objectives in view. First, repos facilitate liquidity management in the short run. Secondly, monetary authorities can transmit policy signals through repos to the money market, which has crucial influence on other segments of the financial market such as gilt-edged and foreign exchange market. Thirdly, repo operations provide liquidity and depth to the underlying treasury securities market. The reaction of money market to repo auctions, however, depends upon the market structure, liquidity conditions and auction rules encompassing the auctioner's objectives and bidders' behavior. This paper is an attempt to study the money market reaction to repo auctions in the Indian context. The organisation of the paper is as follows. Section I briefly discusses the theory of auctions particularly auction formats, objectives of the auctioneer and bidders behavior constituting what is called auction rule, followed by an outline of the trends and developments in repo auctions in India during the process of financial liberalisation in the 1990s. Section II provides the analytics of auction rules and develops a framework for empirical analysis. The empirical findings are discussed in Section III, while Section IV concludes.

1.5 ARTICLE CONCERNING GOVERNMENT SECURITIES

4. HIMANSHU GANDHI in his study on *Liquidity Effects on the Term Structure of Government Securities Market in India* (RBI Occasional Papers) examines empirically the term structure of interest rates in the Indian economy suggesting
co-integration (or long run stable relationship) among interest rates but existence of multiple common trends. The absence of unique common trend implies that long run movements of any one interest rate are not dominated by the movements of other interest rates. The presence of cointegration, however, suggests a long run interlocking of interest rates across markets and a possibility of their common response to changes in expectations about future monetary policy and/ or economic fundamentals. Finally, the results also suggest that structural policies pursued by the Central Bank could be of crucial importance in facilitating market integration. The process of deregulation of interest rates in Government securities market which began in 1992 has culminated into a full fledged market mechanism providing the much needed space for effective conduct of monetary and internal debt management policies in the Indian economy. Market determined interest rates were made applicable to government borrowings in gradual succession beginning with the auctions of 364 day Treasury Bills in April 1992, government of India (GOI) dated securities in June 1992 and 91 day Treasury Bills in January 1993. Later, as the primary market acquired greater depth, new instruments such as funded Treasury Bills, Zero Coupon bonds, Tap Stocks and Partly Paid Stocks, 14 days Treasury Bills and Capital Indexed Bonds were also introduced in keeping with the market's appetite. The changes in the scheme of financing of Government deficits have had important but mixed implications such as desirable reductions in monetary deficits, on the one hand, and an upward pressure on
interest rates resulting in fiscal strains, on the other. Moreover, the introduction of several such instruments of different maturities meant the emergence of multiplicity of yields, resulting in rather complex term structure of interest rates. The problems associated with sharp variability of interest rates in the post reform period provide yet another dimension of the transition from a controlled system to a market regime.

1.6 ARTICLE DESCRIBING MONEY MARKET MUTUAL FUNDS

5. G.C.R.JAISWAL, in his article ‘Money Market Mutual Funds (MMMFs) Initiative in India’ describes the evolution, growth and the future of Money Market Mutual Funds in India. The emergence of MMMF as a short-term financial instrument has added a new dimension to the money market. The study also examines the role of MMMF in money market in terms of its effectiveness as a short-term money market instrument for the banks to adjust their liquidity positions and also the safety features associated with the instrument.

1.7 ARTICLES INVOLVING FINANCIAL MARKETS

6. Integration of Financial Markets in India: An Empirical Evaluation (RBI Occasional Papers), by B.K. BHOI and S.C. DHAL, attempts to empirically evaluate the extent of integration of India's financial markets in the post-liberalization period. The major findings of the paper are the following: a)
although fully competitive environment is yet to emerge, several segments of the financial market have achieved operational efficiency; b) the 91-day Treasury Bill rate has the potential to emerge as a reference rate in the Indian context; c) India's financial markets are getting increasingly integrated at the short-end of the market, such as, money market, credit market, Government securities market since April 1993. However, capital market is least integrated with the rest of the financial sector; d) there are early indications about integration of money market and forex market. However, integration of domestic and overseas financial markets is not robust.

