

IX. ANALYSING ADDITION TIER 1 BONDS THROUGH THE YES BANK FIASCO

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ABSTRACT

First, there is a dearth of literature in Indian academic writing on the issues discussed in this paper. No Indian scholar has critically analyzed the SEBI order or the decision of the High Courts. At best, there have been studies of the impact disclosure on consumer finance, which do not have a direct correlation to the AT-1 bonds. Moreover, even in international literature, the focus has only been on empirical analysis, and not on the interpretation of statutes, circulars, and regulations. Second, the SC has not delivered any verdict on the decision of either the Bombay High Court or the Madras High Court. Moreover, SAT has not given a conclusive order on the issue of violation of PFUTP. Third, the fiasco of AT-1 bonds has been discussed in newspaper articles however; these newspaper articles merely state the stance of the different stakeholders without providing a strong critical analysis. Thus, this paper becomes imperative. It provides a critical and holistic analysis on first, the validity of issuing AT-1 bonds generally, irrespective of the issuing bank, and second, on the specific case of AT-1 bonds issued by YBL.

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I. INTRODUCTORY REMARKS – THE BACKGROUND AND THE STRUCTURE

“Riches either serve or govern the possessor” - Horace¹

In the Yes Bank Limited (“YBL”) fiasco, the riches are the Additional Tier 1 Bonds (“AT-1 bonds”) worth eight thousand four hundred and fifteen crores.² The possessors are the 1346 individual investors, who invested in the AT-1 bonds.³ AT1 bonds have a perpetual tenor and are unsecured. In other words, there is no maturity date for these bank-issued bonds. The banks may use their call option to repurchase these bonds from investors. Banks often employ these bonds to increase their tier-1 or core capital. Only common equity is senior to AT1 bonds, which are subordinate to all other debt.⁴ Before moving further, the author will *first* explain the fiasco, and *second*, the structure of the paper.

A. The Background of the YBL Fiasco

The background can be simply understood in four chronological steps. *First*, is the issuance stage. YBL issued AT-1 bonds in the year 2016 and 2017

¹ *Piyush Bokaria v Reserve Bank of India*, 2020 SCC OnLine Mad 2693 [60] (Sahi J.).

² Yes Bank Limited (‘YBL’), *Draft Reconstruction Scheme* (6 March 2020).

³ In the matter of AT1 Bonds of Yes Bank Limited, Order/SM/MG/2021-22/11306-11309 (SEBI, 12 April 2021) <https://www.sebi.gov.in/enforcement/orders/apr-2021/adjudication-order-in-the-matter-of-at1-bonds-of-yes-bank-limited_49822.html> accessed 10 January 2022 (‘SEBI Order’) [37] (Majumdar AO).

⁴ ‘Additional Tier-1 bonds, and the case against Yes Bank’ (*The Indian Express*, 21 January 2023) <<https://indianexpress.com/article/explained/explained-economics/yes-bank-at1-bonds-bombay-high-court-8395311/>> accessed 22 February 2023.

respectively.⁵ The people, who are bearing the brunt, invested in the AT-1 bonds in the year 2018.⁶ The *second* is the deterioration stage. The financial situation of YBL started deteriorating over some time. For instance, the net and gross non-performing assets of YBL increased considerably.⁷

The third is the remedial stage. To remedy the situation, the Government of India acting on the recommendation of the Reserve Bank of India (“**RBI**”)⁸ issued a moratorium on 5 March 2020.⁹ Furthermore, RBI under Section 36 ACA of the Banking Regulations Act 1949 (“**BR Act**”) appointed an Administrator to supersede the Board of Directors of YBL.¹⁰ After this, the draft reconstruction scheme was released on 6 March 2020.¹¹ This was followed by the final reconstruction scheme.¹² Fourth, is the effect stage. On the one hand, the draft reconstruction scheme stated that the AT-1 bonds are permanently written down.¹³ On the other hand, the final reconstruction scheme contained no such clause.¹⁴ Furthermore, the appointed Administrator informed the stock exchanges that AT-1 bonds are permanently written down.¹⁵ The current situation is that AT-1 bonds of YBL have been permanently written down.

Hence, the crux of the matter is (a) whether the AT-1 bondholders should be compensated for the loss faced by the fiasco (serve the possessor)

⁵ *Piyush* (n 1) [10] (Ramamoorthy J.).

⁶ *ibid.*

⁷ *ibid* [11] (Ramamoorthy J.).

⁸ The Banking Regulation Act 1949 (‘BR Act’), s 45(1). “..., the Reserve Bank may apply to the Central Government for an order of moratorium in respect of a banking company...”

⁹ SEBI Order (n 3) [27] (Majumdar AO).

¹⁰ BR Act, s. 36ACA (1).

¹¹ Draft Reconstruction Scheme (n 2).

¹² YBL, *Final Reconstruction Scheme* (13 March 2020).

¹³ Draft Reconstruction Scheme (n 2) cl 6 ¶ 4.

¹⁴ *Piyush* (n 1) [11] (Ramamoorthy J.).

¹⁵ *Communication from the Administrator of YBL to the stock exchanges* (14 March 2020) cl 3.

or (b) should the loss be treated at best as an investment decision gone wrong (govern the possessor). This dichotomy is the backdrop against which this paper is written.

B. The Structure of the Paper

Structurally, the paper is divided into three parts. The paper in Part I addresses the issue of the validity of the AT-1 bonds in general. The author argues that AT-1 bonds neither violate the provisions of the BR Act nor the provisions of the Companies Act 2013 (“**CA Act**”) [II]. The paper in Part II critically analyses the issue of fraud, miss-selling, and disclosure. The author argues that YBL has violated the provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003 (“**PFUTP Regulations**”) and SEBI Act 1992 (“**SEBI Act**”) among others [III]. The paper in Part III evaluates the viability of SEBI Circulars and their potential to serve as a way forward [IV].

Through these three parts, the thesis of the paper is, ‘While the issuance of the AT-1 is, in general, valid, the issuance of AT-1 bonds by YBL is fraudulent’

II. THE ISSUANCE OF AT-1 BONDS, IN GENERAL, DOES NOT VIOLATE THE PROVISIONS OF ANY STATUTE

One of the major arguments of the investors of AT-1 bonds of YBL is that the issue of AT-1 bonds, irrespective of the issuing bank, should be treated as invalid.¹⁶ There are two prongs to this argument, and hence the author will deal with them accordingly. *First*, the author argues that the issuance of AT-1

¹⁶ *Piyush* (n 1) [14(iii)], [14 (vi)] (Ramamoorthy J.).

bonds does not violate the BR Act, and *second*, AT-1 bonds do not contravene the provisions of the CA Act.

