September 20, 2022 (Revised)

Union Bank of India: [ICRA]AA+ (Stable) assigned to Basel III Tier II bonds; ratings reaffirmed

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
Basel III Tier II Bonds	-	2,200.00	[ICRA]AA+ (Stable); assigned
Certificates of Deposit	15,000.00	15,000.00	[ICRA]A1+; reaffirmed
Total	**19,000.00**	**21,200.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings reaffirmation factors in the continued improvement in Union Bank of India's (Union Bank) capitalisation and solvency profile[1], which is expected to sustain with the increase in internal capital accruals, driven by the moderation in credit costs. The ratings continue to factor in 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 is expected to largely meet its near-term growth requirements through internal capital generation, ICRA expects it to continue receiving support, if required. Union Bank's systemic importance in the banking system has increased, following its merger with erstwhile Andhra Bank and Corporation Bank, with a market share of 5.7% in advances and 6.4% in total deposits as on March 31, 2022. The ratings are also supported by the bank's robust deposit franchise, resulting in a high share of retail deposits and a strong liquidity profile.

While the headline asset quality metrics have seen a relative improvement, the overall share of the standard restructured and overdue advances remains high in relation to the total standard book and this remains a monitorable. The higher-than-expected level of slippages and rising rates could impact the profitability levels, while slowing down the improvement seen in the solvency profile over the last few quarters. However, given the reasonably high level of provision cover on legacy assets, the incremental credit costs are likely to be lower.

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, 2022. Union Bank and other amalgamating banks had received sizeable equity capital support from the GoI amounting to Rs. 41,597 crore during FY2018-FY2021, which, in turn, supported a meaningful reduction in the bank's net non-performing advances (NNPAs) over the last few years.

Following Union Bank's merger with erstwhile Corporation Bank and Andhra Bank, its overall market share increased and stood at 5.7% of advances and 6.4% of total deposits as on March 31, 2022 (against 5.8% and 6.3%, respectively, as on March 31, 2021), signifying its increased systemic importance in the Indian banking system, although it is not yet classified as a domestic

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[1] *Solvency profile = Net stressed assets / Core capital; net stressed assets include NNPAs, net non-performing investments (NPIs) and net security receipts (SRs)*

systemically important bank (D-SIB). Given its importance in the banking industry, ICRA expects the bank to continue receiving support from GoI if required.

Capitalisation and solvency profile continue to improve – The bank's core equity capital (CET I) and Tier I capital stood at 10.68% and 12.14%, respectively, as on June 30, 2022, supported by an improvement in the internal capital generation, with calibrated growth in risk-weighted assets, even while the overall net advances grew by ~16% as on June 30, 2022. The return on assets (RoA) stood in the range of 0.47-0.53% during FY2022-Q1 FY2023 (0.28% in FY2021). Additionally, the capitalisation profile was supported to some extent by an equity raise of Rs. 1,447 crore through a qualified institutional placement (QIP) in FY2021. As a result, the capital cushions above the regulatory requirement have continued to expand.

With the improved capital position as well as the decline in the NNPAs, the solvency level improved to ~39% as on June 30, 2022 (57.8% as on March 31, 2021). Going forward, the solvency profile is expected to improve further from the current level, supported by the high provision cover on legacy NPAs and a moderation in the NPA generation rate from the higher levels in the past. Besides this, the subsidiaries largely remain self-sufficient in meeting their capital requirements although a few of them may require capital support, which is likely to remain manageable in relation to the existing capital levels of the bank.

Well-developed deposit franchise – Union Bank's deposit franchise remains strong and draws support from its extensive network of 8,729 branches as on June 30, 2022. The overall deposit base grew by ~11.75% in FY2022 to Rs. 10.32 lakh crore as on March 31, 2022, largely led by the ~11.39% growth in term deposits. Given the relatively lower share of current and savings account (CASA) deposits of the merging banks, the overall CASA level remained lower than the public sector banks' (PSB) average (~42% as on March 31, 2022) at 36.2% as on June 30, 2022. However, the share of retail deposits remained high at 88% (retail term deposits + CASA + non-callable term deposits) as on June 30, 2022. 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 3.90%[2] compared to the PSBs' average of 3.72% in FY2022.

