mind we will be discussing all those markets that how this market work and who are those participants this in this market, what is the maximum term to maturity of the securities which are traded in this market and who are those investors and who are those measures stakeholder and what kind of responsibilities they play whenever we participate in this particular segments. So, these are the major things what we will be discussing in this session which is basically known as the we have named it that miscellaneous short term financial market.

And those certain financial market miscellaneous certain financial market also plays the role for raising the capital for the different entities and as well as also play the role for the money supply in the economic system.

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What is Commercial Paper?

- ▶ CP is an unsecured money market instrument issued in the form of a promissory note by a corporation with high credit ratings to finance its short-term needs.
- ▶ CPS can be issued in a wide range of denominations, can be either discounted or interest-bearing, and usually have a limited or nonexistent secondary market.

Unsecured

Company financing for investment's

Long term bonds

Short term bonds

High

Unsecured

So, then let us see that what is the first one. The first one is the Commercial Paper. What do you mean by a commercial paper? The commercial paper is an unsecured money market instrument which is issued in the form of a promissory note by the corporation with high credit ratings to finance its short term needs.

If you see that already you might have heard about this thing. Whenever the there is a company the company basically try to raise the financing for the investment, financing or investments. So, whenever the company raises the money for financing, the investments and the financing is divided into two parts; your long term financing and you have the short term financing. The long term financing includes the either they can raise the money from the banks or they can go for the long term bonds, but whenever you talk about the short term financing, here also they can raise from the money from the banks or the short term bonds.

So, here one of those sources is basically your commercial paper. The commercial paper is basically an unsecured instrument. It is one thing you remember that is unsecured. That means, whenever we raise the money through this commercial papers, we do not take any kind of collateral against that. That is why it is an unsecured money market instrument and another thing also you can keep in the mind with high credit ratings.

That means the companies who can issue this commercial paper, the rating of that credit rating of that particular company should be very high. There are certain kind of limits in

terms of the credit ratings which are given and the particular company which has this kind of rating or more than that rating those companies are able to raise the money through these commercial papers as a short term financing instruments. Then the CPs basically if you see the commercial papers these are issued in wide range of denominations. This can be either discounted interest bearing and usually have a limited secondary market.

Commercial paper market in India is not very developed and reasonably it is a new market and the secondary market all of you know that there are two segments of each market. We have a primary market, we have a secondary market. For investment point of view the existence of the secondary market in the context of commercial papers is relatively very underdeveloped in comparison to its primary segment and it is always can be either discounted and or the interest bearing. So, both ways this particular instrument is issued for the investment in this particular segment. That is what always you keep in the mind.

So, this is the basic definition of commercial paper and the objective already you know that why the commercial papers are issued. The commercial papers are issued only to financing the short term investments of the companies and the corporations have companies with the high credit ratings are eligible to issue these commercial papers. So, this is the definition or the nature of the commercial paper.

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The slide is titled "Characteristics of CPs" and lists the following points:

- CPs can be **issued** on discount to face value basis or on a fixed interest basis.
- ▶ CPs are **unsecured, negotiable** by endorsement and normally have a **buy-back facility**
- ▶ CPs as a **source of short-term debt** regarded as **highly safe, simple, flexible, and quality liquid** instrument

Handwritten notes in pink ink on the slide read: "Short-term debt instrument to which Commission is being paid".

The slide features the Swamyam logo at the bottom left and a video inset of a man speaking at the bottom right.

Then, we will see that what are those characteristics of this particular commercial paper? Commercial papers are can be issued a discount to the face value or on a fixed interest rate basis.

