

India Ratings Revises Union Bank of India's Outlook to Positive; Affirms 'IND AA+'

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India Ratings and Research (Ind-Ra) has revised Union Bank of India's (Union) Outlook to Positive from Stable while affirming the Long-Term Issuer Rating at 'IND AA+'. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier II bonds [^]	-	-	-	INR50 (reduced from INR55)	IND AA+/Positive	Affirmed; Outlook revised to Positive
Basel III AT1 perpetual bonds [^]	-	-	-	INR98.5	IND AA/Positive	Affirmed; Outlook revised to Positive
Certificates of deposit	-	-	-	INR300	IND A1+	Affirmed

[^]Details in Annexure

Analytical Approach: Ind-Ra continues to take a consolidated view of Union and its subsidiaries while arriving at the ratings, because of the similar nature of operations.

The Outlook revision reflects the bank's improving capital position and operating buffers, indicating its increasing ability to maintain or increase its market share and absorb the impact of expected and unexpected credit costs. The Positive Outlook also reflects the drastic reduction of adverse provisioning impact of legacy non-performing assets (NPAs) on Union and overall improvement in the lending environment especially for banks. These factors, in the agency's opinion, could boost Union's profitability in FY24 (annualised return on assets (RoA) for FY23: 0.69%) and grow its share in advances and deposits over the medium term. The ratings continue to reflect Union's systemically-important position and Ind-Ra's expectations that the bank will continue to receive support from the government of India (GoI; holds 83.5% stake in Union as on 30 June 2023).

For AT1 instruments, the agency considers the discretionary component, coupon omission risk and the write-down/conversion risk as key parameters to affirm at the rating. The agency recognises the unique going-concern loss absorption features that these bonds carry and that differentiates them from the bank's senior debt, factoring in a higher probability of an ultimate loss for investors in these bonds. Ind-Ra envisages the coupon deferrals and principal write-down risks as remote possibilities, in view of the bank's adequate distributable reserve buffers.

Key Rating Drivers

Better-than-Peers' Capital Buffers: Union's capital buffers have improved over the 15 months ended 1QFY24 and the bank is now better placed than its similar-rated peers, as reflected in the common equity tier I (CET-I) ratio and tier-I capital adequacy ratio of 12.34% and 13.86%, respectively, at end-1QFY24 (FYE23: 12.36%, 13.91%; FYE22: 10.63%, 12.2%;). This also needs to be viewed in context of the bank's net NPAs being reduced to about 1.6% at 1QFY24 from the broader public sector banks' universe (1.5%-2.5%). Also, Union's risk weighted assets to net advances decreased to 72.1% at end-1QFY24 (1QFY23: 75.7%), indicating its progress in capital efficiency. Ind-Ra believes the manageable asset quality would enable the bank to maintain material profitability compared to its previous performance though FY24-FY25 (return on assets could be 1% or more). This, combined with the further utilisation of deferred tax assets, will help Union to partly offset its higher-than-peers net NPAs. Ind-Ra believes the existing capital buffers are adequately placed to also absorb asset quality shocks. After factoring in the elevated provisioning requirements in FY23, on account of the pandemic induced potential slippages, the agency believes Union's capital buffers will be moderately higher than the regulatory requirements while maintaining higher-than-peers' net NPAs over the medium term. In the agency's opinion, if the credit costs exceed 3%, the bank might see equity erosion.

Improved Profitability: Union's profit increased significantly to about INR32 billion in 1QFY24 (FY21: INR84.3 billion; FY22: INR52.3 billion), mainly backed by a decline in its credit costs, growth in advances and improved net interest margins (faster repricing in advances than in deposits played a role). The profits would have been more if not offset partially by a lacklustre treasury performance, given the rising market interest rates. The agency does not expect any significant adverse impact on treasury income hereon at least in FY24. The bank's credit cost (provision for NPA to average net advances) was 1.6% in FY23 (FY22: 1.8%). Ind-Ra expects the bank to witness a credit cost of about 2% over the near-to-medium term. While the bank had a comparable provision cover (net of technical write offs) of about 79.8% at end-1QFY24 (FY23: 78.8%, FY22: 69.5%), the net NPA levels at about 1.58% (1.7%, 3.7%) were modestly higher than that of peers. Hence, the bank might have to take up more provisions, in the agency's opinion, and may be in a position to cover the gap only by next year. Ind-Ra believes Union might be able to maintain its profitability (ex-treasury income) over the short term, as the net interest margins have expanded and any rise in deposit rates would lag the increase in the loan yields over the near term.

