

CMBI Credit Commentary

Asian AT1s Part III – Picks on Asian EM AT1s

Executive summary

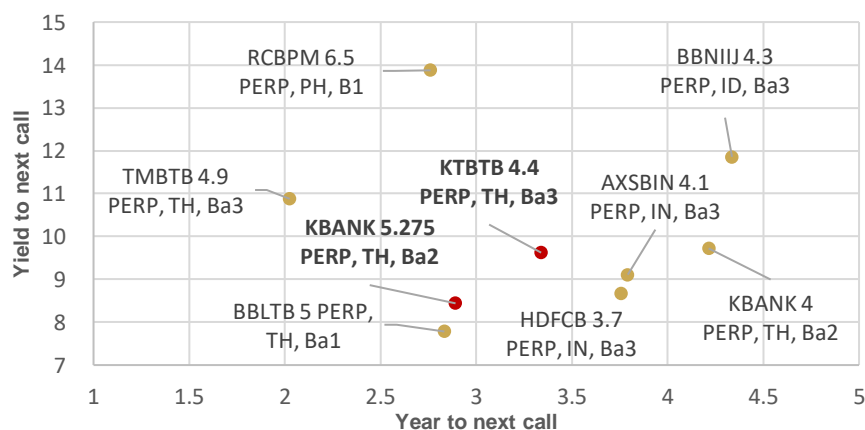
- In the third and last part of our trilogy on Asian AT1s, we turn our focus to AT1s in Asian emerging markets (EMs) including India, Indonesia, Philippines and Thailand. Compared with that of Chinese G-SIBs and Asian DMs, the return predictability of AT1s in Asian EMs are lower. Hence, our analytical approach in Asian EM AT1s will be more “bottom-up”.
- There were loss absorption and non-call incidents for INR capital papers of Yes Bank, Lakshmi Vilas Bank, Dhanlaxmi Bank and ICICI Bank. We notice Indian government's differential treatments in loss absorption for private and public banks. In the case of IDBI Bank, its INR AT1 was called early in 2018 before possible loss absorption triggered by low level of CET 1 ratio.
- Under this backdrop, our picks are **KBANK 5.275 PERP** and **KTBTB 4.4 PERP** in view of their more balanced risk-return profile. As AT1 is a relatively new instrument to Asia EM banks, track record of call and distribution is relatively limited. Hence, we prefer AT1s issued by banks which are more remote to loss absorption given their ample capital buffers and comparatively more stable profitability throughout the cycles.

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Chart 1: Asian EM AT1s YTC



Source: Bloomberg.

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Asian AT1s Part III – Picks on Asian EM AT1s

Higher YTC but lower credit ratings in Asian EMs

Table 1: Summary of key features we compared

Market	Country/ Region	Loss absorption trigger	Loss absorption record	AT1 non-call on first call record	Average yield to call (%)	Average year to call	AT1 rating
DM	Hong Kong	Discretionary	No	No	7.0	2.1	IG/HY/NR
	Singapore	Discretionary	No	No	7.7	1.6	IG
	South Korea	Discretionary	No	No	8.6	2.3	IG/HY
	Australia	Mechanical	No	No	9.4	4.2	IG/HY
EM	Indonesia	Discretionary	No	No	11.9	4.3	HY
	The Philippines	Discretionary	No	No	13.9	2.8	HY
	India	Mechanical	Yes	Yes	8.9	3.8	HY
	Thailand	Mechanical	No	No	9.3	3.1	HY

Source: Bloomberg.

AT1 is a relatively new instrument to Asian EM banks

There is limited record in terms of call and distribution cancellation as most of the AT1s in Asian EMs were issued after 2019. So far, only India has USD AT1 call record so far, State Bank of India issued SBIIN 5.5 PERP in Sep'16 and called the AT1s on the first call date in Sep'21. As of today, there are only 9 outstanding USD AT1s issued by Asian EM banks in total: 5 in Thailand, 2 in India, 1 in Indonesia and 1 in the Philippines.