7. BERNHARD EMUNDS, in his study 'The Integration of Developing Countries into International Financial Markets: Remarks from the Perspective of an Economic Ethics' (Business Ethics Quarterly, Vol. 13 Issue 3 ISSN 1052-150X), he examines the co-responsibility of the north for the development of south, the chance of an authentic development and Rawls'e maxi-min rule are indicated as the ethical perspectives from which the financial integration of developing countries will be evaluated. It follows a brief economic analysis of possible problems of high inflows of portfolio investments for developing countries. They become more vulnerable to financial and monetary crises and their domestic banking systems are weakened by a higher risk of devaluation. This will lead to an outline of the goals for reshaping the financial integration among others.
limitation of capital inflows, strengthening of the domestic banking system and further development of the country's particular economic style. Finally, some regulations of external financial relations and the proposal of a co-operative monetary arrangement between the south and the north are discussed as possible measures to improve this integration.

1.8 ARTICLES RELATING TO MONEY MARKET RATES

8. SYED M. AHMED and LEE SARVER analyze the interdependence of money markets in Europe, North America and Japan in their study 'The International Transmission of Money Market Fluctuations' (The Financial Review, Vol. 29 No. 3 August 1994). The authors estimate the vector-autoregression system using daily data on three-month money market rates from December 31, 1979 through February 28, 1990. Consistent with the notion of informational efficiency, money markets respond very rapidly to a shock in any one country. The US market plays a leading role, in that the after-effects of a shock are much stronger and last much longer than that of a shock elsewhere. In contrast with previous studies on stock markets, the responses are larger and more persistent, the markets are less interdependent, and the US market is relatively less influential.

policy by influencing short-term interest rates in its money market operations. The way in which the bank operates in the market has changed significantly over time, but the aim throughout has been to ensure that the behavior of short-term interest rates is consistent with monetary policy decisions, whether made by the chancellor of the Exchequer or, since 1997, by the bank’s own Monetary Policy Committee. Operational choices by the central, together with developments in the markets themselves, are likely to have affected the volatility of short-term interest rates. This article outlines various measures of volatility in sterling money markets.

10. CHRISTOPHER J. GREEN in his article 'Money Market Arbitrage and Commercial Banks’ Base Rate Adjustments in the United Kingdom' (Bulletin of Economic Research 39:4, 1987) discusses with the opportunities for arbitrage which have arisen in the UK when large companies are able to borrow from a commercial bank and on-lend the money in the market at a higher rate. Such arbitrage is commonly called 'Round-Tripping'. Round-Tripping is investigated in a simple theoretical way, and then a simulation approach is used to estimate the amount of funds involved in Round-Tripping in the 1970s. These estimates tend to support that view that Round-Tripping was probably rather modest in amount in relation to the values of the main monetary aggregates.
11. In a study on ‘International monetary flows and stability in foreign exchange markets’ (Applied Economics 1988), JAE WAN CHUNG investigates empirically the nature of stability in the major international money markets. The stability is examined on the basis of estimated degrees of substitution in broadly defined major international monies demanded-currencies and interest-bearing short-term financial assets denominated in different currencies.

12. ANTHONY BOTTOMLEY in his study on ‘Interest Rate Determination in Underdeveloped Rural Areas’ he emphasized that the interest rates for rural and unorganised money markets in third world societies have not been extensively studied. This paper uses a comprehensive review of agricultural credit literature to explore the relationships between the costs of existing credit, amounts loaned and the borrower’s ability of absorb further capital. High costs in administering small loans and resistance to repay suggest the convenience of linkages between lending agencies and marketing boards for the crops upon which loans are made. Village money lenders-cum-traders may be able to operate more efficiently than public agencies particularly when trained staff are in short supply.

