August 12, 2024

Canara Bank: [ICRA]AA+ (Stable) assigned to Tier I bonds; ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier I bonds	0.00	4,000.00	[ICRA]AA+ (Stable); assigned
Basel III Tier I bonds	5,000.00	5,000.00	[ICRA]AA+ (Stable); reaffirmed
Basel III Tier II bonds	8,900.00	8,900.00	[ICRA]AAA (Stable); reaffirmed
Basel III Tier II bonds	2,500.00	0.00	[ICRA]AAA (Stable); reaffirmed and withdrawn
Total	**16,400.00**	**17,900.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in Canara Bank's (Canara) sovereign ownership and its strong franchise with a market share of 5.7% in net advances and 6.4% in total deposits as on June 30, 2024. It is the fourth-largest public sector bank (PSB) and the sixth-largest bank in the Indian financial system in terms of total business (cumulative advances and deposits) as on June 30, 2024. The ratings are further supported by Canara's strong deposit franchise, resulting in a well-developed retail deposit base and a strong liquidity profile.

The ratings consider the bank's healthy profitability and strong capitalisation profile, which is expected to sustain going forward. The Government of India (GoI) has demonstrated a track record of providing capital support to Canara, which has also raised capital from the market, supporting its overall capital profile.

ICRA expects the bank to remain self-sufficient for its capital requirements for absorbing incremental stress as well as for growth requirements while keeping the desired cushion on the capital well above the regulatory levels (including capital conservation buffers, CCB). However, the impact of transitioning to provisioning, based on the expected credit loss (ECL) framework, and additional provisioning on infrastructure financing on the capital and profitability levels will remain a monitorable.

The headline asset quality indicators have improved and the residual vulnerable book, comprising overdue and standard restructured advances, has witnessed a sustained moderation from the comparatively higher level a year back. Further, given the high provision cover for the legacy stressed assets, ICRA expects that Canara's internal capital generation will remain healthy along with its asset quality and solvency position. However, the asset quality remains monitorable for the seasoning of the loan book, given the high loan growth in recent years and risks arising out of a deterioration in macro-economic parameters such as elevated interest rates. The rating for the Additional Tier-I (AT-I) bonds factors in the healthy level of distributable reserves (DRs), which can be used to service the coupon on these bonds in the unforeseeable event of a loss.

The Stable outlook on the ratings reflects ICRA's expectation that the bank will be able to maintain a steady credit profile, with stable asset quality as well as healthy profitability and capitalisation.

ICRA has reaffirmed and withdrawn the rating assigned to the Rs. 2,500.00-crore Basel III Tier II bonds as these bonds have been fully redeemed with no amount outstanding against the same. The rating was withdrawn in accordance with ICRA's withdrawal policy (click here for the policy).

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The GoI remains the bank's largest shareholder, accounting for a 62.93% equity stake as on June 30, 2024. With two rounds of equity capital raise of Rs. 4,500 crore from the market in FY2021 and FY2022, the GoI's shareholding has declined from 69.33% as on March 31, 2021. However, this provides enough headroom to raise capital from markets, if required. The GoI has not infused any capital into Canara in the last four fiscals as its capital position remained comfortable and it raised capital from the market. Canara and Syndicate Bank (e-SB), which merged with Canara, had received sizeable equity capital support from the GoI, amounting to Rs. 18,234 crore during FY2018-FY2020. Recapitalisation and improving internal accruals over the years have helped the bank reduce its net non-performing advances (NNPAs) substantially. ICRA believes that Canara has strong capital cushions and is likely to remain self-sufficient for its capital requirements and expects it to continue receiving support from the GoI, if required.

Strong capital position and solvency – The bank's core equity capital (CET I) and Tier I capital stood at 12.05%[1] and 14.37%, respectively, as on June 30, 2024 (11.50% and 13.58%, respectively, as on June 30, 2023), maintaining a buffer over the regulatory ratios. With the enhanced capital position and the decline in the NNPA level, NNPA/core capital improved to 14.2% as on June 30, 2024 from 19.6% as on June 30, 2023. In ICRA's view, Canara remains well placed, in terms of its capital position for growth, while absorbing any incremental stress and maintaining more than the desired cushion of 1% on the capital above the regulatory levels. Besides this, the subsidiaries largely remain self-sufficient in meeting their capital requirements although a few may require capital support, which is likely to remain manageable in relation to the bank's profit and the existing capital levels. Notwithstanding the sufficient internal accruals and capital position for growth, the Reserve Bank of India's (RBI) implementation of the ECL framework for credit exposures and additional provisioning on infrastructure financing remain monitorable for the capital position.

