ISSUE NO 39 NOVEMBER 2014

FINly

GOVT SECURITIES

TREASURY BILLS

FINSTREET ...the path to Financial Excellence!

S I M S R

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Cover Story

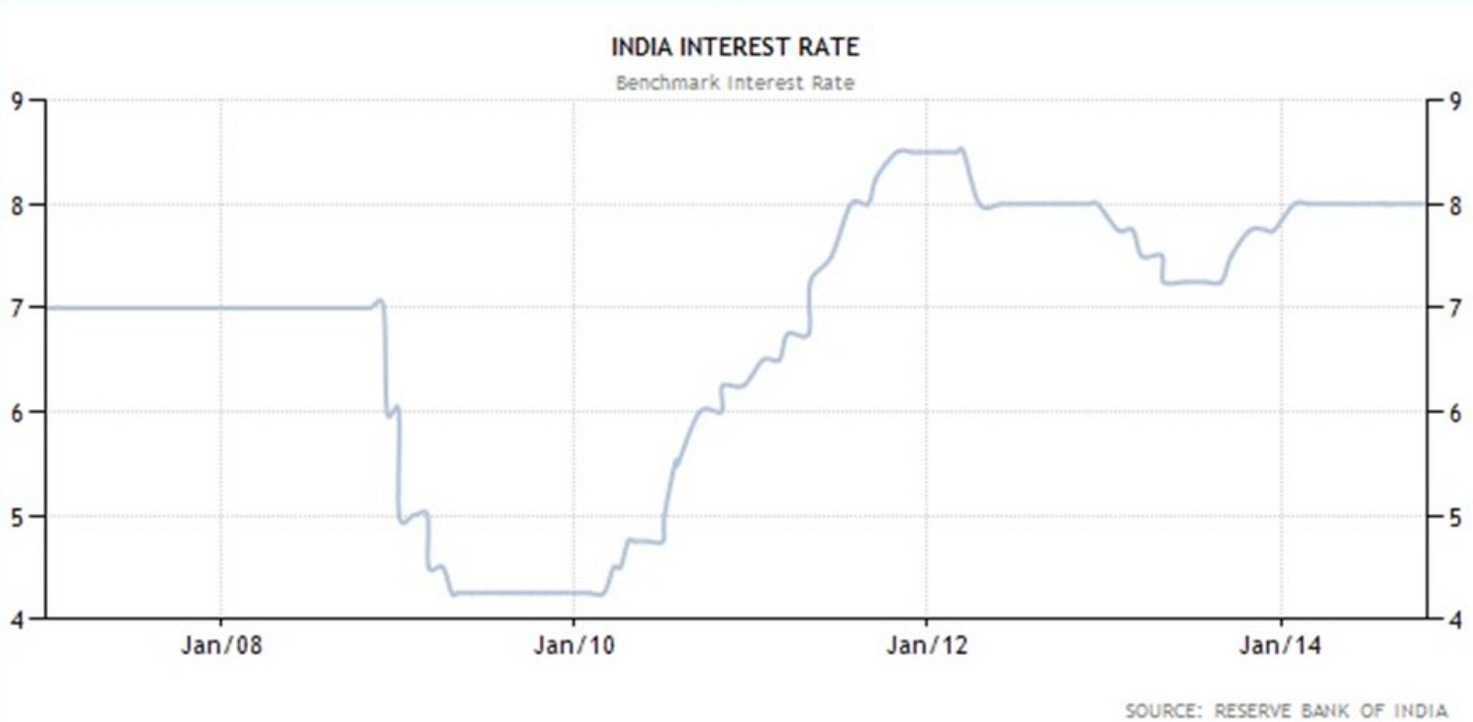
Interest Rate

An interest rate is the amount paid by the borrower to the lender along with the principal. Interest rate are percentage of principle for a period of 1year.

In India RBI (Central Bank of India) lends money to banks at 8% interest and banks further lend it to companies and individual at a higher rate depending upon the type of loan.

Interest rate is a vital tool of the monetary policy for regulating the liquidity , unemployment and inflation in the country. In order to attract investors interest rates are reduced and reduced interest rates promotes more consumption and spending in economy.Real interest rates are decided by RBI in India.

The current real interest rate in India is 8% repo and reverse Repo 7%



Reasons for change in interest rates are:

1) Short-Term Gain: Decrease in the interest rate increases the money supply in the country which makes it look attractive for the short term. FII's funds flow in. Spending increases but it is soon followed by inflation.

2) Liquidity preference: People like to have resources that can be converted easily into cash rather than form that takes much time.

3) Taxes: Gains from some of the interest income is taxable and higher interest rate compensates for the loss.

4) Inflation: Higher interest rate is used to control the inflation in the country.

5) Alternative Investment: It gives a lot of options for investment.

6) Economy: Interest rates fluctuates on the status of the economy. Higher interest rates is sign of strong economy.

