RBI has released a draft Reconstruction scheme for Yes Bank on 6th March 2020. As per draft scheme, the instruments qualifying as Additional Tier 1 capital (AT1), issued by the Yes Bank Ltd. under Basel III framework (AT1 Bonds), shall stand written down permanently.

What are AT1 bonds?

Additional Tier 1 capital is an additional form of capital issued by the banks to shore up their core capital apart from common equity shares and reserves to meet Basel-III norms.

AT1 is in the form of bonds, which have loss-absorption capabilities, unsecured & perpetual bonds.

Features of AT1 Bonds:

- **Optionality:** The bond shall not be issued with a 'put option'. These bonds will have call options at the end of specified period (majority of bonds have call after 5 years; few have after 10 years). Call option can be exercised with the approval of regulator (RBI) and subject to bond is replaced by same or better-quality capital and maintains capital ratios as per regulatory requirement
- **Dividend Discretion:** AT1 bonds are annual coupon bearing perpetual bonds. This means that they have no fixed maturity date. Coupon payments are non-cumulative and discretionary. Coupons can be paid out of the current year profits. However, if the current year's profit is not sufficient, the same can be paid from past reserves subject to the bank meeting the minimum regulatory requirements for capital.
- **Loss Absorption Features:** These AT1 bonds are expected to absorb losses through the write-down/conversion to equity mechanism at the objective pre-specified trigger point of CET-1 capital level as prescribed by the RBI or when the point of non-viability trigger is breached in the RBI's opinion.
- **Seniority of Claim:** The claim of AT-I bondholders is
  a) Superior to equity shareholders and preference shareholders,
  b) Subordinated to claims of depositors and creditors.
  c) It is neither secured nor covered by guarantee of issuer

AT1 bonds are issued by both Public & Private Sector Banks. Total Outstanding AT1 bonds in the market is 93,261/- cr. PSU Bank's have an exposure of 54,576/- crs and the remaining is held by 6 Pvt Sector Banks mainly Axis Bank, HDFC Bank, ICICI Bank, IndusInd Bank.

Mutual fund schemes having an exposure to these perpetual bonds have seen an increase in yield of perpetual bond resulting into MTM impact in the short term, but as the portfolio yield moves up, there will be higher accruals over a period of time. With most of investors coming into a debt scheme with a 3 year investment horizon, such short term yield movement should not worry investors.

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