August 10, 2023

Union Bank of India: Ratings reaffirmed; outlook revised to Positive from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier II Bonds	6,200.00	6,200.00	[ICRA]AA+ (Positive); reaffirmed and outlook revised to Positive from Stable
Certificates of Deposit	15,000.00	15,000.00	[ICRA]A1+; reaffirmed
Total	21,200.00	21,200.00	

**Instrument details are provided in Annexure I*

Rationale

The revision in the outlook on the long-term rating of Union Bank of India (Union Bank) factors in the sustained improvement in its earnings profile, driven by the decline in fresh non-performing asset (NPA) additions, healthy recoveries/upgrades as well as the high provision coverage on legacy NPAs, resulting in a moderation in the credit costs. Going forward, ICRA expects steady operating profitability and benign credit costs to keep the return on assets (RoA) well above the positive rating triggers. Moreover, on the back of the improvement in the internal capital generation levels, the bank's capitalisation and solvency profile has strengthened gradually. Furthermore, 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 also increased, following its merger with erstwhile Andhra Bank and Corporation Bank, with a market share of 5.6% in advances and 6.3% in total deposits as on March 31, 2023. 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.

The ratings also take note of the vulnerable book (SMA-1[1], SMA-2 and standard restructured book), which has moderated meaningfully from the much higher level a year ago, although it remains relatively elevated in relation to standard advances and the core capital. While any macro-economic shock could impact the bank's asset quality and profitability profile, the performance of the residual vulnerable book would remain a near-to-medium-term monitorable and the bank is expected to remain well placed to absorb these shocks through its operating profitability. ICRA also expects Union Bank to remain sufficiently capitalised with no need for regulatory or growth capital requirements. However, the impact of transitioning to provisioning, based on the expected credit loss (ECL) framework, on its capital and profitability levels will remain a monitorable.

The Positive outlook on the rating factors in ICRA's expectation that Union Bank will continue maintaining the improvement in its earnings profile and asset quality levels, thereby leading to further improvement in its solvency, while maintaining sufficient capital cushion over the regulatory levels.

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, 2023. Union Bank and other amalgamating banks had received sizeable

[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 while SMA-2 accounts are overdue by 61-90 days

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 NPAs (NNPAs) meaningfully 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 5.6% of advances and 6.3% of total deposits as on March 31, 2023, signifying its growing systemic importance in the Indian banking system, although it is yet to be classified as a domestic systemically important bank (D-SIB). Given its importance in the banking industry, ICRA expects the bank to continue receiving support from the GoI if required.

Comfortable capitalisation, while solvency profile continues to improve – The bank's core equity capital (CET I) and Tier I capital stood at 12.34% and 13.86%, respectively, as on June 30, 2023, supported by the improvement in internal capital generation. The annualised return on assets (RoA) rose steadily to 1.01% in Q1 FY2024 from 0.69% in FY2023 (0.47% in FY2022). Additionally, the capitalisation profile was somewhat supported by the 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[2] level improved to ~18% as on March 31, 2023 (~44% as on March 31, 2022 and ~58% as on March 31, 2021). Going forward, the solvency profile is expected to improve steadily from the current level, supported by the high provision cover on legacy NPAs and the 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 bank's existing capital levels.

Notwithstanding the improvement in the capitalisation profile, the Reserve Bank of India (RBI) recently issued a discussion paper for transitioning to the expected credit loss framework for credit exposures. As highlighted by ICRA, banks with a high share of overdue/restructured loans could see a one-time impact on their capital position upon transitioning. While the RBI has proposed that these provisions should be spread over a five-year period for the computation of the regulatory capital ratios, the impact on the capital position (without taking regulatory forbearance) will remain a monitorable.