Real interest Rates versus Nominal Rate:

Nominal rate is the amount of interest earned on the principal

Eg If 1000rs in bank gives 1080 after 1 year. Interest earned is 8%

Real Interest Rate = Nominal Interest Rate - Inflation (Expected or Actual)

Real Interest rate measures purchasing power by considering the inflation rate in the nominal rate. If after 1 year 1080 buys same things as 1000Rs a year later indicates inflation is 8%

Zero Interest rate policy :

Zero interest-rate policy (ZIRP) is a macroeconomic concept describing conditions with a very low nominal **interest rate**, such as those in contemporary Japan and, since December 16, 2008, in the United States.

Problems in zero rate policy.

Pension funds are becoming more and more dangerously underfunded, threatening the retirements of many individuals and the balance sheets of companies and governments

Artificially set interest rates misallocates capital, results in malinvestment, and distorts and manipulates markets.

The pricing mechanism/discovery is damaged if the cost of money is fake.

The wealth effect is fleeting and so is its economic impact. Easy money creates illusory feel of an economic fix.

Negative Interest Rate Policy:

Depositors are actually charged to keep their money in an account. In June 2014 the European Central Bank has cut a key interest rate below zero, the first major central bank to venture into negative territory. Banks have to pay money for parking money at ECB.

It's one way to try to reinvigorate an economy with other options exhausted.
Inflation in Europe has fallen far below the 2 percent or so that the central bank aims for, unemployment remains high in much of the continent, and growth sluggish.

In Macroeconomics:

Unemployment: Higher interest rates increase the cost of borrowing which can reduce investment and output and increase unemployment. Expanding businesses, especially entrepreneurs tend to be net debtors. However, the Austrian School of Economics sees higher rates as leading to greater investment in order to earn the interest to pay its creditors. Higher rates encourage more saving and reduce inflation.

Money and Inflation:
Loans, Bonds are connected with money pool and any change in the interest rate causes a lot of volatility. Increase in the money supply causes inflation.

Savings and Pension Funds:
An higher interest rate causes people to save more and increases wealth of Pension Funds.
But Since 2007 financial crisis interest rates in USA are at sub zero rate which is detrimental to Pension Funds.

Market interest rates:
A market for investments which ultimately includes the money market, bond market, stock market, and currency market as well as retail financial institutions like banks. The interest rates yielded by any investment take into account:

- The risk-free cost of capital
- Inflationary expectations
- The level of risk in the investment

