November 14, 2024

Union Bank of India: Ratings 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); reaffirmed
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

Union Bank of India's (Union Bank) ratings continue to be supported by its strong position in the Indian financial system as it is the fifth-largest public sector bank with a market share of 5.3% and 6.0% in net advances and total deposits, respectively, as on June 30, 2024. The ratings also factor in the continued improvement in the earnings profile, driven by the moderation in credit costs with the reduction in fresh non-performing asset (NPA) additions, healthy recoveries/upgrades as well as the high provision coverage on legacy NPAs in FY2024. Fresh NPA generation saw an uptick in Q2 FY2025, though this was primarily due to a large account. On an overall basis, it remains comfortable. In addition, the slight rise in credit costs was countered by the higher operating profit in H1 FY2025, leading to a further improvement in the return on assets (RoA). Moreover, the capitalisation levels and solvency profile have strengthened gradually on the back of the improvement in the internal capital generation levels.

Union Bank's capital cushions remain comfortably above the regulatory level, further strengthened by the capital raise via a qualified institutional placement (QIP) of Rs. 8,000 crore in 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. The ratings are also supported by Union Bank's well-developed deposit franchise, resulting in a high share of retail deposits and a strong liquidity profile. 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 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 levels in the past, although it remains monitorable. While any macro-economic/geopolitical shock could impact the bank's asset quality and profitability, the performance of the residual vulnerable book would remain a near-to-medium-term monitorable. Nevertheless, 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 regulatory or growth capital requirements in the near-to-medium term.

The Stable outlook on the rating reflects ICRA's expectation that the bank will be able to maintain a steady credit profile, with stable asset quality and healthy profitability and capitalisation profile.

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 74.76% equity stake as on September 30, 2024 (76.99% as of September 2023). Union Bank and other

[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

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.

Following merger of Corporation Bank and Andhra Bank with Union Bank, its overall market share increased and stood at 5.3% of advances and 6.0% of total deposits as on June 30, 2024, 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 continued to improve and stood at 13.88%[2] and 15.22%, respectively, as on September 30, 2024 vis-à-vis 13.05% and 14.57%, respectively, as on September 30, 2023. The capital profile was supported by healthy internal accruals with the bank reporting an annualised return on net worth of 17.49% in H1 FY2025 (17.20% in H1 FY2024). Additionally, the capitalisation profile was supported by the capital raise of Rs. 8,000 crore in FY2024 via a QIP. As a result, the capital cushions above the regulatory requirement have continued to expand. The healthy capital cushion would help offset the manageable impact stemming from the stress in the unsecured retail segments, though its share in the overall portfolio remains modest.

Given the better capital position as well as the lower NNPAs, the solvency[3] level improved to 9.85% as on September 30, 2024 (10.22% as on March 31, 2024). Going forward, the solvency profile is largely expected to stay range-bound, given the normalisation in the NPA generation rate. Besides this, the subsidiaries largely remain self-sufficient in meeting their capital requirements although a few may need capital support, which is likely to remain manageable in relation to the bank's existing capital levels.

Notwithstanding the sufficient internal accruals and capital position for growth, the Reserve Bank of India's (RBI) implementation of the ECL framework for credit exposures and additional provisioning on infrastructure financing remains monitorable for the capital position.

Earnings profile improves – Union Bank's overall profitability continued to improve, largely driven by the relatively steady net interest margins, non-interest income and operating expenses. Its operating profit remained healthy at 2.13% of average total assets (ATA) in H1 FY2025 (1.98% in FY2024). As a result, the RoA continued to improve and stood at 1.20% in H1 FY2025 vis-à-vis 1.03% in FY2024 (0.69% in FY2023). However, with the slight increase in fresh NPA additions, credit costs (percentage of ATA) rose to 0.60% in H1 FY2025 (0.57% in H1 FY2024) from 0.48% in FY2024.

