

AT-1 Bonds

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CURRENT AFFAIR

- Recently, the Reserve Bank of India (RBI) has made a proposal to write-down Additional Tier-1 (AT-1) bonds as part of the SBI-led restructuring package for Yes Bank.

- AT-1 bonds are a type of unsecured, perpetual bonds that banks issue to shore up their core capital base to meet the Basel-III norms.

- There are two routes through which these bonds can be acquired:
- Initial private placement offers of AT-1 bonds by banks seeking to raise money.
- Secondary market buys of already-traded AT-1 bonds.

- AT-1 bonds are like any other bonds issued by banks and companies, but pay a slightly higher rate of interest compared to other bonds.
- These bonds are also listed and traded on the exchanges. So, if an AT-1 bondholder needs money, he can sell it in the secondary market.

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- Investors cannot return these bonds to the issuing bank and get the money. i.e there is no put option available to its holders.
- However, the issuing banks have the option to recall AT-1 bonds issued by them (termed call options that allow banks to redeem them after 5 or 10 years).
- Banks issuing AT-1 bonds can skip interest payouts for a particular year or even reduce the bonds' face value.

- AT-1 bonds are regulated by RBI.
- If the RBI feels that a bank needs a rescue, it can simply ask the bank to write off its outstanding AT-1 bonds without consulting its investors.

Basel-III Norms

- It is an international regulatory accord that introduced a set of reforms designed to improve the regulation, supervision and risk management within the banking sector, post 2008 financial crisis.

- Under the Basel-III norms, banks were asked to maintain a certain minimum level of capital and not lend all the money they receive from deposits.
- According to Basel-III norms banks' regulatory capital is divided into Tier 1 and Tier 2, while Tier 1 is subdivided into Common Equity Tier-1 (CET-1) and Additional Tier-1 (AT-1) capital.

- Common Equity Tier 1 capital includes equity instruments where returns are linked to the banks' performance and therefore the performance of the share price. They have no maturity.
- Additional Tier-1 capital are perpetual bonds which carry a fixed coupon payable annually from past or present profits of the bank.
- They have no maturity, and their dividends can be cancelled at any time.

- Together, CET and AT-1 are called Common Equity. Under Basel III norms, minimum requirement for Common Equity Capital has been defined.
- Tier 2 capital consists of unsecured subordinated debt with an original maturity of at least five years.
- According to the Basel norms, if minimum Tier-1 capital falls below 6%, it allows for a write-off of these bonds.

RBI's Regulations Over Banks

- In a situation where a bank faces severe losses leading to erosion of regulatory capital, the RBI can decide if the bank has reached a situation wherein it is no longer viable.
- The RBI can then activate a Point of Non-Viability Trigger (PONV) and assume executive powers of the bank.
- By doing so, the RBI can do whatever is required to get the bank on track, including superseding the existing management, forcing the bank to raise additional capital and so on.
- However, activating PONV is followed by a write down of the AT-1 bonds, as determined by the RBI through the Banking Regulation Act, 1949.



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For questions and doubts



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