

January 08, 2026

Karnataka Bank Limited: Ratings reaffirmed; outlook on long-term rating revised to Stable from Positive

Summary of rating action

Instrument*	Previous rated amount (Rs. crore)	Current rated amount (Rs. crore)	Rating action
Basel III Tier II bonds	300.00	300.00	[ICRA]A+ (Stable); reaffirmed, outlook revised to Stable from Positive
Certificates of deposit	1,500.00	1,500.00	[ICRA]A1+; reaffirmed
Total	1,800.00	1,800.00	

*Instrument details are provided in Annexure I

Rationale

The revision in the outlook to Stable from Positive reflects ICRA's expectation of persisting pressure on Karnataka Bank Limited's (KBL) profitability amid the decline in its portfolio and the compression in the net interest margins (NIMs), which is likely to continue in the near term. Though it has been supported by low credit costs, the net profitability can face challenges due to a decline in the core operating profitability, in case the credit costs normalize. Additionally, ICRA takes note of the recent management churn, which can have a bearing on the bank's strategy and future growth prospects and the trend will remain monitorable. The ratings, however, continue to factor in KBL's comfortable capital buffers with Tier I capital of 19.3%¹ as on September 30, 2025, largely supported by internal accruals and the decline in the loan book in H1 FY2026. Over the medium term, the bank's ability to improve its credit growth trajectory and NIMs will be critical to sustainably improve its profitability.

The ratings also continue to factor in the bank's established and granular deposit franchise in southern India, its strong liquidity profile, with positive cumulative mismatches across all the less-than-one-year maturity buckets and a high liquidity coverage ratio (LCR). In addition, given its healthy capital and profitability profile, the impact of transitioning to expected credit loss (ECL) based loan loss provisioning is likely to be manageable.

ICRA also notes KBL's steady headline asset quality metrics and the declining share of vulnerable loans {overdue loan accounts, i.e. SMA² accounts (SMA-1 and SMA-2), standard restructured advances} of ~3% of standard advances as on September 30, 2025 (~4% as on September 30, 2024). The performance of the residual vulnerable book will remain a near-to-medium-term monitorable, particularly in light of the prevailing geopolitical environment. ICRA expects the bank to remain sufficiently capitalised with no regulatory or growth capital requirements in the near-to-medium term. Its ability to keep the asset quality under control despite the expected increase in slippage rates and improve its NIMs will be key for enhancing its profitability profile and maintaining sufficient capital cushions in the foreseeable future. Besides this, the ratings are constrained by the significant regional concentration of KBL's operations as well as the high share of its top exposures, in relation to the core capital, compared to peer banks.

¹ Excluding profit for H1 FY2026

² 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. The SMA-level data (SMA-1 and SMA-2) is for the entire bank, including exposures below Rs. 5 crore

Key rating drivers and their description

Credit strengths

Established regional franchise in Karnataka with granular deposit base – KBL has an established presence of over a century in southern India. Its long-standing regional franchise in Karnataka provides it with access to core retail deposits. The share of retail term deposits in total term deposits remained high. As a result, KBL's dependence on bulk deposits remains limited. Also, in terms of the granularity of deposits, the share of the top 20 deposits in the bank's total deposits remained the lowest among peers at 3.53% as on March 31, 2025 (3.74% as on March 31, 2024).

Notwithstanding the above, the relatively lower share of current account and savings account (CASA) deposits in the overall deposit base (31% as on September 30, 2025) vis-à-vis the private sector banks' (PVB) average (37%) resulted in a comparatively higher cost of interest-bearing funds. The bank's cost of average interest-bearing funds remained higher at 5.61% in H1 FY2026 (5.45% in FY2025) against the banking sector average of 5.22% (annualised).

Comfortable capitalisation levels – KBL's capitalisation profile remains comfortable with CET I and Tier I capital ratios of 19.3%⁴ each as on September 30, 2025 (15.9%³ each as on September 30, 2024), which continue to be comfortable compared to the respective regulatory requirements of 8.0% and 9.5%. The capital ratios were largely supported by healthy internal accruals, the equity capital raise of Rs. 1,500 crore in FY2024 and decline in the loan book in H1 FY2026. The current capital buffers with the expected internal accrual generation would aid KBL's growth plans for the medium term. The comfortable capital position will continue to provide a buffer against expected slippages from the vulnerable book over the near-to-medium term. Moreover, given the healthy capital and profitability profile, the impact of the proposed transition to ECL-based loan loss provisioning is expected to remain manageable.

