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Perpetual or AT 1 Bonds Are Back, This Time In PSU Banks. Should You Invest?

Perpetual bonds by PSU banks offer higher interest rates than other bonds but they also carry high risk than other bonds.

Perpetual or AT 1 Bonds Are Back, This Time In PSU Banks. Should You Invest?

Nilanjit Das

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Almost two and a half years ago, when Yes Bank wrote down its perpetual bonds in March 2020, several investors were left in the lurch. The risks of perpetual bonds were highlighted then, but it seems banks have not stopped issuing these bonds.

Union Bank of India said last week that it plans to raise Rs 1,320 crore next week by issuing bonds on a private placement basis. “The unsecured, subordinated, taxable, non-convertible, perpetual, fully paid-up Basel III compliant additional tier I bonds in the nature of debentures will carry coupon at 8.69 per cent per annum,” the state-owned lender said in a regulatory filing, according to a PTI report.

Recently, an individual highlighted in a social media post that his bank relationship manager asked him he was interested in investing in perpetual bonds. “My bank RM is proposing that I invest in privately placed perpetual bonds. The interest rates look to be very good, but I don’t have much knowledge on the same. Would appreciate it if anyone has more understanding about this product,” he posted on social media, seeking advice.

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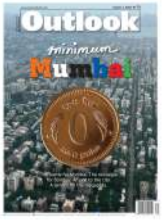

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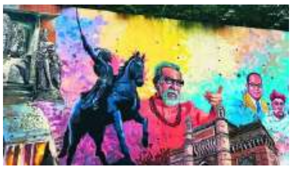

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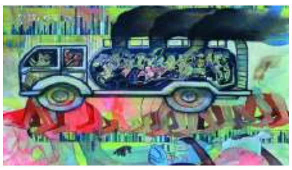

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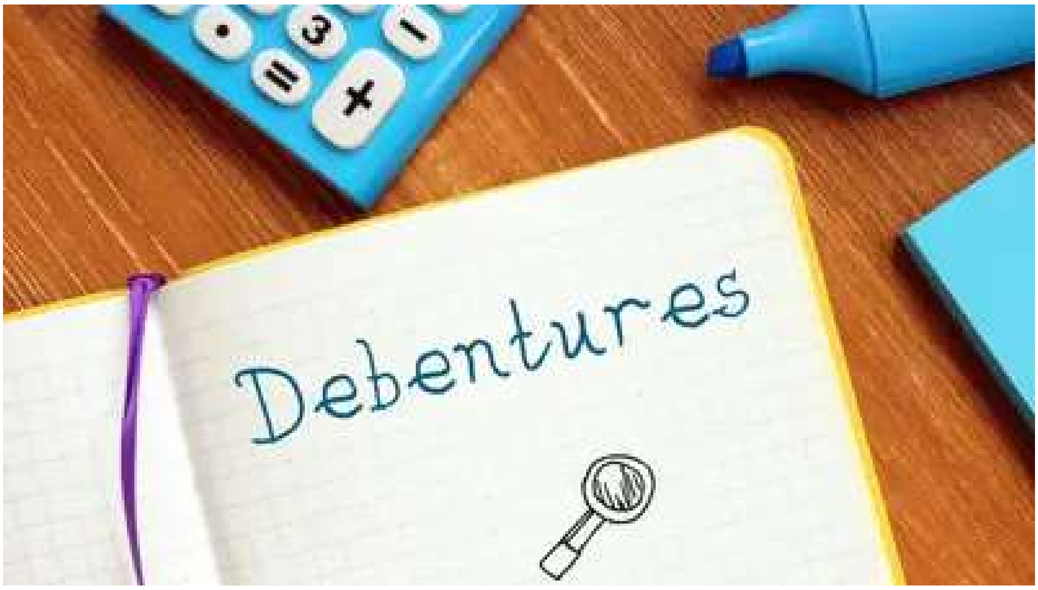

Perpetual bonds or Additional Tier I bonds are attractive because, typically, they offer higher interest rates compared to bank fixed deposits. However, past experience shows that it does not make sense for investors to put money in them without understanding the risks it entails. Read on to know what these bonds are and the things to watch out for when investing in them.

