

March 16, 2021

Indian Overseas Bank: Ratings reaffirmed; outlook changed to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier II Bonds	-	500.00	[ICRA]A+(hyb) (Stable); assigned
Basel III Tier II Bonds	1,100.00	1,100.00	[ICRA]A+(hyb) (Stable); reaffirmed and outlook changed to Stable from Negative
Basel II Lower Tier II Bonds	1,000.00	-	[ICRA]A+ (Stable); reaffirmed and withdrawn; Outlook changed to Stable from Negative
Basel II Upper Tier II Bonds	967.00	-	[ICRA]A- (Stable); reaffirmed and withdrawn; Outlook changed to Stable from Negative
Total	3,067.00	1,600.00	

*Instrument details are provided in Annexure-1

Rationale

The change in the outlook on the long-term rating to Stable factors in the improvement in Indian Overseas Bank's (IOB) solvency¹ position, which is likely to sustain over the medium term in ICRA's view. ICRA expects that the bank is likely to absorb the asset quality stress through its operating profits, thereby protecting its capital position. On a proforma basis and including the slippages in the absence of a standstill² on asset classification as non-performing, the net non-performing advances (NNPA) ratio stood at ~4.0% as on December 31, 2020, and IOB's solvency position improved to ~53% as on December 31, 2020 from ~176% as on December 31, 2019.

The ratings continue to be supported by IOB's sovereign ownership and the demonstrated track record of capital support received by the bank. The Government of India (GoI) infused equity capital of ~Rs. 19,974 crore into the bank during FY2018-2020. Along with this, the bank's deposit base remains stable with the improving share of core deposits supported by a well-established deposit franchise, which, in turn, drives its strong liquidity profile.

The ratings, however, remain constrained by the weak asset quality as reflected by the high overdue loan book level, which is expected to lead to elevated credit provisions and weak internal capital generation. The bank continues to operate under the prompt corrective action (PCA) framework of the Reserve Bank of India (RBI). This, coupled with limited capital buffers over regulatory levels, constrains its ability to pursue credit growth. ICRA, however, expects the incremental credit losses to be absorbed through operating profits, thereby keeping the NNPAs below the PCA threshold. Though the GoI has not announced any capital infusion for IOB in FY2021 till now, ICRA expects the bank to maintain the regulatory capital position. It would nevertheless require growth capital, given ICRA's expectation of weak internal capital generation. As per ICRA's estimate, IOB will require Rs. 1,000-1,200 crore of capital to achieve a nominal credit growth of 2-3% with the Tier I capital position maintained at a minimum of 9.5% of risk-weighted assets (RWAs).

ICRA has withdrawn the ratings assigned to the Rs. 1,000-crore Basel II Lower Tier II Bonds and the Rs. 967-crore Basel II Upper Tier II bonds as these bonds are fully redeemed and no amount is outstanding against the rated instruments. The ratings were withdrawn in accordance with ICRA's policy on withdrawal and suspension (click [here](#) for the policy).

¹ NNPAs / Core capital

² As directed by the Hon'ble Supreme Court

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The GoI remains IOB's largest shareholder, accounting for a 95.84% equity stake as on December 31, 2020. It infused a cumulative ~Rs. 19,974 crore into the bank during FY2018-2020, which supported IOB's capital profile despite its huge losses. While the GoI has budgeted Rs. 20,000 crore for the recapitalisation of public sector banks (PSBs) for FY2021 and FY2022 each, IOB has not received any capital in the current financial year. While ICRA expects the bank to meet the regulatory capital ratio of 8.0% for CET-I and 11.0% for CRAR, it will require capital for growth. ICRA expects the bank to require an additional ~Rs. 1,000-1,200 crore for a 2-3% credit growth and to maintain the Tier I capital at 9.5% while keeping the NNPA below the PCA threshold of 6%. As a part of the Union Budget, the GoI has proposed the divestment of two PSBs and the rating will be reassessed in case of a change in the sovereign ownership.