High Systemic Importance: Union's systemic importance is reflected in its high market share in deposits and net advances of around 6.2% and 5.6%, respectively, at FYE23 (FY22: 6.4% and 5.7% respectively), thereby making it the fifth-largest public sector bank. The bank continues to benefit due to its amalgamation with Corporation Bank and Andhra Bank with effect from 1 April 2020.

At end-June 2023, the amalgamated bank had 8,561 branches (including foreign branches) and over 10,195 automatic teller machines, making it a significantly larger franchise post the amalgamation. Union had last received a capital infusion of INR117.7 billion from the GoI in FY20 (FY19: INR41.1 billion) and the agency expects the government support to come in as and when required. The bank has been able to raise INR50 billion of equity in 2QFY24; the last equity raise was INR14 billion in FY22. Overall, the ability of the bank (including most of the public sector banks) has increased in the opinion of the agency.

Prospective Asset Quality Metrics Expected to be Benign: At end-June 2023, Union had about 2% loans

(as a percentage of net advances: 2% at FYE23; 3% at FYE22) that were restructured and loans worth about INR0.2 trillion that have been, in the agency's opinion, supported by the Emergency Credit Line Guarantee Scheme. The bank has stated that about 7% of these loans are stressed (either slipped into NPAs or are overdue) and expects the balance to follow the standard portfolio behaviour. The bank's special mention accounts rose over 50% yoy to INR50 million in 1QFY24. Union witnessed a gross slippage of about 0.4% in 1QFY24 (FY23: 1.5%; FY22: 4.1%) and net slippage (gross slippage less upgrades and recoveries) of 0.1% (0.07%, 2.04%). Ind-Ra believes the bank may not see significant net slippages in FY24. This is because the gross NPAs and net NPAs improved somewhat to 7.34% and 1.58%, respectively, in 1QFY24 (FY23: 7.53%, 1.70%). Overall, the asset quality is likely to continue to improve and would be manageable over the near-to-medium term.

Liquidity Indicator – Adequate: Union's short-term (one year) asset liability surplus (surplus of short-term assets over short-term liabilities to total inflows) was about 20% at FYE23, better than that of similar-rated peers. The average liquidity coverage ratio was 166.16% at end-June 2023 (FYE23: 192.9%; FYE22: 175.38%), well above the regulatory requirement of 100%. Union's excess statutory liquidity qualifying securities of about INR534 billion also provide substantial liquidity comfort in addition to its assets in balances with the Reserve Bank of India and in government securities, indicating that it will be able to meet its short-term funding requirements under severe stress. The agency believes the bank's funding gap might not widen in the near term, unless it changes its liability structure drastically.

Deposit Profile Could Come Under Pressure: Union's domestic low-cost current account and savings account (CASA) deposits remained steady at 34.14% at end-1QFY24 (FYE23: 35.26%; FY22: 36.54%). However, it is weaker than that of peer public sector banks, and the bank has been ceding CASA market share. During 1QFY24, Union's CASA grew at about 7.2% yoy, the overall deposits, including fixed deposits, grew about 13.6% yoy, while advances grew 12.3% yoy. Given that deposit growth has lagged advance growth for a few quarters, the banks have been under pressure to raise deposit rates. In FY24 so far, public sector banks' term deposit rates have increased 1%-1.5% yoy and are likely to increase further. Union's rates are not likely to be any different. The bank's cost of deposits increased by about 16bp yoy during 1QFY24, from its lowest of 4% that the bank saw in 1QFY23. Given the lower share of the low-cost deposits, the bank's increase in cost of deposits could be marginally higher than peer banks' over the near term.

Rating Sensitivities

Negative: Union's Basel III Tier 2 bond ratings have been equated to its Long-Term Issuer Rating, which could change if there is any unfavourable change in the GoI's support stance that restricts the bank's ability to maintain its systemic importance, or if the equity buffers of the bank consistently operate at close to the minimum regulatory levels.

The notching of the AT1 bonds could be widened from its anchor ratings if Ind-Ra believes there is a dilution in the government's support stance towards hybrid instruments of PSBs or if there is any delay in the timeliness of extending this support. This could lead to, among other things, capital buffers continuing to be close to the regulatory levels. In addition, Ind-Ra expects that the capital buffers would be higher for banks with weaker unsupported profiles; if not, then the notching from the Long-Term Issuer Rating could be wider/higher. These capital buffers could be important as the banks' ability to service the instrument could be impaired if it is incurring losses and/or if the capital levels are lower than the regulatory minimum levels.

