August 17, 2023

Canara Bank: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier I Bonds	1,500.00	1,500.00	[ICRA]AA+ (Stable); reaffirmed
Basel III Tier II Bonds	11,400.00	11,400.00	[ICRA]AAA (Stable); reaffirmed
Total	**12,900.00**	**12,900.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in Canara Bank's (Canara) sovereign ownership and strong franchise with a market share of 6.1% in advances and 6.6% in total deposits as on March 31, 2023. It is the fourth-largest public sector bank (PSB) and the seventh-largest bank in the Indian financial system in terms of total business (cumulative advances and deposits) as on March 31, 2023. The ratings are further supported by Canara's strong deposit franchise, resulting in a robust retail franchise and a strong liquidity profile.

The ratings factor in the improvement in the bank's profitability and solvency profile, which is expected to be maintained 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).

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), driving the Stable outlook on the ratings. However, the impact of transitioning to provisioning, based on the expected credit loss (ECL) framework, on the capital and profitability levels will remain a monitorable.

While the headline asset quality indicators have improved, the ratings take note of the residual vulnerable book, comprising overdue and standard restructured advances, although it has witnessed a sustained moderation from the comparatively higher level a year back. Given the high provision cover for the legacy stressed assets, ICRA expects that Canara's internal capital generation will remain comfortable along with its asset quality and solvency position. Furthermore, the rating for the 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 rating 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, 2023, down from 69.33% as on March 31, 2021 after two rounds of equity capital raising of Rs. 4,500 crore from the market in the last two fiscals. The GoI has not infused any capital into Canara in the last three fiscals as its capital position remained comfortable and it raised capital from the market. Earlier, Canara and erstwhile 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, of which Rs. 6,571 crore was infused in 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 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 9,653 domestic branches as on June 30, 2023, and a strong footprint across South India. Its current account and savings account (CASA) base stood at 30.6% of the total deposits as on June 30, 2023 (32.3% as on June 30, 2022) and it was lower than the PSB average of ~40% as on March 31, 2023. 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 banks based in South India. 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 4.45% compared to the PSBs' average of 4.04% in FY2023.

The depositor concentration level has moderated with the share of the top 20 depositors to total deposits declining to 10.2% of the total deposits as on March 31, 2023 from 15.0% (Canara standalone) as on March 31, 2020. ICRA expects the bank to continue maintaining a strong liquidity profile on account of its healthy core deposit base, widespread branch network and robust retail franchise.

Comfortable capital position; solvency improves – The bank's core equity capital (CET-I) and Tier I capital stood at 11.5% and 13.6%, respectively, as on June 30, 2023 (10.5% and 12.1%, respectively, as on June 30, 2022), supported by internal accruals (return on assets (RoA) of 1.0% (annualised) in Q1 FY2024 and 0.8% in FY2023). 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 over the regulatory ratios. With the improved capital position and the decline in the NNPA level, NNPA/core capital improved to 19.6% as on June 30, 2023 from 33.8% as on March 31, 2022. 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.

Notwithstanding the improvement in the capitalisation profile, the Reserve Bank of India (RBI) recently issued a discussion paper for transitioning to the expected loss framework for credit exposures. As highlighted by ICRA, banks with a high share of overdue/restructured loans could see a one-time impact on their capital position upon transitioning. While the RBI has proposed that these provisions should be spread over a five-year period for the computation of the regulatory capital ratios, the impact on the capital position (without taking regulatory forbearance) will remain a monitorable.

Profitability levels improve – Canara's overall profitability continued to improve, largely driven by a combination of factors including higher net interest margins (NIMs) along with the relatively steady operating expenses and non-interest income. Canara's operating profit improved steadily to 2.0% of average total assets (ATA) in FY2023 from 1.7% in FY2022 and was higher than the PSB average of 1.8% in FY2023. With the moderation in the pace of fresh NPA additions and the high provision coverage on legacy NPAs, the credit costs have moderated. Accordingly, credit costs/ATA remained range-bound at 0.8% in FY2023 (0.8% in FY2022) and declined further to 0.7% in Q1 FY2024, and is at a much lower level compared to previous years.

With the continued improvement in the core operating profit, driven by the improving NIMs and the lower credit costs in FY2023, the bank was able to report an RoA of 0.8% in FY2023 (0.5% in FY2022). The RoA improved further to 1.0% (annualised) in Q1 FY2024, partly supported by higher non-interest income during the quarter. Going forward, ICRA expects the bank to maintain its profitability levels, 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 near-term monitorable – The annualised gross fresh NPA generation eased to 1.68% in Q1 FY2024 from 1.75% in FY2023 (2.26% in FY2022), which was materially lower than the elevated levels seen in the past (~4-8% over FY2017-FY2020). The provision cover ratio also improved significantly, leading to a moderation in the NNPAs. Thus, the bank's headline asset quality metrics improved with the gross NPA (GNPA) and NNPA moderating to 5.15% and 1.57%, respectively, as on June 30, 2023 (6.99% and 2.48%, respectively, as on June 30, 2022) on the back of meaningfully high recoveries, upgrades and write-offs.

