September 30, 2021

Central Bank of India: Rating reaffirmed; outlook changed to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel II Lower Tier II Bonds	500.00	500.00	[ICRA]A+ reaffirmed; Outlook revised to Stable from Negative
Basel III Compliant Tier II Bonds	2,000.00	2,000.00	[ICRA]A+ reaffirmed; Outlook revised to Stable from Negative
Total	**2,500.00**	**2,500.00**	

Instrument details are provided in Annexure-1

Rationale

The revision in the outlook factors in an improvement in Central Bank of India's (CBI) capital cushions and solvency profile, driven by the Rs. 4,800-crore capital infusion by the Government of India (GoI). The size of the capital infusion remains broadly in line with our earlier expectations and will support the bank towards exiting the Reserve Bank of India's (RBI) Prompt Corrective Action (PCA) framework. The rating for CBI continues to factor in its majority sovereign ownership (GoI shareholding of 93.08% as on June 30, 2021).

The rating reaffirmation takes into account the bank's well-established deposit franchise with a strong current account and savings account (CASA) base that also augments its strong liquidity profile. The rating also factors in the reduction in net non-performing assets (NNPAs) to 5.09% as on June 30, 2021 (6.76% as on June 30, 2020) with an increase in the provision coverage levels. With the reduction in the NNPAs, the solvency[1] improved to 39.9% as on June 30, 2021 (91.7% as on March 31, 2020) and the same is likely to be on an improving trajectory going forward.

The rating, however, continues to be constrained by the continued asset quality pressure with high gross fresh slippages in FY2021 (4.4% of standard advances) and Q1 FY2022 (5.2% annualised). Moreover, the SMA[2] 1 and SMA 2 advances stood high at 6.4% of the standard advances in addition to the standard restructured book, which stood at 5.5% of standard advances as on June 30, 2021. ICRA expects this will continue to pose challenges to the asset quality, though the improved provision coverage ratio (PCR) on legacy stressed assets and recoveries from the same will moderate the credit provisioning requirements on incremental fresh slippages.

While the management has guided towards a slippage rate of 2.0-2.5% and credit cost of 1.5% of advances in FY2022, ICRA expects the bank to largely absorb credit provisions from its operating profits even in a stress case scenario of higher slippages. ICRA expects the return on assets (RoA) to remain positive at >0.1% from FY2022 while the NNPAs are expected to remain below 5.0%. In case the slippages are not offset by the targeted recoveries, the RoA and return on equity (RoE) may remain below average.

The Stable outlook factors in the improved prospects of the bank for exiting the PCA framework and resuming business growth, which will be a positive from a profitability perspective. ICRA estimates that CBI remains sufficiently well capitalised with limited incremental capital requirements for regulatory or growth requirements.

[1] *Solvency = (Net NPA + Net non-performing investments and Net security receipts)/Core capital*

[2] *SMA or special mention accounts are accounts that are overdue; SMA 1 accounts are overdue by 31-60 days and SMA 2 accounts are overdue by 61-90 days*

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The rating continues to factor in the bank's majority sovereign ownership (93.08% equity shares held by the GoI as on June 30, 2021) and the demonstrated track record of capital infusion by GoI. ICRA also takes into consideration the capital infusion of Rs. 4,800 crore (3.2% of risk-weighted assets as on March 31, 2021) in CBI on March 31, 2021 as a part of the budgeted recapitalisation for public sector banks (PSBs) of Rs. 20,000 crore for FY2021. Further, given CBI's weak asset quality and capital position, the GoI had supported it with a capital infusion of Rs. 16,600 crore during FY2017-2020, which has supported its capitalisation ratios.

ICRA estimates that the bank is likely to have limited capital requirements for regulatory requirements and growth, though it may raise capital to maintain or improve the capital cushions over the regulatory requirements. ICRA expects the GoI to support CBI for its capital requirements, if needed.

