

August 28, 2020

## Union Bank of India: Rating reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificates of Deposit	15,000.00	15,000.00	[ICRA]A1+; reaffirmed
<b>Total</b>	<b>15,000.00</b>	<b>15,000.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The rating reaffirmation takes into account Union Bank of India's (Union Bank) sovereign ownership and the demonstrated track record of capital support received by the bank. ICRA expects the bank to continue receiving support, given its increased importance in the Indian banking system. Union Bank recently merged with erstwhile Andhra Bank (e-AB) and erstwhile Corporation Bank (e-CB), effective April 1, 2020. The merger has further increased the systemic importance of the bank in the Indian banking sector with a market share of 6.2% in advances and 6.6% in total deposits as on April 1, 2020 compared to ~3.4% and ~3.3%, respectively, on a standalone basis. The rating is also supported by Union Bank's strong deposit franchise, resulting in a high share of retail deposits and a strong liquidity profile.

The above positives are, however, offset by the merged entity's weak capital position and the expected stress on the asset quality because of the high share of loans under moratorium. While the impact of the Covid-19 pandemic on the asset quality is still evolving, the management has provided a guidance of loan slippages of 3.0-3.5% in FY2021. Further, ~5.0-6.0% of the loan book is expected to be restructured while maintaining the asset classification as 'standard'. This will lead to high credit provisioning over the next couple of years.

Supported by a large capital infusion and the consequent accelerated provisioning on stressed assets, the net non-performing assets (NPAs) of the merged entity declined to 5.24% as on April 1, 2020 from an estimated 6.30% as on March 31, 2019. However, despite the reduction, the net NPAs remained significant in relation to the core capital and hence the solvency profile<sup>1</sup> remained weak at ~69.2% as on April 1, 2020. The bank's credit provisioning is expected to remain high, given the significant net NPAs and the expectation of high fresh slippages and restructuring. ICRA expects the credit provisions to exceed Union Bank's core operating profits in FY2021. With a weak capital position and likely stress on internal capital generation, the bank's Tier I capital requirements remain large in relation to the current capital base as well as its market capitalisation. While the Government of India (GoI) has not budgeted any capital infusion for public sector banks (PSBs) in FY2021, the capital raise by the bank will remain critical for it to ride out the expected pressure on its asset quality while maintaining the capital above the regulatory levels. This will be a monitorable in the near term.

<sup>1</sup> Solvency – Net NPAs / Core capital

## Key rating drivers and their description

### Credit strengths

**Sovereign ownership with demonstrated capital support from Gol** – The Gol remains the largest shareholder of the merged bank, accounting for an 89.07% equity stake as on April 1, 2020. The merged entity including Union Bank and the amalgamated banks (e-AB and e-CB), have received sizeable equity capital support from the Gol amounting to ~Rs. 32,796 crore during FY2018-FY2020 of which ~Rs. 11,768 crore was infused in FY2020. Supported by this, the merged entity recorded a substantial reduction in its stock of net NPAs (below the threshold of 6% for inclusion in the Reserve Bank of India's (RBI) prompt corrective action (PCA) framework) while shoring up the capital ratios above the regulatory minimum. The bank has sufficient headroom to raise capital from market sources while maintaining the Gol's shareholding above 51%.

While the Gol has not budgeted any capital infusion for PSBs in FY2021, Union Bank has proposed a capital raise of ~Rs. 10,300 crore for FY2021 (equity capital of up to Rs. 6,800 crore and debt capital of up to Rs. 9,400 crore). The above estimate assumes a 1% capital cushion over the regulatory level of 9.50% for Tier I. However, ICRA expects that the bank's capital requirements could be higher if the slippages and restructuring exceed the guidance provided by the management, especially in the backdrop of weak internal accruals.

**Well-developed deposit franchise** – The merger has further strengthened the bank's network, which has become wider with 9,500+ branches and an improved presence in the southern states. The bank's current account and savings account (CASA) base stood at ~34% of the total deposits (~36% for the standalone entity) as on April 1, 2020, though this was below the PSB average of ~38.7%. Apart from the lower share of low-cost CASA deposits, the term deposit rate for Union Bank as well as the amalgamated entities was higher than that of some large PSBs. Hence, the overall costs of funds for Union Bank on a merged basis was higher at ~5.44% in FY2020 compared to the PSBs' average of ~5%. Union Bank continues to offer a higher rate on its term deposits compared to some other PSBs as it has to compete with some other South-based banks. Therefore, its overall cost of deposits may remain marginally higher than the PSBs' average. Nonetheless, given its widespread network, steady core deposit base and robust retail franchise, ICRA expects the merged entity to maintain its strong liabilities profile.