A. The use of Section 35A of the BR Act to lay down the Master Circular for the Issuance of AT-1 Bonds is valid.

1. Section 12 of the BR Act should triumph over Section 35A of the BR Act with regard to AT-1 bonds – The incorrect argument

The argument from the sides of investors is three-fold. *First*, BR Act envisages the issuance of capital under Section 12,¹⁷ *second*, Section 12 does not encompass AT-1 bonds, and *third*, specific powers conferred by a statute on particular provisions should triumph over the general powers conferred by that same statute on some section/s.¹⁸

Hence, the Master Circular dated 1 July 2015 (“MC”) should be declared invalid to the extent that it talks about AT-1 bonds.¹⁹ This is because the MC was issued using the general powers under Section 35A of the BR Act despite the existence of Section 12. However, the author argues that this three-fold argument is erroneous.

2. Section 12 of the BR Act does not envisage AT-1 bonds, and hence the use of Section 35A is valid – The correct argument

Before moving further, let us understand the origin of the MC. The origin of the MC can be understood in three simple steps. *First*, in 2009, the

¹⁷ BR Act, s. 12(ii).

¹⁸ *Dharani Sugars v Union of India*, (2019) 5 SCC 480 [26], [40-42], [62-63], [72].

¹⁹ Reserve Bank of India, *Master Circular on Basel III Capital Regulations* (July 2015) Annex 4, Annex 16 <<https://rbidocs.rbi.org.in/rdocs/content/pdfs/58BS300685FL.pdf>> accessed 15 January 2022 (Master Circular).

G20 leaders met in Pittsburgh (“**G20 Summit**”) One of the main agendas of the G20 Summit was “Strengthening the International Financial Regulatory System”.²⁰ *Second*, under the G20 Summit, the Basel Committee on Banking Standards (“**BCBS**”) released Basel III: A global regulatory framework for more resilient banks and banking systems (“**Basel III**”).²¹ One of the goals of Basel III is “Strengthening the Global Capital Framework”.²² Furthermore, Section 4 of the Basel Committee Charter (“**Charter**”) states that central banks are members of BCBS.²³ Hence, the Reserve Bank of India (“**RBI**”) is a member of the BCBS. *Third*, to achieve the mandate of the BCBS,²⁴ the RBI using the powers of Section 35A released the consolidated MC.²⁵

Once the background is established, the author has two arguments. *First*, the scope of Section 35A is wide.²⁶ If the RBI is satisfied that a course of action is in the “public interest” or “in the interest of banking policy”, then the RBI can “issue such directions as it deems fit”.²⁷ As abovementioned, the MC was issued to promote the goals of the G20 Summit, and Basel III. These goals are in place to ensure that the banks’ capital adequacy ratio is at a stable level and that the general public does not bear the brunt of the financial crisis.²⁸

²⁰ G20 Research Group, ‘G20 Leaders Statement: The Pittsburgh Summit’ (*G20 Information Centre*, September 2009) <<http://www.g20.utoronto.ca/2009/2009communique0925.html#system>> accessed 15 January 2022.

²¹ Basel Committee on Banking Standards, *Basel III: A global regulatory framework for more resilient banks and banking systems* (2010) <<https://www.bis.org/publ/bcbs189.pdf>> accessed 15 January 2022.

²² *ibid* part A.

²³ Basel Committee on Banking Standards, *Basel Committee Charter* (2013) s. 4, <http://felaban.s3-website-us-west-2.amazonaws.com/boletines_clain/archivo20140723214926PM.pdf> accessed 15 January 2022.

²⁴ *ibid* s. 5.

²⁵ Master Circular (n 19).

²⁶ *Dharani* (n 18) [39]; *ICICI Bank Ltd. v APS Star Industries Ltd.*, (2010) 10 SCC 1 [35].

²⁷ BR Act, s. 35A (1).

²⁸ Master Circular (n 19) part A, Introduction.

Hence, the issuance of AT-1 bonds through MC is in the interest of both public, and banking policy.²⁹ *Second*, AT-1 bonds are not share capital. The sample form of a balance sheet is present in the Third Schedule of the BR Act.³⁰ Under the Third Schedule, there are five different schedules. Schedule 1 mention ‘Capital’ and Schedule 4 mentions ‘Borrowings’.³¹ To qualify as share capital, there should be “issuance, subscription, and paying-up of share capital”.³² If these requirements are met, then the instrument would be categorized as share capital on the balance sheet.³³ However, the MC states that AT-1 bonds are to be construed as “liabilities for accounting purposes”.³⁴ Furthermore, the balance sheet of YBL categorizes AT-1 bonds as borrowings.³⁵ Hence, the AT-1 bonds form part of ‘Borrowings’ and not ‘Capital’. Thus, if AT-1 bonds do not fall under the category of share capital, Section 12 is inapplicable. Consequently, the ‘specific over general’ argument is untenable in the present case.

To conclude, the issuance of AT-1 bonds is valid under the BR Act, as they are within the scope of Section 35A, and do not form part of the share capital.

3. The issuance of AT-1 Bonds does not contravene the provisions of the CA Act

- The CA Act does not envisage perpetual instruments such as AT-1 bonds – The incorrect argument

²⁹ *Piyush* (n 1) [19] (Ramamoorthy J.).

³⁰ BR Act, sch III.

³¹ BR Act, sch III, sub sch I, sub sch IV.

³² *Piyush* (n 1) [24] (Ramamoorthy J.).

³³ *ibid.*

³⁴ Master Circular (n 19) Annex 4, cl 1.10.

³⁵ *Piyush* (n 1).

There are three arguments from the side of the investors. *First*, as the AT -1 bonds are reflected as borrowings in the balance sheet, they should qualify as debentures.³⁶ Furthermore, the MC stipulates that AT-1 bonds should be perpetual.³⁷ This is in direct contravention of the CA Act. CA Act in Section 2(30) defines debentures to include bonds.³⁸ Furthermore, according to Section 71(8) of the CA Act, a company is mandated to redeem the debentures.³⁹ If a company fails to redeem the debenture, then legal action can be taken against it as per Sections 71(10) and 71(12) of the CA Act.⁴⁰ *Second*, Section 71(4) of the CA Act mandates that there should be a creation of a debenture redemption reserve.⁴¹ *Third*, it may be argued that, as per Section 1(4)c of the CA Act, the provisions of the BR Act take precedence over CA Act for banking companies.⁴² However, the provision for AT-1 bonds is not found in the BR Act, but in the MC. Hence, the exception under Section 1(4)(c) cannot be taken. All these arguments may carry some weight, however, all of them are erroneous. The author will now rebut all three arguments.