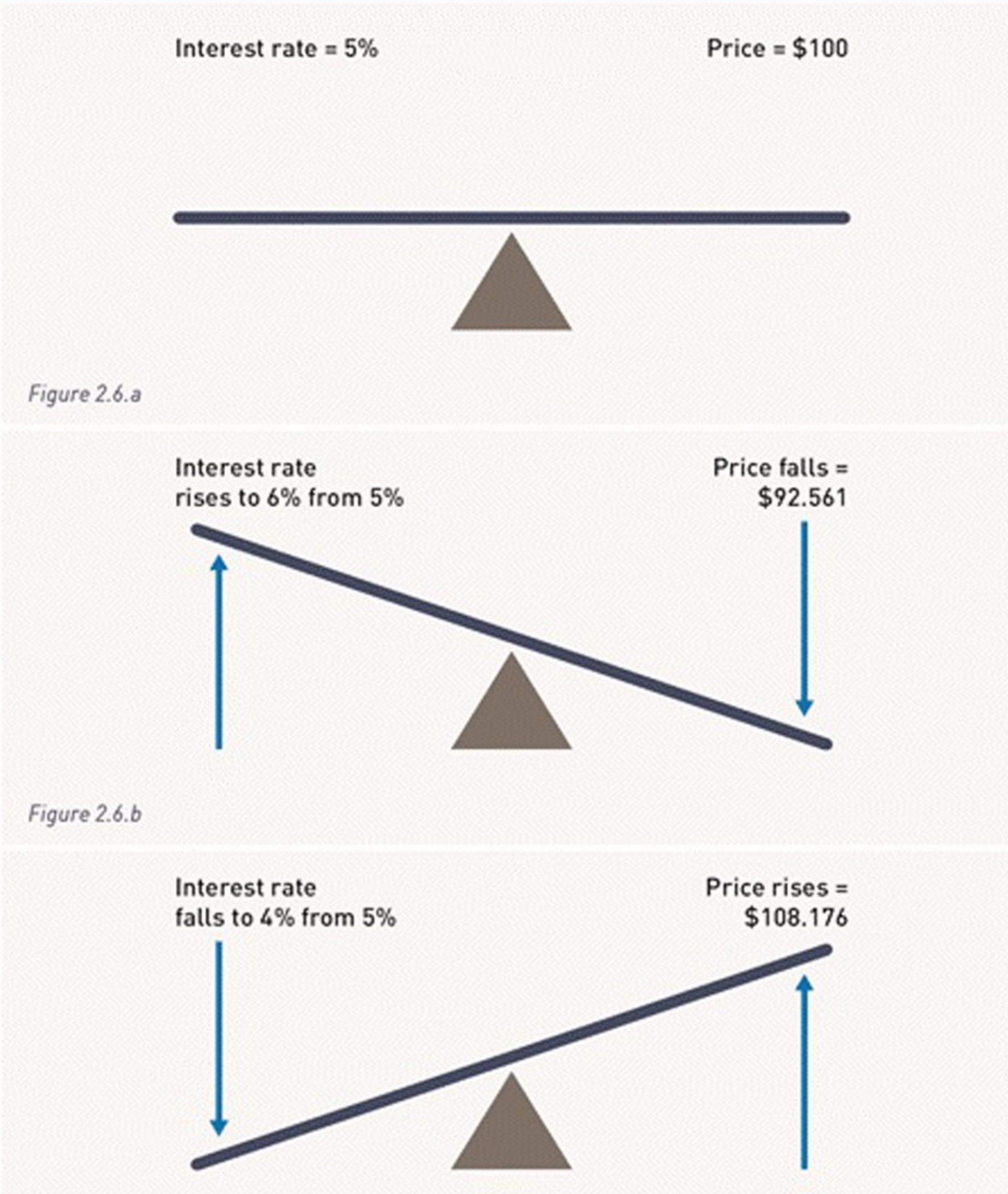
The costs of the transaction

Spread:
The *spread* of interest rates is the lending rate minus the deposit rate. This spread covers operating costs for banks providing loans and deposits. A *negative spread* is where a deposit rate is higher than the lending rate.

Impact on Bond Prices:

Bond Prices are inversely related to interest rates.

Eg Assume you buy a $100 bond with 10 years to maturity, which pays a 5 per cent interest payment (known as a coupon) delivering a required yield of 5 per cent. This is the starting point.
A rise in the interest rate to 6 per cent means that for the bond to have the same initial return of 5 per cent, the face value must reduce proportionally to $92.56 so that the see-saw remains balanced. The reverse is also true. If rates fall to 4 per cent, the bond price must increase to $108.18 to maintain the initial 5 per cent return.



Government Securities

A Government security or a G-sec is a tradable instrument that acknowledges the Government's debt obligations. It is issued by the Central Government, state governments or other local bodies like municipalities etc. It can either be short term (treasury bills) or long term (bonds or dated securities). In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities.

The Government of India also issues savings instruments (Savings Bonds, National Saving Certificates (NSCs), etc.) or special securities (oil bonds, Food Corporation of India bonds, etc.). However, they are not fully tradable and hence not eligible to be **SLR** securities (Statutory Liquid Ratio or SLR, which is the **reserve** requirement that commercial banks in India are required to maintain in the form of gold or un-encumbered government approved securities). The central government also issues **special rupee** securities in the payment of India's subscriptions to IMF, IBRD, Asian Development Bank (ADB), International Development Association (IDA)) etc. These securities are treated as a part of the internal floating debt of the Government and are non- negotiable and non-interest bearing claims.

Government securities as a unique and important financial instrument:

Government securities are important financial instruments in the financial markets of any country. They are helpful in implementing the fiscal policy of the government. They are also closely connected with the workings of two major techniques of monetary control of the Central Bank – open market operations and statutory liquidity ratio. Also, since the RBI can issue currency notes with the backing of Central Government bonds, apart from gold and foreign exchange, they constitute the *ultimate source of liquidity in the economy*.

Treasury bills are available for a minimum amount of Rs.25, 000 and in multiples of Rs. 25,000. Besides auctions, they can also be issued under the **Market Stabilization Scheme (MSS)**. However, T-bills cannot be auctioned by the State Governments.

Mode of Issue:

T-bills auctions are held on *the* ***Negotiated Dealing System (NDS)*** and the members electronically submit their bids on the system. **Non-competitive bids** are routed through the respective custodians or any bank or PD which is an NDS member.

The RBI conducts auctions usually every Wednesday to issue T-bills. Payments for the T-bills purchased are made on the following Friday. The 91 day T-bills are auctioned on every Wednesday. The Treasury bills of 182 days and 364 days tenure are auctioned on alternate Wednesdays. The Reserve Bank releases an annual calendar of T-bill issuances for a financial year in the last week of the previous financial year and also announces the issue details through a press release every week.

Fig. Treasury Bill Securities trading data

Scrip Code	Scrip Name	Issue Date	Maturity Date
421095	364 DAYS T-BILLS MAT 13 NOVEMBER 2014	14/11/2013	13/11/2014
421100	364 DAYS T-BILLS MAT 27 NOVEMBER 2014	27/11/2013	27/11/2014
421149	182 Days T-Bills Mat on 06 Nov 2014	08/05/2014	06/11/2014
421176	91 Days T-Bills Mat on 06 November 2014	07/08/2014	06/11/2014

2) Dated Government Securities:

Dated Government securities are long term securities that are issued at face value. They carry a fixed or floating coupon (interest rate) which is paid on the face value and is payable at fixed time periods (usually half-yearly). The tenor of the security is also fixed and it is redeemed at par on the maturity date.