**High systemic importance as fifth largest PSB and seventh largest bank in Indian banking system in terms of advances/deposit base** – Prior to the merger, Union Bank was the sixth largest PSB and ninth largest bank in the Indian banking system as on March 31, 2019. The merger, with effect from April 1, 2020, has created the fifth largest PSB and seventh largest bank in the Indian banking system with a share of 6.2% of net advances and 6.6% of total deposits as on April 1, 2020. Given the material increase in the bank's size following the merger, ICRA expects it to hold systemic importance in the Indian banking system. While the merged entity is currently not classified as a domestic systemically important bank (D-SIB), its classification in this category would pose additional capital requirements vis-à-vis the regulatory minimum levels. Moreover, given the sovereign ownership, ICRA expects strong support from the Gol if required. The management expects to complete the consolidation/integration of the amalgamating banks by March 31, 2021.

### Credit challenges

**Asset quality to remain weak, given the high level of loans under moratorium** – As the Covid-19 pandemic has led to stress on the debt-servicing ability of the borrowers, the bank had provided a moratorium on debt servicing to its borrowers during March-August 2020 as allowed by the regulator.

A high share (~26% as on March 31, 2020 and ~28% as on June 30, 2020) of the bank's term loans<sup>2</sup> are under moratorium, including 1.0% of the standard advances as on June 30, 2020, where the bank has taken forbearance on the asset classification as NPAs because of the moratorium. Recently, the RBI has also allowed banks to restructure loans while maintaining the same as 'standard'. While the near-term slippages could be lower, this would lead to increased uncertainty regarding the bank's asset quality profile over the medium term.

The impact of the pandemic on the asset quality is still evolving and the management has guided towards a loan slippage rate of 3.0-3.5% in FY2021 and expects ~5.0-6.0% of the loan book to be restructured. The slippage rate provided by the management could increase in FY2021 and FY2022 in a stress case scenario (4.8%E in FY2020 and 5.1%E in FY2019 for the merged entity). With expectations of a high slippage rate, ICRA expects the net NPAs to remain above 5.0% over the next couple of quarters (4.97% as on June 30, 2020 and 5.24% as on April 1, 2020).

The asset quality of the merged entity remained weak across segments with gross NPAs (GNPAs) of ~3.90% in the retail segment as on June 30, 2020, 10.59% in the agriculture segment, 17.04% in the small and micro enterprise (SME) segment and 20.15% in the medium and large corporate segment. Though the bank has increased the provision cover on its GNPAs to 70.25% as on June 30, 2020, the net NPAs remain high at 60.5% of the core capital.

**High credit costs to lead to weak profitability over next two years** – The core operating profit of the merged entity is estimated at 1.55% of average total assets (ATA) in FY2020 (1.66% in FY2019) and remained lower than the credit costs of ~2.09% of ATA for FY2020 (3.12% in FY2019). As a result, the bank reported huge losses during the last two years. On a merged basis, the losses before tax are estimated Rs. 4,216 crore for FY2020 and Rs. 14,386 crore for FY2019. The losses in FY2020 were driven by the harmonisation of the asset quality and provisioning levels among the merging banks apart from various employee-related provisions. The losses in FY2019 were driven by e-CB, which accelerated its NPA provisions to exit the PCA framework.

The management has guided towards ageing-related credit provision on the existing stock of NPAs at ~1.5% of the advances in FY2021, which is likely to consume ~50% of the operating profits for the year. This apart, the fresh slippages and restructuring-related provisions are likely to result in elevated credit provisions even in FY2021 and FY2022. ICRA expects a credit provision of over 2.0% of ATA in FY2021, which is likely to exceed the bank's operating profits and result in losses and capital erosion.

