AMFI

Association of Mutual Funds in India

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135/BP/ 91 /2020-21 March 24, 2021

To,
All AMFI Members

Dear Members,

AMFI Best Practices Guidelines Circular No. 91/ 2020 - 21
Sub: Valuation of AT-1 Bonds and Tier 2 Bonds

SEBI, vide para 8 of the circular No. SEBI/HO/IMD/DF4/CIR/P/2021/032 dated March 10, 2021, has inter alia 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.

Based on the representation of the Mutual Fund Industry, SEBI has decided that the deemed residual maturity for the purpose of valuation of existing as well as new bonds issued under Basel III framework for implementation of the aforesaid circular shall be as per a glide path specified in para 2 of SEBI circular No. SEBI/HO/IMD/DF4/CIR/P/2021/034 March 22, 2021.

Further, SEBI has advised AMFI to issue detailed guidelines with respect to valuation of bonds issued under Basel III framework, which shall be implemented by April 1, 2021.

Accordingly, the guidelines prepared in this regard in consultation with AMFI Valuation Committee are given in Annexure 1 hereto, which have duly endorsed by the AMFI Board at the Board meeting held on March 23, 2021 for being uniformly followed and implemented by all members.

Members are requested to take note of the above guidelines for uniform implementation from April 1, 2021.

Members are also requested to confirm having noted the contents of this circular for compliance and to place the circular before their Trustees for information at their next meeting.

With regards,

N. S. Venkatesh
Chief Executive

Annexure 1

Guidelines for Valuation of Bonds issued under Basel III framework

1. Currently a bond is considered traded, if there is at least one trade in market lot in that particular ISIN. If the bond does not get traded there is a defined waterfall mechanism for valuation of that bond as per AMFI Best Practice Guideline circular no. NO.83 / 2019-20 dated November 18, 2019.

2. The said waterfall requires grouping of same issuer with similar maturity and similar issuers with similar maturity. However, in case any ISIN of issuer has not traded, the valuation of AT-1 Bonds is currently done based on adjusting spread directly to the benchmark security.

3. In order to improve existing valuation of these bonds and implement the defined waterfall, following is proposed to be done:

   i. Form two types of ISINs:
      a) Benchmark ISINs (a non-benchmark ISIN can be linked to only one benchmark ISIN. Currently, SBI ISINs happens to be the benchmark ISINs across all maturities for AT-1 Bonds.)
      b) Non-benchmark ISINs (Will be divided into multiple groups based on similar issuer and similar maturity).
      c) The groups will be decided in consultation with valuation agencies. The two main criteria envisaged to be used here would be Tier 1 / Tier 2 ratings of the ISINs / Issuers, and the spread range in which the group of ISINs / Issuer's trade over the benchmark.

   ii. Take a look back period for trade recognition as under:
      a) 15 working days for benchmark ISINs
      b) 30 working days for non-benchmark ISINs
      c) This will be revised to 7 working days for benchmark ISIN and 15 working days for non-benchmark ISINs from October 01, 2021.

4. If the ISIN gets traded, the traded YTM will be taken for the purpose of valuation. Further, if 1 ISIN of the issuer trades all other ISINs of issuers will be considered as traded but with necessary adjustment of spread to YTM. If none of the ISIN of the issuer gets traded, the trade of similar issuer in the group will be taken to valuation however with necessary adjustment of spread to YTM of similar issuer similar maturity. If none of the ISIN in a group gets traded on any particular day, an actual trade in a look back period will be seen. If there is an actual trade in look back period the security will be considered as traded and valued with necessary adjustment of spread to YTM. According to this valuation will be done based on the trade of issuer, trade of similar issuer and as an additional layer a look back period of is requested. It is confirmed that spread over YTM will be taken without any adjustment of modified duration to call.

5. Further, as the valuation is based on trade during the look back period, it is confirmed that a spread will be adjusted to reflect adverse news, change in credit rating, interest rate etc., which has bearing on the yield of ISIN being valued.

6. However, if there is no actual trade of any ISIN of the issuer as well as similar issuer during look back period also then valuation will be done by taking spread over matrix and/or polling in line with the waterfall mechanism prescribed by AMFI.

Points 4, 5 & 6 have been further elaborated in the detailed Annexure 2 attached hereto.

7. AMCs shall adopt maturity of 100 years for perpetual bond issued by banks. There will be a glide path for smooth implementation. The Deemed Residual Maturity for the Purpose of Calculation of valuation as well as Macaulay Duration for existing as well as new perpetual bonds issued:

Time Period	Deemed Residual Maturity (Years)
Till March 31, 2022	10
April 01, 2022 – September 31, 2022	20
October 01, 2022 – March 31, 2023	30
March 31, 2023 onwards	100

the residual maturity will always remain above the deemed residual maturity proposed above.

8. Hitherto, Mutual Fund industry used to value Tier II bonds considering first call date as a deemed maturity date. Therefore, a glide path is required for valuation as well as calculation of Macaulay Duration for tier II bonds also. Accordingly, valuation methodology, as mentioned above, for AT-1 Bonds is to be followed for the valuation of tier II bonds also. Further, the Macaulay Duration is proposed to be calculated as under for Tier II bonds:

Time Period	Deemed Residual Maturity for all securities (Years)
April 01, 2021 – March 31, 2022	10 years or contractual maturity whichever is earlier
April 01, 2022 onwards	Actual Maturity

9. Besides, AT-1 bonds and Tier 2 bonds being different categories of bonds, the valuation of these bonds will be done separately (i.e.) ISIN of AT-1 bond traded will not mean that ISIN of Tier-2 bonds of the same issuer have also traded. However, if any issuer does not exercise call option for any ISIN, then the valuation and calculation of Macaulay Duration should be done considering maturity of 100 years from the date of issuance for AT-1 Bonds and Contractual Maturity for Tier 2 bonds, for all ISINs of the issuer.

10. It is confirmed that the Macaulay Duration of ISINs will be calculated based on the deemed residual maturity proposed in para 7 and 8 above to reflect the duration risk.

11. Further, henceforth mutual funds will disclose both Yield to Call and Yield to Maturity.

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ANNEXURE 2

Illustration for point 4 to 6

ABC and XYZ are similar issuer and similar maturity:

Maturity of ISIN 1 of ABC is near to maturity of ISIN 1 of XYZ & Maturity of ISIN 2 of ABC is near to maturity to ISIN 2 of XYZ

Issuers	ABC		XYZ		Valuation of ABC ISIN 1
Trade	**ISIN 1**	**ISIN 2**	**ISIN 1**	**ISIN 2**	
Traded Today	Y	-	-	-	Take price and arrive at YTM
Traded Today	N	Y	-	-	Take price of ISIN 2 of ABC and compute YTM of ISIN 2. Then adjust the YTM spread of ISIN 1 and ISIN 2 and compute value of ISIN 1 of ABC.
Traded Today	N	N	Y	N	From the price of ISIN 1 of XYZ compute YTM. The spread between YTM of ABC ISIN 1 and XYZ ISIN 1 is to be adjusted to derive YTM of ABC ISIN 1. The spread should further be adjusted to reflect adverse news, change in credit rating, interest rate etc., which has bearing on the yield of ISIN being valued and final YTM and price of the security should be computed.
Traded Today	N	N	N	Y	From the price of ISIN 2 of XYZ compute YTM of ISIN 2 of XYZ. Then derive YTM of ISIN 1 of XYZ by adjusting spread of YTM. Then by adjusting difference in spread between ISIN 1 of XYZ and ISIN 1 of ABC trade (which happens to be nearest maturity) arrive at YTM of ISIN 1 of ABC. The spread should be adjusted to reflect adverse news, change in credit rating, interest rate etc., which has bearing on the yield of ISIN being valued.
No trade today. Check for actual trade during look back	Y	-	-	-	Take YTM of traded day and adjust spread to the movement of benchmark ISIN over the period. Also adjust to reflect adverse news, change in credit rating, interest rate etc., which has bearing on the yield of ISIN being valued.
No trade today. Check for actual trade during look back	N	Y	-	-	Arrive at YTM of ISIN 2 by adjusting spread to the movement of benchmark ISIN over the period. Derive YTM of ISIN 1 of ABC from ISIN 2 of ABC by adjusting spread over YTM. Also adjustment should be done to reflect adverse news, change in credit rating, interest rate etc., which has bearing on the yield of ISIN being valued.
No trade today. Check for actual trade during look back	N	N	Y	N	Arrive at YTM of ISIN 1 of XYZ by adjusting spread to the movement of benchmark ISIN over the period. Then the spread of YTM of XYZ ISIN 1 and ABC ISIN 1 is to be adjusted to arrive at YTM of ISIN 1 of ABC. Also, adjustment will be done to reflect adverse news, change in credit rating, interest rate etc., which has bearing on the yield of ISIN being valued.
No trade today. Check for actual trade during look back	N	N	N	Y	Take YTM of ISIN 2 of XYZ by adjusting spread to the movement of benchmark ISIN over the period. Adjust the spread of YTM of ISIN 1 of XYZ and ISIN 2 of XYZ to arrive at YTM of ISIN 1 of XYZ. YTM of ISIN I of ABC will be derived by adjusting spread of YTM of ISIN 1 of XYZ to ISIN 1 of ABC (which appears to be a nearest maturity to ABC ISIN 1). Further, YTM will be adjusted to reflect adverse news, change in credit rating, interest rate etc., which has bearing on the yield of ISIN being valued.
Not Traded During look back	N	N	N	N	Valuation will be done considering spread over matrix and/or polling in line with the waterfall mechanism prescribed by AMFI.

Note: The duration to call shall not be considered/adjusted to spread over YTM. Yield to Call and Yield to Maturity shall be disclosed to investors.