13. In a study on ‘Interest rates in domestic and eurocurrency markets’ (Applied Economics 1992, 24), JOHN THORNTON reexamined the issue of the relationship between domestic and eurocurrency interest rates using Granger Causality Test. It is concluded that while earlier results suggesting causality runs
from eurocurrency market to the domestic money market remains valid for the US dollar market, this result can not be generalized to the behavior in the money markets denominated in sterling and deutschmarks.

14. The Expectations Theory of the term structure was tested using data from West German capital and money markets for the period 1975:01 - 1986:12 by W. KLEIN in his paper 'Forward Rates and the Expectations Theory of the Term Structure: Tests for the Federal Republic of Germany'. If forward rates implicit in the term structure are market expectations of future spot rates, and if term premia are not time-dependent, then forward rates should follow a martingale sequence. This hypothesis was tested with the aid of standard time series techniques (autocorrelation functions, box-pierce, unit-roots, F-tests and co-integration). The Expectations Theory was for the most part rejected, although the martingale property, or equivalently, weak form efficiency, held for the latter part of the test period. The rejection of the simple expectations theory is consistent with the hypothesis of time-varying term premia.

15. In his paper on 'Money Markets - Short-term Interest Rates' (Delivered at The Conference board’s Seventh Annual Financial Conference at The Waldorf-Astoria, New York City, February 23-24, 1972), E.I. SHAPIRO discusses the five factors which seem to dominate the outlook for short-term interest rates over the year. First is the overall economic outlook with special reference to its
implications for inflation and the outlook for interest rates on long-term
government securities. The second element is an examination of the outlook for
the overall volume of the financing requirements of non-financial business
corporations and the form these financing requirements will take. The third
element which will have some impact on short rates is the substantial volume of
treasury financing requirements which are implied by the President’s recent
budget message. A fourth uncertainty centers around the questions of the
objectives of the Federal Reserve and of the impact on short rates of the actions
the Fed might take to implement these objectives. In addition to these perennial
problems, there is at least one quite unusual factor which is thought to affect the
current outlook for short rates – the substantial volume of treasury securities
which have been purchased by foreign central banks in the recent past.

1.9 ARTICLES DEALING WITH INTERNATIONAL MONEY MARKETS

16. FRED H. KLOPSTOCK, in his study on 'The International Money Market:
Structure, Scope and Instruments' (The Journal of Finance), identifies and
assesses the determinants of the supply of funds to international money markets.
Drawing on statistics of very diverse origins, it will attempt to trace both the
major suppliers of funds and the ownership structure and magnitude of funds
individual market sectors. The paper will survey the factors bearing on the
suppliers’ choice among the various investment media available to them in
international money markets, and will consider the implications for the international economy of the rise to prominence of euro-currency deposit markets. In the concluding section, the paper will examine the inter-connections of the various sectors of these international deposit markets and their links to other money markets.

17. In a study conducted by THOMAS H. MCINISH and DONALD J. PUGLISI on 'The Efficiency of International Money Markets' (Journal of Business Finance & Accounting 9,2 (1982), deals with the extension of tests for weak form of Efficient Market Hypothesis (EMH) to a number of major international money markets. The other two forms of EMH being the strong form and the semi-strong form. Given the inconsistency of efficiency across US and foreign equity markets and the mixed evidence on efficiency of the various sectors of the US money market, the question of the efficiency of the international money markets is one of interest. If interest rates for a particular money market instrument do not fluctuate randomly, one cannot conclude that the market for that instrument is efficient in the weak form. In such a case, one may be able to develop trading rules that will produce abnormal profits from trading in that instrument.

