B.A./B.Sc. (H) in Economics

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Treasury Bills

Treasury bills are money market instruments issued by the Government of India as a promissory note with guaranteed repayment at a later date. Funds collected through such tools are typically used to meet short term requirements of the government, hence, to reduce the overall fiscal deficit of a country.

They are primarily short-term borrowing tools, having a maximum tenure of 364 days, available at zero coupons (interest) rate. They are issued at a discount to the published nominal value of government security (G-sec).

Government treasury bills can be procured by individuals at a discount to the face value of the security and are redeemed at their nominal value, thereby allowing investors to pocket the difference. For example, a 91-day treasury bill with a face value of Rs. 120 can be bought at a discounted price of Rs. 118.40. Upon maturity, individuals are eligible to receive the entire nominal value of Rs. 120, which allows them to realise a profit of Rs. 1.60. Now, take a look at other important **treasury bill details.**

Why Does the Government Issue Treasury Bills?

A short term treasury bill helps the government raise funds to meet its current obligations, which are in excess of its annual revenue generation. Its issue is aimed at reducing total fiscal deficit in an economy, and also in regulating the total currency in circulation at any given point of time.

The Reserve Bank of India (RBI) also issues such **treasury bills** under its open market operations (OMO) strategy to regulate its inflation level and spending/borrowing habits of individuals. During times of economic boom leading to high and persistent inflation rates in the country, high-value **treasury bills** are issued to the public, which, thereby, reduces aggregate money supply in an economy. It effectively curbs the surging demand rates, and in turn, high prices hurting the poorer sections of the society.

Alternatively, a contractionary OMO regime is undertaken by the RBI during times of recession and economic slowdown through a reduction in **treasury bill** circulation and reduced discounted value of the respective bonds. It disincentives individuals into channelling their resources in this sector, thereby boosting cash flows to the stock markets instead, ensuring a boost in the productivity of most companies. Such a rise in productivity has a positive impact on the GDP and aggregate demand levels in an economy.

Hence, a treasury bill is an integral monetary tool used by the RBI to regulate the total money supply in an economy, along with its fundraising usage.

Types of Treasury Bill

The distinction between different treasury bill types is made based on their tenure, as enumerated below:

14-day treasury bill, 91-day treasury bill, 182-day treasury bill, 364-day treasury bill

While the holding period remains constant for all types of treasury bills issued (as per the categories mentioned above), face values and discount rates of such bonds change periodically, depending upon the funding requirements and monetary policy of the RBI, along with total bids placed.

Features of Treasury Bills

Minimum investment

As per the regulations put forward by the RBI, a minimum of Rs. 25,000 has to be invested by individuals willing to procure a short term treasury bill. Furthermore, any higher investment has to be made in multiples of Rs. 25,000.

Zero-coupon securities

G-Sec treasury bills don't yield any interest on total deposits. Instead, investors stand to realise capital gains from such investments, as such securities are sold at a discounted rate in the market. Upon redemption, the entire par value of this bond is paid to investors, thereby allowing them to realise substantial profits on total investment.

Trading

The method of investment forms an integral part of essential treasury bill details. The RBI, on behalf of the central government, auctions such securities every week (on Wednesday) in the market, depending upon the total bids placed on major stock exchanges. Investors can choose to procure such government assets through depository participant commercial banks, or other registered primary dealers (PDs), wherein the security transfer follows a T+1 settlement process.

Alternatively, many open-ended mutual fund schemes also include treasury bills in their corpus for individuals willing to invest through such funds.

Yield Rate on Treasury Bills

The percentage of yield generated from a treasury bill can be calculated through the following formula –

$Y = (100-P)/P \times 365/D \times 100$

Where Y = Return per cent

P = Discounted price at which a security is purchased, and

D = Tenure of a bill

Let us consider a treasury bills example for better understanding. If the RBI issues a 91-day treasury bill at a discounted value of Rs. 98 while the face value of the bill is Rs. 100, the yield on such G-Secs can be determined as follows –

$\text{Yield} = (100 - 98)/98 \times 365/91 \times 100 = 8.19\%$

Advantages of Government Treasury Bills

Risk-free

Treasury bills are one of the most popular short-term government schemes issued by the RBI and are backed by the central government. Such tools act as a liability to the Indian government as they need to be repaid within the stipulated date. Hence, individuals enjoy comprehensive security on the total funds invested as they are backed by the highest authority in the country, and have to be paid even during an economic crisis.