Comfortable capital metrics and improved solvency profile – With a capital infusion of Rs. 4,800 crore by the GoI in March 2021, CBI's core equity capital ratio improved to 12.82% as on March 31, 2021 from 9.33% as on March 31, 2020. It further improved to 12.94% as on June 30, 2021. The solvency position improved post the capital infusion to 47.32% as on March 31, 2021 from 82.27% as on March 31, 2020 and is expected to be on an improving trajectory going forward with the expectation of declining NNPAs and improving internal capital generation.

Unlike previous years, when the GoI had infused capital through interest-bearing recapitalisation bonds, the capital infusion by the GoI in FY2021 was through zero-coupon bonds (ZCBs) that are redeemable at face value. The regulator has also expressed concerns on the recapitalisation of PSBs through ZCBs as their present value will be relatively lower. For CBI, these recapitalisation bonds accounted for 24% of its reported CET as on June 30, 2021. ICRA notes that even on an adjusted basis for the present value of these bonds, the capital and solvency numbers will remain comfortable. With ICRA's expectations of the NNPAs remaining below the PCA threshold, positive RoA on an incremental basis and capital ratios above the regulatory requirements, CBI's prospects for exiting the PCA framework stand improved, which will be a positive for its business growth and profitability.

Well-developed deposit franchise with strong CASA deposit base – CBI has a long-standing presence in the Indian banking system with an extensive network of over 4,594 branches as on June 30, 2021, of which ~64% are in the rural (35%) and semi-urban regions (29%), providing access to low-cost CASA deposits. The bank had a strong CASA base of 49.20% compared to the PSBs' average of 43% as on June 30, 2021. While the overall branch network remained stable, excluding a few branches that were closed to contain costs by rationalising relatively inefficient branches, the CASA deposits grew by ~8% YoY to Rs. 1.63 lakh crore as on June 30, 2021 (Rs. 1.62 lakh crore March 31, 2021). The cost of interest-bearing funds for CBI has been improving vis-à-vis the PSB average and stood at 3.98% in Q1 FY2022 (4.08% for PSBs) compared to 4.24% in FY2021 (4.41% for PSBs).

Credit challenges

Asset quality pressure likely to remain high – CBI's fresh NPA generation rate remained high at 4.4% of standard advances in FY2021 and 5.5% annualised in Q1 FY2022. Despite the elevated slippages, the SMA 1 and SMA 2 advances remain materially high at Rs. 9,436 crore (6.4% of the standard advances), which is in addition to the standard restructured book of 5.5% as on June 30, 2021, and could be vulnerable to slippage and remain a source of incremental stress for the bank in the near to medium term. In addition, CBI has an exposure of 0.8% of standard advances as on June 30, 2021, towards a stressed infrastructure finance company, which is not included in the above vulnerable exposures.

Unlike the past when the wholesale book accounted for the SMAs and restructured advances, lower ticket size loans account for a large portion of the current vulnerable book. While the management has guided towards a slippage rate of 2.0-2.5% for

FY2022, ICRA estimates that the overall fresh NPA generation could remain higher than the guidance in a stress case scenario, given the sizeable vulnerable book.

The bank has steadily increased the provision cover on its legacy NPAs and reduced its NNPAs below the PCA threshold of 6.0% (5.09% as on June 30, 2021). It has a sizeable pool of NPAs including written-off loans. With the increased PCR on legacy stressed assets and expected recoveries from these assets, ICRA expects that CBI should be able to able to maintain the NNPAs below 5% while absorbing the credit provisions through core operating profits. However, the extent of recoveries will be a critical driver of the credit costs and eventually the overall profitability.