18. ROBERT W. STONE in his paper 'Structural Changes in Money Markets' (The Journal of Finance) deals with the most striking characteristic of the performance of the money market during the last few years, as the interest rates
are unusually stable on a day-to-day and week-to-week basis. During the past two years, in particular, there have been stretches of many weeks in which three-month treasury bills, for example, moved within as narrow a band as two or three basis points. A broad view of the marked reduction in short-term rate fluctuations in recent years may be obtained by noting the average week-to-week change in average issuing rates emerging from the weekly auctions of three-month treasury bills. What is the explanation for the extraordinary short-run stability of rates in recent years? The most fundamental part of the explanation, the author believes, is to be found in the stable behavior of the economy itself. But also of great importance in this connection are certain changes that have emerged in the money market mechanism, and the response of the monetary and debt management authorities to our persisting balance-of-payments problem in a context of interdependent national money markets. All the above factors are being dealt in detail in the paper.

1.10 MISCELLANEOUS ARTICLES ON MONEY MARKETS

19. A study made my THOMAS L. BREWER on 'Political Sources of Risk in the International Money Markets: Conceptual, Methodological and Interpretive Refinements' (Journal of International Business Studies, Spring/Summer 1983) suggests refinements in the analysis of political risks in the international money markets. In particular, it suggests: 1. That the pertinent risks need to be defined
and measured more precisely; 2. That analytically useful variables derivable from models of politics should be included in attempts to develop explanatory/predictive models of variation in risk; and 3. That the analysis of political sources of risk has significant implications for an understanding of market efficiency.

20. BENJAMIN J. COHEN, in his paper 'The Euro-dollar, The Common Market and Currency Unification' (The Journal of Finance, Vol. XVIII, No. 4 December 1963), describes how the development of euro-dollar has retarded currency unification in the common market. The paper discusses the vital role of integrated capital and money markets is easing the process of balance-of-payments adjustment within a common currency area and also describes the new analogous role of the euro-dollar market in the European community and by extension in the Atlantic community. He also explains why, from the point of view of the market's own common interest, it would not be advisable for the six to continue to rely on the euro-dollar as a de facto common currency. He also suggests how the community might proceed towards its own de jure European currency.

the money market integration literature in two ways. First, the study analyzes dollar yield behavior within a multivariate co-integration framework as opposed to the usual bilateral approach based on stock adjustment models or Granger/Sims causality test variants. Second, the relationships between dollar yields in four different geographic markets – Domestic US (New York), Eurodollar (London), Singapore and Hong Kong – are analyzed, providing a more global perspective than earlier studies. The results reveal that (1) simple autoregressive models are adequate for studying interest rate relationships because the series are co-integrated and (2) bivariate analysis of money market time series may yield misleading results.

22. A. BRUCE JOHNSON in his lecture on ‘Inflation and Money Markets’ (Delivered to the American Institute of Chemical Engineers, New York, April 9-14, 1973) discusses the different schools of thought on inflation and, in turn, discusses and defines the term ‘inflation’. He explains the causes for people to suffer from inflation. He categorized the causes for inflation in three broad frameworks; 1) A group of economists whom he refers to as Neo-Keynesians, who think that money is important, but not very important, have been advisors to Presidents and Congressmen too long, 2) Excessive Credit creation, and 3) A failure of congress to comply with a constitutional provision requiring them to regulate the value of money.
23. WESLEY LINDOW, Vice-chairman, Charter New York Corporation, in his paper on 'Lessons of the Money Market Strains of 1974' analyzes in various parameters i.e., whether the closings of banks in the United States and abroad bring out the weaknesses in the market; whether the difficulties of individual banks cast serious doubts on the principles involved in liability management and he also discusses how a prudent management tighten procedures to avoid potential losses from troubled organizations and points out what warning flags does the market raise as borrowers run into trouble.

24. 'An Econometric Model of the impact of Open Market Operations on various bank classes' (The Journal of Finance) by ROY J. RUFFIN, based on traditional banking theory, is developed to determine the short-run impacts of open market operations on the un-borrowed reserves of various bank classes and to detect the main mechanism by which the effects of such operations are transmitted beyond the money market banks. The model ignores the possible influences of regional differences in economic activity, credit conditions, the Federal funds market and correspondent balances. To bring in all the variables that might conceivably influence the impact of open market operations would require building an unmanageable model of the banking system. All the above factors no doubt have some influence, but it would be futile at this stage to bring in problems that are themselves unexplored and difficult. Existing theory is thus the framework of the
analysis. If the results have a large measure of validity, it is plausible to infer that the basic theory itself is useful for organizing other empirical studies.

