August 19, 2022(Revised)

Canara Bank: [ICRA]AAA (Stable) assigned to Basel III Tier II bonds; ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier II Bonds	-	3,500.00	[ICRA]AAA (Stable); assigned
Basel III Tier II Bonds	7,900.00	7,900.00	[ICRA]AAA (Stable); reaffirmed
Basel III Tier I Bonds	1,500.00	1,500.00	[ICRA]AA+ (Stable); reaffirmed
Total	**9,400.00**	**12,900.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in the improvement in the profitability and solvency profile[1] of Canara Bank (Canara), which is expected to be sustained going forward, while the overall capitalisation profile remains comfortable. Further, the ratings remain supported by Canara's sovereign ownership and the demonstrated track record of capital support from the Government of India (GoI). While the bank is adequately capitalised and likely to remain self-sufficient for its capital requirements, ICRA expects it to continue receiving support from the GoI, if required. Canara had merged with erstwhile Syndicate Bank (e-SB), effective April 1, 2020. The merger has increased the systemic importance of the bank in the Indian banking sector with a market share of 6.1% in advances and 6.8% in total deposits as on March 31, 2022. It is the fourth-largest public sector bank (PSB) and the sixth-largest bank in the Indian financial system in terms of total business (advances and deposits cumulatively) as on March 31, 2022. The ratings are further supported by Canara's strong deposit franchise, resulting in a robust retail franchise and a strong liquidity profile.

While the headline asset quality indicators witnessed an improvement, the ratings take note of the vulnerable book comprising overdue and standard restructured advances, which stood at 3.2% of standard advances as on June 30, 2022. This remains a monitorable amid the recent weakening in macro-economic factors. However, given the high provision cover on the legacy stressed assets, ICRA expects Canara's operating profitability to comfortably absorb any incremental credit costs.

The Stable outlook on the ratings factors in the expectation of an improvement in the solvency profile and internal capital generation and the strong liability profile, apart from the bank's sovereign ownership.

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, 2022. The GoI's stake has declined from 69.33% as on March 31, 2021 after two rounds of equity capital raising of Rs. 4,500 crore in the past two fiscals. The bank raised Rs. 2,000 crore and Rs. 2,500 crore through a qualified institutional placement (QIP) in December 2020 and August 2021, respectively. Canara and e-SB had received sizeable equity capital support from the GoI, amounting to Rs. 18,234 crore during FY2018-FY2020, of which Rs. 6,571 crore was last infused in FY2020. The GoI did not infuse any capital into Canara in FY2021 and FY2022 as its capital position remained adequate and it raised capital from the market.

[1] Solvency profile = Net stressed assets / Core capital; net stressed assets include net NPAs, net non-performing investments and net security receipts

Recapitalisation and improving internal accruals over the years have helped the bank substantially reduce its net non-performing advances (NNPAs). ICRA believes that Canara is adequately capitalised and likely to remain self-sufficient for its capital requirements and expects it to continue receiving support from the GoI, if required.

Well-developed deposit franchise – Canara's branch network remains robust with 9,732 domestic branches as on June 30, 2022, with a strong footprint across South India. The bank's current account and savings account (CASA) base stood at 32.3% of the total deposits as on June 30, 2022 (32.5% as on June 30, 2021) although it was lower than the PSB average of 42.3% as on March 31, 2022. Canara continues to offer a higher rate on its term deposits compared to some other PSBs as it has to compete with a few other South-based banks. The higher term deposit rates and lower share of low-cost CASA deposits have kept Canara's overall cost of funds historically above the PSB average. The bank's cost of funds stood at 3.9% in FY2022 compared to the PSBs' average of 3.8%.

As a result, the deposit base is concentrated in comparison to peer PSBs, and the top 20 depositors accounted for 9.5% of the total deposits as on March 31, 2022, even though the same moderated after the merger from 15.0% (Canara standalone) as on March 31, 2020. ICRA expects the bank to continue to maintain a strong liquidity profile on account of its healthy core deposit base, widespread branch network and robust retail franchise.

High systemic importance as fourth-largest PSB – Following the merger with effect from April 1, 2020, Canara turned into the fourth-largest PSB and the sixth-largest bank in the Indian financial system in terms of total business (advances and deposits cumulatively) as on March 31, 2022. Its market share stood at 6.1% of advances and 6.8% of total deposits March 31, 2022, signifying its increased systemic importance in the Indian banking system. While Canara is currently not classified as a domestic systemically important bank (D-SIB), its classification in this category would lead to additional capital requirements vis-à-vis the regulatory minimum levels. We expect that the bank shall be able to meet the enhanced capital requirements based on the current capital position.