Table 2: List of EM AT1s outstanding

		Bond rating	First call date	Yr to call	YTC	Bid price	Coupon reset	Trigger type	Loss absorption	CET1 ratio trigger
TMBTB 4.9 PERP	TH	Ba3	12/02/2024	2.0	10.9	88.5	5yrUST+3.256%	Mechanical	Permanent write-down	5.15%
RCBPM 6.5 PERP	PH	B1	08/27/2025	2.8	13.9	82.8	5yrUST+6.236%	Discretionary	Permanent write-down	7.25%
BBLTB 5 PERP	TH	Ba1	09/23/2025	2.8	7.8	92.4	5yrUST+4.729%	Mechanical	Permanent write-down	5.15%
KBANK 5.275 PERP	TH	Ba2	10/14/2025	2.9	8.4	91.5	5yrUST+4.940%	Mechanical	Permanent write-down	5.15%
KTBTB 4.4 PERP	TH	Ba3	03/25/2026	3.3	9.6	84.8	5yrUST+3.530%	Mechanical	Permanent write-down	5.15%
HDFCB 3.7 PERP	IN	Ba3	08/25/2026	3.8	8.7	83.8	5yrUST+2.925%	Mechanical	Temporary write-down	6.125%
AXSBIN 4.1 PERP	IN	Ba3	09/08/2026	3.8	9.1	84.3	5yrUST+3.315%	Mechanical	Temporary write-down	6.125%
KBANK 4 PERP	TH	Ba2	02/10/2027	4.2	9.7	79.8	5yrUST+3.337%	Mechanical	Permanent write-down	5.15%
BBNIJ 4.3 PERP	ID	Ba3	03/24/2027	4.3	11.9	74.2	5yrUST+3.466%	Discretionary	Permanent write-down	-

Source: Bloomberg.

Loss absorption framework largely the same as that of DM

The CET1 ratio trigger threshold in the Philippines is the highest at 7.25%, followed by 6.125% in India and 5.125% in Thailand. There is no CET1 ratio trigger in Indonesian AT1; the 5.125% level should be a parameter to assess the viability. See table 3 below.

For Thailand, regulator requires the CET1 ratio trigger to be higher than 5.125% while leaving flexibility to the issuing banks to set the exact trigger level. All the outstanding Thai AT1s are with CET1 ratio trigger at 5.15%, 0.025% above the regulatory floor.

That said, loss absorption in India and Thailand is mechanical once issuing bank's CET1 ratio hit the trigger, while loss absorption in Indonesia and the Philippines is discretionary subject to local regulators' decisions. We consider the likelihood of loss absorption trigger is in this descending order: India > Thailand > The Philippines > Indonesia.

Table 3: Comparison of loss absorption triggers

	Indonesia	The Philippines	India	Thailand
Loss absorption classification	Discretionary	Discretionary	Mechanical	Mechanical
PONV trigger	<p>As determined by OJK in accordance with the Applicable Regulations:</p> <p>(i) there being a plan from the competent authority to inject capital into the Bank because the business continuity of the Bank is deemed to be potentially disrupted; and/or</p> <p>(ii) such other circumstances that OJK may, at its discretion, determine from time to time,</p>	<p>As determined by the BSP, non-viability is deviation from a certain level of CET1 ratio, inability of the bank/quasi-bank to continue business, or any other event as may be determined by the BSP, whichever comes earlier.</p>	<p>Earlier of:</p> <p>(a) a decision that a conversion or write-off, without which the firm would become non-viable, is necessary, as determined by the Reserve Bank of India; and</p> <p>(b) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority. Such a decision would invariably imply that the write-off or issuance of any new shares as a result of conversion or consequent upon the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted.</p>	<p>Bank of Thailand and/or any other empowered government agency deciding to officially grant financial assistance to the Issuer such as in the form of a capital injection, without which the bank would become unable to continue its business in any manner, including but not limited to situations as set out below (or any such similar events):</p> <p>(i) having insufficient resources to make repayments to its depositors and creditors; or</p> <p>(ii) its capital funds having depleted to the extent that its depositors and creditors will be adversely affected; or</p> <p>(iii) not being in a position to independently increase its capital base.</p>

CET1 ratio trigger	N/A	CET1 ratio fall below 7.25% or as determined by the BSP	CET1 ratio fall below 6.125%	CET1 ratio shall be higher than 5.125%, exact level to specified by the bank
Dividend stopper	Yes	Yes	Yes	Yes

Source: Otoritas Jasa Keuangan (OJK), Bangko Sentral ng Pilipinas (BSP), The Reserve Bank of India, Bank of Thailand

Increase of loss absorption threshold in India

In 2014, the Reserve Bank of India initially planned to increase the CET1 trigger ratio from 5.5% to 6.125% after Mar'19. To comfort investors, the Reserve Bank of India (RBI) deferred the effective date for one year to Mar'20 in Jan'19. RBI further deferred the implementation of 6.125% trigger ratio to Oct'21, in view of the pressure on banks due to the pandemic. Currently, all the outstanding Indian AT1s are with the same trigger level at 6.125%.