Eg: **7.49% GS 2017** stands for:

Coupon: 7.49 % paid on face value .

Name of the issuer: Govt. of India *Date of Issue*: April 16, 2007 *Maturity*: April 16, 2017

Coupon Payment Dates: Half-yearly (October 16 and April 16) every year

Minimum Amount of issue/sale: Rs. 10,000

Instruments:

a. Fixed Rate Bonds: These are bonds on which the coupon rate is fixed for the entire life of the bond. Most Government bonds are issued as fixed rate bonds.

b. ***Zero Coupon bonds*****:** Zero Coupon bonds are bonds issued at a discount on the face value and are redeemed at par on the maturity date. The tenor of the security is fixed. These were issued first on January 19, 1994 and were followed by two subsequent issues in 1994-95 and 1995-96 respectively.

c. ***Floating Rate Bonds*****:** Floating Rate Bonds are securities which do not have a fixed coupon rate. The coupon is re-set at pre-announced intervals (say, every six months or one year) by adding a spread over a base rate. In the case of most floating rate bonds issued by the Government of India so far, the base rate is the weighted average cut-off yield of the last three 364- day Treasury Bill auctions preceding the coupon re-set date and the spread is decided through the auction. Floating Rate Bonds were first issued in September 1995 in India.

d. Bonds with Call/Put Option**:** Bonds can also be issued with features of optionality wherein the issuer can have the option to buy-back (call option) or the investor can have the option to sell the bond (put option) to the issuer during the currency of the bond.

> **Example:** 6.72%GS2012 was issued on July 18, 2002 for a maturity of 10 years maturing on July 18, 2012. The optionality on the bond could be exercised after completion of five years tenure from the date of issuance on any coupon date falling thereafter. Thus, the Government has the right to buyback the bond (call option) at par value (equal to the face value) while the investor has the right to sell the bond (put option) to the Government at par value at the time of any of the half-yearly coupon dates starting from July 18, 2007.

e. Capital Indexed Bonds: Capital indexed Bonds are bonds where interest rate is a fixed percentage over the wholesale price index. They provide investors with an effective hedge against inflation. These bonds were first floated on December 29, 1997 on tap basis. The government is currently working on a fresh issuance of Inflation Indexed Bonds wherein payment of both, the coupon and the principal on the bonds, will be linked to an Inflation Index

(Wholesale Price Index). In order to provide the holders protection against actual inflation, the final WPI will be used for indexation.

f. Special Securities:

Under the market borrowing programme, the Government of India issues special securities to entities like Oil Marketing Companies, Fertilizer Companies, the Food Corporation of India, etc from time to time. These securities are usually long dated securities. They carry a coupon with a spread of about 20-25 basis points over the yield of dated securities of comparable maturity. These securities are not eligible as SLR securities. They can however be used as collateral for market repo transactions.

g. ***STRIPS:*** STRIPS are instruments wherein each cash flow of the fixed coupon security is converted into a separate tradable Zero Coupon Bond and traded. For example, when Rs.100 of the **8.24%GS2018** is stripped, each cash flow of coupon (Rs.4.12 each half year) will become coupon STRIP and the principal payment (Rs.100 at maturity) will become a principal STRIP. These cash flows are traded separately as independent securities in the secondary market.

3) Cash Management Bills (CMBs):

To meet temporary mismatches in its cash flow, Government of India, decided to issue a short-term instrument, known as Cash Management Bills (CMBs). The CMBs are issued for maturity periods of **less than 91 days**. They are issued at a discount and redeemed at face value at maturity. Their auction is announced by the RBI, one day prior to the date of auction through a Press Release. The settlement of the auction is on **T+1** basis. CMBs are **tradable** and qualify for ready forward facility. Investment in CMBs is also an eligible investment in Government securities by banks for **SLR**. However, the non-competitive bidding scheme has not been extended to them.

4) State Government Securities:

These are securities issued by the state governments and are also known as State Development Loans (SDLs). The issues are also managed and serviced by the Reserve Bank of India. The tenor of state government securities is normally **ten** years. They are available for a minimum amount of Rs.10, 000 and in multiples of Rs.10, 000 at a fixed coupon rate. The auctions for State Government securities are held electronically on PDO-NDS module.

Terms related to Government Securities:

a. **Liquidity Adjustment Facility (LAF):**

LAF is a facility extended by the RBI to the scheduled commercial banks (excluding RRBs) and primary dealers (PDs). It helps them to avail of liquidity in case of requirement or park excess funds with the RBI in case of excess liquidity on an overnight basis. It is done against the collateral of Government securities including State Government securities. Basically LAF enables liquidity management on a day to day basis.

b. **Gilt Funds:**

It is a mutual fund that invests in several different types of medium and long-term government securities.

c. **Crowding out:**

Activity in the government securities market can affect the overall investment in the economy. It may adversely affect private investment by directly competing for limiting resources. This will drive down their prices, leading to a substitution of private bonds with government securities. This phenomenon is called **crowding out**.

e. **Munis:**

It is a debt security issued by a state, municipality or county to finance its capital expenditures.

f. **Tranche**:

It is a piece, portion or slice of a deal or structured financing. This portion is one of several related securities that are offered at the same time but have different risks, rewards and/or maturities.