Profitability and return metrics expected to remain weak – Despite the competitive cost of funds, CBI's core operating profitability (operating profitability excluding gains on bond portfolio) remained low at 0.91% of average total assets in FY2021 (1.07% in Q1 FY2022) compared to the PSBs' average of 1.5% (1.57% in Q1 FY2022). The weak core operating profitability was mainly due to the low credit-to-deposit ratio of 47% compared to the PSBs' average of 63% as on June 30, 2021, resulting in a sub-optimal yield on the assets. This, coupled with the weak asset quality, resulted in the credit costs surpassing the operating profitability of the bank since FY2016. The credit provisions are expected to moderate from FY2022, driven by reduced provisions on legacy stressed assets and recoveries thereof.

ICRA expects the bank to incrementally remain profitable with an RoA of >0.1%, though the overall profitability will remain dependent on an uptick in recoveries from big-ticket NPAs. Given the weak core operating profitability, the RoA may, however, remain <0.4% even in a scenario of strong recoveries from legacy NPAs. Hence, the RoA and RoE may remain below average in medium term.

Liquidity position: Strong

CBI had positive cumulative mismatches across all the maturity buckets up to 1 year as per the structural liquidity statement as on June 30, 2021. Supported by the high level of excess holding of Government securities (G-Secs) above the regulatory requirements and the strong deposit base of the bank, its daily average liquidity coverage ratio (LCR) stood at 378% in Q1 FY2022 (387% for FY2021) against the regulatory requirement of 100%. The excess G-Secs can be sold or utilised to avail liquidity support from the RBI in case of urgent liquidity needs.

Rating sensitivities

Positive factors – ICRA could change the outlook to Positive or upgrade the rating if the bank is able to improve the RoA >0.20% while maintaining capital cushions of 50-75bps over the regulatory level at Tier I (including capital conservation buffers) with the solvency remaining better than the 60% level on a sustained basis.

Negative factors – The rating will be reassessed in case of a change in the sovereign ownership. ICRA could also revise the outlook to Negative if the asset quality or capitalisation profile deteriorates, thereby resulting in the weakening of the solvency profile with the solvency becoming weaker than the 70% level on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	The rating factors in CBI's sovereign ownership and the demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support the bank with capital infusions, if required.
Consolidation/Standalone	To arrive at the rating, ICRA has considered the standalone financials of CBI. However, in line with ICRA's limited consolidation approach, the capital requirement of the Group's key subsidiaries, going forward, has been factored in.

About the company

Central Bank of India was incorporated in 1911. It was nationalised in 1969, along with 13 other major banks of India, by the GoI. Headquartered in Mumbai, CBI is a PSB with the GoI holding a stake of 93.08% as on June 30, 2021. CBI is a mid-sized PSB and is eight largest in terms of assets among 12 PSBs. It had a market share of 1.5% in advances and 2.3% in deposits in the Indian banking sector as on June 30, 2021.

For the year ended March 31, 2021, CBI reported a net loss of Rs. 888 crore on a total asset base of Rs. 3.65 lakh crore compared to a net loss of Rs. 1,121 crore on a total asset base of Rs. 3.65 lakh crore for the year ended March 31, 2020. The net profit and total asset base stood at Rs. 206 crore and Rs. 3.68 lakh crore, respectively, as on June 30, 2021. The CRAR stood at 14.88% (Tier I: 12.94%) as on June 30, 2021 (14.81% and 12.82%, respectively, as on March 31, 2021).

Key financial indicators (standalone)

	FY2020	FY2021	Q1 FY2022*
Net interest income – Rs. crore	7,629	8,245	2,134
Profit before tax – Rs. crore	(909)	(1,324)	622
Profit after tax – Rs. crore	(1,121)	(888)	206
Net Advances – Rs. lakh crore	1.51	1.57	1.55
Total assets^ – Rs. lakh crore	3.53	3.65	3.68
% Net interest margin / Average total assets	2.24%	2.29%	2.33%
% Return on assets	-0.33%	-0.25%	0.22%
% Return on net worth	-6.07%	-3.91%	3.60%
% CET/Tier I	9.33%	12.82%	12.94%
% CRAR	11.72%	14.81%	14.88%
% Gross NPA	18.92%	16.55%	15.92%
% Net NPA	7.63%	5.77%	5.09%
% PCR (excl technical write-offs)	64.61%	69.14%	71.66%
Solvency	91.7%	52.7%	39.9%

