GLOSSARY

Acceptance house: It is a financial institution that 'accepts; a commercial bill, thereby providing a guarantee about the credit-worthiness of the drawer of the bill. This guaranteeing service is provided against a commission.

Bank rate: It is a rate at which the Central Bank of a country rediscounts a bill already discounted by a commercial bank. To put it simply, it is the rate at which the Central Bank provides funds to the commercial banking sector at their time of liquidity problems.

Base money: See **Reserve money**

Bill discounting: When a drawer of a commercial bill (which has been accepted by a drawee) is in need of funds, it can sell the bill to a discounting agent at a discount to its face value. The difference between the face value and the discounted value is the income of the discounting agent.

Bonds: It is a debt instrument that carries with it the promise to repay the loan on a specific maturity date. A bond is a secured instrument, but may not always directly offer an interest return. In case of some bonds, it is issued at a discount to the maturity value, so that the lender gets some return (also see **floating rate bonds**, **deep discount bonds**, **indexed bonds** and **junk bonds**).

Book building process: It is a method of price discovery in the primary capital market. When the price of an issue is discovered on the basis of demand received from the prospective investors at various price levels, it is called *"Book Building process."* Here neither the investor nor the issuer knows the exact price of the issue beforehand. Only an indicative price band is announces. The final issue price is the highest at which there is a demand for the entire issue.

Call money: It is the overnight loan, generally taken by commercial banks, to enable them to overcome their very short term liquidity crisis. The transactions take place mostly among commercial banks, though a few other institutions may be a part of it.

CAMELS guidelines: To ensure that the banks are organised and operated on sound financial principles, RBI has been stressing on the **CAMELS** guidelines. **CAMELS** indicate parameters like "Capital adequacy, **A**sset quality, **M**anagement, **E**arning appraisal, **L**iquidity, and finally, **S**ystem & control".

Capital formation: It refers to the addition to the stock of capital in a society. The source of capital formation is investment, which can come from (i) domestic savings and (ii) net inflow of foreign capital. Of course, depreciation of existing capital stock has to be deducted before arriving at the capital formation figure.

Capital market: It is the market where medium and long term instruments are transacted, that is, instruments with a maturity period of more than one year. It is the market which mobilises fund from the surplus sector and passes it on to the deficit sector for the purpose of investment, that is, for capital formation. Instruments traded are shares, bonds and debentures – all of different types.

Cash management bills: The Cash Management Bill (CMB) is an instrument that is issued to balance the temporary cash mismatches of the government of India, much like the now abolished ad-hoc Treasury Bills. The issues are made through auctions by the RBI. The CMBs have tenure of 80 days.

Clearing Corporation of India Ltd (CCIL): CCIL (established in 2001) is India's clearing house for settlement of market trades in government securities and inter-bank foreign exchange transactions. It runs an electronic trading and settlement platform (the Negotiated Dealing System of RBI) for smooth and quick trading and settlement.

Close-ended Mutual fund scheme: These schemes sell a specific number of units. Investors cannot buy the units of a closed-ended fund after its initial offering period is over. New investors cannot enter, nor can existing investors exit till the term of the scheme ends.

Collateralised Lending and Borrowing Obligation (CBLO): It is a mechanism for borrowing and lending of funds supported by some collateral (government securities) by market participants who are admitted as members in the CBLO Segment of **Clearing Corporation of India Ltd (CCIL).** CBLO has various tenures, from overnight up to a maximum of one year.

Commercial banks: According to the Banking Regulation Act of 1949, 'banking' may be defined as an act of **"....... accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise".** A financial institution that carries out these functions for profit, and also runs the payment system of the country is called a commercial bank.

Convertible debenture: A convertible debenture is a debenture which is converted into equity after a specified period of time, whereupon the investor turns into a shareholder from a lender. Convertibility may be partial or full. In case of a partly convertible debenture, only a one part of the value contained in the debenture is converted into equity, while the other part remains a debenture. The investor becomes simultaneously a lender and a shareholder.

Credit control: *Credit control* policies are those which try to control the **volume** and **direction** of credit in the economy, as provided by the commercial banking sector as well as by non-banking financial companies in the country. Credit control can be considered to be an important part of monetary policy, but there are certain non-overlapping areas as well.

Credit creation: Commercial banks can create deposit money, and hence raise the level of money supply in the economy, by providing credit to customers. This becomes possible because (i) the banks have to hold only a fraction of a deposit made with them, and (ii) banks run the payment mechanism in the country. Thus, out of an initial deposit, many subsequent deposits are created through the credit delivery system. This is called credit creation or deposit money creation.