**Capital position and solvency to weaken unless supported by fresh capital raising** – The bank's Tier I capital stood at 9.48% as on June 30, 2020 and is weak in relation to the regulatory requirement of 9.5% by September 30, 2020. Given the estimates of high credit costs of over 2.0% of ATA in FY2021 and FY2022, ICRA expects that the bank will require Tier I capital for regulatory requirements. In addition, the bank has guided towards a credit growth of 5-6%, which will pose additional capital requirements.

Union Bank has proposed a capital raise of ~Rs. 10,300 crore for FY2021. However, ICRA expects that the bank's capital requirements could be higher if the slippages and the restructuring exceed the guidance provided by the management. In a scenario of a slightly higher slippage rate (5.0% compared to 3.0-3.5% guided by the management) and 3-4% credit growth with a Tier I capital cushion of 75 bps, the bank's Tier I capital requirement could rise to ~Rs. 12,000 crore in FY2021. With the expectation of losses, the bank will need to raise capital in FY2022 as well. In the absence of a capital raise and with the expectation of losses, ICRA expects the bank's capital and solvency position to weaken from the current levels. ICRA expects the GoI to provide requisite capital support to the bank, given its ownership and the bank's systemic importance.

---

<sup>2</sup> Term loans accounted for 54.9% of the overall advances of the bank as on April 1, 2020

## Liquidity position: Strong

The merged entity continues to have a strong liquidity profile as depicted by the positive cumulative mismatches of ~2.64% of the total outflows in the up to 1-year maturity bucket, as per its structural liquidity statement (merged basis) for June 30, 2020, supported by a high share of core deposits and excess SLR investments. The liquidity coverage ratio remains strong at 185.42% (daily average for FY2020 for Union Bank (standalone)), well above the minimum regulatory requirement of 100%. Supported by its sovereign ownership, healthy liabilities profile and excess SLR holdings, ICRA expects the bank to maintain a strong liquidity profile.

## Rating sensitivities

**Positive triggers** – Not applicable

**Negative triggers** – ICRA could downgrade the short-term rating in case of insufficient capital support from the Gol, leading to sustained capital breaches with a CRAR of <9.0%.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">ICRA Rating Methodology for Banks</a> <a href="#">Impact of Parent or Group Support on an Issuer's Credit Rating</a>
Parent/Group Support	The rating factors in Union Bank's sovereign ownership and the demonstrated track record of capital infusions by the Gol. ICRA expects the Gol to support the bank with capital infusions, if required.
Consolidation/Standalone	To arrive at the rating, ICRA has considered the standalone financials of Union Bank and the consolidated financials of Union Bank, e-AB and e-CB. However, in line with ICRA's limited consolidation approach, the capital requirement of the Union Bank of India Group's key subsidiaries/associates/joint ventures, going forward, has been factored in (including the entities taken over post-merger).

## About the company

Incorporated in 1919, Union Bank of India merged with erstwhile Andhra Bank (e-AB) and erstwhile Corporation Bank (e-CB) on April 1, 2020 to form the fifth largest public sector bank and seventh largest bank in the Indian banking system with a total asset base of Rs. 10.2 lakh crore. The merged entity has a market share of 6.2% and 6.6% in net advances and total deposits, respectively, as on April 1, 2020 with majority ownership by the Gol (89.07% as on April 1, 2020). The merged entity has a network of 9,587 branches and 13,311 ATMs as on March 31, 2020.

## Key financial indicators

(Rs. crore)	Standalone FY2019	Standalone FY2020	Merged <sup>^</sup> Q1 FY2021
Net interest income	10,215	11,437	6,403
Profit before tax	(4,028)	(3,927)	479
Profit after tax	(2,948)	(2,898)	333
Net advances	2,96,932	3,15,049	5,81,717
Total assets*	4,92,066	5,46,964	10,69,758
% CET I	8.02%	9.40%	8.40%
% Tier I	9.48%	10.75%	9.48%
% CRAR	11.78%	12.81%	11.62%
% Net interest margin / Average total assets	2.09%	2.20%	2.42%
% Net profit / Average total assets	-0.60%	-0.56%	-0.66%
% Return on net worth	-12.47%	-10.62%	-12.32%
% Gross NPAs	14.98%	14.15%	14.95%
% Net NPAs	6.85%	5.49%	4.97%
% Provision coverage excl. technical write-offs	58.27%	64.75%	70.25%
% Net NPA / Core equity	91.08%	62.40%	60.57%