All AT1 issuing banks' CET1 ratios are well above the regulatory minimum, except RCB...

The CET1 ratio requirement in Asian EMs had gradually increased from 4.5% to higher levels since Basel III implementation in 2014. As of 3Q22, the local regulatory requirement of CET1 ratio are 8% in Thailand and India, 10% in Indonesia and Philippines.

For the Philippines, given BSP set the CET1 ratio requirement at 10% and CET1 ratio loss absorption trigger for its AT1 at 7.25%, Rizal Commercial Banking Corp (RCB)'s CET1 ratio at 12.2% at Dec'21 thus presented a thinner buffer than its EM peers. Nonetheless, all Asian EM AT1 issuing banks have ample capital buffer by international standards.

We view that the chance of hitting the loss absorption trigger of Thai, Indian and Indonesian AT1s in the near future is lower, due to banks' buffers compared with the trigger level. See Charts 2-5 for the issuing bank's capital ratios and minimum regulatory requirements.

Chart 2: Thai banks' CET1 ratio buffer

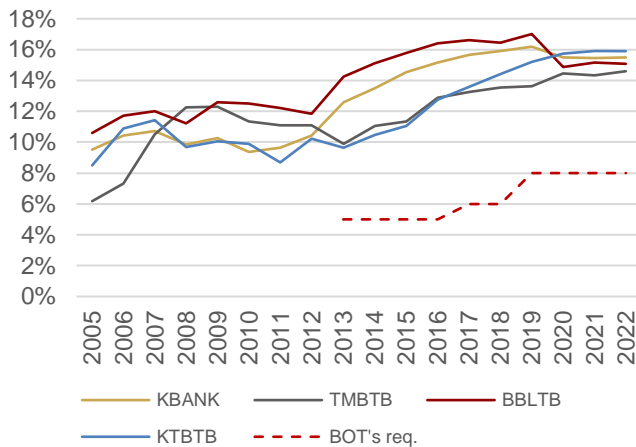


Chart 3: Indian banks' CET1 ratio buffer

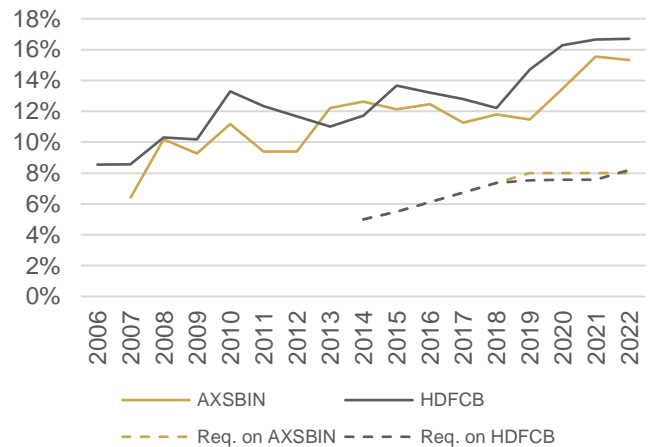


Chart 4: BBNIIJ's CET1 ratio buffer

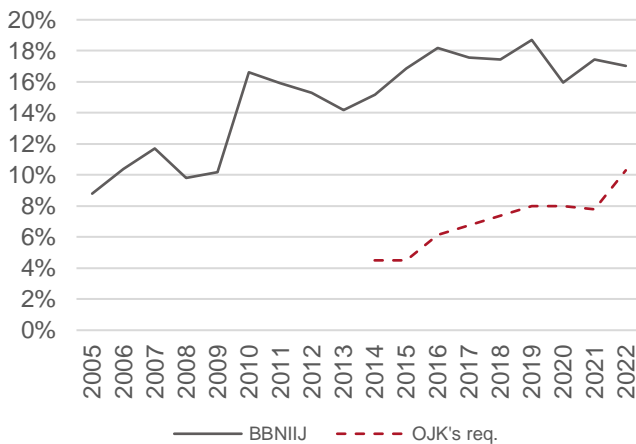
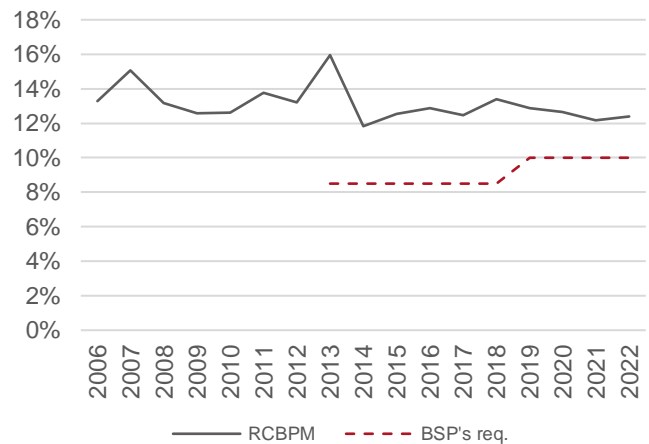


Chart 5: RCBPM's CET1 ratio buffer



Source: Companies' filing.

History of loss absorption and government intervention in India

Write-off of Yes Bank's INR AT1 in 2020

There is no USD AT1 written down in India so far. However, RBI took over Yes Bank, one of the India's largest private banks, when it breached the CET1 ratio requirement in Mar'20. 2 out of 3 onshore AT1s of Yes Bank totaled INR84.15bn (cUSD1.0bn) were written down. These were the first Indian AT1s being written-down.

However, the RBI did not write down another AT1 of INR2.8bn, which was arguably not a Basel III-compliant instrument. Some investors viewed the write-down by RBI unfair given they are ranked pari-passu. This appears that RBI has the discretion to select which AT1s to be written down. We view this