ESOP

-Sandeep JR

What are ESOPs ?

ESOPs are Employee Stock Option plans. An Employee Stock Option Plan is when the company offers its shares to the employees. An ESOP is nothing but an option to buy the company's share at a certain price. This could either be at the market price (price of the share currently listed on the stock exchange), or at a preferential price (price lower than the current market price). If the firm has not yet gone public (shares are not listed on any stock exchange), it could be at whatever price the management fixes it at.

How ESOPs work ?

An ESOP is a kind of employee benefit plan, similar in some ways to a profit-sharing plan. In an ESOP, a company sets up a trust fund, into which it contributes new shares of its own stock or cash to buy existing shares. Alternatively, the ESOP can borrow money to buy new or existing shares, with the company making cash contributions to the plan to enable it to repay the loan. Regardless of how the plan acquires stock, company contributions to the trust are tax-deductible, within certain limits.

When employees leave the company, they receive their stock, which the company must buy back from them at its fair market value (unless there is a public market for the shares). Private companies must have an annual outside valuation to determine the price of their shares. In private companies, employees must be able to vote their allocated shares on major issues, such as closing or relocating, but the company can choose whether to pass through voting rights (such as for the board of directors) on other issues. In public companies, employees must be able to vote all issues.

Provided that an ESOP owns 30% or more of company stock and the company is a corporation, owners of a private firm selling to an ESOP can defer taxation on their gains by reinvesting in securities of other companies.

Uses for ESOPs

To buy the shares of a departing owner*:* Owners of privately held companies can use an ESOP to create a ready market for their shares. Under this approach, the company can make tax-deductible cash contributions to the ESOP to buy out an owner's shares, or it can have the ESOP borrow money to buy the shares.

To borrow money at a lower after-tax cost*:* ESOPs are unique among benefit plans in their ability to borrow money. The ESOP borrows cash, which it uses to buy company shares or shares of existing owners. The company then makes tax-deductible contributions to the ESOP to repay the loan, meaning both principal and interest are deductible.

To create an additional employee benefit*:* A company can simply issue new or treasury shares to an ESOP, deducting their value (for up to 25% of covered pay) from taxable income. Or a company can contribute cash, buying shares from existing public or private owners. In public companies, which account for about 5% of the plans and about 40% of the plan participants, ESOPs are often used in conjunction with employee savings plans. Rather than matching employee savings with cash, the company will match them with stock from an ESOP, often at a higher matching level.

Major Tax Benefits

ESOPs have a number of significant tax benefits, the most important of which are:

Contributions of stock are tax-deductible: That means companies can get a current cash flow advantage by issuing new shares or treasury shares to the ESOP, albeit this means existing owners will be diluted.

Cash contributions are deductible: A company can contribute cash on a discretionary basis year-to-year and take a tax deduction for it, whether the contribution is used to buy shares from current owners or to build up a cash reserve in the ESOP for future use.

Contributions used to repay a loan the ESOP takes out to buy company shares are tax-deductible: The ESOP can borrow money to buy existing shares, new shares, or treasury shares. Regardless of the use, the contributions are deductible, meaning ESOP financing is done in pretax dollars.

Sellers in a corporation can get a tax deferral: In corporations, once the ESOP owns 30% of all the shares in the company, the seller can reinvest the proceeds of the sale in other securities and defer any tax on the gain.

- *Dividends are tax-deductible:* Reasonable dividends used to repay an ESOP loan, passed through to employees, or reinvested by employees in company stock are tax-deductible.

- *Employees pay no tax on the contributions to the ESOP, only the distribution of their accounts, and then at potentially favourable rates:* The employees can roll over their distributions in an IRA or other retirement plan or pay current tax on the distribution, with any gains accumulated over time taxed as capital gains. The income tax portion of the distributions, however, is subject to a 10% penalty if made before normal retirement age.

Limitations

As attractive as these tax benefits are, however, there are limits and drawbacks.

- The law does not allow ESOPs to be used in partnerships and most professional corporations.
- Private companies must repurchase shares of departing employees, and this can become a major expense.
- The cost of setting up an ESOP is also substantial—perhaps $40,000 for the simplest of plans in small companies and on up from there.
- Any time new shares are issued, the stock of existing owners is diluted. That dilution must be weighed against the tax and motivation benefits an ESOP can provide.
- ESOPs will improve corporate performance only if combined with opportunities for employees to participate in decisions affecting their work.

