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INDIAN BANKING SECTOR

Banks likely to issue over Rs. 200 billion of AT-I bonds in FY2023; Issuances largely to be driven by PSBs

August 2022

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AT-I bond outstanding are expected to increase to Rs. 1.1 trillion by March 31, 2023 from Rs. 985 billion as on March 31, 2021.

AT-I bonds outstanding will, however, be marginally lower than Rs. 1.12 trillion as on March 31, 2022 as some of the large private banks are unlikely to roll over their bonds due for call option, given their comfortable capital positions as well as the preponement of the FY2023 refinancing requirements to FY2022.

AT-I bond issuances are likely to remain lower in FY2023 compared to FY2022 and are likely to remain so for the next couple of years, given the reducing call options falling due in the coming years.

BANKS TO ISSUE OVER RS. 200 BILLION OF AT-I BONDS IN FY2023, LED BY PSBS

ICRA expects Additional Tier I (AT-I) bond issuances to remain strong in FY2023, though these will be lower compared to the previous year. Unlike FY2022, when issuances were sizeable and driven by the need to roll over the bonds when the call options were falling due, the issuances in FY2023 would largely be driven by expansion in credit growth. With the sizeable equity capital raise of over Rs. 600 billion in FY2021 by large private banks, post the onset of the Covid-19 pandemic, and the overall improvement in the earnings profile of banks, the issuances by private banks are likely to remain muted in FY2023. The rollover requirements are expected to decline further in the next two years, which means that the AT-I issuances are likely to remain moderate and will be driven only by the growth requirements during this period.

ICRA expects the AT-I bonds outstanding to touch Rs. 1.1 trillion by March 31, 2023, with public banks accounting for 80-82% of the same as some of the large private banks have not rolled over their AT-I bonds recently and are unlikely to do so in the coming months. With various regulatory forbearance, demonstrated support from the Government of India (GoI) to public banks for the servicing of AT-I bonds as well as the improving financial position of public banks, investor appetite for their AT-I bonds has remained strong for recent issuances. This shall ensure that they are able to raise the targeted Rs. 201 billion of these bonds planned for FY2023.

AT-I issuances to remain strong in FY2023, but will decline vis a vis FY2022: The AT-I bond issuances are expected to decline to around Rs. 200 billion in FY2023 from the near all-time high of Rs. 428 billion (see Exhibit 1) in FY2022. As the first call option on most of these bonds is after the fifth year from issuance, the issuances in FY2022 were driven by the refinancing requirements of Rs. 430 billion of AT-I bonds issued in FY2017. While the issuances were strong in FY2018 at Rs. 344 billion, a sizeable portion of the same was already refinanced in FY2022 as the low interest rate environment offered attractive opportunities to banks to refinance these bonds at much lower rates. It must be noted that out of the bond issuances in FY2017 and FY2018, Rs. 376 billion of AT-I bonds were recalled much earlier in FY2019, i.e. before their first call option date, as many public banks were included in the prompt corrective action (PCA) framework of the Reserve Bank of India (RBI), which triggered a regulatory event and the exercise of an early call option.

AT-I bonds outstanding likely to increase to Rs. 1.1 trillion by March 31, 2023: Net of fresh issuances and redemptions during April-July 2022, the AT-I bonds outstanding as on July 31, 2022 stood at Rs. 1.02 trillion. State Bank of India (SBI) has the largest outstanding at Rs. 367 billion or 1.5% of its risk-weighted assets (RWAs). With banking sector estimated to issue over Rs. 200 billion in FY2023 (of which Rs. 53.2 billion was issued in 4M FY2023) and likely redemption (through exercise of call options) of Rs. 94.0 billion during August-March 2023, the AT-I bonds outstanding are expected to increase to Rs. 1.1 trillion by March 31, 2023.

Issuances largely to be driven by public banks in FY2023: Based on the current announcements by the banks, public sector banks (PSBs) have announced their intentions to raise Rs. 201 billion of AT-I bonds in FY2023, while private sector issuances are likely to remain limited. Unlike FY2022, when the issuances were driven by rollover requirements, the issuances by public banks in FY2023 are driven largely by their

Public banks will lead the AT-I issuances in FY2023 as well, driven by their growth requirements rather than their rollover requirements. Investor appetite for their issuances remains strong unlike previous expectations after the changes in the valuation norms for these instruments held by mutual funds.