- The MC prevails over the CA Act with regard to AT-1 bonds – The correct argument

AT -1 bonds do not qualify as debentures because of three reasons. *First*, AT-1 bondholders do not have even the option, let alone the right of demanding repayment of principal.⁴³ *Second*, coupon payment is the only enforceable debt obligation present in AT-1 bonds, and even this obligation has certain restrictions.⁴⁴ *Third*, AT-1 bonds are regulatory capital to meet

³⁶ *ibid* [14(vi)] (Ramamoorthy J.).

³⁷ Master Circular (n 19) Annex 4, cl 1.4.

³⁸ The Companies Act 2013, s. 2(30) (CA Act).

³⁹ CA Act, s. 71(8).

⁴⁰ CA Act, ss. 71(10), 71(12).

⁴¹ CA Act, s 71(4).

⁴² CA Act, s 1(4) c.

⁴³ *Piyush* (n 1) [28] (Ramamoorthy J.); Master Circular (n 19) Annex 4, cl 1.6, 1.7.

⁴⁴ Master Circular (n 19) Annex 4, cl 1.8.

CRAR.⁴⁵ Hence, AT-1 bonds do not fall within the dichotomy of equity and debt, and they are sui generis instruments.⁴⁶

Furthermore, even if AT-1 bonds were within the ambit of debentures, then also they do not violate the CA Act. This is for three reasons. *First*, CA Act does not prohibit perpetual bonds. Secured debentures have a maximum redemption period of 10 years from the date of issue.⁴⁷ However, this is not the case for unsecured debentures. Since AT-1 bonds are unsecured debentures, there is no maximum redemption period specified. *Second*, banking companies are exempted from the creation of a debenture redemption reserve.⁴⁸ *Third*, the provisions of the BR Act overrule the provisions of the CA Act. Section 1(4)(c) of CA 2013 lays down that for banking companies, if there is any contravention of the provisions of the CA Act, then the provisions of the BR Act apply.⁴⁹ The MC was issued by RBI under Section 35A of the BR Act. The Supreme Court of India (“SC”) has held that the circulars issued by the RBI under s 35-A of the BR Act have statutory force.⁵⁰ Furthermore, SC has held that when RBI exercises the powers conferred upon it to issue directions, then such directions become a part of the Act.⁵¹ Hence, Section 1(4) c applies to the MC.

To conclude, AT-1 bonds do not contravene the provisions of the CA Act as they do not fall within the ambit of debentures. In any case, banking

⁴⁵ *Piyush* (n 1) [24] (Ramamoorthy J.).

⁴⁶ *Piyush* (n 1) [29] (Ramamoorthy J.).

⁴⁷ Companies (Share Capital and Debentures) Rules 2014, r 18(1)(a).

⁴⁸ *ibid*, r 18(7)(b).

⁴⁹ CA Act, s. 1(4) c.

⁵⁰ *Central Bank of India v. Ravindra*, (2002) 1 SCC 367 [55].

⁵¹ *Internet & Mobile Association of India v. RBI* (2020) 10 SCC 274 [150], [167]; *ICICI Bank Ltd. v APS Star Industries Ltd.*, (2010) 10 SCC 1 [40]; *Peerless General Finance and Investment Co. Ltd. v Reserve Bank of India*, (1992) 2 SCC 343 [30].

companies are exempted from the provisions of the CA Act to the extent of inconsistency.

To summarise Part I, the MC, and consequently, the *general* issue of the AT-1 bonds is valid. Having said that, the *particular* case of YBL is a separate issue, which will be discussed in the next part of the paper.

III. THE SPECIFIC CASE OF ISSUANCE OF AT-1 BONDS BY YBL IS VIOLATIVE OF STATUTES AND REGULATIONS

In this part, the author will focus on two aspects. The *first* is the theoretical aspect. The author will argue that YBL has violated the provisions of the PFUTP Regulations, the SEBI Act, and the MC. The second is the *empirical* aspect. Using, an empirical case study, the author will argue that the mis-selling by YBL amounts to a violation of the SEBI (Issue of Capital and Disclosure Requirement) Regulations 2009 (“**ICDR Regulations**”), and SEBI (Issue and Listing of Non-convertible Redeemable Preference Shares) Regulations 2013 (“**ILNRPS Regulations**”).

A. YBL is Guilty of Fraud and Mis-selling

The author will follow a general to specific approach in proving the guilt. Hence, *first*, the author argues that YBL is guilty on the general grounds of fraud, and manipulation, and *second*, YBL is guilty as it violates specific provisions.

1. YBL is guilty on the general grounds of fraud and manipulation

The test for assessing fraud and manipulation is “ the totality of the attending facts and circumstances surrounding the allegations/charges made and levelled the test would always be that what inferential process that a

reasonable/prudent man would adopt to arrive at a conclusion”⁵² (emphasis supplied).

In the case of YBL, there are at least ten attending facts and circumstances. The *first* is that YBL has admitted that AT-1 bonds were pitched to the customers, instead of the customers enquiring for the same out of their interest.⁵³ Hence, the contention of YBL, is that AT-1 bonds were not sold by them in the secondary market,⁵⁴ stands rebutted. This is because YBL prepared the step-by-step procedure for selling the AT-1 bonds⁵⁵ and YBL adopted an aggressive marketing strategy to sell the AT-1 bonds.⁵⁶ Thus, it cannot be termed as mere facilitation. *Second*, YBL has admitted that it wanted the subscription of institutional investors to more capital.⁵⁷ Hence, YBL down-sold AT-1 bonds to create shelf space for institutional investors. *Third*, the lot size of AT-1 bonds was substantially reduced, so that a wider number of unsophisticated guileless individual investors can buy AT-1 bonds.⁵⁸ *Fourth*, the application form was made available after the investor had already been sold AT-1 bonds. That is, first, the investor was influenced into buying the AT-1 bonds, second, the bond deal was blocked, and third, the application form was provided after the decision had already been formed.⁵⁹ *Fifth*, more than 97% of individual investors in AT-1 bonds were existing customers of YBL.⁶⁰ Hence, the bank had a fiduciary duty to act in the interests of its client and disclose all details.

