September 27, 2021

Union Bank of India: Ratings reaffirmed; outlook revised to Stable from Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier II Bonds	4,000.00	4,000.00	[ICRA]AA+ (Stable); reaffirmed and outlook revised to Stable from Negative
Certificates of Deposit	15,000.00	15,000.00	[ICRA]A1+; reaffirmed
Total	**19,000.00**	**19,000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the outlook on the long-term rating of Union Bank of India (Union Bank) factors in the improvement in its solvency profile[1], which is expected to be sustained going forward. Supported by the improved capital position, the solvency position has improved over the last one year. With improving profitability metrics and expectations of steady internal capital accruals, the solvency profile is expected to improve further.

The ratings reaffirmation continues to take into account Union Bank's sovereign ownership and the demonstrated track record of capital support from the Government of India (GoI). While the bank is adequately capitalised and likely to remain self-sufficient for its capital requirements, ICRA expects it to continue receiving support, if required. Union Bank had merged with erstwhile Andhra Bank (e-AB) and erstwhile Corporation Bank (e-CB), effective April 1, 2020. The merger had further increased the systemic importance of the bank in the Indian banking sector with a market share of 5.8% in advances and 6.2% in total deposits as on June 30, 2021. It is the fifth largest public sector bank (PSB). The ratings further remain supported by the bank's strong deposit franchise, resulting in a high share of retail deposits and a strong liquidity profile.

The above positives are offset by the bank's weak asset quality and modest profitability. While the asset quality stress because of the Covid-19 pandemic is lower than initially estimated, it remains elevated as reflected by the high level of stressed book in the form of net non-performing assets (NNPAs), SMA-2[2] accounts, and standard restructured advances.

The management has guided towards loan slippages of 2.0-2.5% for FY2022 (3.1% in FY2021 and 4.8% in FY2020). Further, another 2.5-3.0% of the loan book is expected to be restructured under the regulatory package offered by the Reserve Bank of India (RBI) while maintaining the asset classification as 'standard'. While this is likely to keep the asset quality pressure at elevated levels, ICRA expects the bank to significantly absorb the credit provisions from its operating profits. However, the net profitability will remain average with a return on assets (RoA) of less than 0.4% in FY2022.

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The GoI remains the bank's largest shareholder, accounting for an 83.49% equity stake as on June 30, 2021. Union Bank and other amalgamating banks had received sizeable equity capital support from the GoI amounting to Rs. 41,597 crore during FY2018-FY2021 of which Rs. 11,968 crore was infused

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[1] Solvency Profile = Net Stressed Assets / Core Capital; net stressed assets include net NPAs, net non-performing investments and net security receipts

[2] Special mention accounts (SMA-2) are overdue loans with overdue status of 61-90 days

in FY2020. There was no capital infusion budgeted for Union Bank in FY2021 as its capital position remained adequate. Supported by the recapitalisation over the years, the bank has recorded a substantial reduction in its stock of net NPAs.

Union Bank has board approval to raise up to Rs. 3,500 crore of equity capital in FY2022, of which it raised Rs. 1,447 crore through a qualified institutional placement (QIP) in May 2021. The GoI has budgeted Rs. 20,000 crore for the recapitalisation of PSBs for FY2022, though the distribution of capital is yet to be announced. While Union Bank is adequately capitalised and likely to remain self-sufficient for its capital requirements, ICRA expects it to continue receiving support if required.

Well-developed deposit franchise – The merger has further strengthened the bank's network with 9,315 branches as on March 31, 2021 and an improved presence in the southern states. The branch network has, however, declined marginally from 9,587 branches as on March 31, 2020 as Union Bank has rationalised branches to achieve cost synergies with the merging banks.

The bank's current account and savings account (CASA) base stood at 36.4% of the total deposits as on June 30, 2021 (33.3% as on June 30, 2020), though this was below the PSB average of 40-42% during this period. Apart from the lower share of low-cost CASA deposits, the term deposit rate for Union Bank remains comparable to that of some large PSBs. As a result, the overall cost of funds for Union Bank was marginally higher at 4.61% compared to the PSBs' average of 4.24% in FY2021.

Union Bank continues to offer a comparable rate on its term deposits vis-à-vis other South India-based PSBs as it competes for deposits in the region. 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 bank to maintain its strong liabilities profile.

High systemic importance as fifth largest PSB and seventh largest bank in Indian banking system in terms of total business – 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.

