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