25. JAVIER NIEVAS in his paper 'The 'Fisher effect' versus 'German effect' in European Countries: An Empirical Study' (Applied Economics Letters 1998, 5) analyses the impact of the rate of inflation and German short-term interest rates over the short-term interest rates of a number of European Union Member States. The study has been carried out by considering two sub-periods, namely from 1980 to 1988 and from 1989 to 1996, with these representing the periods before and after the initiation of European Monetary Union. The results obtained indicate that there is one group of countries, comprising France and Italy, which has substituted the 'inflation effect' in the first period for the 'German effect' in the second. Another group, made up of Spain, Greece, Holland and Portugal, does not present evidence of the inflation effect prior to Monetary Union, but does present evidence of the 'German effect' after it. Finally, a number of other countries, such as the United Kingdom, Belgium and Denmark are not seem to be influenced by changes in the German interest rate.
1.11 RBI REPORTS ON MONEY MARKETS

1.11.1 REPORT OF THE WORKING GROUP ON THE MONEY MARKET
(JANUARY 1997)

The committee was constituted under the Chairmanship of Shri N. VAGHUL,
Chairman, Industrial Credit and Investment Corporation of India, Mumbai. The
terms of reference of the working group were:

1. To examine money market instruments and recommend specific measures
   for their development;

2. To recommend the pattern of money market interest rates and to indicate
   whether these should be administered or determined by the market;

3. To study the feasibility of increasing the participants in the money market;

4. To assess the impact of changes in the cash credit system on the money
   market and to examine the need for developing specialized institutions
   such as discount houses. In this context, the interaction between the inter-
   corporate market and the expanded money market could also be examined;

5. Any other issues having a bearing on the development of money market.
SUMMARY OF RECOMMENDATIONS OF THE GROUP

Call Money

1. The present interest rate ceiling on the call money fixed by IBA should be abolished and the call money rates should be left to be determined by market forces. The call money rates should be freed only for inter-bank transactions and the ceiling rate of 10 percent should continue to be maintained for borrowings from non-bank participants in the market.

2. It should be necessary for the Reserve Bank to counsel the surplus banks to ensure that call money operations are not disruptive to the banking system and the call money rates do not rise to stratospheric levels over prolonged periods.

3. The call money market should strictly be an inter-bank market. The LIC and the UTI may be permitted to remain in the market. The position could be reviewed, if need be, by the Reserve Bank of India in April 1988.

4. The interest rates on inter-bank term deposits should also be determined by market forces.
5. The measures relating to call money and inter-bank term deposit rates should be implemented with the inception of the slack season at the end of April 1987.

6. There is no need for brokers to be reintroduced into the call money market. To the extent that broker services are felt necessary after the freeing of the call and inter-bank term deposit rates, the proposed finance house could usefully provide this service.

**Bills Rediscounting**

1. There is a need to take a number of positive measures to facilitate the emergence of a genuine bill culture.

2. The government should direct departmental undertakings and public sector organizations that payments for all credit purchases should be in the form of bills which should be strictly honoured on the due dates. Failure to pay a bill on the due date should attract a uniform penal rate of 2 percentage points above the maximum lending rate of banks. A similar procedure should be followed in case of CAS parties. In the event of three instances of defaults on payment of bills, the working capital limits should be reduced suitably.
3. The working capital limits of the large parties should be scaled down and the interest rates increased if bill acceptances are less than a stipulated percentage of credit purchases.