<sup>^</sup> Unaudited merged financials for Union Bank, e-AB and e-CB

\*Total assets and net worth exclude revaluation reserves

Source: Union Bank, ICRA research

All calculations as per ICRA research

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: Not applicable**

### Rating history for past three years

Rating (FY2021)					Rating History for the Past 3 Years				
	Instrument	Type	Amount Rated	Amount Outstanding	Current Rating	FY2020	FY2019		FY2017
					28-Aug-20	28-Jun-19	9-May-18	30-Apr-18	20-Mar-17
1	Certificates of Deposit	ST	15,000.00	NA	[ICRA]A1+; reaffirmed	[ICRA]A1+; reaffirmed	[ICRA]A1+; reaffirmed	[ICRA]A1+; reaffirmed	[ICRA]A1+; reaffirmed
2	Lower Tier II Bonds – Basel II	LT	800.00	-	-	[ICRA]AA+(stable); withdrawn	[ICRA]AA+(stable); reaffirmed	[ICRA]AA+(stable); reaffirmed	[ICRA]AA+(stable); reaffirmed
3	Basel II Compliant Innovative Perpetual Debt Instruments	LT	200.00	-	-	[ICRA]AA(stable); withdrawn	[ICRA]AA(stable); reaffirmed	[ICRA]AA(stable); reaffirmed	[ICRA]AA(stable); reaffirmed

Amount in Rs. crore

### 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 [www.icra.in](http://www.icra.in)

### Annexure-1: Instrument details

ISIN	Instrument	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Certificates of Deposit	-	-	7-365 Days	15,000.00	[ICRA]A1+

<sup>^</sup> Yet to be issued

Source: Union Bank

### Annexure 2: List of entities considered for limited consolidation analysis

S. No.	Name of the entity	Ownership	Consolidation Approach
1.	Union Asset Management Company Pvt. Ltd.	100.00%	Limited Consolidation
2.	Union Trustee Company Pvt. Ltd.	100.00%	Limited Consolidation
3.	Union Bank of India (UK) Ltd.	100.00%	Limited Consolidation
4.	Kashi Gomti Samyut Gramin Bank	35.00%	Limited Consolidation
5.	Star Union Dai-ichi Life Insurance Company Ltd.	25.10%	Limited Consolidation
<b>Entity Taken Over Post Merger</b>			
6.	Andhra Bank Financial Services	100.00%	Limited Consolidation
7.	Corpbank Securities	100.00%	Limited Consolidation
8.	Chaitanya Godavari Grameena Bank	35.00%	Limited Consolidation
9.	IndiaFirst Life Insurance Company	30.00%	Limited Consolidation
10.	ASREC India (P)	26.02%	Limited Consolidation
11.	India International Bank (Malaysia)	25.00%	Limited Consolidation

Source: Union Bank of India, e-AB, e-CB and ICRA research

## Analyst Contacts

**Mr. Karthik Srinivasan**

+91 22 6114 3444

[karthiks@icraindia.com](mailto:karthiks@icraindia.com)

**Mr. Anil Gupta**

+91 124 4545 314

[anilg@icraindia.com](mailto:anilg@icraindia.com)

**Mr. Hemant Sultania**

+91 124 4545 386

[hemant.sultania@icraindia.com](mailto:hemant.sultania@icraindia.com)

**Mr. Aashay Choksey**

+91 22 6114 3430

[aashay.choksey@icraindia.com](mailto:aashay.choksey@icraindia.com)

**Ms. Samiksha Karnavat**

+91 22 6114 3471

[samiksha.karnavat@icraindia.com](mailto:samiksha.karnavat@icraindia.com)

## Relationship Contact

**Mr. L. Shivakumar**

+91 22 6114 3406

[shivakumar@icraindia.com](mailto:shivakumar@icraindia.com)

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**

Tel: +91 124 4545 860

[communications@icraindia.com](mailto:communications@icraindia.com)

## Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

[info@icraindia.com](mailto:info@icraindia.com)

## About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit [www.icra.in](http://www.icra.in)

## ICRA Limited

### Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: [info@icraindia.com](mailto:info@icraindia.com)

Website: [www.icra.in](http://www.icra.in)

### Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

### Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

© Copyright, 2020 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website [www.icra.in](http://www.icra.in) or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents