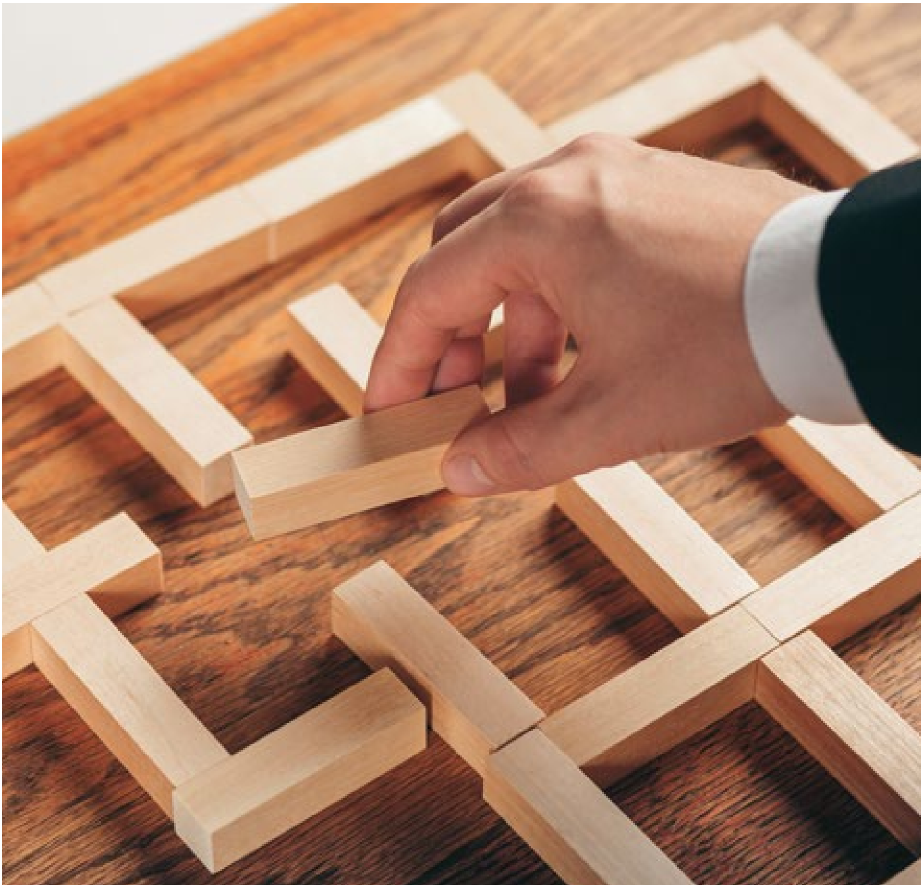
STUDENTS' ECONOMIC FORUM

A monthly publication from South Indian Bank



To kindle interest in economic affairs…
To empower the student community…

www.southindianbank.com
Student's Corner

ho2099@sib.co.in

AT-1 BONDS

NOVEMBER 2020 | THEME 348

29th Year of Publication

UPGRADING HAS ITS REWARDS.

Ask for a Free Upgrade. Enjoy Cashback & Triple Reward Points.

T&C apply.

Upgrade your debit card to MasterCard World, Visa Platinum NFC or Rupay Platinum with South Indian Bank and get rewarded.

Contact your Relationship Manager / Branch Manager now.

**With every Rs.200 spend.*

SOUTH INDIAN Bank

Experience Next Generation Banking

Toll Free (India): 1800-102-9408, 1800-425-1809 (BSNL), Email: customercare@sib.co.in, CIN: L65191KL1929PLC001017

www.southindianbank.com | /thesouthindianbank

Theme No: 348: **AT-1 BONDS**

"When learning is purposeful, creativity blossoms. When creativity blossoms, thinking emanates. When thinking emanates, knowledge is fully lit. When knowledge is lit, economy flourishes."

- Dr. A.P.J. Abdul Kalam

The "SIB Students' Economic forum" is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly publication. Topic of discussion for this month is **"AT-1 Bonds".**

Introduction

The primary objective of a bank is to engage in the business of banking, which entails taking deposits and giving loans. For engaging in this business, banks are required to have sufficient capital, such that their deposit holders are protected. The capital required by banks is regulated by The Reserve Bank of India, which is the primary regulator for all banking activities in India. Internationally, Central Banks like RBI follow common minimum standards of capital adequacy, which are known as the Basel accords. Post the Global Financial Crisis in 2008, regulators around the world agreed to stronger capital adequacy norms, to protect banks from any systemic risk and keep adequate capital buffers. These regulations are known as Basel III regulations and banks in India are following these guidelines for the past few years. In fact, Indian regulations are more conservative, in so much as the minimum Capital Adequacy for banks in India is 1% more than that required under Basel III.