4. It would be necessary to move away from receivable financing to bill financing and accordingly a program commencing from April 1988 should be stipulated for phasing out receivable financing. Of the total receivables, the proportion of receivables eligible for financing under cash credit/overdraft facilities should be 75 percent from April 01, 1988, 50 percent from April 01, 1989 and 25 percent from April 01, 1990. The rest of the receivable should be financed only through demand/usance bill limits.

5. Within the CAS discipline, banks should be given the discretion to increase bill limits for temporary periods.

6. The stipulation on unsecured advances should not be made applicable to bill financing.

7. The maximum discount rate on bills should be that it does not exceed an equivalent effective interest rate of 16 percent. This should be implemented at the end of April 1987 and after an year, the assessment
could be made as to whether the maximum discount rate could be freely
determined by the banks.

8. As at the end of April 1987, the ceiling on the rediscount rate should be
increased from 11.5 percent to 12.5 percent.

9. A review could be undertaken as to whether the ceiling on the rediscount
rate should be removed.

10. Institutions and other units such as companies, trusts etc., which can
satisfactorily demonstrate to the Reserve Bank of India that they have a
resource surplus of a monthly average of at least Rs 5 crore per annum
should be allowed to participate in the bill rediscounting market. Further
rediscounting by institutions should be freely permitted. The procedures
for rediscounting bills should be simplified by the end of April 1987.

**Short-term Commercial Paper**

1. The time is appropriate for starting with a limited introduction of
Commercial Paper. Initially, access to the commercial paper market
should be given only to ‘A’ rated companies.

2. The interest rate on commercial paper should be freely determined by
market considerations.
3. The commercial paper market should function within the overall discipline of the CAS. The Reserve Bank should administer the entry in the market, the amount of each issue and the total quantum that can be raised in a year.

4. There should be no restrictions on the participants in the commercial paper market. The size of any single issue should not be less than Rs 1 crore and the size of each note should not be less than Rs 5 lakh.

5. Commercial paper should be excluded from the stipulation on unsecured advances in the case of the bank.

6. The framework set out for developing a commercial paper market in India could be adopted and necessary legislative/administrative changes should be completed so as to enable commercial paper to be operative by April 01, 1988. The authorities should take an early decision to commit themselves to a time-bound introduction on commercial paper.

Government Paper

1. For an active secondary market in 182-day Treasury Bills, it would be necessary for a large number of participants to bid regularly in the auctions and to build up a portfolio of varying maturities. Suitable measures need to be taken to ensure that the Treasury Bill rate remains flexible. The periodicity of the auctions should be increased.
2. A Treasury Bill refinance facility should be introduced by the end of April 1987 and the refinance rate should be at least 1.5 percentage points above the prevailing Treasury Bill rate. In the event of the proposed facility being introduced, the stand-by refinance facility should be terminated.

3. Inter-bank transactions in dated securities on a buy-back basis should be encouraged and interest rates on such transactions should not be subject to interest rate control.

Setting up of Finance House

1. An autonomous public limited company called the Finance House of India should be set up jointly by the Reserve Bank, the public sector banks and the financial institutions to deal in short-term money market instruments. The finance house should have back-up facilities with banks and the Reserve Bank. In view of the schedule of other policy responses which are to implemented in the slack season of 1987, the Finance House of India should be operative not later than July 01, 1987. Over a period of time, there would a need for more than one finance house.
Development of New Instruments

1. There should be a continuing development and refinement of money market instruments. Each new instrument that is coming into the market must be specifically approved by the Reserve Bank of India.

Inter-bank Participation Certificates

1. From the end of April 1987, inter-bank participation certificates should be reintroduced in a modified form.

Certificates of Deposit

1. The introduction of Certificates of Deposit is not recommended at this stage. In the context of various changes proposed by the working group and the introduction of the 182-day Treasury Bill, the structure of short-term deposit rates up to one year as well as the number of maturities could be reviewed by the end of April 1987 and in the light of this review, the feasibility of introducing Certificates of Deposit could be reconsidered.