⁵² *SEBI v Kishore Ajmera*, (2016) 6 SCC 368 [22].

⁵³ SEBI Order (n 3) [42].

⁵⁴ *ibid* [51].

⁵⁵ *ibid* [52].

⁵⁶ *ibid* [42].

⁵⁷ *ibid* [36], [42].

⁵⁸ *ibid* [17 (27)], [40], [43].

⁵⁹ *ibid* [56].

⁶⁰ *ibid* [36], [57], [93].

The *sixth* is that RBI had originally prohibited the sale of AT-1 bonds to individual investors, and then, later on, had permitted it with restrictions.⁶¹ Hence, AT-1 bonds are inherently risky. *Seventh*, YBL has admitted that there was no risk profiling of individual investors.⁶² However, the risk appetite of institutional investors is different from the risk appetite of individual investors. Hence, the latter needs risk profiling. *Eighth*, YBL has itself submitted contradictory statements.⁶³ At first, YBL states that AT-1 bonds are not inherently risky.⁶⁴ However, later on, YBL states that “the fact that the AT-1 bonds offer a higher return than FDs is ex facie evidence of the fact that there has to be some higher risk”.⁶⁵ *Ninth*, there are discrepancies present between the Verbal Sales Pitch (“VSP”) and the Term Sheet.⁶⁶ Furthermore, the Term Sheet was not shared with the investors in many cases.⁶⁷ *Tenth*, both CARE and India Ratings assign a stable parameter to the AT-1 bonds. However, YBL has claimed that these ratings have assigned them a “high degree of safety and very low credit risk”.⁶⁸

Furthermore, these ten factors expressly or impliedly rebut the submissions made by the YBL.⁶⁹ Hence, the author submits that a reasonable/prudent man should conclude that YBL is guilty of fraud and manipulation.

⁶¹ *ibid* [30], [59].

⁶² *ibid* [63], [67], [69].

⁶³ SEBI Order (n 3) [75].

⁶⁴ *ibid* [17 (7)].

⁶⁵ *ibid* [17 (7)].

⁶⁶ *ibid* [77].

⁶⁷ *ibid* [44].

⁶⁸ *ibid* [17 (24)], [81].

⁶⁹ *ibid* [17].

2. *YBL is guilty of violating specific provisions*

- YBL has violated Regulation 3 of the PFUTP Regulations

Regulation 3 starts with the words, “No person shall directly or indirectly”⁷⁰ (emphasis supplied). Hence, the aggressive market strategy used by YBL to sell AT-1 bonds in the secondary market fall within the ambit of Regulation 3 vis-à-vis the word ‘indirectly’.

In light of this, *first*, YBL has violated Regulation 3(a).⁷¹ *Firstly*, AT-1 bonds fall within the meaning of securities.⁷² *Secondly*, inducement falls within the ambit of dealing in securities which includes such acts which may be knowingly designed to influence the decision of investors in securities.⁷³ *Thirdly*, even without the amendment of PFUTP Regulations,⁷⁴ the SC had held that ‘inducement’ falls within the definition of fraud⁷⁵ in PFUTP.⁷⁶ Hence, the ten aspects mentioned in [III.A.1] and highlighting only the positive features of AT-1 bonds⁷⁷ proves that YBL induced individual

⁷⁰ SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003 (‘PFUTP Regulations’), reg 3.

⁷¹ PFUTP Regulations (n 70), Reg 3(a).

⁷² SEBI, *Issuance, listing, and trading of Perpetual Non-Cumulative Preference Shares (PNCPS) and Innovative Perpetual Debt Instruments (IPDIs)/ Perpetual Debt Instruments (PDIs) (commonly referred to as Additional Tier 1 (AT 1) instruments)* (6 October 2020) cl 2 (a) (ii), <<https://www.sebi.gov.in/legal/circulars/oct-2020/issuance-listing-and-trading-of-perpetual-non-cumulative-preference-shares-pncps-and-innovative-perpetual-debt-instruments-ipdis-perpetual-debt-instruments-pdis-commonly-referred-to-as-additi-47805.html>> accessed 25 January 2022; PFUTP Regulations, reg 2(e); Securities Contract (Regulation) Act 1956, s. 2(h).

⁷³ PFUTP Regulations, Reg 2(1)b (ii).

⁷⁴ SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) (Amendment) Regulations 2018.

⁷⁵ PFUTP, reg 2(1) b.

⁷⁶ *SEBI v Shri Kanaiyalal Baldevbhai Patel & Others*, (2017) 15 SCC 1 [54], [55], [56]; In the matter of Price Waterhouse Co. & Others (*SAT*, 9 September 2019) <http://sat.gov.in/english/pdf/E2019_JO20187_1.PDF> accessed 30 January 2022 [41].

⁷⁷ SEBI Order (n 3) [43].

investors to buy AT-1 bonds. *Second*, YBL has violated Regulation 3(c).⁷⁸ *Firstly*, AT-1 bonds were ‘listed’ by the RBI on the Bombay Stock Exchange.⁷⁹ *Secondly*, YBL had designed a *scheme* in which it created a step-by-step procedure to sell the AT-1 bonds.⁸⁰ *Thirdly*, the ten aspects mentioned in [III.A.1] prove that this scheme was prepared to defraud individual investors in connection with AT-1 bonds. Furthermore, Section 12A (b) of the SEBI ACT is verbatim that of Regulation 3(c).⁸¹ Hence, YBL violated this section as well.

- YBL has violated Regulation 4 of the PFUTP Regulations

The step-by-step procedure was prepared by YBL and they had the intention to dump AT-1 bonds on individual customers to create more shelf space for institutional investors.⁸² Hence, YBL knew⁸³ the contents of the VSP and Term Sheet.

‘Moving on to specific regulations, *first*, ICRA has not provided any rating to the AT-1 bonds.⁸⁴ Hence, the claim by YBL that ICRA has provided an AA rating⁸⁵ to AT-1 bonds is violative of Regulation 4(2)(s)(i).⁸⁶ *Second*, Term Sheets, which contained risks associated with AT-1 bonds were not sent

⁷⁸ PFUTP Regulations (n 70), reg 3(c). “...employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange”.

⁷⁹ SEBI Order (n 3) [45].

⁸⁰ *ibid* [38].

