Indian Infrastructure and Banking Sectors:
Emerging Capital Requirements from Bond Market

Expanding India's Corporate Bond Market – Financing India's Future

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November 28, 2013

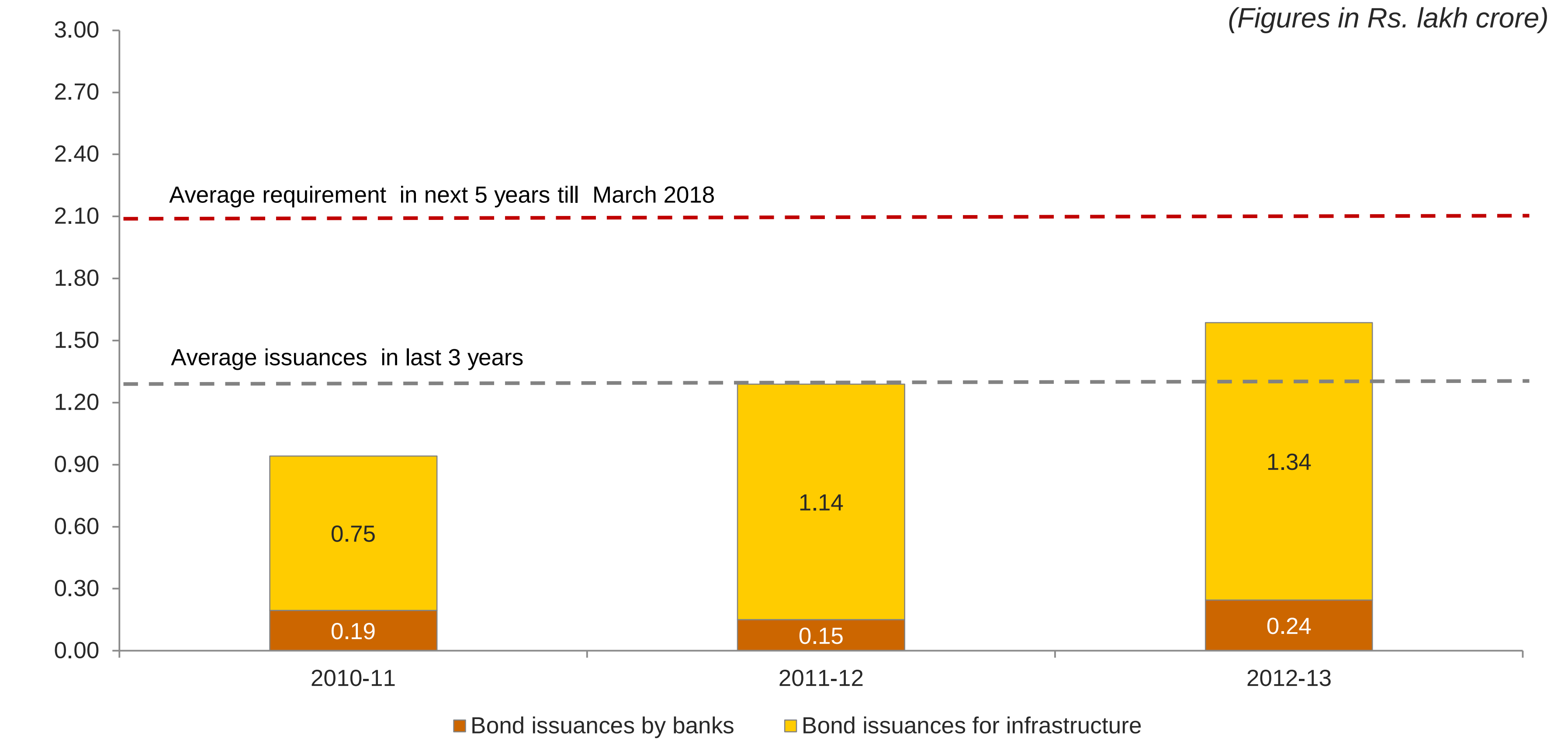
Key messages

- **Infrastructure and banks need Rs.10.4 lakh crore from bond market in 5 years**
  - Demand from infrastructure sector to be Rs.7.0 lakh crore towards debt funding
  - Banks require Rs.3.4 lakh crore non-equity capital under Basel III regulations
- **Three key challenges exist to meet this requirement**
  - Funding quantum is large in the context of existing size of issuances
    - Average annual need (Rs.2.1 lakh crore) is ~60% higher than average of bonds issued in last 3 years
  - Bond market funding to infrastructure is mainly indirect
    - 5 specialised FIs issued ~60% of (Rs.1.3 lakh crore) bonds raised for funding infrastructure in 2012-13
    - Therefore, encouraging direct access of infrastructure projects to bond market is a key priority
  - Bond market's appetite for banks' non-equity instruments to be fully tested
    - Initial signs are encouraging for Tier II instruments
    - Key challenge will be to raise Tier I instruments, given their riskier features
- **Regulatory and policy support will be critical to**
  - Deepen the bond market
  - Develop credit enhanced structures and facilitate scale-up of Infrastructure Debt Funds
  - Realign policies of long-term investors to include eligibility for banks' Tier I instruments