Source: *CBI & ICRA Research; ^ Excluding revaluation reserves*
** Unaudited; All ratios as per ICRA calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019		
					Sep-30-2021	Oct-23-2020	Sep-26-2019	Nov-30-2018	Aug-07-2018	May-07-2018
1	Lower Tier II Bonds	Long Term	500.00	500.00	[ICRA] A+ (Stable)	[ICRA] A+ (Negative)	ICRA] A+ (Negative)	[ICRA] A+ (Negative)	[ICRA] A+ (Negative)	[ICRA] A+ (Negative)
2	Upper Tier II Bonds	Long Term	-	-	-	-	[ICRA] A- (Negative);	[ICRA] A- &	[ICRA] A- &	[ICRA] A- (Negative)
3	Upper Tier II Bonds	Long Term	-	-	-	-	[ICRA] A- (Negative)	[ICRA] A- &	[ICRA] A- &	[ICRA] A- (Negative)
4	Upper Tier II Bonds	Long Term	-	-	-	[ICRA] A- (Negative)	ICRA] A- (Negative)	[ICRA] A- (Negative)	[ICRA] A- (Negative)	[ICRA] A- (Negative)
5	Upper Tier II Bonds	Long Term	-	-	-	[ICRA] A- (Negative)	ICRA] A- (Negative)	[ICRA] A- (Negative)	[ICRA] A- (Negative)	[ICRA] A- (Negative)
6	Basel III Tier II Bonds	Long Term	2,000.00	500.00^	[ICRA]A+(Stable)	[ICRA]A+ (hyb) (Negative	[ICRA]A+ (hyb) (Negative)	-	-	-

Source: *ICRA Research; & Rating under Watch Developing Implications*

^ Balance yet to be placed

Removal of (hyb) suffix from Basel III Tier II rating

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.

Accordingly, ICRA has removed the (hyb) suffix that was earlier being placed alongside the rating symbol for the hybrid instruments issued by CBI. The earlier and revised denotation of the rating for various instruments can be seen in the table above. This rating action only involves the removal of the (hyb) suffix and should not be construed as a change in the credit rating.

Complexity level of the rated instrument

Instrument	Complexity Indicator
Lower Tier II Bonds Programme	Simple
Basel III Compliant 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 instruments 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-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Call Option	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE483A09245	Basel II Lower Tier II Bond	Dec-21-11	No	9.33%	Dec-21-26	500.00	[ICRA]A+; reaffirmed; Outlook revised to Stable from Negative
INE483A08023	Basel III Tier II Bond	Sep-30-19	No	9.80%	Nov-30-29	500.00	[ICRA]A+; reaffirmed; Outlook revised to Stable from Negative
Unplaced	Basel III Tier II Bond	-	-	-	-	1,500.00	[ICRA]A+; reaffirmed; Outlook revised to Stable from Negative
Total						2,500.00	

Source: *CBI*

Key features of rated debt instruments

The servicing of the Basel II Lower Tier II Bonds and Basel III Tier II 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 invoked by the RBI. The Basel III Tier II Bonds have equity-like loss-absorption features. Such features may translate into higher loss severity vis-à-vis conventional debt instruments.

Annexure-2: List of entities considered for consolidated analysis

S. No.	Name of the Entity	Ownership	Consolidation Approach
1.	Cent Bank Home Finance Limited	64.40%	Limited Consolidation
2.	Centbank Financial Services Limited	100.00%	Limited Consolidation
3.	Uttar Bihar Gramin Bank, Muzaffarpur	35.00%	Limited Consolidation
4.	Uttarbanga Kshetriya Gramin Bank	35.00%	Limited Consolidation
5.	Indo Zambia Bank Limited	20.00%	Limited Consolidation

Source: *CBI, ICRA Research*

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