What Are Perpetual Bonds?

As the names suggests, perpetual bonds are those that exist in perpetuity or till the lifetime of the respective bond issuer. Ankit Gupta, founder, BondsIndia.com, a bond investing platform, says that these bonds don't have a maturity date and the interest is paid till the lifetime of the bonds, subject to certain conditions.

"Perpetual bonds are generally issued with a call option, which essentially means that these bonds can be called back by the issuer at any point in time after a defined period. The call option here refers to an option where the bond issuer can call back the bond and pay back the principal amount to the bondholder/investor," he adds.

Typically, the call option is exercised at the end of a minimum of five years, says Ajay Manglunia, managing director and head, Investment Grade Group, JM Financial.

However, banks are under no obligation to exercise the call option. In case of financial trouble, banks can decide against it, which happened in the case of Yes Bank. In such cases, the capital of the investors can get completely wiped out.

Also, the issuer/lender has the right to call them back and issue them at cheaper rates when interest rates fall, says Kartik Parekh, a Sebi-registered investment advisor and co-founder, Gochanakya, a fintech platform.

Rising Popularity

"The Government over the years has shown immense support towards developing the market to ensure that even in the most difficult times AT1s (additional Tier I) issued by PSU Banks have fared well," says Manglunia.

Recently, the popularity of these bonds has increased . AT1 bonds issued by Punjab National Bank and Canara Bank recently were "lapped up by Banks, Institutions, Corporate Treasuries and HNIs", he says. These issues were worth Rs 2,000 crore each. In the past "the market had issuers from both Private and PSU Banks tapping the market. However, in recent years, the majority of the issuances are from PSU Banks only," says Manglunia.

Issuer	Bank Type	Pay-In Date	Coupon (%)	Final Allocation (Rs Cr)
UNION BANK	PSU	11-Jan-21	8.64%	1000
BANK OF BARODA	PSU	13-Jan-21	8.15%	969
PUNJAB NATIONAL BANK	PSU	22-Jan-21	8.60%	495
BANK OF BARODA	PSU	28-Jan-21	8.15%	188
BANK OF INDIA	PSU	28-Jan-21	9.04%	750
UNION BANK	PSU	29-Jan-21	8.73%	205
CANARA BANK	PSU	02-Feb-21	8.30%	120
BANK OF INDIA	PSU	30-Mar-21	9.30%	602
STATE BANK OF INDIA	PSU	03-Sep-21	7.72%	4000
STATE BANK OF INDIA	PSU	18-Oct-21	7.72%	6000
CANARA BANK	PSU	25-Oct-21	8.40%	1200
UNION BANK	PSU	22-Nov-21	8.70%	2000
BANK OF BARODA	PSU	26-Nov-21	7.95%	1997
CANARA BANK	PSU	02-Dec-21	8.05%	1500
PUNJAB NATIONAL BANK	PSU	09-Dec-21	8.40%	2000
STATE BANK OF INDIA	PSU	14-Dec-21	7.55%	3974
UNION BANK	PSU	20-Dec-21	8.40%	1500
PUNJAB NATIONAL BANK	PSU	17-Jan-22	8.50%	1971
BANK OF BARODA	PSU	31-Jan-22	8.00%	752
UNION BANK	PSU	02-Mar-22	8.50%	1500
CANARA BANK	PSU	04-Mar-22	8.07%	1000
BANK OF MAHARASHTRA	PSU	24-Mar-22	8.75%	290
THE JAMMU AND KASHMIR BANK	PVT	30-Mar-22	9.50%	360
PUNJAB NATIONAL BANK	PSU	06-Jul-22	8.75%	2000
CANARA BANK	PSU	19-Jul-22	8.24%	2000

Chart Showing The Various Issue of Perpetual AT1 Bonds By Banks In India- Courtesy of JM Financial

Risks To Watch Out For

Just because institutional investors seem to be taking interest in these bonds doesn't mean they are ideal for retail investors, who need to decide whether they are ready to face the risks that these bonds come with.

Unsecured Nature of Bonds: Manglunia points out that "all PSU banks have thus far either paid their obligations on time like coupon servicing and always exercised the call at option date. This has allowed investors to draw a lot of comfort and they have been participating as it gives better returns."