Healthy earnings profile – Lower interest reversals due to better asset quality as well as the healthy recoveries from stressed assets resulted in a healthy operating profitability of 1.93% of average total assets (ATA) in Q1 FY2025 (1.97% in FY2024, 2.0% in FY2023). Lower slippages, in addition to healthy recoveries, kept the credit cost at a low level, leading to strong return metrics {return on assets (RoA)} of 1.04% (annualised) in Q1 FY2025 (1.03% in FY2024, 0.83% in FY2023).

Well-developed deposit franchise – Canara has a well-developed deposit franchise and draws support from its extensive network of 9,623 domestic branches as on June 30, 2024, with a strong footprint across South India. It witnessed a healthy global deposit growth of 11.97% YoY during the quarter ended June 30, 2024, which helped it maintain its credit-to-deposit (CD) ratio at 71% as on June 30, 2024 (72% as on June 30, 2023). Further, the deposit growth of 11.29% in FY2024 was higher than the PSB average of 10.11%. However, Canara had a relatively lower share of domestic current account and savings account (CASA) base of 31.0% as on June 30, 2024 (33.0% as on June 30, 2023) compared to the PSB average. Lower CASA deposits and the high interest rates on term deposits offered by the bank have kept its overall cost of funds historically above the PSB average. Canara's cost of funds stood at 5.53% compared to the PSB average of 4.95% in FY2024. ICRA expects the bank to continue maintaining a strong liquidity profile on account of its healthy core deposit base and widespread branch network.

Credit challenges

Asset quality improved but remains monitorable – The annualised gross fresh NPA generation rate stood at 1.45% in Q1 FY2025 (1.59% in FY2024, 1.75% in FY2023), materially below the elevated levels seen in the past (~4-8% over FY2017-FY2020). Further, write-offs, healthy recoveries/upgrades and loan book growth led to a decline in the gross NPA percentage to 4.14% as on June 30, 2024 from 5.15% as on June 30, 2023. While NNPAs declined to 1.24% as on June 30, 2024 from the high levels observed in the recent past, it is comparatively higher than the PSB average of 0.75% as on March 31, 2024. The asset quality remains monitorable for the seasoning of the loan book amid the high loan growth in recent years and the risks arising out of

[1] *Including interim profit*

a deterioration in macro-economic parameters such as elevated interest rates. Canara's ability to limit slippages and maintain credit costs at lower levels will remain critical from a profitability perspective.

Environmental and social risks

While banks like Canara do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. If the entities or businesses, to which banks and financial institutions have an exposure, face business disruptions because of physical climate adversities or if such businesses face climate transition risks because of technological, regulatory or customer behaviour changes, it could translate into credit risks for banks. However, such risk is not material for Canara as it benefits from adequate portfolio diversification. Further, the lending is typically short-to-medium term, allowing it to adapt and take incremental exposure to businesses that face relatively fewer downside environmental risks.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as material lapses could be detrimental to their reputation and invite regulatory censure. Canara has not faced material lapses over the years. Customer preferences are increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. Canara has been making the requisite investments to enhance its digital interface with its customers. While it contributes to promoting financial inclusion by lending to the underserved segments, its lending practices remain prudent as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

Canara's reported liquidity coverage ratio of 146.5% and net stable funding ratio of 133.7%, for the quarter ending June 30, 2024, were well above the regulatory requirement of 100%. ICRA expects the bank to maintain its strong liquidity profile, given the large proportion of retail deposits and the high portfolio of liquid investments. It can also avail liquidity support from the RBI (through reverse repo against excess statutory liquidity ratio (SLR) investments and marginal standing facility mechanism) in case of urgent liquidity requirements.