Credit rating: Credit rating is the **opinion** of a rating agency on the relative **ability and willingness** of the issuer of a debt instrument to **meet the debt service obligations**. Rating is usually expressed in **alphabetical or alphanumeric** symbols. Symbols are a simple and easily understood tool which helps the investor to understand the credit quality of a debt instrument.

Cash Reserve Ratio or CRR: It is the average daily balance that a bank is required to maintain with the RBI as a certain per cent of its NDTL, or Net Demand and Time liabilities (which are basically deposits with the banks).

Debenture: A debenture is a document that either creates a debt or acknowledges it. Debentures may be secured or non-secured, that is, they may or may not have a charge on the company's assets.

Debenture Trustee: A 'Debenture Trustee' is a trustee of a trust deed for securing any issue of debentures of a body corporate. SEBI stipulates that the issuer of the debentures must arrange for a debenture trustee to safeguard the interest of the investors.

Deep discount bonds: These are bonds which are issued at a discount to their face value (which is also their maturity value). There is no explicitly specified interest rate, but the lender gets a return as there is a difference between what he invested and he receives back on maturity.

DFHI or SBI DFHI: DFHI was set up in March 1988 by RBI jointly with public sector banks and all India Financial Institutions. The aim was to provide liquidity to money market instruments, to promote the secondary money market i.e. to be an active trader in money market instruments and play a major role in the development of the money market. It was accorded the status of a primary dealer in 1996. After SBI Gilts Ltd. was merged with DFHI in 2004, the new entity is called SBI DFHI Ltd.

Development Financial Institution (DFI): DFIs are financial institutions which have **fixed focus areas**, either a particular sector (like small-scale industries or rural sector), or a particular type of activity (like EXIM Bank for exports and imports). The objective of a DFI is promotion and development of its focus area (profit is not its basic goal). In order to develop the target sector, **DFIs** provide a comprehensive range of services like offering technical consultancy services, entrepreneurship development training etc., apart from arranging financial assistance for productive units.

Discount house: Financial institutions that discount commercial bills to unblock the blocked fund of a productive unit is called a discount house. It is a fund-based financial service that which creates a secondary market for bills.

Equity share: An equity share, also called ordinary share or common stock, represents the form of fractional or part ownership of a company. The shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holders of such shares are members of the company and have voting rights.

Export–Import Bank of India (EXIM Bank): EXIM Bank is a DFI, wholly owned by the Government. It was established in 1982 under Export-Import Bank of India Act 1981 for financing, facilitating and promoting foreign trade of India. EXIM Bank provides assistance to Indian firms in their globalization efforts by locating overseas distributor(s)/ buyer (s)/ partner (s) for their products and services. EXIM Bank lays special emphasis on enhancing export capabilities and international competitiveness of Indian companies through its various Advisory Services.

Financial inclusion: Financial inclusion refers to a situation where individuals and businesses have access to financial products and services that meet their needs. Also, such financial products and services must be affordable and readily available to all.

Financial intermediaries: A **financial intermediary** is an institution or individual that serves as a middleman among diverse parties in order to facilitate financial transactions. Common types include commercial banks, investment banks, stockbrokers, pooled investment funds, and stock exchanges. Financial intermediaries reallocate otherwise uninvested capital to productive enterprises through a variety of debt, equity, or hybrid stakeholding structures.

Financial services: Financial services are **economic services** provided by the finance industry, encompassing a broad range of businesses. It includes **banking, insurance, leasing and hire purchase, merchant banking, portfolio management, depository services, factoring etc.** It is an extremely important sub-sector within the financial system, as it *facilitates* fund flow from the surplus sector to the deficit sector of the economy.

Floating rate bond: These are debt instruments which do not specify a particular interest rate. Instead, the rate is linked to some benchmark rate like, say, the London Inter-bank Offer rate (LIBOR). Floating rates are quotes in terms of a margin around the benchmark rate.

Functions of RBI: The functions of RBI are

(i) issue of notes,
(ii) acting as the banker to the government,
(iii) acting as the bankers' bank,

(iv) public debt management,
(v) custodian of foreign exchange, exchange management and control,
(vi) regulatory, supervisory and promotional functions,
(vii) collection of data and publications,
(viii) developing and regulating the payment mechanism of the country and
(ix) conducting monetary and credit control policies – a very important function.

High-powered money: See **Reserve money**

Indexed bonds: These bonds do not carry any specified fixed interest rate. However, the interest rate is linked to some price index. In this sense, they are similar to floating rate bonds. This is done to protect the investor from inflation, and to ensure a positive real return.