incident negatively, making Indian AT1s issued by private banks less attractive, from the investor's protection point of view.

Lakshmi Vilas Bank's INR Tier 2 wrote down in 2020

The RBI advised Lakshmi Vilas Bank to write down its Tier 2 bonds completely worth INR3.18bn (cUSD38.9mn) before amalgamated with DBS Bank India in Nov'20. This was triggered as the bank was deemed to be approaching non-viability, and it was the first Tier 2 bonds being written down in India.

Dhanlaxmi Bank's INR T2 distribution deferral in 2016

Dhanlaxmi Bank was the first Indian bank to defer coupon payment. The bank followed the order by RBI to stop paying the coupon on its 10% INR275mn T2 in 2016, as its capital adequacy ratio fall below the regulatory requirement of 9%. This instrument was issued under Base II and did not carry loss absorption and thus, it was not written down to absorb loss.

Indian central bank's intervention on IDBI bank before loss absorption...

In May'17, the RBI initiated prompt corrective action on the government-controlled IDBI Bank due to its persistent net losses and large non-performing loans. The bank exercised early call option on its INR AT1 triggered by this regulatory action/event, and the early redemption was funded with capital infusion of INR18.6bn by RBI in Aug'17.

IDBI bank breached the CET1 ratio requirement in Jun'18, market perceived the early redemption was to prevent the AT1 from absorbing loss before the CET1 ratio fall below the regulatory minimum.

Compared with the Yes Bank's case, the RBI took different approaches toward public and private banks when they are in stress. The loss absorption could be more remote for public banks than private banks in India. Still, the track record of differential treatment increases uncertainty on the likelihood and timing of loss absorption.

INR denominated AT1 non-call history in India

Except for India, there is no non-call on AT1 issued in local currencies in Thailand, India and the Philippines. According to Bloomberg, there are 21 INR denominated AT1s, issued by 9 banks, were not called on their first call dates.

