Item No. 16

Additional Tier 1 Perpetual Bonds (Basel – III Compliant)

BACKGROUND

1. IRDAI has issued Circular IRDAI/F&I/CIR/INV/063/02/2014 Dt. 13th Feb, 2014 on Tier-II Capital (Basel-III Compliant) issued by Domestic Banks. In Financial Stability and Development Council (FSDC) meetings, IRDA highlighted the following in connection with permitting Insurers to subscribe AT1 Bonds (Basel III Compliant) on issues, other than "Loss Absorbency Criteria"

    a. Perpetual Nature
    b. Illiquidity of the instruments
    c. Discretion of the Banks to cancel Interest/ Coupon/ Dividends
    d. Credit Rating falling below the minimum required for "Approved Investments" under IRDAI (Investment) Regulations

2. In the FSDC Sub-Committee meeting of 7th Mar, 2014 it was decided to have a "High Powered Inter Regulatory Committee" to examine various issues, apart from the above. Further to the above said meeting, on 23rd Sep, 2014, IRDAI informed the following:

    a. Reduction of tenure from 10 to 5 years with only "call" option favouring the Banks
    b. Matter relating to taxation of income and "valuation" of such security
    c. As some of the bonds will be sold to retail investors, such sale should be done through public issue
    d. Minimum rating of such bonds to ensure Banks do not do any Rating Shopping

3. As a response to the above, RBI clarified the following as a part of ATR:

a. AT1 instruments are perpetual in nature, with the call option only after 5 years' subject to supervisory approval. This will provide more flexibility to banks in structuring the instruments to suit the needs of the investors.
b. Further, banks and investors can mutually decide call date subject to meeting minimum regulatory requirements.
c. There is no RBI's regulatory requirement of rating of AT1 instruments.

Further, RBI requested IRDAI to re-visit their Investment Guidelines to include AT1 as an eligible instrument. In the meantime, IRDAI received requests from IBA and few Bankers requesting IRDAI to permit Insurers to subscribe AT1 Bonds

4. The Working group on Corporate Bonds constituted by FSDC – Sub Committee, had IRDAI as one of the participants with other Regulators as well. The final recommendation was to permit Insurers to subscribe for AT1 Bonds, subject to prudential limits and other Rating criteria up to Investment Grade

5. On 1st Sep, 2014 RBI has made the following changes to the Guidelines of Basel III instruments:

Feature	**Earlier**	**Revised**
Condition for coupon non-payment	*Coupon payments to be made only from current year's profits*	*Coupon payment can be made from revenue reserves, if current year profits **are** not sufficient or in case of loss, provided the bank meets all other regulatory requirements*
Loss absorption	*Conversion to Equity or permanent principal write-down*	*Temporary write-down is also allowed; However, at PONV (Point of Non-Viability), to be decided by RBI, must be permanently*

Feature	Earlier	Revised
		written down or converted to equity.
Call Option	*Call option allowed only after 10 years for Tier I instruments*	*Call option allowed after 5 years*
Issuance to retail investors	*Not allowed for Tier I instruments; only Tier II debt instruments were allowed to have retail investors*	*Allowed for Tier I (subject to investors sign off for having understood features including loss absorbency) and other types of Tyre II instruments (RCPS, RNCPS, PCPS)*

RBI PROVISIONS

Provisions on "Loss Absorption" of AT1 Bonds

Point No: 2 of Annexure 16 of RBI Cir: RBI/2014-15/201 DBOD.No.BP.BC.38/21.06.201/2014-15 Dt. 1st Sep,2014 amongst various criteria, list criteria for "loss absorption" in the case of AT1 Bonds. Thus, Banks should at pre-specified trigger point should:

a. convert the AT1 Bonds into common Shares; or
b. write-down either temporarily or permanently, by allotting losses to the AT1 Bonds
c. all non-equity capital instruments (i.e. both AT1 & AT2) shall provide, when RBI observes PONV, to either permanently write-off or convert into common shares.
d. Coupon payment by Bank on AT1, shall be discretionary. Bank can cancel the payments which will not be construed as a "default event"

FOR THE CONSIDERATION OF THE AUTHORITY

Based on the above background and RBI Provisions and FSDC Working Group recommendations on the subject, IRDAI may consider AT1 (Basel III Compliant) Bonds, as a part of eligible Instruments subject to the following prudential norms:

1. The minimum rating of AT1 Bonds shall, at the time of investment, be not less than “AA”.
2. In the case of IPOs, the offer document of such AT1 Bonds shall have a provision for listing in at least one of the Exchanges.
3. The Insurer shall, not more than 10%, invest in AT1 Bonds offer through IPO. Further, at any point of time, the aggregate value of AT1 Bonds of the particular bank held shall not be more than 10% of the total outstanding AT1 Bonds of the particular Bank.
4. The minimum Common Equity Tier I Capital (CET) **including** Capital Conservation Buffer, of the issuer bank shall be more than 1% the minimum CET prescribed by RBI, at the time of investment in AT1 Bonds
5. Insurers can invest in AT1 Bonds, only where such Banks have declared dividend for the preceding 2 years.
6. The insurer shall comply with Regulation 9 of IRDAI (Investment) Regulations, 2016 and Master Circular issued thereunder, in subAT1 Bonds shall form part of Equity for the purpose of IRDAI Exposure Norms under Regulation 9
7. Investment shall NOT be made in AT1 Bonds, where the issuer Bank is under the Promoter Group of Insurer or Corporate Agent of the Insurer.