However, he adds that investors should understand that these bonds are capital instruments "and not exactly borrowings and in case of insolvency proceeding hierarchy, they are behind deposits, borrowings and Tier II bonds". This essentially means that investors in these bonds will be compensated after others are taken care of in the hierarchy chain, in case something were to go wrong.

"They are unsecured in nature and in case of default, are likely to result in zero recovery if written down in entirety. This was exactly what happened in the case of Yes Bank AT1 perpetual bonds," he says.

Different Concept: Perpetual or AT1 bonds fall in a specialised category of bonds, wherein the " coupon/principal payments are discretionary. It is not a safe/relevant instrument for retail. This is only meant for specialised investors who understand the nuances of these bonds and can take an informed call," says Manglunia.

Only individuals who can take higher risk and can put their capital at stake should consider these bonds. "These bonds are issued mostly by banks under BASEL III norms and only individuals who can take higher risk on the capital should go for these bonds. This is because in certain special cases, like it happened with Yes Bank, they can be written down completely," says Parekh.

Payment Not Mandatory: Gupta explains that these bonds form a part of the Tier 1 capital of the bank or institution, which helps in keeping the debt-equity ratio under control. "The liability to pay interest or principal in not binding in case of losses made or inadequate profits made by the company," he says.

"Also, these bonds are 'going concern' instruments, which essentially means that the instrument can default even if the bank continues to work as a 'going concern', which is not the case with normal bonds or NCDs (non-convertible debentures), wherein if the company defaults, it is a 'gone concern'," adds Manglunia.

Ticket Size And Other Details: Typically, the minimum ticket size or face value of these bonds is Rs 1 crore. "The regulator thankfully upped the minimum ticket size so that the extent of retail involvement in these bonds can be limited. But, as these bonds are listed, rated and traded papers in the markets and they are held in demat not in physical certificate, any HNI or retail can definitely buy this."

"If an investor has Rs 1 crore or higher and wishes to buy these high-risk, high-return bonds he may do so, but he has to understand there is an element of high risk involved," adds Parekh.

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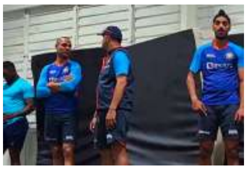

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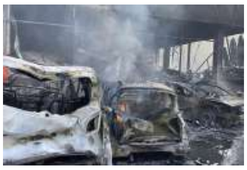

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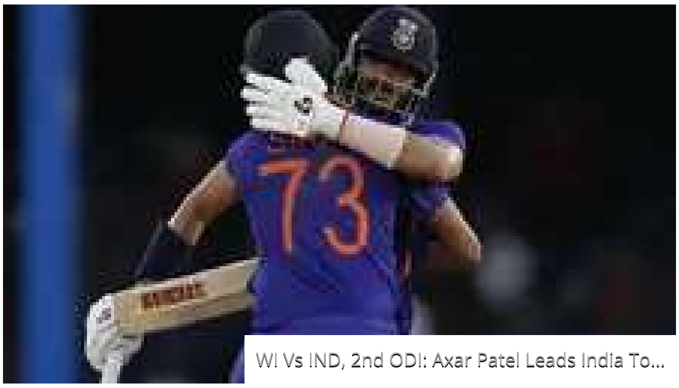

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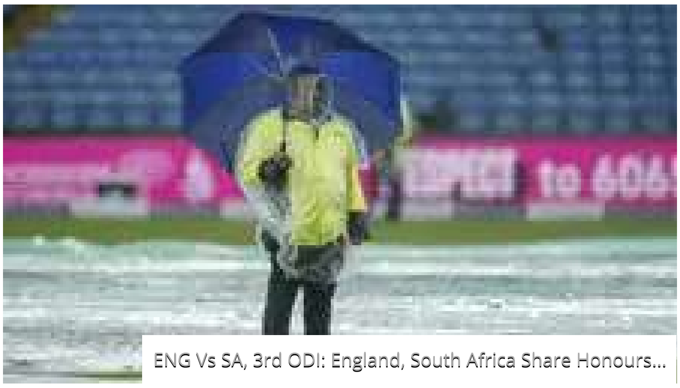