Union Bank's market share stood at 5.8% of advances and 6.2% of total deposits as on June 30, 2021, signifying its increased systemic importance in the Indian banking system. While the bank 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.

Improving capital and solvency position supported by internal accruals as well as fresh capital raising – The bank's core equity capital (CET-I) and Tier I capital stood at 9.77% and 11.09%, respectively, as on June 30, 2021 supported by the improved RoA of 0.28% in FY2021 as well as the recent equity raise of Rs. 1,447 crore through QIP. As a result, the capital cushions have improved compared to the regulatory requirement of 8.0% and 9.5% on CET-I and Tier I, respectively, by October 1, 2021.

ICRA expects the bank to internally generate capital for 6.0-8.0% growth and not depend on raising further capital. Union Bank has call options due on AT-I bonds amounting to Rs. 3,400 crore (0.63% of risk-weighted assets - RWAs) in FY2022 and Rs. 1,000 crore (0.19% of RWAs) in FY2023. Hence, it would need to raise capital to maintain the capital cushion at the Tier I level.

Given the recent capital raising and the expectation of internal capital accruals in FY2022 and FY2023, the solvency profile is expected to improve even in the absence of any further capital raising in FY2022. The solvency profile improved to 55.1% as on June 30, 2021 from 64.6% as on June 30, 2020 and is likely to improve further with steady internal capital generation over the coming fiscals.

Credit challenges

Weak asset quality; performance of restructured advances a monitorable – Despite the challenges posed by the pandemic on the debt-servicing ability of borrowers, the slippages for the bank declined in FY2021 to 3.1% of standard advances (4.8% in FY2020 and 5.1% in FY2019). The reduction was driven by various regulatory forbearance like moratorium on debt servicing for borrowers, one-time restructuring of advances and standstill on asset classification directed by the Hon'ble Supreme Court. The bank had a standard restructured book of 2.9% of standard advances as on June 30, 2021 and the same is likely to increase marginally in the near term but will remain below 3.5%. In addition, the SMA-2 loan book stood at 4.4% of standard advances. Hence, the overall asset quality will remain monitorable for the performance of these restructured and overdue accounts.

The full impact of the pandemic, including that of a potential third wave, is still evolving and the management has guided towards a slippage rate of 2.0-2.5% of advances for FY2022. The credit cost and other provisions are expected to remain at 2.0-2.5% of advances with net NPAs expected to decline close to 4.0% compared to 4.7% as on June 30, 2021.

Earnings profile likely to remain average – With expected credit costs and other provision of 2.0-2.5% of the advances in FY2022, we expect the bank will largely absorb the majority of these provisions through its core operating profits (1.5% of assets in FY2021) for FY2022 onwards. While there could be some one-off expenditure related to the provisioning of pension costs, the RoA is likely to remain positive even after accounting for this. ICRA expects an RoA of less than 0.4% in FY2022, which is expected to improve marginally during the next year.

Liquidity position: Strong

The bank continues to have a strong liquidity profile as depicted by the positive cumulative mismatches of 6% of the total outflows in the up to 1-year maturity bucket, as per its structural liquidity statement for June 30, 2021, supported by a high share of core deposits and excess statutory liquidity ratio (SLR) investments. The liquidity coverage ratio remains strong at 168.64% (daily average for Q1 FY2022), well above the minimum regulatory requirement. Supported by its sovereign ownership, healthy liabilities profile and excess SLR holdings, ICRA expects Union Bank to maintain a strong liquidity profile.

Rating sensitivities

Positive factors – The outlook could be changed to Positive or the long-term rating could be upgraded if the bank is able to improve its solvency with net stressed assets/core capital below 40% on a sustained basis while maintaining Tier I capital cushions of more than 100 bps over the regulatory levels (9.5% including capital conservation buffer). Additionally, an improvement in the profitability with an RoA of over 0.5% will be a positive trigger.

Negative factors – The ratings will be reassessed in case of a change in the sovereign ownership. ICRA could also change the outlook to Negative or downgrade the ratings if the bank's solvency profile weakens with net stressed assets/core capital exceeding 60% on a sustained basis.

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
Parent/Group Support	The ratings factor in Union Bank'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 Union Bank. 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.

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 PSB and seventh largest bank in the Indian banking system with a total asset base of Rs. 10.2 lakh crore. The bank has a market share of 5.8% and 6.2% in net advances and total deposits, respectively, as on June

30, 2021, with the GoI holding a majority stake (83.49% as on June 30, 2021). It has a network of 9,315 branches and 12,957 ATMs as on March 31, 2021.

