यूनियन बैंक ऑफ इंडिया Union Bank of India

भारत सरकार का उपक्रम A Government of India Undertaking

आन्ध्रा Andhra | कार्पोरेशन Corporation

Ref: ISD/20-21/295 March 3, 2021

The Deputy General Manager, Corporate Relationships Dept. **BSE Ltd.** PhirozeJeejeebhoy Towers, Dalal Street, Mumbai-400 001. Scrip Code-532 477	TheDeputy General Manager, Listing Dept. **National Stock Exchange of India Ltd.** Exchange Plaza, Plot No.C/1, G Block Bandra-Kurla Complex, Bandra (E), Mumbai-400 051. Scrip Symbol/Series-UNIONBANK-EQ

Madam/Sir,

Subject: Credit Rating

In terms of Regulation 30 read with point 3 of Para A of Part A of Schedule III of SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 and SEBI circular no. CIR/CFD/CMD/4/2015 dated September 9, 2015, we wish to inform that ICRA Ltd has assigned the below credit ratings to the Bank's proposed Basel III Compliant Tier-II Bonds aggregating to upto Rs. 2000 Crore:

Sr No.	Rating Agency	Rating/Outlook
1.	ICRA Ltd	ICRA AA+(HYB)/NEGATIVE

The rating rationale of the agency is enclosed herewith.

This is for your information and appropriate dissemination.

Thanking you.

Yours faithfully,

Mangesh Mandrekar

(Mangesh Mandrekar)
Company Secretary

Encl: As above

March 02, 2021

Union Bank of India: [ICRA]AA+(hyb)(Negative) 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	-	2,000.00	[ICRA]AA+(hyb) (Negative); assigned
Basel III Tier II Bonds	2,000.00	2,000.00	[ICRA]AA+(hyb) (Negative); reaffirmed
Certificates of Deposit	15,000.00	15,000.00	[ICRA]A1+; reaffirmed
Total	**17,000.00**	**19,000.00**	

**Instrument details are provided in Annexure-1*

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 levels of rating transition and loss severity vis-à-vis conventional debt instruments. The rated Tier II bonds under Basel III are expected to absorb losses once the point of non-viability (PONV) trigger is invoked.

Rationale

The rating action takes into account Union Bank of India's (Union Bank) sovereign ownership and the demonstrated track record of capital support received by the bank. ICRA expects the bank to continue receiving support, given its increased importance in the Indian banking system. Union Bank has merged with erstwhile Andhra Bank (e-AB) and erstwhile Corporation Bank (e-CB), effective April 1, 2020. The merger has further increased the systemic importance of the bank in the Indian banking sector with a market share of 6.2% in advances and 6.6% in total deposits as on April 1, 2020 compared to 3.4% and 3.3%, respectively, on a standalone basis. The ratings are also supported by Union Bank's strong deposit franchise, resulting in a high share of retail deposits and a strong liquidity profile.

The above positives are, however, offset by the merged entity's weak capital position and asset quality position. While the asset quality stress because of the Covid-19 pandemic is lower than initially estimated, it remains elevated as reflected by the high level of proforma[1] slippages and non-performing assets (NPAs). The management has provided a guidance of loan slippages of 2.5-3.0% (3.0-3.5% earlier) in FY2021. Further, another 2.5-3.0% (5.0-6.0% earlier) of the loan book is expected to be restructured while maintaining the asset classification as 'standard'. The high level of proforma NPAs and the tail risk of Covid-19-induced stress will continue to result in high credit provisioning in the next year as well.

With the stress expected to be lower than previously estimated, ICRA expects the bank to significantly absorb the credit losses from its operating profits. However, the net profitability will remain weak with a return on assets (RoA) of less than 0.2% in FY2021 with the same unlikely to improve materially next year. While this is likely to reduce the need for regulatory capital in the near term, the solvency profile[2] will remain weak (~59% as on December 31, 2020) in the absence of meaningful internal capital generation and high net NPAs on a proforma basis (5.02% as on December 31, 2020).

The Negative outlook factors in the expectation of the weakening of the capital cushion and the solvency position below the negative rating triggers in case the asset quality stress increases and the bank is not able to raise incremental equity capital.

[1] *Including the accounts that had a standstill on asset classification as directed by the Hon'ble Supreme Court*

[2] *Solvency profile = Net NPA / core capital*

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The Government of India (GoI) remains the bank's largest shareholder, accounting for an 89.07% equity stake as on December 31, 2020. The merged entity, including Union Bank and the amalgamated banks (e-AB and e-CB), received sizeable equity capital support from the GoI amounting to ~Rs. 32,796 crore during FY2018-FY2020 of which ~Rs. 11,768 crore was infused in FY2020. Supported by this, the merged entity recorded a substantial reduction in its stock of net NPAs (below the threshold of 6% for inclusion in the Reserve Bank of India's (RBI) prompt corrective action (PCA) framework) while shoring up the capital ratios above the regulatory minimum.

