1. AT-1 Bonds

Prelims Syllabus: Economy – Capital Market

Mains Syllabus: GS-III Indian Economy and Issues Relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Why in News?

- 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.

What are AT-1 Bonds?

- 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.
- 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.

There are Two Routes through which these bonds can be Acquired:

1. Initial private placement offers of AT-1 bonds by banks seeking to raise money.
2. Secondary market buys of already-traded AT-1 bonds.

Key points about AT-1 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.
- 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.

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.