June 30, 2021

Bank of Baroda: Rating reaffirmed for Tier II bonds and Fixed Deposit Programme; upgraded for AT-I bonds

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bonds	2,450.00	2,450.00	[ICRA]AAA(hyb)(Stable); reaffirmed
Fixed Deposit Programme	-	-	MAAA(Stable); reaffirmed
Basel III Compliant AT-I Bonds	500.00	-	[ICRA]AA+(hyb)(Stable); upgraded from [ICRA] AA(hyb)(Stable) and withdrawn
Basel III Compliant AT-I Bonds	325.00	325.00	[ICRA]AA+(hyb)(Stable); upgraded from [ICRA]AA(hyb)(Stable)
Total	**3,275.00**	**2,775.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating upgrade for the Basel III Compliant Additional Tier – I (AT-I) bonds factors in Bank of Baroda's (BoB) proposal to set off its accumulated losses against the share premium account, which has been approved by its board of directors. While the proposal is pending regulatory approval, ICRA notes that multiple public sector banks (PSBs) have made similar adjustments recently and have already received regulatory approval from the Reserve Bank of India (RBI) for the same. The proposed adjustments will significantly increase the bank's distributable reserves (DRs), which can be used to service the coupon on these bonds in a year of loss. As of March 31, 2021, the bank's DRs stood at 2.85% of the risk-weighted assets (RWAs) and are likely to increase to 4.6% of the RWAs, thereby significantly augmenting its ability to service the coupon on its Tier I bonds.

The ratings reaffirmation on the other instruments continues to factor in BoB's sovereign ownership and strong, imparting a healthy and stable deposit base and a superior liquidity profile. In terms of the overall business (advances and deposits), BoB is the third largest PSB and fourth largest bank in the Indian banking system as on March 31, 2021. Given its importance, ICRA expects the bank to continue to receive support from the Government of India (GoI), if required.

Despite the Covid-19-induced stress on the asset quality, domestic slippages remained lower in FY2021 and were supported by regulatory/policy measures such as the Emergency Credit Line Guarantee Scheme (ECLGS) and one-time loan restructuring. However, BoB faced elevated slippages in its overseas book, which largely includes corporate loans. The restructuring (including micro, small and medium enterprise (MSME) and Covid-19 restructuring) implemented by the bank stands at Rs. 11,359 crore (1.6% standard advances as on March 31, 2021). In addition the bank has also received request for Covid-19 restructuring of Rs. 7,114 crore (1.04%). With restructuring, the bank was able to prevent a sharp jump in the reported non-performing advances (NPAs). Accordingly, the net NPAs remained stable at 3.09% as on March 31, 2021 (3.13% as on March 31, 2020). BoB had a high level of overdue advances with special mention account (SMA)[1]-1 and SMA-2 standing at 3.87% of standard advances as on March 31, 2021. This, along with the second wave of the Covid-19 pandemic, the legacy net NPAs

[1] *SMA is defined as a special mention account (SMA), which is an account exhibiting signs of incipient stress resulting in the borrower defaulting in the timely servicing of their debt obligations though the account has not yet been classified as an NPA as per the extant RBI guidelines; SMA-1 accounts are overdue by 31-60 days and SMA-2 accounts are overdue by 61-90 days*

and the restructured book, is likely to keep the asset quality and credit provisioning pressures high in FY2022 and may prevent a meaningful improvement in the profitability.

The Stable outlook on the ratings factors in ICRA's expectations that the bank will largely be able to absorb credit losses through its operating profits while continuing to further improve on its asset quality and solvency position. As per ICRA's estimates, BoB is well placed in terms of its capital position for absorbing incremental stress as well as for growth requirements while maintaining more than the desired cushion of 1% on the capital above the regulatory levels.

ICRA has withdrawn the rating assigned to the Rs. 500-crore AT-I bonds as these are fully redeemed and no amount is outstanding against the rated instrument. The rating was withdrawn in accordance with ICRA's policy on withdrawal and suspension (click here for the policy).

