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FINANCE MINISTRY ASKS SEBI TO WITHDRAW CIRCULAR ON AT1 BONDS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

The Department of Financial Services (DFS), under the finance ministry, has purportedly sent a memorandum to the chairman of the Securities and Exchange Board of India (Sebi) asking the regulator to withdraw a rule treating AT1 bonds (perpetuals) as having 100-year maturity. The memorandum was sent on Thursday.

A circular on the AT1 bonds was issued by Sebi on 10 March and the rule was to take effect from 1 April. However, it had generated significant apprehension in the mutual fund industry that losses would result from a consequential revaluation of such bonds. A representation to withdraw this provision was made by industry body AMFI to Sebi on Thursday itself.

Mint has seen a copy of the DFS letter but has been unable to independently verify the authenticity of the same.

“Considering the capital needs of banks going forward and the need to source the same from the capital markets, it is requested that the revised valuation norms to treat all perpetual bonds as 100 year tenor be withdrawn. The clause on valuation is disruptive in nature," the letter said.

The letter also took note of the potential swings in NAV that can follow from the valuation norms and possible disruption in the debt markets as mutual funds sell such bonds in anticipation of redemptions. This can also affect capital raising by PSU banks forcing them to rely more on the government for capital, it noted. However, it did not raise objections to other provisions in the Sebi circular such as those limiting AT1 bond exposure to 10% of scheme assets

AT1 bonds have no fixed maturity, but banks issuing them can repay them at certain specified dates. Mutual funds have historically treated these dates as the maturity dates. A change in maturity to 100 years significantly increases the interest rate sensitivity of the fund’s portfolio, subjecting investors to losses in case of even small increases of interest rates. Mutual funds have expressed fears of a surge in redemptions by investors anticipating such losses. The relatively low liquidity of such bonds also makes them hard to sell.

You can get more information about the circular and its effects here.

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