Additional Tier 1 Bonds

Why in News

Recently, **State Bank of India (SBI)** has raised **Rs. 4,000 crore** of the **Basel compliant Additional Tier 1 (AT1) bonds** at coupon rate of 7.72%.

- This is the **first AT1 Bond issuance in the domestic market** post the **new SEBI regulations.**
- This is also the **lowest pricing ever offered on such debt** issued by any Indian bank since the implementation of Basel III **capital rules** in 2013.

Bonds

- Bonds are units of **corporate debt** issued by **companies and securitized as tradable assets.**
- A bond is referred to as a **fixed-income instrument** since bonds traditionally paid a fixed interest rate (coupon) to debtholders. **Variable or floating interest rates** are also now quite common.
- **Bond prices are inversely correlated with interest rates:** when rates go up, bond prices fall and vice-versa.
- They **have maturity dates** at which point the principal amount must be paid back in full or risk default.

Key Points

- **About:**
    - AT1 bonds, also called **perpetual bonds, carry no maturity date** but have a call option. The issuer of such bonds **may call or redeem the bonds if it is getting money at a cheaper rate,** especially when interest rates are falling.
        - They are like **any other bonds issued by banks and companies,** but pay a slightly **higher rate of interest compared to other bonds.**
    - Banks issue these bonds to **shore up their core capital** base to meet the Basel-III norms.
    - 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.**
    - **Banks issuing AT-1 bonds can skip interest payouts** for a particular year or even reduce the bonds' face value.
- **Regulated By:**
    - **AT-1 bonds are regulated by the** Reserve Bank of India (RBI)**.** If the RBI feels that a bank needs a rescue, it can simply ask the bank to write off its outstanding AT-1 bonds without consulting its investors.

Basel III Norms

- It is an **international regulatory accord** that introduced a set of reforms designed to improve the regulation, supervision and risk management within the banking sector, post 2008 financial crisis.
- Under the Basel-III norms, banks were asked **to maintain a certain minimum level of capital** and not lend all the money they receive from deposits.
- According to Basel-III norms, banks' regulatory capital is divided into **Tier 1 and Tier 2,** while Tier 1 is subdivided into **Common Equity Tier-1 (CET-1) and Additional Tier-1 (AT-1) capital.**
    - Common Equity Tier 1 capital includes **equity instruments where returns are linked to the banks' performance** and therefore the performance of the share price. They have no maturity.
    - Together, **CET and AT-1 are called Common Equity.** Under Basel III norms, minimum requirement for Common Equity Capital has been defined.
- Tier 2 capital consists of **unsecured subordinated debt with an original maturity of at least five years.**
    - According to the **Basel norms,** if minimum **Tier-1 capital falls** below 6%, it allows for a write-off of these bonds.

Source: TH