Key financial indicators

Union Bank of India	Q1 FY2021	FY2021	Q1 FY2022
Net interest income (Rs. crore)	6,403	24,688	7,013
Profit before tax (Rs. crore)	479	2,400	1,779
Profit after tax (Rs. crore)	333	2,906	1,181
Net advances (Rs. lakh crore)	5.8	5.9	5.9
Total assets* (Rs. lakh crore)	10.7	10.7	10.6
% CET-I	8.4%	9.1%	9.8%
% Tier I	9.5%	10.4%	11.1%
% CRAR	11.6%	12.6%	13.3%
% Net interest margin / Average total assets	2.5%^	2.4%	2.6%^
% Net profit / Average total assets	0.1%^	0.3%	0.4%^
% Return on net worth	2.4%^	5.1%	7.8%^
% Gross NPAs	15.0%	13.7%	13.6%
% Net NPAs	5.0%	4.6%	4.7%
% Provision coverage excl. technical write-offs	70.3%	69.6%	68.7%
% Net NPA / Core equity	60.6%	54.6%	52.0%

**Total assets and net worth exclude revaluation reserves*
Source: *Union Bank, ICRA Research*
^ Annualised
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 (FY2022)				Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021			Date & Rating in FY2020	Date & Rating in FY2019	
					Sep-27-2021	Mar-02-2021	Sep-11-2020	Aug-28-2020	Jun-28-2019	May-09-2018	Apr-30-2018
1	Certificates of Deposit Programme	ST	15,000.00	15,000.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Basel II Compliant Lower Tier II Bonds	LT	-	-	-	-	-	-	[ICRA]AA+ (Stable); withdrawn	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3	Basel III Compliant Tier II Bonds	LT	2,000.00	2,000.00	[ICRA]AA+ (Stable)	[ICRA]AA+(hyb) (Negative)	[ICRA]AA+(hyb) (Negative)	-	-	-	-
4	Basel III Compliant Tier II Bonds	LT	2,000.00	2,000.00	[ICRA]AA+ (Stable)	[ICRA]AA+(hyb) (Negative)	-	-	-	-	-
5	Basel II Compliant IPDI	LT	-	-			-	-	[ICRA]AA (Stable); withdrawn	[ICRA]AA (Stable)	[ICRA]AA (Stable)

Removal of (hyb) suffix from Basel III instruments

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 Union Bank. 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
Basel III Compliant Tier II Bonds	Highly Complex
Certificates of Deposit	Very Simple

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: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE692A08094	Basel III Tier II Bonds	Sep-16-2020	7.42%	Sep-16-2030*	1,000.00	[ICRA]AA+ (Stable)
INE692A08102	Basel III Tier II Bonds	Nov-26-2020	7.18%	Nov-26-2035^	1,000.00	[ICRA]AA+ (Stable)
INE692A08144	Basel III Tier II Bonds	Jun-24-2021	7.19%	Jun-24-2031%	850.00	[ICRA]AA+ (Stable)
INE692A08151	Basel III Tier II Bonds	Jul-09-2021	7.25%	Jul-09-2036$	1,150.00	[ICRA]AA+ (Stable)
-	Certificates of Deposit	NIL	-	7-365 days	15,000.00	[ICRA]A1+

**The instrument has a call option date of Sep 16, 2025*

^The instrument has a call option date of Nov 26, 2030

%The instrument has a call option date of Jun 24, 2026

$The instrument has a call option date of Jul 09, 2031

Source: *Union Bank of India*

Key features of rated debt instruments

The servicing of the Basel III Tier II bonds and certificates of deposit 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.

Further, the exercise of call option on the Basel III Tier II 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.

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Union Asset Management Company Pvt. Ltd.	100.00%	Limited Consolidation
Union Trustee Company Pvt. Ltd.	100.00%	Limited Consolidation
Union Bank of India (UK) Ltd.	100.00%	Limited Consolidation
Andhra Bank Financial Services	100.00%	Limited Consolidation
UBI Services Ltd.	100.00%	Limited Consolidation
Chaitanya Godavari Grameena Bank	35.00%	Limited Consolidation
IndiaFirst Life Insurance Company	30.00%	Limited Consolidation
ASREC India (P)	26.02%	Limited Consolidation
Star Union Dai-ichi Life Insurance Company Ltd.	25.10%	Limited Consolidation
India International Bank (Malaysia)	25.00%	Limited Consolidation

Source: *Union Bank of India and ICRA Research*

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