Well-developed deposit franchise and strong liquidity position – IOB has a long-standing presence and established retail franchise in South India with a total branch network of 3,219 as on December 31, 2020. While the branch network has been declining over the last few years as the bank has been shutting down loss-making branches, its deposit base has remained stable at Rs. 2.1-2.3 lakh crore over the last 4-5 years. Further, with steady growth in the low-cost current account and savings account (CASA) deposit base and the overall stability in the deposit base, the share of CASA deposits improved to 40.9% as on December 31, 2020 from 39.1% as on December 31, 2019 (26.3% as on December 31, 2015). However, the improvement was driven by the limited credit growth pursued by the bank because of its weak capital position. With limited credit growth and natural growth in the core deposit base, the need for chasing bulk deposits reduced, with bulk deposits accounting for ~4.3% of the total deposits as on December 31, 2020 compared to ~10.2% as on December 31, 2019. Improving the share of core deposits continues to drive IOB's strong liquidity profile, though the same is also supported by the low credit-to-deposit ratio because of its weak capital position. Supported by the improving share of CASA deposits, the cost of interest-bearing funds for the bank has been improving over the last few years compared to the banking sector average, even though this remains slightly above the average for PSBs.

Credit challenges

Asset quality to remain weak and slippages to remain elevated – IOB's asset quality remains weak with gross fresh slippages of Rs. 7,225 crore (slippage rate of 4.7% of standard advances in FY2020 compared to 4.9% in FY2019). Despite the large slippages, the reduction in the gross NPAs (GNPAs) to 14.8% as on March 31, 2020 (from 22.0% as on March 31, 2019) was driven by huge write-offs of ~Rs. 16,800 crore (50.30% of opening GNPAs as on March 31, 2019) in FY2020. Supported by a large capital infusion in FY2020 from the GoI and the consequent aggressive provisioning, the bank's NNPA's reduced to Rs. 6,603 crore (5.4%) as on March 31, 2020 from Rs. 14,368 crore (10.8%) as on March 31, 2019.

While the moratorium period ended in August 2020, the Hon'ble Supreme Court has directed a standstill on asset classification post August 31, 2020. Along with this, the RBI allowed banks to restructure loans while maintaining the same as 'standard', with the cut-off date for the invocation of the restructuring ending on December 31, 2020. However, even in the absence of a standstill on asset classification, the fresh slippages for 9M FY2021 remained limited at Rs. 1,400-1,500 crore (1.2-1.3% of standard advances for 9M FY2021) as per ICRA's estimates. Consequently, on a proforma basis, the NNPA's reduced further to 4.0% as on December 31, 2020.

While the asset quality numbers have been improving, IOB's overdue³ loan book stood high with SMA 1 and SMA 2 (excluding proforma slippages) at 10.01% of standard advances as on December 31, 2020. Accordingly, the asset quality pressures are

³ Special mention accounts (SMA) - SMA 1 (31-60 days past due) and SMA 2 (61-90 dpd)

likely to remain high even during the coming quarters. However, ICRA expects the bank to maintain the NNPA's below the PCA threshold of 6% while maintaining the capital (CET-I) above the regulatory level of 8.0%.

Weak operating profitability and elevated credit costs to keep profitability in check in FY2022 as well – Despite the reduction in the cost of interest-bearing funds for IOB, the net interest margin (NIM), as a percentage of average total assets (ATA), remained weaker at 2.1% in FY2020 (against the PSB average of 2.4%) because of its low credit-to-deposit ratio. This, in turn, resulted from the bank's weak capital position and the high share of non-earning assets. Further, the scale of operations remains sub-optimal, given the declining loan book over the last many years. This has led to an elevated cost-to-income ratio of ~59.7% compared to ~56% for PSBs in FY2020. Accordingly, IOB's core operating profitability remained weak at ~1.2% of ATA compared to the PSBs' average of ~1.5% in FY2020. The weak operating profitability also impacts the bank's ability to absorb credit costs, which remained high at ~4.4% of ATA in FY2020. As a result, the core profit before tax remained weak at -3.3% of ATA in FY2020.

With a reduction in the stock of NNPA's, ICRA expects that the credit costs could remain high at ~1.3-1.4% of ATA in FY2021 and ~0.9-1.0% of ATA in FY2022, which can be largely absorbed through the operating profits. However, this will result in weak internal capital generation with the return on assets (RoA) being lower than ~0.1% of ATA in FY2021, which is unlikely to improve meaningfully in FY2022.