Liquidity

As stated above, a government treasury bill is issued as a short-term fundraising tool for the government and has the highest maturity period of 364 days. Individuals looking to generate short term gains through secure investments can choose to park their funds in such securities. Also, such G-secs can be resold in the secondary market, thereby allowing individuals to convert their holding into cash during emergencies.

Non-competitive bidding

Treasury bills are auctioned by the RBI every week through non-competitive bidding, thereby allowing retail and small-scale investors to partake in such bids without having to quote the yield rate or price. It increases the exposure of amateur investors to the government securities market, thereby creating higher cash flows to the capital market.

Limitations of Treasury Bill

The primary disadvantage of government treasury securities is that they are known to generate relatively lower returns when compared to standard stock market investment tools. Treasury bills are zero-coupon securities, issued at a discount to investors. Hence, total returns generated by such instruments remain constant through the tenure of bond, irrespective of economic conditions and business cycle fluctuations.

It comes in contrast to the stock market, wherein market variations heavily influence returns generated by both equity and debt tools. Consequently, in the event of an upswing in the stock market, the yield rate of associated tools is significantly higher than the capital gains generated through G-Sec investments.

Taxation

Short term capital gain (STCG) realised on these bills is subject to STCG tax at rates applicable as per the income tax slab of an investor. Nonetheless, one major advantage of such G-Sec schemes is that retail investors are not required to pay any tax deducted at source (TDS) upon redemption of these bonds, thereby reducing the hassles of claiming back the same through income tax returns if he/she does not fall under the taxable income bracket.

Who Should Consider Investing in Treasury Bills?

Government treasury bills are an ideal tool to invest in for individuals looking to park surplus funds in a secure investment tool to enjoy substantial yields. The RBI facilitates a non-competitive bidding process for such bonds, allowing individual investors to partake in the same by placing their bid with the respective primary dealer of a scheduled commercial bank. Also, as details regarding the discount rate and par value are published beforehand, individuals enjoy full transparency in the investment process. It also aids in the process of financial planning for robust wealth accumulation.

Hence, a treasury bill is one of the most secure forms of investment available in the country. It is not only ideal for risk-averse individuals weary of stock market tools but is also popular for portfolio diversification in the case of experienced investors who allocate a portion of their funds into government securities to dilute the overall risk to their corpus. These sovereign bills play a crucial role in regulating the total money supply in an economy, which, in turn, influences funds pooled into the capital market.

Call Money/Notice money

The call money market is an essential part of the Indian Money Market, where the day-to-day surplus funds (mostly of banks) are traded. The money market is a market for short-term financial assets that are close substitutes of money. The most important feature of a money market instrument is that it is liquid and can be turned into money quickly at low cost and provides an avenue for equilibrating the short-term surplus funds of lenders and the requirements of borrowers.

The loans are of short-term duration varying from 1 to 14 days, are traded in call money market. The money that is lent for one day in this market is known as "Call Money", and if it exceeds one day (but less than 15 days) it is referred to as "Notice Money". Term Money refers to Money lent for 15 days or more in the Inter Bank Market.

Banks borrow in this money market for the following purpose:

- To fill the gaps or temporary mismatches in funds
- To meet the Cash Reserve Ratio(CRR) & Statutory Liquidity Ratio(SLR) mandatory requirements as stipulated by the RBI
- To meet sudden demand for funds arising out of large outflows.

Thus call money usually serves the role of equilibrating the short-term liquidity position of banks

Participants in the Call Money Market:

As the RBI guideline, the participants in call/notice money market currently include scheduled commercial banks (excluding RRBs), Development Financial Institutions, Co-operative banks (other than Land Development Banks) and Primary Dealers (PDs), both as borrowers and lenders.

Interest Rate:

Eligible participants are free to decide on interest rates in call/notice money market. Calculation of interest payable would be based on the methodology given by the Fixed Income Money Market and Derivatives Association of India (FIMMDA).

Note: FIMMDA is an association of Commercial Banks, Financial Institutions and Primary Dealers. It is a voluntary market body for the bond, Money and Derivatives Markets.

Commercial paper, also called CP, is a short-term debt instrument issued by companies to raise funds generally for a time period up to one year. It is an unsecured money market instrument issued in the form of a promissory note and was introduced in India for the first time in 1990. Companies that enjoy high ratings from rating agencies often use CPs to diversify their sources of short-term borrowings. This gives investors an additional instrument. They are typically issued by large banks or corporations to cover short-term receivables and meet short-term financial obligations, such as funding for a new project.