Rating sensitivities

Positive factors – Not applicable as all the ratings are at the highest level for the respective instruments

Negative factors – The ratings will be reassessed in case of a change in the sovereign ownership. ICRA could also downgrade the ratings if the bank's solvency profile weakens with net stressed assets/core capital exceeding 40% on a sustained basis. Further, an RoA of less than 0.3% and/or a decline in the capital cushions over the regulatory levels to less than 100 basis points (bps) on a sustained basis will remain negative triggers. A sharp deterioration in the profitability and weakening of the DRs eligible for the coupon payment on the AT-I bonds will be a negative trigger for the rating for these bonds.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions Impact of Parent or Group Support on an Issuer's Credit Rating Rating Approach – Consolidation ICRA's Policy on Withdrawal of Credit Ratings
Parent/Group support	The ratings factor in Canara's sovereign ownership and the demonstrated track record of capital infusions by the GoI. ICRA expects the GoI to support the bank with capital infusions, if required.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of Canara. However, in line with ICRA's consolidation approach, the capital/funding requirement of the Group's various subsidiaries/joint ventures, going forward, has been factored in.

About the company

Canara was incorporated in 1906 and nationalised in 1969, along with 13 other major commercial banks of India, by the GoI. The bank is headquartered in Bengaluru.

Canara was merged with Syndicate Bank (e-SB) on April 1, 2020. It had a total asset base of Rs. 15.2 lakh crore as on June 30, 2024. The bank had a market share of 5.7% and 6.2% in net advances and total deposits, respectively, as on June 30, 2024, with the GoI holding a majority stake (62.93% as on June 30, 2024). It had a network of 9,623 domestic branches and 10,014 ATMs as on June 30, 2024.

Key financial indicators (standalone)

Canara Bank	FY2023	FY2024	Q1 FY2025
Total income	48,304	53,909	14,136
Profit after tax	10,604	14,554	3,905
Total assets* (Rs. lakh crore)	13.38	14.82	15.23
CET I	11.59%	11.58%	12.05%^
CRAR	16.68%	16.28%	16.38%^
PAT / ATA	0.83%	1.03%	1.04%
Gross NPAs	5.35%	4.23%	4.14%
Net NPAs	1.73%	1.27%	1.24%

Source: Canara Bank, ICRA Research
Amount in Rs. crore unless mentioned otherwise
** Total assets exclude revaluation reserves*
^ Including Q1 FY2025 profit
Total income includes net interest income and non-interest income excluding trading income/loss
All calculations as per ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2025)			Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Date & Rating in FY2025	Date & Rating in FY2024		Date & Rating in FY2023	Date & Rating in FY2022
				Aug-12-2024	Nov-28-2023	Aug-17-2023	Aug-19-2022	Nov-03-2021
1.	**Basel III Tier I bonds**	LT	4,000.00	[ICRA]AA+ (Stable)	-	-	-	-
2.	**Basel III Tier I bonds**	LT	1,500.00	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3.	**Basel III Tier I bonds**	LT	3,500.00	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	-	-	-
4.	**Basel III Tier II bonds**	LT	5,400.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
5.	**Basel III Tier II bonds**	LT	3,500.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-
6.	**Basel III Tier II bonds**	LT	2,500.00	[ICRA]AAA (Stable) (withdrawn)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)

LT – Long term; ST – Short term

Complexity level of the rated instrument

Instrument	Complexity Indicator
Basel III Tier I bonds	Highly Complex
Basel III Tier II bonds	Highly Complex

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Unplaced	Basel III Tier I bonds	-	-	-	4,000.00	[ICRA]AA+ (Stable)
INE476A08035	Basel III Tier I bonds	Mar-05-2015	9.55%	Mar-05-2025^	1,500.00	[ICRA]AA+ (Stable)
INE476A08225	Basel III Tier I bonds	Feb-14-2024	8.40%	Feb-14-2029^	2,000.00	[ICRA]AA+ (Stable)
INE476A08217	Basel III Tier I bonds	Dec-11-2023	8.40%	Dec-11-2028^	1,403.00	[ICRA]AA+ (Stable)
Unplaced	Basel III Tier I bonds	-	-	-	97.00	[ICRA]AA+ (Stable)
INE476A08050	Basel III Tier II bonds	Apr-27-2016	8.40%	Apr-27-2026	3,000.00	[ICRA]AAA (Stable)
INE476A08043	Basel III Tier II bonds	Jan-07-2016	8.40%	Jan-07-2026	900.00	[ICRA]AAA (Stable)
INE476A09264	Basel III Tier II bonds	Dec-31-2015	8.40%	Dec-31-2025	1,500.00	[ICRA]AAA (Stable)
INE476A08175	Basel III Tier II bonds	Aug-26-2022	7.48%	Aug-26-2032	2,000.00	[ICRA]AAA (Stable)
Unplaced	Basel III Tier II bonds	-	-	-	1,500.00	[ICRA]AAA (Stable)
INE476A09256	Basel III Tier II bonds	Mar-27-2014	9.70%	Mar-27-2024	1,000.00	[ICRA]AAA (Stable); withdrawn
INE476A09249	Basel III Tier II bonds	Jan-03-2014	9.73%	Jan-03-2024	1,500.00	[ICRA]AAA (Stable); withdrawn