Table 4: List of INR denominated AT1 not call on first call

	Ticker	Type	Coupon (%)	Issue date	First Call	USD AT1 issued
Bank of Baroda	BOBIN	Public	9.54	2/2/2015	2/2/2020	No
Bank of Baroda	BOBIN	Public	10.49	1/17/2017	1/17/2022	No
Canara Bank	CBKIN	Public	11.25	3/30/2016	3/30/2021	No
Canara Bank	CBKIN	Public	8.3	9/29/2020	9/29/2020	No
Canara Bank	CBKIN	Public	9.95	10/24/2016	10/24/2021	No
Canara Bank	CBKIN	Public	8.6	12/13/2016	12/13/2021	No
Canara Bank	CBKIN	Public	11.25	3/30/2016	3/30/2021	No
Canara Bank	CBKIN	Public	9.8	7/25/2017	7/25/2022	No
Export-Import Bank of India	EXIMBK	Public	8.6	3/31/2017	3/31/2022	No
IDBI Bank Ltd	IDBI	Public	10.95	1/20/2017	1/20/2022	No
IDBI Bank Ltd	IDBI	Public	11.09	8/30/2016	8/30/2021	No
Indian Overseas Bank	IOBIN	Public	11.85	3/29/2016	3/29/2021	No
IndusInd Bank Ltd	IIBIN	Private	9.5	3/22/2017	3/22/2022	No
Punjab & Sind Bank	PJSBIN	Public	10.9	5/8/2017	5/7/2022	No
State Bank of India	SBIIN	Public	8.15	8/2/2017	8/2/2022	Yes
Union Bank of India Ltd	UNBKIN	Public	10.95	2/19/2016	2/19/2021	No
Union Bank of India Ltd	UNBKIN	Public	9.08	5/3/2017	5/3/2022	No
Union Bank of India Ltd	UNBKIN	Public	9.2	10/31/2017	10/31/2022	No
Union Bank of India Ltd	UNBKIN	Public	9.1	3/31/2017	3/31/2022	No
Union Bank of India Ltd	UNBKIN	Public	9.1	3/29/2017	3/29/2022	No
Union Bank of India Ltd	UNBKIN	Public	9.1	3/30/2017	3/30/2022	No

Source: Bloomberg.

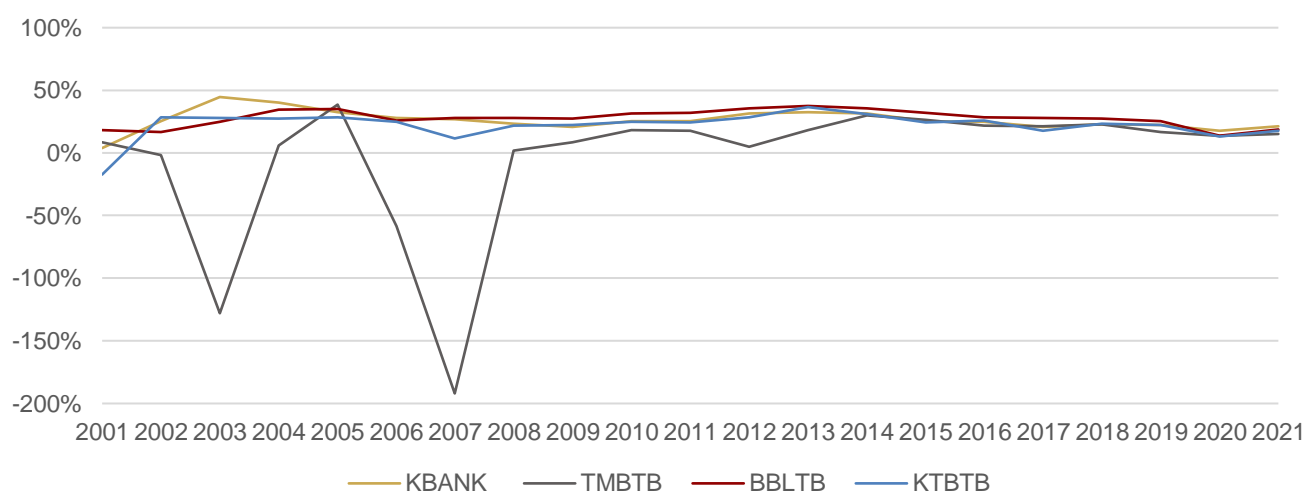
Our picks are KBANK 5.275 PERP, KTBTB 4.4 PERP

We prefer AT1s issued by Thai banks for their sufficient capital buffers, as well as no loss absorption history in USD or THB denominated AT1/T2. Among Thai banks, we like **KBANK 5.275 PERP** and **KTBTB 4.4 PERP**, for their higher YTC and stable profitability throughout economic cycles. The chance of loss absorption and distribution cancellation is lower, in our view.

