November 23, 2023

Union Bank of India: Long-term rating upgraded to ICRA]AAA (Stable); outlook revised to Stable; short term rating reaffirmed

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] AAA (Stable); upgraded from [ICRA]AA+ (Positive); outlook revised to Stable from Positive
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 upgrade in 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. Moreover, the capitalisation levels and solvency profile have strengthened gradually on the back of the improvement in the internal capital generation levels.

Further, Union Bank's capital cushions remain comfortably above the regulatory level, further strengthened by a capital raise via a qualified institutional placement (QIP) amounting to Rs. 5,000 crore in Q2 FY2024. While the bank has demonstrated its ability to raise capital, the ratings continue to factor in its sovereign ownership and the demonstrated track record of capital support from the Government of India (GoI) in the past, which is expected to be forthcoming 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 5.5% in advances and 6.2% in total deposits as on June 30, 2023. The ratings are also supported by the bank's well-developed 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. Union Bank is expected to remain well placed to absorb these shocks through its operating profitability. ICRA also expects the 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.

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 a 76.99% equity stake as on September 30, 2023 (83.49% as of June 2023). 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 supported a meaningful reduction in its net NPAs (NNPAs) over the last few years.

[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

Following Union Bank's merger with erstwhile Corporation Bank and Andhra Bank, its overall market share increased and stood at 5.5% of advances and 6.2% of total deposits as on June 30, 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 and solvency profile – The bank's core equity capital (CET-I) and Tier I witnessed a sustained improvement and stood at 13.05%[2] and 14.57%, respectively, as on September 30, 2023 vis-à-vis 10.67% and 12.26%, respectively, as on September 30, 2022. The capital profile was supported by healthy internal capital accruals with the bank reporting an annualised return on net worth of 17.29% in H1 FY2024 (10.09% in H1 FY2023). Additionally, the capitalisation profile was supported by the equity raise of Rs. 1,447 crore through a QIP in FY2021 followed by another capital raise amounting to Rs. 5,000 crore in Q2 FY2024 via a QIP. As a result, the capital cushions above the regulatory requirement have continued to expand. Furthermore, the latest capital raise would help offset the manageable impact stemming from the recent regulatory measures towards lending to consumer credit and banking credit to non-banking financial companies (NBFCs).

With the improved capital position as well as the decline in the NNPAs, the solvency[3] level improved to 13.74% as on September 30, 2023 (18.00% as on March 31, 2023). 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 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 ECL 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.

Earnings profile improves – Union Bank's overall profitability continued to witness a sustained improvement, largely driven by a combination of factors including higher net interest margins along with relatively steady operating expenses and non-interest income. Union Bank's operating profit improved steadily to 2.00% of average total assets (ATA) in H1 FY2024 from 1.88% in H1 FY2023. With the moderation in the pace of fresh NPA additions and the high provision coverage on legacy NPAs, the credit costs (percentage of ATA) moderated to 0.58% in H1 FY2024 from 1.08% in FY2023 and 1.19% in FY2022. As a result, the return on assets (RoA) continued to improve and stood at 1.04% in H1 FY2024 vis-à-vis 0.69% in FY2023 (0.47% in FY2022).

Going forward, the bank has guided towards strong recoveries/upgrades that could surpass fresh NPA additions for the remainder of FY2024. 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 to get repriced upwards. However, even as the extent of recoveries/upgrades slow down eventually, the overall credit costs are expected to remain benign in relation to the much higher levels in the past, which would be a support from a profitability and growth perspective.

Well-developed deposit franchise – Union Bank's deposit franchise remains strong and draws support from its extensive network of 8,521 branches as on September 30, 2023. The overall deposit base grew by ~9% YoY to Rs. 11.37 lakh crore as on September 30, 2023, largely driven by the ~12% growth in term deposits. However, the current and savings account (CASA) deposit level stood at 34.6% and remained lower than the public sector banks' (PSB) average (~41%) as on June 30, 2023. Union Bank's term deposit rate remains comparable to that of some large PSBs and the share of low-cost CASA deposits remains lower than larger PSBs. As a result, the bank's overall cost of funds was higher at 5.05%[4] compared to the PSBs' average of 4.70% in Q1 FY2024. Nonetheless, given its widespread network, steady core deposit base and robust retail franchise, ICRA expects the bank to maintain its strong liabilities profile.