Funding quantum remains large for existing size of Indian bond market

Average annual need is ~60% higher than issuances in past

Bond-issuance by banks and infrastructure over the period FY 2011 to FY 2013



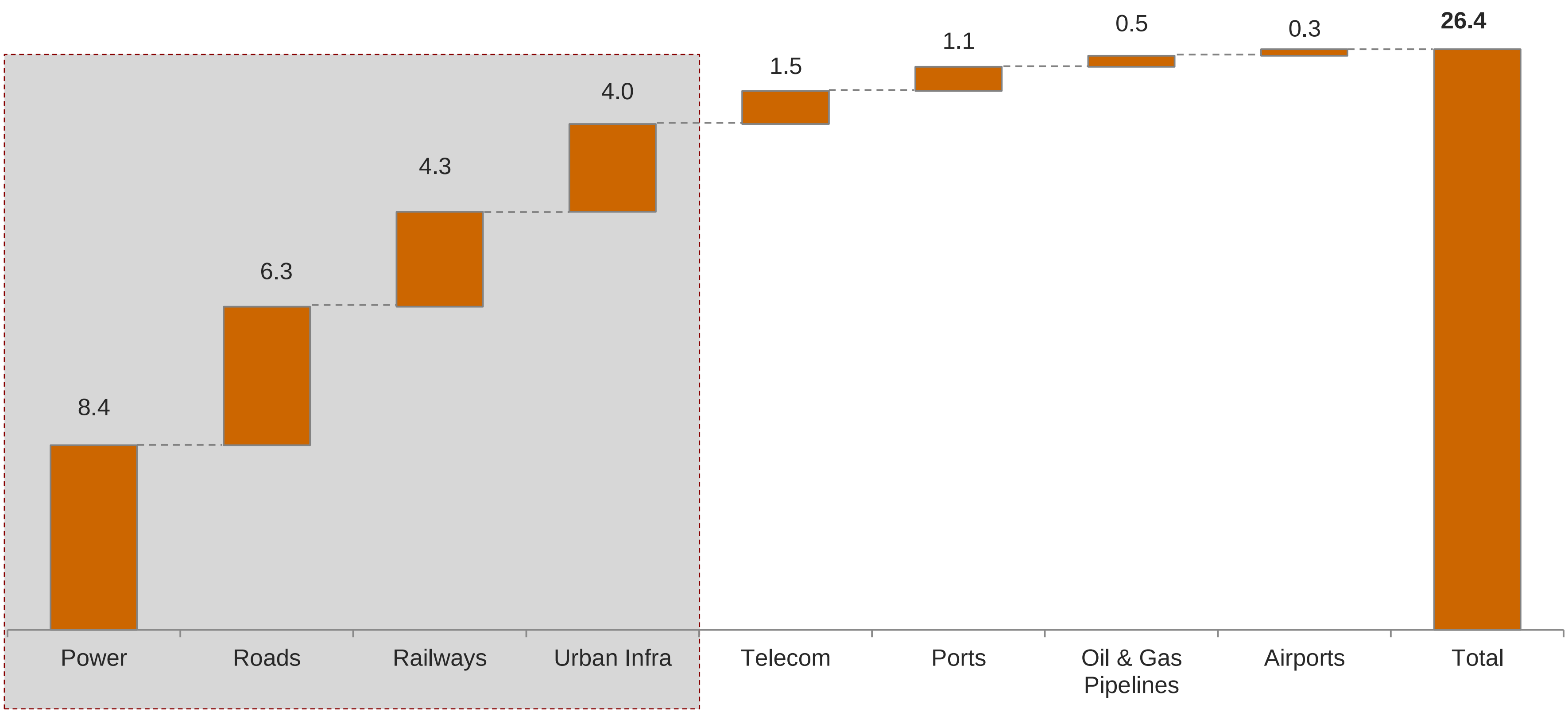
Source: Prime Database, CRISIL Ratings

Encouraging direct access of infrastructure projects to bond market is critical

Rs.26.4 lakh crore investment in infrastructure required over next 5 years

Sectoral break-up of investment in infrastructure till March 2018

(Figures in Rs. lakh crore)



Power, roads, railways, and urban infra to constitute ~85% of overall investments