The bank had earlier received board approval to raise up to ~Rs. 6,800 crore of equity capital. However, with the stress being lower than initially anticipated and given the one-time restructuring of the loans, the capital requirement is likely to be lower. The GoI has budgeted ~Rs. 20,000 crore for FY2021 and a similar amount next year for capital infusion in public sector banks (PSBs). The management has guided for an equity capital raise of Rs. 2,000-3,000 crore in Q4 FY2021. ICRA expects the GoI to provide the requisite capital support for the regulatory levels as has been the trend in the past.

Well-developed deposit franchise – The merger has further strengthened the bank's network, which has become wider with 9,500+ branches and an improved presence in the southern states. The bank's current account and savings account (CASA) base stood at ~35% of the total deposits as on December 31, 2020 (against ~36% for the standalone entity as on March 31, 2020), though this was below the PSB average of ~38-39%. Apart from the lower share of low-cost CASA deposits, the term deposit rate for Union Bank as well as the amalgamated entities was higher than that of some large PSBs. Hence, the overall cost of funds for Union Bank, on a merged basis, was marginally higher at 4.83% in 9M FY2021 compared to the PSBs' average of 4.6-4.8%. Union Bank continues to offer a higher rate on its term deposits compared to some other PSBs as it has to compete with some other South-based banks. 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 merged entity to maintain its strong liabilities profile.

High systemic importance as fifth largest PSB and seventh largest bank in Indian banking system in terms of asset base – Prior to the merger, Union Bank was the sixth largest PSB and ninth largest bank in the Indian banking system as on March 31, 2019. The merger, with effect from April 1, 2020, has created the fifth largest PSB and seventh largest bank in the Indian banking system with a share of 6.1% of net advances and 6.5% of total deposits as on September 30, 2020. Given the material increase in the bank's size following the merger, ICRA expects it to hold systemic importance in the Indian banking system. While the merged entity is currently not classified as a domestic systemically important bank (D-SIB), its classification in this category would pose additional capital requirements vis-à-vis the regulatory minimum levels. Moreover, given the sovereign ownership, ICRA expects strong support from the GoI if required. The management expects to complete the consolidation/integration of the amalgamating banks by March 31, 2021.

Credit challenges

Elevated asset quality stress; remains a monitorable – While the moratorium period ended in August 2020, the Hon'ble Supreme Court has directed a standstill on asset classification post August 31, 2020. Along with this, the RBI also allowed banks to restructure loans while maintaining the same as 'standard', with the cut-off date for the invocation of the restructuring ending on December 31, 2020. The impact of the pandemic on the asset quality is still evolving and the management has guided towards a total stress pool of 4.5-5.0% of the total loan book, which includes a loan slippage rate of 2.5-3.0% of advances, SMA[3]-2 book of 0.8% of advances with another 2.5.0-3.0% of the loan book to be restructured under the RBI's scheme. The estimates for slippages provided by the management could increase in FY2021 and FY2022. With expectations of a high slippage rate, ICRA expects the net NPAs to remain near 5.0% over the next few quarters (5.02% including proforma NPAs as on December 31, 2020).

[3] *SMA 2 loans are overdue loans with overdue status of 61-90 days*

High credit costs to lead to weak profitability next year as well – The management has guided towards a credit provision of 2.5-3.0% of the advances in FY2021, which is likely to consume the majority of the operating profits for the year. Even after significant credit provisions in FY2021, the net NPAs are expected to remain near 5% by March 31, 2021, which shall result in elevated credit provisions even during next year and hence weaker profitability. ICRA expects an RoA of 0.1-0.2% in FY2021, which is unlikely to improve meaningfully even during next year.

Capital position and solvency to weaken unless supported by fresh capital raising – The bank's core equity capital (CET-I) and Tier I capital stood at 9.22% and 10.47%, respectively, as on December 31, 2020, and the capital cushions remain limited in relation to the requirement of 9.5% by October 1, 2021. The bank is likely to meet the regulatory capital requirements even without fresh capital raise in FY2021. However, given the estimates of weak internal capital generation in FY2021 and FY2022, the capital buffers and solvency position are unlikely to improve in the absence of fresh equity capital. The solvency position stood at 59.5% on a proforma basis as on December 31, 2020 (69.2% as on April 1, 2020). In addition, the bank has guided towards a credit growth of 4-6% for FY2021, which will lead to additional capital requirements.

Liquidity position: Strong

The merged entity continues to have a strong liquidity profile as depicted by the positive cumulative mismatches of 2.28% of the total outflows in the up to 1-year maturity bucket, as per its structural liquidity statement (merged basis) for December 31, 2020, supported by a high share of core deposits and excess statutory liquidity ratio (SLR) investments. The liquidity coverage ratio remains strong at 183.99% (daily average for Q3 FY2021), well above the minimum regulatory requirement. Supported by its sovereign ownership, healthy liabilities profile and excess SLR holdings, ICRA expects the bank to maintain a strong liquidity profile.

