Slowing economy: RBI target on Basel III bonds seen threatened

Mumbai, Feb 21: Banks in India are behind schedule on plans to sell $52 billion in Basel III-compliant notes by 2018, as a slowing economy and default concerns drive borrowing costs to a seven-year high.

Lenders have raised the equivalent of $920 million over the past 12 months, according to data compiled by Bloomberg. That compares with the average $10.4 billion they must offer annually in the next four years to meet the Reserve Bank of India's target. Average yields on top-rated 10-year bonds of Indian banks rose 65 basis points to 9.57% in 2013, the most since 2006. That compares with 2.54% on financial debt globally, Bank of America Merrill Lynch indices show.

Failure to meet RBI's target for compliance with the Basel Committee on Banking Supervision would add to concerns after Fitch Ratings said last month that almost ₹1 lakh crore ($16.1 billion) of bank loans are at risk of turning bad. Average default risk on dollar securities of Indian lenders rose 58 basis points in 2013 as stressed assets leapt to 10.2% of total lending, the highest in a decade.

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Fitch said last month that amount of loans at risk of turning NPAs stands at
₹1 lakh crore

RBI estimates that by 2018, banks will need to raise 'non-equity' capital worth
₹3.25 lakh cr

"Banks don't want to issue Basel III securities, which must be long-term, as interest rates are perceived to be high," said Rajesh Mokashi, deputy managing director at credit rater CARE Ratings. "Banks will pace the issuance of Basel III notes based on their capital requirements to fund growth in assets."

The Basel Committee unveiled rules in December 2010 aimed at bolstering the capital of lenders and improving their ability to absorb losses. The changes came after the global financial crisis exposed inadequate buffers to balance sheets. Rules allow RBI to seek conversion of non-equity Tier 1 and Tier 2 capital into shares, or write the debt off, should a lender reach a "point of non-viability."

State-owned United Bank of India will need to defer coupon payments on its debt as losses in the last quarter may send the lender's capital ratios below the regulatory minimum of 9%, according to Fitch Ratings. United Bank reported a loss of ₹1,240 crore in the three months ended December 31 compared with a net profit of ₹42.2 crore in the same period a year earlier, according to an exchange filing on February 7.

RBI estimates banks will need to raise ₹3.25 lakh crore of 'non-equity' capital by March 2018 to fully meet the regulations meant to bolster their ability to absorb balance-sheet shortfalls.

Tier 1 capital consists of common equity and additional securities that have equity-like characteristics such as having no fixed maturity, while Tier 2 includes debt with a minimum maturity of 10 years. Claims of holders of Tier 1 capital such as perpetual securities are lower than Tier 2 debt in the event that a bank is liquidated, according to RBI guidelines.

Financial institutions elsewhere that have issued Basel III compliant bonds include Barclays Plc, Societe Generale SA and Banco Bilbao Vizcaya Argentaria SA. Banco Santander SA's Mexico unit sold $1.3 billion of such securities at a yield of 6.13% in December, according to a statement at the time. In India, there have been only ₹280 crore of Tier 1 bond sales under the Basel III regulations compared with ₹7,250 crore of Tier 2 capital, according to Bloomberg data.

"Investors are still not prepared to invest in Tier 1 capital and until this changes, it will be extremely difficult to meet the regulatory capital needs of the banking industry," said Shameek Ray, Mumbai-based head of debt capital markets at ICICI Securities Primary Dealership. "The market for Basel III Tier 2 bonds in India has already grown faster and will continue to be much larger than that for Tier 1 Bonds as local investor concerns on the equity-like features like write down and conversion are far higher for Tier 1 securities."

RBI governor Raghuram Rajan has raised the benchmark repurchase rate 75 basis points to 8% since taking charge in September to curb mounting consumer costs in Asia's third-biggest economy.

Yields on five-year rupee bonds rated AAA by Crisil, the local unit of Standard & Poor's, rose 53 basis points in 2013, according to Bloomberg data.

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