All Thai banks except TMBTB showed stable profitability trend

Thai banks were severely affected and recorded net loss during 1998-2000 SEA financial crisis. Since then, major Thai banks, except TMBTB, are profitable through the economic cycle. Based on their high net interest margin and stable NPL ratios in recent years, we think the probability that they will become non-viable and put AT1 to absorb loss before first call date is remote.

Chart 6: Net income margin of TH banks (%)



Source: Bloomberg.

Chart 7: NPL ratio of TH banks and industry average (%)

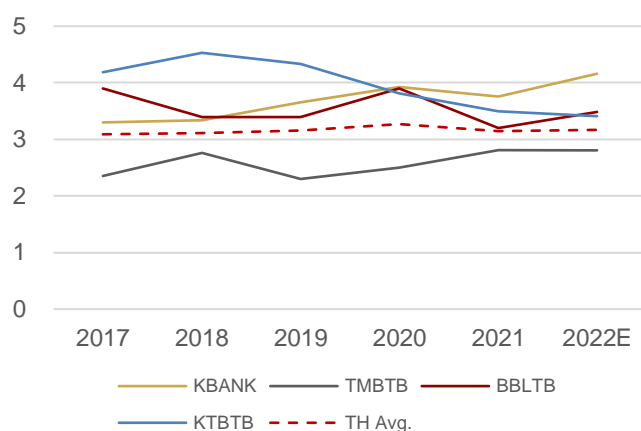
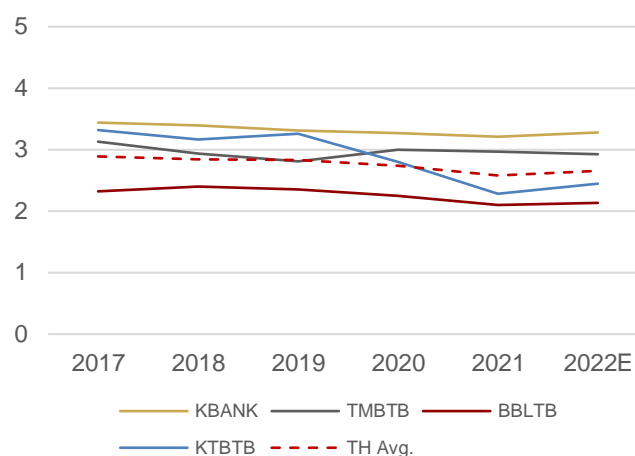


Chart 8: NIM of TH banks and industry average (%)



Source: Bloomberg.

Low non-call risk for KBANK and KTBTB

We consider the capital buffers of KBANK and KTBTB sufficient over the medium term. The latest CET1 ratios of KBANK and KTBTB are 7.5% and 7.9% higher than the BOT's requirement of 8% respectively. During the economic cycle since 2005, the lowest level of CET1 ratio at 9.4% (KBANK) and 8.7% (KTBTB) were noted during 2010-2011 that were still well above the regulatory minimum of 5% which was firstly set in 2013. Based on KBANK and KTBTB's abundant capital resources through the economic cycle, we think the probability that KBANK and KTBTB will call their AT1s on their first call date, in Oct'25 and Mar'26, is high.

There is no non-call history for USD AT1s in these four emerging markets yet. We do see some cases in Asia that the call of bank capital papers is not a pure economic decision as we found in Europe. In Asia, whether bank capital papers will be called will be hinged on the feedback from regulator or investors.