Profitability declines in H1 FY2026, but remains healthy – KBL's return indicators remain healthy with an annualised return on assets (RoA) of 1.02% in H1 FY2026 (1.07% in FY2025), mainly supported by the decline in credit costs to 0.2% of average total assets (ATA; annualised) in H1 FY2026 from 0.2-1.6% during FY2018-FY2025. However, its NIM continued to trend below the PVB average (2.48% of ATA for KBL vs 3.51% for PVBs in H1 FY2026), given the significant share of low-yielding advances (including large exposures to strong corporates as well as deposits against the shortfall to meet priority sector lending targets) and the relatively higher cost of funds. Additionally, the lower share of non-interest income⁴ (0.99% of ATA vs 1.31% for PVBs in H1 FY2026) remains a drag on KBL's core operating profitability⁵, which was below the PVB average (1.33% of ATA vs 2.48% for PVBs in H1 FY2026).

The bank's return indicators remain sufficient to meet its growth requirements. While some compression could be expected in NIMs in the near term, ICRA expects the same to witness some improvement in the medium term due to deposit repricing. This, along with the anticipated growth in advances, would help increase the RoA. Nevertheless, amid the prevalent geopolitical issues, the ability to keep slippages at lower levels and sustain strong recoveries will be key for containing the credit costs and maintaining the healthy RoA and return on average equity (RoE).

Credit challenges

Asset quality remains monitorable – KBL's fresh NPA generation rate⁵ continued to be steady at 1.72% (annualised) in H1 FY2026 (1.71% in FY2025) but was lower than 2.80% in FY2024, while remaining below the PVB average (1.87% in H1 FY2026). With healthy recoveries and upgrades, the headline GNPA and net NPA (NNPA) ratios remained stable at 3.33% and 1.35%, respectively, as on September 30, 2025, compared to 3.21% and 1.46% respectively, as on September 30, 2024. Notwithstanding this, KBL's overdue book, i.e. SMA-1 and SMA-2, stood at 2.3% of standard advances as on September 30, 2025, while the standard restructured book stood at Rs. 939 crore (1.32% of standard advances). Accordingly, the overall potential vulnerable loans (SMA-1, SMA-2 and the standard restructured book, net of overlap) remained high at 22% of the core capital, as on September 30, 2025, but improved from 32% as on September 30, 2024 (58% as on December 31, 2023).

³ Excluding interim period profits

⁴ Excluding trading gains

⁵ Fresh NPA generation – Gross fresh slippages/Opening standard advances

KBL's ability to minimise slippages from the potential vulnerable book, which also remains high compared to peer banks, will be key for ensuring a continued improvement in its profitability levels and for maintaining the solvency⁶ at a comfortable level (8.6% as on September 30, 2025).

High geographical concentration – KBL's operations remain highly concentrated with South India and Karnataka accounting for ~79% and ~64%, respectively, of the total branches as on September 30, 2025. This exposes the bank to local and socio-economic and political risks. ICRA expects KBL's operations to remain regionally concentrated with the same unlikely to improve in the near-to-medium term. Further, some of the bank's exposures are large in relation to its core capital. KBL's top 20 exposures accounted for 109% of the core capital as on March 31, 2025, remaining high compared to peers, despite moderating from 121% as on March 31, 2024. However, ICRA notes that these large exposures are to corporates with strong credit profiles and for deploying excess liquidity; KBL's ability to redeploy these funds towards granular loan segments will be a driver of improved profitability.

Environmental and social risks

While banks like KBL do not face material physical climate risks, they are indirectly exposed to environmental risks through their asset portfolios. If entities or businesses to which banks and financial institutions have exposure face business disruptions due to physical climate adversities or transition risks arising from technological, regulatory or customer behaviour changes, these could translate into credit risks. However, such risks are not material for KBL, as it benefits from adequate portfolio diversification. Moreover, its 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. KBL has not faced such lapses over the years, underscoring its sensitivity to these risks. It operates responsibly in terms of selling practices, with no instances of regulatory fines for misconduct. Customer preference is increasingly shifting towards digital banking, providing opportunities to reduce operating costs. KBL has been at the forefront of 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 steadily improving asset quality numbers.