Source: CRISIL Research

Bond market expected to provide ~40% of debt funding

Equity	+	Debt	=	Total investment
Rs.8.1 lakh crore		Rs.18.3 lakh crore		Rs.26.4 lakh crore

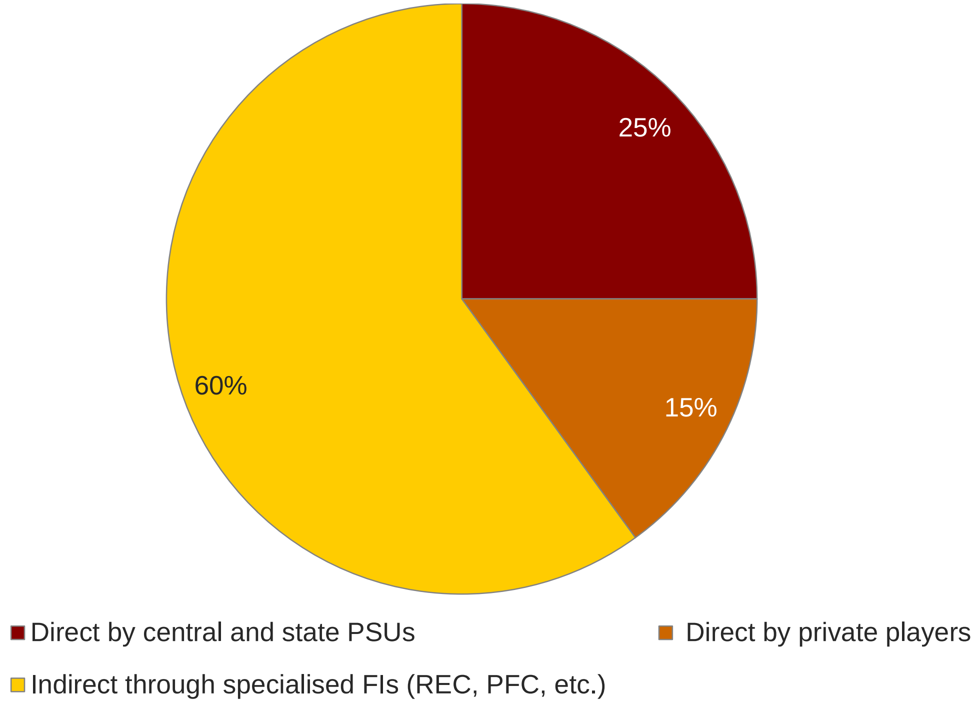
(Figures in Rs. lakh crore)

Sources of debt	FY 2014 to FY 2018
Rupee debt from banks	8.7
ECBs	2.6
Debt from bond market	7.0
Total	18.3

Source: RBI, Prime Database, CRISIL Ratings

Bond market funding to infrastructure is mainly indirect

Five specialised FIs issued 60% of bonds raised to fund infrastructure



Break-up of bond issuances by infrastructure sector in 2012-13 (Rs.1.34 lakh crore)