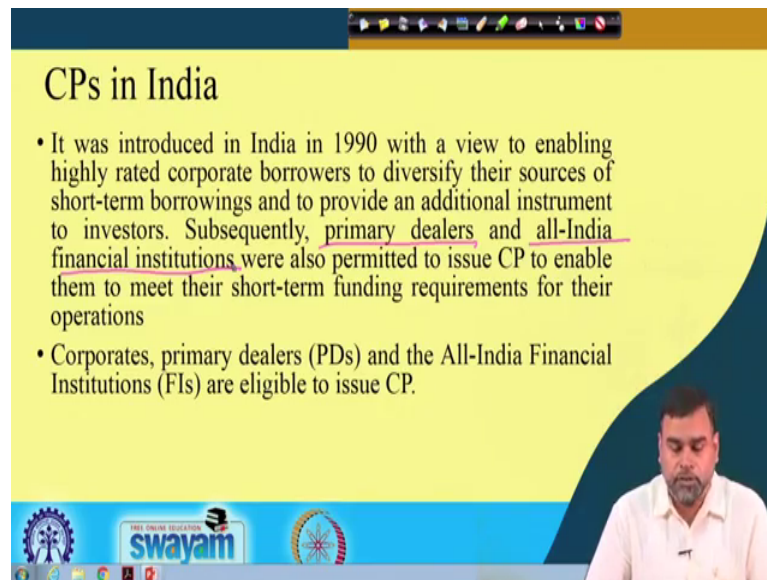
The particular instrument already can be issued at discounted redeemed at par or it can be issued on a fixed interest rate basis. A minimum a fixed amount of interest rate can be charged whenever anybody invest in the commercial paper and that is the way the money is basically raised from the market and another characteristics we have this is unsecured and this is also negotiable and it has a also a buyback facility. Buyback facility means the corporation who has issued this commercial paper, there is a possibility they can buyback that particular to instrument buyback that particular paper from this investor.

So, it is unsecured. That means, it does not carry any collateral, it is a negotiable and as well as there is a buyback facility involved in that and it can be issued with discount or also it can be issued with a fixed interest rate basis. That is also possible for this particular instruments. So, that is why it is a source of short term depth which is regarded as a highly sep simple flexible and quality liquid instrument. Why we call it as a liquid instrument? Because already you know that this is very much short term in nature. So, if it is short term in nature, then liquidity means already you know how fast it can be easily converted into cash.

So, the conversion to cash is very fast. So, as conversion to cash is very fast, what we can say this is that is why we call it is a quality liquid instrument which can create the credit liquidity which can create the liquidity in the market reasonably faster and it is flexible and also the simple there is no such kind of complexity for issuing this if this particular instrument or this particular company has the minimum amount of rating or the adequate amount of rating who which is eligible or make them eligible to issue that particular security in the financial system.

So, that is why these are the major characteristics of the commercial papers always we observe.

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CPs in India

- It 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
- Corporates, primary dealers (PDs) and the All-India Financial Institutions (FIs) are eligible to issue CP.

Then we have to see that how this particular commercial papers are working in India. If you consider from the Indian point of view this was introduced in 1990. . That is why I said it is a reasonably new instrument in comparison to the other financial instruments which are traded in the market and what was the objective. The objective was to enable the highly rated corporate borrowers to diversify the their sources of short term borrowings because the companies always issue the short term depths. The companies issue the short term depths to for financing their short term investments or the short term requirements.

So, in this context what is happening? It is basically an additional instrument with the bank borrowings and other type of bonds what they issue to the market to raise the money for they are called investments in the future. So, that is why the commercial paper is considered as an additional borrowing instruments for the companies and this is basically through that the corporate sector can diversify there short term securities or short term financing instruments to make their investments feasible or possible and it is also the primary dealers and All India Financial Institutions were also permitted to issue the commercial papers to enable them to made their certain funding requirements for their operations.

In India there are certain primary dealers, in India there are certain primary dealers and as well as the all India Financial Institutions there are certain All India Financial

Institutions who are also allowed to do the business to raise the money through the commercial paper. That is also possible in the Indian context. So, this is what basically the commercial paper is and this is why basically the commercial paper is used in the market for this short term debt, fulfillment of the short term requirements of the companies for their short term investments. That is why if you see the summary, the corporates primary dealers and All India Financial Institutions are eligible to issue the commercial papers in the market.

This is what about the issuance of this particular security or who are eligible to issue that particular security in the Indian Financial System.

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The slide is titled "CPs in India" and lists the following guidelines:

- The tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs.4 crore
- CP can be issued in denominations of Rs.5 lakh or multiples thereof.
- The fund based working capital of the company should not be less than 4 crore
- Every issue of CP, including renewal, should be treated as a fresh issue.
- There is no lock in period for CPs

Handwritten notes in pink ink on the slide include: "Short-term Capital", "Short-term requirements of the Company", and "4 crore".

The slide also features the Swayam logo and a video feed of a presenter in the bottom right corner.

