October 01, 2024

Bandhan Bank Limited: Long-term rating downgraded to [ICRA]AA- (Stable) and outlook revised to Stable; Short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
NCD programme	75.00	75.00	[ICRA]AA- (Stable); downgraded from [ICRA]AA (Negative) and outlook revised to Stable from Negative
Term loans	80.00	0.00	[ICRA]AA- (Stable); downgraded from [ICRA]AA (Negative), outlook revised to Stable from Negative and rating withdrawn
Certificates of deposit	3,000.00	3,000.00	[ICRA]A1+; reaffirmed
Total	**3,155.00**	**3,075.00**	

**Instrument details are provided in Annexure I*

Rationale

The downgrade in the long-term ratings of Bandhan Bank Limited (Bandhan) reflects the sustained weakness in the emerging entrepreneur business (EEB) portfolio, which is likely to continue, given the concerns regarding borrower-level overleveraging in the sector. ICRA notes that the bank's gross stress pool {SMA[1]-1 & 2 in EEB portfolio and overall gross non-performing advances (GNPAs)} has declined, though at a slower-than-anticipated pace and driven by significant write-offs in FY2023 and FY2024, leading to high credit costs. Consequently, its profitability has remained subpar in relation to the pre-Covid-19 pandemic levels.

Bandhan's capital cushions have also declined as a result of bank's interpretation of RBI's notification[2] leading to increase in the risk weights on certain exposures to 125%, which was previously calculated at a risk weight of 75%. In addition to affecting the capital cushions, this may pose challenges for growth or absorbing unexpected stress from the asset quality if internal capital generation remains weak. In addition, the bank's profitability gets impacted by the absence of income from sale of priority sector lending certificate (PSLC) and continuing balances in the low-yielding Rural Infrastructure Development Fund (RIDF) deposits, though the same would mature in the coming years. ICRA also takes note of the senior management exits in the bank in the recent past along with the appointment of a nominee director by the RBI to oversee the management transition on the board in June 2024, though at the same time there has been strengthening of the senior management team.

Bandhan's net stress book has also witnessed moderation. However, the sufficiency of provisions on the same will depend on the timely completion of the ongoing audit by the National Credit Guarantee Trustee Company Ltd (NCGTC) and the receipt of claims against these stressed loans under various schemes of the Government.

The revision in the outlook to Stable reflects ICRA's expectation that the bank will be able to generate sufficient internal capital for growth and maintain adequate capital cushions while navigating the challenges that may arise from the asset quality.

ICRA has withdrawn the rating assigned to Bandhan's term loan facility at its request as the bank has not utilised the same and no amount is outstanding against the same. This is in accordance with ICRA's policy on the withdrawal of credit ratings.

[1] SMA is defined as a special mention account (SMA), which is an account exhibiting signs of incipient stress resulting in the borrower defaulting in the timely servicing of their debt obligations though the account has not yet been classified as an NPA as per the extant RBI guidelines; SMA-1 accounts are overdue by 31-60 days while SMA-2 accounts are overdue by 61-90 days

[2] Bandhan's management has interpreted the circular in a way that it is applicable to banks as well and hence they applied higher risk weights, though some other banks have not applied the same citing different interpretation

Key rating drivers and their description

Credit strengths

Long track record in microfinance loan segment – The bank has a long track record in the microfinance industry and has operational experience of more than two decades. Consequently, it has high customer vintage, loyalty and a strong connect with its microloan customers. However, the pandemic has severely impacted the debt-servicing ability of the borrowers, leading to significant deterioration in the asset quality. While Bandhan has diversified into secured lending (housing, 23% of advances as on June 30, 2024) through its merger with GRUH Finance Limited in FY2020, along with expansion of new products like commercial banking (22% of advances as on June 30, 2024), microloans (or EEB segment) continued to account for 49% of its loan portfolio as on June 30, 2024. Given its presence in the microloan segment, the operating profitability remains strong. Nevertheless, the marginal borrower profile makes the portfolio vulnerable to any episodic events, which may translate into high credit costs.

Capitalisation metrics, though moderated, remain adequate; recovery from stressed pool remains monitorable – Bandhan's capitalisation profile witnessed a moderation with a Tier I ratio and a capital-to-risk weighted assets ratio (CRAR) of 14.8%[3] and 15.7%, respectively, as on June 30, 2024 (18.80% and 19.8%, respectively, as on June 30, 2023) because of the increased risk weight of 125% for microfinance exposures. Despite the moderation, the bank continues to maintain adequate Tier I capital cushion vis-à-vis the minimum regulatory ratio (9.5% including capital conservation buffer). Apart from the increase in risk-weighted assets (RWAs), the capitalisation metrics have been on a declining trajectory on account of loan book growth amid moderation in profitability from past levels. The bank last raised equity capital of Rs. 3,662 crore in FY2018 as a part of its initial public offering (IPO) and, since then, its capital position has largely been supported by internal accruals.

