Additional Tier - 1 Bonds (AT-1 Bonds)

Additional Tier - 1 (AT-1 Bonds) Bonds are a type of perpetual bonds that don't have any expiry date which is issued to raise long term capital.

In March 2020, the Reserve Bank of India came up with a proposal to write-down AT-1 bonds. This write-downs was - part of a restructuring package for Yes Bank - led by the State Bank of India.

This article will further elaborate on AT-1 bonds within the context of the Civil Services Examination.

Overview of AT-1 Bonds

AT-1 bonds were first conceptualized following the disastrous global financial crisis of 2008 when a lot of banks were closed down.

AT-1 bonds are like standard bonds but have a comparatively higher rate of interests. They are also listed and traded on stock exchanges. This means that the person holding the bond can sell it in the secondary marketing in case funds are required.

- Banks issuing AT-11 bonds can even reduce the bonds' face value.

- AT-1 bonds are regulated by the Reserve Bank of India (RBI). If there is a need for RBI to bail out a bank it can tell the bank to write-off its outstanding AT-1 bonds without necessarily consulting its investors.

What Norms regulate AT-1 Bonds?

In India, Basel III regulates AT-1 Bonds. Basel III norms require Indian banks to maintain a capital ratio of 11.5% divided into 8% in tier 1 capital and tier 2 capital.

It should be noted that AT-1 bonds are known "unsecured subordinated perpetual non-convertible bonds" that constitute a component of a bank's permanent capital. Banks issue AT-1 bonds so that Basel III norms regarding equity capital are met.

What are the features of AT-1 Bonds?

The following are features of AT-1 bonds:

No fixed maturity date: AT-1 bonds have no maturity dates as they are perpetual bonds that remain with the bank. Sometimes AT-1 bonds are sold as limited-period bonds because they come with a feature of a call option by the one issuing the bond.

Premature recall: AT-1 bonds come with a clause that allows a bank to repay it prematurely, if an unexpected event, such as new taxes or new regulatory laws, occur during the time of issuing the bonds

Interest Payouts can be skipped: One of the crucial features of an AT-1 bond is that there is an option to skip on interest payouts without creditors coming after the issuer for defaulting on interest payments. SInce AT-1 bonds are intended to increase capital of banks they can legally incorporate clauses that allow banks to default on interest payouts provided that their capital falls below the regulatory requirement.

Frequently Asked Questions about AT-1 Bonds

Do AT-1 bonds pay interest?

AT-1 bonds are like any other bond issued by a bank and just like them pay a fixed rate of interest at regular intervals.

What are the Tier 1 and Tier 2 bonds?

Tier 1 capital is the primary funding source of the bank. Tier 1 capital consists of shareholders' equity and retained earnings. Tier 2 capital includes revaluation reserves, hybrid capital instruments and subordinated term debt, general loan-loss reserves, and undisclosed reserve.