Limited capital cushions and weak solvency – IOB's core equity capital position stood at 8.8% of RWA as on December 31, 2020 against the regulatory requirement of 8.0% from October 1, 2020. While ICRA expects the bank to maintain the existing capital levels as the incremental credit losses are likely to be absorbed through the operating profits, the capital cushions and solvency position are unlikely to improve meaningfully from the current levels over the next couple of quarters given the expectation of weak internal accruals. As mentioned earlier, ICRA expects the bank to require a capital infusion of ~Rs. 1,000-1,200 crore for a nominal credit growth of 2-3% while achieving a Tier I level of 9.5%.

Liquidity position: Strong

IOB has a strong liquidity profile with a liquidity coverage ratio of 242.45% for Q2 FY2021 against the regulatory requirement of 100% from January 1, 2019. Moreover, the bank maintained an excess statutory liquidity ratio (SLR) of ~4.9% of the average net demand and time liabilities (NDTL) on a monthly average basis in FY2020. As IOB is weak on the capital front, it has deployed sizeable surpluses in Government securities and reverse repo balances, driving positive cumulative mismatches across all buckets up to 1 year as per the structural liquidity statement as on December 31, 2020. ICRA expects IOB to maintain strong liquidity on the basis of its decreasing deposit concentration and improving core deposit base. The bank can avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility scheme) in case of urgent liquidity requirement.

Rating sensitivities

Positive factors – The outlook could be changed to Positive or the ratings could be upgraded if IOB is able to improve its solvency profile, with NNPA/core equity of less than 60%, while maintaining capital cushions of ~50 bps over the regulatory Tier I level (including capital conservation buffer; CCB) on a sustained basis.

Negative factors – The ratings will be reassessed in case of a change in the sovereign ownership. The rating outlook could be revised to Negative or the rating could be downgraded if IOB does not maintain the capital ratios above the regulatory level (including CCBs) or if the NNPA's exceed 6.0% on a sustained basis. The weakening of the solvency profile with NNPA/core equity exceeding 70% on a sustained basis will also be a negative trigger.

Analytical approach

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

About the company

Indian Overseas Bank is a public sector bank with a market share of ~1.2% of the advances and ~1.7% of the deposits in the banking sector with the Government of India (GoI) having a majority ownership (95.84% as on December 31, 2020). The bank's market share has steadily declined from ~2.5% of advances and ~2.7% of deposits as on March 31, 2015, given its weak asset quality, earnings, and capital position. As on December 31, 2020, IOB had an asset base (net of revaluation reserve) of about Rs. 2.60 lakh crore and a network of 3,219 branches.

IOB reported a net loss of Rs. 8,528 crore in FY2020 (net loss of Rs. 3,737 crore in FY2019) on a total asset base of Rs. 2.58 lakh crore as on March 31, 2020 (Rs. 2.48 lakh crore as on March 31, 2019), translating into an RoA of -3.4% for FY2020 and -1.5% for FY2019. For 9M FY2021, the bank reported a net profit of Rs. 482 crore (net loss of Rs. 8,671 crore in 9M FY2020) on a total asset base of Rs. 2.60 lakh crore as on December 31, 2020 (Rs. 2.45 lakh crore as on December 31, 2019), translating into an RoA of 0.25% and -4.70%, respectively.

Key financial indicators

Indian Overseas Bank	FY2019	FY2020	9M FY2020	9M FY2021
Net interest income (Rs. crore)	5,279	5,303	3,771	4,495
Profit before tax (Rs. crore)	(5,959)	(8,345)	(8,481)	497
Profit after tax (Rs. crore)	(3,737)	(8,528)	(8,671)	482
Net advances (Rs. lakh crore)	1.33	1.21	1.22	1.25
Total assets* (Rs. lakh crore)	2.48	2.58	2.45	2.60
% CET-I	7.82%	8.21%	3.53%	8.82%
% Tier I	7.82%	8.21%	3.53%	8.82%
% CRAR	10.20%	10.72%	5.53%	11.49%
% Net interest margin / Average total assets	2.14%	2.10%	2.04%	2.31%
% Net profit / Average total assets	(1.52%)	(3.37%)	(4.70%)	0.25%
% Return on net worth	(30.10%)	(61.57%)	(102.67%)	4.57%
% Gross NPAs	22.0%	14.8%	17.1%	13.1%^
% Net NPAs	10.8%	5.4%	5.8%	4.0%^
% Provision coverage excl. technical write-offs	57.0%	66.8%	70.1%	72.5%^
% Net NPA / Core equity	149.9%	70.8%	175.5%	52.8%^

