

Banks may raise Rs 15,000 cr through Tier II bonds: What is driving this demand?

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The country's largest lender, the State Bank of India (SBI), raised Rs 7,500 crore through Basel III-compliant Tier II bonds. (File)

Several banks are racing to raise funds through Tier II bonds, debt instruments issued by lenders to boost their capital base, amidst a surge in capital generation through a record number of initial public offerings (IPOs) by companies.

The banking system is expected to mobilise around Rs 25,000 crore in the current financial year via Tier II bonds, of which nearly Rs 10,000 crore has already been raised.

This spike in issuances appears to be driven by a strong demand for long-duration papers, expectations of a cut in the repo rate in the December policy and regulatory investment requirement.

What are Tier II bonds?

Tier II bonds are debt instruments issued by banks to boost their capital base and support business operations. These bonds have to be issued for a minimum period of five years.

They help banks strengthen their capital adequacy ratios (CAR) under Basel III norms, and provide an additional cushion for future credit growth. These bonds also offer an efficient and relatively low-cost way to raise long-term capital without diluting equity, said Venkatakrishnan Srinivasan, founder and managing partner, Rockfort Fincap LLP.

“Tier II instruments offer long-term funding and also allow banks to add some extra buffers to their CRARs (capital to risk-weighted assets ratio),” said Prakash Pandey, associate director (financial institutions), Fitch Ratings.

Rise in Tier II bond issuances

The country's largest lender, the State Bank of India (SBI), **raised Rs 7,500 crore** through Basel III-compliant Tier II bonds. It raised the money at a competitive rate of 6.93 per cent through 10-year bonds. In June this year, private sector lender ICICI Bank raised Rs 1,000 crore through Tier II bonds.

“Banks are expected to collectively raise up to Rs 15,000 crore through Tier II bonds by the end of December,” said Srinivasan of Rockfort Fincap.

Many banks had already secured board approvals earlier in the year but chose to wait due to abundant system liquidity, lower deposit rates, and the expectation of further rate cuts, he said.

In the previous financial year, lenders raised close to Rs 31,000 crore through Tier II bonds, analysts said.

Why are banks raising funds via Tier II bonds?

Tier II issuances tend to occur when local debt markets provide opportunities at competitive costs relative to term deposits, according to Pandey of Fitch Ratings.

The immediate triggers for banks to issue Tier II bonds are both market-driven and regulatory, Srinivasan said. This fiscal year, most corporate issuers have preferred short tenor bonds, creating a clear gap in long-duration papers. Long-term investors are now looking to deploy funds before the December monetary policy amid expectations of a 25-basis-point repo rate cut by the Reserve Bank of India, which is fueling demand for quality long-term instruments, he said.

The scarcity of top-rated long-tenor bonds has further intensified investor appetite. Moreover, some large banks need to refinance their earlier bonds where call options have been exercised.

Besides, SBI's recent issue, priced aggressively at 6.93 per cent, has set a strong benchmark and renewed confidence among issuers.

Provident and pension funds are expected to accelerate investments over the next couple of months to meet their regulatory investment quotas in corporate bonds. This would also drive banks to raise capital through Tier II bonds.

"At a time when market conditions are stable, investor appetite is high, and yields remain attractive, it makes strategic sense for banks to shore up their capital through the bond route rather than wait for later in the fiscal when pricing conditions could turn uncertain," Srinivasan said.

Pandey, however, said future issuances of Tier II bonds will depend on market opportunities.

"Indian banks do not rely on Tier II bonds to fund their growth, or for capital adequacy requirements. This is because banks are predominantly deposit funded, which we expect to continue. Most Indian banks also have sufficient capital buffers and internal capital generation to meet regulatory capital requirements," he said.

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