

## Rating Rationale

June 29, 2022 | Mumbai

### Indian Overseas Bank

*Short-term rating reaffirmed; Long-term rating upgraded to 'CRISIL AA-/Stable' from 'CRISIL A+/Positive'; Rating on fixed deposit programme migrated and simultaneously upgraded*

#### Rating Action

<b>Certificate of Deposits</b>	<b>CRISIL A1+ (Reaffirmed)</b>
<b>Tier II Bonds (Under Basel III) Aggregating Rs.1600 Crore</b>	<b>CRISIL AA-/Stable (Upgraded from 'CRISIL A+/Positive')</b>
<b>Rs.200000 Crore Fixed Deposits</b>	<b>CRISIL AA/Stable (Migrated from 'FAA/Positive' and simultaneously upgraded)</b>

1 crore = 10 million

Refer to Annexure for Details of Instruments & Bank Facilities

#### Detailed Rationale

CRISIL Ratings has reaffirmed its rating on the certificate of deposits programme of Indian Overseas Bank (IOB) at 'CRISIL A1+'. CRISIL Ratings has also upgraded its rating on Tier-II bonds (under Basel III) of IOB to '**CRISIL AA-/Stable**' from 'CRISIL A+/Positive'. CRISIL Ratings has further migrated its rating on the Fixed Deposit (FD) programme of the bank from 'FAA/Positive' and simultaneously upgraded it to '**CRISIL AA/Stable**'.

The upgrade reflects strengthened capital position and steady improvement in the earnings profile. Capital position has been supported by regular fund infusion and expectation of strong support from the majority stakeholder, the Government of India (GoI). In March 2021, the GoI infused Rs 4,100 crore (Rs 8,217 crore in fiscal 2020, Rs 5,963 crore in fiscal 2019, and Rs 4,694 crore in fiscal 2018). Consequently, the Tier 1 and overall capital adequacy ratio (CAR) improved to 12.9% and 15.3%, respectively, as on March 31, 2021, from 8.2% and 10.7%, a year ago. Directive of the Reserve Bank of India (RBI) on fair valuation of zero coupon recapitalisation bonds impacted Tier 1 and total CAR, which declined to 10.7% and 13.8% as on March 31, 2022. However, capitalisation metrics remained adequate with respect to regulatory requirement. Excluding the impact of the fair valuation, Tier 1 and CAR would stand at 12.6% and 15.8%, respectively, as on March 31, 2022.

Supported by regular capital infusion in the past, the bank was able to build sufficient buffers for its non-performing assets (NPAs) with a provision coverage ratio (PCR) of 75% as on March 31, 2022. This, along with lower credit costs helped improve the earnings profile. Asset quality, while still weak, has been improving with gross NPA at 9.8% as on March 31, 2022, as compared to 11.7% a year earlier. Under the Resolution Framework 1.0 and Resolution Framework 2.0 for Covid-19 related stress approved by the RBI, restructuring under these schemes stood at 4.1% of gross advances as on March 31, 2022. Going forward, ability of the bank to manage collections and asset quality, given the current macroeconomic environment, will be a key monitorable. Though the impact of the third wave of the Covid-19 pandemic was not material, any change in the payment discipline of the borrowers may affect delinquency levels and will remain a monitorable.

The RBI, in its press release dated September 29, 2021, had taken IOB out of its prompt corrective action framework.

The rating migration of the FD programme follows the revision in CRISIL Ratings' rating scale for FD programmes, which is now aligned with the Securities and Exchange Board of India (SEBI)-standardised 20-point, long-term scale. Previously, CRISIL Ratings used a 14-point scale for assigning ratings to the FD programmes of issuers. This alignment is in compliance with the regulatory guidelines as per the circular issued by the SEBI on July 16, 2021 and the subsequent SEBI circular dated April 1, 2022, for standardising the rating scales used by credit rating agencies.

This migration represents only a recalibration of the rating from one scale to another and does not reflect any change in the credit risk profile of the FD programme. It is neither an upgrade nor a downgrade of the underlying credit risk profile of the FD programme. (Please refer to CRISIL Ratings' criteria for rating FD programmes for further details).

Migration of the FD ratings on IOB also factors in the granularity of the deposit base with the top 30 depositors constituting around 3.6% of deposit base as on March 31, 2022, and the staggered maturity profile of deposits.

### **Analytical Approach**

CRISIL Ratings has considered the standalone business and financial risk profiles of IOB. CRISIL Ratings has also factored in the strong support that the bank is expected to receive from its majority owner, the Gol, both on an ongoing basis and in the event of distress.