Key rating drivers and their description

Credit strengths

Sovereign ownership and third largest PSB in terms of total asset base – The GoI remains the largest shareholder of BoB with a 63.97% equity stake as on March 31, 2021. It has infused capital of Rs. 21,739 crore between FY2018 and FY2020 into the bank [including e-Dena Bank (e-DB) and e-Vijaya Bank (e-VB)]. BoB is the third largest PSB in the Indian banking sector with an estimated market share of 6.4% in total assets as on March 31, 2021. Given its increased significance in the industry, ICRA expects that BoB could be classified as a domestic systemically important bank (D-SIB), which could require additional equity capital over and above the minimum regulatory requirements. This shall not be a challenge for the bank, given ICRA's outlook on the capital position. Further, ICRA expects BoB to receive continued support from the GoI in terms of required capital as and when required, given its significant importance in the system.

Improved capital position – In FY2021, the bank raised equity of Rs. 4,500 crore from the market, which led to a reduction in the GoI's stake to 63.97% as on March 31, 2021 from 71.60% earlier. With the recent capital raise and improved internal capital generation in FY2021, BoB improved its capital ratios with CET I of 10.94%, Tier I of 12.67% and CRAR of 14.99% as on March 31, 2021 compared to 9.44%, 10.71% and 13.30%, respectively, as on March 31, 2020. ICRA estimates the bank is well placed in terms of its capital position for absorbing incremental stress as well as for growth requirements while maintaining more than the desired cushion of 1% on the capital above the regulatory levels. With the improved capital position, the solvency[2] level also improved to 33% as on March 31, 2021 from 39% as on March 31, 2020 and ICRA expects the same to improve marginally in FY2022 even without any incremental capital raise. The subsidiaries largely remain self-sufficient in meeting their capital requirements in the near-to-medium-term and will require limited capital support from BoB.

Well-developed deposit franchise, leading to competitive cost of funds – Supported by its large branch network across India and well-developed customer franchise, BoB holds a strong position with a 6.6% market share in deposits as on March 31, 2021. The bank had rationalised ~1,300 branches in FY2021 as a part of an amalgamation exercise with e-VB and e-DB. Further, the share of the top 20 depositors stood low at 4.5% of the total deposits as on March 31, 2021. As a result of its widespread deposit franchise, the domestic current account and savings account (CASA) deposit base remained close to the PSB average.

As it is the third largest public bank with a healthy corporate loan book, CASA deposits witnessed an uptick on the back of growth in CA deposits in FY2021 due to the RBI's recent CA circular wherein borrowers with a CC/OD limit with a bank are required to have a CA with the same bank. This led to an improvement in the CASA ratio to 40.15% of total deposits as on March 31, 2021 (35.29% as on March 31, 2020). BoB operates with a low cost of interest-bearing funds, which stood at 4.01% in FY2021 (partially supported by the sizeable overseas asset and deposit base). Going forward, ICRA expects BoB's liability profile to remain a significant positive for supporting its credit growth while maintaining superior liquidity and profitability.

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[2] *Solvency defined as (Net NPAs + Net security receipts + Net non-performing investments) / Core capital)*

Credit challenges

Asset quality remains monitorable – BoB's slippages moderated in FY2021, with fresh gross NPA (GNPA) addition of Rs. 20,005 crore or ~3% of standard advances (Rs. 23,315 crore or ~4% in FY2020). Unlike FY2020, when domestic slippages from corporate accounts were the driver of slippages, the bank witnessed high slippages in corporate loans from its overseas book. The extent of addition to the stock of GNPAs, however, was contained by recoveries and upgrades (Rs. 7,290 crore) and large write-offs of Rs. 15,426 crore in FY2021. This led to a marginal reduction in the GNPAs and NNPAs to Rs. 66,671 crore (8.87%) and Rs. 21,800 crore (3.09%), respectively, as on March 31, 2021 from Rs. 69,381 crore (9.40%) and Rs. 21,577 crore (3.13%), respectively, as on March 31, 2020. The bank's SMA-1 and SMA-2 accounts (>Rs. 5 crore) stood at 3.87% of standard advances while the one-time restructuring book is estimated at Rs. 18,500 crore or 2.70% of standard advances as on March 31, 2021. With the onset of the second wave of the pandemic and given the elevated SMA levels, the asset quality remains a monitorable. ICRA expects that the slippages should incrementally tend to be lower than what the bank witnessed during the last few years, leading to a steady reduction in the GNPAs and NNPAs.

