Q. Zero Coupon bonds are the innovative financial tool used by Government of India to recapitalize Public Sector banks in the Country. Explain

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Answer:—

Zero Coupon Bonds:

The zero Coupon bond is a bond in which the face value is repaid at the time of maturity & it pays no interest & trades at the discount to its face value.

How it help in recapitalization of Public sector banks?

① Recently, the Govt. of India has restored to a novel recapitalization exercise to provide ₹ 5,500-Crore support to State owned listed Punjab & Sind Bank to shore up its regulatory Capital.

→ It will mature in tranches betⁿ 2030 to 2035. The market value of this bond will be around Rs ₹ 2,750 Crore. Punjab & Sind Bank, by investing in these bonds from Held-to-maturity (HTM) category, won't have to book mark-to market loss and value will be ₹ 5,500 Crore. By doing so P&SB's ~~adequac~~

Capital adequacy goes up by ₹ 5,500 Crore, instead of ₹ 2,750 crore.

(2) This support will also facilitate the bank to use this Capital to expand its banking activities for agriculture, rural & MSME Sectors with Prominent Presence in Punjab, Haryana and Delhi.

(3) This type of Capital Support will be achieved without the govt. really infusing funds (no cash Outgo) in the bank.

(4) It will strengthen the bank's balance-sheet.

Issues with this tool :-

(1) Even it improves Capital adequacy in banks, but when it comes to assessing Performance of bank on return on assets, it will be seen in poor light as no interest income is Coming the way of the bank.

(2) It will also raised concern in the accounting fraternity despite RBI clearing it after through internal deliberation.

(3) It will face a high risk from inflation.

Financial illusion (like infusing capital) doesn't solve the problem Permanently but gives you more time to solve it. Upto Some extend this type of Financial innovation really helps to improve the Condition of Public Sector Banks.