⁸¹ SEBI Act 1992 (‘SEBI Act’), s. 12A (b).

⁸² SEBI Order (n 3) [104].

⁸³ ‘Knowledge’ is a requirement mentioned in PFUTP Regulations, reg 4(2) (s); The standard for establishing knowledge is a preponderance of probabilities, held in *Kanaiyalal* (n 76) [62].

⁸⁴ SEBI Order (n 3) [78].

⁸⁵ *ibid* [74].

⁸⁶ PFUTP Regulations (n 70), reg 4(2)(s)(i). “...knowingly making a false or misleading statement.”

to many customers.⁸⁷ Furthermore, the VSP did not contain any risk differentials.⁸⁸ Hence, YBL violated Regulation 4(2) (s) (ii).⁸⁹

Third, the VSP only mentions the positive features of the AT-1 bonds and does not disclose the associated risks.⁹⁰ Hence, YBL violated Regulation 4(2) (s) (iii).⁹¹ *Fourth*, YBL had no system in place to ensure that the Term sheet was being shared with the individual investors.⁹² Furthermore, there was no process to ensure that the customers knew about the risk factors.⁹³ Hence, YBL violated Regulation 4(2) (s) (iv).⁹⁴

- YBL has violated Annex 4 of the MC

First, in the VSP, it is stated that “In all likelihood, the YES Bank would exercise the call option at the end of the 5 years.”⁹⁵ In the Term Sheet, no such expectation is created. However, in many cases, the term sheet was not provided,⁹⁶ and in many cases, the term sheet was provided after influencing the decision of the individual investor.⁹⁷ Hence, YBL has violated clause 1.6(c) of Annex 4 of the MC.⁹⁸ *Second*, YBL has violated clause 1.22 of Annex 4 of the MC. *Firstly*, the VSP mentions the high-interest rates of AT-1 bonds and consequently mentions the comparatively lower interest rates of

⁸⁷ SEBI Order (n 3) [55].

⁸⁸ *ibid* [76].

⁸⁹ PFUTP Regulations (n 70), reg 4(2)(s)(ii). “...knowingly concealing or omitting material facts.”

⁹⁰ SEBI Order (n 3) [41].

⁹¹ PFUTP Regulations (n 70), reg 4(2)(s)(iii). “...knowingly concealing the associated risk factors.”

⁹² SEBI Order (n 3) [47].

⁹³ *ibid* [52].

⁹⁴ PFUTP Regulations (n 70), reg 4(2)(s)(iv). “...not taking reasonable care to ensure the suitability of scheme the securities or service to the buyer.”

⁹⁵ SEBI Order (n 3) [77].

⁹⁶ *ibid* [44].

⁹⁷ *ibid* [41].

⁹⁸ Master Circular (n 19) Annex 4, cl 1.6(c).

Fixed Deposits.⁹⁹ This is a violation of sub-clause (a).¹⁰⁰ *Secondly*, sub-clause (c) places an affirmative obligation on the issuer to state clearly that AT-1 bonds are different from Fixed Deposits.¹⁰¹ However, the VSP, which falls within ‘other communication with the investor’ does not discharge the burden of the affirmative obligation.¹⁰² Hence, YBL has violated sub-clause (c).

To conclude, the author argues that *first*, the totality of attendant facts and circumstances prove YBL’s guilt, and *second*, YBL has violated the PFUTP Regulations, the SEBI Act, and the MC.

3. YBL did not fulfill the disclosure requirements

First, the author will apply the subjective standard test to the facts of the YBL case [II.B.1]. *Second*, using empirical data, the author will apply the objective standard test to the facts of the YBL case [II.B.2].

- YBL violated the subjective standard test of the materiality of disclosure

The ICDR Regulation states, “The offer document shall contain all material disclosures which are true and adequate so as to enable the applicants to take an informed investment decision”¹⁰³ (emphasis supplied). Hence, failure to disclose material information amounts to a violation of ICDR Regulations.¹⁰⁴

⁹⁹ SEBI Order (n 3) [74].

¹⁰⁰ Master Circular (n 19) Annex 4, cl 1.22(a).

¹⁰¹ *ibid* Annex 4, cl 1.22(c).

¹⁰² SEBI Order (n 3) [74], [76].

¹⁰³ SEBI (Issue of Capital and Disclosure Requirement) Regulations 2009 (‘ICDR Regulations’), reg 54(1); SEBI (Issue of Capital and Disclosure Requirement) Regulations 2018, reg 24(1).

¹⁰⁴ In the matter of Brooks Laboratories Ltd. & Others (*SAT*, 21 March 2018) <http://sat.gov.in/english/pdf/E2018_JO2015246.PDF> accessed 1 January 2022.

The issue of violating ICDR Regulations hinges on the ‘materiality’ of disclosure. *Electrosteel Steels Ltd. v. Securities and Exchange Board of India* is the most pertinent case on the issue of materiality.¹⁰⁵ SEBI and SAT gave conflicting decisions on the appropriate standard to assess the materiality of disclosure.¹⁰⁶

SEBI opined, “The test for materiality is objective in nature and is not affected by the subjective assessment or optimistic hopes or views of the [Book Running Lead Managers] and the issuer company”.¹⁰⁷

SAT opined, “In other words, it would imply that only facts/ events which the issuer is undoubtedly sure of having no relevance to the issuer or to the issue can be excluded from disclosure”.¹⁰⁸

Hence, SEBI’s finding is that materiality has no dependency on the subjective views of the issuer whereas SAT’s finding is that materiality is entirely dependent on the subjective views of the issuer. SAT propounded an extremely stringent standard of ‘undoubtedly sure’ for the materiality of disclosure. In the YBL fiasco, YBL itself admitted that AT-1 bonds carry some

¹⁰⁵ Yash Ashar and Anjaneya Das, ‘To Disclose or Not to Disclose? An Analysis of the Order of the Securities Appellate Tribunal in *Electrosteel Steels Limited v. Securities and Exchange Board of India*’ (*India Corporate Law- A CAM Blog*, 2 December 2019) <<https://corporate.cyrilamarchandblogs.com/2019/12/order-of-securities-appellate-tribunal-electrosteel-steels-limited-v-securities-and-exchange-board-of-india/>> accessed 2 January 2022.

¹⁰⁶ Umakanth Varottil, ‘SAT Rules on “Materiality” of Disclosures’ (*IndiaCorpLaw*, 19 November 2019) <<https://indiacorplaw.in/2019/11/sat-rules-materiality-disclosures.html>> accessed 1 January 2022.

