February 21, 2023 (Revised)

HDFC Bank Limited: [ICRA]AAA (Stable) assigned to Basel III Tier II and infrastructure bonds

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier II bonds	25,000.00	[ICRA]AAA (Stable); assigned
Infrastructure bonds	20,000.00	[ICRA]AAA (Stable); assigned
Total	45,000.00	

**Instrument details are provided in Annexure I*

Rationale

HDFC Bank Limited is one of the three systemically important banks and the largest private sector bank in India. It is a part of the HDFC Group (promoted by HDFC Limited; rated [ICRA]AAA (Stable)/[ICRA]A1+), with a presence in various segments in the financial services sector, which has supplemented the bank's strong growth over the years. Further, HDFC Limited is in the process of merging with the bank as a part of a composite scheme of arrangement announced in April 2022. The merged entity is expected to drive up its scale meaningfully from the current level and strengthen the bank's presence in certain retail segments and offer more opportunities to grow by virtue of the customer base that would be acquired.

The rating derives comfort from the bank's strong capitalisation profile, with the CET I at 16.44% of the risk-weighted assets (RWAs) as on December 31, 2022 (including 9M FY2023 profits), as well as its ability to raise capital as demonstrated in the past. HDFC Bank's capital positions are further reinforced by its healthy earnings profile and comfortable asset quality, leading to low credit costs. Additionally, the rating factors in the bank's strong and granular resource base, which is supported by its expansive retail franchise and widespread network of branches, which has contributed to one of the lowest cost of interest-bearing funds in the industry.

The Stable outlook on the rating reflects ICRA's expectation that HDFC Bank will continue to benefit from its retail franchise, which will support growth and profitability. Moreover, ICRA expects it to maintain the solvency (net non-performing advances (NPA)/core equity), return on assets (RoA) and capital cushions at levels better than the negative triggers, with the same expected to be sustained upon the conclusion of the merger with HDFC Limited.

Key rating drivers and their description

Credit strengths

Strong market position as largest private sector bank – HDFC Bank is one of the three systemically important banks in India with an 11.9% market share in the banking sector's advances as of September 30, 2022 and it is also the second largest bank in the country. It currently has two key subsidiaries, namely HDFC Securities Limited (engaged in securities broking) and HDB Financial Services Limited (a non-banking financial company; NBFC). The ongoing merger with HDFC Limited will bring additional subsidiaries/associates, including HDFC Asset Management Company Limited, HDFC Life Insurance Company Limited, HDFC Ergo General Insurance Company Limited and HDFC Credila Financial Services Limited, under its direct ownership/into its fold. While there have been arrangements among HDFC Group companies to cross-sell products, HDFC Bank with its post-merger subsidiaries/associates will have a wide presence across various financial services verticals like life insurance, general insurance, securities broking, asset management, etc. This will allow it to provide a diverse range of financial services to customers, thereby enhancing its customer engagement and retention strategy, particularly in the retail segments.

At the standalone level, the bank has continued to sustain a strong growth momentum, which has usually remained higher than the banking system's growth. Moreover, it managed to maintain a reasonably strong growth despite the Covid-19-induced challenges. As on December 31, 2022, HDFC Bank's overall net advances grew 19.5% year-on-year (YoY) to Rs. 15.07 lakh crore, led by the strong growth seen across segments.

Strong capitalisation profile – HDFC Bank's capitalisation ratios remained strong with the CET I and Tier I at 16.44% and 17.21%, respectively (including 9M FY2023 profits), as on December 31, 2022. The last capital raise by the bank was during July-August 2018 when its CET I was 12.12%[1] and it raised Rs. 23,716 crore (281 basis points (bps) of RWAs as on June 30, 2018). Subsequently, the bank's capital position has been supported by its healthy capital accretion, sustained over the years, even during extended periods of uncertainty, including the pandemic-affected years of FY2021-FY2022.

As per ICRA's estimates, HDFC Bank's current capital position and its internal capital generation are expected to support medium-term growth and absorb any unexpected asset quality shocks even after the conclusion of the merger, while remaining well above the negative triggers. All the subsidiaries (including the incoming subsidiaries upon the merger) are adequately capitalised and the bank will be able to provide requisite capital support if required. Furthermore, it has demonstrated the ability to raise significant capital in the past, which is expected to facilitate the raising of growth capital if needed.