### **Key Rating Drivers & Detailed Description**

#### **Strengths:**

#### **Expectation of strong support from the majority owner, Gol**

The ratings continue to factor in the expectation of strong government support, both on an ongoing basis and in the event of distress. This is because the Gol is both majority shareholder in public sector banks (PSBs) and the guardian of India's financial system. Stability of the banking sector is of prime importance to the government, given its criticality to the economy, strong public perception of sovereign backing for PSBs, and severe implications of any PSB failure, in terms of political fallout, systemic stability and investor confidence. The majority ownership creates a moral obligation on Gol to support PSBs, including IOB.

As part of the Indradhanush framework, the government had pledged to infuse at least Rs 70,000 crore in PSBs over fiscals 2015-2019, of which Rs 25,000 crore each was infused in fiscals 2016 and 2017. Furthermore, in October 2017, the government had outlined a recapitalisation package of Rs 2.11 lakh crore over fiscals 2018-2019. IOB received Rs 4,694 crore in fiscal 2018 and Rs 5,963 crore in fiscal 2019 under this package. Also, the Gol allocated Rs 70,000 crore in fiscal 2020, of which IOB received Rs 8,217 crore. During fiscal 2021, the Gol infused Rs 4,100 crore. Thus, over the past four fiscals, Gol has infused Rs 22,974 crore in IOB.

This has helped the bank in improving its capital ratios and meeting regulatory requirements. Tier 1 and overall CAR stood at 10.7% and 13.8%, respectively, as on March 31, 2022.

#### **Weakness:**

#### **Weak asset quality and earnings profile, albeit improving**

Asset quality remains weak, with NPA ratios higher than the industry average. However, gross NPAs improved to 9.8% as on March 31, 2022, from 11.7% as on March 31, 2021 (14.8% as on March 31, 2020; 22.0% as on March 31, 2019; and 25.3% as on March 31, 2018), aided by write-offs. The bank has written off Rs 3,769 crore during fiscal 2022 and Rs 4,618 crore during fiscal 2021 (Rs 16,407 crore written off in fiscal 2020; Rs 7,683 crore in fiscal 2019). Slippages (as a percentage of net opening advances) have inched up slightly to 4.0% in fiscal 2022 from 2.6% in fiscal 2021; however remain better than previous years (5.4% in fiscal 2020, 6.7% in fiscal 2019 and 12.0% in fiscal 2018).

Given asset quality pressures, the bank's overall profitability was constrained over the last few years. The bank reported net profit in fiscals 2021 and 2022 after six consecutive years of incurring losses. Profitability improved due to reduction in credit costs to 1.4% during fiscal 2022 and 1.9% during fiscal 2021, from 4.7% in fiscal 2020 and 4.4% in fiscal 2019. Sustained

profitability will remain a key monitorable, given the pressure to improve asset quality and absorb higher provisioning requirements, if needed, and, impact of treasury income in a rising interest rate environment.

### **Liquidity: Strong**

Liquidity is supported by a sizeable retail deposit base, forming a sizeable chunk of total deposits. Liquidity coverage ratio was 178% as on March 31, 2022, which is higher than the regulatory requirement. Liquidity also benefits from access to systemic sources of funds such as the liquidity adjustment facility from the RBI, call money market, and refinance limits from sources such as National Housing Bank and National Bank for Agriculture and Rural Development.

### **Outlook: Stable**

CRISIL Ratings believes IOB will continue to benefit from the strong support it receives from the government.

### **Rating Sensitivity Factors**

#### **Upward Factors**

- Improvement in asset quality and profitability on a sustained basis, with the bank reporting return on assets of over 0.6% on steady-state basis, and
- Capitalisation metrics improving considerably with significant cushion over regulatory requirement

#### **Downward Factors**

- Material change in shareholding or expectation of support from the government
- Decline in CAR below minimum regulatory requirement (including capital conservation buffer, which is Tier I of 9.5% and overall CAR of 11.5%)

### **About the Bank**

Established in 1937 by Mr M Ct M Chidambaram Chettyar, IOB was nationalised in 1969. Headquartered in Chennai, the bank had 3,214 domestic branches, four overseas branches and 3,355 automated teller machines as on March 31, 2022. As on March 31, 2022, total advances and deposits were Rs 1,55,801 crore and Rs 2,62,159 crore, respectively. The loan portfolio comprises corporate loans (24%), MSME loans (19%), agriculture loans (25%), retail loans (24%) and overseas loans (8%). Current account and savings account (CASA) deposits-to-total deposit ratio was 43.4% as on March 31, 2022 (42.5% as on March 31, 2021, and 40.3% as on March 31, 2020).

During fiscal 2022 the bank reported profit after tax (PAT) of Rs 1,710 crore on total income (net of interest expense) of Rs 11,214 crore as compared to Rs 831 crore and Rs 11,458 crore, respectively, in the previous fiscal.