Well-developed deposit franchise – Union Bank's deposit franchise remains strong and draws support from its extensive network of 8,561 branches as on June 30, 2023. The overall deposit base grew by ~14% YoY to Rs. 11.28 lakh crore as on June 30, 2023, largely driven by the ~16% growth in term deposits. However, the current and savings account (CASA) deposits level stood at 34.1% and remained lower than the public sector banks' (PSB) average (~40% as on March 31, 2023) as on June 30, 2023. While the term deposit rate for Union Bank remains comparable to that of some large PSBs, the share of low-cost CASA deposits remains lower than larger PSBs. As a result, the bank's overall cost of funds was marginally higher at 4.26%[3] compared to the PSBs' average of 4.04% in FY2023.

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 continued to witness a sustained improvement, largely driven by a combination of factors including an improvement in the net interest margin along with the relatively steady operating expenses and non-interest income. Union Bank's operating profit improved steadily to 1.98% of average total assets (ATA) in FY2023 from 1.65% in FY2022 and was higher than the PSB average of 1.80% in FY2023. With the moderation in the pace of fresh NPA additions and the high provision coverage on legacy NPAs, the credit costs have moderated. Accordingly, credit costs/average total assets (ATA) remained range-bound at 1.0% in FY2023 (1.0% in FY2022) but declined further to 0.62% in Q1 FY2024 and is at a much lower level compared to previous years.

Going forward, the bank has guided towards strong recoveries/upgrades that could surpass fresh NPA additions. As a result, credit costs are expected to remain at or better than the FY2023 level, which would continue to support the profitability even while tighter liquidity conditions may pressurise the lending spreads as the deposit base continues to get repriced upwards.

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

[3] *As per ICRA's calculations*

Credit challenges

Asset quality remains a near-term monitorable – The annualised gross fresh NPA generation eased to 1.73% in Q1 FY2024 from 1.97% in FY2023 (4.06% in FY2022), which was materially lower than the elevated levels seen in the past (~5-10% over FY2017-FY2020). The provision cover ratio also improved significantly, leading to a moderation in the NNPAs. Thus, the bank's headline asset quality metrics improved with the gross NPA (GNPA) and NNPA moderating to 7.34% and 1.58%, respectively, as on June 30, 2023 (10.22% and 3.31%, respectively, as on June 30, 2022) on the back of meaningfully high recoveries, upgrades and write-offs.

However, the overall standard restructured book (Covid restructuring) remained higher than the banking system average at Rs. 16,371 crore (2.16% of standard advances) as on June 30, 2023. In addition to this, the special mention account (SMA-1 and SMA-2) loan book remained high at 2.71% of standard advances on March 31, 2023. Given the relatively elevated (though moderating) share of the vulnerable book in relation to the total standard assets and the core capital, its performance as well as the bank's ability to limit slippages will remain a near-to-medium-term monitorable. Further, the impact of the weakening macro-economic factors could affect the debt-servicing ability of borrowers and remains a monitorable.

Environmental and social risks

While banks like Union Bank do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. If the entities or businesses, to which banks and financial institutions have an exposure, face business disruptions because of physical climate adversities or if such businesses face climate transition risks because of technological, regulatory or customer behaviour changes, it could translate into credit risks for banks. However, such risk is not material for Union Bank as it benefits from adequate portfolio diversification. Further, the lending is typically short-to-medium term, allowing it to adapt and take incremental exposure to businesses that face relatively fewer downside environmental risks.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as material lapses could be detrimental to their reputation and invite regulatory censure. Union Bank has not faced material lapses over the years. Customer preferences are increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. Union Bank has been making the requisite investments to enhance its digital interface with its customers. While it contributes to promoting financial inclusion by lending to the underserved segments, its lending practices remain prudent as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

The liquidity profile remains strong, reflected by the positive cumulative mismatches of 7% of the total outflows in the up to 1-year maturity bucket, as per the structural liquidity statement for March 31, 2023. 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 166% for Q1 FY2024, while the net stable funding ratio (NSFR) stood at 142%, with both remaining well above the minimum regulatory requirement.

Rating sensitivities

Positive factors – The long-term rating could be upgraded if the bank is able to maintain its profitability with RoA of more than 0.5% and Tier I cushions of more than 100 basis points (bps) over the regulatory Tier I levels (including capital conservation buffers) on a sustained basis.