The improved financial position of public banks, multiple instances of regulatory forbearance and support from the GoI have improved the risk appetite of investors for the AT-I issuances of public banks.

growth requirements. The improved financial position and better ability to service the AT-I bonds after setting off of their accumulated losses against the share premium account have been supporting investor appetite for these bonds, given the better risk-adjusted returns. The yields on the recently issued AT-I bonds by public banks were 8.0-8.75% compared to 7.25% on a five-year government bond and 7.55% on a five-year AAA corporate bond. The coupon on the bonds issued recently has been higher compared to the issuances in FY2022, though these are still lower than the rates at which the bonds were issued in FY2017 and FY2018.

Issuances from private banks likely to remain muted in FY2023: Of the scheduled call option on AT-I bonds of Rs. 253 billion in FY2023, Rs. 180 billion is accounted for by private banks (Rs. 73 billion by public banks). However, of the Rs. 180 billion, Rs. 80 billion is accounted by HDFC Bank, Rs. 55.55 billion by ICICI Bank, Rs. 35 billion by Axis Bank and Rs. 10 billion by IndusInd Bank. While HDFC and Axis refinanced their AT-I bonds in FY2022 itself (through overseas issuances), ICICI and IndusInd are unlikely to issue AT-I bonds, given their comfortable capital positions. However, opportunistic issuances, if any, are unlikely to exceed Rs. 50 billion from these banks.

Overseas issuances seem unlikely in FY2023: Unlike large overseas bond issuances by HDFC and Axis (totalling Rs. 128 billion) in FY2022, the chances of overseas issuances are low in FY2023 given the elevated borrowing costs after the sharp increase in the benchmark rates in foreign currency as well as the tightening liquidity conditions across the world. Further, public banks are likely to be rated much lower for these AT-I instruments compared to some of the private banks, which have raised funds internationally. Hence, public banks are likely to tap domestic markets for their bond issuances.

AT-I Bond Issuances Were Almost At An All-time High In FY2022, Likely To Remain Moderate Over Next Few Years

EXHIBIT 1: AT-I bond issuances in FY2023 expected to be lower than FY2022

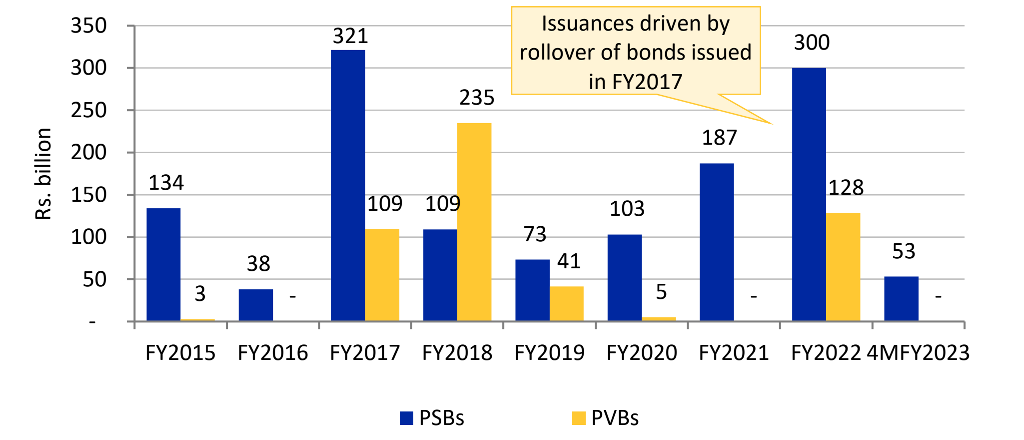
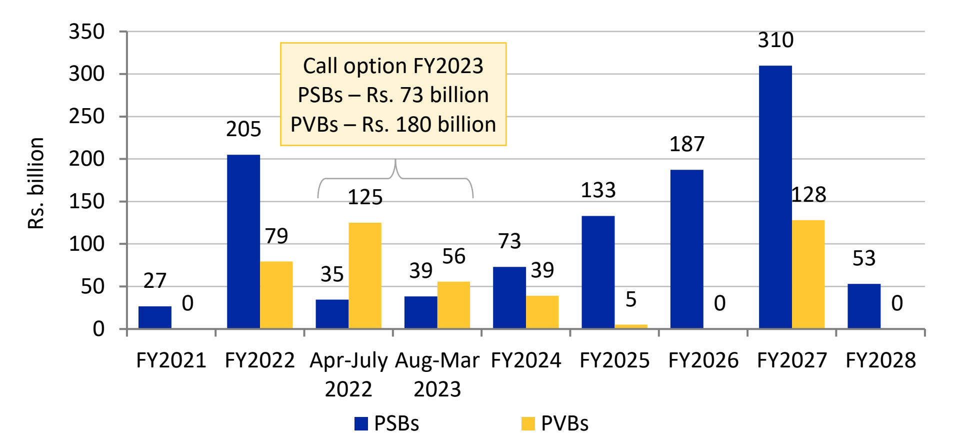