### **Key Financial Indicators**

<b>As on/for the half year ended March 31,</b>	<b>Unit</b>	<b>2022</b>	<b>2021</b>
<b>Total assets</b>	<b>Rs crore</b>	<b>2,99,377</b>	<b>2,74,010</b>
<b>Total income (net of interest expense)</b>	<b>Rs crore</b>	<b>11,214</b>	<b>11,458</b>
<b>PAT</b>	<b>Rs crore</b>	<b>1,710</b>	<b>831</b>
<b>Gross NPA</b>	<b>%</b>	<b>9.8</b>	<b>11.7</b>
<b>Overall CAR</b>	<b>%</b>	<b>13.8</b>	<b>15.3</b>
<b>Return on assets</b>	<b>%</b>	<b>0.6</b>	<b>0.3</b>

### **Any other information:**

#### **Note on tier-II instruments (under Basel III)**

The distinguishing feature of tier-II capital instruments under Basel III is the existence of the point of non-viability (PONV) trigger, the occurrence of which may result in loss of principal to the investors and hence, to default on the instrument by the issuer. According to the Basel III guidelines, the PONV trigger will be determined by the RBI. CRISIL Ratings believes the PONV trigger is a remote possibility in the Indian context, given the robust regulatory and supervisory framework and the systemic importance of the banking sector. The inherent risk associated with the PONV feature is adequately factored into the rating on the instrument.

#### **Note on complexity levels of the rated instrument:**

CRISIL Ratings' complexity levels are assigned to various types of financial instruments. The CRISIL Ratings' complexity

levels are available on [www.crisil.com/complexity-levels](http://www.crisil.com/complexity-levels). Users are advised to refer to the CRISIL Ratings' complexity levels for instruments that they consider for investment. Users may also call the Customer Service Helpdesk with queries on specific instruments.

#### Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs.Crore)	Complexity level	Rating Assigned with outlook
INE565A08035	Tier II Bonds	24-Sep-19	9.08	24-Sep-29	500	Complex	CRISIL AA-/Stable
INE565A09264	Tier II Bonds	10-Dec-18	11.7	10-Dec-28	300	Complex	CRISIL AA-/Stable
INE565A09256	Tier II Bonds	03-Nov-16	9.24	03-Nov-26	800	Complex	CRISIL AA-/Stable
NA	Fixed deposit programme	NA	NA	NA	200000	Simple	CRISIL AA/Stable
NA	Certificate of deposits programme	NA	NA	7-365 days	NA	Simple	CRISIL A1+

#### Annexure - Rating History for last 3 Years

Instrument	Current			2022 (History)		2021		2020		2019		Start of 2019
	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Certificate of Deposits	ST	0.0	CRISIL A1+		--	24-12-21	CRISIL A1+	31-07-20	CRISIL A1+	29-07-19	CRISIL A1+	CRISIL A1+
			--		--	31-07-21	CRISIL A1+		--	05-07-19	CRISIL A1+	--
Fixed Deposits	LT	200000.0	CRISIL AA/Stable		--	24-12-21	F AA/Positive	31-07-20	F AA/Stable	29-07-19	F AA/Stable	F AA/Stable
			--		--	31-07-21	F AA/Stable		--	05-07-19	F AA/Stable	--
Lower Tier-II Bonds (under Basel II)	LT		--		--	31-07-21	Withdrawn	31-07-20	CRISIL A+/Stable	29-07-19	CRISIL A+/Stable	CRISIL A+/Stable
			--		--		--		--	05-07-19	CRISIL A+/Stable	--
Perpetual Tier-I Bonds (under Basel II)	LT		--		--		--	31-07-20	Withdrawn	29-07-19	CRISIL A-/Stable	CRISIL A-/Stable
			--		--		--		--	05-07-19	CRISIL A-/Stable	--
Tier II Bonds (Under Basel III)	LT	1600.0	CRISIL AA-/Stable		--	24-12-21	CRISIL A+/Positive	31-07-20	CRISIL A+/Stable	29-07-19	CRISIL A+/Stable	CRISIL A+/Stable
			--		--	31-07-21	CRISIL A+/Stable		--	05-07-19	CRISIL A+/Stable	--
Upper Tier-II Bonds (under Basel II)	LT		--		--	31-07-21	Withdrawn	31-07-20	CRISIL A-/Stable	29-07-19	CRISIL A-/Stable	CRISIL A-/Stable
			--		--		--		--	05-07-19	CRISIL A-/Stable	--

## Criteria Details

### Links to related criteria

[CRISILs Approach to Financial Ratios](#)

[Rating Criteria for Banks and Financial Institutions](#)

[Rating Criteria for Finance Companies](#)

[CRISILs criteria for rating fixed deposit programmes](#)

[CRISILs Criteria for rating short term debt](#)

[Rating criteria for Basel III - compliant non-equity capital instruments](#)

[Rating Criteria for Hybrid Capital instruments issued by banks under Basel II guidelines](#)

[Criteria for Notching up Stand Alone Ratings of Entities Based on Government Support](#)

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