*Total assets and net worth exclude revaluation reserves

Source: Indian Overseas Bank, ICRA research

^ Proforma numbers including proforma NPAs and standstill slippages as directed by the Hon'ble Supreme Court

All calculations as per ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)						Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2021			FY2020	FY2019		FY2018	
					Mar-16-21	Dec-29-20	Oct-12-20	Dec-20-19	Oct-24-18	Aug-14-18	Jun-14-18	Nov-24-17
1	Basel III Tier II Bonds	LT	300.00	300.00	[ICRA]A+ (hyb) (Stable)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	-	-	-
			500.00	500.00	[ICRA]A+ (hyb) (Stable)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)
			300.00	300.00	[ICRA]A+ (hyb) (Stable)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)	[ICRA]A+ (Hyb) (Negative)
			500.00^	-	[ICRA]A+ (hyb) (Stable)	[ICRA]A+ (hyb) (Negative)	-	-	-	-	-	-
2	Basel II Lower Tier II Bonds	LT	1,000.00	-	[ICRA]A+ (Stable); withdrawn	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
			290.00	-	-	-	-	[ICRA]A+ (Negative); withdrawn	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
			300.00	-	-	-	-	-	[ICRA]A+ (Negative); withdrawn	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
			500.00	-	-	-	-	-	-	-	-	-
3	Certificates of Deposit	ST	15,000.00	-	-	[ICRA]A1+; withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Basel II Upper Tier II Bonds	LT	967.00	-	[ICRA]A- (Stable); withdrawn	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)
			655.30	-	-	-	-	-	[ICRA]A- (Negative); withdrawn	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)
			510.00	-	-	-	-	[ICRA]A- (Negative); withdrawn	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)

			500.00	-	-	-	-	-	-	-	-	-
5	Basel II Perpetual Bonds	LT	300.00	-	-	-	-	-	[ICRA]A- (Negative); withdrawn	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)
			80.00	-	-	-	-	-	-	-	-	-
			400.00	-	-	-	-	-	-	-	-	-

^Yet to be placed; LT – Long term; ST – Short term

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [click here](#)

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE565A09256	Basel III Tier II Bonds	Nov-03-16	9.24%	Nov-03-26	800.00	[ICRA]A+(hyb) (Stable); reaffirmed and outlook changed to Stable from Negative
INE565A09264		Dec-10-18	11.70%	Dec-10-28	300.00	[ICRA]A+(hyb) (Stable); reaffirmed and outlook changed to Stable from Negative
Proposed		-	-	-	500.00	[ICRA]A+(hyb) (Stable); assigned
INE565A09215	Basel II Lower Tier II Bonds	Dec-31-10	8.95%	Dec-31-20	1,000.00	[ICRA]A+ (Stable); reaffirmed and withdrawn; Outlook changed to Stable from Negative
INE565A09223	Basel II Upper Tier II Bonds	Jan-10-11	9.00%	Jan-10-26 [#]	967.00	[ICRA]A- (Stable); reaffirmed and withdrawn; Outlook changed to Stable from Negative

[#] Call option can be exercised by the bank at the end of 10 years after approval from the RBI (exercised as on January 11, 2021)

Source: Indian Overseas Bank

Key features of the rated instruments

The servicing of the Basel II Lower 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. The letters 'hyb' in parenthesis, suffixed to a rating symbol, stand for hybrid, indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features. Such features may translate into higher loss severity vis-à-vis conventional debt instruments. The rated Tier II bonds are expected to absorb losses once the PONV trigger is invoked.

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
India International Bank (Malaysia)	35.00%	Limited Consolidation
Odisha Gramya Bank	35.00%	Limited Consolidation
Universal Sampo General Insurance	18.06%	Limited Consolidation

Source: Source: Indian Overseas Bank, ICRA research

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