- **Critical to encourage direct access of private infrastructure projects to bond market**
- **Particular focus needed for credit enhanced structures**

Source: RBI, Prime Database, CRISIL Ratings

Appetite for banks' non-equity capital instruments yet to be fully tested

Banks' total capital requirement to be Rs.4.7 lakh crore

Equity capital

Rs.1.3 lakh crore

+

Non-equity capital (Tier I +Tier II)

Rs.3.4 lakh crore

=

Total capital

Rs.4.7 lakh crore

(Rs. lakh crore)	Equity capital	Non-equity capital		Total capital
		Non-equity Tier I	Tier II	
Public sector banks	0.9	1.2	1.5	3.6
Private sector banks	0.4	0.2	0.5	1.1
Total	**1.3**	**1.4**	**2.0**	**4.7**

- **Capital requirement is over 5 years up to March 2018**
- **Estimates are net of internal accruals and adjusted for phase-out of existing instruments**

Market appetite for Tier II instruments to remain healthy

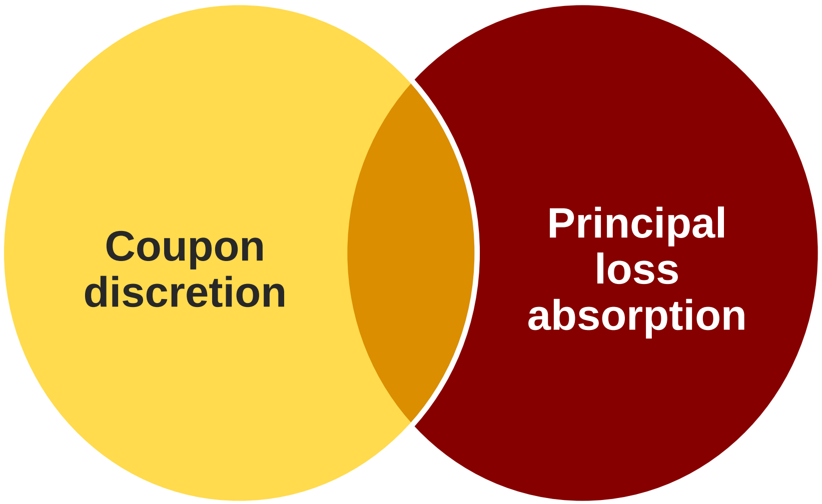
- **Promising start already visible in issuances**
  - Five banks have already issued Tier II bonds (under Basel III), all rated by CRISIL

Bank	Rated Amount (Rs. crore)	Current rating
United Bank	500	CRISIL AA+/Negative
Bank of India	1,500	CRISIL AAA/Stable
Bank of Baroda	1,500	CRISIL AAA/Stable
Central Bank of India	2,000	CRISIL AA/Stable
Union Bank	2,000	CRISIL AAA/Stable

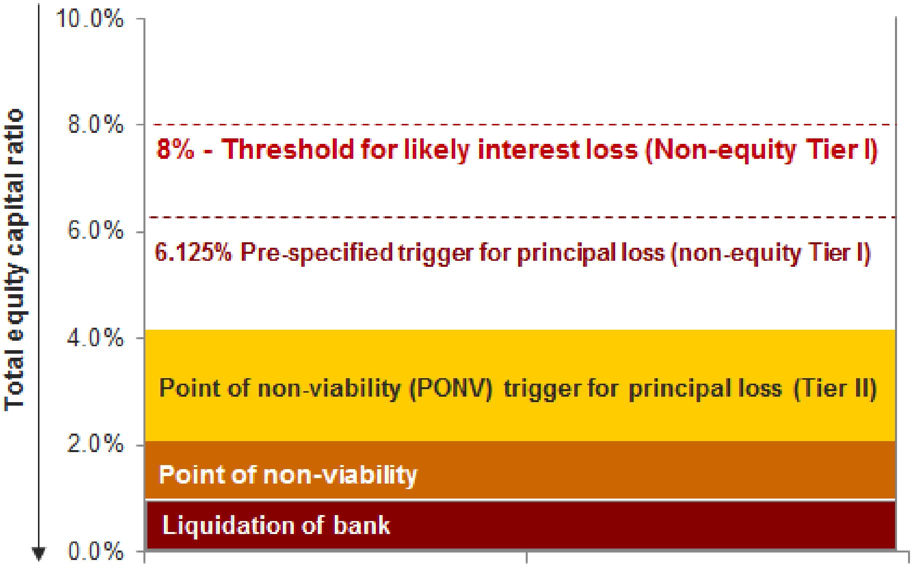
- **Raising Tier II instruments not expected to be a challenge**
  - Likelihood of breach in point of non-viability (PONV) trigger (a new feature in Tier II instruments) is a remote possibility in Indian context
  - Investors will, however, expect a marginally higher coupon

