June 12, 2023

Central Bank of India: Ratings upgraded/assigned; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier I Bonds	-	1,000.00	[ICRA]A+ (Stable); assigned
Basel III Tier II Bonds	-	1,500.00	[ICRA]AA- (Stable); assigned
Basel III Tier II Bonds	2,000.00	2,000.00	[ICRA]AA- (Stable); upgraded from [ICRA]A+ (Positive)
Total	**2,000.00**	**4,500.00**	

**Instrument details are provided in Annexure I*

Rationale

Central Bank of India's (CBI) long-term rating has been upgraded, given the continued improvement in its capitalisation and solvency profile. Furthermore, its exit from the Reserve Bank of India's (RBI) prompt corrective action (PCA) framework supported growth, resulting in an increase in the credit-to-deposit ratio and an improvement in the operating profitability. This, coupled with further moderation in credit costs, shall support the bank's return indicators even though they have lagged the public sector average. The rating continues to factor in the sovereign ownership, with the Government of India's (GoI) shareholding at 93.08%, as well as the demonstrated capital support over the years. Moreover, with the higher provision on legacy stressed assets, the overall net non-performing advances (NNPAs) continued to remain on a downward trajectory. Incrementally, CBI's dependence on capital from the GoI in the near term remains limited, however impact of transitioning to provisioning based on the expected credit loss (ECL) framework will also remain a monitorable. Further, the rating continues to factor in CBI's well-established deposit franchise with a strong current account and savings account (CASA) base that also augments its strong liquidity profile, leading to a competitive cost of interest-bearing funds in relation to the public sector banks' (PSB) average.

Despite the relative improvement in the headline asset quality numbers and the continued moderation in the overall vulnerable/monitorable book (comprising SMA[1]-1, SMA-2 and the standard restructured book), the same remains high. In addition to this, few stressed exposures in the corporate book (largely comprising BB and below rated corporates) will also remain a monitorable from an asset quality perspective. Going forward, ICRA expects the credit costs to remain comparatively lower than the levels seen in recent years, which will support an improvement in the return on assets (RoA).

The Stable outlook on the ratings factors in ICRA's expectations that the bank will continue to report profitable operations, while continuing to further improve on its asset quality and solvency position while maintaining sufficient capital cushion above the regulatory levels.

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The ratings continue to factor in the bank's majority sovereign ownership (93.08% equity stake as on March 31, 2023) and the demonstrated track record of capital infusions by the GoI. ICRA also takes into consideration the capital infusion of ~Rs. 21,000 crore during FY2017-FY2021, including capital

[1]*SMA is defined as a special mention account; SMA-1 accounts are overdue by 31-60 days while SMA-2 accounts are overdue by 61-90 days*

support of Rs. 4,800 crore in FY2021 by way of zero-coupon bonds (ZCBs)[2]. Given the significant amount of capital received during the aforementioned period, the overall NNPAs were brought down to a much lower level while improving the overall capitalisation profile. Moreover, the bank is not expected to require capital in the near term. Further, as a part of the Union Budget, the GoI had proposed the divestment of two PSBs in the past. CBI's ratings will be reassessed in case of a change in the sovereign ownership.

Capitalisation profile and solvency continue to improve – CBIs capitalisation profile improved with the CET I {as a percentage of risk-weighted assets (RWA)} at 12.11% as on March 31, 2023 (11.48% as on March 31, 2022), supported by the improvement in internal capital accretion over the last two years. Besides this, the continued increase in the provision coverage ratio on legacy NPAs resulted in a sustained decline in the NNPA levels. Accordingly, the overall solvency levels (NNPA + Net non-performing investments (NPI) + Net security receipts (SRs) / Core capital) moderated to 17.90% as on March 31, 2023 (40.24% as on March 31, 2022).

Notwithstanding the expected improvement in the capitalisation profile, the 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 these provisions to 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.

Well-developed deposit franchise with strong CASA base – CBI has a long-standing presence in the Indian banking system with an extensive network of over 4,493 branches as on March 31, 2023, of which ~65% is in rural (36%) and semi-urban regions (29%), providing access to low-cost CASA deposits. CBI's share of low-cost CASA stood at 50.2% as on March 31, 2023, which remained meaningfully higher than the PSBs' average of 42.4%, thereby translating into a lower cost of interest-bearing funds for the bank. CASA, in turn, grew by 4.5% YoY to Rs. 1.80 lakh crore as on March 31, 2023 and will remain a source of support for the bank. Given the deposit mix and the low credit-deposit ratio, the bank has been able to maintain competitive cost of interest-bearing funds which is expected to continue to support the bank from a profitability perspective.

