Oriental Bank of Commerce

Instrument	Amount	Rating
Basel III Compliant Tier 2 Bonds programme	Rs 2000 crore	Rating revised from [ICRA]AA+(hyb)(negative) to [ICRA]AA(hyb)(Stable)
Basel III Compliant Additional Tier 1 Bonds programme	Rs 1000 crore	Rating revised from [ICRA]AA-(hyb)(negative) to [ICRA]A+(hyb)(stable)
Lower Tier 2 Bonds programme	Rs 2200 crore	Rating revised from [ICRA]AA+(negative) to [ICRA]AA(stable)
Upper Tier 2 Bonds programme	Rs 1000 crore	Rating revised from [ICRA]AA(negative) to [ICRA]AA-(stable)
Perpetual Bonds (Tier 1) programme	Rs. 250 crore	Rating revised from [ICRA]AA(negative) to [ICRA]AA-(stable)

ICRA has revised the ratings on the Rs. 2000 crore Basel III Compliant Tier 2 Bonds of Oriental Bank of Commerce from [ICRA]AA+(hyb)(negative)(pronounced ICRA double A plus hybrid with a negative outlook) to [ICRA]AA(hyb)(stable)(pronounced ICRA double A hybrid with a stable outlook). The rating for the Rs. 2200 crore Lower Tier 2 Bonds programme have been revised from [ICRA]AA+(negative) (pronounced ICRA double A plus with a negative outlook) to [ICRA]AA(stable) (pronounced ICRA double A stable). The ratings for the Rs. 1000 crore Upper Tier 2 Bonds programme and Rs. 250 crore Perpetual Bonds programme have been revised from [ICRA]AA (negative) (pronounced ICRA double A with a negative outlook) to [ICRA]AA-(stable) (pronounced ICRA double A minus with a stable outlook). ICRA has also revised the rating on the Basel III compliant Additional Tier 1 Bonds programme from [ICRA]AA-(hyb)(negative) (ICRA double A minus hybrid with a negative outlook) to [ICRA]A+(hyb)(stable) (pronounced ICRA A plus hybrid with a stable outlook). 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 levels of rating transition and loss-severity vis-à-vis conventional debt instruments.

The rating for the Basel III compliant Tier I bonds is two notches lower than the Basel III complaint Tier II bonds of the bank as these instruments have the following loss absorption features that make them riskier.

- Bank has full discretion at all times to cancel distribution/payments and cancellation of discretionary payments shall not be an event of default.
- The minimum capital conservation ratio applicable to the banks may restrict the bank from servicing these Tier I bonds in case the Common Equity Tier-I falls below limit as prescribed by RBI.
- These Tier I bonds are expected to absorb losses through Write-Down Mechanism at the Objective Pre-Specified Trigger Point fixed at Bank’s Common Equity Tier-I ratio as prescribed by RBI, 5.5% till March 2019 and thereafter 6.125% of Total Risk Weighted Assets of the Bank or when the “Point of Non Viability” (PONV) trigger is breached in the RBI’s opinion.

The revision in rating is on account of higher than anticipated stress, slower than expected pace of recovery and weak outlook for several credit intensive sectors which led to sharp deterioration in asset quality indicators of the bank and has impacted the earnings profile of the bank. Further, in ICRAs opinion, earnings profile of the bank over the medium term is likely to remain weak given the relatively high share of stressed assets (7.4% restructured advances(excluding SEBs and Air India) as a percentage of standard assets and other weak assets),relatively high un-provided NPAs (Net NPA% of 4.99% as on December 31, 2015). Limited visibility on capital availability to fully support credit growth while meeting the regulatory minimum requirement also constrains the rating.

The ratings continue to draw comfort from OBCs majority sovereign ownership (59.13% equity shares are held by Government of India or GoI as on December 31, 2015), bank's strong franchise imparting healthy and stable deposits base, comfortable liquidity profile.