Profitability could remain muted if slippages increase – Supported by the competitive cost of interest-bearing funds, improving asset quality and lower total slippages (lower interest reversals), the operating profit (before divestments and trading income) improved to 1.49% of average total assets (ATA) in FY2021 (1.45% in FY2020). However, it remains lower than the pre-merger levels of 1.67% in FY2019. With lower slippages in FY2021, the credit costs also declined (1.27% of ATA in FY2021 compared to 1.75% of ATA in FY2020). This, coupled with the strong gains on the bond portfolios, resulted in an improvement in the pre-tax profit to 0.48% of ATA in FY2021 (-0.16% in FY2020). As the bank moved to a new tax regime with lower tax rates, it wrote off deferred tax assets leading to a lower improvement in the return on assets (RoA) and return on equity (RoE) in FY2021.

Going forward, given the impact of the second wave of the pandemic, the outlook on the asset quality and profitability remains a monitorable. ICRA expects that the bank would largely be able to absorb the incremental credit provisions through its operating profits while reducing its net NPAs. However, that could lead to limited internal capital generation in FY2022, which is likely to improve FY2023 onwards.

Liquidity position: Superior

BoB's liquidity profile remains superior supported by a high statutory liquidity ratio (SLR) of ~23% of the net demand and time liabilities (NDTL) as on March 31, 2021 (above the regulatory requirement of 18%) and comfortable liquidity coverage ratio (LCR) of ~181% of high quality liquid assets (HQLA; daily average) in Q3 FY2021. ICRA expects BoB to maintain superior liquidity, given the large proportion of retail deposits and the high portfolio of liquid investments. It can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility mechanism) in case of urgent liquidity needs.

Rating sensitivities

Positive factors – Not applicable as all the ratings are at the highest possible level

Negative factors – Given its sovereign ownership and its position as the third largest public bank, ICRA expects BoB to receive requisite capital support from the GoI, if required. Any dilution in the expected stance will be a credit negative. Solvency weaker than 40% on a sustained basis could also be a credit negative for the bank.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating ICRA's Policy on Withdrawal of Credit Ratings
Parent/Group Support	The ratings factor in BoB's sovereign ownership and the demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support BoB with capital infusions, if required.
Consolidation/Standalone	The ratings are based on the standalone financial statements of BoB. However, in line with ICRA's limited consolidation approach, the capital requirements of BoB's key subsidiaries have been factored in while assessing its credit profile.

About the company

Bank of Baroda was incorporated in 1908 and was nationalised in 1969, along with 13 other major commercial banks of India, by the GoI. BoB is headquartered in Vadodara while its corporate office is in Mumbai.

On September 17, 2018, the GoI announced the merger of Vijaya Bank and Dena Bank with BoB. The merger came into effect on April 01, 2019. As of March 31, 2021, the bank had 8,214 branches and 10,033 ATMs across India, of which ~60% are rural/semi-urban branches. It has an international presence spanning 96 overseas offices across 19 countries. Post-merger, BoB is the third largest PSB in the Indian banking sector with an estimated market share of 6.4% in total assets as on March 31, 2021. The GoI held a 63.97% stake in the bank as on March 31, 2021.

BoB reported a net profit of Rs. 829 crore in FY2021 on a total asset book of Rs. 11.50 lakh crore[3]. Its gross NPA% and net NPA% stood at 8.87% and 3.09%, respectively, as on March 31, 2021. The regulatory capital adequacy ratio stood at 14.99% as on March 31, 2021 (CET I: 10.94% and Tier I of 12.67%).

