

October 03, 2017

Bank of Baroda

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Corporate Governance Practices	NA	CGR2; reaffirmed

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the CGR2 rating to the Corporate Governance practices of Bank of Baroda (BOB). This rating is on a scale of CGR1 to CGR6 where CGR1 denotes the highest rating. The CGR2 rating implies that in ICRA's current opinion, the rated bank has adopted and follows such practices, conventions and codes as would provide its financial stakeholders a high level of assurance on the quality of corporate governance. In case of banks, ICRA has considered financial stakeholders to include both shareholders and depositors. ICRA's opinion, however, is not a certificate of statutory compliance or a comment on the rated bank's future financial performance, credit rating or stock price.

Rationale

The rating reflects BOB's transparent ownership structure with majority ownership with Government of India (59.24% equity shares are held by GoI as on June 30, 2017) (GoI), experienced board composition, well-defined delegation of power and accountability, satisfactory board processes, effective oversight by the Board in the area of monitoring performance, strategy formulation, ensuring adherence to internal control procedures and adoption of risk management practices as per the guidelines laid down by the Reserve Bank of India (RBI) and well established structure with various sub committees of the Board. The rating also favourably factors in the bank's good risk management policies and practices in line with the structure proposed by RBI, Board level committee for overseeing risk management system and BOB's preparedness for implementation of advanced approaches of BASEL II. Further, the bank has formed a separate Board level committee to monitor recovery from such stressed accounts. The favourable factors also include BOB's strong internal audit system which along with inspection by independent statutory audit firms and inspection by RBI provides comfort towards the audit process of the bank. As for overall credit risk profile of BOB, the bank carries a [ICRA]AAA (Stable) credit rating from ICRA for its bond programmes. The ratings factor in BOB's majority sovereign ownership, its relatively better current capitalisation level (CET1 capital 8.83%) vs. other public sector banks or PSBs, its strong franchise imparting healthy and stable deposits base and sound liquidity profile.

BOB's corporate governance rating is however constrained by systemic and structural issues facing Public Sector Banks (PSBs) with respect to composition of the Board, lack of succession planning, restrictions on voting rights for non-government shareholders and other structural challenges. Most of the directors are appointed/ nominated by GoI; as on March 31, 2017 out of thirteen members on the board of BOB, ten were appointed/ nominated by GoI including director representing RBI and three were appointed by minority shareholders (shareholders other than GoI). Also, key executives of PSBs (Managing Director and Executive Directors) are appointed by majority shareholder (GoI). However, the Board has been strengthened in FY17. There has been an increase in the number of directors from 10 as on March 31, 2016 to 13 as on March 31, 2017. GOI has appointed separate MD and Chairman to the Board of BOB.

Key rating drivers

Credit Strengths

- **Transparent shareholding structure with majority GoI ownership and management control:** The bank has majority Government ownership at 59.24% as on June 30, 2017. Most of the directors are appointed or nominated by the parent; as on March 31, 2017 ten members of the Board were appointed or nominated by the GoI including director representing RBI while three shareholder directors were elected by shareholders other than the Central Government.
- **Adequate governance structure; transparent process of appointing directors and board functioning, with close monitoring by the regulator:** BOB had a thirteen member strong Board as on March 31, 2017 as compared with ten as on March 31, 2016. The members have considerable experience in their respective domains. During FY2017, an independent director was appointed in the Chartered Accountant (CA) and Human Resources (HR) field category, one director was appointed as a nominee for RBI and two executive directors were also appointed while two directors (including one executive director and one RBI nominee director) retired after completion of their tenures. ICRA notes that by virtue of being a PSB, the voting rights of minority shareholders remain limited in comparison with the minority shareholders of other companies which fall under the purview of the Companies Act.
- **Progress in compliance with building risk management systems as required by the RBI; migration to advanced approaches for monitoring risk in process:** The bank has been strengthening its risk management framework by introducing a comprehensive risk management policy, upgrading the existing systems to monitor risk and improving the IT base in its efforts to adopt advanced approaches of risk management under Basel II. The bank had applied to the RBI in September 2012 to allow it to move to the IRB Approach in calculating capital requirement emanating from Credit Risk. Bank had received permission from RBI to begin parallel run for FIRB approach under credit risk in July 2013. The bank had sought exemption for retail which they are now in the process of implementing. The bank is the process of implementing the Advanced Measurement Approaches (AMA) for operational risk and Internal Models Approach (IMA) for market risk.
- **Capitalisation profile remains adequate for current scale of operations:** The bank's capitalisation levels (CET1 of 8.83%, Tier 1 of 9.77% and CRAR of 11.81% as on June 30, 2017 as against regulatory requirement of 7.375%, 8.875% and 10.875% respectively as on March 31, 2018) remain comfortable. While capital levels are adequate for current scale of operations and projected basel III requirements, however capital cushion has been weakening consistently because of weak internal capital generation and growth in advances.