<u>Meaning of Commercial Paper</u>

Commercial paper is an unsecured, short period debt tool issued by a company, usually for the finance and inventories and temporary liabilities. The maturities in this paper do not last longer than 270 days. These papers are like a promissory note allotted at a huge cost and exchangeable between the All-India Financial Institutions (FIs) and Primary Dealers (PDs).

Most of the commercial paper investors are from the banking sector, individuals, corporate and incorporated companies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs), etc. However, FII can only invest according to the limit outlined by the Securities and Exchange Board of India (SEBI)

In India, commercial paper is a short-term unsecured promissory note issued by the Primary Dealers (PDs) and the All-India Financial Institutions (FIs) for a short period of 90 days to 364 days.

Commercial Paper in India

On 27th March 1989, commercial paper in India was introduced by RBI in the Indian money market. It was initially recommended by Vaghul working Group on the basis of the following points.

- The registration of commercial papers should only be granted to companies having Rs. 5 cores and above net worth with excellent dividend payment record.
- The market should follow the CAS discipline. The RBI should manage the paper amount, entry of the market, and total quantum which can be upgraded in a year.
- No limitation on the commercial paper market apart from the least size of the note. However, the size of one issue and each lot should not be less than Rs. 1 crore and Rs. 5 lakhs respectively.
- It should be eliminated from the provision of insecure advances in the state of banks.
- The company using commercial paper should have minimum 5 cores as net worth, a debt ratio maximum of 105, a debt servicing ratio closer to 2, current ratio minimum 1033, and should be recorded on the stock exchange.
- The paper can be made in terms of interest or at a discount rate to face value.
- It should not be compelled to stamp duty while issuing and transferring.

Features of Commercial Paper

Few distinct features are:

- It is a short-term money market tool including a *promissory note* and a set maturity.
- It acts as an evidence certificate of unsecured debt.
- It is subscribed at a discount rate and can be issued in an interest-bearing application.
- The issuer guarantees the buyer to pay a fixed amount in future in terms of liquid cash and no assets.
- A company can directly issue the paper to investors or it can be done through banks/dealer banks.

Types of Commercial Paper

According to the Uniform Commercial Code (UCC), commercial papers are divided into four different types.

- Draft – It is written guidance by an individual to another and to pay a stipulated sum to a third party.
- Check – It is a unique draft where the drawee is a bank.
- Note – Here, an individual is promised to pay another individual or bank a particular amount.
- Certificates of Deposit – In this type, a bank confirms the receipt of deposit.

According to security, there are two types of commercial papers

- Unsecured Commercial Papers – These are traditional papers and allotted without any security.
- Secured Commercial Papers – It is also known as Asset-Backed Commercial Papers (ABCP) and assured by other financial assets.

Advantages of Commercial Paper

- Contributes Funds – It contributes extra funds as the cost of the paper to the issuing company is cheaper than the loans of the commercial bank.
- Flexible – It has a high liquidity value and flexible maturity range giving it extra flexibility.
- Reliable – It is highly reliable and does not have any limiting condition.
- Save Money – On commercial paper, companies can save extra cash and earn a good return.
- Lasting Source of Funds– Maturity range can be customised according to the firm's requirement and matured papers can be paid by selling the new commercial paper.

Commercial Paper Formula

The formula for estimation discounted price of a commercial paper.

Price = Face Value/ [1 + yield x (no. of days to maturity/365)]

Yield = (Face value – Price)/ (price x no of days to maturity) X 365 X 100

What You Need to Know about Certificate of Deposit in India?

What is a Certificate of Deposit?

Certificate of Deposit or CD is a fixed-income financial instrument governed under the Reserve Bank and India (RBI) issued in a dematerialized form. The amount at payout is assured from the beginning. A CD can be issued by any All-India Financial Institution or Scheduled Commercial Bank. They are issued at a discount provided on face value. Like a fixed deposit (FD), a CD's purpose is to denote in writing that you have deposited money in a bank for a fixed period and that bank will pay you interest on it based on the amount and duration of your deposit.

Difference Between CD vs FD

There is no major difference between a certificate of deposit and a fixed deposit. They are one and the same. Fixed deposits are even referred to as CDs or time deposits by certain banks. They come with the same term period, a minimum requirement for a deposit, and high-interest rates compared to traditional savings accounts. One difference is that CDs are freely negotiable while FDs are not.

Features of CD

Here are some salient features of CD's and how they compare to other financial instruments.

