ICRA

November 13, 2017

Bank of India

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 India (BOI). 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 BOI's transparent ownership structure with majority ownership with Government of India (75.12% equity shares are held by GoI as on September 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 BOI'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 BOI'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 BOI, the bank carries a [ICRA]AA-(negative) credit rating from ICRA for its innovative perpetual debt instruments and a rating of MAA+(negative) for the term deposits programme. The ratings factor in BOI's majority sovereign ownership, its strong franchise imparting healthy and stable deposits base and sound liquidity profile. The rating also factors in BOI's weak current capitalisation level (CET1 capital 7.28% as on June 30, 2017) vs. similar rated public sector banks or PSBs.

BOI'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 October 31, 2017 out of ten members on the board of BOI, eight were appointed/ nominated by GoI including director representing RBI and two 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). GOI has appointed separate MD and Chairman to the Board of BOI.

Key rating drivers

Credit Strengths

- **Transparent shareholding structure with majority GoI ownership and management control -** The bank has majority Government ownership at 75.12% as on September 30, 2017. Most of the directors are appointed or nominated by the parent; as on October 31, 2017 eight members of the Board were appointed or nominated by the GoI including director representing RBI while two 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:** BOI had a ten member strong Board as on October 31, 2017. The members have considerable experience in their respective domains. During FY2017 and till date, new CEO and MD and two executive directors were appointed in place of existing directors. The nominee directors for RBI and GoI retired and were duly replaced. One independent director was appointed in the Chartered Accountant (CA) field category while one office employee director retired after completion of his tenure. Both the shareholder directors completed their tenure in October 2017 and new directors were appointed in their place. 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 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 August 2013. The bank had sought exemption for retail which they are now in the process of implementing. The bank has also applied to the RBI to allow it to move to Advanced Measurement Approaches (AMA) for operational risk and Internal Models Approach (IMA) for market risk and the approval is awaited.

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 75.12% as on September 30, 2017, eight members of the Board were appointed or nominated by the GoI while two 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 -** The headline asset quality of the bank continued to be under stress, with fresh slippages remaining high during FY2017 and Q1FY2018. While there was an improvement in recoveries and upgradations, the bank’s gross and net NPAs remained elevated at 13.05% and 6.70% respectively as on June 30, 2017 (13.22% and 6.90% respectively as on March 31, 2017 and 13.07% and 7.79% respectively as on March 31, 2016). ICRA however takes comfort from the bank’s high provision coverage ratio (52.23% as on March 31, 2017 as against PSB average of 43.1% and banking sector average of 43.6%); this strengthens the bank’s ability to absorb any significant future losses. While the bank’s operating profit/ ATA stood at 1.05% in FY2017 (0.87% in FY2016), its high credit cost (credit provisions/ ATA of 1.94% in FY2017 and 2.23% in FY2016) resulted in continued net losses (PAT/ATA of -0.25% in FY2017 and -1.00% in FY2016). The ability of the bank to curtail incremental slippages and demonstrate recoveries from the current pool of NPA accounts will remain a key rating consideration.

- **Weak current capitalisation compared to similar rated peers -** Notwithstanding the regular capital infusion from the GoI (Rs. 2,838 crore in FY2017 and Rs. 3,605 crore in FY2016), the bank's capitalisation (CET-1 of 7.28%, Tier 1 of 9.02% and CRAR of 12.38% as on June 30, 2017 as against regulatory requirement including CCB of 7.375%, 8.875% and 10.875% respectively for March 2018) remained weaker than that of other similar rated peer banks. The bank's capitalisation was also supported by the Rs. 2,500 crore additional tier I bonds raised during FY2017. ICRA takes note of the proposed capital infusion by GoI under the bank recapitalisation plan, however, the quantum of the capital allocation to BOI will be 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
Bank of India (BOI) was incorporated in 1906 and was nationalised along with 13 other banks, in July 1969. The Government of India held a 75.12% stake in the bank as on September 30, 2017. The bank has a wide spread network of 5,125 branches and 7,717 ATMs across India as on June 30, 2017. During FY2017, the bank reported a net loss of Rs. 1,558 crore on a total asset base of Rs. 6.26 lakh crore as on March 31, 2017 as against a net loss of Rs. 6,089 crore during FY2016 on a total asset base of Rs. 6.08 lakh crore as on March 31, 2016. Further, in Q1FY2018, the bank reported a net profit of Rs. 88 crore on a total asset base of Rs. 6.20 lakh crore as on June 30, 2017 as against a net loss of Rs. 741 crore during Q1FY2017 on a total asset base of Rs. 5.87 lakh crore The bank reported a capital adequacy of 12.38% with a Tier I capital of 9.02 % (CET-1 of 7.28%) as on June 30, 2017.