Bandhan's ability to grow while maintaining/improving its capitalisation profile would remain contingent upon the restoration of its profitability, which will remain a function of credit costs. Moreover, credit costs will depend on the timely receipt of claims against the stressed loans under various schemes of the Government (ECLGS[4], CGFMU[5] and AMFIRS[6]).

Healthy growth in deposits with higher share of retail deposits – The overall deposit base expanded by 22.8% year-on-year (YoY) to Rs. 1,33,210 crore as on June 30, 2024. While the share of current and savings account (CASA) deposits was low at 33% of total deposits as on June 30, 2024 (36% as on June 30, 2023), the bank continues to have a high share of retail deposits at 69% of total deposits as on June 30, 2024 (71% as on June 30, 2024). Deposit growth is also supported by the higher interest rate proposition on deposits (including savings deposits), due to which the cost of interest-bearing fund remained high at 6.28% in Q1 FY2025 compared to the private sector bank average (PVB) of 5.42%. Given the loan book mix, the yields on average earning assets remain high at 13.48% in Q1 FY2025 compared to PVB average of 8.96%, which supports net interest margins.

Credit challenges

Asset quality remains a monitorable, given the presence in marginal borrower profile segment – Although, the fresh NPA generation rate moderated to 2.97% (annualised) of the standard advances in Q1 FY2025, it remained elevated at 5.48% in FY2024 (10.46% in FY2023, 11.97% in FY2022). The sustainability of slippage rate however remains monitorable.

The gross EEB stress pool reduced to Rs. 4,487 crore (7.2% of EEB portfolio) as on June 30, 2024 from Rs. 6,238 crore (12.2%) as on June 30, 2023. Additionally, the bank has witnessed stress in its housing loan portfolio, with a high level of overdues. With weak recoveries from the stress pool, elevated write-offs have led to subpar profitability. The net stressed book at the bank level also reduced to Rs. 2,263 crore or 1.8% of standard advances or 10.7% of the Tier I capital as on June 30, 2024. This

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[3] Including Q1 FY2025 profit
[4] ECLGS: Emergency Credit Line Guarantee Scheme
[5] CGFMU: Credit Guarantee Fund for Micro Units
[6] AMFIRS: Assam Microfinance Incentive and Relief Scheme

reflected an improvement from 16.6% of standard advances and 84.2% of Tier I capital as on September 30, 2021, driven by partial recoveries as well as write-offs.

Despite the reduction in its net stress book, Bandhan's asset quality remains monitorable, given the concerns of overleveraging by microloan borrowers, the marginal profile of the borrowers and portfolio vulnerability to episodic events that may translate into higher credit costs. The bank's ability to contain slippages in the EEB segment and ensure timely recoveries from the stress pool will be a key credit monitorable.

High geographical concentration of loan portfolio – While Bandhan has increased its pan-India presence across 35 states and Union Territories (UTs), 55% of the banking outlets were in the eastern and north-eastern regions as on June 30, 2024. Its advances and deposits have high geographical concentration in the eastern and north-eastern regions of India (41% of advances as on June 30, 2024), specifically West Bengal and Assam, owing to the concentration of the branch network. This exposes the bank to event risks and economic conditions, especially in these geographies. Following the merger with GRUH, Bandhan has diversified geographically, especially in the western part of India. However, ICRA expects portfolio concentration to continue in these regions in the medium term, given the size of the existing portfolio and branch network.

Environmental and social risks

Environmental considerations – Given the service-oriented business of Bandhan, its direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material. While it does not face any material physical climate risks, it is exposed to environmental risks indirectly through its portfolio of assets. However, such risk is unlikely to be material because the bank benefits from portfolio diversification. Further, the lending is usually short-to-medium term, which allows Bandhan to adapt while taking incremental exposures on less environmentally vulnerable businesses.

Social considerations – Data security and customer privacy are among the key sources of vulnerability for Bandhan as any material lapse could be detrimental to its reputation and could invite regulatory censure. Customer preference is increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. However, the possibility of subpar execution of the information technology strategy, and thus the inability to adequately meet the customers' needs, could result in more costs than benefits.

On the positive side, Bandhan contributes towards enhancing financial inclusion by providing several products and services that are specifically targeted towards the marginalised sections of society and attempts to address and cater to social concerns. Prudent lending to such underserved segments could create growth opportunities. However, such growth opportunities must be seen in conjuncture with the asset quality risks that could impact the bank's credit quality.