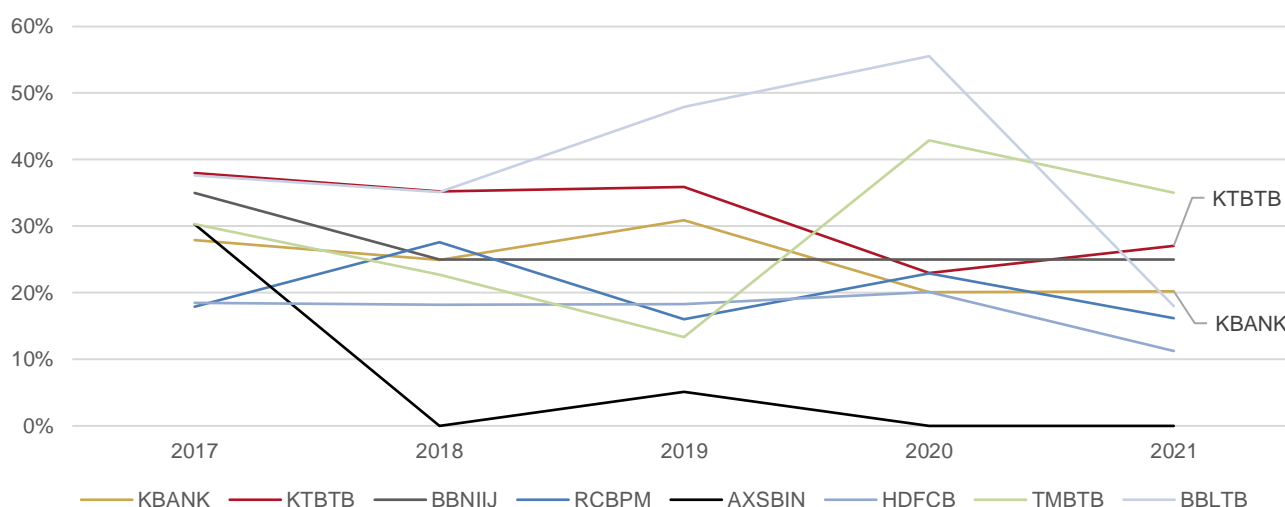
The most recent example is South Korea's Heungkuk Life Insurance reversed the non-call decision in Nov'22. The company planned not to call its perp due to high refinancing cost. As the non-call event could affect other South Korean issuers to access offshore capital markets and therefore, the local regulator requested the company to change the decision and urged commercial banks to provide liquidity for Heungkuk Life Insurance to call its perp.

Another example is ICICI Bank of India, the bank initially chose not to call its 3 USD T2 bonds issued in 2006 on the first call dates in 2011, and proposed to exchange the 3 bonds with new bonds due 2020. ICICI Bank made a U-turn on the decision after the negative market reaction and called the 3 T2 bonds on the first call dates. This incident also reinforced our belief that Asia EM banks care the so-called "reputational risk" and would consider investor's feedback when making the call decisions.

Low likelihood of distribution cancellation of our picks

The capital adequacy is also supported by the stable profitability of Kasikornbank and Krug Thai Bank throughout the year, and at the same time lower the chance of distribution cancellation. We also believe that the chance of distribution cancellation of these two Thai banks are low given the track record of dividend payout.

Chart 9: Dividend payout ratio of EM banks

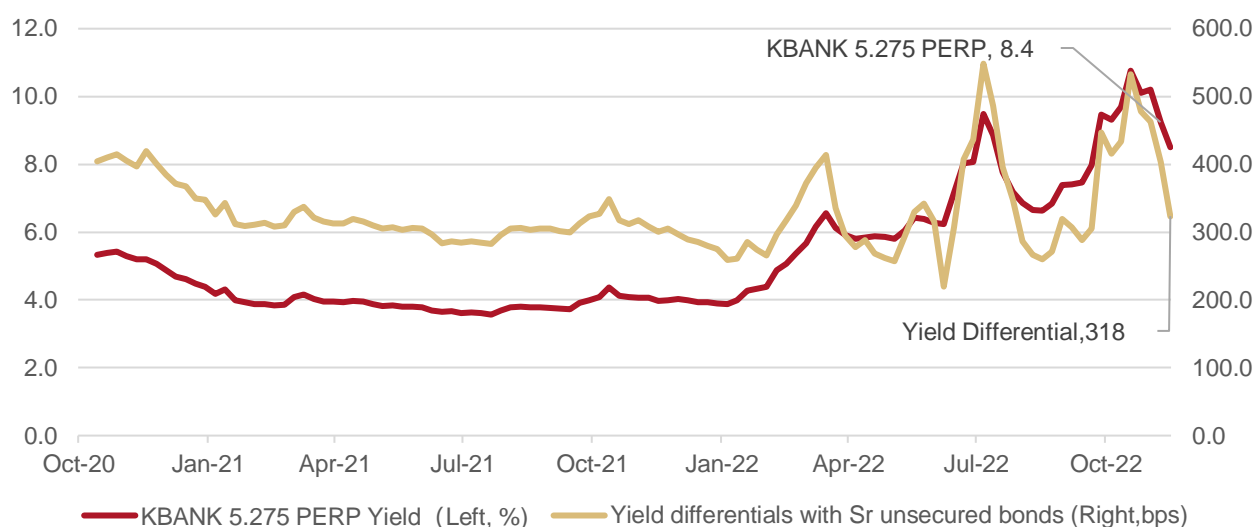


Source: Bloomberg.