Positive: Sustained systemic importance reflected in the bank's improving market share in advances and deposits could lead to a positive rating action. On the standalone credit profile, a consistent improvement in the bank's capital and profitability buffers (with increased profitability from the core lending operations), while

maintaining peer-comparable asset quality or better, and an overall improvement in the operating environment could also lead to a positive rating action.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on Union, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra’s ESG Relevance Disclosures, please click [here](#). For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click [here](#).

Company Profile

Union is a PSB with operations across India. At end-June 2023, the Gol held an 83.5% stake in the bank.

FINANCIAL SUMMARY

Particulars (INR billion)	FY23	FY22
Net advances	7,618.5	6,610.1
Total deposits	11,177.2	10,323.9
Net income/loss	84.3	52.32
CET I (%)	12.4	10.6
Capital adequacy ratio (%)	16.0	14.5
Source: Union, Ind-Ra		

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

Rating History

Instrument Type	Current Rating/Outlook						
	Rating Type	Rated Limits (billion)	Rating	1 November 2022	15 July 2022	10 February 2022	De

Issuer Rating	Long-term	-	IND AA+/Positive	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	AA
Basel III AT1 Bonds	Long-term	INR98.5	IND AA/Positive	IND AA/Positive	IND AA/Stable	IND AA/Stable	A
Basel III-Compliant Tier II Bonds	Long-term	INR50	IND AA+/Positive	IND AA+/Positive	IND AA+/Stable	IND AA+/Stable	AA
CDs	Short-term	INR300	IND A1+	IND A1+	-	-	

Annexure

Instrument	ISIN	Date of Allotment	Tenor (years)	Maturity Date	Amount Mobilised (billion)	Coupon Rate (% p.a.)	Put/Call Option	Rating/Outlook
Basel III Compliant Tier II Bonds								
Basel III-compliant Tier II bonds	INE112A08044	14 November 2017	10	14 November 2027	INR5	8.02	Call 14 November 2022	WD (Paid in Full)
Basel III-compliant Tier II bonds	INE112A08051	8 November 2019	10	8 November 2029	INR10	8.93	Nil	IND AA+/Positive
Basel III-compliant Tier II bonds	INE692A08094	16 September 2020	10	16 September 2030	INR10	7.42	Call – 16 September 2025	IND AA+/Positive
Basel III-compliant Tier II bonds	INE692A08102	26 November 2020	15	26 November 2035	INR10	7.18	Call – 26 November 2030	IND AA+/Positive
Basel III-compliant Tier II bonds	INE692A08144	24 June 2021	10	24 June 2031	INR8.5	7.19	Call – 24 June 2026	IND AA+/Positive
Basel III-compliant Tier II bonds	INE692A08151	09 July 2021	15	9 July 2036	INR11.50	7.25	Call – 9 July 2031	IND AA+/Positive
Total utilised					INR50			

Basel III Compliant AT1 Bond								
Basel III AT1 Bonds	INE692A08029	15 September 2016	Perpetual	Perpetual	INR10	9.5	Call - 15 September 2026	IND AA/Positive
Basel III AT1 Bonds	INE692A08110	15 December 2020	Perpetual	Perpetual	INR5	8.73	Call -15 December 2025	IND AA/Positive
Basel III AT1 Bonds	INE692A08128	11 January 2021	Perpetual	Perpetual	INR10	8.64	Call – 11 January 2026	IND AA/Positive
Basel III AT1 Bonds	INE692A08136	29 January 2021	Perpetual	Perpetual	INR2.05	8.73	Call – 29 January 2026	IND AA/Positive
Basel III AT1 Bonds	INE692A08169	22 November 2021	Perpetual	Perpetual	INR20	8.70	Call-22 November 2026	IND AA/Positive
Basel III AT1 Bonds	INE692A08177	20 December 2021	Perpetual	Perpetual	INR15	8.4	Call-20 December 2026	IND AA/Positive
Basel III AT1 Bonds	INE692A08185	2 March 2022	Perpetual	Perpetual	INR15	8.5	Call-2 March 2027	IND AA/Positive
Basel III AT1 Bonds	INE692A08193	25 July 2022	Perpetual	Perpetual	INR13.20	8.69	Call-25 July 2027	IND AA/Positive
Basel III AT1 Bonds	INE692A08227	23 Dec 2022	Perpetual	Perpetual	INR6.63	8.4	Call Dec 2027	IND AA/Positive
Total utilised					INR96.88			
Total unutilised					INR1.62			

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Basel III-compliant Tier II bonds	Moderate
Basel III AT1 bonds	High
CDs	Low

For details on the complexity level of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

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APPLICABLE CRITERIA

Rating Bank Subordinated and Hybrid Securities

Financial Institutions Rating Criteria

Rating FI Subsidiaries and Holding Companies

Evaluating Corporate Governance

The Rating Process

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