^ Call option date; Can be exercised on respective dates and annually on the coupon payment dates thereafter
Source: Canara Bank

Key features of rated debt instruments

The servicing of the Basel III Tier II bonds is not subject to any capital ratios and profitability. However, the Basel III Tier II bonds and Basel III Tier I bonds (AT-I bonds) are expected to absorb losses once the point of non-viability (PONV) trigger is invoked by the RBI. These Basel III bonds have equity-like loss-absorption features. Such features may translate into higher loss severity vis-à vis conventional debt instruments.

Further, the exercise of the call option on the Basel III Tier I bonds is contingent upon the prior approval of the RBI. Moreover, the bank will need to demonstrate that the capital position is well above the minimum regulatory requirement, post the exercise of the said call option.

The rated Tier I bonds have the following loss-absorption features that make them riskier:

- Coupon payments are non-cumulative and discretionary, and the bank has full discretion at all times to cancel the same. Cancellation of discretionary payments shall not be an event of default.
- Coupons can be paid out of the current year's profits. If the current year's profit is not sufficient or if the payment of the coupon is likely to result in a loss, the coupon payment can be made through the reserves and surpluses[2] created via the appropriation of profits (including statutory reserves). However, the coupon payment is subject to the bank meeting the minimum regulatory requirements for the CET I, Tier I and total capital ratios (including CCB) at all times as prescribed by the RBI under the Basel III regulations.

These Tier I bonds are expected to absorb losses through the write-down mechanism at the objective prespecified trigger point fixed at the bank's CET I ratio as prescribed by the RBI, i.e. 6.125% of the total risk-weighted assets (RWAs) of the bank or when the PONV trigger is breached in the RBI's opinion.

Given the above distinguishing features of the Tier I bonds, ICRA has assigned a one notch lower rating to these than the rating for the Tier II instruments. The DRs that can be used for servicing the coupon in a situation of inadequate profit or a loss during the year stood at a comfortable 7.7% of RWAs as on June 30, 2024.

The rating for the Tier I bonds continues to be supported by the bank's capital profile, which is likely to remain strong, given the outlook on Canara's profitability. However, the transition to the ECL framework and its impact on the capital and DRs remain monitorable.

[2] *Calculated as per the amendment in Basel III capital regulations for Tier I bonds by the RBI, vide its circular dated February 2, 2017. As per the amended definition, DRs include all reserves created through appropriations from the profit and loss account*

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership*	Consolidation Approach
Canbank Financial Services Ltd.	100.00%	Full Consolidation
Canbank Venture Capital Fund Ltd.	100.00%	Full Consolidation
Canara Bank Securities Ltd.	100.00%	Full Consolidation
Canara Bank (Tanzania) Ltd.	100.00%	Full Consolidation
Canbank Factors Ltd.	70.00%	Full Consolidation
Canbank Computer Services Ltd.	69.14%	Full Consolidation
Canara HSBC Life Insurance Company Ltd.	51.00%	Full Consolidation
Canara Robeco AMC Ltd.	51.00%	Full Consolidation
Andhra Pragathi Grameena Bank	35.00%	Full Consolidation
Karnataka Gramin Bank	35.00%	Full Consolidation
Karnataka Vikas Grameena Bank	35.00%	Full Consolidation
Kerala Gramin Bank	35.00%	Full Consolidation
Can Fin Homes Ltd.	29.99%	Full Consolidation
Higher Education Financing Agency	9.09%	Full Consolidation

*Source: Canara Bank, ICRA Research; *As on June 30, 2024*

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About ICRA Limited:

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