Too Many Assumptions While Rating Perpetual Bonds, Regulators Worried

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Mumbai: Regulators have raised issues over the rating of banks' additional tier-1 bonds and the state-run non-banking finance companies such as Power Finance backed by the sovereign.

Regulators have said there are too many assumptions behind rating of these bonds which may not be right, two people familiar with the matter said.

"Additional tier-1 bonds issued by banks are being rated by some rating agencies as plain bonds when they are not," said a person familiar with the matter.

Additional tier-1 or perpetual bonds are quasi-debt instruments, which do not have any fixed maturity period. It bears higher risk compared with normal bonds. Under the Basel-III requirement, an international capital standard, perpetual bonds are more of a quasi-equity obligation. If an issuing bank incurs losses in a financial year, it cannot make coupon payment to its bondholders even if it has enough cash. The Reserve Bank of India and the Securities & Exchange Board of India are holding discussions on the issue, said an executive with the knowledge of the matter.

"But, any such announcement in changes in rules is unlikely to come now as the Election Commission's model code of conduct has become applicable," the second person said. The rating agency uses a tag (hybrid) while simultaneously assigning the ratings it applies for bonds. The regulators are worried over its treatment as retirement bodies too invest in them earning relatively higher rate of interest.

For example, Cholamandalam Investment Finance raised ₹250 crore in February offering 10.88% per year, shows data from Prime Database. Normally, a non-banking company or bank offers about 200-300 basis points higher than similar maturity pure debt papers.