- CDs can be issued in India for a minimum deposit of ₹1 lakh and in subsequent multiples of it.
- Scheduled Commercial Banks (SCBs) and All-India Financial Institutions are eligible to issue a CD. Cooperative Banks and RRBs cannot issue a CD.
- CDs issued by SCBs have in term period anywhere between 3 months to a year.
- CDs issued by financial institutions have a term period ranging from 1–3 years.
- Similar to dematerialized securities, CDs in dematerialized forms are transferable through means of endorsement or delivery.
- There is no lock-in required for a CD.
- One cannot issue a loan against a CD.
- A certificate of deposit is fully taxable under the Income Tax Act.
- A CD cannot be publicly traded.
- Banks are not permitted to buy back a CD before its maturity.

Difference between CD vs Commercial Paper

There are two glaring differences between commercial paper and a CD. The first is who can issue them. A CD is issued by financial institutions and banks. Commercial papers are issued by primary dealers, large corporations and All-India Financial Institutions. The second difference is the minimum amount of deposit. A certificate of deposit requires a minimum investment of ₹1 lakh and thereafter permits multiples of it. A commercial paper, on the other hand, is issued for investments of at least ₹5 lakhs and in multiples of ₹5 lakh, thereafter.

When Do Banks Issue a CD in India?

CDs can be high-risk liabilities for any scheduled commercial bank. There are certain times where some banks are more likely to issue a CD compared to others. There can be boiled down to two factors:

- In case of both low deposit growth and high demand for credit.
- When there are stiff or tight liquidity conditions in the market signifying that cash is tied up in non-liquid assets.

*NRIs that have invested in a CD are not permitted to repatriate to their home country after the amount has matured.

Advantages of Issuing CD in India

CD: There are benefits to issuing a CD which makes it such a popular choice among investors. They are:

- **Security:**

  A certificate of deposit or FD is not going to eat up your capital due to market volatility. It is a completely secure financial instrument with an assured sum at maturity, similar to traditional insurance. The money you put into your CD will continue to predictably increase and there is no risk of any loss. It is a very secure short to mid-term investment.

- **High-Interest Rate:**

  This benefit is what attracts most investors towards a CD. They offer larger rates of interest which can go as high as 7.8% on the lump sum deposited than traditional savings accounts whose interest rates average around 4%.

- **Flexibility:**

  You can opt for monthly payouts, annual payouts, or a lump sum withdrawal of your CD at maturity. You can pick the duration and price you want to invest, although it has to fit certain parameters set by the bank. Tailoring the CD to your needs helps you get the most from it.

- **Low to Minimum Maintenance Costs:**

  When it comes to the market there are always brokerage costs for the delivery, buying and selling of shares. There are usually no additional costs associated with a CD. You only pay what you invest with some banks.

Conclusion

Issuing a certificate of deposit is a secure way to invest in the short to medium term. Hopefully, this guide to CDs has shown you the eligibility, features, and benefits of fixed income instruments like CDs and why you should invest in them for your financially securing your future.

However, before you can proceed with your CD, you would first need to open a Demat account. Demat account is short for a dematerialized account. An online Demat account is required to hold dematerialized securities like a CD. You can open a Demat account with a few, simple, easy steps and be well on your way to procuring your first CD.

Short type questions

Commercial Paper

1. What is Commercial Paper (CP)?

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note.

2. When it was introduced?

It was introduced in India in 1990.

3. Why it was introduced?

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.

4. Who can issue CP?

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

5. Whether all the corporates would automatically be eligible to issue CP?

No. A corporate would be eligible to issue CP provided –

a. the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore

b. company has been sanctioned working capital limit by bank/s or all-India financial institution/s; and

c. the borrowal account of the company is classified as a Standard Asset by the financing bank/s/ institution/s.

6. Is there any rating requirement for issuance of CP? And if so, what is the rating requirement?

Yes. All eligible participants shall obtain the credit rating for issuance of Commercial Paper either from Credit Rating Information Services of India Ltd. (CRISIL) or the Investment Information and Credit Rating Agency of India Ltd. (ICRA) or the Credit Analysis and Research Ltd. (CARE) or the FITCH Ratings India Pvt. Ltd. or such other credit rating agency (CRA) as may be specified by the Reserve Bank of India from time to time, for the purpose.

The minimum credit rating shall be A-2 [As per rating symbol and definition prescribed by Securities and Exchange Board of India (SEBI)].

The issuers shall ensure at the time of issuance of CP that the rating so obtained is current and has not fallen due for review.

7. What is the minimum and maximum period of maturity prescribed for CP?

CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. However, the maturity date of the CP should not go beyond the date up to which the credit rating of the issuer is valid.