Liquidity position: Strong

KBL's strong liquidity profile is supported by the surplus statutory liquidity ratio (SLR) holding of 7.7% of net demand and time liabilities (NDTL) as on October 31, 2025, over and above the regulatory ask of 18% SLR requirement, partly supporting the positive cumulative gaps across all near-term maturity buckets as per the structural liquidity statement as on September 30, 2025. The bank's average LCR and net stable funding ratio (NSFR) stood at 188% and 149%, respectively, in Q2 FY2026, well above the regulatory requirement of 100%. In addition, access to call money markets and the Reserve Bank of India's (RBI) repo and marginal standing facility (MSF) in case of urgent liquidity needs aid KBL's liquidity profile.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the bank achieves meaningful growth in its business, maintains profitability with an RoA of more than 1.0% and ensures that its Tier I capital cushions remain above 3% while increasing the geographical diversification of its asset and liability base.

Negative factors – Deterioration in the asset quality with the solvency exceeding 20% or the RoA below 0.8% would be a negative factor. Additionally, weakening of the Tier I capital cushions with the same falling below 2% over the regulatory level or a deterioration in the liability franchise will be a negative trigger.

⁶ Solvency is defined as $\{(NNPAs + \text{Net security receipts} + \text{Net non-performing investments})/\text{Core capital}\}$

Analytical approach

Analytical approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions
Parent/Group support	Not applicable
Consolidation/Standalone	To arrive at the ratings, ICRA has considered the standalone financials of KBL. However, in line with ICRA's consolidation approach, the standalone assessment of the bank factors in the ordinary and extraordinary support that it is expected to extend to its subsidiary.

About the company

KBL is a mid-sized private sector bank set up in 1924 in Mangaluru. It had a market share of 0.4% in advances and total deposits in the Indian banking sector as on September 30, 2025. With an asset size of Rs. 1.19 lakh crore as on September 30, 2025, KBL is widely held by public individuals (60.1%), domestic institutions (16.1%), foreign institutional investors and foreign portfolio investors (14.6%), and corporate bodies and others (9.2%). It had a network of 955 branches and 1,488 ATM outlets as on September 30, 2025 with ~79% of its total branches in South India.

Key financial indicators (standalone)

Karnataka Bank Limited	FY2024	FY2025	H1 FY2026
Total income	4,504	4,495	2,089
Profit after tax	1,306	1,272	612
Total assets (Rs. lakh crore)	1.16	1.21	1.19
CET 1	16.17%	18.35%	19.28%*
CRAR	18.00%	19.85%	20.84%*
PAT/ATA	1.21%	1.07%	1.02%
Gross NPAs	3.53%	3.08%	3.33%
Net NPAs	1.58%	1.31%	1.35%

Source: KBL, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore unless mentioned otherwise; * Excludes H1 profit

Total income = Net interest income + Non-interest income (excluding trading gains)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Current (FY2026)				Chronology of rating history for the past 3 years					
Instrument	Type	Amount rated (Rs. crore)	Jan 08, 2026	FY2025		FY2024		FY2023	
				Date	Rating	Date	Rating	Date	Rating
Basel III Tier II bonds	Long term	300.00	[ICRA]A+ (Stable)	Jan-13-2025	[ICRA]A+ (Positive)	Feb-02-2024	[ICRA]A (Positive)	Mar-16-2023	[ICRA]A (Stable)
Basel III Tier II bonds	Long term	-	-	Jan-13-2025	[ICRA]A+ (Positive); withdrawn	Feb-02-2024	[ICRA]A (Positive)	Mar-16-2023	[ICRA]A (Stable)
Basel III Tier II bonds	Long term	-	-	-	-	Feb-02-2024	[ICRA]A (Positive); withdrawn	Mar-16-2023	[ICRA]A (Stable)
Certificates of deposit	Short term	1,500.00	[ICRA]A1+	Jan-13-2025	[ICRA]A1+	Feb-02-2024	[ICRA]A1+	Mar-16-2023	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity indicator
Basel III Tier II bonds	Highly Complex
Certificates of deposit	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
INE614B08054	Basel III Tier II bonds	Mar-30-2022	10.70%	Mar-30-2032 [^]	300	[ICRA]A+ (Stable)
NA	Certificates of deposit	NA	NA	NA	1,500	[ICRA]A1+

