CRISIL
An S&P Global Company

Rating Rationale

September 01, 2020 | Mumbai

Union Bank Of India Limited

Rating removed from 'Watch Developing' ; Rating Reaffirmed

Rating Action

Lower Tier- II Bond (Under Basel II) Aggregating Rs.800 Crore	**CRISIL AA+/Negative (Removed from 'Rating Watch with Developing Implications'; Rating Reaffirmed)**
Tier-II Bond Issue (Under Basel III) Aggregating Rs.3750 Crore	**CRISIL AA+/Negative (Removed from 'Rating Watch with Developing Implications'; Rating Reaffirmed)**
Upper Tier-II Bond Issue Aggregating Rs.2000 Crore (Under Basel II)	**CRISIL AA+/Negative (Removed from 'Rating Watch with Developing Implications'; Rating Reaffirmed)**
Tier-I Perpetual Bond Issue Aggregating Rs.300 Crore (Under Basel II)	**CRISIL AA+/Negative (Removed from 'Rating Watch with Developing Implications'; Rating Reaffirmed)**

1 crore = 10 million
Refer to annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL has removed its ratings on the long-term debt instruments of Union Bank of India Limited (Union Bank) from 'Rating Watch with Developing Implications', reaffirmed the ratings at **'CRISIL AA+'** and assigned **'Negative'** outlook on the same.

CRISIL had placed the ratings on Union Bank's long-term debt instruments on 'watch with developing implications' on December 20, 2019, given the significant progress in the amalgamation of Andhra Bank and Corporation Bank with Union Bank, and pending clarity on the business and financial risk profiles of the combined entity.

The watch resolution follows the completion of the amalgamation process, effective April 1, 2020, and greater clarity on the credit risk profile of the merged entity.

The reaffirmation of the rating on the long term instruments continues to factor in expectation of strong support that Union Bank is likely to receive from its majority owner, Government of India (GoI). The rating also reflects the merged entity's larger balance sheet size and wider geographic reach. Merger synergies are expected to flow in over time, with the bank already having significantly harmonized its products and service offerings across the merged entity.

At the same time, the 'Negative' outlook on the debt instruments reflects the potential stress that the bank's asset quality, and consequently its profitability, could witness owing to the challenging macro environment. The bank's capital cushion to absorb any potential asset side risks has reduced somewhat post amalgamation- Tier I and overall capital adequacy ratio (CAR) for the merged entity stood at 9.7% and 12.0%, respectively, for the merged entity as on March 31, 2020 compared with 10.75% and 12.8% , respectively, for Union Bank pre-amalgamation. Also, the bank's resource profile, while adequate, is not as strong as that of some of the other large banks.

Post amalgamation, Union Bank's asset quality remains modest with elevated gross non-performing assets (NPAs) at 14.95% as on June 30, 2020 (14.59% as on March 31, 2020). Union Bank's gross NPAs (pre amalgamation) were 14.15% as on March 31, 2020. Also, the combined entity is estimated to have reported a loss of Rs 6,614 crore for fiscal 2020 with a return on assets (RoA) of -0.7% for the period, driven by high provisioning costs of Rs 24,317 crore. The same, however, has led to a considerable improvement in provisioning coverage ratio (PCR) to around 68% as on March 31, 2020 and which has further increased to around 70% as on June 30, 2020. While the combined entity has reported a profit of Rs 333 crore in the quarter ended June 30, 2020, supported by treasury gains of Rs 637 crore and low incremental provisioning costs, sustained improvement in the bank's asset quality and profitability would be a key rating sensitivity factor.

The nationwide lockdown imposed by the GoI to contain the spread of the Covid-19 pandemic has impacted disbursements and collections of financial institutions. The lockdown has been eased in a phased manner. However, certain states have implemented local lockdowns. CRISIL believes the eventual lifting of restrictions will continue to be in a phased manner. Any delay in return to normalcy will put further pressure on collections and asset quality metrics of financial institutions.