Credit weaknesses

- **Systemic issues related to composition of the Board of Directors, limits progress in adopting best practices in Board composition and functioning:** With GoI ownership of 59.24% as on June 30, 2017, ten members of the Board were appointed or nominated by the GoI while three shareholder directors were elected by shareholders other than the GoI. Consequently there is limited representation of shareholders other than the GoI which in turn affects the overall corporate governance for the bank. In addition, the bank is faced with regulatory issues pertaining to ownership and cap on voting rights for minority shareholders being a PSB.
- **Weak profitability and subdued asset quality:** ICRA has taken note of the bank's weak asset quality (gross and net NPA of 11.40% and 5.17% respectively as on June 30, 2017) and the subdued profitability (profit after tax (PAT) % of Average Total Assets (ATA) of 0.20% in FY2017 and 0.12% in Q1FY2018). ICRA, however, takes comfort from BOB's provision coverage of 57.7% as on June 30, 2017 being the highest in the industry (Public sector bank's (PSB) average of 43% as on June 30, 2017). With high provision coverage, the solvency ratio for the bank stood at 52.9% as on

June 30, 2017 as compared to PSB average of 83%. The ability of the bank to restrict slippages to similar level as FY2017 along with resolutions in already slipped accounts will remain a key rating monitorable.

- **Lack of flexibility in employee compensation constrains the bank's ability to attract and retain talent:** Being a PSB, the bank faces difficulties in adopting emerging best practices in the area of succession planning and executive compensation, which in turn affects the competitive position of the bank vs. other private sector banks. The bank also lags behind private and foreign banks in technology adoption and service quality

Analytical approach:

For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria

[ICRA's Corporate Governance Rating Methodology](#)

About the bank

BOB was incorporated in 1908 and was under private ownership and control till July 1969 when it was nationalized along with 13 other banks. Government of India held 59.24% stake in the bank as on Jun 30, 2017. The bank has a wide spread domestic network of 5,434 branches across India (as on June 30, 2017) and a large overseas presence with 107 offices. During the year ended March 31, 2017, BoB reported a net profit of Rs. 1,383 crore on total assets of Rs.6.91 lakh crore as compared to a net loss of Rs. 5,396 crore on total assets of Rs. 6.67 lakh crore during the previous year. The bank's Gross NPA% and Net NPA% stood at 10.46% and 4.72% respectively as on March 31, 2017 as against 9.99% and 5.06% respectively, as on March 31, 2016. The regulatory capital adequacy ratio stood at 12.24% as on March 31, 2017 (Tier 1: 9.93% and CET 1 of 8.98%). The bank reported a PAT of Rs. 203 crore in Q1FY2018 as compared to Rs.424 crore in Q1FY2017. The gross and net NPA% stood at 11.40% and 5.17% respectively as on June 30, 2017.

Key Financial Indicators:

	FY2016	FY2017	Q1FY2017	Q1FY2018
Net Interest Income	12,740	13,513	3,371	3,405
Profit before tax	-6,698	2,473	665	280
Profit after tax	-5,396	1,383	424	203
Net advances	383,770	383,259	362,766	377,607
Total assets	667,250	691,299	657,655	660,906
% CET 1	10.29%	8.98%	10.19%	8.83%
% Tier 1	10.79%	9.93%	10.70%	9.77%
% CRAR	13.17%	12.24%	13.07%	11.81%
% Net Interest Margin / Average total assets	1.84%	1.99%	2.04%	2.01%
% Net Profit / Average total assets	-0.78%	0.20%	0.26%	0.12%
% Return on Net Worth	-14.40%	3.80%	4.67%	2.21%
% Gross NPAs	9.99%	10.46%	11.15%	11.40%
% Net NPAs	5.06%	4.72%	5.73%	5.17%
% Provision coverage excl. technical write offs	52.11%	57.68%	51.66%	57.73%
% Net NPA/ Net worth	53.80%	49.23%	56.95%	52.85%

*Source: Bank's investor presentation and ICRA research; Amount in Rs. crore
All ratios are as per ICRA calculations*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for last three years:

Table:

Sr. No.	Name of Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years					
		Type	Rated amount (Rs. crore)	Oct 2017	Jun 2017	FY2017	FY2016		Fy2015		
						Jul 2016	Jul 2015	April 2014	Dec 2013	Jul 2013	April 2013
1	Basel III Compliant Tier II Bonds Programme	Long Term	1,000	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	-	-
2	Term Deposits Programme	Long Term	NA	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)
3	Basel II Compliant Tier II Bonds Programme	Long Term	-	-	-	[ICRA] AAA (stable) withdrawn	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)
4	Certificate of Deposit Programme	Short Term	-	-	[ICRA] A1+ withdrawn	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
5	Corporate Governance Rating	-	-	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2	CGR2

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

**Annexure-
Instrument Details**

ISIN No.	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
INE028A08059	Basel III Compliant Tier II Bonds Programme	17-Dec-2013	9.73%	17-Dec-2023	1,000	[ICRA]AAA (hyb) (stable)
NA	Medium Term Deposits	-	-	-	-	MAAA (stable)

Source: BOB

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