

## India Ratings Affirms Union Bank of India at 'IND AA+' / Stable; Off RWE

# 14

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India Ratings and Research (Ind-Ra) has affirmed Union Bank of India's (Union) Long-Term Issuer Rating at 'IND AA+' while resolving the Rating Watch Evolving (RWE). The Outlook is Stable. The detailed rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier II bonds*	-	-	-	INR45	IND AA+/Stable	Affirmed; Off RWE
Basel III Additional Tier 1 (AT1) Perpetual Bonds*	-	-	-	INR45	IND AA/Stable	Affirmed; Off RWE

\*Details in Annexure

**Analytical Approach:** Ind-Ra continues to take a consolidated view of Union and its subsidiaries while arriving at the ratings. Union's ratings were placed on RWE on 4 September 2019, following the finance ministry's announcement on the proposed amalgamation of Corporation Bank and Andhra Bank with Union, with Union being the anchor bank post amalgamation. Subsequently, post receiving all the necessary regulatory approvals, the amalgamation came into effect from 1 April 2020.

The resolution of RWE factors in an increase in Union's systemic importance post its amalgamation with Corporation Bank and Andhra Bank and continued support from the government of India's (GoI) given its majority shareholding at 89.1%, as at end-June 2020. Post the amalgamation, the bank's total deposit and net advances market share increased to around 6.7% and 6.1%, respectively, at FYE20, thereby making it the fifth-largest public sector bank. While the bank has received periodic equity support from the GoI, Ind-Ra expects the bank's asset quality and capital buffers to be

under pressure for FY21 and FY22 owing to incremental provisioning requirement apart from ageing provisions due to the challenging macro-economic environment. The bank's asset quality; provisioning requirements; capital position; and the GoI's consequent stance and actions towards the bank will be a key monitorable.

For AT1 instruments, the agency considers the discretionary component, coupon omission risk and the write-down/conversion risk as key parameters to arrive at the rating. The agency recognises the unique going-concern loss absorption features that these bonds carry and differentiates them from the bank's senior debt, factoring in a higher probability of an ultimate loss for investors in these bonds.

The agency also notes the sharp improvement in distributable reserves of the bank on an amalgamated basis as at end-June 2020, which has significantly improved the bank's coupon-paying ability on its AT1 instruments. This is the result of the bank setting off its accumulated losses of INR327.58 billion against its securities premium. This is post receiving the shareholder approval in August 2020 supported by an enabling provision, in line with the gazette notification issued by the Ministry of Finance on 23 March 2020 which allows a nationalised bank to appropriate any sum from its share premium account by following the same procedure for reduction of paid-up capital. The same is subject to regulatory approval and be in effect in the books of accounts upon the receipt of the Reserve Bank of India's approval. Ind-Ra believes that this provision reduces the risk of erosion of serviceable distributable reserve as banks can set-off their losses through premium account if required. Post the above adjustment, the bank's distributable reserves now stand at 4.8% of risk weighted assets, as at end-June 2020. The agency believes that with the promulgation of the aforementioned gazette notification, the loss-absorbing characteristics of the AT1 instrument stands diluted.

## KEY RATING DRIVERS

**Increased Systemic Importance:** Union's systemic importance is reflected in its increased market share in deposits and net advances at FYE20 due to its amalgamation with Corporation Bank and Andhra Bank with effect from 1 April 2020. Post the amalgamation, the bank's total deposit and net advances market share increased to around 6.7% and 6.1%, respectively, at FYE20, thereby making it the fifth-largest public sector bank.

As of June 2020, the amalgamated bank had over 9,500 domestic branches, over 13,300 ATMs and more than 120 million customers, making it a significantly larger franchise post amalgamation. Union received a capital infusion of INR41.1 billion from the GoI in FY19 and INR117.7 billion in FY20 and the agency expects the government support to continue, if required, and the same has been factored into the ratings.

**Asset Quality Challenges to Continue:** The agency in its recent report highlighted that around 7.7% of the total bank credit as at end-March 2020 could come under restructuring from corporate and non-corporate segments. With the prevailing COVID-19 pandemic situation, the agency believes that certain corporate sectors would be impacted severely, despite borrowers opting for a debt moratorium.