Under the Basel III framework, banks' regulatory capital is divided into Tier 1 and Tier 2 capital. Tier 1 capital is subdivided into Common Equity (CET1) and Additional Tier 1 Capital (AT-1). Equity capital is classified as CET1, whose returns are linked to the banks' performance. Perpetual bonds that satisfy specific conditions stipulated by RBI are classified as AT-1. Under Basel III norms, minimum requirement for Common Equity Capital has been defined. In India, Banks must maintain capital at a minimum ratio of 9 per cent (excluding CCB) of their risk-weighted assets, within which 7 per cent has to be in the form of Tier 1 capital. Within Tier 1 capital, 5.50 percent needs to be in the form of CET1 capital. Additionally, at present, Banks are required to maintain Capital Conservation Buffer (CCB) of 1.875 per cent of risk-weighted assets in the form of CET1 capital. By 31-03-2021, this requirement will increase to 2.50 percent, and hence the total capital requirement to 11.50%. Tier 2 capital inter-alia consists of subordinated debt with an original maturity of at least five years. Both AT-1 and Tier 2 bonds are subordinated debt instruments and are ranked lower than deposits, secured and unsecured creditors in the order of liquidation.

What are AT-1 Bonds?

AT-1 bonds or the Additional Tier 1 Bonds are issued by banks in order to secure an external capital base to be used in times of a financial emergency without being subjected to insolvency and distress measures. The issuance of AT-1 Bonds was first formulated after the 2008 financial crisis that saw the infamous fall of a banking behemoth 'The Lehman Brothers' in United States of America. The world economy witnessed an unavoidable slump due to the liquidity crunch that all the banks in the world faced at that time.

Features of AT1 Bonds

- AT-1 bonds are a type of unsecured, perpetual and non-convertible bonds that banks issue to shore up their core capital base to meet the Basel-III norms.
- There are two routes through which these bonds can be acquired:
    - Initial private placement offers of AT-1 bonds by banks seeking to raise money.
    - Secondary market buys of already-traded AT-1 bonds.
- The interest payable to the investors may be either at a fixed rate or at a floating rate referenced to a market determined rupee interest benchmark rate.
- AT-1 bonds are like any other bonds issued by banks and companies, but pay a slightly higher rate of interest compared to other bonds, which may turn out to be an alluring factor for the investors.
- These bonds are also listed and traded on the exchanges. So, if an AT-1 bondholder needs money, he can sell it in the secondary market.
- Investors cannot return these bonds to the issuing bank and get the money. i.e there is no put option available to its holders.
- Issuing banks have the option (subject to conditions stipulated by RBI being satisfied) to recall AT-1 bonds issued by them (termed call options that allow banks to redeem them after a minimum of 5 years). However, the banks are not compulsorily mandated to exercise such call option, it is the banks discretion whether to redeem the AT-1s or not.
- Banks issuing AT-1 bonds can skip interest payouts for a particular year or even reduce (subject to conditions) the bonds' face value.
- The majority of investments since the inception of AT-1 bonds have been made by big corporates, mutual fund entities and high net worth individuals (HNIs) etc.
- These instruments have principal loss absorption feature at an objective pre-specified trigger point through either (i) conversion into common shares or (ii) a write-down mechanism which allocates losses to these instruments. The loss absorption through conversion / write-down of AT 1 instruments is triggered when CET falls below a pre-determined threshold of Risk Weighted Assets (RWAs).
- AT-1 bonds are regulated by RBI.

RBI's Regulations over Banks

- In a situation where a bank faces severe losses leading to erosion of regulatory capital, the RBI can decide if the bank has reached a situation wherein it is no longer viable.
- The RBI can then activate a Point of Non-Viability Trigger (PONV) and assume executive powers of the bank.
- By doing so, the RBI can do whatever is required to get the bank on track, including superseding the existing management, forcing the bank to raise additional capital and so on.
- However, activating PONV is followed by a write down of the AT-1 bonds, as

determined by the RBI through the Banking Regulation Act, 1949.

What is in News?

- The Securities and Exchange Board of India has tightened rules for fresh issues of additional tier-1 securities issued by banks, restricting retail investors from investing in such instruments. The restrictions follow the Yes Bank Ltd. episode where AT-1 securities were written-off at the time a scheme of reconstruction was approved for the lender, catching a large number of retail investors off-guard.

  In a circular dated Oct.6, the capital market regulator detailed the following rules:

  - The issuance of AT-1 instruments shall be done mandatorily on the electronic book provider platform irrespective of the issue size.
  - Issuers and stock exchanges will ensure that only qualified institutional buyers are allowed to participate in the issuance of AT-1 instruments.
  - The minimum allotment of AT-1 instruments shall not be less than Rs 1 crore.
  - The minimum trading lot for AT-1 instruments shall be Rs 1 crore.

