Special Zero Coupon Recapitalisation Bonds

Why in News

Recently, the government has used **financial innovation to recapitalise Punjab & Sind** Bank by issuing the bank **Rs. 5,500 crore** worth **Special Zero Coupon Recapitalisation Bonds.**

- Punjab & Sind Bank is a **Government of India undertaking.**

Key Points

- **Bank Recapitalisation:**
  - It means **infusing more capital in state-run banks** so that they meet the capital adequacy norms.
    - Indian public sector banks are emphasized to maintain a **Capital Adequacy Ratio (CAR) of 12%.**
    - CAR is the ratio of a bank's capital in relation to its risk weighted assets and current liabilities.
  - The government, **using different instruments,** infuses capital into banks facing shortage of capital. As the government is the biggest shareholder in public sector banks, the responsibility of bolstering banks' capital reserves lies with the government.
  - The government infuses capital in banks **by either buying new shares or by issuing bonds.**
- **Reason for Recapitalisation:**
  - In compliance with **Reserve Bank of India (RBI)** guidelines which are based on **Basel norms** requiring banks to maintain certain amounts of capital reserves.
- **Recapitalisation Bonds:**
  - The government **issues bonds which are subscribed by banks.** The money collected by the government goes to banks in the form of equity capital as the government increases its share of equity holding, thereby shoring up banks' capital reserves.
  - The money invested by banks in recapitalisation bonds is classified as an investment which earns them an interest. This **helps the government in maintaining its fiscal deficit target** as no money directly goes out from its coffers.
- **Special Zero Coupon Recapitalisation Bonds :**
  - These are special types of bonds **issued by the Central government specifically to a particular institution.**
  - **Only those** banks, whosoever is **specified, can invest** in them, **nobody else.**
  - It is **not tradable,** it is **not transferable.** It is **limited** only to a **specific bank,** and it is for a **specified period.**
  - There is **no coupon,** it is zero coupon, it is **issued at par** and will be **paid at the end of the specified period.**
    - **Coupon** is the Interest which the Investor gets on a bond.

        - It is held at the **Held-To-Maturity (HTM)** category of the bank as per the RBI guidelines.
            - **HTM** securities are purchased to be **owned until maturity.**
        - These are instruments which are **a variation of the recapitalisation bonds** but effectively meet the same purpose, and these are **issued in conformity with the RBI guidelines.**
        - **Financial Innovation:** As the issuance of these special bonds will **not affect the** fiscal deficit while at the same time **provide much needed equity capital to the bank.**
- **Difference Between Normal Zero Coupon Bonds and Special Zero Coupon Bonds:**
    - **Zero Coupon Bonds:**
        - **Zero-Coupon Bond,** also known as the **pure discount bond or deep discount bond,** is purchased at a discounted price and **does not pay any coupons or periodic interests to the fundholders.**
        - The **difference** between the **purchase price** of a zero coupon bond and the **par value at the time of maturity,** indicates the **investor's return.**
        - The Zero Coupon bonds **generally** come with a **time horizon of 10 to 15 years.**
    - **Difference: Special Zero Coupon Bonds** are being **issued at par,** there is no interest however **Normal Zero Coupon Bonds** are **issued at discount** therefore they technically are interest bearing.

Bonds

- A bond is a **fixed income instrument** that represents a loan made by an investor to a borrower. In simpler words, a bond acts as a **contract between the investor and the borrower.**
- Mostly Companies and Government issue bonds and Investors buy those bonds as a **savings and security option.**
- These bonds **have a maturity date** and when once that is attained, the issuing company needs to pay back the amount to the investor along with a part of the profit.

Source: IE