Then already we show that there are certain guidelines, there are certain guidelines through which we can understand that which are those companies who can issue the commercial papers, which are those companies who can issue the commercial papers. The first thing there are certain kind of norms, there are certain kind of guidelines which are issued by the regulatory bodies to see that whether this particular company is able to meet those kind of norms, those kind of conditions.

Then only those kind of organizations, those kind of companies are able to issue that. What is the first one? The first one who has the tangible net worth of the company as for the latest audited balance sheet not be less than 4 crore. Remember the tangible net worth of the company should not be less than 4 crore. That is the first point, then these

commercial papers can be issued in denominations of rupees 5 lakhs or the multiples of that. The minimum denominations of the commercial paper says rupees 5 lakhs or the multiples of that the fund based working capital of the companies should not be less than 4 crore rupees that is another one. This fund based working capital of the company should not be what do you mean by the working capital.

You know that the what do mean by the working capital. The working capital means the short term capitals. The short term requirements of the companies short term requirements of the companies it can be the day to day expenses, inventories and all kinds of things which are coming under the working capital. So, the fund based working capital of the company should not be less than 4 crore and every issue of commercial papers or including renewal should be treated as a fresh issue, any kind of additions to the commercial paper is considered as a fresh issue or even if the existing council papers if it is again renewed, 2nd time or 3rd time that is also considered as the fresh issue in the market.

And there is no lock in period for the CPs. The CPs have no lock in period do you know. What do you mean by the lock in period? Whenever you invest in a particular security up to a particular time period, you cannot redeem it. For example, whenever you are investing in a particular kind of deposits or particular kind of instruments up to 3 years or up to 2 years depending upon the type of instrument; if you even if you want, you cannot redeem that particular security and he can get back your money, but if in the case of the commercial papers this particular instrument has no such lock in period. So, this is more or less more often and this can be redeemed or this can be basically again traded in the market at any point of time if the investor wants. So, that is the way basically the commercial papers are defined in India and the companies who are eligible to issue this.

This would have the minimum rating. This would have the minimum rating that we will see that what kind of everything they need.

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CPs in India

- CP can be issued for maturities between a minimum of 7 days and a maximum up to one year from the date of issue (since October 2004).
- Individuals, banking companies, other corporate bodies (registered or incorporated in India) and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs) etc. can invest in CPs.
- The total amount of CP proposed to be issued should be raised within a period of two weeks from the date on which the issuer opens the issue for subscription.
- Mandatory credit-rating for issuance of Commercial Paper. The minimum credit rating shall be P-2 of CRISIL and A2 for ICRA.

So, the CPs maturity period is between minimum 7 days and maximum up to 1 year already. We told you that the money market instruments in the system maximum maturity period is up to 1 year and some cases it can go up to 3 years, but generally we consider the maturity period of the money market is up to 1 year from 1 day 1 day to 1 year. The maturity period varies. So, that is why in this context if you see the CPs can be issued for the maturity between 7 days to maximum up to 1 year and this is basically started since October 2004.

Who can invest in the CPs? Individuals, banking companies, other corporate bodies, registered or incorporated in India, non-resident Indians FIIs, everybody can invest in CP chip demand as a sort of investment. The CPs basically are open to all type of entities both retail it is applicable or it is available for retail investor and as well as the institutional investors. It is available to both retail investor and the institutional investor. If anybody wants to invest in that, then those kind of investors are eligible to invest in this kind of security. The total amount of commercial paper propose to be issued should be raised within a period of 2 weeks from the date on which the issuer opens the issue for the subscription.

The maximum 2 weeks maximum 2 weeks are given to subscribe that particular issue and to raise the money from the market. The total window period if anybody wants to raise the money through the commercial papers, the total period will be given 15 days or

the 2 not 15 days, it is basically 2 weeks and within that 2 weeks the issuance of that particular instrument will be over, then investor has to subscribe that issue within that particular stipulated period and I was talking about the credit rating. The minimum rating what the companies would have to issue the commercial paper that is your, it shall be it should be P-2 of the Crisil and A2 for the ICRA.