Improving capital and solvency position supported by internal accruals as well as fresh capital raising – The bank's core equity capital (CET-I) and Tier I capital stood at 10.5% and 12.1%, respectively, as on June 30, 2022 (8.9% and 10.3%, respectively, as on June 30, 2021), supported by internal accruals (return on assets (RoA) of 0.7% in Q1 FY2023 and 0.5% in FY2022) as well as capital raising (including Tier-I bonds). Given the current capital cushions, the bank is expected to be well positioned to sustain the growth momentum in the near to medium term while maintaining a buffer of ~100 basis points (bps) over the regulatory ratios.

With the improved capital position and the decline in the NNPA level, the NNPA/CET ratio improved to 32.47% as on June 30, 2022 from 53.57% as on March 31, 2021. With the expectation of a decline in the NNPAs and the overall net stressed assets and an improvement in internal capital generation, the solvency profile is expected to improve even in the absence of further capital raising.

Profitability levels improve; likely to be sustained – With the improvement in the core operating profits, driven by the improving net interest margins (NIMs) and the lower credit costs in FY2022, the bank was able to report an RoA of 0.5% in FY2022 (0.2% in FY2021). The RoA improved further to 0.7% (annualised) in Q1 FY2023, partly supported by higher non-interest income during the quarter. Going forward, ICRA expects the improvement seen in the bank's profitability trajectory to be sustained, supported by the high provision cover on legacy stressed assets, leading to lower credit costs compared to the past.

Credit challenges

Asset quality remains a monitorable – Despite the Covid-19 pandemic-induced pressures on the debt servicing ability of borrowers, the fresh NPA generation moderated to 2.3% of standard advances in Q1 FY2023 and FY2022 (3.0% in FY2021 and 4.0% in FY2020). Moreover, the headline asset metrics were supported by meaningfully high recoveries and upgrades as well as write-offs. As a result, the gross NPAs (GNPAs) and NNPAs improved to 7.0% and 2.5%, respectively, as on June 30, 2022 (8.5% and 3.5%, respectively, as on June 30, 2021).

However, the standard restructured book, which stood at 2.5% of standard advances, and the SMA[2]-1 and SMA-2 loan book (above Rs. 5 crore ticket size) of 0.7% of standard advances as on June 30, 2022 remain a monitorable. Moreover, the weakening macro-economic factors, including the recent sharp increase in inflation levels leading to the weakening of the Indian currency, faster monetary policy tightening and the sharp rise in interest rates could potentially impact the debt servicing ability of certain borrowers; this remains a monitorable. Nevertheless, the high provisions on legacy stressed assets and the improving profitability are expected to help Canara absorb any incremental asset quality pressure from its operating profit.

Liquidity position: Strong

Canara's liquidity profile remains strong, supported by its strong retail liability franchise, the estimated excess statutory liquidity ratio (SLR) holding of 6.1% of total deposits as on June 30, 2022, the liquidity coverage ratio of 119% and the net stable funding ratio of 140% for the quarter ending March 31, 2022 against the regulatory requirement of 100%. ICRA expects Canara to maintain its liquidity profile, given the large proportion of retail deposits and the high portfolio of liquid investments. The bank can also avail liquidity support from the Reserve Bank of India (RBI; through reverse repo against excess 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 change the outlook to Negative or downgrade the ratings if the bank's solvency profile weakens with net stressed assets/core capital exceeding 40% on a sustained basis. A sharp deterioration in the profitability and weakening of the distributable reserves eligible for the coupon payment on the additional tier I (AT-I) bonds will be a negative trigger for the rating on the AT-I bonds.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating Rating approach – Consolidation
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	To arrive at the ratings, ICRA has considered the standalone financials of Canara. However, in line with ICRA's limited consolidation approach, the capital requirement of the Canara Bank Group's key subsidiaries/associates/joint ventures, going forward, has been factored in.

About the company

Incorporated in 1906, Canara Bank was merged with erstwhile Syndicate Bank (e-SB) on April 1, 2020 to form the fourth-largest PSB and the sixth-largest bank in the Indian banking system with a total asset base of Rs. 12.6 lakh crore as on June 30, 2022. The bank has a market share of 6.1% and 6.8% in net advances and total deposits, respectively, as on March 31, 2022, with the GoI holding a majority stake (62.93% as on June 30, 2022). It has a network of 9,732 branches and 10,802 ATMs as on June 30, 2022.

[2] *Special mention accounts; SMA-1 is overdue by 31-60 days and SMA-2 is overdue by 61-90 days*

Key financial indicators (standalone)

Canara Bank	FY2021	FY2022	Q1 FY2022	Q1 FY2023
Net interest income	24,103	26,384	6,159	6,785
Profit before tax	3,707	8,962	2,022	2,916
Profit after tax	2,558	5,678	1,177	2,510
Net advances (Rs. lakh crore)	6.39	7.04	6.49	7.47
Total assets* (Rs. lakh crore)	11.45	12.18	11.53	12.60
CET-I	8.61%	10.26%	8.85%	10.49%
Tier I	10.08%	11.91%	10.34%	12.13%
CRAR	13.18%	14.90%	13.36%	14.91%
Net interest margin / Average total assets	2.20%	2.23%	2.14%^	2.19%^
Net profit / Average total assets	0.23%	0.48%	0.41%^	0.65%^
Return on net worth	5.05%	9.86%	8.61%^	13.80%^
Gross NPAs	8.93%	7.51%	8.51%	6.99%
Net NPAs	3.82%	2.65%	3.46%	2.48%
Provision coverage excl. technical write-offs	59.46%	66.46	61.46%	66.19%
Net NPA / Core equity	53.57%	33.79%	48.28%	32.47%

