# Zero-Coupon Bonds

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In news

Recently, the government has used financial innovation to recapitalize Punjab & Sind Bank by issuing the lender Rs 5,500-crore worth of **non-interest bearing bonds valued at par.**

What is a Zero-coupon bond?

- A zero coupon bond also called a deep discount is a bond in which the face value is repaid at the time of maturity. That definition assumes a positive time value of money.
- It does not make periodic interest payments or have so-called coupons, hence the term zero coupon bond
- When the bond reaches maturity, its investor receives its par (or face) value.

More about recent innovation by the government

- Funds raised through issuance of these instruments, which are a variation of the recapitalisation bonds issued earlier to public sector banks, are being deployed to capitalise the state-run bank.
- These will earn no interest for the subscriber
- Market participants term it both a 'financial illusion' and 'great innovation' by the government where it is using Rs 100 to create an impact of Rs 200 in the economy.
- According to MD & CEO of Punjab and Sind bank, these are special types of zero coupon bonds issued by the government after proper due diligence and these are issued at par.
- As these bonds are not tradable, the lender has kept them in the HTM bucket, not requiring it to book any

mark-to-market gains or losses from these bonds.

## Why did the government use this innovative tool?

As per Financial market participants, government seems to have found an innovative way to capitalise banks, which does not affect the fiscal deficit while at the same time provides much needed equity capital to the banks

## How are Zero coupon bonds different from other recapitalization bonds?

- Unlike the previous tranches of recapitalization bonds which carried interest and were sold to different banks, these "non-interest bearing, non-transferable special GOI securities" have a **maturity of 10-15 years and issued specifically to Punjab & Sind Bank.**
- These recapitalization bonds are special types of bonds **issued by the Central government specifically to a particular institution.**
- Though zero coupon, **these bonds are different from traditional zero coupon bonds on one account as they are being issued at par,** there is no interest; in previous cases, since they were issued at discount, they technically were interest bearing.
- **Only those banks, whosoever is specified, can invest in them**, nobody else andand it is for a specified period
- It is held at the held-to-maturity (HTM) category of the bank as per the RBI guidelines.
- Since it is held to maturity, it is accounted at the face value (and) no mark-to-market will be there.

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| The investment portfolio of banks is classified under held to maturity (HTM), available for sale (AFS) and held for trading (HFT) category. The holding of securities under HTM provides cushion for banks from valuation changes. |

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- According to Finance ministry, these are instruments which are a variation of the recap bonds but effectively meet the same purpose, and these are issued in conformity with the RBI guidelines

## Difference between zero coupon bonds issued by private firms and special zero coupon bonds by the government

- Zero coupon bonds by private companies are normally issued at discount, but since these special bonds are not tradable these can be issued at par
- The special bonds are issued to a specified person

## Does it solve the problems faced by Banks?

- According to market participants, the innovative move by the government may not be a permanent solution for the banking sector’s problems.
- They also state that it doesn’t solve the problem permanently but gives you more time to solve it.