From the company's point of view:

The new Companies Act has defined ESOPs to mean options that are provided to officers, directors, or employees of a company, or of its holding company, or subsidiary company or companies, if any, that gives such directors, officers or employees the right or benefit to purchase or subscribe for the shares at a future date at a pre-determined price.

A company must familiarize itself three terms when it is mulling the issue of ESOPs: granting, vesting and exercising. Granting of the stock options refers to the issue of stocks to the employee. Vesting refers to the right of the employee to apply for the shares granted to him.

Exercising refers to the actual conversion of the employee's rights to owning the stock.

A company has two options when it considers ESOPs. One is the direct route wherein an employee can be allotted fresh shares as and when it is exercised. The other option is to create a welfare trust through which the shares can be transferred.

A good way to acquaint oneself about ESOPs is to perhaps first answer the following questions. Once this exercise is complete (with no ambiguity), the steps that follow are fairly straightforward.

Things to be answered for issuing ESOPs:

1. What is the size of the option pool that the company would like to set aside?

2. Will it be through an issue of fresh shares or would it involve the transfer of existing shares? Identify the sellers if it's a transfer of shares.

3. Have you identified the eligible employees?

4. What should be the vesting period of the stocks and related conditions?

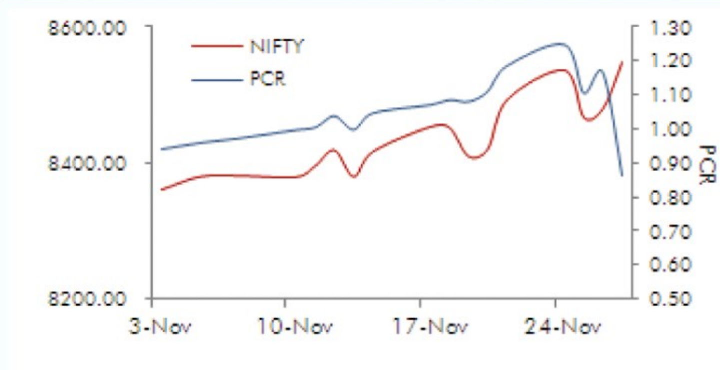
5. What should be the process involved to exercise the stocks?

News Section

Indices Change

INDEX	Price	Price Change (%)	Rollover	3 month avg.
NIFTY	8494.20	3.98	76.01	67.86
BANKNIFTY	18022.50	7.53	63.46	62.32
CNXIT	11900.85	6.98	55.52	64.40
NFTYMCAP50	3361.55	4.22	99.01	0.00
CNXINFRA	3239.70	0.94	0.00	0.00

NIFTY & PCR Graph



Monthly Gainers

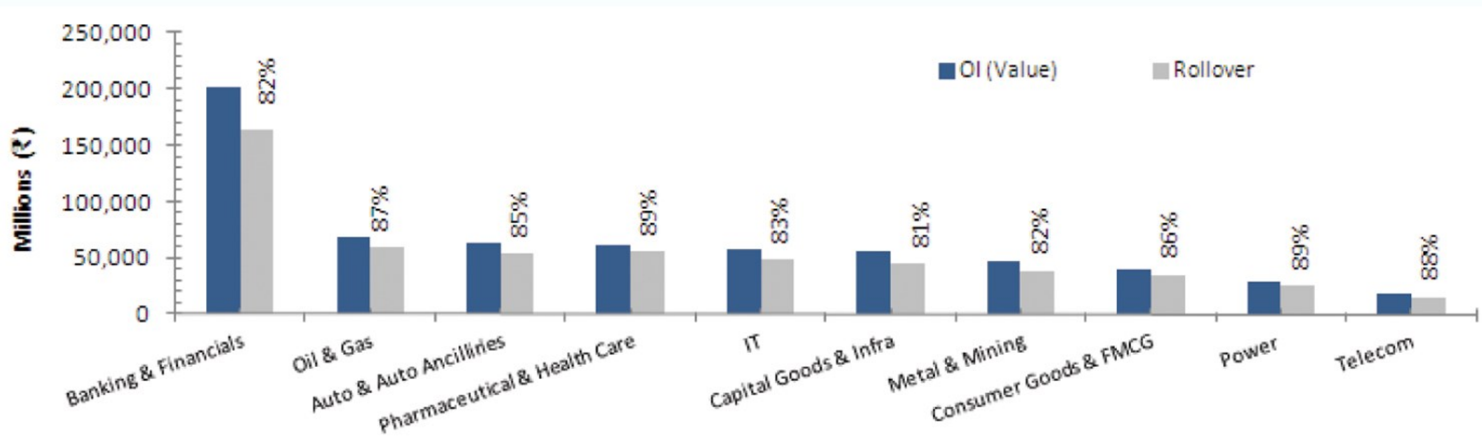
Scrip	Price	Price Change (%)	Open Interest	OI Change (%)
KTKBANK	144.15	19.38	20214000	10.90
BHARATFORG	963.05	19.37	4071500	(6.40)
DLF	148.95	19.30	21886000	(12.01)
LICHSGFIN	412.65	18.61	8747000	(26.25)
JSWENERGY	93.80	17.10	15544000	174.82

Note: Stocks which have more than 1000 contract in Futures OI.