¹⁰⁷ In the matter of Initial Public Offer (IPO) of M/s. Electrosteel Steels Ltd. (formerly M/s. Electrosteel Integrated Ltd.), AK/AO-8-12/2016 (*SEBI*, 31 March 2016) <https://www.sebi.gov.in/enforcement/orders/mar-2016/adjudication-order-in-the-matter-of-m-s-electrosteel-steels-limited-and-m-s-electrosteel-castings-limited-_32230.html> accessed 1 January 2022 [62].

¹⁰⁸ In the matter of *Electrosteel Steels Ltd.* (*SAT*, 14 November 2019) <http://sat.gov.in/english/pdf/E2019_JO2016223.PDF> accessed 1 January 2022 [16].

higher risk.¹⁰⁹ Furthermore, the MC specifies that AT-1 bonds are risky instruments.¹¹⁰ Hence, YBL could not have been ‘undoubtedly sure’ that disclosing the risk is not relevant to the investor. Thus, YBL violated ICDR Regulations.

SAT’s subjectivity test makes the author’s job easier. However, the author in good faith, argues that the correct standard to assess materiality is the objective standard propounded by SEBI. This is because, *first*, a literal reading of Regulation 54(1) makes it clear that any information that is material for the investors to make an informed and sound decision must be disclosed. Hence, the legal validity of the regulation depends on the condition that the investors are able to make an informed decision and not on whether the issuer finds the information relevant to disclose. *Second*, the objective of disclosure requirements is investor protection as opposed to honouring the intent of the issuer.¹¹¹

- YBL violated the objective standard test of the materiality of disclosure

The objective standard test is that the disclosure should not mislead or omit a material fact so that investors can make an informed decision.¹¹² The author will now explain an experimental design, conducted by Dvara Research, to argue that YBL did not adhere to the disclosure requirements. Let’s take a hypothetical bond, which has a high rate of interest. Two forms were circulated with regards to this form, *first* was the accurate form that

¹⁰⁹ SEBI Order (n 3) [17(17)].

¹¹⁰ Master Circular (n 19) Annex 4, cl 1.22.

¹¹¹ Luca Enriques and Sergio Gilotta, ‘Disclosure and Financial Market Regulation’ in Niamh Moloney, Eilís Ferran, and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (OUP 2015); John Armour and others, *Principles of Financial Regulation* (1st edn, OUP 2016) chp 8.

¹¹² *Electrosteel* (n 107) [62].

contained information on both returns and risks. *Second*, was the inaccurate form that closely resembles the disclosure for AT-1 bonds of YBL.¹¹³

The result of this experiment was *first* that only 14% of people, who received the accurate form,¹¹⁴ opted for buying the product as opposed to 50% for the inaccurate form.¹¹⁵ The figure below-mentioned explains this better.¹¹⁶

TABLE 3: Overall purchase decision by disclosure type

Disclosure Type	Decision to Buy		
	Not Buy	Buy	Total
Inaccurate	85	86	171
	49.71	50.29	100.00
Accurate	114	18	132
	86.36	13.64	100.00
Total	199	104	303
	65.68	34.32	100.00

(The first row has frequencies and the second row has row percentages)

¹¹³ Niyati Agarwal and others, 'Impact of Information Disclosure on Consumer Behaviour: Case of AT1 Bonds' (2021) Dvara Research Working Paper Series No. WP-2021-01, 9 <<https://www.dvara.com/research/wp-content/uploads/2021/02/Impact-of-Information-Disclosure-on-Consumer-Behaviour-Case-of-AT1-Bonds.pdf>> accessed 2 February 2022.

¹¹⁴ *ibid* pg 10.

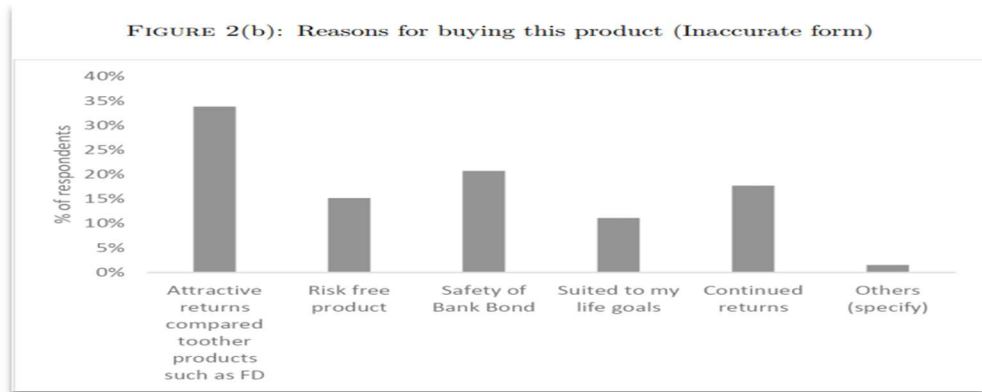
¹¹⁵ SEBI, *Clarification on the valuation of bonds issued under Basel III framework* (22 March 2021) cl 2, <https://www.sebi.gov.in/legal/circulars/mar-2021/clarification-on-the-valuation-of-bonds-issued-under-basel-iii-framework_49604.html> accessed 19 January 2022.

¹¹⁶ *ibid* pgs 10-12.

TABLE 1: Results of the test for difference in proportions across the two forms of disclosures — Inaccurate and Accurate