Key challenge lies in raising non-equity Tier I instruments

Two new and riskier features under Basel III



Capital thresholds can trigger loss



- **Such equity-like features and pre-defined capital thresholds increase risks for investors**
  - Domestic investors' appetite for such instruments likely to be limited
  - Pricing expected to be higher by 100-150 bps (relative to Tier II bonds)
  - Regulations to constrain investors' decisions

Regulatory support critical to enhance bond market participation

Policy and regulatory facilitation will be critical

Deepen bond market

- Encourage foreign participation in domestic corporate bonds
- Liberalize investment norms for pension funds and insurance companies

Focus on credit enhancement mechanisms

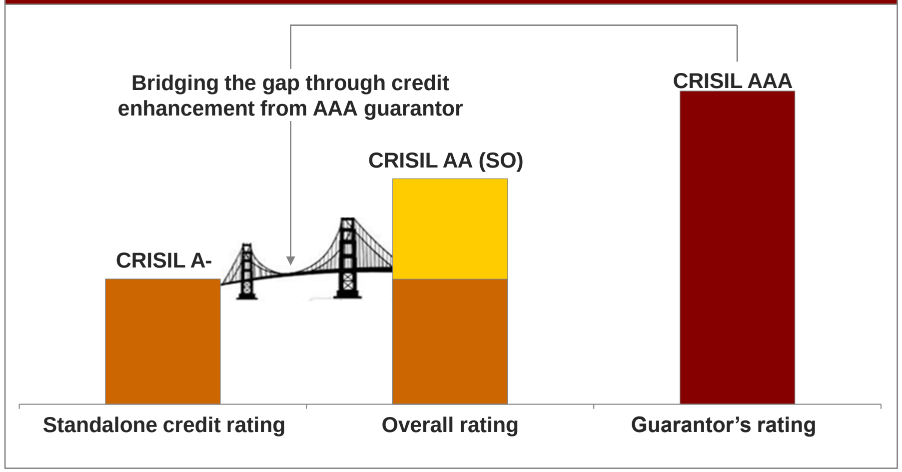
- Develop market for innovative instruments like
  - Partial guarantees
  - Securitisation of annuity in roads
  - Securitisation of receivables by municipal corporations
- Allow banks to provide credit enhancements in order to grow market
- Ensure successful implementation of IDFs
  - First two IDF-NBFCs, both rated 'CRISIL AAA', have commenced operations

Build investor comfort for banks' Tier I instruments under Basel III

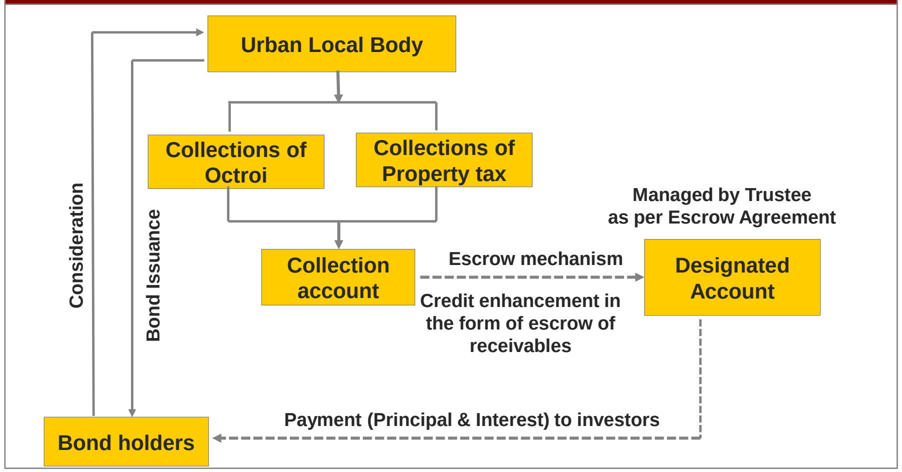
- Realign investment policies of long-term investors to include eligibility for Tier I instruments
- Enable refinancing of banks' infrastructure exposures to conserve capital