Key Financial Indicators:

	FY2016	FY2017	Q1FY2017	Q1FY2018
Net Interest Income	11,725	11,826	2,775	2,533
Profit before tax	(7,791)	(2,373)	(1,116)	134
Profit after tax	(6,089)	(1,558)	(741)	88
Net advances	359,189	366,482	363,386	363,978
Total assets	604,608	621,344	586,759	620,272
% CET 1	7.97%	7.17%	7.59%	7.28%
% Tier 1	9.03%	8.90%	9.00%	9.02%
% CRAR	12.01%	12.14%	12.10%	12.38%
% Net Interest Margin / Average total assets	1.92%	1.93%	1.87%	1.63%
% Net Profit / Average total assets	-1.00%	-0.25%	-0.50%	0.06%
% Return on Net Worth	-23.90%	-6.08%	-11.98%	1..30%
% Gross NPAs	13.07%	13.22%	13.38%	13.05%
% Net NPAs	7.79%	6.90%	7.78%	6.70%
% Provision coverage excl. technical write offs	43.87%	51.38%	45.52%	52.23%
% Net NPA/ Net worth	114.42%	94.42%	112.90%	89.89%

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.	Instrument	Current Rating (FY2018)				Chronology of rating history for the past 3 years					
						FY2017			FY2016		FY2015
		Type	Rated amount (Rs. crore)	Nov 2017	June 2017	Sep 2016	Aug 2016	July 2016	Feb 2016	Nov 2015	Jul 2014
1	Innovative Perpetual Debt Instruments	Long Term	658	[ICRA]AA-(negative)	[ICRA]AA-(negative) Outlook revised to negative	[ICRA]AA-(stable)	[ICRA]AA-(stable)	[ICRA]AA-(stable)	[ICRA]AA-(stable); downgraded from [ICRA]AA(stable)	[ICRA]AA(stable) downgraded from [ICRA]AA+(stable)	[ICRA]AA+(stable)
2	Term Deposits Programme	Long Term	-	MAA+(negative)	MAA+(negative); Outlook revised to negative	MAA+(stable)	MAA+(stable)	MAA+(stable)	MAA+(stable) downgraded from MAAA(stable)	MAAA(stable)	MAAA(stable)
3	Lower Tier II Bonds Programme	Long Term	-	-	--	-	-	[ICRA]AA(stable); withdrawn	[ICRA]AA(stable); downgraded from [ICRA]AA+(stable)	[ICRA]AA+(stable); downgraded from [ICRA]AAA(stable)	[ICRA]AAA(stable)
4	Upper Tier II Bonds Programme	Long Term	-	-	-	-	[ICRA]AA-(stable) withdrawn	[ICRA]AA-(stable)	[ICRA]AA-(stable); downgraded from [ICRA]AA(stable)	[ICRA]AA(stable); downgraded from [ICRA]AA+(stable)	[ICRA]AA+(stable)
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-1

Instrument Details

ISIN No.	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Rated Amount (Rs. crore)	Current Rating and Outlook
NA	Innovative Perpetual Debt Instruments	Yet to be placed	Yet to be placed	Yet to be placed	3	[ICRA]AA- (Negative)
INE084A09126	Innovative Perpetual Debt Instruments^	27-Jul-2007	10.55%	Perpetual (Call: 27-Jul-2017)	400	[ICRA]AA- (Negative)
INE084A09134	Innovative Perpetual Debt Instruments^	27-Sep-2007	10.45%	Perpetual (Call: 27-Sep-2017)	100	[ICRA]AA- (Negative)
INE084A09142	Innovative Perpetual Debt Instruments^	11-Oct-2007	10.40%	Perpetual (Call: 11-Oct-2017)	155	[ICRA]AA- (Negative)
NA	Term Deposits Programme	-	-	-	-	MAA+ (Negative)

Source: BOB

^to be withdrawn

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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.

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