	Variables	Inaccurate	Accurate	Proportion (Inaccurate)	Proportion (Accurate)	Difference	p-value
Gender	All observations	171	132	0.56	0.44	0.1288**	0.026
	Male	89	72	0.55	0.45	0.11	0.183
	Female	82	60	0.58	0.42	0.155*	0.068
Age	18 - up to 24 years	4	4	0.50	0.50	0.00	1.000
	24 - up to 34 years	42	30	0.58	0.42	0.17	0.163
	34 - up to 44 years	45	40	0.53	0.47	0.06	0.588
	44 - up to 54 years	53	39	0.58	0.42	0.15	0.149
	54 - up to 60 years	18	10	0.64	0.36	0.29	0.146
	60 - up to 70 years	9	8	0.53	0.47	0.06	0.809
	70 and above	0	1	0.00	1.00	-1.00	
Marital Status	Married	134	108	0.55	0.45	0.1074*	0.097
	Unmarried	31	21	0.60	0.40	0.19	0.173
	Divorced	4	0	1.00	0.00	1.00	
	Separated	1	2	0.33	0.67	-0.33	
	Widow/Widower	1	1	0.50	0.50	0.00	
Occupation	Private Sector, salaried	62	54	0.53	0.47	0.07	0.459
	Public Sector, salaried	7	4	0.64	0.36	0.27	0.383
	Self-employed						
	professional	21	18	0.54	0.46	0.08	0.632
	Business	22	18	0.55	0.45	0.10	0.529
	Freelancer/Consultant	5	5	0.50	0.50	0.00	1.000
	Homemaker	40	27	0.60	0.40	0.19	0.119
	Retired	5	2	0.71	0.29	0.43	0.297
	Retired and partly working again	5	0	1.00	0.00	1.00	
	Others	4	4	0.50	0.50	0.00	1.000
Income Tax Bracket	₹0 - ₹2,50,000	17	17	0.50	0.50	0.00	1.000
	₹2,50,001 - ₹5,00,000	17	9	0.65	0.35	0.31	0.134
	₹5,00,001 - ₹7,50,000	14	9	0.61	0.39	0.22	0.308
	₹7,50,001 - ₹10,00,000	28	12	0.70	0.30	0.4**	0.019
	₹10,00,001 - ₹12,50,000	11	8	0.58	0.42	0.16	0.497
	₹12,50,001 - ₹15,00,000	7	10	0.41	0.59	-0.18	0.474
	Above ₹15,00,000	38	36	0.51	0.49	0.03	0.816
	Do not want to mention	39	31	0.56	0.44	0.11	0.343
Risk	Low risk	19	20	0.49	0.51	-0.03	0.873
	Medium Risk	66	59	0.53	0.47	0.06	0.532
	High Risk	86	53	0.62	0.38	0.2374***	0.007

Second, the third most cited rationale, by people who got the inaccurate form, for buying the bond was that of the safety of the bond¹¹⁷. The figure below-mentioned explains this better.¹¹⁸



Hence, the inaccurate form falsely induced the investors to buy the bond. This whole exercise coupled with the violation of statutes and regulations proves that disclosing risk factors is a material fact for investors to make an informed decision. Hence, YBL violated ICDR Regulations. Furthermore, once it is proven that ICDR Regulations are violated, ipso facto, Regulation 23 of ILNRPS Regulations stands violated.¹¹⁹

To conclude, YBL has violated ICDR Regulations through the subjective standards test. To summarize Part II, YBL has contravened the provisions of the PFUTP Regulations, SEBI Act, MC, ICDR Regulations, and ILNRPS Regulations.

IV. THE VIABILITY OF THE SEBI CIRCULARS AND THEIR POTENTIAL TO SERVE AS A WAY FORWARD

¹¹⁷ Ibid.

¹¹⁸ *ibid* 13.

¹¹⁹ SEBI (Issue and Listing of Non-convertible Redeemable Preference Shares) Regulations 2013, reg 23(1).

The *first* solution is to allow only Qualified Institutional Buyers to “participate in the issuance of AT-1 instruments”.¹²⁰ The *second* solution deals with AT-1 bonds in general, and the solution is that the AT-1 bonds should have a fixed maturity date. As the first solution is straightforward, this paper focuses only on the second solution.

A. The Solution of AT-1 Bonds Having a Fixed Maturity Date is iable

1. *The valuation principle – pro-investor move*

SEBI released a circular, which stated that “the maturity of all perpetual bonds shall be treated as 100 years from the date of issuance of the bond for the purpose of valuation”.¹²¹ Hence, SEBI changed the nature of AT-1 bonds from perpetual¹²² to instruments with a fixed maturity period. Furthermore, SEBI has put a ceiling on the percentage of AT-1 bonds that mutual funds can have in their portfolios.¹²³ The author argues that all of this combined is a pro-investor move, as this disincentivizes mutual funds from introducing AT-1 bonds to low-risk appetite investors.

¹²⁰ SEBI, *Issuance, listing, and trading of Perpetual Non-Cumulative Preference Shares (PNCPS) and Innovative Perpetual Debt Instruments (IPDIs)/ Perpetual Debt Instruments (PDIs) (commonly referred to as Additional Tier 1 (AT 1) instruments)* (6 October 2020) cl 3, <https://www.sebi.gov.in/legal/circulars/oct-2020/issuance-listing-and-trading-of-perpetual-non-cumulative-preference-shares-pncps-and-innovative-perpetual-debt-instruments-ipdis-perpetual-debt-instruments-pdis-commonly-referred-to-as-additi-_47805.html> accessed 25 January 2022.

¹²¹ SEBI, *Review of norms regarding investment in debt instruments with special features, and the valuation of perpetual bonds* (10 March 2021) cl 8 <https://www.sebi.gov.in/legal/circulars/mar-2021/review-of-norms-regarding-investment-in-debt-instruments-with-special-features-and-the-valuation-of-perpetual-bonds_49463.html> accessed 20 January 2022.

¹²² Master Circular (n 19) Annex 4, cl 1.4.

¹²³ SEBI, *Review of norms regarding investment in debt instruments with special features, and the valuation of perpetual bonds* (10 March 2021) cl 2 <https://www.sebi.gov.in/legal/circulars/mar-2021/review-of-norms-regarding-investment-in-debt-instruments-with-special-features-and-the-valuation-of-perpetual-bonds_49463.html> accessed 20 January 2022.

The author's argument is based on the rationale of the valuation principle. Let us understand how bonds are valued by the markets. The pricing (valuation) is a function of the time value of money.¹²⁴ It simply means that a rupee tomorrow is less valuable than a rupee today.¹²⁵ In terms of the valuation of bonds, the general method is to use a 'cash flow method'.¹²⁶ In this method, the future principal pay-out and the future recurring coupon payments are discounted back to the current period to determine the current valuation of the bonds.¹²⁷

Once the basics of the valuation are clear, the author will now apply it to the AT-1 bonds. Assume that a mutual fund is holding an AT-1 bond, which has a face value of 2 lakhs, and a coupon at 10%. Now, before the SEBI Circular, the AT-1 bond would have been redeemed in 2025 (there is an assumption in the market that the call period of AT-1 bonds is 3-5 years).¹²⁸ However, after the SEBI circular, the impact will be that repayment of 2 lakhs will be presumed to happen in the year 2122, and not 2025. As the value of 2 lakhs, hundred years later is exponentially less than the value of 2 lakhs in 2025, the value of AT-1 bonds in the portfolios of mutual funds will reduce drastically. This will result in lower dealing in AT-1 bonds, and consequently lower negative impacts for individual investors.