EXHIBIT 2: Year-wise call option due for AT-I bonds



Source: Banks, ICRA Research

PSBs lead issuances: While the AT-I issuances of private banks were strong at Rs. 128 billion in FY2022, these were largely accounted for by HDFC and Axis through overseas issuances in H1 FY2022. The domestic AT-I issuances picked up momentum after GoI approval came for most banks in H2 FY2022 as public banks need prior GoI approval for issuing these bonds. Initially, at the beginning of the year, there were apprehensions regarding investor appetite for AT-I bonds after the revised valuation norms for these instruments held by mutual funds (which was a sizeable investor segment for these bonds). However, despite this, domestic issuances remained strong in FY2022. The issuances were supported by demand from corporate treasuries, family offices and high-net-worth individuals apart from some private banks (which later down sold them to other investors). Almost Rs. 140 billion of the overall Rs. 300 billion of issuances by public banks in FY2022, was accounted for by the largest public bank, i.e. SBI.

For FY2023, based on the announced issuances (see Exhibit 3), we expect public banks to raise Rs. 201 billion of AT-I bonds in FY2023, of which Rs. 53.20 billion was already raised till July 2022. Within the Rs. 201 billion, SBI is expected to issue AT-I bonds of Rs. 70 billion in FY2023.

Issuances likely to remain moderate over the next few years: Unlike FY2022, when the AT-I issuances were driven by the rollover requirements of the issuances done in FY2017 as well as the upcoming call options on these bonds in FY2023, the call options falling due in the coming years are relatively lower. Accordingly, the issuances are likely to be lower during the next few years, though there could be a need to raise these bonds for supporting the growth requirements.

Bond Issuances In FY2023 Driven By Growth Requirements

EXHIBIT 3: Bank-wise AT-I bonds outstanding, call option schedule and expected issuances in FY2023