Rating sensitivities

Positive factors – The outlook could be changed to Stable if the bank is able to improve its solvency (below 50%) on a sustained basis while maintaining Tier I capital cushions of more than 50-75bps over the regulatory levels.

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 remains weak (net NPA/core capital of more than 60%) on a sustained basis or if the regulatory capital ratios are breached 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
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 and the consolidated financials of Union Bank, e-AB and e-CB. 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 (including the entities taken over post-merger).

About the company

Incorporated in 1919, Union Bank of India merged with erstwhile Andhra Bank (e-AB) and erstwhile Corporation Bank (e-CB) on April 1, 2020 to form the fifth largest public sector bank and seventh largest bank in the Indian banking system with a total asset base of Rs. 10.2 lakh crore. The merged entity has a market share of 6.1% and 6.5% in net advances and total deposits, respectively, as on December 31, 2020, with the GoI holding a majority stake (89.07% as on December 31, 2020). The merged entity has a network of 9,587 branches and 12,961 ATMs as on December 31, 2020.

Key financial indicators

Union Bank of India	Standalone FY2019	Standalone FY2020	Merged 9M FY2021
Net interest income (Rs. crore)	10,215	11,437	19,286
Profit before tax (Rs. crore)	(4,028)	(3,927)	1,124
Profit after tax (Rs. crore)	(2,948)	(2,898)	1,577
Net advances (Rs. lakh crore)	2.97	3.15	5.83
Total assets* (Rs. lakh crore)	4.92	5.47	10.27
% CET I	8.02%	9.40%	9.22%
% Tier I	9.48%	10.75%	10.47%
% CRAR	11.78%	12.81%	12.98%
% Net interest margin / Average total assets	2.09%	2.20%	2.52%
% Net profit / Average total assets	-0.60%	-0.56%	0.21%
% Return on net worth	-12.47%	-10.62%	3.73%
% Gross NPAs	14.98%	14.15%	15.25%^
% Net NPAs	6.85%	5.49%	5.02%^
% Provision coverage excl. technical write-offs	58.27%	64.75%	70.62%^
% Net NPA / Core equity	91.08%	62.40%	59.47%^

**Total assets and net worth exclude revaluation reserves*
***Source:** Union Bank, ICRA research*
^ Proforma numbers including proforma NPAs and standstill slippages as directed by the Hon'ble Supreme Court
All calculations as per ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)			Chronology of Rating History for the past 3 years						
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2021			FY2020	FY2019		FY2017	
					Mar 02, 2021	Sep 11, 2020	Aug 28, 2020	Jun 28, 2019	May 09, 2018	Apr 30, 2018	Mar 27,2017	Mar 20,2017
1	Certificates of Deposit Programme	ST	15,000.00	15,000.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
2	Basel II Compliant Lower Tier II Bonds	LT	800.00	-	-	-	-	[ICRA]AA+ (Stable); withdrawn	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3	Basel III Compliant Tier II Bonds	LT	2,000.00	2,000.00	[ICRA]AA+ (hyb) (Negative)	[ICRA]AA+ (hyb) (Negative); assigned	-	-	-	-	-	-
4	Basel III Compliant Tier II Bonds^	LT	2,000.00	-	[ICRA]AA+ (hyb) (Negative); assigned	-	-	-	-	-	-	-
5	Basel II Compliant IPDI	LT	200.00	-		-	-	[ICRA]AA (Stable); withdrawn	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)

^Yet to be placed

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website click here

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Basel III Tier II Bonds^	Proposed	-	-	2,000.00	[ICRA]AA+(hyb) (Negative)
-	Certificates of Deposit	NA	NA	7-365 days	15,000.00	[ICRA]A1+
INE692A08094	Basel III Tier II Bonds	Sep 16, 2020	7.42%	Sep 16, 2030*	1,000.00	[ICRA]AA+(hyb) (Negative)
INE692A08102	Basel III Tier II Bonds	Nov 26, 2020	7.18%	Nov 26, 2035#	1,000.00	[ICRA]AA+(hyb) (Negative)

** First call-option after five years from issuance date; # First call-option after 10 years from issuance date*

Source: *Union Bank of India*

Annexure-2: List of entities considered for consolidated analysis

Company Name	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
Kashi Gomti Samyut Gramin Bank	35.00%	Limited Consolidation
Star Union Dai-ichi Life Insurance Company Ltd.	25.10%	Limited Consolidation
Entity Taken Over Post Merger		
Andhra Bank Financial Services	100.00%	Limited Consolidation
Corpbank Securities	100.00%	Limited Consolidation
Chaitanya Godavari Grameena Bank	35.00%	Limited Consolidation
IndiaFirst Life Insurance Company	30.00%	Limited Consolidation
ASREC India (P)	26.02%	Limited Consolidation
India International Bank (Malaysia)	25.00%	Limited Consolidation

Source: *Source: Union Bank of India, e-AB, e-CB and ICRA research*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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