However, the overall standard restructured book of ~Rs. 13,000 crore (1.5% of standard advances), as on June 30, 2023, as well as the special mention account (SMA-1 and SMA-2) loan book (~1% of standard advances) together remained elevated. Given the relatively high (though moderating) share of the vulnerable book in relation to the total standard assets and the core capital, its performance as well as the bank's ability to limit slippages will remain a near-to-medium-term monitorable. Further, the impact of the weakening macro-economic factors could affect the debt-servicing ability of borrowers and remains a monitorable.

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 strong liquidity profile is supported by its excess statutory liquidity ratio (SLR) holding of 6.6% as on March 31, 2023, resulting in a liquidity coverage ratio of 129% and a net stable funding ratio of 121% for the quarter ending June 30, 2023, which remains well above 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. It can also avail liquidity support from the 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 DRs eligible for the coupon payment on the AT-I bonds will be a negative trigger for the rating on these bonds.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA Rating Methodology for Banks and Financial Institutions 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 with a total asset base of Rs. 13.8 lakh crore as on June 30, 2023. The bank has a market share of 6.1% and 6.6% in net advances and total deposits, respectively, as on March 31, 2023, with the GoI holding a majority stake (62.93% as on June 30, 2023). It had a network of 9,653 branches and 10,683 ATMs as on June 30, 2023.

Key financial indicators (standalone)

Canara Bank	FY2022	FY2023	Q1 FY2023	Q1 FY2024
Net interest income	26,384	31,435	6,785	8,666
Profit before tax	8,962	14,173	2,916	4,885
Profit after tax	5,678	10,604	2,022	3,535
Net advances (Rs. lakh crore)	7.04	8.31	7.47	8.55
Total assets* (Rs. lakh crore)	12.18	13.36	12.60	13.78
CET-I	10.26%	11.59%	10.49%	11.50%
Tier I	11.91%	13.78%	12.13%	13.58%
CRAR	14.90%	16.68%	14.91%	16.24%
Net interest margin / Average total assets	2.23%	2.46%	2.19%^	2.55%^
Net profit / Average total assets	0.48%	0.83%	0.65%^	1.04%^
Return on net worth	9.86%	16.03%	13.80%^	20.82%^
Gross NPAs	7.51%	5.35%	6.99%	5.15%
Net NPAs	2.65%	1.73%	2.48%	1.57%
Provision coverage excl. technical write-offs	66.46%	68.91%	66.19%	70.56%
Net NPA / Core equity capital	33.79%	21.80%	32.47%	19.63%

**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 (FY2024)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Aug-17-2023	Aug-19-2022	Nov-03-2021	Nov-13-2020
1	**Basel III Tier I Bonds**	LT	1,500.00	1,500.00	**[ICRA]AA+ (Stable)**	**[ICRA]AA+ (Stable)**	**[ICRA]AA+ (Stable)**	**[ICRA]AA(hyb) (Stable)**
2	**Basel III Tier II Bonds**	LT	7,900.00	7,900.00	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AA+(hyb) (Stable)**
3	**Basel III Tier II Bonds**	LT	3,500.00	2,000.00^	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	-	-

LT – Long term; ST – Short term; ^ Balance yet to be issued; In compliance with the circular issued by the Securities and Exchange Board of India (SEBI) on July 16, 2021 for standardising the rating scales used by credit rating agencies, ICRA has discontinued its practice of affixing the (hyb) suffix alongside the rating symbols for hybrid instruments

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 Tier 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)
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)

^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 (AT-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 and 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 coupon payments. 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[1] created via 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 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 on 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 8.02% of RWAs as on March 31, 2023.

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. However, the transition to the ECL framework and its impact on the capital and DRs remain monitorable.

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

[1] 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

Company Name	Ownership*	Consolidation Approach
Canbank Factors Ltd.	70.00%	Limited Consolidation
Canbank Computer Services Ltd.	69.14%	Limited Consolidation
Canara HSBC Life Insurance Company Ltd.	51.00%	Limited Consolidation
Canara Robeco AMC Ltd.	51.00%	Limited Consolidation
Andhra Pragathi Grameena Bank	35.00%	Limited Consolidation
Karnataka Gramin Bank	35.00%	Limited Consolidation
Karnataka Vikas Grameena Bank	35.00%	Limited Consolidation
Kerala Gramin Bank	35.00%	Limited Consolidation
Can Fin Homes Ltd.	29.99%	Limited Consolidation
Higher Education Financing Agency	9.09%	Limited Consolidation

Source: Canara Bank, ICRA Research; As on March 31, 2023

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About ICRA Limited:

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