[2] *Excluding H1 profit*

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

[4] *As per ICRA's calculations*

Credit challenges

Asset quality remains monitorable – The annualised gross fresh NPA generation eased to 1.57% in H1 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 6.38% and 1.30%, respectively, as on September 30, 2023 (8.45% and 2.64%, respectively, as on September 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. 14,521 crore (1.83% of standard advances) as on September 30, 2023. In addition to this, the special mention account (SMA-1 and SMA-2) loan book stood at 2.41% of standard advances as on September 30, 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 the total outflows in the near-term maturity bucket, as per the structural liquidity statement. 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 144.61% in Q2 FY2024, while the net stable funding ratio (NSFR) stood at 136.95%, with both remaining well above the minimum regulatory requirement. The excess SLR holding above the regulatory levels can be utilised to avail liquidity support from the RBI (through repo) apart from the marginal standing facility of the RBI in case of urgent liquidity requirement.

Rating sensitivities

Positive factors – Not applicable as all the ratings are at the highest level for the respective instruments

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 40% on a sustained basis. Further, an RoA of less than 0.3% and/or a decline in the capital cushions over the regulatory levels to less than 100 basis points (bps) on a sustained basis will remain negative triggers.

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	For arriving at the ratings, ICRA has considered the standalone financials of Union Bank. However, in line with ICRA's consolidation approach, the capital/funding requirement of the Group's various subsidiaries/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. 13.1 lakh crore as on September 30, 2023. It had a market share of 5.5% and 6.2% in net advances and total deposits, respectively, as on June 30, 2023, with the GoI holding a majority stake (76.99% as on September 30, 2023). It had a network of 8,521 branches and 10,013 ATMs as on September 30, 2023.

Key financial indicators (standalone)

Union Bank of India	FY2022	FY2023	H1 FY2023	H1 FY2024
Net interest income	27,786	32,765	15,887	17,966
Profit before tax	8,579	12,138	4,667	10,627
Profit after tax	5,232	8,433	3,406	6,748
Net advances (Rs. lakh crore)	6.6	7.6	7.3	8.0
Total assets (Rs. lakh crore)	11.8	12.7	12.0	13.1
CET-I	10.63%	12.36%	10.67%*	13.05%*
Tier I	12.20%	13.91%	12.26%*	14.57%*
CRAR	14.52%	16.04%	14.50%*	16.69%*
Net interest margin / ATA	2.47%	2.67%	2.67%^	2.78%^
PAT / ATA	0.47%	0.69%	0.57%^	1.04%^
Return on net worth	7.95%	11.68%	10.09%^	17.29%^
Gross NPAs	11.11%	7.53%	8.45%	6.38%
Net NPAs	3.68%	1.70%	2.64%	1.30%
Provision coverage excl. technical write-offs	69.46%	78.80%	70.65%	80.71%
Net NPA / Core equity capital	41.87%	18.08%	31.75%	13.49%

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 H1*

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		
					Nov-23-2023	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+	[ICRA]A1+
2	Basel III Tier II Bonds	Long Term	4,000.00	4,000.00	[ICRA]AAA (Stable)	[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]AAA (Stable)	[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]AAA (Stable)
INE692A08102	Basel III Tier II Bonds	Nov-26-2020	7.18%	Nov-26-2035#	1,000.00	[ICRA]AAA (Stable)
INE692A08144	Basel III Tier II Bonds	Jun-24-2021	7.19%	Jun-24-2031*	850.00	[ICRA]AAA (Stable)
INE692A08151	Basel III Tier II Bonds	Jul-09-2021	7.25%	Jul-09-2036#	1,150.00	[ICRA]AAA (Stable)
INE692A08201	Basel III Tier II Bonds	Nov-29-2022	7.80%	Nov-29-2032*	700.00	[ICRA]AAA (Stable)
INE692A08219	Basel III Tier II Bonds	Nov-29-2022	7.85%	Nov-29-2037#	1,500.00	[ICRA]AAA (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 10 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. 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 consolidated analysis