Amount (Rs. crore)				Call option due during the period								
	ICRA Rating Tier II	ICRA Rating Tier I	Outstanding as on July 31, 2022^	Apr-Jul 2022	Aug-Mar 2023	FY2024	FY2025	FY2026	FY2027	FY2028	Expected Issuance in FY2023	Issuances till July 2023
Bank of Baroda	AAA (Stable)	AA+ (Stable)	11,231	-	1,350	-	3,397	3,735	2,749	-	-	-
Bank of India	AA+ (Stable)~	Not Rated	1,352	-	-	-	-	1,352	-	-	-	-
Canara Bank	AAA (Stable)	AA+ (Stable)	10,436	450	-	-	1,500	2,936	4,000	2,000	5,500	2,000
Indian Bank	Not Rated	Not Rated	2,000	-	-	-	-	2,000	-	-	-	-
Punjab National Bank	AA+ (Stable)	AA (Stable)	7,966	1500	-	-	1,500	495	3,971	2,000	5,500	2,000
Bank of Maharashtra	AA (Stable)	Not Rated	295	-	-	-	-	-	295	-	-	-
Union Bank of India	AA+ (Stable)	Not Rated	9,525	500	500	-	-	1,705	6,000	1,320	2,100	1,320
State Bank of India	AAA (Stable)	AA+ (Stable)	36,696	-	2,000	7,317	6,905	6,500	13,974	0	7,000	-
Public Sector Banks –Total			**79,501**	**3,450**	**3,850**	**7,317**	**13,302**	**18,723**	**30,989**	**5,320**	**20,100**	**5,320**
Axis Bank	AAA (Stable)	AA+ (Stable)	4,500	3,500	-	-	-	-	4,500	-	-	-
HDFC Bank	Not Rated	Not Rated	8,318	8,000	-	-	-	-	8,318	-	-	-
ICICI Bank	AAA (Stable)	AA+ (Stable)	6,695	-	5,555	1,140	-	-	-	-	-	-
IndusInd Bank	Not Rated	Not Rated	1,489	1,000	-	1,489	-	-	-	-	-	-
Jammu and Kashmir Bank	Not Rated	Not Rated	1,000	-	-	1,000	-	-	-	-	-	-
South Indian Bank	Not Rated	Not Rated	500	-	-	-	500	-	-	-	-	-
Yes Bank	A- (Positive)	BB (positive)	280$	-	-	280	-	-	-	-	-	-
Private Sector Banks – Total			**22,782**	**12,500**	**5,555**	**3,909**	**500**	**-**	**12,818**	**-**	**-**	**-**
All Banks – Total			**1,02,283**	**15,950**	**9,405**	**11,226**	**13,802**	**18,723**	**43,807**	**5,320**	**20,100**	**5,320**

^ Outstanding as on July 31, 2022 includes issuances during April-July 2022; $ No longer included by the bank in Tier I capital; ~ For fixed deposits
Source: RBI, ICRA Research

Public banks raising more AT-I bonds than amount due for call option in FY2023: As seen in the table above, public banks have a call option on Rs. 73 billion compared to planned issuances of Rs. 201 billion in FY2023. Further, the issuing banks are expected to issue more than the call options that are falling due for them in FY2023. This reflects that the issuances are driven more by their expectations of higher credit growth in future as well as by the opportunity to raise funds at competitive rates as the rates are likely to harden going forward. We expect that public banks shall be able to raise the targeted amounts through these instruments as the response to the recent issuances has been encouraging with good oversubscription. Moreover, the planned amounts are lower than the amount raised by these banks in FY2022. Further, the outlook on the asset quality, profitability and capital position is relatively much better today, which improves investor appetite for their bonds.

