Zero Coupon Bonds - Innovative Tool to Fund PSBs

Why in news?

- The Centre, in a first move of its kind, has issued Rs 5,500 crore in zero-coupon bonds for recapitalising Punjab & Sind Bank (P&SB).
- It has allowed it to park the paper in its held-to-maturity (HTM) category at face value rather than the discounted market rate.

What are zero coupon bonds?

- A coupon is a periodic interest received by a bondholder from the time of issuance of the bond till maturity.
- Zero coupon bonds, also known as discount bonds, do not pay any interest to the bondholders.
- Instead, they get a large discount on the face value of the bond.
- On maturity, the bondholder receives the face value of the investment.
- In simple words, the investor purchasing a zero coupon bond profits from the difference between the buying price and the face value, contrary to the usual interest income.

What kind of bonds is issued now?

- The bonds issued to P&SB are a variation of the recapitalisation bonds issued earlier to public sector banks.
- The previous tranches of recapitalisation bonds carried interest and were sold to different banks.
- Unlike these, the present bonds are “non-interest bearing, non-transferable special GOI securities”, limited only to a specific bank, and for a specified period (maturity of 10-15 years).
- Only those banks, whosoever is specified, can invest in them, nobody else.
- It is held at the held-to-maturity (HTM) category of the bank as per the RBI guidelines.
- Since it is held to maturity, it is accounted at the face value and no mark-to-market will be there.
- Also, though zero coupon, these bonds are different from traditional zero coupon bonds.
- One factor is because they are being issued at par, there is no interest.
- In previous cases, since they were issued at discount, they technically were

interest bearing.
    - Normally zero coupon bonds are issued at a discount, which are tradable also.
    - But since these special bonds are not tradable these can be issued at par.

Why is it welcome?

- These are special types of zero coupon bonds issued by the government after proper due diligence and issued at par.
- The move does not affect the fiscal deficit while at the same time provides the much needed equity capital to the banks.

What is the need for caution?

- The government is issuing a zero coupon bond aggregating to Rs 5,500 crore at par to Punjab & Sind Bank that will mature in tranches between 2030 to 2035.
- The market value of the bonds would be around Rs 2,750 crore.
- The government will infuse Rs 5,500 crore into equity capital of Punjab & Sind Bank.
- By doing so, the capital adequacy of Punjab & Sind Bank goes up by Rs 5,500 crore (instead of Rs 2,750 crore).
- It is a great innovation by the government where it is using Rs 100 to create an impact of Rs 200 in the economy.
- This is indeed a financial illusion.

- So essentially, it gives more time to solve the problem, and does not solve the problem permanently.
- These bonds may thus not be a permanent solution for the banking sector's problems.

Source: The Indian Express