Credit challenges

Vulnerable book remains elevated; asset quality a monitorable – The overall gross fresh NPA generation eased to 2.52% of standard advances in FY2023 (3.20% in FY2022) and was materially lower than the elevated levels seen in the past (~6-14% over FY2017-FY2020). The provision coverage ratio also improved significantly, leading to a moderation in the NNPAs. Besides this, the bank's vulnerable book, comprising the SMA-1 and SMA-2 book, saw a relative moderation to Rs. 6,813 crore (3.42% of standard advances from 5.58% as on March 31, 2022), while the standard restructured book declined to Rs. 6,766 crore as on March 31, 2023 (3.39% of standard advances from 5.45% as on March 31, 2022). In addition to exposure to corporates rated BB and below, CBI has exposure to a stressed aviation/airline at ~1% of standard advances. 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, inflation levels have increased sharply recently, leading to the weakening of the Indian currency, faster monetary policy tightening and a sharp rise in the interest rates. The impact of the weakening macro-economic factors could also affect the debt-servicing ability of borrowers and remains a monitorable.

Profitability and return metrics improve but remain weaker than the industry average – CBI's core operating profitability (operating profitability excluding gains on bond portfolio) improved to 1.7% of average total assets in FY2023 (1.3% in FY2022) although it remained lower than the PSBs' average of 1.8% in FY2022 (1.5% in FY2022). This was supported by the competitive cost of funds, pickup in credit growth leading to a gradual increase in the credit-to-deposit ratio (60.86% as on March 31, 2023 from 55.63% as on March 31, 2022) and the moderation in the pace of fresh NPA generation. The improvement in the operating profitability, along with lower slippages and the higher provision cover on legacy NPAs, helped keep the credit costs lower than

[2] *These ZCBs were issued at face value and are redeemable at face value after the 10-15th year from issuance; accordingly, the fair value is lower than the face value. CBI has accounted for these ZCBs at fair value from its March 2022 financials*

the operating profitability during the last two years with the RoA at 0.40% in FY2023 (0.28% in FY2022 and losses for six consecutive years prior to that). ICRA expects the bank's profitability to largely remain at similar levels in the near term, though the overall profitability will remain dependent on recoveries from NPAs as well as the ability to ensure that fresh slippages remain at a lower level.

Environmental and social risks

While banks like CBI 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 CBI 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. CBI 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. CBI 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

CBI's strong liquidity profile is supported by its excess statutory liquidity ratio (SLR) holdings of ~10% of total deposits in Q4 FY2023, resulting in positive cumulative mismatches across all <1 year maturity buckets, as well as the liquidity coverage ratio (LCR) of 286% for Q4 FY2023 (daily average) against the regulatory requirement of 100%. The bank reported a net stable funding ratio (NSFR) of 162% in Q4 FY2023 against the regulatory requirement of 100%. It can also avail liquidity support from the RBI (through repo against excess SLR investments and marginal standing facility mechanism) in case of urgent liquidity needs.

Rating sensitivities

Positive factors – ICRA could revise the outlook to Positive and/or upgrade the ratings if the bank is able to improve its profitability, with an RoA of more than 0.6%, while maintaining the solvency profile with net stressed assets/core equity of less than 30% and Tier I cushions of more than 1% over the regulatory Tier I levels (including capital conservation buffers).

Negative factors – The ratings will be reassessed in case of a change in the sovereign ownership. ICRA could also revise the outlook to Negative and/or downgrade the ratings if the asset quality or capitalisation profile deteriorates, thereby weakening the solvency profile with net stressed assets/core equity exceeding 70% on a sustained basis. Additionally, a sharp deterioration in the profitability, leading to a weakening in the distributable reserves (DRs) eligible for the coupon payment on the Tier I bonds, will be a negative trigger for the rating on these bonds.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group support	The ratings factor in CBI'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 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 March 31, 2023. CBI is a mid-sized PSB and is the eighth largest, in terms of assets, among PSBs. It had a market share of 1.5% in advances and 2.0% in deposits in the Indian banking sector as on March 31, 2023. Furthermore, given the improvement in its performance over the last two years, the bank exited the RBI's prompt corrective action (PCA) framework in September 2022.

For the year ended March 31, 2023, CBI reported a profit of Rs. 1,582 crore on a total asset base of Rs. 4.03 lakh crore compared to a net profit of Rs. 1,045 crore on a total asset base of Rs. 3.83 lakh crore for the year ended March 31, 2022. The CRAR stood at 14.12% (Tier I: 12.11%) as on March 31, 2023 (13.84% and 11.48%, respectively, as on March 31, 2022).

Key financial indicators (standalone)

Central Bank of India	FY2021	FY2022	FY2023
Net interest income	8,245	9,487	11,687
Profit before tax	(1,324)	1,717	2,645
Profit after tax	(888)	1,045	1,582
Net advances (Rs. lakh crore)	1.57	1.68	2.03
Total assets (Rs. lakh crore)	3.65	3.83	4.03
CET I	12.82%	11.48%	12.11%
Tier I	12.82%	11.48%	12.11%
CRAR	14.81%	13.84%	14.12%
Net interest margin / ATA	2.29%	2.54%	2.98%
PAT / ATA	-0.25%	0.28%	0.40%
Return on net worth	-3.91%	4.39%	6.21%
Gross NPAs	16.56%	14.85%	8.44%
Net NPAs	5.77%	3.97%	1.77%
Provision coverage excl. technical write-offs	69.1%	76.2%	80.5%
Net NPA / Core equity capital	47.3%	39.2%	17.9%

Source: Central Bank of India, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore

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	Amount outstanding as of Jun 12, 2023	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
		(Rs. crore)	(Rs. crore)	Jun 12, 2023	Sep 23, 2022	Sep 30, 2021	Oct 23, 2020
1 Basel III Tier II Bonds	Long term	2,000	500^	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (hyb) (Negative)
	Long term	1,500	-	[ICRA]AA- (Stable)	-	-	-
2 Basel III Tier I Bonds	Long term	1,000	-	[ICRA]A+ (Stable)	-	-	-

^ *Balance amount yet to be placed*

Complexity level of the rated instruments

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
INE483A08023	**Basel III Tier II Bonds**	Sep-30-2019	9.80%	Nov-30-2029^	500.00	[ICRA]AA- (Stable)
Unplaced	**Basel III Tier II Bonds**	-	-	-	1,500.00	
Unplaced	**Basel III Tier II Bonds**	-	-	-	1,500.00	
Unplaced	**Basel III Tier I Bonds**	-	-	-	1,000.00	[ICRA]A+ (Stable)

Source: Central Bank of India
^ *With first call option after 62 months of issuance and annual coupon anniversary thereafter*

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 bonds and Tier I bonds is contingent upon the prior approval of the RBI, and the bank will also 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[3] created through 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 capital conservation buffer, 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 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 on 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 4.12% 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 CBI's profitability. However, transitioning 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	CBI Ownership	Consolidation Approach
Cent Bank Home Finance Limited	64.40%	Limited consolidation
Centbank Financial Services Limited	100.00%	Limited consolidation
Uttar Bihar Gramin Bank, Muzaffarpur	35.00%	Limited consolidation
Uttarbanga Kshetriya Gramin Bank	35.00%	Limited consolidation
Indo Zambia Bank Limited	20.00%	Limited consolidation

Source: Central Bank of India

[3] *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 appropriation from the profit and loss account*

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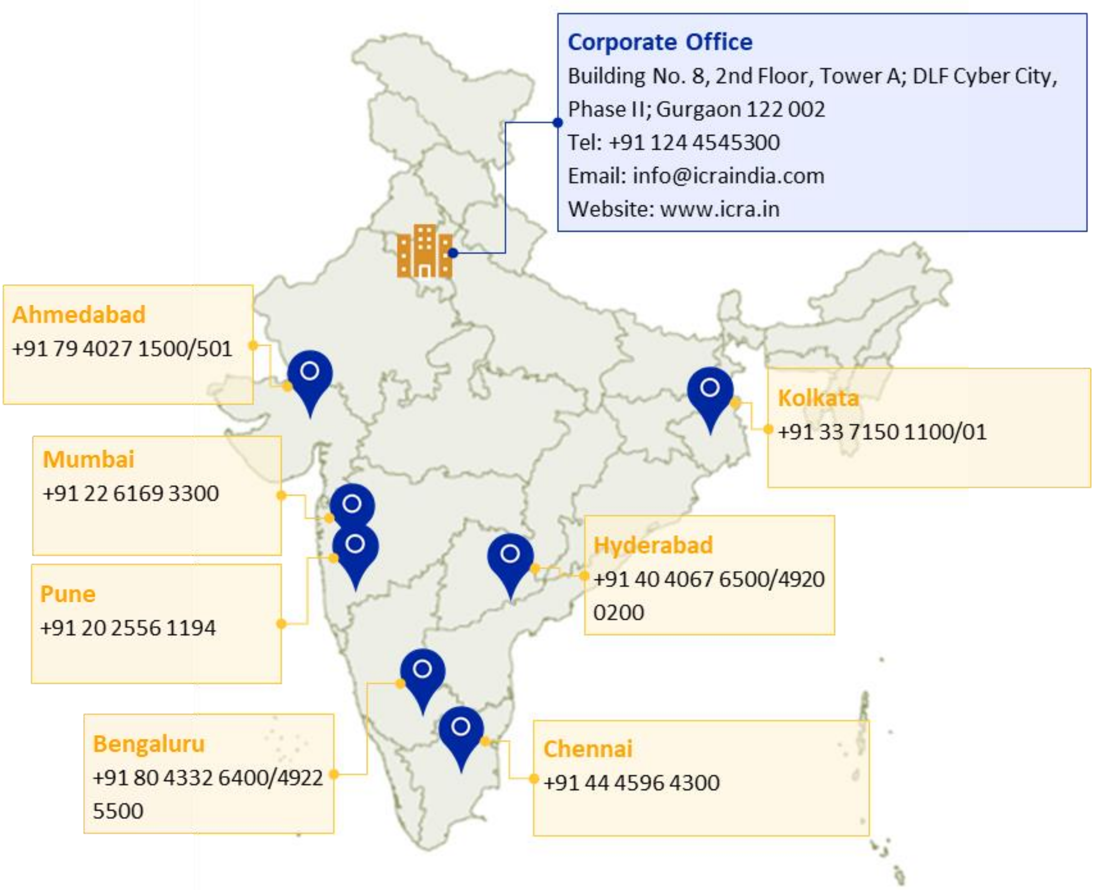

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