Factoring Services

1. The banks and private non-bank financial institutions should be encouraged to provide factoring services. A few factoring divisions should be set up by July 01, 1987.
Legislative Changes

1. In the interest of developing a strong financial and banking system, the Government of India should take necessary measures to abolish the stamp duty on bills.

2. The viability of the new instrument of Commercial Paper would be better ensured if Commercial Paper is exempt from stamp duty.

3. Suitable amendments may need to be effected in the Reserve Bank of India Act to enable the bank to provide refinance to the Finance House of India.

1.11.2 REPORT ON REPURCHASE AGREEMENTS (AUGUST 06, 1999)

The committee was constituted by The Reserve Bank of India under the Chairmanship of Dr. T. C. NAIR, General Manager, Internal Debt Management Cell, Reserve Bank of India. The terms of reference of the working group include detailed discussions on various aspects of expansion of the Repo market. The group separately met representatives of a cross section of public sector banks to seek their views on widening of the Repo market in terms of participation and larger number of instruments apart from the need to put in place appropriate clearing and settlement system evolving uniform accounting standards,
documentation etc. Officials of foreign banks, private banks and financial institutions were also involved to discuss various issues.

SUMMARY OF RECOMMENDATIONS OF THE GROUP

- Need to withdraw the government notification dated June 27, 1969;
- RBI needs to acquire regulatory powers under Sec. 29A of SCR Act;
- Need to replace Public Debt Act 1944;
- “Over the Counter” and “Tripartite” Repos to expand the market;
- Uniform accounting practices to be introduced;
- Day light overdraft facility for current account holders required;
- Guidelines for Constituents’ SGL account operations to be issued;
- Date of deal and settlement to be specified;
- A Master Repurchase Agreement for Repos to be introduced;
- Code of conduct for Repo transactions to be laid down;
- Repo market to be supervised and closely monitored by RBI;
- Rollover of Repos to be permitted;
• Maximum eligible duration of Repos to be clarified.

1.11.3 REPORT OF THE INTERNAL GROUP TO REVIEW THE GUIDELINES RELATING TO COMMERCIAL PAPER (MARCH 18, 2000)

The Internal Group was constituted by RBI under the chairmanship of Dr. Y. V. Reddy, Deputy Governor, Reserve Bank of India, Mumbai. The group held discussions to examine the following issues relating to CP market.

• Review the growth and operation of CP market in India;

• Examine policy related, legal and structural factors inhibiting faster and healthy growth of CP market;

• Analyse the reasons for underdeveloped secondary market for CP;

• Discuss the role of CP in meeting the short-term funds requirement of borrowers in the context of withdrawing the prescription of maximum Permissible Bank Finance (MPBF);

• Examine the usefulness of CP for All India Financial Institutions. in the context of introduction of ALM and risk management systems;

• In the light of evolution of CP market in India and international experience identify the scope for modifications in the extent guidelines and
recommend measures which need to be taken for developing an efficient and liquid CP market.

SUMMARY OF RECOMMENDATIONS OF THE GROUP

• At present only highly rated corporates, primary dealers and satellite dealers are permitted to issue commercial paper. The group felt that Financial Institutions may also be permitted to raise resources by way of CP within the overall umbrella limit fixed by RBI;

• It is recommended that RBI may continue to prescribe a minimum credit rating for issuance of CP. The prescription of minimum rating by RBI would provide an automatic mechanism for placing a cap on the amount of CP. Thus, the limits for CP issuance would emerge from the minimum credit rating stipulated by RBI and the actual rating given by CRA based on its assessment. The CRA has to take responsibility of monitoring that the limits of CP issuance are strictly adhered to by the corporate;

• The group suggested that in the interest of healthy development of CP market, banks may be allowed to offer standby line of credit for issuance of CP. The group, further recommends that bank’s decision whether or not to offer a standby line of credit should entirely depend upon their own commercial judgment and should be with the prior approval of their boar;
- Banks' role in the CP market would continue to be crucial as the banks, in addition to providing standby credit line to the corporates, banks will also act as Issuing and Paying Agents;