[3] *Excluding revaluation reserves*

Key financial indicators (standalone)

	FY2020	FY2021
Net interest income	27,451	28,809
Operating profit (excl trading gain)	16,146	17,254
Profit after tax	546	829
Net advances (Rs. lakh crore)	6.90	7.06
Total assets* (Rs. lakh crore)	11.52	11.50
% Net interest margin / Average total assets	2.46%	2.50%
% Return on assets	0.05%	0.07%
% Return on net worth	0.83%	1.15%
% CET I	9.44%	10.94%
% Tier I	10.71%	12.67%
% CRAR	13.30%	14.99%
% Gross NPA	9.40%	8.87%
% Net NPA	3.13%	3.09%
% PCR (excl TWO)	69%	67%
% Solvency ((NNPA + SRs + NPIs)/CET)	39.0%	33.4%

Source: *BoB & ICRA research; Amount in Rs. crore unless mentioned otherwise*
** Excluding revaluation reserve; All ratios as per ICRA calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Sr. No.	Name of Instrument	Current Rating (FY2022)					Chronology of Rating History for the Past 3 Years			
		Type	Rated Amount	Amount Outstanding	FY2022	FY2021	FY2020	FY2019		
					Jun-30-2021	Jun-12-2020	Apr-26-2019	Nov-29-2018	Sep-28-2018	Jun-11-2018
1	Basel III - Tier II Bonds Programme	Long Term	1,000.0	1,000.0	**[ICRA]AAA(hyb) (Stable)**	**[ICRA]AAA(hyb) (Stable)**	**[ICRA]AAA(hyb) (Stable)**	**[ICRA]AAA (hyb)&**	**[ICRA]AAA (hyb)&**	**[ICRA]AAA (hyb) (Stable)**
2	Term Deposits Programme	Long Term	NA	NA	**MAAA (Stable)**	**MAAA (Stable)**	**MAAA (Stable)**	**MAAA&**	**MAAA&**	**MAAA (Stable)**
3	Basel III - Tier II Bonds Programme (erstwhile Vijaya Bank)	Long Term	1,450.0	1,450.0	**[ICRA]AAA(hyb) (Stable)**	**[ICRA]AAA(hyb) (Stable)**	**[ICRA]AAA(hyb) (Stable)**	-		-
4	Basel III AT-I Bonds (erstwhile Vijaya Bank)	Long Term	325.0	325.0	**[ICRA]AA+(hyb) (Stable) Upgraded**	**[ICRA]AA(hyb) (Stable)**	**[ICRA]AA(hyb) (Stable)**	-		-
5	Basel III AT-I Bonds (erstwhile Vijaya Bank)	Long Term	500.0	0.0	**[ICRA]AA+(hyb) (Stable); upgraded and withdrawn**	**[ICRA]AA(hyb) (Stable)**	**[ICRA]AA(hyb) (Stable)**			

Source: *ICRA research*

Complexity level of the rated instrument

Instrument	Amount in Rs. crore	Complexity Indicator
Basel III Compliant Tier II Bonds	2,450.00	Highly Complex
Basel III Compliant AT 1 Bonds	325.00	Highly Complex
Medium Term Fixed 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 instruments 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	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE705A08037	Tier II Bonds – Basel III	10-30-2014	9.15%	10-30-2024	500.00	[ICRA]AAA(hyb) (Stable); reaffirmed
INE705A08052	Tier II Bonds – Basel III	02-18-2015	8.62%	02-18-2025	500.00	
INE705A08078	Tier II Bonds – Basel III	01-22-2016	8.64%	01-22-2026	450.00	
INE028A08059	Tier II Bonds – Basel III	12-17-2013	9.73%	12-17-2023	1,000.00	
INE705A08094	AT-I Bonds – Basel III	01-17-2017#	10.49%	-	325.00	[ICRA]AA+(hyb) (Stable); upgraded from [ICRA] AA(hyb) (Stable)
INE705A08086	AT-I Bonds – Basel III	03-03-2016	11.25%	-	500.00	[ICRA]AA+(hyb) (Stable); upgraded from [ICRA] AA(hyb) (Stable) and withdrawn
NA	Medium-term Deposits	-	-	-	-	MAAA (Stable); reaffirmed