Union Bank has provided moratorium to its borrowers in line with the relief measures provided by the Reserve Bank of India (RBI). As on June 30, 2020, 28% of the term loans of the bank were under moratorium. Any change in the payment discipline of borrowers post the moratorium has the potential to affect asset quality metrics and will be a monitorable. Also, while the one-time restructuring scheme announced by RBI will provide the necessary support to affected borrowers in the current environment, the details and operational implementation of the same will have to be seen. While the management has indicated that the extent of restructuring in the overall book should be within 5-6%, the same will also remain a monitorable.

Analytical Approach

For arriving at the ratings, CRISIL has considered the consolidated business and financial risk profiles of Union Bank and its subsidiaries. CRISIL has also factored in the strong support that the bank is expected to receive from its majority owner, GoI, both on an ongoing basis and in the event of distress.

Key Rating Drivers & Detailed Description

Strengths
*** Expectation of strong support from government**
The rating continues to factor in expectation of strong government support. This is because GoI is the 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 GoI to support PSBs, including Union Bank.

As a part of the Indradhanush framework, GoI had pledged to infuse at least Rs 70,000 crore in PSBs over fiscals 2015 to 2019, of which Rs 25,000 crore each was infused in fiscals 2016 and 2017. In October 2017, the government outlined a recapitalisation package of Rs 2.11 lakh crore over fiscals 2018 and 2019; Union Bank, Andhra Bank and Corporation Bank together received Rs 8,601 crore in fiscal 2018 and Rs 21,028 crore in fiscal 2019 under this package. Also, GoI allocated Rs 70,000 crore in fiscal 2020, of which Rs 11,768 crore was received. Thus, over the past three fiscals, GoI has infused around Rs 41,397 crore in the combined entity.

The bank also has flexibility to raise additional equity from the market, with GoI stake at 89.1% as on June 30, 2020. The bank's common equity tier-1 ratio, Tier-I CAR and overall CAR stood at 8.4%, 9.5% and 11.6%, respectively, as on June 30, 2020 (8.6%, 9.7% and 12.0% as on March 31, 2020).

*** Sizeable scale of operations backed by extensive branch network**
Union Bank is the fourth-largest PSB by asset size, as on June 30, 2020. Its share in deposits and advances in the domestic banking system was 6.2% and 6.1%, respectively, as on June 30, 2020. The bank has 46% of the total advances in the form of loans to corporates followed by retail (20%), micro, small & medium enterprises (18%) and agriculture (16%). Within retail, housing loans constituted almost 47% of the loan book.

The bank benefits from its sizeable branch network of 9,587 as on June 30, 2020 and wide reach in the rural and semi-urban areas, this facilitates access to a low-cost, stable resource base. As on June 30, 2020, current accounts and savings account (CASA) deposits-to-total deposit ratio was 33.1% (34.1% in March 31, 2020); while it is adequate, it is lower than that for some of the other large banks. Union Bank is likely to maintain its market share and pan-India presence over the medium term.

Weaknesses
*** Modest asset quality**
The bank's gross NPAs are elevated at 14.95% as on June 30, 2020 (14.59% as on March 31, 2020). Around 67% of the NPAs are contributed by the medium and large corporates, which have gross NPAs at 20.2% as on June 30, 2020 (19.5% as on March 31, 2020). As on June 30, 2020, retail, agriculture and micro-and-small segments had gross NPAs of 3.9%, 10.6% and 17.0%, respectively.

The slippages for the bank remained high. It witnessed slippages of Rs 23,580 crore (4.1% of opening net advances) in fiscal 2020. With standstill on asset classification, incremental slippages in the first quarter of fiscal 2021 reduced to Rs 1,750 crore (1.2% (annualised) of opening net advances). However, the bank's ability to arrest slippages in a challenging macro-environment will be a monitorable. Also, the possible slowdown in recoveries over the medium term may impact bank's asset quality. This could be partly offset by the effective implementation of restructuring scheme announced by the RBI. Ability to contain slippages to NPAs and improve recoveries will remain key monitorable in the near to medium term.

*** Pressure on earnings profile**
Profitability has been constrained by high provisioning costs taken on board by the bank to support its balance sheet. The amalgamated bank is estimated to have reported a net loss of Rs 6,614 crore (with a negative RoA of 0.7%) for fiscal 2020 as against net loss of Rs 12,066 crore (with negative RoA of 1.3%) for fiscal 2019. Loss in fiscal 2020 declined due to lower provisioning expenses of Rs 24,317 crore (2.5% of average assets) in fiscal 2020 as against Rs 30,825 crore (3.2% of average assets) in the previous fiscal. In the quarter ended March-20, the bank adopted a conservative approach and harmonized provisions for common accounts at the highest level among the three merging banks.