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 this 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.

Earnings profile improves – Union Bank's overall profitability has seen a gradual improvement despite the Covid-19 pandemic-induced headwinds. This was largely driven by a combination of factors including an improvement in the net interest margin, supported by the higher systemic liquidity, leading to a lower cost of funds. This, along with the relatively steady operating expenses and non-interest income, resulted in an improvement in the core operating profitability. While slippages remained high during FY2022-Q1 FY2023, the credit costs have been on a downward trajectory on the back of the high provision coverage on legacy NPAs. Credit costs/average total assets (ATA) moderated to 1.0% in FY2022 (1.3% in FY2021) though it was comparatively higher at 1.25% in Q1 FY2023. The overall net profitability was also supported by trading gains during FY2021-FY2022. However, with rising interest rates, these are likely to remain limited in the near future.

Despite the sharp hardening seen in Q1 FY2023, the overall mark-to-market losses remained limited for the bank. As a result, the overall net profitability inched up to 0.53% in Q1 FY2023 from 0.47% in FY2022 and remained well above 0.28% in FY2021 (losses during FY2018-FY2020). Going forward, the expected decline in absolute slippages and the resultant decline in credit costs are likely to support profitability, even while tighter liquidity conditions may pressurise the lending spreads as the deposit base gets repriced upwards.

Credit challenges

Asset quality remains a near-term monitorable – Fresh NPA generation was elevated at 4.1% of standard advances in FY2022 (3.1% in FY2021) and remained high at 2.7% (annualised) in Q1 FY2023, largely due to the impact of the pandemic on borrowers. Moreover, it was higher than the PSB average of 2.84% in FY2022. Despite this, the bank's headline asset quality metrics

[2] *As per ICRA's calculations*

improved with the gross NPA (GNPA) and NNPA moderating to 10.23% and 3.31%, respectively, as on June 30, 2022 (13.61% and 4.69%, respectively, as on June 30, 2021) on the back of meaningfully high recoveries, upgrades and write-offs.

As a part of the relief measures to borrowers impacted by Covid-19, Union Bank has restructured loans and has provided a moratorium of up to two years for its borrowers. However, its overall standard restructured book remained higher than the banking system average at Rs. 22,704 crore (3.47% of standard advances) as on June 30, 2022. In addition to this, the special mention account (SMA[3]-1 and SMA-2) loan book remained high at 2.42% of standard advances on the aforementioned date. Given the relatively large restructured book, a sizeable share of which is still under moratorium, the performance upon exit will remain a monitorable. Furthermore, the recent weakening of macroeconomic factors, including the sharp rise in commodity prices/rising input prices as well as elevated servicing costs, is likely to pressurise the servicing ability of relatively more vulnerable borrowers. This will remain a monitorable. Despite this, overall slippages are expected to trend downwards and remain lower than the comparatively higher levels seen in recent years, which should support the continued improvement in the headline asset quality metrics.

Liquidity position: Strong

The liquidity profile remains strong, reflected by the positive cumulative mismatches of 8% of the total outflows in the up to 1-year maturity bucket, as per the structural liquidity statement for March 31, 2022. This is supported by the high share of core deposits and the excess statutory liquidity ratio (SLR) investments. Moreover, the liquidity coverage ratio remained strong at 177% for Q1 FY2023, while the net stable funding ratio (NSFR) stood at 142%, with both remaining well above the minimum regulatory requirement.

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 basis points (bps) over the regulatory level (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 ICRA's Rating Methodology on Consolidation
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.