2. *Criticisms of the fixed maturity solution*

However, one might argue there are two problems with the SEBI Circular. The *first* is the policy implication. Mutual funds are an important

¹²⁴ Robert S. Pindyck and Daniel L. Rubinfeld, *Microeconomics* (8th edn, Pearson 2017).

¹²⁵ *ibid.*

¹²⁶ Ishan Chopra, 'Valuing AT-1 Bonds: SEBI Calling Spade a Spade' (*NLSBLR*, 7 July 2021) <<https://www.nlsblr.com/post/valuing-at-1-bonds-sebi-calling-spade-a-spade>> accessed 17 January 2022.

¹²⁷ *ibid.*

¹²⁸ *ibid.*

source for maintaining the capital requirements of banks. Hence, such a drastic reduction in valuation would plummet the appetite of mutual funds for AT-1 bonds. Consequently, it will impose a higher burden on the Government to infuse equity into banks to meet the capitalization requirements.¹²⁹ The *second* problem is the retrospective nature problem. SEBI circular uses the words, “all perpetual bonds”.¹³⁰ This will have the draconian effect of heavy losses on the existing retail investors of the AT-1 bonds because of the valuation principle.

3. *The response to the criticisms*

With regard to the policy problem, the author argues that a balance should be struck between meeting the capitalization requirements and establishing a safeguard against the mis-selling of AT-1 for individual investors. Furthermore, the revised circular by SEBI establishes such a balance. In this revised circular, SEBI has adopted a phased manner approach. By a phased manner approach, the author means that the “deemed residual maturity” of AT-1 bonds will gradually increase from 10 years till 31 March 2022 to 100 years from 1 April 2023.¹³¹ The figure below-mentioned explains this better.¹³²

¹²⁹ Shivani Bazaz, ‘Finance ministry asks SEBI to withdraw new rule on AT1 bonds’ (*The Economic Times*, 12 March 2021) <<https://economictimes.indiatimes.com/mf/mf-news/finance-ministry-asks-sebi-to-withdraw-new-rule-on-at1-bonds/articleshow/81463006.cms?from=mdr>> accessed 17 January 2022.

¹³⁰ SEBI, *Review of norms regarding investment in debt instruments with special features, and the valuation of perpetual bonds* (10 March 2021) cl 8 <https://www.sebi.gov.in/legal/circulars/mar-2021/review-of-norms-regarding-investment-in-debt-instruments-with-special-features-and-the-valuation-of-perpetual-bonds_49463.html> accessed 20 January 2022.

¹³¹ SEBI, *Clarification on the valuation of bonds issued under Basel III framework* (22 March 2021) cl 2, <https://www.sebi.gov.in/legal/circulars/mar-2021/clarification-on-the-valuation-of-bonds-issued-under-basel-iii-framework_49604.html> accessed 19 January 2022.

¹³² SEBI, *Clarification on the valuation of bonds issued under Basel III framework* (22 March 2021) cl 2, <https://www.sebi.gov.in/legal/circulars/mar-2021/clarification-on-the-valuation-of-bonds-issued-under-basel-iii-framework_49604.html> accessed 19 January 2022.

Hence, this will have the effect of *first*, reducing the immediate burden imposed on the Government to infuse equity. Second, under clause 2 of the original circular and clause 2 of the revised circular, there will be less exposure of guileless individual investors to the high-risk AT-1 bonds.

Time Period	Deemed Residual Maturity of Basel III AT-1 bonds (Years)	Deemed Residual Maturity of Basel III Tier 2 Bonds (Years)
Till March 31, 2022	10	10 years or Contractual Maturity whichever is earlier
April 01, 2022 – September 30, 2022	20	Contractual Maturity
October 01, 2022 – March 31, 2023	30	Contractual Maturity
April 01, 2023 onwards	100 *	Contractual Maturity
*100 years from the date of issuance of the bond.		

With regards to the retrospective problem, the law of the land is that alteration of the substantive proposition of law should have a prospective application unless otherwise explicitly or impliedly stated.¹³³ Furthermore, the SC has held that enacting legislation having a retrospective effect is out of the ambit of Section 11(1) of the SEBI Act.¹³⁴ Moreover, the retrospective nature can cause heavy losses to the existing retail investors of AT-1 bonds.¹³⁵ Hence,

¹³³ *SEBI v Classic Credit Ltd.*, (2018) 13 SCC 1 [10]; *Hitendra Vishnu Thakur v. State of Maharashtra*, (1994) 4 SCC 602 [26]; *Sudhir G. Angur v. M. Sanjeev*, (2006) 1 SCC 141 [11].

¹³⁴ *SEBI v Alliance Finstock Ltd.*, (2015) 16 SCC 731; SEBI Act, s 11(1). “Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit”.

¹³⁵ Samie Modak, ‘Explained: What are perpetual bonds & why have new Sebi rules irked FinMin?’ (*Business Standard*, 17 March 2021) <https://www.business-standard.com/article/markets/explained-what-are-perpetual-bonds-why-have-new-sebi-rules-irked-finmin-121031601260_1.html> accessed 22 January 2022.

the author admits that the SEBI circulars have a fault to the extent of retrospectivity, and this should be cured.

To summarise Part III, the author argues that the move by the SEBI to cap the maturity period of AT-1 bonds is a viable solution. Furthermore, if the circulars are given prospective applications, then they can serve as a way forward.

V. CONCLUDING REMARKS

In the YBL fiasco, the loss faced by AT -1 bonds (the riches) should have been compensated to the individual investors (serve the possessor). The paper aimed to provide a critical analysis of three aspects of AT-1 bonds. *First*, is the general aspect. The author argued that AT-1 bonds in general do not violate the provisions of the BR Act or the CA Act. Hence, in principle, the MC, and consequently the issuance of AT-1 bonds are valid. The *second* is the specific aspect. The author argued that the YBL committed fraud and did not adhere to disclosure requirements. Hence, the issuance of AT-1 bonds by YBL is invalid. *Third*, is the strategic aspect. The author argued that imposing a fixed maturity period on AT-1 bonds is a viable solution to diminish the risk of individual investors investing in them. Hence, SEBI circulars can serve as a way forward if they have a prospective application.