Going forward, with the expected uptick in the slippage rate and the slowdown in the extent of recoveries/upgrades, credit costs are likely to normalise and remain above the FY2024 level, which could moderate the profitability. Nevertheless, 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 8,555 branches as on September 30, 2024. The overall deposit base grew by ~9% YoY to Rs. 12.42 lakh crore as on September 30, 2024, largely driven by the ~13% growth in term deposits. Its current and savings account (CASA) deposits stood at 31.9% and remained lower than the public sector banks' (PSB) average (~37%) as on June 30, 2024. 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 5.43%[4] compared to the PSBs' average of 5.15% in Q1 FY2025. Nonetheless, given its widespread network, steady core deposit base and robust retail franchise, ICRA expects the bank to maintain its strong liabilities profile.

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[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 rate rose modestly to 1.75% in H1 FY2025 from 1.57% in H1 FY2024 though it was materially lower than the elevated levels seen in the past (5-10% over FY2017-FY2020). The provision coverage 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 4.36% and 0.98%, respectively, as on September 30, 2024 (6.38% and 1.30%, respectively, as on September 30, 2023) on the back of meaningfully high recoveries, upgrades and write-offs.

Though the standard restructured book (Covid restructuring) has moderated, it remained higher than the banking system average at Rs. 11,238 crore (1.27% of standard advances) as on September 30, 2024. The asset quality will remain a near-to-medium-term monitorable, given the relatively elevated (though moderating) share of the vulnerable book in relation to the total standard assets and the core capital, the concerns around overleveraging in the retail segment, and the seasoning of the recently originated book amid the persisting elevated interest rate environment and geopolitical issues.

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 risks are 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 segment, 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 for June 2024. 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 144.12% in Q2 FY2025, while the net stable funding ratio (NSFR) stood at 126.68%, with both remaining well above the minimum regulatory requirement. The excess SLR holding above the regulatory level 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 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 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, standalone assessment of the bank factors in the ordinary and extraordinary support that the bank is expected to extend to its subsidiaries.

About the company

Incorporated in 1919, Union Bank of India became the eighth-largest bank in the Indian banking system after Andhra Bank and Corporation Bank merged with it on April 1, 2020. Union Bank had a total asset base of Rs. 14.06 lakh crore as on September 30, 2024 with the GoI having a majority stake (74.76% as on September 30, 2024). It had a network of 8,555 branches and 9,124 ATMs as on September 30, 2024.

Key financial indicators (standalone)

Union Bank of India	FY2023	FY2024	H1 FY2025
Total income	46,600	51,013	27,249
Profit after tax	8,433	13,648	8,399
Total assets (Rs. lakh crore)	12.75	13.86	14.06
CET I	12.36%	13.65%	13.88%*
CRAR	16.04%	16.97%	17.13%*
PAT / ATA	0.69%	1.03%	1.20%^
Gross NPAs	7.53%	4.76%	4.36%
Net NPAs	1.70%	1.03%	0.98%

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; Total income = Net interest income + Non-interest income (excluding trading gains); ^ Annualised; * Excludes profits for H1*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Current (FY2025)			Chronology of rating history for the past 3 years					
				FY2024		FY2023		FY2022	
Instrument	**Type**	**Amount rated (Rs. crore)**	**Nov 14, 2024**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**
Certificates of Deposit Programme	Short term	15,000.00	[ICRA]A1+	23-Nov-23	[ICRA]A1+	20-Sep-22	[ICRA]A1+	27-Sep-21	[ICRA]A1+
				10-Aug-23	[ICRA]A1+	-	-	-	-
Basel III Tier II Bonds	Long term	4,000.00	[ICRA]AAA (Stable)	23-Nov-23	[ICRA]AAA (Stable)	20-Sep-22	[ICRA]AA+ (Stable)	27-Sep-21	[ICRA]AA+ (Stable)
				10-Aug-23	[ICRA]AA+ (Positive)	-	-	-	-
Basel III Tier II Bonds	Long term	2,200.00	[ICRA]AAA (Stable)	23-Nov-23	[ICRA]AAA (Stable)	20-Sep-22	[ICRA]AA+ (Stable)	-	-
				10-Aug-23	[ICRA]AA+ (Positive)	-	-	-	-

