Additional Tier 1 bonds (AT1)

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Context- Recently, the Bombay High Court quashed the write-off of Additional Tier 1 (AT1) bonds issued by Yes Bank Ltd.

Key Highlights

SEBI investigation:

- A Sebi probe recently found that the bank facilitated the selling of AT1 bonds from institutional investors to individual investors.
- It also found that during the process of selling the AT1 bonds, individual investors were not informed about all the risks involved in the subscription of these bonds.

Super FD' and 'as safe as FD':

- The Sebi investigation found that Yes Bank represented these bonds as a 'Super FD' and 'as safe as FD' to the investors.

Reckless selling of the bonds:

- SEBI found that the push from the managing director of Yes Bank to down-sell the AT1 bonds led its private wealth management team to recklessly sell the bonds to individual investors.

Additional Tier-1 AT1 bonds

- AT1 bonds are unsecured bonds which have a perpetual tenor.
- These bonds, issued by banks, have no maturity date.
- They have a call option, that can be used by the banks to buy these bonds back from investors.
- These bonds are typically used by banks in order to bolster their core or tier-1 capital.
- AT1 bonds are subordinate to all other debt and these are only senior to common equity.
- Mutual funds were among the largest investors in perpetual debt instruments.

More about the Bonds

  - A bond is a loan taken out by a company.
  - Instead of going to a bank, the company gets the money from investors who buy the bonds of the company.

- **Interest coupon:**
  - In exchange for the capital, the company pays an interest coupon, which is the annual interest rate paid on a bond expressed as a percentage of its face value.
- **Interest**:
  - The company pays the interest at predetermined intervals i.e. usually annually or semiannually and returns the principal on the maturity date, ending the loan.
- **Significance**:
  - The bond market helps investors diversify beyond stocks.
  - Some of the characteristics of bonds are their maturity, their coupon (interest) rate, their tax status, and their callability.

Stock vs. Bonds:

  - **Safer**:
    - When bonds and stocks are compared, bonds are considered to be a safer investment option.
    - It is crucial to note that bonds are not completely risk-free and only receive preference in case of bankruptcy.

- **Less volatility:**
    - Owning a stock offers more potential for returns, but bonds come with less downside volatility.
    - Bond investments play a key role in balancing and reducing the short-term volatility associated with the stocks.

- **Larger market:**
    - The bond market is indeed much larger than the stock market, in terms of aggregate market value.
  - **Risks**:
    - Various types of risks associated with bonds include interest rate risk,

credit/default risk, and prepayment risk.

- **Bond Ratings:**
    - Most of the bonds come with a rating that outlines their quality of credit.
    - That is, how strong the bond is and its ability to pay its principal and interest. Ratings are published and they are used by investors and professionals to judge their worthiness.
- **Rating agencies:**
    - The most commonly cited bond rating agencies are such as Standard & Poor's, Moody's Investors Service, and Fitch Ratings.
    - They rate a company's ability to repay the obligations.
- **Ratings range:**
    - Ratings range from AAA to Aaa for high-grade issues much likely to be repaid to D for issues that are currently in default.

Types of Bonds:

- **Central Government Bonds:**
    - As they are issued by the government, central government bonds carry a sovereign guarantee.
    - It makes them one of the safest types of bonds. However, these bonds are exposed to inflation rate risk due to the long maturity period.
- **State Government Bonds:**
    - State Government bonds are known as state development loans (SDLs).
    - They are issued by state governments in order to fund infrastructural developments in the state or during liquidity crunch etc.
- **Public Sector Bonds:**
    - These bonds are mainly issued by top public sector companies or institutions to fund their growth and expansion needs.
    - They are relatively less risky as compared to corporate bonds.
- **Corporate Bonds:**
    - Corporate bonds are issued by private companies and they represent a large portion of the bond market in India.
    - By issuing corporate bonds, companies can raise capital at a very low cost.

Securities and Exchange Board of India (SEBI)

- It is a statutory body established on April 12, 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992.
- Before SEBI came into existence, Controller of Capital Issues was the regulatory authority; that derived authority from the Capital Issues (Control) Act, 1947.

- **Aim**:
    - Its aim is to protect the interests of investors in securities and to promote the development of, and regulate the securities market.
- SEBI is the regulator of the securities and commodity market in India owned by the Government of India.
- **Statute**:
    - Initially it was a non statutory body without any statutory power.
    - Then it became autonomous and given statutory powers by SEBI Act 1992.