Different rating agencies give the different names for the rating. So, we were discussing about the different type of rating agencies which are existing in India. We have the Crisil, we have the ICRA, we have the KR. So, these are the major rating agencies which were functioning in the Indian Financial System. So, if you go by those kind of rating agencies the companies who are eligible to issue that particular kind of securities that particular kind of instrument should have the minimum rating of P-2 if it is issued by crisil and it should be minimum A2 if it is issued by the ICRA. So, this is what basically about the who are those investor and what is the maturity period of the commercial papers and what is the subscription period of the commercial paper and what kind of minimum rating the company should have to issue the commercial papers in the market.

So, this is another certain features always we observe in the Indian context.

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The slide is titled "CPs in India" and contains the following bullet points:

- Only a scheduled bank can act as an IPA for issuance of CP.
- CPs are actively traded in the OTC market. Such transactions, however, are to be reported on the FIMMDA reporting platform within 15 minutes of the trade for dissemination of trade information to market participation thereby ensuring market transparency.
- When the CP is held in physical form, the holder of the CP shall present the instrument for payment to the issuer through the IPA.
- When the CP is held in demat form, the holder of the CP will have to get it redeemed through the depository and receive payment from the IPA.

Handwritten notes in pink ink on the right side of the slide include:

- "Company - A" with an arrow pointing to the first bullet point.
- "Bank - B" with an arrow pointing to the first bullet point.
- "Depository - I" with a circle around the letter 'I' and an arrow pointing to the second bullet point.

The slide also features a video feed of a presenter in the bottom right corner and logos for "swayam" and "THE UNION EDUCATION" at the bottom.

Then here what is happening whenever we the commercial papers are issued, the companies always apparent one IP issuing and paying agent for the issuance of the commercial paper because all of you know that India is a bank dominated economy.

Mostly all kind of payment transactions gateway always we always use the banks, but any of the commercial banks are responsible to go for or is responsible for making the transactions related to that kind of instruments or that kind of trading we always any scheduled commercial bank in the country is always act as an IP. IBM means it is where we refer to issuing and paying agency for issuance of the commercial paper.

They are actively traded in the OTC market for over the counter market and such transactions once it is traded in the OTC market, the particular transactions details has to be reported to the FIMMDA reporting platform within 15 minutes of the trade because that information or trade information should come to all market participants to make the market more transparent. If it is available in the FIMMDA platform, then everybody has the idea that what kind of transactions, what is the demand and supply in that particular segment everything would be clear whenever it comes to the FIMMDA platform. So, because of that even if this particular trading takes place in the OTC market, the information has to come to the FIMMDA trading platform within the 15 days.

The CPs can be held in the physical form and the CPs also can be held in the demat form. We have we can have a demating count to invest in the commercial papers; we can also invest in the CPs in terms of the physical bond. So, if the CPs are in the physical form, then the holder of the commercial papers always present this instrument for payment to the issuer through the IP. For example, if the company A the company A has issued that particular commercial paper and bank is B, then the investor is I, then for if this I is holding that thing in the physical form, then the I has to contact the B for any kind of transactions and B will deal with A.

Investor will go to the bank which is act as IPA and the IPA deals with the company and because IPA is basically recruited by or maybe chosen by the company A who always does this IP business or IP activities on behalf of the company A. So, this kind of transactions are all done through the bank B and the investor always contacts the IPA for any kind of payment or any kind of repayment of that particular transactions, of that particular security. If the IPA is held in the demat form again the holder of CP will have to get it redeemed through the depository and receive the payment from the IPA. The depository agencies are responsible for redemption of that, but the payment again come through the commercial bank who is acting as an IPA for that particular company who has issued that particular commercial payment.

So, because of that it can be that means what here what we have seen the commercial papers can be hold in terms of the physical asset or a physical bond or it also can be held as a demat form and the IPA plays a significant role or is an intermediary between the investors and the issuer for any kind of transactions which may happen in the market. So, this is about the kind of how the transactions happen in this particular segment.

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Role and responsibilities of the Issuer

- Every issuer must appoint an IPA for issuance of CP.
- The issuer should disclose to the potential investors its financial position as per the standard market practice.
- After the exchange of deal confirmation between the investor and the issuer, issuing company shall issue physical certificates to the investor or arrange for crediting the CP to the investor's account with a depository.

