

● What are Tier 1 and Tier 2 bonds?

TIER 1 AND Tier 2 bonds are specialised debt instruments issued by banks to meet regulatory capital requirements under Basel III norms. They help banks maintain capital adequacy ratios to absorb losses and ensure financial stability.

If a bank nears or reaches a point of non-viability, the Reserve Bank of India (RBI) can write off the principal on these bonds. Due to this, these bonds carry higher risk. This means bondholders may lose part or all of their principal during financial stress. As a result, these bonds offer higher interest rates than other bonds issued by banks. However, the issuing bank can offer a 'call' option often after five years, where it redeems or asks bondholders to return the bonds.

These bonds were first introduced in line with the Basel banking norms after the global financial crisis of 2008 so as to strengthen the quality of banks' capital and improve the resilience of the banks to absorb shocks and stress.

Unlike government bonds or blue-chip corporate bonds, Tier-2 bonds are not highly liquid, making it difficult for investors to exit early.

● Difference between Tier 1 and Tier 2 bonds

TIER 1 BONDS, often called Additional Tier 1 (AT1) bonds, form part of a bank's core capital and act as the first line of defence during financial stress. These bonds have no fixed maturity, and rank below other forms of debt but above common equity in the repayment

hierarchy. In a financial crisis or if the bank's Common Equity Tier 1 (CET-1) ratio drops below a set threshold, these bonds are the first to be converted into equity or written off, reflecting their higher risk.

Meanwhile, Tier 2 bonds are

considered as supplementary capital, providing a secondary loss buffer during liquidation after Tier 1 instruments. These bonds are senior to Tier 1 bonds but junior to other debt instruments. Besides, they have fixed maturities of at least five years.



CAPITAL BUFFERS

Why Tier 2 bonds find favour with banks for raising funds

State Bank of India (SBI) recently raised ₹6,051 crore via Tier 2 bonds, the second time it took this route this fiscal to strengthen its capital base. While this will help the bank expand its loan book efficiently, it indicates that SBI's debt-raising strategy worked even in a tight interest rate environment, writes *Christina Titus*

TIER 2 BONDS REMAIN ATTRACTIVE COMPARED TO TIER 1 BONDS ON ACCOUNT OF PRICING, ACCEPTABILITY, AND FIXED DURATION

₹41,661 cr

RAISED VIA TIER 1 & TIER 2 BONDS IN FY26 BY ALL BANKS AGAINST ₹47,672 CR IN FY25

● Number of issuers in FY26

STATE BANK OF India recently raised ₹6,051 crore through Tier 2 bonds at a 7.05% annual coupon rate. The bonds have been issued for 10 years, with a call option after 5 years. The issue attracted an excellent response from investors with bids of approximately two times against the base issue size of ₹5,000 crore. The investors were across provident funds, pension funds, mutual funds, and banks, among others. This marks the second time this financial year that SBI has raised Tier 2 bonds. In October 2025, India's largest public sector bank raised ₹7,500 crore via 10-year Tier 2 bonds at a competitive coupon rate of 6.93%.

Interest rates have been going through a cycle of tightening and adjustment, and the market's response to SBI's Tier 2 issuance indicates strong trust from

institutional investors.

SBI's fundraising is part of a larger trend in India's banking space as several banks issued Tier 2 bonds this fiscal to beef up their regulatory capital. Canara Bank raised ₹5,000 crore in late February at 7.24% through Tier 2 bonds, maturing in 10 years. It also raised ₹3,500 crore through AT-1 bonds in November at a 7.55% coupon rate, the only such issuance so far in FY26.

In June 2025, private sector lender ICICI Bank raised ₹1,000 crore through Tier 2 bonds.

In FY25, banks had raised ₹47,672 crore through both Tier 1 and Tier 2 bonds, as per Primedatabase. So far in FY26, they have raised ₹41,661 crore. Public sector banks dominated the issuances, while participation from private banks stay muted.

● Why banks are issuing Tier 2 bonds

TIER 2 BONDS are low-cost, long-term funding for banks to fund as well. "The last quarter has always been favourable for long-term bonds. Insurance companies, pension funds, and EPFOs drive seasonal demand by deploying more funds into them. This creates clear tailwinds from the demand side. Meanwhile, over the past one or two years, banks have been issuing Tier 2 bonds primarily to bolster deposits—more so than for capital raising, though it helps there too," said Soumyajit Niyogi, director - India Ratings & Research. Moreover, several large banks have to refinance earlier bonds after exercising their call options, he added.

● Why AT 1 bonds are losing lustre

INVESTORS HAVE BEEN shying away from AT1 bonds as the pricing does not adequately compensate for the risks involved. Moreover, they remain cautious, especially after the Yes Bank crisis in 2020. During the bank's reconstruction, the RBI superseded its board amid severe financial stress and wrote off AT1 bonds, causing investors to lose about ₹9,000 crore.

Niyogi said that Tier 2 bonds remain attractive compared to Tier 1 bonds on account of pricing, acceptability, and fixed duration. As AT1 bonds are much costlier than Tier 2 bonds due to more risks involved, Tier 2 works better for both issuers and investors.