Solid yield differentials over comparable senior bonds

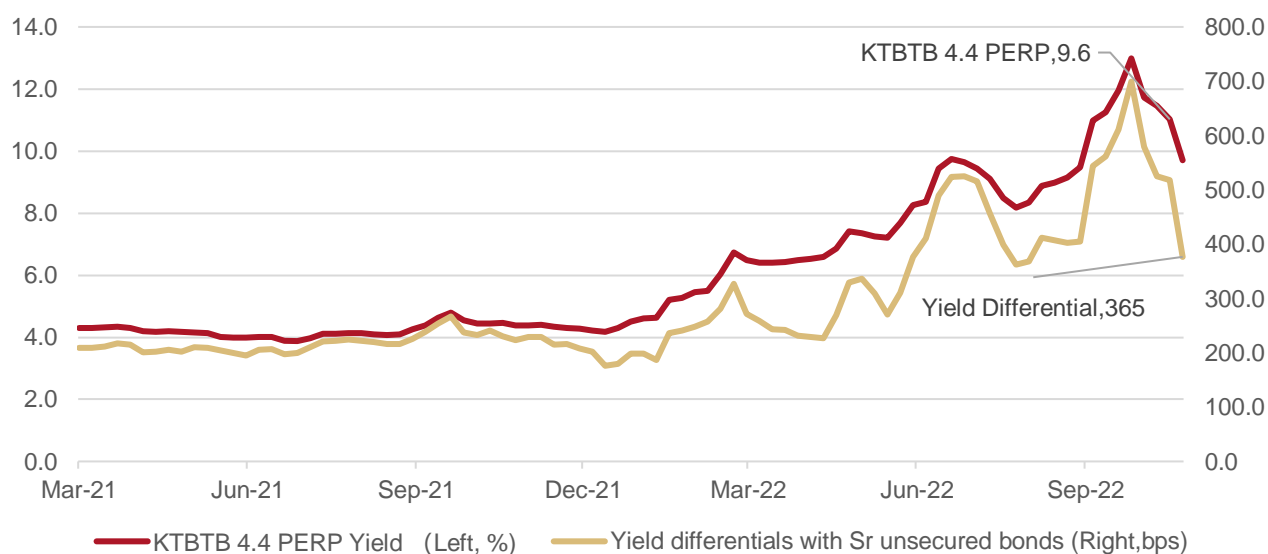
There are only few outstanding senior unsecured bonds issued by our selected banks, therefore for the yield differentials comparison, we selected the senior bonds with similar tenor issued by other TH banks being rated the same as KBANK and KTBTB. As shown in Charts 10-11 below, differentials between our picks and comparable senior unsecured bonds is considerably decent. As of 23 Nov'22, the yield differential of KBANK 5.275 PERP, KTBTB 4.4 PERP are 318bps and 365bps, at the 32% and 38% quantile of all historical differential.

Chart 10: KBANK 5.275 PERP



Source: Bloomberg.

Chart 11: KTB TB 4.4 PERP



Source: Bloomberg.

Appendix 1: Credit metrics of our picks

	Kasikornbank PCL (KBANK)	Krung Thai Bank PCL (KTB TB)
Credit ratings (M/S/F)		
Issuer rating	Baa1/BBB/BBB	Baa1/BBB-/BBB+
Outlook	Stable	Stable

Standalone rating	baa2/bb+/bbb	baa3/bb/bbb-
Senior unsecured rating	Baa1/BBB/BBB	Baa1/BBB-/BBB+
AT1 rating	Ba2/-/-	Ba3/-/-

3Q22 Key credit metrics

ROA	1.00%	0.94%
ROE	8.49%	9.48%
Net interest margin (NIM)	3.33%	2.51%
CET 1 ratio	15.08%	15.62%
Tier 1 ratio	16.14%	16.57%
Total capital ratio	18.22%	20.64%
NPL ratio	3.07%	3.32%
Loan-to-deposit ratio	92.65%	100.39%

Source: Bloomberg, Companies' filling.

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