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	8,775.00	[ICRA]A1+
INE692A16HP7	**Certificates of Deposit**	Jun-27-2024	7.60%	Mar-18-2025	2,975.00	[ICRA]A1+
INE692A16HP7	**Certificates of Deposit**	Jun-28-2024	7.60%	Mar-18-2025	1,625.00	[ICRA]A1+
INE692A16HR3	**Certificates of Deposit**	Jun-28-2024	7.60%	Mar-19-2025	1,625.00	[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) BHD	25.00%	Full Consolidation

*Source: Union Bank of India; * As on September 30, 2024*

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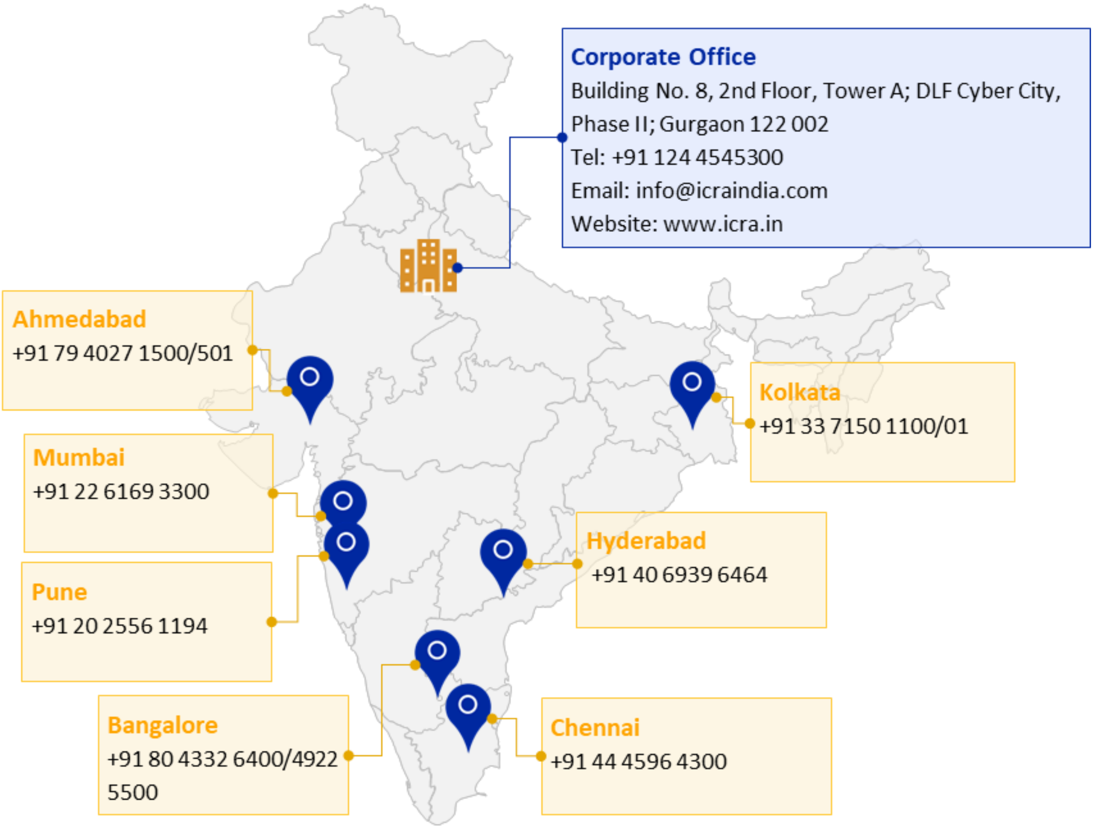

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