Low cost of funds supported by extensive retail franchise – The bank's deposit base grew at a healthy pace to Rs. 17.33 lakh crore as on December 31, 2022 (19.9% YoY growth), driven by its widespread branch network. The low-cost current account and savings account (CASA) ratio stood at 44.0% as on December 31, 2022, which is comparable to the private sector average of ~44-45%. Additionally, the share of the top 20 depositors in total deposits stood at 3.90% as on March 31, 2022, the lowest among peer banks, reflecting the granularity of the deposit base. HDFC Bank has continued to maintain a competitive cost of interest-bearing funds in relation to the private sector average and large peer banks, even while continuing to mobilise deposits at a heathy pace.

Going forward, it is expected to benefit from HDFC Limited's deposit base (Rs. 1.62 lakh crore as on December 31, 2022) and sizeable long-term borrowings, which will be eligible for infrastructure bonds after the merger. Given the long tenor of HDFC Limited's assets, the bank's ability to garner retail deposits at a faster pace will be a driver of its liquidity profile.

Earnings profile expected to remain healthy – HDFC Bank's profitability levels are supported by the strong and consistent growth in net advances, steady fee income and comfortable asset quality levels, resulting in robust operating profitability. Furthermore, despite the relatively elevated credit costs in relation to the past, the overall profitability levels have remained healthy with the RoA at 1.94-1.96% during FY2022-9M FY2023. Additionally, the sizeable floating and contingency provision of Rs. 10,851 crore (0.72% of standard advances), as on December 31, 2022, is expected to provide adequate relief from potential future asset quality stress. Going forward, the bank is expected to continue to maintain its profitability levels, which will support its growth targets.

Credit challenges

Impact of material weakening of macroeconomic factors a monitorable – HDFC Bank has consistently maintained comfortable asset quality levels over the years, which has also kept its credit costs at a lower level. The fresh NPA generation rate increased relatively during FY2022-9M FY2023 (annualised rate of 2.38% and 1.91%, respectively) due to the impact of the pandemic. Nevertheless, the headline asset quality metrics have remained comfortable with the gross NPAs (GNPAs) at 1.23% and net NPAs (NNPAs) at 0.33% as on December 31, 2022. This was supported by meaningful recoveries and upgrades, given the granularity of the slippages in the recent past. Going forward, ICRA expects the overall asset quality metrics to remain at comparable levels, although a severe impact due to the material weakening of macroeconomic factors such as the steep rise in interest rates, currency depreciation and high inflation could remain a monitorable for the asset quality.

[1] As on June 30, 2018, as per Basel III disclosures

Environmental and social risks

While banks like HDFC Bank 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 a risk is not material for HDFC Bank 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 lesser downside environmental risks. Consequently, while the bank does not face material climate risks in the near to medium term, such risks could materialise in the long term.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as any material lapses could be detrimental to its reputation and invite regulatory censure. After the instances of technical outages faced by HDFC Bank, the regulator had imposed restrictions on some of its business activities in December 2020. Subsequently, the bank made requisite investments to enhance its digital interface and all these restrictions were lifted by the regulatory body in March 2022. HDFC Bank is generally seen to be operating responsibly in terms of its selling practices and it contributes to promoting financial inclusion by lending to the under-served segments. Its lending practices remain prudent, as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Superior

HDFC Bank's (consolidated) daily average liquidity coverage ratio (LCR) stood at 113% in Q3 FY2023, which is above the regulatory requirement of 100%. However, strong credit growth led to a relative moderation from higher levels (123% in Q3 FY2022). Similarly, the net stable funding ratio (NFSR) stood at 116%, which exceeded the regulatory ask of 100%. Besides this, HDFC Bank maintains statutory liquidity ratio (excess SLR) holdings, which are significantly above the regulatory level. This can be utilised to avail liquidity support from the Reserve Bank of India (RBI; through repo) apart from the marginal standing facility of the RBI in case of urgent liquidity requirement.