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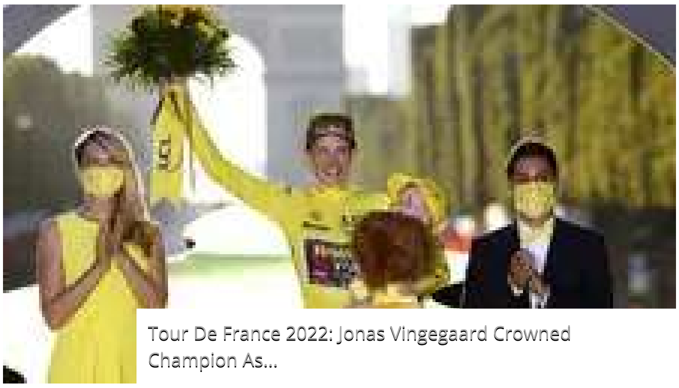

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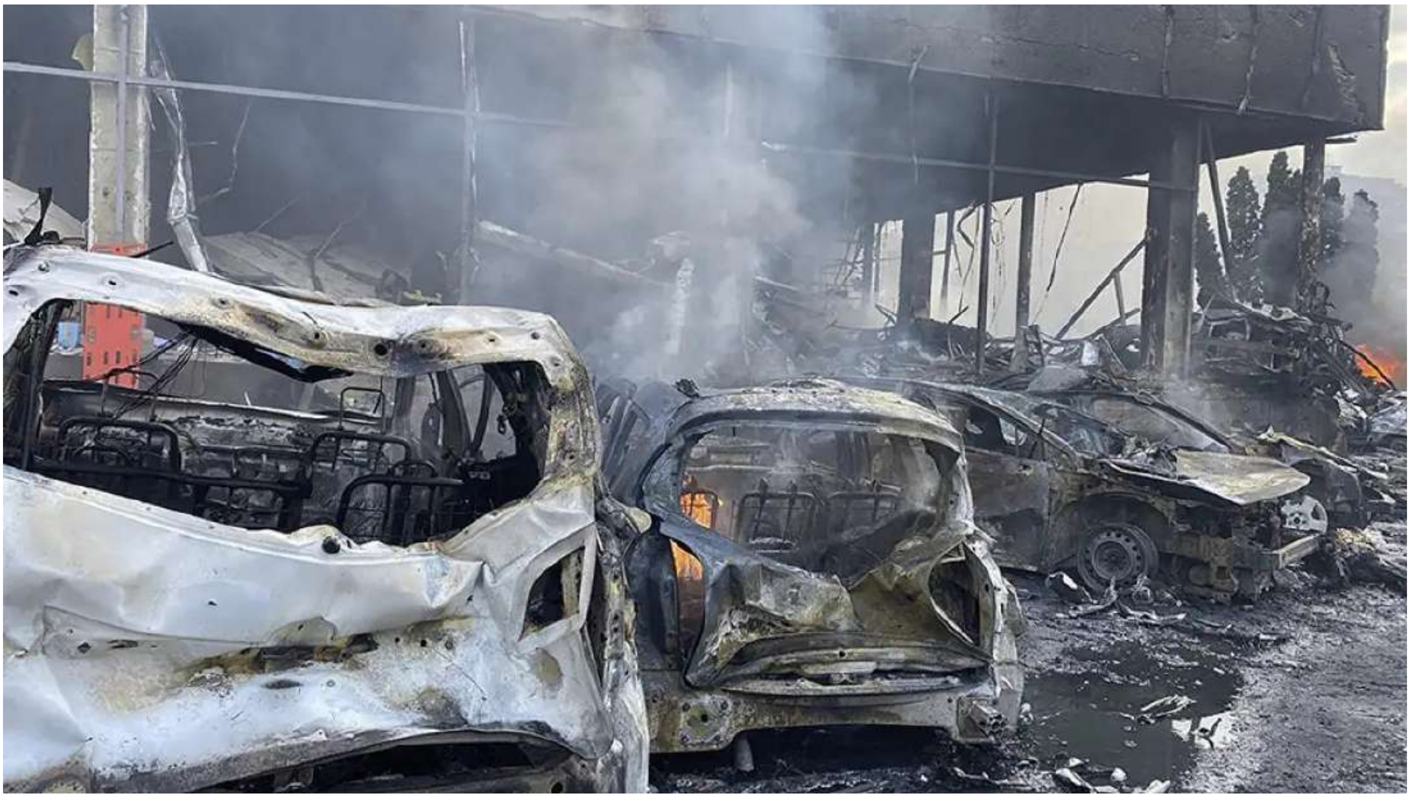

