

## SEBI's New AT1 Bond Norms

#### Why in news?

- Securities and Exchange Board of India (SEBI) has slapped restrictions on mutual fund (MF) investments in additional tier-1 (AT1) bonds.
- This has raised concerns in the MF and banking sectors, and the Finance Ministry has asked the SEBI to withdraw the changes.

## What are AT1 bonds? What is the total outstanding in these bonds?

- AT1 Bonds stand for additional tier-1 bonds.
- These are unsecured bonds which have perpetual tenure.
- In other words, the bonds have no maturity date.
- They have call option, which can be used by the banks to buy these bonds back from investors.
- These bonds are typically used by banks to bolster their core or tier-1 capital.
- Mutual funds (MFs) are among the largest investors in these perpetual debt instruments.
- MFs hold over Rs 35,000 crore of the outstanding additional tier-I bond issuances of Rs 90,000 crore.

# What is SEBI's recent decision and why?

- In a recent circular, the SEBI told mutual funds to value the perpetual AT1 Bonds as a 100-year instrument.
- This essentially means MFs have to make the assumption that these bonds would be redeemed in 100 years.
- The regulator also asked MFs to limit the ownership of the bonds at 10% of the assets of a scheme.
- The RBI recently allowed a write-off of Rs 8,400 crore on AT1 bonds issued by Yes Bank Ltd after it was rescued by State Bank of India (SBI).
- The SEBI has probably made the decision after this.
- According to the SEBI, these instruments (AT1 Bonds) could be riskier than other debt instruments.

#### How will MFs be affected?

• Typically, MFs have treated the date of the call option on AT1 bonds as maturity date.

- Now, if these bonds are treated as 100-year bonds, it raises the risk in these bonds as they become ultra long-term.
- This could also lead to volatility in the prices of these bonds as the risk increases, the yields on these bonds rises.
  - Bond yields and bond prices move in opposite directions.
  - Therefore, higher yield will drive down the price of bond.
- This, in turn, will lead to a decrease in the net asset value of MF schemes holding these bonds.
- Moreover, these bonds are not liquid and it will be difficult for MFs to sell these to meet redemption pressure.
- Potential redemptions on account of this new rule would lead to mutual fund houses engaging in panic selling of the bonds in the secondary market.
- This again will lead to widening of yields.

## What is the impact on banks?

- AT1 bonds have emerged as the capital instrument of choice for public banks as they strive to shore up capital ratios.
- If there are restrictions on investments by mutual funds in such bonds, banks will find it hard to raise capital.
- It becomes especially hard at a time when banks need funds in the wake of the soaring bad assets.

## Why has the Finance Ministry called for a review?

- The Finance Ministry has sought withdrawal of valuation norms for AT1 bonds prescribed by the SEBI for mutual fund houses.
- The Ministry feels that the decision might lead to mutual funds making losses and exiting from these bonds.
- That would affect capital raising plans of PSU banks.
- Two PSU banks are on the privatisation block.
- Also, banks are yet to receive the proposed capital injection in FY21 although they will need more capital to face the asset-quality challenges in the foreseeable future.
- Given these, the government does not want a disruption in the fund mobilisation exercise of banks.

## **Source: The Indian Express**

