AT-1 Bonds

Why in news?

The Securities Exchange Board of India (SEBI) has restricted the small investors their access to AT-1 bonds.

What are AT-1 bonds?

- AT-1 bonds, short for Additional Tier-1 bonds, are innovative debt instruments.
- AT-1 includes perpetual non-cumulative preference shares and perpetual bonds.
- It is a type of unsecured, perpetual bonds that banks issue to shore up their core capital base to meet the Basel-III norms.

What are the new requirements?

- The SEBI has said that offers of such instruments should take the electronic book provider route, with participation restricted to QIBs.
- [QIBs - Qualified Institutional Buyers]
- The minimum ticket size for initial offers and secondary market trading in these bonds has been raised to ₹1 crore.
- Explicit disclosures will now be required on the perpetual character of these bonds.
- The Point-of-Non-Viability (PONV) clause that allows the RBI to direct a troubled bank to completely write-off the principal value.

Why these requirements are welcomed?

- These new requirements are a welcome attempt by the SEBI to ward off YES Bank-like situations.
- In YES Bank, the write-off of AT-1 bonds as a part of the bank's restructuring plan came as a shock to the hundreds of retail investors.
- This case brought into focus the widespread mis-selling of AT-1 bonds to retirees and low-risk investors by banks and intermediaries.

What are the loose ends?

- While SEBI's new rules will keep retail investors off these instruments, there

are loose ends that need tying up.

- **Blocked out** - Now, a key category of investors called high net worth individuals are blocked out.
- So, the banks should compete with fewer buyers for their future AT-1 offerings at a time when sentiment towards these bonds has been soured by the YES Bank write-off.
- The RBI opened AT-1 bonds to retail investors a couple of years ago.
- It was done to broad-base demand and give public sector bank (PSB) bond offers a leg-up.
- **Impact on liquidity** - The increase in the minimum trading lot can impact secondary market liquidity.
- This will render these bonds less appealing to institutions.
- **Shooting up capital needs** - A shallow market for AT-1 bonds can hurt when Tier 1 capital requirements for PSBs may shoot up on the back of Covid-related provisioning.
- Fitch estimates banks' capital requirement at $15-58 billion in the coming year.

What should the regulators do?

- In this context, the SEBI and the RBI can evaluate if AT-1 bond participation can be opened up to **informed non-QIB investors**.
- [Non-QIB investors - Corporate treasuries and family offices with appropriate caveats.]
- The regulators also need to work out an **exit window**.
- This can be done through buybacks, for retail investors stuck in older AT-1 bonds with a current outstanding value of over ₹84,000 crore.
- The SEBI needs to initiate specific **penal actions** against intermediaries guilty of mis-selling.
- The RBI should **tighten its lax oversight of banks** acting as intermediaries for third-party products.
- SEBI's actions should serve as a wake-up call for the RBI to pay more serious attention to investor protection.

Source: Business Line

SHANKAR IAS PARLIAMENT
Information is Empowering