Negative factors – ICRA could revise the outlook to Stable and/or downgrade the rating if the asset quality or capitalisation profile deteriorates. Further, an RoA of less than 0.3% and/or a decline in the capital cushions over the regulatory levels to less than 100 bps on a sustained basis will remain negative triggers. The rating will also be reassessed in case of a change in the sovereign ownership.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA Rating Methodology for Banks and Financial Institutions Impact of Parent or Group Support on an Issuer's Credit Rating Rating Approach - 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 Group's key subsidiaries/associates/joint ventures, going forward, has been factored in.

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 eighth-largest bank in the Indian banking system with a total asset base of Rs. 12.8 lakh crore as on June 30, 2023. It had a market share of 5.6% and 6.3% in net advances and total deposits, respectively, as on March 31, 2023, with the GoI holding a majority stake (83.49% as on June 30, 2023). It had a network of 8,561 branches and 10,195 ATMs as on June 30, 2023.

Key financial indicators (standalone)

Union Bank of India	FY2022	FY2023	Q1 FY2023	Q1 FY2024
Net interest income	27,786	32,765	7,582	8,840
Profit before tax	8,579	12,138	2,166	5,174
Profit after tax	5,232	8,433	1,558	3,236
Net advances (Rs. lakh crore)	6.6	7.6	6.8	7.7
Total assets (Rs. lakh crore)	11.8	12.7	11.5	12.8
CET I	10.63%	12.36%	10.68%*	12.34%*
Tier I	12.20%	13.91%	12.14%*	13.86%*
CRAR	14.52%	16.04%	14.42%*	15.95%*
Net interest margin / ATA	2.47%	2.67%	2.60%^	2.77%^
PAT / ATA	0.47%	0.69%	0.53%^	1.01%^
Return on net worth	7.95%	11.68%	9.36%^	17.54%^
Gross NPAs	11.11%	7.53%	10.22%	7.34%
Net NPAs	3.68%	1.70%	3.31%	1.58%
Provision coverage excl. technical write-offs	69.46%	78.80%	69.94%	79.81%
Net NPA / Core equity capital	41.87%	18.08%	38.03%	17.66%

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 (FY2024)			Chronology of rating history for the past 3 years					
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021		
					Aug-10-2023	Sep-20-2022	Sep-27-2021	Mar-02-2021	Sep-11-2020	Aug-28-2020
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+ (Positive)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+(hyb) (Negative)	[ICRA]AA+(hyb) (Negative)	-
		Long Term	2,200.00	2,200.00	[ICRA]AA+ (Positive)	[ICRA]AA+ (Stable)	-	-	-	-

^ Balance yet to be issued; In compliance with the circular issued by the Securities and Exchange Board of India (SEBI) on July 16, 2021, for standardising the rating scales used by credit rating agencies, ICRA has discontinued its practice of affixing the (hyb) suffix alongside the rating symbols for hybrid instruments

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+ (Positive)
INE692A08102	Basel III Tier II Bonds	Nov-26-2020	7.18%	Nov-26-2035#	1,000.00	[ICRA]AA+ (Positive)
INE692A08144	Basel III Tier II Bonds	Jun-24-2021	7.19%	Jun-24-2031*	850.00	[ICRA]AA+ (Positive)
INE692A08151	Basel III Tier II Bonds	Jul-09-2021	7.25%	Jul-09-2036#	1,150.00	[ICRA]AA+ (Positive)
INE692A08201	Basel III Tier II Bonds	Nov-29-2022	7.80%	Nov-29-2032*	700.00	[ICRA]AA+ (Positive)
INE692A08219	Basel III Tier II Bonds	Nov-29-2022	7.85%	Nov-29-2037#	1,500.00	[ICRA]AA+ (Positive)
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 10 years from issuance

Source: Union Bank of India

Key features of the rated instruments

The Basel III Tier II Bonds are expected to absorb losses once the point of non-viability (PONV) trigger is invoked by the RBI. The Basel III Tier II Bonds have equity-like loss-absorption features. Such features may translate into higher loss severity vis-à vis conventional debt instruments.

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

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