- Credit Rating Agencies role is crucial as they are expected to perform various functions in addition to assigning rating for issuance of CPs by the corporates i.e., monitoring CP limits of corporates, reporting any irregularities to the RBI, informing RBI on the amount of CP issued by a corporate within 3 days from the date of completion of CP issuance;

- Corporates are expected to follow the guidelines and procedures laid down by RBI strictly for issuance of CP. Corporates are subjected to penal action if they violate the procedures and guidelines in issuance of CP;

- IPAs should be made responsible for verifying the documents and issuing a certificate that the documents are in order. The original documents verified by the IPA should also be held in the custody of IPA and IPA is expected to make payment of the CP on maturity;

- The group also made recommendations on the types of CPs to be issued, possibility of the CP being in Demat form, validity of rating, possibility of CP to be the eligible security for Repo, underwriting of CP and also prescribed the benchmark for pricing CP.
1.1.4 REPORT OF THE WORKING GROUP ON DISCOUNTING OF BILLS BY BANKS
(SEPTEMBER 28, 2000)

This committee was constituted by RBI under the Chairmanship of Shri K. R. RAMAMOORTHY and the terms of the reference of the group are;

- To examine the feasibility and suggest measures to strengthen the existing bills discounting mechanism as an instrument for facilitating financing, in particular trade and services sectors, including discounting of trade bills against letters of credit opened by banks;

- To examine the role and scope for introducing “Bankers Acceptance” facility

- To examine all critical and relevant issues including the necessary safeguards to be put in place before extending bills discounting to new areas like services and introduction of Bankers Acceptance facility;

- Any necessary changes in the existing legal/regulatory framework that may be needed;

SUMMARY OF RECOMMENDATIONS OF THE GROUP

- Bills discounting, being advantageous from the banker’s point of view, can carry interest at a lower rate than the loan, whilst interest rate on the
loan component of working capital may be charged according to the tenor of the loan; Cash Credit may carry a higher interest rate in keeping with the international practice, where overdraft, which serves more of less an identical purpose as cash credit, attracts higher interest rate;

- Individual bank might lay down norms for satisfying itself about the genuineness of the transaction and the movement of goods. Banks may accept other documents like goods received note also as evidence of genuine trade transaction instead of exclusive reliance on transport receipts;

- As there are inherent advantages to commercial banks in encouraging bill financing, particularly in the small and medium sector, it would but be necessary for the commercial banks to revisit the existing procedures and processes and simplify the same with transparent time and cost norms, from the time the bills are tendered for discounting till their realization, including value dating of client’s account, taking advantage of the improved computer and communication network;

- In view of the existing trade practice of elongation of credit period beyond 90 days and taking note of the procedural hassles entailed in stamping of bills hindering the development of bill culture, the group recommends that
stamp duty for all the bills of usance up to 182 days be abolished. The exemption, which is presently available only on the bills discounted by banks, may also be made available to all bills discounted by financial institutions and registered non-banking finance companies;

- The group suggests that corporates and other commercial entities who have a turnover above a threshold level be mandated to disclose the 'ageing schedule' of their overdue payables in their annual report as well as in their periodical reports to their banks;

- The group considers that the irregularities pointed out by the supervisory authorities in respect of L/C bills discounting were more in the nature of operational deficiencies stemming from lax internal processes and controls that were obtaining in the respective banks than any inherent flaw in this as an instrument of credit. It is against this background, the group recommends that the erstwhile micro-level guidelines concerning bill financing in the RBI circular be amended leaving it to individual banks to lay down appropriate internal guidelines and prescribe suitable controls;

- Banks could convert the existing drawals under the working capital demand loan into liquid instruments in the nature of buyer's usance promissory notes which, when discounted in the market place, will emerge