Rating sensitivities

Positive factors – Not applicable as the rating for all the instruments is at the highest possible level

Negative factors – ICRA could assign a Negative outlook or downgrade the rating if there is a material deterioration in the asset quality or capital position, leading to the weakening of the solvency profile with net NPA/core equity exceeding 15% on a sustained basis. Further, a sustained RoA of less than 1.0% (annualised) and/or a decline in the capital cushions over the regulatory levels to less than 4% at the CET I level on a sustained basis will remain negative triggers. A material weakening in the bank's liability franchise, thereby impacting its resource profile, will also remain a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions ICRA's Rating Methodology on Consolidation
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the rating, ICRA has considered the standalone financials of HDFC Bank. However, in line with ICRA's limited consolidation approach, the capital requirement of the bank's subsidiaries, going forward (including those that will become subsidiaries/associates upon the merger with HDFC Limited), has been factored in. In ICRA's view, the bank's subsidiaries are well capitalised and largely self-sufficient for their growth capital requirements and any capital infusion in the near to medium term in the subsidiaries is expected to remain limited in relation to the bank's overall profits.

About the company

HDFC Bank Limited is a systemically important as well as the largest private sector bank in India with an 11.9% market share in the banking sector's advances as on September 30, 2022. It is promoted by HDFC Limited (19.01% shareholding as on December 31, 2022), which has a presence in the banking, insurance (HDFC Life Insurance Company Limited and HDFC Ergo General Insurance Company Limited), education loans (HDFC Credila Financial Services Limited), and asset management (HDFC Asset Management Company Limited) segments and is a large player in the Indian financial system. On April 4, 2022, a composite scheme of amalgamation was announced, wherein HDFC Limited will amalgamate into HDFC Bank Limited. While the process of receiving various customary and regulatory approvals is underway, the bank's overall size after the merger will increase significantly. Besides this, HDFC Limited's subsidiaries will become direct subsidiaries/associates of the bank. Furthermore, given the retail-oriented nature of HDFC Limited's portfolio, the overall share of retail advances is expected to rise from the current level.

As of December 31, 2022, the bank had 7,183 branches. It has three overseas branches, one each in Dubai, Bahrain, and Hong Kong, as well as two representative offices, one each in the United Arab Emirates and Kenya. Further, it has an offshore banking unit at International Financial Services Centre (IFSC) in GIFT City, Gandhinagar (Gujarat).

HDFC Limited

HDFC, India's largest housing finance entity, has been in existence for over 40 years. It reported a total income of Rs. 43,532 crore on an asset base of Rs. 7.10 lakh crore in 9M FY2023 compared to Rs. 47,990 crore and Rs. 6.41 lakh crore, respectively, in FY2022. It reported a profit after tax (PAT) of Rs. 11,814 crore in 9M FY2023 compared to Rs. 13,742 crore for the year ended March 31, 2022.

Key financial indicators (standalone)

HDFC Bank Limited	FY2021	FY2022	9M FY2022	9M FY2023
Net interest income	64,880	72,010	55,137	63,490
Profit before tax	41,659	49,015	35,971	42,550
Profit after tax	31,117	36,961	26,906	32,061
Net advances (Rs. lakh crore)	11.33	13.69	12.61	15.07
Total assets (Rs. lakh crore)	17.47	20.69	19.38	22.95
CET I	16.85%	16.67%	17.10%*	14.70%*
Tier I	17.56%	17.78%	18.37%*	15.47%*
CRAR	18.79%	18.89%	19.53%*	17.66%*
Net interest margin / ATA	3.96%	3.77%	3.85%	3.88%
PAT / ATA	1.90%	1.94%	1.95%	1.96%
Return on net worth	15.27%	15.39%	16.80%	16.84%
Gross NPAs	1.32%	1.17%	1.26%	1.23%
Net NPAs	0.40%	0.32%	0.37%	0.33%
Provision coverage excl. technical write-offs	69.81%	72.69%	70.79%	73.22%
Net NPA / Core equity capital	2.39%	1.95%	2.16%	2.22%

Source: HDFC Bank Limited, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore unless mentioned otherwise

** As per Basel III disclosures, excluding 9M profits*

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 (Rs. crore)	Amount outstanding as of Feb 21, 2023 (Rs. crore)	Date & rating in FY2023 Feb 21, 2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
1	**Basel III Tier II bonds**	Long term	25,000	-^	[ICRA]AAA (Stable); assigned	-	-	-
2	**Infrastructure bonds**	Long term	20,000	-^	[ICRA]AAA (Stable); assigned	-	-	-