Investment: investment is the amount of goods produced per unit time which are not consumed at the present time. Types of investment include (i) residential, (ii) non-residential investment (such as new machinery or factories), and inventory (the accumulation, intentional or unintentional, of goods inventories). One feature of investment is that it leads to increase in productivity (except in the case of inventory accumulation of consumption good). Investment leads to capital formation, as it adds to the stock of capital.

Investor protection: Investor protection is a set of actions to encourage honest advertising of financial products, and to prevent malpractices to make sure that investors do not lose money if their investments default (are not repaid). It may also be defined as the extent to which the relevant laws and their effective enforcement protect investors from malpractices or negligent practices on the part of the company or market intermediaries.

Investor protection fund: The Investor Education and Protection Fund (IEPF) was established in 1999 under Section 205C of the Companies Act by way of an amendment for promotion of investor awareness and education.

The body has a main committee (the apex committee) which discharges important functions relating to investors' awareness, education and protection.

Insurance Regulatory and Development Authority (IRDA): The Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include

- Promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums,
- Ensuring the financial security of the insurance market.

Junk bond: A junk bond is a high-risk, high yield bond (issued in USA) intended to finance either a leveraged buy-out or a merger of a company in financial distress.

Letter of Offer: See **Offer document.**

Liquidity Adjustment Facility (LAF): LAF is a monetary policy tool. It is now the principal tool for conducting monetary policy in India. LAF is used to assist banks in adjusting the day to day liquidity mismatches. LAF helps banks to borrow (or lend) money from (to) the RBI. It consists of repo and reverse repo operations (*see repo and reverse repo*).

Marginal Standing Facility or MSF: A facility under which scheduled commercial banks can borrow **additional amount of overnight money** from the RBI by adjusting their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest.

Market Stabilisation Scheme or MSS: This instrument for monetary management was introduced in 2004. Surplus liquidity arising from **large foreign capital inflows** is absorbed through sale of short-dated government securities and treasury bills. The cash so mobilised is held in a separate government account with the RBI.

Merchant banking: According to SEBI, a merchant banker may be defined as *any entity* "*who is engaged in the **business of issue management** either by making arrangement regarding selling, buying or subscribing to securities as **manager, consultant, advisor or rendering corporate advisory services in relation to such issue management**."*

Micro Finance Institution (**MFI**): A **MFI** is a non-deposit taking NBFC, provided it fulfils certain conditions like

a. having not less than 85% of its assets which are basically loans disbursed to financially backward people.

b. tenure of the loan not to be less than 24 months for loan amount in excess of ₹ 15,000 with prepayment without penalty;

c. loan to be extended without collateral;

Monetary policy: Broadly speaking, **monetary policy** is the process by which the monetary authority of a country controls

(i) the overall supply of money,
(ii) the availability of liquidity to different sectors of the economy, and
(iii) the cost of money (the interest rates) in the country.

Money market: Money market is a financial market that deals in short term financial instruments, that is, the class of instruments with maturity period of up to one year. It evens out the liquidity imbalances of an economy and is an important source of working capital. It

also provides a platform for the monetary policy operations of the Central Bank of a country.

Money market mutual fund: It is a mutual fund**,** that is, a financial institution that pools funds from investors (unit-holders) and channelises the funds into the money market. It offers an opportunity for retail investors to transact in the money market, which is otherwise not very accessible to them.

Mutual Funds: A Mutual Fund is a financial intermediary that collects money from investors (who share a common financial goal), and invest the proceeds in different asset classes, as defined by the investment objective of the Fund. The investors get 'units' of the Fund in exchange of their money. So, just as there are shareholders of a company or depositors in a bank, there are unit-holders in a Mutual fund.

Thus, we can say that a Mutual Fund **pools money** from many investors and trades in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these assets with the money pooled from its unit-holders.

NABARD: NABARD is India's **apex Development Financial Institution**, formed by an Act of Parliament in 1982. Owned by the Government of India and the RBI, NABARD aims at bringing rural prosperity through credit and non-credit initiatives in the fields of agriculture, cottage & village industries, handicrafts and small scale industries.

Negotiated dealing system: The Negotiated Dealing System, or NDS, is an **electronic trading platform** started by the Reserve Bank of India to facilitate the issuing and exchange of government securities and other types of money market instruments. The **Clearing Corporation of India Ltd (CCIL)** carries out the trading and settlement of the money market instruments through NDS.