With the banks under the amalgamation process in fiscal 2020, operating expenses increased to 1.8% of average assets from 1.5% in fiscal 2019. Nevertheless, the bank has improved its pre-provisioning profit to 1.8% of average assets in fiscal 2020 from 1.7% of average assets in fiscal 2019 driven by increase in non-interest income to 1.2% of average assets from 0.9% of average assets in fiscal 2019.

With decline in incremental slippages owing to standstill in asset classification, credit costs declined to 1.4% (annualised) of the total assets in the first quarter of fiscal 2021 from 2.5% in fiscal 2020. Hence, with the support of treasury income of Rs 637 crore, the bank reported a profit of Rs 333 crore with RoA of 0.1% (annualised). Further, the bank has maintained relatively high PCR at 70.3% as on June 30, 2020. Nevertheless, profitability is a key monitorable given the current challenging environment due to the pandemic, and hence earnings will remain a key rating sensitivity factor.

Liquidity Strong
Liquidity should remain comfortable, supported by strong retail deposit base. Liquidity coverage ratio stood well above the minimum regulatory requirements as on June 30, 2020.Liquidity also benefits from access to systemic sources of funds, such as the liquidity adjustment facility from RBI and access to the call money market.

Outlook: Negative
The 'Negative' outlook on the debt instruments reflects the potential stress on the bank's asset quality, and consequently its profitability, on account of the challenging macro environment. However, Union Bank should continue to benefit from strong government support and large size and scale.

Rating sensitivity factors
Upward factors
* Improvement in asset quality and profitability on a sustained basis with the bank reporting RoA of over 0.25% on a steady state basis.
* The capitalisation metrics improving considerably with significant cushion over the regulatory requirements
* Improvement in proportion of CASA deposits to overall deposits from current levels.

Downward factors
* Deterioration in asset quality with GNPAs rising from current levels, and/or
* Decline in capital adequacy ratios below minimum regulatory requirements (including CCB, which is Tier I of 9.5% and overall CAR of 11.5% with effect from October 1, 2020) for an extended period

About the Bank

Incorporated in 1919 in Mumbai, Union Bank was nationalised in 1969. GoI's ownership stood at 89.1% as on June 30, 2020, post issuing shares under amalgamation to the shareholders of Andhra Bank and Corporation Bank.

Amalgamation of Andhra Bank and Corporation Bank into Union Bank was effective from April 1, 2020. Post amalgamation, the merged entity enjoys the benefits of larger balance sheet and wider geographic reach. As on June 30, 2020, Union Bank is fourth largest PSB with total assets of Rs 1,075,646 crore and a strong domestic branch network comprising 9,587 branches and 13,311 automated teller machines.

The bank reported a profit of Rs 333 crore on total income (net of interest expense) of Rs 7,865 crore in the quarter ended June 30, 2020, as against Rs 381 crore and Rs 7,365 crore, respectively, in the corresponding quarter of the previous year.

Key Financial Indicators

Particulars as on March 31,	Unit	2020	2019
Total assets	Rs crore	1021875	956458
Total income (net of interest expense)	Rs crore	35406	30823
Profit after tax	Rs crore	-6614	-12066
Gross NPA	%	14.6	15.4
Overall CAR	%	12.0	12.4
RoA (annualised)	%	-0.7	-1.3

Note: Income statement numbers/ratios represents pro-forma merged entity financials

Any other information: Not applicable

Note on complexity levels of the rated instrument:
CRISIL complexity levels are assigned to various types of financial instruments and are included (where applicable) in the Annexure -- Details of Instrument in this Rating Rationale. For more details on the CRISIL complexity levels, please visit www.crisil.com/complexity-levels.