  Issuers will also need to comply with enhanced disclosure requirements. This includes details of the conditions under which the call option included in these bonds may be exercised. The issuer would also need to clearly state the inherent risk factors of AT-1 bonds. In addition, the 'point of non-viability clause', which gives the RBI absolute right to direct a bank to write down AT-1 bonds should be detailed, the capital markets regulator said. The circular came into effect from Oct. 12. SEBI is trying to address the concerns around miss-selling that came up during the Yes Bank crisis where AT-1 bonds issued by the bank had to be written-off and retail investors too were hit.

- Perpetual bonds have come under fire ever since these instruments were written off as part of the rescue package of Yes Bank. Investors of these bonds had dragged the lender to the court demanding that they be compensated. However, the Reserve Bank of India (RBI) has said risks to these bonds were well known to investors and the rules allow writing off the bonds if the capital falls below the r egulatory minimum level prescribed for such write off. The debate rages as cases of mis-selling of these bonds have emerged. Sure, sentiment has soured towards these bonds but experts believe that investors can be lured back with the right price.

Extra Read

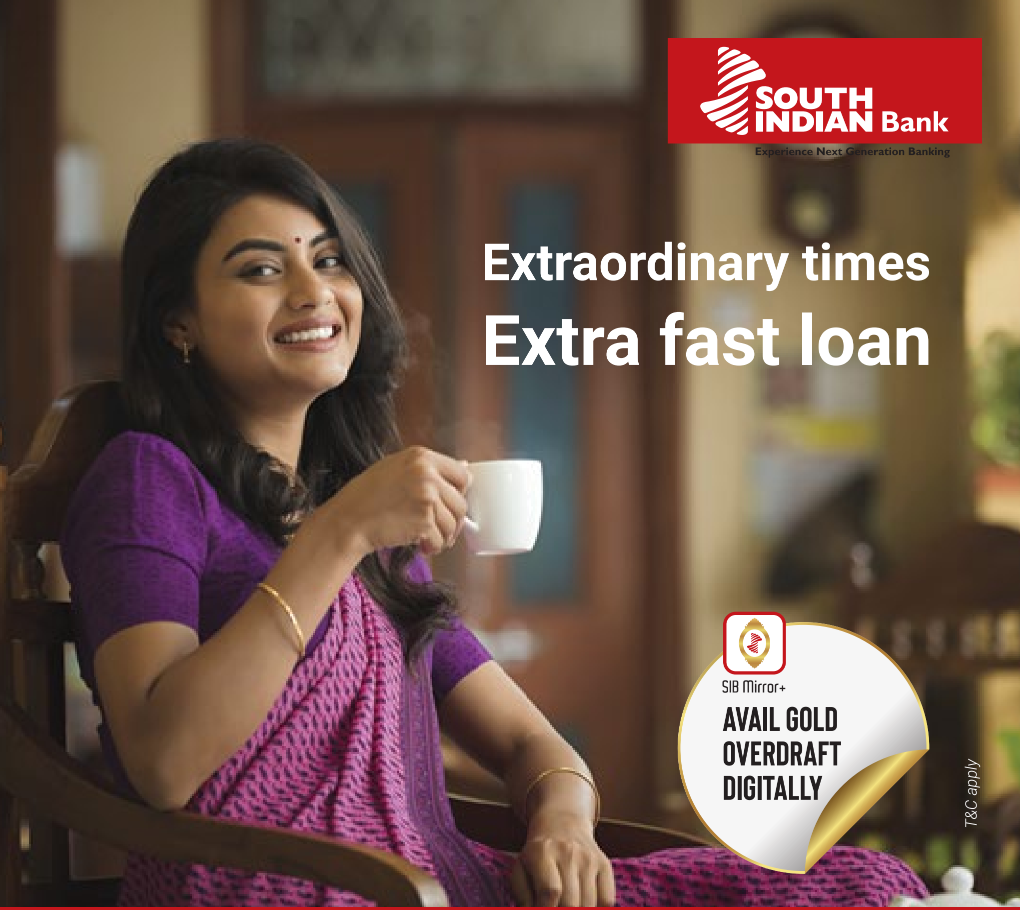
Qualified Institutional Placement (QIP)

- Qualified institutional placements (QIPs) are a way to issue shares to the public without going through standard regulatory compliance.
- QIPs instead follow a relaxed set of regulations but where allottees are more highly regulated.
- The practice is mostly used in India and other Southeast Asian countries.
- QIPs were created to avoid dependency on foreign resources for raising capital.
- Qualified institutional buyers (QIBs) are the only entities allowed to purchase QIPs.