Examples of successful credit enhanced structures

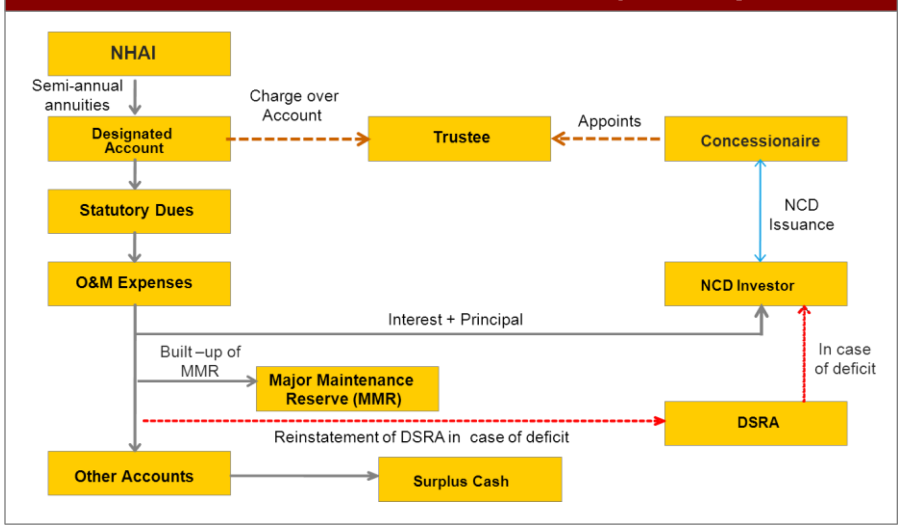
Partial guarantee



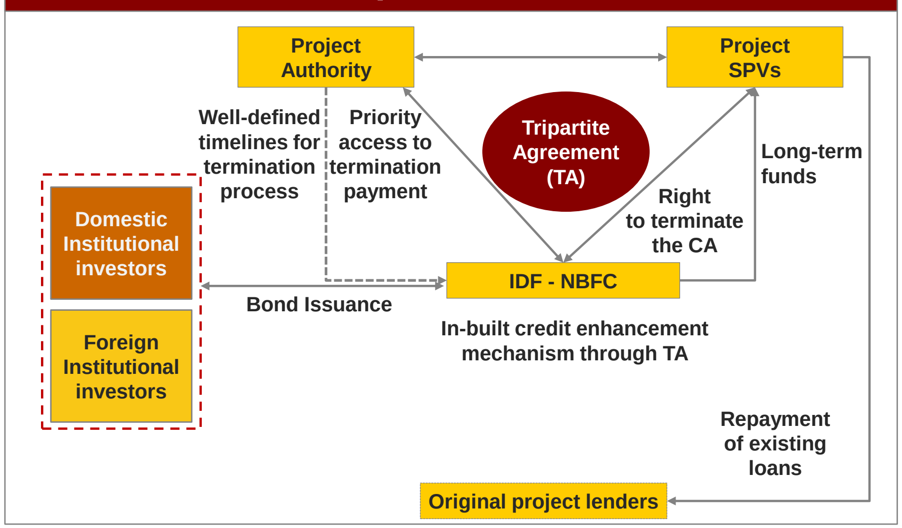
Escrow of future receivables of urban bodies



Securitisation of road annuity receipts



Concept of IDF-NBFC



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