[3] *SMAs are accounts that are overdue; SMA-1 accounts are overdue by 31-60 days and SMA-2 accounts are overdue by 61-90 days*

About the company

Incorporated in 1919, Union Bank of India merged with erstwhile Andhra Bank and erstwhile Corporation Bank on April 1, 2020 to form the fifth-largest PSB and the seventh-largest bank in the Indian banking system with a total asset base of Rs. 11.5 lakh crore as on June 30, 2022. The bank has a market share of 5.7% and 6.4% in net advances and total deposits, respectively, as on March 31, 2022, with the GoI holding a majority stake (83.49% as on June 30, 2022). It had a network of 8,729 branches and 11,154 ATMs as on June 30, 2022.

Key financial indicators (standalone)

Union Bank of India	FY2021	FY2022	Q1 FY2022	Q1 FY2023
Net interest income	24,688	27,786	7,013	7,582
Profit before tax	2,400	8,579	1,779	2,166
Profit after tax	2,906	5,232	1,181	1,558
Net advances (Rs. lakh crore)	5.9	6.6	5.9	6.8
Total assets (Rs. lakh crore)	10.7	11.8	10.6	11.5
CET I	9.07%	10.63%	9.77%*	10.68%*
Tier I	10.36%	12.20%	11.09%*	12.14%*
CRAR	12.56%	14.52%	13.32%*	14.42%*
Net interest margin / ATA	2.37%	2.47%	2.64%^	2.60%^
PAT / ATA	0.28%	0.47%	0.44%^	0.53%^
Return on net worth	4.88%	7.95%	7.76%^	9.36%^
Gross NPAs	13.74%	11.11%	13.61%	10.23%
Net NPAs	4.62%	3.68%	4.69%	3.31%
Provision coverage excl. technical write-offs	69.62%	69.46%	68.74%	69.94%
Net NPA / Core equity capital	54.56%	41.87%	52.03%	38.03%

Source: Union Bank of India, ICRA Research; Amount in Rs. crore unless mentioned otherwise; Total assets and net worth exclude revaluation reserves; All ratios as per ICRA's calculations
*^ Annualised; * Excludes profits for Q1*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)			Chronology of rating history for the past 3 years					
		Type	Amount rated (Rs. crore)	Amount outstanding as of Sep 06, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021			Date & rating in FY2020
					Sep-20-2022	Sep-27-2021	Mar-02-2021	Sep-11-2020	Aug-28-2020	Jun-28-2019
1	Certificates of Deposit Programme	Short Term	15,000.00	-^	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Basel III Tier II Bonds	Long Term	4,000.00	4,000.00	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+(hyb) (Negative)	[ICRA]AA+(hyb) (Negative)	-	-
3	Basel III Tier II Bonds	Long Term	2,200.00	-^	[ICRA]AA+ (Stable); assigned	-	-	-	-	-
4	Basel II Lower Tier II Bonds	Long Term	-	-	-	-	-	-	-	[ICRA]AA+ (Stable); withdrawn
5	Basel II IPDI	Long Term	-	-	-	-	-	-	-	[ICRA]AA (Stable); withdrawn

^ Balance yet to be issued

Complexity level of the rated instruments

Instrument	Complexity Indicator
Certificates of Deposit Programme	Very Simple
Basel III Tier II Bonds	Highly Complex

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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	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)
Unplaced	Basel III Tier II Bonds	-	-	-	2,200.00	[ICRA]AA+ (Stable)
Unplaced	Certificates of Deposit	NA	NA	NA	15,000.00	[ICRA]A1+

** The instruments have a first call option after five years from issuance*

 # The instruments have a first call option after ten years from issuance

Source: Union Bank of India

Key features of the rated 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 the call option on the Basel III Tier II bonds is contingent upon the prior approval of the Reserve Bank of India (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 II: List of entities considered for limited consolidated analysis

Company Name	Union Bank 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
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

Corrigendum

Rationale dated September 20, 2022, has been revised with changes as below:

- Addition of "ICRA's Rating Methodology on Consolidation" in the analytical approach section
- Addition of "Impact of Parent or Group Support on an Issuer's Credit Rating" in the analytical approach section

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