In light of the challenges highlighted above and higher exposure of OBCs to stressed sectors, its asset quality indicators are likely to remain weak over the next 1-2 years; given that it would be a challenge to reduce the pace of fresh NPA generation as well as recover from a large stock of Gross NPAs and standard restructured advances (estimated at around 15% as on December 31, 2015). Recognition of stress was reflected in Q3, FY16 asset quality indicators for OBC, when RBI post its 'asset quality review' directed banks to bring consistency in NPA recognition for stressed accounts. OBC's Gross NPA% increased from 5.70% as on September 2015 to 7.75% as on December 2015.

Higher than expected slippage in OBC's asset quality has led to significant dilution in earnings in relation to the risk (OBC's annualized operating profits[*] in relation to net NPAs have dropped to 35% in Q3, FY16 vs. 67% in Q2, FY16). Additionally, sizeable Net NPAs (4.99% as on December 31, 2015) and other weak assets (standard restructured advances of around 7.4% and some other weak standard assets) are likely to keep credit costs elevated over the next 2-3 years, leading to pressure on earnings and therefore internal capital generation. Furthermore, requirement to increase provisioning cover for some restructured advances could elevate credit costs further in FY17.

OBCs core operating profitability[†] at 1.14% for Q3FY16 (1.43% for 9MFY16 (declined by ~15 bps in 9MFY16 from FY15 with rising proportion of non-income accruing assets)), is low compared to its high credit cost (credit provisions in relation to ATA[‡] of around 2.44% for Q3FY16) leading to losses at net level in Q3FY16. The bank reported a net loss of Rs. 425 crore during Q3FY16 (PAT of Rs 134 crore during 9M FY16). OBC's profitability is expected to remain under pressure over the medium term as cost of deposits increase and credit cost is expected to remain at elevated levels.

Though OBCs reported Tier 1 capital at 8.17% as on December 31, 2015 is above the minimum requirements of 7.625% as on March 31, 2016 as per RBI regulations , the bank would need to raise sizeable capital to meet increasing regulatory minimum requirements as well as for growth. In ICRA's estimate, OBC would require to raise common equity capital of Rs 27-47[§] billion and additional tier I capital (AT1) of Rs 21-24 billion during FY17-FY19 to meet increase in regulatory minimum capital requirement as well as for growth. OBC's Tier 1 requirement is equivalent to 200-290% of its current market capitalisation. In case of lack of adequate investor appetite for AT1 capital raising, the gap would need to be met through further core capital raising, thereby increasing core capital raising requirements. Further Given the current stance of Govt on

[*] Excluding profit on sale of investments

[†] Operating profit before credit provisions and profit on sale of investments in relation to ATA

[‡] Average Total Assets

[§] Assuming buffer of 0.5% over and regulatory minimum requirement and annualized growth of 7-10% in risk weighted assets during FY17-FY19 providing equity, OBC will have mobilize significant equity / Tier I from non-Government sources. Given that internal Capital generation is expected to remain weak, bank's ability to raise fresh capital and hence maintain the minimum regulatory capital would be a key rating sensitivity.

Bank Profile

Oriental Bank of Commerce was incorporated in 1943 and nationalised in April 1980. Government of India held 59.13% stake in OBC's as on December 31, 2015 .OBC was merged with the financially depressed Global Trust Bank in August 2004 and prior to that with Punjab Co-operative Bank and Bari Doab in 1997.OBC has a strong franchise in northern India, which allows it to have a stable deposit base and gives it access to a wide range of customers. The bank's presence in the South and West has improved following its August 2004 acquisition of GTB. OBC reported a Profit After Tax(PAT) of Rs 497 crore on an asset base of Rs 2,29,892 crore in 2014-15vis-a-vis PAT of Rs 1139.41 crore on an asset base of Rs. 2,19,652 crore in 2013-14. For the nine months ended December 31, 2015, OBC reported a PAT of Rs. 134.46 crore vis-a-vis PAT of Rs. 675 .52 crore for the nine months ended December 31, 2014.

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