MOST OF THE LARGE PRIVATE BANKS HAVE REDUCED THE SHARE OF AT-I BONDS IN THEIR OVERALL CAPITAL

EXHIBIT 4: AT-I bonds as % of RWAs – Public banks

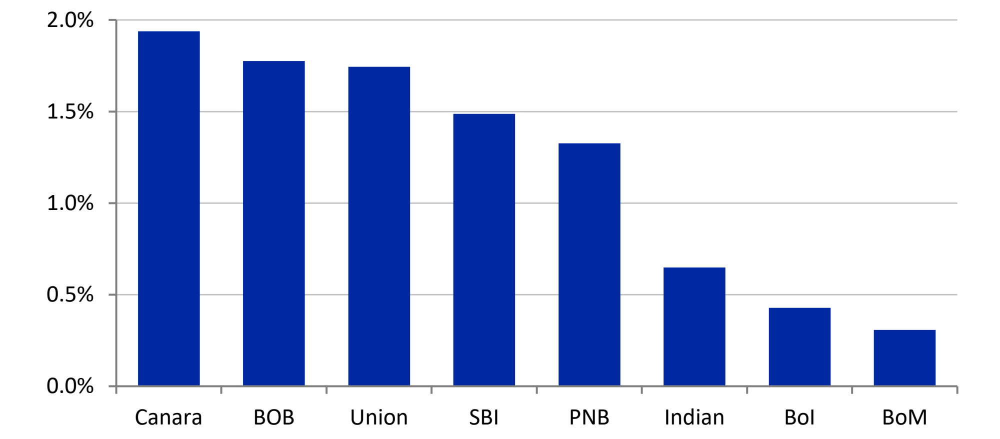
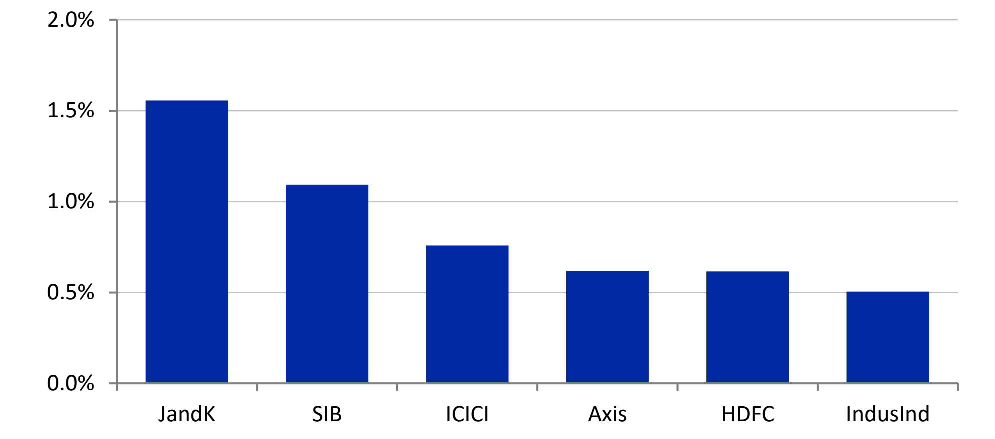


EXHIBIT 5: AT-I bonds as % of RWAs – Private banks



Source: Banks, ICRA's estimates based on bonds outstanding as on July 31, 2022; Data only for banks having AT-I bonds outstanding as on July 31, 2022

Sizeable equity capital raise and improved internal accruals likely to keep AT-I requirements limited for large private banks: The risk of coupon skip could be high for weak banks, given the features of AT-I instruments[1]. Hence, the issuances are likely to be driven by stronger private banks. Post the onset of the pandemic, large private banks raised sizeable equity capital of over Rs. 600 billion in FY2021 and the outlook on internal capital generation also remains favourable for both private as well as public banks. Given the sizeable capital raise and comfortable capital position of most of the large private banks, we do not expect materially large issuances from these banks in the near term, even though the existing AT-I bonds are relatively much lower in relation to their RWAs when compared to public banks.

Group exposure norms linked to Tier I capital, which is one of the reasons for AT-I bond issuances: Under the large exposure framework, the single party exposure or group exposure norms are linked to the Tier I capital (core equity capital + AT-I capital) of a bank instead of the total capital (including Tier II bonds) of the bank followed previously. Accordingly, the need to raise AT-I bonds could also be driven by the willingness of certain banks to take a larger exposure to certain large counterparties. Public banks with a relatively lower core capital position (compared to private banks) may, therefore, require these bonds to improve their single/group exposure limits apart from shoring up the overall Tier I levels.

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[1] The coupon on AT-I bonds can be serviced by banks through their profits or accumulated profits (in a year of loss), provided the bank remains above the regulatory capital ratios. Moreover, in an event of asset quality stress, consequent losses and erosion of capital, these bonds can be written down, leading to even a complete loss of principal for the investors

Related ICRA articles on AT-I instruments

1. Indian Banking Sector: Dislocation of AT-I market could increase the bank recapitalisation burden for the Government of India – March 2021
2. Accounting adjustments to improve serviceability of Additional Tier I bonds of public sector banks – October 2020
3. Indian Banking Sector: Equity capital requirements for banks could increase as risk aversion for AT-I bonds likely to go up – March 2020
4. Indian Banking Sector: Risk of coupon skip subsides as weak PSBs initiate early recall of their AT-I bonds – February 2018
5. Indian Banking Sector: Investors in Additional Tier-I bonds should be mindful of possibility of coupon skip – October 2017
6. ICRA's bank rating methodology – August 2020

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