PSBs can't sell perpetual bonds to retail investors

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MUMBAI: Public sector banks will not be able to issue perpetual bonds to retail investors.
The Securities and Exchange Board of India (Sebi) has struck down requests of state-owned banks, such as State Bank of India, to sell these securities to smaller investors citing potential risks of mis-selling.
Instruments like perpetual bonds have no maturity date and pay interest forever. They fetch a higher coupon than normal bonds since they could skip interest payments in case of deterioration of financials at the issuer.

Sebi is not in favour of allowing banks to sell the product to retail in vestors because they do not understand the complexities, said a senior regulatory official."There is an investor protection issue here," the Sebi official said. "In any bond, whether you make loss or profit, you have to pay an interest. But here, if the bank incurs loss or its profits fall below a certain threshold limit, it won't be allowed to pay interest to these bond holders."

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At present, perpetual bond issues are private placements and the typical subscribers are provident funds who buy them in bulk and sell them to high networth investors. Banks and finance companies have raised close to `19,000 crore through perpetual bonds.

The risk of mis-selling is when the product is sold like a fixed deposit, when it is not, the official said. In the recent past, at least two large lenders including SBI and Indian Overseas Bank have approached the capital market regulator seeking permission to sell such securities to retail investors. The proposed issue size was at about `1,000 crore or more. Banks want perpetual bond issues for retail investors as they can sell it directly to their clients instead of going through distributors, who bring in the HNIs. "Why not sell them directly to investors and save on cost? This thought has prompted some banks to think of floating public issuances," said a banker, who is not authorised to talk to the press.

About a decade ago, a large private sector bank had applied to Sebi but it was denied permission then.

"Perpetual, or CoCo, bonds are riskier products especially for retail investors, who could be misguided at the time of sale pitch," said Ajay Manglunia, executive VP (fixed income) at Edelweiss Finance. "But, some retail investors are informed enough to understand that. There could be a separate class within retail with higher investment limit, who might be allowed."

India adopted the use of perpetual bonds, known as additional tier-I (AT1) securities in market parlance, on April 1, 2013. If an issuing bank incurs losses in a financial year, it cannot make coupon payment to its bondholders even if it has enough liquidity. If the equity capital of the issuer falls below 6.125%, the entire investment of bondholders would be either written down or converted to equity. Hence, the securities are called quasi-equity instrument.

In the past six months, SBI sold `2,100 crore AT1 securities to a single investor - Yes Bank, which may eventually sell it down to other investors.

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