^ *Balance amount yet to be placed*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Basel III Tier II bonds	Highly Complex
Infrastructure bonds	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
Unplaced	**Basel III Tier II bonds**	-	-	-	25,000	[ICRA]AAA (Stable); assigned
Unplaced	**Infrastructure bonds**	-	-	-	20,000	[ICRA]AAA (Stable); assigned

Source: HDFC Bank

Key features of rated debt instruments

The servicing of the Basel III Tier II bonds and infrastructure bonds is not subject to any capital ratios and profitability. However, the Basel III Tier II bonds are expected to absorb losses once the point of non-viability (PONV) trigger is breached in the RBI's opinion. The rated Basel III Tier II instruments are hybrid subordinated debt instruments with 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
HDFC Securities Limited	95.6%	Limited Consolidation
HDB Financial Services Limited	94.9%	Limited Consolidation

Source: HDFC Bank

Corrigendum

Rationale dated February 21, 2023, has been revised with changes as below:

– Addition of "ICRA's Rating Methodology on Consolidation" in the analytical approach section

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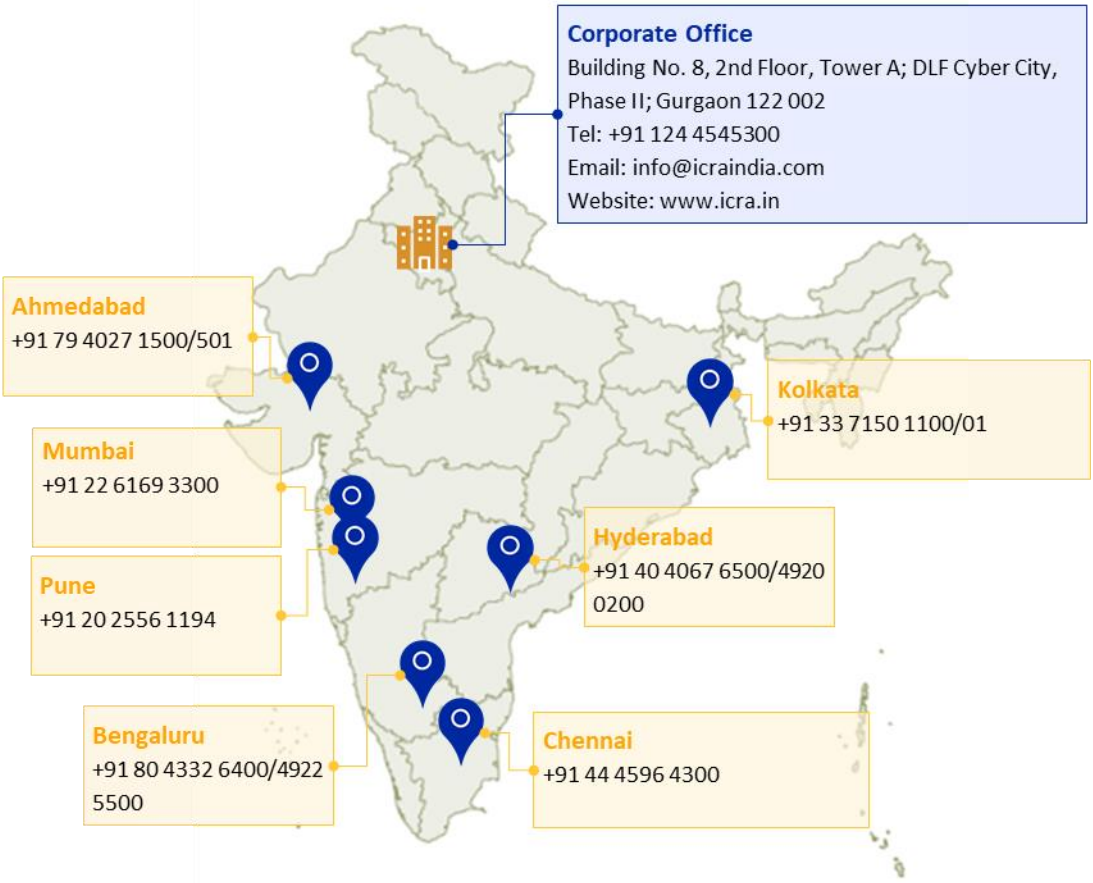

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