Source: KBL; Certificates of deposit (CD) outstanding was NIL as on December 26, 2025

[^] First call option due on March 30, 2027, with subsequent call dates on every anniversary of the coupon payment date and is subject to RBI approval as well as KBL's ability to meet the regulatory capital ratio requirements

Key features of rated debt instruments

The servicing of the rated certificates of deposit is not contingent on the capital ratios or the bank's profitability. However, the Basel III Tier II bonds are expected to absorb losses once the point of non-viability (PONV) trigger is invoked by the RBI. These bonds have equity-like loss-absorption features. Such features may translate into higher loss severity vis-à-vis conventional debt instruments.

Annexure II: List of entities considered for consolidated analysis

Company name	Ownership	Consolidation approach
KBL Services Limited	100%	Full consolidation

Source: KBL

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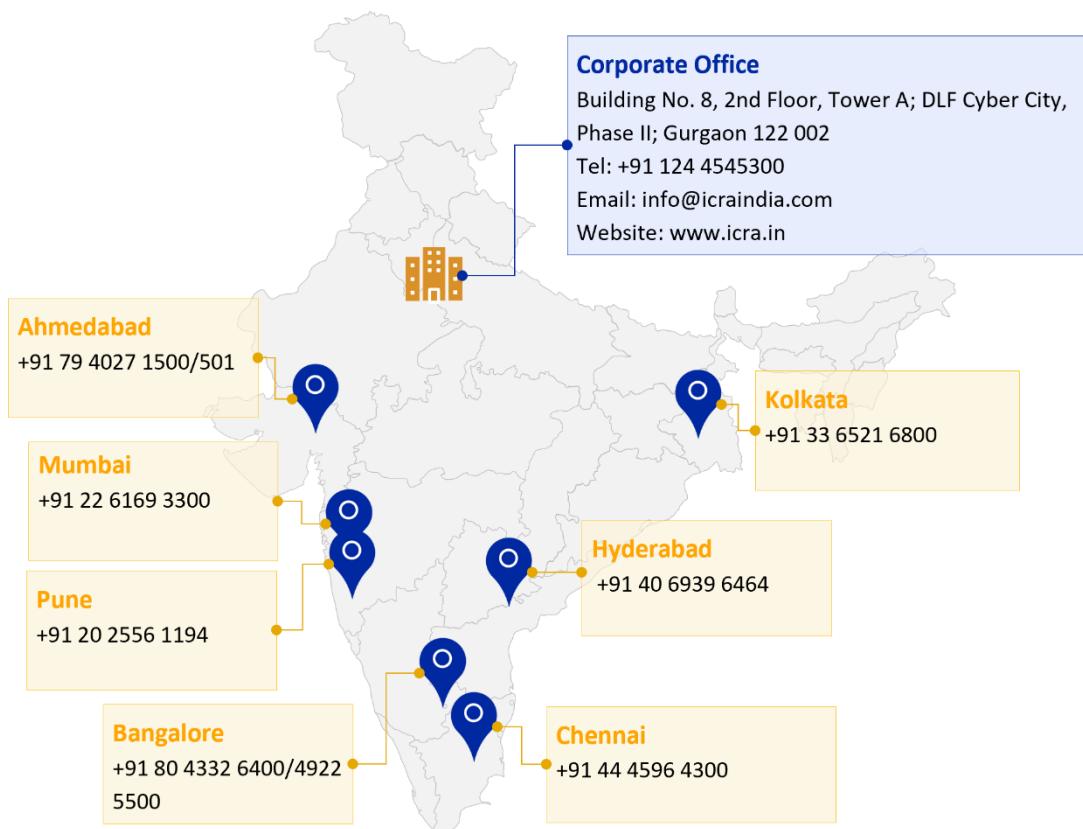
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