Qualified Institutional Buyer (QIB)

- An investor is dubbed a Qualified Institutional Buyer (QIB) if they are thought to require less regulatory protection than unsophisticated investors.
- Typically, a QIB is a company that manages a minimum investment of $100 million in securities on a discretionary basis or is a registered broker-dealer with at least a $10 million investment in non-affiliated securities.
- Under Rule 144A, QIB's are allowed to trade securities on the market, which increases the liquidity for these securities.

Reference: Business Line, Financial Express, Investopedia, Moneycontrol



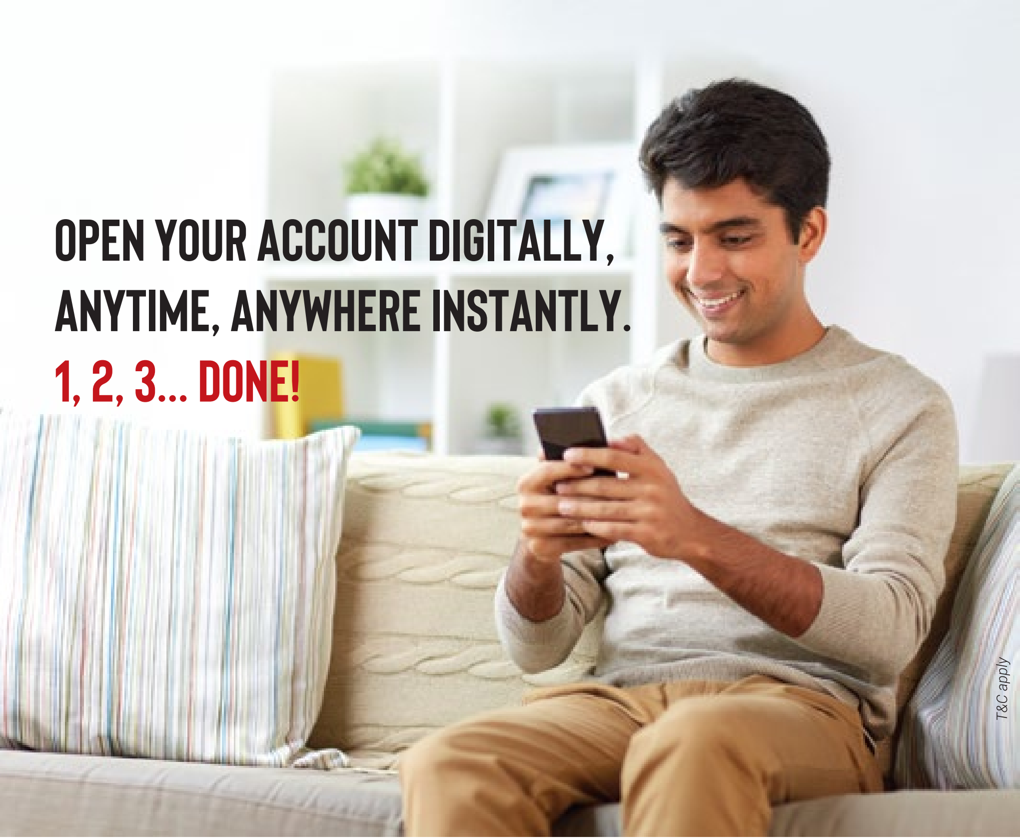
SIB SUPERFAST GOLD LOAN

You don't have to sell your favourite gold jewellery, when you can pledge it. With South Indian Bank's Superfast Gold Loan, you get the money to meet your different needs, really fast. It is a gold loan tailor-made for the uncertain times we are living in. Go ahead, encash your dreams with SIB Superfast Gold Loan.

- Easy processing
- Tenure up to 12 months
- No processing, documentation charges
- Attractive interest rate

Wear masks in public spaces. Follow social distancing.

Toll Free (India): 1800-102-9408, 1800-425-1809 (BSNL), Email: customercare@sib.co.in, CIN : L65191KL1929PLC001017
www.southindianbank.com | /thesouthindianbank



SIB INSTA

No forms to fill. No queue.

Presenting SIB Insta - a savings account for those living life on the fast lane.

- **Instant account opening**
- **No physical documentation**
- **No minimum balance commitment**
- **Get 200 reward points & a free personalised Debit Card on initial remittance of Rs.1000/-**
- **Option to select branch of your choice**

Prerequisites:
Aadhaar and PAN Card.

To know more, scan the QR code

SOUTH INDIAN Bank

Experience Next Generation Banking

Toll Free (India): 1800-102-9408, 1800-425-1809 (BSNL), Email: customercare@sib.co.in, CIN: L65191KL1929PLC001017

www.southindianbank.com | /thesouthindianbank