Monthly Losers

Scrip	Price	Price Change (%)	Open Interest	OI Change (%)
NMDC	141.35	(15.61)	19634000	134.07
INDIACEM	95.40	(14.13)	18506000	(2.72)
TITAN	365.80	(13.57)	9477000	(4.73)
JINDALSTEL	143.05	(10.51)	19227000	8.18
TVSMOTOR	232.90	(9.97)	6340000	101.65

Note: Stocks which have more than 1000 contract in Futures OI.



NEWS BUZZ

- Tamoghna Das

WTO Accedes to India’s Food Stockpiling Demand

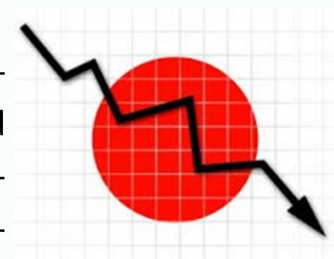
World Trade Organization adopted the first trade reform in its history to approve a framework for implementation of a global pact for easing customs norms after acceding to India’s demand to remove constraints on food stockpiling following US’ support.

Kotak Mahindra Bank to acquire ING Vysya Bank

India's fifth-biggest bank by market value, Kotak Mahindra Bank, has clinched a deal with Dutch financial giant ING to acquire ING Vysya Bank in an all stock deal. The deal will help Kotak Mahindra Bank expand its national presence and improve its market value.

Japan Falls into Recession

Japan has fallen into a recession following two consecutive quarters of economic contraction. Real gross domestic product fell 1.6% on an annualized basis in the July-September period, following a 7.3% contraction in the previous quarter. Rising sales taxes have been blamed for triggering the downturn by deterring consumer spending.

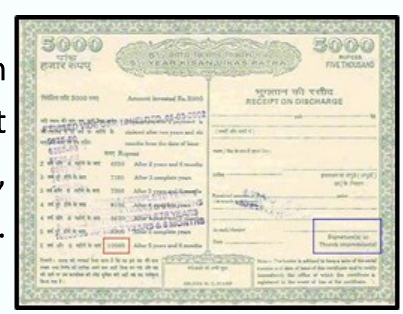


Market capitalization hits Rs 100 lakh crore

India’s mcap has risen 41% so far this year, highest among all countries on the back of Rs 93,000-crore investment by foreign institutional investors. In the last three months alone, FIIs have invested Rs 21,727 crore.

Kisan Vikas Patra Re-launched

Widely popular in the 1990s, the government has re-launched the Kisan Vikas Patra opening up a new avenue of investment for small investors. It will available to the investors in the denominations of Rs 1,000, 5000, 10,000 and 50,000 and can be purchased at present from post offices. There is however no upper limit on investments into the scheme.



RBI sells Rs10,000 crore of bonds

The Reserve Bank of India (RBI) sold Rs10,000 crore of bonds in the secondary market on under its open market operation. Prevailing liquidity conditions have been cited as reason for the sale of the bonds. Banks parked Rs6,637 crore of their excess money with RBI on October end.

New rules for NBFCs

The Reserve Bank of India (RBI) introduced a slew of changes in regulations for non-banking financial companies (NBFCs), tightening rules in a phased manner over the next four years in order to create a level-playing field for all financial any institutions.

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GST dream one step closer to reality

The empowered committee of state finance ministers endorsed the so-called 'place of supply' rules giving a significant boost to the government's bid for early implementation of the goods & services tax (GST) that will replace a plethora of levies and create a common market.

Cooling inflation, rising IIP

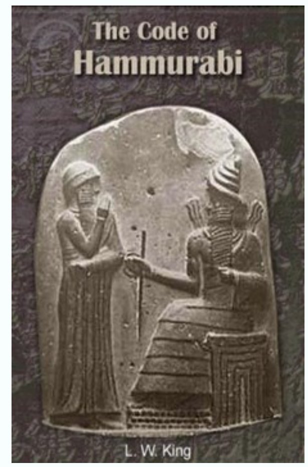
Industrial output grew to three-month high of 2.5% in September, while retail inflation cooled to 5.5% in October, reflecting improvement in economy. Consumer Price Index (CPI) fell in October to 5.52%. Production of capital goods grew by 11.6% in September and power generation by 3.9%. However, consumer goods output contracted by 4%.

Service Sector Slowdown

Services sector activity in India stagnated during October amid weaker growth of new business orders. The HSBC India Services Business Activity Index, that tracks changes in activity at Indian services companies on a month-by-month basis, fell from 51.6 to exactly 50.0 in October.