Company Name	Union Bank Ownership*	Consolidation Approach
Union Asset Management Company Pvt. Ltd.	100.00%	Full Consolidation
Union Trustee Company Pvt. Ltd.	100.00%	Full Consolidation
Union Bank of India (UK) Ltd.	100.00%	Full Consolidation
Andhra Bank Financial Services	100.00%	Full Consolidation
UBI Services Ltd.	100.00%	Full Consolidation
Chaitanya Godavari Grameena Bank	35.00%	Full Consolidation
ASREC India (P)	26.02%	Full Consolidation
Star Union Dai-ichi Life Insurance Company Ltd.	25.10%	Full Consolidation
India International Bank (Malaysia)	25.00%	Full Consolidation

*Source: Union Bank of India; * As on September 30, 2023*

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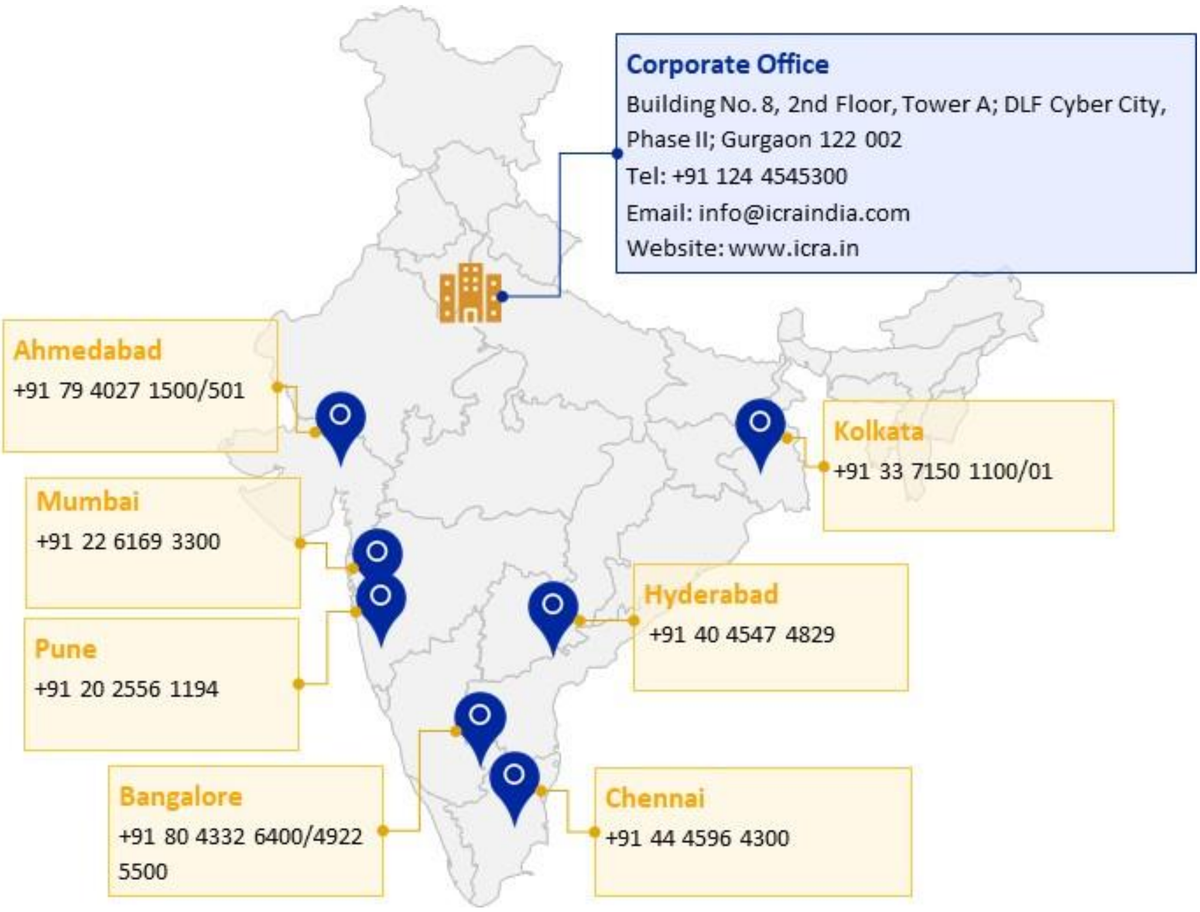

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