Net Asset Value (NAV): NAV is a mutual fund scheme's assets minus the value of its liabilities per unit. It is the price at which an investor buys the unit of a scheme. It may also be the price at which he would sell the unit (minus any load if applicable). NAV reflects the composite prices of all the securities held by the mutual fund scheme along with the liquid cash held. It is calculated on per unit basis after deducting all liabilities. If the prices of the securities held by the scheme goes up, the NAV will also rise and vice versa. Thus, the efficiency of fund utilisation by the Fund is shown by movements in NAV.

Non-banking financial company (NBFC): An NBFC is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of securities, leasing, hire-purchase, insurance business etc but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

Non-performing Assets (NPA): An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A non performing asset **(NPA)** is a loan or an advance where;

i. interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,
ii. the account remains **'out of order'** in respect of an Overdraft/Cash Credit (OD/CC),
iii. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
iv. the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
v. the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,

Notice money: The notice money market facilitates lending and borrowing of funds between banks and entities like Primary Dealers. An institution which has surplus funds may lend them on an uncollateralized basis to an institution which is short of funds. The Notice money transactions represent borrowing/lending operations with maturity periods of 2-14 days.

Objectives of monetary policy in India: Broadly speaking, **monetary policy** is the process by which the monetary authority of a country controls

(i) the overall supply of money,
(ii) the availability of liquidity to different sectors of the economy, and
(iii) the cost of money (the interest rates) in the country.

The primary objectives of **monetary policy** are to

(i) maintain price stability, and at the same time
(ii) promote growth in the economy through an adequate expansion of credit

The secondary objectives are to

(i) ensure financial stability, including exchange rate stability,
(ii) promote exports etc.

Offer document: It is a document which contains all the relevant information about an issue of securities. Such details include details about the company, the promoter(s), project, financial details etc. The **Offer document** is used to invite subscription to the issue.

The **Offer document** is called

- a **'Prospectus'** in case of a public issue, and
- a **'Letter of Offer'** in case of a rights issue.

Open Market Operations (OMO): it is an instrument of monetary policy that involves the sales and purchase of government securities by the Central Bank with commercial banks as

the other party in the sales/purchase process. Through OMO, the Central Bank can (i) control the liquidity in the banking system, and (ii) yields of the government securities.

Open-ended Mutual fund scheme: These mutual fund schemes buy and sell units on a continuous basis. Thus, the units can be purchased and sold even after the initial offering period. Investors can enter and exit as per their convenience, and so the unit capital may vary continuously.

Payment mechanism: It refers to the mechanism by which the receivables and payables (arising out countless economic transactions taking place every moment) are settled. It facilitates transfer of value between a payer and a payee or the beneficiary. Commercial banks act as the key players in the payment mechanism, while the Central Bank provides the platform (the clearing house) for running the mechanism.

Preference share: A preference share represents a fractional or part ownership of a company. It has greater preference over equity share in respect of getting back the funds if the company is liquidated.

Primary dealer: In India, the Primary Dealer (PD) business model was established to develop an active, vibrant and liquid secondary market for Government Securities. The core activities of a PD comprise of underwriting, bidding, market making and trading in Government Securities, Treasury Bills and other fixed income securities. Apart from the above, PDs are an active participant in the money market instruments. PDs are the only entity outside the banking system which can participate in the call money market.

Primary functions of a commercial bank: The **primary functions** of a commercial bank are those which follow directly from the definition of a commercial bank, that is:

(a) Accepting deposits,
(b) Lending and investing the deposits accepted, and
(c) Running the payment mechanism in the economy

Prospectus: See **Offer document.**

Prudential norms: prudential norms are norms specified by a Central Bank for better and more transparent functioning of banks. In general, they include norms on:

(i) income recognition,
(ii) asset classification and
(iii) provisioning for the advances portfolio of the banks.

These norms ensure that the banks move towards greater consistency and transparency in the published accounts.

In line with the international practices and as per the recommendations made by the Committee on the Financial System (Chairman Shri M. Narasimham), the Reserve Bank of India has been introducing, in a phased manner, prudential norms in India since the 1990s.

RBI: Reserve Bank of India is India's Central Bank. It carries out the usual Central Banking functions (see **functions of RBI**).

Red herring prospectus: It is an **offer document** used in case of a **book-built issue** (see **book-building process**). It contains all relevant details about the issue except that of the price or the number of shares that are being offered.

Registrar to an Issue: A Registrar to the Issue is a person appointed by an issuing entity to carry on the following activities on its behalf
(i) Collecting application for investor in respect of the issue;
(ii) Keeping a proper record of applications and monies received from investors
(iii) Assisting the issuer in determining the basis of allotment of the securities in consultation with the stock exchange.