 # As on June 20, 2021; Call option on 01-17-2022
Source: *BoB*

Key features of the rated instruments

The rated Basel III Compliant Tier I bonds (or Additional Tier I or AT-I bonds) have the following loss-absorption features that make them riskier:

- Coupon payments are non-cumulative and discretionary, and the bank has full discretion at all times to cancel the coupon payments. The cancellation of discretionary payments shall not be an event of default.
- Coupons can be paid out of the current year's profits. However, if the current year's profit is not sufficient or if the payment of the coupon is likely to result in a loss, the coupon payment can be made through reserves and surpluses[4] created through the appropriation of profits (including statutory reserves). However, the coupon payment is subject to the bank meeting the minimum regulatory requirements for CET I, Tier I and total capital ratios (including capital conservation buffer; CCB) at all times as prescribed by the RBI under the Basel III regulations.

These Tier I bonds are expected to absorb losses through the write-down mechanism at the objective prespecified trigger point fixed at the bank's (CET I) ratio as prescribed by the RBI – 5.5% till September 30, 2021, and thereafter 6.125% of the total RWAs of the bank or when the point of non-viability trigger (PONV) is breached in the RBI's opinion.

The letters 'hyb' in parenthesis, suffixed to a rating symbol, stand for hybrid, indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features. Such features may translate into higher loss severity vis-à-vis conventional debt instruments. The rated Basel III Tier II bonds are expected to absorb losses once the PONV trigger is invoked.

Given the above distinguishing features of the Tier I bonds, ICRA has assigned a one notch lower rating on these than the rating on the Tier II instruments. The DRs, that can be used for servicing the coupon in a situation of inadequate profits or a loss during the year, stood at 2.85% of the RWAs as on March 31, 2021. However, the bank has proposed to set off its accumulated losses against the share premium, which is subject to regulatory approval. Following this, the DRs are expected to increase to 4.63% of the RWAs. This will significantly improve BoB's ability to ride out the asset quality stress while maintaining its ability to service the coupon on its Tier I bonds.

[4] Calculated as per the amendment in Basel III capital regulations for AT-I bonds by the RBI, vide its circular dated February 2, 2017; as per the amended definition, DRs include all reserves created through appropriations from the profit and loss account

Annexure-2: List of entities considered for consolidated analysis

S. No.	Name of the entity	Ownership	Consolidation Approach
1	BOB Financial Solutions Limited	100.00%	Limited Consolidation
2	BOB Capital Markets Limited	100.00%	Limited Consolidation
3	Baroda Global Shared Services Limited	100.00%	Limited Consolidation
4	Baroda Sun Technologies Limited	100.00%	Limited Consolidation
5	Baroda Asset Management India Limited	100.00%	Limited Consolidation
6	Baroda Trustee India Private Limited	100.00%	Limited Consolidation
7	Bank of Baroda (Botswana) Limited	100.00%	Limited Consolidation
8	Bank of Baroda (Guyana) Limited	100.00%	Limited Consolidation
9	Bank of Baroda (New Zealand) Limited	100.00%	Limited Consolidation
10	Bank of Baroda (Tanzania) Limited	100.00%	Limited Consolidation
11	Bank of Baroda (UK) Limited	100.00%	Limited Consolidation
12	Nainital Bank	98.57%	Limited Consolidation
13	Bank of Baroda (Kenya) Limited	86.70%	Limited Consolidation
14	Bank of Baroda (Uganda) Limited	80.00%	Limited Consolidation
15	India First Life Insurance Company Limited	44.00%	Limited Consolidation
16	India Infradebt Limited	40.99%	Limited Consolidation
17	India International Bank (Malaysia), Berhad	40.00%	Limited Consolidation
18	Baroda Uttar Pradesh Gramin Bank	35.00%	Limited Consolidation
19	Baroda Rajasthan Gramin Bank	35.00%	Limited Consolidation
20	Baroda Gujarat Gramin Bank	35.00%	Limited Consolidation
21	Indo-Zambia Bank Limited	20.00%	Limited Consolidation

Source: *BoB*

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