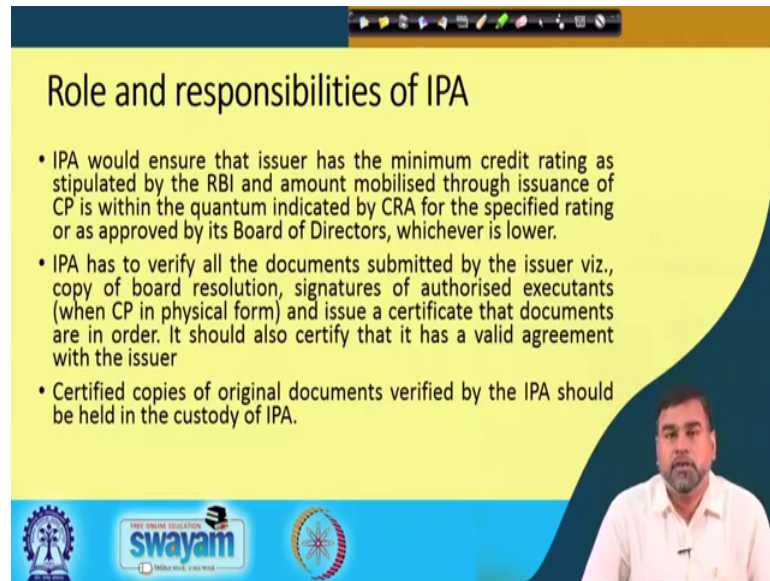
Then what is this? What is the role of the issuer? What the issuer has to do? The issuer always first of all for any kind of transactions the; if the issuer one should do with respect to CP or the commercial paper. The first job of the issuer is they should appoint an IPA or issuing and paying agency.

And the issuer also should disclose to the potential investors its financial position as for the Standard Market Practice. What does it mean? The issuer should say that make this balance it balance it public all kind of profitability ratios, structure of the board, everything all kind of market disclosure which are required. So, everything has to be always made public and the investor will get the idea that what kind of company it is and also the credit rating whatever rating the company has. So, everything will be reported or everything will be informed to the potential investor and after the exchange of deal confirmation between the issuer between the investor and the issuer.

The issuing company always issue the physical certificate to the investor or arrange for crediting the commercial paper to the investors account with the depository if it is in the

demat form. So, this is the job of the responsibilities of the issuer whenever any kind of major thing is, they have to happen an IPA and they have to disclose their all the financial data or the financial information to the public to the potential investor for transparency making this particular system transparent. So, this is what the responsibility of the issuer is.

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Role and responsibilities of IPA

- IPA would ensure that issuer has the minimum credit rating as stipulated by the RBI and amount mobilised through issuance of CP is within the quantum indicated by CRA for the specified rating or as approved by its Board of Directors, whichever is lower.
- IPA has to verify all the documents submitted by the issuer viz., copy of board resolution, signatures of authorised executants (when CP in physical form) and issue a certificate that documents are in order. It should also certify that it has a valid agreement with the issuer
- Certified copies of original documents verified by the IPA should be held in the custody of IPA.

Then we have the what are those responsibility of the IPA. The IPA always ensure that the issuer has the minimum credit rating as stipulated by RBI to issue that particular IPO.

They should also ensure that the amount of the amount mobilized to the issuance of CPs within the limit indicated by the CRA Credit Rating Agency for the specified rating or as approved by the board of directors whichever is lower, then IPA also has the responsibility to verify all the documents submitted by the issuer like copy of the board resolution, signature of the authorized executives and issue and issue a certificate, the documents are in order and is also certified that it has a valid agreement with the issuer. This would have a valid agreement with an issuer and the issuer fulfills all the criteria for the issuance of commercial papers. That is the responsibility of the IP and the certified copies of the original documents verified by the IPS would be held in the custody of the IP.

Everything is basically the IPA is the meditating agency which works between the issuer and the investor in the CP market.