**Total assets and net worth exclude revaluation reserves; ^ Annualised*
Source: Canara Bank, ICRA Research; Amount in Rs. crore unless mentioned otherwise
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 (FY2023)					Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020			
			(Rs. crore)	(Rs. crore)	Aug-19-2022	Nov-03-2021	Nov-13-2020	Jan-31-2020	Sep-19-2019	Jul-11-2019	Apr-26-2019
1	Basel III Tier II Bonds	LT	3,500.00	-	[ICRA]AAA (Stable)	-	-	-	-	-	-
2	Basel III Tier I Bonds	LT	1,500.00	1,500.00	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA(hyb) (Stable)	[ICRA]AA-(hyb)&	[ICRA]AA-(hyb)&	[ICRA]AA-(hyb) (Stable)	[ICRA]AA-(hyb) (Stable)
3	Basel III Tier II Bonds	LT	7,900.00	7,900.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AA+(hyb) (Stable)	[ICRA]AA+(hyb)&	[ICRA]AA+ (hyb)&	[ICRA]AA+(hyb) (Stable)	[ICRA]AA+(hyb) (Stable)
4	Certificates of Deposit	ST	-	-	-	-	-	-	-	[ICRA]A1+; withdrawn	[ICRA]A1+
5	Basel II Lower Tier II Bonds	LT	-	-	-	-	-	-	-	-	[ICRA]AA+ (Stable); withdrawn

& Rating watch with developing implications; 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
INE476A08035	Basel III AT-I Bonds	Mar-05-2015	9.55%	Perpetual^	1,500.00	[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)
INE476A09256	Basel III Tier II Bonds	Mar-27-2014	9.70%	Mar-27-2024	1,000.00	[ICRA]AAA (Stable)
INE476A09249	Basel III Tier II Bonds	Jan-03-2014	9.73%	Jan-03-2024	1,500.00	[ICRA]AAA (Stable)

^The instrument has a call option date of March 05, 2025
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 are expected to absorb losses once the point of non-viability (PONV) trigger is invoked.

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

The rated Basel III Tier I bonds (AT-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 coupon payments. Cancellation of discretionary payments shall not be an event of default.
- Coupons can be paid out of the current year's profits. However, 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[3] created through the appropriation of profits (including statutory reserves). However, the coupon payment is subject to the bank meeting the minimum regulatory requirements for CET-I, Tier I and total capital ratios (including capital conservation buffer, 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 RWAs of the bank or when the PONV trigger is breached in the RBI's opinion.

Given the above distinguishing features of the AT-I bonds, ICRA has assigned a one notch lower rating on these than the rating on the Tier II instruments. The distributable reserves that can be used for servicing the coupon in a situation of inadequate profit or a loss during the year, stood at a comfortable 6.1% of the risk-weighted assets (RWAs) as on March 31, 2022.

The rating on the Tier I bonds continues to be supported by the bank's capital profile, which is likely to remain comfortable, given the outlook on Canara's profitability and its strong capital-raising ability.

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Canbank Financial Services Ltd.	100.00%	Limited Consolidation
Canbank Venture Capital Fund Ltd.	100.00%	Limited Consolidation
Canara Bank Securities Ltd.	100.00%	Limited Consolidation
Canara Bank (Tanzania) Ltd.	100.00%	Limited Consolidation
SyndBank Services Ltd.	100.00%	Limited Consolidation

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

Company Name	Ownership	Consolidation Approach
Canbank Factors Ltd.	70.00%	Limited Consolidation
Canbank Computer Services Ltd.	69.14%	Limited Consolidation
Canara HSBC OBC Life Insurance Ltd.	51.00%	Limited Consolidation
Canara Robeco AMC Ltd.	51.00%	Limited Consolidation
Commercial Indo Bank LLC	40.00%	Limited Consolidation
Karnataka Gramin Bank	35.00%	Limited Consolidation
Kerala Gramin Bank	35.00%	Limited Consolidation
Andhra Pragathi Grameena Bank	35.00%	Limited Consolidation
Karnataka Vikas Grameena Bank	35.00%	Limited Consolidation
Can Fin Homes Ltd.	30.00%	Limited Consolidation

Source: Canara Bank, ICRA Research

Corrigendum

Rationale dated August 19, 2022, has been revised with changes as below:

Addition of "Rating Approach- Consolidation" in the analytical approach section

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