Annexure - Details of Instrument(s)

ISIN	Name of Instrument	Date of Allotment	Coupon Rate (%)	Maturity Date	Issue Size (Rs.Cr)	Complexity level	Outstanding rating with Outlook
INE692A09241	XVI-B Lower Tier II	28-Dec-12	8.9	28-Dec-22	800	Complex	CRISIL AA+/Negative
INE692A08045	Basel III compliant Tier 2 Bonds	24-Nov-16	7.74	24-Nov-26	750	Complex	CRISIL AA+/Negative
INE692A08011	Basel III compliant Tier 2 Bonds	22-Aug-16	8	22-Aug-26	1000	Complex	CRISIL AA+/Negative
INE692A09266	XVII-A Basel III compliant Tier II bonds	22-Nov-13	9.8	22-Nov-23	2000	Complex	CRISIL AA+/Negative
INE692A09225*	XIV-C Upper Tier II	27-Jan-10	8.55	27-Jan-25	500	Highly complex	CRISIL AA+/Negative
INE692A09233*	XV-A Upper Tier II	28-Jun-10	8.48	28-Jun-25	500	Highly complex	CRISIL AA+/Negative

NA	Upper Tier II (under Basel II)^	NA	NA	NA	250	Highly complex	CRISIL AA+/Negative

^yet to be issued
**Awaiting third party confirmation*

Annexure - List of entities consolidated

Entity consolidated	Extent of consolidation	Rationale for consolidation
Union Bank of India (UK) Ltd	Full	Subsidiary
Union Asset Management Co Pvt Ltd	Full	Subsidiary
Union Trustee Co Pvt Ltd	Full	Subsidiary
Corp Bank Securities Limited	Full	Subsidiary
Andhra Bank Financial Services Limited	Full	Subsidiary
Star Union Dai-ichi Life Insurance Co. Limited	Proportionate	Joint venture
India First Life Insurance	Proportionate	Joint venture
ASREC India limited	Proportionate	Joint venture
India International Bank (Malaysia) BHD	Proportionate	Joint venture
Chaitanya Godavari Gramin Bank	Proportionate	Associate

Annexure - Rating History for last 3 Years

	Current			2020 (History)		2019		2018		2017		Start of 2017
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Lower Tier-II Bonds (under Basel II)	LT	800.00 01-09-20	CRISIL AA+/Negative			20-12-19	CRISIL AA+/Watch Developing	31-08-18	CRISIL AA+/Stable	31-08-17	CRISIL AA+/Negative	CRISIL AAA/Negative
						05-09-19	CRISIL AA+/Stable	25-01-18	CRISIL AA+/Stable			
						27-08-19	CRISIL AA+/Stable					
Perpetual Tier-I Bonds (under Basel II)	LT	0.00 01-09-20	CRISIL AA+/Negative			20-12-19	CRISIL AA+/Watch Developing	31-08-18	CRISIL AA+/Stable	31-08-17	CRISIL AA+/Negative	CRISIL AAA/Negative
						05-09-19	CRISIL AA+/Stable	25-01-18	CRISIL AA+/Stable			
						27-08-19	CRISIL AA+/Stable					
Tier II Bonds (Under Basel III)	LT	3750.00 01-09-20	CRISIL AA+/Negative			20-12-19	CRISIL AA+/Watch Developing	31-08-18	CRISIL AA+/Stable	31-08-17	CRISIL AA+/Negative	CRISIL AAA/Negative
						05-09-19	CRISIL AA+/Stable	25-01-18	CRISIL AA+/Stable			
						27-08-19	CRISIL AA+/Stable					
Upper Tier-II Bonds (under Basel II)	LT	1000.00 01-09-20	CRISIL AA+/Negative			20-12-19	CRISIL AA+/Watch Developing	31-08-18	CRISIL AA+/Stable	31-08-17	CRISIL AA+/Negative	CRISIL AAA/Negative
						05-09-19	CRISIL AA+/Stable	25-01-18	CRISIL AA+/Stable			

						27-08-19	CRISIL AA+/Stable					

All amounts are in Rs.Cr.

Links to related criteria
CRISILs Approach to Financial Ratios
Rating Criteria for Banks and Financial Institutions
CRISILs Criteria for rating short term debt
Criteria for Notching up Stand Alone Ratings of Entities Based on Government Support
Rating Criteria for Hybrid Capital instruments issued by banks under Basel II guidelines
Rating criteria for Basel III - compliant non-equity capital instruments

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