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Role and responsibilities of Credit Rating Agency

- Code of Conduct prescribed by the SEBI for CRAs for undertaking rating of capital market instruments shall be applicable to them (CRAs) for rating CP.
- Further, the credit rating agencies have the discretion to determine the validity period of the rating depending upon its perception about the strength of the issuer. Accordingly, CRA shall at the time of rating, clearly indicate the date when the rating is due for review.
- While the CRAs can decide the validity period of credit rating, CRAs would have to closely monitor the rating assigned to issuers vis-a-vis their track record at regular intervals and would be required to make its revision in the ratings public through its publications and website

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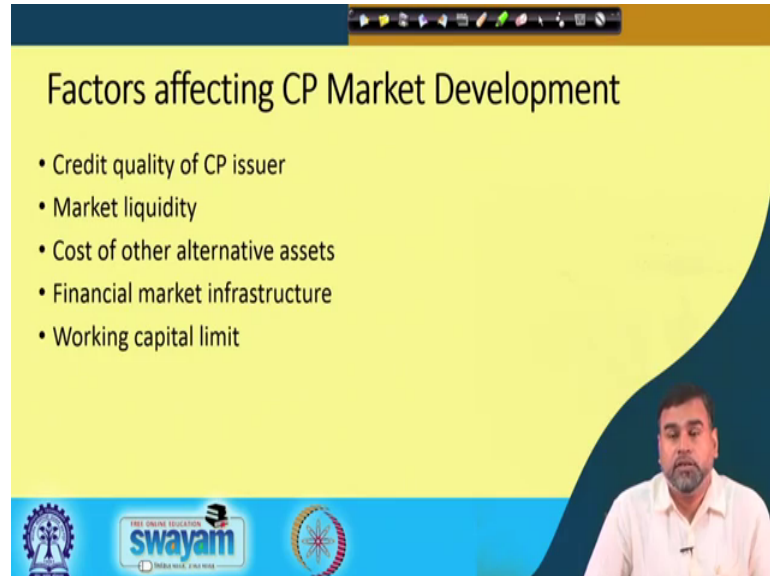
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Then there is a responsibility of the Credit Rating Agency. They have a very strong role. The code of conduct prescribed by the SEBI for undertaking the rating of capital market instrument shall be applicable to them. For all kind of rating of the CPs, they have the credit rating agencies have the discrimination to determine the validated period of the rating depending upon its perception about the strength of the issuer and accordingly this all at the time of rating clearly indicate that when the rating is due is review.

For example the particular thing is issued on let some date and the rating is valid up to 1 year rating is valid up to let 6 months and these issuance, the issuer is trying to make this particular maturity period 1 year. They cannot do that. The reason is the validity period of the credit rating is basically up to 1 year, now up to 6 months. So, because of that because the validated period is 6 months, the maximum maturity period of the CP cannot be 1 year. So, the credit rating will say that when the next review is over and this is the responsibility of the investor and the IPA to see that whether this particular rating is valid for the company up to the maturity period of that particular security, that is why the CRA can decide the validity period of the credit rating and the credit rating agencies would have to closely monitor the rating assigned to the issuer vis a vis their track record at regular intervals and would be required to make its revision in the ratings public through its publications and websites over the period of time, from time to time they always

disclosed what kind of rating the company has and whether there is a change in the rating etcetera.

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The image shows a presentation slide with a yellow background and a dark blue curved border on the right side. The title is "Factors affecting CP Market Development". Below the title is a bulleted list of five factors. At the bottom of the slide, there are logos for "swayam" and "INDIA WISE, FUTURE BOUND". A small video inset in the bottom right corner shows a man in a white shirt speaking.

- Credit quality of CP issuer
- Market liquidity
- Cost of other alternative assets
- Financial market infrastructure
- Working capital limit

Then if you see overall that what are those factors which are affecting the development of the CP market, we have the credit quality. Always we have seen that credit rating is the major factor which decides whether the company can issue the CP or not and credit rating also attracts the investor to invest in that particular security. If it is should by a particular issuing agent or issuing company market liquidity, the liquidity is less in the market that has the impact on because it is very difficult to raise the money from the market at that time maybe the company can take the help from the CPs to raise the money from the market for the short term reasons.

What are the cost of other alternative assets for financing the short term requirements? If the cost of other instruments are relatively less, the company may not go for using The CP as the alternative instrument or alternative borrowing instruments for them. Financial Market Infrastructure means how far the market is or the infrastructural development is there for the trading in that particular type of instruments. If it is very highly developed, then it is easier to invest in kind of security and the working capital limit of this particular company that is also one of the another factors which decide that how much money they need for the working capital requirements. So, these are the different factors which are affecting the development of the CP market in India. So, this is about the brief

idea about the commercial papers, then we can move on to the other markets like CDs and all these things in the next session.

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Please go through these particular references for this particular session.

Thank you.