Liquidity position: Strong

Bandhan's largely stable deposit profile, coupled with the short tenure of microloans, mainly supports its strong liquidity profile. The daily average liquidity coverage ratio (LCR) remained strong at 166% for Q1 FY2025, while the net stable funding ratio (NSFR) stood at 123.2%, with both remaining above the regulatory level of 100%. Further, the bank had positive cumulative mismatches of 2.5% of the total outflows in the up to 1-year maturity bucket, as per its structural liquidity statement for August 15, 2024.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the bank witnesses an improvement in its earnings profile, with a return on assets (RoA) of 2.5%, and maintains a Tier I capital of more than 18% while ensuring that the net stress book (NPA + SMA-1 + SMA-2) remains below 3.5% of the portfolio on a sustained basis.

Negative factors – ICRA could downgrade the ratings on a deterioration in the asset quality, with an increase in the net stressed book to more than 5% of the bank's portfolio and a decline in the Tier I ratio to less than 13%.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions ICRA's Policy on Withdrawal of Credit Ratings
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financials of Bandhan

About the company

The erstwhile Bandhan Financial Services Private Limited (BFSL) was the largest non-banking financial company-microfinance institution (NBFC-MFI) in India and the first entity to receive an in-principle universal banking licence from the RBI. Following the transfer of BFSL's business to the bank, Bandhan Bank Limited (Bandhan) commenced operations in August 2015.

Bandhan was incorporated in December 2014 as a wholly-owned subsidiary of Bandhan Financial Holdings Limited (BFHL). On August 3, 2020, BFHL diluted its stake in Bandhan to 40% to comply with the regulatory requirement on promoter holding in the bank. Earlier, BFHL's stake was diluted to 82.28% upon the initial public offering by Bandhan in March 2018 and later to 60.96% upon the amalgamation with GRUH (housing finance company with a presence in 11 states and one UT through 195 GRUH centres, most of which are in the western part of India) in October 2019. BFHL is now required to further reduce its shareholding in the bank to 26% by August 2030.

Bandhan has its headquarters in Kolkata and follows the group-based individual lending model for the microfinance business. As on June 30, 2024, Bandhan had a network of 6,297 branches, banking units or doorstep service centres (DSCs) and GRUH centres, spread across 35 states and UTs.

Key financial indicators (audited)

Bandhan	FY2023	FY2024	Q1 FY2025
Total income#	11,814	12,490	3,533
Profit after tax	2,195	2,230	1,063
Total assets^ (Rs. lakh crore)	1.56	1.78	1.73
CET I / Tier I	18.70%	17.20%	14.83%*
CRAR	19.80%	18.30%	15.73%*
PAT / ATA	1.58%	1.39%	2.42%
Gross NPAs	4.87%	3.84%	4.23%
Net NPAs	1.17%	1.11%	1.15%

Source: Bandhan Bank, ICRA Research; Amount in Rs. crore unless mentioned otherwise
Note: Quarterly results are unaudited; annual results are audited
 # Total income includes net interest income and non-interest income excluding trading income/loss
^Total assets and net worth exclude revaluation reserves
**Including Q1 FY2025 profit*

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
				Oct 01, 2024	Oct 19, 2023	Oct 28, 2022	Nov 9, 2021
1	Term loans*	LT	80.00	[ICRA]AA- (Stable); withdrawn	[ICRA]AA (Negative)	[ICRA]AA (Negative)	[ICRA]AA (Negative)
2	Certificates of deposit	ST	3,000.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Non-convertible debenture programme	LT	75.00	[ICRA]AA- (Stable)	[ICRA]AA (Negative)	[ICRA]AA (Negative)	[ICRA]AA (Negative)
4	Non-convertible debenture programme	LT	-	-	[ICRA]AA (Negative); reaffirmed and withdrawn	[ICRA]AA (Negative)	[ICRA]AA (Negative)
5	Non-convertible debenture programme	LT	-	-	-	[ICRA]AA (Negative); reaffirmed and withdrawn	[ICRA]AA (Negative)
6	Subordinated Tier II NCD	LT	-	-	-	-	[ICRA]AA (Negative); reaffirmed and withdrawn

**Amount is yet to be allocated*
LT – Long term; ST – Short term

Complexity level of the rated instruments

Instrument	Complexity Indicator
NCD programme	Very Simple
Term loans	Simple
Certificates of deposit	Very Simple

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	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term loans***	NA	NA	NA	80.00	[ICRA]AA- (Stable); withdrawn
INE580B07455	**Non-convertible debentures^**	Oct-30-2018	9.50%	Oct-30-2028	75.00	[ICRA]AA- (Stable)
INE545U16467	**Certificates of deposit**	Mar-27-2024	8.30%	Mar-05-2025	200.00	[ICRA]A1+
Unplaced#	**Certificates of deposit#**	NA	NA	7-365 days	2,800.00	[ICRA]A1+

**Amount yet to be allocated; ^ These NCDs were transferred to Bandhan from erstwhile GRUH Finance Limited as a part of the amalgamation*
Source: Bandhan Bank, ICRA Research; #As on September 17, 2024

Annexure II: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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