Trivia

It's not gold that John Maynard Keynes famously called a **"barbarous relic"** in 1923; he was actually referring to the gold standard

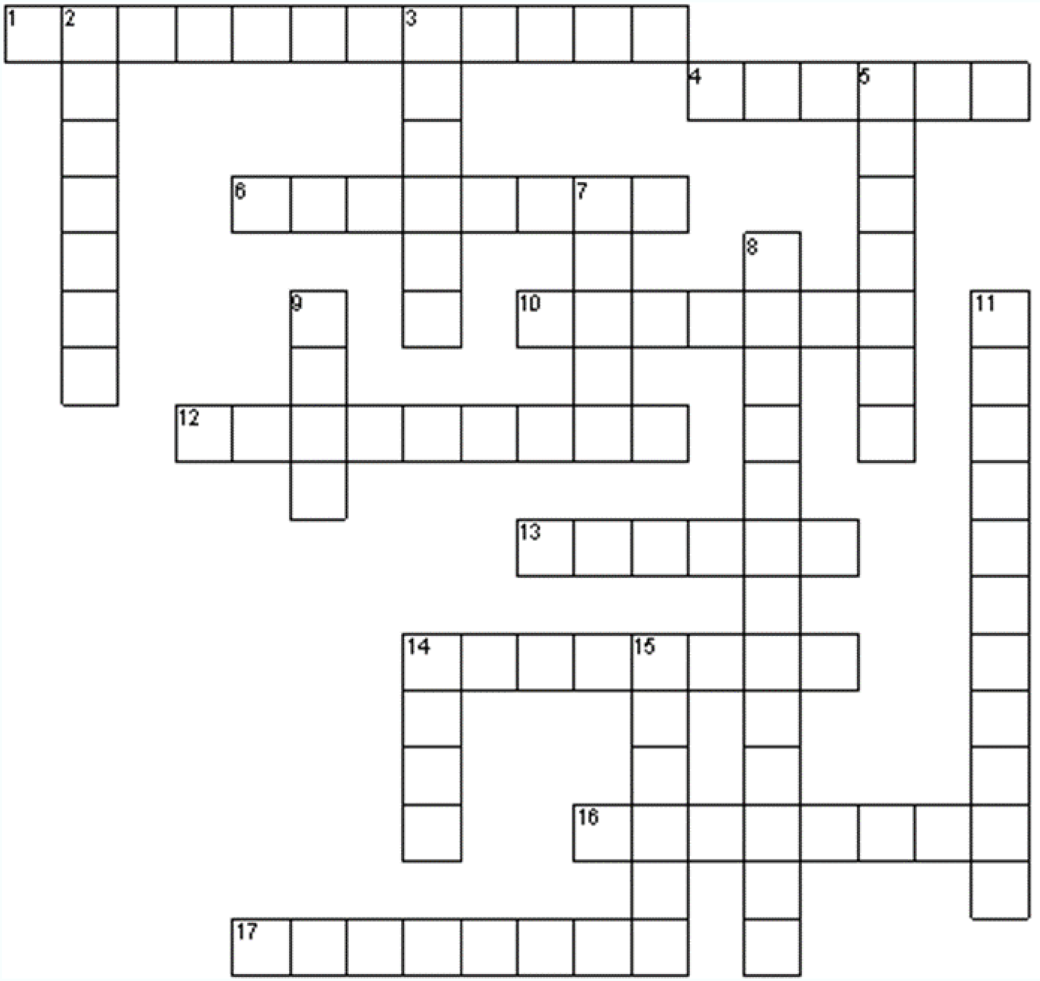


The **oldest known monetary law code**, the Code of Hammurabi, was created ca. 1760 BC in ancient Babylon. It formalized the role of money in civil society by setting amounts of interest on debt, fines for wrong-doing, and compensation in money for various infractions of formalized law.

The physically **smallest U.S. bond** was the State of Louisiana 'Baby Bond' Certificate, called a Baby Bond for three reasons: Its small denomination of $5 (the lowest denomination U.S. municipal bond), its small size (three inches by five inches), and its vignette of a baby wearing a hat.

The **first self-made female millionaire** was Madam C.J. Walker. In the early 1900s, Walker developed and operated a cosmetics empire focused on African-American women.

FINANCE CROSSWORD



N.B. There are no spaces between words.	
Across	**Down**
1. rate and efficiency of work 4. ask the bank to advance money 6. money paid for a loan 10. wealth of person or business 12. promise to repair or replace 13. amalgamation of two companies 14. legal agreement 16. total sales of a company 17. share of profits paid to shareholders	2. proof of payment 3. put money into a company or business 5. money paid to owner of copyright or patent 7. part of the capital of a company 8. where shares are bought and sold 9. money lent 11. amount of money spent 14. neither cheque nor credit card 15. money returned

1-productivity(across),2-receipt (down),3-invest(down),4-borrow (across),5-royalty(down),6-interest(across),7-share,8-stockexchange,9-loan,10-capital,11-expenditure,12-guarantee,13-merger,14-contract,15-refund,16-turnover,17-dividend

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Finstreet, Finance Committee of SIMSR

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