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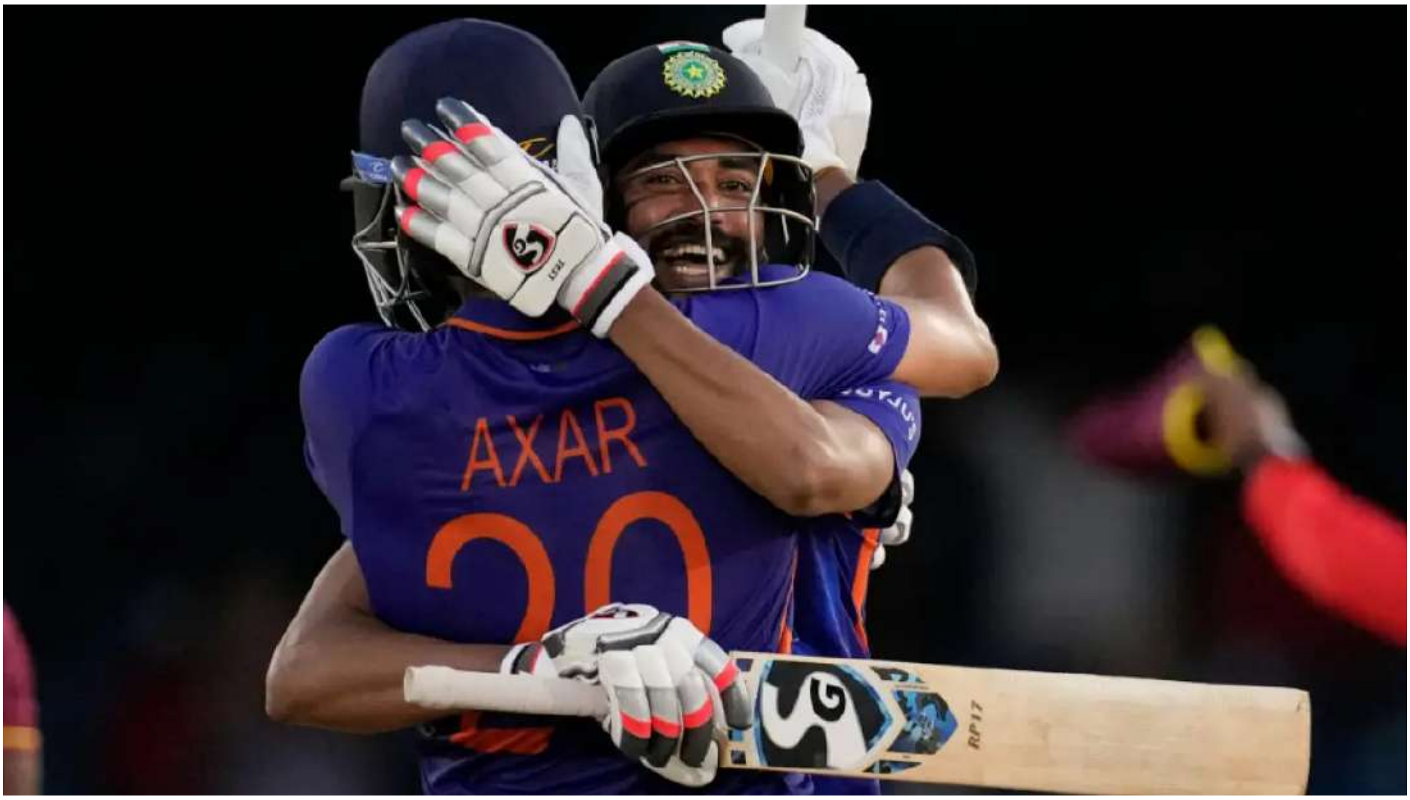

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