Repurchase agreement or repo: The (fixed) interest rate at which RBI provides very short term liquidity to banks against the collateral of government and other approved securities under the liquidity adjustment facility (LAF).

Reserve money or High-powered money or Base money: It is the sum of

(i) Currency in circulation,
(ii) Bankers' deposits with the Central bank, and
(iii) 'Other' deposits with the RBI

It may be noted that the 'other' deposit component is of little significance, and thus, the first two are the main components of reserve money.

Reserve money acts the monetary base on which the money multiplier in the economy is calculated (also see **Sources of Reserve money**).

Reverse repo: The (fixed) interest rate at which the RBI absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities under the LAF.

Risk management: Outcome of economic decisions cannot always be perfectly predicted, as there is often an element of uncertainty in economic events. This leads to **'risks',** which represent a situation in which the decision maker has some ideas about the probabilities of different outcome. Thus, risk management is a set of policies/methods/tools which are used to (i) evaluate and monitor risks, and (ii) reduce their impact.

Satellite dealer: Satellite dealers are the second tier of institutions (primary dealers form the first) that were established to promote the **distribution and trading of government**

securities. They are required to generate an outright annual turnover of at least Rs. 30 crore in government securities (including T-Bills).

SEBI (Securities and Exchange Board of India): SEBI was established as a **regulatory body of the Indian capital market,** in 1988 through an administrative order. Later, in 1992, the SEBI Act, 1992 was passed and SEBI now carries out its functions in terms of this Act, and a few other Acts.

The Preamble of the Securities and Exchange Board of India describes the basic functions of the SEBI as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto." So SEBI's functions are:

(i) Protective functions,
(ii) Developmental and promotional functions, and
(iii) Regulatory functions

Secondary functions of a commercial bank: The secondary functions of commercial banks can be divided into

(i) Agency functions and (ii) Utility functions.

Agency functions include:

- *To collect and clear cheques, and other similar instruments:* This is the function related to the payment mechanism mentioned above.
- *To deal in foreign exchange transactions:* This is an extremely important function of a commercial bank as it facilitates international economic transactions.
- *To act as trustee, attorney, correspondent and executor*
- *To accept tax proceeds and tax returns:* In this case, the bank acts as the agent of the government.

Utility functions include:

- *To provide safety locker facility to customers*
- *To issue traveller's cheque*
- *To accept various bills for payment: phone bills, gas bills, etc.*
- *To provide various cards- credit cards, debit cards, etc.*

SIDBI: Small Industries Development Bank of India (SIDBI) was first set up as a wholly-owned subsidiary of IDBI in 1989. Later, on 2nd April 1990, SIDBI was established as a DFI under an Act of Indian Parliament, so that there is a dedicated agency to look after the needs of the small scale sector.

SIDBI acts as the principal financial institution for promotion, financing and development of the Indian Micro, Small and Medium Enterprise (MSME) sector (previously referred to as the small, tiny and cottage sector).

Sources of Reserve money: The sources of reserve money are as follows:

(i) Net RBI Credit to Government +
(ii) RBI Credit to Banks +
(iii) RBI Credit to the Commercial Sector +
(iv) Net Foreign Exchange Assets of RBI +
(v) Govt.'s Currency Liabilities to the Public –
(vi) Net Non-Monetary Liabilities of RBI

Share Transfer Agent: A share transfer agent is (i) any person who, on behalf of a body corporate, maintains the records of holders of securities issued by such body corporate and deals with all matters connected with the transfer and redemption of its securities.

Statutory Liquidity Ratio or SLR: The share of its Net Demand and Time Liabilities that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.

STCI

Term money

Transmutation effect

Treasury bill

Underwriter: An Underwriter means an entity, such as a financial institution, bank, merchant banker, broker or other person, who engages in the business of underwriting of an issue of securities of a body corporate. **Underwriting** is an arrangement whereby one or more such entities assure the issuing company to buy issued securities to a specified extent in case the public subscription does not amount to the desired levels.

PORTFOLIO MANAGERS Portfolio manager means any person who pursuant to contract or arrangement with the client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the clients as the case may be. "Discretionary portfolio manager" is defined as one who exercises or may exercise, under a contract relating to portfolio management, any degree of discretion as to the investment or the management of the portfolio of the securities or the funds of the client. "Portfolio" means the total holdings of securities belonging to any person.

The Depositories Act, 1996 defines a depository to mean "a company formed and registered under the Companies Act, 2013 and which has been granted a certificate of registration under sub-section (IA) of section 12 of the Securities and Exchange Board of India Act, 1992. A Depository Participant (DP) is described as an agent of the depository. They are the intermediaries between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act, 1996.