Union had indicated that 24%-28% of its term loan book by value, had availed of the RBI-prescribed moratorium between March and June 2020. The bank expects 5%-6% of its book to come under restructuring and that the need for restructuring will largely arise in the corporate and micro, small and medium enterprises segments, where the impact of COVID-19 led lockdown is more severe. The agency believes the stressed assets that were not eligible for restructuring could subsequently slip into NPAs, which may lead to slippages of around 2.75%-3.00% for FY21.

Union's gross NPA and net NPA stood at 14.95% and 4.97%, respectively, as at end-1QFY21 (end-4QFY20: 14.6% and 5.2%; 1QFY20: 15.6% and 6.5%). The overall provision coverage ratio (excluding technical write-offs) improved to 70.3% as at end-1QFY21 (end-4QFY20: 67.8%; 1QFY20: 62.6%) in line with its similar-rated peers. Ind-Ra, however, believes that the weakening economy (GDP contracting 11.8% in FY21) could result in a significant asset quality deterioration for the overall banking industry.

**Moderate Capital Buffers:** Union has moderate capital buffers relative to its similar-rated peers, as reflected in common equity tier I (CET-I) ratio and tier-I capital adequacy ratio (CRAR) of 8.4% and 9.5%, respectively, as at 1QFY21 (FYE20: 8.6% and 9.8% on amalgamated basis and 9.4% and 10.8% on standalone basis). While the bank received sizeable capital infusion of INR117.7 billion in FY20, the capital buffers of the amalgamated entity moderated/depleted due to high credit costs of 5.4% (INR88.24 billion) in 4QFY20. The agency believes the COVID-19 led lockdown and its subsequent impact could result in incremental credit costs as the weak borrower profiles could see defaults in almost all the business segments that are not a part of the current restructuring framework. The bank has

provisioned for INR6.83 billion on account of the COVID-19 related provisions. If the slippages and credit cost requirements are significantly higher than the management's expected business-as-usual slippages, then Union could see capital erosion and may further need capital support from the GoI to maintain its minimum regulatory requirement.

**Liquidity Indicator – Adequate:** Union's short-term (one year) asset liability mismatches at end-1QFY21 at 6.1% were in line with most similar-rated peers. The average liquidity coverage ratio was 163.8% at end-1QFY21, well above the regulatory requirement of 100%. Also, the bank maintains over 20% of its total assets in balances with the RBI and in government securities, indicating that it will be able to meet its short-term funding requirements. The agency believes the banks' funding gap will not widen materially, unless it changes its liability structure materially.

**Profitability Remains Under Pressure:** Union witnessed net losses of INR71.56 billion in 4QFY20 mainly due to an increase in provisions. It reported a marginal net profit of INR3.32 billion in 1QFY21.

Prior to the outbreak of COVID-19, Ind-Ra expected the amalgamated bank to witness at least 2.5%-2.6% credit costs in FY21, against an expected pre-provisioning operating profits of 2.6%; the COVID-19 impact could further add credit costs to this estimate. These credit costs, the agency believes, will emanate from aging provisions; slippages from existing stressed accounts; provisioning on restructured book and slippages on account of COVID-19, thereby exerting pressure on the bank's profitability in FY21. The bank has, in the last two years, focussed on retail growth and better-rated corporates. Ind-Ra expects branch rationalisation benefits to materialise for the bank over the next three-four years.

## RATING SENSITIVITIES

**Negative:** Union's Basel III Tier 2 bond ratings have been equated to its Long-Term Issuer Rating, which could change if there is a change in the GoI's support stance, thereby restricting its ability to maintain its systemic importance, or if the equity buffers of the bank consistently operate at close to the minimum regulatory levels.

The rating of the AT1 bonds could be downgraded in case of a material deterioration in the unsupported credit profile of the bank which, among other factors, could reflect in a material decline in Union's market share, loss of deposit franchise or a large spike in delinquencies. The ratings could also be downgraded in the event of the bank reporting high annual losses, or a significant depletion of CET-1 capital buffers on a consistent basis (threshold of 100 basis points above the minimum regulatory requirements for CET-I and tier-I), which could impair the coupon-servicing capability. This could be important in case the bank incurs losses, causing the capital ratios to fall below the minimum regulatory requirement, thereby impairing its ability to pay coupons.

