

# **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, whosever 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 <u>fiscal</u> <u>deficit</u> 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

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