8. What is the limit up to which a CP can be issued?

The aggregate amount of CP from an issuer shall be within the limit as approved by its Board of Directors or the quantum indicated by the Credit Rating Agency for the specified rating, whichever is lower.

As regards FIs, they can issue CP within the overall umbrella limit prescribed in the Master Circular on Resource Raising Norms for FIs, issued by DBOD and updated from time-to-time.

9. In what denominations a CP that can be issued?

CP can be issued in denominations of Rs.5 lakh or multiples thereof.

10. How long can the CP issue remain open?

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.

11. Whether CP can be issued on different dates by the same issuer?

Yes. CP may be issued on a single date or in parts on different dates provided that in the latter case, each CP shall have the same maturity date. Further, every issue of CP, including renewal, shall be treated as a fresh issue.

12. Who can act as Issuing and Paying Agent (IPA)?

Only a scheduled bank can act as an IPA for issuance of CP.

13. Who can invest in CP?

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. However, investment by FIIs would be within the limits set for them by Securities and Exchange Board of India (SEBI) from time-to-time.

14. Whether CP can be held in dematerilaised form?

Yes. CP can be issued either in the form of a promissory note (Schedule I given in the Master Circular-Guidelines for Issue of Commercial Paper dated July 1, 2011 and updated from time – to-time) or in a dematerialised form through any of the depositories approved by and registered with SEBI. Banks, FIs and PDs can hold CP only in dematerialised form.

15. Whether CP is always issued at a discount?

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

16. Whether CP can be underwritten?

No issuer shall have the issue of Commercial Paper underwritten or co-accepted.

17. Whether CPs are traded in the secondary market?

Yes. 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.

18. What is the mode of redemption?

Initially the investor in CP is required to pay only the discounted value of the CP by means of a crossed account payee cheque to the account of the issuer through IPA. On maturity of CP,

(a) 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.

(b) 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.

19. Whether Stand by facility is required to be provided by the bankers/FIs for CP issue?

CP being a `stand alone' product, it would not be obligatory in any manner on the part of banks and FIs to provide stand-by facility to the issuers of CP.

However, Banks and FIs have the flexibility to provide for a CP issue, credit enhancement by way of stand-by assistance/credit backstop facility, etc., based on their commercial judgement and as per terms prescribed by them. This will be subjected to prudential norms as applicable and subject to specific approval of the Board.

20. Whether non-bank entities/corporates can provide guarantee for credit enhancement of the CP issue?

Yes. Non-bank entities including corporates can provide unconditional and irrevocable guarantee for credit enhancement for CP issue provided :

a. the issuer fulfils the eligibility criteria prescribed for issuance of CP;

b. the guarantor has a credit rating at least one notch higher than the issuer by an approved credit rating agency and

c. the offer document for CP properly discloses: the networth of the guarantor company, the names of the companies to which the guarantor has issued similar guarantees, the extent of the guarantees offered by the guarantor company, and the conditions under which the guarantee will be invoked.

21. Role and responsibilities of the Issuer/Issuing and Paying Agent and Credit Rating Agency.

Issuer:

a. Every issuer must appoint an IPA for issuance of CP.

b. The issuer should disclose to the potential investors its financial position as per the standard market practice.

c. 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.

Investors shall be given a copy of IPA certificate to the effect that the issuer has a valid agreement with the IPA and documents are in order (Schedule II given in the Master Circular-Guidelines for Issue of Commercial Paper dated July 1, 2011 and updated from time –to-time).

Issuing and Paying Agent

a. 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.

b. 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 (Schedule II given in the Master Circular-Guidelines for Issue of Commercial Paper dated July 1, 2011 and updated from time –to-time).

c. Certified copies of original documents verified by the IPA should be held in the custody of IPA.

Credit Rating Agency

a. 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.

b. 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.

c. 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

22. Is there any other formalities and reporting requirement with regard to CP issue?

Fixed Income Money Market and Derivatives Association of India (FIMMDA), may prescribe, in consultation with the RBI, any standardised procedure and documentation for operational flexibility and smooth functioning of CP market. Issuers / IPAs may refer to the detailed guidelines issued by FIMMDA on July 5, 2001 in this regard, and updated from time-to-time.

Every CP issue should be reported to the Chief General Manager, Reserve Bank of India, Financial Markets Department, Central Office, Fort, Mumbai through the Issuing and Paying Agent (IPA) within three days from the date of completion of the issue, incorporating details as per Schedule III given in the Master Circular-Guidelines for Issue of Commercial Paper dated July 1, 2011 and updated from time-to-time.