**Positive:** A significant increase in Union's market share in advances and deposits, leading to a material increase in its systemic importance and consistent improvement in the bank's capital and profitability buffers could lead to the Outlook revision to Positive.

## COMPANY PROFILE

Union is a public sector bank with operations across India. At end-June 2020, the bank had more than 9,500 domestic branches, more than 13,300 ATMs and more than 120 million customers. At end-June 2020, the GoI held 89.1% stake in Union.

## FINANCIAL SUMMARY

Particulars (INR billion)	1QFY21 (Amalgamated)	4QFY20 (Amalgamated)
Net advances	5,817.17	5,998.30
Total deposits	8,925.41	8,686.32
Net income/loss	3.32	-71.56
CET I (%)	8.4	8.6

Capital adequacy ratio (%)	11.6	12.1
Source: Union, Ind-Ra		

## RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook/Rating Watch		
	Rating Type	Rated Limits (billion)	Rating	11 September 2020	5 November 2019	30 October 2018
Issuer Rating	Long-term	-	IND AA+/Stable	IND AA+/RWE	IND AA+/RWE	IND AA+/Negative
Basel III AT1 Bonds	Long-term	INR45	IND AA/Stable	IND AA/RWE	IND AA/RWE	IND AA/Negative
Basel III-Complaint Tier II Bonds	Long-term	INR45	IND AA+/Stable	IND AA+/RWE	IND AA+/RWE	IND AA+/Negative

## ANNEXURE

Issue Name/Type	ISIN	Date of Allotment	Tenor (years)	Maturity Date	Amount Mobilised (billion)	Coupon Rate (% p.a.)	Put/Call Option	Rating/Outlook
<b>Basel III Compliant Tier II Bonds</b>								
Basel III-Complaint Tier II Bonds	INE692A09274	29 March 2016	10	29 March 2026	INR10	8.61	Call – 29 March 2021	IND AA+/Stable
Basel III-Complaint Tier II Bonds	INE112A08044	14 November 2017	10	14 November 2027	INR5	8.02	Nil	IND AA+/Stable
Basel III-Complaint Tier II Bonds	INE112A08051	8 November 2019	10	8 November 2029	INR10	8.93	Nil	IND AA+/Stable
Basel III-Complaint Tier II Bonds	INE692A08094	16 September 2020	10	16 September 2030	INR10	7.42	Call – 16 September 2025	IND AA+/Stable
<b>Total utilised</b>					<b>INR35</b>			
<b>Total unutilised</b>					<b>INR10</b>			
<b>Basel III Compliant AT1 Bond</b>								
Basel III AT1 Bonds	INE692A08029	15 September 2016	Perpetual	Perpetual	INR10	9.50	Call - 15 September 2026	IND AA/Stable

Basel III AT1 Bonds	INE692A08037	4 November 2016	Perpetual	Perpetual	INR10	9.00	Call - 4 November 2021	IND AA/Stable
Basel III AT1 Bonds	INE692A08052	29 March 2017	Perpetual	Perpetual	INR2.5	9.10	Call - 29 March 2022	IND AA/Stable
Basel III AT1 Bonds	INE692A08060	30 March 2017	Perpetual	Perpetual	INR7.5	9.10	Call - 30 March 2022	IND AA/Stable
Basel III AT1 Bonds	INE692A08078	31 March 2017	Perpetual	Perpetual	INR5	9.10	Call - 31 March 2022	IND AA/Stable
Basel III AT1 Bonds	INE692A08086	3 May 2017	Perpetual	Perpetual	INR5	9.08	Call - 3 May 2022	IND AA/Stable
<b>Total utilised</b>					<b>INR40</b>			
<b>Total unutilised</b>					<b>INR5</b>			

## COMPLEXITY LEVEL OF INSTRUMENTS

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## Applicable Criteria

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Financial Institutions Rating Criteria  
Rating Bank Subordinated and Hybrid Securities

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